

M. Com. Part - II
Accountancy Group
PAPER -V

RELATED APPLIED
COMPONENT
DIRECT AND INDIRECT TAXES

Dr. Sanjay Deshmukh
Vice Chancellor,
University of Mumbai

Dr. Ambuja Salgaonkar
Incharge Director,
Institute of Distance and
Open Learning,
University of Mumbai.

Dr. Dhaneswar Harichandan
Incharge Study Material Section,
Institute of Distance and
Open Learning,
University of Mumbai.

Course and Programme Co-ordinator : **Dr. Madhura Kulkarni**
Lecturer-Cum. Asst. Director
University of Mumbai IDOL

Course Writer : **Dr Paras B. Jain,**
B.Com. LL.M, ACS, FCA, PH.D (Law),
Chartered Accountant
Associate Professor
Maharshi .Dayanand .College,
Parel, Mumbai 400 012.
Email: drparasjain@hotmail.com.

Komal Paras Jain
M.Com. ACS, ACA
Chartered Accountant
Visiting Faculty:
H. R. College of Commerce & Economics,
Mumbai-400 020.

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SYLLABUS
M.COM. PART –II
ACCOUNTANCY GROUP-PAPER-V
RELATED APPLIED COMPONENT
DIRECT AND INDIRECT TAXES

SECTION-1	INCOME TAX	50 Marks
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- 1. Definitions –(S.2)**
 Person, Assessee, Income.
- 2. Basis of Charge (S. 3to 9)**
 Previous Year, Assessment Year, Residential Status,
 Scope of Total Income, Deemed income
- 3. Exclusions from Total Income (S.10)**
 Exemptions related to specified Heads of incomes to be covered with the relevant provisions such as Salary, Income from Other Sources.
 Agricultural Income
 Sum received from HUF by a member
 Share of a profit from Firm
 Income from Minor Child
 Dividend
- 4. Heads of Income**
 (Including relevant items from S 2 and S 10)
 Salary (S. 15 to S. 17)
 Income from house Property (S. 22 to S. 27)
 Profits and Gains from Business, Profession & Vocation (S. 28 to 32 35, 36, 37, 40, 40A, 43B)
 Capital Gains (S. 45 to S 50C)
 Income from Other Sources (S.56 to S. 59)
- 5. Deduction U/s 80**
 S. 80C, 80CCF: 80D, 80DD, 80DDB, 80E, 80U:
- 6. Computation of Income and tax for Individual, Firm and Company** (excluding MAT)
- 7. Advance Tax payment- S 208**
- 8. Provisions for filing of returns (Including forms of Return)**
 Sec-139(1), 139(5)

SECTION-II**INDIRECT TAXES****50 Marks**

1. SERVICE TAX**1.1 Basic Terms**

- Terms- Service, Activity, Consideration, Person, Declared Services
- Applicability of Service Tax
- Registration under Service Tax law (Sec 69)
- Registration Procedure
- General Exemptions from Service Tax in certain cases, Threshold Exemption
- Service Tax Returns and Penalty for late filing
- Payment of service tax and rate of service tax
- Penal consequences for delay and default in service tax payments
- Books and records maintained by the assessee
- Time limit for issue of an invoice
- Negative List (Sec 66 D Specifies services which are not taxable)

1.2 Services Specifically Excluded

- Transfer of title in goods or immovable property
- Transfer delivery or supply of any goods which is deemed sale
- Transactions on money or actionable claims
- Provision of service by employee to employer
- Services provided by MP, MLA, etc.
- Duties performed by persons who hold posts in pursuance of provision of constitution e.g. Central Vigilance Committee
- Duties performed as a chairperson or member or director in body established by central, state Govt or local authority

1.3 Point of Taxation

- Determination of point of taxation
- Point of Taxation for export of services from 1.4.2012
- Special provision for individual, partnership, LLP's

1.4 Valuation of Taxable Services

- Value for the purpose of taxable services
- Rules for valuation
- The essential ingredients of the rules
- Value of similar services

III

- Valuation on the basis of equivalent monetary value of consideration where value of similar services can not be ascertained
- Inclusion/Exclusion of certain expenditure or cash
- Taxable services provided from outside India
- Value of services involved in execution of works contracts
- Value of services involved In supply of food and any other article of human
- consumption in a restaurant or as outdoor catering

1.5 Place of Provision of Services

- Introduction
- Basic Framework
- Rule 3- Location of the Receiver
- Rule 5- Location of Immovable Property
- Rule 7- Part performance of a service at different locations

2. MAHARASHTRA VALUE ADDED TAX –(MVAT)

1. Introduction:

Definitions: Sec 3, 4, 5,6,7,8, (Only Theory)

2. Registration Procedure and Rules –S 16

3. Audit-Section 22 & 61

4. Penalty and interest

5. Set-Off, Refund- composition scheme

1. The Syllabus is restricted to study of particular sections, specifically mentioned rules and notifications only.

2. All modules / units include Computational problems / Case Study.

3. The Law In force on 1st April immediately preceding the commencement of Academic year will be applicable for ensuing Examinations.



SECTION-I: DIRECT TAXES

INCOME TAX

1

INTRODUCTION AND BASIC CONCEPTS

Synopsis

1. Introduction and Objectives
2. Assessment Year
3. Previous Year
4. Person
5. Assessee
6. Assessment
7. Income
8. Gross Total Income
9. Total Income
10. Scheme of charging income tax
11. Self Examination Questions

1. INTRODUCTION AND OBJECTIVES :

Under Entry 82 of the Schedule VII to the Constitution of India, the central government is empowered to levy 'Tax on income other than agricultural income in India. Accordingly , the parliament has enacted Income Tax Act, 1961["The Act"] to provide for the scope and machinery for levy and collection of Income Tax in India supported by Income Tax Rules,1962 and several other subordinate rules and regulations.

Further, the Central Board of Direct Taxes (CBDT) and the Ministry of Finance, Government of India issue from time to time circulars and notifications dealing with various aspects of the levy of Income tax.

Unless otherwise stated, references to the sections will be the reference to the sections of the Income Tax Act, 1961.

Section 4 is the charging section. It states that Income tax is a **tax on the total income** of a **person** called the assessee of **the previous year** relevant to the **assessment year** at the rates prescribed in the relevant Finance Act

This phrase sets the tone and agenda of any study on Income Tax Law This comprises of the understanding of the following:

- Concept of assessment year and previous year,
- Meaning of person and assessee,
- How to charge tax on income,
- What is regarded as income under the Income-tax Act,
- What is gross total income,
- What is total income or taxable income and
- Income-tax rates

This lesson deals with all these aspects, which lay down the basic framework for levy of income tax in India and explain the basic concepts and terms used in the income tax law.

2. ASSESSMENT YEAR – S. 2(9)

Section 2(9) defines an “Assessment year” as ***“the period of twelve months starting from the first day of April every year*** “

An assessment year begins on 1st April every year and ends on 31st March of the next year. Thus, for example, the assessment year 2016-17 means the period of one year beginning on 1st April, 2015 and ending on 31st March, 2016.

Income of an assessee during the previous year is taxed in the relevant assessment year. It is therefore, also called as the “Tax Year”

3. PREVIOUS YEAR- S. 2(34)& S. 3

3.1. Definition:

Section 3 defines “Previous year” as ***“the financial year immediately preceding the assessment year”***.

Income earned by an assessee in one financial year is taxed in the next financial year. The year in which income is earned is called the “previous year” and the year in which it is taxed is called the “assessment year”.

This will be explained from the following illustrations:

Illustration -1:

Income earned during financial year 2015-16 will be taxed in the financial year 2016-17. In other words, 2016- 17 will be the assessment year and the preceding financial year 2015-16 will be the previous year”

Illustration -2

For the assessment Year 2017-18 previous year will be 2016-17 i.e. from 1st April, 2016 to 31st March 2017.

3.2. Common previous year for all source of income:

A person will be liable to pay taxes on his total income earned from different sources. In other words previous year will be common for all sources of income so even if he maintains records or books of accounts separately for different sources of income.

Illustration-3:

During the financial year 2015-16 Ashok earns Rs 10,00,000 from salaries from A Limited and Rs 2,00,000 as salary from B Limited. He also earns Rs 2,00,000 from his profession and Rs 3,00,000 as interest on bank fixed deposits. Ashok will be liable to pay tax on aggregate income of Rs 17,00,000 from all the sources i.e. (Rs 10,00,000+ 2,00,000+ 2,00,000 + 3,00,000) earned during the previous year 2011-12 and it will be taxed in the assessment year 2016-17.

3.3. New Business or Profession:

Where a business is newly set up during a financial year or where a new source of income has arisen during that financial year, the previous year will be the period (obviously less than one year) commencing from the date of setting up of the new business or the date of new source of income arising.

Illustration-4:

Ramesh sets up a business in January, 2016. The period of three months beginning on 1st January, 2016 and ending on 31st March, 2016 will be the previous year 2015-16 and taxed in the assessment year 2016-17. . It is immaterial that previous year is of a period of less than 12 months.

3.4. Exception:

Ordinarily the income of the previous year is taxable in the next assessment year. However, in some cases an assessee is liable to pay tax on the income in the same previous year in which he earns it. These exceptional cases ensure safeguards to smooth collection of income tax from a class of taxpayers who may not be traceable until the commencement of the normal assessment year. In such cases, previous year and assessment year will be the same. Some of the exceptions are as under:-

- a) Realisation of bad debts written off in the earlier years and allowed as deduction - S 41(1)
- b) Deemed dividend – Sec 56
- c) Income of non-residents from shipping business—S.172;
- d) Income of persons leaving India either permanently or for a long period of time and not likely to return back –S. 173-174;
- e) Income of bodies formed for short duration for a particular event or purpose – S 174A;

- f) Income of a person trying to alienate his assets with a view to avoiding payment of tax – S. 175 ,
- g) Income of a discontinued business- S.176

4. . PERSON –S. 2(31)

4.1 Definition:

Section 2(31) gives an inclusive definition of “person”

“Person” includes:

- a) an individual;
- b) a Hindu undivided family (HUF);
- c) a company;
- d) a firm;
- e) an Association of Persons(AOP) or a Body of Individuals,(BOI) whether incorporated or not;
- f) a local authority; and
- g) every artificial juridical person not falling within any of the preceding categories

4.2 Inclusive definition:

Since the above definition of “person” is inclusive one and not exhaustive, there may be cases, when an entity not falling in the above seven categories may still be treated as “person” inviting the provisions of the Act.

4.3 Profit Motive not necessary:

As per Explanation to S. 2 (31), an entity need not be formed for profit. Thus, Non-Profit Organisations or charitable trusts are also covered by the definition of “person” although their income is not taxable under the Act on satisfying the certain terms and conditions.

4.4 Description of types of persons :

A brief description of these seven categories is as follows:

- a. Individuals** are all living persons of blood and flesh e.g. .Ram, Shyam, Gopal, Albert, Ibrahim etc.
- b. Hindu Undivided Families (HUF)** or Hindu joint families are regarded as separate tax entities in view of the specific law of succession prevalent among the Hindus.
- c. Company** as per section 2(31) includes Indian as well as foreign companies and public as well as private Companies. Besides, the CBDT has the power to declare any institution as a Company. Even 25 companies incorporated for charitable purpose are also included in the definition, although they can claim exemption from tax on compliance of the legal conditions given in other provisions of the Act. . .

d. Partnership firms including Limited Liability Partnerships (LLPs) are regarded as distinct taxable units separate from their partners. Therefore, under the Act, firms are taxed as the firms and individual partners are taxed separately in their personal capacity.

e. Body of individual (BOI) and Association of Persons (AOP) are the group of persons carrying on some activities to earn income such as joint venture.

Normally, AOPs are contractual in nature like a joint venture agreement if such venture not formed as a partnership or a company.

On the other hand, BOI may be due to circumstances such as joint owner of a estate. Clubs, Societies, Charitable Trusts etc are covered under this head.

f. Municipal Corporations, Panchayats, Cantonment Board, Zila Parishads etc are the examples of Local authorities.

g. Final category is residual category and covers all such persons which are not covered in any of the above six categories.

Illustration-5:

Determine the status in the following persons as per the Income Tax Act, 1961:

Person	Status
Ramesh Agrawal	Individual
Asha Jain	Individual
Reliance Industries limited	Company
Warna Co-Society Ltd	AOP
Indian Red Cross society	AOP
Legal heirs to receive property of late Shri Nusserwanji	BOI
Tata power Ltd	Company
Sachin Tendulkar	Individual
Board for Cricket control in India	AOP
Family of Shri PB Hindu	HUF
Pune Cantonment Board	Local Authority
Mumbai University	Artificial Juridical Person
Ramsay Brothers doing business in partnership	Firm

5. ASSESSEE–S. 2(7)

5.1 Definition :

U/s 2(7) “Assessee” means a person by whom income tax or any other sum of money is payable under the Act and it includes:

- a. every person in respect of whom any proceeding under the Act has been taken for the assessment of his income or loss or the amount of refund due to him
- b. a person who is assessable in respect of income or loss of another person or who is deemed to be an assessee, or
- c. an assessee in default under any provision of the Act

5.2 The definition of “assessee” is also inclusive and very broad in scope. It includes any other person not covered in the above categories. The definition covers not only a person but also his representative such as legal heir, trustee liquidator of a company assessee etc. Moreover, importance is given to not only the amount of tax payable but also to refund due and the proceedings taken.

5.3 Thus an assessee may be :-

1. A person by whom income tax or any other sum of money is payable under the Act
2. A person in respect of whom any proceeding under the Act has been taken for the assessment of his :
 - a. income or
 - b. loss or
 - c. the amount of refund due to him
3. A person who is assessable in respect of income or loss of another person or
4. A person who is deemed to be an assessee,
5. an assessee in default under any provision of the Act

5.4 A minor child is a separate assessee but his income is included in the income of the parent having the higher income unless such income is from an asset assets acquired from the minor's sources of income or income generated out of activities performed by him like singing in radio jingles, acting in films, tuition income, delivering newspapers, etc.

6. ASSESSMENT - S 2(8)

In an inclusive definition, sec. (8) “**an assessment includes reassessment**”.

Assessment is the procedure to determine the taxable income of an assessee and the tax payable by him.

U/s 139 of the Act, every assessee is required to file a self-declaration of his income and tax payable by him called "return of income".

The Income Tax officer may accept the return summarily without making any enquiry into its contents. This is called as the 'summary assessment'-S (143(1)).

Alternatively, the assessing officer may call upon the assessee to explain his return of income and thereafter the assessing officer after making necessary enquiry frames a reasoned order determining the total income and the tax payable by the assessee. This is called the "regular assessment"—S 143(3)."

Completed assessment becomes final except in certain circumstances. These circumstances are;

- a. U/s 147, an assessment can be reopened to assess income which has escaped assessment,
- b. U/s 263, the Commissioner of Income Tax may ask an assessment to be redone if the assessment order is erroneous and prejudicial to the interest of the revenue,
- c. U/s 264, the Commissioner of Income Tax at the application of an assessee or *suo motu*, may ask an assessment to be redone. This is normally done to give relief to the assessee.
- d. U/s 254, the Income Tax Appellate Tribunal (ITAT) in appeal proceedings may pass an order directing the assessment to be redone.

In all the above cases "reassessment" of the income is required to be done. The definition of assessment includes the regular assessment and reopened or reassessment.

7. INCOME- S 2(24)

7.1 Definition :

Sec 2(24) in an inclusive definition states that Income" includes—

- (i) profits and gains ;
- (ii) dividend ;
- (iia) **voluntary contributions** received by
 - a trust on created or wholly or charitable or religious purposes- U/s 10 (21)
 - a scientific research association or institution established u/s - S.10(23) ;

- a fund or trust or institution (sports body) u/s 10(23C) (iv) or (v) or
- any university or other educational institution referred to in Sec 10(23C) (iiiad) or (vi) or
- by any hospital or other institution referred to in Sec 10(23C) (iiiiae) or (via) or by an electoral trust.

For this purpose "trust" includes any other legal obligation;

Receipts by the employees:

(iii) the **value of any perquisite or profit in lieu of salary** taxable u/s 17 (2) and (3);

(iiia) any **special allowance or benefit**, other than perquisite included u/s 17 (iii), specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit ;

(iiib) any **allowance** granted to the assessee either to meet his **personal expenses** at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living ;

(iv) the value of any **benefit or perquisite**, whether convertible into money or not, obtained from a company either by

- a director or by a person who has a substantial interest in the company, or
- by a relative of the director or such person, and

any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid ;

(iva) value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee mentioned in section 160 (1) (iii) or (iv) or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee called the "beneficiary" and any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary ;

Income from business

(v) Managerial compensation Sec 28 (ii) and

Balancing charge and other receipts earlier allowed as deduction –S 41 or section 59

Export Benefits;

- (va) Duty drawback - Sec 28 (iiia) ;
- (vb) cash assistance- sec 28 (iiib);
- (vc) DEPB -Sec 28 (iiic);
- (vd) Value of any benefit or perquisite taxable the value of any benefit or perquisite taxable – S 28 (iv);
- (ve) any sum chargeable to income-tax- S. 28(v);
- (vi) any capital gains chargeable u/s 45;
- (vii) the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule ;
- (viiia) the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members;
- (viii) Omitted
- (ix) any winnings from lotteries (including winnings from prizes awarded to any person by draw of lots or by chance or in any other manner), crossword puzzles, races including horse races, card games and other games of any sort (including any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game) or from gambling or betting of any form or nature whatsoever.
- (x) Any contribution received from employees towards any provident fund or superannuation fund or Employees State Insurance Act, 1948, or any other fund for the welfare of such employees ;
- (xi) any sum received under a Keyman insurance policy as defined in Sec 10(10D) including the sum allocated by way of bonus on such policy.

Gifts U/s 56

- (xiv) Any sum of money or value of property received as gift –S 56(2) from 01/06/2010
- (xv) any sum of money or value of property referred to in clause Sec 56 (vii) or (viiia);
- (xvi) any consideration received for issue of shares as exceeds the fair market value of the shares referred to in Sec 56 (2) (viib);

(xvii) any sum of money referred to in Sec 56 (2) (ix);

(xviii) assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee other than the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to Sec 43 (1);

7.2 Sec 2(24) offers an inclusive definition of income, As per the section the term income covers not only the income in its natural and general sense but also several items not otherwise considered as income.

As a result, Income means not only the revenue receipts arising or accruing regularly but also capital receipts like gifts and even donations and gifts. On the other hand, certain revenue receipts like agricultural income are left out from the scope of the term income.

Some of the principles that have emerged out as a result of customs, practices and judicial pronouncements to ascertain as to what does or does not constitute income are as follows.

1. Ordinarily Income is a regular periodical receipt, received or derived from a certain source.
2. The source of income must be external. No one can earn income by or from himself.
3. On this principle , income accruing to clubs, societies etc. from their own members are not taken as taxable income on the ground of mutuality.
4. Normally only revenue receipts are regarded as income unless specifically exempted.
5. On the other hand, capital receipts are not treated as income unless the law specifically provides such as capital gains or gifts, maturity proceeds of Keyman Insurance Policy, sales tax subsidy, voluntary contribution by a donor to a trust , which are included in income in spite of being capital receipts .

Income is likened to the fruit of a tree, where tree is the source or the capital asset and fruit is the income.

6. Income may be in cash or kind.
7. Income need not be legal. It may even be derived from illegal sources like, smuggling, theft, bribery, corruption etc.
8. It is the receipt, which is income not its application or use. .
9. However , receipt diverted at the origin from the source will not be regarded as income.

10. Any dispute regarding the title of the income does not take away its nature as income.
11. A gift is a capital receipt normally excluded from income. However, the law has been amended to bring gifts in the tax net. This will be clear from the following :
 - a. Sec 17 deems a gift given by an employer to an employee as salary.
 - b. Section 28 provide for inclusion of a gift by a client or customer in the profits and gains from the business or profession. Thus, a car given by a client to his lawyer or a disciple to his guru will be taxable in the hands of income from business or profession.
 - c. Sec 56 is amended to provide for taxation of personal gifts in excess of Rs. 50,000 as income from other sources subject to certain exceptions . The Section also provides for taxation of deemed gifts arising due to inadequate consideration on transfer of immovable and movable assets. This aspect is dealt with in great detail in the lesson relating to income from other sources
12. Income may be recognised either on receipt basis or on accrual basis depending upon the facts and circumstances of each case and method of accounting applied in that case.
13. Income must be certain. Contingent income is not regarded as income unless and until such contingency occurs and the income arises to the assessee.
14. Income is the sum total of all receipts from all the sources and considered accordingly.
15. Pin money received by a woman for personal expenses or even the savings made by her from such receipts is not considered as income. However, the husband will not get any credit from his income for these payments.
16. Income may be received in lump sum or in instalments. Thus, arrears of salary received by a person in lump sum are regarded as his income.
17. Awards received by a professional sportsperson would be income unless the award is in nature of a gift in personal consideration. Some of the above items are discussed in detail in subsequent lessons at appropriate places.
18. Income of wife is be taxable in the hands of the husband if the assets out of which the income is arising have not been acquired out of the sources of the wife or from an asset gifted by the husband except as consideration for living apart .
19. Income of minor children is be taxable in the hands of the parents having higher income [mother or father] except when the income is arising from the efforts of the minor child say modeling charges.

8. GROSS TOTAL INCOME- S -14:

Section 14 of the Act defines the Gross Total Income as the aggregate of the incomes computed under the five heads after making adjustments for set-off and carry forward of losses. The five heads of income are as follows namely:

1. Income from Salaries
2. Income from House Property
3. Profits and Gains from Business & Profession
4. Capital Gains
5. Income from Other Sources

The aggregate income under these heads is termed as “Gross Total Income” In other words; gross total income means total income computed in accordance with the provisions of the Act before making any deduction under sections 80C to 80U. However, any exemptions as allowed by Section 10 are deducted from the respective heads before arriving at the gross total income like conveyance allowance, capital gains on sale of personal effects, dividend income, etc.

9. TOTAL INCOME:

The total income of an assessee is computed by deducting from the gross total income all permissible deductions available under the Chapter VI A of the Income Tax Act, 1961. This is also referred to as the “Net Income” or “Taxable Income”.

10. SCHEME OF CHARGING INCOME TAX

Income tax is a tax on the total income of an assessee for a particular assessment year. This implies that;

- Income-tax is an annual tax on income
- Income of previous year is chargeable to tax in the next following assessment year at the tax rates applicable for the assessment. year This rule is, however, subject to some exceptions discussed in Para 4 above.
- Tax rates are fixed by the annual Finance Act and not by the Income-tax Act. For instance, the Finance Act, 2016 fixes tax rates for the financial year 2016-17 relevant to assessment year 2017-18
- Tax is charged on every person if the gross total income exceeds the minimum income chargeable to tax.

Tax rates are given in the lesson dealing with computation of income.

11. SELF ASSESSMENT QUESTIONS

1. Income of a previous year is chargeable tax in the immediately following assessment year. Is there any exception to this rule? Discuss
2. Define the term "person"
3. How would you calculate income tax for the assessment year 2016-17 in the case of different assesses?
4. Explain how education cess will be computed for the assessment year 2016-17? [Ans: 2%+1%]
5. What will be the previous year for X, who starts his business on April 6, 2014[Ans: A.Y. 2015-16]
6. Will the answer to Q 5 be different, if X starts his business on 28th March,2014? [Ans: A.Y. 2014-15]
7. Explain that a financial year is a previous year and also an assessment year .Every financial year can also be an assessment year,
8. Previous year is a financial year immediately preceding the Assessment year Comment
9. What will be the status of University of Mumbai?
[Ans: Artificial juridical person]
10. Indicate whether the following persons will be taxed as individuals:
 - a) X a partner of a firm
 - b) Y, a managing director of A Ltd;”
 - c) Z is the member of Z HUF
 - d) Municipal Commissioner of Mumbai in respect of the Income of the Municipal Corporation
 - e) Municipal Commissioner of Mumbai in respect of his salary from the Municipal Corporation
 - f) A minor acting in TV commercials

[Ans: All except (d) will be taxed, Firm X , A Ltd , Z HUF , Mun Corpn. Separate tax entities]



BASIS OF CHARGE AND INCIDENCE OF TAX

Synopsis

1. Introduction and Objectives
2. Basic Charge of Income Tax
3. Residential Status
4. Residential status and incidence of tax
5. Income deemed to be received in India
6. Income deemed to be accrue or arise in India
7. Receipt vs. Remittance
8. Actual receipt Vs. Deemed Receipt Total Income
9. Receipt vs. Accrual
10. Basis of Charge of Dividend Income
11. Heads of Income
12. Self-Examination Questions

1. INTRODUCTION AND OBJECTIVES

This lesson deals with the scheme of income Tax laid down in section 4 to 9 as to the basis of charging income tax , income on which tax is to be levied , the status of persons and effect of the status of persons on which the income tax is to be levied, periodicity of the tax and other incidental matters .

2. BASIS OF CHARGE OF INCOME TAX (S. 4-9)

Section 4 to 9 define a detailed scheme and basis of charge of income tax in India

Section 4 – Scope and basis of charge

U/s 4 income tax shall be charged for any assessment year at any rate or rates prescribed in the Finance Act in respect of the total income of the previous year of every person. From the above it appears that :

- Tax is payable
- on total income
- of a person called assessee
- during the previous year

- Relevant to assessment year
- At the rates prescribed in the Finance Act

Relevant terms have been explained in the previous lesson

Section 5 and 6 - Residential status and place

U/s 5 total income of an assessee is chargeable to tax depending upon his residential status and place and time of accrual of income. Section 6 lays down the rules for determining residential status of various types of persons

Section 7, 8 and 9 – income accrued or received in India

Section 7 certain specifies the incomes, which are not received in India but are deemed to be received in India and Section 9 specifies the incomes though not accrued. Section 9 specifies the incomes though not accrued or arisen in India but are deemed to accrue or arise in India. Section 8 deals with the year of taxability of dividend income

3. RESIDENTIAL STATUS – S 6

- 3.1** Under Section 5 total income of an assessee is chargeable to tax depending upon
- a) the residential status of a person; and
 - b) place and time of accrual of such income.

Section 6 gives the rules for determining residential status of different categories of persons. These provisions are discussed in detail below:

3.2 Classification of persons:

Provisions for determination of the residential status are different for different categories of the assessee viz:-

- a) individuals;
- b) Hindu Undivided Families (HUF)
- c) Firms, BOI or Associations of Persons (AOP);
- d) Companies; and
- e) Every other person

3.3 Residential status of individual:

3.3.1 Basic conditions: -Section 6(1):

Sec 6(1) lays down that to determine the residential status of an individual for a previous year, first step is to ascertain whether the individual is resident or a non-resident in India during that previous year. These conditions are given below.

An individual is said to be a resident in India in any previous year, if he satisfies **at least one** of the following **TWO basic conditions viz. : —**

- a) He is in India in that previous year for a period or periods amounting in all to **182 days or more** OR
- b) He has been in India is in India for a period or periods amounting in all to **365** days or more during **4** years immediately preceding that previous year **AND**

He is in India in that previous year for a period or periods amounting in all to **60** days or more during that previous year.

Exception:

The limit for stay in India for **60 days or more** as per condition (b) will be extended to **182 days or more** in following two circumstances:

- i. **An Indian citizen leaves India** during the previous year
 - for the purpose of taking up employment outside India. OR
 - as a member of the crew of an Indian ship OR .
- ii. **An Indian citizen or a person of Indian origin (PIO) comes on visit** to India during the previous year.

A person is said to be of Indian origin (PIO) if either he or any of his parents or any of his grandparents was born in undivided India.

In other words , in both the cases, an individual needs to be present in India for a minimum of **182 days or more** to become resident in India **instead of 60 days**.

If the individual satisfies any of the two conditions, he is a resident in India and if he does not satisfy any of the conditions, he is a non- resident during that particular assessment year.

3.3.2 Resident and Ordinarily Resident [R & O R]-S-6(6)

If an individual satisfies any of the two basic conditions given in Sec 6(1) for a particular previous year , next step would be to determine whether he will be a resident and ordinarily resident of India in that previous year as per Sec 6(6)..

Sec. 6(6) provides that a person will be “**resident and ordinarily resident**” in India in any assessment year if he satisfies **BOTH** of the following two conditions Viz he has been:-

- 1) resident in India in 2 out of 10 previous years immediately preceding that previous year as per Sec 6(1) AND .
- 2) has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, 730 days or more. ;

In simple words, an individual must be resident in India in at least 2 years out of 10 years immediately preceding that previous year as per AND he must be in India for a period of 730 days or more .

3.3.3 Resident and Not Ordinarily Resident [R &N O R]

A resident individual, who does not satisfy BOTH of the above conditions given above, will be a Resident but Not Ordinarily Resident in India.

In other words, an individual becomes resident but not ordinarily resident in India if he

- (a) Is non-resident in 9 out of 10 previous years immediately preceding that previous year or
- (b) has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, 729 days or less.

A person will be Resident and Not Ordinarily Resident if he-

- satisfies at least one of the basic conditions but satisfies **NONE** of the additional conditions OR
- Satisfies **ONLY ONE** of the two additional conditions.

3.3.4 Non- Resident

An individual is a non-resident in India if he satisfies none of the basic conditions .It must be noted that if a person satisfies the additional conditions but does not satisfy the basic conditions, he will still be treated as Non-Resident. In such a case, additional conditions are not relevant.

3.3.5 SUMMARY

On an analysis of the above legal provisions, an individual can either be:

- (a) resident and ordinarily resident in India;
- (b) resident but not ordinarily resident in India; or
- (c) non-resident

Following table gives the summary of the provisions

Status of the Individual	Basic Conditions S.6(1)	Additional Conditions – S 6(6)
Resident and ordinarily Resident	Must satisfy either of the two conditions	Must satisfy BOTH conditions
Resident but not ordinarily Resident	Must satisfy either of the two conditions	MUS NOT satisfy any one or both the conditions
Non Resident	Does not satisfy any conditions	Not Necessary that the two conditions are satisfied or not.

3.3.6 Some Important points:

Following points are important in determine the residential status of a person

- a) In computing the day on which a person is in India
 - a. Stay at difference places in India will be aggregated . Stay need not be at one place only .
 - b. Stay in India in intervals will also be aggregated .Stay need not be continuous.
 - c. the day on which a person enters India as well as the day on which .he leaves India shall be taken into consideration even if on such days the person is in India only for a part of a day.

Note: According to decided cases, a total of 24 hours of stay spread over a number of days is to be counted as being equivalent to the stay of one day. However, in most questions the hours of arrival and departure are not given. In all such cases day of departure and arrival both shall be computed as two days.

- b) A person, who is in India for 182 days or more will always be a resident of India.
- c) Conversely, a person, who is in India for 59 days or less, will always be Non-Resident of India.
- d) An Indian citizen must leave India **for employment or as crew to** avail extended limit of 182 days instead of 60 days
- e) An Indian citizen leaving India Resident and ordinarily in India will not get the extended time limit of 182 days .
- f) The condition is relaxed only for Indian citizens and not for persons, who are not Indian citizens.
- g) Indian citizens or persons of Indian origin(PIO) must come to India on visit for any purpose – pilgrimage, medical treatment or tourism but NOT business or job to avail extended limit of 182 days Indian citizenship is not the requirement for this purpose.
- h) While computing the period of stay in number of days, note that 2004, 2008, 2012 and 2016 were leap years. ..

3.3.7 Illustrations :

Illustration -1:

Rajesh leaves India for the first time on December 20, 2006. During the financial year 2015-16, he came to India on May 27 for a period of 45 days. Determine his residential status for the assessment year 2016-17

Solution:

During the previous year 2015-16, Rajesh is in India only for 45 days. He does not satisfy any of the basic conditions laid down in section 6(1). Hence, Rajesh is a non-resident in India for the assessment year 2016-17.

Illustration -2:

Mahesh comes to India, for the first time, on April 16, 2013. He stays in Chennai up to April 29, 2015 and thereafter shifts to Mumbai. He departs from Mumbai for his native country on October 8, 2015. Determine his residential status for the assessment year 2016-17.

.Solution:

During the previous year 2015-16, Mahesh is in India for 182 days. He satisfies the first condition u/s 6(1) of staying in India for 182 days or more during the previous year 2015-16, he is a **resident in India u/s 6(1)**.

Month	April	May	June	July	August	Sept	Oct.	Total
Days	30	31	30	31	31	30	2	185

During the previous year 2013-14, Mahesh was in India for 351 days from 16/04/2013 to 31/03/2014 and for the full year or 365 days. Hence, Mahesh was resident in India for these two years. Hence he fulfills the first additional condition under Section 6(6) that he must be a resident in India in at least two years out of the ten preceding years i.e. from 2005-06 to 2014-15 (Feb 2016 Leap Month).

However, Mahesh does not satisfy the second condition as per Sec 6(6) as he was in India for a period of 716 days only [351 days in 2008-09 and 365 days in 2014-15], which is less than 730 days stay required in the seven preceding years from 2008-09 to 2014-15 as per the second additional condition.

Therefore, Mahesh satisfies one of the basic conditions and only one of the two additional conditions, he is, therefore, resident but not ordinarily resident in India for the assessment year 2016-17.

Illustration -3:

Determine residential status for the assessment year 2016-17, of Venkat, an Indian Citizen who leaves India for employment in Canada on July 1, 2015.

Solution:

Venkat was in India for 92 days in 2015-16 (April : 30 days; May - 31 days; June : 30 days and July 2015: 1 day). Venkat is an Indian citizen, leaving India to take up a job. Hence he will be given the extended limit of 182 days' stay in India during

2015-16. Hence Venkat will be a Non -resident although he was in India for more than 365 days during the four years preceding the previous year

Illustration - 4:

What will be the position in the above case, if Venkat leaves India for world tour?

Solution:

Venkat will be Resident and Ordinarily Resident of India as he satisfies the second basic condition u/s 6(1) of 365 days' stay in the preceding four years and 60 days stay during 2015-16 and also the two additional conditions of section 6(6), as being a person born in India, Venkat satisfies both the additional conditions of being resident in India for two years in preceding 10 years and stay of 730 days in seven preceding years.

Illustration -5:

Supposing in the above case, Venkat wants to postpone his stay in India, what would be the last date by which he should leave India ?

Solution:

Since Venkat is covered by the exception, he should depart latest by September 28, 2015 so that his stay in India during the previous year 2015-16 is of 181 days (less than 182 days).

Illustration -6:

What will be the position in the above case if Venkat is a Nepali citizen settled in India?

Solution

Venkat will not be covered by the exception U/s 6(1) as he is not an Indian citizen. Since he satisfies the basic condition and also both the additional conditions of 730 days in 7 preceding years and 2 years resident in preceding 10 years, he will be a resident and ordinary resident in India

Illustration -7:

Chappell, an Australian Citizen comes to India as the Coach of Indian Cricket team. During the previous year 2015-16, he stayed in India for 95 days. Before that, he was in India for more than 365 days during the 4 years prior to 2015-16. What will be his residential status for the assessment year 2016-17?

Solution:

Chappell satisfies the second basic condition of stay of 365 days or more during the four years preceding the previous year 2015-16, and he was in India for more than 60 days during the financial year 2015-16. He will be Resident of India. Since he is not a person of Indian origin nor he comes in India on visit, he will not get the extended time limit of 182 days. Since Chappell was never in India, he does not fulfill the additional two

conditions, hence he will be Resident but not Ordinarily Resident of India [RNOR] .

Illustration -8:

Will the position be different in the illustration 7 if Chappell is a resident of Bangladesh?

Although Bangladesh was part of undivided India, Chappell will not get any benefit as he has not come on visit but as a professional coach.

Illustration -9:

Will the above position change If Chappell is a Pakistani citizen and visits India as a tourist. ?

Solution:

Yes, Chappell will get the extended limit of 182 days and he will be a Non- resident.

3.4. Residential status of HUF :

3.4.1 Resident

As per Section 6(2), a Hindu Undivided Family (HUF) will be:

- **Resident** in India if control and management of its affairs is **wholly or partly** situated in India.
- **Non- resident** in India only if control and management of its affairs is situated **wholly outside** India.

3.4.2 Resident and Ordinarily resident (ROR)

U/s 6(6) , a HUF can will be Resident and Ordinarily Resident if its Karta or manager satisfies **both** of the following **two conditions** viz. The Karta or the manager :-

- (a) has been a non-resident in India in 9 out of the 10 previous years preceding that year, and
- (b) has during the 7 previous years preceding that year been in India for a period of, or periods amounting in all to 729 days or less

It may be noted that additional conditions are same as those applicable to the individual but applicable on the Karta or the manager of a HUF.

3.4.3 Resident and Not Ordinarily resident (ROR)

If the Karta does not satisfy both of the two additional conditions, the HUF will be treated as a **resident but not ordinarily resident** (RNOR) in India

3.4.4 Non-Resident

A HUF will be **non- resident** in India **ONLY** if control and management of its affairs is situated **wholly outside**

It is important that place of control and the management of HUF is relevant to determine whether the HUF is Resident or Non-Resident.

However, to determine ROR status the two additional conditions will be applicable with reference to its Karta or Manager.

3.4.5 Summary

Thus, like an Individual a HUF may be either:-

- (a) Resident and ordinarily in India if is controlled or management wholly or partly in India or
- (b) Non-resident in India if its control or management is wholly outside India .
- (c) Resident and ordinarily in India if two additional conditions are satisfied as per Sec 6(6) by the Karta / Manager.

3.5. Residential Status of Other Non-Company Persons (S. 6(2) / S 6(4))

3.5.1 Resident –S 6(2) :

Under Section 6(2) Residential status of all non-company persons viz a firm an Association of Persons (AOP) or a Body of Individuals (BOI) and every other person will also depend upon the place of control and management like HUFs.

Any such person will be:

- **Resident** in India if control and management of its affairs is **wholly or partly** situated in India, ;
- **non-resident** in India if control and management of its affairs is situated **wholly outside** India.

3.5.2 Non Resident

An AOP, BOI or a firm will be non-resident in India if control and management of its affairs is situated **wholly outside** India.

These persons can only be either resident or not resident but not ordinarily resident .

Illustration -10:

An entity XYZ has its operations in India but India but it takes instructions from London either wholly or partly .

What will be the residential status of XYZ if it is HUF, c) AOP, d) BOI , e) Artificial juridical person?

Solution

XYZ will be Resident of India in all the cases.

Illustration -11:

What will be the status in the above cases if XYZ is wholly controlled from Mauritius ?

Solution

XYZ will be Non -Resident of India in all the cases .

It is important to note that control and management means *de facto* (actual) control or manage but not merely the right to control or manage. Place of control and management is situated where the decision making of the entity as a whole is situated.

3.6. Residential Status of a Company –Section 6(3)

Under the amended section 6(3) with effect from **01/04/2016** a company will be resident of India in any previous year, if—

- (i) it is an Indian company; or
- (ii) its **place of effective management** (POEM), in that year, is in India.

"Place of effective management" means a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made.

From the above , it follows that :-

- 1 Residential status of a company is based on its place of registration and control and management.
- 2 An Indian company will be resident in India irrespective of where their control or management is.
- 3 Any other company(i.e.. a foreign company) will be a Resident in India if place of effective management (POEM)) of such company is situated in India .
- 4 A foreign company will be non-resident will be resident if their control and management is wholly in India if place of effective management (POEM)) of such company is situated outside India.

The legal provisions are summarised in the following table.

Company	Status
Indian company	Resident
Foreign company if POEM is situated in India	Resident
Foreign company if POEM is situated outside India	Non resident

Illustration -12:

What will be the residential status of X LTD an Indian company managed from India?

Solution

X Ltd. being an Indian company will be Resident in India . Place of management is immaterial.

Illustration -13:

What will be the residential status of Y LTD an Indian company managed from London?

Solution

Y Ltd. being an Indian company will be Resident in India . Place of management is immaterial.

Illustration -14:

What will be the residential status of T LTD a British company managed from India?

Solution

T Ltd. will be resident in India as its POEM is situated in India.

Illustration -15:

What will be the residential status of U Inc.a US Company managed from London?

Solution

U limited will be a Non-resident in India as its POEM is wholly situated outside India.

3.7. Miscellaneous:

Following points are noteworthy:

(a) Residential status for each previous year:

Residential status of a person shall be determined for each previous year independently.

(b) Different residential status for different assessment years:

Residential status may change from previous year to previous year and a person may have different residential status for different assessment years. For instance, if a person leaves India for two years and then comes back, he can be non-resident for those two years and resident for other years.

(c) Resident in India and abroad:

A person may be “resident” in two or more countries in a particular year. Similarly, in a particular assessment year, a person may be a non-resident in India as well as other countries.

In other words, It is not necessary that a person, who is “resident” in India, will necessarily be non-resident in all the other countries for the same assessment year.

This is particularly true of a person, who has changed his country two three times in a year and he does not fall in any category of residents anywhere in the world.

(d) Residence for all sources:

If a person is a resident for one source of income in a previous year, he shall be deemed to be a resident for all other sources of income also. [Section 6(5)]

4. RESIDENTIAL STATUS AND INCIDENCE OF TAX

Section 5 defines the scope of total income taxable in India. Brief provisions of the section are given as under :-

4.1. Scope of total income for a Resident

As per Sec 5(1) the total income of any previous year of a person who is **a resident** includes all income from whatever source derived which—

- (a) is received or is deemed to be received in India in such year by or on behalf of such person ; or
- (b) accrues or arises or is deemed to accrue or arise to him in India during such year ; or
- (c) accrues or arises to him outside India during such year .

4.2. Person not ordinarily resident in India

The section provides that total income of a person who is not ordinarily resident in India within the meaning of Sec 6(6) shall not include the income which accrues or arises to him outside India unless it is derived from a business controlled in or a profession set up in India. Thus the Income of such person shall include the following income from whatever source derived which—

- (a) is received or is deemed to be received in India in such year by or on behalf of such person ; or
- (b) accrues or arises or is deemed to accrue or arise to him in India during such year ; or
- (c) accrues or arises to him outside India during such year if such income is derived from a business controlled in or a profession set up in India

4.3. person who is a non-resident

As per Sec 5(2) the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

- (a) is received or is deemed to be received in India in such year by or on behalf of such person ; or
- (b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Thus the total income of a non-resident shall not include accrues or arises to him outside India during such year.

4.4. Important points

Following are some important points with regard to the scope of total income as per the provisions of Sec 5

- (a) Incidence of tax on a taxpayer depends on:-
 - his residential status,
 - the place and time of accrual or receipt of income.;
- (b) Income accruing or arising outside India shall not be deemed to be received in India by reason only of the fact that it is taken into account in a balance sheet prepared in India.
- (c) income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India.
- (d) **Indian income will be taxable in all cases . Indian income** or Income received, accruing or arisen in India or deemed to be received, accruing or arising in India will be included in the income of every person regardless of his residential status whether resident or non-resident or R & OR or R & NOR.

Some income may be **Indian income** in a previous year if :-

- Income might be received or deemed to be received in India and such income also accrued or arisen or deemed to be accrued or arisen in India;
- If income is received or deemed to be received in India BUT it **accrues or arises outside India; or.**
- If income **is received outside India** but it accrues, arises, or is deemed to accrue or arise in India.

(e) **“Foreign income”** or income which is not Indian Income or Income not received , accrued or arisen in India nor deemed to be received , accrued or arisen in India is taxable as under:-

- I. ;Foreign income is not included in the total income of a non-resident ,
- II. Foreign Income is included in the total income of a resident and ordinarily resident ,

III. Foreign income **will not be** included in the total income of a resident but not ordinarily resident RNOR unless such income is derived from:

- a business controlled in India or
- A profession set up in India

Non-business foreign income will not be included in the income of a person who is resident but not ordinarily resident in India.

Thus foreign income taxable only by a ROR and conditionally by RNOR

(f) Residents will be liable in respect of all income Indian or foreign but Non- residents liable for Indian income only

The Scope of total income chargeable to tax is summarised as follows:

Scope of total income –S 5			
Income	Status		
	Resident & Ordinarily Resident	Resident & Not Ordinarily Resident	Non Resident
Indian income	Taxable	Taxable	Taxable
Foreign income	Taxable	Taxable if income is from <ul style="list-style-type: none"> • a business controlled from India or • a profession set up in India 	Not Taxable

4. INCOME DEEMED TO BE RECEIVED IN INDIA - S. 7

As per Section 7, the following incomes are included in the scope of total income even if they are not actually received in India:

1. Annual accretion to the credit balance of an employee in the case of recognized provident fund to the extent provided under rules
2. Excess contribution of employer in the case of recognized provident fund to the extent as provided in the rules.
3. Transfer balance to a recognized provident fund from unrecognized provident fund to the extent as provided under the rules.

5. INCOME DEEMED TO ACCRUE OR ARISE IN INDIA- SEC 9

As per Section 9, which is a deeming section, certain incomes are deemed to accrue or arise in India even though they may actually accrue or arise outside India. These incomes are given below::

1. All incomes accruing or arising whether directly or indirectly through or from-
 - a. Any business connection in India or
 - b. Any property in India or
 - c. Any asset or any source of income in India or
 - d. The transfer of a capital asset situated in India.

Exceptions: No income is deemed to accrue or arise in following cases:

- I. **Purchase of goods** India by a Non- resident for Export
- II. **Collection of news** by a non- resident running a new agency , or publishing newspapers, magazines or journals
- III. **Shooting of film** in India by a non- resident foreign citizen individual or a company or firm in which no Resident Indian citizen is a partner or shareholder
- IV. Indian Income to be taken **pro rata** if all operations of a business not carried in India

Explanation: The term “business connection” includes a person , who –

- I. holds or habitually exercises holds an authority to conclude contract on behalf of the non-resident, except for purchase of goods or merchandises
- II. has no such authority but maintains stock of goods and merchandise in India, from which he regularly delivers stock or merchandise on behalf of the non-resident.
- III. Secures orders in India for the non-resident and other non-resident, controlling, controlled by or subject to the same common control as that of non-resident.

However, there will be no business connection as above if a non-resident carries on a business through a broker, general commission agent or any other agent of independent status, acting in ordinary course of business.

For this purpose A broker, general commission agent or an agent shall be deemed to be of an independent status if he does not work mainly or wholly on behalf of the non-resident.

2. "Salary" earned in India i.e. salary payable for services rendered **in India**. It also includes salary paid for the rest period or leave period preceded and succeeded by services rendered in India and forms part of service contract of employment.
3. Salary received by **Indian national from the government** in respect of services rendered **out of India**. However, any allowance or any perquisite paid abroad is fully exempt from tax under Section 10(7).
4. Any **dividend paid by an Indian company** outside India.
5. **Interest** payable by government or a resident person unless such interest is payable in respect of borrowed funds used for a business or profession carried out of India, or by a non-resident person on funds borrowed for the business or profession carried in India. W.e. f. A.Y. 2016-17, Interest payable by the permanent establishment in India of a non-resident assessee and engaged in the business of banking in India to such resident or its head office or any permanent establishment or any other part of such non-resident outside India.
6. **Royalty** payable by the government or a resident person unless such royalty is in respect of any right of property or services utilised for a business or profession carried out of India for the purpose of earning any income out of India or by a non-resident person in respect of any right of property or services utilised for the purpose of business or profession carried in India or for the purpose of earning any income in India).

Exception:

- (i) Royalties payable for the transfer of any data, drawings, etc. outside India or imparting of information outside India under an approved agreement by the Central Government made before the 1st day of April, 1976.
 - (ii) Royalties paid in lump sum, by a resident for transfer of computer software, supplied by a non-resident along with the computer or computer-based equipment under a scheme duly approved by Government of India
7. **Fees for technical services** payable by: by the government or a resident person unless such fees are payable in respect of services utilised in a business or profession for earning any income out of India or by a non-resident person for services utilised in a business or

profession carried on by him in India or for earning any income from any source in India..

Exception: fees are payable under agreement made before the 1st day of April, 1976 and approved by the Central Government.

The income of a non-resident is deemed to accrue or arise in India under any of the above clauses, shall be included in the total income of the non-resident, whether or not, the non-resident has -

- (i) a residence or place of business or business connection in India; or
- (ii) has rendered services in India.

8. Eligible Fund Managers in India will however not to constitute business connection of offshore funds as per an exception inserted vide Section 9A W. e. f. A.Y. 2016-17

6. RECEIPT VS. REMITTANCE

The “receipt” of income refers to the first occasion when the recipient gets the money under his control. Once an amount is received as income, any remittance or transmission of the amount to another place does not result in “receipt” at the other place.

7. ACTUAL RECEIPT VS. DEEMED RECEIPT

It is not necessary that an income should be actually received in India in order to attract tax liability. An income deemed to be received in India in the previous year is also included in the taxable income of the assessee. The Act enumerates the certain incomes which were dealt with earlier. E.g. If a resident holds an immovable property in Delhi and the rent received thereon is transferred to his bank account in Mauritius, the rent would still be subject to income tax though the income has not been received in India.

8. RECEIPT VS. ACCRUAL

Income is said to be received when it reaches the assessee; when the right to receive the income becomes vested in the assessee, it is said to accrue or arise.

9. BASIS OF CHARGE FOR DIVIDEND INCOME

Under the companies Act, 2013, a company can declare dividend only at its Annual General Meeting Accordingly, U/s 8, dividend is deemed to be the income of the previous year in which it is declared irrespective of the fact when it was received

by the shareholder. Hence the method of accounting for the dividend becomes immaterial for the purposes of this section.

But the position is quite the opposite in case of interim dividend, which is deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to a shareholder irrespective of the date of declaration of interim dividend.

Deemed Dividend under S 2(22) is deemed to accrue or arise in the year in which it was paid or distributed.

This can be summarised as follows:

Final Dividend	Date of declaration
Interim Dividend	Date of distribution
Deemed dividend	Date of Distribution

Illustration-16:

Determine the scope of total income in respect of the following incomes if the assessee is a (1) resident or (2) a resident and ordinarily resident or (3) a resident but not ordinarily resident:

	Rs
Interest from U.S. Growth Bonds received in India	10,000
Interest from U.S. Growth Bonds received in U.S.	60,000
Interest from U.S. Growth Bonds received in U.S but remitted to India	60,000
Capital gain on house in Mumbai but sold in London	60,000
Capital gain on house in Mumbai but sold in Mumbai	60,000
Rent of a villa in Paris received in Paris	60,000
Rent of a villa in Paris received in Paris	60,000
Agricultural Income from Tea Gardens in Sri Lanka received in Sri Lanka	60,000
Agricultural Income from Tea Gardens in Sri Lanka received in Mumbai	60,000
Profit from a Branch in Sydney	60,000
Profit from a branch in Mumbai	60,000
Salary for working in Jaipur received in Jaipur	60,000
Salary for working in Jaipur received in Lahore	60,000
Salary for working in Lahore received in Jaipur	60,000
Salary for working in Lahore received in Lahore	60,000

Solution

Particulars	R&OR	R&NOR	N R
Interest from Uncle Sam Bonds U.S.A. received in India	60,000	60,000	60,000
Interest from Uncle Sam Bonds U.S.A. received in U.S	60,000	—	—
Interest from Uncle Sam Bonds U.S.A. received in U.S but remitted to India	60,000	—	—
Capital gain on house received in Mumbai but sold in London	60,000	60,000	60,000
Capital gain on house received in Mumbai and t sold in Mumbai	60,000	60,000	60,000
Rent of a villa in Paris received in Paris	60,000	—	—
Rent of a villa in Paris received in Mumbai	60,000	60,000	60,000
Agricultural Income from Tea Gardens in Sri Lanka received in Sri Lanka	60,000	—	—
Agricultural Income from Tea Gardens in Sri Lanka received in Mumbai	60,000	60,000	60,000
Profit from a Branch in Sydney	60,000	60,000*	—
Profit from a branch in Mumbai	60,000	60,000	60,000
Salary for working in Jaipur received in Jaipur	60,000	60,000	60,000
Salary for working in Jaipur received in Lahore	60,000	60,000	60,000
Salary for working in Lahore received in Jaipur	60,000	60,000	60,000
Salary for working in Lahore received in Lahore	60,000	60,000	60,000
Total	9,00,000	6,60,000	6,00,000

*if controlled from India

10.HEADS OF INCOME

10.1. Classification of income

Income tax is payable by an assessee on his total income from all the source of income. Each source has its own unique features and requires specific treatment for correct computation of income from that particular source. Naturally, rules and method for computation of income from each such source are different according to the nature of the source. These sources of income are classified under various heads of income in section 14. These heads of income are as follows:

- 1) Income under the head salaries (Section 15 – 17)
- 2) Income from house property (Section 22 – 27)
- 3) Profits and gains from business or profession (Section 28 – 44)
- 4) Capital gains (Section 45 – 55)
- 5) Income from other sources (Section 56 – 59)

10.2. Importance of different heads

Each head of income provides a different scheme of computation of taxable income under that head depending upon the nature of income and the complexities attached with that head of income. For this reason, each of the head of income has its own deeming provisions and provisions for exclusions and deductions and deductions of expenses etc.

It is therefore, necessary that an income belonging to a specific head must be computed under that head only. If an income cannot be placed under any of the first four heads, it will be taxed under the head “Income from other sources”.

Aggregate of net income under various heads gives total income of the assessee person, from which deductions are made under chapter VIA. The net result is called the total income or sometimes taxable income. Therefore, computation of income under different heads provides the starting point of determining the tax liability.

10.3. Heads to be mutually exclusive

All the heads of income are mutually exclusive. If any income is considered under a particular head e.g. Income from house property, it will not be taken into consideration for another head e.g. Profits and Gains from business and profession.

The nature of income is such that at times, it may not be possible to have water-tight compartmentalization.

Illustration 17

Under which head would the income of 3 offices are compositely let out on rent by alongwith services like intercom, security guard, telephone connection, furniture and fixtures, etc. of Swayam will be taxable ?

Solution

The rent in respect of the commercial property should be taxed under "Income from House Property". However, income arising out of rentals of the other services should be taxable under the head "Income from Other Sources". Alternatively, the entire income arising out of the property as well as the services could be taxable as "Income from Business or Profession"

As per departmental clarification, the income in respect of properties should be taxed as "Income from House Property" and the income out of rentals of the other services to be taxed under "Income from Other Sources".

10.4. Tax on aggregate income under all the heads

Although the income is computed under five different heads of income, tax will be computed on the aggregate or total income from all the sources taken together at the prescribed rates. However, different tax treatment is given to different items. For instance, Long-term Capital gains (LTCG) are generally taxed at 20%. But LTCG on listed securities is exempt from tax. Similarly, short-term capital gain on sale of equity shares is taxed at 18%. The amount of such short-term capital gains would be deducted from the aggregate total income and accordingly tax rates are applied. Similarly, shipping companies are taxed based on tonnage of the shipping fleet. Lotteries, horse races etc. are taxed at the maximum rate of tax @ 30%. All such incomes are excluded and tax is computed on rest of the total income.

10.5. Common residential status for all the heads

S. 6 provides that where a person is resident for the purpose of any particular head of income, he will also be considered as resident for the purposes of computation of income under all the heads of income.

10.6. Separate sources of income under one head.

Income is classified for each head of income. That head of income may have different sources of income falling under that head. For instance a person may be in receipt of his salary from more than one employer or rent from two or more house properties or more than one business. All such sources will be clubbed together to arrive at the income from that head.

10.7. Expenses under each head of income

It may be noted that expenses may be allowed under each head of income according to the provisions applicable. The recent trend is to restrict and standardize the allowance of expenditure. For instance virtually no expenses except professional tax are allowed under the head salaries. Capital gains envisage deduction if only the cost of acquisition and improvement and transfer expenses and so on and so forth.

10.8. Expenditure incurred in relation to income not includible in total income

Section 14 A provides that no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to exempted income that is the income which does not form part of the total income under this Act

12.SELF ASSESSMENT QUESTIONS:

1. Why determination of residential status is important to ascertain the income tax liability?
2. Discuss the legal provisions in respect of residential status of an individual.
3. Briefly state the provisions for determination of the residential status of an (a) AOP (b) Firm (c) Company.
4. What is meant by the control and management of business?
5. When the income is deemed to accrue or arise or be received in India?
6. The incidence of income-tax depends upon the residential status of an assessee". Discuss.
7. Determine whether the following is true or false:
8. The business income received by X Ltd. an Indian company in New York is foreign income of X.
9. The dividend received from a foreign company in India is Indian Income
10. Write short notes on the following:
 - a. Income received in India
 - b. Income deemed to accrue or arise in India
 - c. Control and management of a business
11. Enumerate various heads of income under the Income Tax Act, 1961.
12. State with reason that can an Income be computed under two heads of income.
13. How are the different heads mutually exclusive?

14. Would expenses in respect of collection of dividend be deductible from income from other sources?
15. Ascertain residential status for the assessment years 2015-16 and 2014-15, of Greg, an Australian citizen, came to India as a commentator during the following period:

From	To	Purpose
10.2. 2013	20-04-2013	World Cup
6-10-2013	25-12-2013	England Tour
04-01-2014	12-01-2014	Training Camp
02-03-2014	29-03-2014	Triangular Cup

Besides, Greg was in India for 340 days in four previous years from 2008-09, to 2011-12nd 260 days in three previous years from 2006-07 to 2009-10.

(Ans: 2015-16 Non-residents, 2014-15 R but RNOR)

16. Parthiv made his debut in international cricket on 11/03/2009. In the first match, he was injured and had to be hospitalized. In U.S. He was discharged from the hospital on 29/03/2010. He returned to India took over as coach for Indian cricket team visiting Pakistan. Parthiv submits the following details of his stay outside India :

From	To	Purpose/ Place
10.4. 2013	28-04-2013	World Cup in Dhaka
03-05-2013	09-07-2013	England Tour
27-08-2013	10-09-2013	Canada Tour
11-09-2013	01-10-2013	US holidays
04-01-2014	26-03-2014	Pakistan Tour

(Ans: Non-Resident)

17. Ashok, an Indian citizen, leaves India on May 22, 2012 for vacation to Uganda and returns on April 9, 2014. Determine the residential status of X for the assessment year 2014-15?

(Ans: Non-Resident)

18. Determine the residential status for the assessment year 2014-15, of Sheila, a foreign citizen, who visits India since 1985 every year for a period of 100 days

(Ans: Non-Resident)

19. Fletcher, a foreign citizen comes to India, for the first time on March 20, 2012. On September 1, 2012, he leaves India for Nepal on a business trip. He comes back on February 26, 2013 to permanently stay in India. Determine the

residential status of X for the assessment year 2015-16 and 2016-17

(Ans Resident and Not Ordinarily Resident for both the years)

20. Determine residential status for the assessment year 2014-15 of Marconi, an Italian citizen, who comes to India for the first time on May 28, 2012.

(Ans: Resident and Not Ordinarily Resident)

21. Determine the scope of total income in respect of the following incomes if the assessee is a (1) resident or (2) a resident and ordinarily resident or (3) a resident but not ordinarily resident

New York business income controlled from India	Rs. 100000
Mumbai Business Controlled from Paris	Rs. 40000
Salary in New York as Indian ambassador	Rs. 90000
Profit on sale of shop in Kolkata paid in Karachi	Rs. 50000
Acting in Indian film –fee received in Rome	Rs. 70000
Past untaxed profits remitted to India from London	Rs. 120000

(Ans. Resident 350000, R & OR 250000, R & NOR 350000/ past profits not taxable)

22. Blair, a French Citizen had the following incomes during the year ended 31/3/2014. Compute his Total Income for Asst. Year 2014-15 if he is a (1) resident or (2) a resident and ordinarily resident or (3) a resident but not ordinarily resident.

Income from House property in India	Rs. 30000
Income from property in Rome	Rs. 20000
Interest from Bank account in India	Rs. 2400
Income from business in Bangladesh controlled from India	Rs. 32000
Interest from Bank account in U.S.	Rs. 22000
Salary earned and received in Tokyo	Rs. 24000
Income earned and received in London	Rs. 26000
Dividend from British Company received in India	Rs. 34000

(Ans. Resident 19400, R & OR Rs. 98600 R but NOR Rs 66400)

23. Following are the particulars of income of X for the previous year 2014-15:

- i. X is employed in India and receives Rs. 24,000 as salary.
- ii. Dividend received in London on June 3, 2013: Rs. 31,000 from a foreign company;

- iii. Share of profit received in London on December 15, 2013 from a business situated in Sri Lanka but controlled from India:
- iv. Rs. 60,000; remittance from London on January 15, 2014 out of past untaxed profit of 2003-04 earned and received there: Rs. 30,000 and interest earned and received in India on May 11, 2014 Rs. 76,000.

Find out his gross total income, if he is (a) resident and ordinarily resident, (b) resident but not ordinarily resident, and (c) non-resident for the assessment year 2014-15

(Ans: R&OR, his gross total income will be Rs. 105000 i.e. Rs. 24,000 + Rs. 31,000 + Rs. 60,000 R& N OR Rs. 84,000 i.e., Rs. 24,000 + Rs. 60,000). Non-resident, Rs. 24,000.

The remittance from London of Rs. 30,000 is not taxable it is not "receipt" of income. The interest of Rs. 76,000 earned and received in India is taxable 2015-16.)



SALARIES

(Sections 15, 16 & 17)

Synopsis

1. Introduction and Objectives
2. Basis of Charge
3. Meaning and characteristics
4. Scope of salary income
5. Tax Treatment of some receipts:
[Basic Salary, Fees, Commission and Bonus, Arrears of Salaries, Advance salary, Gratuity, Commuted Pension, Leave Salary, Retrenchment compensation , House Rent Allowance (S. 10-13A), Pension to Gallantry award winners]
6. Taxable Value of cash allowances-
[Taxable, wholly or partly exempt allowances]
7. Taxable Value of Perquisites
8. Classification of Perquisites
9. Valuation of Perquisites
10. Profits in lieu of Salary
11. Deductions -Entertainment Allowance, Profession Tax
12. Practical illustrations
13. Self- Assessment Questions

1. INTRODUCTION AND OBJECTIVES:

This lesson intends to explain “Salaries” the first and most important of the 5 heads of income given in section 14. Under the tax laws , concept “Salaries” is very wide and includes not only the salary in common parlance but also various other receipts, gifts, perquisites and benefits. The lesson will deal with various provisions as to what constitutes salaries and other relevant matters like salary, types of allowances , perquisites and benefits and their valuation for tax along with the applicable legal provisions contained in Sections 15,16 and 17. Section 15 defines scope of the term “salaries”. Section 16 and 17 respectively prescribe the deductions to be made while computing the income from salary and explain the terms.

2. BASIS OF CHARGE AND MEANING- Sec 15

2.1. Basis of charge

Section 15 provides that the following income shall be chargeable to income tax under the head "Salaries"—

- (a) any salary due from an employer or a former employer to an assessee in the previous year, whether paid or not;
- (b) any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him;
- (c) any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.

Thus the term salary embodies of past (arrears) , present and future salary(Advance) .

However, the section clarifies that where any salary paid in advance is included in the total income of any person for any previous year it shall not be included again in the total income of the person when the salary becomes due.

Further, any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from the firm shall not be regarded as "salary" for the purposes of this section because it is considered as business income u/s 28 ..

3. Meaning and Characteristics

Section 15 does not define the term salaries. It only says salaries –past, present and future will be taxable under the head “salaries”. Hence, it becomes necessary to determine, whether any particular income is to be taxed under the head “Salaries” or not. This is done with the help of common practices, tests , norms , yardsticks, criteria and essential characteristics to find out whether the income is taxable as salaries or not . These are discussed in detail as under: -

1. Employer-Employee Relationship:

Salary can be defined as the payment of remuneration by an employer to the employee for rendering personal services to the employer under an expressed or implied contract for rendering such services. From the definition the term salary implies the existence of the following conditions namely-- ,

- a) There are two parties – the employer and employee
- b) The parties have an agreement of employment
- c) The agreement can be express or implied.

- d) Agreement is for rendering of personal services by the employee to the employer.
- e) In consideration of the services rendered, the employer makes payment of remuneration to the employee.

2. Compensation for services rendered :

Salary is paid as a compensation for the services rendered as an employee and not in any other capacity. E.g. Remuneration paid by a hospital to a doctor employee for taking care of the patients in that hospital will be salary but the services rendered by that doctor to patients in his private clinic will not be salary as he is not an employee of the patients. Payment received from patients will not be salary but his professional income.

It will be true of services rendered by other professionals like doctors, architects; lawyers, Chartered Accountants etc. to their clients and the fee paid by their clients will be professional fees not salary.

Under Section 17 , salary includes payment made in other forms like gift, perquisites etc. .

3. Name or form not important:

Any remuneration paid as compensation for services rendered by an employee to his employer will be treated as salary regardless of name given such as salary or wages or otherwise so long as -

- the relationship between the payer and payee is that of employer and employee; and
- the payment is made as a compensation for the services rendered by the employee

4. . Mode of Payment

Salary may be paid in cash or kind.

5. More than One Sources :

Salary may be from more than one employers.

6. Type of Employment:

Salary may be in any capacity like part-time employment or full time employment.

7. Past, Present and prospective employer

Salary may be received from not just the present employer but also a prospective employer and in some cases even from a former employer for example pension received from a former employer.

8. Real intention to pay :

Salary income must be real and not fictitious. There must exist an intention or an obligation to pay and 'receive salary'.

9. Subsequent Surrender of Salary not tax-free;

Salary is taxed on due basis. A subsequent surrender of the salary will not be tax-free except where an employee surrenders his salary to the central government, and then the salary so surrendered will not be treated as taxable income of the employee.

10. Tax- Free salary

Salary paid as tax-free is also taxable in the hands of the employee, though contractually income tax on such is borne not by the employee but by the employer.

11. Time of taxability;

Salary is taxable in the year of *receipt* or in the year of *earning or accrual* of the salary income, *whichever is earlier*. In simple terms following situations may arise :-

- Current salary will be taxable on accrual basis as it will be payable later.
- Past salary or arrears will be taxable when they are actually received, if they were not taxed earlier.
- Advance salary will be taxable at the time of receipt and it will not be taxed again when it is accrued.

As result, salary is taxable at the time of accrual or receipt, whichever is earlier. Accordingly accounting method employed by the employee is not relevant to determine the taxability of salary.

12. Salary received by individuals only

Salary is a compensation for personalised services, which can obviously be rendered by a normal human being and not a body corporate. Salary income is taxable in the hands of individuals only. No other type of person such as a firm, HUF or a company can earn salary income.

13. Voluntary payments taxable as salary

Voluntary payments like gift by an employer to an employee also form the part of taxable salary.

14. Salary in respect of services rendered in India

Under section 9 salary, leave salary and pension paid outside India are deemed to accrue and arise in India and are taxable in India. Similarly, salary paid to Indian diplomats by the Government of India is deemed to accrue and arise in India although the same is exempted u/s 10.

15. Gross salary Taxable;

Compulsory deductions from salary such as employees' contribution to provident fund, deduction for medical scheme or staff welfare scheme etc. are examples of instances of application of income. In these cases, for computing total

income, these deductions have to be added back in the net salary received and gross salary will be taxable. .

4. SCOPE OF SALARY INCOME

4.1. Section 15 provides the basis of charging salary income and section 17 explains it. Section 17 gives an inclusive definition of salary.

Salary includes:-

- a. Wages;
- b. Any Pension or Annuity;
- c. Any Gratuity;
- d. Any fees, commission, perquisites or profits in lieu of or in addition to salary or wages;
- e. Any advance of salary;
- f. Any encashment of leave salary;
- g. Annual accreditation to provident fund above the prescribed limits; and
- h. Any amount of credit to provident fund of employee to the extent it is taxable.

4.2. The term "salary" includes not only the basic salary but also fees, commission, bonus, taxable value of cash allowances and perquisites, retirement benefits, encashment of leave salary, advance of salary, arrears of salary, various allowances such as dearness allowance, entertainment allowance, house rent allowance, conveyance allowance, value of perquisites by way of free housing, free car, free schooling for children of employees, etc. Tax treatment of all such receipts is given later in this lesson.

5. TAX TREATMENT OF CERTAIN RECEIPTS

5.1. Basic Salary

Basic salary is the amount of salary fixed as per the terms of employment. It may be a pre-determined fixed sum or a graded amount enhanced by pre-fixed annual increment. Under the graded system, the terms of employment fix the salary at say Rs.12000-300-15000-500-20,000. This means that the employee will begin his job with a basic salary of Rs 12,000 per month. After one year, his salary will be Rs 12,300 p.m. after an annual increment of Rs. 300. This annual increment will be given till he gets salary of Rs 15,000 p.m. and thereafter his annual increment will be Rs 500 per annum till he gets the salary of Rs 20,000 p.m. Once his salary becomes Rs 20,000 p.m. , his annual increment will be frozen and no further increment will be given unless he is promoted and placed in other grade.

5.2. Fees, Commission and Bonus

Any fees, commission, bonus, or incentive paid or payable to an employee by an employer is taxable and is included in salary. Such Commission etc may be payable as a fixed amount or as a percentage of turnover or partly fixed and partly as a percentage of turnover. When commission is based on fixed percentage of turnover achieved by employee, it is included in basic salary for the purpose of grant of retirement benefits and for computing, certain exemptions discussed later

5.3. Arrears of salary:

Arrears of salary are taxed on receipt basis, if the same has not been taxed earlier. However the employee will be entitled to claim relief u/s 89 in respect of such arrears.

5.4. Advance Salary:

Salary received in advance is taxable on receipt basis in the year of receipt. There will be no tax again in the year in which the salary actually accrues. The employee can claim relief u/s 89 in respect of advance salary. It is important to note that salary received in advance is taxable **not advance or loan against salary**.

5.5. Gratuity (Section 10(10)):

Gratuity is a lump-sum payment to reward an employee for his past services, on his retirement or termination. Amount received as gratuity on termination is exempt U/s 10(10) is as under:-

- 1 Employees of Central or State governments or local authorities fully **exempt**
- 2 Employees in a concern covered under the Payment of Gratuity Act, 1972 is **exempt** subject to the lowest of the following amounts :
 - a. Amount of gratuity received,
 - b. Rs 10,00,000
 - c. 15 days' salary for every completed or part thereof in excess of six months, year of service computed based on last salary drawn taking numerator of 26.

$$\frac{* \text{Completed year of service} \times 15 \text{ days} \times \text{Last Drawn Salary}}{26}$$

- 3 Employees in a concern NOT covered under the Payment of Gratuity Act, 1972 is exempt subject to the lowest of the following amounts :
 - a. Amount of gratuity received,
 - b. Rs 10,00,000
 - c. Half month's salary for every completed year of service in excess of six months (ignoring the fraction) computed

based on average salary of last 10 months preceding the retirement.

***Completed year of service* $\frac{1}{2}$ * Avg Salary for last 10 months**

[*Completed year of service includes a year or part thereof in excess of six months]

Illustrations -1

Ashik, a government servant, retires 1 June 2016 after 22 years and 9 months' service. He receives gratuity of Rs 15,00,000. Determine the amount of exemption of gratuity if he was drawing a basic Salary for 10 months preceding the month of his retirement at Rs 40,000 p.m.

Solution

Since Ashik is a government employee, amount received as gratuity on retirement is fully exempt U/s 10(10).

Illustrations-2

In the above case, what will be the effect if Ashik was working with ABC Limited, covered under the Payment of Gratuity Act, 1972?

Solution:

Since Ashik is the employee of a private employer XYZ Limited covered under the Payment of Gratuity Act, 1972, exempt amount will be Rs 5,30,769 being the least of the following:

I. Actual amount received	15,00,000
II. Notified amount	10,00,000
15-day's salary based on last drawn salary Rs.40, 000* 15/26 *23 years	5, 30,769
Taxable	9,69,231

Illustrations-3

In the above case, what will be the effect if ABC Limited is NOT covered under the Payment of Gratuity Act, 1972?

Solution:

Since Ashik is the employee of a private employer XYZ Limited not covered under the Payment of Gratuity Act, 1972, exempt amount will be the lowest of the following:

I. Actual amount received	Rs 15,00,000
II. Notified amount	Rs. 10,00,000
III day's salary based on last drawn salary Rs.40, 000* 15/26 *23 years	Rs 4,60,000
Balance Taxable	Rs 10,30,000

5.6. Commuted Pension (Section 10(10A) :

Pension is a regular payment made at monthly or annual intervals by an employer to his employee on retirement. Retirement of an employee by an employer as a reward for his past services. When an employee is allowed to forgo a portion of pension in lieu of a lump sum amount called commutation of pension. Tax treatment of these two kinds of pension is as under:

- a) *Regular payment* of pension (monthly or quarterly or at some other interval) Periodical or uncommuted pension is **fully taxable** in the hands of all employees, whether government or non-government.
- b) Lump sum payment received by an employee on commutation of pension as per service rules will be-
 - i. *fully exempt* for employees of the Central or State Government or a Local Authority or a Statutory Corporation
 - ii. partially exempt for other employees to the extent of -
 - a. *One half of the total value* of pension If the employee has not received any gratuity on termination of employment, and
 - b. *One-third of the total value* of pension, if the employee has received any gratuity on termination of employment.

Illustration-4

Determine the amount of taxable pension if A receives a monthly pension of Rs 50,000 from the government.

Solution:

Regular monthly payment of pension received from government will be fully taxable.

Illustration-5

Determine the amount of taxable pension if A receives a monthly pension of Rs 50,000 from a private limited company.

Solution:

Regular monthly payment of pension received from government will also be fully taxable. It is immaterial who the employer is.

Illustration-6.

A retires from government service on 01/06/2015. He receives a pension of Rs 5000 p.m. till 31/12/2015. On 01/01/2016, A opts for commutation of 40 per cent of the value of his pension for a lump sum amount of Rs 1, 20, 000.

After the commutation, A gets pension @ Rs 3,000 per month being 60% of the total pension. Determine the taxability of pension if no gratuity is paid to A.

Solution:

1. Lump sum amount of Rs. 1,20,000 received on commutation of pension will be **exempt** as A is a government employee
2. Regular pension Received during the year 2015-16 Rs 44,000 *will be **fully taxable**

*Rs 35,000 (for 7 months from 01/06/2016 to 31/12/2016 @ Rs 5,000 per month) plus Rs 9,000 (for 3 months from 01/01/2016 to 31/03/2016 @ Rs 3000 p. m

Illustration-7

What will be the position in the above illustration if A is a private employee?

Solution;

a. Commutation of Pension

	Rs.
Amount Received on commutation of 40% of salary	1,20,000
Full Value of Pension = 1,20,000 /40%	3,00,000
Amount Received during on commutation	1,20,000
½ of Full Value of Pension Rs 3,00,000* ½	1,50,000
Exempted Amount - being the lower of the two	1,20,000
Taxable Amount [1,20,000-1,20,000]	NIL

- b. Regular pension of Rs 44,000 will be taxable irrespective of the fact that A is government employee or a private employee or whether or not he is in receipt of any gratuity.

Illustration-8

Ascertain the taxability if A also receives Rs 50,000 as gratuity.

Solution:

- a. Regular pension of Rs. 44,000 will always be taxable in all cases.
- b. If A is a government employee, the amount received on commutation of pension will be fully exempt regardless of the fact that he also receives gratuity.
- c. If A is a non- governmental employee and is in receipt of gratuity and he receives Rs 1,20,000 on commutation , he will be entitled to exemption of Rs 1,00,000 being 1/3 of full value of pension 1/3 of Rs 3,00,000). Balance Rs 20,000 will be taxable.

5.7. Encashment of Leave Salary {Section 10(10AA)}

When an employee, instead of enjoying leave at his credit, gets the same encashed, following tax treatment will be given:-

- a. Amount received on encashment of leave during the *continuity of employment by all the employees*, will be *taxable* in the year of receipt. However, the employee will be entitled to relief u/s 89.
- b. Amount received on encashment of leave at the time of retirement by way of *superannuation* or otherwise, by
 - a. an employee of the *Central or State Government* will be *fully exempt* and
 - b. any other *employees including employees of a local authority or a statutory corporation*, would be exempt at the lowest of the following and only the balance will be taxable:-
 - i. Actual amount received
 - ii. Notified Amount currently Rs 3,00,000;
 - iii. 10 months' average salary or
 - iv. Cash equivalent of leave to be encashed
- i.e. (Leave Entitlement - Leave Availed) X Average Salary

Other Points

- i. Salary for the purpose of calculating the exempt leave encashment means total of basic salary, dearness allowance and commission on sales achieved by salesmen.
- ii. Average salary means average salary of 10 months immediately preceding the retirement.
- iii. Leave entitlement is to be taken at 30 days for each completed year of service. *Part of the year will be ignored and not considered as completed year of service.*
- iv. If leave is encashed from more than one employers, the exemption limit will be taken in respect of all the employers.
- v. Superannuation means retirement on attaining a certain age e.g. 60 years. Courts have held that termination and even resignation of the employee will entitle them to exemption under this section.
- vi. Leave to the credit of the employee means total leave available as reduced by total leave availed.

Illustration- 9

A is government servant working the Government of Maharashtra. A retires on 01/06/2016 after rendering services for 22 years and 9 months.

He was drawing a basic Salary for 10 months preceding the month of his retirement at Rs 8000 p.m.

Under the service rules, A was entitled to 2 months' leave for every year of service or part thereof against which A availed total earned leave of 10 months.

On Retirement, A received Rs 2,88,000 worked out as :
 Leave entitlement for 23 years @ 2 months 46 months for every year of service or part thereof ; Less -Leave already taken 10 months

Leave entitlement 36 months @ Rs 8000 p.m.
 Compute amount of exemption of encashment of leave salary

Solution:

Since A is a government employee amount, received as leave encashment on retirement is **fully exempt U/s 10(10AA)**.

Illustration-10

What will be the exempt amount if A was employed with MSFC?

Solution:

MSFC is a statutory corporation not regarded as government. Hence, exemption would be at par with a private employee and worked out as the least of the following:

	Rs.
Amount Received on leave encashment	2,88,000
Notified Amount	3,00,000
10 months' average pay @ Rs. 8,000 p.	80,000
Encashment of unavailed leave 12* Months @ Rs 8,000	96,000
Exempted Amount - being the lower of the two	80,000
Taxable Amount [2,88,000-80,000]	2,08,000

*[*Leave entitlement – 22 months – Leave availed 10 Months ignoring fractional period of service of 9 months as it is not rounded off .]*

Illustration-11

What will be the exempt amount if A receives it while in service?

Solution

Leave encashment of Rs 2,88,000 during the continuance of employment will be fully taxable regardless of the fact who the employer is .

IMP - The time and notified amount (wherever applicable in this lesson) should technically be available in question itself as the rules are not in syllabus.

5.8. Retrenchment compensation –S.10 (10B)

Any compensation received by a workman at the time of retrenchment or closure or transfer of undertaking including

change of management resulting in interruption of service is exempt fully if it is paid under a scheme of closure approved by the central government and in other cases, least of the following amounts would be exempt:

- Notified amount presently Rs. 5,00,000
- 15 days' average pay for every completed year of service or any part thereof in excess of six months
- Actual amount.

Other points;

- Compensation under a Voluntary Retirement Scheme is also exempt u/s 10(10C).
- Where an assessee has to pay higher tax on account of such lump sum receipts, he is entitled to relief u/s 89.
- If an assessee claims exemption under this section, then he can not claim relief u/s 89[1].

Illustration-12:

A workman was retrenched after 20 year and 10 months service His average salary was Rs 15,000 per month. He was paid Rs 1,80,000 as the retrenchment compensation. Calculate the exempt amount.

Solution

The exempt amount will be least of the following:

	Rs.
Actual Amount Received	1,50,000
Notified Amount	5,00,000
#10-1/2 months' average salary Rs 15,000 per month	1,42,500
Exempted (Lowest of the above	1,42,500
Taxable 1,50,000-1,42,500	7,500

#(15 days for 20 years and 10 months rounded off to next number.

Relief u/s 89 not available if he claims the above exemption..

5.9. House Rent Allowance (Section 10-13A)

House Rent Allowance or HRA paid by the employer to the employee to meet the housing expenses of the employee, is exempt from tax U/s 10(13A) being the least of the following :

- HRA actually received.
- Rent paid by employee in excess of 10 per cent of salary during the previous year.
- 50 per cent of salary, if employee is residing in the 4 metro cities of Mumbai, Delhi, Chennai or Kolkata and 40 per cent of salary, if the employee is residing at any other place.

Salary for the purpose of calculating the amount of deduction from HRA means the aggregate of Basic Salary, Dearness Allowance and Commission received by salesman on sales achieved by him but it does not include other receipts such as overtime pay, conveyance allowance, etc.

In simple words, so long, the rent paid is upto 10% of the salary, no HRA will be exempt. It is only if the rent paid is more than 10 % , then the actual HRA may be exempt to the extent of 40% or 50% of the salary.

Illustrations-13:

Calculate the amount of HRA exempt U/s 10(13A) in respect of an employee residing in Mumbai who was in receipt of basis salary of Rs. 65,000 Dearness allowance of Rs. 35,000 and HRA of Rs 25,000. and he paid the actual rent of Rs 15,000 per annum.

Solution:

Exemption of HRA will be the least of the following:

	Rs.
Actual HRA Received	25,000
Rent paid in excess of 10 % of salary	5,000
$15,000 - \{10 \% (65,000 + 35,000)\}$	
50% of salary	50,000
Exempted (Lowest of the above)	5,000
Taxable $25,000 - 5,000$	20,000

Illustrations-14:

Compute the exempt HRA If rent paid is Rs. 50,000 .

Solution:

	Rs.
Actual HRA Received	25,000
Rent paid in excess of 10 % of salary	40,000
$50,000 - \{10 \% (65,000 + 35,000)\}$	
50% of salary	50,000
Exempted (Lowest of the above)	25,000
Taxable $25,000 - 25,000$	NIL

Illustrations-15:

Calculate the amount of HRA exempt U/s 10(13A) in respect of an employee residing in Agra who was in receipt of basis salary of Rs. 65,000 Dearness allowance of Rs. 35,000 and HRA of Rs 60,000 and he paid the actual rent of Rs 50,000 per annum .

Solution:

	Rs.
Actual HRA Received	60,000
Rent paid in excess of 10 % of salary	40,000
$50,000 - \{10 \% (65,000 + 35,000)\}$	
40% of salary	40,000
Exempted (Lowest of the above)	40,000
Taxable $60,000 - 40,000$	20,000

6. TAXABLE VALUE OF CASH ALLOWANCES:

Most employers give different types of allowances or fixed monetary amount to the employees over and above basic salary. These allowances are paid to meet some personal expenses like house rent, conveyance etc. or for performance of his duties such as entertainment or telephone allowance or partly for personal and partly for official purpose.

All such allowances are taxable and included in gross salary unless specific exemption is provided in respect of such allowance. Accordingly, the allowances are of four categories –

- a) Allowances, which are fully taxable;
- b) Allowances, which are wholly and unconditionally exempt
- c) Allowance, which are tax-free or taxable subject to certain conditions or limits.
- d) Allowances, in respect of which exemption is allowed only for a sum prescribed on *ad hoc* basis .

Some of these allowances are dealt with as under:-

6.1. Allowances Fully Taxable :

- a. **Dearness Allowance** , a compensatory allowance paid to meet high prices and increased cost of living, - S 15 & 17
- b. **City Compensatory Allowance** also a compensatory allowance paid to employees posted in big cities like Delhi, Mumbai to compensate the high cost of living in such cities
- c. **Non- practicing Allowance** normally paid to compensate professionals in government service like doctors, chartered accountants, engineers, scientists etc , who are prohibited from doing private practice,
- d. **Warden or Proctor Allowance** paid in educational institutions for working as a Warden of the hostel or as a Proctor in the institution,
- e. **Deputation Allowance** paid to an employee sent from his permanent place of service to some place or institute on deputation for a temporary period,
- f. **Overtime Allowance paid** as extra wages paid to an employee putting in extra working hours over and above his normal hours of duty,
- g. **Servant Allowance**, if paid in cash even if the employee may have employed servants.
- h. **Other Allowances** by whatever name called such as family allowance, project allowance, Marriage allowance, education allowance, and holiday allowance as these allowances are not specifically exempt.

6.2. Wholly and unconditionally exempt Allowances

- a. **Allowances to Judges** of the High Courts and the Supreme Court,
- b. **Allowances by the United Nations organization** to its employees.
- c. **Foreign allowance** paid by the government to its employees being Indian citizen posted out of India for rendering services abroad
- d. **Pension to Gallantry award winners like** Paramvir Chakra, Mahavir Chakra, Vir Chakra etc - S. 10(18)

6.3. Wholly or partly tax-free Allowances:

Following allowance are wholly or partly tax-free. Some of the exemptions are conditional. Most of the *conditions and monetary limits, though prescribed in rules are incorporated in brief to make the subject comprehensive*. Brief description of these allowances is as follows

a. Entertainment Allowance- S.16 (ii)

Entertainment Allowance to the employee for entertaining the business relations and clientele of the employer is fully taxable by the private sector employees even if the entire amount may have been spent by them.

Government employees are entitled to a deduction/s16 (ii) upto 20 per cent of Basic Salary subject to a maximum of Rs 5,000 per annum, whichever is lower. Full amount is first included in the salary and then the exempted amount is reduced.

b. Fixed Medical Allowances

Fixed Medical Expenses are taxable but reimbursement of medical expenses is exempt upto Rs 15,000

c. Tiffin / Lunch Allowance

Tiffin / Lunch Allowance paid in cash is fully taxable but Cost of Lunch provided to employees on their work place or even lunch coupons redeemable with restaurants is a tax-free perquisite subject to fulfillment of certain *conditions prescribed by the CBDT*.

d. Transport Allowance- S 10(14)

Any allowance or benefit given to meet the expense wholly and necessarily in the course of employment is fully exempt u/10(14) subject to the assessee presenting the proof in this regard.

Under Rule 2BB, Transport or conveyance allowance paid to meet conveyance expenses of the employee from place of residence to place of work and back is exempt upto Rs 1600 per month (Rs 3,200 in case of a handicapped employee).

For example, if A is in receipt transport allowance @ Rs 2,000 per month, Rs 400 per month (Rs 2000-Rs 1,600) will be included in total income of A

e. Other allowances for official purposes-S 10(14) ;

U/s 10(14) allowances (other than conveyance between residence and office) are exempt to the extent of amount actually spent from those allowances by the employee in meeting the official expenses.

For e.g. where an employee receives uniform allowance of Rs 5000, out of which he spends Rs 4000 for buying uniforms, sum of Rs 4,000 actually spent will be exempt and unspent sum of Rs1000 will be taxable in the hands of the employee.

Some other examples of the allowances paid for meeting expenses incurred exclusively in performance of official duties are travelling allowance, daily allowance, conveyance allowance, helper allowance, research allowance.

f. Education Allowance:

Education Allowance given to meet the education expenses of the employee's is taxable in hands of employee. However, under rule 2BB a sum of Rs100 per month per child per year (Rs 300 if the child stays in a hostel) subject to maximum of two children is allowed as exemption from such allowance received by the employee.

g. Out of station allowance

An allowance granted to an employee working in a transport system to meet his personal expenses in performance of his duty in the course of running of such transport from one place to another is exempt upto 70% of such allowance or Rs.6000 per month, whichever is less.

7. TAXABLE VALUE OF PERQUISITES

7.1. Definition and Meaning of Perquisites:

Section 17(2), which states that value of perquisites allowed to an employee is chargeable to tax does not define the term. In normal commercial parlance, perquisites denote any casual emoluments or benefits attached to an office or position in addition to salary or wages. Perquisites are normally allowed in kind ;not in cash ; and are measurable in monetary terms.

7.2. Taxability of perquisites:

Perquisites are included in gross taxable salary only if they are:

- allowed by an employer to an employee,
- allowed during the continuation of employment,
- directly dependent on service,

- resulting in the nature of personal advantage to the employee; and
- derived by virtue of employer's authority.

7.3. Taxable perquisites

Sec. 17 (2) provides the following list of taxable perquisites:

- i. Value of *rent-free accommodation* provided to the employee by the employer.
- ii. Value of *concession in the matter of rent* in respect of accommodation provided to the employee by his employer.
- iii. Value of any *benefit or amenity* granted free of cost or at a concessional rate in any of the following cases:
 - a) by a company to an employee who is a director thereof
 - b) by a company to an employee who has substantial interest in the company
 - c) by any employer to an employee who neither is a director, nor has substantial interest in the company, but his monetary emoluments under the head 'Salaries' exceeds Rs.50,000.
- iv. Any sum paid by the employer towards any obligation of the employee
- v. Any sum payable by employer to effect an assurance on the life of assessee
- vi. The value of any other fringe benefit given to the employee as may be prescribed.

7.4. Classification of Perquisites

On an analysis of Section 17(2), the perquisites are of three broad categories :

- Perquisites taxable in all cases
- Perquisites not taxable at all
- Perquisites taxable only in the hands of specified employees only

A. Perquisites taxable in all cases:

U/s 17(2) the following perquisites are taxable in the hands of all type of employees, whether specified or not:

1. Value of Rent free house provided by employer
2. Value of house provided at concessional rate
3. Any obligation of employee discharged by employer e.g. payment of club or hotel bills of employee, salary to domestic servants engaged by employee, payment of school fees of employees' children etc.
4. Any sum paid by employer in respect of insurance premia on the life of employee

B. Perquisites, which are tax-free for all the employees

Section 17 specifically states the some benefits will not be taxable at all in the hand of the employees and as such, they are exempt from income tax .these perquisites are given below:

a. Medical benefits within India :

Medical benefits within India, which are exempt from tax, include the following:

- a) Medical treatment provided to an employee or any member of his family in a hospital maintained by the employer.
- b) Any sum paid by the employer in respect of any expenditure incurred by the employee on medical treatment of himself and members of his family:
 - (i) in a hospital maintained by government or local authority or approved by the government for medical treatment of its employees.
 - (ii) In respect of the prescribed diseases or ailments in any hospital approved by the Chief Commissioner.
- c) If the ordinary medical treatment of the employee or any member of his family is done at any private hospital, nursing home or clinic, the exemption is restricted to Rs.15000.

b. Medical benefits outside India

Medical Treatment outside India, which is exempt from tax, includes the following:

- a) Any expenditure incurred by employer on the medical treatment of the employee or any member of his family outside India.
- b) Any expenditure incurred by employer on travel and stay abroad of the patient (employee or member of his family) and one attendant who accompanies the patient in connection with such treatment, shall be exempt to the following extent :
 - (i) The expenditure on medical treatment and stay abroad shall be exempt to the extent permitted by the Reserve Bank of India.
 - (ii) The expenditure on travel shall be exempt in full provided the gross total income of the employee (including this expenditure) does not exceed Rs.2,00,000.

c. Medical Health Insurance within India

Following are exempted perquisites in respect of medical Health Insurance

- Premium paid by the employer on health insurance of the employee under an approved scheme u/s 36(1)(ib)
- Premium on insurance of health of an employee or his family members paid by employer on any scheme approved u/s 80D (Mediclaime).

d. ESOP or Sweat Equity

Any benefit provided by a company free of cost or at a concessional rate to its employees by way of allotment of shares, debentures or warrants directly or indirectly under any Employees Stock Option Plan or Scheme *ESOP/ESOS* of the company offered to such employees in accordance with the guidelines issued in this behalf by the Central Government. However, the difference between the fair Market Value and the issue price will be treated, when such equity is issued at concessional price, as the taxable perquisite value of ESOP

e. Transport

Amenity or benefit granted or provided free of cost or at concessional rate for use of any vehicle provided by a company or an employer for journey by the assessee from his residence to his office or other place of work, or from such office or place to his residence,

f. Refreshments

Refreshment provided by an employer to the employee during working hours in office environment

g. Others:

- a. Value of Leave Travel Concession in India.
- b. Amount spent by the employer as its contribution to staff welfare schemes.
- c. Laptops and computers provided for personal use.
- d. Rent free official accommodation provided to a Judge of High Court or Supreme Court or an official of Parliament including Minister and Leader of Opposition in Parliament.
- e. Recreational facilities extended not to a particular employee but to a class of employees.
- f. Amount spent on training of employee or fees paid for refresher course.
- g. Telephone provided to an employee at his residence.
- h. Goods manufactured by the employer sold to employees at concessional rates
- i. Allowances to employees of UNO

Since FBT has been discontinued, value of cars and other perquisites will be taxable in the hands of the employees.

C. Perquisites taxable in case of Specified Employees only

U/s 17(2)(iii) the value of any benefit or amenity granted or provided free of cost or at concessional rate *Specified Employees only* will be taxable and *Specified Employees* means an employee who is

- a *director* of or
- who has a *substantial interest* i.e. more than 20 % voting power in the company; where he is employed or
- Any other employee (of any employer including a company) whose income [under the head Salaries *exceeds fifty thousand rupees*

Salary for this purpose means salary due from, or paid or allowed by, one or more employers, exclusive of the value of all benefits or amenities not provided for by way of monetary payment,

The following perquisites are taxable in case of such employees:

1. Free supply of gas, electricity or water supply for household consumption
2. Free or concessional educational facilities to the members of employees household
3. Free or concessional transport facilities
4. Sweeper, watchman, gardener and personal attendant
5. Any other benefit or amenity

7. VALUATION OF PERQUISITES:

Perquisites are benefits granted in kind. Hence, monetary value of the perquisites taxable in the hands of the employee is required to be determined. Broad principles for determining the value of taxable perquisites are stated as under:-

- a) Amount actually spent by the employer will be the taxable value of perquisite allowed entirely for personal benefits of the employee.
- b) The perquisite allowed to an employee for official purposes only, then such perquisites are not be treated as taxable perquisites in the hands of employee.
- c) In case of the perquisites allowed partly for both personal and official personal purposes , a reasonable amount of the value of perquisites which is used for personal purposes only will be added to the salary income of the employee.

Though the actual valuation rule are beyond the scope of the syllabus, general principles for valuation of perquisites may be considered

a. Accommodation & Furniture

Valuation of furnished and unfurnished accommodation is made according to Valuation Rules. If the employer owns the furnishings, then 10 per cent of the cost will be added to the value of accommodation.

b. Transport

Broadly, no perquisite value is taken in the hands of individual employees when:-

- Common transport such as bus provided to all the employees;
- the employer is in the transport business; or
- a car is provided only for official use or for the purpose of travel from residence to office.

In other cases, a reasonable cost of such transport facilities will be treated as taxable value of perquisites in respect of such facilities

In case of a car owned by the employer is provided to an employee exclusively for his personal uses, the taxable amount will be determined by taking reasonable expenses incurred by the employer on the car maintenance and depreciation on the car as per income tax rules.

If such car is used both for private and official purposes, then a reasonable proportion of the perquisite value relatable to the personal use will be taken as the taxable value of the car perquisite in the hands of the employee.

c. Domestic servant

Salary of domestic servants of employer paid by the employer, perquisite value will be taken as per rules.

d. Gas, water or electricity:

- i. If the employer himself is engaged in the business of providing supply of gas, water, or electricity, then there will *not be any taxable perquisite* in the hands of the employee in respect of such facilities.
- ii. If the employer is not in the business of supply of gas, water or electricity, then the amount spent by the employer in providing the facilities to the employee will be the taxable value of perquisites in the hands of the employee provided the entire facilities are for the personal use of the employees only. Any amount recovered from the employee will be reduced from the perquisite value.

- iii. Where the connection for gas, electricity, water supply is in the name of employee and the bills are paid or reimbursed by the employer, it is an obligation of the employee discharged by the employer. Such payment is taxable in case of all employees under Section 17(2)(iv)

e. Educational facilities:

- i. If the employer is a school, college or educational institution, there will not be any perquisites value taxable in the hands of any employee.
- ii. If the employer is not a school, college or educational institution, but is engaged in some other business or profession, the value of school fees or colleges fees of the children of the employee paid by the employer will be the taxable value of perquisites in respect if such facility.
- iii. If the children of the employee are allowed free education in an institute run by the employer where the employer is engaged in other activities, then the value of the perquisites is reasonable cost of education and deemed by the income tax officer in the hands of specified employees.

f. Medical facilities

- A sum of up to Rs 15000 paid by the employer to the employee by way of reimbursement of medical expenses of the employee and his family will be exempt perquisite in the hand of the employee. Any payment made in excess of Rs15000 will be taxable.
- If the treatment is taken in a government approved hospital or recognized hospital, or in government hospital, no value will be taken as the perquisite value in respect of such medical treatment reimbursement.
- If the medical treatment is done outside India, then up to the amount approved by the RBI for such treatment, no perquisite value will be added to the taxable income of the employee. If payments made by the employer to the employee in this connection exceed the amount approved by the RBI, then such excess will be treated as taxable salary in the hands on of the employee.
- If the employer himself is a medical institution, provision of medical facilities will not attract any tax in the hands of the employee.

In other words if an employer's own institution provides transport, education or medical facilities , there will be no taxable perquisite value in the hands of the employee.

8. PROFITS IN LIEU OF SALARY – S 17(3)

U/s 17 (3) profit in lieu of salaries includes:

1. Compensation for Termination of Employment or modification of Terms & Conditions

The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment or the modification of the terms and conditions relating thereto;

2. Payment from Employer from PF or Other Fund

Any payment (other than any pension, gratuity, HRA, Retrenchment compensation, etc) due to or received by an assessee from an employer or a former employer or from a provident or other fund , to the extent to which it does not consist of contributions by the assessee or interest on such contributions.

3. Keyman Insurance Policy

Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

4. Sums Received from Future or Former Employer

Any amount due to or received, whether in lump sum or otherwise, by any assessee from any person (A) before his joining any employment with that person or (B) after cessation of his employment with that person.

5. Payment of Employee's Obligation Employer

Any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee;

6. Payments from Certain Funds :

Any sum payable by the employer, whether directly or through a fund, other than a recognised provident fund or an approved superannuation fund or a Deposit-linked Insurance Fund established u/s 3G of the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 or u/s 6C of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 to effect an assurance on the life of the assessee or to effect a contract for an annuity;

7. Treatment of Annual Accretion to Provident Fund;

Provident Funds are established to provide for the retirement benefits of the employees. The Scheme of funds envisages annual contributions from both the employer and the employee and the accumulation of interest on the balances. The funds are of three types Viz.

- I. Statutory Provident Fund set up or established and administered by the Government.

- II. Recognised Provident Fund set up by others but recognised by the Commissioner of Income Tax
- III. Unrecognised Provident Fund set up by others but not recognised by the Commissioner of Income Tax due to non-compliance with the guidelines laid down for recognition.

The above position is summarised in the following table:

Tax Treatment under Different Provident Fund Schemes(PF)			
Type of Fund	Employer's Contribution	Interest on PF	Payment on Retirement
Statutory	Exempt	Exempt	Exempt
Recognised	Exempt upto 12% of Basic Salary(Excess taxable)	Exempt up to 8.5% p.a. (Excess taxable).	Exempt subject to rules
Unrecognised	Exempt	Exempt	Employers' Contribution & interest taxable –S 17(3).

Other Points:

1. Employer's Contribution to all the three funds is exempt at the time of contribution.
- 2.If the P.F. is deducted from the salary of the employee, salary will have to be grossed up in all the three cases.
- 3.Employees' Contribution when received back on retirement is exempt in all the three above mentioned cases.
- 4.Interest on Employees' Contribution from Unrecognised Provident Fund will be treated as Income from Other Sources.

8. Transferred Balance: - S. 7

When an Unrecognised Provident Fund is subsequently recognised, the balances standing in the Unrecognised Provident Fund are transferred to the Recognised Provident Fund. These balances are called transferred balances and are deemed to be the income of that year as per section 7. Such amount consisting of employees' contribution in excess of 12% of Basic Salary and interest credited in excess of 8.5% per annum are taxed as the salary under section 17(1).

9. DEDUCTIONS FROM SALARIES: - S. 16

From the aggregate of taxable amounts chargeable as taxable salary viz. salary, Bonus, allowances and perquisites (called gross salary), income under the head "Salaries" shall be

computed after making the following deductions u/s 16, namely:—

a) **Entertainment Allowance**

A deduction in respect of any entertainment allowance specifically received by a government employee, a sum equal to one-fifth of his basic salary or Rs. 5,000 whichever is less;

b) **Profession Tax:**

A deduction of any sum paid by the assessee on account of a tax on employment (profession tax) leviable by or under any law by the state government. .

Other than that, no further deductions are allowed under this head.

10. ILLUSTRATIONS

Illustration-16:

R, a Chartered Accountant was appointed as Finance Manager with ABC Bank on 1/4/2009 in the Salary grade of Rs. 12000 – 500 – 20000 – 1000 – 30000.

He was entitled to Leave Travel Concession for proceeding on leave of Rs. 4000. His actual expenditure on this account amounted to Rs. 5000.

As the bank is situated at a place where home food is available, R was offered Tiffin Allowance Rs. 6000, His actual lunch expenses amounted to Rs.10,000

Reimbursement of medical expenses for treatment of R and his family in private clinic was Rs. 50,000

The Bank has provided free unfurnished flat at Mumbai (rent paid by Bank: Rs.80,000). However the perquisite value of that Flat was Rs. 30000.

The employer provided two watchmen (salary Rs .2000 per month each).

Free use of Santro car for official use, car can be used for journey between office and residence.

Free refreshments provided at place of work (Rs. 100 per day for 200 days).

Compute Salary Income for the assessment 2016-17

Solution:

Computation of Salary Income R for AY 2016-17

Particulars	Rs.
Basic salary (Rs 12,000 + 6 increments of Rs 500)	1,80,000
Leave Travel Concession (Exempt)	NIL
Tiffin Allowance (Taxable)	6,000
Medical Expenses Reimbursed (50000 – 15000)	35,000
Rent Free Accommodation (Given)	30,000
Watchmen's Salary (2000 * 2 *12)	48,000
Santro Car only for Office use	NIL
Free Refreshments at workplace	NIL
Taxable salary	<u>2,99,000</u>

Illustration -17:

X is in negotiation with two employer A &B, who have made the following offers to X. Help him in making an appropriate choice.

Particulars	Rupees	
	A	B
Basic Salary	500000	50,0000
HRA – Actual Rent Rs. 200000	25,0000	0
Free House –fair rental value 50000	0	250000
Transport Allowance	100000	0
Free Use of Car – Amount spent		100000
Education Allowance for one child	5,0000	0
Free Education for 1 child. Amount spent	0	50000
Gardener Allowance	60000	0
Gardener's salary paid by employer		60000
Salary	960000	960000

Solution**Taxable salary from employer A**

Basic Salary		500000
HRA (Actual)	250000	
Less : Exempt (HRA or 50 per cent of salary or Rent paid less 10 per cent of salary 200000- 10% of 500000)	<u>150000</u>	100000
Education Allowance	50000	
Less : Exempt (100*12)	<u>1200</u>	48800
Gardener Allowance		60000
Transport Allowance	100000	
Less : Exempt (800*12)	<u>9600</u>	90400
Taxable Salary		<u>799200</u>

Taxable salary from employer B

Basic Salary	500000
Free House Value	50000
Free Education for 1 child	50000
Gardener's Salary(120 * 12)	1440
Free Car	100000
Taxable Salary	851440

Taxable salary will be less with B, He should be preferred to A .

Illustration- 18:

XY Ltd offers a job with following options to M, who is neither a director nor he has substantial interest in the company:

PARTICULARS	I	II
	Rs.	Rs.
Basic Salary	1,70,000	1,70,000
Bonus	6,000	6,000
Education Allowance for 2 children	10,200	--
Education facility for 2 children in an Institution maintained by the employer	--	10,200
Sweeper Allowance	10,000	--

Free Sweeper	--	10,000
Entertainment Allowance	6,000	--
Club Facility	--	6,000
Conveyance Allowance for personal use	12,000	--
Free Car Facility for Personal Use	--	12,000
Medical Allowance	18,000	--
Medical Facility for M and Family Members in own hospital	--	18,000
Free gas, electricity and water supply	--	4,500
Fair Rent Rent-free unfurnished house:	24,000	24,000

Which option M must choose on the assumption that he and XY LTD will both contribute 10% of salary towards unrecognised PF?

SOLUTION:

PARTICULARS	I	II
	Rs.	Rs.
Income from Salary		
Basic Salary	1,70,000	1,70,000
Bonus	6,000	6,000
Education Allowance (10,200 - 2,400)	7,800	Exempt
Education Facility	--	Exempt
Sweeper Allowance/Facility	10,000	--
Entertainment Allowance/Club Facility	6,000	6,000
Conveyance Allowance/Car Facility	12,000	Exempt
Medical Allowance/facility	18,000	--
Allowance for gas/electricity/water/free facility	4,500	--
Rent free unfurnished house	13,430	7,600
Gross Salary	2,47,730	1,89,600

Since taxable income is lower in option II, it should be preferred.

11. SELF ASSESSMENT QUESTIONS

1. What is Salary?
2. Discuss the difference profits in lieu of salary and perquisites.
3. Discuss various deductions available under the head salary.
4. Discuss the tax treatment of the perquisites for different employees.
5. Non- specified employees pay less tax than specified employees". Comment.
6. Rajesh is an employee of ABC Ltd. Since 1997, he is receiving entertainment allowance of Rs. 500 p.m. He submits following further information as on 31.03.2016 with the request to compute his taxable salary.
 - a) Net Salary of Rs. 4,000 p.m. (including entertainment allowance of Rs. 500 p.m. but after deducting income tax Rs. 500, Provident Fund Rs. 500 and Profession tax Rs. 70)
 - b) He is provided car for his exclusive use during office hours for office work. The petrol and other maintenance expenses come to Rs. 12,000 p.a.
 - c) Received Leave Travel Concession for himself and his family for proceeding on leave to hometown of Rs. 5,000 as prescribed, while actual amount spent by him was Rs. 3,500.
 - d) During the year, he received free services of a cook. (Cost to the employer Rs. 4,400)
 - e) Received Rs. 8,000 on encashment of leave to his credit.
7. Rita was an employee of R India Ltd since 1968 covered by the Payment of Gratuity Act, 1972, retired on 31 January 2014 after 35 years and 7 months' service. At the time of retirement her employer paid gratuity of Rs. 65,000 (exempt u/s 10(10) Rs. 51,000). She received Rs. 50,000 being the accumulated balance of recognised Provident Fund. The due date of salary etc was 1st day of the next month and were paid on due date. He was entitled to a monthly pension of Rs. 400 with effect from 1st day of February 2016, which becomes due on the last day of the month.

8. Compute the taxable income of Mr. Hitesh for the AY 2016-17 on the basis of the following further information:

- (A) Basic Salary Rs. 2,5000 p.m.
- (B) House Rent Allowance Rs. 4000 p.m. Taxable value is 50% of the amount received.
- (C) Project Allowance paid during the year Rs. 12,000.
- (D) Bonus paid during the year Rs. 3,6000.
- (E) In retirement, on encashment of earned leave at his credit of 15 months he received Rs. 37,500. (Exempt u/s 10(10AA) Rs. 24,600)

9. Suhas submits the following information pertaining to the year 31.3. 2014 and asks you to compute his income from salaries for the AY 2016-17.

- a) Basic Salary Rs. 5,000 p.m.
- b) Dearness Allowance Rs. 3,000 p.m.
- c) Bonus @ 20% on salary plus Dearness Allowance
- d) Employee contribution 12.5% of basic salary+DA to RPF . Employer also contributes an equal sum.
- e) Interest on balance credited to his RPF @ 14% p.a. Rs. 17,500
- f) House Rent Allowance Rs. 10,000 p.a.
- g) Profession tax paid by employee Rs. 840.

He retired from services on 31.3.2016 opting for 60% commutation of pension and received Rs. 2,40,000 as the only terminal benefit.



INCOME FROM HOUSE PROPERTY (SECTIONS 22- 27)

Synopsis:

1. Introduction and objectives
2. Basis of Charge
3. Deemed owner
4. Income Exempt U/s 10
5. Computation of income from house property
[GAV, NAV SOP, Deemed let out partly let-out and partly self-occupied Co-ownership, deductions]
6. Miscellaneous- Arrears , Losses , TDs and no other deductions
7. Illustrations
 1. Self - Examination Introduction and Objectives

1. INTRODUCTION AND OBJECTIVES:

This lesson explains the provisions related to “Income from house property”. Income from house Property” is significantly different from the other heads of income unlike the other heads as it covers not only the actual income but also the notional income.

2. SCOPE AND BASIS OF CHARGE: S. 22

2.1 Sections 22 to 27 prescribe the law in relation to taxation of income from house property . Brief gist of these provisions is as follows :

- Sec 22 defines the scope of Income from House Property.
- Sec .23 gives the mode of computation of income,
- Sec. 24 specifies the amounts deductible therefrom.
- Sec. 25 deals with the amounts not deductible.
- Sec.26 deals with the income of co-owners of a property and
- Sec. 27 gives the cases where a person not being an owner of the property will be taxed as the deemed owner of such property.

2.2 Section 22 provides that Annual Value of property consisting of **any building or lands appurtenant thereto** of

which the **assessee is the owner**, shall be chargeable under the head Income from House Property.

The section specifically excludes property occupied for the purpose of assessee's own business or profession-Sec 22.

2.3 An analysis of the sections brings about the following attributes to attract chargeability under the head the income from house property. :-

(a) The head "income from house property" extends to a property being a building or land appurtenant or adjacent thereto.

'Building' means any habitable four-wall structure covered by a roof. It is immaterial whether the building is residential or commercial such as warehouse, office or factory godown, wedding hall, auditorium, business centre, etc.

'Land appurtenant' means the land connected or adjacent to the building e.g. open space, approach roads, courtyard, compounds, courtyards, backyards, playgrounds, parking spaces, etc.

(b) Income from any other property e.g. rental Income from a vacant plot of land is not chargeable to tax under this head unless it is appurtenant to a building.

(c) The assessee owns the property. It is only the owner or deemed owner of house property who is liable to tax on income under this head.

Following points are important in this regard:

(a) Any person may be the owner whether an individual, HUF, firm, company, cooperative society or an association of persons.

(b) Such person is the owner of the property in the previous year. Any subsequent change in the ownership of the property is immaterial.

(c) A tenant is not the owner of a property. Hence, income of a tenant from sub-letting a rented property to another tenant is also not covered under this head. It will be taxable as business income or income from Other Sources.

(d) The property is either let-out or used for own residence. The section specifically excludes a property used for assessee's own business or profession.

3. DEEMED OWNER- SEC. 27:

Section 27, provides exceptions to the principle that ownership as the basis of charging income under the head 'income from house property'. The section states that following classes of persons shall be deemed to be the owner of a property although he may not be the legal owner thereof.

a) When an individual transfers any property to **his spouse or a minor child** other than a married daughter for inadequate consideration, such individual shall be treated as deemed owner of that property.

In such cases, the legal owner of the property is the spouse or the minor child; still the transferor shall be treated as owner for the purpose of charging income under the head income from house property.

b) The holder of an **impartible estate** is deemed to be the owner of the entire property. E.g., an HUF jointly holding a property on behalf of all its members shall be deemed to be the owner of such property although the property may be in the name of an individual member of family.

c) A **member of co-operative society, company or other association of persons** to whom a building has been allotted under a house building scheme of society will also be deemed to be the owner of that property.

d) A purchaser who has received possession of a property in part performance of a contract within the meaning of **section 53A of the transfer of property Act** is deemed to be the owner of that property despite the fact that the agreement for buying of property has not been registered with the appropriate authority.

e) A person being a lessee, who has acquired right by way of long-term lease of property for period of more than 12 years, is deemed to be the owner of such property and income from that property will be chargeable as the income from house property. This provision is not applicable on any right by way of a lease renewable from month to month or for a period not exceeding one year.

4. HOUSE PROPERTY INCOME EXEMPT U/S 10

Section 10, 11 & 13 prescribe exemptions in respect of Income from house property of certain institutions, organisations or persons or in certain circumstances. Some of such exemptions are as under:-

- (a) A farmhouse used for agricultural purposes.-S. 10(1)
- (b) Income of one Palace of an ex- Ruler - S. 10(19A)
- (c) A local authority S. -10(20)

- (d) A scientific research association -S. 10(20),
- (e) An Institution for development of Khadi & Village Industries -S. 10(23BB)
- (f) Khadi & Village Industries Board -S. 10(23BB)
- (g) A body for administration of charitable & religious trusts & endowments -S. 10(23BBA)
- (h) Approved funds, educational institutions or hospitals - S. 10(23C),
- (i) A trade union or association of trade union- S. 10(24)
- (j) Resident of Ladakh district -S. 10(26A)
- (k) Statutory corporations/ other institution or association finance by the government for promoting the interests of the members of the scheduled caste and scheduled tribes- S. 10(26B)
- (l) Co-operative society for promoting the interests of the members of the scheduled caste and scheduled tribes- S. 10(27)
- (m) A Property held for charitable purposes -S. 11
- (n) A political party -Sec 13)

Besides , Under Sec 22 , a property used for own business or profession such as letting out property to paying guest, employees' quarters, residence of partners or directors is excluded from the income. If such property yields any income, it will be chargeable as business income and not house property income.

U/s 23(1) One Self Occupied Property of an individual or a HUF assessee is exempt. This benefit is not available to a property which is let out nor to non-living entities like firms, companies, etc.

5. COMPUTATION HOUSE PROPERTY INCOME:

Section 23 lays down the methodology for computing the income from house property. Under the section, first step is to determine the annual value of the house property.

Section 24 provides for deductions to be made from the annual values determined u/s 23,

These provisions are explained below:

5.1 Annual Value -Sec 23

Section Sec 2(22) defines annual value "as the annual value determined under Sec. 23. The section assigns no definitive meaning to the term annual value. Hence, the term annual value is to be construed in common parlance.

'Annual value' refers to the inherent capacity of a property to earn income or the amount for which the property may reasonably be expected to be let out from year to year.

Thus it is not the receipt of the actual rent but the capacity of the property to fetch rent which is determinant of its annual value. This implies that a property need not necessarily be let out. Annual value of a property depends on the use of the property- self occupied, let out or partly vacant etc.

The provisions of section 23 for determination of annual value are given below:

5.2 Determination of Gross Annual Value [GAV]

5.2.1. U/s 23(1) (a), Annual value of a property is higher of the two viz. Actual Rent or Reasonable Lettable Value

5.2.2. Actual Rent [AR]

Actual rent means the rent received or receivable if the property is actually let out by the owner or

5.2.3. Reasonable Lettable Value [RLV].

Reasonable Lettable Value [RLV] is the expected rent, which the property might reasonably be expected to yield from year to year. RLV may be estimated whether the property is let out or not. Such estimation may be based on the following factors:

- (a) Fair rent or the rent of similar properties in the same locality. The fair rent may be different in different circumstances or different contractual obligations.
- (b) Municipal Ratable Value or the value of the property fixed by the local authorities for the purposes of assessment of local taxes payable. Municipal Ratable Value is normally based on the market rent receivable in respect of a property and is therefore considered as a very reliable yardstick to determine the reasonable letting value of the property.
- (c) Standard Rent or the rent fixed under the Rent Control Act to control or limit the prevailing rents in a locality. It only means that the landlord cannot charge more rent than the limit fixed under the law. However, the landlord is free to charge lower rent than the rent fixed under the law. Thus, actual rent can be more or less than the fair rent but can never exceed the standard rent.

The following diagram depicts the legal position:

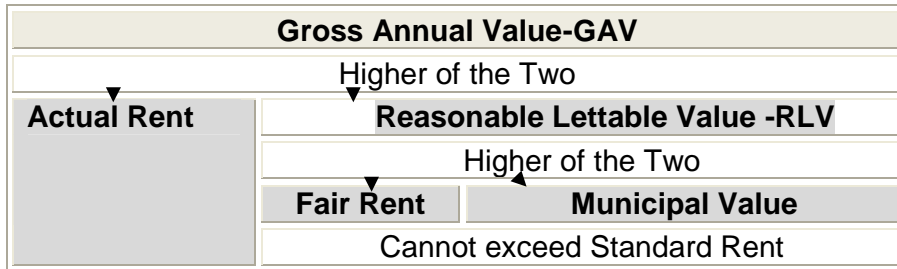


Illustration-1:

Find out the Gross Annual Value from the details given in respect of premises:

Actual Rent: Rs 10,000 per month.

Rent of similar premises in the area Rs. 15,000 per month.

Municipal ratable value Rs. 8000 per month

Standard Rent fixed under the Rent Control Act. Rs. 12,000 p.m.

Solution:

	Rs	Rs
Actual Rent -Rs 10,000 per month		1,20,000
(a) Fair rent - Rs. 15,000 per month	1,80,000	
(b) Municipal ratable value Rs. 8000 P.M.	96,000	
Higher of the (a) and (b) – Fair Rent	1,80,000	
Standard Rent Rs 12,000 per month	1,44,000	
Fair rent cannot exceed the Standard Rent ,Hence		1,44,000
Reasonable Lettable Value RLV restricted to		
Gross Annual Value Higher of the		1,44,000
Two		

Illustration-2:

What will be the GAV if the Standard rent Rs. 18,000 p.m.?

Solution:

	Rs	Rs
Given Actual Rent -Rs 10,000 per month		1,20,000
(a) Fair rent - Rs. 15,000 per month	1,80,000	
(b) Municipal ratable value Rs. 8000 P.M.	96,000	
Higher of the (a) and (b) – Fair Rent	1,80,000	
Standard Rent Rs 18,000 per month	2,16,000	
Reasonable Lettable Value RLV		1,80,000
Gross Annual Value Higher of the Two		1,80,000

Standard rent being only a limiting factor is ignored.

Illustration-3:

What will be the annual value of the property if the Actual rent in the above case is Rs. 20,000 per month; fair rent, ratable value and standard rent remain at the same level of Rs. 15,000, 8000 and 12,000 per month respectively.

Solution:	Rs	Rs.
Given Actual Rent -Rs 20,000 per month		2,40,000
(a) Fair rent - Rs. 15,000 per month	1,80,000	
(b) Municipal ratable value Rs. 8000 P.M.	96,000	
Higher of the (a) and (b) – Fair Rent	1,80,000	
Standard Rent Rs 12,000 per month	1,44,000	
Fair rent cannot exceed the Standard Rent ,Hence		1,44,000
Reasonable Lettable Value RLV restricted to		
Gross Annual Value (Higher of two)		<u>2,40,000</u>

5.2.4. Comparison of RLV and AR - Sec .23(1(b) :

Gross annual value is the higher of the two values namely the rent received or receivable as compared with the reasonable letting value. Such comparison may throw two possibilities viz:-

- (a) Actual rent received/ receivable is more than the reasonable letting value. In such a case, actual rent will be the Gross Annual Value u/s 23(1) (b). OR
- (b) Conversely, the reasonable letting value is more than the actual rent received/ receivable. In this case if the reason for deficiency or shortfall between the actual rent the reasonable letting value is :
 - I. Vacancy only and no other reason, such lower rent will be taken as the gross annual value u/s 23(1)(c) or and
 - II. Any other reason, reasonable letting value will be the gross annual value.

The above position will be clear from the following diagram:

Situation	Gross Annual Value	
Actual Rent > RLV	Actual Rent	
RLV > Actual Rent	Reason Vacancy	Actual Rent = GAV
	Other reason	RLV =GAV

5.3. Other Important points:-

- i. Actual rent is relevant only if the property is let out. A property, which remains vacant or is not let out at all or a self- occupied property cannot have any actual rent. In such a case, reasonable letting value alone will be the guiding factor.
- ii. The amount of Rent actually received/ receivable during the previous year will be arrived after deducting rent for the period for which the property was vacant and unrealised rent or bad debts,

- iii. In case of composite rent, expenses on providing amenities to the tenant such as water will be deducted to find out the actual rent.
- iv. For determining the Annual value, the actual rent shall not include the rent, which cannot be realised by the owner. However, the following conditions need to be satisfied for this:
 - (a) The tenancy is bona fide;
 - (b) The defaulting tenant has vacated, or steps have been taken to compel him to vacate the property.
 - (c) The defaulting tenant is not in occupation of any other property of the assessee;
 - (d) The assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfied the Assessing Officer that legal proceedings would be useless.

Illustration-4

Find out the annual value of a house let out for @ Rs 2,000 per month. Reasonable Lettable Value is Rs 20,000.

Solution:

Annual value will be the actual rent of Rs 24,000 because it is higher than the reasonable lettable value of Rs 20,000

Illustration-5

What will be the GAV if the reasonable lettable value is Rs 30,000 but the actual rent is Rs 2,000 per month?

Solution:

Annual value on this case be the reasonable lettable value i.e. Rs. 30,000 being higher than the actual rent of Rs. 24,000,.

Illustration-6

A house was let out on a monthly rent of Rs. 20,000 for 8 months only. Remaining 4 months it remained vacant. Reasonable lettable value of the house is Rs. 2,40,000. What would be its annual value?

Solution:

Actual rent is Rs. 1,60,000 for 8 months . However, RLV is Rs. 2,40,000 for the full year. There is a shortfall of Rs. 80,000 compared to the reasonable lettable value.

Actual rent for full year will Rs. 2,40,000 , if there is no vacancy . Since the shortfall of Rs .80,000 is solely on account of vacancy, the gross annual value will be Rs. 1,60,000 being the actual rent.

5.4. Computation of Net Annual Value:

Sec 23 classifies the house properties into different categories as discussed below:

5.4.1 Self-occupied Business Properties:

Income from house property used for own business or profession is exempt from tax. If any rent or other income is generated from such property, the same should be treated as business income. Similarly, municipal taxes, repairs, insurance premium, and other expenses incurred on such property etc. will be admissible as business expenses.

5.4.2 Self-occupied Residential Properties (SOP):

Following are the provisions in respect of the annual value of a self-occupied residential property .

5.4.2.1 SOP – Annual Value to be taken as NIL

Under Sec23(2) annual value of a house or part of a house which is in the occupation of the owner(i.e. **Self-Occupied Property**) for the purposes of his own residence shall be taken to be nil.

The exemption will be available in respect of a property which cannot actually be occupied by the owner by reason of the fact that owing to his employment, business or profession carried on at any other place and he has to reside at that other place in a building not belonging to him

5.4.2.2 Exceptions- Sec 23(3)

The exemption will not be available in following two cases:-

- a) If the house or part of the house is actually let during the whole or any part of the previous year; or
- b) any other benefit therefrom is derived by the owner.

5.4.2.3 More than one properties – Sec 23(4)

Where the self-occupied property consists of more than one house, then the exemption shall be available only in respect of **one of** such houses, which the assessee may, at his option, specify in this behalf.

The annual value of the other house or house shall be determined if such house or houses had been let out.

In other words, where the assessee *owns more than one* self-occupied *properties*, the assessee, at his option, may *choose any one* property as self-occupied by him.

The remaining properties will be deemed or assumed to have been let-out even if they are occupied by him and not actually let out. Annual Value of such properties deemed to have been let-out will be determined based on their notional rental value as if the properties were let-out even if no rent has

actually been received by the assessee. However, deductions u/s 23 & 24 will be allowed in the normal manner on such property.

5.4.2.4 Exemption only to individuals and HUFs:

This exemption is available only to *individuals and HUFs*. Other non- living persons cannot avail this exemption.

5.4.2.5 No Deductions allowed from SOP except Interest:

Where the annual value of a SOP is taken as nil, no deduction will be allowed from such annual value u/s 23 or 24 except in respect of interest paid or payable on borrowed funds. In other words, municipal taxes will not be allowed as deduction while computing, nor repair allowance of 30% of annual value will be allowed u/s 24.

5.4.2.6 Provisions regarding deduction of interest : -

Following is the gist of provisions in respect of deduction of interest on borrowed capital from income from house property:-

1. Amount of deduction

Deduction in respect of the amount of any interest payable on capital where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital will be allowable. The amount of deduction will be restricted to actual amount subject to following limits:-

- Rs 30,000 if the amount was borrowed prior to 01-04-1999 to acquire, construct, renew or restructure the property.
- Rs 30,000 if the amount is borrowed after 01-04-1999 for repairs of the house property
- Rs 2,00,000 if the amount was borrowed after 01-04-1999 to borrowed
 - > to acquire or construct the property and
 - > such acquisition or construction of the property is completed within 3 years from the end of the financial year in which capital was borrowed,

2. Pre-construction interest

Interest payable on capital borrowed to acquire or construct the house property, for the period prior to the previous year in which the property has been acquired or constructed, will be allowed as deduction in five equal instalments beginning from that previous year and for each of the four immediately succeeding previous years:

3. Interest allowed under other provisions :

Amount of interest will be reduced to the extent it is allowed under any other provision of the Act.

4. Interest on New Loan to pay old loan :

Where the assessee, subsequent to the capital borrowed for construction or acquisition etc. of property takes a new loan to make repayment of old loan, interest payable on such new loan will also be allowed. However, any interest payable on interest will not be allowed as deception.

5. Accrual Basis

Interest on capital borrowed is allowed as deduction when it is accrued. Actual payment during the previous year is not necessary.

6. Other provisions:

- I. Brokerage or commission paid to arrange a loan for house construction will not be allowed.
- II. Interest payable on loan taken for construction etc. of a property is allowed and not on any loan taken for payment of interest.
- III. Any loss arising under the head 'income from house property' may be set-off against the other heads in the same assessment year.
- IV. The assessee is required to furnish a certificate, from the person to whom any interest is payable on the capital borrowed, specifying the amount of interest payable by the assessee for the purpose of such acquisition or construction of the property, or, conversion of the whole or any part of the capital borrowed which remains to be repaid as a new loan.

INTERST ALLOWABLE ON LOANS TAKEN		
Before 01/04/1999	AFTER 01/04/1999	
Rs 30,000	For Acquisition or Construction	For Renovation or Repairs
	Rs 2,00,000	Rs 30,000

Illustrations-7:

Find out the interest deductible U/s 24 for the assessment year 2016-17 if A borrows Rs. 25,00,000 @ 6% p. a. on 1/4/2013 to construct a Bungalow for own residence, which was completed in May, 2015.

Solution:

The Bungalow is constructed within three years of taking the loan, 1,50,000 will be allowed out of interest payable Rs.

2,50,000. Interest paid in F.Y.2013-14 and 2014-15 Rs 3,00,000 will be allowable in five equal instalments of Rs 60,000 for five years beginning from A.Y. 2016-17. Hence total deduction, will be limited to Rs 2,00,000 ..

Illustration-8:

Determine the amount of interest allowable in the above illustration if the money was borrowed in 1998.

Solution

The deduction would be restricted to Rs. 30,000.

Illustration-9:

What would be amount of deductible interest if the loan was used for repairs of the bungalow?

Solution

The deduction would be restricted to Rs. 30,000.

Illustration-10:

If the construction of the Bungalow was completed in June 2015, what would be the amount of deductible interest?

Solution:

The construction is not completed within three years of taking loan, the deduction will be restricted to Rs 30,000.

5.5. Let-out Properties (LOP)

Following principles will be applicable for determination of annual value of properties let out including deemed to be let out. (self-occupied properties (DLOP))

5.5.1 Net Annual Value (NAV)

Net annual value of a let-out property value (NAV) is arrived at by deducting Municipal taxes *paid* by the owner from GAV- (Proviso to S. 23(1)). Municipal taxes paid or borne by the tenant are not deductible. **Municipal taxes are taken on cash basis and not accrual basis.**

$$\text{NAV} = [\text{GAV}] - [\text{Municipal Taxes paid by the Owner}]$$

5.5.2 Deductions under section 24:

(a) Standard deduction

From the net annual value a standard deduction in respect of Repairs and Collection Charges is allowed to the extent of 30% of the net annual value irrespective of whether the assessee has actually incurred the expenses or not. However, if the repairs are borne by the tenant, this deduction will not be allowed in the hands of the owner of the property.

(b) Arrears of Rent

A deduction of 30% is allowed for repairs and collection charges from the arrears of rent received in respect of a property let out, which were earlier not charged to tax and the same will be taxable in the year of receipt - Sec 25 B

(c) Interest on funds borrowed

Interest on loan taken for acquisition, construction, renewal, repairs or reconstruction is allowed on let-out properties **without limit** of Rs 30,000/ 2,00,000 unlike in case of a SOP. The interest on loans, is allowable on accrual basis. Similarly, pre-construction interest from the date of the loan to the end of the previous year before the previous year in which the house was acquired is amortized 1/5th per year for 5 years as in case of SOP from the financial year in which the construction was completed. .

Illustration -11

A took a loan on 01/10/ 2008 of Rs 10,00,000 @ 10% interest p.a for the construction of his house. The house was finally constructed on January 1, 2012. Calculate the pre-construction period interest and also mention the AY.s in which the deduction for such interest may be allowed.

Solution

Loan was taken on 01/10/2008 and the house is constructed in the financial year 2011-12 (Assessment year 2012-13)

Pre-construction period = 01/10/2008 to 31/03/2011 = 2.5 years.

Interest for preconstruction period : Rs 10,00,000 X 10% X 2.5 = Rs 2,50,000 , which will be amortized in five equal instalments of Rs 50,000 each from Assessment Year 2012-13, in which the house was constructed, onwards till 2016-17.

6. Property let-out and self-occupied for part of the year

If a property is let-out for whole or any part of the year and self-occupied for the remaining part of the year, it shall be treated as let-out property and computation will be made accordingly by comparing actual rent with the fair rent for the whole property u/s 23(1). It will not be treated as SOP as Sec 23(3) makes it clear the **SOP shall not be let-out for any part of the year nor should any benefit be derived from it.**

7. Property partly let-out and partly self-occupied:

If a part of the property – say one or two floors or few rooms have been let out and another part of the property is self-occupied, then for each portion the calculation will be made separately. Relevant expenses like property taxes and interest will be allocated suitably for each portion and deductions will be allowed separately for each portion.

NOTE the difference between properties let out /SOP for split period and with split portion used for letting out/SOP.

8. Co-ownership – Section 26:

A property owned by more than one owners having definite and ascertainable share therein, will not be assessed as an association of persons but share of each owner shall be included in his individual income. Supposing the co-owners themselves occupy the property, share of each owner will be

treated as nil. Each of the co-owners would be entitled to the deduction in respect of interest subject to the limit of Rs 30,000 or Rs 1,50,000, as the case may be.

6. MISCELLANEOUS:

Recovery of past arrears of AY 2002-03 onward-S 25B

Arrears of rent pertaining to period from assessment year 2002-03 or thereafter will be taxable in the year of recovery and 30% deduction is allowable in that year S. 25B

Recovery of arrears for pre AY 2002-03 –S 25A/25AA

Recovery of unrealised rent earlier allowed as deduction u/s 24 upto Assessment Year 2002-03 and thereafter from the annual value, are taxable in the year of recovery but 30% deduction will not be allowed (S. 25-A/ 25-AA)

TDS

Interest paid to a non-resident outside India without deduction of tax at source will not be allowed as deduction.

Set off and carry forward of losses :

Any loss arising under the head “Income from House Property” in respect of interest only can be set off against income arising from other heads and the remaining loss will be allowed to be set off and carried forward for a period of 8 assessment years

No other Deductions allowed;

No deduction would be available in respect of charges like electricity, land revenue, ground rent, insurance, etc. even though they may be actual outgoings since the standard deduction of 30% is supposed to take care of all expenses.

7. SOLVED ILLUSTRATIONS:

Illustration-12

Find out the Gross Annual Value in the following cases:-

Particulars	Property				
	I	II	III	IV	V
Municipal Value	5000	5000	5000	5000	5000
Rent Received	5200	5200	5700	5700	6000
Fair Rental Value	5600	5600	5600	5800	6100
Standard Rent under [Rent Control Act]	NA	5500	5500	5500	7300

Solution:					
	I	II	III	IV	V
Municipal Value	5000	5000	5000	5000	5000
Rent Received	5200	5200	5700	5700	6000
Fair Rental Value	5600	5600	5600	5800	6100
Standard Rent under Rent Act	NA	5500	5500	5500	7300
Gross Annual Value	5600	5500	5700	5700*	6100*

- House I- Fair Rent being highest
- House II- fair rent Rs 5,600 limited to Standard Rent Rs 5,500
- House III : Actual Rent being higher Rs 5700
- House IV Actual rent Rs 5,700 being higher than RLV i.e. Fair Rent Rs 5800 limited to Standard rent RS 5,500
- House V – Fair rent being the highest Rs 6100. Standard rent is only a limiting factor, hence ignored.

Illustration-13

A owns two houses, I & II. House I is let-out throughout the previous year. House II is self-occupied for nine months and let-out for three months on a monthly rent of Rs 5,000. Determine Taxable income, given the following details:-

	House I	House II
Municipal Value	40,000	50,000
Fair Rent	50,000	48,000
Rent Received	48,000	15,000
Municipal Taxes paid	4,000	5,000
Insurance Premium (not yet paid)	2,000	2,500
Ground Rent	1,000	1,500
Maintenance Charges	3,000	3,500
Electricity Bill	5,000	6,000

Solution:

	House I	House II
Gross Rental Value (fair rent for house I and municipal value for house –II)	50,000	50,000
Less : Municipal Taxes paid	4,000	5,000
Net Rental Value	46,000	45,000
Less : Deduction u/s 24		
Repairs & Collection Charges 30%	13,800	13,500
Taxable Income	32,200	31,500

8. SELF EXAMINATION QUESTIONS:

1. What is annual value? How is it determined?
2. Discuss briefly the various expenses and allowances that are deductible under the head "Income from House Property"
3. Mention the amounts which are not deductible from Income from House Property
4. Write a short note on property owned by co-owners
5. Explain briefly (a) Owner of a house property (b) A member of a co-operative society (c) Annual Value
6. What do you mean by "Self-Occupied house property"? How is the annual value of such property determined?
7. Explain briefly, house property "deemed to be let-out" and how the income from such house property is determined?
8. Is interest paid on a housing loan out of India allowable as a deduction?
9. Explain with reason if the Interest paid by the assessee on borrowed capital in the construction of the property, till the date of letting out an admissible expenditure.
10. Discuss the provisions of Income Tax Act regarding unoccupied residential house?
11. Are there any exceptions to the rule that Ownership is the criterion for assessment of Income from house property under Section 22". Enumerate and explain.
12. Discuss tax liability of arrears of rent.
13. Explain the provisions of the Income Tax Act with respect to the computation of income from a self-occupied house property.
14. Explain the tax treatment of unrealized rent.
15. Lakdawala completed construction of a residential house on 1.4.1999. Interest paid on loans borrowed for purpose of construction during the 2 year prior to completion was Rs 20,000/- and for the current years was Rs 10,000 The house was let out on a monthly rent of Rs. 4,000/-. Annual Municipal tax was Rs. 6,000/-. Interest paid during the year is Rs. 15,000/-. Amount spent on repairs is Rs. 2,000/-. Fire insurance premium paid is Rs. 1,500/- p.a. The property was vacant for 3 months. Annual letting value is Rs. 30,000/-. Compute the income chargeable to tax under the head "Income from House Property" for AY 4-15 (Ans. Rs. 8,500)
16. Ram owned a house property at Chennai which was occupied by him for the purpose of his residence. He was transferred to Mumbai in June 2011 and therefore he let-out the property with effect from July 1, 2011 on a monthly rent

of Rs. 3,000/-. The municipal tax payable in respect of the property was Rs. 6,000/- of which only 50% was paid by him before 31.3.2012. Interest on money borrowed for the construction of the property amounted to Rs. 20,000/- Compute the income from house property for the AY 2012-13(*Ans. Loss Rs 8250*)

17. Arvind commenced his construction of a residential house intended exclusively for his residence on 1.11.2010. He raised a loan of Rs. 5,00,000/- at 10% interest for the purpose of construction on 1.11.2006. Finding that there was an overrun in the cost of construction he raised a further loan of Rs. 8, 00,000/- at the same rate of interest on 1.10.2012. What is the interest allowable under Section 24 assuming that the construction was completed on 31.3.2008?

(*Ans. Loss Rs. 1,50,000 pre- construction interest 1/5th*)

18. From the following particulars of his property furnished by Shri S , Calculate income from house property who owns a residential house actually let out for 10 months for total rent of Rs. 25,000. Fair rent of this house is Rs. 27,000 and municipal ratable valuation is Rs. 24,000. Total outgo on account of this house included repairs of Rs. 9,000, Municipal taxes of 18 months Rs. 9,000 and insurance premium of Rs. 1,500. Interest on funds borrowed amounted to Rs. 1,75,000.

He also owns another residential house at Andheri, which is used for own residence. Fair rent of this house is Rs. 80,000 and municipal ratable valuation is Rs. 75,000. Total outgo on account of this house included repairs of Rs. 6,000, Municipal taxes Rs. 18,000 and insurance premium of Rs. 1,500. Construction of this house was complete in 2011 from the funds borrowed from HDFC. During the current year, interest amounting to Rs. 90,000 was paid for the current year and Rs. 60,000 for the last year. A further interest of Rs. 65,000 was paid on loans taken for renovation necessitated due to heavy rains. The interest pertains equally to this year as well as the last year.

(*Ans –Let out Property- loss 1,63,000 , SOP 1,50,000 –interest paid*)

19. State with reason whether the following incomes will be taxable as income from house property.
- R lets out his house to Y, who uses it as his office.
 - R uses his house as the godown to store his factory goods .
 - R rents out his property as residential quarters to the workers in his factory at a nominal rent of Rs.500 p.m.
 - R enters into a written agreement to purchase a property from Y for Rs. 5,00,000 . He has paid the consideration and taken the possession of the Property but the property is yet to be registered in the name of R.

- e) R owns a property, which is given on lease to Y for a period of 6 years, lease rent being Rs.10,000 per month. Y has a right to get the lease renewed for a further period of 6 years.
- f) R owns a property, which is given on lease to Y for a period of one month, Y has a right to get the lease renewed for a period of one month, in each subsequent month, and such renewal is possible with mutual consent till 2020.
- g) R owns a property, which is given on rent to Y. Y annually pays Rs.1,50,000 as rent of the building as well as the charges for different services (like lift, security, etc.) provided by R.
- h) R owns an air-conditioned furnished lecture hall. It is let out, annual rent being Rs 5,00,000, which includes rent of building as well as rent of air conditioner and furniture.

(Ans : a, d, e, f, and g)



PROFITS AND GAINS OF BUSINESS OR PROFESSION (Sections 28 to 44)

SYNOPSIS:

1. Introduction and objective
2. Concept of business
3. Scheme of computation
4. Deductions Expressly Allowed Under The Act
5. Specific Deductions -S.36
6. General deductions
7. Specific Disallowances
8. Typical Illustrations
9. Self Assessment Questions

1. INTRODUCTION AND OBJECTIVE

This lesson deals with “profits and gains of business and profession”. The income under this head includes “profits” and “gains” and such profits or gains are of “Business “and “Profession” along with their various types and forms viz. vocation, trade, commerce, manufacture and any adventure in the nature of trade or profession.

The lesson covers various aspects of the income from the head “Profits and gains of business and profession”, its computation, general and specific deductions allowable under this head and also items not allowed as deduction to the extent contained in Sections 28 to 32, 35 , 36, 37, 40, 40A, 43B

2. CONCEPT OF BUSINESS AND PROFESSION :

2.1 Definitions

2.1.1. Business :

Sec. 2 (13) defines Business as under - :

“Business includes any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce or manufacture.”

The definition of the term “business” is an inclusive one. It includes “business” in its general commercial sense but also several other activities, namely- trade, commerce, manufacture and any adventure in the nature of trade, commerce or manufacture.

Business, trade and commerce refer to buying and selling of goods or services for profit and other incidental activities. Manufacturing means producing new goods or articles.

2.1.2. Profession

Section 2 (36) gives an inclusive definition of “profession” viz. **“Profession” includes vocation**”.

“Profession” in common parlance means rendering of skilled services like as those of doctors, architects, lawyers, chartered accountants or other professionals.

Vocation means a specified occupation, profession, or trade or calling or career especially a religious one. It will therefore include services of priests, preachers delivering sermons or discourses, management gurus, yoga gurus, palmists and astrologers, tarot readers, plumbers, mechanics, priests performing havan or pooja etc.

2.1.3. Adventure

The phrase “Adventure in the nature of trade, commerce or manufacture” indicates that business or profession need not be organised, systematic or regular. A single act may constitute a business or profession. For instance, when a land was purchased developed and subdivided in smaller plots for resale was held as an adventure in the nature of trade or commerce or manufacture.

2.1.4. Provisions to apply uniformly

Income under this head will be uniformly chargeable to tax regardless of the following considerations:-

- a) **Type or description** of an activity namely a business, a profession, or an adventure in the nature of business or profession. However, there are some provisions dealing with some specific cases such as presumptive tax applicable to different activities.
- b) **Legality or illegality** of the activity. Accordingly, income from theft, bribery or smuggling or other criminal or illegal activities will be chargeable to tax under this head just like the income of a legal and legitimate business or profession.
- c) **Regularity or irregularity** of the business or profession. A business or a profession may be regular, irregular or occasional. Even the activity of a single activity

or adventure will be chargeable under this head if it is in the nature of a business or a profession :-

- d) **organised or unorganised** ; and
- e) whether or not requires **personal talents or skill**.

3. SCHEME OF COMPUTATION -SEC. 28-29

3.1. Chargeable income- (Sec 28) :

Under Sec 28 following income are chargeable to income-tax under the head "Profits and gains of business or profession",—

- (i) the profits and gains of any business or profession which was carried on by the assessee at any time during the previous year;

Compensation for termination or modification of contracts

- (ii) any compensation or other payment due to or received by any person at or in connection with the termination of contract modification of the terms and conditions relating thereto for ;

- a. managing the whole or substantially the whole of the affairs of an Indian company
- b. managing the whole or substantially the whole of the affairs in India of any other company
- c. holding an agency in India for any part of the activities relating to the business of any other person by any person,
- d. vesting in the Government, or in any corporation owned or controlled by the Government, under any law ,of the management of any property or business ;

- (iii) income derived by a trade, professional or similar association from specific services performed for its members;

Export incentives

- (iiia) profits on sale of an import licence ;

(iiib) cash assistance received or receivable by any person against exports under any scheme of the Government of India ;

- (iiic) duty drawback in respect of customs or excise duty person against exports ;

(iiid) any profit on the transfer of the Duty Entitlement Pass Book Scheme (DEPB);

(iiie) any profit on the transfer of the Duty Free Replenishment Certificate;

(iv) value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;

(v) any interest, salary, bonus, commission or remuneration due to or received by a partner of a firm as adjusted by any amount not allowed to be deducted u/s 40(b);

Non- compete agreement

(va) any sum, whether received or receivable, in cash or kind, under an agreement for not carrying out any activity in relation to any business or profession or not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services if such amount

- is chargeable under the head "Capital gains" or
- Is received as compensation, from the multi-lateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme(UNEP), in accordance with the terms of agreement entered into with the Government of India.

(vi) any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

(vii) any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD (scientific research) in earlier years

(viii) Amount recovered on account of bad debts allowed in the earlier years;

(ix) Speculation Business

Speculation business is deemed to be distinct and separate from any other business if speculative transactions (which are **settled by payment of difference in price of goods or securities and not by**

actual delivery) carried on by an assessee are of such a nature as to constitute a business.

3.2. Computation of business income –(Sec.29):

Sec. 29 states that the income under the head profits and gains of business or profession as referred to in Sec 28 shall be computed in accordance with the provisions contained in sections 30 to 43D. On a collective reading of the provisions of sections 28 and 29) following important points emerge out: -

1. Income under this head is the aggregate of all income:
 - a. from different sources specified in Sec 28 ;
 - b. in respect of a business or profession ;
 - c. carried on by the assessee.
 - d. any time during the previous year ;
2. From the aggregate income deduction will be allowed in respect of expenses of
 - a. incurred by the assessee ;
 - b. during the previous year ;
 - c. for earning such income .
3. The deduction in respect of expenses incurred is subject to the following conditions:-
 - a. Expenses will not be deducted if such business or profession is closed down during the previous year.
 - b. Expenses incurred before setting of the business will not be allowed except where specifically provided by law.
 - c. Some expenses are fully deductible , while others are deductible only partially ;
 - d. Similarly , some deductions are allowable to certain classes of assessees such as a company or a firm but not to others ;
 - e. Some deductions are without conditions, while others are subject to fulfillment of conditions attached with the deduction.

3.3. Basic Scheme of computation –Sec 28- 43D

From the above, scheme for computation of income under the head profits and gains of business and profession may be summarised as under:-

- (i) Sec. 28 is the charging section. It defines what constitutes income under the head profits and gains of business or profession.

- (ii) Sec. 29 provides mode of computation of taxable income under this head viz. by deducting expenses from income.
- (iii) Sec. 30 to 35 provide expressly for deduction of expenses in some cases
- (iv) Sec 36 and 37 provide for general deductions.
- (v) Sec. 40, 40A and 43B provide for non- deduction in certain circumstances; of expenses, which are otherwise deductible.
- (vi) Section 44A to 44D provide for computation of income on presumptive basis in case of smaller assesseees like , insurance agents retailers, construction contractors, transporters etc. These provisions are not in syllabus.

3.4. Method of Accounting: (Sec 145 / 145A)

3.4.1 As per the provisions of Sec 145(1), income chargeable under the head "Profits gains of business or profession "or" income from other sources may be computed according to either cash or mercantile system of accounting regularly employed by the assessee. These methods are explained below:-

a) Mercantile system or accrual system of accounting

Under the mercantile or accrual system of accounting, income and expenditure accrued during the previous year will be recorded in the books and the taxable income from profits or gains from such a business or profession will be the difference between the expenses or income accrued during that previous year.

Actual receipt of the income or payment of expenses during the year is not mandatory .Instead, such income may be received or expenses may be paid in the previous year or in a year preceding or following the previous year.

b) Cash system of accounting

Under the cash system of accounting, incomes actually received and expenses actually paid during a particular previous year will be recorded and considered for computing taxable profits or gains from a business or a profession . Net profit under the cash system will be equal to difference of incomes received and expenses paid during the accounting year whether such receipts and payments relate to that particular year or some other year or years.

c) Hybrid System of accounting

In practice, an assessee often maintains his account as per the accrual or mercantile system but records some items of income or expenses on cash or receipt basis. Such an accounting system is called hybrid system of accounting as it combines the features of both the methods viz. accrual method and cash method of accounting. For instance, u/s 43B certain items are allowed as expenses only if they are actually paid although the method of accounting employed may be mercantile.

Illustration-1:

A earns commission in the financial year 2011-12 but receives it in the year 2015-16. Under the mercantile system, the commission will be taxed in the year of earning it viz 2011-12 (A.Y. 2012-13) although not actually received during that year.

Under the cash system, it would be taxed in the year of actual receipt 2016-17 (A. Y. 2016-17) although not earned in that year.

3.4.2 Income Computation and Disclosure Standards (ICDS)

As per Sec 145(2), the central government may notify in the official gazette from time to time Accounting Standards to be followed by any class of assessee or in respect of any class of income. Such accounting standards are called *Income Computation and Disclosure Standards (ICDS)*. So far, the CBDT has notified 10 *Income Computation and Disclosure Standards (ICDS)*, which will be effective from A.Y. 2017-18 onwards.

4. DEDUCTIONS EXPRESSLY ALLOWED

The following expenses are expressly allowed as deductions against profits and gains of business or profession:

4.1 Rent, Rates, Taxes, Repairs & Insurance for Building- S. 30

Under Sec. 30, the following deductions are allowed in respect of rent, rates, taxes, repairs and insurance for premises, used for the purposes of the business or profession :---

- a) where the premises are occupied by the assessee as tenant : —
 - (i) rent paid for such premises; and
 - (ii) the amount paid on account of repairs of such premises ;
- b) where the premises are occupied by the assessee otherwise than as a tenant, the amount paid by him on account of current repairs to the premises;
- c) any sums paid on account of land revenue, local rates or municipal taxes (subject to the provisions of section 43B ; and
- d) the amount of insurance premium paid against risk of damage or destruction of the premises .

Capital expenses are not allowed as deduction under this section.

4.2 Repairs & Insurance of Machinery, Plant & Furniture- S. 31:

Under Sec. 30, the following deductions are allowed in respect of repairs and insurance of machinery, plant or furniture used for the purposes of the business or profession,—

- (i) the amount paid on account of current repairs thereto if such expenses are revenue expense and no capital expenses;
- (ii) the amount of any insurance premium paid against risk of damage or destruction thereof.

It may be noted that machinery hire charges are not allowed u/s 31 but u/s 37 as residual expenses.

4.3. Depreciation - S.32:

4.3.1 Conditions for claiming depreciation:

U/s 32 an assessee is entitled to claim deduction in respect of depreciation in computing the total income if he fulfills the following conditions:-

(i) Claim not necessary

Deduction in respect of depreciation will be allowed irrespective of whether or not the assessee has made a claim for deduction so long as the conditions for the allowance of depreciation are satisfied.

(ii) Depreciation allowed on eligible assets only:

Depreciation will be allowed only on the following assets called depreciable assets:

- a) buildings, machinery, plant or furniture, being *tangible assets*;
- b) Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being *intangible assets* acquired on or after 01/04/1998.

“Building” means the superstructure only. It does not include the land on which it is constructed.

“Plant” includes ships, vehicle, books including technical know-how, scientific apparatus and surgical equipments used for the purpose of business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.

(iii) Assets not eligible for depreciation

Following assets are not eligible for depreciation:

- a) Foreign car acquired between 01/03/ 1975 and 31/03/ 2001 unless it is used in a business of running it on hire for tourists or outside India in his business or profession in another country ; *It means that foreign cars purchased on or after 01/04/2001 will be eligible for depreciation ;* and
- b) Any machinery or plant if the actual cost thereof is allowed as a deduction in one or more years under an agreement entered into by the Central Government under Section 42.

(iv) Ownership – Partial ownership:

Assessee must own the depreciable asset wholly or partly as the sole owner or the co-owner thereof. In case of an asset owned by different assessees, each co-owner will be entitled to depreciation on his contribution to the cost of asset.

However, as an exception, the section provides that depreciation will be allowed on capital work or renovation or construction of any structure in building though *not owned* by the assessee is held on lease or other right of occupancy and the new structure is owned by the assessee

(v) Purpose or User of the Assets

The assessee must use the asset for the purpose of his business or profession.

(vi) User of the Assets during the previous year:

An asset acquired by the assessee during the previous year should be put to use for the purposes of his business or profession for a period of 180 days or more. In such a case , the assessee will entitled to claim depreciation at full rate prescribed.

However, if the period for which the asset is put to use during the previous year is of (less than 180 days i.e. 179 days or less depreciation will be allowed at fifty percent of the rate prescribed .

Further, It may be noted that this condition will apply only in respect of *asset acquired during the year* and no other asset. This is because the machinery would undergo wear and tear even if it was not put to actual use

Illustration -2

A Machine is purchased on 31/03/2015 but it is put to use on 01/01/ 2016.

As the machine is acquired during the previous year 2014-15 but not put to use in that previous year, there will be no depreciation in the A.Y. 2015-16;

However, depreciation will be allowable in full in the assessment year 2016-17 although the machine has been put to use for less than 180 days .

4.3.2 Additional Depreciation- [Sec 32(1)(ia)]

Following is the scheme for allowing additional depreciation in addition to normal depreciation :-

(i) Eligibility

Any assessee being an industrial undertaking engaged in the business of manufacture or production of any article or thing

will be entitled to claim additional depreciation.

(ii) Quantum of deduction

a) Additional depreciation will be available @ 20% on the actual cost of new plant or machinery (not being ships or aircrafts) acquired and installed after 31st March, 2005.

b) Additional depreciation will be enhanced to 35% (*instead of 20%*) w. e. f. A.Y. 2016-17 if the following conditions are satisfied -

- (i) A manufacturing undertaking or enterprise is set up in the notified backward areas of the States of Andhra Pradesh, Bihar, Telangana and West Bengal on or after 1st April, 2015.
- (ii) Assessee acquires and installs new plant & machinery between 1st April 2015 and 31st March 2020.

- (iii) if the plant or machinery is acquired and installed for less than 180 days of the relevant previous year, the amount of the additional depreciation of would be fifty percent of the prescribed rate i.e. 10% [being 50% of 20%] and 17.5% being 50% of 35% in case of a notified backward area ;
- (iv) The balance 50% of the additional depreciation i.e. 10% or 17.5% will be allowed in the immediately succeeding previous year w. e. f. A.Y. 2016-17
- (v) Following assets will not be eligible for additional depreciation:- :
 - a. Ships and aircrafts;
 - b. Second hand machinery used by any other person in or out of India;
 - c. Machinery installed in a residential premises or a guesthouse;
 - d. Any office appliances or road transport vehicles;
 - e. Any plant or machinery, actual cost of which is already allowed as a deduction e.g. asset for scientific research; and
 - f. Buildings, furniture & fittings and old plant

4.3.3 Important Terms :

(i) Block of Assets

Sec 2(11) defines the term block of assets as under:-

“Block of assets” means a group of assets falling within a class of assets comprising of —

- a) Tangible assets, being buildings, machinery, plant or furniture;
- b) intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed.

From the above definition, it follows that block of assets means classification of depreciable assets according to the group viz. building, plant, furniture or machinery and each group is further classified according to the applicable rate of depreciation.

It means that if rate of depreciation is different for more than one asset in the same group or two or more assets of different groups have the same rate applicable , such assets will not form the part of the block.

(ii) Written Down Value (WDV) of an asset

Written down value of an asset means:

- a. actual cost to the assessee of the asset acquired in the previous year, and
- b. the actual cost to the assessee less all depreciation actually allowed thereafter

(iii) Written Down Value (WDV) of block of assets

Written down value of any block of assets, means

- a. the opening WDV of the block (after 01/04/1988) or
- b. the opening value of the block of the previous owner or entity(in case of slump sale, amalgamation, succession of business and demerger, conversion into company etc. or holding /subsidiary company)
- c. adjusted by: -
 - (i) *the increase* by the actual cost of any asset falling within that block, acquired during the previous year; and
 - (ii) *the reduction* of the moneys payable in respect of any asset falling within that block, which is sold or discarded or demolished or destroyed during that previous year together with the amount of the scrap value, if any, so, however, that the amount of such reduction does not exceed the written down value as so increased.

This may be explained by the following chart :

BLOCK OF ASSETS					
Depreciated value of the Block		Actual cost of assets falling in the block		Money received or receivable or scrap value of the asset falling within the block of assets sold, discarded, demolished or destroyed during P.Y. 2015-16	
On 01/04/2015	+	acquired In P.Y. 2015-16	-		= Value of Block on 31/03/2016

Other important points:

- (i) Any other things or benefit which can be converted in terms of money cannot be deducted
- (ii) If the resultant block value figure is negative because the sale proceeds exceed the original block value plus increases, it will be treated as short term capital gain.

Illustration-3:

Opening value of block having four machines (depreciation rate -25%) is Rs 5,00,000 as at 01/04/2015. On

01/06/2015, the assessee purchases another machine with depreciation rate of 25 per cent for Rs 2,00,000 and sells an existing machine for Rs 4,00,000. Find out, amount of depreciation and the closing value of block for the A.Y.2016-17.

Solution.

	Rupees
WDV as on 1/4/2015	5,00,000
Add: Purchase during the year	<u>2,00,000</u>
	7,00,000
Less: Sales during the year	<u>4,00,000</u>
Adjusted Block	<u>3,00,000</u>
Depreciation @ 25 per cent	<u>75,000</u>
WDV of block as on 31 /3/2016	<u><u>2,25,000</u></u>

(iii) Actual Cost

Actual cost is determined on the following principles

i. Subsidy or grant to be reduced to determine actual cost

Actual cost means the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority i.e. subsidy or grant and expenses incurred for acquiring the asset or installation thereof. –Sec 43(1) .

By an amendment to section 2(24) w. e. f. A.Y. 2016-17 a specific provision has been inserted to include the government assistance in the definition of income, it will be taxable whether the receipt is of revenue nature or capital nature unless it has been reduced from the actual cost of a depreciable asset.

Illustration 4:

ABC purchases a machine for Rs 10 lakhs with non- refundable subsidy of Rs. 4 lakhs from SIDBI. Actual cost of the machine will be Rs. 6 lakhs [Rs. 10 lakhs-Rs 4 lakhs].

ii. Scientific Research Asset

Actual cost of asset purchased for scientific research and brought into business use will be *Actual Cost minus deduction available u/s 35*.

Illustration 5:

A purchases a machine for scientific research for Rs 10 lakhs with the non- refundable subsidy of Rs. 5 lakhs from SIDBI. The machine is eligible for deduction u/s 35 to the extent of Rs. 3 lakhs . Actual cost of the machine will be Rs. 2 lakhs i.e. Rs. 10 lakhs- Rs 5 lakhs - Rs. 3 lakhs

iii. *Gift , inheritance*

Actual cost of asset acquired by way of *gift* or *inheritance* will be the WDV to the previous owner

Illustration 6:

If A gifts away to B the machinery in the above illustration, the cost of machine to B will also be Rs. 2 lakhs, which was the cost to A.

iv. *Enhanced cost*

Where the asset is acquired at an enhanced cost to claim more depreciation and reduce tax liability, actual cost of may be determined by the assessing officer. Actual cost of asset used and transferred earlier but now reacquired would be the old WDV or cost of repurchase whichever is less.

Illustration 7:

A sold a machinery for Rs. 3 lakh , when its WDV was Rs. 2 lakhs and repurchased the same after two years at the then prevailing market value of Rs. 10 lakh . If the assessing officer comes to the conclusion that the machine is repurchased for getting more depreciation allowance on enhanced purchase value of Rs. 10 lakh, he can ignore it and allow depreciation only on Rs. 2 lakh.

4.3.4 Mode of computation

Following principles are important in computing the depreciation:

- a) Depreciation is calculated on the WDV of the block after adjusting the sales and purchase during the year in that block.
- b) Rates of depreciation for different assets are taken as prescribed in rules.
- c) Depreciation will not be allowed on a block if WDV of that block comes to Zero, even if some assets in that block may be existing.
- d) Similarly , no depreciation will be allowed on a block, in which no assets are left and the block become empty, or ceases to exist, . WDV of the block will be treated as short term loss.
- e) Depreciation will be allowed at 50% of the prescribed rates, if the asset is put to use for less than 180 days in the year of acquisition.
- f) Straight Line Method (SLM) method is applied in case of the assets of the power companies i.e. undertakings engaged in generation or generation and distribution of power at the prescribed rates of depreciation on the *actual cost* of the assets.

- g) Additional depreciation of 20% or 35% on actual cost in is allowable as discussed above .
- h) Different treatment is given to depreciation on foreign cars purchased between 1975- 2001 as depreciation has been denied to such cars subject to some exceptions discussed earlier.
- i) Depreciation will not be allowed on scientific research assets , entire cost of which is allowed as deduction u/s 35.

4.3.5 Succession of Business

Succession means takeover of a business by another new entity e.g. conversion of a firm or sole proprietor to company (S. 47 –xiii/xiv), amalgamation, or demerger, or succession of business (S.170), succession of a private company or unlisted public company, by limited liability partnership S. 47 –xiiib, . In such cases of succession of business, aggregate depreciation for a year will not exceed the amount of depreciation had such event not taken place and such depreciation shall be apportioned between the old and new entity

Illustration-8

Under a scheme of amalgamation A Ltd, transfers to B Ltd, machinery having WDV of Rs 3,65,000 on 1/09/2015. Calculate the depreciation in the hands of A Ltd. & B Ltd. If rate of depreciation is 20%.

Solution:

- Depreciation for the full year if the amalgamation has not taken place : Rs. 73000 [20% on Rs. 3,65,000]
- Hence, aggregate depreciation for the assessment year 2016-17 can not exceed Rs. 73000
- *Pro rata* allocation of depreciation for the two periods :

$$\text{Pre amalgamation} - 153/366 \times 73000 = \underline{\underline{\text{Rs } 30,516}}$$

[01/04/2015 to 31/08/2015= 153 days]

$$\text{Post amalgamation} - 213/366 \times 73000 = \underline{\underline{\text{Rs } 42,484}}$$

01/09/2015 to 31/03/2016=213 days

4.3.6 Depreciation to be allowed even if no claim made

The controversy whether depreciation has to be claimed or it can be simply allowed is now settled and explanation 5 makes it clear that the depreciation will be allowed whether or not the assessee has claimed the deduction in respect of depreciation in computing his total income

4.3.7 Loss on Sale of Machinery

When an asset is sold, discarded, demolished or destroyed in the previous year following rules apply:

a) If block has not become empty and the *assets are still existing* in the block and also *some value is left* in the block, sales proceeds/ scrap value will be deducted from the value of the block and depreciation will be allowed on the resultant value of the block after **increase by the actual cost** of assets acquired, if any

Illustration 9:

One of the assets from a block with depreciation rate of 30% having WDV of Rs. 5 Lakhs is sold for Rs. 1 Lakh; the resultant value of the block will be Rs. 4 Lakhs and the depreciation will be Rs. 1.20 Lakhs

b) When the *value of the block comes to zero*, but *assets still exist* and the block has not become empty, depreciation will not be allowed.

Illustration 10:

In the above example, if the asset is sold for Rs. 5 Lakhs, The resultant value of the block will be zero. Hence, no depreciation will be allowed.

c) If the sale proceeds are more than the adjusted WDV of the block, the resultant surplus will be treated as Short Term Capital Gain regardless of the fact that assets are still left in the block or the block is empty.

Illustration 11:

If the above asset is sold for Rs 8 Lakhs, there will be a surplus of Rs 3 lakhs, which will be taxed as short term capital gain.

d) If there are no assets in the block and the block becomes empty but WDV is not fully Witten off:

- there will be no depreciation allowance and
- existing WDV will be treated as terminal loss or short term capital loss due to cessation of the block as result of sales,

Illustration 12:

In the above example, if all the assets are sold for Rs 3 Lakhs, The block will be empty as there will be no assets in it. The balance of WDV in the block of Rs 2 lakhs will be treated as short term capital loss there will be no depreciation allowance.

e) When the depreciation is allowed on the **actual cost** / WDV of the assets of the undertakings engaged in generation or destitution of power called power companies, following rules will apply:

- When such an asset viz. any building, machinery, plant or furniture in respect of which depreciation is allowed, is sold, discarded, demolished or destroyed

in the previous year not being the year in which it is first brought into use, terminal depreciation will be allowed.

- Terminal depreciation is the deficiency or shortfall between the written down value and the sales proceeds / or moneys payable including scrap value, insurance, salvage or compensation moneys payable in respect thereof.
- Terminal depreciation is not allowed in the year in which it was first brought to use.
- Such deficiency must be actually written off in the books of the assessee.
- Any surplus, arising therefrom is called the balancing charge and taxed as income u/s 43.
- Any moneys received over and above the depreciation allowed will be treated as capital gains.(s. 50A)
- In respect of some motor cars, the actual cost was allowed only upto Rs. 25,000, although the actual cost may be higher. In such a case actual cost/deficiency will be taken proportionately in the ratio of actual cost and Rs 25,000
- Sale includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation.

Illustrations -13

Cost of a machine is Rs 1 lakh. Total depreciation of Rs 80,000 is written off. The Machine is sold for Rs 15,000.

The Written down value of the machine will be $\text{Rs. } 1,00,000 - 80,000 = \text{Rs } 20,000$. The deficit of Rs 5,000 or (20,000-15,000) will be the terminal depreciation.

Illustration 14

If the above machine is sold for Rs. 90,000, the surplus of Rs 70,000 i.e. (Rs 90,000-20,000) will be treated as balancing charge (maximum to the extent of depreciation allowed)

Illustration 15:

If the sale price is Rs.1,05,000, then there will be surplus of Rs 85,000 i.e.(1,05,000-20,000). Rs. 80,000 (up to the depreciation allowed) will be the balancing charge and Balance of Rs. 5,000 will be treated as capital gain.

4.3.8 Unabsorbed Depreciation- Sec. 32(2)

If amount of depreciation cannot be wholly or partly deducted in any previous year because of the lack or inadequacy of profits or gains, the amount of depreciation

not deducted is treated as unabsorbed depreciation and allowed to be carried forward to the for the following previous year and deemed to be part of that allowance, or if there is no such allowance for that previous year, be deemed to be the allowance for that previous year, and so on for the succeeding previous years for indefinite period – S 32(2).

Moreover, the unabsorbed depreciation is treated as part of the current depreciation; it can be set-off against any other head of income even if the business has been discontinued. Old condition of continuance of business to claim set-off of unabsorbed depreciation is no longer a valid condition.

Illustration -16

If the profits before depreciation Rs 50,000 and depreciation allowable is Rs 80,000, depreciation of Rs 50,000 will be deducted and the balance of Rs 30,000 will be unabsorbed depreciation.

Illustration-17

Determine taxable income & unabsorbed depreciation :

Particulars	Rs.
Business Income (before depreciation)	10,00,000
Depreciation allowable as per Income Tax Act	16,00,000
Income from other sources	8,00,000

Solution:

Particulars		Rs.
Business Income before depreciation	10,00,000	NIL
Less: Depreciation to the extent of profits	<u>10,00,000</u>	
Income from other sources	8,00,000	2,00,000
Balance of the current depreciation (16,00,000 - 10,00,000)	<u>6,00,000</u>	
Taxable Income	Rs.	2,00,000

Illustration-18:

Assume depreciation is of Rs. 20,00,000 in above case.

Solution:

Particulars		Rs.
Business Income (before depreciation)	10,00,000	NIL
	<u>10,00,000</u>	
Less: Depreciation to the extent of profits		
Income from other sources	8,00,000	NIL
Unabsorbed Depreciation for the current year to the extent of income	<u>8,00,000</u>	
Taxable Income	Rs.	NIL
Balance to be carried forward to next year as Unabsorbed Depreciation	Rs.	2.00.000

Illustration-19:

Compute the Block Value the A.Y. 2016-17 from the following:

A. Written down value on April 1, 2015

Particulars & Dep Rate)	Rs.
Plant A,B & C -15%	1,00,000
Plant D & E – 40%	2,60,000
Plant F – 50%	70,000
Building A & B -10%	2,00,000
Building C&D - 5%	7,00,000
Building Temporary Sheds E - 100%	8,00,000

B. Purchase during the previous year 2016-17

Date	Particulars	Rs.
02/04/2015	Plant G -50%	60,000
01/05/2015	Plant H-15%	18,000
01/06/2015	Furniture-10%	60,000
01/08/2015	Building G- 5%	5,00,000
01/09/2015	Computer-60%	1,00,000
01/10/2015	Franchise Rights -25%	10,00,000

C. Sales during the previous year 2015 -16

DATE	PARTICULARS	(RS.)
31/10/2015	Plant C	25,000
31/01/2015	Plant D	15,000
01/06/2015	Furniture	50,000
06/03/2016	Building E	2,00,000

Temporary Sheds were put to use during the previous year.

Solution Computation of Depreciation / Cost of Block

Block	Rate	Block 01/04/2015	Purchase	Sales	Block	Dep.	Block 31/03/2016
Plant A/B/C	15%	1,00,000	18,000	25,000	93,000	13,950	79,050
Plant D/E	40%	2,60,000	-	15,000	2,45,000	98,000	1,47,000
Plant F/ G	50%	70,000	60,000	-	1,30,000	65,000	65,000
Building A& B,	10%	2,00,000	-	-	2,00,000	20,000	1,80,000
Building C/D /G	5%	7,00,000	5,00,000	-	12,00,000	60,000	11,40,000
Building E	100%	8,00,000	-	2,00,000	6,00,000	0	0
Furniture	10%	-	60,000	50,000	10,000	0	0
Computer	60%	-	1,00,000	--	1,00,000	60000	40,000
Franchise rights	25%	-	10,00,000	-	10,00,000	2,50,000	7,50,000

Note: No depreciation will be allowed on block of temporary sheds as the block ceases to exist. WDV Rs 6,00,000 left in the Block will be treated as short term capital loss. Similarly, no depreciation will be allowed on furniture purchased and sold in the same year.

Illustration-20

Opening balance in a certain block of assets consisting of three cars (rate of depreciation: 20%) is Rs. 18,00,000. During the year 2015-16, new car is purchased for Rs. 6,00,000 and an old vintage car was sold for Rs. 24,00,000. Compute the Depreciation for the assessment year 2016-17

Solution**Computation of the value of Net Block**

Particulars	Rs
Opening WDV of Block (Three Cars)	18,00,000
Add: cost of New Car purchased	6,00,000
Total (Four Cars)	24,00,000
Less: One Car Sold	24,00,000
Closing Balance Three Cars	0

WDV of the block is zero; no depreciation will be admissible for the A.Y. 2016-17 although three cars still exist in the block

Illustration-21

What would be the position, if all of the above four cars were sold for Rs. 2,00,000 ?

Solution**Computation of the value of Net Block**

Particulars	Rs
Opening WDV of Block (Three Cars)	18,00,000
Add: cost of New Car purchased	6,00,000
Total (Four Cars)	24,00,000
Less: Four Car Sold	20,00,000
Closing Balance -No Cars	4,00,000

As the block becomes empty on the last day of the previous year, no depreciation is admissible. The residual WDV on the block Rs. 4,00,000 will be treated as short term capital loss on sale of cars

4.4. Expenditure on Scientific Research –(Sec. 35)

Section 35 offers tax incentives in respect of expenses incurred on scientific research .Sec 43[4] defines scientific research” as “*any activity for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries*”. The incentives are discussed as under :-

4.4.1 Expenditure for own business-100% sec. 35(1)(ii)/35[2]

In case of in-house research 100% deduction will be allowed in respect of following expenditure incurred by the assessee himself on scientific research relating to his own business :-

- a) any Revenue expenditure; or

- b) any Capital Expenditure other than the cost of land;
or
- c) expenses both capital and revenue excluding cost of land incurred up to *three years prior to the commencement of business* including salaries of the research staff or research material used in scientific research. Such expenses are allowed as deduction in the previous year in which the business is commenced.

Following points are important:

- a. Expenses must be incurred in relation to assessee's own business. Expenses *not related to assessee's own business would not be allowed* as deduction
- b. Deduction is available *even if the relevant asset is not put to use for research and development* during the previous year.
- c. The expenses may be on plant or equipment for research or construction of building (excluding cost of land) for research or other expenses of capital nature connected with the research.
- d. The deduction is not available in respect of capital expenditure incurred on acquisition of any land.
- e. No deduction for depreciation is admissible in respect of an asset used in scientific research covered u/s 35
- f. If a scientific research asset is sold, its sales price or amount allowed as deduction u/s 35, whichever is less, will be treated as business income of the previous year in which the sale took place [section 41(3)]. *The excess of sale price over cost of acquisition (or indexed cost of acquisition) will be treated as "Capital gains".*

Illustration -22

AB Ltd incurs expenses on scientific research related to its business during the financial years 2012-13 onwards @ Rs 1 Lakh per year. It commences the business during the financial year 2015-16. Determine the amount allowable as deduction U/s 35. .

Solution

Business was commenced in financial year 2015-16. Hence , aggregate expenditure of Rs 4 lakh incurred in F.Y. 2015-16 and three years prior to that i. e 2012-13 , 2013-14 and 2014-15 will be allowed in the assessment year 2016-17

Illustration -23

A scientific research asset costing Rs. 5,00,000 purchased on 01/01/2008 is sold on 31/03/2016 for Rs. 7,00,000.

Solution

Rs. 5,00,000 incurred on scientific research asset will be allowed as deduction in A.Y. 2008-09.

When the asset is sold for Rs 7,00,000 the original deduction of Rs 5,00,000 will be charged as business income and excess over the cost Rs,2,00,000 will be chargeable as capital gain in assessment year 2016-17.

4.4.2 Weighted deduction in respect of expenditure on in-house scientific research- 200% [Sec 35(2AB)]

Section 35(2AB) provides for a weighted deduction of **200%** of the expenditure (revenue or capital) incurred by a company assessee on the in-house research and development (R&D) facility. Relevant legal provisions for claiming the deduction are given below-

1. Deduction is available only to a company assessee; non-company assessee are not eligible.
2. The company shall be engaged in the business of
 - bio-technology or
 - manufacture or production of any article or thing and
 - such article or thing should not be specified in the list of the Eleventh Schedule – Sec 35(2AB)(1)
3. The expenditure is incurred on :-
 - in-house research or
 - development facility
 - approved by the prescribed authority
4. The expenditure may be of capital or revenue nature but should not be expenditure in the nature of cost of any land or building. However, cost of building will be eligible for 100% deduction u/s 35(2). Further , the expenditure must be incurred on or before 31.03.2017.
5. Deduction shall be of a sum equal to **two times** of the expenditure so incurred.
6. The company has entered into an agreement of cooperation with the prescribed authority and agreed to submit periodical reports and audited accounts in prescribed form in relation to such facility.
7. The prescribed authority shall submit its report in relation to the approval of the said facility to the *Principal Chief Commissioner or Chief Commissioner* or Principal Director General or Director General in prescribed form and within the prescribed time.
8. The expenditure, on which weighted deduction is allowed under this section will not be eligible for deduction under any other provisions of the Act.

9. "Expenditure on scientific research", in relation to drugs and pharmaceuticals, shall include expenditure incurred on clinical drug trial, obtaining approval from any regulatory authority under any Central, State or Provincial Act and filing an application for a patent under the Patents Act, 1970

10. The items prohibited by schedule XI include:

- a) Beer, wine and other alcoholic spirits.
- b) Tobacco products like cigars and cheroots, cigarettes, biris, smoking mixtures for pipes and cigarettes, chewing tobacco and snuff.
- c) Cosmetics and toilet preparations.
- d) Tooth paste, dental cream, tooth powder and soap.
- e) Aerated waters
- f) Confectionery and chocolates.
- g) Gramophones including record-players
- h) Projectors
- i) Photographic apparatus and goods.
- j) Office machines and apparatus such as typewriters, calculating machines, cash registering machines, cheque writing machines, intercom machines and teleprinters but NOT Computers.
- k) Steel furniture, whether made partly or wholly of steel
- l) Safes, strong boxes, cash and deed boxes and strong room doors.
- m) Latex foam sponge and polyurethane foam.
- n) Crown corks, or other fittings of cork

4.4.3 Contribution made to outsiders -[sec. 35(1)(ii) / (iii) and Sec 352AA]

The section provides for incentives for contributions made to outside institutions for scientific research. The provisions are given as under:-

1. Weighted deduction is allowed in respect of the amount actually paid by a person to other institutions as per the details given below :-
 - (A) One and three fourth times or 175% of the sum paid to:
 - a) a university, college or other institution to be used for research in social science or statistical research- sec. 35(1)(ii]
 - b) Approved and notified research association which has as its object undertaking of scientific research or
 - c) a university, college or other institution to be used for scientific research : - sec. 35(1)(iii]

(B) Twice or 200% of the sum paid to a

- a) National Laboratory; or
- b) University; or
- c) Indian Institute of Technology(IIT) ; or
- d) Specified person with a specific direction
 - that the amount paid shall be used for scientific research undertaken
 - under a programme approved by the prescribed authority , who shall satisfy itself about the feasibility of carrying out the scientific research and
 - shall submit its report to the **Principal Chief Commissioner or Chief Commissioner** or Principal Director General or Director General having jurisdiction over the company in the prescribed form- -sec. 35(2AA).

(C) One and One fourth times (**125%**) of the sum paid to:

A company for scientific research if the company is registered in India with object of scientific research and development and is approved by the prescribed authority- sec. 35(1)(iia).

2. Other important provisions :

(a) Scientific research carried on by such institutes *need not be related to the business of the assessee*

(b) Contribution eligible for weighted deduction under this section will not be eligible for deduction under other provisions of the Act.

(c) If approval to a notified university, college, research association or other institution etc. , which has its object undertaking of scientific research is withdrawn subsequently by the prescribed authority , then also weighted deduction will not be denied to the assessee.

4.5. Amortisation of Preliminary Expenses-S 35D

4.5.1 Eligible assessee

Sec. 35D provides for amortisation of preliminary expenses by an assessee being

- a) an Indian company, or
- b) a resident non-corporate assessee.

A foreign company, whether or not resident in India ; is not eligible to claim deduction under this section

4.5.2 Time and purpose of preliminary expenses –

Sec. 35D covers the following:-

1. Expenses incurred for setting up an undertaking or business BEFORE commencement of business; or

2. Expenses incurred AFTER commencement of business in connection with:

- a) extension of an industrial undertaking; or
- b) setting up a **new industrial** unit

Hence, expenses incurred after commencement of business, in connection with extension of or setting up a non-industrial undertaking will not be eligible for deduction under this section.

4.5.3 Eligible Expenditure:

Section 35D gives the following list of expenses eligible for deduction :-

- a) Expenditure in connection with:
 - preparation of feasibility report,
 - preparation of project report,
 - conducting a market survey (or any other survey necessary for the business of the assessee) or
 - engineering services related to the business of the assessee.

However , such work of preparation of the feasibility report or the project report or conducting of market survey or of any other survey or the engineering services should be carried out by the assessee himself or by a concern approved by the CBDT.

- b. Legal charges for drafting any agreement for setting up or conduct of the business.
- c. Legal charges for drafting the Memorandum and Articles of Association.
- d. Printing expenses of the Memorandum and Articles of Association.
- e. Registration fees of a company under the provisions of the Companies Act.
- f. Expenses in connection with the public issue of shares or debentures of a company, underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus.
- g. Any other prescribed expenditure.

4.5.4 Qualifying Expenditure:

The aggregate expenditure is subject to the following limit:-

- a) corporate assessee - 5% of (a) cost of project; or (b) capital employed, whichever is more
- b) non-corporate assessee: 5 per cent of cost of project

Any expenditure in excess of the above limits any will not be eligible for deduction under this section.

4.5.5 Definitions of the terms

(a) Cost of project:

Cost of project means the aggregate of actual cost of fixed assets appearing in the books of the assessee as on the last day of the previous year in which the business of the assessee commences.

Fixed assets include land, buildings, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on development of land and buildings), or additional cost incurred after commencement of business in connection with extension or setting up an industrial undertaking) of fixed assets,

(b) Capital employed –

Capital employed means the aggregate of the issued share capital, debentures and long-term borrowings, as on the last day of the previous year in which the business of the company commences or additional capital borrowings etc. brought after commencement of business in connection with extension or setting up an industrial undertaking,

Long term borrowings for this purpose means moneys borrowed in India by any company from the Government or Financial institutions like ICICI, IFCI etc or banks or foreign borrowings in connection with acquisition of plant and machinery repayable after a term of seven years or more.

4.5.6 Amount of deduction:

One-fifth of the qualifying expenditure is allowable as deduction in each of the five successive years beginning with the year in which the business commences, or as the case may be, the previous year in which extension of the industrial undertaking is completed or the new industrial unit commences production or operation.

4.5.7 Other Points:

1. Non- corporate assesseees are required to get their account audited for claiming deduction under this section.
2. On amalgamation/ demerger of the assessee company with other company, deductions can be claimed by the amalgamating or demerged company.

3. Amount deducted under this section will not be eligible for deduction under any other provision of the Act.

Illustration -24:

ABC Ltd is an existing Indian company engaged in developing and providing computer software services. It incurs the following expenditure in connection with the setting up of a new unit. The project is complete in March 2016. Determine the amount deduction admissible u/s 35D.

Particulars	Rs
Preparation of project report	2,00,000
Market Survey	6,00,000
Legal charges for additional capital for the new unit	3,00,000
Engineering Services* Blab Ltd not approved by CBDT	5,00,000
Cost of the Project as on 31/03/2014*	60,00,000
Capital employed in the new unit as on 31/03/2014	50,00,000

Solution:

Eligible Expenditure:

Particulars	Rs
Preparation of project report	2,00,000
Market Survey	6,00,000
Legal issue of additional capital for the new unit	3,00,000
Engineering Services Not Eligible – as not approved	0
Total	11,00,000

Gross Qualifying Amount:

5% of the cost of the project-(5% X 60,00,000)	3,00,000
5% of the capital employed (5% X 50,00,000)	2,50,000
Gross Qualifying Amount (higher of the two)	3,00,000

Qualifying Amount:

Net qualifying amount Rs 3,00,000 being the lower of the following:

- I. Gross qualifying amount :Rs 3,00,000 or
- II. Actual amount of preliminary expenses: Rs 11,00,000

Amount of Deduction:

$\frac{1}{5}^{\text{th}}$ of the net qualifying amount ($\frac{1}{5} \times 3,00,000$) or Rs. 60,000 for each of the 5 assessment from A.Y. 2016-17 onwards

4.6. Specific deductions: - Sec. 36

Sec. 36(1) allows certain specific deductions in computing taxable income under the head profits and gains of business or profession. These deductions are summarised as follows:

4.6.1 Insurance premium paid –Sec. 36(1)(i)/(ia)/(ib)

Any amount of any premium paid :-

- In respect of insurance against risk of damage or destruction of *stocks* or stores used for the purposes of the business or profession; - S. 36(1)(i)
- by a federal milk co-operative society to effect or to keep in force an insurance on the *life of the cattle* owned by a member of a co-operative society, being a primary society engaged in supplying milk raised by its members to such federal milk co-operative society -S. 36(1)(ia)
- by any mode of payment other than cash (i.e .cheque) by the assessee as an employer to effect or to keep in force an insurance on the *health of his employees* under an approved scheme framed in this behalf by the General Insurance Corporation of India or any other insurer approved by the Insurance Regulatory and Development (IRDA)- S. 36(1)(ib)

4.6.2 Bonus or commission- S. 36(1)(ii):

Any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission.

However, u/s 43B, such bonus or commission will be allowed as deduction only where payment is made during the previous year, on, or before the due date of furnishing return of income u/s139.

4.6.3 Interest paid on capital borrowed - S. 36(1)(iii):

With effect from A. Y. 2016-17, interest paid or payable on borrowed funds will be allowed as deduction-

- if the assessee uses borrowed funds for the purpose of business or profession.

Recurring subscriptions paid periodically by shareholders, or subscribers in Mutual Benefit Societies, which fulfill the prescribed conditions is deemed to be capital borrowed for this purpose.

– Such interest paid or payable in respect of the period after the asset is put to use for the first time.

In other words, interest shall not be allowed as deduction if such interest is paid or payable in respect of capital borrowed

- for acquisition of an asset for extension of existing business or profession
- whether capitalized in the books of account or not
- for the period
 - beginning from the date on which capital was borrowed for acquisition of the asset
 - till the date on which such asset was first put to use.

In such a case, interest will be added to the cost of the asset. Interest will be deductible when the asset is put to use. This provision is amended in terms of requirement of ICDS- IX, which requires that the capitalization of interest shall commence from the date on which funds were borrowed and cease when such asset is first put to use, irrespective of whether the acquisition of the qualifying asset is for extension of existing business / profession or not.

4.6.4 Discount on Zero Coupon Bonds- S. 36(1)(iiia):

Discount on notified (by Central Government) Zero Coupon Bonds issued by an infrastructure capital company or infrastructure capital fund or a public sector company on or after 01/06/2005 is allowable on *pro rata* basis provided no other benefit or payment is received in respect of such bonds before their maturity.

The bonds, which carry not coupon rate of interest, are called Zero Coupon Bonds. Such bonds are issued at a price lower than their redemption value. The difference between the issue price and redemption value) or the discount is allowed as deduction on *pro rata* basis having regard to the period of life i.e. date of issue to the date of maturity or redemption of such bonds. Simply speaking, discount on Zero Coupon is amortised over the life time of the Bonds.

Illustration-25:

Infrastructure Capital Company issues 1 Crore duly notified Zero Coupon Bonds of Rs. 1000 each at a price of Rs. 640 on 01/01/2013. The bonds are redeemable at par on 31/12/2015. Show how the discount would be deducted from the total income of the company.

Solution:

Face value of Bond- Rs 1,000

Issue price - Rs 640

Discount offered Rs 1000-640 = Rs 360

Total discount offered on 1 Cr bonds Rs. 360 Crore

The tenure of the coupon is three years or 36 months.
Pro rata deduction to be allowed

A.Y. 2013-14	01Jan- 31March 2013 3 Months	3/36X360Cr	Rs.30Cr.
A.Y. 2014-15	12 Months	12/36X360Cr	Rs120Cr.
A.Y. 2015-16	12 Months	12/36X360Cr	Rs120Cr.
A.Y. 2016-17	01April -Dec. 31,2015 =9 Mon	9/36X360Cr	Rs 90Cr.

4.6.5 Contribution towards recognised provident fund/ approved superannuation Fund -S. 36(1)(iv):

Any sum paid by the assessee as an employer by way of contribution towards a recognised provident fund or an approved superannuation fund, subject prescribed limits and conditions and also subject to the provisions of S 43B.

4.6.6 New Pension Scheme- (Sec- 36(1)(iva) :

Any contributions by employer to a pension scheme referred to in Section 80CCD(2) on account of employee to the extent of 10%, deductible effective from 1st April 2012

4.6.7 Contribution towards an approved gratuity fund- Sec. 36(1)(v):

Any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust;

4.6.8 Employee's Contribution towards provident fund or ESIC -S. 36(1)(va)

Contribution received by an employer from his employees for crediting in any fund (e.g. *provident fund* or Employees state Insurance Contribution etc. covered u/s 2[24][x] and credited by the assessee to the Employees' account in the relevant fund or funds on or before the due date prescribed under the relevant law .

Net effect of the provisions read with S. 43B is that such contributions are treated as income at first and when paid by the due date are allowed as deductions. If however, the contribution is not paid in time, it will not be allowed as a deduction and effectively considered as the income of the employer even if it is paid later.

4.6.9 Death of animals-- S. 36(1)(vi)

In respect of animals which have been used for the purposes of the business or profession otherwise than as stock-in-trade and have died or become permanently useless for such purposes, the difference between the actual cost to the assessee of the animals and the amount, if any, realised in respect of the carcasses or animals;

Where the animals are treated as stock in trade, the loss or profit is the part of normal sales and purchase, therefore this provision is not applicable.

4.6.10 Bad debts-- S. 36(1)(vii)

Under Sec S. 36(1)(vii) and Sec 36(2)) Any amount of bad debt or part thereof, which is written off as irrecoverable in the accounts of the assessee for the previous year is allowable subject to following conditions -

1. There is relationship of debtor and creditor.
2. The debt must be incidental to the business or profession.
3. The debt must have been taken into account in the computation of income, or it represents money lent in ordinary course of the business of banking or money-lending.
4. Bad debt should be written off as irrecoverable in assessee's accounts in the Previous year
5. Any debt written off but not allowed earlier may also be deducted as bad debts
6. Bad debts will not *include any provision* for bad and doubtful debts made in the accounts of the assessee;
7. Any deficiency will be deductible in the previous year in which the ultimate recovery is made;
8. any such debt or part of debt may be deducted if it has already been written off as irrecoverable in the accounts of an earlier previous year but the Assessing Officer had not allowed it to be deducted on the ground that it had not been established to have become a bad debt in that year;
9. Assessing officer may deduct bad debt written off as bad in the previous year in an earlier previous year u/s 155(6) within a period of 4 years if he is satisfied that the debt became irrecoverable in earlier years .
10. With effect from A.Y. 2016-17 deduction can be claimed under this section
 - If a debt has been taken into account in the computation of income as per the notified ICDSs ;but ,

- such debt has not been recognised in the books of account as per the accounting standards ;and
- it shall be deemed that the debt has been written off as irrecoverable in the books of account by virtue of the 2nd proviso to Sec 36(1)(vii). . In other words, a bad debts can be claimed without recording in books of account as irrecoverable or bad.

4.6.11 Provision for bad or doubtful debts by banks- Sec. 36(1)(viia):

U/s 36(1)(viia): deduction is allowed to Indian schedule and nonscheduled banks and financial institutions in respect of provision for bad and doubtful debts upto the following limits namely - :

- 7-1/2% of total income by a scheduled Indian bank other non-scheduled bank,
- 5% of total income a public financial institution or a State financial corporation or a State industrial investment corporation and a foreign bank of the total income (computed before making any deduction under this clause and Chapter VI-A) and
- 10% of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner, and subject to certain conditions or
- 5% of (Non-Performing Assets or NPAS in accordance with the RBI guidelines assets shown in the books of account of the bank on the last day of the previous year a bank at the option of the bank.,

The deduction is subject to two conditions :

- a) Assessee has debited the amount of such debt or part of debt in that previous year to the provision for bad and doubtful debts account made under that clause and
- b) Deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause.

4.6.12 Special reserve-- S. 36(1)(viii)

Under Sec 36(1)(viii) financial institutions are entitled to a deduction upto 40% of their profits in respect of amounts transferred to a special reserve created and maintained by them subject to . a ceiling of twice the amount of the paid-up share capital and of the general reserves.

Financial corporation mean

- a corporation which is engaged in providing long-term finance for
 - industrial or
 - agricultural development or
 - development of infrastructure facility in India ,or
- a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes,
- Profit means profits derived from such business of providing long-term finance computed under the head Profits and gains of business or profession before making any deduction under this clause

4.6.13 Promotion of family planning - S. 36(1) (ix)

Under S. 36(1) (ix) revenue expenses incurred bonafide by a company for Promotion of family planning amongst its employees deductible fully .

On fifth of any capital expenditure will be allowed in each of the five years beginning with the previous year in which it was incurred .

Unabsorbed family planning expenditure will be allowed to be carried forward and set off in the same manner as depreciation.

4.6.14 Expenses by Statutory bodies - S. 36(1)(xii):

Under Section 36(1)(x) any expenditure (not being in the nature of capital expenditure) incurred by a corporation or a body corporate constituted or established by a Central, State or Provincial Act incurred for the objects and purposes authorised by the Act under which it is constituted or established will be deductible.

4.6.15 Banking Cash Transaction Tax S. 36(1)(xiii):

Any amount of banking cash transaction tax paid by the assessee during the previous year on the taxable banking transactions entered into by him shall be deductible u/s 36(1)(xii):

4.6.16 Contribution to Credit Guarantee Fund- Sec. 36(1)(xiv):

Any sum paid by a public financial institution by way of contribution to a specified credit guarantee fund trust for small industries as the Central Government may, by notification in the Official Gazette, specify in this behalf will be deductible u/s 36(1)(xiv).

4.6.17 Security Cash Transaction Tax S. 36(1)(xv):

An amount equal to the commodity transaction tax paid by the assessee in respect of the taxable securities transactions entered into in the course of his business during the previous year will be deducted u/s36(1)(xvi), if the income arising from such taxable securities transactions is included in the income computed under the head "Profits and gains of business or profession"

4.6.18 Commodity Cash Transaction Tax S. 36(1)(xvi):

An amount equal to the securities transaction tax paid by the assessee in respect of the taxable securities transactions entered into in the course of his business during the previous year will be deducted u/s36(1)(xv), if the income arising from such taxable commodity transactions is included in the income computed under the head "Profits and gains of business or profession"

4.6.19.6.3 Expenditure by Co-operative Society for purchase of Sugarcane [Sec 36(1)(xvii)]

The amount of expenditure incurred by a co-operative society engaged in the business of manufacture of sugar for purchase of sugarcane at a price, which is equal to, or less than the price fixed or approved by the Government, will be allowed as a deduction under Sec 36(1)(xvii)

5. GENERAL DEDUCTIONS– S. 37:

Section 37 provides that all the expenses will be allowed as deduction computing the income chargeable under the head "Profits and gains of business or profession" subject to following provisions or conditions : -

- (a) The expenses should be incurred in respect of a business or profession carried on by the assessee.
- (b) The expenditure, subject to the provisions of Section 43B, should be incurred during the previous year
- (c) The expenditure must be *laid out or expended wholly and exclusively for the purposes of the business or profession* for which income chargeable under the head "Profits and gains of business or profession" is being computed.
- (d) *The expenses should be incurred after the business or profession is set up*
- (e) *Expenses must be revenue expenses in nature .*
- (f) All expenses whether by way of cost of raw materials, tools, spares , cost of labour, salary , brokerage, commission, legal fees, litigation expenses, professional tax, trade mark registration , lease rent or other business expenses incurred by the assessee;

(g) Following expenses are not allowed under this section

- i. Capital expense such as expenses incurred for acquisition or renovation of assets , conveyance or registration of land or for eviction of a tenant etc. ;
- ii. Personal expenses such as income or wealth tax, drawings or household expenses of the assessee;
- iii. Expenses allowable specifically in sec. 30 to 36;
- iv. Any illegal expenses such as any penalty, bribery, composition money paid in respect of any offences or breach of law, or penal interest under any law;.
- v. Expenses on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party specifically excluded from the purview of the section -. S. 37(2B)
- vi. any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013

6. SPECIFIC DISALLOWANCES– S.40-40A-43B

6.1. Disallowance of expenses may be due to several reasons such as :-

- Not satisfying conditions attached with the allowance. For instance, personal and capital expenses will be disallowed u/s 37 as the section allows only revenue expenses incurred wholly and exclusively in the course of business or profession.
- Absolute disallowances for policy reasons such as political advertisement and CSR expense, which are expressly disallowed u/s 37.
- Defaults such as non-deduction of tax at source.
- Some expenses are disallowed in full but other disallowances are only partial.
- Deferment or time factor. For instance u/s 44B payment of certain taxes is linked with their actual payment attracting disallowance in the year of accrual .
- the entity- specific disallowances such as personal expense in case of an individual, interest and remuneration in case of a firm.

In addition, sections 40, 40A and 43B expressly disallow some expenses while computing income chargeable under the head “Profits and gains of business or profession”. These disallowances are discussed below

6.2. Disallowance in the case of any assessee – S. 40(a)

1. Payments to Non-Residents without TDS [S. 40(a)(i)]

Any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable,—

- (A) outside India; or
- (B) in India to a non-resident, not being a company or to a foreign company,

on which tax is deductible at source and such tax has not been deducted or, after deduction, has not been paid on or before the due date for filing return of income u/s 139 (1).

The amount so disallowed will be allowed as a deduction in computing the income of a subsequent previous year in which such tax has been paid.

Illustration-26.

Commission of Rs. 1,50,000 has been paid to a Non-Resident for the previous year 2015-16, on which tax of Rs 30,000 is required to be deducted. Show whether the commission will be allowable in the following situations.-

- a) The assessee has not deducted tax at source at all,,
- b) The assessee has duly deducted tax at source but not paid the same to the Government in time.
- c) The assessee has duly deducted tax at source and paid the same to the Government.
- d) The assessee has paid the tax to Government after deducting the same in December 2016

Solution:

In first two case, sum paid as commission will be disallowed u/s 40(a) (i) as the assessee fails to deduct tax or pay the tax deducted at source.

In case(c) deduction will be available in A.Y. 2016-17.

In case(d), deduction will be allowed in A.Y. 2017-18

2. Payments made to residents without TDS [S.40(a)(ia)]

30% of any sum paid or payable to a resident, on which tax is deductible at source and such tax has not been deducted or, after deduction, has not been paid on or before the due date for filing return of income u/s 139 (1) shall be disallowed u/s 40(a)(ia).

Such disallowance will not be made if the recipient of the income has paid the due tax thereon and as a result thereof the assessee is not deemed to be an assessee in default U/s 201(1).

However, the sum so disallowed (30%) will be allowed as a deduction in computing the income of a later previous year in which such tax has been paid:

3. Any sum paid on account of fringe benefit tax [S. 40(a)(ib)]:
4. Any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains.-[S. 40(a) (ii)];
5. Any sum paid on account of *wealth-tax*. [S. 40(a) (iia)]
6. Any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called, which is levied exclusively on; or which is appropriated, directly or indirectly, from, a State Government undertaking by the State Government.
7. *Salary payable outside India* or to a non-resident, and if the tax has not been deducted or deducted and has not been paid therefrom under Chapter XVII-B.
However, such salaries will be allowed as a deduction in the year in which the tax has been paid in respect of the salary. [S. 40(a) (iii)]
8. Any payment to a provident or other fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to secure that tax shall be deducted at source from any payments made from the fund, which are chargeable to tax under the head Salaries. Such payment will not be allowed as a deduction if tax has not been deducted in the year in which such payments have been made. However, these payments will be allowed as a deduction in the year in which tax has been paid.[S.40(a) (iv)]
- 8 Any tax actually paid by an employer on perquisites u/s10 (10CC)-[S. 40(a) (v)]

6.3. Disallowances in the case of any firms- S.40(b)

a. Disallowance of Remuneration to Partners— S. 40(b)

Following are the provision about remuneration payable to partners of a firm assessable as such namely.-

- (i) Any payment of remuneration to any partner ,
 - a. who is **not a working partner**; or
 - b. who is a **working partner**, but such payment of remuneration is **not authorised** by, or is not in accordance with, the terms of the partnership deed;

c. a working partner but payment of remuneration though authorised, relates to any period falling **prior to the date of such partnership deed** or

For this purpose "working partner" means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner;

- (ii) any payment of remuneration, to a working partner though authorised and otherwise allowable, if the remuneration to all partners in aggregate exceeds the following limits:

Book Profits	Remuneration allowable
on the first Rs. 3,00,000 of the book profit or in case of a loss	Rs.1,50,000 or 90 % of the book- profit, whichever is more;
on the balance of the book-profit	60 % of the book profits

"Book-profit" means the net profit, as shown in the profit and loss account for the relevant previous year, computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit. In other words, Book Profit means net profit before providing for remuneration to partners.

"Remuneration" means "any payment of salary, bonus, commission or remuneration by whatever name called.

b. Disallowance of Interest to Partners-S. 40(b)

- (i) Any payment of *interest* to any partner which is *not authorised by* or is not in accordance with, the terms of the partnership deed; or
- (ii) *Interest*, to partner though authorised, relating to any *period falling prior to the date* of such partnership deed or
- (iii) Interest in accordance with the deed of partnership but in excess of the amount calculated at the rate of twelve per cent simple interest per annum;

Following points are also relevant in this regard:-

- (i) A partnership deed may, at any time during the said previous year be amended to provide for payment of interest but such amendment will be applicable only prospectively. Retrospective effect can not be given to such terms.

- (ii) The interest will be taken into account in the same capacity in which it is paid. For e.g. A is a partner in a firm

as a trustee of B. The firm pays interest to A in his personal capacity and as the representative or trustee of B. In this case, interest payable to A in his capacity of trustee will be considered u/s 40(b). Interest paid in his individual capacity will be ignored. On the other hand, if A is a partner in his individual capacity, then interest paid to him in his representative capacity shall be ignored.

Illustration-27:

For the financial year 2015-16, a firm shows net profit of Rs 50,000 after debiting the following amounts:

- Remuneration to A -Rs 50,000. A is not a working partner.
- Remuneration to B- Rs 5,00,000 for the full year. The firm has made provision for his remuneration by a partnership deed dated 01/7/2015
- Interest to partners @ 18% per annum Rs. 90,000. Compute the business profits for the assessment year 2016-17

Solution:

Computation of Profits from Business A.Y. 2016-17			
Particulars			Rupees
<i>Business Profits as per P/L A/c</i>			50,000
<i>Add back- Salaries & Interest paid to partners (50,000+5,00,000+90,000)</i>			6,40,000
<i>Book Profits before interest & remuneration</i>			6,90,000
<i>Less: Interest authorised by partnership deed restricted to 12% i.e. 90,000 X 12/18</i>			60,000
<i>Book Profit Before Remuneration</i>			6,30,000
<i>Remuneration to Partners (Lowest of the following)</i>			3,75,000
<i>A –(Nor working partner</i>	<i>NI</i>	<i>L</i>	
<i>B- Actual Remuneration</i>	<i>5,00,000</i>		
<i>Remuneration allowed from the date of deed viz. 01/07/2015 to 31/03/2016 for 9 months</i>	<i>3,75,000</i>		
<i>5,00,000 X9/12</i>			
<i>Maximum allowable</i>	<i>4,75,200</i>		
<i>90% of first Rs 3,00,000 of book profit</i>	<i>2,70,000</i>		
<i>60% of the balance book profit of Rs (6,42,000-3,00,000)</i>	<i>2,05,200</i>		
<i>Profits from Business</i>			2,55,000

c. Disallowances of Remuneration/Interest by an association of persons(AOP) /body of individuals (BOI)-S. 40(ba):

Any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by an association of persons (AOP) /body of individuals (BOI) to a member of such association or body.

“Association or “body” does not include a company or a co-operative society or a society registered under the Societies Registration Act, 1860, or other registered charitable trusts).

Following points are also relevant:-

a. Unlike a firm, no part of interest paid to a member is allowable in case of an association or a body. Hence , capacity or status of the member in such AOP or BOI is relevant . Accordingly ,

- i. Interest paid by a member in his representative capacity to the association or body or *vice versa* shall be ignored if he is a member in his individual capacity.
- ii. Conversely , Interest paid by a member in his individual capacity to the association or body or *vice versa* shall also be ignored if he is a member in his representative capacity
- iii. However, Interest paid by a member in his representative capacity to the association or body or *vice versa* shall be considered if he is a member in his representative capacity.
- iv. Similarly , Interest paid by a member in his individual capacity to the association or body or *vice versa* shall be considered if he is a member in his individual capacity

b. Where ,interest is paid to a member on funds borrowed by him, the disallowances will be only on the net amount receivable by such members.

c. Remuneration or interest to members of AOP/BOI are not allowed to be deducted for computing income from business and profession

Illustration-28

X is a member of BOI. X borrows a sum of Rs. 1,00,000 from market with interest rate of 12% and advances it to the BOI. A BOI pays Interest @ 15% p. a to X. Determine the amount to be disallowed.

Solution:

Particular	Rs
Interest payable by BOI to X 15% on Rs 1,00,000	15,000
Interest payable by X on his borrowing 12% on Rs 1,00,000	12,000
Disallowable u/s 40(b) (Net)	3,000

6.4. Disallowances In the case of all assesses –S.40A

S. 40A provides for disallowance of certain expenses in certain circumstances. Most of these disallowances are anti-avoidance measures in nature and as such are overriding and prevailing. Sec 40A (1) expressly states that:-

“ The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other provision of this Act relating to the computation of income under the head "Profits and gains of business or profession".

A detailed description of such disallowance is given as under:-

1. Excessive payment to relatives -S. 40A (2)

U/s 40A(2)(a) Any expenditure resulting in any payment to any specified person may be disallowed to the extent it is excessive or unreasonable in the opinion of the assessing officer having regard to the market value of the goods or services and the benefit to the business or profession.

The section specifically excludes domestic transaction referred to in section 92BA, if such transaction is at arm's length price as defined in 92F(ii).

Sec 40A(2) (b) gives a long list of specified persons , which is summarised as under :-

A. Persons connected with the assessee	
Status of assessee	Specified person
Individual	any relative of the assessee;
Company	any director or his relative
Firm	any partner or his relative
Association of Persons	any member or his relative
Hindu Undivided Family	any member or his relative

B. Sister concerns	
Entity holding substantial interest of the assessee	
<i>Person holding a substantial interest in the business or profession of the assessee</i>	<i>Specified person</i>
Individual	Individual or his relative
Company	any director or his relative
Firm	any partner or his relative
Association of Persons	any member or his relative
Hindu Undivided Family	any member or his relative
C. Persons connected with the sister concerns	
If partner of a firm, or director of company or member of a HUF, AOP hold substantial interest, then such company, firm, AOP or HUF will be the specified person also other directors, partners, members and their relatives will be the specified persons (The above table will be applicable to the concerns of where such persons are partners directors or members)	
D : Reverse connection :	
Where assessee or his relatives, or if the assessee is a company, firm, HUF, AOP its directors, members or partners etc or their relatives), hold substantial interest in the business of other individual, company, firm, AOP or HUF, the latter will be treated as the specified persons.	

“Relative” in this context means husband, wife, and brother, sister or any lineal ascendant or descendent of the individual.

A person holding *“Substantial interest”* means a person holding 20% voting power in a company at any time during the previous year or twenty per cent of the profits of other concern viz proprietary concern, HUF, AOP, BOI etc.

Illustrations -29:

Determine the specified persons u/s 40A(2)

- A is an individual. His wife is a specified person
- A is a firm having B, C & D as partners, B, C & D and their relatives will be the specified persons
- If A is a HUF with B, C & D as members, B, C & D and their relatives will be the specified persons
- If A is a AOP with B, C & D as members, B, C & D and their relatives will be the specified persons

- e. If A is a Company with B, C & D as directors B, C & D and their relatives will be the specified persons.
- f. In the above cases B is a company, then B and all directors of B will be the specified persons.
- g. If C is a firm, then C and all partners of C will be the specified persons
- h. If D is A HUF or AOP, all the members as well as D will be the specified persons .

2. Payments exceeding Rs 20,000 /35,000 other than by way of crossed cheque or demand draft – S. 40A(3) /(3A)

Where in respect of any expenditure, payment exceeding Rs. 20,000 (Rs. 35,000 in cases of payments made for plying, hiring or leasing goods carriages) during a single day is made otherwise than by way of crossed bank cheque or draft; *whole* of this expenditure will be disallowed.

Following points require attention:

- 1. The disallowance is on total payment if it crosses the limit of Rs. 20,000 or Rs. 35,000 i.e. on payments of Rs 20,001 (or 35,001) and more .
- 2. Limit of Rs. 20,000 or Rs. 35,000 will be considered with reference to the aggregate of all payments made in a single day.
- 3. If expenditure is allowed in past on the basis of its accrual and subsequently cash payment is made in respect of such liability, in excess of Rs. 20,000 or Rs. 35,000 , such excess payment will be deemed to be the business profit in the year of payment.
- 4. Rule 6D provides some case where, no disallowance will be made even if the payment exceeds Rs 20,000 and is made otherwise than by way of crossed cheque or crossed bank draft some of theses circumstances are: new buyer, bank holiday, lack of banking facility, etc.
- 5. S 40A (4) forbids a person to raise an issue in a suit for being offered payment by account payee cheque or draft and not in cash.

Illustration-30:

Audit fee provided during the financial year 2010-11 for Rs. 50,000 is paid by cash on 31.03.2016.

Solution

Audit fee allowed as deduction in A.Y. 2011 -12 paid in cash , hence Rs. 50,000 will be deemed be the profit of the A.Y. 2016-17

Illustration-31

A makes a payment of Rs. 25,000 by a bearer cheque for purchase of goods and claims that disallowance u/s 40A(3) is not applicable and even if it is applicable, it will be restricted only on Rs. 5,000 being , the amount exceeding Rs. 20,000. Examine his claim.

Solution

If payment in excess of Rs 20,000 is made otherwise than by an account payee cheque or draft etc., entire payment of Rs 25,000 will be disallowed without any basic limit. Bearer cheque and cash are not acceptable modes of payment.

3. Provision for Gratuity-S. 40A (7)

Any provision for payment of gratuity to employee on their retirement or termination of their services for any reason will not be allowed u/s 40A (7). But if such provision is made by contributing to an approved gratuity fund or for payment of gratuity that has become payable during the previous year, will be allowed as deduction.

Hence, gratuity is allowed as a deduction only when it has become due and payable. However, once the provision for gratuity has been allowed as deduction in any year, then any subsequent payment thereof will not be deductible again.

4. Provision for non- statutory funds -S.40A (9)

U/s 40A (9) , deduction will not be allowed in respect of any sum paid by the assessee as an employer towards the setting up or formation of, or as contribution to, any fund, trust, company, association of persons, body of individuals, society or other institution for any purpose, except where such sum is paid for the purposes and to the extent provided by or under S. 36(1)(iv)/ (v) or as required by or under any other law for the time being in force like approved provident/gratuity funds etc. However, any *bonafide* sum actually spent out of such fund will be allowed as deduction U/s.40 (10). Further, u/s S.40 (11) assessee will be entitled to receive back the unutilised part of any such fund/assets

5. Disallowances in respect of unpaid liabilities-Sec. 43B

Section 43B provides an exception to the mercantile system of accounting. As per the section , taxes and other statutory payments will be allowed in the previous year, in which they are actually paid irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him. The section covers any sums payable by the assessee:-

(a) by way of tax duty, cess or fee, by whatever name called, under any law for the time being in force, or

(b) as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees, or

(c) as Bonus or commission to employees u/s 3691)(iv) ; or

(d) as interest on any loan or borrowing from any public financial institutions i.e. ICICI, IFCI, UTI, IDBI LIC or a State financial corporation or a State industrial investment corporation, in accordance with the terms and conditions of the agreement governing such loan or borrowing , or financial arrangement or

(e) as interest on any loan or advances from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan or advances,

(f) as an employer in lieu of any leave at the credit of his employee,

Sec 43B provides will not be applicable if :—

1. such payment is actually made on or before the due date of submission of return of income; and
2. the evidence of such payment is submitted along with the return of income.

In brief Sec .43B provides that

1. sums accrued and paid within the same previous year would be allowed in that year ;
2. Sums accrued in one year and paid in the following year but before the due date of filing will also be allowed on accrual basis on submission of proof of payment .
3. Other sums will be allowed only on cash basis and not on mercantile basis. Following table summarises the position:

Application of Section 43B	
Date of Payment	Year of Deduction
During the year in the year of its accrual	year of payment or accrual as both are same
After the end of the year in which it is accrued but on or before the due date of submission of return of income for that year and the proof of deposit is submitted along with the return of income	year of accrual
Any other time not covered above or proof not attached with return	Year of payment

Illustration-32

ABC Limited pays Sales Tax for the financial year 2015-16 before 30/09/2016. Determine the assessment year in which the sales tax may be claimed as deduction.

Solution

Tax is paid before due date for filling return of income viz. 30/09/2016. Hence, it will be allowed on accrual basis in A.Y.2016-17.

Illustration-33:

ABC Ltd pays excise duty for the previous year 2015-16 on 01/10/2016. In which assessment year will it be allowed?

Solution;

ABC Ltd. pays tax after the due date for filling return of income , deduction will be allowed only in the year of actual payment year 2016-17 relevant to A.Y. 2017-18.

Illustration -34

Determine the year in which the excise duty will be deducted from the business profits of X Ltd., who made following payment of excise duty in the year 2015-16.

S.No.	Date of payment	Rupees
1	2/5/2015	25,000
2	20/07/2015	65,000
3	16/8/2015	80,000
4	5/12/2015	20,000
5	12/06/2016	40,000
6	2/12/2016	10,000
7	Unpaid	10,000
	Total	2,50,000

Solution

- First four payments due and paid in the same year 2015-16 will be allowed as deduction in A.Y. 2016-17
- Rs. 40,000 paid on 12/06/2016 paid before the due date of filing return will be allowed as deduction in A.Y. 2016-17 if proof of payment is furnished along with return of income .
- Rs. 10,000 paid on 02/12/2016 is paid after the due date for filing of return for A.Y 2016-17 will be allowed in the year of payment i.e. A.Y.2017-18
- Unpaid amount of Rs. 10,000 will not be allowed as deduction until it is actually paid.

7. ILLUSTRATIONS:

Illustration -35

From the following Income & Expenditure account of Law Bros. for the year ending March 31, 2016 , compute the total income of the firm.

To Expenses	150,000	Professional Receipts	480,000
To Depreciation	20,000		
To Remuneration to partners	250,000	By Other fees	90,000
Interest on Capital to partners @ 20 per cent	20,000		
To Net Profit	130000		
Total	570000		570000

Other Information:

1. Expenses include Rs. 18,000 and Rs. 12,000 paid in cash as brokerage to a single party on a single day .
2. Depreciation calculated as per section 32 is Rs. 40,000

Solution

Computation of Total Income of Law Bros. (A. Y. 2016-17)

Net profit as per Income & Exp account	1,30,000
Add: Expenses not allowable	
40A(3)- Cash paid to broker over Rs. 20,000	30,000
40(5) Excess interest to partners -20,000 *8/20	8,000
	1,68,000
Less: Less: Depreciation u/s32 (40,000-20,000)	20,000
	1,48,000
Add: Remuneration to partners debited in PLA	2,50,000
Book Profits before remuneration	3,98,000
Remuneration to partners Actual Rs 2,50,000 or 1.50.000 +60% of Rs 398200-150000) = 2,98,920	2,98,920
Total Income	99,080

Illustration -36

From the given Trading and P & L A/c of A&B for the year ended 31st March 2016 , compute taxable income of the firm for the Asst year 2016-17

Particulars	Rs.	Particulars	Rs.
To Opening Stock	75,000	By Sales	20,00,000
To Purchases	15,00,000	By Closing Stock	85,000
To Gross Profit	<u>5,10,000</u>		
Total	<u>20,85,000</u>	Total	<u>20,85,000</u>
To Salaries	2,50,000	By Gross Profit	5,10,000
To Sales Commission	40,000	By Bad Debts Recovery	25,000
To Sales Tax	35,000		
To General Expenses	5,000		
Advance Income Tax	54,000		
To Interest on Loan	42,000		
To Interest on Capital	18,000		
To Depreciation on Furniture & Fittings	4,000		
To Advertisement	16,000		
To Free Distribution of Samples	3,000		
To Insurance premium on Life of Partners	8,500		
To Printing & Stationery	3,500		
To Net Profit	56,000		
Total	5,35,000	Total	5,35,000

Additional information::

1. Salaries include Rs. 40,000/- paid to partners, as per partnership deed and well within the limits u/s 40(b).
2. General Expenses are incurred for the purposes of pleasure tour of partners with their family members to Goa.
3. Income Tax includes Rs. 14,000 paid for the partners.
4. Bad Debts recovered were earlier allowed as a deduction.
5. Interest on Capital to partners is in excess of limits specified u/s 40(b) by Rs. 1,500/- but as per partnership deed.
6. Cash expenses over Rs 35,000 for carriage of Rs. 40,000.

SOLUTION:

Computation of Total Income of X & Y Co. for A.Y. 2016-1715.		
Particulars	Rs.	Rs.
Profit as per Profit and Loss Account		56000
Add: Exp. disallowed /considered separately		
Salaries to Partners	40000	
General Expenses incurred for personal purpose by the partners	5000	
Cash expenses 40A(3)	40000	
Income Tax (Advance)	54000	
Interest on Capital	18000	
Insurance on Life of Partners	8500	165500
		221500
Less: Interest to partners (18000-1500)		16500
Book Profit		205000
Less: Salaries to partners		40000
Business income		165000

8. SELF-EXAMINATION QUESTIONS:

- 1) Define and explain the term "Business".
- 2) Explain any six deductions which are specifically allowed as a deduction while computing income from business or profession
- 3) Give a detailed note on depreciation
- 4) Is Depreciation always allowed on Written Down Value ?
- 5) What happens when block ceases to exist?
- 6) Discuss the tax treatment when block comes to zero.

- 7) What are the incomes chargeable under the head "Profits and Gains of Business or Profession"?
- 8) Explain the items of expenses, which are expressly not allowed as deductions while computing income from "Profits and Gains of Business."
- 9) Explain "while computing Profits and Gains of Business or Profession" "Section 37(1) is the residuary section to claim deduction .
- 10) Explain the expenses allowed on payment basis U/s 43B.
- 11) State the disallowance under Section 40A (3) if a purchase bill of Rs 45,000 was immediately paid by cash.
(Ans: Rs. 45,000)
- 12) State whether following expenses are allowed as a deduction or not while computing income from business or profession, if not, give reasons:
 - a. Interest paid outside India wherefrom no tax has been deducted nor there is any representative assessee.
 - b. Income tax paid by the firm.
 - c. Salary paid outside India wherefrom no tax has been deducted nor there is any representative assessee.
 - d. Salary paid to a partner.
 - e. Guest House expenses.
 - f. Advertisement expenses.
 - g. Contribution to Gratuity Fund.
 - h. Interest on borrowed capital.

(Ans: Item f & h only allowable, d allowed subject to book profits)

- 13) Discuss the admissibility and/ or inadmissibility of the following expenditure under the Provision of Income Tax Act, 1961
 - a. A technical consultant was paid consultancy fee of Rs. 20,000 in cash by assessee and a deduction was claimed towards the expenditure.
 - b. A senior advocate conducted the Income tax proceeding before the Income Tax authority and was paid Rs 18,000.
 - c. Provision made for gratuity as per actuary valuation of Rs 1,00,000.
 - d. A sum of Rs 1,30,00., was paid towards sales tax liability in the account for the year ending 31.3.2006
 - e. Stock-in-trade was lost to fire amounting to Rs 10,000/- and was debited to Profit and Loss Account.

(Ans : a, b & e allowable)

14) Discuss the implication of the following transactions in the case of a doctor running a nursing home:

- (i) Amounts received from the employees of the nursing home as contribution towards Provident Fund for the month of March 2011 paid to the PF - Rs 25,000 in December 2013

- (ii) Cash paid for purchase of medicines –Rs 50,000

(Ans. 25000 Income u/s/ 43 B (2) Rs 50,000 disallowed u/s 40A(3))

15) Are the following expenses allowable as deduction under section 37(1): (a) Litigation expenses for official purposes. (b) Expenses relating to purchase of stationary for official purpose and (c) interest on loan taken for the purpose of paying income-tax.

(Ans; 1&2 allowable)

16) From the P/L A/c of X for the year ending March 31, 2016, ascertain his total income for the assessment year 2016-17 :

Expenses	Rs.	Income	Rs.
General expenses	13,400	Gross profits	3,64,500
Bad debts	22,000	Commission	8,600
Advance tax	21,000	Brokerage	37,000
Insurance	600	Sundry receipts	2,500
Salary to staff	26,000		
Salary to X	32,000		
Interest on overdraft	4,000		
Interest on loan to Mrs. X	42,000		
Interest on capital of X	23,000		
Depreciation	48,000		
Advertisement exp.	7,000		
Contribution to RPF	13,000		
Net profit	1,60,600		
Total	4,12,600	Total	4,12,600

Other information:

(A) Depreciation allowable is Rs. 37,300 as per the I.T. Rules.

(B) Gen. exp. include Rs. 500 for arranging a party to a friend .

(Ans: $160600 + 21000 + 32000 + 23000 + 48000 - 37300 + 500 = 247800$)

17) From the following data, calculate the depreciation admissible to an individual carrying on business, for A.Y. 2016-175

Particulars	%	WDV
Factory Building	10	5,00,000
Plant & Machinery	20	8,00,000
Addition to Plant		1,00,000
Sale proceeds of Plant (cost 1,00,000)		5,00,000
Furniture & Fixture	10	1,00,000
Motor Car	20	60,000
New computer	60	60,000

(buildg. Rs. 50,000, P&M . 60,000, Comp. Rs.36000, Furni. Rs.10,000 & Car Rs.12,000)

- 18) From the following figures, you are required to ascertain the depreciation admissible and other liabilities, if any. In respect of the previous year relevant to the AY 2016-17

Particulars	Plant & Mach	Building
Rate of Depreciation	25%	10%
WDV at the beginning of the year	Rs2,50,000	Rs 5,00,000
Additions during the year	Rs3,00,000	Nil
Sales during the year	Rs10,00,000	Rs 2,00,000

(Ans. P&M Rs. Nil Rs. 2,00,000 Short term capital gain, Building Rs. 5,000)

- 19) X Ltd. owns two plants A & B on 1/4/ 2015 (rate of depreciation: 15 per cent) with opening depreciated value of the block at Rs. 2,37,000. It purchases Plant C with depreciation rate of 15% on 31/5/ 2015 for Rs. 20,000 and sells Plant A on 10/04/2015 for Rs 10,000, Plant B on 12/12/2015 for Rs. 15,000 and Plant C on 1/03/2016 for Rs. 24,000,. Determine the WDV of the block as on 31/03/2014 and also the depreciation

{Ans. $237000 + 20000 - 49000 = 208000$ Short Term Capital Loss, block empty, Depn –NIL}

- 20) Compute depreciation for A.Y. 2016-17 from the following:

Plant & Machinery A, B & C – W DV on 1/4/ 2015 Rs. 5,00,000 rate of dep.15%. Plant D purchased on 12/06/2015 Rate of dep. 15% for Rs. 40,000. Plant A sold on 8/12/ 2015 for Rs. 1,60,000.

(Ans Value of Block $500000 + 40000 - 160000 = 380000$ Dep. 57000)



CAPITAL GAINS

Sections 45 to 55

Synopsis:

1. Introduction and Objectives
2. Basis of charge S.45, 46A
3. Capital asset – S. 2(14)
4. Types of assets – Short Term & Long Term
5. Transfer –S.2(47)
6. Types of Capital Gains - S 2(29A/B)/(42A/B)
7. Period of holding
8. Computation of Capital Gains
9. Value of Consideration
10. Cost of Transfer
11. Cost of Acquisition
12. Fair Market Value
13. Transactions covered u/s 49(1)
14. Cost of improvement
15. Indexed cost of acquisition /improvement
16. Transactions not regarded as transfer
17. Typical Illustrations
18. Self Assessment Questions

1. INTRODUCTION AND OBJECTIVES

The Income tax was introduced as a tax on income. Income by definition excludes capital receipts. Hence, levying tax on capital gains arising on transfer of capital assets was not a popular idea. Further, capital assets are acquired out of the income on which income tax has already been paid. Secondly the capital gain is not an income *per se* but only reflects the inflated value of the asset over a period of years due to reduction in purchasing power of money because of inflation.

However, a progressive tax regime could not ignore capital gain as a precious source of revenue. The result is a complex cobweb of legal provisions seeking to tax capital gains.

The lesson intends to explain different aspects of tax treatment of the capital gains including the concept of “Capital Asset”, “Transfer”, what constitutes a capital asset and what is not capital asset, types of capital gains, concept of indexation and computation of the capital gain and other machinery provisions dealing with contained in Sections 45 to 55.

2. BASIS OF CHARGE -SEC. 45/46A

2.1 Capital Gains Defined :

Section 45 is the charging section. It states that “any profits or gains arising from the transfer of a capital asset effected in the previous year shall be the income of the previous year in which the transfer took place”

Section 45 is attracted on loss or profit arising on ‘transfer’ of a ‘capital Asset’ during the ‘previous year’. Hence, the section will apply if:-

- (i) a capital asset ,
- (ii) is transferred by the assessee,
- (iii) during the previous year and
- (iv) And it results in some gain or loss.

The term “capital asset” is defined in sec. 2(14) and the term “transfer” is defined in Sec. 2(47). On a plain reading of the section it would appear that every asset may not be a ‘capital asset’ nor every movement of a capital asset from one person to another can be called “transfer”. If the two ingredients do not co-exist simultaneously, there will be no liability for tax u/s 45.

E.g. profit on transfer of a personal motor will not be chargeable as capital gain because motorcar being a personal effect is not a ‘capital asset’.

Similarly, where the shares are registered in the name of a legal heir on the death of a shareholder , there will not be any capital gain as devolution or transmission of an asset unto heirs by succession is not regarded as transfer u/s 2(47).

2.2 Other receipts chargeable to capital tax

Sec. 45 extends the term “capital gain” to cover several other receipts, discussed below:-

a) Insurance money:

Money or other assets received during the previous year from an insurer on account on account of damage to or destruction of a capital asset, as a result of:

- I. Flood, typhoon, hurricane, cyclone, earthquake or other convulsions of nature or
- II. Riot or civil disturbance or
- III. Accidental fire or explosion or
- IV. Action by an enemy or action taken in combating an enemy

b) Conversion of capital asset into stock:

Transfer by way of conversion, by the owner of a capital asset into, or its treatment by him as stock-in-trade of a business carried on by him, but is chargeable to tax in the previous year in which such stock-in-trade is sold or otherwise transferred by him.

c) Interest in securities

Transfer made by a depository or a participant of beneficial interest in any securities during the previous year in which such transfer takes place.

d) Transfer of asset as capital to firm, AOP or BOI :

Transfer of a capital asset made by a person to a firm or other association of persons or body of individual (not being a company or a co-operative society) in which he is or becomes a partner or member by way of capital contribution or otherwise in the previous year, in which the transfer takes place.

e) Transfer of asset on dissolution of firm, AOP or BOI

Transfer of a capital asset by way of distribution of capital assets on dissolution of a firm or association of persons or body of individuals (not being a company or co-operative society) or otherwise, in the year previous year in which the transfer takes place

f) Compulsory Acquisition

Transfer of capital asset by way of compulsory acquisition under any law is chargeable to tax in the previous year in which such compensation or part thereof is received.

Any additional compensation shall be taxable in the previous year, in which it is actually received.

If the initial compensation is subsequently reduced by any court, tribunal or any authority, the capital gains assessed in the year of receipt of initial compensation or enhanced compensation will be amended to re-compute the capital gains with reference to such reduced compensation.

g) Repurchase of Units of Mutual Funds

Transfer of capital asset being the units of UTI or other mutual funds issued under the Equity-Linked Savings Scheme on the repurchase thereof by the mutual fund will be taxed in the year of such repurchase.

h) ESOP /ESOS

Sale value of the shares issued to employees under an equity stock option plan/scheme as reduced by the cost of acquisition / indexed cost of acquisition of the shares will be taxed in the year of such issue.

i) Buyback- Sec46A

The value of a consideration received by share of a company under a scheme to buyback its own shares u/s 77A of the Companies Act, 1956 as reduced by the cost of acquisition /indexed cost of acquisition will be taxed in the year of buyback.

3. CAPITAL ASSET – S. 2(14)

Sec.2(14) defines capital asset as:

“Property of any kind held by an assessee, whether or not connected with his business or profession,” but does not include -

- a. **any stock-in-trade, consumable stores or raw materials** held for the purposes of his business or profession ;
- b. **personal effects**, i. e. movable property including wearing apparel and furniture held for personal use by the assessee or any member of his family dependent on him, but excludes
 - (a) Jewellery; b) archaeological collections; (c) drawings; (d) paintings; (e) sculptures; or (f) any work of art.

For this purpose “Jewellery” includes:

- (a) **ornaments made of gold, silver, platinum** or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stone, and whether or not worked or sewn into any wearing apparel;
- (b) **precious or semi-precious stones**, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel;

It is important to note that although jewellery is a movable property held for personal use, yet it is deemed as a “capital asset”. Definition of jewellery covers only ornaments not other articles like silver or gold utensils, which are neither “jewellery nor ornaments”.

- c. **Agricultural land** in India, not being land situate in :
 - a. areas not in the jurisdiction of a municipality, municipal corporation notified area committee, town area committee, town committee, or by any other name or a cantonment board or cantonment board having population of 10000 or more and
 - b. *in any area within the distance, measured aerially, from the local limits from any area of municipality etc. as above-*

Distance not more than	Population of the area of municipality etc. as per last published census
2 KM	10,001 – 1,00,000
6 KM	1,00,001 – 10,00,000
8 KM	More than 10,00,000

- d. Special Bearer Bonds, 1991
- e. 6 1/2 per cent Gold Bonds, 1977
- f. 7 per cent Gold Bonds, 1980
- g. National Defence Gold Bonds 1980
- h. Gold deposit Bonds under old Deposit Scheme 1999

The section clarifies *that* “property” shall include any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever;

4. TRANSFER –S.2(47)

Sec 2(47) defines “Transfer” in an inclusive definition:

“Transfer in relation to capital assets includes the following:-

- (1) sale, exchange or relinquishment of the asset ;
Relinquishment of a right means transfer of a right in favour of another person e.g. sale of right to subscribe shares.
- (2) extinguishment of rights on the capital asset;
Extinguishment of rights results in cessation or destruction or cancellation of rights in a capital asset like surrender of tenancy right for e.g. buyback of shares results in extinguishment of shares.
- (3) compulsory acquisition under any law;
- (4) conversion of capital asset into stock in trade of a business;
- (5) maturity or redemption of a zero coupon bond issued by an infrastructure capital company, a fund or a public sector company notified by the central government in respect of which, no payment or benefit is received before maturity or redemption;
- (6) any transfer involving the allowing the possession of an immovable property u/s 53A of Transfer of Property Act, in part performance of the contract for transfer of that property;
- (7) any transaction involving transfer of membership of a group, association housing society, company, etc, which have the effect of transferring or enabling enjoyment of any immovable property or any rights therein in any manner whatsoever;
- (8) distribution of assets on the dissolution of a firm, body of individuals or association of persons;

- (9) transfer of a capital asset by a partner or member to the firm or AOP, whether by way of capital contribution of otherwise;
- (10) transfer under a gift or an irrevocable trust of shares, debentures or warrants allotted by a company directly or indirectly to its employees under the ESOP Scheme of the company as per the guidelines of the Central Government.

It may be noted that many transactions are not regarded as “transfer” under the provision of sections 47 and 47A do not e.g. transfer upon reorganisation of business entities like amalgamation, demerger, gift, will. (These transactions are not in syllabus, hence not discussed.)

5. TYPES OF CAPITAL ASSETS

A capital asset may be classified as a short term capital asset or a long term capital asset depending upon the period for which it is held by the assessee before such asset is transferred that is:-

a) Short Term Capital Asset (STCA)- Sec 2(42A)

Short-term capital asset means a capital asset held by an assessee for less than 36 months before it is transferred.

The period of 36 months is taken as 12 months in the following cases:

- (i) Equity or Preference shares whether quoted or not,
 - (ii) Securities like debentures, government securities and notified derivatives, which are listed in recognised stock exchange u/s 10-23(D),
 - (iii) Units of UTI
 - (iv) Units of Mutual Funds
 - (v) Zero Coupon Bonds
- ### b) Long Term Capital Asset (LTCA)

A long term capital means a capital asset, which is not a short-term capital asset. In other words, a capital asset will be a long term asset if it is held for more than 12 or 36 months before it is transferred.

6. TYPES OF CAPITAL GAINS

Capital gains arising on the transfer of a capital asset will be short term capital gain or long term capital gain depending upon the type of the asset which is transferred that is:-

i. Short Term Capital Gain (STCG)

Capital gain arising on transfer of a short term capital asset i.e. asset held by an assessee for less than 36 or 12 months will be short term capital gain and any loss arising on

the transfer of short term asset will be short term capital loss – Section 2(29B)

Further, capital gains arising on sale of long term business assets in a block in case of a slump sale as covered under section 50 would be treated as a short term capital gain or short term capital loss.

ii. Long Term Capital Asses (LTCG)

Long-term capital gain is the gain arising on transfer of a long-term asset or an asset held by an assessee for 36/12 months or more. Conversely, any loss arising on transfer of long-term asset will be long-term capital loss – Section 2(42B)

5. PERIOD OF HOLDING- S. 2(42A):

Holding of an asset is the yardstick to determine whether the type of capital gains arising on transfer of the capital asset. Some important principles to determine the holding of an asset are given as under:-

1. In case of shares held in company in liquidation, the period subsequent to the date of liquidation will not be included. Period of holding will stop running on date of liquidation.

Illustration-1

A company goes into for winding up on 01/01/2004. The liquidator settles the claim on 01/ 01/2016. In computing the period of holding, the period after 01/01/2004 will not be included.

2. In case capital assets have become the property of the assessee in circumstances mentioned in section 49(1) in determining the period, the period for which the previous owner held the capital asset will also be included.

Illustration- 2:

A dies on 01/01/2016 leaving his house which was purchased on 15/02/2003 to his son B. B sells this house on 20/03/2016. The capital gain arising of the house will be long term as the holding of the house will be computed from the date of acquisition from 15/02/2003, date since which the previous owner A held the house.

3. In case of shares of an amalgamated company allotted to a shareholder against the shares in an Indian company, which was amalgamated, the period for which the assessee held the shares in the amalgamated company will also be included.

Illustration-3:

R purchased shares of S Ltd on 12/11/2004. S Ltd amalgamated with H Ltd. on 31/12/2015. Under the scheme of amalgamation,

original 1000 shares in S Ltd were converted into 300 shares of H Ltd. R sells these 300 shares of H Ltd. on 1/1/2016. The capital gain will be treated as long term as the period of holding will be reckoned from 12/11/2004 and not 31/12/2015.

4. In case of *rights issue* of shares or other securities subscribed to by the assessee on the basis of his rights to subscribe, the counting of the period shall start from the date of allotment by such person or other person in whose favour such right has been renounced.
5. In case of *renunciation of a rights issue*, for the person who has acquired the rights, the period shall be reckoned from the date of the offer of such rights by the company or institution.
6. In case of a *bonus issue*, allotted without payment on the basis of holding of any other financial asset, period shall be reckoned from the date of allotment of such financial asset.
7. In case of shares in a resulting company received under a scheme of demerger of a company, the period for which the *shares in the demerged company* were held by the assessee will also be included.
8. In case of shares of trading or clearing rights of a recognised stock exchange acquired by a person under its demutualisation or corporatisation, the period for which, such person was a member will also be included.
9. In case of equity shares allotted under demutualisation or corporatisation of a recognised stock exchange in India, the period for which such person was a member will also be included.
10. Period of holding of other capital assets will be decided according to the rules framed by the CBDT in that regard.

Important: *The CBDT has clarified that date of transfer/ acquisition of shares will be considered on the basis of the brokers' note / date of contract or date of allotment and FIFO (first in First Out Basis) in the case of Demat Accounts.*

11. In case of security or sweat equity shares allotted or transferred by the employer free of cost or at concessional rate to this employees including former employees, popularly called as ESOP, the period shall be reckoned from the *date of their allotment or transfer*.
12. The period of holding of units acquired in the consolidated scheme of mutual fund shall include the period for which the units in consolidating schemes were held by the assessee.
13. The period of holding of a capital asset, being share or shares of a company, acquired by a non-resident assessee on redemption of GDRs would be reckoned from the date on which a request for such redemption was made.

6. COMPUTATION OF CAPITAL GAINS- SEC. 48

8.1. General Rule

U/s 48 the income under the head "Capital Gains" shall be computed. by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely :-

- (i) Expenditure incurred wholly and exclusively in connection with such transfer;
- (ii) The cost of acquisition of the asset and the cost of any improvement thereto:

8.2. Long Term Capital Gains

Where the capital gain is to be computed in respect of a long term asset, instead "cost of acquisition" and "cost of improvement", "indexed cost of acquisition" and "indexed cost of improvement" are to be deducted subject to following two exceptions, when benefit of indexation of cost will not be available, viz.-

- a. On capital gains on transfer of shares or debentures of Indian company by a non-resident ; In this case capital gain will be computed firstly by converting the cost of acquisition, full value of consideration and expenses incurred for transfer into originally utilised foreign currency and reconverting capital gain into Indian ,
- b. On transfer of bonds and debentures even though they may qualify to be called long term capital assets. This is because bonds and debentures are normally issued and redeemed at par and if benefit of indexation is given, it will always give capital loss, and
- c. In case of slump sale u/s 50B

Mode of computation can be depicted as under:

COMPUTATION OF CAPITAL GAINS			
Sales Consideration			
Less			
Expenses on Transfer			
Less			
Indexed cost of acquisition	Indexed Cost of Improvements	Cost of acquisition	Cost of Improvement
Long Term [LTCA]		Short Term [STCA]	

Note: The STCG / LTCG computed above are subject to deductions/exemptions under sections 54, 54B, 54D and 54EC, 54ED, 54F 54G etc, which are not in the syllabus.

8.3. Depreciable Capital Assets– Sec. 50

Where a capital asset has been sold or transferred and in respect of such capital asset depreciation had been allowed, the position will be as shown in the diagram below :

Depreciable Capital Assets			
Sales Consideration			
LESS	Expenses on Transfer		
LESS	Opening WDV	PLUS	New Purchase
▼			
IF WDV IS ZERO No Depreciation	Surplus Left Taxable as STCG	WDV still Remains	
		If Block Empty	Block Not Empty
		Short Term capital Loss No Depreciation	Claim depreciation

The detailed rules are as follows:-

- A. Written down value of the block at the beginning of the year as increased by the cost of acquisition of any new asset falling in the same block purchased during the year and the incidental expense on transfer the asset purchased. The balance will be the written down value of the block and there will be no capital gain.
- B. If sales consideration exceeds the WDV of the block as increased by the new purchase and the incidental expense on transfer, such excess consideration will be treated as short term capital gain.
- C. If the resulting figure is negative, it will be treated as short term capital loss.
- D. If block ceases to exist, that is all assets in a block are sold, the WDV in the block will be short-term capital loss.

Thus, capital gain will arise only if the full value of sale price exceeds the aggregate of the following:-

- Incidental expenses on transfer
- The written down value of the block at the beginning of the previous year.
- Cost of acquisition of the asset falling in that block of assets during the previous year

The resulting figure will be short term capital gain or short term capital loss. If block cease to exist, no further deduction will be available and no further deduction will be allowed.

Illustration -4:

From the following particulars in respect of a block of assets :

- a. Opening WDV Rs 50,000
- b. Cost of new asset purchased Rs 20,000
- c. Rate of depreciation 20%
Compute the depreciation or capital gain if _
1. No asset was sold during the year , or
2. value of the consideration for asset sold was
 - a. Rs 70,000
 - b. Rs. 40,000
 - c. Rs. 1,00,000
3. All assets in the block sold
 - a. Rs 40,000

Solution:

Particulars	1	2	3	4	5
	Rupees				
Opg WDV	50,000	50,000	50,000	50,000	50,000
Add-New Purchase	20,000	20,000	20,000	20,000	20,000
Total	70,000	70,000	70,000	70,000	70,000
Sales	0	70,000	40,000	1,00,000	40,000
WDV /Gain	70,000	0	30,000	(30,000)	30,000
Depreciation	14,000	0	6,000	0	0
STCG	-	-	-	30,000	-
STCL	-	-A	-	NA-	30,000
Clos. WDV	56,000	0	24,000	0	0

Notes: No depreciation in case 2 as WDV in block comes to zero and in case 5 , all the assets are sold, hence the block ceases to exist. Residual WDV of Rs. 30,000 will be short term capital loss.

6.4. Depreciable assets of power undertaking: Sec 50A

In respect of a depreciable assets of an undertaking engaged in generation or distribution of power or energy, short-term gain/loss will be computed with reference to the cost of acquisition as adjusted u/s 43(6).

Since land is not a depreciable asset, in case of a composite agreement for sale of a factory building along with the land, depreciable asset will be building. Land will be considered as general capital asset giving rise to long term or short term capital gain depending upon the period for which it is held.

6.5. Assets in Slump Sale – Sec. 50B

Slump sale means the transfer of one or more undertakings by way of sale for a lump sum consideration without assigning values to individual assets and liabilities of the undertaking.

In case of slump sale the undertaking itself will be treated as a capital asset and any profit on sale thereof shall be treated as long term or short depending upon the period of holding of such undertaking .

For the purposes of slump sale, 'net worth' [Sec. 50B (2)] of the undertakings shall be the cost of acquisition and improvement and no indexation u/s 48 is allowed in respect of such cost.

Net worth means the aggregate value of total assets i.e. WDV of depreciable assets and book value of other assets (excluding any revaluation of assets) reduced by the value of liabilities of such undertaking or division

6.6. Sale of Land or building – Sec. 50C

U/s 50C in case of transfer of a capital asset being land or building or both , the sales consideration will be the higher amount of the following ;

- the actual consideration received or accruing or
- value adopted or assessed or assessable by stamp duty authorities or the purpose of payment of stamp duty in respect of such transfer.

If the assessee does not accept the stamp duty valuation and prefers appeal with the appellant authorities, the value finally determined shall be treated as the value of consideration.

However, if the assessee does not prefer any appeal but claims that agreement value is much lower than the valuation adopted by the stamp duty/registration authorities, the assessing officer may refer it for valuation. The consideration will not exceed the value adopted by the state authorities.

Illustration: 5

Agreement value of a land is Rs 5 Lakh. It is valued at Rs 4 lakhs only by the stamp duty authorities. Agreement Value Rs 5 lakhs will be taken as the consideration accruing for computing capital gains

Illustration: 6

Assuming the above land sold for Rs 5 lakh is valued at Rs 6 lakh by the stamp duty authorities , the consideration will be taken at Rs 6 lakh if the assessee does not dispute it.

Illustration: 7

If in the above case, the assessee, files an appeal with the stamp duty authorities, the consideration will be taken at the amount finally determined by those authorities.

Illustration: 8

If in the above case, the assessee, does not file an appeal with the stamp duty authorities, but disputes the stamp duty

valuation, the assessing officer will refer the valuation to the Departmental Valuation Officer. However, such valuation cannot be more than Rs 6 lakhs.

7. VALUE OF CONSIDERATION- SEC.48

“Full total value of consideration” means the value received or accruing because of the transfer.

It indicates the whole of the price; in terms of money or money's worth or both; bargained for between the parties *inter se*, which accrues or arises upon transfer of a capital asset.

The Capital gains will be chargeable on accrual basis and not on cash basis Actual receipt of the value is irrelevant.

Further, “full value of consideration” does not refer to the market value of the asset transferred or the adequacy of the price. However, there are some specific provisions, which require ascertainment of fair market value accruing or arising on transfer of a capital asset

If the consideration cannot be expressed in money's worth, it will not form part of full value of the consideration for the transfer. Subject to the provision of Sec 56, there will no capital gain in such a case. Some of such cases are as follows:-

- (i) In case of transfer of a property without consideration or out of natural love and affection or patriotism, subject to the provisions of Sec 56, there will no capital gain in such a case.
- (ii) in case transfer by a company as a gift or under an irrevocable trust of any shares, debentures, or warrants allotted directly or indirectly to its employees under employees stock option scheme (ESOP/ESOS) as per the guidelines issued by the Central Government, full value of the consideration will be the fair market value of shares on the date of transfer
- (iii) In case of a transfer resulting in exchange of two or more assets, full value of consideration of the assets transferred will be equal to the fair market value of the asset received.

Illustration 9

A exchanges his flat for B's shop. In this case “Full total value of consideration of A's flat will be the fair market value of the shop transferred by B and vice versa.

- (iv) Amount of any insurance claims received in respect assets destroyed in natural conditions like tsunami, floods, earthquakes, would be deemed the full value of consideration.

S 45 specifies the year of the capital gain liability and the value of consideration arising or accruing in some cases, which are given in the following table :

Sub Section and the nature of the transaction	Previous year when taxed year of -	Value of consideration
(1) Sale or Transfer	Sale or transfer	Sales consideration
(1A) Damage or Destruction	Receipt of claim money	Money received or fair market value
(2) Conversion into stock	Sale of stock	Market value on the date of conversion
(2A) Transfer of securities by depository	Transfer determined on FIFO basis	Consideration for transfer
(3) Transfer as capital contribution in firm / AOP / BOI	Transfer	Value credited in capital account
(4) Transfer on dissolution of firm/AOP/BOI	Transfer	Fair market value on date of transfer
(5) Compulsory acquisition	Receipt of compensation	Initial compensation or enhanced compensation as the case may be
(6) Repurchase of mutual fund units	Receipt or discontinuation of scheme	Repurchase price

Illustration-10

A jeweller converted his personal gold ornaments bought on 01/04/81 for Rs. 1,00,000 into stock in trade of his business, when the fair market value of the ornaments was Rs. 7,00,000. He sold the ornaments on 31/03/2016 for Rs. 12,00,000. Find out the tax incidence on this transaction .

Solution

Transfer takes place on 01/01/2004 being the date of conversion of personal gold into stock-in- trade and the amount of Capital gain will be:

	Rs
Full values of consideration [FMV 01/04/2004]	7,00,000
-Indexed Cost of Acquisition[1,00,000 X 463/100]	4,63,000
Long Term Capital Gain as on 01/04/2004	2,37,000

LTCG of Rs 2,37,000 arising on 01/04/2004 will be chargeable in A.Y. 2016-17 when actual sales of the ornaments took place .

The balance Rs. 5,00,000 excess of sale price of Rs 12,00,000 over FMV on 01/04/2004 of Rs 7,00,000 will also be chargeable in A.Y. 2016-17 under the head “profits and gains of business” .

10. COST OF TRANSFER – SEC. 48(1)

Expenditure incurred wholly and exclusively in connection with the transfer of asset will be deducted from the total value of consideration while computing the capital gain. This is subject to the following conditions:

- (i) The expenses should be incurred wholly and exclusively in connection with the transfer.

Lawyers' fee for transfer, brokerage, travelling expenses for transfer, advertisement, stamp duty and registration fee ,if paid by the seller etc. will be allowable but normal administrative expenses like salary of staff for upkeep or maintenance of property will not be allowable .

- (ii) The expenses must not be claimed as deduction as expenditure under any other head.

- (iii) No expenses will be allowed in respect of share transactions covered under the securities transaction tax.

11. COST OF ACQUISITION – [SEC 48 - 46 & 49]

Cost of acquisition is the sum total of amounts spent for acquiring a capital asset including the following-

- (i) price paid by the assessee for purchase of property ; or
- (ii) fair value on the date of exchange , of the asset transferred in exchange, where the asset is acquired in exchange for another asset ; and .
- (iii) expenses incurred on transfer, registration, stamp duty etc.

The relevant provisions are given as under:-

Cost of Acquisition	
Date of Acquisition of Assets	
Prior to April, 1, 1981	April, 1, 1981 onwards
Fair market value of asset as on 01/04/1981 –Optional	Actual cost paid for acquisition of asset

A. (1) Where the asset becomes the property of the assessee by a mode referred to in S 49(1) before 1.4.81:

- i. Cost of acquisition is the actual cost to the previous owner or the fair market value as on **1.4.81** at the option of the assessee.
- ii. Actual cost to the previous owner cannot be ascertained fair market value on the date on which the asset became the property of the assessee will be taken
- iii. Where there are successive transfers under this mode, the reference to the previous owner will mean last of such

previous owners who has acquired the assets by a mode otherwise than any of the modes u/s 49(1).

- iv. In these case the period for which asset was held by the previous owner is also taken into consideration to determine the period for which the asset was held

A. (2) Where the asset becomes the property of the assessee by a mode referred to in S 49(1) on or after 1.4.1981:

- i. Cost of acquisition is the actual cost to the previous owner.
- ii. Actual cost to the previous owner cannot be ascertained fair market value on the date on which the asset became the property of the assessee will be taken.
- iii. Where there are successive transfers under this mode, the reference to the previous owner will mean last of such previous owners who has acquired the assets by a mode otherwise than any of the modes u/s 49(1).

B. (1) where the asset becomes the property of the assessee by a mode other than referred to in S 49(1) before 1.4.1981:

Cost of acquisition is the actual cost to the assessee or the fair market value as on 1.4.81 at the option of the assessee.

B. (2) Where the asset becomes the property of the assessee by a mode other than referred to in S 49(1) on 1.4.1981 or thereafter:

Cost of acquisition is the amount actually spent by the assessee in acquiring the actual asset i.e. the actual cost of acquisition.

C. Where the asset becomes the property of the assessee subject to tax u/s 56 :

If any asset being cash, movable property, or shares of closely held companies with, or without consideration or immovable property without consideration has been subjected to in the manner prescribed in u/s 56, the cost of acquisition would be the cost taken u/s 56 for income tax purposes. The section is discussed in detail in the next chapter. The provision is apparently enacted to avoid double taxation of the same property.

D. Specific Cases:

i. Earnest money forfeited – S. 51;

Any earnest money received in advance and forfeited by the assessee, due to failure in negotiation is reduced from the actual cost of acquisition or the fair market value as on 1.4.1981 as the case may be and cost of acquisition will be adjusted accordingly. Now , earnest money forfeited will be taxable as "income from other sources" . Hence , the provision of sec 51

will be applicable only if the earnest money was forfeited prior to that date.

Illustration-11

A acquired a building on May 12, 2000 for Rs. 28 lakhs. In 2004, He entered into negotiation with a prospective buyer, who gave him advance money of Rs. 5 lakhs at that time. However, the negotiations failed and A forfeited the advance money. Subsequently, he actually sold the building in August 2015 for Rs 65 Lakhs. Calculate the indexed cost of acquisition and the taxable capital gains on the sale of the building.

Solution:

Particulars	Rs	Rs
Sales Consideration		65,00,000
Actual Cost	28,00,000	
Less: Earnest money forfeited-sec 51	5,00,000	
	<u>23,00,000</u>	
Indexed Cost of Acquisition $23,00,000 \times 1081 / 406$		61.23.892
Long Term Capital Gain		3,76,108

1081 and 406 are the Index for financial years 2016-17 & 2000-01
If the earnest money is forfeited from A.Y. 2015-16, then the amount of Rs 5,00,000 will be taxable as the income from other sources in the year in which it was forfeited. In that case, cost of acquisition will not be adjusted

ii. Self-generated assets

The courts have taken the view that self-generating assets such as goodwill, patents, copyrights, tenancy rights, which have no actual cost of acquisition incurred were not liable to capital gain tax as the cost of acquisition was Nil.

Now the amended law expressly provides that “ in relation to the goodwill of a business, trade mark or brand name associated with a business, tenancy rights, loom hours, route permits, right to manufacture or produce any process any article, cost of acquisition shall be taken as the purchase price if such price is paid, or NIL, if such price is not paid.”

Effectively, entire sale proceeds less expenses on transfer of self-generated assets will be treated as capital gain. An assets for a price from some other person, it will not be a self-generated assets and the other normal provisions of the Income Tax Act apply *mutatis mutadis**. (* with necessary modification)

iii. Financial assets – shares and other securities

Where an assessee becomes entitled to subscribe any additional securities, known as ‘Rights’ or where additional shares are issued as bonus i.e. without any payment, the cost of acquisition shall be as follows:

- Amount actually paid for acquiring such asset by way of subscription to the securities or

- b. Amount actually paid for acquiring such asset by way of exercising his right or entitlement.
- c. NIL; where rights are renounced for a price, then consideration for renouncement of rights will be the amount of capital gains as reduced by transfer cost, if any.
- d. Amount paid to the renouncer of rights entitlement and amount paid to the company, which has allotted the rights shares
- e. NIL in case of bonus shares- in other words, sales proceeds of bonus share will be liable to capital gain as reduced by transfer costs, if any. However if the bonus shares have been acquired prior to 1/4/1981, then the share market value of bonus shares as on 1/4/1981 will be treated as the cost of acquisition.
- f. Fair Market Value on the date of distribution of capital assets by a Company u/s 46 (2).
- g. Cost of acquisition of the original asset Consolidation, division, conversion, reconversion of share into stock or vice versa and where such cost cannot be reasonably ascertained, the fair market value.
- h. Cost of acquisition of the original shares held by the shareholders in the demerged company as reduced by the amount arrived at u/s 49 (2C).
- i. Cost of acquisition of original membership of a recognised stock exchange when equity share/s allotted to shareholders of recognized stock exchange under a scheme of demutualisation or corporatisation of the exchange – Sec. 55(2)(ab)
- j. NIL in respect of trading or clearing rights of stock exchange.
- k. *Pro rata* amount i.e. the amount which bears to the Cost of Acquisition of the shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger will be the cost of acquisition of Shares in the resulting company– Sec. 49 (2C).
- l. Stock option Specified security taxed as perquisites u/s 17 (2) – Sec. 49 (2AA)
- m. Actual cost of acquisition in all the other cases.

12 FAIR MARKET VALUE

Fair market value, in relation to a capital asset, means the price that the capital asset would ordinarily fetch on sale in the open market on the relevant date. If the assessee has acquired the asset prior to 1/4/81, he has the option of substituting the fair share market value of the asset as on 1/4/81 instead of actual cost of acquisition. However, this option is

available to the assessee only when the asset has been acquired prior to 1/4/81. Fair market value is adopted in many cases like where ascertainment of actual cost is not possible; assets distributed on liquidation have already been dealt with at their appropriate places. Some other cases are considered below:

a) Conversion of capital asset into stock-in-trade

When the assessee converts a capital asset held by him into stock-in-trade of his business, it will be treated as taxable transfer giving rise to notional capital gains or loss. For this purpose, the fair market value of the capital asset on the date of conversion is treated as notional sale proceeds from which the cost of acquisition / indexed cost of acquisition is deducted in order to get the capital gain. Later, when this converted capital asset is sold there will be business profit or loss i.e. actual sale proceeds less notional fair market value taken, as cost will be the taxable business profit or loss. However business income as well as capital gains will be chargeable to tax only in the year of actual sale to a third party.

Illustration-12:

A jeweller converts his ancestral gold ornaments into the stock in-trade of his business on 1/1/2002. The ornaments are actually sold on 31/12/2015 for Rs. 22 Lakh. The market value of the ornaments was Rs. 5 Lakhs on 1/4/81 and Rs. 30 Lakhs on 1/1/2002.

Solution:

Capital gain arises on the date of conversion of a private asset into stock in trade

Cost of acquisition as on 01/04/81 = Rs. 5 lakh .

Indexation in F.Y. 2001-02 – Index 426

LTCG = Rs 30 lakh – (Rs *5 lakh X 426/100)

= Rs 22 lakh -21.30 lakh = Rs 070 lakh

Position 31/12/2005 (A.Y. 2016-17)- Date of Sales

Profit = Sales consideration – FMV on 31/2/2005

= Rs 22 lakh – Rs 5 lakh = Rs. 17 lakh

Amount taxable in A.Y, 2016-17

LTCG – Rs 0.70 lakh

Profits & gains of business & profession = Rs 17 lakh

b) Introduction of capital asset by a partner:

When a partner transfers his personal asset by way of his capital contribution in a partnership firm, the amount credited to his capital account in respect of this capital asset will be treated as sales proceeds in the hands of the partner from which the cost or indexed cost of acquisition will be reduced to get the amount of capital gains or loss taxable in the hands of the partner..

c) Takeover of assets by the partner on dissolution of the partnership firm

When a partner is allocated a capital asset upon the dissolution of a firm the fair market value of the capital asset on the date of dissolution of the firm will be treated as sales proceeds from which the cost of acquisition or indexed cost of acquisition, as the case may be, will be reduced to get the amount of taxable capital gains in the hands of the firm.

d) Compulsory acquisition of capital asset

Where there is compulsory acquisition of capital asset by the government or any government authority under law, there will be a taxable capital gain or loss in the year of such compulsory acquisition. However, such capital gain will be chargeable only in the year in which the compensation is received. If the compensation is enhanced later, then the receiver of such additional amount is chargeable to capital gains in the previous year in which such additional compensation is received. If the compensation amount is subsequently reduced, the capital gain already charged will be recalculated as if it were a mistake apparent from the record u/s 155.

d) Amount received by shareholder on liquidation of the company:

Out of the money received by the shareholder, a part of the amount will be treated as deemed dividend under section 2(22) and the remaining amount less the indexed cost of acquisition or cost of acquisition, as the case may be, is taxable as capital gains on sale of the shares.

f) Capital Gains on Sale of Shares under Depository System

Where an assessee has any depository account and any shares are sold from the depository account, then such cost of acquisition of the shares sold will be determined on FIFO i.e. on first in first out basis. It will be assumed that the assessee is shares deposited in the account first were sold first and accordingly the cost of acquisition, date of acquisition and the period of holding will be calculated.

g) Stock Lending

Any share given under the stock-lending scheme approved by SEBI in this behalf will not give rise to any taxable capital gain.

h) Corporatisation of Stock Exchanges

In case any person transfers equity shares allotted to him as member of a recognised stock exchange in India under a SEBI approved scheme of corporatization of stock exchanges, his original cost of acquisition of membership of the stock exchange will be the cost of acquisition for computation of capital gains on those shares.

i) Demerger:

Cost of acquisition of shares in the resulting company in case of a demerger shall be determined as follows:-

$$\frac{\text{Cost of shares of demerged company} \times \text{Net book value of assets}}{\text{Net worth of demerged company before demerger}}$$

The cost of acquisition of the original shares in the demerged company shall be reduced by the amount calculated as above

j) Taxation of capital gains of listed shares

Share are treated separately by the provisions of sec. 111A/112, whereby an assessee is given the option to either pay a lump-sum tax of 18%+3% cess and forego the benefit of indexation or alternatively pay regular tax under the normal provisions including indexation .

13. TRANSACTIONS COVERED U/S 49(1):

U/s 49 in cases where capital asset became the property of the assessee in certain circumstances ,

- the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it,
- as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be.

These circumstances are as under :_-

- (i) any distribution of assets on the total or partial partition of a Hindu undivided family;
- (ii) under a gift or will;
- (iii) by succession, inheritance or devolution,
- (iv) distribution of assets on the dissolution of a firm, body of individuals, or other association of persons, where such dissolution had taken place at any time before 01/04/1987, or
- (v) distribution of assets on the liquidation of a company, or
- (vi) under a transfer to a revocable or an irrevocable trust, or
- (vii) under any such transfer as is referred to in clause (iv) or clause (v) or clause (vi) or clause (via) 33[or clause (viaa) or clause (viab) or clause (vib) or clause (vica) or clause (vicb) or clause (vicc)] or clause (xiii) or clause (xiiib) or clause (xiv) of section 47;
- (viii) such assessee being a Hindu undivided family, by the mode referred to in sub-section (2) of section 64 at any time after the 31st day of December, 1969,

- (ix) under a gift or will not being gift or transfer through an irrevocable trust of shares, debentures or warrants allotted by a company directly or indirectly to its employees under a Central Government approved employees stock option (ESOP or scheme (ESOS). In such cases, the market value of the shares, debentures or warrants gifted or transferred to the irrevocable trust on the date of transfer will be treated as the sale proceeds for the purpose of capital gains.
- (x) by succession, inheritance or devolution.
- (xi) distribution of assets on liquidation of company.
- (xii) under a revocable or irrevocable trust.
- (xiii) on transfer by a wholly owned Indian subsidiary company from its holding company and by a parent company to its 100 per cent Indian subsidiary company.
- (xiv) on any transfer in scheme of amalgamation by the amalgamated company from the amalgamating company.
- (xv) by Hindu undivided family where one of the members has converted its self acquired property into a joint family property.

Illustration-13:

ABC HUF allotted a flat purchased by it on 30 June 1998 for Rs 5 Lakhs to A as his share in HUF property on partition. A sells the flat for Rs. 30 lakhs on 1 April 2015. What will A's liability for tax?

Solution:

a) There will be no liability for capital gain on 30/06/1998 as *partition of HUF is exempted u/s 49.*

b) On 01-04-2015 relevant to A.Y. 2016-17, *cost and date of acquisition are same as previous Owner (HUF) viz Rs 5 lakhs and 30/6/1998.* The capital gain will be as under:

Sales consideration	40,00,000
Indexed cost of Acquisition 5,00,000 X 1081/161	<u>33,57,142</u>
LTCG	<u><u>6,16,858</u></u>

14. COST OF IMPROVEMENT:-S. 55(1)(B)

Cost of Improvement in relation to capital asset means any expenditure or cost of capital nature incurred by (a) *the assessee* or (b) *the previous owner* in case of an asset acquired by an assessee in any of the circumstances mentioned in S 49(1):-

- for substantially improving or raising the value of the capital asset or
- in making addition or alteration to capital asset after date of acquisition or
- for any expenditure incurred to protect or complete the title of the capital asset or
- to cure the title of the property or remove any defect from the title.

In other words, cost of improvement includes all those expenditures, which are incurred to increase the value of the capital asset

Following additional points are noteworthy in this regard

- a.) In case of a capital asset acquired prior to 1/4/81, where the fair market value of the capital asset as of 1/4/81 is substituted in place of cost of acquisition, all capital expenditure incurred by the assessee or the previous owner *after 1/4/81* in making any additions or alterations to capital asset will be included in cost of improvement but **Cost of improvement incurred prior to 1/4/81 will be ignored** in all cases.

The reason behind it is that for carrying any improvement in asset before 1st April 1981, asset should have been purchased before 1st April 1981. If asset is purchased before 1st April the fair market value is adopted and the fair market value of asset on 1st April 1981 will certainly include the improvement made in the asset.

- b.) In any other case all the capital expenditure incurred in making in additions or alterations to the capital asset by the assessee after it become his property.
- c.) There will be no cost of improvement to goodwill, right to manufacture or produce or process any articles or right to carry on any business.
- d.) expenditure deductible from the income from house property will not be included in cost of improvement.

15. INDEXED COST

Sec 48(iii), vide Expln iii defines Indexed Cost of Acquisition and Indexed cost of Improvement as under:-

"Indexed cost of acquisition" means:-

- an amount which bears to the cost of acquisition the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 1st day of April, 1981, whichever is later; and

"Indexed cost of any improvement" means:-

- an amount which bears to the cost of improvement the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset took place; and

"Cost Inflation Index" (CII) for any year means:-

- Such Index as the Central Government may, having regard to seventy-five per cent of average rise in the Consumer Price Index for urban non-manual employees for that year, by notification in the Official Gazette, specify in this behalf

Indexed cost of acquisition/ improvement can be shown by the following formulae:

Indexed cost of acquisition

Cost of Acquisition X CII (the year of Transfer)
CII in the year of acquisition or 01-04-1981 , whichever is later

Indexed Cost of Improvement

Cost of Improvement X CII (the year of Transfer)
CII in the year of Improvement

Exceptions:

Indexation benefit is not available in respect of the following:

1. Short term capital assets
2. Bonds / debentures other than Capital Indexed Bonds Issued by Government;
3. Shares/Debentures of Indian Company Purchased in Convertible Forex by non-residents
4. Depreciable assets
5. Units Purchased in Foreign Currency u/s 115AB by Offshore Fund
6. GDRs purchased in Foreign Currency u/s 115AC Non-Residents
7. Securities u/s 115AD purchased by non-residents
8. Where option of 15% tax rate is claimed/s 112 in respect of capital gain on shares
9. Slump Sale u/s 50B
10. Foreign exchange assets u/s 115-O by Non- Resident Indians.

Cost inflation Index (CII) Notified

Financial Year	Index	Financial Year	Index	Financial Year	Index
1981-82	100	1993-94	244	2005-06	497
1982-83	109	1994-95	259	2006-07	519
1983-84	116	1995-96	281	2007-08	551
1984-85	125	1996-97	305	2008-09	582
1985-86	133	1997-98	331	2009-10	632
1986-87	140	1998-99	351	2010-11	711
1987-88	150	1999-00	389	2011-12	785
1988-89	161	2000-01	406	2012-13	852
1989-90	172	2001-02	426	2013-14	939
1990-91	182	2002-03	447	2014-15	1024
1991-92	199	2003-04	463	2015-16	1081
1992-93	223	2004-05	480		

16. TRANSACTIONS NOT ‘TRANSFER’ – SEC 46, 47

A. Section 47 provides that following transactions will not be regarded as transfer for the purpose of section 45 :

- 1) any distribution of capital assets on the total or partial partition of a HUF ;
- 2) any transfer of a capital asset under a gift or will or an irrevocable trust not being issue of securities allotted under ESOP or ESOS by a company to its employees ;
- 3) any transfer of a capital asset not being an asset transferred as stock in trade by a:-
 - (a) by a holding company to its 100% Indian subsidiary company or
 - (b) 100% subsidiary company to its Indian holding company,
- 4) any transfer, in a scheme of amalgamation,
 - (a) of any capital asset by the amalgamating company to an Indian amalgamated company or ;
 - (b) of any shares held in an Indian company by the amalgamating foreign company to the amalgamated foreign company if at least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company, and such transfer does not attract tax on capital gains in the

country, in which the amalgamating company is incorporated;

- (c) of any capital asset by a banking company to a banking institution if such scheme is u/s 45(7) of the Banking Regulation Act, 1949;
 - (d) of any shares held by a shareholder in the amalgamating company, made in consideration of the allotment to him of any share or shares in an Indian amalgamated company ;
- 5) any transfer, in a scheme of demerger,
- (a) of a capital asset by the demerged company to the resulting Indian company;
 - (b) of shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if the shareholders holding not less than 3/4th in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company and such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.
 - (c) any transfer or issue of shares by the resulting company, to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking;
- 6) any transfer in a business reorganisation,
- (a) of a capital asset by the predecessor co-operative bank to the successor co-operative bank;
 - (b) of shares in the predecessor co-operative bank by a shareholder, made in consideration of the allotment to him of any share or shares in the successor co-operative bank.
- 7) any transfer of bonds or Global Depository Receipts U/s 115AC (1), made outside India by a non-resident to another non-resident;
- 8) any transfer of agricultural land in India effected before 01/03/1970 ;
- 9) any transfer of any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print, to the Government or a notified University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution ;

- 10) any transfer by way of conversion of bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company;
- 11) any transfer by way of conversion of bonds referred to section 115AC (1)(a) into shares or debentures of any company;
- 12) any transfer membership of a recognised stock exchange to a company made on or before 31/12/1998 by a person (not being a company) in exchange of shares allotted by that company to the transferor;
- 13) any transfer of land of a sick industrial company managed by its workers' co-operative during the period of loss till the period upto which the company's losses are equal to or more than its capital), under rehabilitation scheme U/s 18 of the Sick Industrial Companies (Special Provisions) Act, 1985;
- 14) any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualisation or corporatisation of a recognised stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company if:
 - (a) all the assets and liabilities of the firm or of the association of persons or body of individuals relating to the business immediately before the succession become the assets and liabilities of the company;
 - (b) all the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of the succession;
 - (c) the partners of the firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company; and
 - (d) the aggregate of the shareholding in the company of the partners of the firm is not less than fifty per cent of the total voting power in the company and their shareholding continues to be as such for a period of five years from the date of the succession;
 - (e) the demutualisation or corporatisation of recognised stock exchange in India is carried out under an approved scheme

- 15) any transfer of a membership right held by a member of a recognised stock exchange in India for acquisition of shares and trading or clearing rights acquired by such member in that recognised stock exchange under an approved scheme for demutualisation or corporatisation ;
- 16) any transfer of a capital asset or intangible asset by a private company or unlisted public company to a limited liability partnership or any transfer of a share or shares held in the company by a shareholder as a result of conversion of the company into a limited liability partnership if –
 - (a) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership;
 - (b) all the shareholders of the company immediately before the conversion become the partners of the limited liability partnership and their capital contribution and profit sharing ratio in the limited liability partnership are in the same proportion as their shareholding in the company on the date of conversion;
 - (c) the shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership;
 - (d) the aggregate of the profit sharing ratio of the shareholders of the company in the limited liability partnership shall not be less than fifty per cent at any time during the period of five years from the date of conversion;
 - (e) the total sales, turnover or gross receipts in the business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty Lakh rupees; and
 - (f) no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.
- 17) Any transfer of any capital asset or an intangible asset upon conversion of proprietary concern into a company, if
 - (a) all the assets and liabilities of proprietary concern become the assets and liabilities of the company upon such conversion ;
 - (b) sole proprietor holds 50% or more of the total voting power for a period of five years from the date of the succession; and

(c) the consideration is paid by way of allotment of shares in the company and not in any other form;

18) any transfer in a scheme for lending of any securities under an agreement or arrangement, between the lender and the borrower .

19) any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government.

B. Similarly U/s 46(1) , any distribution of assets of a company under liquidation by the liquidator to the shareholder is not regarded as transfer because such distribution is deemed as dividend u/s 2(22);

17. ILLUSTRATIONS

Illustration 11

State whether the following are the capital Asset or not:

1. Bicycle
2. Horse
3. Car
4. House for self residence
5. Jewellery
6. House let on hire
7. Silver utensils
8. Air Conditioner used as stock in trade
9. Air Conditioner not used as stock in trade
10. Rural Agricultural Land
11. Urban Agricultural Land

Solution:

Items 1, 2, 3, 7 & 9 **Bicycle , horse , personal air conditioner and silver utensils** (if used for personal use) are personal effects, hence not capital assets .

Item 8 **Air Conditioner** used as stock in trade and Item 10 **Rural agricultural land** are excluded from the definition of capital asset.

All the remaining items are capital assets including , Item 4 House for self residence, item 5 Jewellery , item 6 House let out on hire , item 7 Silver utensils and item 11 Urban agricultural land as they are not excluded from the definition of capital asset .

Illustration-12

State whether the following transactions are transfer :

1. A house transferred by way of will to son.
2. Bonus shares given by a company to its shareholders.
3. Giving away jewellery for a piece of land.

4. Getting money in lieu of shop in a shopping complex.
5. Giving the rights to use the asset.

Solution

- 1) Transfer by will is not transfer
- 2) Issue of Bonus share is not transfer
- 3) Exchange of jewellery with land is transfer of both assets.
- 4) Money being consideration of shop, It is transfer.
- 5) Not transfer as asset only hired

Illustration -13:

An asset was acquired on 31 May 1994 for Rs 10,000, it is substantially improved on 30 June 1996 for Rs 5,000 and it is sold on 10 December 5for Rs 75,000.

Solution:

Particulars		Rs
Sales consideration		75,000
Indexed cost of acquisition (10,000* 939/259)	36,255	
Indexed cost of improvement 5,000 X 1081/305).	17,721	53,976
Long Term Capital Gain		21,024

Illustration-14.

Assume that the asset was acquired before 1/4/81 & and improvement were carried before 1/4/81 there is no change in fair market value on 1/4/81

Sales consideration		75,000
Indexed cost of acquisition (10,000 X 939/100) on 1/4/81*	93,900	
Cost of improvement Ignored (Pre-01/04/1981 *Optional	0	93,900
Long Term Capital Loss		18,900

Illustration-15:

A sells a residential house property in Mumbai for Rs. 30,00,000 on May 15, 2015. The house was purchased by him on June 11, 1982 for Rs 2,00,000. Compute the capital gain

Solution:

Sales Consideration.	Rs. 30,00,000
Less- Indexed cost of acquisition 9,00,000X 1081 /109	19,83,486
Long Term Capital Gain	10,16,514

Illustration-16:

A sells a flat on 13 March 2016 for Rs 7,00,000. He had acquired the flat on 15 August 1993 for Rs 1,00,000 and had incurred capital cost of major repairs of Rs 50,000 in 1994-95.

Solution

Sales Consideration		Rs.
		7,00,000
Indexed cost of acquisition (1,00,000*1081 /244)	4,42,033	
Indexed cost of improvement (50,000* 1081/ 259)	2,08,687	6,50,720
Long Term Capital Gain		49,280

Illustration-17:

X purchased a house property for Rs. 1,00,000 01/07/2000 and constructed the first floor in March 2003 for 1,10,000. The house property was sold for Rs 7,10,000 31/03/2016. The expenses incurred on transfer of asset were Rs. 10,000. Compute the capital gains from the transaction and show the difference, if any, if the house was constructed in March, 2014

Solution:

Sales consideration		7,10,000
Less: Expenses For Transfer		10,000
Net Sales Consideration		7,00,000
Indexed cost of acquisition 1 lakh * 1081/406	2,66,256	
Indexed cost of improvement 1,10,000 x 1081/447	2,66,017	5,32,273
Long Term Capital Gain		1,67,727

Notes: 1. Date of purchase will be the date of acquisition. Construction of additional floor is improvement to the property.

2. If the house was constructed in March, 2014, it is held for 24 months, which is less than 36 months. It will be short term capital asset not entitled to indexation. Resultant capital gain of Rs 4,90,000 will be Short Term Capital gain [Rs. 700000- (1,00,000+ 1,10,000)- 4,90,000]

Illustration 18.

On 1/7/2011 X sold gold jewellery for Rs.1,10,000. It was purchased on 1/7/1970 for Rs 9000. Market Value of the jewellery as on 1st April 1981 was Rs. 10,000 compute taxable amount of capital gain, if the expense on transfer is .5%.on sales price.

Solution:

Sales Consideration		Rs. 1,10,000
Less: Indexed Cost of Acquisition cost as on 01/04/81 -10,000x 1081/100	1,08,100	
Expenditure on transfer (0.5% x 80,000)	400	1,08,500
Long Term Capital Gains		1,500

Illustration-19:

X invested Rs. 1,00,000 in ornaments and Rs. 50,000 in equity shares on 1st March 2013. He sold the jewellery for Rs. 1,20,000 and shares for Rs. 1,00,000 on 1st August 2015. There was a ½% brokerage on both the investments, both at the time of purchase and sale. Calculate the taxable amount of capital gain.

Solution:**A- Capital Gain on sale of Jewellery**

Particulars	Rs.	Rs.
Sales Consideration of Jewellery		1,20,000
Less: Cost of Acquisition	,00,000	
Brokerages on purchases (0.5% x100,000)	500	
Brokerages on Sales (0.5% x120,000)	600	1,01,100
Short Term Capital Gain Jewellery held for 30 months (1/3/2013 to 1/8/2016) less than 36 months, hence STCG, no indexation.		<u>18,900</u>

B- Capital Gain on sale of Shares

Particulars	Rs.	Rs.
Sales Consideration on Sale of Shares		1,00,000
Less: Indexed Cost of Acquisition	50,000	
Brokerages on purchases (0.5% x50,000)	250	
50,250* 1081/582	50,250	
	81,073	
Brokerages on Sales (0.5% x 1,00,000)	500	93,334
Long Term Capital Gain		<u>06,666</u>

18. SELF ASSESSMENT QUESTIONS:

- Write short note on:
 - Short Term Capital Gain
 - Cost of Acquisition
 - Cost of improvement
 - Expenditure on transfer
 - Transfer
- Explain the term 'capital asset'.

3. Explain capital gains on compulsory acquisition of a capital asset.
4. What is "transfer" in relation to a capital asset?
5. State the situations under which the written down value of a "block of assets" will be reduced to nil.
6. Give any five items are not considered as 'capital asset'.
7. Explain the provisions of the Income Tax Act, 1961 regarding:
 - i. Conversion of capital assets to stock-in-trade.
 - ii. Computation of capital gains in case of depreciable assets.
8. State whether the following are the capital Asset or not:
 - a. Bicycle
 - b. Horse
 - c. Car
 - d. House for self residence
 - e. Jewellery
 - f. House let on hire
 - g. Silver utensils
 - h. Air Conditioner used as stock in trade
 - i. Air Conditioner not used in own house
 - j. Rural Agricultural Land
 - k. Urban Agricultural Land

{Ans: item g is not capital asset}
9. Whether the following transactions are transfer in relation to capital asset.
 - a. A house transferred by way of will to son.
 - b. Bonus shares given by a company to its shareholders.
 - c. Giving away jewellery for a piece of land.
 - d. Getting money in lieu of shop in a shopping complex.
 - e. Giving the rights to use the asset.

[Ans: only c and d are transfers]

10. M sold his house in Mumbai on 15/04/2015 for Rs 6.5 Lakh. He had purchased it at a cost of Rs. 50,000 on 03 / 07 / 1983. The purchaser paid Rs. 4 lakhs 01/05/2015 and the balance on 30/06/2015 M paid brokerage of Rs. 13,000 for the sale transaction. Compute the total taxable capital gain.
(Ans: LTCG 1,71,052 i.e. $6,50,000 - 13,000 - 4,65,948 = \{50,000 \times 1081/116\}$)

11. S purchased shares in unlisted Indian companies on 10/06/1982 for Rs. 2,00,000. On 1/06/2000 he started a business as a dealer in shares and transferred the entire holdings to the business. The market value of the shares as on that date was Rs. 8,00,000. He sold the shares Rs. 9,20,000 on 30/10/2015. Compute taxable capital gains .
(Ans: LTCG Rs. 8,00,000 - Rs. 2,00,000 $\times 406/109$ Rs. = Rs. 55,046 for AY 2001-2002 & Business Profits Rs. 1,20,000 taxable in AY 2016-17)

12. Aditya sold his only house property occupied by him as residential house for Rs 18 lakh on 31/12/2015. The house property was purchased by him on 28/02/1985 for a consideration of Rs 2 lakhs. Determine the capital gains.

(Ans: LTCG Rs 70,400 = [18,00,000-17,29,600(Rs. 2,00,000X) 1081/125

13. Siddharth converts his plot of land purchased in July 1996 for Rs 60,000 into stock-in-trade on 31st March 2004. The fair market value on 31.3.2004 is Rs 1,60,000. The stock-in-trade was sold for Rs 2,00,000 in the month of January 2014. Find out the taxable income, if any, and if so under which "head" of income and for which "assessment year".

(Ans: LTCG 1,60,000-60,000 X 463/305 = Rs. 68,918 in AY 2004-2005.& Business Income Rs. 40,000 taxable in AY 2016-17)

14. X acquired a plot of land on 30.6.1992 for Rs. 2,20,000. Brokerage and other incidental expenses on acquisition of plot were Rs. 30,000. X sold the plot of land on 30.6.2015 for Rs. 12,50,000. What will be the amount of capital gain? Can he claim deduction for ground rent paid by him amounting to Rs. 5,000 during the period when he held the asset?

(Ans: LTCG 12,50,000-2,50,000X 108138,117= Rs. 1,47,309 , No)

15. Purchases 250 equity shares of ABC Ltd on 01/04/1988 @ Rs. 270 per share and incurs Rs. 500 on brokerage and transfer. On 01/07/1992, he gets 200 bonus shares. On 01/09/1994 he gets 300 right shares @ Rs 140 per share. On 28/02/ 2016 he sells all the 750 shares@ Rs 1000 per share and incurs expenditure of Rs. 1,500 on brokerage. Compute his taxable capital gain.

(Ans: Sales [750X 1000]- 1500 – Purchase [(250X270+500) X 1081/161]+0 Bonus+ Right [300X140]X 1081/259 =LTCLG Rs. 1,16,632) { 298,500-5,48,867=[4,56,571+0+1,75,297]

16. Mrs. Padmini owned 2 motor cars mainly for business purposes. The written down value on 1/4/2013 of the block of assets comprising of only these 2 cars, both of which were purchased on 01/05/1999 was Rs. 1,81,000. These 2 cars were sold on 30/06/ 2014 for Rs. 1,50,000. She had purchased the same during March 1999 for Rs. 2,44,000.

Compute the amount of capital gain chargeable/ Depreciation. (Ans: STCL - 31,000 No depreciation on empty block).

17. P holds 500 shares of ABC Ltd which were allotted to him on 22/4/1996 at Rs. 30 per share. On 24/7/2009. ABC Ltd made right issue to the existing shareholders at the rate of one share for every five shares held at Rs. 20 per share. P renounced the right entitlement in favour of Q at Rs. 13 per right share entitlement on 4/8/ 2009. Determine the nature and amount of capital gain, if any, taxable in the hands of P. What will be the cost of acquisition of shares purchased by Q? (Ans: STCG 1300 , Cost of Acquisition for Q Rs. 1,300)

18. Kishore Industries owned six machines for use in its business. The written down value of these machines at the end of the previous year relevant to the assessment year 2016-17 was Rs. 6,50,000. Rate of depreciation is 25% per annum. A new plant was bought for Rs. 6,50,000 on 30/11/2015. Three of the old machines were sold on 10/6/2015 for Rs. 9,00,000. Compute :

- the claim to depreciation for AY 2016-17
- Capital gains liable to tax for the same assessment year.
- If Kishore Industries had sold the three machines in June 2015 for Rs. 14,00,000 will there be any difference in your above working? Explain.

(Ans: a)-100000 25% on Rs. 4,00,000 [Rs. 6,50,000+ Rs. 6,50,00-Rs. 9,00,000] b)STCG Nil c) Depreciation- Nil. STCG Rs. 1,00,000)

19. Arjun purchased Jewellery on 10/3/1995 for Rs. 1,05,000 and sold it on 2/11/2015 for of Rs. 4,98,000. He incurred expenses of Rs. 4,000 at the time of the purchase and Rs. 2,000 at the time of sale for brokerage. Compute capital gains chargeable to tax.

(Ans: LTCG RS 42,062= {498000-2000 -[4,54,938 i.e. [1,05,000+4000 X 1081/259

20. Sunder sold a residential house for Rs 85 lakhs on 31/03/2015. He had inherited the house from his father in 1990, the fair market value of which as on 1.4.1981 was Rs. 5 lakhs. During the year 1992-1993, he carried out further construction and improvements, at a cost of Rs. 6 lakhs. Expenditure in connection with transfer Rs. 50,000 Compute the taxable capital gains.

(Ans: LTCG Rs 1,35,980 Rs. 85Lakhs -50,00 83,14,020 [Rs. 5 lakhs X 1081/100+Rs. 6 Lakh X1081/223]



INCOME FROM OTHER SOURCES

(Sections 56 -59)

Synopsis:

1. Introduction & Objectives
2. Basis of Charge
3. Incomes specifically chargeable u/s 56
4. Other incomes chargeable u/s 56
5. Some specific incomes – gifts, dividend
6. Deductions
7. Amounts not deductible
8. Miscellaneous- Balancing charge, Method of accounting
9. Self Assessment Questions

1. INTRODUCTION AND OBJECTIVES

Section 56 to 59 deal with “income from other sources. Of all the heads of income given in Section 13 , “income from other sources is the last and residuary head of income. All the incomes, if not covered under any other head of income , will be chargeable to tax under this head . The lesson explains the scope of “Income from other sources”, its computation and the deductions allowable therefrom.

2. BASIS OF CHARGE- S 56(1)

Section S 56[1] provides that any income which is not chargeable to tax under any other heads of income and which is not to be excluded from the total income shall be chargeable to tax as residuary income under the head “Income from Other Sources”.

Under Section 56(2) some well-defined incomes such as interest, dividend, winnings from lotteries and gifts, etc. are chargeable as “Income from other sources”

Briefly speaking, any income which is taxable but cannot be classified under any other heads of income viz salary, Income from house property, capital gains or profits and gains of business and profession shall be charged under the head "Income from Other Sources"

3. INCOMES SPECIFICALLY CHARGEABLE -S. 56(2)

Under section 56(2), the following incomes are specifically chargeable to tax under the head "Income from Other Sources":-

- i. Dividends
- ii. Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.
- iii. Any sum received by the assessee from his employee as contribution towards provident fund , superannuation fund or Employee State Insurance fund or any other employees' welfare fund , if not chargeable under the head 'profits and gains of business or profession'.
- iv. Interest on securities, if not chargeable under the head 'profits and gains of business or profession'.
- v. Rental income from machinery, plant or furniture belonging to the assessee and let on hire if not chargeable under the head 'profits and gains of business or profession.'.
- vi. Composite rental income from letting machinery, plant or furniture with buildings and letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, if not chargeable under the head 'profits and gains of business or profession'.
- vii. Any sum including bonus received under Keyman Insurance Policy shall be treated as income chargeable to tax under this head if not taxable as salary or 'profits and gains of business or profession'.
- viii. Any sums of money exceeding Rs. 50,000 in aggregate received without consideration by an individual or HUF.
- ix. Fair market value of movable property received without consideration by an individual or HUF if it exceeds Rs 50,000 in aggregate.
- x. The difference between the aggregate fair market value and the consideration received by an individual or HUF in respect of a movable property or immovable property, if such difference exceeds Rs 50,000.

- xi. The stamp duty value of any immovable property (whether assessed or assessable) if it exceeds by Rs 50,000 than the consideration for such immovable property received by an individual or HUF .
- xii. Shares of closely held companies having aggregate fair market value exceeding Rs. 50,000 received by a firm or a closely held company without consideration or for a consideration which is less than the aggregate fair market value of the property by an amount exceeding Rs 50,000 ,
- xiii. Interest received on compensation or on enhanced compensation referred to in section 145A (b).
- xiv. Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset if such sum is forfeited and the negotiations do not result in transfer of such capital asset.

4. OTHER INCOMES CHARGEABLE

In addition to the residuary income chargeable to tax but not covered under other heads of income, the head “ income from other sources” also covers some well-defined income given as under:-

- i. Dividend received from any entity other than a domestic company; This is because dividend received from a domestic company is exempt under section 10(34) in the hands of the receiver; However, dividend received from a cooperative bank or a foreign company will be chargeable under this head.
- ii. Pension received by the legal heirs of an employee; Pension received by the employee himself during his lifetime is charged under section 17(3) as the income from salaries;
- iii. Any winnings from lotteries, crosswords, puzzles, races including horse races, card games or other games of any sort or gambling or betting of any form or nature;
- iv. Income from letting out any plant, machinery or furniture on hire where it is not the business of the assessee to do so;
- v. Interest on securities if it is not chargeable as the profit and gains of business or profession .;
- vi. Employees' contribution to any staff welfare scheme received by the employer which is not paid within the prescribed time, However deduction will be allowed in respect of the amount of contribution paid , only the balance amount will be taxable;
- vii. Income from sub-letting;
- viii. Interest on bank deposits and loans and securities;

- ix. Royalty;
- x. Directors' fees;
- xi. Casual income;
- xii. Agricultural income when taxable e.g. land situated in a foreign country,
- xiii. Income from undisclosed sources;
- xiv. Rent of plot of land;
- xv. Mining rent and royalty;
- xvi. Casual income under a will, contract, trust deed;
- xvii. Salary payable to a member of parliament;
- xviii. Gratuity received by a director who is not an employee of a company; and
- xix. Any other receipt which is income but which does not fall under the other four heads of income viz. salary or business income or income from house property or capital gain.

5. SOME SPECIFIC INCOMES :

5.1. Dividend - Sec 56(2) (i)

Dividend is the amount of profits distributed by a company among its shareholders or members. Some important principles concerning the dividend are given as under: -

1. Taxable amount of dividend shall be chargeable as income from other sources.
2. It is not relevant whether dividend is :-
 - in cash or kind or
 - out of taxable profits or tax -free income,
 - out of revenue profits or capital gains.
3. Dividend is to three types :
 - a) Final dividend ;
 - b) Interim Final dividend; and
 - c) Deemed dividend
4. Final dividend is declared at the at the Annual General Meeting of a company (AGM) , where the final accounts for the financial year are laid before the members . Final dividend is chargeable to tax on the date of AGM, when it is declared. Date of actual payment of the dividend is not relevant. Final dividend , once declared becomes a debt due and can not be withdrawn . in case of non-payment it is earmarked in a separate account as per the Companies Act ,2013

5. The dividend declared by the Board of directors between two AGMs is called Interim dividend. Interim dividend will be taxable when it is made available or paid to the shareholder.
6. Deemed dividend is not dividend in real terms. Certain payments made to shareholders by the company or its liquidator are deemed to be dividend in the hands of the shareholder in different circumstances prescribed in Section 2(22) and are chargeable to under the head income from other sources when such sums are actually paid .
7. Dividend received from a domestic company shall be exempt from tax under Section 10(34) if it is chargeable to dividend distribution tax under Section 115-O.
8. However, as per section 115BBDA (as inserted by Finance Act, 2016), in the case of resident individual/HUF/firm, dividend shall be chargeable to tax at the rate of 10% if aggregate amount of dividend received during the year exceeds Rs. 10,00,000

5.2. Deemed dividend: -Loan to shareholders- S. 2(22) (e)

Under Section 2(22)(e) any sum paid as loan or advance :-

- to a shareholder
- for his individual benefit
- by a closely held company

will be deemed to be the dividend in the hands of such shareholder if he -

- holds substantial interest (10 per cent stake in share capital or voting power)in the company or
- to a concern(HUF/Firm etc) where the person having substantial interest has at least 20 per cent interest,

This provision was inserted to prevent persons having substantial control and influence over the affairs of a company to take away all funds of the company as low-interest loans for their personal benefit to the prejudice of the other shareholders.

Some other important points are relevant: -

1. Dividend income will be taxable in the hands of the recipient in the year in which such loan or advance was given- Sec 8 .
2. The section will apply only on cash loans or advances .
3. Advances made in kind e.g. of sale of goods on credit in the normal course of business will not be deemed to dividend.;
4. Dividend will be chargeable even if the loan or advance has been repaid. The courts have repeatedly held that there is no inequity in this;
5. A shareholder is entitled to set off the deemed dividend if and when company declares any dividend. In practice, since the dividend is tax-free in the hands of the shareholder, the set –off

provision does not grant any real benefit of set-off to the shareholder;

6. The loan will be taxable as dividend only to the extent of free reserves of the company;
7. Loans or advance made by the lending company for which lending is the main or substantial part of its business will also not be covered by this section;
8. Any advance or loan made to a shareholder or the concern by a company in the ordinary course of its business, for purchase of its own shares or on demerger etc will also be not be covered under this section;
9. The dividend will also be subject to TDS;
10. Substantial interest may be existing at any time during the year;
11. Any deemed dividends u/s 2(22) (e) or dividend from any other entity is, however taxable in the hands of the recipient; and.
12. Deduction of expenses on collection and interest on loan, taken for investment in shares, is available against dividend income.

Illustrations

Ascertain the amount of deemed dividend u/s 2(22) (e) in the following situations ., Assume that the companies are closely held and the shareholder has substantial interest therein .

1. A borrows Rs 20 as loan from A Ltd. and returns the loan next day, when he makes his own arrangement for finance. The Company was had free reserves of Rs 10 lakh.

Solution

Out of the loan amount of Rs 20 lakh , only Rs. 10 lakhs , to the extent of free reserve of A Ltd. will be treated as deemed dividend u/s 2(22)(e). Repayment of loan does not affect the tax liability. A is entitled to setoff dividend against dividend If and when declared . Since, the final dividend is tax free, A will have no real benefit.

2. A takes a loan of Rs 20 lakhs from B Ltd., having free reserves of Rs 20 lakhs.

Solution:

Entire loan amount of Rs 20 lakhs will be deemed dividend in the hands of B U/s 2(22) (e)

3. In the above case, assume B Ltd is a loss making company having no free reserves

Solution

Since B Ltd. has no free reserves, the loan taken will not be taxable in the hands of A as dividend.

4. A takes a temporary loan of Rs 20 lakhs from D Ltd., for one month only. Thereafter, he transfers the shares. The Company was having free reserves of Rs 20 lakhs.

Solution

Entire loan amount of Rs 20 lakhs will be deemed dividend in the hands of B U/s 2(22) (e) even if A holds substantial interest only for a part of the year.

5.3. Deemed dividend – Distribution by Companies: S. 2(22)

Any distribution by the a company to its shareholders which entails the assets of the company , or distribution made on liquidation or reduction of capital is regarded as dividend to the extent of accumulated profits of the company.

Similarly, any distribution by a company to its preference shareholder or debentureholders is also regarded as deemed dividend to the extent of accumulated profits of the company. Dividend in this class is directly taxable in the hands of the company.

5.4. Interest on securities

Interest received from debentures of company, mutual funds, and government securities is taxable as income from other sources except when such income is exempt U/s 10 or is taxed as business income. If any tax is deducted at source from interest on such securities, it should be added back and only the gross income should be considered. However, in case of tax-free govt. securities, grossing up is not required as there is no deduction or TDS. However, grossing up is required in case of taxable securities and non-government securities.

From the Interest income from this head, reasonable bank charges and other collection charges, office and other expenses if the same were incurred for earning the income and interest payable on loans taken for acquiring securities can be deducted.

Illustration -5

A received Rs 36,900 as interest net of TDS @ 10% on debentures of B Tea Ltd worth Rs 2,50,000 held by him. Calculate the interest income and the amount of TDS @ 10% that can be claimed.

Solution:

Dividend received net of 10% TDs:	Rs 36,900
Gross Dividend – 36000/90% :	Rs 41,000
TDS claim 10 % of Gross dividend	Rs 4,100

5.5. Winning from Lotteries, Crossword puzzles, etc

Winnings from, Lottery, crossword puzzles, card games or other games including any game show like KBC and horse races, betting, gambling etc are all treated as income from other sources and taxed at the maximum marginal rate u/s 115BB on the gross income without considering -:

- Claiming basic exemption limit
- Deductions under chapter VI-A.
- Expenditure including collection charges, etc or allowances;
- Benefit of set off and carry forward of losses.

Illustration 6

The winnings out of Sawaal Aapka were Rs 1,50,000. Calculate the net receipt.

Solution

Winning received subject to maximum marginal rate is 30%, + 3% education cess and the secondary and higher education cess 9 total 30.9%)payable at source .

Hence, gross winning – (Rs 1, 50,000 X 30.9%)	Rs 46,350
Net receipts of winnings-(Rs 1, 50,000 – Rs 46,350)	Rs1,03,650
Alternatively – Rs 1,50,000X 69.1% = Rs 1,03,650	

5.6. Family Pension

Family pension means a regular monthly payment made to the legal heirs of the employee after his death. This is treated as income from other source and not salary because there is no employer-employee relationship between the legal heirs and the employer.

Standard deduction equal to 1/3rd of the pension or Rs. 15,000 is available as deduction from this income. Significantly, pension amount received during the lifetime of employee is taxable as salaries u/s 17(3) and not entitled to standard deduction.

Illustration 7

Mrs. S receives Rs 75,000 as yearly pension after the death of her husband. She pays Rs 2,000 per month to Ali to collect it from the office of the employer. Calculate the net taxable pension of Mrs. S.

Solution

Pension amount	Rs 75,000
Less: Lower of the following :	Rs 15,000
• 1/3 rd of the pension i.e. =	
Rs 75,000 X 1/3 = Rs 25,000 or	
• Rs 15,000	
Taxable Pension	Rs 60,000

The expenses occurred for collection of family pension to the extent of Rs 24,000 shall not be allowable as deduction since the standard deduction of 1/3 rd of family pension or Rs 15,000 is to cover such expenses.

5.7. Gifts in the hands of individuals and HUFs:

In a major deviation to the principle that income tax is a tax on income and not on capital receipts, the Finance Act, 2004 amended Sec 56 to bring gifts under the tax net. Since then, the section has been amended several times to widen the scope of taxable gifts. The latest legal position is summarised as follows:

5.7.1 Taxable Gifts

U/s 56(2) ((vii), Following receipts by an individual or a Hindu undivided family, in any previous year from any person or persons will be taxable as "Income from Other Sources:

- a. Any sum of **money, without consideration, the aggregate value** of which Rs 50,000 , the whole of the aggregate value of such sum
- b. Any **immovable property**,
 - i. **without consideration**, the stamp duty value of which Rs 50,000 , the stamp duty value of such property;
 - ii. for a **consideration** which is less than the stamp duty value of the property by an amount exceeding Rs 50,000 , the stamp duty value of such property as exceeds such consideration:

Following points are important in this regard :

5.7.2 Date of valuation

When the date of agreement and the date of registration are not the same stamp duty value will be considered on :-

- the date of agreement if and part or whole of the amount of consideration thereof, has been paid by any mode other than cash on or before the date of the agreement,
- the date of registration in all other cases .

5.7.3 Disputed Value

If the stamp duty value of immovable property is disputed by the assessee u/s 50C(2) , the Assessing Officer may refer the valuation of such property to a Valuation Officer as per the

provisions of Sec 50C and 155(15) will apply for valuation of capital asset.

5.7.4 Any property, other than immovable property-

- iii. **without consideration**, the **aggregate fair market value of which exceeds Rs. 50,000**, the whole of the aggregate fair market value of such property; or
- iv. **for a consideration which is less than the aggregate fair market value** of the property by an amount exceeding Rs 50,000, the aggregate fair market value of such property as exceeds such consideration

5.7.5 Exceptions:

The provisions will not apply to any sum of money or property received- :

- (a) from any relative; or
- (b) on the occasion of the marriage of the individual; or
- (c) under a will or by way of inheritance; or
- (d) in contemplation of death of the payer or donor; or
- (e) from any local authority defined in S 10[20]-Explanation
- (f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in S. 10 (23C) ; or
- (g) from any trust or institution registered u/s 12AA

5.7.3 Meaning of Property:

Property” means the following capital asset of the assessee: —

- a. immovable property being land or building or both;
- b. shares and securities;
- c. jewellery;
- d. archaeological collections;
- e. drawings;
- f. paintings;
- g. sculptures;
- h. any work of art; or
- i. Bullion

5.7.4 Meaning of Relative

Relative “means:

- I. In relation to an Individual :
 - a. spouse of the individual;
 - b. brother or sister of the individual.
 - c. brother or sister of the spouse of the individual ;
 - d. brother or sister of the either of the parents of the individual,
 - e. any lineal ascendant or descendant of the individual
 - f. any lineal ascendant or descendant of the spouse of the individual
 - g. spouse of the persons referred to in (2) to (6) above.

RELATIVE OF A OR MRS. A		
Spouse	Mrs. A	A
Siblings	A's brother	Mrs. A 's Brother
	A's sister	Mrs. A's sister
Lineal Ascendants – paternal	A's Parents	Mrs. A's Parents
	A's grandparents	Mrs. A's grandparents
Lineal Descendants Paternal	A's sons	Mrs. A's sons
	A's daughters	Mrs. A's daughters
	A's grandsons	Mrs. A's grandsons
Siblings of Parents Of Individual (Not of Spouse) Mother's brothers / sister + Father's brother / sister		
Spouses of All the above persons		

Note: This relationship is explained in a diagram , where
Lineal ascendants or descendants taken on male side

II. In Relation a Hindu Undivided Family any member thereof.

5.7.5. Cost of Acquisition

While computing capital gains, cost of acquisition of a property received by a transferor from any exempted mode of transfer e.g. will, is taken at the same cost as that of the previous owner. Further, cost of acquisition of a property received without consideration and is chargeable u/s 56 when it is subsequently sold or transferred shall be the value considered u/s 56.

Illustration -8

A painting valued at Rs 5,00,000 is transferred for Rs 3,00,000. Difference of between the consideration and the fair market value of Rs 2,00,000 (5,00,000-300,000)will be charged u/s 56 being value of inadequate consideration. The painting is resold for Rs 10,00,000, the capital gain will be computed by taking the cost of acquisition of Rs 5,00,000 i.e. Rs 10,0000-5,00,000 or Rs. 5,00,000

5.8. Issue of shares at premium

Aggregate consideration received by a closely held company (private company), which issues shares at premium or above their face value during a previous year to any person being a resident, to the extent such consideration exceeds the fair market value of the shares by Rs 50,000 except when the shares are issued

- to a venture capital company or
- other company notified by the Central government..

Fair market value of the shares will be determined as per the prescribed rules(Net Asset Value or Break-Up Value Method) any other method as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the

date of issue of shares, of its assets, including intangible assets, being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature

Illustration -9

Fair market value of a company's share is Rs 100 per share. It issues 1000 shares for Rs 800 per share, then $10500 \times (800-100) = \text{Rs } 7,00,000$ will be treated as "income from other sources", unless the company is a venture fund or other notified company.

Following table summarizes the position of gifts

TAXABLE GIFTS AT A GLANCE		
INDIVIDUALS AND HUFs		
RECEIPTS WITHOUT CONSIDERATION		
Cash	50,001	Aggregate
Movable Assets	50,001	Aggregate
Immovable Assets	50,001	Per Property
INADEQUATE CONSIDERATION [FMV- CONSIDERATION]		
Movable Assets	50,001	Aggregate
Immovable Assets	50,001	Per Property
Shares Of Pvt Co.	50,001	Consideration or
Recd by firm or Co		difference with FMV
Sh. Premium by Pvt Co	50,001	Difference with FMV

Important Points:

1. Limit of Rs 50,000 is for each category in case of cash and movable assets and cash but Rs. 50,000 is per immovable property as the section says "such property"
2. Rs 50,000 is not the basic limit. Once the limit of Rs 50,000 exceeds, entire sum will be taxable. For instance, A receives cash gift of Rs 40,000 it will be exempt as it is below Rs 50,000. If he receives another gift of Rs. 10,100 from C. The aggregate gifts of Rs 50,100 will be taxable without any basic exemption.
3. The list of relatives **does not include nephews/nieces/ cousins.**
4. List of relatives includes Spouses, Siblings - own, spouses' and parents, lineal ascendants and descendants and spouses.
5. List of relatives includes uncles and aunts of the individual but not those of the spouse.
6. Stamp duty valuation will have same meaning as in S 50C.
7. Fair Market Value can be determined by the valuers.
8. Business assets like stock are not covered by these provisions and normal sale or purchase transactions will not attract the provisions of this section.

9. Any movable property like shares, securities, jeweler, drawings, paintings, sculptures, work of art or archaeological collections or immovable, without consideration the fair market value of which exceeds Rs 50,000 in aggregate during a previous year, or for a consideration falling short of their aggregate fair market value by more than Rs 50,000 will be covered by this provision.

Illustration 10:

Compute the total income of XYZ, who receives Rs 60,000 in cash and of 1000 shares of a company valued at Rs. 40 per share as gift from each of the following persons:

1. B, his neighbour.
2. C, employer
3. D, one of his patients
4. E, his sister on the occasion of his daughter's marriage.
5. F, in contemplation of death.
6. Mrs. A
7. Mr. husband of E
8. H, son of E
9. X, a stranger on his marriage.

Solution

COMPUTATION OF TOTAL INCOME OF XYZ Rs.

	Rupees	Rupees
Salaries Gift from employer Mr. C U/s 17		1,00,000
Profits and Gains Of Business & Profession- Gift from patient D u/s 28		1,00,000
Income From Other sources- Se 56 sister E 's son [nephew not exempted B- his neighbour		2,00,000
Total income		3,00,000

- Gift of shares of Rs 40,000 and cash Rs 60,000 each treated at par. Therefore total gift in each case Rs 1,00,000
- Exempt gifts from – (with reason in brief)
 - E - sister – Relative
 - F in contemplation of death (*Gift mortis Causa*).
 - Mrs. A- spouse –Relative
 - G -E's husband – Sister's spouse –Relative
 - On Occasion of marriage (Relationship not relevant)

5.9 Gifts Received by firms and companies

When a firm or a closely held company receives, in any previous year, from any person or persons, any shares of another closely held company-

- i. Without consideration and the aggregate fair value of such shares exceeds Rs 50,000, the whole of the aggregate fair market value of such shares or property;
- ii. for a consideration which is less than the aggregate fair market value of the shares by an amount exceeding Rs 50,000, the aggregate fair market value of such property as exceeds such consideration .

This section will not however apply to transactions not regarded as transfer u/s 47 .

Illustration-11:

A Pvt. Ltd. buys shares in B Ltd of Rs 5 lakhs for Rs 1 lakh from C. the difference in the consideration and the fair market value amounting to Rs 4 lakhs will be taxable u/s 56.

A. Important points :

- i. The limit of Rs 50,000 is for each category.
- ii. Rs 50,000 is not the basic limit. Once the limit of Rs 50,000 exceeds, entire sum will be taxable. For instance, A receives cash gift of Rs 45,000 it will be exempt as it is below Rs 50,000 . Now assume A receives another gift of Rs. 5,100 from C. The aggregate gifts of Rs 50,100 will be taxable without any basic exemption
- iii. In case of immovable property , the limit of Rs. 50,000 is per property
- iv. The list of relatives **does not include nephews/nieces./cousins**
- v. List of relatives includes Spouses, sibling- own, souses' and parents , lineal ascendants and descendants and spouses .
- vi. Stamp duty valuation will have same meaning as in S 50C.
- vii. Fair Market Value can be determined by the valuers .
- viii. Business assets like stock are not covered by these provisions and normal sale or purchase transactions will not attract the provisions of this section.
- ix. Any movable property like shares, securities, jeweler, drawings, paintings, sculptures, work of art or archaeological collections, without consideration the fair market value of which exceeds Rs 50,000 in aggregate during a previous year, or for a consideration falling short of their aggregate fair market value by more than Rs 50,000 will be covered by this provision.

5.10. Additional compensation

Income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A.]

6. DEDUCTIONS -S. 57

Following deductions are available u/s 57 in computing the income from other sources:

I In case of taxable dividend income and interest from securities:

Any reasonable sum paid by way of remuneration or commission for the purpose of realising such income including interest on borrowed capital if such borrowed capital is used for making investment in shares or securities.

II In case of income from plant, machinery or furniture given out on hire:

- a. Current repairs to building.
- b. Current repairs to machinery, plant or furniture.
- c. Insurance premium paid for insuring the plant, machinery, building or furniture.
- d. Depreciation on building, machinery, plant or furniture.
- e. Any expenditure (not being capital expenditure or personal expenditure) which has been incurred wholly, necessarily and exclusively for earning income, such expenditure will also be allowed as a deduction, e.g. sub-letting expenses. Office stationery, rent, salaries, etc where maintenance of office is necessary for earning the income.

III In case of family pension received by legal heirs of an employee,

A standard deduction of 1/3rd of such amount received as family pension or Rs. 15,000, whichever is less.

For this purpose, family pension means a regular monthly payment made to the legal heirs of the employee after his death. Significantly, pension amount received during the lifetime of employee is taxable as salaries and not entitled to standard deduction.

IV. Employees' contribution to Provident or any other fund if deposited before the due date.

V. Any allowances paid for breeding or maintaining the racehorses.

VI. A deduction of 50% against the enhanced compensation received and no further deduction will be allowed from the income.

7. AMOUNTS NOT DEDUCTIBLE- S. 58

The following amounts are not deductible while computing income under the head "Income from Other Source":-

- Personal expenses of the assessee;
- Any interest which is payable outside India on which income tax has not been paid or deducted at source;
- Any sum paid on account of wealth tax in India or abroad;
- Any amount not allowable by virtue of it being unreasonable;
- In case of foreign companies, expenditure in respect of royalties and technical services received under an agreement made after 31/3/76; and
- Any expenditure in connection with income from winning from lotteries, crosswords, puzzles, races including racehorses, car races and other games of races, gambling, betting of any form. However, expenses are allowed as a deduction in computing the income of an assessee who earns income from maintaining as well as holding racehorses.

8. MISCELLANEOUS

a) Balancing charge taxable-S. 59

Any amount received or benefit derived in respect of any expenditure, incurred or loss or trading liability allowed shall be deemed to be the income of the year in which such benefits is accrued or received as the case may be.

b) Method of accounting.- S. 145

Section 145 relating to method of accounting is also applicable to the computation of income from other sources. Income under this head is computed in accordance with the method of accounting regularly employed by the assessee i.e. if the assessee accounts only on cash receipt and cash payment basis, income will be treated on cash payment and cash receipt basis only; otherwise it will be treated on mercantile basis. An assessee can adopt either the cash method or accrual method of accounting. Hybrid method is not permissible. However, certain items like lottery, horse races, dividend u/s 2(22)(e) can only be recorded on cash basis because of their variable nature.

c) Grossing Up:

Many times dividends, interest from securities are received after TDS. In such case amount to be included in total income is gross amount and not the amount received. Amount of TDS should be added back.

Illustration- 3.

A receives taxable interest of Rs. 18,000 after deduction of 10% TDS . Find out the taxable income.

Solution

Since TDS is 10% and 144 amount is Rs. 100

Net amount will be 90%

Amounts to be taxed will be gross amount Rs 20,000 i.e.

$$\frac{\text{Rs } 18,000 \times 100}{90}$$

Rupees 20,000 will be included in the income and credit for TDS of Rs. 2,000 will be claimed against the tax payable.

9. SELF-EXAMINATION QUESTIONS:

- 1) Enumerate any five items of income, which are included under the head 'income from other sources'.
- 2) Define Dividend. Discuss the taxability of dividend.
- 3) What are the incomes included under the subhead of winning? What is the rate of tax on such incomes?
- 4) What are the deductions allowable in respect of hire charges of plant and machinery?
- 5) Are there any amounts, which are not allowed as deductions while computing the income from other sources? Give examples.
- 6) A is in receipt of pension as a retired government employee @ Rs. 10000 per month. Besides, he is in receipt of family pension of his late wife @ Rs. 6000 per month. Show how the two amounts will be treated for tax purposes.,
(Hint. Own pension salary / wife's pension other sources with standard deduction Rs 15000)
- 7) Show the head of income under which the following items would be charged.
 - a. Rent received by an event manager on letting out tents /pandal.
 - b. Hiring charges received by a taxi driver.
 - c. Car hiring charges received by a company from the cars requisitioned by the Election Commission
 - d. Interest on Income Tax Refund
 - e. Rent received by letting out own house and
 - f. Rent received by sub-leasing premises.
 - g. Computer hiring charges.
 - h. Salary of director

- i. Salary of M.P/ MLA
- j. Rent of a house.
- k. Rent of a plot of land.
- l. Rent of a machine let on hire along with building and letting is separable.
- m. Dividend from domestic company.
- n. Winning from TV game show like.

(Hints/Answers: item e/j remaining other sources. Director if employee, then salary)



EXCLUSIONS AND DEDUCTIONS

Synopsis:

1. Introduction and Objectives
2. Exemptions and deductions
3. Income exempt under section 10
 - a. Agricultural income-S10(1)
 - b. Receipts by a member from a Hindu Undivided Family-S 1092)
 - c. Share of profit of a partner in a firm –S10(2A)
 - d. Income of minor Child –S.10(32)
 - e. Dividend Income –domestic companies-S10(34)
 - f. Dividend Income- Mutual fund units- S10(35)
 - g. Other Exemptions
4. Deductions –S.80 –Chapter VIA
 - a. Investments –S80C
 - b. Pension Plan –S 80CCF
 - c. Medclaim -80D,
 - d. Physical Disability -80DD,
 - e. Treatment f major diseases -80DDB,
 - f. Interest on educational Loans 80E,
 - g. Physical Disability(Own)-80U:
5. Solved Examples
6. Self Assessment questions

1. INTRODUCTION & OBJECTIVES

Some incomes are not chargeable under the Income Tax Act 1961. This is done two ways namely – some incomes are not included in the total income and some incomes are taken into consideration for computing the total income but deduction is allowed in respect of such income under section 80 of chapter VIA of the Act. This lesson deals with the provisions of Income Tax Act 1961 relating to exemptions and deductions.

2. EXCLUSIONS VS DEDUCTIONS

2.1. Exclusions:

Income, which is not chargeable to income tax, is called exempt income. Hence, such incomes are excluded from the computation of total income and do not form part of total income

Every income is chargeable to income tax unless it is specifically exempt and the person, who claims an income to be exempt, has to prove that such receipt is so exempt.

Exemptions are granted to a person or class of persons e.g., charitable trusts in respect all or some of their incomes. On the other hand, some incomes are e.g., agricultural income exempt in the hands of all types of assesseees. Further, exemptions may be un conditional or subject to fulfillment of certain condition such as in case of startups, SEZ etc.

Sections 10 to 13 deal exclusively with incomes , which are exempt from income tax while sections 15 to 56 provide for certain exemptions available under a particular head while computing income under different heads viz Salaries, Income from house property, Profits and gains of business & profession, capital gains and Income from other sources.

A receipt not falling under the definition of income u/s 2(14) or a receipt , which is of capital nature may be claimed as exempt unless it is specifically chargeable to income tax .

To summarize exempt incomes may be of following types:

- Income exempt u/s 10-13
- Income exempted under different heads of income S 15-56
- Income of capital nature not specifically chargeable to income tax and
- Income not falling in the definition of income.

2.2 Deductions

After the income has been computed under different heads of income as provided in sections 15-56 deductions are allowed under the provisions of sections 80 of chapter VIA of the Act. Hence, deductions are allowed **after** the gross total income is computed either in respect of any income or revenue or in respect of any payment or expenditure.

Sections 80IA, 80IB etc. provide for deduction in respect of revenue or income of a class of assesseees like software, infrastructure companies, companies engaged in construction of affordable housing etc. , while sections 80 C , 80D etc. provide for deductions in respect of investments in specified

securities, payment of mediclaim, expense on handicapped dependent etc.

Some important exemptions and deduction are discussed below.

3. INCOME EXEMPT UNDER SECTION 10:

Section 10 provides that any income falling within any of the clauses of that section shall not be included in computing the total income of a previous year of any person. However, burden is on the assessee to prove that a particular item of income falls within this section.

Following exempt incomes (covered in syllabus) are discussed as under:-

3.1 AGRICULTURAL INCOME – S 10(1):

Under the constitution of India, agriculture is in the state list and the central government is not constitutionally competent to levy taxes on agriculture. Accordingly, agricultural income is exempt u/s 10(1) of the Act. rate purposes, if agricultural income exceeds Rs 5000)

Meaning of agricultural income

U/s 2(1A) Agricultural income” means any :-

- A. any **rent or revenue** derived from land-
 - which is situated in India and
 - is used for agricultural purposes
- B. any **income derived from such land** by
 - agriculture; or
 - raising the performance by a cultivator or receiver of rent-in-kind of any process to render the produce raised or received by him fit to be taken to market or
 - the sale of such produce without performing any other process as stated above. ;
- C. **any income derived from any building :**
 - owned and occupied by owned and occupied by the
 - i. receiver of the rent or revenue of any such land, or
 - ii. cultivator or
 - iii. receiver of rent-in-kind, of any such land
 - iv. IF such building is
 - a) on or in the immediate vicinity of the land, and
 - b) required as a dwelling house, or storehouse, or other outbuilding by reason of its connection with the land, and the land is
 - assessed to land revenue in India or
 - subject to local rates and taxes assessed and collected by the government and

- situated in any area within the distance measured aerially from the local limits of any municipality or cantonment board depending upon its population as per the last published census namely -
 - 2 kms if population is more than 10,000 but not exceeding 1 lakh;
 - 6 kms. if population is more than 1 lakh but not exceeding 10 lakh; or
 - 8 kms. if population is more than 10 lakh.

Other Points

1. Income from land situated in urban area is not exempt
2. Land situated in areas having population of 10,000 or less will qualify for exemption.
3. Agricultural income must be received in India.
4. Agricultural income from a foreign country is treated as non-agricultural income in India.
5. Receipts arising on transfer of agricultural land u/s 2(14) is not considered agricultural income
6. Any income arising from letting out the building for residential or business purpose other than agriculture will not be agricultural income

Illustration 1

Tukaram employs Sakham to carry out agriculture on his agricultural land at a remuneration based on the value of agricultural produce. Sakham remits the sale proceeds of the agricultural produce to Tukaram after deducting his share of remuneration. Discuss the tax liability of Tukaram and Sakham.

Solution

Income on sale of agricultural produce derived from agricultural in India is agricultural income be exempt u/s 10(1) in the hands of Tukaram.

However, Sakham gets salary for rendering his services. Salary income is not derived from agricultural land; hence, it will be chargeable to income tax under the head "Income from Salaries".

3.2 Receipts by a member from a HUF-Sec10(2)

S 10(2) provides that any sum received by an individual as a member of a Hindu undivided family either out of income of the family or out of income of impartible estate belonging to the family will be exempt from tax.

A Hindu Undivided family (HUF) is a separate and independent entity liable to pay tax on its income. Hence, when its income is distributed among its members, there will be no

further tax liability as it will amount to taxing the same income twice.

This is subject to an exception. When a member of the family converts his personal property into the family property (called as throwing self-property into family hotchpot), then the income derived from such converted property will not be eligible for exemption u/s 10(2). Instead, it will be clubbed u/s 64(2), in the hands of the member, who has transferred the property to the family

Illustration 2

X, an individual, has personal income of Rs. 5,00,000 . He is also a member of a Hindu undivided family, which has an income of Rs. 2,50,000 , Out of income of the family, X gets Rs. 1,25,000, as his share in the income of the family . Show the status of the income from taxability point of view.

Solution:

X is liable to pay tax only on his personal income of Rs. 5,00,000. His share of Rs. 1,25,000 from HUF is exempt in the hands of X under section 10(2) irrespective of the fact whether the family is chargeable to tax or not . The HUF is liable to tax in respect of its income of Rs, 2, 50,000

3.3 Share of Profit of a partner in a firm –Sec. 10(2A)

In the case of a person being a partner of a firm which is separately assessed as such, his share in the total income of the firm will be exempt from tax u/s 10(2A). Since, a firm like a HUF is assessed as a separate entity, this exemption is provided to avoid double taxation of same income first in the hands of the firm and then again in the hands of the partners.

However, any remuneration paid by the firm or any interest on capital shall not form part of the share of profit received by partner and will be taxed in the hands of the partners to the extent it was allowed as a deduction to the firm , and will be taxed in the hands of the partners. But any remuneration or interest on capital in excess of the limits laid down in section 40 shall be chargeable to tax in the assessment of the firm and will form the part of the income allocated to partners exempt u/s 10(2A).

3.4 Income of minor child-S10(32):

Under 64(1A), income of a minor child is clubbed in the hands of his parent, who is having higher income except income earned by minor's personal efforts or skill. Section 10(32) provides for an exemption of the amount included in the income of such parent subject to a maximum of Rs. 1,500 per child.

Illustration 3

What will be the amount exempted U/s 10(32) if income of Rs 1,000 of Suresh, a minor son is included in the income of his father Sudesh ?.

Solution

Exemption u/s 10(32) is equal to actual income included in the hands of parent or Rs. 1,500, whichever is less. Hence Exemption available to u/s 10 (32) will be Rs. 1000 only.

Illustration 4

In the illustration 3, what will be the amount exempted U/s 10(32) if income of Suresh is Rs 15,000.

Solution

Exemption U/s 10(32) is equal to actual income included in the hands of parent or Rs. 1,500, whichever is less. Hence exemption available to u/s 10 (32) will be Rs. 1,500 only

Illustration 5

What will be the amount of deduction U/s 10(32) if Incomes of Ashok and Babu amounting Rs 7,500 and Rs 5,500 were clubbed with the income of their father Chandu.

Solution

Chandu will get exemption of Rs 3,000 being Rs 1,500 per child.

3.5 Dividend from domestic companies—S 10(34)

U/s 115-O, an additional tax @ 18% is payable on distributed profits of domestic companies including SEZ developers. Hence to avoid double taxation of dividend income, any income by way of dividend referred to in section 115-O

It may be noted that deemed dividend covered in S 2(22)(e) is not distribution of profit U/s 115-O. Hence, deemed dividend is not eligible for exemption under this section as well.

3.6 Dividend from Units of mutual funds –S 10(34)

Dividend or income received in respect of units of mutual fund or Administrator of the specified undertaking; or specified company is also exempt from Income tax under section 10 (35). However, the income does not include income on transfer of such units.

3.7 Other Exemptions:

Sec. 10 provides a comprehensive list of exempt incomes. Important exemptions e.g. gratuity, pension etc., which are for computation of income under the five heads of income, are incorporated at appropriate lessons dealing with such heads of income. *Remaining exemptions, though not directly covered by the syllabus, may have a bearing on the computation.* A brief summary of such exemptions is given in the following Appendix

APPENDIX

A. EXEMPTION TO FOREIGNERS/ NON RESIDENTS.

1. Interest income of non-resident from notified securities, saving certificates/ NRE Account –Sec 10(4).These exemptions are conditional and applicable mainly to persons of Indian origin purchasing the securities in convertible foreign exchange.
2. Remuneration of foreign diplomats -Sec 10(6).
3. Remuneration of a Trainee of a Foreign Government-Sec 10(6)(xi),
4. Remuneration received by Foreign National as an Employee of Foreign Enterprise I – Sec 10(6)(vi)
5. Salary of Non-Resident Employee of a Foreign Ship. –Sec 10(6)(viii)

B. EXEMPTION TO SALARIED EMPLOYEES

1. Several sections provide for exemption to salaried employees such as leave Travel Allowance, House Rent allowance, Gratuity, Retrenchment allowance, Commuted pension, special allowances etc. and dealt with in the chapter relating to salaries.
2. Certain other incomes of Non-Resident deriving income other than salary, royalty or fees for technical services from Government or an Indian concern under an approved agreement and if their tax liability is paid by the employer the tax so paid is exempt from tax. A – Sec 10(6B)
3. Foreign allowances and perquisites to Government employees outside India – Sec. 10(7),
4. Income of an Employee by way of remuneration or social security tax or otherwise of a Foreign Government under Co-operative Technical Assistance Programme/ projects - Sec. 10(8)
5. Income of a Consultant by way of remuneration or, social security tax or otherwise under a Technical Assistance Grant Agreement between the International Organisation and the Government of Foreign State- Sec .10(8A) :
6. Income of any other person, being a non-resident, engaged by the agency for rendering technical services in India in connection with any technical assistance programme or project, provided in accordance with an approved agreement- Sec .10(8A)
7. Income of an Individual who is assigned to duties in India in connection with any Technical Assistance Programme and Project in accordance with an Agreement entered into by the Central Government and the Agency - Sec .10(8A)

8. Remuneration received directly or indirectly by an individual who is assigned to duties in India in connection with any technical assistance programme and project in accordance with the agreement entered into by the Central Government and the Agency, , for such duties from any consultant referred to in clause (8A), income- S. 10(8B)
9. Income accruing or arising outside India by any family member of persons covered u/s 10 (8),(8A) or (8B) , in respect of which such member is required to pay any income tax or social security tax to the Government of that foreign state. –Sec 10(9)
10. Value of any travel concession or assistance received or due to the assessee from his employer for himself and his family in connection with his proceeding on leave to any place in India not exceeding the amount of the expenditure actually incurred on fare only through the shortest route-on a maximum of two journeys in a block of four years . S. 10(5),
11. Any allowance paid or allowed outside India by the Government to an Indian citizen for rendering service outside India - Sec 10(7)
12. Amount of tax actually paid by an employer, at his option, on non-monetary perquisites on behalf of an employee in the hands of the employee. Sec – 10(10CC). ,

C. EXEMPTIONS TO INSTITUTIONS / FUNDS :

The income of the following institutions is exempt subject to certain conditions:

1. Local authority i.e. a panchayat, municipality, municipal committee, district board or cantonment board.- S. 10(20)
2. Approved Notified scientific and research association applying which has as its object, undertaking research in social science or statistical research, and applying its income wholly and exclusively to its objects, including profits and gains of a business carried on by an institution, which is incidental to its objects. - S. 10(21)
3. News agency set up in India which applies its income or accumulates it for application solely for collection and distribution of news and does not distribute its income in any manner to its members.- S. 10(22B)
4. Regimental Fund or non-public fund.- S. 10(23AA)
5. Approved fund for the welfare of employees.- S. 10(23AAA)
6. Pension fund (Jeevan Suraksha) set up by the Life Insurance Corporation of India or a pension fund of any other insurance company.- S. 10(23AAB)
7. Khadi and Village industries Board.- S. 10(23B)
8. Public charitable Trusts and Religious Institutions.- -S. 11

9. European Economic Community.
10. SAARC Fund for Regional Projects.
11. ASOSAI-Secretariat
12. Insurance Regulatory and Development Authority
13. Prime Minister's Relief Fund
14. National Foundation for Communal Harmony
15. University/educational institution, hospital or medical institution 10 (22)/(22A)
16. Professional bodies. S. 10(23A)
17. Notified fund, charitable/ religious institution or trust.- Sec 10(22B)
18. Mutual fund -. S. 10(22B)
19. Notified Investor Protection Fund set up by recognised Stock Exchanges
20. Credit Guarantee Fund Trust for Small Industries
21. Approved Venture Capital Fund or Venture Capital Company-10(23FB)
22. Prasad Bharati (Broadcasting Corporation of India) S.10(23BBH)
23. Swachh Bharat Kosh – S . 10(23C(iiiaa))
24. Clean Ganga Fund - S . 10(23C(iiiaaa))
25. Core Settlement Guarantee Fund set up by a recognized clearing corporation in accordance with notified regulations- S 10(23EE)w.e.f 2016-17 to the extent of contributions from members fines and income from investments.
26. Trade Union or Association of trade Unions from house property and other sources.- S. 10(24)
27. Statutory Provident Fund under P. F. Fund Act.- S. 10(25)
28. Employees' State Insurance Fund set up under the ESI Act- . S. 10(25A)
29. Members of scheduled tribes residing in specified areas. - S. 10(26)
30. Statutory Corporation, body, association or institution formed or established for promoting the interests of the members of Scheduled Castes/ Schedules Tribes or backward classes or of any two or all of them.- S. 10(26B)
31. Corporation established by the Central/ State Government for promoting the interests of a notified minority community. - S. 10(26BB)
32. Ex-Servicemen Corporation established under an Act for the welfare and economic upliftment of ex-servicemen being the citizens of India.- 10(26BBB)

33. Co-operative Society formed for promoting the interest of members of either the Scheduled Caste or Scheduled Tribes.- S. 10(27)

34. Coffee Board, Rubber Board, Tea Board, Tobacco Board, Marine Products Export Development Authority, Agricultural and Processed Food Products Export Development Authority and Spice Board.- S. 10(29A)

35. Subsidy received from the Tea Board for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea under any scheme notified by the Central Government-. S. 10(30)

36. Subsidy received from the Rubber Board, Coffee Board, Spices Board or any other Board under any scheme of replanting or replacement, etc.-. S. 10(31)

37. Daily allowance of Members of Parliament while the parliament is in session is and Members of State Legislative Assemblies (upto Rs. 2000) - Sec 10(17)

Exemptions will not be available if the institutions specified [Section 10(23C) (iv) & (have commercial receipts of 25,00,000 or more

D. CAPITAL GAINS

- i. Any long-term capital gain arising on transfer of eligible equity shares of a company acquired on or after 1.3.2003 but before 1.3.2004 and held for 12 months or more.
- ii. Any capital gain arising to an individual/ HUF on compulsory acquisition of an agricultural land in urban areas (situated within the jurisdiction of a municipality or a cantonment board having population of 10,000 or more or within 8 Kms from the local limits of such municipality/ board), where the compensation/ consideration is received by the assessee on or after 1.4.2004. Provided, the land was being used for agricultural purposes by the HUF/ individual or his parent(s), during the period of 2 years immediately before acquisition.
- iii. Any long-term capital gains from transfer of equity shares of a company or units of an equity-oriented fund on or after 1.10.2004 and subject to Securities Transaction Tax -Sec 10(38).
- iv. Any income arising from the transfer of a US 64 subject to the condition that any loss arising on transfer of units of US.64 cannot be set off against any income in the same year in which it is incurred and the same cannot be carried forward—Sec 10(33.)

E. MISCELLANEOUS

- i. Any sum received on life insurance policy (including bonus) not being the amount received on the following policies -

- a. any sum received u/s 80DD (3) or 80DDA (3);
 - b. any sum received under a Keyman insurance policy;
 - c. any sum received under an insurance policy (issued after March 31, 2003) in respect of which the premium payable for any of the years during the term of policy, exceeds 20 per cent of the actual sum assured except in case of the death of the person and the value of any premiums agreed to be returned or of any benefit by way of bonus or otherwise, over and above the sum actually assured, which is received under the policy by any person, which shall not be taken into account for the purpose of calculating the actual capital sum assured under this clause. -Sec 10(10D),
- ii. Family pension received by the widow or children or nominated heirs of a member of the armed forces or paramilitary forces of the Union is not chargeable to tax from the assessment year 2005-06, if death is occurred in such circumstances given below—
- a. acts of violence or kidnapping or attacks by terrorists or anti-social elements;
 - b. action against extremists or anti-social elements;
 - c. enemy action in the international war;
 - d. action during deployment with a peace keeping mission abroad;
 - e. border skirmishes;
 - f. laying or clearance of mines including enemy mines as also mine sweeping operations;
 - g. explosions of mines while laying operationally oriented mine-fields or lifting or negotiation mine-fields laid by the enemy or own forces in operational areas near international borders or the line of control;
 - h. in the aid of civil power in dealing with natural calamities and rescue operations; and
 - i. in the aid of civil power in quelling agitation or riots or revolts by demonstrators. - Sec 10(19),
- iii. Any income by way of dividend referred to in section 115-O [i.e., dividend, not being covered by section 2(22)(e), from a domestic company or any income in respect of units of mutual fund; UTI [, from the administrator units from the specified company is exempt under section 10(34)/ (35),
- iv. U/s 10AA export incomes of undertakings in SEZ are exempt on pro rata basis i.e.

Business Profit X Export Turnover

Total Turnover

- v. Incomes of charitable trusts and political parties subject to the provisions of Sec 11, 12 and 13.
- vi. any income of a foreign company received in India in Indian currency on account of sale of crude oil to any person in India subject to approved conditions being satisfied received under a notified agreement or an arrangement with the Central Government or approved by it and the receipt of the money is the only activity carried out by the foreign company in India

If the premium payable during any previous year for a policy issued on or after 1.4.2012 exceeds 10% of the actual capital sum assured, the entire amount received under such policy shall be taxable except when the sum received on the death of a person

4. DEDUCTIONS UNDER CHAPTER VI A

4.1 Sec. 80A, and 80AB of chapter VIA provide for a basic framework for deduction to be made from gross total income. Salient points of such framework for such deductions are as under:-

- (a) Aggregate of total income of an assessee will be computed under different heads of income before making any deduction under this chapter called the gross total income ;
- (b) From the gross total income long term capital gains, short term capital gain under section 111A, winnings from lottery, crossword puzzles etc. are excluded as these items are treated differently for tax purposes.
- (c) From the gross total income, deductions are allowable under chapter VIA (Sec 80C to 80U) .
- (d) The aggregate amount of the deductions under this chapter can not exceed the gross total income of the assessee
- (e) Deduction is admissible to the members of an AOP or BOI in relation to their share therein under sections 80G, 80GGA, 80GGC, 80HHA, 80HGB, 80HHC, 80HHD, 80I 80IB , 80IC, 80ID, 80IE, 80J or 80JJA.
- (f) No deduction will not be allowed if any exemption is claimed and allowed to eligible assessee, enterprises, units, or undertakings under sections 10A, 10Aa, 10B, 10BA, or 35AD for that year and such deduction shall not exceed the profits and gains of such undertaking or unit or enterprise or eligible business. Further the deduction will be available only if the assessee makes a claim in his return of income for any deduction under the above sections .- Sec 80A
- (g) Deduction in respect of any income shall be allowed if such income is included in gross total income. Sec 80AB

- (h) Deduction in respect of any payment will be allowable if the assessee claims these and gives proof of such investments/ expenditure/ income.
- (i) Deductions under Chapter VIA available of three types:
 - I. Sec. 80C to 80G allow deduction in respect of expenditure or investments made by the assessee
 - II. Sec. 80HH to 80RRB are in respect of certain income
 - III. Sec 80 U is in the category allowable to a handicapped person irrespective of either income or expenditure.

Some of the deductions covered by the syllabus are discussed in the following paragraphs.

4.2 Deduction in respect of investments in Specified Saving Schemes-Sec 80C:

Section 80C provides for deduction in respect of investment or contribution towards specified saving schemes. The basic scheme of the section is as follows:

- a. Only individuals and HUFs are eligible for deduction under this section. Other assesseees are not eligible for deduction u/s 80C.
- b. Both residents and the non-resident assessee are eligible for the deduction under the section
- c. The deduction is allowed in respect of the aggregate amount **paid or deposited** during the previous year by the assessee in eligible saving schemes.
- d. The aggregate amount paid or deposited towards these schemes is called **Gross Qualifying Amount**.
- e. The payments/investments eligible under this section are:
 - i. **Life Insurance premium**
Premium paid on a policy taken or renewed by
 - An individual
 - on his own life,
 - life of the spouse or any child
 - child may be dependent or independent
 - A Hindu undivided family on the life of any member of the family

The premium including the arrears of premium should not exceed 10% of sum assured if policy taken after 01-04-2013 (15% for persons with handicap u/s 80U or person suffering from serious disease u/s 80DDB on policy taken after 01-04-2014). Prior to this, the restriction was up to 20% for all assesseees.

- ii. Any sum paid under the contract of non –commutable deferred annuity plan for the purpose of securing the

individual or his spouse or children to pay a deferred annuity ;

- iii. Any sum deducted from salary payable to a Government employee for the purpose of securing the individual or his spouse or children to pay a deferred annuity subject to a maximum of 20% of salary;
- iv. Contribution towards **Statutory Provident Fund**;
- v. Contribution towards **15 year public provident fund(PPF)** in the name of himself, wife or child or a family member upto a maximum of Rs 1,00,000;
- vi. Contribution towards **Recognized Provident Fund**;
- vii. Contribution towards an approved **Superannuation Fund**;
- viii. Investment in 10 / 15 years Post Office Cumulative Term Deposits(**CTDS**);
- ix. Subscription to notified deposit scheme e.g. NSS
- x. Subscription to **National Savings Certificates**, VIII Issue
- xi. Contribution for participating in the Unit-Linked Insurance Plan (**ULIP**) of Unit Trust of India;
- xii. Contribution for participating in the unit-linked insurance plan (**ULIP**) of LIC Mutual Fund (i.e. Dhanraksha plan of LIC Mutual Fund);
- xiii. Payment for notified annuity plan of LIC (i.e. Jeevan Dhara, Jeevan Akshay, New Jeevan Dhara, etc. or any other insurer;
- xiv. Subscription towards notified units of Mutual Fund or UTI
- xv. Contribution to notified pension fund set up by Mutual Fund or UTI;
- xvi. Any sum paid including accrued interest as subscription to Home Loan Account Scheme of the National Housing Bank(**NHB**);
- xvii. Any sum paid as tuition fees (but not donation) to any university/college/educational Institution in India for full time education for maximum 2 children;
- xviii. Any subscription towards infrastructure bonds or units of Mutual Funds;
- xix. Any amount paid for the purchase or construction of a residential house property or for purchase of land;
- xx. Term deposits for a fixed period for at least 5 years with a scheduled bank under a notified scheme;
- xxi. Deposit in an account under Senior Citizens Savings Scheme, 2004;

- xxii. 5- years Post Office Time Deposit Account;
- xxiii. Subscription to notified bonds issued by NABARD;
- xxiv. Subscription to eligible issues of equity shares or debentures of an Indian public company or a public financial institution where the entire proceeds of the issue is wholly and exclusively for the purposes of any business specified for developing, maintaining and operating an infrastructure facility for generation or generation and distribution of power or for providing telecommunication services whether basic or cellular or for developing, developing and operating or operating and maintaining an industrial park or a special economic zone- SEZ

Amount of deduction

Amount of deduction allowable u/s 80C will be:-

- Whole of the aggregate amount paid or deposited in the above mentioned schemes the gross qualifying amount or
- Rs 1,50,000, whichever is less.
- U/s 80CCE , maximum deduction u/s 80C, 80CCC and 80CCD cannot exceed Rs 1,50,000.

f. Some important points:

- Payment for house include amount paid to authorised developers or repayment of loans.
- The amount of investments need not necessarily be made out of the taxable income
- Life insurance premium paid for parents will not be allowable even if parents are dependent on the assessee.
- Life insurance premium paid for married daughter will be allowable.
- Dependence of wife or children is not necessary for claiming deduction under this section.
- Refundable premium and bonus on premium are not eligible for deduction
- Premature termination(before the period shown below) from any scheme will have the following effects:
 - In the year of termination, deduction will not be allowed and
 - Premium earlier paid and allowed as deduction will be brought back to tax in the current year and added to the total income in the assessment year pertaining to the year of withdrawal.

House property Transfer	Five Years
Premature Withdrawal/Transfer/ Termination	
Life insurance Policy	Two years for whole life policy
	One year for other policy
P/O TDS / SCSS	Five Years
Unit Linked Insurance Plan	Five Years

Illustration 1:

A whole life policy on which a premium of Rs. 6,000 has been paid upto last year and Rs. 3000 is the current year's premium otherwise eligible for deduction u/s 80C. What will be the effect if the contract is prematurely terminated during the financial year 2015-16

Solution

Premium paid in financial year 2015-16 will not be eligible for deduction u/s 80C and the old premium of Rs. 6000 allowed earlier will be added to the income of assessment year 2016-17.

Illustration 2

Shyam makes the following payments during the financial year 2015-16. His Gross Total Income amounts to Rs 5,00,000. Shyam asks you to calculate the deduction available under section 80C and the taxable income for the A.Y. 2016-17.

School fees of his 4 children	Rs 50,000
University fees of his wife	Rs 20,000
Life insurance for wife and kids	Rs 10,000
Life insurance for parents	Rs 15,000
Life insurance for father-in-law	Rs 10,000
NSC	Rs 20,000
Repayment of principal for house	Rs 35,000
Coaching class fees	Rs 11.030

Solution

Gross Total Income		Rs. 5,00,000
School fees up to 2 children	Rs 25,000	
University fees of wife - Not allowed	NIL	
Life insurance for wife and kids	Rs 10,000	
Life insurance for parent Not allowed	NIL	
Life insurance for father-in-law- Not allowed	NIL	
NSC	Rs 20,000	
Repayment of principal for house	Rs 35,000	
Coaching class fee Not allowed	NIL	
Deduction u/s 80C		Rs. 90,000
Total Income		Rs.4,10,000

Illustration 3

Ashok has a Gross Total Income of Rs 8,00,000 for the AY 2016-17. He had availed of a deduction in AY 2010-11 of Rs 7,000 in respect of a Life insurance policy, which was prematurely terminated in P.Y. 2015-16. He made the following investments for the P.Y. 2015-16 Insurance for himself (sum assured Rs 1,00,000) Rs 28,000

Insurance for wife (employed with MNC) Rs 25,000
 Insurance for son but unpaid Rs 7,500
 Compute deduction u/s 80C and the taxable income of Ashok.

Solution

Computation of total income		Rs
Gross Total Income		5,00,000
Add: Deduction of last year on termination of policy		7,000
Revised Gross Total Income		5,07,000
Insurance for himself (in excess of 20% of sum assured)	Rs 20,000	
Insurance for wife (dependence not relevant)	Rs. 25,000	
Insurance for son (not paid)	Nil	
Total deduction u/s 80C		45,000
Total Income		4,62,000

Illustration – 4

GTI of W for AY 2016-17 is Rs 12,00,000. He pays premium of Rs 22,000 on a policy on his own life for Rs 1,00,000, Rs 10,000 each for policies of his son and brother, both being dependent on him. W also pays Rs. 20,000 for unrecognized Provident Fund, Rs 10,000 towards PPF Rs 10,000 in ULIP. He also repaid housing loan to ICICI Bank Rs 80,000 with Rs 20,000 towards outstanding interest.

School fees of three his children amounts to Rs 4,000 Rs. 5,000 and Rs 6,000 respectively.

Compute the deduction/s 80C and the taxable income of W

Solution

Computation of total income		Rs
Gross Total Income		12,00,000
Insurance-self (over 10% of sum assured)	2,000	
Insurance(son)–dependence not relevant	10,000	
Insurance for brother not allowed	Nil	
Unrecognized Provident Fund – Not allowed	Nil	
Public provident Fund	10,000	
Unit Linked insurance plan	10,000	
Housing loan –Principal	80,000	
School fee –2 children – Higher figures considered 6,000=+5,000	11,000	
Total deduction u/s 80C-maximum	1,41,000	1,00,000
Total Income		11,00,000

4.3 Deduction in respect of Contribution to certain pension funds – Sec 80CCC.

Eligible assessee:

Deduction is available only to Individuals Resident or Non – Resident . Other assesseees are not eligible.

Conditions

Amounts is **paid or deposited** during the previous year to effect or keep in force a contract for any annuity plan of Life Insurance Corporation of India or any other insurer for receiving pension from the fund u/s 10(23AAB).

Maximum Deduction:

the whole of the amount paid or deposited (excluding interest or bonus accrued or credited to the assessee's account, if any) or Rs 1,50,000 whichever is less .

Other Points -

The amount received by the assess or his nominee

a) on account of the surrender of the annuity plan whether in whole or in part, in any previous year, or

(b) as pension received from the annuity plan,

shall be deemed to be the income of the assessee or his nominee, as the case may be, in that previous year in which such withdrawal is made or, as the case may be, pension is received, and shall accordingly be chargeable to tax as income of that previous year.

As per Sec 80CCE, maximum deduction u/s 80C, 80CCC and 80CCD cannot exceed Rs 1,50,000.

4.4 Deduction in respect of Investment in Infrastructure Bonds- S 80CCF

Eligible assessee:

Deduction of Rs 20,000 available under this section to individuals and HUF in respect of amounts is **paid or deposited** during the previous year for Subscription to notified infrastructure bonds is discontinued

4.5 Deduction in respect of Health Premia- Sec 80D:

Section 80D provides for a deduction from the total income of an individual or a HUF in respect of the payment made towards medical insurance premia paid during the previous year. Following points are important in this regard:-

(a) Eligible Assessee

The deduction under this section is available only to an **individual** or a **Hindu undivided family**.

(b) Mode of Payment

The payment of premium shall be made by any mode other than cash for e.g. by cheque , ECS or other electronic mode and any mode including cash, in respect of any sum paid on account of preventive health check-up;

(c) Amount of Deduction
In case of an individual assessee

I Premia etc paid for self and family

The amount of deduction shall be aggregate of the following or: or Rs 25,000 whichever is less

- (a) the whole of the amount paid (premium) to effect or to keep in force an insurance on the health of the assessee or his family ; or
- (b) any contribution made to the Central Government Health Scheme or such other scheme notified by the Central Government (popularly called Mediclaim policy), or
- (c) any payment made on account of preventive health check-up of the assessee or his family upto Rs 5,000

II Medical expenditure

The whole of the amount paid on account of medical expenditure incurred on the health of the assessee or any member of his family being a very senior citizen if no amount has been paid to effect or to keep in force an insurance on the health of such person or Rs 30,000, whichever is less.

Maximum deduction under both the above cases will be restricted to Rs 30,000.

(iii) Premia paid for parents

The amount of deduction shall be aggregate of the following or: or Rs 25,000 whichever is less

- (a) the whole of the amount paid to effect or to keep in force an insurance on the health of the parent or parents of the assessee or
- (b) any payment made on account of preventive health check-up of the parent or parents of the assessee as does not exceed Rs 5,000

(iv) Medial Expenditure for parents

The whole of the amount paid on account of medical expenditure incurred on the health of any parent of the assessee being very senior citizen , as does not exceed in the aggregate Rs 30,000 if no amount has been paid to effect or to keep in force an insurance on the health of such person

Maximum deduction under both the above cases will be restricted to Rs 30,000

(a) Other points

- i. 'Family' means the spouse and dependant children of the assessee
- ii. "senior citizen" means an individual resident in India who is of the age of sixty years or more at any time during the relevant previous year;
- iii. (ii) "very senior citizen" means an individual resident in India who is of the age of eighty years or more at any time during the relevant previous year.

- iv. The parents and the spouse need not be dependent upon individual assessee but children should be dependent for claiming the deduction
- v. Deduction is available u/s 80 to an individual in respect of payments made to insure his children but not *vice versa* and therefore , children cannot claim deduction under this section.
- vi. Expenses paid for preventive health check-up have a sub limit of Rs 5,000 within the overall limit of Rs 25,000 /30,000 and such expenses may be paid in cash.
- vii. Ant medical insurance premia is paid to effect or keep in force an insurance on the health of any person being a senior citizen, or a very senior citizen, the limit of Rs 25,000 (for individual and HUF) will be enhanced to Rs 30,000
- viii. Insurer are notified by the IRDA or Central Government

Amount of Deduction to A Hindu undivided family :

Where the assessee is a Hindu undivided family, amount of deduction shall be the aggregate of the following, namely:—

- (a) whole of the amount paid to effect or to keep in force an insurance on the health of any member of that Hindu undivided family as does not exceed in the aggregate Rs 25,000 ; and
- (b) the whole of the amount paid on account of medical expenditure incurred on the health of any member of the Hindu undivided family being a very senior citizen as does not exceed in the aggregate Rs 30,000 , if no amount has been paid to effect or to keep in force an insurance on the health of such person:

However, the aggregate deduction under the two clauses shall not exceed Rs 30,000 .

Sec 80D – Amount of deduction available to an individual (inclusive of preventive health check-up)			
Situation	Self, Spouse and Dependent Children Rs	Parent(s) (Whether dependent or not) Rs	Total deduction U/s 80D Rs
All below the age of 60 years	25,000	25,000	50,000
Assessee and his family less than 60 years and parents above 60 years	25,000	30,000	55,000
Assessee and his family have attained the age of 60 years and above	30,000	30,000	60,000
Sec 80-D Amount of deduction available to a HUF (inclusive of preventive health check-up)			
One or more member of HUF is a senior citizen			30,000
None of the members is a senior citizen			25,000

Illustration 6

Raj and his wife are not senior citizens. Raj pays mediclaim insurance of Rs 18,000 for self, Rs 20,000 for his wife, and Rs 5,000 each for both of his sons, who are independent. He also pays Rs 18,000 for each of his parents who are senior citizens. Calculate the amount of deduction allowable u/s 80D.

Solution

Amount of deduction u/s 80D		
Premium in respect of wife		Rs 18,000
Premium for himself		Rs. 20,000
Premium in respect of children (not dependent)		Nil
Total Rs 38,000 restricted to		Rs 25,000
Add : Premium in respect of parents (senior citizens) Rs36,000 restricted to maximum		Rs 30,000
Deduction available u/s 80D		Rs 55,000

4.6 Sec 80DD: Deduction in respect of expenses on maintenance and medical treatment of a dependant who is a person with disability.

Eligible assessee:

An assessee, being an individual or a Hindu undivided family, who is a resident of India, is eligible to claim deduction u/s 80DD.

Eligible Payments:

Deduction is available in respect of the following:

- Expenditure incurred for medical treatment including nursing, training and rehabilitation of a dependent, being a person with disability or
- any amount paid or deposited under a scheme framed by the or any other insurer or the administrator or the specified company (UTI) approved by the Board in this behalf for the maintenance of a dependant, being a person with disability.

Amount of Deduction :

Amount of deduction will be a sum of Rs 75,000 in all cases except a dependant person who suffers from severe disability person, in which case the amount of deduction will be Rs 1,00,000. The deduction will be available irrespective of the amount actually spent as long as the assessee incurs some amount of eligible expenditure, which need not be Rs 75,000 or 1 lakh rupees.

Conditions for of Deduction :

The deduction under this section will be allowed if the following conditions are fulfilled:-

- Deduction is available in respect of a dependant" A dependant person means in the case of an individual, the

spouse, children, parents, brothers and sisters of the individual or any of them and in the case of a Hindu undivided family, a member of the Hindu undivided family.

- (b) Such person must be dependant wholly or mainly on such individual or Hindu undivided family for his support and maintenance,
- (c) A dependant person must not claim any deduction u/s 80U while computing his total income for that assessment year;
- a) The assessee nominates either the handicapped dependent or any other person or trust to receive the payment under the scheme for the benefit of the handicapped dependent;
- b) In the event of the death of the subscriber assessee, the amount of annuity or lump-sum under the scheme is paid for the benefit of the handicapped dependent.
- c) If the handicapped dependent predeceases the subscriber assessee, then the amount so received shall form part of the total income of the subscriber assessee in the previous year in which the amount is received.
- d) The assessee must furnish a certificate from a neurologist (in case of children, a paediatric neurologist) or a civil surgeon or Chief Medical Officer of a Government hospital in form 10IA (in case of autism, cerebral palsy or multiple disability)
- e) Where the condition of disability requires reassessment, a fresh certificate shall have to be obtained on expiry of the period mentioned in the original certificate.

4.7 Deduction in respect of medical Treatment-Sec. 80DDB

Eligible Assessee :

Deduction u/s 80DDB can be claimed by an individual or a HUF assessee resident in India, Other assessees not eligible

Eligible Payments :

Amount actually paid for medical treatment of specified disease or ailment of the assessee himself or a person dependent on him or a member of HUF

Amount of Deduction

Amount of deduction under Sec 80DDB will be a sum , which is lower of the following :-

- Amount actually paid in the previous year or
- Rs. 40,000 or
- Rs 60,000, if such person or member is a senior citizen, or
- Rs 80,000, if the person or member is a very senior citizen.

Other Points

- i. Dependent relative means an individual himself or , his/her spouse, children, parents or brothers and sisters or a member of the HUF , who is wholly or mainly*

dependent for support and maintenance on the individual or the HUF

- ii. *"senior citizen" means an individual resident in India who is of the age of 60 years or more at any time during the relevant previous year;*
- iii. *"very senior citizen" means an individual resident in India who is of the age of 80 years or more at any time during the relevant previous year,*
- iv. The assessee shall furnish with the return of income, a certificate in prescribed form, from a neurologist, an oncologist, a urologist, a haematologist, an immunologist or such other prescribed specialist, working in a Government hospital :
- v. Amount of deduction shall be reduced by any amount received under an insurance from an insurer, or reimbursed by an employer

4.8 Deduction in respect of interest on loan taken for higher education Sec 80E

Eligible assessee

- Any individual assessee, whether resident or non-resident,
- who has taken loan
- from a financial institution or any approved charitable institution
- for pursuing higher studies of himself or his relative

Amount and term of deduction

- Interest on such loan paid by the assessee without any limit.
- Upto a maximum period of 8 years from the year in which the payment of interest on the loan begins or till the interest is paid in full, whichever is earlier.

Other Points

- i. Higher education" means any course or study pursued after passing Senior Secondary Education or its equivalent from any Government recognized school, Board or university.
- ii. Course may be any post-SSC course whether full -time or part time any Government recognised school, Board or university.
- iii. Higher education may be for the assessee himself or any of his relatives. Relative means the spouse and children of the assessee or the student for whom such individual is the guardian.
- iv. The deduction can be claimed by the student assessee himself if the interest is paid by him or his relative say father if interest on the student's loan is paid by the relative.

Illustration: 7

Advise A on the deduction in respect of interest on loan of Rs. 10 lakhs taken from SBI on 01/04/2014 for doing MBA repayable in 10 equal annual instalment carrying interest @ 10% per annum.

Solution:

A being the student himself, is eligible to get deduction/s 80E. A will be entitled to claim interest as under :-

Assessment Year	Interest allowable u/s 80E
2014-15	100,000
2015-16	90,000
2016-17	80,000
2017-18	70,000
2018-19	60,000
2019-20	50,000
2020-21	40,000
2021-22	30,000

Thereafter, for the remaining two years, no deduction will be available.

Illustration: 8

Will B father of A be entitled to deduction U/s 80E in respect of interest paid on A's Loan?

Solution:

Yes, if father pays the interest, he will be entitled to claim the deduction.

4.9 Deduction in case of a Person with Disability – 80UEligible assessee :

- Available to Individual resident of India
- With at least 40% disability
- at any time during the previous year.

Amount of deduction

- Person with minimum disability of 40%- Rs 75,000 and
- with severe case disability of over 80% - Rs. 1,25,000

Other Points

- 1) The deduction u/s 80U of Rs 75,000 or Rs 1,25,000 is of a flat amount . There is no requirement that the amount is spent or not.
- 2) Mere submission of a disability certificate in the prescribed form will be enough to avail the deduction alongwith the return of income of the assessment year for which the deduction is claimed for the first time.

- 3) Where the condition of disability requires reassessment of its extent after a period stipulated in the medical certificate, deduction for any year falling after the expiry of such period shall be allowed only if a new certificate is obtained and furnished.
- 4) "Disability" means blindness, low vision, leprosy-cured, hearing impairment, locomotor disability, mental retardation, mental illness, autism, cerebral palsy and multiple disabilities.
- 5) "Person with disability" means a person so referred under the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 or the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1995.
- 6) "Person with severe disability" means a person with 80% or more of one or more disabilities as referred to in Section 56(4) of the 1995 Act or a person with severe disability referred to in Section 2(o) of the 1999 Act referred to above.

5. ILLUSTRATION

Illustration 9

S presents the following data for the previous year 2015-16.

1. Business income Rs.8,10,000
 2. Capital Gains Rs. 3,15,000
 3. Payment of medical insurance premium on own life Rs.5,000
 4. He pays Rs. 20,000 to GIC for maintenance of his severely disabled son under an approved scheme.
 5. He has borrowed Rs 5,00,000 as educational loan for his younger son who pursues MBA from IIM and pays 10% interest on the loan.
 6. S himself his severely disabled.
- Determine the income of S for the assessment year 2016-17

Solution:

Computation of Total Income of X

		Rs
Business Income		8,10,000
Capital gains		3,15,000
Gross Total Income		11,25,000
Deductions under chapter -VIA-		
80D :Mediclaime	5,000	
80DD:Maintenance of dependent with severe disability	*1,00,000	
80E interest on study loan	50,000	
80U :Severe disability	*1,25,000	
Total Deductions under chapter -VIA		2,80,000
Total Income		8,45,000

For 80U full deduction available. Amt spent not relevant

6. SELF-EXAMINATION QUESTIONS:

1. Enumerate and explain various items of income, which are exempt from under Section 10.
2. Explain the difference between deduction and exemption with 3 suitable examples.
3. Define Gross Total Income.
4. Explain the deduction u/s 80C of the Income Tax Act, 1961.
5. What is the amount of maximum deductions u/s 80D?
6. Briefly explain the provisions available under the Income Tax Act relating to deductions from the Gross Total Income in the case of blind or physically handicapped person.
7. What are the exemptions available to foreign nationals in India?
8. Describe any 8 exemptions u/s 10 of the Income Tax Act, 1961.
9. Write short notes on:
 - a) Gratuity
 - b) Leave Salary
 - c) Retrenchment Compensation
 - d) House Rent Allowance
 - e) Dividends
 - f) Income of a minor child
10. Manan gets Rs 8,000 by letting out his agricultural land to a tenant who used the land for vermiculture. Clarify if Manan would be eligible for exemption for agricultural income with appropriate reasons.
11. The net profit as per the P & L A/c was Rs. 2, 85,000 after taking credit of Rs. 45,000 received on maturity of LIC policy and Rs. 30,000 as Interest from government securities and donation of Rs. 40,000 to BMC for promotion of family planning and Rs 5,000 as alms to destitute. He also pays Mediclaim for Rs 10,000 in cash and Rs. 10,000 by a credit card and Rs. 25,000 for his 70 year old father . Compute total income for the A.Y. 2016-17
 (Ans: Bus. Income 2,47,000, Other Sources 30,000 GTI 2,77,000, Total income 2,47,000)
12. A Resident person, who is physically handicapped (75%) earns a net income of Rs 5, 76,000 from a consultancy business run by him. Compute his total income for the AY 2016-17
 (Ans : Business income 576,000, deductions, 80U- 75,000 total Income 5,01,000)



COMPUTATION OF TOTAL INCOME

Synopsis

1. Introduction and Objective
2. Typical Illustrations on computation of income
3. Filing of Returns
4. Advance Tax
5. Self Assessment Questions.

1. INTRODUCTION AND OBJECTIVES

The lesson deals with procedural aspect of law in respect of like filing of income tax returns and payment of advance tax and other incidental matters like procedure for computation of total income of individuals, firms and companies, computation of tax liability etc.

As per the syllabus , law applicable as on as on 01/04/2016 will be considered for computation of total income for the assessment year 2016-17(previous year 2015-16; and the computation will be restricted to not more than two heads of income and two deductions at a time.

2. COMPUTATION OF TAXABLE INCOME-

2.1 Taxation Of individuals

Following are the salient features of the procedure law relating to preparation of income tax returns.

1. Collection of preliminary details :
 - a. Name of the assessee
 - b. Birth date and age
 - c. Gender
 - d. Residential status
 - e. Assessment year (2016-17)
 - f. Pervious year (2013-5-16)
 - g. Detail of parents and age
 - h. Detail of children and age
 - i. List of Relatives and Associate concerns

These detail may have an impact on the applicable tax rate (e.g. woman, senior citizen, deductions (e. g insurance premium, handicapped assessee , education loan etc.) , disallowances based on relation as in 40A(2) or exemption based on relation such as in Sec 56 regarding gifts etc.

2. Ascertainment of income under various heads of income as per the applicable provisions of laws
3. Income of other assessees which are to be included u/s 60-64 – clubbing provisions
4. Aggregate of income from all such sources, (excluding exempt income) is called the Gross total Income.
5. From the Gross Total Income reduce the amount of deductions available in Chapter VI A of the Act.
6. The Result will be the total income.
7. Ascertain the tax liability at appropriate rate applicable including special rates applicable to some items of income –horse race , Capital gains on shares.
8. From the tax liability, any tax rebates are to be reduced.
9. The result will be the net tax liability, from which any amounts deducted at source (TDS) or Tax Collected at Source (TCS), and taxes paid in advance are reduced.
10. The final balance, if payable is paid by way of self –assessment tax or if excess paid is shown as the refund due.

11. Other Important Points

- a) Clubbing provisions (S-60- 64), whereby income of other persons is included in the hands of the individual e.g. Income of the minor children
- b) Adjustment of agricultural income if in excess of Rs 5,000 is added in total income and then tax agricultural income is computed separately. Difference will be the tax liability
- c) Interest and remuneration from firm taxable if allowed in the hands of firm. Profit from the firm exempt as it is taxable in the hands of the firm

- d) Income of HUF is to be excluded as tax on such income will be payable by the HUF.
- e) Any loan taken from a company is deemed dividend u/s2 (22)) (e), if the individual has 10% voting power therein.

12. Income Tax Rates for Assessment Year 2016-17

A. In case of an Individual (resident or non-resident) or HUF or Association of Person or Body of Individual or any other artificial juridical person

Individuals	Senior Citizens	Very Senior Citizen#	Tax Rate
0- 2,50,000	0- 3,00,000	0-5,00,000	NIL
250,001 5,00,000	3,00,001- 5,00,000	-NA	10%
5,00,001-10,00,000			20%
10,00,001 and above			30%
Surcharge on Tax amount Applicable only where total income exceeds Rs one Cr Marginal Relief - Surcharge shall not exceed the amount of income tax payable on income over Rs 1 Cr.			12%
Education Cess on Tax amount			2%
Secondary and Higher Education Cess on tax and surcharge (SHE) on tax amount			1%
<p><i>*Senior Citizen is an individual, who has reached the age of 60 years at any time during the previous year but has not reached 80 years of the age as on the last day of the previous year</i></p> <p><i>#Very Senior Citizen is an individual , who has reached the age of 80 years at any time during the previous year</i></p> <p><i>The Tax rate is subject to rebate of 100% of tax or Rs 2,000 U/s 87A</i></p> <p><i>For assessee having income of Rs 5,00,000 or less</i></p>			

PROCEDURE OF COMPUTATION:

A. Preliminary Information
Name and address of the assessee , PAN Residential Status Assessment Year (2016-17) Previous Year -2015-16
B. Computation of Total Income
1. Income From Salary 2. Income From House Property 3. Profit And Gain of business and Profession 4. Capital Gains 5. Income From Other Sources
C. Gross Total Income (Total of B 1 to 5) Exclude exempt income
D. Deduction under chapter VIA
E. Total Income [D-E]
F. Ascertain Tax Liability Tax at applicable rates + Surcharge Add –Education Cess -2 % on tax Add Secondary and Higher Education Cess @ 1% of tax
G. Less : Rebates, Advance Tax , TDS , TCS
H. Add : Interest Payable To Government
I Self Assessment Tax / Refund Due (F-G+H)

Illustration -1.

Ascertain the tax liability of Rajesh, whose total income is Rs 5,00,000 and also show if there will be any difference in the tax liability if he also has Agricultural income Rs 2,00,000

Solution

I If Agricultural income is totally exempt

	Rs
Tax on first Rs 2,50,000	NIL
On Next Rs 2,50,000 @ 10%	25,000
Total	25,000
Less Rebate U/s 87A	2,000
	23,000
Add Cess EC+SHEC	690
Total Tax on Rs 5,00,000	23,690

II If Income includes Agricultural income

(a) Tax on Total income plus agricultural income
Rs 5,00,000 + 2,00,000 = Rs 7,00,000

	Rs
Tax on first Rs 2,50,000	NIL
On Next Rs 2,50,000 @ 10%	25,000
On Balance Rs 2,00,000 @ 20%	40,000
	65,000
Add Cess EC+SHEC	1,950
Total Tax on Rs 7,00,000	66,950

(b) Tax on basic limit plus agriculture income - Rs 18,540
Rs 2,00,000 + 2,50,000 = Rs 4,50,000
[First 2,50,000 – NIL + Next 2,00,000 @ 10% - Rs 20,000]

Tax payable (a)- (b) or Rs 66,950 – 20,000 = Rs 46,950

Normal tax works out to Rs 23,690 , against Rs 46,950 .This implies that agricultural income is indirectly taxed.

2.3. Specific points applicable to Partnership Firms

U/s 184 the; partnership firm are classified as the (a) partnership firm assessed as such (PFAS) or (b) partnership firm assessed as an association of person. Firms including Limited Liability Partnerships (LLP) are liable to uniform tax rate of 30 % surcharge of 12% of tax if firm's income exceeds Rs 1 Cr (subject to marginal relief that surcharge and .9% (30% + 3% Cess) without any basic exemption. However the firms have to comply with certain procedural requirements given below:-

- The firm shall be evidenced by a partnership deed and the deed must specify the individual shares of the partners. [Sec. 184(1)]
- The firm must file a certified copy of the partnership deed along with the return of income in the first year. [Sec.184 (2)]

- In case of a change in the constitution of the firm or in the sharing ratio of partners, a certified copy of the revised deed of partnership must be submitted along with the return of income for that year. [Sec. 184(4)]
- There should not be any failure on the part of the firm as is specified in Sec. 144 [Sec. 184(5)]
- After the first year, the firm continues to be assessed as firm, unless there is change in either firm's constitution or partner's profit sharing ratio and the firm does not satisfy the above conditions. However, there should not be any failure mentioned in sec. 144. [Sec. 184(3)]
- A partnership deed shall be certified in writing by all the major partners. In case of a dissolved firm, and the return is filed after its dissolution, the copy of deed may be certified by all the major partners in the firm immediately before the dissolution. A legal heir can sign for a deceased partner. [Sec. 184(2) Expl.]
- Besides, provisions relating to remuneration and interest paid to partners must be specified in the deed, otherwise the same are not allowed to be deducted in computing the income of the firm.
(These provisions are dealt with in the lesson dealing in profits and gains of business)
- If a firm is not assessed as a firm it will be treated as AOP and shall pay tax at the maximum marginal rate. The income will again be added in the income of partners but they will be entitled to rebate u/s 86.

2.4. Specific points applicable to Companies:

The companies are classified as (a) Domestic and (b) foreign companies. Domestic companies are again of two types (a) Widely held companies and (b) Closely held companies. Different tax rates are applicable on these companies as would appear from the following:

- Domestic Companies: Tax @ 30%, Surcharge 2.5% and Education cess and SHEC 3% on tax and surcharge (effectively 31.6725%)
- Foreign Companies: Tax @ 40% , Surcharge 2% and Education cess and SHEC 3% on tax and surcharge (effectively 42.024%)
- *Surcharge is payable if the total income exceeds Rs 1 Crore.*

- Some provisions like 40A(2) excessive payment to directors and their relatives, 35 D amortization of expenses are applicable only on companies, merger, demerger, amalgamation, ESOP/ESOS are applicable on company assessees. Companies are also liable to pay Minimum alternative Tax 18.5%).

(Discussed under the head capital gains and profits and gains of business and profession to the extent covered in the syllabus.)

3. ILLUSTRATIONS

Illustration 1

Compute the taxable income of Mangesh for the AY 2016-17 from the following and also compute the tax liability.:

Profit and Loss Account for the year ended 31st March, 2014			
Particulars	Rs.	Particulars	Rs.
To Salaries	2,10,000	By Gross Profit	5,18,000
To Rent	20,000	By Interest on Bank FD	8,000
To postage	7,000	By Dividend-Indian Co	20,000
To Stationery & Ptg	27,000	By dividend from -Co-Op Bank	2,000
To Advertising Exp.	20,000	By Lottery Prize	15,000
To Repairs to Office	22,700	By Interest on Debentures	5,000
To Conveyance	17,000		
To Income Tax	30,000		
To IT scrutiny Exp	4,000		
To CA's Fees for Tax	10,000		
To Misc. Expenses	25,000		
To Depreciation	5,000		
To Donation	20,000		
To Net Profit	1,50,300		
	<u>5,68,000</u>		<u>5,68,000</u>

Additional Information:

- (1) Salaries include bonus due to employees Rs. 30,000 which was not paid before the due date of filing of Income Tax return.
- (2) Rent is paid for the residential house of Mr. Mangesh.
- (3) Repairs to office include a one-time cash payment of Rs. 20,000 on 18/08/2015.
- (4) Miscellaneous expenses include purchase of shares of an Indian company for Rs. 20,000.
- (5) Donations include charity of Rs. 15,000 and Rs 5,000 given to GIC for maintenance of his handicapped brother.
- (6) Depreciation as per Income tax rules is Rs. 4,000.

Solution:

Computation of Total Income of Mangesh for A.Y. 2016-17		
Particulars	Rs	Rs
Income from Business		
Net Profit as per P/L Account		1,50,300
<u>Add: Disallowable Expenditure</u>		
Bonus due but not paid u/s 43B	30,000	
Rent (Personal)	20,000	
Purchase of share (Misc Exp)	20,000	
Income Tax	30,000	
Donation (15,000+ 5,000)	20,000	
Depreciation	<u>5,000</u>	<u>1,25,000</u>
		2,75,300
<u>Less: Income Considered Separately</u>		
Interest on Bank FD	8,000	
Dividend from Indian Company	20,000	
Dividend from Co-operative Bank	2,000	
Winning from Lottery	15,000	
Interest on Debentures of Ltd Co	<u>5,000</u>	<u>50,000</u>
		2,25,300

Less: Depreciation as per rules		<u>4,000</u>
INCOME FROM BUSINESS		2,21,300
II <u>Income from Other Sources</u>		
Interest on Bank FD	8,000	
Dividend from Indian Company (Exempt)	0	
Dividend from Co-operative Bank	2,000	
Winning from Lottery	15,000	
Interest on Debentures of Ltd Co	<u>5,000</u>	
INCOME FROM OTHER SOURCES		30,000
GROSS TOTAL INCOME		2,51,300
Less: Deductions- under Ch. VI-A		
80-DD: Maint. of handicapped dependant		<u>50,000</u>
TAXABLE INCOME		<u><u>2,21,300</u></u>
Tax Payable		2,130
Surcharge -3%		<u>64</u>
Total Tax Payable		2,194

Note: To claim deduction u/s 80DD, it is not necessary that there must be actual expenses incurred on handicapped dependent.

Illustration 2

Compute the total income and ascertain the tax liability of Sam for the A.Y. 2016-17 from the following Profit and Loss Account:

<i>Profit and Loss Account for the year ended 31st March, 201.</i>			
<i>Particulars</i>	<i>Rs.</i>	<i>Particulars</i>	<i>Rs.</i>
To Salaries	1,30,000	By Gross Profit	7,67,000
To Rent	30,000	By UTI Dividend	9,000
To Entertainment Exp	18,000	By LIC Mutual	5,000
To Printing & Stn	25,000	By Gift from Mother	5,000
To Advt Exp	50,000	By Winning- Puzzle	12,000
To Motor Car Exp	30,000	By Interest on NSC	3,000
To Drawings	60,000		
To Income Tax	16,000		
To Embezzlement -Employee	7,000		
To Staff Welfare Exp	70,000		
To Donation	30,000		
To Depreciation	35,000		
To Net Profit	<u>3,00,000</u>		
Total	<u>8,01,000</u>		<u>8,01,000</u>

Additional Information:

- (1) Depreciation as per Income tax rules is Rs. 38,000.
- (2) Staff Welfare expenses include Rs. 20,000 for his own treatment.
- (3) 50% of the rent is paid for his residential house
- (4) Printing includes Rs. 5,000 paid for printing marriage cards for his daughter's marriage

Solution:

Computation of Total Income of Sam for AY: 2016-17			
	Rs	Rs	Rs
I Income from Business			
Net Profit as per P/L Account		3,00,000	
Add: Disallowable Expenditure			
Own Medical Expenses	20,000		
Rent (Personal)	15,000		
Printing of Marriage Cards	5,000		
Income Tax	16,000		
Donation	30,000		
Depreciation	35,000		
Drawings	<u>60,000</u>	<u>1,81,000</u>	
Less: Income Considered Separately		4,81,000	
UTI Dividend	9,000		
Income from LIC Mutual Fund	5,000		
Gift from Mother	5,000		
Winning from Crossword Puzzle	12,000		
Interest on NSC	<u>3,000</u>	<u>34,000</u>	
Less: Depreciation as per rules		4,47,000	
<u>INCOME FROM BUSINESS</u>		<u>38,000</u>	4,09,000
II Income from Other Sources			
UTI Dividend (exempt)		Nil	
LIC Mutual Fund (exempt)		Nil	
Gift from Mother (exempt)		Nil	
Winning from Crossword Puzzle		12,000	
Interest on NSC		<u>3,000</u>	
<u>INCOME FROM OTHER SOURCES</u>		<u>15,000</u>	<u>15,000</u>
GROSS TOTAL INCOME			4,24,000
<u>Less:</u> Deductions under Chapter VI-A			
80-C NSC Interest Re-invested		3,000	<u>3,000</u>
TAXABLE INCOME			4,21,000
Tax Payable on Income			24100
Surcharge @3%			723
Total Tax			24,823

Illustration 3

Mr. Joshi is a Chartered Accountant, Following is his Receipt and Payments Account for the year ended 31st March, 2016.

Receipts	Rs.	Payments	Rs.
To Cash & Bank B/f	70,000	By Office Rent	6,000
To Fees from Clients (net)	6,60,000	By Ptg & Stn	5,000
To Hon. For Articles	40,000	By Gifts to Staff	11,000
To Dividend-Indian Co	5,000	By General Exp.	14,000
To Interest- Bank SB A/c	2,000	By Motor Car Exp	16,000
To Interest.-on PO SB A/c	3,000	By Telephone Exp	12,000
To Interest- Bank FD	8,000	By Income Tax	40,000
To Int. on Govt Securities	6,000	By Drawings	1,20,000
To Sale of Motor Car	1,00,000	By Car Insurance	12,000
		By conveyance	13,000
		By Tally Software	19,000
		By LIC Premium paid	64,000
		By Salaries to Staff	12,000
		By Computer (cost)	50,000
		By Cash & Bank C/f	5,00,000
TOTAL	8,94,000	TOTAL	8,94,000

Additional Information:

- (1) Computer was purchased on July 1, 2015 and depreciation is allowed @ 60% on the same.
- (2) Opening WDV of Block of Motor Cars consisting of 2 Motor Cars was Rs. 2,50,000 and depreciation is allowed @ 20% on the same.
- (3) Personal use of the Motor car is estimated to be 25%.
- (4) Fees from clients are after TDS of Rs. 2,000.
- (5) General expenses include a sum of Rs. 4,000 given to his daughter as birthday gift.
- (6) Drawings include a sum of Rs. 30,000 given premium for self and family of Rs. 20,000 and Rs. 10,000 for his father, who is a senior citizen/.

Compute the net taxable income of Joshi for the AY 2016-17.

Solution:

Computation of Total Income of S. V. Joshi –Asst. Year 2016-17		
Particulars	Rs	Rs
<u>Income from Profession</u>		
Fees from Clients	5,60,000	
Add: Tax Deducted at Sources	<u>2,000</u>	5,62,000
<u>Less:</u> Allowable Expenses		
Depreciation on Motor Car	22,500	
Motor Car Expenses @ 75%	12,000	
Office Rent	6,000	
Printing and Stationery	5,000	
General Expenses	10,000	
Motor Car Insurance @ 75%	9,000	
Telephone Expenses	12,000	
Conveyance Expenses	13,000	
Depreciation on Computer @ 60%	30,000	
Salaries to Staff	2,000	
Gifts to Staff	<u>11,000</u>	-
<u>INCOME FROM BUSINESS</u>		<u>1,32,500</u>
		5,29,500
<u>II Income from Other Sources:</u>		
Receipts for Writing Articles	40,000	
Interest on Fixed Deposit	8,000	
Interest on Government Securities	6,000	
Interest on SB Account	2,000	
Interest on PO Savings Account (exempt)	Nil	
Dividend from Indian Companies (exempt)	<u>Nil</u>	
INCOME FROM OTHER SOURCES	<u>56,000</u>	<u>56,000</u>
GROSS TOTAL INCOME		<u>5,85,500</u>
<u>Less: Deductions under Chapter VI-A</u>		
80-C Life Insurance paid	64,000	
80-D Medical insurance Premia : Rs 30,000 for father + Rs. 25,000 for self=maximum	<u>55,000</u>	<u>1,19,000</u>
TAXABLE INCOME		4,66,500
Tax Payable on Income		11650
Surcharge @ 3%		350
Total Tax		13,000

Illustration 4

Compute total income and tax liability on the income of X from the particulars given below:

Basic pay: Rs. 20,000 pm

Education allowance for one child: Rs. 300 pm

Bonus: Rs. 20,000

Salary in lieu of leave: Rs. 15,000

He contributed Rs. 18,400 to the recognized provident fund and an equal amount was contributed by his employer. He received Rs. 14,000 from bank as interest, dividend of Rs. 10,000 from a foreign company and winning from horse race of Rs. 42,500 (gross). He paid Rs. 500 professional tax.

Solution

COMPUTATION OF TOTAL INCOME – A.Y. 2016-17		
Basic Salary 20,000 X 12)		2,40,000
Education allowance (300 X 12)	3,600	
Less: Exempt (100 X 12)	<u>1,200</u>	2,400
Bonus		20,000
Leave Encashment		15,000
		1,81,400
Less Profession Tax		500
Income from Salaries		1,80,900
Dividend from foreign company	10,000	
Winnings from Horse Race	42,500	
Bank Interest	14,000	
Income from Other Sources		66,500
Total Income		3,43,400
Tax Payable		8,340
Education Cess -3% of Tax		250
Total Tax		8,590

Illustration-5

ABC is a partnership Firm carrying on a business, in which A, B, and C are partners sharing profits and losses equally. In respect of Assessment Year 2016-17 it furnishes the following particulars (*amounts in Rs.*):

- 1 Net loss as per P/L A/c after debiting remuneration/ Interest to partners Rs 2,50,000

- 2 Remuneration paid to partner – A Rs 90,000, B Rs 60,000 & C Rs 30,000
- 3 Interest paid to partners @ 20% per annum on their capital of Rs 1,00,000 each as of 01/04/2015

You are required to work out the income of the firm and the partners A, B and C assuming that partners have no other income.

Solution:

COMPUTATION OF TOTAL INCOME OF FIRM		
Net Profit as per Profit and Loss A/c (Loss)		[2,50,000]
Add: Remuneration to Partners	1,80,000	
Interest to partners - 20,000 X3	60,000	2,40,000
Profit before remuneration & Interest		[10,000]
Less: Less: Interest allowable only upto 12		36,000
Profit before remuneration		
Max. Remuneration upto profit		1,50,000
LOSS		[186000]

TAXABLE INCOME IN THE HANDS OF PARTNERS

	A	B	C
Salary	75000	50000	25000
Interest	12000	12000	12000
Total Income	87000	62000	37000

- Salary allowed as deduction to firm Rs 1,50,000 taxed in the hands of partners in the ratio of the salary paid to them by firm 90:60:30
- Interest allowed to firm will also be taxed in the hand of the partners
- Total Income of Partners i.e. Salary and Interest taxable as Profits and Gains from Business or Profession:
- Excess of salary and interest, which was disallowed in the hands of the firm is not liable to be taxed in the hands of the partners.

4. PAYMENT OF ADVANCE TAX -SECTIONS 207-219

4.1 Advance tax is payable by all types of persons- individual, firms HUF Companies etc irrespective of their residential Status during the financial year itself in respect of the assessment year next following the financial year if such tax liability for payment of tax is Rs.10,000 or more- (S 208) . Further, the advance tax is payable on total income of the year from all sources i.e. salary, business, profession house property, capital gains or other sources.

4.2. Amount and due Dates for payment of Advance Tax;

Advance tax is payable four instalments by the companies and in three instalments by other assessees as per the following table:

PAYMENT OF ADVANCE TAX			
Instalment	Due date for Payment	Companies	Other Assesseees
Tax Payable as % of total tax			
I	15 June	Not Less than 15%	Not applicable
II	15 September	Not Less than 45%	Not Less than 30%
III	15 December	Not Less than 75%	Not Less than 60%
IV	15 March	Not Less than 100%	Not Less than 100%
Payment made by 31 st March considered Advance Tax			

4.3. Miscellaneous;

- Advance tax is payable by the assess on the current income estimated by it
- The Assessing officer may, serve a notice upon the assessee to pay advance tax on the basis of the last regular assessment and if the assessee does not pay the advance tax he/it shall be deemed to be an assessee in default.
- For shortfall / non- payment assessee will be liable to pay inters U/s 234 B and 234 C.

Illustration -5:

Explain the liability for Advance Tax payment by Mr. Ramesh whose Income is estimated to be Rs 8,00,000 for the A.Y. 2017-18

Solution:

Ramesh is a non-corporate assessee. Tax on his income of Rs 8,00,000 works out to Rs. 87,550 , which is more than Rs.10,000. Hence Ramesh is liable to pay advance tax as under:

I – 30%	15th September,2016	Rs 26265
II- 60%	15th December,2016	Rs 26,265
III-100%	15th March,2017	Rs 35,020

Illustration-6:

Explain the liability for Advance Tax payment by Ramesh Limited whose Income is estimated at Rs 8,00,000 during the financial year 2016-17 (A. Y. 2017-18)

Solution:

Ramesh Ltd is a company assessee liable to pay tax of Rs 2,47,200 on total income of Rs 8,00,000 , which is more than Rs.10,000. Hence Ramesh Ltd is liable to pay advance tax as under:

Instalment	Last Date for payment	Amount payable
I – 15%	15th June,2012	Rs 37,080
II- 45%	15th September,2012	Rs 1,11,240
III-75%	15th December,2012	Rs 1,85,400
IV-100%	15th March,2013	Rs 247,200

5. FILING OF RETURNS- SEC 139(1) AND 139(5)

5.1. LIABILITY FOR FILING RETURNS:

Section 139(1) casts the burden of filing return of income or loss on assessee. For some of the assesseees it is mandatory to file on or before the due date a return of income or loss for the previous year in prescribed form, Verified in prescribed manner and setting forth such other particulars as may be prescribed

For the following ,assesseees filing the return of income is mandatory:

1. Companies and Firms

2. Every Person (other than a company or a firm,) if his total income or the total income of any other person in respect of which he is assessable under the Act during the previous year exceeds the basic exemption limit.

(3) Further, every person, being an individual or a HUF or an AOP or BOI or an artificial juridical person—

– whose total income or the total income of any other person in respect of which he is assessable under this Act during the previous year

– Without giving effect to the provisions of section 10A or 10B or 10BA or Chapter VI-A exceeds the basic exemption limit is required to file a return of his income or income of such other person—

2. For companies and other assesseees having tax audit or having income of Rs 10 lakhs or more , filing of return in a digitally signed electronic form is mandatory.(Section 139D)

5.2. DUE DATE FOR FILING RETURN OF INCOME;

A return of income has to be filed on or before the due date of filing return. , 'Due date' means -

(a) 30th September of the assessment year, where the assessee is -

- (i) a company; or
- (ii) a person (other than a company) whose accounts are required to be audited under the Income-tax Act, 1961 or any other law in force; or
- (iii) a working partner of a firm whose accounts are required to be audited under the Income-tax Act, 1961 or any other law for the time being in force.

(b) 31st July of the assessment year, in the case of any assessee other than those covered in (a) above.

Illustrations : -

1. XYZ Limited shall file the return of income for the A.Y. 2016-17 on or before 30/09/2016
2. X having income of Rs 50,000 , is not liable to file his return of income .
3. Z has a loss of Rs 2 lakhs, and his accounts are not audited, due date in his case will be 31/07/2016

5.3 REVISED RETURN – SECTION 139(5)

If any person having furnished a return under section 139(1) or in pursuance of a notice issued under section 142(1), discovers any omission or any wrong statement therein, he may furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before completion of assessment, whichever is earlier.

From the above , it is apparent that a *belated return and it cannot be revised. It may be noted that a belated return can be filed under S 139(4) within one year from the end of the assessment year i.e. 31/03/2015 in case of a belated return for AY 2016-17.*

5.4 OTHER POINTS :

- CBDT is vested with the powers to prescribe forms of return
- A return must be properly verified and signed by an individual or partner of a firm or a director of company etc.
- Consequences of late filing of return ;
 - Liability for Interest @ 1% per month U/s 234A
 - Penalty of Rs 5,000 if return filed after 31st March of the assessment year U/s 271
 - Certain exemptions cannot be claimed
 - Return cannot be revised
 - Loss is not allowed to be carried forward.

6. Prescribed returns for the Asst Year 2016-17re as follows

Form	By Whom to be filed
ITR-1 SAHAJ	Individuals having <ul style="list-style-type: none"> • Income from salary/pension: or • Income from one house property(excluding where loss brought forward from previous year): or • Income from other sources(excluding winnings from lottery and income from races horses) • In a case where income of another person like spouse, minor child, is to be clubbed with the assessee this return form can be used only if the income being clubbed falls in to above income categories.

ITR-2	Individuals and HUFs <ul style="list-style-type: none"> • Not covered by ITR-1 and • Not having "Profits or gains of business or profession"
ITR-3	Individuals and HUFs <ul style="list-style-type: none"> • being partners in firms having income as any interest, salary, bonus, commission or remuneration from the firm and • not carrying out business or profession under any proprietorship
SUGAM (ITR-4S)	Sugam - Presumptive Business Income tax Return 44AD /44AE
ITR-4	For individuals and HUFs <ul style="list-style-type: none"> • Not covered above and • having income from a proprietary business or profession
ITR-5	For firms, AOPs and BOIs and Others Applicable for All source of Incomes
ITR- 6	Company other than companies claiming exemption u/s 11
ITR-7	person including a company whether or not registered under section 25 of the Companies Act, 1956 required to file a return 139(4A) /(4B) / (4C) or (4D)
ITR-8	Acknowledgment English where data submitted without digital signatures
ITR-V	Acknowledgment English

4. SELF ASSESSMENT QUESTIONS

1. Discuss the provisions of the advance Tax in the income tax Act.
2. Explain advance tax liability of Ms. ABC if her income will be Rs15,00,000.
3. What are the due dates of payment of advance tax by different assessees ?
4. Mr. Ram gives you the Profit and Loss Account for the year ended 31st March, 2015. You are required to compute the total income of Ram for AY 2016-17 assuming that Ram has paid LIC premium of Rs. 5,000.and interest of Rs 25,000 for educational loan of his son.

Profit and Loss Account for the year ended 31 st March 2016			
Particulars	Rs.	Particulars	Rs.
To Opening Stock	1,60,000	By Sales	18,50,000
To Purchases	14,05,000	By Closing Stock	1,08,500
To Salaries	1,84,350	By Winnings	5,000
To Office Expenses	70,040	from Lottery	
To Office Rent	20,000	By Interest on fixed deposits	15,000
To Staff Welfare	13,000	with bank	16,000
To Advertisement	65,000	By Interest on RBI Bonds	20,000
Exp. To Donations	5,000	(exempt u/s 10)	
To R.D.D.	10,000	By bad debts recovered	9,000
To Mediclaim (Cash)	21,000	By dividend from Indian companies	
To insurance	10,000		
To Income Tax	20,000		
To Depreciation	32,110		
To Net Profit	<u>20,23,500</u>		<u>20,23,500</u>

Additional Information:

- a) Advertisement expenses include Rs. 11,000 for advertisement in a souvenir of a local political party and Rs. 20,000 for introducing a new product in the market.
 - b) Donations are given for books to poor students
 - c) On August 10, 2015 furniture of Rs. 20,000 was purchased on credit the payment for which was made on April 2, 2016. The same was not recorded in the books of accounts. The rate of depreciation on furniture is 15% per annum. On other fixed assets, depreciation was charged exactly as per I.T. Rules.
 - d) Bad debts recovered were allowed during the A.Y 2009-10.
5. Sheela who is suffering from a permanent disability, received the following emoluments from SWY Ltd, her employer for last 10 years during the year ended March 31, 2016: You are required to compute her total income for the AY 2016-17.

Basic Salary (NET) April 1, 2015 to September 30, 2015	Rs. 10,000 p.m. (TDS Rs 600 P.M) , (Profession Tax Rs 1,250 P.M.)
October 1, 2015 to March 31, 2016	Rs. 12,000 p.m. (TDS Rs. 700 p.m.) (Profession Tax Rs 1,250 P.M.)
Dearness Allowance	40% of basic salary
Entertainment Allowance (Actually spent Rs. 300 p.m.)	Rs. 500 p.m.
Bonus for the year	Rs. 8,000
Conveyance Allowance (Actually spent Rs. 800 p.m.)	Rs. 1,000 p.m.

- 1) Commission from employer is 1% of turnover of Rs. 10 lakhs;.
- 2) She needs a personal physical attendant whose salary of Rs. 2,000 p.m. was paid by the employer.
- 3) She paid Medclaim insurance of Rs. 12,000 for himself and Rs. 5,000 for his brother. Statutory Provident Fund @ 10% of basic salary was deducted from her salary.

6. Mrs. Sweety aged 66 years took voluntary retirement on January 1, 2016 from a private bank after completing 26 years and 11 months of service. She furnishes you with the following information: Compute her net taxable income for the AY 2014-15. After retirement, She delivers lectures as guest faculty in Indian Institute of Banking for which She receives honorarium of Rs. 22,000. She paid Medclaim premium of Rs. 13,200 by crossed cheque. She invests Rs. 50,000 in National Saving Certificates. She received gifts from her colleagues for Rs. 3,00,000 in January 2015.

Basic Salary	Rs. 2,800 p.m.
Dearness Allowance	128% of basic salary
Conveyance Allowance (actual expenses. For official purpose Rs. 600 p.m.)	Rs. 900 p.m.
Gratuity	Rs. 1,29,200
Commuted pension	Rs. 67,500
Leave Encashment	3 months basic salary
Uncommuted pension	Rs. 2,500 p.m.
Voluntary retirement compensation	Rs. 8,72,000
Profession tax paid	Rs. 1,200

7. Compute total income of Krishna for the AY 2016-17 from the Profit and Loss Account of his proprietary concern for the year ended March 31, 2016.

Particulars	Rs.	Particulars	Rs.
To Opening Stock	2,34,000	By Sales	12,40,000
To Purchase	10,00,000	By Closing Stock	2,05,000
To Office Salaries	57,000	By Income Tax Refund	15,000
To Proprietor's Salaries	30,000	(including interest Rs. 2,000)	
To Bad Debts	25,000	By Dividend from UTI	20,000
To Advertisement	10,500	By Dividend from Y Ltd (an Indian Company)	25,000
To Fire Insurance Premium	4,500	By Interest on PPF	5,000
To Conveyance Exp	6,000	By Lottery prize received	10,000
To Interest on Proprietor's Funds	25,000		
To Medical Expenses	20,000		
To General Expenses	35,000		
To Wealth Tax paid	5,000		
To Residential Telephone expenses	14,000		
To Depreciation	30,000		
To Net Profit	20,000		
	<u>15,20,000</u>		<u>1520,000</u>

Additional Information

- The residential telephone is used half the time for office work.
 - Purchases include Rs. 1,00,000 paid for cash purchases, exceeding the limits prescribed under Section 40A(3).
 - General expenses include advance income tax of Rs. 10,000 paid during the year and Rs. 500 for purchase of lottery tickets.
 - Depreciation allowable as per Income Tax Rules Rs. 25,000
 - Agricultural income Rs.70,000.
8. Compute total income of R with 40% disability, from following information regarding his house property for the AY 2016-17

Particulars	HOUSE I	HOUSE II
Fair Rent	40,000	60,000
Municipal Valuation	55,000	50,000
Rent received	60,000	--
Municipal tax:		
(a) Paid by the tenant	4,000	--
(b) Paid by Ri	6,000	5,000
Interest on capital borrowed (due but not paid) for the purpose of construction of house property	6,000	13,000
Ground Rent	2,000	--
Insurance premium paid	1,500	--
Other information:		--
(i) Interest from debentures in Y Ltd	12,000	--
(ii) Dividend from UTI	5,000	--
(iii) Bank interest from SBI	3,500	--
(iv) Winning from lottery	28,000	--
(v) Interest from Post Office Savings Account	5,000	--
(vi) Dividend from a co-operative society	5,000	



SECTION –II: INDIRECT TAXES

10

INTRODUCTION TO SERVICE TAX

Synopsis

1. Introduction and objectives:
2. Legal framework
3. Taxability of Services
4. Self-Examination Questions

1. INTRODUCTION AND OBJECTIVES:

In response to the Chelliah Committee on Tax, which recommended for bringing the service tax under the tax net, the Finance Act, 1994 introduced a modest 5% service tax on three services viz. telephone services, Non-life insurance and stock brokers' services with effect from 01 July, 1994.

The list of taxable services was systematically expanded from time to time to include as many as 119 services in 2012. The rate of service tax also increased from 5% in 1994 to 8% in 2003, 10% in 2004 and 12% in 2006. After a reduction to 9% in 2009, the present rate of service tax is 15% in 2016.

Upto 2012, service tax regime was selective and only specified services were taxed on selective basis. In a paradigm shift in the manner of taxing services, the Finance Act, 2012, introduced with effect from 01 July, 2012 the comprehensive or negative tax regime applicable where by all services were made liable to service tax, unless they were exempt or were included in the negative list.

This lesson, followed by next lessons will deal with the mechanism for levy of service tax in India in the light of various legal provisions made up to 01/04/2016

2. LEGAL FRAMEWORK :

2.1 There is no separate legislation for levy of service tax. Instead, sections 64 to 98 of Chapters V and VA of the Finance Act, 1994 provide for the scheme and mechanism for levy of the tax and allied matters. The Act extends to the whole of India (including the

designated areas in the Continental Shelf and Exclusive Economic Zone of India except the state of Jammu & Kashmir. Any reference to sections will be construed as reference to the sections of the Finance Act, 1994

2.2 Rate of service tax fixed u/s 66B of the Finance Act, 1994 is at 14% . Besides, U/s 19 (chapter v) of the Finance Act, 2015 0.5% Swachh Bharat Cess (SBC) is also payable with effect from 07 November, 2015, taking the effective service tax rate to 14.5%. Moreover with effect from 01- July 2016 Krishi Kalyan Cess (KKC) @ 0.5% is also payable . Hence effective service tax rate as of now is 15%. (As per syllabus amendment upto 01/04/2016 are only to be considered, hence effective rate for academic year 2016-17 will be 14.5% .

Earlier, Education Cess (EC) @ 2% Secondary and Higher Education Cess (SHE) of 1% on service tax were payable vide Finance Act, 2004 & 2007 respectively and effective service tax rate was 12.36%. With the introduction of KKC / SBC, EC and SHEC are not applicable .

2.3 A brief summary of provisions dealing with levy and collection of service tax is given below:

Sec	Subject matter
64	Extent, commencement & application of the service tax
65	Definitions of various terms used in the Act
65A	Classification of Taxable Services
65B	Interpretation of Various Terms
66	Charge of Service tax –up to 30-06-2012
66A	Charge of service tax on services received from outside India,
66B	Charging Section w. e. f. 01-07-2012
66C	Determination of Place of provision of service
66D	Negative list of services
66E	Declared Services
66F	Principles of interpretation of specific description of services or bundled services
67	Valuation of taxable services for charging Service tax
67A	Date of determination of rate of tax, value of taxable services and rate of exchange
68	Payment of Service Tax
69- 98	Procedural matters including registration, filing of returns appeals, revision, assessment, penalties etc.

2.4 For administration of the service tax regime a number of rules have been framed such as:

- (a) Service Tax Rules, 1994
- (b) Service Tax (Advance Ruling) Rules, 2003
- (c) CENVAT Credit Rules, 2004
- (d) Export of Services Rules, 2005
- (e) Service Tax (Registration of Special Category of Persons) Rules, 2005
- (f) Service Tax (Determination of Value) Rules, 2006
- (g) Taxation of Services (Provided from Outside India and Received in India) Rules, 2006
- (h) Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007
- (i) Service Tax (Publication of Names) Rules, 2008
- (j) Service Tax (Provisional Attachment of Property) Rules, 2008
- (k) Service Tax Return Preparers Scheme, 2009
- (l) Service Tax (Removal of Difficulty) Order, 2012
- (m) The Point of Taxation Rules, 2011 and
- (n) The Place of Provision of Services Rules, 2012
- (o) Indirect Tax Ombudsman Guidelines, 2011
- (p) Service Tax (Settlement of Cases) Rules, 2012;
- (q) Service Tax (Compounding of Offences) Rules, 2012.

2.5 The Central Board of Excise and Customs (CBEC) has been entrusted with the task to administer the Service Tax. The CBEC and the Central Government Issue, notifications, trade notices, circulars and orders granting exemptions, abatements and clarifications on various issues from time to time.

2.6 For meanings of various terms, definitions of services and service providers etc., the Act refers to various other laws such as Architects Act, 1972, Chartered Accountants Act 1949, Motor Vehicles Act, 1988, Banking Regulation Act, 1949 etc. Words and expressions not defined in the Act but defined in Central Excise Act, 1944 or rules made thereunder, apply to service tax as well.

3. TAXABILITY OF SERVICES

3.1 Charge of Service Tax

Section 66B of the Finance Act ,1994 provides that with effect from 01-07-2012 , there shall be levied a service tax @ 14% on the *value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another* and collected in such manner as may be prescribed. In addition , Swachh Bharat Cess(SBC) of 0.5% w. e. f. Nov 5, 2015 and 0.5% Krishi Kalyan Cess (KKC) are also payable

Hence, as per sec. 66B the following elements are essential to attract liability for service tax :-

- (a) There must be provision of some service ;
- (b) Service must be provided
 - a. by one person
 - b. to another ;
- (c) for consideration immediate or deferred ;
- (d) Service may be provided immediately or may be provided in future ;
- (e) Service must be provide within the taxable territory ; and
- (f) Such Service is not in the negative or excluded list or otherwise exempt.

These elements are taken up for discussion in the lesson later.

3.2.1 Service

Section 65B (44) defines. "Service" means any activity carried out by a person for another for consideration, **and includes** declared service, **but shall not include—**

- (a) an activity which constitutes merely , -
 - (i) a transfer of title in **goods or immovable property**, by way of sale, gift or in any other manner; or
 - (ii) such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of Art 366 (29A) of the Constitution; or (interstates Sales)
 - (iii) a transaction in **money or actionable claim**;

The section vide expalantion-2 clarifies that transaction in money or actionable claim shall not include the following :-

- (a) any activity relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or

denomination for which a separate consideration is charged. Hence, services of authorized foreign exchange dealers not be taxable)

(b) any activity carried out, for a consideration, in relation to, or for facilitation of, a transaction in money or actionable claim, including the activity carried out

a. by a lottery distributor or selling agent on behalf of the State Government, in relation to promotion, marketing, organising, selling of lottery or facilitating in organising lottery of any kind, in any other manner, in accordance with the provisions of the Lotteries (Regulation) Act, 1998

b. by a foreman of chit fund for conducting or organising a chit in any manner

(b) a provision of service by an employee to the employer in the course of or in relation to his **employment**;

(c) fees taken in any Court or tribunal established under any law for the time being in force.

(d) series provided the following persons:-:

(i) The Members of Parliament, State Legislative, Panchayats, Municipalities and other local authorities who receive any consideration in performing the functions of that office as such member; or

(ii) Any person who holds any post in pursuance of the provisions of the Constitution in that capacity; or

(iii) Any person, who is a Chairperson or a Member or a Director in a body established by the Central Government or State Governments or local authority and who is not deemed as an employee before the commencement of this section. (Explanation -1)

3.2.2 The section ignores principle of mutuality and clarifies that:-

(i) Members of the an Association of Persons (AOP) or Body of Individual (BOI) will be treated as distinct persons form such AOP /BOI

(ii) an establishment of a person in the taxable territory and any of his other establishment in a non-taxable territory shall be treated as establishments of distinct persons.

- (iii) A person carrying on a business through a branch or agency or representational office in any territory shall be treated as having an establishment in that territory;
(Expln 3 & 4)

3.3 Person

3.3.1 Person" includes -

- (a) an individual
- (b) a Hindu undivided family
- (c) a company
- (d) a society
- (e) a limited liability partnership
- (f) a firm
- (g) an association or body of individuals, whether incorporated or not
- (h) Government
- (i) a local authority, or
- (j) Every artificial juridical person, not falling within any of the preceding sub-clauses.

3.3.2 Definition of 'service' requires that there should be two persons namely -

- provider of the service
- the receiver of the service.

3.3.3 Following points are important in this regard:

- (a) The relationship between the two persons must be on principal-to-principal basis. Service provided in terms of employment or as an agent (except a foreign agent) will be excluded from the purview of the term " Service"
- (b) A person cannot provide service to himself. Accordingly, service provided by one department to another department in the same organization, or from one branch to another branch / head office, unless the other branch is a foreign branch will also be excluded.
- (c) Principle of mutuality is also not considered in the cases given in Para 3.2.2 above i.e. members of AOP BOI etc., Offices in the taxable and non-taxable territories or offices of agents;

Accordingly, the following cases service provided shall constitute "service"

- a. By a club or a society ,AOP or BOI to their members for cash, deferred payment or any other valuable consideration or
- b. by a branch to a foreign branch or vice versa
- (d) A person carrying on a business through a branch or agency or representational office in any territory shall be treated as having an establishment in that territory.
- (e) Branch/office in India and outside India are different establishments but not different persons but a liaison office is not 'establishment', as business is not carried through it.
- (f) *Government, and Local [Municipal Corporations, Panchayats etc will be considered as "person" in respect of any services rendered by them , which are not in their sovereign capacity or are in the negative list.*

3.4 Activity

"Service" is an activity performed by one person for another for consideration. The term 'activity' is not defined by the Act. However, the CBE&C in its Clarification dated 20-6-2012 states that the word "activity" would include:

An act done, a work done, a deed done, an operation carried out, execution of an act, provision of a facility etc.

Thus, the term activity may mean that - :

- (a) An activity may be **active** or doing something for instance a beauty parlours services is active service that result in performance of some act ; or
- (b) It can be passive or not **doing something or** and would include *forbearance* to act. Sec 66E specifically includes in the list of declared services an activity of -
 - Agreeing to an obligation to refrain from an act or
 - to tolerate an act or a situation

Non-compete agreement would be an example of forbearance of an act regarded as "service".

3.5 Consideration:

Explanation to Sec 67 states that the service must be rendered for consideration, for an amount which is payable for the taxable services provided or to be provided. Thus, consideration is an

essential element of 'service' Following are some important points in regard to "consideration":

- i. An activity must be performed:
 - for the service-receiver
 - by the service provider
 - for a consideration.
- ii. *Any service provided free of cost or gratuitously will not be a "service".*
- iii. Consideration may be **past, present or future**;
- iv. Consideration is something **done or not done** as a reciprocal promise to rendering of service;
- v. Consideration may be in cash or kind ;

Illustration

1. A courier agrees to carry the mail of a Chartered Accountant. In return, the CA files his return of income.

This is case of reciprocal promises forming consideration for one another. Courier's fees shall be the consideration for the service provided by CA, and *vice versa*.

- vi. Activity or the service may be performed in future except in cases of small service providers, cases of reverse charges etc.
- vii. Consideration may come from a receiver of the service or a third party. The service will be taxable, so long as there is nexus between the service provided and consideration.

Illustration

2. The BCCI books room in a hotel for the cricketers participating in IPL tournament.

In this case , hotel is the service provider and the players are the service receivers but considerations is paid by a third party .

- viii. Charities /Grants, donations and free service will not be regarded as "service", unless there is a corresponding obligation on the receiver to provide some service in return. Similarly, any grant stipulating proper accounts or use of fund will also be not chargeable to service tax.

3.6 Declared Service (Activities Deemed to be service)

Declared services means activities deemed to be taxable service. As per section 66E, the following shall constitute declared services namely:-

- (a) renting of immovable property;
- (b) construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, except where the entire consideration is received after issuance of completion certificate by the competent authority such as the Municipality or architect etc.;

The expression "construction" includes additions, alterations, replacements or remodeling of any existing civil structure

- (c) temporary transfer or permitting use of Intellectual property Right - IPR,
- (d) development, design, programming, customisation, adaptation, upgradation, enhancement, and implementation of information technology **software**;
- (e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;
 - non-compete agreement or agreement not to compete, or not joining competitors come under the category of **not doing any act**.
 - Payment of demurrage or late delivery charges , booking cancellation charges , cheque return charges , penalties, forfeiture of deposit or advance are some examples of **"agreeing to tolerate an act or situation"**
- (f) transfer of goods by way of hiring, leasing, licensing or in any such manner without transfer of right to use such goods
- (g) activities in relation to delivery of goods on hire purchase or any system of payment by instalments;
- (h) service portion in execution of works contract,
- (i) service portion in an activity wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of the activity
- (j) assignment by the Government of the right to use the radio-frequency spectrum and subsequent transfers thereof;

Actors, singers, artists, authors, consultants, music directors, Brand Ambassadors, or models are declared services liable to service tax.

3.7 Service must not be in the “Negative List”

A service must not be exempt or excluded service under the provisions sections 66B, 66C, 66D, 66E or 66F. Transactions for sale and purchase of Immovable properties, money, actionable claims and goods, services provided by or to constitutional functionaries are some of such exclusions, which will not be subject to service tax. In this context ,section 66 D gives a negative list of services not chargeable to service tax . Sec 66D provides that the negative list shall comprise of the following services, namely:--

(a) services **by Government or a local authority** excluding the following services to the extent they are not covered elsewhere—

- (i) services by the Department of Posts by way of speed post, express parcel post, life insurance, and agency services provided to a person other than Government;
- (ii) services in relation to an aircraft or a vessel, inside or outside the precincts of a port or an airport;
- (iii) transport of goods or passengers; or
- (iv) support services, other than services covered under clauses (i) to (iii) above, provided to business entities.

(b) services **by the Reserve bank of India**.

(c) services by a **foreign diplomatic mission located** in India.

(d) services relating to **agriculture or agricultural produce** by way of

- (i) agricultural operations directly related to production of any agricultural produce including cultivation, harvesting, threshing, plant protection or testing;
- (ii) supply of farm labour;
- (iii) processes carried out at an agricultural farm including tending, pruning, cutting, harvesting, drying, cleaning, trimming, sun drying, fumigating, curing, sorting, grading, cooling or bulk packaging and such like operations which do not alter essential characteristics of agricultural produce but make it only marketable for the primary market;
- (iv) renting or leasing of agro machinery or vacant land with or without a structure incidental to its use;

- (v) loading, unloading, packing, storage or warehousing of agricultural produce
- (vi) agricultural extension services;
- (vii) services by any Agricultural Produce Marketing Committee or Board or services provided by a commission agent for sale or purchase of agricultural produce.
- (e) trading of goods.
- (f) services by way of any process of **manufacture** or **production** of goods excluding alcoholic liquor for human consumption;
- (g) **selling of space or time slots for advertisements** other than advertisements print media;
- (h) service by way of access to a **road or a bridge on payment of toll charges**.
- (i) **betting, gambling or lottery services** by a lottery distributor or selling agent in relation to promotion, marketing, organising, selling of lottery or facilitating in organising lottery of any kind, in any other manner.
- (j) Omitted (it related to entry to amusement parks)
- (k) transmission or distribution of **electricity** by an electricity transmission or distribution utility.
- (l) Education Services by way of
 - (i) Pre-school education or education up to higher secondary school or equivalent;
 - (ii) education as a part of a curriculum for obtaining a qualification recognized by law;
 - (iii) (education as a part of an approved vocational education course.

Note that private tuitions will be taxable .

- (m) services by way of **renting of residential dwelling** for use as residence;

{ U/s 65B(41) Renting means allowing, permitting or granting access, entry, occupation, usage or any such facility, wholly or partly, in an immovable property, with or without the transfer of possession or control of the said immovable property and includes letting, leasing, licensing or other similar arrangements in respect of immovable property.

Residential accommodation, but does not include hotel, motel, inn, guest house, camp site, lodge, house boat, or like places meant for temporary stay.}

(n) services by way of-

- (i) extending deposits loans or advances in so far as the consideration is represented by way of interest or discount;
- (ii) inter-se sale or purchase of foreign currency amongst banks or authorized dealers of foreign exchange or amongst banks and such dealers;

(o) service of transportation of passengers, with or without accompanied belongings, by

- (i) deleted (stage carriage);
- (ii) railways in a class other than (A) first class; or (B) an air conditioned coach;
- (iii) metro, monorail or tramway;
- (iv) inland waterways;
- (v) public transport, other than predominantly for tourism purpose, in a vessel between places located in India; and
- (vi) metered cabs, or auto rickshaws;

(p) services by way of transportation of goods by-

- (i) road except the services of (A) a goods transportation agency; or (B) a courier agency
- (ii) deleted (aircraft)
- (iii) by inland waterways;

(q) Funeral, burial, crematorium or mortuary services including transportation of the deceased.

3.8 Exclusion of Services- Section 65BB (4):

Section 65B (44) ,which defines service also defines what is not 'service'. Such service will not amount to a service at all and be excluded from definition of 'service'. Declared services on the other hand are services which are covered in the definition of service but are not taxable services. These are as follows:

IMAGE = Immovable Properties + Money+ Actionable claim + Goods + Employment

(i) Any activity that that constitutes only a transfer in title of goods

Goods include securities hence sale or purchase of securities (shares, derivatives) forward contracts, future contracts or derivatives not taxable under this clause.

(ii) Transfer of immovable property by way of sale, gift or in any other manner

- (iii) A transfer, delivery or supply of goods which is deemed to be a sale of goods within the meaning of article 366(29A) of the Constitution.

These Transactions are:

- transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;
 - transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;
 - delivery of goods on hire-purchase or any system of payment by instalments;
 - transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration,
 - supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;
 - Supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration; and.
- (iv) a transaction only in *money*
Following are not transactions only in money and are chargeable to service tax:-
- a) any activity relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged;
 - b) bank charges, LC charges, Bank Inspection charges, Bank guarantee charges, Loan processing fees;
 - c) commitment charges by Banks for sanctioned Bank Limit;
 - d) cheque collection charges, services of recovery agents, chit funds are not mere transaction in money;
 - e) credit card charges.
- (v) a transaction only in actionable claim of unsecured debt or beneficial interest in movable property or participation in a lottery;
- (vi) a service provided by an employee to an employer in the course of the employment;

It is the relationship of employer and employee, which is the deciding factor not the mode of payment. Hence, a whole time director in employment of a company even if his remuneration may be based as a percentage of profits of the company will not be liable for service tax. Similarly, visiting professional like doctors, chartered accountants, lawyers, civil engineers, architects or consultants providing service under a **contract of service**, will be professionals liable to service tax, as there is no contract of employment.

- (vii) Fees payable to a court or a tribunal set up under a law for the time being in force.

3.9. Exclusion of Services- Section 65BB – Explanation

It is provided by way of explanation that the following Activities are not covered in the definition of “service” These are the constitutional posts and elected representatives.

- (i) Functions performed by elected representatives such as the Members of Parliament, State Legislative, Panchayats, Municipalities and other local authorities who receive any consideration in performing the functions of that office as such member; or
- (ii) the duties performed by any person who holds any post in pursuance of the provisions of the constitution in that capacity; or
- (iii) the duties performed by any person as a chairperson or a member or a director in a body established by the central government or state governments or local authority and who is not deemed as an employee before the commencement of this section.
- (iv) an establishment of a person in the taxable territory and any of his other establishment in a non-taxable territory

3.10. Service Not chargeable –Mega Circular

The central government issued a mega exemption notification No. 25/2012-ST dated 20-6-2012 exempting as many as 39 services w. e. f. 01-07-2012. The notification has been amended from time to time to extend, modify or restrict the scope of exemption given under the original notification. Brief description of these services is as follows:

1. Services provided to **the United Nations** or a specified international organizations such as WHO, UNESCO, ILO, IMF etc. ;
2. Health care services by a clinical establishment, an authorised medical practitioner or Para-medics;

(ii) Services provided by way of transportation of a patient in an ambulance, other than those specified in (i) above

“Health care services” means any service by way of diagnosis or treatment or care for illness, injury, deformity, abnormality or pregnancy in any recognised system of medicines in India such as allopathy, yoga, naturopathy, ayurveda, homeopathy, siddha, unani or any other system of medicine recognized by central government and includes – services by way of transportation of the patient to and from a clinical establishment, but does not include:

– hair transplant or cosmetic or plastic surgery, except when undertaken to restore or to reconstruct anatomy or functions of body affected due to congenital defects, developmental abnormalities, injury or trauma;

Thus, medical treatment and ambulance services are exempted but not the hair transplant, cosmetic, or plastic surgery.

2B Services provided by operators of the Common Bio-medical Waste Treatment ,Facility to a clinical establishment by way of treatment or disposal of biomedical waste or the processes incidental thereto

3. Services by a veterinary clinic in relation to health care of animals or birds;
4. Services by an entity registered under section 12AA of the Income tax Act, 1961 by way of charitable activities;

“Charitable activities” means activities relating to -

(i) public health by way of -

(a) care or counseling of (i) terminally ill persons or persons with severe physical or mental disability, (ii) persons afflicted with HIV or AIDS, or (iii) persons addicted to a dependence-forming substance such as narcotics drugs or alcohol; or

(b) public awareness of preventive health, family planning or prevention of HIV infection;

(ii) advancement of religion or spirituality;

(iii) advancement of educational programmes or skill development relating to,-

- (a) abandoned, orphaned or homeless children;
- (b) physically or mentally abused and traumatized persons;
- (c) prisoners; or
- (d) persons over the age of 65 years residing in a rural area;
- (iv) preservation of environment including watershed, forests and wildlife;

5. Services by a person by way of (a) renting of precincts of a religious place meant for general public; or (b) conduct of any religious ceremony;

***“Religious place”** means a place, which is primarily meant for conduct of prayers or worship pertaining to a religion, meditation, or spirituality;*

6. Services provided by-
- (a) *an arbitral tribunal* to –
 - (i) any person other than a business entity; or
 - (ii) a business entity with a turnover up to rupees ten lakh in the preceding financial year; or
 - (b) a partnership firm of advocates or an individual as an advocate other than a senior advocate, by way of legal services to-
 - (i) an advocate or partnership firm of advocates providing legal services;
 - (ii) any person other than a business entity; or
 - (iii) a business entity with a turnover up to rupees ten lakh in the preceding financial year;
 - (c) senior advocate by way of legal services to a person other than a person ordinarily carrying out any activity relating to industry, commerce or any other business or profession

Thus, services provided by advocates to non business entities and small business entities upto turnover of Rs 10 lakh are exempt. Further , service tax on advocates is payable by the business entity as reverse charge.

7. Exemption on clinical testing of drugs deleted ;
8. Services by way of training or coaching in recreational activities relating to arts, culture or sports ;

Services rendered by P Gopichand to train P.V Sidhu in his badminton training institute will be exempt under this clause.

9. Services provided

- (a) by an educational institution to its students, faculty and staff;
- (b) to an educational institution, by way of,-
 - (i) transportation of students, faculty and staff;
 - (ii) catering, including any mid-day meals scheme sponsored by the Government;
 - (iii) security or cleaning or house-keeping services performed in such educational institution;
 - (iv) services relating to admission to, or conduct of examination by, such institution

It may be noted that tuition fees are in negative list , hence exempt. Grant –in aid received from government will also be exempt . But ,any fees charged from companies for campus recruitment will be liable to service tax as it is a commercial activity .

9A. Any services provided by, _

- (i) the National Skill Development Corporation(NSDC) set up by the Government of India;
- (ii) a Sector Skill Council(SSC) approved by the NSDC;
- (iii) an assessment agency approved by the SSC or the NSDC;
- (iv) a training partner approved by the NSDC or the SSC in relation to
 - (a) the National Skill Development Programme implemented by the NSDC or
 - (b) a vocational skill development course under the National Skill Certification and Monetary Reward Scheme; or
 - (c) any other Scheme implemented by the NSDC;

9B. Services provided by the Indian Institutes of Management, as per the guidelines of the Central Government, to their students, by way of the following educational programmes, except Executive Development Programme, -

- (a) two year full time residential Post Graduate Programmes in Management for the Post Graduate Diploma in Management, to which admissions are made on the basis of Common Admission Test (CAT), conducted by Indian Institute of Management;
- (b) fellow programme in Management;
- (c) five year integrated programme in Management

9C Services of assessing bodies empanelled centrally by Directorate General of Training, Ministry of Skill Development and

Entrepreneurship by way of assessments under Skill Development Initiative (SDI) Scheme

9D Services provided by training providers (Project implementation agencies) under Deen Dayal Upadhyaya Grameen Kaushalya Yojana under the Ministry of Rural Development by way of offering skill or vocational training courses certified by National Council For Vocational Training

10. Services provided to a recognised sports body by

- (a) an individual as a player, referee, umpire, coach or team manager for participation in a sporting event organized by a recognized sports body;
- b) another recognised sports body such as Indian Olympic association.;

Hence, service of players to IPL teams like Mumbai Indians , who are franchisees of IPL will not be covered under this clause as the service is not o a recognised sports body.

11. Services by way of sponsorship of sporting events organised by:

- (a) a national sports federation, or its affiliated federations, where the participating teams or individuals represent any district, state, zone or country;
- (b) Association of Indian Universities, Inter-University Sports Board, School Games Federation of India, All India Sports Council for the Deaf, Paralympics Committee of India or Special Olympics Bharat;
- (c) Central Civil Services Cultural and Sports Board; or
- d) as part of national games, by Indian Olympic Association; or
- (e) under Panchayat Yuva Kreedha Aur Khel Abhiyaan (PYKKA) Scheme;

12. Services provided to the Government, a local authority or a governmental authority by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of

- a) a civil structure or any other original works meant predominantly for use other than for commerce, industry, or any other business or profession;
- (b) a historical monument, archaeological site or remains of national importance, archaeological excavation, or antiquity specified under the Ancient Monuments and Archaeological Sites and Remains Act, 1958 ;
- (c) a structure meant predominantly for use as (i) an educational, (ii) a clinical, or (iii) an art or cultural establishment;
- (d) canal, dam or other irrigation works;

- (e) pipeline, conduit or plant for (i) water supply (ii) water treatment, or (iii) sewerage treatment or disposal; or
- (f) a residential complex predominantly meant for self-use or the use of their employees or other persons specified in SEC 65B(44) Explanation 1

12A. Services provided to the Government, a local authority or a governmental authority by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of -

- (a) a civil structure or any other original works meant predominantly for use other than for commerce, industry, or any other business or profession;
- (b) a structure meant predominantly for use as (i) an educational, (ii) a clinical, or (iii) an art or cultural establishment; or
- (c) a residential complex predominantly meant for self-use or the use of their employees or other persons specified in the Explanation 1 to clause (44) of section 65 B of the said Act;
under a contract which had been entered into prior to the 1st March, 2015 and on which appropriate stamp duty, where applicable, had been paid prior to such date

13. Services provided by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of

- (a) a road, bridge, tunnel, or terminal for road transportation for use by general public;
- (b) a civil structure or any other original works pertaining to a scheme under Jawaharlal Nehru National Urban Renewal Mission or Rajiv Awaas Yojana;
 - (ba) a civil structure or any other original works pertaining to the 'In-situ rehabilitation of existing slum dwellers using land as a resource through private participation' under the Housing for All (Urban) Mission/Pradhan Mantri Awas Yojana, only for existing slum dwellers
 - (bb) a civil structure or any other original works pertaining to the 'Beneficiary led individual house construction / enhancement under the Housing for All (Urban) Mission/ Pradhan Mantri Awas Yojana'

(c) a building owned by an entity registered under section 12 AA of the Income tax Act, 1961 and meant predominantly for religious use by general public;

(d) a pollution control or effluent treatment plant, except located as a part of a factory; or

(e) a structure meant for funeral, burial or cremation of deceased;

14. Services by way of construction, erection, commissioning, or installation of original works pertaining to,

a) railways, excluding monorail or metro; (contracts for monorail or metro entered into before 01/03/2016 will continue to be exempt

(b) a single residential unit otherwise than as a part of a residential complex;

(c) low- cost houses up to a carpet area of 60 square meters per house in a housing project approved by competent authority empowered under the 'Scheme of Affordable Housing in Partnership' framed by the Ministry of Housing and Urban Poverty Alleviation, Government of India;

(ca) low cost houses up to a carpet area of 60 square metres per house in a housing project approved by the competent authority under:

(i) the "Affordable Housing in Partnership" component of the Housing for All (Urban) Mission/Pradhan Mantri Awas Yojana;

(ii) any housing scheme of a State Government.

(d) post- harvest storage infrastructure for agricultural produce including a cold storages for such purposes; or

(e) mechanised food grain handling system, machinery or equipment for units processing agricultural produce as foodstuff excluding alcoholic beverages;

For this purpose, "original **works**" means:

(i) All new constructions;

(ii) All types of additions and alterations to abandoned or damaged structures on land that are required to make them workable;

- (iv) Erection, commissioning or installation of plant, machinery or equipment or structures, whether pre-fabricated or otherwise.

“Residential complex” means any complex comprising of a building or buildings, having more than one single residential unit;

“single residential unit” means a self-contained residential unit which is designed for use, wholly or principally, for residential purposes for one family;

14A. Services by way of construction, erection, commissioning, or installation of original works pertaining to an airport or port provided under a contract which had been entered into prior to 1st March, 2015 and on which appropriate stamp duty, where applicable, had been paid prior to such date and is so certified by Ministry of Civil Aviation or the Ministry of Shipping in the Government of India;

15. Services provided by way of temporary transfer or permitting the use or enjoyment of a copyright a copyright covered u/s 13(1)(a) or (b) of the Indian Copyright Act, 1957 relating to original literary, dramatic, musical, artistic works or cinematograph films for exhibition;

16. Services by a performing artist in folk or classical art forms of (i) music, or (ii) dance, or (iii) theatre, **excluding** services provided by such artist as a brand ambassador if the consideration for such performance does not exceed Rs one lakh fifty thousand; Service provided as a brand ambassador will not be covered by this exemption irrespective of any monetary consideration.

17. Services by way of collecting or providing news by an independent journalist, Press Trust of India or United News of India;

18. Services by way of renting of a hotel, inn, guest house, club, campsite or other commercial places meant for residential or lodging purposes, having declared tariff of a unit of accommodation below rupees one thousand per day or equivalent;

“Declared tariff” includes charges for all amenities provided in the unit of accommodation (given on rent for stay) like furniture, air-conditioner, refrigerators or any other amenities, but without excluding any discount offered on the published charges for such unit;

All kind of hotels , Sarais , dharmshalas will be governed by this exemption if the daily tariff is Rs 1000 or less. Further service

tax will be levied only on actual rent received (if its less than the declared tariff) . If declared tariff is more during a season and it is uniformly charged , then also service tax will be charged only on the declared tariff value .

19. Services provided in relation to serving of food or beverages by a restaurant, eating joint or a mess, other than those having (i) the facility of air-conditioning or central air-heating in any part of the establishment, at any time during the year;

19A. Services provided in relation to serving of food or beverages by a canteen maintained in a factory covered under the Factories Act, 1948, having the facility of air-conditioning or central air heating at any time during the year

20. Services by way of transportation by rail or a vessel from one place in India to another of the following goods

- (a) Omitted
- (b) relief materials meant for victims of natural or man-made disasters, calamities, accidents or mishap;
- (c) defence or military equipments;
- (d & (e)) Omitted ;
- (f) newspaper or magazines registered with the Registrar of Newspapers;
- (g) railway equipments or materials;
- (h) agricultural produce;
- (i) foodstuff including flours, tea, coffee, jaggery, sugar, milk products, salt and edible oil, excluding alcoholic beverages; r
- (j) chemical fertilizer and oilcakes; and
- (k) Cotton, ginned (no seed cotton) or baled

21. Services provided by a goods transport agency, by way of transport in a goods carriage of,-

- (a) agricultural produce ;
- (b) where gross amount charged for transportation of all such goods for a *single consignee* (receiver) does not exceed Rs.750 only ; or
- (c) where gross amount charged for the transportation of goods on a consignment transported in a single carriage does not exceed Rs. 1,500 only.
- (d) foodstuff including flours, tea, coffee, jaggery, sugar, milk products, salt and edible oil, excluding alcoholic beverages;

- (e) chemical fertilizer and oilcakes;
- (f) newspaper or magazines registered with the Registrar of Newspapers;
- (g) relief materials meant for victims of natural or man-made disasters, calamities, accidents or mishap; or
- (h) defence or military equipments
- (i) cotton ginned or baled

Goods carriage means any motor vehicle constructed or adapted for use solely for the carriage of goods, or any motor vehicle not so constructed or adapted when used for the carriage of goods. Transport services are taxable on reverse charge basis and the service tax is payable by the consignee.

22. Services by way of giving on hire to a

- (a) state transport undertaking, a motor vehicle meant to carry more than twelve passengers; or
- (b) goods transport agency, a means of transportation of goods;

Mini buses carrying 12 or less passengers will not be covered even if they are rented to ST undertakings. For non-governmental agencies, capacity is immaterial. Government agency means, central government or state government or any local bodies.

Illustration

3. A gives his 50-seater bus on hire to MSRTC and another bus to ABC for carrying their employees, What will be service tax liability?

Solution

Bus rented to MSRTC a state transport undertaking, is exempt from service tax as it is meant to carry more than 12 passengers. The bus rented to ABC will be chargeable to service tax.

23. Transport of passengers, with or without accompanied belongings, by

- (a) air, embarking from or terminating in an airport located North-eastern states (seven sisters Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, or Tripura) at Bagdogra located in West Bengal;

- (b) non-air-conditioned contract carriage other than radio taxi, for transportation of passengers, excluding tourism, conducted tour, charter or hire; or
- (c) ropeway, cable car or aerial tramway; (This exemption withdrawn w. e. f. 01/04/2016 but still valid for March and October ,2017 examinations)

24. Omitted

25. Services provided to Government, a local authority or a governmental authority by way of

(a) carrying out any activity in relation to any function ordinarily entrusted to a municipality in relation to water supply, public health, sanitation conservancy, solid waste management or slum improvement and upgradation; or

(b) repair or maintenance of a vessel;

26. Services of general insurance business provided under following schemes –

(a) Hut Insurance Scheme;

(b) Cattle Insurance under Swarnajaynti Gram Swarozgar Yojna (earlier known as Integrated Rural Development Programme

c) Scheme for Insurance of Tribals;

(d) Janata Personal Accident Policy and Gramin Accident Policy;

(e) Group Personal Accident Policy for Self-Employed Women;

(f) Agricultural Pumpset and Failed Well Insurance;

(g) premia collected on export credit insurance;

(h) Weather Based Crop Insurance Scheme or the Modified National Agricultural Insurance Scheme, approved by the Government of India and implemented by the Ministry of Agriculture;

(i) Jan Arogya Bima Policy

;(j) National Agricultural Insurance Scheme (Rashtriya Krishi Bima Yojana);

- (k) Pilot Scheme on Seed Crop Insurance
- l) Central Sector Scheme on Cattle Insurance
- m) Universal Health Insurance Scheme
- n) Rashtriya Swasthya Bima Yojana;
- o) Coconut Palm Insurance Scheme;
- p) Pradhan Mantri Suraksha Bima Yojna , or
- q) Niramaya□ Health Insurance Scheme implemented by the National Trust for the Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities.

26A. Services of life insurance business provided under the following schemes–

- (a) Janashree Bima Yojana (JBY); or
- (b) Aam Aadmi Bima Yojana (AABY);
- (c) life micro-insurance product as approved by the Insurance Regulatory and Development Authority, having maximum amount of cover of fifty thousand rupees
- (d) Varishtha Pension Bima Yojana
- (e) Pradhan Mantri Jeevan Jyoti Bima Yojana;
- (f) Pradhan Mantri Jan Dhan Yojana

26B. Services by way of collection of contribution under Atal Pension Yojana

26C. Services of life insurance business provided by way of annuity under the National Pension System regulated by Pension Fund Regulatory and Development Authority of India (PFRDA) ;

27. Services provided by an incubatee up to a total turnover of fifty lakh rupees in a financial year subject to the following conditions, namely:-

- (a) the total turnover had not exceeded fifty lakh rupees during the preceding financial year; and
- (b) a period of three years has not been elapsed from the date of entering into an agreement as an incubatee;

“incubatee” means an entrepreneur located within the premises of a Technology Business Incubator (TBI) or Science and Technology Entrepreneurship Park (STEP) recognised by the National Science and Technology Entrepreneurship

Development Board (NSTEDB) of the Department of Science and Technology, Government of India and who has entered into an agreement with the TBI or the STEP to enable himself to develop and produce hi-tech and innovative products;

28. Service by an unincorporated body or a non- profit entity registered under any law for the time being in force, to its own members by way of reimbursement of charges or share of contribution

- (a) as a trade union;
- b) for the provision of carrying out any activity which is exempt from the levy of service tax; or
- (c) up to an amount of five thousand rupees per month per member for sourcing of goods or services from a third person for the common use of its members in a housing society or a residential complex;

Illustration

- 4. A housing society collects contribution from its members to provide community health service to the poor . It will not be liable for service tax as the activity of providing health care service is not chargeable .

29. Services by the following persons in respective capacities

- (b) sub-broker or an authorised person to a stock broker;
- (c) authorised person to a member of a commodity exchange;
- (d) (mutual Fund agents deleted)
- (e) selling agent or a distributor of SIM cards or recharge coupon vouchers;
- (f) business facilitator or a business correspondent to a banking company or
- g)an insurance company, in a rural area; or
- (h) sub-contractor providing services by way of works contract to another contractor providing works contract services which are exempt;

30. Carrying out an intermediate production process as job work in relation to –

- (a) agriculture, printing or textile processing;
- (b) cut and polished diamonds and gemstones; or plain and studded jewellery of gold and other precious metals, falling under Chapter 71 of the Central Excise Tariff Act, 1985;

- (c) any goods excluding alcoholic drinks for human consumption on which appropriate duty is payable by the principal manufacturer; or
 - (d) processes of electroplating, zinc plating, anodizing, heat treatment, powder coating, painting including spray painting or auto black, during the course of manufacture of parts of cycles or sewing machines upto an aggregate value of taxable service of the specified processes of one hundred and fifty lakh rupees in a financial year subject to the condition that such aggregate value had not exceeded one hundred and fifty lakh rupees during the preceding financial
- 31.** Services by an organiser to any person in respect of a business exhibition held outside India;
- 32.** Deleted w. e. f 01/04/2015 (telephone booths)
- 33.** Services by way of slaughtering of bovine animals;
- 34.** Services received from a provider of service located in a non- taxable territory by-
- (a) Government, a local authority, a governmental authority or an individual in relation to any purpose other than commerce, industry or any other business or profession; (
 - b) an entity registered u/s 12AA of the Income tax Act, 1961 for the purposes of providing charitable activities; or
 - (c) a person located in a non-taxable territory;
- 35.** Services of public libraries by way of lending of books, publications or any other knowledge- enhancing content or material;
- 36.** Services by Employees' State Insurance Corporation to persons governed under the Employees' Insurance Act, 1948;
- 37.** Services by way of transfer of a going concern, as a whole or an independent part thereof;
- 38.** Services by way of public conveniences such as provision of facilities of bathroom, washrooms, lavatories, urinal or toilets;
- 39.** Services by a governmental authority by way of any activity in relation to any function entrusted to a municipality under article 243 W of the Constitution.

- 40.** Services by way of loading, unloading, packing, storage or warehousing of rice, cotton, ginned or baled
- 41.** Services received by the Reserve Bank of India, from outside India in relation to management of foreign exchange reserves;
- 42.** Services provided by a tour operator to a foreign tourist in relation to a tour conducted wholly outside India;
- 43.** Services by operator of Common Effluent Treatment Plant by way of treatment of effluent ;
- 44.** Services by way of pre-conditioning, pre-cooling, ripening, waxing, retail packing, labelling of fruits and vegetables which do not change or alter the essential characteristics of the said fruits or vegetables ;
- 45.** Services by way of admission to a museum, national park, wildlife sanctuary, tiger reserve or zoo;
- 46.** Service provided by way of exhibition of movie by an exhibitor to the distributor or an association of persons consisting of the exhibitor as one of its members;
- 47.** Services by way of right to admission to,-
- (i) exhibition of cinematographic film, circus, dance, or theatrical performance including drama or ballet;
 - (ii) recognised sporting event
 - (iii) award function, concert, pageant, musical performance or any sporting event other than a recognised sporting event, where the consideration for admission is not more than Rs 500 per person ;
- 48.** Services provided by Government or a local authority to a business entity with a turnover up to rupees ten lakh in the preceding financial year ;
- 49.** Services provided by Employees Provident Fund Organisation (EPFO) to persons governed under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952
- 50.** Services provided by Insurance Regulatory and Development Authority of India (IRDA) to insurers under the IRDA Act, 1999;
- 51.** Services provided by Securities and Exchange Board of India (SEBI) set up under the SEBI Act, 1992 by way of protecting

the interests of investors in securities and to promote the development of, and to regulate, the securities market

52. Services provided by National Centre for Cold Chain Development under Ministry of Agriculture, Cooperation and Farmers' Welfare by way of cold chain knowledge dissemination

3.11. Exemption and Negative List

A service may not be liable to service tax for any of the following three reasons:

1. An activity is excluded or not covered by the definition of "service" as given in section 65B (44). Such an activity will not be a "service".

Hence, the activity will not be chargeable to service tax and CENVAT also will not be allowed in respect of such activity.

2. An activity, although a service, may be covered in the negative list. This will be a case of a "Service", which is exempt from service tax. There will be no service tax on such a service.
3. Similarly, a service may be exempted under an executive notification. Such a service will also be a service, but there will be no liability for payment of service tax thereon .

3.12. "Principles of interpretation

3.12.1 With effect from 01-07-2012 service tax is payable on all the services provided or to be provided other than those excluded, exempted or in negative list.

Tax treatment of different services varies having regard to their nature, meaning and scope with reference to their eligibility for CENVAT or rates of abatement.

Hence, it is very important to classify the services under their proper heading particularly when the services are overlapping other services or are composite or bundled in nature and include more than one service. For example, a banquet hall provides a service, which includes a composite package of mandap keeper, event management and catering.

3.12.2 Section 66F gives the principles of interpretation of specified descriptions of services or bundled services. These principles are given as under:-

A. Reference to ***main service does not include auxiliary service***, which is used for providing main service [section 66F (1)].

If the 'main service' is either excluded or exempt from service tax, service provided to the 'main service' by auxiliary service provider may still be taxable or vice versa .

Illustrations:

5. Advertisement is in negative list but service tax is payable on services of advertisement agents and services of design of advertisements
6. Construction of public road is also in the negative list. However, hire of equipment, excavation, manpower supply services provided for it will be subject to service tax.
7. A service provider in SEZ is exempt but a sub-contractor will not be so exempt.

However, where the service of main contractor is exempt **or** excluded, service provided by a sub-contractor to main contractor will also be exempt from service tax.

B. Specific description prevails over general description
even in cases of “bundled service” [section 66F (2)]

Illustrations:

8. If a hotel provides food at a convention organised in that hotel, the general description of the service is organising convention. Hence, the service will be classified as convention service ; not catering or mandap keeper service.

C. In case of composite service or naturally bundled services
description will be taken on the basis of its **essential character**
ignoring the incidental services provided [section 66F (3) (a)]

Illustrations

9. Service provided by an airline, which serves food on board, will be classified by its basic character air transport service; not catering.
10. Similarly, an airline may provide door delivery of good booked by it, yet the service will be treated as transport of goods by air service, not courier service.
11. Boarding facilities provided by an educational institution will be classified as educational service.
12. Food and hotel facilities provided by package tour operators will be classified on the basis of their core activity as tour operator.
13. Facilities of water, electricity security etc. provided along with renting of commercial premises will be classified as renting of commercial premises service.

D. If services are not naturally bundled, then the description as single service, which results in highest liability of service tax, will be adopted as description of that service. In such cases trade understanding practices will be a relevant factor to determine the nature of the service.

Illustrations

14. If a consultant partly lets out his office premises keeping the remaining part for his profession, the renting, though bundled with consultancy, will be treated as renting only.

15. A commercial premises, let out partially for residence of employees and mainly for commercial premises, will be treated as renting of commercial premises.

E. Pure agent and 'Bundled Service'

Where the expenses are incurred or sub-services are provided for providing any service, then :-

- a) In case of a bundles service, the expenses incurred will be included in the value of service provided; and
- b) If the service provider is a 'pure agent', the expenses incurred not part of the service and will not be included in the value of service provided.

Illustrations

16. A travel agent engaged in providing booking service is a pure agent liable for service tax only on the commission and not on the value of ticket booked.

17. A customs house Agent [CHA] provides incidental services in client's account he is pure agent and value of incidental services for internal transport, storage, loading/unloading/ stevedoring, crane charges etc will not be not part of his services. But if the CHA provides this services as a bundled package, then he will be liable to pay service tax on entire amount, except the statutory charges paid by him on behalf of the client.

3.13. Service must be rendered in taxable territory:

Section 66B, a service will be taxable if provided in taxable territory. Conversely, services provided in a non-taxable territory will not be chargeable to service tax.

U/s 65B (52) "**taxable territory**" is defined as whole of India excluding the state of Jammu and correspondingly, the territory

other than the taxable territory is defined as “**Non-taxable territory**” U/s 65B (35).

“**India**” is defined in S 65 B (27). “**India**” means—

- (a) the territory of the Union of India as per Art 1(2) & (3) of the constitution i.e. whole of India excluding the state of Jammu & Kashmir
- (b) its territorial water (12 nautical miles), continental shelf, exclusive economic zone or any other maritime zone as defined in the Territorial Waters, Continental Shelf, Exclusive Economic Zone (EEZ) and Other Maritime Zones Act, 1974 (upto 200 nautical miles from the coastline)
- (c) the seabed and the subsoil underlying the territorial waters;
- (d) the air space above its territory and territorial waters; and
- (e) the installations structures and vessels located in the continental shelf of India and the EEZ of India, for the purposes of prospecting or extraction or production of mineral oil and natural gas and supply thereof;

Special Economic Zones (SEZ) are part of ‘India’ for this purpose.

3.14. Principles for determination of location

Section 66C empowers the Central Government to make rules for determination of place of provision of service. Accordingly, the Place of Provision of Services Rules, 2012 (PPSR) have been made. The rules provide certain principles to determine the location, where the service is provided. Under Rule 2(h) location of the service provider” means-

(a) Place of service tax registration

Where the service provider/receiver has obtained a single registration, whether centralized or otherwise, the premises for which such registration has been obtained;

Illustration

- 18.** A builder is registered in Mumbai, constructs a building in Pune and rents his property in Delhi. Mumbai being the place of registration will be the location for service provided by him.
- 19.** A has three offices in Dadar, Andheri and Fort in the city of Mumbai. A obtains centralised registration at fort office. Fort premises shall be the location A.

(b) the location of business establishment;

Where the service /receiver is not registered, location of business establishment will be location of service provider/ receiver, where ***service is provided or received.***

Illustration

20. A club has branches all over India but it is not registered for service tax. If the club provides taxable service from Chennai, then Chennai will be the location of the service provider.

(c) Place of permanent establishment

If the location of business establishment is not the place, where service provided/received, then location of fixed establishment where service is provided/received is the location of service provider/receiver

Illustration

21. P of Patna has a permanent establishment in Pune, in respect of service provided from Patna, the location of service provided /received will be Pune.

(d) Establishment most directly concerned

If service is provided from or received at two or more establishments, then establishment most directly concerned with provision/use of service would be location of service provider/receiver .

(e) Usual Place of Residence

If there is no place as per the above , usual place of residence of service provide/receiver is location of service provider/receiver (e.g. NRI, foreign resident person

Usual place of residence will include

- the address of billing in case of telecom service ; and
- the place of constitution or otherwise establishing a corporate body

Illustrations

CBEC in its Education Guide has provided following illustrations:

22. A business has its headquarters in India, and branches in London, Dubai, Singapore and New York. Its business establishment is in India.

23. An overseas business house sets up offices with staff in India to provide services to Indian customers. Its fixed establishment is in India.

24. A company with a business establishment abroad buys a property in India, which it leases, to a tenant. The property ipso facto (by itself) does not create a fixed establishment. If the company sets up an office in India to carry on its business by managing the property, this will create a fixed establishment in India.

25. A company is incorporated in India, but provides its services entirely from Singapore. The location of this service provider is Singapore, being the place where the establishment most directly concerned with the supply is located.

Permanent establishment is a place where major decisions are taken and place of residence for a body corporate is its registered office

3.15 Determination of Place of Provision of Service:

Place of Provision of Service Rules 2012 lay down the following principles:

1. General Rule to determine place of Provision –Rule 3

Under Rule 3 the place of provision shall be:

- the **location of the recipient of the service** or
- the **place where service is provided** if the location of recipient is not available in the ordinary course of business.

Effect of the rule will be that the location of the recipient will determine whether a service is taxable or not.

(1) Accordingly if the location of recipient of a service is :

- in the taxable territory, the service will be taxable in India ;
- outside the taxable territory, the service will be excluded and no service tax will be payable thereon.

(2) Conversely, where:-

- the service provider is located outside the taxable territory ;
but
- the recipient of the service is located in taxable territory,
the person liable to pay service tax is the receiver of the service under the reverse liability

- (3) If both the provider of a service and the receiver of the service are located outside the taxable territory, there will be no tax liability

Illustrations

26. ABC & Co Chartered Accountants, Mumbai provide audit service to Srinagar Airways Ltd, Srinagar. The recipient of the service is located in Jammu & Kashmir, place of provision shall be Srinagar and the service will not be taxable as it is provided outside the taxable territory

27. In the above example, assuming that ABC & Co is based in Srinagar and the audit service is provided in Mumbai. The recipient of the service and the place of provision shall be Mumbai, which is in the taxable territory. The **Service** provided by ABC of Jammu and Kashmir to the Company in Mumbai will be taxable in the hands of the receiver of the service as a reverse charge.

2. Performance based services- Rule 4

The place of provision shall be the location where the **services are actually performed**, that is to say -

- a) If the service to be provided involves supply of material by the recipient (or his agent) to the service provider, the place where service is actually performed. (e.g. a pure construction contract service is provided on the building site ;
- b) If service is provided to an individual, whose(or agent's) physical attendance is necessary for such services will be deemed to be provided where the actual service is provided (e.g. beauty parlour service)

The above rule is subject to two exceptions;

- a) Place where goods are situated at the time of provision of service will be the place of provision, if such services are provided from a remote place by way of electronic means.
- b) The above rule will not apply in the case of a service provided in respect of goods temporarily imported into India for repairs, reconditioning or reengineering for re-export.

3. immovable properties related services- Rule -5

Service in relation to immovable property such as civil engineer, architect, estate agent, provision of hotel accommodation, inn,

guesthouse, club or campsite ,place where immovable property is located or intended to be located ;

4. Events related Services – Rule-6

Place where event is actually held will be the place of provision of services by way of admission to, or organization of, a cultural, artistic, sporting, scientific, educational, or entertainment event, or a celebration, conference, fair, exhibition, or similar events, and of services ancillary to such admission.

5. Services provided at more than one locations- Rule 7

Place of provision in such case, will be at the location in the taxable territory where the greatest proportion of the service is provided.

6. Taxable Territory – Rule 8

If the recipient and provider of service both are located in taxable territory, location of the recipient of service shall be the location of the recipient of service.

7. Location of Service Provider – Specific services –Rule 9

Place of provision shall be the location of the service provider in respect of specified services:

- (a) Services provided by a banking company, or a financial institution, or a non-banking financial company, to account holders;
- (b) Online information and database access or retrieval services;
- (c) Intermediary services;
- (d) Service consisting of hiring of means of transport, upto a period of one month.

8. Goods Transport service _ Rule 10

The place of provision of services of transportation of goods, other than by way of mail or courier, shall be the place of destination of the goods;

However, the place of provision of services of goods transportation agency shall be the location of the person liable to pay tax.

9. Passenger Transportation Service : Rule 11

The place of provision in respect of a passenger transportation service shall be the place where the passenger embarks on the conveyance for a continuous journey.

10. Services provided on board a conveyance –Rule 12

The first scheduled point of departure of that conveyance for the journey shall be the place of provision in respect of services provides including services intended to be wholly or substantially consumed while on board a conveyance during the course of a passenger transport operation.

11. Notification- Rule 13

Central government is empowered to notify description of services or circumstances purposes to prevent double taxation or non-taxation of the provision of a service, or for the uniform application of rules

12. Order of application of rules- Rule 14 (LIFO)

Where the provision of a service is, determinable in terms of more than one rule, the last rule shall be applied first

13. Service Receiver

A service receiver is the person who is legally entitled to receive a service and, obliged to make payment whether or not he actually makes the payment or someone else makes the payment on his behalf regardless of the location of the person making the payment.

Illustration

28. A Books a hotel room in Mumbai for B of Bahrain and makes the payment. Hotel facility is availed by B hence B is receiver of service, although A has made the payment.

4. SELF EXAMINATION QUESTIONS

- 1 What is the constitutional validity of the levy of service tax?
- 2 What is Service? How it is valued?
- 3 What are the items not included in the definition of taxable service?
- 4 When does the liability of payment of service tax arise?
- 5 X contracts with Y, a real estate agent to sell his house and thereupon Y gives an advertisement in television costing Rs 5

lakhs. Y billed Rs 15 lakhs to X including charges for TV advertisement showing them separately in invoice. Y says that the value of taxable service in his case is Rs 10 lakhs only, as he acted as a pure agent of X while taking advertisement. Compute service tax to be billed.

[If ads are issued to sell the house as an agent, part of services but if ads issued on behalf of X separately on sellers' behalf to be excluded]

- 6 A clearing and forwarding agent charges Rs 50,000 for his services, which includes Octroi charges Rs 10,000 paid on behalf of the client. Compute the value of the taxable service and service tax liability. *(Octroi will be excluded)*
- 7 A service, provider incurs costs such as travelling expenses, postage, telephone, etc. of Rs 20,000. He charges Rs 80,000 for his services and indicates the said costs separately on the invoice issued to the recipient of service. Compute the amount of service tax to be billed by the service provider. Ans *(Depends if the service provider is a pure agent)*
8. What do you mean by point of taxation? How is it different from cash receipt method?



SMALL SERVICE PROVIDERS

Synopsis

1. Introduction and objectives:
2. Features of Exemption Scheme
3. Effect of Crossing the Limit
4. Exceptions
5. Illustrations
6. Self – Examination Questions.

1. INTRODUCTION AND OBJECTIVES

This lessons seeks to explain the exemption scheme provided to Small service providers vide Notification No. 33/2012-ST dated 20-6-2012, whereby Small service providers are given the option to claim exemption from payment of whole of the service tax payable u/s 66 of the Finance Act ,1994 .

2. FEATURES OF EXEMPTION SCHEME

Small service providers are given the option to claim exemption from payment of whole of the service tax payable u/s 66 vide Notification No. 33/2012-ST dated 20-6-2012. Following are the important feature of the exemption scheme

1. This exemption is **optional** and a small service provider may choose not to exercise the option and continue paying the service tax and claim CENVAT in normal course.
2. However , if the service providers exercise the option to claim exemption for any financial year , **he can not withdraw** the option in that financial year
3. Small Service provider means a person if the aggregate value of taxable services provided by him in the preceding financial year **did not exceed Rs 10 lakh.**
4. Aggregate value” means the sum total of value of taxable services charged in the first consecutive invoices issued during a financial year but does not include value charged in invoices

issued towards such services which are exempt from whole of service tax

I.

1. Following are the important points in computing the threshold limit of Rs 10 lakh

- a) Value of only taxable **services provided will be included** computing the limit;.
- b) Value of tax-free services or services not taxable u/s 66 or notifications will not be included;.
- c) Value of sale or manufacture of goods will not be included;
- d) The limit will be computed for every financial year ;
- e) Aggregate value Considering of all the taxable services , if there are more than one taxable service provided by the service provider will be taken into consideration
- f) Similarly, aggregate value of taxable services provided at **all the premises**, if the services are rendered from more than one premise will be taken .Separate limit for each premise will not be computed .
- g) In case of a Service receiver (such as mutual fund distribution; services rendered from outside India, life insurance, general insurance auxiliary services mutual fund agents, Goods Transport Agency insurance agent, non- residents etc) liable to pay service tax as the reverse liability u/s 68(2), such payment will be excluded for ascertaining the limit. These service receivers cannot claim the benefit of exemption scheme because the exemption is to service providers.
- a) The notification will not apply in respect of taxable services provided by a person under a brand name or trade name, whether registered or not, of another person;

3. EFFECT OF CROSSING THE LIMIT:

If aggregate value of taxable services crosses the threshold limit of Rs 10 lakhs in any financial year and the service provider exercises the option for exemption, then the following consequences will follow .

1. Effect on tax liability

- a) There will be no tax **liability** till the limit does not cross the threshold limit of Rs 10 lakhs in a financial year ,

- b) **Tax will be payable** on taxable services provided or to be provided **over Rs10 lakhs** in that financial year.
- c) In the next financial year , no exemption will be available and service tax liability will arise even if the value of taxable services is below Rs 10 lakh
- d) The service provider will be liable to register for service tax when such value of services provided crosses Rs 9 lakhs
- e) The service provider **not allowed to withdraw the option** in that financial year.

2. Effect on CENVAT

- a) After the service provider exercises the option to avail the exemption, he shall **not claim** Cenvat in respect of:
 - i. Service tax on any input service used for providing such taxable service for which exemption is opted for ;
 - ii. duty on capital goods received in his premises during period in which the service provider has availed the exemption;
- b) The service provider shall pay back the amount of Cenvat credit taken by him for inputs lying in stock or in process on the day on which he starts availing exemption
- c) Service provider shall avail Cenvat credit only on inputs or input services used for providing taxable services received on or after the day he starts paying tax;
- d) If there is any unutilised Cenvat credit on inputs ,and input services (used in providing service for which exemption is availed) **shall lapse on the date** on which he starts availing exemption. In other words, the same cannot be claimed.

4. EXCEPTIONS:

The exemption is not available in the following cases:

- (a) If the taxable service is provided by a person under a brand name or trade name of another person(including name, mark, logo, label, signature or other written word) whether registered or not.

- (b) If the service provider is not liable to pay service tax on the services provided.
- (c) If the Service receivers liable to pay service tax as the reverse liability provision u/s 68(2). These persons can not claim the benefit of exemption because the exemption is to service providers. These persons are as under:
- i. Person receiving Goods Transport Agency Service
 - ii. Asset Management Company or Mutual Fund receiving Business Auxiliary Service of distribution of Mutual Fund
 - iii. Recipient in case of Import of Services Insurer or
 - iv. Reinsurer in case of Insurance Business
 - v. Body Corporate or firm receiving Sponsorship service in India

5. ILLUSTRATIONS

1. A Chartered Accountant has three offices at Fort, Thane and Bandra having turnover of Rs.8,50,000, Rs.1,50,000 and Rs.2,00,000 respectively. He wants to claim benefit of threshold limit at each of the three offices. Advise him.

Solution;

The threshold limit of Rs. 10 Lakhs will be calculated by taking the total taxable services from all the three offices. He cannot claim separate threshold limit for each of the three premises.

2. B registers turnover of taxable service of Rs. 8 Lakh by 30th June, 2016. He exercises the right to exemption. Because his service tax liability works out to Rs. 1,16,000 being 14.5% of Rs. 8 Lakh. During this period, he estimated set off claim of only Rs. 80,000. In the later part of the year the turnover shoots upto additional Rs. 3 Lakhs. He finds that correct CENVAT credit Rs. 1,20,000 not Rs. 5,000. B wants to withdraw the option. Advise him.

Solution:

Option once granted cannot be withdrawn during the financial year. However, once he crosses the threshold limit of Rs. 10 Lakh, he has to start paying service tax on the remaining services which are taxable. Any CENVAT credit arising then can be claimed against his liability for Service Tax.

6. SELF – EXAMINATION QUESTIONS:

1. Discuss the Provisions relating to Small Service Providers.
2. Is it mandatory to claim exemption. Give reasons.
3. A has claimed exemption as a Small Scale Service Provider, subsequently he discovered that the amount of CENVAT available to him will be far more than the tax liability. He wants to withdraw the option to claim exemption, can he do so?
4. KPMG wants a separate exemption limit for Pune office and Mumbai Office respectively. Can they do so? Give Reasons
5. B is a small provider of services. Thinking that the taxable services rendered by him would not exceed Rs. 10 lakhs, he availed the option of not paying service tax under the threshold limit. Subsequently, the services provided by him were of Rs. 10 lakhs. He realised he did not claim a CENVAT Credit of Rs. 90,000. Can he now claim the credit by changing his option to set-off of service tax?

(Hint: No, option once exercised cannot be changed. Additionally, registration is required once the turnover exceeds Rs 9 lakhs.)



VALUATION OF TAXABLE SERVICES

Synopsis

1. Introduction and objectives:
2. Valuation of Taxable Service
3. Services involved in the execution of Works' Contract
4. Value of services involved in supply of food and any other article of human consumption in a restaurant or as outdoor catering
5. Self-Examination Questions

1. INTRODUCTION AND OBJECTIVES:

Section 66 of the Finance Act, 1994 provides that there shall be levied a tax at the rate of fourteen per cent (Plus 0.5% Swachh Bharat Cess) of the value of taxable services provided or to be provided. Therefore, the valuation of service becomes crucial in order to determine the service tax liability.

This lesson seeks to have a detailed look into the valuation aspect of services provided and how the value of the services provided are to be determined for the purposes of taxation in the context of the provisions of Section 67 and the valuation rules.

2. VALUATION OF TAXABLE SERVICE –SEC 67

2.1. Value of Taxable Service

Section 67, deals with the valuation of taxable service. The section lays down the following principles for determining the value of taxable services provided or to be provided:

- (i) Where the consideration for provision of service is money , value of a taxable service will be the Gross Amount Charged for a taxable service provided or to be provided by a service provider,
- (i) When the consideration for the provision of service is not wholly or partly consisting of money, be such amount in money, with

the addition of service tax charged, is equivalent to the consideration;

- (ii) When the consideration for the provision of service is not ascertainable, gross amount charged will be determined on the basis of Valuation Rules.
- (iii) The gross amount charged includes payment of any amount by way of cash, cheque or credit card towards the taxable service AND by issue of credit or debit notes or any book adjustment, or any amount credited or debited, to any account, whether called "Suspense account" or by any other name, in the books of account of In cases of the transaction of taxable service with any associated enterprise.
- (iv) Gross amount charged may be before, during or after provision of a taxable service.
- (v) Thus, any advance payment received for providing any taxable service will be included in the value of such service;

2.2. Computation of gross amount charged

- i. Gross amount charged for any service will always include value of taxable service and the service tax payable i.e.

$$\begin{array}{l} \text{Gross amount charged} = \\ \boxed{\text{Value of taxable service} + \text{Service tax payable}} \end{array}$$

Illustration:

[Where gross amount charged shows both the value of taxable service and service tax separately]:

- 5. An assessee charges Rs 1,00,000 towards the value of taxable service and Rs 12,360 towards the service tax.

Gross amount charged will be Rs 1,00,000+ 12360 = Rs 1,12,360

- ii. If an assessee does not collect service tax from its clients separately, his receipts will be taken as inclusive of service tax and service tax liability will be computed as above.

Illustration

[Where gross amount charged does not include service tax]:

- 6. A raises a bill of Rs 2,00,000 for providing a taxable service exclusive of service tax . What would be A's liability for payment of service tax, if tax rate is 14. %

Solution:

- (a) Value of table service - Rs 2,00,000.
 (b) Service tax liability - Rs 28,000
 (c) Gross amount charged - Rs 2,28,000 =Rs 2,28,000

iii. If gross amount charged is inclusive of service tax then value of taxable service will be arrived by making back calculations given below:

(a) Value of taxable services [Rate of Service tax 14%] =

$$\frac{\text{Gross amount charged inclusive of service tax} \times 100}{100 + \text{Rate of service tax i.e. 114}}$$

(b) Service tax payable

$$\frac{\text{Gross amount charged (inclusive of service tax)} \times 14}{100 + \text{Rate of service tax i.e. 114.2.}}$$

OR Service Tax= 14% X Value of Taxable Service

Illustration:

[Gross Value of Bill is inclusive of service tax]

7. A service provider raises an invoice for service at a gross amount of Rs1,71,000 inclusive of service tax. Find out the value of taxable services rendered and the service tax payable on the services.

Solution:

The gross amount charged is inclusive of service tax, value of taxable service will be arrived by making back calculations:

(a) Gross amount charged = Value of taxable service +Service tax
 Rate of Service Tax- 14%,
 Gross amount charged incl. of service tax: 100 + 14 14%.

(b) From the amount inclusive of service tax and value of taxable services the two will be computed as under:

$$\begin{aligned} 1. \text{ Value of Taxable Service:} &= \frac{\text{Gross Amount Charged} \times 100}{114} \\ &= \frac{\text{Rs } 1,68,540 \times 100}{114} \\ &= \underline{\text{Rs } 1,50,000} \\ &= \text{Service Tax } 14\% \text{ of Rs } 1,50,000 = \text{Rs } 21,000, \\ \text{Gross Amount Charged:} &= \text{Rs } 1,50,000 + \text{Rs } 21,000 = \text{Rs } \underline{1,71,000}: \end{aligned}$$

2.3 Import of Service and Foreign currency Transactions

Service tax is a destination-based tax levied on services provided in the taxable territory. Hence, it is the place where the taxable service is rendered and not the domicile of the service provider that will decide the taxability of the service.

On this analogy, foreign firms providing taxable service to Indian clients will be liable to pay services tax on their Indian turnover of taxable services.

However, in case of import of service, i.e. service rendered by a person based outside the taxable territory, will be taxed in the hands of the receiver of the service as “Reverse Liability”

Further, it is specifically provided in Section ‘67A that *the rate of service tax, value of a taxable service and rate of exchange will be taken as prevailing at the time when the taxable service has been provided or agreed to be provided.*

Illustration

8. KPMG, U.S provides consultancy service to Reliance Industries Limited in India. The service will be taxable in India and Reliance Industries will be liable to pay service tax as Reverse liability.

2.4. Advance payment taxable

Service Tax is a tax on the “Value” of service and not on “amount” of service. This implies that existence of the two factors viz provision of service and receipt of amount as consideration are necessary to bring a service into tax net. Accordingly, advance for service was not taxable, as the amount did not match the actual service. This position has been changed and now the gross amount charged is calculated with reference to amount received on *service provided or to be provided*. Accordingly, advance payment received for a service to be provided in future is taxable *in all cases*.

Illustration.

9. A Chartered Accountant receives an advance of on April, 1, 2016 for audit of Accounts for the financial year 2015-16. Service tax liability will arise on April, 1, 2016 even if the service is rendered in later as the Gross amount charged includes amount of advance received for service to be provided,

2.5. Free Service not taxable:

Service rendered free of charge is not taxable as there is no amount is received as a consideration for provision of service.
Notional value of consideration for service will not be taxable.

Illustration

10. A is a Chartered Accountant, who provides audit service free of charge to a charitable trust, for which his normal fees will be Rs 50,000. Free service is not taxable and the notional value cannot be considered as taxable.

Illustration:

11. A coaching class charges the normal tuition fees of Rs. 10,000 for students from city based colleges, Rs. 5,000 for students from rural area but charges no fees to students for freedom fighters and teachers. 20 students were admitted from each of the four categories. Find out the value of taxable services and amount of service tax payable.

Solution:

Value of Taxable Services

General students [20X10,000]	Rs	2,00,000
Rural students [20X5,000]	Rs	1,00,000
(Concession given in fee ignored)		
Children of freedom fighters		Free
Children of teachers		Free
Gross Amount Charged		<u>Rs 3,00,000</u>
Value of Taxable Services U/s 67(2)		<u>Rs.2,63,158</u>
$3,00,000 \times \frac{100}{114}$		
Service Tax payable 14%		<u><u>Rs.36,842</u></u>

2.6. Shifting of service tax from receipt to accrual basis

The Finance Act, 2011 and The Point of Taxation Rules, 2011(PTR) , with effect from 01-05-2011 have shifted the point of times for the service tax liability from receipt to accrual , whichever is earlier, except in case of smaller assesseees. These provisions are separately considered in detail.

2.7. Reimbursements not included in the taxable value:

Value of taxable service means the gross amount charged without deduction of expenses incurred in rendering/providing the service and without any abatement from the taxable value except specified otherwise.

Reimbursement of out of pocket expense like travelling, lodging and boarding etc will also be included in the value of taxable service.

However, expenses paid by a service provider as a pure agent or as part of business practice or custom or convenience on behalf of the service user, will be excluded from the value of taxable service on presentation of documentary evidence and fulfillment of prescribed conditions - Rule 5(2).

For illustration Octroi and custom duty, demurrage Coolie charges paid by a customs agent on behalf of a client or filing fee paid by a Company Secretary for incorporation of a company and then recovered will be excluded from the values of taxable service.

Illustrations

12. A Chartered Accountant based in Mumbai goes for audit work at Bangalore. The Auditee Company reimburses Rs. 20,000 being the actual cost of travel and hotel bills. Discuss the taxability of the sum.

Solution:

The Chartered Accountant has not incurred the travelling expenses 'on behalf of the client' In fact, Bangalore Audit will necessarily require travelling to that city. Hence, the reimbursement of expenses of Rs. 20,000 will be liable to service tax.

Following illustrations are in the Service Tax (Determination Of Value) Rules, 2006 duly adapted)

13. X sells a house for Y and gives a TV advertisement. Cost of TV ad will be part of the gross amount charged even if it is separately mentioned . Because. Advertising service is an input service for the estate agent in order to enable or facilitate him to perform his services as an estate agent.

14. X is management consultant for Y. He incurs expenses on traveling telephone, etc., and indicates these items separately on the invoice issued to Y . The expenses will be included in the gross amount charged because X is not acting as an agent of Y but procures such inputs or input service on his own account for providing the taxable service.

15. B acts as an architect for a builder A. A incurs expenses on telephones, air travel tickets, hotel accommodation, etc., to enable him to effectively perform the provision of services to A. The expenses will be included in the gross amount charged even if separately itemized as part of an inclusive overall fee. .

16. X provides a taxable service of rent-a-cab by providing chauffeur-driven cars for overseas visitors. The chauffeur is given a lump sum amount to cover his food and overnight accommodation and any other incidental expenses such as parking fees by the Company X during the tour. At the end of the tour, the chauffeur returns the balance of the amount with a statement of his expenses and the relevant bills. Company X charges these amounts from the recipients of service. The cost incurred by the chauffeur and billed to the recipient of service constitutes part of gross amount charged for the provision of services by X.

2.8. Material cost not included in taxable value:

Service tax can be levied only on service and not on material sold. Hence, in case of a composite service including cost of material sold and labour, cost of material or goods sold to the service users will have to be excluded from the gross amount charged to arrive at the value of taxable service.

This is ensured by granting *ad hoc* “abatement” for the material portion included in the gross amount. Taxable value of some service such as construction, *work* contract or supply of food and beverage in an air-conditioned hotel, which include labour as well as cost of material costs, is determined after deducting *ad hoc abatement* to exclude cost of material sold to the customer. In some cases, an option is given to pay tax after abatement or claim Cenvat.

Similarly, if the parties intended to enter into a contract of purchase and sale of goods, the transaction will be ‘sale’ even though some services might have been provided and the value of such service will be taxed separately.

3. SERVICES INVOLVED IN THE EXECUTION OF A WORKS CONTRACT

3.1 Meaning and Scope:

Works contract is a “declared service” u/s 65B (22) and u/s Section 66E (h) service portion in the execution of a works contract. In terms of Article 366 (29A) of the Constitution of India transfer of

property in goods involved in execution of works contract is deemed to be a sale of such goods.

Sec. 65B(4) defines “works contract”. It means “a contract wherein transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods and such contract is for the purpose of carrying out **construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, alteration of any movable or immovable property** or for carrying out any other similar activity or a part thereof in relation to such property;”.

Works Contract Service		
Construction, Erection, Commissioning,	Installation, Completion Fitting Out,	Repair, Renovation Alteration
of <u>any movable or immovable property</u>		
OR		
for carrying out any other similar activity or a part thereof in relation to such property		

Thus, a work contract would include:

- Construction of building or other civil structure,
- Painting repair or renovation of a building, wall tiling, flooring
- laying of pipelines, erection ,commissioning of or installation of plant, machinery, equipment or structures attached to earth
- Electrical fittings, plumbing and Job work
 - where some material is used by job worker.

Works contract has two components namely sale of goods and provision of service. Thus, for instance a plumber fits a tap for a composite amount. The contract will cover the cost of the tap and the fitting charges.

Even in the normal sales of say Motor cars contain after sales service or post sale warranty and may be treated as composite contracts including goods and service.

Under the negative list regime, individual description of the service is dispensed with. Hence, a composite contract involving goods and services will attract the service tax liability.

3.2. Exclusions from Scope of services:

Under the mega exemption notification, service of a sub-contractor will be exempt n two circumstances:

- a. If the service is provided to main contractor and service of the main contractor is exempt(such as roads, airports, railways, transport terminals, bridges, tunnels and dams etc.) and
- b. If sub-contractor himself is undertaking work, which is, exempt from service tax (e.g. sub-contractor undertaking work of construction of public road).
- c. Pure works contract Works contract (e.g. maintenance, job work, processing not involving material etc..
- d. A contract for sales of a ready flat will not be taxable under this head as it is not a construction contract. However, if a flat is booked with a builder or developer in a building, which is under construction, the construction activity will attract service tax under this head. .
- e. Construction work done for a person himself will not be work contract. Accordingly a builder entering into contract for sale of flat or a developer entering into contract for construction of an individual flat for personal residential use of client are not liable to pay service tax.
- f. Construction and works contract services relating to ports exempt, but no exemption to finishing or repairing services.

3.3 Valuation of services: - Rule 2A- A. Normal Valuation

An assessee may opt for normal determination of the value of service component as per Rule 2A of Service Tax Determination of Values Rules 2006 I as under:

Gross amount charged for the works contract

Less :VAT or Sales Tax paid on paid on transfer of property in goods involved in the execution of the said works contract

Less: The value of transfer of property in goods involved in the execution of the works contract

Value of Service involved in work contract

Value of services involved in works contract shall include,-

- a. Labour charges for execution of the works;
- b. Amount paid to a sub-contractor for labour and services;
- c. Charges for planning, designing and architect's fees
- d. Charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract;
- e. Cost of consumables such as water, electricity, fuel, used in the execution of the works contract

- f. Cost of establishment of the contractor relatable to supply of labour and services;
- g. Other similar expenses relatable to supply of labour and services; and
- h. Profit earned by the service provider relatable to supply of labour and services;

Advantage of this option is that the assessee will be entitled to claim full credit for material and Cenvat. The assessee will be required to comply with the requirement of maintenance of record to claim deduction for such Cenvat and cost of services.,

3.4 Composition Scheme:

For valuing the Works Contract Service provided in The Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007 and discharge his Service Tax liability at 4% of the gross amount charged for the works contract.

As per explanation to Rule 3 of The Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007, Gross Amount Charged for the Works Contract(after 07-07-2009) **shall include:**

- a. The value of all goods used in or in relation to the execution of the works contract, whether supplied under any other contract for a consideration or otherwise.,
- b. The value of all the services that are required to be provided for the execution of the works contract; BUT EXCLUDE
 - a. The value added tax or sales tax as the case may be paid on transfer of property in goods involved;
 - b. The cost of machinery and tools used in the execution of the said works contract except for the charges

Moreover, Following additional conditions will be applicable :

- i. the assessee, who has opted for the composition scheme , will not be eligible to claim Cenvat
- ii. The assess should exercise the option prior to payment of Service Tax in respect of such contract,;
- iii. The option so exercised shall be applicable for the entire works contract and shall not be withdrawn until the completion of the said works contract ; and

- iv. The option shall be permissible only where the declared value of the works contract is not less than the gross amount charged for such works contract.

Alternatively, the assessee may opt for the Composition Scheme under Rule 2A(ii) and the value of the service portion in a work contract will be : --

- a. **40%** of the total amount charged for the works contract for execution of **original works** ;
 “Original Works” means-
 - (i) all new constructions;
 - (ii) all types of additions and alterations to abandoned or damaged structures on land that are required to make them workable.
 - (iii) erection, commissioning or installation of plant, Machinery or equipment or structures, whether pre-fabricated or otherwise
- b. **70%** of the total amount charged for the works contract for **maintenance or repair or reconditioning or restoration** or servicing of any goods ; and
- c. **60%** of the total amount charged for the works contract for other , not covered above , including maintenance, repair, completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings of an immovable property,
- d. **25%** of the total value of contract of construction if includes value of land (75% is allowed by way of abatement)

3.5 Other points:

- (i) Under both the options, VAT/sales tax will not be included in the ‘value’ for purpose of calculating service tax.
- (ii) Fair Value or cost of goods and utilities supplied by the customer, such as electricity, canteen, water etc. will be added in the value of the contract.
- (iii) Each works contract can be valued separately
- (iv) Even service provider and service receiver can value the same contract on separate basis
- (v) Cenvat credit of tax paid on input services subcontractors, insurance, telephone, manpower supply, architect etc. and capital goods will be available, but not of duty paid on inputs

- (vi) Small sub- contractors are entitled to claim general exemption upto Rs. 10 lakhs

Illustration

17. X raised a bill fabricating a new machine for Rs 1,00,000(ex-service tax). Parts were supplied by the customer having fair cost of Rs 2,00,000. What will be the value of the service?

Solution;

- A-** Normal value will be Rs 1,00,000 being the value of service charged by X and service tax will be Rs 14,0000. Gross amount charged will be Rs 1,14,000 (14,500 with Swachh Bharat Cess
- B-** If S opts for the exemption scheme value of the service will be 60% of Rs 3,00,000 = Rs 1,80,000. Service tax will be 14% of Rs 1,80,000 = Rs 25,200. Gross amount charged will be Rs 1,00,000+ 25,200= Rs 1,25,200 (with SBC Rs 26,100/ 1,26,100

It will be preferable to go for normal valuation

3.6 Reverse charge in works contract service

Where, service provider of works contract service (including Construction, Job work or AMC) is an individual, HUF, proprietary or partnership firm or an AOP and service receiver is company or business entity incorporated as body corporate, 50% of the service tax shall be borne by service receiver and 50% by service provider

- “Business entity” means any person ordinarily carrying out any activity relating to industry, commerce or any other business or profession.
- Body Corporate means company, Cooperative Society, LLP
- This provision will not be applicable, If the service receiver is a charity organisation, Government, trust or firm or individual.

Illustrations

18. A undertakes a building contract for Rs 3,00,000 . B, the Principal supplies material of Rs 50,000 and also various utilities valued at Rs 60,000 . Under Rule 2A the value of the contract will be taken as 4,10,000 . Service tax thereon will be

$$[40\% \text{ of } 4,10,000] \times 14/114 = \text{RS } 20,140$$

A can claim CENVAT Credit of tax paid on input services and capital goods will be available, but not of duty paid on inputs.

Illustrations

19. A is the sub-contractor of B, who is the main contractor. A provides services to B under a works contract amounting to Rs 4

lakhs (excluding ST). B in turn charges his client Rs 6 lakhs and discharges the service tax liability on the same. Whether A is required to pay the service tax? Assume cost of materials used in the course of work contract is Rs 3,00,000

Solution

- a. If A is a small service provider , he can claim the exemption upto Rs 10 lakh and his tax liability will be NIL and Cenvat will not be available .
- b. If A is liable for service tax, then merely because B has paid full service tax will not be discharge him from his liability to pay service tax. His service liability under the composition scheme will be Rs 22,400 i.e. 14% of 40% of Rs 4 lakh and he, will be entitled to claim CENVAT credit except on inputs , if any.
- c. Alternatively, A can opt for regular tax and claim Cenvat. Tax liability will be Rs 14,000 i.e. 14% of (Rs 4 lakh- Rs 3 lakh)

Illustrations

20. A submits the following details to find out the gross charges and the net charges for the contract.

Amount charged for works contract	Rs.	1,04,000
VAT paid	Rs	4,000
Value of transfer of property in goods involved of works contract	Rs	70,000

Solution

VAT is to be excluded. Hence Gross charges for the contract will be Rs 1,00,000 i.e. Rs 1,04,000 – Rs 4,000

Since the value of the goods provided is Rs. 70,000 , Net charges for the contract will be Rs 30,000 = [Rs 1,04,000 – Rs 4,000]- Rs 70,000 = Rs 30,000

Liability for service tax will be Rs 4,200 being 14% on Rs 30,000 subject to CENVAT credit, if any

Under the composition scheme, service tax will be Rs 5,600 being 5.6% % on Rs 1,00,000 . There will be No CENVAT credit on inputs.

4. VALUE OF SERVICES INVOLVED IN SUPPLY OF FOOD AND ANY OTHER ARTICLE OF HUMAN CONSUMPTION IN A RESTAURANT OR AS OUTDOOR CATERING

4.1 Definition and Scope

U/s 66E (i) service portion in an activity wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of the activity is a declared service.

This a case of a bundled service by way of supply of food or any other article of human consumption or any drink, in a premises (including hotel, convention center, club, pandal, shamiana or any other place, specially arranged for organising a function together with renting of such premises Accordingly the service covers the following activities:- ;

- a. Supply of food or drinks in a restaurant as part of its regular activity or business ;
- b. Supply of food or drinks by an outdoor caterer.
- c. Bundled up service including Supply of food or drinks in a hotel, convention center, club, pandal, shamiana or any other place, specially arranged for organising a function together with renting of such premises

For this purposes:

- a. Food articles must be for human consumption.
- b. Drinks may or may not be intoxicating.

4.2 Valuation

Rule 2C of the Service Tax (Determination of Value) Rules, 2006 deals with for determination of the value of service portion in supply of food or any other article of human consumption or any drink in a **restaurant or as outdoor catering** as percentage of the total amount charged given below : .

Type /place of supply	%
In a restaurant -	40
As part of outdoor catering –	60
As a bundled service - *	70
*Allowed by way of 30% abatement vide Notification No. 26/2012-ST dated 20.06.2012	

“Total amount” means

- the fair market value of all goods and services supplied
- in or in relation to the supply of food or any other article of human consumption or any drink (whether or not intoxicating),
- whether or not supplied under the **same contract or any other contract**,
- after deducting the amount charged for such goods or services and the value added tax and sales tax levied thereon.
- The fair market value of goods and services so supplied may be determined in accordance with the generally accepted accounting principles

4.3 Cenvat Credit

Cenvat credit will be available on

- a. Input Services and
- b. Capital Goods and
- c. Other Inputs Not being
 - food items meant for human consumption
 - classifiable other than under Chapters 1 to 22 of the Central Excise Tariff Act, 1985.)

4.4 Exemptions

With effect from 01.04.2013, Only the restaurants air-conditioning or central air-heating in **any part of the establishment, at any time during the year**, will be liable to pay service tax in view of Notification No 03/2013 di 01.03.2013 .

Other restaurants, eating joints or a mess providing serving of food or beverages will be exempt from service tax

The CBEC has clarified, that in case of a partly air-conditioned restaurant a complex where air conditioned as well as non-air conditioned restaurants are operational but food is sourced from the common kitchen, non-air-conditioned or non-centrally air-heated restaurant will not be liable to service tax. In such cases, service provided in the non-air-conditioned / non-centrally air-heated restaurant will be treated as exempted service and credit entitlement will be as per the Cenvat Credit Rules.

Illustrations

21. Asoka hotel entertains guests of B for Rs 10 lakh being cost of food and drinks find out the value of the service , if hotel is air-conditioned ?

Solution

An Air- conditioned hotel is liable to pay tax on 40% of amount charged. Hence. Value of taxable service will be Rs 4 lakh
 Service tax on 4 lakh X 14%= Rs 56,000 being pure catering service

22. If Asoka is a banquet hall , what will be the value and tax for service tax .

Solution

Asoka is a banquet hall hence it gives hall on hire with supply of food. Hence the value of taxable service will be 60% of amount charges = Rs 6 lakh and Service tax @ 14% =Rs 84,000 .

23. If Asoka is a banquet hall and hosting a sales conference for B , what will be the value and tax for service tax .

Solution

Asoka is a banquet hall . It is providing bundled services. Hence entitled to 30% abatement . Value of taxable service will be 70% or Rs 7 lakh and Service tax x @ 14% = Rs 98,000.

2.11 Scope of service to be defined by parties:

W. e. f. 1-7-2012, in absence of definition of any specific service, scope of service can be determined by mutual agreement between service provider and service receiver.

Under Rule 3 the responsibility of valuation of a taxable service has been cast upon the service provider.

An assessee is free to take different method of valuation for different contracts.

5. SELF EXAMINATION QUESTIONS:

1. Discuss the concept of Gross Amount Charged .
2. Whether Reimbursement of expenses will be included in the gross amount charge
3. What are the provision regarding valuation of work contract service ?
4. McDonnell have been asked to pay tax on food supplied in non-air-conditioned section . discuss their rights and liability .
5. Is it true that the parties can determine their own terms?



POINT OF TAXATION RULES FOR PAYMENT OF TAX

Synopsis

1. Introduction and objectives:
2. Legal framework
3. Taxability of Services
4. Small Service Providers
5. Valuation of Taxable Service
6. Point of Taxation Rules, 2011
7. Typical Illustrations
8. Self-Examination Questions

1. INTRODUCTION AND OBJECTIVES:

This lesson seeks to analyse the implication of the new system of reckoning and the mechanism for levy of service tax in India in the light of various legal provisions made in this regard to determine the point of time for levy and payment of service tax. .

2. POINT OF TAXATION FOR PAYMENT OF TAX

2.1. Point of Taxation [POT]

Prior to 01-04-2011, as per Rule 6 of Service Tax Rules, 1994, due date for payment of service tax was 5th (6th in case of e-payment) day of the next month or quarter from *the date on which payment for service was received*.

With effect from 01-04-2011, Point of Taxation (POT) Rules, 2011 were introduced the concept of point of taxation to change the cash system of payment to accrual system instead of cash basis except in case of small service providers.

With effect from 01-07-2012, rate of service tax will be determined u/s 67A as prevailing on the date on which service is provided or agreed to be provided. The taxable event attracting the service tax liability is service provided or to be provided.

The POT Rules only determine the due date for payment of Service Tax NOT the rate of service tax.

2.2 Determination of Point Of Taxation (POT)- [Rule 3]:

Under Rule 3 of the POT Rules, 2011 POT will be the earliest time the following : :

(a) (i) Date of invoice

If the invoice for the service provided or agreed to be provided is issued within the prescribed time of 30 days (45 days in case of banking financial service) from the date of completion of the provision of service. ; OR

(ii) Date of completion of the taxable service or event,

If invoice is not issued within the above time limit of 30/45 days prescribed under Rule 4A of the Service Tax Rules, 1994, OR

(b) Date of receipt of the payment

- i. If the service provider receives the payment before the time specified above to the extent of such payment
- ii. This implies that **each advance** will be regarded as a **separate** point of taxation.
- iii. In such cases, an invoice can be issued only after receipt of advance.

(c) Above two dates are subject to following modifications

i. Continuous supply of Service

Where a service provider provides whole or part of any service under a contract periodically and the receiver of the service makes the payment periodically on completion of each event on a recurrent basis, the date of completion of each such event as specified in the contract shall be deemed to be the date of completion of provision of service.

ii. Advance Up to Rs 1000

In In case of receipt payment upto Rs ,1000 in excess of the invoice amount raised by the provider of taxable service, POT in respect of such excess amount , may at the option of the service provider the date of invoice (as per(a) above.

iii. Advance Up to Rs 1000 – Continuous Supply

Advance upto Rs 1,000 in case of continuous supply service like telephones, payment of credit card etc., payment of service tax can be on the date of provision of service and not the date of receipt of advance.

Illustrations -1 (Determination of POT)

Date of			Point Of Tax POT	Reason
Providing Service	Issuing invoice	Receipt payment		
2014				
April 10	April 20	June 30	April 20	Invoice issued within 30 days
April 10#	June 01	June 30	April 10	Invoice issued beyond days
June 10	June 10+	April 20	April 20	Date of payment
Qtrly @	NA	April 01	April 01	Date of Advance
Notes : @ Advance will not be again charged to tax when service provided / invoice raised				
# If service provider is a financial /banking service , invoice is in time ,POT will be June 01 – date of invoice				

Illustration-2

Determine the tax liability of A , who undertakes a contract of internal audit of a company subject to following terms:

- The Company pays on 01-04-2016 Rs 1,00,000 in advance to mobilize the requisite audit staff
- A raises bill in respect of the work done during a quarter by the end of succeeding quarter. The Company settles the bill within a month of the date of invoice deducting Rs 25,000 every quarter towards the advance paid to A.
- Assume that every quarter the amount billed was Rs 1,00,000
- Company does not pay the final bill as it was not satisfied by the performance of A . .

Solution

- 01-04-2016 date of Advance Rs 1,00,000 received for service to be provided *

Value of service provided: $\text{Rs } 1,00,000 \times 100 / 114.5 = \text{Rs } 87,332$
 Service Tax payable @ 14.5% by Rs 12,668
 Gross Value of Service provided U/s 67 Rs 1,00,000

POT 01/04/2016 First quarter April- June, 2016:

Value of service provided: = 75,000* 100/114.5	Rs 65,502
Rs 1,00,000 Less 25,000 Advance adjusted)s	
Service Tax payable@ 14.5%	<u>Rs 9,498</u>
Gross Value of Service provided U/s 67	<u>Rs 75,000</u>

This is a case of continuous service completed on **30-06-2016** invoice is issued on 30-09-2016 and date of payment 31-10-2016. Since the invoice is not issued within 30 days , POT will be 30-06-2016 being date of completion of service.

b) Second quarter July- Sept., 2016

Service Tax payable will be Rs 12,668 as computed in the first quarter. POT being the date of continuous service 30-09-2016, the date of invoice and date of payment will be 31-12-2016 and 31-01-2017 respectively.

c) Third quarter – October- December, 2014 :

POT 31-12-2016 (Date of service, Date of invoice 31-03-2017 and date of payment 30-04-2017); Service Tax Payable Rs 8,250

d) Fourth quarter Jan- March, 2015

POT 31-03-2017(Date of service, Date of invoice 30-06-2015 and date of payment 31-07-2015); Service Tax Payable Rs 8,250.

If the company has not paid the amount, still A will be liable to pay service tax on accrual basis. There may be reversal if service not provided but not for bad debts.

2.3. Meaning of certain terms used:

a. "Invoice"

Invoice means the invoice referred to in rule 4A of Service Tax Rules, 1994 and shall include any document as referred to in the said rule -. Rule 2(d):

b. Time-limit for issue of invoice –Rule 4A

A service provider is shall issue an invoice, bill or challan in respect of taxable service provided or to be provided within 30 days [45 days for a banking company or other financial institution or a finance company (NBFC) from the date of

- completion of such taxable service or

- receipt of any payment towards the value of such taxable service,
Whichever is earlier.

The time limit of 30 days will be from the date of the completion of *each taxable event* in case of continuous supply of service.

If the date of payment is required to determine according to any other rule, such date shall be the date of payment.

c. “Continuous supply of service”

“Continuous supply of service means any service, which is provided or to be provided *continuously or on recurrent basis*, under a contract, for a period exceeding *three months* with the obligation for payment periodically or from time to time or a service notified by the Central Government, a continuous supply of service - Rule 2(c);

Telecommunication, Construction Internet, Works contract, Renting of Immovable Property, Insurance and Security are examples of the services notified as “continuous supply of services”.

d. “Date of payment”:- Rule 2A

- A. Date of payment shall be the date on which the payment is entered in books of account or the date of credit in bank account of the person liable to pay tax ,whichever is earlier;
- B. Date of credit in bank account will be the date of payment if there is a change in effective rate of tax or when a service is taxed for the first time during the period between such entry in books of accounts and its credit in the bank account **and** the credit in the bank account is after four working days from the date when there is change in effective rate of tax or a service is taxed for the first time; and the payment is made by way of an instrument which is credited to a bank account.

2.4. Point of Taxation in case of Change of Rate (Rule- 4)

A. If the taxable service has been provided **before the change** in effective rate of tax the taxability will be as under;

Date of Invoice issued	Date of Receiving Payment	Point of Taxation
<u>Before</u> the change of Rate of Tax	<u>After</u> the change of rate of tax	Date of invoice at old rate
<u>After</u> the change of rate of tax	<u>Before</u> the change of Rate of Tax	Date of Receipt at old rate
<u>After</u> the change of rate of tax	<u>After</u> the change of rate of tax	Date of Invoice or Payment , whichever is earlier i.e. New Rates

Broadly, service provided before the change in rate of tax will be taxable at old rate if at least one of the two events viz issue of invoice or payment has occurred before such change

B. If the taxable service has been provided **After the change** in effective rate of tax the taxability will be new but point of taxation will be as under:

Date of Invoice issued	Date of Receiving Payment	Point of Taxation
<u>Before</u> the change of Rate of Tax	<u>After</u> the change of rate of tax	Date of Payment invoice New Rate
<u>After</u> the change of rate of tax	<u>Before</u> the change of Rate of Tax	Date of Invoice at New rate
<u>After</u> the change of rate of tax	<u>After</u> the change of rate of tax	Date of Invoice or Payment, whichever is earlier i.e. New Rate

2.5 Point of Taxation in case of a new service –Rule 5

With the introduction of the negative list regime of service tax, many services, which were not liable to service tax, have become taxable for the first time w. e. f. 01-07-2012.

Rule 5 deals with such a situation and provides where a service is taxed for the first time, then no tax shall be payable:-

- to the extent the invoice has been issued and the payment received against such invoice before such service became taxable; or
- if the payment was received before the service becomes taxable and invoice is issued within 14 days of the date when the service is taxed for the first time.

It may be noted that grace period of 14 days is allowed only to issue of bill and not to the payment. Payment has to be received before the date on which the service became taxable.

2.6. Point of Taxation on Cash basis

2.6.1. Individuals and firms (Rule 6 of Service Tax Rules):

From 01-07-2012 onwards, individuals and firms, whose aggregate value of taxable services provided from one or more premises is Rs 50 lakh or less in the previous financial year, shall have the option to pay tax on taxable services provided or agreed to be provided. Thus, such individuals and firms can pay service tax on cash receipt basis or on accrual basis.

2.6.2. Reverse charge – Payment Basis:

The point of taxation in respect of the persons required to pay tax as recipients of service in respect of services notified/s 68(2) e.g. Goods Transport Agency, or Importer of Service shall be **the date on which payment is made**. This is subject to the condition that the payment must be made within a period of six months of the date of invoice; otherwise the point of taxation shall be determined as if this rule does not exist:

2.6.3. Associated concerns- Accrual Basis

In case of “associated enterprises”, where the person providing the service is located outside India, the point of taxation shall be the date of debit in the books of account of the person receiving the service or date of making the payment whichever is earlier.

2.7. Point of Taxation in case of Copyrights etc- Rule 8:

In respect of royalties and payments pertaining to copyrights, trademarks, designs or patents, where the whole amount of the consideration for the provision of service is not ascertainable at the time when service was performed, and **subsequently** the use or the benefit of these services by a person other than the provider gives rise to any payment of consideration, the service shall be treated as having been provided each time when a payment in respect of such use or the benefit is received by the provider in

respect thereof, or an invoice is issued by the provider, whichever is earlier.

In other words, every payment or benefit will be the point of taxation.

Illustration-3:

A, music producer sell Music rights of a song to B depending upon the number of CDs sold by it. Subsequently, B transfers these rights to a music channel at a certain royalty payable to A. The benefit is accrued to the producer on the date of payment, which will be the point of taxation.

2.8. Determination of point of taxation - Rule- 8A

Where the point of taxation cannot be determined as per these rules as the date of invoice or the date of payment or both are not available, the Central Excise officer, may, require the concerned person to produce such accounts, documents or other evidence as he may deem necessary and after taking into account such material and the effective rate of tax prevalent at different points of time, shall, by an order in writing, after giving an opportunity of being heard, determine the point of taxation to the best of his judgment.

2.9 Miscellaneous:

2.9.1. Cenvat credit on invoice:

Under the POT Rules, the liability arises on the date of issue of invoice. Correspondingly, Cenvat credit can be availed on receipt of invoice. However, if payment is not made within 3 months, the Cenvat credit is required to be reversed.

2.9.2 Issue of Credit Note

If a service provider pays the service tax when invoice is issued or advance is received and subsequently refunds the payment or issue credit note to the service user, because

- service is *not provided* partly or fully or
- the amount of invoice is *renegotiated* due to deficient provision of service or any terms contained in the contract, then, after such refund or credit note, he can take self-credit of excess service tax paid by him on issuing the invoice or receipt of advance under Rule 6(3).

Apparently, the rule provides for adjustment because of any rebate, discount or reduction or deduction, but NOT bad debts. Hence adjustment for bad debts is not permissible.

3. TYPICAL ILLUSTRATIONS

4) A Chartered Accountant raises a bill for audit service at a gross amount of Rs. 55,150 inclusive of service tax. Find out the value of taxable services rendered and the service tax payable on the services.

Solution:

Under explanation 2 to section 67, the value taxable service and the service tax are deemed equal to the gross amount charged. Since the service tax rate is 14.5%, the gross amount will be $100 + 14.5 = 114.5\%$ inclusive of service tax.

Value of Taxable service will be $55150/114.5\% = \text{Rs. } 48,166$ and service tax will be Rs. 6,984 being 14.5% on Rs. 49,083.

5) Ashok, A Chartered Accountant completes the audit for the year 2015-16 by July 31, 2016 and immediately raises the invoice for Rs 3,00,000. The payment is received on August 10, 2016. Ascertain his service tax liability (a) under POT rules, (b) on cash basis and (c) audit fees is paid in two instalments – 50% on 31/03/2016 and the balance on 31/08/2017

Solution:

a) Under accrual system,

- Service tax liability will arise on July, 31, 2016 being the date of issuing invoice the liability will be computed
- U/s 67(2). Gross amount charged is Rs 3,00,000.

Tax liability will be $3,00,000 \times 14.5/114.5 = \text{Rs } 37,991$.

There will be no further liability to pay any tax in 2016 when the payment is received .

(b) On cash basis

The Liability for service tax of Rs 37,991 will arise on August 31, 2016 the date on which the payment was received . There will not be any liability on the date of service / invoice .

(c) Audit fee received in instalments

- On 31-03-2016, there will be service tax liability of Rs 18,496 on the advance of Rs 1,50,000 [$\text{Rs } 1,50,000 \times 14.5/114.5$] under both the s accrual as well as cash .
 - On 31-07-2016 , the invoice is raised , the balance of Rs 150,000 will attract service tax liability under accrual method on balance Rs 1,50,000 ,(Service Tax Rs 18,495). There will be no further tax in August ,2016 , when the payment is received
 - Under the system , liability will arise on 31-08-2016 . There will be no liability in July 2016,when the invoice is raised.
 - Credit will be given for the tax paid on advance money received at the time of Receipt or accrual as the case may be,
1. A provides taxable services worth Rs 20 lakhs on which service tax liability was arrived at Rs 2,47,200 and immediately raises the bill for the taxable services on 30-09-2012. Arrive at the service tax liability and the time of payment in the following cases:
- a) Rs 20 lakhs is received on 31-05 2013 in full and final settlement of the bill.
 - b) Rs 5 lakhs is received as advance on 03-11-2012 and Rs 15 lakhs is received on 31-05 2013 in full and final settlement of the bill.
 - c) Rs 10 lakhs is received as an advance on 03-11-2012. The client refuses to pay any further and the remaining amount become bad debts.

Ascertain the service tax liability (a) under point of tax Rules (b) On Receipt Basis

Solution:**Under POT Rules**

Under POT Rules, the service tax liability will arises on the 30-09-2012 being the date of issue of invoice.

Gross amount charged: Rs 22,47,200 inclusive of service tax payable at Rs 2,47,200

Hence there will be no further tax liability in any of the 3 cases as date of payment not relevant . There will be no credit for bad debts.

On cash receipt basis,

In all the three situations (a) , (b) and (c) ,

- There will no liability for service tax on On 30-09-2012 – date of provision of the service as the service tax will be payable only on the date of receipt of the payment .
- Amounts will be deemed to include service tax u/s 67[2]

(a) On 31-05-2013 A will be liable to pay service tax on Rs 20 lakh received = Rs 2,20,007 i.e. $[20 \text{ lakhs} \times 12.36 / 112.36]$.

There will be neither any tax nor any credit on balance of Rs 5 lakh not received.

(b) On 03-11-2012 A will have to pay service tax on advance received Rs 5 lakhs i.e. Rs 55,002 $[Rs 5 \text{ lakhs} \times 12.36 / 112.36]$

- On 31-05 2013, A will be liable to pay service tax of Rs.1,65,005 on Rs 15 lakh received $[15,00,000 \times 12.36 / 112.36]$.
- There will be neither any tax nor any credit on balance of Rs 5 lakh not received
- On 03-11-2012 A will be liable to pay service tax of Rs.1,10,004 i.e. $[10,00,000 \times 12.36 / 112.36]$ on Rs. 10 lakhs received by him as advance. No further tax liability would arise since the balance amount was not received by the assessee.

Note; Under POT, Rules there is no right of reversal on bad debts, although rebates /discount etc can be reversed within 90 days and auto credit can be claimed

6) Find out the point of taxation if the:-

- (a) Service was completed on 10-04-2016
- (b) Invoice was issued on 30-04-2016 and
- (c) payment was received on 30-04-2016

Solution :

30-04-2016 Date of invoice will be the point of taxation as the invoice is issued within 20 days .

7) What will be the effect if in the above case; the service was completed on 10-06-2016?,

Solution: -

30-04-2012 Date of invoice will be the point of taxation

8) On 01-04-2016 , A receives the payment in advance for service to be provided by the end of each quarter .A does not issue any invoice until the work is completed. What will be the POT?

Solution;

01-04-2016 being the advance shall be treated as the date of payment even if no invoice was issued.

9) Find out the point of taxation and rate applicable if service tax rate is changed on 01/06/2016 at 15% , old rate being 14.5%
Old Rate 14.5 % | New Rate 15%

Taxable service rendered on	Date of issue of invoice	Date of payment	Point of taxation	Applicable Rate
31.05.2016	31.05.2016	11.06.2016	31.05.2016	14.5%
31.05.2016	10.06.2016	01.07.2016	10.06.2016	15%
31.05.2016	01.07.2016	30.05.2016	30.05.2016	14.5%
10.06.2016	31.05.2016	30.06.2016	10.06.2016	15%

4. SELF EXAMINATION QUESTIONS

- 1 When does the liability of payment of service tax arise?
- 2 What do you mean by point of taxation? How is it different from cash receipt method?
- 3 What are the classes of assessee exempted under the POT Rules? A receives Rs 10,000 as advance on 01/01/2016 ,He completes the service on 01/02/2016 and raises invoice on 15/06/2016 for Rs 1,00,000 . The clients pays him Rs 40,000 on account on 31/03/2016 and the balance on 31/07/2016 . Determine his tax liability. (Ans: 10,000 on 1/1/2016,90,000 on 01/02/2016. , No tax on payment , bill raise after 30 days , date of service is the POT)



IMPORT AND EXPORT OF SERVICE

Synopsis:

1. Introduction and objectives
2. Exempted services
3. Export of Services
4. Import of Services
5. Services provided to Developers/ SEZ Units
6. Exemption in respect of cost of Materials
7. Illustrations
8. Self examination Questions

1. INTRODUCTION AND OBJECTIVES:

U/s 93 of the Finance Act, 1994, the Central Government may grant partial or total exemption, in respect of some services by issuing an 'exemption notification'. Such exemption may be partial or total, conditional or unconditional.

Besides, some services are exempted from service tax as they do not fall in any of the clauses describing taxable services. Services provided by general doctors are not covered under the purview of service tax and as such are not taxable. Then there are some services, which are exempt in certain circumstances or if rendered by certain persons or rendered to certain persons or places.

This lesson intends to explain the concept of exemptions available in respect of service in different circumstances.

2. EXEMPTED SERVICES

After the introduction of negative list concept, all the services are prima facie chargeable to service tax. Therefore the concept of "exempted has to be read in the context of definition of Service in section 65B (4)

- a. Some services are **not covered or excluded in Sec 65(4)** in the definition of the taxable services, but specific exemption is granted in the clause itself or by way of notification.

- b. There are 39 services listed in the “**Negative List** in Section 66D of the Finance Act, 1994, which are not chargeable to service tax.
- c. In respect of some services, only a portion is taken as the taxable services. Rest of the services is exempted. These exemptions are considered at their respective places. For example, in respect of a practicing Chartered Accountant representation by a Chartered Accountant was not covered under the purview of taxable services upto 30-04-2011. Similarly lawyer’s services are liable only if rendered by or to a business entity e/g. a firm of lawyers to a company.
- d. Some services are not taxable if rendered to certain recipients e.g. services rendered to, R.B.I, UN and other International Organisations, SEZ, etc.
- e. Export of taxable service is exempted under Export of Services rules, 2005 subject to fulfillment of certain conditions.
- f. Small service providers are exempted from service tax upto a limit of Rs. 10 lakhs subject to certain conditions.
- g. The Central Government has issued a mega- notification granting exemption to as many as 39 services ,
These points have been considered at their respective places.

3. EXPORT OF SERVICES

3.1. Background

In common parlance, export of services means provision of service outside India. Since service tax is tax on service rendered in India, logically service tax should not be payable on export of service and if paid, it should be refunded in some form of rebate or other.

These matters were covered under the Export of Service Rules, 2005. The Rule provided that any service can be exported outside India if; the service is to be **provided from India and used outside India** and Payment for such service is **received** by the service provider in **convertible foreign exchange**. The Rules also prescribed some conditions based on the category of service (e.g. immovable property outside India, service performed outside India, recipient is located outside India).

3.2 The Export of Service Rules, 2005 rules were omitted w. e .f 30-06-2012 and a new Rule 6A was inserted in the Service Tax Rules 01-07-2012. Rule 6A deals with the Export of service and provides that .

“The provision of any service provided or agreed to be provided shall be treated as export of service when-

- (a) the **provider of service is located in the taxable territory**
- (b) the **recipient of service is located outside** India
- (c) the service is not a service specified in the section 66D of the Act
- (d) the place of provision of the service is outside India
- (e) the payment for such service has been received by the provider of service in **convertible foreign exchange**, and
- (f) the provider of service and recipient of service are not merely establishments of a distinct person in accordance with item (b) of Explanation 3 of clause (44) of section 65B of the Act

In simple words, export of service means provision of a taxable service **outside India** by an **Indian entity** for a foreign **entity** for a **consideration received in convertible foreign exchange**.

If branch in India of a company provides some service to another branch outside India, it will not be export service

Rule 6A(2) empowers the Central Government to grant rebate of service tax or duty paid on input services or inputs, as the case may be, used in providing such service subject to such safeguards, conditions and limitations, as may be notified by it

3.3. To sum up, the position is once service is provided outside taxable territory including Jammu and Kashmir, Nepal or Bhutan, no service tax is payable because it will be outside the purview of service tax. Service rendered outside India will not automatically become export of service. To qualify as export of service, the conditions in Rule 6A should be satisfied. **If it qualifies as export, all benefits meant for export would be allowed.** If it does not satisfy the conditions under Rule 6A, it will remain non-taxable, but will not attain the status of export.

Export of Services Rules, 2005 and Taxation of Services (Provided from outside India and received in India) Rules, 2006 were replaced by the Place of provision Rules, 2012. These rules prescribe 14 principles for determination of place where a service is deemed to be provided. These principles have been discussed in detail in Lesson 1 discussed in detail in lesson 1. However, a broad summary of these principles is given below:

- Location of service receiver [R. 3]
- Performance of service/ Location of immovable property (also include multiple locations of performance) [R.4,5,6,7]

- Both provider and receiver in India [R. 8]
- Location of service provider [R.9]
- Service of transportation of goods and services [R.10,11]
- Services provided on board conveyance earliest place of embarkment on board is to be taken POP [R 12]
- Notified services[R.12 , 13]
- Where the provision of a service is, prima facie, determinable in terms of more than one rule, it shall be determined in accordance with the rule that occurs later among the rules that merit equal consideration

3.4 – Incentive to Export of Service

These incentives are available under different notifications and are subject to documentary compliance.

- (a) Service provided outside India is **not taxable** whether qualifies as export or not
- (b) Service provided outside India will qualify for CENVAT, Rebate and Refund of taxes and duty. Alternatively , CENVAT can be adjusted against payment of Excise or Service Tax etc These incentives are as follows :
- In case of rebate declaration prior to export is required to be filled with the specified authority but there is no such declaration for refund
 - Rebate is allowed on actual amount of tax paid but refund is allowed in proportion of export turnover to total turnover – much less in case company is doing taxable activity and exempted activity:

(c) .Rebate of Service Tax paid on Input Services used for export of services

Conditions for Rebate

- Service has been exported in terms of rule 6A;
- Duty on the inputs, for which rebate claimed has been paid to the supplier;
- That the service tax and cess, for which rebate claimed have been paid on the input services to the provider of service;
- If the person himself is liable to pay for any input services; he should have paid the service tax and cess to the Central Government.

- No CENVAT credit has been availed of on inputs and input services on which rebate has been claimed

Procedure for claiming Rebate

- Filing of Declaration - prior to date of export of service
- Verification of declaration
- Presentation of claim for rebate accompanied by, invoices for inputs issued under the Central Excise Rules, 2002 and invoice for input services issued under the Service Tax Rules, 1994,
- documentary evidence of receipt of payment against service exported
- a declaration that such service, has been exported in terms of rule 6A of the said rules

(d) Refund of input service under Rule 5 of Cenvat Credit Rules 1994

A service provider who export output service without payment of duty

Maximum amount of refund:

$$\frac{\text{Net Cenvat credit} * (\text{Export turnover of goods} + \text{services})}{\text{Total turnover}}$$

Net Cenvat credit means total CENVAT credit availed on input and input services by the manufacturer or the output service provider reduced by the amount reversed in terms of Rule 3(5c), during the relevant period

“**Export turnover of goods**” means the value of final products and intermediate products cleared during the relevant period and exported without payment of Central Excise duty under bond or letter of undertaking;

“**Export turnover of services**” means the value of the export service calculated in the following manner namely:-

Payment received during the relevant period for export services + Export services whose provision has been completed for which payment has been received in advance in any period prior to relevant period

Advances received for export service for which the provision of service has not been completed during the relevant period

“Total turnover” means sum total of the value of -

(a) all excisable goods cleared during the relevant period including exempted goods, dutiable goods and excisable goods exported;

(b) export turnover of services determined in terms of clause (D) of sub rule (1) above and the value of all other services, during the relevant period; and

(c) all inputs removed as such under sub-rule (5) of rule 3 against an invoice, during the period for which the claim is filed.

- **Exemption to service tax on commission to foreign agent and Goods Transport Agency services** In these cases “ Service tax is required to be paid on reverse charge basis in following cases - (a) Commission paid to foreign agent (b) Goods Transport Agency (GTA) service used for export of goods. An exporter may claim direct exemption in lieu of first paying the amount and then getting the refund of the same.
- **Rebate of input services used for export of goods**

Illustrations

1. A of Mumbai provides a taxable service to B of Delhi for a project in Dubai. Under PPS Rules , since the provider and the recipient of these service both are in India , the service will be deemed to be provided in India Hence it will not be export of service .
2. Ashok of Agra provides taxable service to Jain of Jammu, Kale of Kathmandu, and Tikam of Thimpu in Bhutan. Service in all the three cases is provided outside the taxable territory , hence will not be taxable in India but since in all the three cases consideration is not realised in convertible foreign exchange , Rule 6A will not apply and it will not be export outside India. Hence, CENVAT as an exporter will not be allowed.
3. A European gets the services of a motor garage to fix his car in Mumbai and makes payment in convertible foreign exchange. It will not be export of service as service is used in India.
4. A Chartered Accountant gives his consultancy on tax matter to a non- resident, who remits the fees in Indian currency, the exemption will not be available although the service is used outside India
5. An advertising agency makes a film for Singapore Tourism and receives payment in dollar for services provided in India. This will be case of service exported “from’ India to

be used outside India. It will qualify exemption as export of service.

6. An Indian film star gives performance at Macau in an award ceremony held there and receives the money in foreign currency. This will be Export of Service as the service is provided at the place of the event.

4. IMPORT OF SERVICES

Import of Service is just opposite of Export of Service that is **“Taxable Service Provided/ agreed to be provided in India** by any person who is **located in a non-taxable territory** and received by any person located in the taxable territory”

Location means such person has established a business or. a fixed establishment from which the service is provided or to be provided his permanent address or usual place of residence in a country India or outside India, as the case may be

Some examples of import of service are: Foreign Agents, Consultants, Banking and financial service providers, Ad in foreign Media etc

In case of import of service, Service tax to be paid by service recipient as reverse charge. However, CENVAT credit can be taken after payment of service tax by GAR-7 challan, if the service is eligible as Input Service under Cenvat Credit Rules.

Exemptions from service tax on Import of Service

- Import of service by Government, local authority or Governmental authority for non-commercial purposes
- Import of service by individual for purpose other than commerce, industry, business or profession
- Imports for charitable purposes by Charitable Organisations registered under section 12AA of Income Tax Act.

5. SERVICES PROVIDED TO SEZ

Service received by units or developer of SEZ which is used for authorized operation would be exempt from ST and cess.

Conditions

- Exemption is provided by way of refund except where service is wholly consumed within the SEZ
- Maximum refund is in ratio of export turnover of goods and services multiplied by the service tax paid on services other than wholly consumed services to the total turnover for the given period to which the claim relates
- Declaration by the SEZ developer to the effect that the specified services have been used for the authorised operations;
- Unit of a SEZ or developer should have paid the amount indicated in the invoice to the person liable to pay the said tax or the amount of service tax payable under reverse charge, as the case may be,
- No CENVAT credit of service tax paid on the specified services
- Unit of a SEZ or developer, who intends to avail exemption and or refund under this notification, shall maintain proper account of receipt and use of the specified services
- The benefit under the said notification is to be availed by filing a claim for refund of Service tax paid
- Exempt if wholly consumed in SEZ for authorised operations as defined in Notification 40/2012-ST dated 20-6-2012.
- If SEZ unit or developer has business outside SEZ, then in case of services not relating to goods or immovable property, service tax has to be charged and refund has to be applied by SEZ unit or developer on proportionate basis
- No reversal or payment of amount if services provided to SEZ unit or developer [Rule 6(6A)]

6. EXEMPTION IN RESPECT OF COST OF GOODS AND MATERIALS

When a taxable service (such as catering, construction) includes cost of goods and material sold apart from the service charged to the recipient, a proportionate amount equal to the value of goods and materials sold by the service provider to the recipient of service shall be exempt from service tax leviable if -

i) No credit of duty paid on such goods and materials sold has been taken under the provisions of the CENVAT Credit Rules, 2004 or

ii) if such credit has been taken by the service provider on such goods and materials, he has paid back the amount equal to such credit availed before the sale of such goods and materials.

Recently, this deduction is provided in the form of a composition amount e.g. 6% in case of a construction contract or by way of abatement or reduction from the gross value.

7. ILLUSTRATIONS

7. Advise A Coaching class which imparts training for GMAT to a Nepali student and claims it to be export of service.

Solution:

It will not be export of service since the service is not accruing out of India. However, it will be exempted service as it is rendered outside the taxable territory.

8. Will the services rendered by a Chartered Accountant by auditing the books of a Dubai based company in Mumbai be export of service. .

Solution:

If audit fee is received in India in Indian currency, It will not be export of service as the service has not accrued outside India.

However, if the fee is received in convertible foreign exchange it will be export of service even if rendered from in India foreign exchange is being received into India from outside India. So long as the auditee's location is Dubai.

9. What will be tax liability of a Chartered Accountant who audits the accounts of a multinational corporation also having some offices in India;

Solution:

It will be export of Service since the service accrues out of India and foreign exchange is received from abroad.

10. A mandap keeper providing services in Macau for IIFA awards and claims it to be an export of service, will he succeed?

Solution:

Yes, as the immovable property in relation to which Mandap services are provided is outside India, it will be export of services.

8. SELF EXAMINATION QUESTIONS

- 1) What are the incentives available to exporter of services?
- 2) What are the conditions for claiming rebate of service tax?
- 3) What is meant by export of services?
- 4) What is 'import of service'? Is import of services taxable?
- 5) In which cases are small service providers taxable?
- 6) A Chartered Accountant from Jammu and Kashmir conducted audit for the Shimla warehouse of ABC Ltd. The bill was of Rs 75,000. What should be the service tax to be collected?

(Hint: No service tax liability since the scope of service tax does not extend to Jammu and Kashmir)

- 7) An architect undertook a contract for the renovation of a house in Kashmir. He charged a lump-sum for the contract for Rs 5 lakhs. Calculate the service tax liability of the architect.

(Hint: No service tax liability since the scope of service tax does not extend to Jammu and Kashmir)

- 8) JKL Co Ltd provided services valuing Rs 7 lakhs during the FY 2015-16. During, 2016-17 it has provided taxable services valuing Rs 10 lakhs and has received payments towards taxable services Rs 7.5 lakhs. It also received services in the nature of transport of goods by road valuing Rs 50,000, in respect of which it is the person liable for the payment of service tax. Compute the service tax liability of JKL Co. Assume that goods transport service is exempt to the extent of 75% of value thereof.

(Ans: both the years, service provided covered by exemption. ST on transport service u/s 68(2): $50,000 \times 25\%$ 14.5/114.5)

- 9) KJ & Co Chartered Accountants raised bills for Rs 12,75,000 in September, 2015 including a bill for Rs 75,000 to UN. They have not received payments for bills of Rs 1.5 lakhs till date, but receive a sum of Rs 50,000 in advance from XYZ Ltd on 25-09-2015 for the service was to be provided in October 2015. Calculate the taxable value of services and amount of service tax payable.

(Not covered by POT, gross amount chargeable $12.75 - 0.75 - 1.5 + 0.50$) Rs 11 lakhs and service tax liability Rs 1,21,003)

- 10) In Q 9 assume KJ & Co are covered by Point of Taxation Rules and ascertain the tax liability.

(Gross amount chargeable $(11.75 - 0.75 + 0.50)$ Rs 11.50 lakhs and service tax liability Rs 1,26,504)



REGISTRATION AND RETURNS

Synopsis

1. Introduction and Objectives: Requirement of registration
2. Persons liable for Registration
3. Procedure for Registration
- 4... Filing of Returns
5. Payment of Service Tax
6. Illustration
7. Self Examination Questions

1. INTRODUCTION AND OBJECTIVE :

This lesson undertakes a study of the procedural law in relation to registration, filing of service tax returns and payment of the service tax and other allied matters.

2. PERSONS LIABLE FOR REGISTRATION - Sec 69

Rule 4 of the Service Tax Rules, 1994 and Section 69 deal with the Registration and its procedural aspects. Briefly, these provisions are as under

1. Service Providers

U/s 69 every person, who is liable for paying the service tax is also liable for Registration. These may be the following persons:

a) Existing Service Providers

Every person liable for paying the service tax shall make an application to the concerned Superintendent of Central Excise in Form ST-1 for registration within a period of thirty days from the date on which the service tax under section 66 is levied.

b) **New Business**

Where a person commences the business of providing a taxable service after such service has been levied, he shall make an application for registration within a period of thirty days.

*Liability for registration arises on commencement of business.
Actual provision of service is not necessary*

Illustrations

1. A is an existing service provider. Services provided by him were not taxable till the negative regime came into force w. e. f. 01-07-2012. A will be liable to apply for registration before 31-07-2012.
2. X commences business on 01-04-2014 and provides taxable service for the first time on 01-06-2016. X will be liable to apply for registration before 01-05-2016. Date of commencement of business is not relevant,

2. Input distributor

Every input service distributor [as defined in clause (m) of rule 2 of the CENVAT Credit Rules, 2004] shall make an application for registration within a period of thirty days of the commencement of business or within 30 days of service becoming taxable for the first time, whichever is earlier

3. Specified Persons liable for Registration:

Under Rule 2(1) (d) of the Service Tax Rules 1994 **Some specified persons** are deemed to be the persons liable for paying tax and accordingly such persons will be liable to get the registration; some such persons are:

- (a) The Director General of Posts and Telegraphs, or The Chairman-cum-Managing Director, MTNL or any other Licencee for providing Telecommunication Service,
- (b) Any **insurer or reinsurer** providing insurance service ;
- (c) An insurance agent, any person carrying on the general insurance or the life insurance business in India providing Insurance Auxiliary Service
- (d) **Importer of service** that is a person in India receiving any taxable service provided or to be provided by any person from a country other than India U/s 66A.

(e) in case of services of a **goods transport agency**, the liability for the payment of service tax on freight paid to transporter is on the consignee, if the consignee is a

- factory ;
- company ;
- statutory corporation;
- non- profit society;
- cooperative society;
- dealer registered under the central excise;
- body corporate ;
- partnership firm registered or unregistered; or
- a person who pays or is liable to pay freight either himself or through his agent for the transportation of such goods by road in a goods carriage; For other consignees like individuals the transporter will continue to be liable for payment of service tax.

(f) A **Mutual Fund** or Asset Management Company receiving such service a mutual fund distributor or an agent;

(g) A body corporate or firm located in India who receives any **sponsorship** service.

(h) in relation to service provided or agreed to be provided by,-

- an arbitral tribunal, or
- an individual advocate or a firm of advocates by way of legal services, to any business entity located in the taxable territory, the recipient of such service;

(i) in relation to support services provided or agreed to be provided by Government or local authority except,-

- renting of immovable property, and
- services specified sub-clauses (i), (ii) and (iii) of clause (a) of section 66D of the Finance Act, 1994, to any business entity located in the taxable territory, the recipient of such service;

(j) in relation to service provided or agreed to be provided by a director of a company to the said company, the recipient of such service;

(k) in relation to services provided or agreed to be provided by way of :-

- renting of a motor vehicle designed to carry passengers, to any person who is not engaged in a similar business; or
- supply of manpower for any purpose [or security services; or
- service portion in execution of a works contract -

- (l) Such other person or class of persons as the Central Government in Official Gazette may specify even though not liable to pay service tax. In respect of any service received by any individual, Hindu Undivided Family or partnership firm, whether registered or not, including association of persons, located in the taxable territory to a business entity registered as a body corporate, located in the taxable territory, both the service provider and the service recipient to the extent notified u/s 68(2), for each respectively

4. Small service provider having turnover of Rs. 9 lakhs:

Small service providers having turnover upto Rs. 10 lakhs are not liable for service tax but any provider of taxable service whose aggregate value of taxable service in a financial year exceeds **Rs 9 lakh** shall make an application for registration within a period of thirty days of exceeding the aggregate value of taxable service of **Rs 9 lakh**. However, liability to pay service tax will arise only **after crossing the limit of Rs 10 lakhs**.

“Aggregate value of taxable service” means the sum total of first consecutive payments received during a financial year towards the gross amount charged by the service provider towards taxable services but does not include payments received towards such gross amount, which are exempt from the whole of service tax leviable thereon.

The limit of 9 lakh /10 lakh is computed only considering the **first consecutive payments received during a financial year** towards the gross amount charged by the service provider towards taxable services **ignoring or excluding** payments received towards such gross amount, which are exempt from the whole of service tax leviable thereon

Small service providers may **opt not to avail the general exemption of Rs. 10 lakhs** and apply for voluntary registration at any time

5. **An unincorporated body of individuals** is a person liable for service tax in respect of taxable services rendered to members or others

6. Penalty :

U/s 77(1) Any person, who is liable to pay service tax or required to take registration, fails to take registration in accordance with the provisions of section 69 or rules made under this Chapter shall be liable to a penalty which may extend to **ten thousand rupees**

3. PROCEDURE FOR REGISTRATION – Rule 4

Registration is the starting point. It involves the following procedure:

1. Application for Registration;

- (i) Application for Registration is required to be filed within the prescribe time of 30 days of commencement of business on line by uploading Form ST-1 at **www.aces.gov.in**;
- (ii) Within 15 days of uploading the application, *the applicant has to file the required documents with* the jurisdictional Superintendent of Central Excise. These documents are; Permanent Account Number (PAN) , proof of residence , constitution of firm , companies etc and a Power of Attorney in respect of authorized person(s).
- (iii) Normally, the PAN based registration number is generated by system immediately. However, registration certificate is issued by Superintendent in form ST-2 after the documents are submitted.
- (iv) Registration will be deemed to have been granted if not received within seven days of making the application. [Rule 4(5)] and the applicant can begin carrying on his activities.

2. Multiple Premises:

If a person provides services from more than one place , following principles are followed :-

- a) Ordinarily, Separate application is required to be made for each place of business if bills are raised separately.
- b) If billing or accounting system is centralised in respect of all the places , and the bills are raised from a centralized place, premises or office , only one application needs to be made for such place from where the billing is done in respect of all types of services provides -[Rule 4(2)].

Illustrations:

3. A mandap keeper has multiple offices in Mumbai, Delhi and Kanpur. He does his billing from Mumbai only. In that case, he would require service tax registration in Mumbai only.

Illustration-2:

4. XYZ Coaching Classes have one regional and multiple branch offices but does billing from the regional office in respect of all the branches within that region the classes may be permitted to register his regional office only.

- c) Input Service Distributors (ISD) are required to make application for registration at the Head Office, branch or depot as ISD and distribute credit to centres which are providing taxable services

3. Single Registration for all service provided :

If a person provides multiple services from a single place, a common application needs to be made for all the services provided by the service provider from a single place. However, if multiple services are provided from multiple places and billing is done separately, separate application is required to be made for each such place needs.

4. Transfer of Business

When a registered assessee transfers his business to another person, the transferee should obtain a fresh certificate of registration.

5. Discontinuation

When a registered assessee ceases to carry on the service activity for which he is registered, he should surrender his registration certificate immediately to the department.

6. Change in particulars ;

Any change in the particulars of the certificate, shall be intimated to the Service Tax Officer in Form ST-1 with in thirty days of change taking place, who, will issue a fresh certificate after making the necessary change within 4 days. There is no penalty if change is not notified. But in that case liability to file return will continue even if the tax payable in nil

4. FILING OF RETURNS-SEC. 70- Rule 7

Following are the important provisions with respect to filing of return of service tax.

1. Regular Returns

The Return has to be filed, by an assessee within 25 days of the end of each half-year as shown below;

Half year	Last Date for filing return
'1April-September30'	25 October
October1- March -31	25 April

If the last date of filing falls on a holiday, the return can be filed on the next working day.

- If the assessee has not provided any taxable services during the half year, he should submit a NIL return within the prescribed time.
- Only one return is to be filed for multiple services.
- Following provisions have become inoperative because e-payment and e-filing of service tax return have been made mandatory for all the assessees. These requirements are
 - Filing return in Form ST3/3A in triplicate
 - Attaching all tax payment challans for the half year
 - Furnishing details of all the bank accounts maintained by the assessee
- The return can be filed by downloading utility from the website ACES in filed in proper e form. There is provision for manual filing of returns in case of difficulty and also rectification of the return , Late filing of return invites penalty and interest if the assessee does not succeed in e filing . ;

2. Revised Return

A revised return can be filed within 90 days of filing the original return to correct any mistakes therein. **E filed Return can be revised only once.** After 90 days, revised return cannot be filed, but if tax paid was less, pay with interest and inform department – if paid more, file refund claim or adjust in future return if otherwise allowable.

3. Late filing of return

- Non-filing of return on time attracts Late filing fee of Rs 500 for delay of 15 days or less, and Rs. 1000 for delay of 15 days to 30 days.
- If delay is beyond 30 days from the due date penalty will be Rs. 1000 plus Rs, 100 per day for every day beyond 30 days subject to a maximum of Rs. 20000 – Rule 7C . This is given in the following table ;

Delay in fling return from the due date	Due Dates		Late Fee Rs
	April 25,	October 25,	
	Return Filing dates		
01- 15 days ,	10 May	09 Nov	500
16 - 30 days.	25 May	24 Nov	1,000
31 days and more	26 May or after	25 Nov or after	1000 + Rs 100 per day from delay from 31 days onwards till it reaches Rs 20,000

- The term used is “late fee’ not penalty , hence , the fee will be payable even in case of a Nil return if it is filed late.
- Late fee is to be paid voluntarily , however , Central Excise Officer is authorised to waive the same on showing reasonable cause for the delay
- No late fees is payable by the recipient of service in case of reverse charge .
- the input Service distributor shall furnish a half yearly return in Form ST-3, giving the details of credit received and distributed during the half year period to the Superintendent of Central Excise. [Rule 9(10) CENVAT Credit Rules, 2004.]

4. Filing of return by a Input Service distributor

Half-yearly Return should be submitted before the last day of the following month from the end of the half year period i.e. . except that such return is to be filed by October 31

Half year	Last Date for filing return
April 1-September 30'	31 October
October1- March -31	30 April

5. Records to be maintained

Every assessee shall furnish to the Superintendent of Central Excise at the time of filing of return for the first time, a list in duplicate of-

- all the records prepared or maintained by the assessee for accounting of transactions in regard to,-
- providing of any service,
- receipt or procurement of input services and payment for such input services;
- receipt, purchase, manufacture, storage, sale, or delivery, as the case may be, in regard of inputs and capital goods;
- other activities, such as manufacture and sale of goods, if any.
- all other financial records maintained by him in the normal course of business;
- All such records shall be preserved at least for a period of five years immediately after the financial year to which such records pertain.

- The records including computerised data, as maintained by an assessee in accordance with the various laws in force from time to time shall be acceptable.

5. PAYMENT OF SERVICE TAX- Rule 6 STR 1994,

Following are some important points in relation to payment of service tax;

(a) Service tax payable on receipt or arrear basis

With effect, 01-05-2011 service tax is payable on receipt, or accrual or raising of the bill, whichever point is earlier in time. Except in case of some, GTA, Individual and partnership with turnover of Rs 50 lakh etc

(b) Liability for payment

Normally a service provider is liable for payment of Service tax except in some cases like import of service, sponsorship, Goods Transport Agency, the recipient of the service is liable for paying the Service Tax.

(c) Mode of payment

E-Tax Payment is made Mandatory w.e.f. from 19-02-2010 for the assessee who has “paid” Service Tax of Rs. 10 Lakh or more in the current financial year or the previous financial year on aggregate of tax paid on Service provided AND service received

Further “paid” includes payment through Cash as well as CENVAT Credit and Service Tax

The limit of Rs 10 lakh is for each premise if such premises are registered separately.

In all other cases, Service tax may be paid at any of the designated banks by filling Challan GAR-7.

(d) Associated Enterprises

In case of service provided to associated enterprises, service tax is payable as soon as book entry is made in the books of service provider (when he is liable) or service receiver (when he is liable to pay service tax under reverse charge method).

(e) Time for payment-Monthly /Quarterly :

For non- corporate service providers (individuals , firm, LLP etc) and , one man company ,

- The service tax on the value of taxable services received during any calendar month as per point of taxation rules shall be paid to the credit of the Central Govt. by the 5th (**6th in case of e payment**) of the month immediately following the said calendar month.
- Where the assessee is an individual or proprietary firm or partnership firm, the service tax on the value of taxable services received during any **quarter shall be paid** to the credit of the Central Government by the 5th [**6th in case of e payment**] of the month immediately following the said quarter.
- In case of a company service provider, the tax is to be paid to the credit of the Central Government by the 5th [**6th in case of e payment**] of the month immediately following the said month in which service is provided or to be provided.

All assessee's to pay the tax of **the last month /quarter, tax has to be paid before 31 March.**

Those with liability for payment of Rs 10 lakh or more have to make payment electronically. In that case the due date is extended by one day i.e. 6th of next month / quarter.

b. Procedure –Challan and payment

Service Tax is payable by GAR-7 challan using appropriate accounting code. (Earlier TR-6 challan) . E-payment is compulsory for all the assessees. However Central Excise Officer may allow payment otherwise than by internet banking (the old threshold limit Rs 10 lakhs per annum is no longer valid) . Tax payable shall be rounded off in rupees.

Mandatory interest

With effect from 1.10.2014(upto 14.05.2016), interest for delayed payment of service tax would be charged at new rates which would vary on the extent of delay. Simple interest rates per annum payable on delayed payments under section 75, are prescribed as follows:-

Period of delay	Assessee with taxable service upto Rs 60 lakh %	Other assessees %
First 6 months	15	18
Next 6 months	21	21
Balance	27	24

If the payment is made after prescribed date, then assessee is liable to pay the interest at the simple rate of 1.5% per month or part of the month by which payment has been delayed under

section 75.(1.25% for service providers upto turnover of Rs 60 lakhs.

c. Advance payment of service tax

A person liable to pay service tax can pay any amount in advance towards future service tax liability. After such payment he should inform Superintendent of Central Excise within 15 days [Rule 6(1A)]. When he adjusts the advance, he should indicate details in the subsequent return filed.

Under Rule 6B , If actual calculations not possible an assessee can pay excess amount to avoid interest liability and adjust subsequently and while filing the return disclose the amount so d . – rule 6(4B). No separate no intimation to Superintendent is required

While filing return, after utilizing the Cenvat credit first , balance can be shown as payment by cash.

d. Excess payment of Tax

A Service provider can refund the payment or issue credit note when –

- service is not provided partly or fully
- amount of invoice is re-negotiated due to deficient provision of service or any terms contained in the contract.
- “ After such refund or credit note, assessee can take self-credit of excess service tax paid by him when he had issued invoice/Bill/Challan -Rule 6(3) of Service Tax Rules
- However no credit will be granted in respect of bad debts

6. PENAL CONSEQUENCES FOR DELAY AND DEFAULT IN PAYMENT OF SERVICE TAX

Penal consequences follow for default and delay in payment of service tax, which are briefly summarised below : .

1. Late filing of Return –Sec77(2)

If return of service tax is not filed within the prescribed period penalty is leviable upto Rs. 10,000.

2. Delay in filing Return

Rule 7C of Service Tax Rules, 1994 provides for levy of late fee for delay in filing of service tax return depending upon the number of days for the return was delayed subject to a maximum of Rs 20,000. This provision has been dealt with in detail earlier in this lesson

3. Interest for delayed payment

For delay in payment of service tax , interest is payable at different rates given earlier in this lesson for the assessee with turnover of Rs 60 lakhs or above and for others .

4. Penalty for delayed payment – Non- Fraud case –Sec76

1.No penalty will be levied if service tax alongwith interest is paid within 30 days of issue of Show cause cum demand notice issued and.

2.If the payment is not made within 30 days penalty levied is maximum 10% of service tax evaded

3 Show cause cum demand notice issued and service tax alongwith interest and reduced penalty is paid within 30 days of issue of Show cause cum demand notice Penalty levied is maximum 25% of service tax evaded

5. Other Penalties and Prosecution

In case of failure to furnish information, produce documents or appear before the Central Excise officer , Sec 77 provides for a penalty of Rs. 200 for each day or Rs 10,000 whichever is higher starting with the first day after the due date, till the date of actual compliance

Besides, Sec 77 provides for imposition of a penalty up to Rs 10,000 for the following defaults:

- (1) Failure to keep, maintain or retain books of account and other documents, which are required, by the Act or rules made thereunder.
- (2) When tax is required to be paid electronically,
- (3) failure to pay tax electronically.
- (4) Issuing invoice with incorrect or incomplete details or failure to account of invoice issued in his books of account.
- (5) Contravention of any Service Tax Provision or any rules made there under for which no penalty is provided specifically elsewhere in the Act (General Penalty

No penalty will be imposed if the assessee proves there was a reasonable cause for failure in payment of service tax- Section 80

1. Non- payment – Sec 75

Any person who fails to pay service tax, shall pay, in addition to such tax and the interest on that tax amount, a penalty which shall not be less than;

- (a) Rupees 100 per day during which such failure continues; or

(b) 1% of such tax, per month,

Whichever is higher, subject a maximum of 50% of the service tax payable.

The penalty will be computed from the first day after the due date till the date of actual payment of the outstanding amount of service tax.

If the amount of penalty amount of Rs. 1,000 or less, the assessee will be given an opportunity to deposit Service Tax along with interest within 30 Days and if assessee pays the sum within specified time then no penalty should be levied -Circular No. 76/ 6/ 2004 – ST]

2. Penalty for evasion of tax Sec-78

Where any service tax has not been levied or paid or has been short-levied or short-paid or erroneously refunded, by reason of

- a) fraud; or
- b) collusion; or
- c) willful misstatement; or
- d) suppression of facts; or
- e) contravention of any of the provisions or of the rules with intent to evade payment of service tax the person shall be liable to pay service tax or erroneous refund, and

the assessee shall be liable to pay a penalty, in addition to such service tax and interest which shall equal to the amount of service tax so not levied or short-paid or erroneously refunded.

3. Relaxation in penalty

The amount of penalty shall be reduced to:

- (a)** 50% where true and complete details of the transactions are available in the specified records.
- (b)** 25% where true and complete details of the transactions are available in the specified records and the amount of service tax, interest and penalty has been paid within 30 days.
- (c)** In case of service providers whose taxable value of service tax does not exceed Rs 60 lakhs, the period of 30 days shall be extended to 90 days.

Section 78 provides that if penalty is applicable under this section, provisions section 76 shall be apply.

4. Offences by companies

Where a company has committed any of the following contraventions, namely:

- (a) evasion of service tax; or
- (b) issuance of invoice, bill or, as the case may be, a challan without provision of taxable service in violation of the rules ; or
- (c) availment and utilisation of credit of taxes or duty without actual receipt of taxable service or excisable goods either fully or partially in violation of the rules made under the provisions of this Chapter; or
- (d) failure to pay any amount collected as service tax to the credit of the Central Government beyond a period of six months from the date on which such payment becomes due,

then any director, manager, secretary or other officer of such company, who at the time of such contravention was in charge of, and was responsible to, the company for the conduct of business of such company and was knowingly concerned with such contravention shall be liable to a penalty, which may extend **to one lakh rupees.**

5. Miscellaneous

As per Section 80, penalty under Sections 76, 77 or first proviso to section 78 (1) can be waived if assessee proves that he had reasonable cause for the failure.

6. Prosecution

Section 89 provides for prosecution of an assessee for certain offenses of tax evasion , under payment , suppression of facts etc. Several provisions such as sections 9A, 9AA, 9B, 9E and 34A of the Central Excise Act, 1944 have been made applicable service tax for this purpose.

7. ILLUSTRATIONS

5. Show liability for registration if the value of taxable services provided by A for five years are Rs. 8,00,000, Rs. 9,50,000 , Rs. 15,00,000, Rs. 8,50,000 and Rs. 6,00,000 respectively. What will be his liability for registration , payment of tax

Solution

Year 1 – Turnover Rs 8,50,000

There will be no liability for payment of service tax and also for registration, as the turnover is less than Rs 9,00,000..

Year 2 -Turnover Rs 9,50,000

A will be liable to get the registration within 30 days from the date on which the turnover exceeds Rs 9, 00,000.

There will be no liability for service tax as the turnover does not exceed Rs 10,00,000. The assessee will be required to file ST return showing nil tax liability.

Year 3: -Turnover Rs 15,00,000

Since A has been registered in the year 2, there is no need for a fresh registration. However, limit of Rs 10,00,000 is computed separately for every financial year .

Hence, A will be liable to file nil return till the time his turnover does not exceed Rs 10,00,000, if applicable . However, once the, turnover crosses the limit of Rs 10,00,000, service tax will be payable on Rs. 5,00,000 (Gross Amount charged U/s 67).

Tax liability Rs. 5,00,000*12.36/112.36 = **Rs. 55,002** ,

Year 4- Turnover Rs 8,50,000

During the previous financial year A's turnover was above Rs 10 lakhs, hence A will be liable to pay Service Tax is on Rs. 8,50,000 although it does not exceed Rs. 10,00,000.

Tax liability: be 8,50,000*12.36/112.36 = **Rs. 93,503** .

Year 5 - Turnover Rs 8,00,000

During the previous financial year, the turnover did not exceed Rs 9,00,000. A will have no liability to pay service Tax . He can apply for cancellation of registration.

8. SELF EXAMINATION QUESTIONS

- 1) ABC Contractors receives Rs 5,00,000, Rs 8,47,000 and Rs 9,25,000 in 2009-2010 as charges for setting up mandaps and shamiana for social functions. Discuss the liability of ABC Contractors with respect to service tax registration and tax liability. [Liable for St on aggregate services]
- 2) Which persons have to get themselves registered under the Service Tax Rules?
- 3) What is the procedure for filing of returns?
- 4) How is the payment of service tax made to the Government?
- 5) Elaborate on the process if registration under service tax rules.



16

MAHARASHTRA VALUE ADDED TAX ACT, 2002 (MVAT): BASIC CONCEPTS

SYNOPSIS

1. Introduction and Objective:
2. Concept of VAT
3. Definitions:
 - 3.1. Business
 - 3.2. Dealer
 - 3.3. Goods
 - 3.4. Importer
 - 3.5. Manufacturer
 - 3.6. Purchase Price
 - 3.7. Resale
 - 3.8. Sale
 - 3.9 Sale Price
 - 3.10 Service
 - 3.11 Turnover of Sales
4. Illustrations
5. Self Examination Questions

1. INTRODUCTION & OBJECTIVE:

The lesson undertakes a detailed look into the basic concept of MVAT, the process, and the administration of the MVAT regime in the context of the statutory provisions of Maharashtra Value Added Tax Act, 2002 (**MVAT**). All the sections and provisions referred to will be the sections and provisions of MVAT, unless otherwise specifically stated

2. CONCEPT OF VAT

The Maharashtra Value Added Tax Act, 2002 (MVAT) is a piece of legislation which provides for multipoint tax on sales of goods within the state of Maharashtra with corresponding credit for tax paid at the earlier stages.

Thus, MVAT provides for collection of a tax on sales at every stage, through which the goods pass from the manufacturer to every other dealer; distributor, stockist, and wholesaler until the goods reach the ultimate consumer.

A multipoint taxation system always carries the disadvantage of cascading effect or duplication of tax at multiple stages. To avoid this, MVAT embodies an inbuilt scheme for allowing set off for taxes already paid at the earlier stages. As a result, there is no risk of duplication of a tax on tax and every taxpayer in the distribution chain will pay tax only on the value added at his level and no more. Following illustration will explain the concept of VAT.

Illustration 1

A dealer purchased inputs worth Rs. 2,00,000 on which tax was collected at 10%. The inputs were put in a manufacturing process and the output was sold for Rs. 10,00,000 with tax rate of 10%. The tax liability will be as follows:

	Rs
Tax on output 4% on Rs. 10,00,000	40,000
Less- Credit for Tax paid on inputs 10% on Rs 2,00,000	20,000
Net Tax Liability	20,000

A uniform and simple tax system acts as a catalyst for opening up for the articles manufactured in the state, the vast market across the country. This is the rationale behind the introduction of a uniform Goods and Services Tax (GST). In anticipation of the proposed GST, most states have adopted a uniform VAT regime prescribing only five rates of tax; zero% (tax free goods), 1.1 %, 4% (5.5% in Maharashtra), 12.5% and 20%, (25% for liquor).

Other objects of VAT are:

- Evolution of a set off scheme on previous purchases,
- Abolition of multiple taxes like turnover tax, additional tax etc,
- Rationalization of overall burden,
- General fall in prices,
- Self-assessment by dealers,
- Increase in revenue, and
- Evolution of a transparent tax system.

3.DEFINITIONS: SECTION 2

3.1. BUSINESS- (Section 2(4))

In this act unless the context otherwise requires-

“Business” includes:-

- “(a) any service;
 - (b) any trade, commerce or manufacture;
 - (c) any adventure or concern in the nature of service, trade, commerce or manufacture;
- whether or not the engagement in such service, trade, commerce, manufacture, adventure or concern is with a motive to make gain or profit and whether or not any gain or profit accrues from such service, trade, commerce, manufacture, adventure or concern.

Explanation. For the purpose of this clause,

- (i) the activity of raising of man-made forest or rearing of seedlings or plants shall be deemed to be business;
- (ii) any transaction of sale or purchase of capital assets pertaining to such service, trade, commerce, manufacture, adventure or concern shall be deemed to be a transaction comprised in business;
- (iii) sale or purchase of any goods, the price of which would be credited or, as the case may be, debited to the profit and loss account of the business under the double entry system of accounting shall be deemed to be transactions comprised in business;
- (iv) any transaction in connection with the commencement or closure of business shall be deemed to be a transaction comprised in business;”

The definition of “Business” is an inclusive one. It not only includes the “business as a business in normal commercial sense but also extends its scope to several other activities namely:-

1. Trade i.e. sale and purchase of goods
2. Commerce –Trade with other activities,
3. Manufacturing- production of articles
4. Services
- 5 Adventure in the nature of trade, commerce, manufacture and service implying that in order to constitute business, there need not be any regular or systematic activity. A single transaction may constitute business by nature.
6. The activity of raising of man-made forest or rearing of seedlings or plants

7. Sale or purchase of capital assets pertaining to such service, trade, commerce, manufacture, adventure or concern as a transaction comprised in the concerned business.
8. Incidental goods such as stationery articles debited or credited in Profit & Loss Account as a transaction comprised in the concerned business.
9. Any transaction in connection with the commencement or closure of business as a transaction comprised in the concerned business.
10. Neither Profit motive nor actual realisation of profit is necessary to constitute any activity as business

Illustration 2:

A teacher conducts coaching for students appearing MPSC Examinations. He purchases the books necessary for the examination and supplies the same to the students. Whether such activity would be termed as business?

Solution

Single transaction by its very nature constitutes business. Any adventure in the nature of trade, commerce, manufacture and service, whether regular or systematic, is termed to be “business”, Hence such activity would be termed to be as “business”.

3.2. DEALER- {Section 2(8)}

“Dealer” means any person who for the purposes of or consequential to his engagement in or, in connection with or incidental to or in the course of, his business buys or sells, goods in the State whether for commission, remuneration or otherwise and includes,-

- (a) a factor, broker, commission agent, del-credre agent or any other mercantile agent, by whatever name called, who for the purposes of or consequential to his engagement in or in connection with or incidental to or in the course of the business, buys or sells any goods on behalf of any principal or principals whether disclosed or not;
- (b) an auctioneer who sells or auctions goods whether acting as an agent or otherwise or, who organizes the sale of goods or conducts the auction of goods whether or not he has the authority to sell the goods belonging to any principal whether disclosed or not and whether the offer of the intending purchaser is accepted by him or by the principal or a nominee of the principal;
- (c) a non resident dealer or as the case may be, an agent, residing in the State of a non-resident dealer, who buys or sells goods in the State for the purposes of or consequential

to his engagement in or in connection with or incidental to or in the course of, the business.

- (d) any society, club or other association of persons which buys goods from, or sells goods to, its members;

Explanation- For the purposes of this clause, each of the following persons, bodies and entities who sell any goods whether by auction or otherwise, directly or through an agent for cash, or for deferred payment, or for any other valuable consideration, shall, notwithstanding anything contained in clause (4) or any other provision of this Act, be deemed to be a dealer, namely:-

- (i) Customs Department of the Government of India administering the Customs Act, 1962;
- (ii) Departments of Union Government and any Department of any State Government;
- (iii) Incorporated or unincorporated societies, clubs or other associations of persons;
- (iv) Insurance and Financial Corporations, institutions or companies and Banks included in the Second Schedule to the Reserve Bank of India Act, 1934;
- (v) Local authorities
- (vi) Maharashtra State Road Transport Corporation constituted under the Road Transport Corporation Act, 1950;
- (vii) Port Trusts;
- (viii) Public Charitable Trusts registered under the Bombay Public Trusts Act, 1950;
- (ix) Railway Administration as defined under the Indian Railways Act, 1989 and Konkan Railway Corporation Limited;
- (x) Shipping and construction companies, air transport companies, airlines and advertising agencies;
- (xi) any other corporation, company, body or authority owned or constituted by, or subject to administrative control, of the Central Government, any State Government or any local authority:

Exception I.- An agriculturist who sells exclusively agricultural produce grown on land cultivated by him personally shall not be deemed to be a dealer within the meaning of this clause.

Exception II.- An educational institution carrying on the activity of manufacturing or selling of goods in the performance of its

functions for achieving its objects shall not be deemed to be a dealer within the meaning of this clause.

Exception III.- A transporter holding permit for transport vehicles (including cranes) granted under the Motor Vehicles Act, 1988, which are used or adopted to be used for hire or reward shall not be deemed to be a dealer within the meaning of this clause in respect of sale or purchase of such transport vehicles or parts components or accessories thereof.

On an analysis of the pervasive and comprehensive definition of “dealer”, following features emerge out :-

1. A dealer is a person who is engaged in business of sales and purchase of goods in Maharashtra.
2. Such sale or purchase may be for remuneration or commission or otherwise.
3. Following are included in the definition:
 - i. Clubs or Societies serving their members,
 - ii. Agents of all types- Factor, Broker, Mercantile Agent etc,
 - iii. Auctioneers,
 - iv. Agent of a person outside the State Of Maharashtra
 - v. Customs Department of The Government of India administering The Customs Act, 1962;
 - vi. Government Departments -Central as well as State
 - vii. Societies, Clubs Or Other Associations of Persons;
 - viii. Insurance and Financial Corporations, Institutions or Companies and Banks;
 - ix. Local Authorities;
 - x. Maharashtra State Road Transport Corporation
 - xi. Port Trusts;
 - xii. Public Charitable Trusts
 - xiii. Railway Administration
 - xiv. Shipping and Construction Companies, Air Transport Companies, Airlines and Advertising Agencies;
 - xv. Any Other Corporation, Company, Body Or Authority Owned or Constituted by, or Subject to administrative control, of the Central Government, any State Government or any Local Authority

3.3. GOODS- [Section 2(12)]:

“Goods” means “Every kind of moveable property not being newspapers, actionable claims, money, stocks, shares, securities

or lottery tickets and includes live stocks, growing crop, grass and trees and plants including the produce thereof including property in such goods attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.

This definition is similar to the definition of 'goods' given in the Sale of Goods Act. Following are the important exclusions / inclusions in the definition.

Items Excluded	Items Included	
	As per definition	As per departmental clarification
Newspapers, Actionable Claims, Money, Stocks, Shares and Securities, Lottery Tickets	Livestock, Growing Crops, Grass and Trees and Plants Produce of Trees and Plants Property in such goods attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale;	Patents, Trademarks, Copyrights & Registered Designs, Import Licences, Exim Scrips, Export Permits, Licence Or Quota, Software Packages, DEPB- (Export Credit), Technical Know-How, Goodwill, Sim Cards used In Mobile Phones.

Illustration 3

A farmer grows maize in his farm. Whether such crops would be goods and whether the farmer would be called a dealer as per the provisions of the MVAT Act, 2002.

Solution

Any growing grass or crops are covered under the definition of goods. Hence the maize would be termed to be "goods".

Farmer being an agriculturalist selling exclusively agricultural produce grown on land cultivated by him personally is covered by the exclusions to the definition of "dealer". Hence, the *crops are goods but the farmer is not a dealer*.

3.4. IMPORTER -Section 2(13):

"Importer" means a dealer who brings any goods into the State or to whom any goods are dispatched from any place outside the State;

As per the above definition, an Importer is a person engaged in inter-state purchases. A person will be an importer if:-

- a) He is a dealer ; and
- b) brings any goods from outside the state of Maharashtra OR
- c) to whom any goods are dispatched from any place outside the State of Maharashtra.

Hence, a person who is not a dealer will not be an importer even if he brings goods from outside the state of Maharashtra.

Illustration 4

State with reason whether an educational institution, which purchases paper from Gujarat, will be an importer under MVAT

Solution

No because an educational institution is not a dealer.

Illustration 5

State with reason whether farmer who purchases seed from Goa for growing crops, will be an importer under MVAT

Solution

No because a farmer (agriculturist) is not a dealer.

3.5. MANUFACTURE- Section 2(15)

“ ‘Manufacture’ “ with all its grammatical variations and cognate expressions includes producing, making, extracting, altering, ornamenting, finishing or otherwise processing, treating or adapting any goods”;

The definition of manufacture is also an inclusive definition, it includes not only any process, which amounts to manufacture in a normal commercial sense i.e. some process whereby a new substance, article or product is produced, but also additional activities listed in the definition viz.

- Producing,
- Making
- Extracting,
- Altering,
- Ornamenting,
- Finishing or otherwise Processing,
- Treating or
- Adapting any goods;

3.6. PURCHASE PRICE-Section 2(20)

“Purchase price” means the amount of valuable consideration paid or payable by a person for any purchase made including any sum charged for anything done by the seller in respect of the goods at the time of or before delivery thereof,

other than the cost of insurance for transit or of installation, when such cost is separately charged;

Explanation I. —The amount of duties levied or leviable on the goods under the Central Excise Act, 1944, or the Customs Act, 1962 or the Bombay Prohibition Act, 1949 shall be deemed to be part of the purchase price of such goods, whether such duties are paid or payable by or on behalf of the seller or the purchaser or any other person.

Explanation II. —Purchase price shall not include tax paid or payable by a person in respect of such purchase.

Explanation III. —Purchase price shall include the amount paid by the purchaser by way of deposit whether refundable or not which has been paid whether by way of a separate agreement or not, in connection with or incidental or ancillary to, the said purchase of goods;

Explanation IV.—The amount of valuable consideration paid or payable by a dealer for the purchase of drugs specified in entry 29 of Schedule C shall be the maximum retail price printed on the package containing the drugs.

Explanation V- Where the purchase is effected by way of transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract, purchase price shall be taken to mean, the total consideration for the works contract and for the purpose of levy of tax, purchase price shall be taken to mean, the price as may be determined in accordance with the rules, by making such deduction from the total consideration for the works contract as may be prescribed.”

_Purchase price means valuable consideration or the price of goods paid by purchaser to seller. The price will include/ exclude the following:

PRICE INCLUDES	DOES NOT INCLUDE
<ul style="list-style-type: none"> ▪ Excise, customs and other duties ▪ Any sum charged by the seller -for anything done by the seller -on or before the delivery of goods to the purchaser ▪ Any deposit paid by the purchaser to seller -refundable or non-refundable -whether by separate agreement or otherwise 	<ul style="list-style-type: none"> ▪ VAT charged ▪ Cost of insurance and ▪ Cost of installation <p><u>If Charged Separately</u></p>

Illustration 6:

ABC buys goods worth Rs 10,400 from XYZ of which 4% sales tax has been included. What is the purchase price of the goods?

Solution

Gross Purchase value inclusive of 4% tax is Rs. 10,400, which includes tax of Rs 400* (being Rs 10,400 X 4/104)

Purchase price does not include the taxes paid on the purchases.

Hence ,Purchase price = Rs 10,400 – Rs 400 = Rs 10,000

3.7. RESALE-[Section 2 (22)]:

“Resale” means “ a sale of purchased goods -

- i. in the same form in which they were purchased,
- ii. or without doing anything to them which amounts to, or results in a manufacture

and the word “resell” shall be construed accordingly;

Resale means to sell the goods in the same form, shape, design and character. **Alteration in the shape, character or utility amounts to manufacture** but incidental activities like cutting cloth from a lump, or only melting of ornaments or cutting of steel circles from big sheet are held not to be manufacture as such process does not change their character or utility. However, putting a brand name after purchasing the same is considered to be manufacture.

Illustration 7

ABC purchases sewing threads from a job worker, packages the same and sells them under their brand name. Will it amount to resale?

Solution

Since ABC packages the sewing threads and sells them under their brand name, it is tantamount to manufacture, and not resale.

3.8. SALE – [Section 2 (24)]

“Sale” as a sale of goods made within the State for cash or deferred payment or other valuable consideration but does not include a mortgage, hypothecation, charge or pledge; and the words “sell”, “buy” and “purchase”, with all their grammatical variations and cognate expressions, shall be construed accordingly;

Explanation - For the purposes of this clause,—

(a) a sale within the State includes a sale determined to be inside the State in accordance with the principles formulated in section 4 of the Central Sales Tax Act, 1956;

(b) (i) the transfer of property in any goods, otherwise than in pursuance of a contract, for cash, deferred payment or other valuable consideration;

(ii) the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract namely, an agreement for carrying out for cash, deferred payment or other valuable consideration, the building, construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property.

(iii) a delivery of goods on hire-purchase or any system of payment by instalments;

(iv) the transfer of the right to use any goods or any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;

(v) the supply of goods by any association or body of persons incorporated or not, to a member thereof or other valuable consideration;

(vi) the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service is made or given for cash, deferred payment or other valuable consideration:

The definition of sale assumes the following essential components to constitute a sale within the meaning of S. 2(24):

1. There should be goods.
2. Property in goods must be transferred.
3. Transfer of property in goods may be through :
 - i. contract
 - ii. otherwise than under a contract
 - iii. under hire purchase or instalment sales
 - iv. under a work contract for repairs, improvement, fabrication, construction, installation of machinery, immovable or movable asset. etc
 - v. right to use the goods for a period whether specified or not
 - vi. by an association, club etc to its members and
 - vii. under a catering contract for food, drinks etc.
4. Goods must be sold for valuable consideration i.e. money or money's worth.
5. Goods must be sold within the state of Maharashtra.

6. Sale within Maharashtra means the sale should not be inter-state sale within the meaning of S. 4 of the Central Tax Act, 1956. When the sale occasions movement of goods or transfer of documents from one state to another, it is inter-state sale. However, if the goods incidentally cross another state but origin and the destination for delivery of the goods is in Maharashtra, it will be a sale in Maharashtra.
7. The sale does not include mortgage, hypothecation, charge or pledge of goods.

Illustration 8:

Whether the following transactions are sale under MVAT or not.

- a) Goods delivered from Sholapur in Maharashtra to Wadi in Maharashtra pass through Gulbarga in Karnataka.
- b) Goods produced in Talasari in Maharashtra are delivered to Mumbai from Umargaon Station in Gujarat.
- c) Parts used in repairs of a watch.
- d) Cement used in construction of a building.
- e) Gold ring pledged with a credit society as security.
- f) Goods given in charity to Indian Red Cross.
- g) Sale of building.
- h) Sales of The Times of India
- i) Food and beverages supplied by Garware Club to its members.
- j) Sales of surplus papers by the Mumbai University.
- k) Sale of share at BSE
- l) Material used in catering a marriage party
- m) Goods sold to B in Ahmadabad
- n) Sale of import license
- o) Sale of wheat by farmer

Solution

- a) Movement of goods is within the state of Maharashtra. Incidental passage through Karnataka in transit does not make the sale inter-state sale. Hence, it is sale under MVAT.
- b) In this case, also, movement of goods is within the state of Maharashtra. Incidental passage through Gujarat in transit does not make the sale inter-state sale. Hence, it is sale under MVAT.
- c) Material supplied for repair work constitute sale under MVAT.
- d) Material supplied for work contract constitute sale under MVAT.

- e) Pledge of goods is specifically excluded from the definition of Sales.
- f) There is no valuable consideration for charity, hence not sales.
- g) Immovable property are not goods, hence no sale under MVAT.
- h) Newspapers are not goods, hence no sale. Food supplied by the club to its members will be sales to the extent of goods used in such goods.
- i) Mumbai University is an educational institute, hence sale of paper is not sale under MVAT.
- j) Shares and other securities are not goods, hence no sales.
- k) Material supplied for marriage catering will constitute sale under MVAT.
- l) Goods sent to Ahmadabad are in the course of inter-state sales hence not sale under MVAT.
- m) As clarified by the Department, import license would constitute goods under the MVAT Act. Hence the transaction would be treated as a sale.
- n) Though wheat is treated as goods, an agriculturist is an exception to the definition of dealer. Therefore the transaction will not be treated as a taxable sale.

Goods, Valuable Consideration, Dealer and Transfer within State are the four factors which are taken together to determine whether a transaction is sale under MVAT.

3.9. SALE PRICE -Section 2(25)

“Sale Price” means the amount of valuable consideration paid or payable to a dealer for any sale made including any sum charged for anything done by the seller in respect of the goods at the time of or before delivery thereof, other than the cost of insurance for transit or of installation, when such cost is separately charged.

Explanation 1. —The amount of duties levied or leviable on goods under the Central Excise Act, 1944 or the Customs Act, 1962 or the Bombay Prohibition Act, 1949, shall be deemed to be part of the sale price of such goods, whether such duties are paid or payable by or on behalf of the seller or the purchaser or any other person.

Explanation II. — Sale price shall not include tax paid or payable to a seller in respect of such sale.

Explanation III. — Sale price shall include the amount received by the seller by way of deposit, whether refundable or not, which has been received whether by way of a separate agreement or not, in

connection with or incidental or ancillary to, the said sale of goods;

Explanation IV: The amount of valuable consideration paid or payable of a dealer for the sale of Drugs specified in entry 29 in Schedule C shall be the maximum retail price printed on the package containing the Drug.

To understand the true meaning of sales price, it must be borne into mind that:

- a) The sales price is just the converse of purchase price. Therefore if the purchase price means valuable consideration or simply the price of goods paid or payable by the purchaser to the seller, then the sales price is logically the valuable consideration received or receivable by a seller from the purchaser ,
- b) The sale price will include the following:
 - Excise, customs and other duties
 - Any sum charged by the seller for anything done by the seller on or before the delivery of goods to the purchaser
 - Any deposit paid by the purchaser to seller –refundable or non-refundable whether by separate agreement or otherwise
- c) The sale price does not include the following, if charged separately:
 - VAT charged
 - cost of insurance and cost of installation .
- d) By a retrospective amendment, it is clarified the valuable consideration in case of Schedule C 29, drugs will be the MRP (maximum retail price).

3.10. SERVICE – [Section 2[27]]

“Service means any service notified by the state government in official gazette from time to time ‘

Ordinarily service should not be the part of VAT as VAT is basically concerned with the goods. However, in view of the recent developments like proposed transition to goods and Service Tax GST, an enabling definition of service for transition is enacted..

3.11. TURNOVER OF SALES-[Section 2[33]]

“Turnover of Sales” means “the aggregate of the amounts of sale price received and receivable by a dealer in respect of any sale of goods made during a given period after deducting the amount of-

- (a) sale price, if any, refunded by the seller, to a purchaser, in respect of any goods purchased and returned by the purchaser

within the prescribed period (currently 6 months from the date of transaction); and

(b) deposit, if any, refunded in the prescribed period, by the seller to a purchaser in respect of any goods sold by the dealer.

Explanation I. —In respect of goods delivered on hire-purchase or any system of payment by instalment or in respect of the transfer of the right to use any goods for any purpose (whether or not for a specified period) the amounts of sale price received or receivable during a given period shall mean the amounts received or as the case may be, due and payable during the said period;

Explanation II. —Where the registration certificate is cancelled, the amounts of sale price in respect of sales made before the date of the cancellation order, received or receivable after such date, shall be included in the turnover of sales during a given period;

From the above definition following points emerge out:

1) Turnover is the sum total of all the sales effected by the seller. From the total of all the sales following amounts *refunded by the seller to the purchaser are reduced*'

- goods returned within prescribed period of 6 months; and
- Deposits refunded within the prescribed period(6 months).

2]. Turnover of sales, will however, include the following items by virtue of the two explanations to the section 2[33]:

- In respect of hire purchase and instalment agreements as well agreements under the Right to use any goods, only the amount accrued during the period shall be included.
- In case of cancellation of Registration Certificate, sales proceeds of sales made before the cancellation order are received AFTER the cancellation order, will be included in the turnover of sales the given period.

4. ILLUSTRATIONS:

1. Explain with reasons whether the following are Sales as per the provisions of MVAT Act 2002.

Activity	Validity	Reason
Free Sample	No	Transfer of Goods free of cost
Pledge of Goods	No	Specifically Excluded
Works Contract by a contractor	Yes	Works contract will be treated as sale of goods to the extent of material supplied by the contractor
Canteen Sale of College	Yes	Transfer of Food for price
Hypothecation of Stock	No	Specifically Excluded
Transfer of Motor Cycle on installment system	Yes	Transfer of Motor Cycle for a Price
Computer given on rent	Yes	Transfer of right to use for a Price
Construction of a Bridge	Yes	Transfer of Property for a price.
Interior decoration consultancy by architect	No	Only service rendered
Interior decoration by architect with supply of material	Yes	Transfer of property in goods involved in execution of the Contract.
Transfer of goods from Head Office to OMS Branch	No	Transfer to own place
Gift of goods to a Charitable Institution	No	Transfer of goods without price.
Fridge on hire purchase basis	Yes	Transfer of right to use goods
Fridge on instalment basis returned back within 6 months	No	Goods returned back within 6 months
Selling textbooks by educational institutions	No	Educational Institution specifically excluded from the definition of dealer
Donating free samples to orphanages	No	Valuable consideration not received
Sale of vacant plot of land	No	Immovable property not considered as goods
Contract for arranging Khanna's daughter's wedding	Yes	The value of the goods shall be taxable under MVAT.
Operating a stock exchange bolt	No	Sale of shares is not treated as sale of goods
Sale of food and drinks by US Club to its members	Yes	Specific inclusion of the clause under the definition of dealer

2. Explain with reasons whether the following are Goods as per the provisions of the MVAT Act, 2002?

Item	Validity	Reason
Mango Trees	Yes	Specifically Included
Equity Shares of ABC Ltd.	No	Specifically Excluded
Residential Flat used for business	No	Immovable Property specifically excluded
Malai Kulfi	Yes	As per normal definition of goods
Super Lotto Tickets	No	Specifically excluded from the definition
SIM cards for mobile phones	Yes	On basis of departmental clarification
Trademarks	Yes	On basis of departmental clarification
Newspapers	No	Specifically excluded
Sale of goodwill	Yes	On basis of departmental clarification

3. Explain with reasons whether the following are Dealers as per the provisions of MVAT Act, 2002?

Item	Validity	Reason
Sale of Confiscated car by IDBI Bank	Yes	In normal course of business
Auctioneer	Yes	Included in definition.
Machinery Sold by State Government	Yes	Included in definition.
Sales of Food at concessional rates by Club to its members	Yes	Included in definition.
Jewellery sold by household person	No	Not trading .
Sale of packaged drinking water by airline companies	Yes	Included in definition.

5. SELF ASSESSMENT QUESTIONS:

1. Define and explain as per the provisions of MVAT Act, 2002
(a) Business (b) Dealer (c) goods
2. Can a Charitable Trust be a dealer under the MVAT Act, 2002?
Give reasons.
3. Profit motive is not necessary to attract the VAT. Explain
4. Define and explain the Sales Price under MVAT Act, 2002
5. State the importance of VAT.
6. What is purchase price with regard to hire purchase?.
7. What is the definition of turnover of sales?
8. What are the inclusions for dealers?
9. What is the definition of a manufacturer?
10. What is meant by an importer of goods?



MVAT- REGISTRATION, INCIDENCE AND LEVY OF TAX: SEC- 3 - 8

Synopsis

1. Introduction and Objectives
2. Incidence of tax- Section 3
3. Practical Examples on registration
4. Levy of Tax (Section 4)
5. No Tax on Schedule A Goods (Section 5)
6. Levy of Tax on Specified Goods (Section 6)
7. Schedules and Rates of Tax
8. Rate of Tax on Packing Materials (Section 7)
9. Exemptions on Certain Sales or Purchases not liable to Tax
– Section 8
10. Exemption under Section 41
11. Exempted versus Tax-free Sales
12. Registration Procedure - Section 16, Rule 8
13. Self Examination Questions

1. INTRODUCTION AND OBJECTIVE :

This lesson aims to discuss the machinery provisions of MVAT including the incidence of tax. Levy of tax, the methodology, exemption, classification and other incidental matters. Following is the broad scheme of MVAT

Section 3 deals with the incidence of tax and defines the persons liable to pay MVAT and section 4 deals with the charging provisions. Sections 5, 6 and 7 deal with the exempted goods under Schedule A, taxable goods under other schedules and tax on packing materials respectively. Similarly, Section 8 deals with the provisions relating to sales or purchase not liable to tax.

2. INCIDENCE OF TAX - SECTION 3 :

Section 3 of MVAT defines the incidence of the tax. The main points of the provisions of section 3 are as follows:

2.1 Threshold (Basic) Turnover Limits:

A dealer will be liable to MVAT if his turnover exceeds the limits given in Section 3.

The limits of turnover are of two types –

- Total Turnover of **Sales** AND
- Turnover of **Sales OR Purchases of Taxable Goods**.

These limits are different for IMPORTERS and OTHER types of Dealers.

However, These limits are NOT Applicable to dealers opting for Voluntary Registration. These limits are given in the following table:

Category of Dealer	Total Sales Turnover		Turnover of Sales or Purchases of Taxable Goods
1. Importer	Total Sales Turnover of Rs 1,00,000	AND	Taxable Sales/ Purchases not less than Rs 10,000
2. Others (including Manufacturer, Reseller, Liquor dealer, Works Contractors, Lessors, etc.)	Total Sales Turnover of Rs 5,00,000	AND	Taxable Sales/ Purchases not less than Rs 10,000
3. Dealers opting for Voluntary registration	No Limit of Turnover		

2.2 Scope of Turnover:

Following point are important, while applying the above limits:

I. TOTAL TURNOVER LIMIT OF 1 LAKH/ 5 LAKHS

- (a) Total turnover limits INCLUDES turnover of SALES ONLY.
- (b) Turnover of PURCHASE IS NOT INCLUDED in total turnover limit.
- (c) Turnover of ALL types of goods - tax-free, taxable or outside the state is INCLUDED in total turnover limit.
- (d) Total turnover limit has to EXCEED the applicable benchmark limit of Rs. 1,00,000 for an importer or Rs. 5,00,000 for a dealer other than an importer. Effectively, the limit of Total turnover of sales for attracting of liability is *Rs. 1,00,001 and above for an importer and Rs. 5,00,001 and above for others .*

II TURNOVER LIMIT RS 10,000 TAXABLE SALES OR PURCHASE

- (a) The limit of taxable turnover of Rs 10,000 APPLIES TO ALL DEALERS whether importers or others
- (b) This limit INCLUDES EITHER turnover of TAXABLE SALES OR turnover of TAXABLE PURCHASE
- (c) The limit DOES NOT INCLUDE SALES AND PURCHASE BOTH aggregated together. It means that dealer should give either turnover of sales of taxable goods or he should have turnover of purchase of taxable goods of Rs. 10,000 or more.
- (d) ONLY turnover of taxable goods in Maharashtra only INCLUDED IN THE LIMIT. *Turnover of Tax-free goods or turnover outside Maharashtra is not relevant.*
- (e) What is important is that a dealer must reach the benchmark turnover limit of Rs 10,000. There is no requirement of crossing it. In effect, it means that the limit is more than Rs 9,999 in all case

III. Other Important points:

- (a) No turnover limit for import is specified for importer. Even an import of Re. 1 is sufficient to treat the dealer as an importer and will be subject to turnover limit of Rs. 1,00,000
- (b) Turnover includes all the sales made by the dealer whether by his own account or on behalf of his principal whether disclosed or not.
- (c) In case of an agent of a non– resident dealer the turnover will also include the sales of non - resident dealers effected in the state.
- (d) The turnover limits have to be computed with reference to each financial year separately.

SUMMARY OF TURNOVER LIMITS PRESCRIBED		
DEALER	Total Turnover Of Sales	Turnover of Taxable Purchase or Sales
IMPORTER	Must exceed Rs 1,00,000	Must reach 10,000
OTHER	Must exceed Rs 5,00,000	Must reach 10,000
BOTH LIMITS ARE CUMUALTIVE		

2.3 Certain Important Points

(A) Liability for Registration:

A dealer has to apply for registration within 30 days from the date on which his turnover exceeds the relevant prescribed limits

(B) Liability to continue till cancellation of registration

Every dealer who becomes liable under this Act to pay tax shall continue to be so liable until his registration is cancelled.

(C) Agent and Non-resident dealers

Any agent, non-resident dealer is liable to pay tax if he is covered by the turnover limits prescribed under section 3. Actual status of principal is irrelevant i.e. principal may or may not be dealer or may or may not be disclosed.

(D) Compulsory registration for CST dealers

It is mandatory for a person registered under CST Act, to obtain registration under MVAT even if he may not be reaching the turnover limits prescribed under section 3. In other words, persons engaged in inter-state trade have to register under MVAT also irrespective of the fact whether their turnover exceeds the limits of Rs. 1 lakh/ 5 lakhs.

(E) Successor or Transferee

Where a business of a dealer is liable to pay tax under MVAT is transferred by sale or assignment, then the successor will be liable for compulsory registration irrespective of the fact whether their turnover exceeds the limits of Rs. 1 lakh/5 lakhs and payment of tax after the date of succession.

(F) Voluntary Registration

Any person can apply for voluntary registration even if he is not legally liable for registration by paying a deposit of Rs 25,000 In such case, there is no requirement for any turnover limits given above but once the registration is granted to him, he will be liable to pay tax like normal dealers.

3. ILLUSTRATIONS ON REGISTRATION:

Illustration1:

Rajesh starts a business on 10/5/2015. He furnishes the following information regarding the turnover of purchases and sales transactions. He wants to find out whether he is liable for registration under the MVAT Act 2002. Advise him.

MONTH	PURCHASES			SALES	
	WITHIN STATE	OUTSIDE THE STATE			
	Tax Free Goods	Tax Free Goods	Taxable Goods	Tax Free Goods	Taxable Goods
	Rs.	Rs.	Rs.	Rs.	Rs.
May-13	90000	4000	5500	85000	4000
Jun-13	102000	3500	3500	150000	3500
Jul-13	150000	6000	2500	175000	1500
Aug-13	110000	2500	4000	100000	3000
Sep-13	175000	1500	3000	250000	3500

Solution:

The above data is reclassified as follows:

MONTH	PURCHASES			SALES		SALES TURNOVER		Cum Taxable Sales Rs.	Cum taxable Purchase Rs.
	WITHIN STATE	OUTSIDE THE STATE							
	Tax Free Goods	Tax Free Goods Rs.	Taxable Goods Rs.	Tax Free Goods Rs.	Taxable Goods Rs.	Total sales T.O. Rs.	Cum Total. T.O Rs.		
	Rupees								
May-13	90000	4000	5500	85000	4000	89000	89000	4000	5500
Jun-13	102000	3500	3500	150000	3500	153500	<u>242500</u>	7500	9000
Jul-13	150000	6000	2500	175000	1500	176500	419000	9000	<u>11500</u>
Aug-13	110000	2500	4000	100000	3000	103000	522000	<u>12000</u>	15500
Sep-13	175000	1500	3000	250000	3500	253500	773500	15500	18500

Since Rajesh is an Importer, following turnover limits are applicable

- Turnover of sales of in excess of Rs. 1,00,000
- Taxable sales/purchases of Rs. 10,000 or more and

Rajesh crosses the turnover limit of sales in the month of May.2015, when the aggregate sales turnover is Rs. 2, 42,500. Purchase turnover exceeds Rs, 10,000 in July, 2015

Rajesh is liable for Registration in July 2015 that is the earliest date on which he fulfills both the conditions. Thereafter sales also exceed Rs. 10,000 in August, 2015 is immaterial.

Illustration 2:

The following information regarding the turnover of purchases and sales transactions is submitted by Allen, who started Business on 1st March 2015. Find out whether as per the provision of the MVAT Act 2002, it is liable for registration and payment.

MONTH	PURCHASES			SALES	
	WITHIN STATE	OUTSIDE STATE	THE		
	Tax Free Goods Rs.	Tax Free Goods Rs.	Taxable Goods Rs.	Tax Free Goods Rs.	Taxable Goods Rs.
March- 15	30000	2000	3500	40000	3500
April- 16	20000	3000	2500	10000	3000
May- 16	70000	4000	4500	80000	1500
June- 16	40000	5000	6500	50000	3000
July- 16	25000	6000	3000	20000	3500

Solution:

Given data is for two financial years 2014-15 and 2015-16. Hence limits will have to be computed separately for both the years.

MONTH	<u>PURCHASES</u>			SALES				Cum Taxable Sales Rs.	Cum taxable Purchase Rs.
	WITHIN STATE	OUTSIDE STATE	THE						
	Tax Free Goods Rs.	Tax Free Goods Rs.	Taxable Goods Rs.	Tax Free Goods Rs.	Taxable Goods Rs.	Total sales T.O. Rs.	Cum Total. T.O Rs.		
2009-10									
March	30000	2000	3500	40000	3500	43500	43500	3500	3500
	2010-11								
April	20000	3000	2500	10000	3000	13000	13000	3000	2500
May	70000	4000	4500	80000	1500	81500	94500	4500	7000
June	40000	5000	6500	50000	3000	53000	147500	7500	13500
July	25000	6000	3000	20000	3500	23500	171000	11000	16500

Allen is an Importer covered by the following turnover limits

- Turnover of sales of in excess of Rs. 1,00,000 and
- Taxable sales/purchases of Rs. 10,000 or more

During the financial year 2014-15, Allen starts his business in the month of March 2015, during the year he has total turnover of sales of Rs 43,500 and his turnover of taxable purchase as well as sales is Rs. 3,500 each. He does not satisfy both the limits; hence, he is not liable to registration during the year 2014-15.

During the next financial year, 2015-16 it is clear from the information given, that Allen has crossed the turnover limit of sales in the month of June 2015, when his sales is Rs. 1,47,500 and his taxable Purchase turnover exceeds Rs, 10000 in July, 2015

Allen is liable for Registration in *July 2014* that is the earliest date on which he fulfills both the conditions.

Illustration -3:

From the following information regarding the turnover of purchases and sales transactions submitted by M/s Castalinos, who was not liable to be registered till 1 April 2015, find out whether he is liable for registration as per the provisions of MVAT. Give reasons.

MONTH	PURCHASES	SALES	
	Taxable Goods Rs.	Taxable Goods Rs.	Tax Free Goods Rs.
April	1000	2000	200000
May	2500	3000	250000
June	3500	4000	300000
July	4500	5000	110000

Solution:

MONTH	PURCHASES	SALES					Cum. Taxable Purchase
	Taxable Goods Rs.	Taxable Goods Rs.	Tax Free Goods Rs.	Total Sales Rs.	Cum. Sales Rs.	Cum. Taxable Sale	
April	1000	2000	200000	202000	202000	2000	1000
May	2500	3000	250000	253000	455000	5000	3500
June	3500	4000	300000	304000	759000	9000	7000
July	4500	5000	110000	115000	874000	14000	11500

Castalinos is not an importer, following limits are applicable:

- (a) Total Turnover of sales exceeds Rs. 5,00,000.
- (b) Taxable sales/purchases are of Rs. 10,000 or more. .

From the above working it is clear that Castalinos crosses the turnover limit of Rs. 5, 00,000 in June, 2015, but t his turnover of purchase as well as sales exceeded the limit of Rs. 10,000 only in the month of July, 2015.

He will be liable to registration in July, 2015, when he fulfills both the conditions.

Illustration -4

Track Builder submits the following detail in respect of their construction business commenced on 1 April 2013. Find out whether it is liable for registration as per MVAT.

MONTH	PURCHASES	SALES	
	Taxable Goods Rs.	Taxable Goods Rs.	Tax Free Goods Rs.
Apr-13	1500	3000	80000
May-13	1000	5000	190000
Jun-13	2500	----	175000
Jul-13	3500	1500	95000

Solution:

Month	Taxable Purchase of Goods Rs.	Sales					Cum. Taxable Purchase Rs
		Taxable Goods Rs.	Tax Free Goods Rs.	Total Sales Rs.	Cum. Sales Rs.	Cum. Taxable Sale Rs.	
April	1500	3000	80000	83000	83000	3000	1500
May	1000	5000	190000	195000	278000	8000	2500
June	2500	----	175000	175000	453000	8000	5000
July	3500	1500	95000	96500	549500	9500	8500

Since Track Builder is not an importer, following turnover limits are applicable:

- (a) Total Turnover of sales exceeds Rs. 5,00,000.
- AND
- (b) Taxable sales/purchases are of Rs. 10,000 or more. .

From the above data , it appears that Track Builder crosses the limit for turnover of sales of Rs. 5,00,000 in July,2013 but Turnover Neither Taxable purchases nor turnover of taxable sales exceeds the limit of Rs 10,000 . In other words Track Builders do satisfy first condition but do not satisfy the second condition.

Since BOTH the conditions are not satisfied, **Track Builder is not liable for Registration.**

Illustration - 5

A is an agent for B whose turnover is Rs. 40,000. He is also an auctioneer and he sells on behalf of the actual sellers of Rs. 1,00,000. Besides, A's own taxable turnover is Rs. 3,80,000. Please find out whether he is liable to registration under MVAT

Solution:

Total turnover of sales includes not only own turnover but also, the sale effected on behalf of the principals and as an auctioneer. Therefore his total turnover is Rs. 5,20,000 (i.e. 40,000+1,00,000+3,80,000) Since all the turnover is taxable, A satisfies both the conditions of total turnover of sales of Rs. 5,00,000 and taxable turnover of Rs. 10,000. A is therefore liable for registration.

4. LEVY OF TAX – SECTION 4

S .4 sets in motion the process of levy of Taxes payable and observes that ‘Subject to the provisions of this Act and rules, there shall tax under this Act, the tax or taxes leviable in accordance with the provisions of this be paid by every dealer or, as the case may be, every person, who is liable to pay Act and rules.

Under MVAT Act, 2002, sales tax is payable on all sale of goods effected from the state whether manufactured or resold or imported from out of the State of Maharashtra or purchased from unregistered dealer. There is no concept of resale or second sale under the MVAT Act, 2002. Further, the liability to pay is on a dealer or other person who is liable to pay tax. The tax liability depends upon the nature of the goods, location of the goods, tax rate prescribed etc.

However, the dealer is entitled to avail of the input tax credit at the time of payment of service tax liability. A dealer is liable to pay tax on the turnover of sales of goods, within the State, as per the rates specified in the schedules. The tax so payable for any tax period shall be reduced by the amount of input tax credit (set off) for which the dealer is eligible during the same tax period.

5. TAX FREE GOODS - (SECTION 5 AND SCHEDULE A)

Section5 provides that subject to the other provisions of this Act, and the conditions or exceptions, if any, no tax shall be payable on the sales of any goods specified in Schedule A . Schedule A covers tax- free goods which are generally necessities of life. Some of the items covered by the Schedule A are agricultural implements, cattle feed, books, bread, fresh vegetables, milk, sugar, fabrics, water etc.

6. TAX ON SPECIFIED GOODS*– S. 6- SCH- B,C,D& E

Section 6 provides for levy of tax on turnover of goods covered by schedule B, C, D, and E at the rates set out against each of them the respective Schedule.” A brief description of goods covered in theses schedules is as follows:

- Schedule B covers jewellery, diamonds and precious stones. Goods covered by Schedule B are subject to tax at 1%.
- Schedule C covers items of daily use or raw material items like drugs, readymade garments, edible oil, utensils, iron and steel goods, non ferrous metal, IT products, oil seeds, paper, ink, chemicals, sweetmeats, farsan etc. Goods covered by

Schedule C are subject to tax at 5%. some items are taxed at 4%

- Schedule D covers liquor which is subject to 20% tax. It also covers various types of motor spirits which are subject to tax from 24% to 31% and on liquor up to 50%
- All items which are not covered in any of the above Schedules are automatically covered in residuary Schedule E. Goods covered by Schedule E are subject to tax at 12.5%.

Original Scheme of having four basic rates of VAT - 0%, 1%, 4%, and standard rate of 12.5% has been changed on selective basis.

7. RATE OF TAX ON PACKING MATERIALS – SEC. 7

Under section 7, rate of tax on packing material will be the same rate applicable on the goods. The section provides that where any goods are sold and such goods are packed in any material, the tax on such sale of packing material shall be at the same rate of tax, if any, at which tax payable on the sale of the goods is so packed, whether the packing material is charged separately or not.

Illustration: 6

A plastic packing material normally liable to MVAT at 5% is used for packing of liquor liable to Vat @ 25%. In this case sachet will also be liable to VAT @ 25%. .

Illustration 7

Assuming the above packing material is used for packing of Bullion liable to VAT @ 1%. In this case, packing material will be liable to VAT @ 1% only, even though the particular prescribed rate on such material is 5%

8. SALES/ PURCHASES NOT LIABLE TO TAX – S. 8

Following sales transactions are exempt from payment of tax – S8:

- (a) Inter-state transactions covered by the Central Sales Tax Act, 1956 viz. [S.8(1)]
- (b) Sales or purchase of goods taking place outside the state of Maharashtra as per Section 4 of the Central Sales Tax Act, 1956
- (c) Sales in the course of Imports or exports of goods- [Sec 8(1)]
- (d) Sales of fuels and lubricants to foreign aircrafts registered in a foreign country subject to prescribed conditions. [Section 8 (2)]

- (e) Inter se Sales between Special Economic Zones, developers of SEZ, 100% EOU, Software Technology Parks (STP) and Electronic Hardware Technology Parks Units (EHTP) subject to certain conditions. [Section 8 (3)]
- (f) Sales to any class of dealers specified in the Foreign Trade Policy notified from time to time, by the Government of India. [Section 8(3A)]
- (g) Sales to the Canteen Stores Department or the Indian Naval Canteen Services As per wholly or partly to the extent specified by the State Government by general or special order, [Section 8(3B),].
- (h) Sale by transfer of property in goods involved in the processing of textile covered in column 3 of the first schedule to the Additional Duties of Excise (Goods of Special Importance) Act, 1957 under the general or specific order of the State Government - [Section 8(3C)],,
- (i) Sales effected by manufacturing units holding certificate of entitlement in backward area under the package incentive scheme -S8 (4). – To avail this exemption such units have to pay tax and then claim refund.
- (j) Any class or classes of sales of goods made by any registered dealer to the central government or state government or Licenced Company engaged in generation, transmission or distribution of electricity subject to general or special order and prescribed conditions. To the extent if full or partly exempted by, the State Government may, by general or special order. For instance, by Notification dated 19.4.2007 concessional rate of tax @ 4% is provided for sale to specified Electric Power Generating and Distribution Companies', MTNL, BSNL and other specified telephone service providers Section 8(5)].

9. EXEMPTION U/S 41

The State Government may issue the notification to grant refund of any tax levied and collected from any class or classes of dealers or persons or as the case may be, charged on the purchases or sales made by any class or classes of dealers or persons- (Section 41). At present this notification is issued for grant of refund in case of Consulate and Diplomat authorities and sale of motor spirit at retail outlets is exempted from tax by a notification.

10. EXEMPTED V/S TAX FREE SALES

Tax on goods mentioned in Schedule A is NIL. These goods are called Tax-free goods .Goods covered in the transactions mentioned in Section 8 are not Tax-free but tax on

such goods is ZERO. **These goods are taxable goods having Zero tax.** This distinction is useful to determine the turnover limits u/s 3 for registration and also for Set off purposes.

11. REGISTRATION PROCEDURE – Section 16- Rule 8

11.1. Requirement and procedure for Registration is given in Section 16 and Rule 8: Section 16 provides that every dealer liable to pay tax can carry on business only if he possesses a valid certificate of registration under the Act. Registration Certificate NO (RC No) is now referred to as Tax Payers' Identification Number or *VAT TIN*.

11.2. Time Limit for Application - Rule 8

Time limit for making Application for Registration is given below:

Reason for registration	Time limit
1 Voluntary	Not applicable
2 Change in constitution	30 days from the date of change
3 Transfer of business due to death of the dealer	60 days from the date of death
4 Part/full transfer of business not covered by serial no 3, above.	30 days from the date of transfer
5 Exceeded the TO limits	30 days from the date on which the turnover first exceed the limits

11.3. Effect of Delay

If a dealer applies for registration within the prescribed time of 30 or 60 days,, registration certificate will be granted from the date of liability, otherwise from the date of application. If there is an interval between the date of making application and day original date of liability and the date of registration, then:-

- (a) the dealer would be unregistered dealer liable for paying penalty for delay in registration a
- (b) Dealer cannot claim set off
- (c) subsequent dealers purchasing goods from him shall not be entitled to claim set off in respect of tax paid to such dealer

11.4. Procedure for Registration

Following procedure is to be adopted for Registration;

1. Application in Prescribed form

An application for registration (VAT TIN) is to be made in Form No.101 along with the required documents. An application incomplete in any respect shall not be considered to be an

application and shall not be accepted. (Application will not be accepted by the system if all the fields are not filled up.) Now *all applications for registration have to make electronically*. Payment of fee has to be made electronically and deposit in case of Voluntary registration will be made through a Demand Draft. Otherwise the procedural requirements are same.

2. Common TIN number for all places

Where a dealer has more than one place of business, he shall make a single application in respect of all such places specifying one place as the principal place of business. The application shall be submitted to the registering authority having jurisdiction over the principal place of business. One TIN number will be issued for whole state of Maharashtra, covering all the places of business of the dealer. Subsequently, if there is a shifting of place of business from one place to another place, there is no need to cancel the existing number and apply for new number. The existing TIN will continue. However, the event of shifting should be intimated to the registration authority of the old place.

3. Fees and Deposit:

A dealer applying voluntarily for registration has to pay fees of Rs 5,000 in addition to a deposit Rs 25,000. Other dealers have to pay a fee of Rs 500 and are not liable to make any deposit. The fees are to be electronically paid in Challan no. 210, appended to the MVAT Rules. Deposit amount can be paid by a demand draft.

4. Submission of PAN

No application is accepted without PAN. If PAN is not there, proof of filing Income Tax Return is also accepted

5. Business name:

The business name on the application should be the same as on the PAN, except in case of a proprietary concern. In case of other constitutions, the business name on the application should match with the constitution related document such as the partnership deed, Certificate by the Registrar of Companies etc

6. Constitution:

The constitution related documents should be furnished, depending upon the constitution selected by the dealer. Such documents are:

Individual	No Documents
HUF,	No documents except PAN
Firm	Partnership Deed
Companies	Articles/memorandum and the certificate issued by Registrar of companies
Co-Operative Society	Bye laws ,Certificate issued by Registrar of Societies
Trust	Trust Deed ,Certificate issued by Competent Authority companies

7. Verification Name and Status of the signatory:

Application has to be signed and duly verified by the proper person given in the table below. The person so signing and verifying is required to state the capacity in which he is signing and verifying as also, where possible, the particulars of his authority to sign and verify -Rule 8(6)

Applicant	To be Signed by
Individual	Proprietor or an authorized parson
Firm	Any partner of the firm but every partner of the firm is also required to furnish a declaration as provided in the form of application, to the registering authority.
HUF,	the karta or any adult member thereof
Companies and other bodies corporate	Any director, manager, secretary or the principal officer or authorized signatory
an association of individuals other than a firm, HUF or body corporate	the principal officer of, or person managing the business
Government Departments and other persons	Manager, Principal Officer or a duly authorized person.

8. Documents to be submitted

Following document are to be submitted for physical verification, when asked by the registering authority:

Reasons for registration	Document
Voluntary Registration	Business PAN, Introduction of the dealer by a Registered dealer for 5 years or by an agent or current account in a bank – Rule 8 (11)
Change in the constitution from partnership to proprietary	Dissolution Deed
Change in constitution from proprietary to partnership	Partnership Deed
Full/Part Transfer of business	Transfer deed duly signed by the transferor and the transferee.
Exceeding the prescribed limit	Sales/purchase statement supported by sales/purchase invoices, sales/purchase register

9. Passport Size Photo

Two passport size photographs of the proprietor or any one partner of the firm or any one director of private limited company are to be submitted. This is not required for Public Ltd. Companies public trusts, corporations or a local authority.

10. Proof of address

Proof of address of place of business and residence of applicant, partners, directors etc The proof can be in the form of any one of the documents viz copy of maintenance bill, electricity bill, property card, leave license agreement for place of business as well as for place of residence is required.

11. Proof of Identity

Proof of identity can be:

- (a) Copy of passport / driving license / voter card of applicant / partners/ directors.(any one proof is required)
- (b) Copy of license or certificate issued under any other Act, if any.
- (c) Income Tax PAN of the applicant / company / firm / partners / HUF and Karta.
- (d) Profession tax number of the proprietor /Company /Partners / Directors.

- (e) Proof of bank account of the applicant, Firm or Company.
- (f) Copy of proof of filing of last return and assessment order, if any (applicable only in case of application for registration due to change in constitution or change in ownership of the concern).

12. Issue of certificate

After scrutiny of the application and after such inquiry as it deems fit, if the registering authority is satisfied that the application for registration is in order and the prescribed conditions, if any, are fulfilled, it shall register the applicant and issue to him a certificate of registration in the prescribed form.

Where the application is not complete or that the information or documents prescribed for grant of registration certificate have not been furnished, or, the prescribed conditions are not fulfilled, the registering authority may, after giving the applicant a reasonable opportunity of being heard, reject the application for reasons to be recorded in writing.

13. Amendment of certificate

The Commissioner may, after considering any information furnished under any of the provisions of this Act or otherwise received, amend from time to time, any certificate of registrations 16(4)

12. ILLUSTRATIONS ON REGISTRATION

Illustration -6:

In a case the turnover of sales by a reseller, exceeds Rs. 5 Lakh on 1-5-2015 and he files the application on 30-5-2015, the MVAT TIN shall be effective from 1-5-2015.

Illustration -7:

AB son of A takes over as legal heir the business of his father, expired on 15-12-2015 the legal heir took over the business. AB must apply for registration within 60 days of the death i.e. on or before 12/02/2016. The limitation period in this case being 60 days. If the application is filed in time, the TIN shall be effective from 15-12-2016, the date of the death of the proprietor.

Illustration -8:

ABC was converted into a proprietary from partnership on 1-4-2015. B was the proprietor. B applies for registration on 1-6-2015. In this case, the application is late hence; the TIN will be effective from the date of application i.e. 1-6-2015. During the period from 1-4-2015 to 31-05-2015, B shall be treated as an unregistered dealer all the consequences for remaining URD shall follow. B cannot collect any tax during this period and shall also not be eligible to claim any set off for the purchases made during this period.

12. SELF EXAMINATION QUESTIONS

1. Mr. Kaliya is a new dealer. From the following information find out on which day he will be liable to pay tax. Give reasons.
answer:

<u>DATE</u>	PURCHASES		SALES	
	<u>Taxable</u>	<u>Tax Free</u>	<u>Taxable</u>	<u>Tax Free</u>
02/04/15	10000	15000	-----	-----
04/04/15	-----	-----	6000	14000
11/04/15	20000	40000	5000	10000
20/04/15	-----	-----	10000	40000
30/04/15	40000	60000	-----	-----
02/05/15	-----	-----	50000	15000
11/05/15	5000	20000	10000	30000
20/05/15	10000	10000	5000	15000
31/05/15	-----	-----	10000	10000
01/09/15	15000	315000	20000	320000
03/09/15	5000	10000	20000	30000

[Ans: 01/09/2015]

2. Sajjan is a new dealer. From out of which month he will be liable for registration as per the provisions of the MVAT Act, 2002.

Month/Year 2015	PURCHASES		SALES	
	<u>Taxable</u>	<u>Tax Free</u>	<u>Taxable</u>	<u>Tax Free</u>
April to June	3500	13500	2500	14000
July	2500	24000	2000	26000
August	3500	52000	1000	65000
September	3000	25000	4000	28000
October	4500	72000	2500	75000
November	6000	225000	4500	326000
December	9000	75000	7000	84000

[Ans Other: Nov 2015]

3. Mrs. Vidya commences business from 1st April 2015. She furnishes the following information furnished and wants to find out from which month she will be liable for Registration and to pay tax as per the provisions of Maharashtra Value Added Tax Act, 2002.

Month - Year 2015	PURCHASES		SALES	
	<u>Tax Free</u>	<u>Taxable</u>	<u>Tax Free</u>	<u>Taxable</u>
April to July	45000	9000	60000	8000
August	100000	20000	120000	25000
September	150000	40000	175000	50000
October	80000	50000	20000	15000
November	20000	10000	50000	20000
December	100000	25000	120000	40000

[Ans Other: Nov 2015]

4. Explain when a dealer becomes liable to pay MVAT.
5. Explain when an importer becomes liable to pay VAT under MVAT.
6. Explain 'incidence of tax' under the MVAT Act.
7. Which are the special cases under which registration is required?
8. List out the schedules Under MVAT dealing with levy of tax.
9. Discuss the provisions of MVAT relating to export incentives.
10. What the difference is between Schedules A goods and exempted goods U/s 8?
11. Discuss the sales and purchases outside the ambit of MVAT Act.
12. What are the VAT rates?
13. List out the exemptions as available to goods under Schedule A.



SET-OFF, REFUNDS, COMPOSITION, PENALTIES & INTEREST, AUDIT

Synopsis

1. Introduction and objectives
2. Composition Scheme
3. Composition Scheme for different classes of dealers
4. Set off
5. Penalties
6. Interest payable
7. Business audit
8. Tax Audit
9. Solved illustrations
10. Self Assessment Questions

1. INTRODUCTION:

To reduce the burden of maintaining detailed records by dealers as well as restrict the number of dealers under VAT system of taxation, the MVATA 2002 provides vide section 42 for a simplified system of accounting for small dealers . This is called the Composition Scheme.

Similarly Section 48 and 49 make detailed provision for credit of earlier taxes paid this credit is called as the set off of taxes already paid on the inputs to avoid double taxation and cascading effect of the taxes on taxes.

This lesson aims at taking up the key provisions like composition set- off and refunds under the MVAT and the concept of input credits, to whom and what circumstances it is to be allowed or not to be allowed with reference to the provisions of S. 48 & 49 and Rules 52, 53 & 54. MVAT Rules.

2. COMPOSITION SCHEME – SECTION 42

2.1 Legal framework

The composition scheme is an optional scheme for specified dealers to make a lump- sum payment in lieu of tax payable. The

scheme is statutorily supported by Section 42 .In pursuance of the authority vested in it by Section 42, the State Government has issued Notification No.VAT-1505/CR-105/Taxation-1 dated 1st June, 2005, which provides for Composition to different types of dealers and subject to various conditions.

2.2 Applicability :

Separate composition schemes are available for different classes of dealers viz :

- (a) Retailers: -S42(1)/Rule 85,
- (b) Restaurants, eating house, refreshment room, boarding establishment, factory canteen, clubs, hotels or caterers etc , up to four star hotels , who serve non-alcoholic-drinks and food;.
- (c) Bakeries;
- (d) Dealers having principal business of Second-hand passenger motor vehicles;
- (e) Dealers engaged in work-contracts; and
- (f) *Decorators hiring Mandap* or tarpaulin

2.3 Dealers not eligible

The Scheme is not available to the following: classes of dealers:

- a) A Manufacturer or
- b) An importer or
- c) A reseller who purchases any goods from a registered dealer exempted u/s 8(1) (High seas basis)
- d) A dealer retail liquor including imported liquor or, Indian Made Foreign Liquor or Country Liquor
- e) Dealer engaged in inter- state purchases and stock transfers
- f) Dealers selling retail drugs as per entry C-29 (valued at MRP)
- g) Dealers selling notified motor spirit

2.4 General Conditions:

General features of the composition scheme are:

a) Application;

The Scheme will be available on making application in prescribed form. New dealers should apply for composition at the time of registration.

b) Turnover Limit

Turnover of sales of goods shall not exceed Rs.60 lakhs in previous year for which the composition is availed of and if the dealer was not liable for registration under B.S.T Act or as the case may be under MVAT Act in the immediately preceding year, then he shall be entitled to claim the benefit of the scheme in

respect of the first sixty lakh rupees of the total turnover of sales in the current year.

c) Taxable Purchase from Registered Dealers

The taxable goods resold must be purchased from registered dealers. However, purchase of tax free goods can be from registered dealers as well as unregistered dealers. Any other purchases from unregistered dealers must be of packing materials only.

d) No Set-Off Available

Dealer opting for composition is not eligible for any set-off or refund except dealer in second hand motor vehicle.

e) Not to Issue Tax-Invoice:

The dealers cannot issue 'tax Invoice'. The claimant dealers shall not be eligible to recover composition amount from any customer separately. It can issue bill or cash memo, wherein tax cannot be separately collected.

f) Option not to be changed

Once, the option to join the composition scheme is exercised, in any year, it can be changed only at the beginning of the next financial year

g) Other Points

Following other points are also important:

- i. Dealer may opt for payment under composition, if he so desires
- ii. Existing dealers opting for composition to send intimation in the relevant prescribed form appended to the Notification
- iii. No separate R.C. Number for composition dealers.
- iv. Amount of composition payable cannot be recovered separately. Accordingly, composition dealers cannot issue tax invoice.
- v. Single dealer eligible to claim composition under more than one scheme or for a particular activity of the business
- vi. Composition dealers are not eligible for set-off on certain class of purchases which are specifically excluded.

2.5 Amount of Tax:

Different Forms, tax rates are prescribed by rules. For instance, Decorators are required to pay tax @ 1.5% as per Section 42. Similarly, works contract attract 8% tax on total value of contract Tax as reduced by the value of sub-contract given. The tax rate is 5% in respect of works contract for construction. For retailers tax rate is 5% and 8% in some cases, for Second Hand Motor Car

dealer the rate is 15% , For Hotels, restaurants and four star hotels tax rate is 5% subject certain conditions .

3. COMPOSITION SCHEME FOR DEALERS

3.1 Retailers

Meaning of Retailer

“Retailers” means the dealers engaged in prescribed business of reselling at retail, any goods or merchandise. A dealer is deemed to be engaged in the business of retailers if 90% of his sales are to persons who are not dealers. In simple words scheme is applicable to retailers or the dealers catering to the ultimate consumers. In case of any dispute, the matter may be referred to the joint commissioner, whose decision, after hearing the concerned party shall be final. The scheme is not available to:

- a manufacturer or
- an importer or
- a dealer who effects inter-State sales or purchases or receives goods from outside the State on stock transfer basis

Eligible Turnover

Following Class of goods excluded from the scheme and Turnover of sales / purchases is not to be considered for calculation of composition

- a) Foreign liquor, Country liquor and liquor imported in India
- b) Drugs covered by Entry C 29
- c) Notified motor spirits viz. High Speed Diesel, Petrol, Aviation Turbine Fuel and Aviation Gasoline

Turnover liable to composition

- Turnover of sales including turnover of tax free goods as reduced by turnover of
- Turnover of purchases including turnover of tax free goods and tax paid on purchases
- Calculation of turnover to be made at half yearly intervals.

Composition amount

5% for retailers who's aggregate of the turnover of sales of goods covered by Schedule A and goods taxable at 5% is more than 50% of the total turnover of sales and 8% in other cases

Conditions:

- i. Dealers covered under the composite scheme cannot collect tax separately

- ii. Such dealers are not entitled to claim set-off in respect of the purchases corresponding to any goods which are sold or resold or used in packing of goods
- iii. Turnover of the dealer should not exceed Rs.100 lakhs and in case of new dealers – Composition applicable for first Rs.100 lakhs only (increased from 50 lakh with effect from 01/04/2016
- iv. The turnover of purchases is reduced by the amount of every credit of any type received from the vendor
- v. Taxable goods resold are purchased from registered dealer
- vi. Purchases of tax free goods may be from registered dealer or unregistered dealers Any other purchases from unregistered dealers are meant only for packing of goods resold
- vii. From 01/04/2016 , dealer will be liable to file returns in the same manner as a non- composition dealer .
- viii. Further , the new dealer were required to file their application in form 4A or 4B with the nodal VAT officer.

3.2. Restaurants and Caterers

The composition scheme is available to Restaurants, Eating house, Refreshment rooms, Boarding establishments, Factory canteen, Clubs, Hotels upto four star and Caterers in respect of the sales of Food and non-alcoholic drinks:

- served for consumption in any restaurant etc or in the immediate vicinity of any restaurant etc
- Supplied by way of counter sale
- Served for consumption at any other place other than restaurant etc. or by a caterer

With effect from 01-04-2016 , composition amount would be 5% of the turnover of food and non-alcoholic drinks in case of a dealer whose turnover of food and non-alcoholic drinks does not exceed Rs 3 Cr and 8% in case of a dealer , whose turnover exceeds Rs 3 Cr ..Composition amount would be 10% in the case of an unregistered dealer) of the turnover of sales of food and non-alcoholic drinks. Both the turnover limit and actual turnover will be only of food and non-alcoholic drinks.

Where the dealer is also serving alcoholic drinks, tax payable on sales of alcoholic drinks will not be considered for composition

(Other Conditions)

- dealer cannot collect tax separately
- dealer not entitled to claim set-off in respect of the purchases corresponding to any goods which are sold or resold or used in packing of goods
- Dealer can not to issue tax invoice .

The dealer was permitted to opt for composition scheme by 15/05/2016 . In such cases , the dealer will have to pay the amount of set off already availed when he files the first return after the composition .

Similarly , a composition dealer has been allowed to opt out of the composition scheme with the application to the nodal sale tax officer and thereafter , the dealer will be eligible to issue tax challan and claim set off , if any.

3.3 Bakers:

Composition scheme applicable to sales by manufacturer of bakery products, who are existing, registered dealers having turnover of bakery products including bread not to exceed Rs. 50 lakhs in the previous year. For a newly registered dealers - concession available for first Rs.50 lakhs of turnover.

From 01/04/2016 , a baker will be allowed to deduct the sale of bread (tax free under entry A-7) from his turnover.

Rate of composition is 4% (6% in the case of an unregistered dealer) of first thirty lakh rupees of total turnover of sales of goods including bread in loaf, rolls, or in slices, toasted or otherwise, whether manufactured by the baker himself or imported in the State

Conditions

- The claimant dealer should be certified by the Joint Commissioner
- The claimant dealer not entitle to claim set-off in respect of purchases corresponding to any goods which are sold or resold or used in packing of goods
- Turnover in excess of first thirty lakhs rupees taxable at the applicable rate
- Such dealer cannot issue tax invoice

3.4. Dealers of Second Hand Motor Vehicles

The scheme is available to a registered dealer whose principal business is of buying or selling of second-hand passenger

motor vehicles whether or not sold after reconditioning or refurbishing. Composition rate is 12.5% on 15% of the sale price of the vehicle – effectively 1.88%

Conditions:

- The dealer should be certified by the Joint Commissioner
- The dealer to prove that entry tax, if payable, has been paid on the said vehicle or the vehicle is registered in the State of Maharashtra
- The dealer shall not be eligible for set-off of tax paid or payable or entry tax paid or payable, on purchases of second-hand motor vehicles

3.5 Works Contractors, Builders and Developers

U/s 42 A dealer involved in the execution of a works contract, may subject to prescribed restrictions and conditions , pay lump-sum by way of composition,—

- (a) 5% of the total contract value of a construction contract, or
- (b) 8% in any other case,

After deducting from the total contract value of the works contract, the amount payable towards sub-contract involving goods to a registered sub-contractor.

In case of a registered dealer, who undertakes the construction of flats, dwellings or buildings or premises and transfers them in *pursuance of an agreement* along with land or interest underlying the land. The scheme covers all agreements registered *from* 01/04/2010 onwards including agreements entered before 01/04/2010. Unregistered agreements will not be eligible for composition.

Rate of MVAT payable is 1% of the aggregate amount specified in the agreement or

Value specified for the purpose of stamp duty in respect of agreement under Bombay Stamp Act, 1958, whichever is *higher*

Conditions.

The dealer should -

- include the agreement value in turnover of sale in the period in which agreement is registered;
- make e-payment of MVAT payable against such agreements for the purpose of filing return;

- not claim any set-off of taxes paid in respect of purchases of goods used against opted works contract;
- Not use any goods or *property in goods* purchased from out of the state against C-Form for the purpose of contract for which composition of tax is opted. i.e. in relation to flat, dwelling, etc
- not issue declaration in Form 409 to sub-contractor in respect of work contract for which composition is opted;
- not issue Tax Invoice
- No change the method of computation of tax liability in respect of contract for which he has opted for this scheme;

3.6. Mandap -Keepers

S 42, a dealer engaged in providing the right to use Mandap or tarpaulin (whether or not for a specified period), then he may, subject to prescribed conditions and restrictions pay in lieu of the amount of tax payable by him a sum 1-1/2% of the turnover.

Right to use Mandap includes the right to use Mandap, pandal, shamiana or the decoration of such Mandap, pandal or shamiana, furniture, fixtures, lights and light fittings, floor coverings, utensils and other articles ordinarily used alongwith a Mandap, pandal or shamiana.”

4. INPUT CREDIT – SET OFF- S.48/ RULES 51-58

4.1. Section 48 and 49 deal with input tax credit to any registered dealer in respect of any sales tax paid on his purchase and Refund of tax on declared goods sold in the course of inter-state trade or commerce respectively. Rules 51 to 58 of the VAT Rules, 2005. Prescribe the modalities for set- off and refund.

4.2. Concept of set-off

Set-off is the amount of tax credit which can be claimed in the VAT return. It is the tax that has been charged on goods at the prior stage. This credit can be adjusted against the VAT payable on the sales and the balance of VAT has to be paid to the Government.

4.3. Eligibility:

Under Rule 52 .any registered dealer who has not opted to pay tax by way of composition as a retailer, owner of a restaurant / hotel or a bakery owner can claim set-off on purchases affected on or after 1.4.2005.

In other words, set-off can not be claimed by a dealer opting for **composition scheme** except in the case of works contracts and dealers in second hand motor vehicles where special provisions apply.

4.4. Taxes available

Following taxes paid are eligible for set-off under Rule 52 :-

- Maharashtra Value Added Act 2002, i.e VAT
- Entry for Motor Vehicles into Local Areas Act, 1987, i.e Entry Tax
- Entry of Goods into Local Areas Act, 2003, i.e Entry Tax

However the following taxes are not available for set-off:

- tax paid under the Central Sales Tax Act, 1956 or
- centrally collected taxes,
- taxes paid in another state or
- Taxes paid to a municipal or other local self government.

4.5. Eligible goods

Under Rule 52 Set off can be claimed on the full amount of tax paid on total purchases of the business affected from registered dealers. This includes

- capital assets,
- goods the purchases of which are debited to profit and loss account,
- trading goods,
- raw materials, parts, components and spares,
- Packing materials and fuel.

But following Purchases not qualified for set-off:

- Motor vehicles (other than goods vehicles) and parts, components and accessories thereof treated as capital assets unless the dealer is in the business of transferring the right to use such vehicles.
- motor spirits, unless sold or resold in the course of inter-state trade, or exported outside India or are sent outside the state on consignment or as a branch transfer, or where the dealer is a commission agent sending the goods to the place of business of his principal.
- Crude oil used for refining.
- Consumables or capital assets where the dealer is principally involved in doing job-work or labour work.
- Raw materials purchased by a dealer with an Entitlement certificate.
- Goods of an intangible character other than those specifically excluded.
- goods purchased by a shipping company
- Purchase effected by way of works contract where the contract is for erection of immovable property.
- Building materials which are not resold but are used in the activity of construction.

- Office equipment, furniture, fixtures and electrical installations which are meant for own consumption.
- Purchase effected by a wholesaler or retailer of drugs and medicines covered by Entry 29 of schedule C.
- With effect from 01/04/2016 entry tax on motrotor vehicle will also not be allowed st off .
- In case of mobile phones imported and sold locally , set off will not exceed the CST liability paid on them
- Howeve, set off will be available on motor vehiclesp purchased and leased out.

4.6. Conditions related to claiming set-off – Rule 52 :

A dealer must be registered for VAT at the time of purchase of goods.

- a) Dealer should not be paying tax by way of composition as a retailer, hotel / restaurant business or bakery.
- b) Set off must be supported by valid tax invoice for the goods purchased and the amount VAT must be shown separately in the invoice ,
- c) The dealer must maintain an account of all purchases in chronological order in respect of which setoff is being claimed

4.7. Restrictions/ Reduction /retention on the set-off – Rule 53

Rule 53 provides for reduction of set-off amount in certain circumstances. The circumstances and the extent of reduction are given below:

- i. *Reduction of 3% of Purchase Price* If taxable goods purchased are used
 - As **fuel**, or
 - For manufacture of any tax-free goods (other than sugar and fabrics) , or
 - for **packing** of any **tax-free** goods and or
 - If taxable goods despatched to a place **outside the state** otherwise than by sale i.e. transfer of taxable goods to branch in other State or to agent in other State, (only 1% of the Purchase Price of Schedule B goods, 3% reduction applicable on goods other than capital assets and fuel),
- ii. *Reduction of 64% of the Purchase Price* to dealers opting for composition scheme @ 8% of the value of works contract, reduction will be 16/25 or 64% of the tax and ser-off will be 9/25 or 36%.

- iii. Reduction to of 4 % of the purchase price, if the dealer has opted for composition scheme @ 5% of the value of works contract.
- iv. In the event of business being discontinued or not continued by successor, set off on closing stock (other than capital assets) on the date of such event and set off already received has to be repaid
- v. If the receipts from sale of goods is less than 50% of the gross receipts of the business, set off is available only on those goods which are sold or consigned or used in manufacturing or packing of the goods sold or consigned.
- vi. If retailer of liquor holding specific liquor license, effect sale of liquor at the price lower than MRP. Set off available will be on pro rata basis =

$$\text{Set off X } \frac{\text{selling price allowable on purchase}}{\text{MRP value of the liquor sold.}}$$

- vii. 3% set off can be claimed on office equipment furniture and fixtures by dealers not in the business of leasing of office equipment, furniture and fixtures.
- viii. Deficiency in tax to be paid

The dealer shall deduct the amount required to be reduced under this rule from the amount of set-off available in respect of the period in which the contingency specified in this rule occurs and claim only the balance amount as set-off and when the amount so required to be deducted exceeds the said amount of set off available in respect of that period, he shall pay an amount equal to the excess at the time when he is required to pay the tax in respect of the said period. [Rule 53(8)].

5. NEGATIVE LIST -RULE 54

Rule 54, gives a negative list in respect of the purchases of goods not eligible for set off: The list is as follows:

- 1) *Motor vehicles*, (except goods vehicle), if treated as capital assets and their parts components and accessories. However, a dealer dealing in sale of motor vehicles or leasing of motor vehicles is entitled to set off.
- 2) *Motor spirits*, as notified u/s 41(4) unless it is resold or transferred to branch or agent outside the State.
- 3) *Crude oil* described in Section 14 of the C.S.T Act, if it is used by refinery for refining.

- 4) If a dealer is engaged in *pure job work* or labour work and where only waste/scrap is sold then no set off will be granted on consumables and capital assets.
- 5) Unit covered by package scheme of incentive under exemption scheme or deferment scheme is not entitled for set off of tax paid on "raw materials" as defined in Rule 80. However, it can claim refund of tax paid on such purchases, which will be equal to set off.
- 6) Incorporeal or intangible goods like trademark, patents, copyrights and SIM cards are not eligible for set off. Import licenses, exim scrips, export permits license/ Quota and DEPB are eligible for set off. Software packages are eligible for set off only if resold (traded).
- 7) Purchases effected by way of works contract where the contract results in immovable property other than plant and machinery.
- 8) Purchase of building materials, if not resold but are used in construction activity.
- 9) Purchase of Indian Made Foreign Liquor or country liquor by a dealer who has opted for composition scheme.
- 10) Purchase of mandap, tarpaulin, shamiana, pandal, lights, etc. for use in a mandap by a mandap keeper if he has opted for composition scheme.
- 11) Purchases of capital goods by hotels not connected with provision of food or beverages

6. GENERAL CONDITIONS FOR REFUND ETC – R- 54

Set- off or refund will be allowed only if the following conditions are satisfied

- i. In the year in which a dealer is registered under VAT and has purchased goods from outside Maharashtra , unless the dealer was registered at time of purchased or the goods have been used in a capital asset and the asset has not been sold before the date of registration
- ii. Set off is allowable as and when purchase is made, irrespective of its disposal. However, it is subject to the restrictions specified in Rule 53 and negative list contained in Rule 54.

- iii. The dealer keeps a chronological record of purchase in respect of which set-off is claimed including name of the dealer, amount, tax collected etc
- iv. Set off is allowed against tax- invoice only and invoice has to be produced on demand.
- v. Amount of Set off can be adjusted against VAT dues in the VAT return
- vi. If the set-off exceeds the tax due, It can be adjusted-to reduce the amount of CST payable or can be carried forward to next VAT return or the dealer can claim a refund.
- vii. Commissioner can recover sales tax arrears against the set-off amount under a demand notice and only the balance will be refunded. But once such demand is notice is issued, dealer can not adjust set-off against tax of that period.
- viii. Where items of purchase cannot be individually identified FIFO method will be used.
- ix. Entry tax on vehicles is eligible for set off.
- x. In case of succession of a business due to death of a dealer or transfer or disposal of business, the set-off credit can be taken by the successor.
- xi. Set-off is normally not to be refunded – except in case of a dealer who is eligible under the package scheme for exemption of tax
- xii. Set off is by way of adjustment in tax liability.
- xiii. When goods are sent outside the state of Maharashtra in the course of inter-state sale, tax paid locally may be refunded.
- xiv. If the set off amount exceeds the tax liability, the excess can be claimed as refund or adjusted against CST or carried forward to next period and adjusted against the VAT payable.
- xv. CST paid on interstate purchase is not eligible for set off unless it is shown that VAT was paid on it in earlier transaction- Sec 49.

PENALTIES - sec 29

A summary of penalties prescribed is given below:

Sec	Contravention	Penalty
29(3)	Concealment of particulars or Furnishing false particulars	100% of Tax avoided + Tax
29(4)	Issue of false sales Bill , document or Misclassification of goods	100% of Tax avoided+ Tax
29(5)	Contravention of terms of exemption granted U/s 8 (3)/(3A),/(3B)/(5) in respect of goods purchased	150% of tax normally payable
29(6)	Contravention of the provision of section 86, resulting in under-assessment of tax payable	50% of amount of tax under-assessed
29(7)	Non- Compliance of Notice for any proceedings	Rs 5,000
29(8)	Not or late filing of return u/s 20	Rs 5,000
29(9)	Filing return, not complete or not self consistent	Rs 1,000
29(10)	Unauthorized collection of tax U/s 60	Forfeiture of tax & Rs 2,000
61	Not getting the Account Audited or Not filing complete audit report	One tenth percent of turnover

Notes:

- Penalties will be imposed after giving the opportunity of being heard
- Penalty may be imposed within a period of 8 years from the end of the financial year in which the contravention took place
- For penalties exceeding Rs 5 lakh approval of deputy commissioner and for penalties exceeding approval of Joint commissioner of sales Tax is a pre-requisition
- Penalty for late filing will be late filing fee payable before filing the return as per the proposal in budget 2012.

7. INTEREST

Under rule 41, MVAT is payable by dealer on or before due date of filing the return, If the return is filed after the due date

simple Interest @ 1.25% per month is payable by the dealer u/s.30. Interest is to be paid, along with tax before filing MVAT return.

- (a) **By an Unregistered Dealer on** late payment or non- payment of tax due as he has failed to apply for registration in time. Interest is to be calculated from 1st April of the year in which he has defaulted in getting registration to the making payment of tax. When tax is paid in part, then interest is to be calculated to that date in respect of part payment. However the amount payable in respect of a year shall not exceed the amount of tax payable in respect of that year- Section 30 (1).
- (b) **By a Registered Dealer** on late payment of tax, i.e. interest is paid after due date of filing return. Interest is to be calculated from due date to date of payment of tax. If tax is payable on filing of revised return or fresh return, then interest is to be calculated from due date of filing original return to date of payment of tax- Sec 30(2).
- (c) **By a Registered Dealer on** assessment for any period. interest is to be calculated on the amount remaining unpaid; after taking into consideration the amount on which interest is paid u/s.30 (2) and has remained unpaid up-to one month after the end of the period of assessment, and Interest is to be calculated from next date following last day of the period covered by assessment order to the date of assessment -. Sec 30(3)
- (d) **By any Dealer** on amount of additional tax paid along with one or more return filed on account of circumstances mentioned in as a consequence of audit of business of dealer for any period, or inspection of the accounts, registers and documents pertaining to any period, kept at an place of business of the dealer, or entry and search of any place of business of any other place where the dealer has kept his accounts, registers, documents pertaining to any period or stock of goods or any intimation issued section 63(7). Interest is payable @25% of Additional Tax Paid- Sec30(4)

8. BUSINESS AUDIT

MVAT relies upon self-Compliance by the dealers. To promote, the self- compliance by the dealers, concept of business audit is introduced vide Section 22. Basic feature of the business audit are as follows:

1. **Selection of Dealers :**

The Commissioner may arrange for Audit of the Business of any Registered Dealer selected on the following basis -.

- (a) who have not filed returns by the prescribed date or
- (b) Who have claimed refund of tax or
- (c) Where the Commissioner is not prima facie satisfied with the correctness of any return filed by a dealer or with any claim made, deduction claimed or turnover disclosed in any return filed by the dealer or
- (d) Who are selected by the Commissioner on the basis of the application of any criteria or on a random selection basis or
- (e) Where the Commissioner has reason to believe that detailed scrutiny of the case is necessary

2. **Appointment and Powers of the auditor :**

The business audit will be conducted by any officer authorised by the Commissioner in writing U/s 22. Such officer, during the Course of the audit, the audit officer may require the dealer

- (i) to afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place
- (ii) To afford him the necessary facility to check or verify the cash or stock which may be found therein
- (iii) To furnish such information as he may require as to any matter which may be useful for or relevant to any proceedings under this Act.

However, the officer conducting the audit CAN NOT remove or cause to be removed any books of account, other documents or any cash or stock in any circumstances..

Therefore, it follows that the business audit is carried out by the departmental officer at the place of business of the dealer prima facie to verify the compliance by the dealers such as .

- 1. To obtain Registration in time ,
- 2. To file correct, complete and self consistent returns(MVAT & CST)
- 3. To intimate important changes in the business change in ownership, conversion of partnership into private limited, shifting of place of business, change in name and style of business, change in activity within the prescribed time

4. To pay due taxes in time in the proper forms of return;
5. To disclose correctly tax liability, classification , set-off etc
6. To Comply with the departmental notices ;
7. To maintain proper books of account, invoices, declarations etc .
8. To get the account audited and submit audit report in time , if liable

3. Scope of Audit

The department has clarified that the business audit includes:-

1. To verify all books of account and relevant records
2. To know business and accounting system from the dealer.
3. To take statement on oath
4. To physically verify cash , stock or bank balances and seek clarification for any differences . However, the cash, stock or books cannot be removed from the dealer's premises.
5. To verify any records of any period and any issues in a financial year for which audit notice is given.
6. To take assistance of investigation branch with the approval of the Joint Commissioner if dealer does not co-operate .

The audit officer will inform the dealer about the discrepancies noticed by him and ensure remedial measure like filing of revised return, payment of tax etc

9. MVAT AUDIT – Section 61

10.1 Liability for audit ;

Section 61 of the MVAT Act 2002, prescribes mandatory audit in the following cases:

- (a) If turnover, either of sales or purchases, of a dealer who is liable to pay tax, exceeds Rs. 60 lakhs during the financial year, or
- b) A dealer or person who holds prescribed licences or permits for liquor spirit, beer, country liquor etc

10.2 Audit Report

Such dealers are required to get their returns and accounts audited by Chartered Accountants or a Cost Accountant and submit the report of the same in Form no. 704 to the department within a period of eight months from the end of the year to which the report

relates. i.e. audit report must be submitted on or before 30 November each year to avoid penalty.

10.3 Definition of Terms

- **‘Turnover of Sales’** means the aggregate of the amount of the sale price received and receivable by a dealer during the period, after deducting the sales price of the goods and amount of refund deposited with in a period of six month If a person is carrying on business at two or more places in same date under same R. C. No., the turnover of all such business shall be taken into consideration while calculating the prescribed turnover limit. -33(2)

- **‘Turnover of Purchases’** means the aggregate of the amount of the purchase price paid or payable by a dealer in respect of any purchase of goods made by him during the year after deducting the purchase price of the goods returned and amount of deposit refunded within a period of six months

- Turnover of all sale and /or purchase will include sale/ purchase of trading goods, scrap and movable capital assets. Further turnover of purchase will also include purchase of goods, which are debited to the profit and loss account.

- As per explanation, if the goods are delivered on hire purchase or any system of payment by instalment or in respect of the transfer of the right to use any goods for any purpose, the amount of purchase price paid or payable during a given period shall mean the aggregate of the amount paid and payable, for this purpose, during the given period.

10.4 Other Provisions

- If a dealer fails to get his accounts audited and furnish the “complete ‘report in form 704, he is liable to penalty equivalent to 1/10% of the turnover. Complete audit report means that all the items of Form 704, annexures, and schedules are filled up and consistent and arithmetically accurate. Such penalty will be imposed after giving opportunity f being heard.

- Departments of Central and State governments, Railways and Local authorities are excluded from the purview this section, hence audit is not applicable on them.

- A dealer is required to pay dues as per Audit Report within 30 days from receipt of notice and if not paid interest u/s 30(2) will be applicable.

- A dealer have to file single revised return for the entire year case of revision as per the audit report u/s 61 or as per intimation

u/s 63 of MVAT Act, 2002. With effect from 01/04/2016 revision of return has been allowed .

10. ILLUSTRATIONS

- 1) A dealer purchases the following goods in Maharashtra during December 2015:

Particulars	Total	Input Tax	Net Purchases
4 % VAT Goods	7,80,000	30,000	7,50,000
12.5% VAT Goods	15,75,000	1,75,000	14,00,000
VAT Exempt Goods	1,50,000	NIL	1,50,000

He also furnishes the following additional Information:

1. VAT payable on sales made during the month is Rs. 5,27,500
2. During December 2015 the dealer utilised 4% VAT Goods costing Rs. 1, 50,000 as input for manufacturing Exempted Goods.
3. On 01/02/2016 VAT Credit Receivable/Set off Account showed an opening balance of Rs. 10,000
4. The dealer has received a refund of Rs. 2,500 out of VAT Credit Receivable Account.

Prepare a statement of computation of Tax to be paid under the provisions of Maharashtra Value Added Tax Act 2002.

Solution:

Tax Payable	Rs.	5,27,500
<i>Tax Credit for tax Paid</i>	<i>Rs</i>	2,08,000
4% VAT Goods Rs 7,50,000	30,000	
12.5% VAT Goods Rs 15,75,000	<u>1,75,000</u>	
<i>Total Tax Paid</i>	<i>2,05,000</i>	
<i>Reduction under Rule 53 for goods used in manufacture of exempted goods – 3% of Rs 1,50,000</i>	<u>4,500</u>	
<i>Balance credit Available</i>	<i>2,00,500</i>	
<i>Add Opening balance</i>	<u>10,000</u>	
	<i>2,10,500</i>	
<i>Less –Refund Received</i>	<u>2,500</u>	
<i>TAX CREDIT AVAILABLE</i>	<u>2,08,000</u>	
VAT Payable	Rs	3,19,500

- 2) Prepare a statement of computation of Tax for the month of May 2015 to be paid under the provision of MVAT. 2002.

Particulars	Total	Input Tax	Net Purchases
Schedule C Goods	5,20,000	20,000	5,00,000
Schedule E Goods	11,25,000	1,25,000	10,00,000
Schedule A Goods	4,50,000	NIL	4,50,000

Additional Information:

- VAT collected on sales made during the month is Rs. 2,25,000/-
- During the month the dealer utilised Schedule C Goods costing Rs. 2,00,000 as fuel.
- There is brought forward of set off of Rs. 22,500/- from the last month.
- Amount debited to P & L Account for material is Rs. 10,000/- on which tax paid is Rs. 400/- @ 4%.
- Purchases of Schedule E Goods from Registered Dealer on which tax is not separately charged is Rs. 20,500/-

Solution:

Tax Payable	Rs.	2,25,000
Less: Tax Credit		
4% VAT Goods Rs	20,400	
12.5% VAT Goods	1,25,000	
	1,45,400	
<u>Less:</u> 3% on 2,00,000- fuel (Reduction under Rule 53	6,000	
	1,39,400	
Add: Opening Balance	22,500	1,61,900
VAT PAYABLE		63,100

- 3) Compute tax liability of M/s Sudha Enterprises for the month of December 2011 under the provision of MVAT Act, 2002

Particulars	Total	Input Tax	Net Purchases
Schedule C Goods	20,800	800	20,000
Schedule E Goods	3,60,000	40,000	3,20,000
Schedule A Goods	1,25,000	NIL	1,25,000

Additional Information:

1. VAT collected @ 4% on Sales during the month is Rs. 1,20,000
2. The dealer has purchased Office Equipment costing Rs. 40,000 tax paid is Rs. 5,000 @ 12.5%.
3. The dealer has made Branch Transfer of Schedule E goods purchased in the last month costing Rs. 1,00,000 (excluding tax).
4. There was an opening balance of Rs. 10,500/- in VAT Credit Receivable Account.
5. OMS Purchases was Rs. 30,000/- on which tax paid is Rs. 1,200/- @ 4%.

Solution;

Tax Payable	Rs.	1,20,000
Less: Tax Credit		
4% VAT Goods Rs	800	
12.5% VAT Goods (including office equipment)	45,000	
	45,800	
Less: Reduction under Rule 54		
on Branch Transfer 3% of Rs. 1,00,000- Sch. E goods 3,000		
Reduction on Capital Asset -3% on Rs 40,000 1,200	4,200	
	41,600	
<u>Add: Opening Balance</u>	10,500	52,100
VAT PAYABLE		67,900

11. SELF EXAMINATION QUESTIONS

- 1) Explain the Composition Scheme and its main features.
- 2) Which dealers are eligible to avail the Composition Scheme?
- 3) Which dealers are not eligible to avail the Composition Scheme?
- 4) Can a retailer having total turnover Rs. 40,00,000, of which Rs. 12,00,000 are of wholesale supply avail the composition Scheme?
- 5) Can a Hotel with four stars avail the Composite Scheme?
- 6) Explain who is an eligible retailer.

- 7) Show the amount of tax payable if Composition Scheme is availed
- 8) Explain the legal provisions governing the Composition Scheme.
- 9) Explain in detail the particulars in respect of the Composition Scheme if the same have to be availed of by a) Bakers b) Retailers c) Restaurants d) Second Hand Vehicle Dealers.
- 10) What is set off? What are the conditions for set off?
- 11) In what circumstances tax paid can be refunded?
- 12) When the set off can be reduced?
- 13) Set off achieves the uniformity of tax rates and avoids double taxation, Comment.
- 14) What are the rules for a hotel to claim set off?



Question Paper April 2015

- Note :** 1) Questions no. 1 and Question No. 2 from section I are compulsory.
 2) Answer any one question from Question no. 3 and question no. 4 from section - I.
 3) Answer all questions from section - II.
 4) Figures to the right indicate full marks.
 5) Working notes form part of answer.
 6) Use of simple calculator is permitted.

SECTION - I

1. Mr. Zebra, a resident aged 52 years, is running an homoeopathy clinic. His Income and Expenditure Account and other relevant information for the year ending 31st March, 2014 are given below. **(20)**

Expenditure	₹	Income	₹
Staff Salary	2,40,000	Fees	10,00,000
Clinic Rent	1,20,000	Dividend from Indian Companies (Gross)	10,500
Medicines	1,05,000	Winning from lotteries (net of TDS)	
Depreciation	81,000	(TDS ₹3,000)	7,000
Donation	20,000	Income Tax Refund	1,750
Administrative Expenses	1,52,000		
Net Profit	3,01,250		
	10,19,250		10,19,250

Other Information :

- 1) Depreciation in respect of all assets has been ascertained at ₹90,000 as per income tax rules.
- 2) Medicines of ₹22,000 have been used for his family.
- 3) Fees include ₹24,000 being honorarium for valuing homoeopathy examination answer books and balance from clients.
- 4) He has paid ₹25,000 as Life Insurance Premium for self.
- 5) Mr. Zebra has received interest on debentures of ₹31,000 (gross) on 1st January, 2014. It is not included in the above account.
- 6) Income tax refund includes interest ₹200 paid by Income Tax Department.
- 7) Administration expenses include ₹2,000 mediclaim insurance on life of grandfather.

From the above compute the total income and tax there on Mr. Zebra for the Assessment Year 2014-15.

- 2. A) Select most appropriate answer : (5)**
- 1) Income earned from a manufacturing business in Delhi, which is controlled from Nepal is chargeable to tax in case of
 - a) Resident and ordinary resident
 - b) Resident but not ordinarily resident
 - c) Non - resident
 - d) All of the above
 - 2) Y, an employee of B Ltd. (not being covered by payment of Gratuity Act, 1972) retires after rendering service for 15 years 11 months and 29 days. The completed years of service for calculating exemption of gratuity shall be
 - a) 15 years
 - b) 16 years
 - c) None of the above
 - 3) Interest on borrowed capital for the purpose of acquiring a capital asset pertaining to the period after the assets is first put to use is ----- while computing income from business.
 - a) Allowable
 - b) Dis allowable
 - c) None of the above
 - 4) Interest on borrowed capital is deductible under the head "Income from House Property"
 - a) On payment basis
 - b) On accrual basis or payment basis which ever is earlier.
 - c) On accrual basis
 - 5) Reimbursement of medical expenses incurred by the employee on his medical treatment
 - a) is full taxable
 - b) is exempt from tax upto ₹15,000 (balance is taxable)
 - c) is tax free, in case of Government Employees
 - d) None of the above
- 2. B) State whether the following statements are True or False. (10)**
- 1) Gross Annual Value of one self-occupied house property can not exceeds ₹1,50,000.
 - 2) Assessment year is a period of 12 months commencing on April 1st every year.
 - 3) Uncommuted pension from the Government is not chargeable to tax in the hands of employee.
 - 4) Tution fees paid for full time education of children outside India is deductible under section 80C.
 - 5) Computer used for business purpose is qualified for depreciation for business income.

- 6) Conversion of a capital asset into stock in trade is treated as 'transfer'.
 - 7) Share of profit received by a partner from his partnership firm is not chargeable to tax.
 - 8) Arrears of bonus received from former employer is taxable as income from other sources.
 - 9) Jewellery is a capital asset.
 - 10) Section 80DD provides deduction to an assessee who is non resident in India.
3. X and Y are equal owners of a house property. The property has four units of Which X and Y each owns two units. Each of them has let out one of two units on monthly rent of ₹30,000 (each unit remains vacant for one month) and the other unit is self occupied for own residence. Other expenses in respect of the property shared equally by the co-owners are :
Repairs ₹5,000; Municipal tax ₹60,000; Interest on capital (borrowed on 6th May 1998) ₹1,35,000.
Compute taxable income from house property of X and Y. **(15)**
4. Write short notes (any three) **(15)**
- a) Taxability of pension under salary
 - b) Pre-construction period interest
 - c) Deduction u/s 80 U
 - d) Capital Assets

SECTION - II

5. From the following details calculate the service tax payable by M/s CD Agencies registered service provider as advertising agency services under service tax. **(10)**
- i) Fees for designing and visualising of advertisement ₹2,40,000 (excluding service tax).
 - ii) Fees for procuring orders for advertisements for the Magazine ₹4,00,000 (excluding service tax).
 - iii) Fees for services rendered to the different departments of United Nations Organisation in relation to advertisement ₹7,00,000 (excluding service tax).
 - iv) Fees from Mr. Z for preparing banners ₹6,40,000 including cost of banners ₹2,00,000 (excluding service tax).
- Following expenses were Incurred for providing the taxable services.
- 1) Telephone charges ₹20,000 (excluding service tax).
 - 2) Mobile charges ₹30,000 (excluding service tax).
- Service tax rate is 12.36%.

6. A) Select the correct answer (AS per service tax). (5)

- 1) Revised return should be filled within ----- days of original return.
a) 30 b) 40 c) 90 d) 120
- 2) Credit of service tax on input services can be availed.
a) On use of input service
b) On payment of service tax by the service provided of input service
c) On receipt of Invoice
d) None of the above
- 3) Due date of payment of service tax for the month / quarter ending 31st March, 2015.
a) 5th April b) 31st March
c) 5th June d) none of the above
- 4) Maximum penalty for non-filing of service tax return within due dates is ₹-----.
a) 1,000 b) 20,000 c) 15,000
- 5) Return of service tax has to be filed
a) Monthly b) Half yearly c) Quarterly d) Yearly

B) State whether the following statements are True or False (Apply service tax) (5)

- i) Service tax is an Indirect Tax levied by Maharashtra Government.
- ii) Service provided free of cost is exempt from service tax.
- iii) An assessee has to submit a revised return in duplicate.
- iv) CENVAT credit cannot be taken on that portion of input services which are used for export of services.
- v) Service tax is applicable to whole of India except Jammu and Kashmir.

7. A) Mr. XYZ is a registered service provider. He gives the details to calculate his penalty on delay of payment of service tax. Ignore the exemption of small service provider. (5)

Quarter 2014-15	Service Tax 12.36% (₹)	Date of Payment of service tax
First	25,250	16 th July 2014
Second	66,660	12 th October, 2014
Third	80,240	15 th January 2015
Fourth	40,450	3 rd April 2015

- B)** Mr. BC is an architect, registered service provider, gives the following details to calculate his service tax liability for the quarter ended 31st March, 2015. **(5)**

	Excluding service tax
1. Map drawing fees from M/s AA Builders in Mumbai.	4,00,000
2. Map drawing fees from M/s KK Builders of UK for building in Mumbai.	5,00,000
3. Elevation fees from Mr. ZY at Thane for site at Thane.	8,00,000

- 8.** YY & Co., a registered dealer, request you to compute the liability of sales tax under MVAT Act, 2002, from the following information. **(10)**

Month	Sales within State		Purchase within State	
	Schedule B ₹	Schedule C ₹	Schedule B ₹	Schedule C ₹
January, 2015	28,00,000	50,00,000	20,00,000	4,00,000
February, 2015	16,00,000	9,00,000	5,00,000	5,00,000
March, 2015	4,00,000	24,00,000	3,00,000	13,50,000

Rate of VAT :

B → 1% C → 5%

- 9. A)** State whether the following can be considered as Goods under the MVAT Act 2002. **(5)**

- Chickens
- Loom Hours
- Equity shares
- Remote control
- Pain Balm

- B)** State whether the following can be considered as Sales under the MVAT Act 2002. **(5)**

- Exchange of old currency notes against new notes.
- Branch Transfer
- Donation to a trust
- Pledge of machinery
- Sale of scrap



Question Paper April 2016

- Note :** 1) Questions no. 1 and Question No. 2 from section I are compulsory.
 2) Answer any one question from Question no. 3 and question no. 4 from section - I.
 3) Answer all questions from section - II.
 4) Figures to the right indicate full marks.
 5) Working notes form part of answer.
 6) Use of simple calculator is permitted.

SECTION - I

1. Mr. Z, is a practicing Chartered Accountant furnishes the following particulars of his Receipts and Payments Account for the year ending 31-3-2015 (20)

Receipt and Payment Account for the year ended 31-3-2015

Receipts	₹	Payments	₹
Balance b/d	17,500	Office Salaries	15,000
Professional Fees	2,40,000	Office Rent	5,000
House Rent	22,500	Telephone Expenses	2,000
		Printing & Stationary	3,000
		Motor Car Expenses	8,000
		Sundry Expenses	5,000
		Furniture	
		(Purchased on 1/6/14)	50,000
		Income Tax	3,000
		Interest	20,000
		Expenses relating to the Property	
		Municipal Tax	5,000
		Repairs	2,000
		Balance c/d	1,62,000
	2,80,000		2,80,000

Compute the taxable income for Assistant Year 2015-16 after taking into account the following information.

- i) Mr. Z stays in his house property which is partly let out (50%) and partly self occupied. The annual value of which is ₹20,000. The following are expenses in respect of the let out part.
- | | |
|-------------|--------|
| Insurance | ₹1,500 |
| Ground Rent | ₹500 |

- ii) Only three-fourth of the motor car expenses relate to the profession.
- iii) Sundry expenses include ₹1,000 amount given to an employee as advance written off as irrecoverable and ₹1,500 as insurance premium on his health.
- iv) Depreciation on Furniture is 10% p.a. as per Income Tax Law and allowable depreciation on Motor Car is ₹4,000.
- v) Interest is paid on loan taken for his son's education in USA for post graduation specialization.

2) A) State followings as True or False. (10)

- 1) Indian companies are always Resident in India.
- 2) Advance salary is taxable in the year of receipt.
- 3) Family pension is Income from Other Sources.
- 4) Gross Annual Value is always more than Net Annual Value of house property.
- 5) Cost of improvement of goodwill is always taken as NIL.
- 6) Deduction under section 80C is available on "Payment" basis and not on "Accrual basis."
- 7) Indexation benefit is not available in the case of transfer of Bonds.
- 8) Loss arising from negligence or dishonesty of an employee is allowed as Business Loss/Expenses for calculating Business Income.
- 9) Rental income of a vacant plot of land is always taxable under the head "Income from House Property."
- 10) An assessee is always a "Person." However, a "Person" may or may not be an assessee.

B) Match the columns : (5)

<ul style="list-style-type: none"> • Mumbai University • Entertainment allowance deduction • Jewellery • Pre-acquisition interest on house property • Bonus to employees 	<ul style="list-style-type: none"> • Only to Government employees • An Artificial Juridical person • Deductible in five equal instalments • Deductible as expenditure when paid for Business Income • Capital asset
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3. Compute Mr. Suraj's taxable income for the Assessment Year 2015-16. (15)

- 1) Basic Salary 8,000 p.m.
- 2) Dearness Allowances 10% of Basic
- 3) Commission on sales turnover 16,000
- 4) Bonus 55,000
- 5) Leave Salary encashed 15,000

- 6) Arrears of salary (not taxed in earlier years) 75,000
- 7) Professional tax paid ₹5,000 of which ₹2,000 was paid by the employer.

He has following investments as on 1/4/2014 :

- 1) Fixed Deposits with SBI ₹10,00,000. Rate of interest is 8% p.a.
- 2) Deposits with companies ₹5,00,000. Rate of interest is 7% p.a.

In addition to above he has received the following.

- 1) Royalty for writing the books ₹3,00,000 (Gross)
- 2) Honorarium received from a college is ₹45,000.
- 3) Family pension of ₹52,000 on the death of his wife from her employer.

4. Write short notes (any three) (15)
 - 1) Short Term Capital Gain
 - 2) Advance tax payments
 - 3) Computation of income and tax of a partnership firm
 - 4) Exclusion from Total Income under Section 10
 - 5) Previous Year and Assessment Year

SECTION - II

5. M/s BK Ltd., a courier agency is registered service provider. From the following details calculate service tax liability of the agency. Service tax rate is 12.36%. (10)
 - 1) Received ₹4,80,000 (excluding service tax) for courier delivery services.
 - 2) Received ₹5,00,000 as a co-loader for sending goods to Pune.
 - 3) Dispatched medicines to WHO. Delivery charges charged ₹1,50,000.
 - 4) Received ₹2,50,000 for value of services to an Indian bank.
6. Determine the following as True or False (as per Service Tax Law). (10)
 1. Money for the purpose of valuation of taxable service includes cheques only.
 2. Point of Taxation shall be the time when the invoice for the service provided or agreed to be provided as issued.
 3. The rate of service tax shall be the rate in force at the time when the taxable service has been provided or agreed to be provided.
 4. A person seeking registration for service tax should file an application in form ST-2.

5. Every person who has provided a taxable service of value exceeding ₹9,00,000 in the financial year is required to register with the Service Tax Office, if not registered earlier.
 6. Failure to obtain registration would not attract penalty.
 7. Service Tax Return is required be filed twice in a financial year.
 8. If there is delay of 15 days in filing the return, the penalty is ₹15,000.
 9. The nature of records to be maintained and the form in which the records are to be maintained are left at the judgement of the assessee.
 10. Service recipient where liable to pay tax, has to calculate tax liability on the basis of the cost of providing the service.
7. Mr. KK, an architect is registered and liable for payment of service tax. He gives the following information to calculate his service tax liability. **(10)**

	₹ (Excluding Service tax)
1. Fees from a company at Japan, work done at Mumbai	5,00,000
2. Fees from a client at UK, work done at UK and amount received in foreign currency.	10,00,000
3. Fees from the Government	5,00,000
4. Fees from RBI	2,00,000

He has paid the following during the same period.

- 1) Telephone bills ₹12,036 (including service tax).
 - 2) Courier charges for delivery services ₹ 52,000 (including service tax). The service tax rate is 12.36%.
8. Rakesh & Co., a registered dealer request you to compute the liability of tax under MVAT Act, 2002 from the following information.

Month	Sales with in the State (₹)				Set-off (₹)
	Schedule A	Schedule B	Schedule D	Schedule E	
Jan. 2016	12,00,000	15,00,000	18,00,000	21,00,000	50,000
Feb. 2016	15,00,000	20,00,000	25,00,000	25,00,000	25,000
March 20 16	20,00,000	18,00,000	22,00,000	30,00,000	30,000

Rate of Tax :

Schedule A	= NIL
Schedule B	= 1%
Schedule D	= 20%
Schedule E	= 12.5%

9. State whether followings are True or False as per MVAT Act, 2002. **(10)**

1. VAT is a single point tax.
2. A chartered accountant is 'not a dealer under MVAT Act, 2002.
3. Sale price under MVAT Act, 2002 shall include tax paid or payable to a seller in respect of such sale.
4. All services are subject to MVAT Act, 2002.
5. Dealer registered based on limits of turnover is liable to pay tax on sales after date of registration.
6. VAT paid on purchase of capital asset is never eligible for full set off.
7. Central Sales Tax paid on inter-state purchase is eligible for set-off under MVAT Act, 2002.
8. A person who voluntarily desires to get registered has to deposit an amount of ₹5,00,000.
9. If a dealer files an incorrect return, the penalty may be equal to ₹50,000.
10. The turnover of sales for calculating registration liability includes export sales (out of India).

