

STUDY MATERIAL

PROFESSIONAL PROGRAMME

**ADVANCED DIRECT
TAX LAWS & PRACTICE**

GROUP 1

ELECTIVE PAPER 4.5



**THE INSTITUTE OF
Company Secretaries of India**

भारतीय कम्पनी सचिव संस्थान

IN PURSUIT OF PROFESSIONAL EXCELLENCE

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PROFESSIONAL PROGRAMME

ADVANCED DIRECT TAX LAWS & PRACTICE

The roles & duties of Company Secretary are very important in a business origination. In the Context of Direct Tax Laws, a Company Secretary is responsible for ensuring that a company meets its all legal and statutory requirements regularly, such as filing or managing tax returns timely, maintaining records and relevant documents related thereto. The Company Secretary can also act as an authorized representative before the Income tax authority with respect to assessment and appeals matter.

Keeping in mind the versatile role of Company Secretary in present era, the faculty of the Directorate of Academics publish this study material to aid the students in preparing for the Advanced Direct Tax Laws and Practice paper of the CS Professional Programme. It is part of the educational kit and takes the students step by step through each phase of preparation stressing key concepts, pointers and procedures. Company Secretaryship being a professional course, the examination standards are set very high, with emphasis on knowledge of concepts, applications, procedures and case laws, for which sole reliance on the contents of this study material may not be enough. Besides, as per the Company Secretaries Regulations, 1982, students are expected to be conversant with the amendments to the laws applicable for relevant examination. The material may, therefore, be regarded as the basic material and must be read along with the original Bare Acts, Rules, Orders, Case Laws, Student Company Secretary e-bulletin published and supplied to the students by the Institute every month as well as recommended readings given with each study lesson.

The subject of Advanced Direct Tax Laws & Practice is inherently dynamic and is subjected to constant refinement through new primary legislations, rules and regulations made thereunder and court decisions on specific legal issues. It therefore becomes necessary for every student to constantly update himself with the various changes made as well as judicial pronouncements rendered from time to time by referring to the Institutes journal 'Chartered Secretary' and 'Student Company Secretary e-bulletin' as well as other law/professional journals on tax laws. The purpose of this study material is to impart conceptual understanding to the students of the provisions of the Direct Tax covered in the Syllabus.

The legislative changes made upto October 31, 2025 have been incorporated in the study material. In addition to Study Material, students are advised to refer to the updations at the Regulator's website, supplements relevant for the subject issued by ICSI and ICSI Journal Chartered Secretary and other publications. Specifically, students are advised to read "Student Company Secretary" e-Journal which covers regulatory and other relevant developments relating to the subject, which is available at academic portal <https://www.icsi.edu/academic-portal/>. In the event of any doubt, students may contact the Directorate of Academics at academics@icsi.edu.

The amendments to law made upto 31st May of the Calendar Year for December Examinations and upto 30th November of the previous Calendar Year for June Examinations shall be applicable.

Although due care has been taken in publishing this study material, the possibility of errors, missions and /or discrepancies cannot be rules out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

Note: This study material is based on Finance Act, 2025 applicable for Assessment Year 2026-27. Besides, as per the Company Secretaries Regulation, 1982, students are expected to be conversant with the amendments to the laws applicable for respective exam.

PROFESSIONAL PROGRAMME
Group 1 • Elective Paper 4.5
ADVANCED DIRECT TAX LAWS & PRACTICE

SYLLABUS

OBJECTIVES: To acquire expert knowledge on practical application of Direct Tax Laws

Advanced Direct Tax Laws & Practice (100 Marks)

1. Computation of Total Income, Tax Liability and Filing of Returns of various entities excluding Companies

Computation of Total Income and Tax liability of Individual, Hindu Undivided Family 'HUF', Partnership Firm / LLP, Co-operative Societies, Association of Person 'AOP' and Body of Individual 'BOI', Filing of Income Tax Return, Technological aspects of tax compliances [Practical Questions, Case Laws and Case Studies]

2. Computation of Total Income, Tax Liability and Filing of Return of Companies

Computation of taxable income and tax liability of Company including Foreign Company, Filing of Return [Practical Questions, Case Laws and Case Studies]

3. Income Tax Implication on specified transactions

Taxation on Dividend Income, Slump Sale; Restructuring; Buy Back of shares; Redemption of Preference shares; Issue of shares at Premium; Transfer of shares; Reduction of share Capital; Equalization Levy, Carbon Credit [Practical Questions, Case Laws and Case Studies]

4. Tax Audit

Introduction, Provision of Section 44AB, Tax Auditor, Tax Audit Report, Analysis of various clauses in Tax Audit Report, Penalty for non-compliance

5. Assessment

Assessment, Types of Assessments, Self-Assessment, Inquiry, Scrutiny Assessment, Best Judgement Assessment, Income Escaping Assessment, Faceless Assessment

6. Appeals

Commissioner of Income Tax (CIT) Appeals, Appeals before Income Tax Appellate Tribunal (ITAT), Appeals before High Court, Appeal Before Supreme Court, Faceless Appeals, Revision of Orders

7. Transfer Pricing & General Anti Avoidance Rules "GAAR"

Introduction & Concept of Arm's Length Price; International and Specified Domestic Transaction; Transfer Pricing Methods; Advance Pricing Agreement & Roll Back Provision; Documentation and Return, Basic concept of GAAR; Impermissible avoidance arrangement; Arrangement to lack commercial substance; Application of GAAR Rule; GAAR v/s SAAR.

8. Double Taxation Avoidance Agreement (DTAA)

Introduction, Double Taxation Avoidance Agreement, Necessity for DTAA, Objectives of Tax Treaties, Juridical Double Taxation, Economic Double Taxation, Double Taxation Relief, Unilateral Relief from Double Taxation, Bilateral Relief from Double Taxation.

Annexure - Reports and Certificates under Income Tax Law

ARRANGEMENT OF STUDY LESSONS

ADVANCED DIRECT TAX LAWS & PRACTICE

Group 1 • Elective Paper 4.5

ADVANCED DIRECT TAX LAWS & PRACTICE

Sl. No. Lesson Title

1. Computation of Total Income, Tax Liability and Filing of Returns of various entities excluding Companies
2. Computation of Total Income, Tax Liability and Filing of Return of Companies
3. Income Tax Implication on specified transactions
4. Tax Audit
5. Assessment
6. Appeals
7. Transfer Pricing & General Anti Avoidance Rules “GAAR”
8. Double Taxation Avoidance Agreement (DTAA)

Annexure – Reports and Certificates under Income Tax Law

PROFESSIONAL PROGRAMME

ADVANCED DIRECT TAX LAWS & PRACTICE

An income tax is a tax that governments impose on income generated by businesses and individuals within their jurisdiction. By law, taxpayers must file an income tax return annually to determine their tax obligations. Income taxes are a source of revenue for governments. They are used to fund public services, pay government obligations, and provide goods for citizens.

Income Tax Act, 1961 provides for levy, administration, collection and recovery of Income Tax. It provides progressive rate schedule, exemption limits, and incorporates number of incentive provisions. It provides sound tax system. Rate schedule & Exemption limits are prescribed by Finance Act.

Indian tax legislative and judicial environment is constantly evolving, along with globalization, economic shifts, and operational adjustments. Businesses are faced with a tax regime with greater complexities and challenges, nonetheless moving towards a globally cohesive tax world. Now, more than ever, businesses must have an ongoing system for adapting to and staying on top of these complex changes.

The tax laws of the country undergo significant changes every year on the passing of Annual Finance Act. Apart from the amendments coming out every year through the Finance Act, there are circulars / notifications issued by the CBDT to implement the provision of the act, clarifying the scope of the provision.

The study material contains detailed provisions related to Direct Taxes and comprises of Total 8 lesson. The broad coverage of the lessons is summarized below.

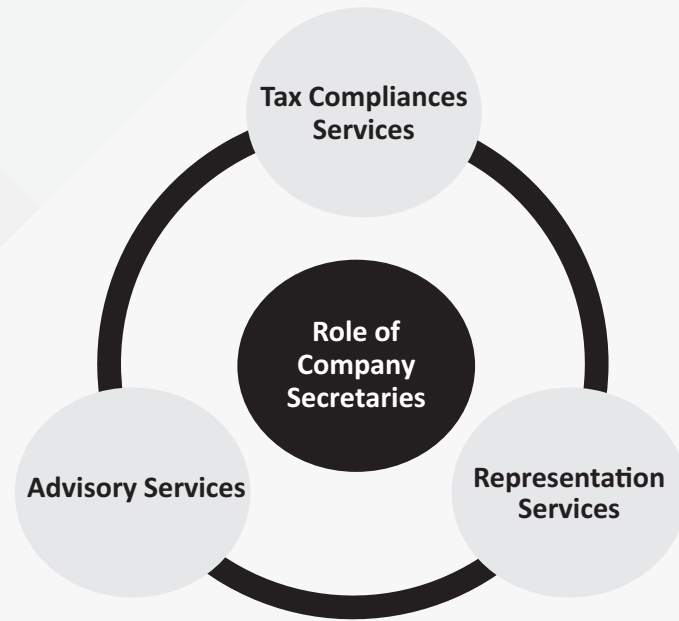
1. Computation of Total Income, Tax Liability and Filing of Returns of various entities excluding Companies
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3. Income Tax Implication on specified transactions
4. Tax Audit
5. Assessment
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8. Double Taxation Avoidance Agreement (DTAA)

Annexure – Reports and Certificates under Income Tax Law

ROLE OF COMPANY SECRETARIES IN DIRECT TAX LAW

The Company Secretaries as experienced tax professionals can assist in resolving various challenges such as keeping abreast with tax regulations, efficiently manage compliances, address uncertain tax positions, among many others. The Company Secretaries can provide with an insight into how to best work to meet the business needs.

The following are the key important areas under the direct tax regime where a Company Secretaries can play a vital role.

**Tax Compliance Services:**

As the complexities of businesses increase, the amount of time spent by professionals in cracking up the law codes increases. However, tax and regulatory systems of even the most developed countries cannot keep pace with the developments across each industry as businesses emerge day by day. These also bring out the requirements for new compliances and the challenges of meeting them every single day. More detailed Income Tax Return forms including disclosures on tax residency certificates and details of foreign assets, and higher penalties for non-disclosures require businesses to gear up for efficient tax compliance. Following are the areas or avenues where company secretaries can assist client:

- Assist in obtaining Permanent Account Number 'PAN No.' Tax Deduction / Collection Account Number 'TAN No.'
- Filling of Income tax Returns
- Filling of TDS / TCS returns
- Tax Payroll assistance
- Income tax clearance certificate
- Tax Residency Certificate

Advisory Services: Corporate taxation is an essential aspect of doing business in India and its importance cannot be undermined. The Company Secretaries can provide the corporate tax advisory services in the following areas:

- Establishing tax efficient Indian business presence for an MNC.
- Planning a heavy capital outlay in the existing business
- Addressing concerns about cash flow and examining tax inefficiencies
- Ensuring that the tax function is aligned with the business plan
- Assessing the impact of any tax and regulatory changes/ amendments

Representation Services: The Appellate hierarchy in India consists of assessing officer, first appellate authority, Appellate Tribunal, High Court and Supreme Court. The Company Secretaries can provide the following range of services comprise of:

- Assisting in filing appeals before the appellate authorities and complying with appellate requirements and procedure
- Determining the appeal strategy and approach and drafting of legal submissions
- In-house service of the expert counsel with experience in representation before appellate authorities
- Advising on the course of action to be adopted before revenue authorities to mitigate the risk of penal consequences
- Reviewing pending litigation and other uncertain tax positions, to comment on adequacy of defense, probability of success and prevention of recurrence
- Assisting the external legal counsel in preparing or representing for appeals, writ petition and special leave petition before the Supreme Court and court subordinate to it (High Court).

LESSON WISE SUMMARY

ADVANCED DIRECT TAX LAWS & PRACTICE

Lesson 1: Computation of Total Income, Tax Liability and Filing of Returns of various entities excluding Companies

The taxes are the basic source of revenue for the Government. Revenue raised from the taxes are utilized for meeting expense of Government like, provision for education, infrastructure facilities such as roads, dams etc. Taxes are broadly divided into two parts i.e., direct taxes and indirect taxes. The tax that is levied directly on the income or wealth of a person is called direct tax. Income tax is one of form of direct taxes. The levy of income tax in India is governed by the Income Tax Act, 1961 and Income Tax Rules, 1962. It is charged on the Total Income and to derive the total income one must know certain concepts of the Income Tax Act, such as residential status, assessment year, previous year, assessee etc. Income tax is leviable on taxable income and to determine taxable income, residential status of the person and scope of total income are the initial steps.

For calculation of income, amount received is classified under 5 heads of income; it is then to be adjusted with reference to the provisions of the income tax laws. The coverage of the lesson would include the income tax treatment with relation to individual, Hindu Undivided Families (HUF), Firms, Associations of Persons and Co-operative Societies is being discussed. The Tax implications, rates of tax and other issues relating to the above persons have been discussed elaboratory. Further, the lesson also includes the provision related to filing of Income tax Returns.

Lesson 2: Computation of Total Income, Tax Liability and Filing of Return of Companies

In the previous lessons we have learn the tax provisions of persons not being the company. Here, we will go through the income tax provisions of corporate entity. The coverage of the lesson would include the Computation of taxable income and tax liability of Company including Foreign Company. The provision relating to computation of Books Profits, Minimum Alternate Tax (MAT) etc. Further, the lesson also includes the provision related to filing of Income tax Returns in case of companies.

Lesson 3: Income Tax Implication on specified transactions

The coverage of the lesson includes:

- Tax implication on Dividend Income
- Tax implication in case of Buy Back of Shares
- Tax implication in case of Slump Sale
- Tax implication on issue of Shares at Premium
- Tax implication in case of Transfer of Shares
- The tax implication on Reduction of Share Capital
- Provision related to Equalization Levy
- Provision related to Carbon Credit
- Tax Implication in case of Restructuring of Business (Amalgamation / Merger / De-merger)

Lesson 4: Tax Audit

The provisions of Tax Audit were first introduced in the Finance Act, 1984. Tax audit is an examination or review of accounts of any business or profession carried out by taxpayers from an income tax perspective. Any business entity or an individual exceeding certain threshold limits of turnover is liable to get the accounts audited.

The coverage of the lesson includes:

- The provisions related to applicability of Tax Audit
- Objectives of Tax Audit
- Provisions related to Tax Auditor
- Tax Audit Report [Form 3CA/3CB – 3CD]
- Analysis of various clauses in Tax Audit Report
- Penalty for non-compliance

Lesson 5: Assessment

Every assessee has to submit his income details to the income tax department by filing his Income tax return. After submission of return of income, the next step is the processing of the income tax return by the income tax department. While processing, department verifies and examines the correctness of the income details provided by assessee. This process of examining the income tax return by the Income Tax Department is called “Assessment”.

The coverage of the lessons includes:

- Types of Assessment
- Self-Assessment
- Inquiry before Assessment
- Summary Assessment/Processing of Return
- Scrutiny Assessment
- Best Judgement Assessment
- Income Escaping Assessment
- Faceless Assessment
- Time Limit to complete the Assessment, Reassessment & Re-computation
- Faceless Assessment of Income Escaping Assessment
- Rectification of Mistakes

Lesson 6: Appeals

The right to appeal must be given by express enactment in the Act. Therefore, in case there is no provision in the Act for filing an appeal regarding a particular matter, no appeal shall lie. The right to appeal arises where the taxpayer is aggrieved by the order passed by the income-tax authority. However, where the Assessing Officer accepts the return filed by the tax payer and passes an order making no modification, an appeal does not lie against that order as the taxpayer cannot be said to be aggrieved of that order. Similarly, where an appellate authority accepts the contention of the taxpayer and allows the appeal, there is no further appeal by the assessee against that order.

The assessee may prefer an appeal against the orders of the Assessing Officer to the Joint Commissioner (Appeals) or Commissioner (Appeals) as the case may be, in accordance with the relevant provisions under Section 246 or 246A and appeal against the order of the Joint Commissioner (Appeals) or Commissioner (Appeals) can be preferred by the Assessee or the Income Tax Authority and such appeal lies with the Appellate Tribunal.

The assessee or CIT if not satisfied with the order of the tribunal can appeal directly to the High Court, if High Court is satisfied that the case involve a substantial question of law and if the assessee or Commissioner of Income-tax is not satisfied with the order passed by the High Court they may file an appeal against the order of the High Court to the Supreme Court. However, it should be noted that in the case of question of fact tribunal is the final & binding authority and its decision is final.

The coverage of the lessons includes:

- The provisions related to appeal before Joint Commissioner (Appeal) / Commissioner (Appeal)
- The provisions related to appeal before Income Tax Appellate Tribunal 'ITAT'
- The provisions related to appeal before High Court
- The provisions related to appeal before Supreme Court
- The provisions related to Revision of orders prejudicial to the interest of Revenue or Assessee

Lesson 7: Transfer Pricing & General Anti Avoidance Rules “GAAR”

In this lesson we will discuss the two important concept / provisions of Income Tax Laws:

Transfer Pricing Provisions in India: After the liberalization of Indian economy and easing of restrictions on the entry of foreign entities, cross border business transactions have increased manifold. With the ratification of WTO by the Government of India, our economy has become robust and an atmosphere has sprung up where FII investments in India have increased tremendously. All these economic activities have ramifications for tax laws of the country.

The Finance Act, 2001 introduced law of transfer pricing in India through Sections 92 to 92F of the Income Tax Act, 1961 which guides computation of the transfer price and suggests detailed documentation procedures.

General Anti Avoidance Rules ‘GAAR’ - Since the liberalization of the Indian economy, increasingly sophisticated forms of tax avoidance are being adopted by the taxpayers and their advisers. The problem has been further compounded by tax avoidance arrangements spanning across several tax jurisdictions. This has led to severe erosion of the tax base. Further, appellate authorities and courts have been placing a heavy onus on the Revenue when dealing with matters of tax avoidance even though the relevant facts are in the exclusive knowledge of the taxpayer and he chooses not to reveal them. This emphasises upon the need of having a general anti-avoidance rule, which will act as a dampener to such transactions in line with best practices around taxation internationally.

The coverage of the lesson would include:

- The need of GAAR provisions in India
- Impermissible avoidance agreements
- Specific anti avoidance rules
- Case study on invoking the provision of GAAR
- The exclusion of GAAR / circumstances where GAAR cannot be invoked

Lesson 8: Double Taxation Avoidance Agreement (DTAA)

A tax treaty is a bilateral agreement made by two countries to resolve issues involving double taxation of passive as well as active income. Tax treaties generally determine the amount of tax that a country can levy to a taxpayer's income, capital.

Many countries have entered into tax treaties (also called double tax agreements, or DTAs) with other countries to avoid or mitigate double taxation. Such treaties may cover a range of taxes including income taxes, inheritance taxes, value added taxes, or other taxes.

The coverage of the lesson would include:

- The meaning of Tax Treaty?
- Source Rule v/s Residence based taxation
- Types of Double Taxation
- Economic Double Taxation, Juridical Double Taxation
- Objectives and Need of DTAA
- Application of Tax Treaty
- Interpretation of Tax Treaty

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Computation of Total Income, Tax Liability and Filing of Returns of various Entities excluding Companies

Lesson 1

KEY CONCEPTS

- Individual ■ Hindu Undivided Families 'HUF' ■ Firm ■ Partner ■ Partnership ■ Alternate Minimum Tax 'AMT' ■ Book Profit
- Association of Person 'AOP' ■ Body of Individual 'BOI' ■ Signing of Returns

Learning Objectives

To understand the:

- The Tax Rates applicable to various entities excluding Companies
- The Computation of Total Income and Tax Liability of Individuals
- Special Provisions for computation of Total Income and Tax Liability u/s 115BAC
- Special provisions for computation of Total Income and Tax Liability u/s 115BAD / 115BAE
- Concept of Hindu Undivided Family 'HUF' and how HUF comes into existence?
- When and How HUF can be partitioned?
- What are the Tax implications before and after partition of HUF?
- What is Partnership Firm?
- What are the Tax implications in the hands of Partners and Firm?
- What is Book Profit?
- What are Admissible Expenses/ Inadmissible expenses while calculating the Book Profit of the Firm?
- What are the provisions of Alternate Minimum Tax 'AMT'?
- What is Association of Persons and how it is formed?
- What is the method of computation of share of a member of 'AOP'?
- What is Co-operative Societies and how the tax liability of Co-operative societies is determined?
- What is Return of Income?
- Persons who have to compulsorily file the Return of Income
- Due dates for filing Return of Income
- Consequences for late filing of Return of Income
- Person who are authorized to verify the Return of Income
- Payment of Self-Assessment Tax before filing Return of Income

Lesson Outline

- Introduction
- Tax Rates
- Special Tax Regime for Individual & HUF
- Special Tax Regime Applicable to a Co-operative Societies
- Taxation of Individuals
- Taxation of Hindu Undivided Families 'HUF'
- Computation of Income of Hindu Undivided Families ('HUF')
- Taxation of Firms
- Computation of Book Profit
- Alternate Minimum Tax 'AMT'
- Taxation of Association of Persons / Body of Individual
- Taxation of Co-Operative Societies
- Lesson Round-Up
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

Sections	Income-tax Act, 1961
Section 115BAC	Special Tax Regime for Individual, HUFs, AOP, BOI, Artificial Juridical Person
Section 115BAD	Special Tax Regime applicable to a Co-Operative Societies
Section 115BAE	Tax on Income of Certain New Manufacturing Co-Operative Societies
Section 87A	Rebate
Section 171	Partition of a Hindu Undivided Family
Section 184	Assessment as a Firm
Explanation 3 to section 40(b)]	Meaning of Book Profit
Section 188	Succession of one firm by another firm
Section 188A	Joint and Several Liabilities of Partners for Tax Payable by Firm
Section 189	Firm Dissolved or Business Discontinued
Section 115JC to 115JF	Alternate Minimum Tax (AMT)
Section 67A	Method of Computing Share of a Member of Association of Persons / Body of Individuals
Section 177	Assessment in case of Dissolution of an Association of Persons
Section 2(10)	Meaning of Co-operative Society
Section 80P	Deduction in respect of Income of Co-operative Societies
Section 139(1)	Due Date of Filing of Return of Income
Section 140	Verification of Return of Income
Section 140A	Self-Assessment Tax

INTRODUCTION

Under the scheme of Indian Income Tax Act 'the Act', the income of a tax-payer falls in one or more of the following heads of income:

- (i) Income from Salaries
- (ii) Income from House Property
- (iii) Profits and Gains from Business or Profession
- (iv) Capital Gains
- (v) Income from Other Sources.

Specific provisions are contained in the Act for computation of income under each head of income. Income from different sources under each 'head of income' is to be separately computed. For example, a person may be the owner of more than one business in which case, the profit of each business will be computed separately and total of all will be the income under the head 'profits and gains from business or profession'. Similarly, a person may earn capital gains from more than one transaction in which case gains arising from each transfer is to be separately computed and the total of such gains will come under the head 'Capital gains'.

Further, if there is income from one source and loss from another source falling within the same head of income the loss will be adjusted (technically known as set off) against the income of another source and only the net figure will be the income under the head. If, for example, there is profit of Rs. 50,000 from business 'A' and loss of Rs. 30,000 from business 'B', it is only Rs. 20,000 after such intra-head adjustment that will be 'profit from business'.

Having computed income under individual heads, the next step is the aggregation of income under all the heads. If the income computed under any head or heads is a loss, such loss is allowed to be adjusted against the income under other heads subjects to certain exceptions. After the inter-head set off mentioned in above, the next step is to allow set-off of the past losses.

The income of each head after inter-head set off and set off of carried forward losses as mentioned above is then aggregated to give Gross Total Income.

Next step for calculation of taxable income is the deduction. The Gross Total Income is reduced by the deductions mentioned in Chapter VIA (If applicable). It is important to note that such deductions cannot exceed the Gross Total Income. After the deductions are made the resulting figure is total income which is subjected to tax at the rate or rates mentioned in the Finance Act.

The Basic Concept of Income Tax, Definition such as Person, Assessee, Assessment Year, Previous Year, Residential Status, Computation of Total Income under each head of Income, Deductions, Set-off and carried forward, and Clubbing provisions have already discussed in details at Executive Level.

Further, the above steps are illustrated below for better understanding. Taxable income of an assessee shall be calculated in the following manner:

1. Determine the residential status of the person.
2. Determine the Taxation Regime whether Old Taxation regime (OTR) or New Taxation Regime (NTR)
3. Calculate the Income as per the provisions of respective Heads of Income. Section 14 classifies the income under five heads.
 - (i) Income from Salaries
 - (ii) Income from House Property
 - (iii) Profits and Gains from Business or Profession
 - (iv) Capital Gains
 - (v) Income from Other Sources.
4. Consider all the Deductions and Allowances given under the respective heads before arriving at the net under each head. Exclude the Incomes exempt under section 10 of the Act.
5. Aggregate of Incomes computed under the 5 heads of income after applying Clubbing provisions and making adjustments of set off and carry forward of losses to derive Gross Total Income.
6. Deduct therefrom the deductions admissible under Sections 80C to 80U (If applicable). The balance is called Total Income.

7. The total income is rounded off to the nearest multiple of Rupees ten. (Section 288A)
8. Add Agriculture Income (if any) in the total income. Then calculate tax on the aggregate as if such aggregate income is the Total Income.
9. Calculate income tax on the net agricultural income as increased by Rs. 2,50,000 / 3,00,000 / 5,00,000 as the case may be, as if such increased net agricultural income were the total income.
10. The amount of income tax determined above will be deducted from the amount of income tax determined above.
11. Calculate income tax on capital gains under Section 112, 112A, 111A and on other income at specified rates.
12. The balance of amount of income tax left as per (10) above plus the amount of income tax at (11) above will be the income tax in respect of the total income.
13. Deduct the following from the amount of tax calculated under (12) above.
 - (i) Rebate under section 87A (if applicable).
 - (ii) Tax deducted and collected at source.
 - (iii) Advance tax paid.
 - (iv) Double taxation relief (Section 90 or 91).
14. The balance of amount left after deduction of items given in (13) above, shall be the net tax payable or net tax refundable for the assessee. Net tax payable/refundable shall be rounded off to the nearest multiple of Ten rupees (Section 288B).
15. Along with the amount of net tax payable, the assessee shall have to pay late fee, penalties or fines, if any, imposed on him under the Income-tax Act.

For calculation of income, amount received is classified under 5 heads of income; it is then to be adjusted with reference to the provisions of the Income Tax laws in the following manner.

Computation of Tax Liability	Sections	Amount
1. Income from Salary Less: Deduction's u/s 16 i. Standard Deduction of Rs. 50,000 or Gross Salary, whichever is lower in Old Tax regime. From FY 2024-25 onwards, Standard Deduction of Rs. 75,000 or Gross Salary, whichever is lower in New Tax regime. ii. Entertainment Allowance (allowed only for Old Tax Regime) iii. Professional Tax Paid (allowed only for Old Tax Regime)	15 to 17	XXX
2. Income from House Property Less: Deduction u/s 24 Standard Deduction Interest on House Property Loan	22 to 27	XXX

Computation of Tax Liability	Sections	Amount
3. Income from Profits and Gains from Business and Profession Turnover / Receipts / Fees / Sales Less: Deduction's u/s 30 to 37(1)	28 to 44	XXX
4. Income from Capital Gains Full value of consideration Less: Cost of acquisition/Cost of Improvement/Transfer expenses Less: Exemption u/s 54/54B/54EE etc.	45 to 55A	XXX
5. Income from Other Sources Income u/s 56 Less: Deduction's u/s 57	56 to 59	XXX
Add: Clubbing of Income Less: Set Off & Carry Forward Provisions under respective heads		XXX (XXX)
Gross Total Income [GTI]		XXX
Less: Deductions under Chapter VIA (If applicable) (allowed only for Old Tax Regime except some exceptions)	80C to 80U	(XXX)
Total Income (Rounded off to nearest Rs.10 u/s 288A)		XXX
Tax on Total Income		XXX
Add: Surcharge on Total Tax (if applicable)		XXX
Less: Rebate u/s 87A		(XXX)
Add: 4% Health & Education Cess on [Total tax + Surcharge – Rebate]		XXX
Net Tax Liability		XXX
Less: (i). TDS/TCS (ii). Advance Tax (iii). Relief u/s 89		(XXX)
Balance Tax Payable on Self-Assessment [Section 140A]		XXX

TAX RATES FOR FY 2025-26 I.E. AY 2026-27**Calculation of Tax on Income**

- Tax rate depends upon the category of person
- Taxation Regime
- Amount of Income
- Residential status of person
- Age of Individual
- Type of Income

Components of Tax

Tax	+	Surcharge	+	Education Cess	+	SHEC	=	Tax Payable

Tax Rates for Different types of persons depending upon various parameters:

1. For:

- Resident Individual of the age below 60 years
- Non-Resident Individual
- Hindu undivided family
- Association of Persons
- Body of Individuals (other than Co-operative society)
- Artificial Juridical Person

Total Income (Rs.)	Tax Rate	Tax liability (Rs.)
Upto 2,50,000	Nil	Nil
2,50,001 – 5,00,000	5%	5% of (Total Income – 2,50,000)
5,00,001 – 10,00,000	20%	20% of (Total Income – 5,00,000) + 12,500
Above 10,00,000	30%	30% of (Total Income – 10,00,000) + 1,12,500

2. Applicable for:

Resident individual of the age of 60 years or more but less than eighty years at any time during the previous year

Total Income (Rs.)	Tax Rate	Tax liability (Rs.)
Upto 3,00,000	Nil	Nil
3,00,001 – 5,00,000	5%	5% of (Total Income – 3,00,000)

Total Income (Rs.)	Tax Rate	Tax liability (Rs.)
5,00,001 – 10,00,000	20%	20% of (Total Income – 5,00,000) + 10,000
Above 10,00,000	30%	30% of (Total Income – 10,00,000) + 1,10,000

3. Applicable for:

Resident Individual of the age of 80 years or more at any time during the previous year

Total Income (Rs.)	Tax Rate	Tax liability (Rs.)
Upto 5,00,000	Nil	Nil
5,00,001 – 10,00,000	20%	20% of (Total Income – 5,00,000)
Above 10,00,000	30%	30% of (Total Income – 10,00,000) + 1,00,000

CBDT has clarified vide Circular No. 28/2016 27.07.2016, that a person born on 1st April would be considered to have attained a particular age on 31st March, the day preceding the anniversary of his birthday.

Therefore, a resident individual, whose 60th / 80th birthday falls on 1st April, 2026 would be treated as having attained the age of 60 years/80 years in the P. Yr. 2025-26.

4. For Firm and Local Authorities:

Types of persons	Tax Rates
Firms (including LLP)	30% of total Income
Local Authorities	30% of total Income

Good to Know: Entity or individual other than a company whose adjusted total income exceeds Rs. 20 lakhs are liable to pay Alternate Minimum tax @ 18.5%.

5. For Co-operative Society:

Income Slabs		Tax Rates
i.	Where the taxable income does not exceed Rs. 10,000	10% of the income
ii.	Where the taxable income exceeds Rs. 10,000 but does not exceed Rs. 20,000	Rs. 1,000 + 20% of income in excess of Rs. 10,000
iii.	Where the taxable income exceeds Rs. 20,000	Rs. 3,000 + 30% of the amount by which the taxable income exceeds Rs. 20,000

Surcharge

Surcharge is an additional tax imposed on certain cases. It is imposed over the basic tax rate calculated on the income.

For example: Suppose total taxable income of an individual of 45 years is Rs. 1,30,00,000, then Base tax will be: Rs. 1,12,500 + 30% of (1,20,00,000) = Rs. 37,12,500.

Surcharge @ 15%* of Rs. 37,12,500 = Rs. 5,56,875. There are different rates of surcharge prescribed in the following manner:

S. No.	Types of persons	Income	Surcharge Rates
i.	Individuals, HUF, AOP, BOI	If Income exceeds Rs. 50 lakhs but does not exceed Rs. 1 crores	10% of income tax
		If income exceeds Rs. 1 crore but does not exceed Rs. 2 crores	15% of income tax
		If income exceeds Rs. 2 crores but does not exceed Rs. 5 crores	25% of income tax
		If total income exceeds Rs. 5 crores	37% of income tax
ii	Firm/Local Authority	If income exceeds Rs. 1 crore	12% of income tax
iii	Co-operative Society	If income exceeds one crore rupees but not exceeding ten crore rupees	7%
		If total income exceeds ten crore rupees	12%

Marginal Relief in Surcharge

When an assessee's taxable income exceeds applicable slab mentioned above, for example, exceeds Rs. 1 crore, he is liable to pay Surcharge at prescribed rates mentioned above on Income Tax payable by him. However, the amount of Income Tax and surcharge on total income shall not exceed the amount of income that exceeds the respective slabs, for example, Rs. 1 crore.

Health and Education Cess 'HEC'

- Governments resort to imposition of cess for meeting specific expenditure.
- Education Cess and Secondary and Higher Education Cess are additional levy on the basic tax liability + surcharge, if applicable.
- Rate of Education Cess – 2%
- Rate of SHEC – 1%.
- Rate of Health Cess – 1%.
- Total HEC – 4%

Example: Suppose Mr. Ram an individual assessee of 42 years is having taxable income of Rs. 1,00,01,000/- assuming Mr. Ram is covered under Old Taxation regime

Particulars		Amount (Rs.)
1.	Income Tax	Rs. 28,12,800
2.	Surcharge @ 15% of Income Tax	Rs. 4,21,920

Particulars		Amount (Rs.)
3.	Income Tax on income of Rs. 1 crore including 10% Surcharge	Rs 30,93,750
4.	Maximum Surcharge payable (Income over Rs. 1 crore i.e. Rs. 1,000)	Rs. 1,000
5.	(Income Tax + Surcharge) payable	Rs. 30,94,750
6.	Add 4% HEC	Rs. 1,23,790
7.	Total Tax Payable	Rs. 32,18,540

Thus, in the above case, though the surcharge @15% is Rs. 4,21,920. However, since the income of Mr. Ram exceeds Rs. 1 crore by just Rs. 1,000, Ram will be eligible for marginal relief and maximum surcharge will be restricted to Rs. 281250 plus Rs. 1,000 only.

SPECIAL TAX REGIME FOR INDIVIDUAL, HUFs, AOP, BOI, ARTIFICIAL JURIDICAL PERSON [SECTION 115BAC]

New Taxation regime u/s 115BAC was introduced from A/Y 2021-22 by Finance Act, 2020. The Finance Act, 2023, had made new Taxation regime as the default tax regime from Assessment Year 2024-25 onwards. Below rates are applicable from Assessment Year 2026-27:

Total Income (Rs)	Rate
Up to 4,00,000	Nil
From 4,00,001 to 8,00,000	5%
From 8,00,001 to 12,00,000	10%
From 12,00,001 to 16,00,000	15%
From 16,00,001 to 20,00,000	20%
From 20,00,001 to 24,00,000	25%
Above 24,00,000	30%

Surcharge: Surcharge is levied on the amount of income-tax at following rates if total income of an assessee exceeds specified limits:

Rs. 50 Lakhs to Rs. 1 Crore	Rs. 1 Crore to Rs.2 Crores	Exceeding Rs. 2 Crores excluding dividend & income u/s 111A, 112, 112A
10%	15%	25%

Note 1: The enhanced surcharge of 25% or 37% is not levied, on income by way of dividend or from income chargeable to tax under sections 111A, 112, 112A and 115AD(1)(b). Hence, the maximum rate of surcharge on tax payable on such incomes shall be 15%. Also, the surcharge rate for AOP with all members as a company, shall be capped at 15%.

Note 2: Marginal relief is available from surcharge.

Note 3: Health and Education Cess: Health and Education Cess is levied at the rate of 4% on the amount of income-tax plus surcharge.

Alternate Minimum Tax: The assessee who are paying tax as per section 115BAC have been kept out of the purview of Alternate Minimum Tax (AMT) of section 115JC. Further the provision relating to the computation, carry forward and set off of AMT credit shall not apply to these assesses.

Few Incentives not available for person paying tax u/s 115BAC:

1. Total Income of the assessee is calculated under the tax regime of section 115BAC without claiming the following deductions/exemptions (which are otherwise available under regular tax regime):
 - a) Leave Travel concession [Section 10(5)]
 - b) House Rent Allowance [Section 10(13A)]
 - c) Official and personal allowances (other than those as may be prescribed) [Section 10(14)]
 - d) Allowances to MPs/MLAs [Section 10(17)]
 - e) Allowances for income of minor [Section 10(32)]
 - f) Deduction for units established in Special Economic Zones (SEZ) [Section 10AA]
 - g) Exemption of perquisite in respect of free food and non-alcoholic beverage (i.e. Rs.50 per meal) provided through paid voucher [Section 17(2) read with Rule 3 (7)(iii)]
 - h) Entertainment Allowance [Section 16(ii)]
 - i) Professional Tax [Section 16(iii)]
 - j) Interest on housing loan in the case of one or two self-occupied properties [Section 24(b)]
 - k) Additional depreciation in respect of new plant and machinery [Section 32(1)(ia)]
 - l) Deduction for investment in new plant and machinery in notified backward areas [Section 32AD]
 - m) Deduction in respect of tea, coffee or rubber business [Section 33AB]
 - n) Deduction in respect of business consisting of prospecting or extraction or production of petroleum or natural gas in India [Section 33ABA]
 - o) Deduction for donation made to approved scientific research association, university college or other institutes for doing scientific research which may or may not be related to business [Section 35(1) (ii)]
 - p) Deduction for payment made to an Indian company for doing scientific research which may or may not be related to business [Section 35(1) (ia)]
 - q) Deduction for donation made to university, college, or other institution for doing research in social science or statistical research [Section 35(1) (iii)]
 - r) Deduction for donation made for or expenditure on scientific research [Section 35(2AA)]
 - s) Deduction in respect of capital expenditure incurred in respect of certain specified businesses, i.e., cold chain facility, warehousing facility, etc. [Section 35AD]

- t) Deduction for expenditure on agriculture extension project [Section 35CCC]
 - u) Deduction under section 80C – 80U {Except employer's contribution towards NPS under section 80CCD(2), deduction under section 80JJAA, Deduction u/s 80CCH(2) and deduction under section 80LA(1A)}. Finance Act 2024 has increased tax deduction limit for employer contribution from 10% to 14% of basic salary.
2. Total income of the assessee is calculated after claiming depreciation under section 32, other than additional depreciation, and without adjusting brought forward losses and depreciation from any earlier year (if such loss or depreciation pertains to any deduction under the aforesaid sections). Further, loss under the head house property can't be set off against other heads of Income. Moreover, such loss and depreciation will not be carried forward.
 3. If the assessee has any unabsorbed depreciation, relating to additional depreciation, which has not been given full effect, the corresponding adjustment shall be made to WDV of the block of assets in the prescribed manner.
 4. In case the assessee has business or professional income, and no option is exercised, he will be governed by the New tax regime. The assessee can avail benefit of regular tax regime by exercising the option under section 115BAC (6). Such option can be exercised on or before the due date of submission of return of income under section 139(1) and such option once exercised shall apply to subsequent assessment year as well.
 5. However, the option once exercised for any previous year can be withdrawn only once for a previous year (other than year in which it was exercised) and thereafter the person shall never be eligible to exercise the option of availing the benefit of regular tax regime (except where such person ceases to have any income from business or profession.)
 6. If assessee does not have business or professional income, the option under section 115BAC(6) i.e. to opt for regular tax regime must be exercised along with return of income under section 139(1) for every previous year.

SPECIAL TAX REGIME APPLICABLE TO A CO-OPERATIVE SOCIETIES [SECTION 115BAD]

The Finance Act, 2020 has inserted a new section 115BAD in Income-tax Act to provide an option to the resident co-operative societies (Other than those mentioned in Section 115BAE) to get taxed at the rate of 22% plus 10% surcharge and 4% cess. The resident co-operative societies have an option to opt for taxation under newly introduced section 115BAD of the Act w.e.f. Assessment Year 2021-22. The option once exercised under this section cannot be subsequently withdrawn for the same or any other previous year.

If the new regime of Section 115BAD is opted by a co-operative society, its income shall be computed without providing for specified exemption, deduction or incentive available under the Act. The societies opting for this section have been kept out of the purview of Alternate Minimum Tax (AMT). Further, the provision relating to computation, carry forward and set-off of AMT credit shall not apply to these assesses.

The option to pay tax at lower rates shall be available only if the total income of cooperative society is computed without claiming following exemptions or deductions:

- a) Deduction for units established in Special Economic Zones (SEZ) [Section 10AA];
- b) Additional depreciation in respect of new plant and machinery [Section 32(1)(iia)];

- c) Deduction for investment in new plant and machinery in notified backward areas [Section 32AD];
- d) Deduction in respect of tea, coffee or rubber business [Section 33AB];
- e) Deduction in respect of business consisting of prospecting or extraction or production of petroleum or natural gas in India [Section 33ABA];
- f) Deduction for donation made to approved scientific research association, university college or other institutes for doing scientific research which may or may not be related to business [Section 35(1)(ii)];
- g) Deduction for payment made to an Indian company for doing scientific research which may or may not be related to business [Section 35(1)(iia)];
- h) Deduction for donation made to university, college, or other institution for doing research in social science or statistical research [Section 35(1)(iii)];
- i) Deduction for donation made to National Laboratory or IITs, etc. for doing scientific research which may or may not be related to business [Section 35(2AA)];
- j) Deduction in respect of capital expenditure incurred in respect of certain specified businesses, i.e., cold chain facility, warehousing facility, etc. [Section 35AD];
- k) Deduction for expenditure on agriculture extension project [Section 35CCC];
- l) Deduction in respect of certain incomes other than specified under Section 80JJAA [Part C of Chapter VI-A].

Where a co-operative society exercises option for availing benefit of lower tax rate under section 115BAD, it shall not be allowed to claim set-off of any brought forward losses or depreciation attributable to any restricted exemption or deduction in the Assessment Year for which the option has been exercised and for any subsequent Assessment Year.

TAX ON INCOME OF CERTAIN NEW MANUFACTURING CO-OPERATIVE SOCIETIES [SECTION 115BAE]

Conditions:

- The co-operative society is set up and registered on or after 01-04-2023;
- It is engaged in manufacture or production of any article or thing;
- It commences manufacturing on or before 31-03-2024; and
- It does not claim specified exemption, incentive or deduction.

Tax rate: 15% (Income from manufacturing activities)

Surcharge: The surcharge is levied at a rate of 10% on the amount of income-tax irrespective of the total income of such co-operative society.

Health & Education Cess: 4% of such income-tax and surcharge.

Special Tax Rates which are Taxable at Fixed Rates (Applicable for Both Regime)

- a. Section 111A: STCG: 20%
- b. Section 112: LTCG: 12.5%

- c. Section 112A: LTCG: 12.5% provided incomes greater than Rs. 1,25,000
- d. Section 115BB: Casual Incomes: 30%
- e. Section 115BBE: Income u/s 68 or 69 or 69A or 69B or 69C or 69D: 60%
- f. Section 11BBJ: Tax on winning from online games – 30%

REBATE [SECTION 87A]

In case of tax payable as per Old Taxation regime, an assessee, being an individual resident in India, whose total income does not exceed Rs. 5,00,000 shall be entitled to a deduction, from the amount of income-tax (as computed before allowing the deductions under this Chapter) on his total income with which he is chargeable for any assessment year, of an amount equal to 100% of such income-tax or an amount of Rs. 12,500, whichever is less.

The rebate under section 87A for the assessee paying tax under default scheme of section 115BAC shall be as follows:

Conditions:

- a. Assessee should be resident individual.
- b. The assessee wants to pay tax under default regime of section 115BAC and;
- c. Whose Total Income does not exceed Rs.12,00,000.
- d. Rebate u/s 87A will be not allowed from Incomes Taxable at Special rates eg Section 111A/112/112A/115BB etc.

Quantum of Rebate:

If the aforesaid conditions are satisfied, the amount of rebate under section 87A shall be 100% of Income Tax or; Rs.60,000, whichever is less.

Marginal Relief in Rebate for assessee paying tax u/s 115BAC:

If Net income exceeds Rs.12,00,000 income tax on such income cannot exceed the amount by which the net income exceeds Rs.12,00,000.

Example:

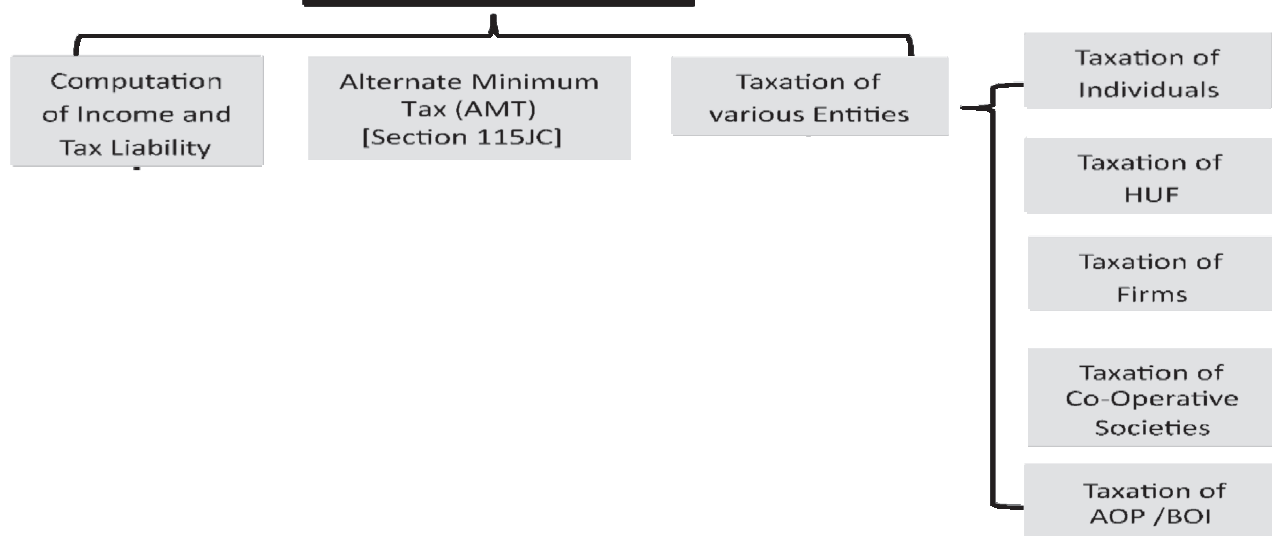
Compute Income Tax liability in following situations for Assessment Year 2026-27 given that in none of the cases assessee wants to opt for the regular tax regime i.e. computation is to be done under section 115BAC and the assesses are resident individuals. Given are the Total Incomes.

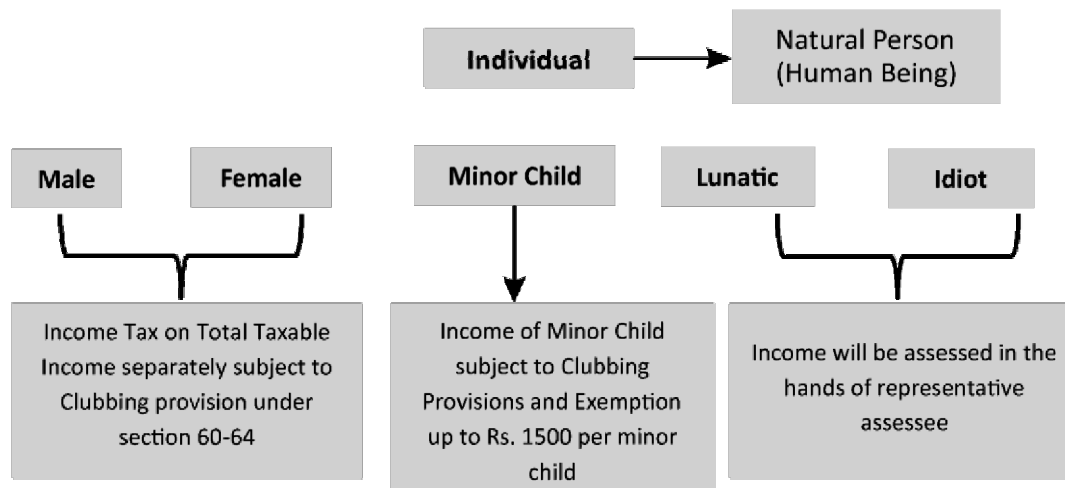
- 1. Mr. Ishank (30 years): Rs.10,00,000.
- 2. Ms. Shirin (29 years): Rs.12,00,000.
- 3. Mr. Aroha (21 years): Rs.12,40,000.
- 4. Mr. Nirvan (23 years): Rs.13,00,000.

Solution:

Computation of Tax liability for the Assessment Year 2026-27:

Particulars	Mr. Ishank	Ms. Shirin	Mr. Aroha	Mr. Nirvan
Total Income (1)	10,00,000	12,00,000	12,40,000	13,00,000
Tax on Total Income as per section 115BAC	40,000	60,000	66,000	75,000
Less: Rebate u/s 87A	(40,000)	(60,000)	(Nil)	(Nil)
Less: Marginal relief Adjustment u/s 87A Applicable in case of Mr Aroha only as Increase in Tax beyond 12 lakhs is 66,000 is more than increase in Income beyond 12 lakhs i.e. 40,000. Hence Marginal relief is 66,000-40,000 = 26,000	(Nil)	(Nil)	(26,000)	(Nil)
Therefore, Income Tax after Rebate u/s 87A	Nil	Nil	40,000	75,000
Add: Health and Education Cess @ 4%	Nil	Nil	1,600	3,000
Therefore, Total Tax Liability	Nil	Nil	41,600	78,000

CHAPTER OVERVIEW

TAXATION OF INDIVIDUALS

Income of Individual and its Tax Treatment		
Taxable Income of Individual	Income	Taxability/Exemption
	Income earned by Individual	Based on Individual capacity
	Remuneration in terms of Salary, Bonus, Commission etc. received by partner (As Individual)	Taxable as Business Income
	Interest on capital/Loans to Firm/LLP received by partner (As Individual)	Taxable as Business Income
	Income received as Member of AOP or BOI	Share of Income from AOP/BOI is taxable
	Income from impartible estate of HUF	Income is taxable in hands of Karta
Exempted in the hands of Individuals	Share of Profit of Firm/LLP	Exempt in the hands of Partner [Section 10(2A)]
	Income of AOP/BOI is chargeable at Maximum Marginal Rate (MMR)	Share of income of member will not be included in taxable income
	Share of Income from HUF	Exempt in the hands of Individual [Section 10(2)]

List of deductions available to Individuals under Chapter VI-A covered in OTR (Old Tax Regime)	
Section	Particulars
80C	Deduction in respect of life insurance premia, deferred annuity, contributions to provident fund, subscription to certain equity shares or debentures, etc.

80CCC	Deduction in respect of contribution to certain pension funds. Only Section 80CCD(2) allowed in NTR (New Tax Regime)
80CCD	Deduction in respect of contribution to pension scheme of Central Government
80CCE	Limit on deductions under sections 80C, 80CCC and 80CCD
80CCH	Contribution to Agniveer corpus fund. Only Section 80CCH(2) allowed in NTR (New Tax Regime)
80D	Deduction in respect of health insurance premia
80DD	Deduction in respect of maintenance including medical treatment of a dependent who is a person with disability
80DDB	Deduction in respect of medical treatment, etc.
80E	Deduction in respect of interest on loan taken for higher education
80EE	Deduction in respect of interest on loan taken for residential house property
80EEA	Deduction in respect of interest on loan taken for certain house property
80EEB	Deduction in respect of purchase of electric vehicle
80G	Deduction in respect of donations to certain funds, charitable institutions, etc.
80GG	Deductions in respect of rents paid
80GGA	Deduction in respect of certain donations for scientific research or rural development
80GGC	Deduction in respect of contributions given by any person to political parties
80-I	Deduction in respect of profits and gains from industrial undertakings after a certain date, etc.
80-IB	Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings
80-IBA	Deductions in respect of profits and gains from housing projects
80-IE	Special provisions in respect of certain undertakings in North-Eastern States
80JJA	Deduction in respect of profits and gains from business of collecting and processing of bio-degradable waste.
80JJAA	Deduction in respect of employment of new employees
80QQB	Deduction in respect of royalty income, etc., of authors of certain books other than text-books
80RRB	Deduction in respect of royalty on patents
80TTA	Deduction in respect of interest on deposits in savings account
80TTB	Deduction in respect of interest on deposits in case of senior citizens
80U	Deduction in case of a person with disability

CASE 1

Mr. DP, has earned gross salary of Rs. 6,55,000 including HRA of Rs. 45,000. He has paid Rs. 15,000 p.m. as rent for his residential accommodation in Delhi. Besides that, he earned Rs. 12,000 from saving bank deposit during the year 2025-26 and at the same time he has deposited to Rs. 65,000 to PPF. You are required to compute total income and tax payable by DP if

- He opts to pay tax as per regular scheme.
- He pays tax under Section 115BAC

Solution: Statement showing computation of Total income and tax liability

Particulars	Opts to pay tax as per regular scheme		He pays tax under section 115BAC	
	Amount (Rs.)	Amount (Rs.)	Amount (Rs.)	Amount (Rs.)
Salary received	6,55,000		6,55,000	
Less: HRA Exempted u/s 10(13A)	(45,000)		Nil	
	6,10,000		6,55,000	
Less: Standard Deduction	(50,000)		(75,000)	
Income under the head salary		5,60,000		5,80,000
Income from saving bank deposit		12,000		12,000
Gross Total Income		5,72,000		5,92,000
Less:				
Deduction u/s 80C	65,000			
Deduction u/s 80TTA	10,000	(75,000)		Nil
(a) Actual 12,000				
(b) Limit 10,000				
Whichever is less				
Total Income		4,97,000		5,92,000
Tax on total Income		12,350		9,600
Less: Rebate u/s 87A				
(a) 100% of Tax				
(b) Limit 12,500 or Rs. 60,000 (as applicable)		(12,350)		(9,600)
Whichever is less				

Balance		Nil		Nil
Add: HEC @ 4%		Nil		Nil
Total Tax Payable (R/O)		Nil		Nil

Illustration 1:

Gross total income of Mr. X, a tax consultant based at Mumbai, is Rs. 18,00,000 (income from profession Rs. 17,00,000 and interest on bank fixed deposit Rs. 1,00,000). He pays Rs. 3,00,000 as house rent. He deposits Rs. 50,000 in public provident fund. Compute his taxable income for the assessment year 2026-27.

Option 1: Assessee has opted to pay tax under Old scheme

Option 2: Assessee is paying tax as per Section 115BAC

Solution:

Option 1: Assessee has opted to pay tax under old scheme

Computation of Taxable Income of Mr. X for the A.Y. 2026-27

Particular	Amount (Rs.)	Amount (Rs.)
Professional Income – PGBP		17,00,000
Interest on Bank Deposit – Other sources		1,00,000
Gross Total Income		18,00,000
Less: Deductions under Chapter VI-A u/s 80C (PPF)	(50,000)	
u/s 80 GG (Note-1)	(60,000)	(1,10,000)
Total Income		16,90,000

Note 1: Deduction u/s 80GG is least of the following:

- Rs. 60,000 (i.e., Rs. 5000 x 12 months)
- Rs. 4,37,500 [25% of Adjusted total income (Rs. 18,00,000 - 50,000)]
- Rs. 1,25,000 [Excess of rent paid over 10% of Adjusted total income (Rs. 3,00,000 – 1,75,000)]

Option 2: Assessee pays tax as per section 115BAC

Computation of Taxable Income of Mr. X for the A.Y. 2026-27

Particular	Amount (Rs.)
Professional Income – PGBP	17,00,000
Interest on Bank Deposit – Other sources	1,00,000
Gross Total Income	18,00,000

Less: Deductions under Chapter VI-A	Nil
Total Income	18,00,000

Note 1: Deduction u/s 80C & 80GG not allowed.

Illustration 2:

From the following profit and loss account of Vinay for the year ended 31st March 2026, compute his total income and tax liability for the assessment year 2026-27:

Particulars	Amount Rs.	Particulars	Amount Rs.
Interest on capital	12,000	Gross profit	5,10,000
Insurance	2,000	Brokerage	30,000
Bad debts	30,000	Bad debts recovered (earlier allowed as deduction)	15,000
Depreciation	34,000	Sundry receipts	18,000
Advance tax	25,000	Interest on debentures (gross) [TDS Rs. 4,000]	40,000
General expenses	12,000		
Advertisement	5,000		
Salary (including salary to Vinay Rs.20,000)	85,000		
Interest on loan	8,000		
Net profit	4,00,000		
Total	6,13,000	Total	6,13,000

Additional information:

- The amount of depreciation allowable as per income-tax rules is Rs.42,000.
- General expenses include Rs.5,000 given as Health insurance Premium for Mr. Vinay.
- Vinay pays Rs. 5,200 as premium on his own life insurance policy of Rs. 50,000 issued in 2020-21.
- Loan was obtained for payment of income-tax.

Option 1: Assessee has opted to pay tax as per Old scheme

Option 2: Assessee is paying tax as per Section 115BAC

Solution:**Option 1: Assessee has opted to pay tax as per old scheme**

Particulars	Amount (Rs.)	Amount (Rs.)
(I) Income from business		
Net profit for the year		4,00,000
Add: Expenses not allowed under Income tax Act but debited to P & L A/c		
Interest on capital (Note 2)	12,000	
Depreciation as per books of a/c	34,000	
Advance tax	25,000	
General Expenses	5,000	
Salary to Vinay	20,000	
Interest on loan (Note 2)	8,000	1,04,000
Less: Income not related to business and profession but credited to P&L a/c		
Interest on debentures	40,000	
Deductible expenses not debited to P&L Account		
Depreciation as per Income tax Act	42,000	(82,000)
Profits and Gains of Business & Profession		4,22,000
(II) Income from other sources Interest on debenture		40,000
Gross Total Income (I + II)		4,62,000
Less: Deduction U/S 80C – 80U		
(i) Premium on life insurance policy (u/s 80C) (Note 1)		(5,000)
(ii) Health insurance Premium (u/s 80 D)		(5,000)
Total Taxable Income		4,52,000

Note

- Under section 80C deduction of life insurance premium cannot exceed 10% of the sum assured.
- Under Section 36(1)(iii) Interest paid on borrowed capital is allowed as a deduction. Interest on own capital is not deductible. Similarly, interest on money borrowed to pay income tax is not allowed as a deduction.

Option 2: Assessee is paying tax as per Section 115BAC

Particulars	Amount (Rs.)	Amount (Rs.)
(I) Income from Business		
Net profit for the year		4,00,000
Add: Expenses not allowed under Income tax act but debited to P & L A/c		
Interest on capital (Note 2)	12,000	
Depreciation as per books of A/c	34,000	
Advance tax	25,000	
General Expenses	5,000	
Salary to Vinay	20,000	
Interest on loan (Note 2)	8,000	1,04,000
Less: Income not related to business and profession but credited to P& L A/c		
Interest on debentures	40,000	
Deductible expenses not debited to P&L Account		
Depreciation as per Income tax Act (Working Note)	42,000	(82,000)
Profits and Gains of Business & Profession		4,22,000
(II) Income from other sources Interest on debenture		40,000
Gross total income (I + II)		4,62,000
Less: Deduction U/S 80C – 80U		NIL
Total Taxable Income		4,62,000

Note:

1. Deduction u/s 80C is not allowed under section 115BAC.
2. Under Section 36(1)(iii) Interest paid on borrowed capital is allowed as a deduction. Interest on own capital is not deductible. Similarly, interest on money borrowed to pay income tax is not allowed as a deduction.
3. Depreciation u/s 115BAC is allowed except Additional depreciation as per prescribed manner.

Illustration 3:

For the Assessment Year 2026-27, Mr. Ram, who is 58 years old, resident in India, furnishes the following information:

Basic salary	Rs. 15,000 pm
Dearness Allowance (20% forming part for retirement benefits)	40% of basic salary
City Compensatory Allowance	Rs. 300 pm
Children education allowance	Rs. 200 pm per child for 2 children
Transport allowance	Rs. 2,000 pm
House Rent Allowance	Rs. 6,000 pm
Actual rent paid for a house in Delhi	Rs. 7,000 pm
He travels via Delhi metro from his residence to office and back in which he spends	Rs. 1,500 pm
Medical allowance	Rs. 1,000 pm
Lunch allowance	Rs. 200 pm

He owns a house property in Mumbai whose construction is completed in 2005 and which is let out for Rs. 40,000 pm. The standard rent as per Rent Control Act is Rs. 3,10,000. He pays Rs. 32,000 for municipal taxes and interest on capital borrowed for construction of house Rs. 75,000. Further, he incurs Rs. 10,000 on repairs of the house.

Long-term capital gains Rs. 225,000

Short term capital gains for the year Rs.1,01,000 (STT not applicable).

Dividend received from Indian Company X Ltd. Rs. 12,000.

Interest received @10% on listed debentures of face value 14,00,000

Diwali Gift of gold coins received from a friend. Market value Rs. 60,000

Share of profit from:

Firm	40,000
HUF	34,000
Income from Lotteries (gross)	50,000

Mr. Ram invested in PPF Rs.1,50,000 and also paid a life insurance premium of Rs. 21,000.

Donation to National Defence Fund Rs.10,000.

Compute the total income and Tax liability of Mr. Ram for the Assessment year 2026-27.

Option 1 : Assessee has opted to pay tax as per the old scheme

Option 2 : Assessee is paying tax as per section 115BAC

Solution:

Option 1: Assessee has opted to pay tax as per the old scheme

A. Computation of Total Income

Particulars	Amount (Rs.)	Amount (Rs.)
Income from Salary		
Basic salary (15000 *12)		1,80,000
Dearness Allowance (180,000*0.40)		72,000
CCA (fully taxable) (300*12)		3,600
Children Education Allowance	4,800	
Less: Exempt	(2,400)	2,400
Transport allowance	24,000	
Less: Exempt (Exemption withdrawn by Finance Act, 2018)	NIL	24,000
House Rent Allowance (Note)		7,440
Lunch Allowance		2,400
Medical Allowance		12,000
Less: Deduction under section 16 (ia) Standard Deduction		(50,000)
Taxable Salary		2,53,840
Income from house property		
Gross Annual Value (Rent Received 40,000*12)		4,80,000
Less: Municipal Taxes		(32,000)
Net Annual Value		4,48,000
Less: Standard Deduction @ 30% of 4,48,000		(1,34,400)
Less: Interest on capital borrowed		(75,000)
Income from House property		2,38,600
Income from Business/Profession		
Firm (Exempt)		NIL
HUF (Exempt)		NIL

Income under the head Capital Gains		
Long-term capital gains u/s 112		2,25,000
Short term Capital Gain u/s 111A		1,01,000
Income from other sources		
Dividend received from Indian Company X Ltd.	12,000	
Interest received on listed debentures	1,40,000	
Winning from Lotteries	50,000	
Gift in kind	60,000	2,62,000
Gross Total Income		10,80,440
Less: Deduction under section 80C to 80U		
(i) Under section 80C (maximum)		(150,000)
(ii) Under section 80G		(10,000)
Total Income		9,20,440

(B) Computation of Tax on Total Income

Tax on winning from lotteries (30% of Rs. 50,000)	15,000
Tax on long-term capital gains (12.5% of Rs. 2,25,000)	28,125
Balance of Total Income Rs. 6,45,440	41,588
Total tax	84,713
Add: Health and Education cess at 4%	3,388.52
Total tax liability	88,101.52
Total tax liability (round off)	88,101

Notes:

1. House Rent Allowance: Least of three is exempt
 - i. 50% of the salary* because the house is in Delhi = $0.50 \times 1,94,400 = \text{Rs. } 97,200$
 - ii. HRA received = Rs. 72,000
 - iii. Rent paid – 10% of the salary = $(7000 \times 12) - 0.10 \times 1,94,400 = 84,000 - 19,440 = \text{Rs. } 64,560$

Exempted HRA = Rs. 64,560

Taxable HRA = 72,000 – 25,680 = Rs. 7,440

*Salary here = Basic salary + Dearness allowance (forming part only) = 1,80,000 + 1,80,000 * 0.40 * 0.20 = Rs. 1,94,400

- The tax liability is subject to set-off of TDS for winning from lotteries and interest from listed debentures.

Option 2: Assessee is paying tax as per section 115BAC

(A) Computation of Total Income

Income from salary	Rs.	Rs.
Basic salary (15,000 *12)		1,80,000
Dearness Allowance (1,80,000*0.40)		72,000
CCA (fully taxable) (300*12)		3,600
Children Education Allowance	4,800	
Less: Exempt	NA	4,800
Transport allowance	24,000	
Less: Exempt	NA	24,000
House Rent Allowance (Note)		72,000
Lunch Allowance		2,400
Medical Allowance		12,000
Less: Deduction under section 16		(75,000)
Taxable Salary		2,95,800
Income from House Property		
Gross Annual Value (Rent Received 40,000*12)		4,80,000
Less: Municipal Taxes		(32,000)
Net Annual Value		4,48,000
Less: Standard Deduction @ 30% of 4,48,000		(1,34,400)
Less: Interest on Capital Borrowed		(75,000)
Income from House property		2,38,600

Income from Business/Profession		
Firm (Exempt)	NIL	
HUF (Exempt)	NIL	NIL
Income under the head Capital Gains		
Long-term capital gains u/s 112		2,25,000
Short term Capital Gain other than 111A		1,01,000
Income from other sources		
Dividend received from Indian Company X Ltd.	12,000	
Interest received on listed debentures	1,40,000	
Winning from Lotteries	50,000	
Gift in kind	60,000	2,62,000
Gross Total Income		11,22,400
Less: Deduction under section 80C to 80U		NA
Total Income		11,22,400

(B) Computation of Tax on Total Income

Tax on winning from lotteries (30% of Rs. 50,000)	15,000
Tax on long-term capital gains (12.5% of Rs. 2,25,000)	28,125
Balance of Total Income Rs. 8,47,400	24,740
Total tax	67,865
Less : Rebate u/s 87A	24,740
Tax After Rebate	43,125
Add: Health and Education Cess at 4%	1,725
Total liability	44,850

Notes:

1. Exemption from House Rent Allowance / Children Education allowance, Deduction under section 80C & 80G is not allowed
2. The tax liability is subject to set-off of TDS for winning from lotteries and interest from listed debentures.

Illustration 4:

Mr. X aged 62 years; resident individual furnishes the following particulars relevant for the assessment year 2026-27:

Profit and Loss Account			
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Salaries	30,000	Gross profit	4,36,000
General Expenses	45,000	Commission	1,20,000
Bad Debts	15,000	Sundry Receipts	40,000
Reserve for losses	3,000	Short term capital gain	30,000
Insurance	5,200	Discount	2,000
Advertisement 10,000 Add: outstanding (2,000)	12,000	Profit on sale of import license	1,00,000
Interest on capital	4,500		
Interest on bank loan	12,500		
Expenditure on acquisition of patent and put to use on 30th June	16,000		
Depreciation on Plant	24,000		
Depreciation on Building	10,000		
Depreciation on Furniture	4,000		
Provision for outstanding GST liability	12,000		
Taxation reserve	12,000		
Loss by fire of a part of building (Uninsured)	8,000		
Net profit	5,14,800		
Total	7,28,000	Total	7,28,000

Other information

1. Bank loan is used for business purposes.
2. The amount of depreciation as per tax rates, in respect of plant, building, furniture, amounts to Rs. 20,000, 12,000, 7,400 respectively.

3. Salary includes payment to a relative which is unreasonable to the extent of Rs. 5,000.
4. Out of GST liability Rs. 2,000 is paid on 04.07.2026 and Rs. 6,000 is paid on 03.10.2026. The balance is still outstanding. Due date of filling the return of income is 31.7.2026.
5. Income of X from other sources is Rs. 24,000.
6. X paid medical insurance premium Rs. 16,000 for himself and Rs. 16,000 for his mother (dependent)
7. X repaid housing loan to the extent of Rs. 45,000.

Determine the taxable income and tax liability of Mr. X for the assessment year 2026-27 assuming STT is not applicable on STCG.

Assume Assessee has opted out of section 115BAC.

Solution:

Computation of total income of Mr. X for the AY 2026-27

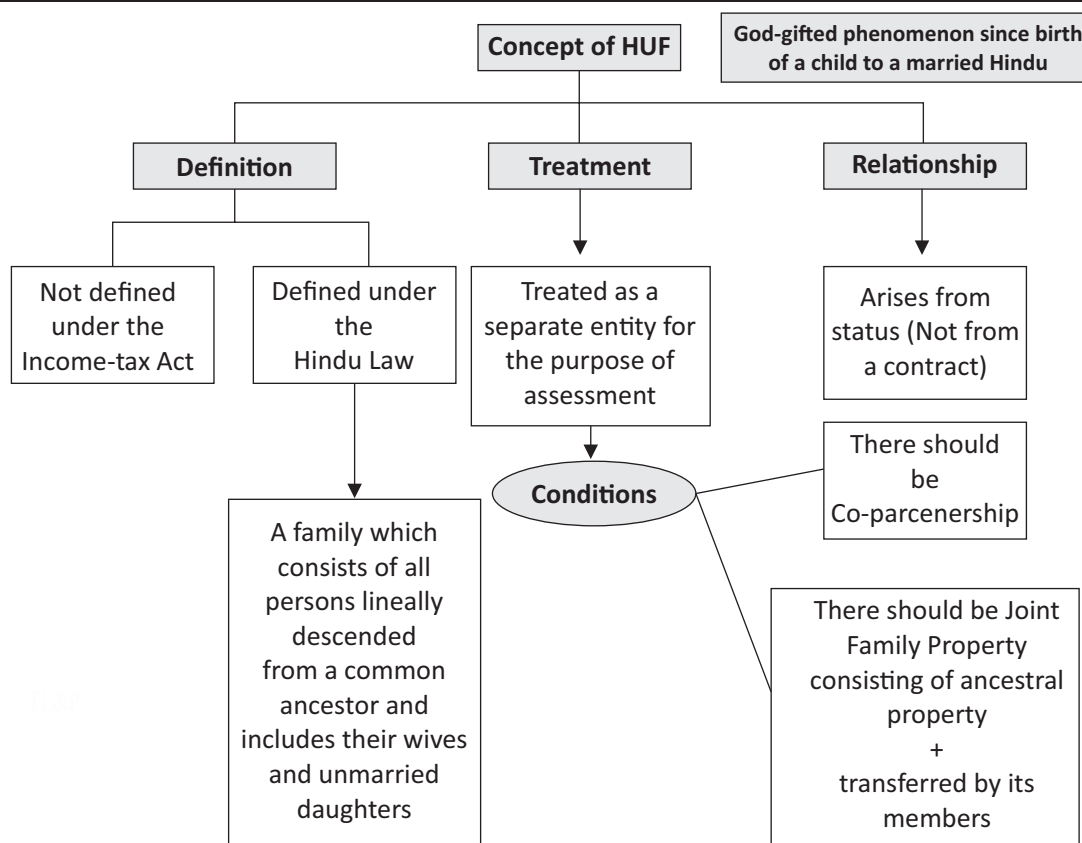
Particulars	Rs.
Profit and gain from business profession (Note)	5,37,900
Income under the head capital gain [STCG]	30,000
Income from other sources	24,000
Gross Total Income	5,91,900
Less: Deduction	
Repayment of Housing Loan (Section 80C)	(45,000)
Medical Insurance Premium (Section 80D)	(32,000)
Total Income	5,14,900

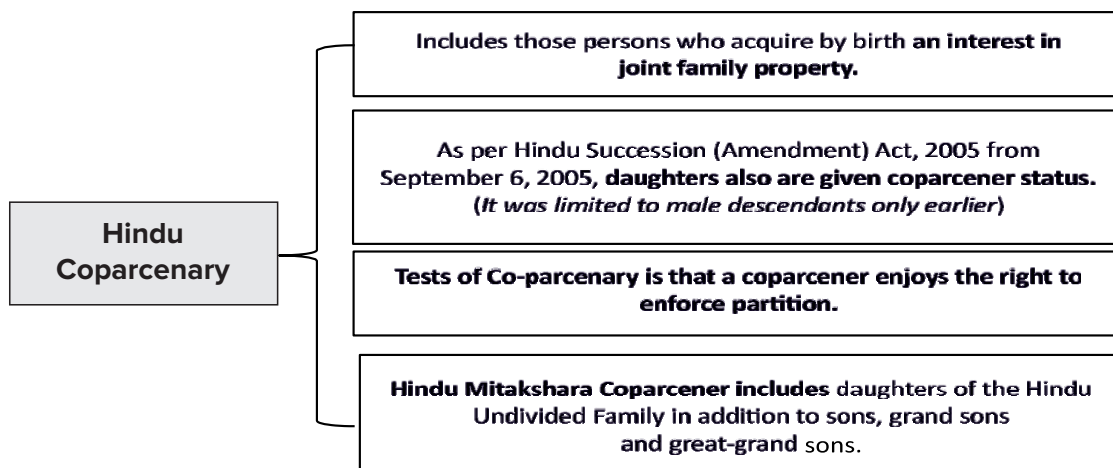
Computation of Tax on Total Income

Tax on Rs. 3,00,000	Nil
Tax on Rs. 2,00,000 @ 5%	10,000
Balance of Total Income 14,900 @ 20%	2,980
Total tax	12,980
Add: Health and Education Cess at 4%	519.2
Total Liability	13,499.2
Total Liability (round off)	13,500

Working Note:**Calculation of Business Income**

Particulars	Rs.
Profit as per P&L A/C	5,14,800
<i>Add:</i> Inadmissible Expenses	
Reserve for losses	3,000
Interest on capital	4,500
Patent right [16,000 - 25% of 16,000]	12,000
Excess salary paid to relative	5,000
Outstanding GST liability [12,000-2,000]	10,000
Taxation reserve	12,000
Loss by fire of part of building	8,000
<i>Less:</i> Admissible Expenses Depreciation [39,400-38,000]	(1,400)
<i>Less:</i> Income taxable under head capital gain (STCG)	(30,000)
Business Income	5,37,900

TAXATION OF HINDU UNDIVIDED FAMILIES (HUF)



The term 'Hindu undivided family' has not been defined in the Income-tax Act but it is treated as a separate entity or person under section 2(31) of the Income-tax Act, 1961 for the purpose of assessment under the Act. Under Hindu Law, an HUF is a family which consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. Jain and Sikh families even though are not governed by the Hindu Law, but they are treated as HUF under the Act. An HUF cannot be created under a contract and is created automatically in a Hindu Family. Creation of a HUF is a God-gifted phenomenon since birth of a child to a married Hindu, automatically creates a new HUF. It is not at all necessary that every HUF must have joint property or family income. [R. Subramania Iyer v. CIT (1955) 28, ITR, 352]. However, to become an assessee under the Income-tax Act, there must be 'income-yielding' joint property of the family.

A HUF may consist of a number of smaller HUFs. A smaller HUF has a legal existence and may be assessable as a unit distinct from the apex joint family even when the bigger HUF is in place [CIT v. Khanna (1963) 49 ITR 232].

The Supreme Court's decision in the case of Surjit Lal Chhabra v. CIT (1975 101 ITR 776) has come to stay as one of the leading case laws. The ratio laid down by the Supreme Court had been applied by the Andhra Pradesh, Orissa and Madras High Courts, followed by Bombay, Patna, Madhya Pradesh and Delhi High Courts and relied upon by the Punjab High Court. In the latest case, the Delhi High Court held in Commissioner of Income-tax v. S.P. Chopra (1991, 191 ITR 455) that the income from the half share of the property had to be treated as the individual income of the assessee under the personal law and not as income of the family. The character of the property had to be determined in accordance with the personal law of the assessee and not on the basis of how the property had been treated by the revenue in respect of earlier assessments.

A son conceived or in his mother's womb is equal in many respects to a son actually in existence, viz., inheritance, partition, survivorship etc. But this doctrine does not apply to the Income-tax Act. Hence, a son conceived is not treated a member of the H.U.F. for Income-tax purposes. [IS. Srinivasan v. C.I.T., (1966) 60, ITR, p.36 (S.C.)].

Jain and Sikh undivided families are also treated as Hindu undivided families unless, under special circumstances, the assessee claims not to be treated as such. If such claim is made, the assessee shall have to prove that there is some such custom in his family on account of which it cannot be treated as a Hindu undivided family.

If a Hindu gets converted as a Christian, the family of such a person will not be a HUF. However, a Hindu, along with his son (by a Christian wife) who has been brought up as a Hindu will be a HUF. [CWT v. R. Sridharan (1976) 104, ITR, 436 (S.C.)].

A Hindu Joint Family consists of two types of members:

1. **Coparceners:** The lineal male descendants of a person up to the third generation of such person are

known as coparceners. The coparceners acquire, on birth, ownership in the ancestral properties of such ascendant and have a right to claim partition of such property at any time. However, w.e.f. 09.09.2005 due to amendment of Hindu Succession Act, the daughter of a coparcener shall by birth become a coparcener in her own right in the same manner as the son. Hence, the daughter can also ask for partition.

2. **Other members:** Such members include wives of male members of the family and other male members. Widow or widows of deceased male member or members. [Gowli Buddanna v. C.I.T. (1966) 60, ITR, p. 293 (S.C.)]

However, an unmarried coparcener who receives share on the partition of joint family properties, cannot form a Hindu undivided family unless he marries. After his marriage, he can hold the property received from family as joint family property consisting of himself and his wife. [C. Krishna Prasad v. C.I.T. (1974) 97, p. 493 (S.C.)].

The joint property of the HUF is managed through Karta: Property of the family is ordinarily managed by the father or other senior member for the time being of the family. He is called Karta. However, the senior member may give up his right of management and a junior member may be appointed as Karta with the consent of all other members. [Narendra Kumar J. Modi v. CIT (1976) 105, ITR, 109 (S.C.)]. In the absence of a male member in the family or when all male members are minors, a woman member can be treated as manager of the family for income-tax purposes. [Smt. Champa Kumari Singhi v. Addl. Member of the Board of Revenue (1962) 46, ITR, p. 81].

Views of different schools of Hindu law under taxation of HUF	
School of Hindu Law	● Dayabhaga School of law ● Mitakshara School of law
Dayabhaga School of law (Summarized Provision)  No coparcener till the death of father	● It prevails in West Bengal and Assam. ● Son does not acquire any interest by birth in an ancestral property but acquires such interest only after the death of his father. (i.e., No enjoyment of right to demand partition during the lifetime of his father) ● On the other hand, the father enjoys an absolute right to dispose of the property of the family according to his desire. ● Father is assessed as an individual (Not as HUF)
Mitakshara School of law	● Applicable to the whole of India except West Bengal and Assam ● Both son and daughter acquire by birth an equal right in the ancestral property along with their father. ● The Co-parcenary is a fluctuating body which is enlarged at the time of each birth and reduced at the time of each death of a Co-parcenary child. ● As per Hindu Succession Act, 2005 (Amendment), Daughter and Her Children (In case of pre-deceased daughter) are eligible for share in the family assets on partition. ● Ancestral property refers to property which a man inherits from any of his 3 immediate male ancestors (i.e., His father, grandfather and great grandfather) ● Jain and Sikh families will not be governed as per Hindu Law but treated as HUF for the purpose of Income Tax Act.

Position under Hindu Succession Act, 1956

This Act came into force on and from 17th June, 1956. It lays down a uniform and comprehensive system of inheritance and applies to persons governed by the Mitakshara as well as the Dayabhaga Schools, superseding and abrogating all previous law or customs or usage having the force of law.

Under this Act, the heirs of a male Hindu dying intestate on or after 17th June, 1956 are divided into three classes. Class I heirs get the right to the deceased's property simultaneously to the exclusion of all other Classes of heirs. Class II relations succeed only if there is no class I relation and, the heirs in the first entry of class II being preferred to heirs in the second entry, and so on, but heirs in any one entry taking in equal shares amongst themselves.

The students should note that Section 4 of the Hindu Succession Act, 1956 clearly lays down that "save as otherwise expressly provided in the Act, any text, rule or interpretation of Hindu Law or any custom or usage as part of that law in force immediately before the commencement of the Act shall cease to have effect with respect to any matter for which provision is made in the Act." And, Section 8 of the Hindu Succession Act, 1956, lays down the scheme of succession to the property of a Hindu dying intestate. The schedule classifies the heirs on which such property shall devolve.

The preferential heirs of class I are as under:

(1) Son, (2) Daughter, (3) Widow, (4) Mother, (5) Son/daughter/widow of a predeceased son, (6) son/daughter of a predeceased daughter and (7) Son/daughter/ widow of a predeceased son of a predeceased son.

A son's son is not mentioned as an heir under Class I of the schedule and, therefore, he cannot get any right in the property of his grandfather under the provision. The right of a son's son in his grandfather's property during the lifetime of his father which existed under the Hindu Law as in force before the Act, is not saved expressly by the Act and, therefore the earlier interpretation of Hindu Law giving a right by birth in such property 'ceased to have effect'.

Therefore, the property which devolves on a Hindu on the death of his father intestate after coming into force of the Hindu Succession Act, 1956, does not constitute H.U.F. property consisting of his own branch including his sons. [Shri Vallabhdas Modani v. C.I.T. (1982) 138, ITR, p. 673].

The Allahabad High Court's decision supra in the case of Shri Vallabhdas Modani v. Commissioner of Income-tax was followed by the Andhra Pradesh High Court (1983, 144 ITR 18) and later approved by the Supreme Court in the case of Commissioner of Wealth-Tax v. Chander Sen (1986, 161 ITR 370) holding that it is not possible to say that when a son inherits the property in the situation contemplated by the Hindu Succession Act, 1956, he takes as Karta of his own undivided family.

COMPUTATION OF INCOME OF HINDU UNDIVIDED FAMILY 'HUF'

Income of the HUF is assessed as joint family income of HUF if there exists a co-parcenership and joint property of the family till partition is claimed by any of its coparceners.

Joint Property of the family consists of:

- (i) ancestral property which a man inherits from any of his three immediate male ancestors, namely, father, grandfather, great grandfather;
- (ii) accretion thereto;
- (iii) acquisition with joint funds; and
- (iv) self-acquired property of any member thrown by him into the common stock to be treated as family property. In the case of Pushpa Devi v. C.I.T. the Supreme Court has held that a Hindu female, not being

a coparcener, cannot blend her separate property with Joint family property. However, she can make a gift of her property or sell the property to the family. [(1977) 109, ITR p. 730].

The gross total income of the family for the relevant previous year shall be computed under the relevant heads (as per the provisions of the Income-tax Act) as it is computed for other assessee's. Incomes exempt under section 10 to 13A are exempt and deductions allowable under chapter VIA are to be provided. However, in this connection the following points are worth noting:

- (i) The holder, who is the senior most male member of the family, of an impartible estate is liable to tax on income from that estate in his individual capacity though the estate belongs to HUF.
- (ii) Conversion of self-acquired property into joint family property- Section 64(2) provides that where an individual being a member of Hindu undivided family transfers his separate property after 31st December, 1969 to the family for the common benefit of the family, otherwise than for adequate consideration, such property is known as converted property. The income derived from the converted property or any part thereof shall be included in the total income of the transferor individual and not in the income of the family.
- (iii) If the funds of a Hindu Undivided family are invested in a company or a firm, fees or remuneration received by the member as a director, or a partner in the company or firm may be treated as income of the family in case the fees or remuneration is earned essentially as a result of investment of funds. But, if the fees or remuneration is earned essentially for services rendered by the member in his personal capacity, the income shall constitute the personal income of the member.
- (iv) Where a member of a HUF is a partner in a firm on behalf of the family and on partition of the property of the family, the share in the firm is allotted to such a member, subsequent to such allotment when the firm settles its accounts the whole income for that year would be the income of the individual member and no part of the income would be added to the income of the family. [CIT v. Ashok Bhai Chiman Bhai (1965) 56, ITR, 42 (SC)].
- (v) The personal earning, including income from self-acquired property of a member of the HUF, even though he has sons, would not be included in the income of the family. Such income shall be assessed as income of that individual. [Kalyanji Vithal Das v. CIT (1937) 5 ITR 90 (PC)].
- (vi) Any sum paid by an HUF to a member of the family out of its income is not deductible in computing the income of the family. However, such amount will not be included in the income of such individual whether the family had paid tax on its income or not [Section 10(2)].
- (vii) If any remuneration is paid by the Hindu Undivided family to the Karta or any other member for services rendered by him in conducting family's business, the remuneration is deductible if remuneration is (a) paid under a valid and bona fide agreement; (b) in the interest of, and expedient for, the business of family; and (c) genuine and not excessive. Jugal Kishore Baldeo Sahai v. CIT [1967] 63 ITR 238 (SC).
- (viii) If salary is paid by the Hindu undivided family to its Karta for looking after its interest in firms in which it is partner through said Karta, such salary is allowable as deduction – CIT v. Prakash Chand Agarwal [1982] 11 Taxman 55 (MP).
- (ix) Income from 'stridhan' is not includible in the income of the family. Property derived by a woman from her father or brother or husband or any other relative either before or after her marriage is known as 'stridhan'.
- (x) Under the Dayabhaga School of law, as stated in a preceding page, no son has any right in the ancestral property during the lifetime of his father. If, therefore, the father does not have any brother as a coparcener, income arising from ancestral property is taxable as his individual income.

Partition of a Hindu Undivided Family [Section 171]

'Partition' signifies division of property. In the cases of property capable of physical division, share of each member is determined by making physical division thereof. It must be noted that a division of income without physical division of property does not amount to partition. Where, however, the property is not capable of physical division, partition implies such division as the property may admit.

Who is entitled to share on partition?

Though only coparceners can demand partition, once the partition takes effect, the following persons are entitled to a share:

- i. all coparceners;
- ii. a son in the womb of his mother at the time of partition;
- iii. mother, who gets an equal share if the partition takes place among her sons after the death of her husband; and
- iv. wife, who gets a share equal to that of a son at the time of a partition between father and sons.

Assessment after partition (Section 171)

Section 171 applies to an HUF which is assessed as such. Therefore, if in case a family is not assessed as a Hindu Undivided Family, this section does not apply. A joint family, once assessed as a HUF, continues to be assessed as such till one or more coparceners claim partition. Such claim must be made by the coparceners before the assessment of the income of the HUF for the relevant assessment year is completed. On the receipt of such a claim, the Assessing Officer must make an inquiry after giving due notice to the members and record a finding whether there has been a partition and, if so, the date of the partition. The income of the family from the first day of the previous year to the date of partition is assessed as income of the HUF and from the next date of the partition to the date of close of the previous year, as the individual income of the recipient-members. If the recipient member forms another HUF along with his wife and son(s), the income of the property which was subject to partition is chargeable to tax in the hands of the new H.U.F.

A partition of the HUF can be both total partition and partial partition

Where the entire joint family property is divided among all coparceners and the family ceases to exist as an undivided family, the partition is total. A partial partition may be as regards: (a) the persons constituting the joint family, or (b) the properties belonging to the joint family, or (c) both. In case of partial partition, some coparceners continue as a joint family or some properties continue as a joint estate as against some coparceners or properties which separate from HUF. The device of partial partition has been used as a medium for reduction of proper tax liability. To curb such a practice, the Finance (No. 2) Act, 1980 inserted Sub-section 9 in Section 171 which lays down that partial partitions of HUFs assessed as such (Union of India vs. MV Valliappan 1999 AIR SCW 2689), effected after 31st December, 1978 will not be assessed for tax purposes.

The provisions made by Sub-section (9) in Section 171 are as follows:

- (i) In a case where a partial partition of a HUF has taken place after 31.12.1978, no claim of such partition will be enquired into and the Assessing Officer will not record a finding as to whether there has been a partition of the family property. Further, any finding regarding partial partition recorded under Section 171(3) will be null and void and of no legal effect.

- (ii) Such family will continue to be assessed as if no such partial partition has taken place, i.e., the property or source of income will be deemed to continue to belong to the Hindu undivided family and no member will be deemed to have separated from the family.
- (iii) Each member or group of members of such family will be jointly and severally liable for any tax, interest, penalty, fine or other sum payable under the Act by the family, whether before or after such partition. The several liability of any member or group of members of such family will be computed according to the portion of the joint family property allotted to him on such partial partition. This amendment has come into force with effect from April 1, 1980 and has, accordingly, been applicable with effect from assessment year 1980-81 and onwards.

Illustration 5:

Ram Manhar & Sons HUF, running Raghuveer Departmental Stores consists of Karta, his wife, two sons and daughter. Both the sons who are having professional/technical qualifications as a Company Secretary and as an Automobile Engineer started in partnership, a garage for the repairing of motor cars, with a clear understanding that the technical side of the business be looked after by the Engineer while the general administration and finance part be taken care by the Company Secretary. They had taken an interest-free loan of Rs. 5,00,000 from the HUF for starting the venture. The business of garage resulted in a net profit of Rs. 15,00,000 for the year ended 31.03.2026. The Assessing Officer proposes to assess the income from the business of motor garage in the hands of HUF. Examine the validity of the proposition of the Assessing Officer in the light of a decided case law.

Solution:

The facts of the case are similar to that of the case of CIT v. Charan Dass Khanna & Sons (1980) 123 ITR 194, where the Delhi High Court observed that if the investment made by the HUF in the business started by the coparceners plays a minor role and it is primarily the personal efforts, specialized skill and enterprise of the individual coparceners which resulted in setting up of a new business and earning of goods profits, then it may not essentially be said that the income belongs to the HUF.

The Supreme Court has also supported this view in the case of K.S. Subbiah Pillai v. CIT (1999) 237 ITR 11 and held that where the remuneration and commission earned by the Karta were on account of the personal qualifications and exertions and not on account of the investment of the family funds, such income cannot be treated as income of the HUF.

Thus, in the given case, profits were earned primarily because of the specialized skills acquired by both the partners in their respective fields and used in the business of motor garage. The initial capital taken from the HUF as interest free loan, of course, has its role but it is nevertheless a minor one. Therefore, the income from the business set up by the brothers is assessable in their individual hands and not as the income of the family.

Further, the proposition of the Assessing Officer to tax the profits of the business of motor garage earned by the two sons in the hands of the HUF is not valid.

Illustration 6:

Ram (59 years) and his two brothers (Ramesh (57 years) and Somesh (50 years) are engaged in family business of cultivation of wheat. Last year they had losses to the extent of Rs. 12,000 but this year, due to good season the Business earned a Profit of Rs. 2,20,000.

The family owns a house property, the municipal valuation of which is Rs. 280000 and the market rent of similar property is Rs. 2,85,000. The standard rent as per Rent Control Act is Rs. 3,50,000. The family pays Rs. 48,000 for municipal taxes during the previous year out of which Rs. 20,000 pertains to earlier year which could not be paid due to business loss. Interest on capital borrowed for repaying original loan for construction of house Rs. 75,000. Further, the rental income of the property is Rs. 3,10,000.

Dividend received from Indian Company X Ltd. Rs. 12,000. Interest received on listed debentures Rs.8,10,000 (net).

Compute the total income and Tax liability of the family X (HUF) for the Assessment year 2026-27.

Option 1: Assessee has opted to pay tax as per the old scheme.

Option 2: Assessee is paying tax as per Section 115BAC.

Solution:

Option 1: Assessee has opted to pay tax as per the old scheme:

Computation of Total Income of X (HUF) for the Assessment Year 2026-27

Income from House Property	(Rs.)
Gross Annual Value	3,10,000
Less: Municipal Taxes	(48,000)
Net Annual Value	2,62,000
Less: Standard Deduction @ 30% of 2,62, 000	(78,600)
Less: Interest on Capital borrowed	(75,000)
Income from House Property	1,08,400
Income from Business/Profession	
Agricultural income (Exempt)	NIL
Income from other Sources	
Dividend received from Indian Company X Ltd.	12,000
Interest on Listed Debentures $8,10,000/90 \times 100$	9,00,000
Gross Total Income	10,20,400
Less: Deduction under Section 80C to 80U	NIL
Total Income	10,20,400

Note: The share of Karta and other coparceners in the profits of HUF will be exempt under section 10(2)

Computation of tax on Total Income of X (HUF) for the Assessment Year 2026-27

Particulars		Amount (Rs.)
(a)	Agricultural income (2,20,000-12,000)	2,08,000
(b)	Non-agricultural income	10,20,400
(c)	Total of (a) and (b)	12,28,400
(d)	Tax payable on (c)	1,81,020
	Tax on first 2,50,000 NIL	
	Tax on next 250,000 @ 5% = Rs. 12,500	
	Tax on next 500,000 @ 20% = Rs. 100,000	
	Tax on remaining income Rs. 2,28,400 @ 30% = 68,520	
(e)	Total of agricultural income and basic exemption limit	4,58,000
(f)	Tax payable on (e) (As per slab rates)	10,400
(g)	Net tax payable = (d) – (f)	1,70,620
(h)	Add: Health and Education cess of 4% on Rs.170620	6,824
(i)	Total tax (round off)	1,77,440

Option 2: Assessee is paying tax as per section 115BAC**Computation of Total Income of X (HUF) for the Assessment Year 2026-27**

Income from House Property	(Rs.)
Gross Annual Value	3,10,000
Less: Municipal Taxes	(48,000)
Net Annual Value	2,62,000
Less: Standard Deduction @ 30% of 2,62,000	(78,600)
Less: Interest on capital borrowed	(75,000)
Income from House property	1,08,400
Income from Business/Profession	(Rs.)
Agricultural income (Exempt)	NIL

Income from other sources	
Dividend received from Indian Company X Ltd.	12,000
Interest on listed debentures	9,00,000
Gross Total Income	10,20,400
Less: Deduction under section 80C to 80U	NIL
Total Income	10,20,400

Note: The share of Karta and other coparceners in the profits of HUF will be exempt under section 10(2).

**Computation of Tax on Total Income of X (HUF) for the
Assessment Year 2026-27**

Particulars		Amount (Rs.)
(a)	Agricultural income (2,20,000-12,000)	2,08,000
(b)	Non-agricultural income	10,20,400
(c)	Total of (a) and (b)	12,28,400
(d)	Tax payable on (c)	64,260
	Tax on first 4,00,000 NIL	
	Tax on next 4,00,000 @ 5% = Rs. 20,000	
	Tax on next 4,00,000 @ 10% = Rs. 40,000	
	Tax on next 28,400 @ 15 % = Rs.4,260	
(e)	Total of agricultural income and basic exemption limit	6,08,000
(f)	Tax payable on (e) (As per slab)	10,400
(g)	Net tax payable = (d)-(f)	53,860
(h)	Add: Health and Education cess of 4% on Rs. 53,860	2,154.40
(i)	Total tax (round off)	56,010

Illustration 7: Ram, 66 years is the Karta of a HUF with his two sons Ramesh (39 years) and Somesh (25 years). The family owns a house property, the rental income of the same is Rs. 3,10,000. Family business profits Rs. 2,80,000. Long-term capital gains Rs. 25,000 and short-term capital gains for the year Rs.11,000 (STT applicable). Dividend received from Indian Company X Ltd. Rs. 12,000. Interest received on listed debentures Rs.8,000 (gross) Ram invested in PPF Rs. 1,50,000 out of family funds and received share of profits from a firm in which he represented HUF being Karta. Ram gifts Rs. 1,00,000 to family. Salary income of Ramesh Rs. 6,00,000 Interest on Government Securities Rs. 10,000(gross) out of own funds of Ram.

Compute the total income and Tax liability of the family X (HUF) and Ram, Ramesh and Somesh for the Assessment year 2026-27. Assume that assessee are opting to pay tax as per old scheme.

Solution:

Computation of Total Income of X (HUF) for the Assessment Year 2026-27

Income from House Property	Amount (Rs.)
Rent	3,10,000
Less: Standard Deduction @ 30%	93,000
Income from House property	2,17,000
Income from Business/Profession	
Business Profits	2,80,000
A Firm (Exempt)	NIL
Income under the Head Capital Gains	
Long-term Capital Gain	25,000
Short term Capital Gain	11,000
Income from other sources	
Dividend received from Indian Company X Ltd.	12,000
Interest received on listed debentures	8,000
Gift (Exempt)	NIL
Gross Total Income	5,53,000
Less: Deduction under section 80C to 80U	
Under section 80C (maximum)	1,50,000
Total Income	4,03,000

Note: The share of Karta and other coparceners in the profits of HUF will be exempt under section 10(2)

Computation of tax on Total Income of HUF for the Assessment Year 2026-27

Tax on long-term capital gains (12.5% of Rs. 25,000)	3,125
Tax on short-term capital gains (20% of Rs. 11,000)	2,200
Balance of Total Income Rs. 3,67,000	5,850
Total tax	11,175
Add: Health and Education Cess at 4%	447
Total liability (round off)	11,620

Note: The share of Karta and other coparceners in the profits of HUF will be exempt under section 10(2)

Computation of taxable income of Ram, Ramesh and Somesh for the Assessment Year 2026-27

Particulars	Ram	Ramesh	Somesh
Salary Income		6,00,000	
Business Income:			
Profit share in HUF	Exempt	Exempt	Exempt
Income from other sources			
Interest on Government Securities	10,000		
Gross Total Income	10,000	6,00,000	
Deduction's u/s 80C to 80U			
Taxable Income	10,000	6,00,000	
Tax liability	NIL	33,800	NIL

TAXATION OF FIRMS

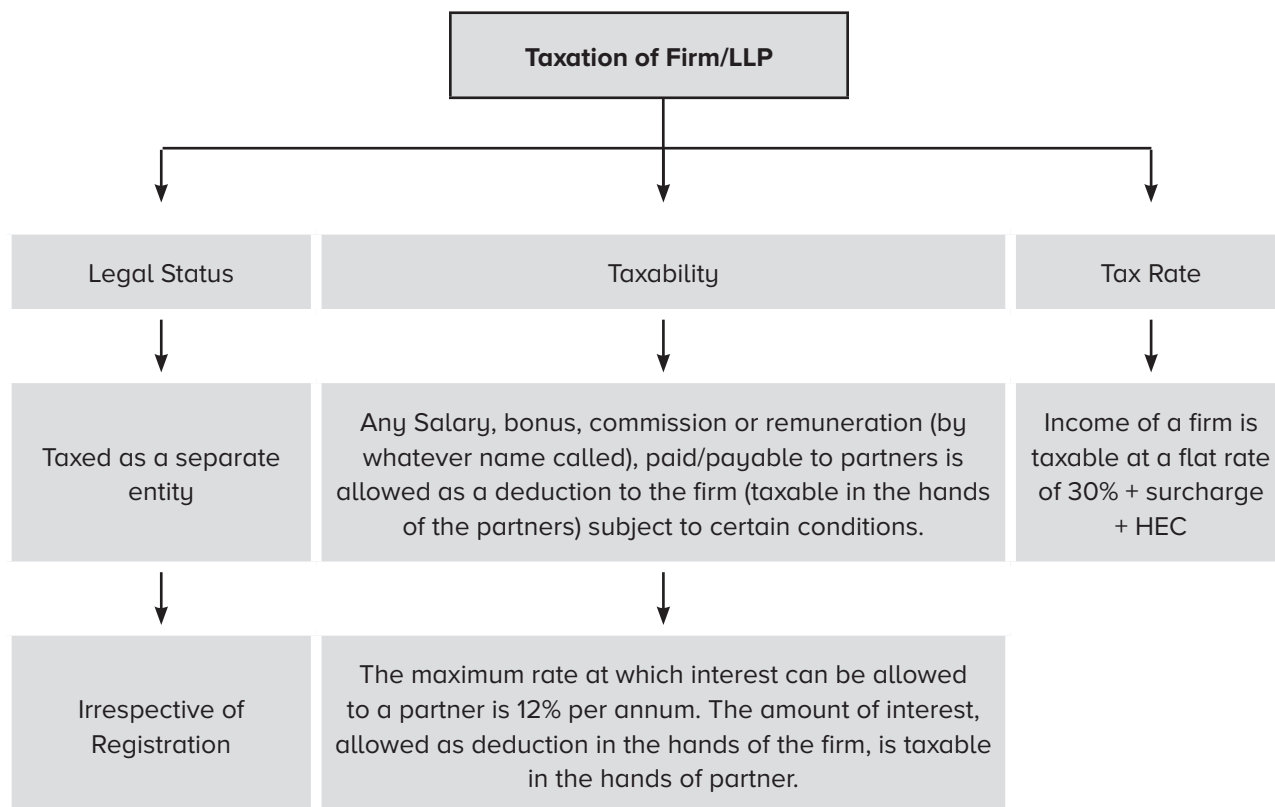
Under Section 2(23) of the Income-tax Act, the terms “firm”, “partner”, and “partnership” have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.

The expression “partner” also includes a minor who has been admitted to the benefits of partnership and a partner of a Limited Liability Partnership Act, 2008. However, a minor cannot validly enter into any partnership as a ‘full partner’ with other persons but he can be admitted to the benefits of partnership only.

A joint Hindu family as such cannot be a partner in a firm. However, through its Karta it may enter into a valid partnership with a third person or with a member of the undivided family in his individual capacity. In such a case, the Karta occupies a dual position. On the partnership he functions in his individual capacity; on the relations to other members of the Hindu undivided family, in his representative capacity.

An incorporated company being a legal person may form a partnership with an individual or with another company. In considering the maximum number of partners comprising a firm, the company will be considered as one person only.

A partnership firm as such is not entitled to enter into a partnership with another firm, H.U.F., individual, or a company. However, its partners in their individual capacity can enter into another partnership.



Assessment as a Firm [Section 184]

As per the scheme, a partnership firm in the first assessment year shall be assessed as a firm if the following conditions are satisfied:

1. The partnership is evidenced by an instrument, i.e., partnership deed which is to be in writing containing necessary clauses.
2. The individual shares of the partners as specified in that instrument (including how the loss will be borne by major partners in case of a minor admitted for benefits only).

A copy of the partnership deed certified by all the partners or their duly authorized agents, in writing (other than the minors) is submitted along with the return of income in respect of which assessment as a firm is first sought.

Where the return is made after the dissolution of the firm, the copy of the partnership deed should be certified in writing by all persons (excluding minors) who were partners of the firm immediately before its dissolution and by the legal representative of any deceased partner.

When a firm is assessed as such for any assessment year, it shall be assessed in the same capacity for every subsequent year if there is no change in the constitution of the firm or in the shares of partners as evidenced by the partnership deed on the basis of which assessment as a firm was first sought.

Where any such change has taken place in the previous year, the firm shall furnish a certified copy of the revised instrument of partnership along with the return of income for the assessment year relevant to such previous year. In doing so all the provisions of Section 184 will apply to the firm. Further, any change in remuneration or interest to partners is to be notified in the same manner to comply with section 40(b).

Circumstances where the firm will be assessed as a firm but shall not be eligible for deduction on account of interest, salary, bonus, etc.

Where the firm—

1. fails to make the return required under Section 139(1) and has not made a return or revised return under Section 139(4) or 139(5), or
2. fails to comply with all the terms of a notice issued under Section 142(1) or fails to comply with a direction issued under Section 142(2A), or
3. having made a return, fails to comply with all the terms of a notice issued under Section 143(2)(d) does not comply with three conditions mentioned above u/s 184.

Then the firm shall not be eligible for any deduction on account of interest to a partner and remuneration to a working partner although the same is mentioned in the partnership deed.

Computation of Income and Tax Liability of Firm

The income of the firm shall be computed as per the normal provisions of the Act under various heads of income excluding incomes exempt from tax and deductions under section 80 as applicable.

Rate of Tax: In the case of a firm which is assessable as such (i.e., as a firm), tax is chargeable on its total income at the rate of 30%.

Surcharge @12% shall be applicable where the total income exceeds Rs. 1 crore.

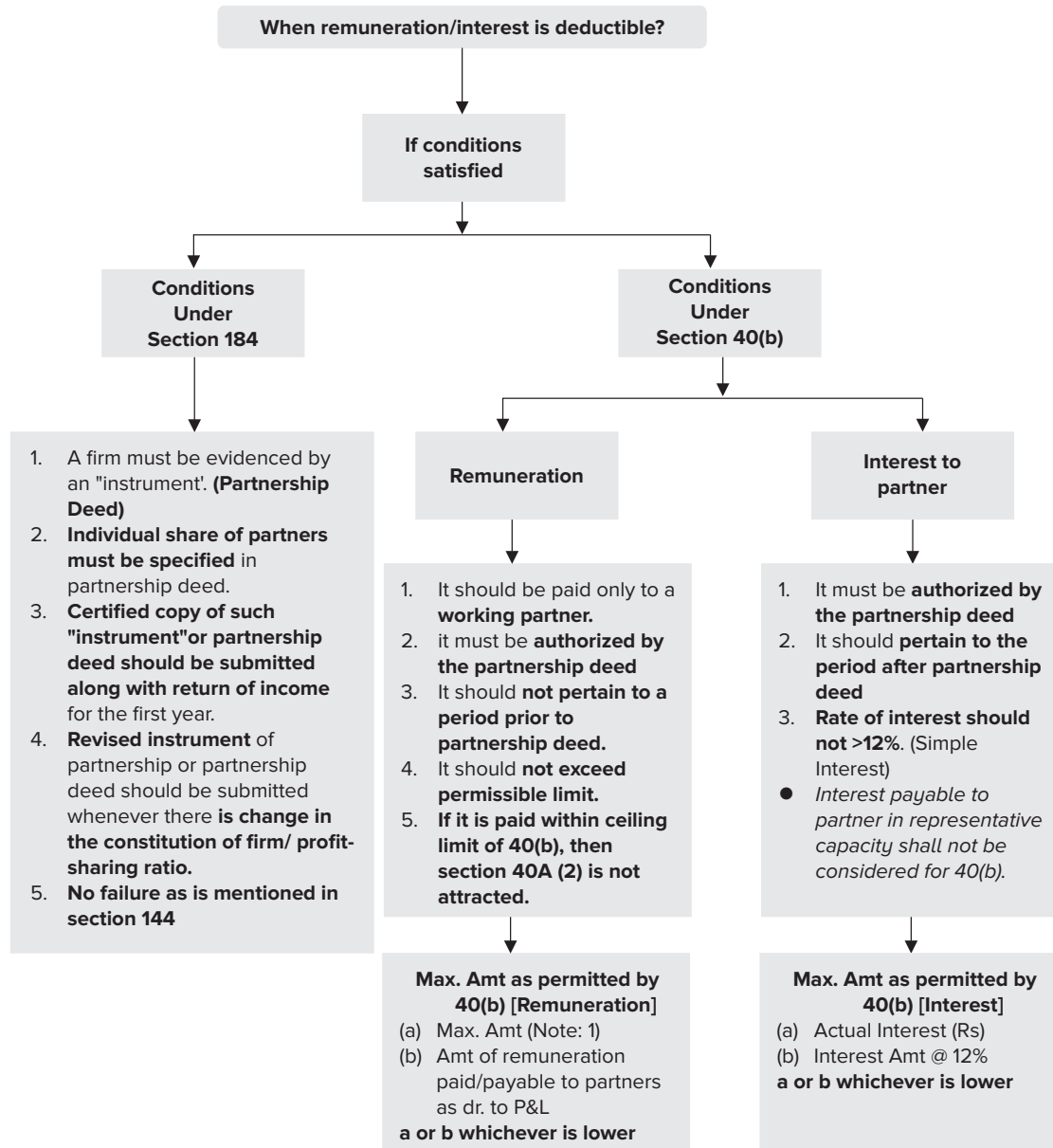
Health and Education Cess shall be added as 4% of tax plus surcharge. However, firm and LLP is subject to Alternate Minimum Tax 'AMT' under section 115JC (discussed in detail later in this chapter).

Partnership is not a separate entity distinct from the partners, but for tax purposes a partnership is taxed as a separate entity and therefore total income will be computed under various heads of income. A partnership firm is also entitled for deductions under section 30 to 38 for expenditures incurred. However, for payment of remuneration to partners and interest on capital are allowed subject to conditions laid down under section 40(b).

Section 40(b), contains the following conditions which need to be complied with while making payment of remuneration and interest on borrowed capital to the partners:

- (i) Payment of salary, bonus, commission or remuneration by whatever name called to a non-working partner shall not be allowed as deduction. Such payments are allowed only to working partners if it is assessed by the partnership deed and are in accordance with partnership deed. Also, such payments should pertain to the period after the partnership deed.
- (ii) Interest payable to a partner, assessed by the partnership deed for period after the partnership deed shall be allowable as deduction subject to a maximum of 12% p.a. If the partnership deed provides for interest at less than 12% p.a, the deduction of interest shall be allowed to the extent provided by the partnership deed.
- (iii) the payment of remuneration to working partner, although assessed by partnership deed however it is subject to maximum of the following limits.

Uniform limits for both Professional Firms and Non-Professional Firms	
On the first Rs. 6,00,000 of the book-profit or in case of a loss.	Rs. 3,00,000 or 90% of the book-profit, whichever is more.
On the balance of the book-profit	60% of the book profits.



Meaning of Book Profit [Explanation 3 to section 40(b)]

Book-profit" means the net profit, as shown in the profit and loss account and make the additions and deductions as per section 28 to 44DB explained under the head income from Business and Profession 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. Interest paid/payable to partners in excess of 12% shall also be disallowed as per section 40(b).

Net profit as per P&L account	**
Add/less: Adjustments as provided by sections 28 to 44DB	
Add: Remuneration to partners if debited to the P & L	
Book profit	**

Note:

- Income chargeable to tax under the heads “Income from house property,” “Capital gains” and “Income from other sources” is not part of “book profit”
- Brought forward business losses are not to be deducted from “book profit” (Adjust b/f unabsorbed depreciation from earlier years); and for allowing unabsorbed depreciation, b/f business loss shall have to be notionally allowed first from current business income.
- Permissible deductions from gross total income under sections 80C to 80U shall be ignored for computing “book profit”.
- Interest on FD is considered to be business income and hence it will be included in book profit. CIT v. J.J. Industries [2013] 216 Taxman 162(Guj.)

CASE 1

D Patel & Associates, a firm carrying on business provides details for the FY 2025-26 stated a book profit before adjusting unabsorbed depreciation and b/f business loss of Rs 1,85,000. However, the unabsorbed depreciation of earlier years and b/f business loss would be Rs. 85,000 and Rs. 1,15,000 respectively. Kindly advise towards treatment of Brought forward business losses and allowable remuneration under section 40(b).

Solution:

Provision for Brought forward business losses

Brought forward business losses are not to be deducted from “book profit” (Adjust b/f unabsorbed depreciation from earlier years); and for allowing unabsorbed depreciation, b/f business loss shall have to be notionally allowed first from current business income.

Computation of allowable remuneration under section 40(b)

Particulars	Amount Rs
Book profit before adjusting unabsorbed depreciation and b/f business loss	1,85,000
Less: B/F business loss (Notional Deduction)	(1,15,000)
Balance	70,000
Less: Set off unabsorbed depreciation (To the extent of Rs. 70,000)	(70,000)
Balance	0
Add: B/F business loss (Notional Deduction) but not allowed to be set off as carried under section 72	1,15,000
Book Profit	1,15,000
Allowable Remuneration under section 40(b)	
(a) 3,00,000	3,00,000
(b) 90% of Book profit (i.e. 90% of 1,15,000) = 1,03,500	
Whichever is higher	

Summarized provisions of carry forward and set off of loss in the case of Firm		
Points to be noted	● No separate provision of carry forward and set off of loss of firms. ● Same as applicable in case of other assesses ● Losses and unabsorbed depreciation of firm can be carried forward by firm only.	
Set off and carry forward in case of Change in the constitution of firm	● Section 78 provides that where there is a change in the constitution of the firm on account of death/ retirement, the firm shall not be entitled to carry forward of so much of the loss as is attributable to such partner. ● This provision covers when a partner goes out of the firm (i.e., the case of retirement or death). ● It does not cover the case of change in profit-sharing ratio or the case of admission of a partner. ● Section 78 is not applicable in the case of unabsorbed depreciation and unabsorbed capital expenditure on scientific research.	
Tax Treatment in case of change in constitution of firm	Step 1: Compute Share of outgoing partner in the profit of the firm in the year of change in the constitution of firm	**
	Step 2: Compute the share of loss of outgoing partner in the brought forward loss.	**
	Step 3: Set off share in b/f loss of outgoing partner for his share of profit of current year.	**

CASE 2

XL and Associates (A firm) having 3 partners sharing profit in the ratio of 2:2:1 provides you the following details for the PY 2025-26.

Profit (Before) setting of b/f loss and depreciation	3,60,000
B/F depreciation for AY 2025-26 (i.e. PY 2024-25)	1,50,000
B/F loss of AY 2025-26	2,00,000

You are requested to advice on Tax Treatment in case of change in constitution of firm when one of the partners retired on 31.8.2025 from the firm.

Solution:

Particulars	Amount
Step 1: Share of outgoing partner in the profit of the firm in the year of change in the constitution of firm $(3,60,000 \times \frac{2}{5} \times \frac{5}{12})$ [Period from 1.4.2025-31.8.2025]	60,000

Step 2: Share of loss of outgoing partner in the brought forward loss. $(2,00,000 \times 2/5)$	80,000
Step 3: Set off loss to the extent of profit	
Loss 80,000	
Less: Set off of profit (60,000)	60,000
Balance of Loss (Can't be carried forward and set off by firm)	20,000
Firm is allowed to set off b/f loss $(2,00,000 - 20,000)$ to the extent of	1,80,000

Assessment of Partners

As per Section 10(2A) of the Act, any person who is a partner of a firm which is assessed as such, his share in the total income of the firm will not be included in computing his total income. Partner includes a minor admitted to the benefits of partnership as per Section 2(23) of the Act.

Further, the explanation to Sub-clause (2A) provides that the share of a partner in the total income of the firm assessed as a firm shall be an amount which bears to the total income of the firm the same proportion as the amount of his share in the profits of the firm (in accordance with the partnership deed) bears to such profits.

In terms of a formula, the amount exempt would be: Partners share in the profit of the firm = as shown in the partnership deed $\frac{\text{Total Profits of the Firm}}{\text{Total income of the firm}}$.

Any interest, salary, bonus, commission or remuneration by whatever name called which is due to or received by a partner of a firm from the firm will be chargeable to tax in the hands of the partner (to the extent allowed as deduction to the firm) under the head "profits and gains of business or profession". However, if such salary, interest, bonus, commission or remuneration (or any part thereof) has not been allowed as deduction as per Section 40(b) in the hands of the firm, the amount not allowed as deduction shall not be charged to tax in the hands of partners.

Further, deductions under Sections 32 to 37 can be claimed by a partner from any income where any expenditure was incurred to earn such income.

Succession of one firm by another firm [Section 188]

When all the partners in the predecessor firm are replaced by new partners in the successor firm, it is known as succession of one firm by another firm. If a firm is dissolved and some of the partners take over the firm's business or carry on a similar business with or without new partners, it would be a case of succession by a new firm (62 I.T.R. 75).

In CIT v. K.H. Chambers (1965) 55 ITR 674, the Supreme Court laid down the following requisites of succession:

- (i) There is a change of ownership.
- (ii) The whole business is transferred.
- (iii) Substantially the identity and the continuity of the business are preserved.

Where the partnership deed does not provide specifically for continuance of the firm on the death of a partner, there would be no change in constitution of the firm but it would be a case of succession. [Addl. CIT v. Thyagasundara Mudaliar (1981) 127 ITR 520].

Where a firm is succeeded by another firm, separate assessments are made on the predecessor and successor firms respectively in accordance with the provisions of Section 170. Section 170 provides that the predecessor shall be assessed in respect of the income of the previous year in which the succession took place up to the date of succession and the successor shall be assessed in respect of the income of the previous year after the date of succession. If the predecessor cannot be found, or the tax assessed on the predecessor cannot be recovered from him for the previous year (in which the succession took place) and the previous year immediately preceding such previous year, the assessed tax payable by the predecessor shall be recovered from the successor.

However, the successor firm is entitled to recover from the predecessor firm any tax paid by it on behalf of the former. If any tax is due against any partner of the predecessor firm, it cannot be recovered from the successor firm.

Joint and Several Liabilities of Partners for Tax Payable by Firm [Section 188A]

Section 188A provides that every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of Income-tax Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.

Firm Dissolved or Business Discontinued [Section 189]

Where any business or profession carried on by a firm has been discontinued or where a firm is dissolved, the assessment of the total income of the firm shall be made as if no such discontinuance or dissolution had taken place and all the provisions of the Act, including the provisions relating to penalty or any other sum (interest, fine) chargeable under the Act, shall apply. Consequently, every person who was a partner of the firm at the time of discontinuance of business or dissolution of the firm and legal representative of the deceased partner shall be jointly and severally liable to the amount of tax penalty and any other sum. Where the dissolution or discontinuance of business takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the partners or legal representative of a deceased partner from the stage at which the proceedings stood at the time of such dissolution or discontinuance.

Thus, every partner of the firm and the legal representative of the deceased partner is liable to pay the tax which is already due or may have become due after the dissolution, irrespective of his interest in the firm.

However, if there was any irrecoverable amount at the time of dissolution or discontinuance of business and later on it was recovered by the partners, the partners shall personally pay the tax on their share so recovered.

ALTERNATE MINIMUM TAX (AMT) [SECTION 115JC]

Summarized provisions of Alternate Minimum Tax [AMT]	
Chapter	XIIB (Special provisions relating to certain persons other than a company)
Section	115JC to 115JF

Applicability ↓ Non Corporate Assessee	<table><tr><th>Non Corporate Assessee</th><th>Condition</th></tr><tr><td>Individual/HUF/AOP/BOI/AJP</td><td>If Adjusted Total Income (ATI) > Rs. 20 Lakh</td></tr><tr><td>LLP/Any other firm/Any person other than company</td><td>If claimed deduction - u/s 10AA/80H to 80RRB (Except 80P) for AY 13-14 or 14-15 or - u/s 10AA/35AD/80H to 80RRB (Except 80P) for AY 15-16 onwards </td></tr></table>	Non Corporate Assessee	Condition	Individual/HUF/AOP/BOI/AJP	If Adjusted Total Income (ATI) > Rs. 20 Lakh	LLP/Any other firm/Any person other than company	If claimed deduction - u/s 10AA/80H to 80RRB (Except 80P) for AY 13-14 or 14-15 or - u/s 10AA/35AD/80H to 80RRB (Except 80P) for AY 15-16 onwards						
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Non-Applicability	- Non-Corporate Assessee whose adjusted total income (ATI) is Rs 20,00,000 or less. - Person who has opted to pay tax under section 115BAC/115BAD/115BAE.												
Tax Rate (AMT)	<table><tr><td>Normal Tax Rate</td><td>18.5% of ATI</td></tr><tr><td>Co-Operative Society</td><td>15% of ATI</td></tr><tr><td>Units located in IFSC and derived income solely in convertible forex</td><td>9% of ATI</td></tr></table>	Normal Tax Rate	18.5% of ATI	Co-Operative Society	15% of ATI	Units located in IFSC and derived income solely in convertible forex	9% of ATI						
Normal Tax Rate	18.5% of ATI												
Co-Operative Society	15% of ATI												
Units located in IFSC and derived income solely in convertible forex	9% of ATI												
Tax liability	A. Tax on total income as per normal provision of Income Tax Act. B. 18.5% (+SC+HEC) of Adjusted Total Income. Amount of tax payable = (A) or (B) whichever is higher												
A > B	- Non-Corporate has to pay normal income tax. - Non-Corporate can utilize amount of AMT credit in that year if available. Maximum Amount of Credit Utilized = A-B												
A<B	- Non-Corporate has to pay AMT u/s 115JC. - Non-Corporate can only avail AMT credit. AMT Credit Available = B-A												
How to compute ATI	<table><tr><td>Net Income or Total Income</td><td>**</td></tr><tr><td>Add:</td><td></td></tr><tr><td> - Deduction under section 10AA </td><td>**</td></tr><tr><td> - Deduction under section 80H to 80RRB (Except 80P) </td><td>**</td></tr><tr><td> - Deduction claimed, if any, under section 35AD (as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction under section 35AD was allowed in respect of the assets on which the deduction under that section is claimed). </td><td>**</td></tr><tr><td>Adjusted Total Income</td><td>**</td></tr></table>	Net Income or Total Income	**	Add:		Deduction under section 10AA	**	Deduction under section 80H to 80RRB (Except 80P)	**	Deduction claimed, if any, under section 35AD (as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction under section 35AD was allowed in respect of the assets on which the deduction under that section is claimed).	**	Adjusted Total Income	**
Net Income or Total Income	**												
Add:													
Deduction under section 10AA	**												
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Deduction claimed, if any, under section 35AD (as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction under section 35AD was allowed in respect of the assets on which the deduction under that section is claimed).	**												
Adjusted Total Income	**												

Set off and Carry forward AMT credit	● Not beyond 15th Assessment year ● From AY 2018-19, AMT Credit shall not be carried forward to subsequent year to the extent such credit relates to difference between Foreign Tax Credit (FTC) allowed against AMT. ● No interest is payable on AMT credit. ● AMT can't be adjusted in case of person who has opted for the Alternative Tax regime under section 115BAC/115BAD/115BAE.
Report	The assessee will have to obtain a report in Form No. 29C electronically from a chartered accountant one month prior to the due date of submission of return certifying that the ATI and AMT have been computed in accordance with the provisions of this Chapter.
Other Provisions	Advance tax, interest u/s 234A/B/C shall apply to assessee

The provisions of section 115JC are applicable to all assessee except companies where the regular income tax payable for a previous year is less than the alternate minimum tax payable for such previous year then the adjusted total income shall be deemed to be the total income of that person for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% plus Health and Education Cess @ 4%.

12% surcharge if Adjusted Total income of the firm or LLP exceeds INR 1 crore plus 4% Health & Education cess in all cases. In case of individual surcharge will be 10% if Adjusted Total income exceeds INR 50 Lacs and 15% if it exceeds INR 1 crore and 25% if it exceeds INR 2 crores and 37% if it exceeds INR 5 crores.

It is further provided that the provisions of AMT under Chapter XII-BA shall only apply to an individual or a Hindu undivided family or an association of persons or a body of individuals (whether incorporated or not) or an artificial juridical person if the adjusted total income of such person exceeds **twenty lakh rupees**.

However, AMT is levied @ 9% in case of a non-corporate assessee being a unit located in International Financial Services Centre and deriving its income solely in convertible foreign exchange.

For Co-operative Society rate of AMT will be 15% from AY 2025-26 onwards. Surcharge and cess as applicable will also be levied.

The regular income tax payable shall be the income-tax payable for a previous year by a person other than a company on his total income in accordance with the provisions of the Act other than the provisions of Chapter XII- BA, i.e., section 115JC to 115JF.

Adjusted total income shall be the total income before giving effect to the provisions of Chapter XII-BA as increased by the deductions claimed under any section 80H to Section 80RRB (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" and deduction claimed under section 10AA. Further, total income shall be increased by the deduction claimed under section 35AD for purpose of computation of adjusted total income. The amount of depreciation allowable under section 32, as if no deduction u/s 35 AD in respect of such assets was allowed, shall however, be reduced in computing the adjusted total income.

Particulars	(Rs.)
Taxable income of the taxpayer	XXXX

Particulars	(Rs.)
Add: Amount of deduction claimed under section 80H to 80RRB (except 80P)	XXXX
Add: Amount of deduction claimed under section 35AD (as reduced by the amount of depreciation allowable in accordance with the provisions of section 32)	XXXX
Add: Amount of deduction claimed under section 10AA	XXXX
Adjusted total income	XXXX

The provisions can be summarized as:

1. If regular income tax payable is more than or equal to the alternate minimum tax (18.5% plus Health and Education cess @ 4% of adjusted total income), the regular income tax payable is the tax liability of the assessee.
2. If regular income tax payable is less than the alternate minimum tax (18.5% plus Health and Education cess @ 4% of adjusted total income), the adjusted total income is the deemed income of the assessee for that year and alternate minimum tax is the tax liability.

However, the credit for tax (tax credit) paid by a person on account of AMT under Chapter XII- BA shall be allowed to the extent of the excess of the AMT paid over the regular income-tax. This tax credit shall be allowed to be carried forward up to the fifteen assessment years immediately succeeding the assessment year for which such credit becomes allowable and set off against regular tax liability. In other words, it shall be allowed to be set off for an assessment year in which the regular income-tax exceeds the AMT, to the extent of the excess of the regular income-tax over the AMT.

The amount of AMT credit shall not be allowed to be carried forward to the subsequent year to the extent such credit relates to the difference between the amounts of foreign tax credit (FTC) allowed against AMT and FTC allowable against the tax computed under regular provisions of the Act.

Every person to which this section applies shall obtain a report, before the specified date referred to in section 44AB, in such form as may be prescribed, from an accountant referred to in the Explanation below sub-section (2) of section 288, certifying that the adjusted total income and the alternate minimum tax have been computed in accordance with the provisions of this Chapter and furnish such report by that date.

All other provisions of the Act, like advance tax, interest u/s 234A/B/C shall apply to assessee who is liable to pay AMT.

The provisions of AMT shall not apply to a person who has exercised the option referred to in section 115BAC or section 115BAD or section 115BAE.

Illustration 8:

A, B and C are the partners for 3:2:1 share respectively, in a firm engaged in medical profession. Compute the total income of the firm for the year ended 31st March, 2026:

Particular	Rs.	Particular	Rs.
Office Expenses	15,400	Gross Profit	40,000
Income Tax	1,000	Net Loss A	8,700

Salary to A	5,000	Net Loss B	5,800
Salary to B	4,000	Net Loss C	2,900
Salary to C	10,000		
Bonus to A	10,000		
Bonus to B	12,000		
Total	57,400	Total	57,400

Solution:

Computation of Book Profit of the Firm	Rs.	Rs.	Rs.
Net Loss as per P & L A/c			(17,400)
Add: Inadmissible Expenses:			
Income-tax		1,000	
Salary to partners:			
A	5,000		
B	4,000		
C	10,000	19,000	
Bonus to partners			
A	10,000		
C	12,000	22,000	42,000
Book Profit			24,600

Permissible Remuneration to Partners

90% of first Rs. 6,00,000 of Book-profit or Rs. 3,00,000 whichever is more, is allowed as deduction. Here the permissible remuneration comes to Rs. 3,00,000, but as the partners have claimed Rs. 41,000 only, hence the entire amount will be allowed.

Computation of total income of the firm

Book Profit		24,600
Less: Salary to Partners	19,000	
Bonus to Partners	22,000	(41,000)
Loss of the Firm		(16,400)

Note: Loss of the firm will be carried forward by the firm to the next year(s).

Illustration 9:

M, N and O are partners sharing profits and losses in the ratio of 2:1:1 respectively. Their summarized Profit and Loss A/c for the year ending 31st March, 2026 is appended below:

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Office salaries	5,680	Gross Profit	60,570
Telephone and Telegram	2,000	Rent received	6,000
Interest on loan from M	2,000	Interest on securities	4,000
Local taxes (let out property)	1,000		
Salary to N	3,000		
Commission to partners			
M	4,000		
N	5,000		
O	6,000		
Collection charges of interest on securities	50		
Bad debts reserve	1,000		
Net Profit to partners:			
M	20,420		
N	10,210		
O	10,210		
Total	70,570	Total	70,570

Compute total income of the firm for the Assessment Year 2026-27 and tax liability thereon. Interest paid to M has been calculated at the rate of 20% p.a.

Solution:**Computation of Book-Profit**

Particulars	Rs.	Rs.
Net Income as per P & L A/c		40,840
Add: Inadmissible items -		
Local taxes (on let out property)	1,000	

Salary to N (Partner)	3,000	
Commission to partners	15,000	
Collection charges	50	
Bad debts reserve	1,000	20,050
		60,890
Less: Other Incomes -		
Rent received	(6,000)	
Interest on securities	(4,000)	(10,000)
Book Profit		50,890

Maximum remuneration payable to partners

Here Rs. 3,00,000 will be allowed as maximum remuneration. But as the partners have drawn only Rs. 18,000 by way of salary and commission, the entire amount will be allowed as deduction.

Computation of Total Income of the Firm [Assessment Year 2026-27]

Particulars	Rs.	Rs.
Book Profit:		50,890
Less: Salary and commission to partners		(18,000)
– Taxable Business Profit		32,890
– Income from house property		
Rent received		6,000
Less: Municipal taxes		(1,000)
Net adjusted annual value (NAAV)		5,000
Less: Repairs (30% of NAAV) u/s 24		(1,500)
Income from House Property		3,500
– Income from other sources:		
Interest on Securities	4,000	
Less: Collection charges	(50)	3,950
Gross Total Income (32,890 + 3,500 + 3,950)		40,340

The firm will have to pay tax on Rs. 40,340 @ 30%, which comes to Rs. 12,102 plus health and education cess @ 4% on 12,102 making the total liability as Rs. 12,586.

Illustration 10:

Compute tax liability of the firm X & Co. for the assessment year 2026-27 considering the provisions of Section 115JC. The business income of the firm is Rs. 21,00,500 before deduction under section 32 and before deduction under section 35AD Rs. 11,00,000, because of which depreciation of Rs. 40,000 cannot be claimed. Deduction under section 80IB Rs. 1,00,000. Donation paid to a political party Rs. 85,000.

Solution:

Particulars	(Rs.)
GTI – Business Income (Rs. 21,00,500 less 11,00,000)	10,00,500
Less: Deductions	
Under section 80IB	1,00,000
Under section 80GGC	85,000
Net Income	8,15,500
Tax on Rs. 8,15,500 @ 30%	2,44,650
Add: Health and Education Cess @ 4%	9,786
Tax liability	2,54,436
Adjusted total income and alternate minimum tax for the purpose of section 115JC	
Net Income	8,15,500
Add: Under section 80IB	1,00,000
Add: under section 35AD (Rs. 11,00,000 less 40,000)	10,60,000
Adjusted total income	19,75,500
AMT on Rs. 19,75,500 @ 18.5%	3,65,467
Add: Health and Education Cess @ 4%	14,618
AMT liability	3,80,085
AMT liability (round off)	3,80,090
Tax payable is Rs. 3,80,090 being higher of tax liability Rs. 2,54,436 and AMT Rs. 3,80,090.	

Illustration 11:**Income & Expenditure A/c of Lawyers & Co. for the year ending March 31, 2026**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Expenses	1,50,000	By Professional Receipts	3,80,000
To Depreciation	20,000	By Other fees	90,000
To Remuneration to partners	1,50,000		
Interest on Capital to partners @ 20%	20,000		
To Net Profit	1,30,000		
Total	4,70,000	Total	4,70,000

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.

Compute the Total Income of the Firm.

Solution:**Computation of Total Income of Lawyers & Co. for A. Y. 2026-27**

Particulars	Amount (Rs.)	Amount (Rs.)
Net profit as per profit and loss account		1,30,000
Add: Expenses not allowable		
Section 40A(3)- Cash payments to a broker exceeding Rs. 10,000 (Note 1)	30,000	
Section 40(b)-Excess interest on capital to partners 20%-12%, i.e., (20000*8/20) (Note 2)	8,000	38,000
Add: Remuneration to partners debited to profit and loss account		1,50,000
Less: Depreciation u/s 32 (Rs. 40,000 – Rs. 20,000 debited in profit and loss account)		(20,000)
Book profit (Note 3)		2,98,000
Maximum permissible remuneration (higher of the two: (i.e., 90 per cent of Rs. 2,98,000 or Rs. 3,00,000)	3,00,000	

Actual (Subject to actual)	1,50,000	(1,50,000)
Business Income of the Firm		1,48,000
Tax Liability (30% of 1,48,000)		44,400
Add: Health and Education Cess @ 4%		1,776
Total Tax Liability R/O		46,180

Notes:

1. As per section 40A(3) of the Act, if the aggregate payment made (otherwise than by an account payee cheque/draft) to the same person during a day exceeds Rs. 10,000/- the entire amount of such payment is disallowed.
2. As per section 40 (b) of the Act, if the interest payable to the partners exceeds simple interest of 12% per annum, the excess amount is not deductible.
3. The remuneration paid to the working partners cannot exceed the permissible limits specified under section 40 (b) of the Act.

Illustration 12:

Mr. X, carrying on the business of operating a warehousing facility for storage of sugar, has a total income of Rs. 80 lakhs. In computing the total income, he had claimed deduction under section 35AD to the tune of Rs. 70 lakhs on investment in building (on 1.4.2025) for operating the warehousing facility for storage of sugar. Compute his tax liability for A.Y. 2026-27. Show the calculations of Alternate Minimum Tax also.

Option 1: Assessee paying tax under old tax regime

Option 2: Assessee paying tax under Section 115BAC

Solution:

Option 1: Assessee paying tax under old tax regime

Computation of Tax payable by Mr. X for AY 2026-27

Computation of Normal Tax

Particulars	Amount (Rs. In lakh)
Tax liability under the normal provisions of the Income-tax Act, 1961 on Total Income of 80 Lakhs	22.125
Add: Surcharge @ 10% of Total income > 50 lacs	2.2125
Add: Health and Education Cess @ 4% of 24.3375	0.9735
Total Tax Liability	25.311

Computation of Alternate Minimum Tax

Particulars	Amount (Rs. In lakh)
Actual Total Income	80.00
Add: Deduction under section 35AD	70.00
Less: Depreciation under section 32	(7.00)
Adjusted Total Income	143.00
AMT @18.5%	26.46
Surcharge @ 15% (since adjusted total income > Rs. 100 lakh)	3.97
Tax	30.43
Add: Health and Education Cess @ 4%	1.217
Total tax Liability	31.647

Since the regular income tax payable is less than the AMT payable, the adjusted total income of Rs. 143 lakhs shall be deemed to be the total income of Mr. X and tax is payable @18.5% thereof plus surcharge @ 15% and cess @4%. Therefore, tax liability is 31.647 lakhs.

However, Mr. X would be eligible for credit in 15 subsequent years to the extent of difference between the AMT and Normal Tax, i.e. Rs., 6.336 lakhs.

Option 2 : Assessee paying tax under Section 115BAC**Computation of Tax payable by Mr. X for AY 2026-27****Computation of Normal Tax**

Particulars	Amount (Rs. In lakh)
Tax liability under the normal provisions of the Income-tax Act, 1961 on Total Income of 143 Lakhs	38.70
Add: Surcharge @ 15% of Total income > 100 lacs	5.805
Add: Health and Education Cess @ 4% of 44.505	1.7802
Total Tax Liability	46.2852

Note: Alternate Minimum Tax is not applicable if assessee covered u/s 115BAC

Illustration 13:

Mr. A, 42 years, and Mr. B, 50 years, are equal partners in a partnership firm AB and Co. engaged in furniture business. From the profit and loss account of the firm compute net income and tax liability of the firm as well as the partner's for the assessment year 2026-27.

Profit and Loss Account
For the year ending March 31, 2026

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Cost of goods sold	5,10,000	Sales	19,00,000
Salary to staff	6,00,000	Long term capital gain	1,00,000
Depreciation	1,20,000	Lottery prize	35,000
Fees for technical service	40,000	Other business receipts	1,47,000
Remuneration to partners A 1,40,000 B 60,000	2,00,000		
Other Expenses	2,10,000		
Interest on capital @ 20%			
A 43,000			
B 60,000	1,03,000		
Provision for bad debts	10,000		
Net profit	3,89,000		
Total	21,82,000	Total	21,82,000

Other Information

- 1) Remuneration and interest to partners is paid as per partnership deed.
- 2) Depreciation as per income tax rules Rs. 1,00,000.
- 3) Firm paid bonus to employees Rs. 20,400 relating to last year on 15-12-2025.
- 4) Other expenses include donation to approved charitable institution for the purpose of family planning Rs. 45,000.
- 5) Fees for technical services are paid out of India wherein TDS rules apply. Tax has been deducted at source on time on 31 July, 2025 but it is deposited to Government 21 days late on 28 August, 2025.
- 6) The firm complies with conditions of section 184 and 40(b).
- 7) Income and investments of Mr. A and Mr. B are as follows:

Particulars	Mr. A (Rs.)	Mr. B (Rs.)
Interest on Government Securities	60,000	56,000
Interest on Bank Deposit (gross)	4,500	5,000
Dividend from Indian Company	20,000	22,000
Contribution to PPF	1,00,000	1,10,000
Interest on listed Debentures (net)	6,300	6,300

8) Mr. A received gift of Rs. 80,000 from a friend.

9) Assessee paying tax under normal tax regime.

Solution:

Computation of Total Income of AB and Co. for the Assessment Year 2026-27

Calculation of Business Income

Particulars	Amount (Rs.)
Net Profit as per P&L A/C	3,89,000
Add: Inadmissible Expenses	
Excess depreciation [1,20,000-1,00,000]	20,000
Remuneration to partners	2,00,000
Interest on capital in excess of 12% p.a.	
A: $43,000 \times 8/20 = 17,200$	
B: $60,000 \times 8/20 = 24,000$	41,200
Provision for bad debts	10,000
Donations	45,000
Less: Admissible Expenses	
Bonus to employees	(20,400)
Less: Income taxable under head capital gain and other sources	
LTCG	(1,00,000)
Lottery prize	(35,000)
Book profit	5,49,800

Less: Remuneration to partners	
On First 6,00,000 of book profit @ 90%	4,94,820
4,94,820 or Rs. 2,00,000 whichever is less	(2,00,000)
Business Income	3,49,800
Income under the head capital gain [LTCG]	1,00,000
Income from other sources	
Lottery prize 35,000*100/70	50,000
Gross total income	4,99,800
Less: Deduction u/s 80	
80G [100% of 45,000 or 10% of [(4,49,820 – 1,00,000)]]	(34,980)
Taxable Income	4,64,820

Share of A and B in the income of the firm Rs. 2,32,410 (4,64,820/2)

Computation of Tax on Total Income of AB and Co. for the Assessment Year 2026-27

Particulars	Amount (Rs.)
Tax on winning from lotteries (30% of Rs. 50,000)	15,000
Tax on long-term capital gains (12.5% of Rs. 1,00,000)	12,500
Balance of Total Income 3,14,820 @ 30%	94,446
Total tax	1,21,946
Add: Health and Education Cess @ 4%	4,877.84
Total Liability	1,26,823.84

Rs. 1,26,820 (round off, subject to setoff of TDS for winning from lotteries)

Computation of Taxable Income of partners for the Assessment Year 2026-27

Particulars	A (Rs.)	B (Rs.)
Business Salary		
Remuneration	1,40,000	60,000
Interest on capital	25,800	36,000

Profit share in firm	Exempt	Exempt
Income from other sources		
Interest on Government securities	60,000	56,000
Interest on Bank deposits	4,500	5,000
Dividend from Indian companies	20,000	22,000
Interest on listed debentures (6,300*100)/90	7,000	7,000
Gift from a friend	80,000	-
Gross Total Income	3,37,800	1,86,000
Deduction's u/s 80-80C PPF	1,00,000	1,10,000
Taxable Income	2,37,800	76,000
Tax liability	NIL	NIL
TDS amounting to Rs. 700 to be claimed for refund		

Illustration 14:

Mr. A (40 years) and Mr. B (49 years) are equal partners in a firm of company Secretary, AB Co. On April 1, 2025 they amended their partnership deed and provided for salary and interest to partners as follows:

Particulars	Amount (Rs.)
Salary to A	2,50,000 p.a.
Salary to B	3,00,000 p.a.
Interest to A and B	24 % p.a.

From the income and expenditure account of the firm compute net income and tax liability of the firm as well as the partners for the assessment year 2026-27. Assessee has not opted for section 115BAC and paying tax under normal tax regime.

Income and Expenditure Account For the year ending March 31, 2026

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Office expenses	2,51,000	Receipts from clients	8,40,000
Salary to staff	82,000	Interest on drawings	3,500
Income Tax	39,000		
Salary to A	2,50,000		

Salary to B	3,00,000		
Interest on loan to minor son of X @ 15%	6,000		
Interest on capital @ 24%			
A 17,000			
B 19,000	36,000		
Net profit	1,14,500		
Total	8,43,500	Total	8,43,500

Other Information

- 1) The firm does not comply with conditions of section 184 and 40(b).
- 2) The firm has received funds from minor son of X as loan.
- 3) Income and investments of Mr. A and Mr. B are as follows:

Particulars	Mr. A (Rs.)	Mr. B (Rs.)
Investment in 5% Government Loan	12,00,000	11,20,000
Interest from Post office savings bank	4,500	5,000
Medical Insurance Premium	12,000	15,000
Dividend from Foreign Companies	40,000	30,000

Solution:**Computation of Total Income of AB and Co. for the Assessment Year 2026-27****Calculation of Business Income**

Particulars	Rs.
Net Profit as per P&L A/C	1,14,500
Add: Inadmissible Expenses	
Income Tax	39,000
Salary to A	2,50,000
Salary to B	3,00,000
Interest on capital in excess of 12% p.a.	
A: 17000*12/24 8,500	
B: 19000*12/24 9,500	18,000

Book profit	7,21,500
Less: Remuneration to partners [not allowed as conditions of section 184 & 40(b) are not met]	NIL
Business Income	7,21,500
Taxable Income	7,21,500

Share of A and B in the income of the firm Rs. 7,21,500/2= 3,60,750

Computation of tax on Total Income for the Assessment Year 2026-27

Particulars	Amount (Rs.)
Tax on Rs. 7,21,500 @ 30%	2,16,450
Add: Health and Education Cess @ 4%	8,658
Total liability	2,25,108
Total (round off)	2,25,110

Computation of taxable income of partners for the Assessment Year 2026-27

Particulars	A	B
Business Salary		
Remuneration	–	–
Interest on capital	8,500	9,500
Profit share in firm	Exempt	Exempt
Income from other sources		
Interest on Government Loan (5% of 12,00,000; 5% of 11,20,000)	60,000	56,000
Interest on Post office savings bank (exempt upto Rs. 3,500 u/s 10(15)(i))	1,000	1,500
Dividend from Foreign companies	40,000	30,000
Gross Total Income	1,09,500	97,000
Deductions u/s 80		
80D Mediclaim Insurance	(12,000)	(15,000)
Taxable Income	97,500	82,000
Tax liability	NIL	NIL

CASE 4

Tax on total income as per normal provision of Income Tax Act is Rs. 2,05,000 and AMT is Rs. 3,05,000. Compute the tax liability and implications assuming Foreign Tax Credit (FTC) will be Rs. 45,000 and Rs. 60,000 attributable to Normal provision and AMT respectively.

Solution:

Computation of tax liability and adjustment of FTC

Particulars	Amount (Rs.)	Amount (Rs.)
Tax on total income as per normal provision of Income Tax Act	2,05,000	
Less: FTC attributable to Normal Tax	(45,000)	
A. Tax on total income as per normal provision of Income Tax Act		1,60,000
Alternate Minimum Tax	3,05,000	
Less: FTC attributable to AMT	(60,000)	
B. Tax as per AMT		2,45,000
Amount of Tax payable = (A) or (B) whichever is higher		2,45,000
Tax Implications:		
A < B - Non-Corporate has to pay AMT u/s 115JC - Non-Corporate can only avail AMT credit. - AMT Credit Available = B - A = 2,45,000 - 1,60,000 = Rs. 85,000		

CASE 5

The taxable income for the year 2025-26 of Mr. Shah (resident and age 40 years) computed as per the provisions of Income-tax Act is Rs. 28,40,000. The taxable income has been computed after deduction of Rs. 2,00,000 under section 80QQB in respect of royalty on books. Compute the tax liability and tax implications with reference to AMT assuming Mr. Shah does not opt to be taxed under section 115BAC/BAD and paying tax under normal tax regime.

Solution:

Check the eligibility	
Applicable to Non-Corporate Assessee (i.e. Mr. Shah)	Yes
If claimed deduction	Yes
- u/s/ 10AA/80H to 80RRB (Except 80P) for AY 13-14 or 14-15 or - u/s 10AA/35AD/80H to 80RRB (Except 80P) for AY 15-16 onwards	

ATI > Rs. 20,00,000 (i.e. 30,40,000)		Yes
Provision of AMT apply		Yes
Computation of Adjusted Total Income (ATI)		
Net Income or Total Income		28,40,000
Add: ● Deduction under section 10AA ● Deduction under section 80H to 80RRB (Except 80P) (i.e. 80QQB) ● Deduction claimed, if any, under section 35AD (as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction under section 35AD was allowed in respect of the assets on which the deduction under that section is claimed).		Nil 2,00,000 Nil
Adjusted Total Income (ATI)		30,40,000

A	Tax on total income as per normal provision of Income Tax Act		6,91,080
	Tax on 28,40,000	6,64,500	
	Less: Rebate u/s 87A	N.A.	
	Balance	6,64,500	
	Add: Surcharge	N.A.	
	Tax and Surcharge	6,64,500	
	Add: HEC @ 4%	26,580	
	Total Tax Payable	6,91,080	

B	18.5% (+SC+HEC) of Adjusted Total Income		5,84,896
	18.5% on 30,40,000	5,62,400	
	Add: Surcharge	N.A.	
	Tax and Surcharge	5,62,400	
	Add: HEC @ 4%	22,496	
	Total Tax Payable	5,84,896	

Amount of tax payable = (A) or (B) whichever is higher		6,91,080
A > B	Tax Implications – Non-Corporate (i.e. Mr. Shah) has to pay normal income tax – Non-Corporate can utilize amount of AMT credit in that year if available. Maximum Amount of Credit Utilized = A-B = 6,91,080 – 5,84,896 = 1,06,184	

CASE 6

The taxable income for the financial year 2025-26 of Mr. Jay (resident and age 35 years) computed as per the provisions of Income-tax Act is Rs. 20,84,000. The taxable income has been computed after deduction of Rs. 5,00,000 under section 80JJA. Will he be liable to AMT? What will be his tax liability for the year? Assuming Mr. Jay does not opt to be taxed Under section 115BAC/BAD and paying tax under normal tax regime.

Solution:

Check the eligibility	
Applicable to Non-Corporate Assessee (i.e. Mr. Jay)	Yes
If claimed deduction u/s 10AA/35AD/80H to 80RRB (Except 80P) for AY 15-16 onwards	Yes
ATI > Rs. 20,00,000 (i.e. 25,84,000 Refer Note:2)	Yes
Provision of AMT apply	Yes

Computation of Adjusted Total Income (ATI)	
Net Income or Total Income	20,84,000
Add:	
- Deduction under section 10AA	Nil
- Deduction under section 80H to 80RRB (Except 80P) (i.e. 80JJA)	5,00,000
- Deduction claimed, if any, under section 35AD (as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction under section 35AD was allowed in respect of the assets on which the deduction is claimed).	Nil
Adjusted Total Income (ATI)	25,84,000

A	Tax on total income as per normal provision of Income Tax Act		4,55,208
	Tax on 20,84,000	4,37,700	
	Less: Rebate u/s 87A	N.A.	
	Balance	4,37,700	
	Add: Surcharge	N.A.	
	Tax and Surcharge	4,37,700	
	Add: HEC @ 4%	17,508	
	Total Tax Payable	4,55,208	
B	18.5% (+SC+HEC) of Adjusted Total Income		4,97,162
	18.5% on 25,84,000	4,78,040	
	Add: Surcharge	N.A.	
	Tax and Surcharge	4,78,040	
	Add: HEC @ 4%	19,122	
	Total Tax Payable	4,97,162	
	Amount of tax payable = (A) or (B) whichever is higher		4,97,162
A<B	Tax Implications - Non-Corporate (i.e. Mr. Jay) has to pay AMT u/s 115JC - Non-Corporate (i.e. Mr. Jay) can only avail AMT credit. AMT Credit Available = B-A = 4,97,162-4,55,208 =Rs 41,954		

CASE 7

The tax liability of SP Enterprises (a partnership firm) for the financial year 2025-26 under the normal provisions of the Income-tax Act is Rs. 8,40,000 and the liability as per the provisions of AMT is Rs. 10,00,000. Will it be entitled to claim any AMT credit in the subsequent year(s)?

Solution:

A	Tax on total income as per normal provision of Income Tax Act	8,40,000
B	18.5% (+SC+HEC) of Adjusted Total Income	10,00,000
Amount of tax payable = (A) or (B) whichever is higher		10,00,000

Note: Tax Implications**A<B**

- Non-Corporate has to pay AMT u/s 115JC
- Non-Corporate can only avail AMT credit.

AMT Credit Available = B-A = 10,00,000-8,40,000 = **Rs. 1,60,000**

CASE 8

The taxable income for the financial year 2025-26 of Mr. Dixy (resident and age 35 years) who established **unit located in IFSC** and derived income solely in convertible forex computed as per the provisions of Income-tax Act is Rs. 20,84,000. The taxable income has been computed after deduction of Rs. 5,00,000 under section 80JJA. Will he be liable to AMT? What will be his tax liability for the year? Assuming Mr. Jay does not opt to be taxed under section 115BAC/BAD.

Check the eligibility

Applicable to Non-Corporate Assessee (i.e. Mr. Jay)	Yes
If claimed deduction - u/s/ 10AA/80H to 80RRB (Except 80P) for AY 13-14 or 14-15 or - u/s 10AA/35AD/80H to 80RRB (Except 80P) for AY 15-16 onwards	Yes
ATI >Rs. 2000000 (i.e. 25,84,000 Refer Note:2)	Yes
Provision of AMT apply	Yes

Computation of Adjusted Total Income (ATI)

Net Income or Total Income	20,84,000
Add: - Deduction under section 10AA - Deduction under section 80H to 80RRB (Except 80P) (i.e. 80JJA) - Deduction claimed, if any, under section 35AD (as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction under section 35AD was allowed in respect of the assets on which the deduction is claimed).	Nil 5,00,000 Nil
Adjusted Total Income (ATI)	25,84,000

A	Tax on total income as per normal provision of Income Tax Act		4,55,208
	Tax on 20,84,000	4,37,700	
	Less: Rebate u/s 87A N.A Balance	4,37,700	
	Add: Surcharge	N.A.	
	Tax and Surcharge	4,37,700	
	Add: HEC @ 4%	17,508	
	Total Tax Payable	4,55,208	
B	9% (+SC+HEC) of Adjusted Total Income		2,41,862
	9% on 25,84,000	2,32,560	
	Add: Surcharge	N.A.	
	Tax and Surcharge	2,32,560	
	Add: HEC @ 4%	9,302	
	Total Tax Payable	2,41,862	
Amount of tax payable = (A) or (B) whichever is higher			4,55,208
A > B	Tax Implication - Non-Corporate (i.e. Mr. Dixy) has to pay normal income tax - Non-Corporate can utilize amount of AMT credit in that year if available. Maximum Amount of Credit Utilized = A-B = 4,55,208 – 2,41,862 = 2,13,346		

TAXATION OF ASSOCIATION OF PERSONS / BODY OF INDIVIDUALS

'Association of Persons' has not been defined in the Income-tax Act. However, in the case of CIT v. Indira Balkrishna [(1960) 39 ITR 546] the Supreme Court has defined it as:

"Association of Persons" means an association in which two or more persons join in for a common purpose or common action to produce income, profits or gains.

An association of persons may consist of non-individuals (Companies, Firms, Joint Families) [Ipoh v. CIT (1968) 67 ITR 106 (S.C.)]. A minor can join an AOP if his lawful guardian gives his consent. [Murugesan & Bros. v. CIT (1973) 88 ITR 432 (SC)].

Applying the ratio laid down by the Supreme Court in the case of G Murugesan and Bros. v. Commissioner of Income-tax (1973, 88 ITR 432), the Kerala High Court held in the case of Commissioner of Income-tax v. Goel Dalal and Perin C. Dalal (1990, 184 ITR 248) that in order to acquire the status of an association of persons, the

persons must join in a common purpose or action and the object of the association must be to produce income. It is not enough that the persons receive the income jointly.

For the formation of an AOP, the association need not necessarily be on the basis of a contract, consent and understanding may be presumed [Shanmugham & Co. v. CIT(1971) 81 ITR 310 (S.C.)].

Applying the ratio laid down by the Supreme Court in the case of N.V. Shanmugham & Co. v. Commissioner of Income- tax (1971, 81 ITR 310) the Calcutta High Court held in the case of Gopal Chand Sen v. Income-tax Officer and others (1977, 109 ITR 820) that an assessment of business income has to be done in the hands of receivers and in such an assessment, the receivers are never assessed as independent earners of income. The income in the hands of the receiver is assessable in the like manner and to the same extent as it would have been assessed on the real owners.

However, co-owners, co-heirs or co-legatees do not constitute an AOP in respect of the income of the joint or common asset by reason only of their jural relationship. But if they write themselves with the objective of earning income they constitute an AOP for assessment purposes. [Estate of Mohamed Rowther v. CIT (1963, 49 ITR 39)]. Section 26 of the Income-tax Act provides that where property consisting of building or buildings and lands appurtenant thereto is owned by two or more persons in definite and ascertainable shares, such persons shall not, in respect of such property be assessed as an AOP, but on their respective share of income therefrom.

In order to constitute an association of persons, there must be joining together in a common purpose or in a common action, the object of which is to produce income, profits and gains. Though a body of individuals is not identical with an association of persons, they have some similarities. An association of persons may consist of non-individuals also but a body of individuals has to consist only of human beings. The word 'body' would require an association for some common purpose or for a common cause or there must be unity under some common tie or occupation. A mere collection of individuals without a common tie or common aid cannot be taken to be a body of individuals failing under Section 2(31) of the Income-tax Act, 1961. [See CIT v. Deghamwala Estates (1980, 121 ITR 684)].

Tax Liability of Association of Persons / Body of Individuals

With effect from assessment year 1989-90, the following provisions are applicable to assessee other than companies, co-operative societies and societies registered under the Societies Registration Act, 1860 or any law corresponding to that Act in force in any part of India.

- (1) Interest paid by the AOP to a member will not be allowed as deduction from the income of the AOP [(Section 40(ba)]. In cases where interest is paid by the AOP to any member, who has also paid interest to the AOP, the amount of interest, that will be disallowed, is the amount of interest paid by the AOP to the member less the amount of interest paid to the AOP by the member. Explanation 1 to section 40(ba).
- (2) In cases where an individual is a member of an AOP in a representative capacity, any interest paid by the AOP to such individual or by such individual to the AOP, otherwise than in a representative capacity will not be subject to disallowance under explanation 2(i) to Section 40(ba).
- (3) In the cases of interest paid by AOP to such individual or by such individual to the AOP in a representative capacity any interest paid by the AOP to the person represented by such person or vice versa, will not be allowed under Section 40(ba) [Explanation 2(ii) to Section 40(ba)].
- (4) Explanation 3 to Section 40(ba) further provides that where an individual is a member of the AOP otherwise than as member in a representative capacity, any interest paid by the AOP to such individual will not be disallowed if the interest is received by him on behalf of any other person.
- (5) Any salary, bonus, commission or remuneration (by whatever name called) paid by the AOP to a member will not be allowed as a deduction.

Section 167B makes the following provisions as regards the incidence of charge of tax on the association of persons.

A. Where Shares of Members are Determinate

In this case, tax is chargeable on the income of the association of persons at the same rate as applicable to an individual. However, where the total income of any member of the association of persons for the previous year (excluding his share of income from the association of persons) exceeds the maximum amount not chargeable to tax in the case of an individual, tax will be charged on the total income of the AOP at the maximum marginal rate of 30%, i.e., the highest slab applicable to an individual.

More so, where the total income of any member of the AOP, irrespective of whether or not it exceeds the maximum amount not chargeable to tax in the case of an individual, is chargeable to tax at a rate higher than the maximum marginal rate (e.g. foreign company), tax will be charged on the total income of the AOP at such higher rate for that portion of the income of AOP which relates to the share of such member and the balance of income at a maximum marginal rate of tax.

Note:

1. Some incomes are taxable at special rates.
2. Provisions of alternate minimum tax under section 115JC to 115JF shall apply.

Illustration 15:

Mr. A, Mr. B and a foreign company X Ltd. Are members of a AOP sharing profits and losses in the ratio of 2:2:1. The total income of the AOP is Rs. 2,50,000 including long term capital gains Rs. 40,000. Calculate tax liability of the AOP for AY 2026-27.

Solution: Foreign Company X Ltd. is taxable at a rate higher than maximum marginal rate (i.e., 35%)

Tax on LTCG	40,000 at 12.5%	5,000
Tax on share of X Ltd. (2,10,000 *35%*1/5)		14,700
Balance	(2,10,000 *35%*4/5)	58,800
Total Tax		78,500
Add Cess (4%)		3,140
Tax liability		81,640

B. Where the Shares of the Members are Indeterminate

In this case, tax will be charged on the total income of the AOP at the maximum marginal rate, that is, the rate of tax as well as surcharge, if any, applicable to the highest slab of income in the case of an individual as specified in the Finance Act of the relevant year. However, if income of any member of AOP is chargeable to tax at a rate higher than maximum marginal rate, then the rate of tax for the entire income of AOP shall be such higher rate.

The individual shares of the members in the whole or any part of the income of the AOP will be deemed to be indeterminate or unknown if such shares are indeterminate or unknown on the date of formation of the AOP, or at any time thereafter.

Method of Computing Share of Member of Association of Persons / Body of Individuals [Section 67A]

Section 67A seeks to provide for the method of computing a member's share in the income of an association of persons or a body of individuals, wherein the shares of the members are determinate, in the same manner as provided for in Sub-sections (1) to (3) of Section 67 for computing a partner's share in a firm.

This section lays down the following methods of computing the member's share:

- (a) Any interest, salary, bonus, commission or remuneration, by whatever name called, paid to any member in respect of the previous year shall be deducted from the total income of the association or body and the balance ascertained and apportioned among the members in the proportion in which they are entitled to share the income of the association or body.
- (b) Where the amount apportioned to a member under (a) hereinabove is a profit, any interest, salary, bonus, commission or remuneration paid to the member by the AOP in respect of the previous year shall be added to that amount – the result shall constitute the member's share in the income of the association or body.
- (c) Where the amount apportioned to a member under (a) is a loss, any interest, salary, bonus, commission or remuneration aforesaid paid to the member by the association or body in respect of the previous year shall be adjusted against that amount, the result shall be adjusted against that amount, and the result shall be treated as the member's share in the income of the association or body.

Notes:

1. The share of each member of AOP/BOI shall be apportioned under the various heads of income as is determined while computing the income of the AOP/BOI.
2. Deductions under section 80 to the extent allowed to AOP/BOI shall not be allowed to the members.

Taxation of share of income of a member of AOP/BOI

Section 86 relates to shares of members of an association of persons or a body of individuals in the income of the association or body. This section provides that if the assessee is a member of an association of persons or a body of individuals (other than a company or a Co-operative society or a Society registered under the Societies Registration Act, 1860, or any law corresponding to that Act in force in any part of India), his share in the income of the association or body, computed in the manner provided in Section 67A shall not be liable to tax.

Further, the taxability of share of income of a member of AOP/BOI depends on the rate at which income of such AOP/BOI is taxable:

1. Where AOP/BOI is chargeable to tax on its total income at the maximum marginal rate or any higher rate, the share of the member shall not be included in his total income.
2. Where AOP/BOI is chargeable to tax on its total income at the rate applicable to individuals (normal rate) and tax is paid, share of income of a member shall be chargeable to tax as part of his total income and rebate under section 86 shall be claimed.
3. Where AOP/BOI is chargeable to tax on its total income at the rate applicable to individuals (normal rate) and no tax is chargeable, share of income of a member shall be chargeable to tax as part of his total income and no rebate under section 86 shall be claimed.

Assessment in case of Dissolution of an Association of Persons [Section 177]

Where any business or profession carried on by an AOP has been discontinued or an AOP is dissolved, the Assessing Officer shall make an assessment of the total income of the AOP as if no such discontinuance or

dissolution had taken place, and all provisions of this Act, including the provisions relating to the levy of penalty or any other sum chargeable under any provisions of the Income-tax Act shall apply.

Every person who was at the time of such discontinuance or dissolution a member of the AOP and the legal representative of any such person who is deceased, shall jointly and severally be liable for the amount of tax, penalty or other sum payable.

Where such discontinuance or dissolution takes place after any proceeding in respect of an assessment year have commenced, the proceedings may be continued against the members from the stage at which the proceedings stood at the time of such discontinuance or dissolution.

CASE 9

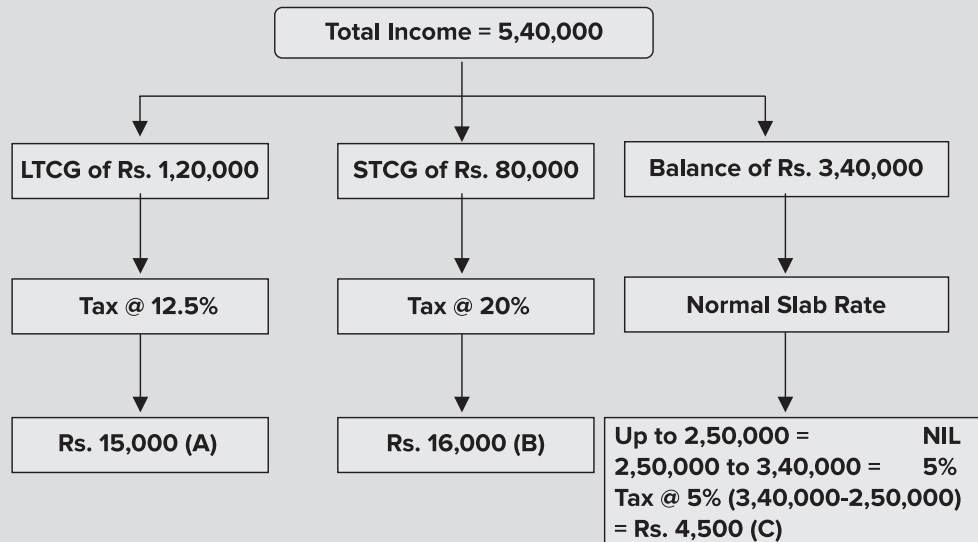
DD, D and P are the three partners of AOP having profit sharing ratio of 2:2:1. Details of income provided are as follows:

	Rs.
DD	1,00,000
D	90,000
P	1,10,000

Total income of AOP 5,40,000 (Including LTCG Rs. 1,20,000 and STCG under 111A Rs. 80,000) You are required to compute tax liability of AOP for AY 2026-27 assuming opted for old taxation regime.

Solution:

Here, in this case, AOP will be assessed and taxed like an individual assuming



Total Tax [A+B+C]	35,500
Add: HEC @4%	1,420
Tax Payable	36,920

TAXATION OF CO-OPERATIVE SOCIETIES

Meaning [Section 2(10)]

'Co-operative Society' means a co-operative society registered under the Co-operative Societies Act, 1912, or under any other law for the time being in force in any state for the registration of co-operative societies. The Income of the co-operative society is computed in the same manner as provided for other assesses. A co-operative society is entitled to the deductions from its gross total income u/s 80G, 80GGA, 80GGC, 80IA, 80-IB, 80JJA and 80P.

A regional rural bank (to which provisions of the Regional Rural Bank Act, 1976, apply) is deemed to be a co-operative society.

Computation of Income of Co-operative Societies

The income of a co-operative society is computed in the same manner as provided for other assesses under the Act. The provisions under various heads of income, clubbing of incomes, set off and brought forward losses, deductions under section 80 shall apply.

Further, the subsidy given by the government to a co-operative society for meeting managerial expenses and admission fee collected by the society is treated as revenue receipt and liable to tax. [Ludhiana Central Co-Operative Consumers' Stores Ltd. V. C.I.T. (1980) 122 I.T.R. 942]. There is, however difference of opinion with regard to tax treatment of 'subsidy' received from the Government. Distinguishing the ratio laid down by the Punjab & Haryana High Court in the case of Ludhiana Central Co-operative Consumers' Stores Ltd. Commissioner of Income-tax (1980, 122 ITR 942), the Punjab & Haryana High Court held in the case of Commissioner of Income-tax v. Jindal Brothers Rice Mills (1989, 179 ITR 470) that depreciation is allowable on the cost of the machinery or plant reduced by the amount of the subsidy as actual cost stands reduced by the percentage allowed by the subsidy. Though this case was followed by it in the case of Commissioner of Income-tax v. Janak Steel Tubes (Pvt.) Ltd. (1989, 179 ITR 536) (the capital subsidy should be deducted from the value of plant and machinery) but had been dissented from by the Bombay, Madras and Rajasthan High Courts in the following cases:

- (i) Srinivas Industries v. Commissioner of Income-tax (1991, 188 ITR 22): The Madras High Court held that the subsidy really partook the character of cash grant expendable for any purpose-consequently, the amount of subsidy granted could not be deducted from the capital cost of the machinery.
- (ii) In Commissioner of Income-tax v. Elys Plastics Pvt. Ltd. (1991, 188 ITR 11) the Bombay High Court held that the subsidies were not deductible in computing the cost of plant and machinery for purposes of allowing depreciation.
- (iii) In Commissioner of Income-tax v. Ambica Electrolytic Capacitors (P) Ltd. And others (1991, 191 ITR 494) the Rajasthan High Court held that the subsidy or investment subsidy given by the Government cannot be deducted from the actual cost for purposes of investment or depreciation allowance.

Rates of Income-tax on Co-operative Society

The rates of income-tax applicable to a co-operative society for the assessment year 2026-27 are as follows:

1. Where the total income does not exceed Rs. 10,000	10% of total income
2. Where the total income exceeds Rs. 10,000 but total income does not exceed Rs. 20,000.	Rs. 1,000 plus 20% of the amount by which income exceeds Rs. 10,000
3. Where the total income exceeds Rs. 20,000	Rs. 3,000 plus 30% of the amount by which income exceeds Rs. 20,000

Health and Education Cess @ 4%.

Surcharge: The amount of income-tax shall be increased by a surcharge at the rate of 7% of such tax, where total income exceeds one crore rupees but not exceeding ten crore rupees and at the rate of 12% of such tax, where total income exceeds ten crore rupees.

Note:

1. Some incomes are taxable at special rates.
2. Provisions of alternate minimum tax under section 115JC to 115JF shall apply.

Note:- The special tax Regime and Tax Rates applicable for Co-operative under Section 115BAD/115BAE is already discussed in detail at the beginning of the lesson.

Deduction in respect of Income of Co-operative Societies [Section 80P]

Section 80P provides for certain deductions from the gross total income of a Co-operative Society. These deductions are:

- (a) In the case of Co-operative Society engaged in:
 - (i) the business of Banking or providing credit facilities to its members, or
 - (ii) a cottage industry, or
 - (iii) the marketing of the agricultural produce grown by its members, or
 - (iv) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for purpose of supplying them to its members, or
 - (v) the processing, without the aid of power, of the agricultural produce of its members, or
 - (vi) the collective disposal of the labour of its members, or
 - (vii) fishing or allied activities, i.e., catching, curing, processing, preserving, storing or marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to its members, the whole of the amount of profits and gains of business attributable to any one or more of such activities shall be deducted from the gross total income provided that in the case of a co-operative society falling under Sub-clause (vi) or (vii), the rules and bye-laws of the society restrict the voting rights to the following classes of its members:
 - (i) the individuals who contribute their labour or carry on the fishing or allied activities;
 - (ii) the co-operative credit societies which provide financial assistance to the society;
 - (iii) the State Government
- (b) In the case of primary co-operative society engaged in supplying milk, oilseeds, fruits, vegetables raised or grown by its members to a federal co-operative society engaged in supplying the above-mentioned products; or a Government or a local authority; or a Government Company or a Corporation established by or under a Central, State or a Provincial Act (being a company or corporation engaged in supplying the above-mentioned products to the public).
 The whole of the amount of profits and gains of such business shall be deducted from the gross total income.
- (c) In the case of a co-operative society engaged in activities other than those specified in clauses (a) or (b) either independently of, or in addition to, profits and gains attributable to the activities mentioned at

clauses (a) and (b) deduction from the gross total income will be allowed to the extent of Rs. 50,000. However, where such co-operative society is a Consumers' Co-operative Society, the deduction shall be Rs. 1,00,000.

- (d) In the case of every co-operative society, the whole of the income by way of interest or dividends derived from its investments with any other co-operative society shall be deducted from the gross total income.
- (e) In the case of every co-operative society, the whole of the income derived by the society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities shall be deducted from its gross total income.
- (f) In the case of every co-operative society, not being a housing society or an urban consumers' society, or a society carrying on transport business or a society engaged in the performance of any manufacturing operations with the aid of power, where the gross total income does not exceed Rs. 20,000 the amount of any income by way of interest on securities or any income from house property shall be deducted from the gross total income.

Urban Consumers' Co-operative Society

An urban consumers' co-operative society means a society for the benefit of consumers, within the limits of a municipal corporation, municipality, notified areas committee, town area, or cantonment [Explanation to Section 80P(2)].

The provisions of this Section shall not apply in relation to any cooperative bank other than a primary agricultural credit society or a primary cooperative agricultural and rural development bank.

Other points

- Amount received for letting of godowns, incidental services of taking delivery of stock at rail-head and transporting it to godowns were also rendered and amount received was described as 'commission' was wholly exempt. I.T. v. South Arcot District Co-operative Marketing Society Ltd. (1989) 43 Taxman 328/176 ITR 117 (SC).
- Income from ginning and pressing of cotton is exempt. Broach Distt. Co-operative Cotton Sales, Ginning & Pressing Society Ltd. V. CIT (1989) 177 ITR 418/44 Taxman 439 (SC).
- Where assessee, an apex co-operative society, derived (i) interest on cash security furnished by it for carrying on sugar agency business, and (ii) interest on temporary loans given by it for financing sugar business, while former interest was not exempt, latter was exempt under Section 14(3)(iii) of the 1922 Act, CIT v. U.P. Co-operative Federation Ltd. (1989) 176 ITR 435/43 Taxman 20 (SC).
- Amount of subsidy received by assessee from National Co-operative Development Corpn. Towards loss incurred on account of price fluctuation qualifies for deduction under Section 81(1)© – CIT v. Punjab State Co-operative Supply & Marketing Federation Ltd. (1989) 46 Taxman 156 (Punj. & Har.).
- Proportionate expenditure relating to such business activities of assessee co-operative society as are contemplated by Section 80P(2) is not to be disallowed. Baghapurana Co-operative Marketing Society Ltd. V. CIT (1989) 178 ITR, 653/44 Taxman 92 (Punj. & Har.).
- In the cases of agricultural produce, the agricultural produce marketed by assessee co-operative society need not have been produced by assessee's members – CIT v. Punjab State Co-operative Supply & Marketing Federation Ltd. (1989) 46 Taxman 156 (Punj. & Har.).

- The expression ‘the marketing of the agricultural produce of its members means that agricultural produce should be owned by its members, whether supplied by them (that is, the members) or purchased from the market or acquired from any other producer. C.I.T. v. Haryana State Co-operative Supply & Marketing Federation Ltd. (1989) 79 CTR (Punj. & Har.) 94.
- Short-term call deposits are investment within the meaning of Section 80P(2)(d). CIT v. Haryana Co-operative Sugar Mills Ltd. (1989) 46 Taxman 28 (Punj. & Har.).

Assessment of Co-operative Societies

The following are the provisions which are specifically applicable to the assessment of Co-operative Societies.

Co-operative Housing Society: Under Section 27(iii), a member of co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a house building scheme of the society, company or association, as the case may be, shall be deemed to be owner of that building or part thereof.

Clause (iiia) further provides that a person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act, 1882 shall be deemed to be the owner of that building or part thereof; and

As per Clause (iiib), a person who acquires any rights (excluding any rights by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof, by virtue of any such transaction as is referred to in Clause (f) of Section 269UA, shall be deemed to be the owner of that building or part thereof.

Clause (f) of Section 269UA, it may be noted, defines “transfer” for the purposes of Chapter XX-C of the Income-tax Act, dealing with purchase by Central Government of immovable properties in certain cases of transfer.

Profits and Gains of Co-operative Society from Insurance Business [Section 44]: The profits and gains of any business of insurance carried on by a Co-operative Society shall be computed in accordance with the rules contained in the First Schedule.

In this connection, the First Schedule and Rule 6E of the Income-tax Rules, 1962 provides as under:

The profits of non-life insurance business, e.g., Fire insurance business, marine insurance business, general insurance business etc. shall be the profits disclosed by the annual accounts required to be prepared under the Insurance Act, 1938 subject to the following adjustments:

- (a) If such profits are arrived at after deducting any expenditure or allowance which is not admissible under Sections 30 to 43B of the Income-tax Act, such expenditure or allowance shall be added back to the profits.
- (b) The reserve for unexpired risks shall be allowed as a deduction to the following extent:
 - (c) where the insurance business relates to fire insurance or miscellaneous insurance – 50% of the net premium income of such business of the previous year;
 - (d) where the insurance business relates to marine insurance, 100% of the net premium income of such business of the previous year.

‘Net premium income’ means the amount of premium received, as reduced by the amount of re-insurance premiums paid during the relevant previous year.

In the context of computing the total income of co-operative society, the following cases are worth noting.

- (1) Where the credit facility is extended to members of the society by virtue of sale of goods to them by

consumers' co-operative society, the exemption is not available. When the society sells goods on credit to its members, such transaction cannot be construed as a credit society to which the benefit of Section 80P(2)(a)(i) can be extended. [Rodier Mill Employees' Co-operative Stores Ltd. V. CIT (1982) 135 ITR 355].

Following the ratio laid down by the Madras High Court in the case of Rodier Mill Employees' Co-operative Stores Ltd. V. Commissioner of Income-tax (1982, 135 ITR 355), the Kerala High Court held in the case of Kerala Co-operative Consumers Federation Ltd. V. Commissioner of Income-tax (1988, 170 ITR 455) that the words 'providing credit facilities', occurring in Section 80P(2)(a)(i) of the Income-tax Act, 1961 should be construed as similar to, or akin to the 'carrying on the business of banking', preceding the words "or providing credit facilities" in the same sub-section. The words 'providing credit facilities to its members' means providing credit by way of loans and not selling goods on credit.

- (2) Where society purchases auto-rickshaws and sells them to members on hire-purchase, it is not providing credit facility to members and not entitled to exemption [C.I.T. v. Madras Auto Rickshaw Drivers' Co-operative Society (1983) 143 ITR 981]. In this case it was held that the tax relief under Section 80P(2)(a)(i) of the Income- tax Act, is a grant not to a category of income but to a category of assessee namely, a co-operative society answering the description of a society engaged in carrying on the business of providing credit facilities to its members. If the society in question does not answer to this description, it is not entitled to the relief.
- (3) In Bihar State Co-operative Bank Ltd. V. C.I.T. [(1960) 39 I.T.R. 114] the Supreme Court has held that if a co- operative society carrying on banking business invests its circulating capital in such a manner that it is readily available, the interest on such investment shall constitute income from banking business and therefore shall be exempt in the hands of the co-operative society.
- (4) Interest received on Government Securities held by co-operative society as its stock-in-trade qualifies for deduction from gross total income. But the deduction is inapplicable to interest received from Government Securities held as investments. [CIT v. Bombay State Co-operative Bank Ltd. (1968) 70 ITR 86 (SC)].

The Madhya Pradesh High Court held in the case of M.P. State Co-operative Bank Ltd. V. Addl. Commissioner of Income-tax (1979, 119 ITR 327) that income from investment of reserve capital in securities was not a part of the income from banking business and did not qualify for exemption. Similarly, the interest income from investment of provident fund income did not form part of the income from the banking business and did not qualify for exemption under Section 80(i)(a) (now Section 80P). Distinguishing the ratio laid down in this case, the Madhya Pradesh High Court held in the case of Commissioner of Income-tax v. Bhopal Co-operative Central Bank Ltd. (1987, 164 ITR 713) that the security deposits made are in accordance with the Banking Regulation Act, 1949 and interest income received on deposits formed part of income from business of banking and exempt under Section 80P(2)(i) of the Income-tax Act, 1961.

The Allahabad High Court held in the case of Addl. Commissioner of Income-tax v. U.P. Co-operative Cane Union (1978, 114 ITR 70) that selling goods on credit was only a mode of carrying on business. It did not become a business of providing credit facility. Following this case, the Allahabad High Court held in the case of Commissioner of Income-tax v. U.P. Co-operative Cane Union Federation Ltd. (1980, 122 ITR 913) that the expression 'providing credit facilities' in Section 80P(2)(a)(i) would comprehend the business of lending money on interest. It would also comprehend the business of lending services on profit for guaranteeing payments because guaranteeing payment is as much a part of banking business for affording credit facility as advancing loans.

However, where a co-operative society holds securities as per requirements of Banking Regulation Act and directions of the RBI, the deduction is available on such interest income. Similarly, subsidy from

Government for opening new branches and giving loans to poorer sections at lower rate of interest, is income attributable to banking business [CIT v. Madurai District Central Co-operative Bank Ltd. (1984) 148 ITR 196].

- (5) The Income earned by a co-operative society carrying on the business of banking and providing credit facilities to its members from commission and brokerage by dealing in bills of exchange, subsidy from Government, admission fee from members, incidental charges and financial penalties is attributable to the business of banking of providing credit facilities to its members and hence deductible under Section 80P(2)(a) [CIT v. Dhar Central Co-operative Bank (1984) 149 ITR 438 (MP)].

Following its decision in the case of Commissioner of Income-tax v. Dhar Central Co-operative Bank (1984, 149 ITR 438), the Madhya Pradesh High Court held in the case of Commissioner of Income-tax v. Bhopal Co-operative Central Bank Ltd. (1988, 172 ITR 423) that a co-operative society carrying on the business of banking is entitled to exemption in respect of interest on securities, commission, subsidy, donation and locker rent. Again, the said decision was followed by it in the case of Madhya Pradesh Rajya Sahakari Bank v. Commissioner of Income-tax (1988, 174 ITR 150) holding that the income from commission, exchange and other miscellaneous income was attributable to the business of banking and that the assessee was entitled to exemption under Section 81 (now 80P) of the Income-tax Act, 1961 in respect thereof.

- (6) A society which buys and sells products of other societies or individuals is not entitled to exemption.

Where a society manufactures and sells its own products or the products of its members, such society is entitled to exemption. Hence, the Central Cottage Industries Emporium, New Delhi, is not entitled to exemption under Section 80P [Addl. C.I.T. v. Indian Co-operative Union Ltd. (1982) 134 ITR 108(Delhi)].

If the godown or warehouse is let for a purpose other than storage, processing or facilitating the marketing of commodities, the income derived therefrom by a co-operative society would not be deductible under Section 80P. In C.I.T. v. Ahmedabad Maskati Cloth Dealers Co-operative Warehouses Society Ltd. [(1986) 162 ITR 142 (Guj.)] it was also held that shops in which wholesale or retail business in cloth is carried on cannot come within the meaning of 'godowns' or 'warehouses'.

The Gujarat High Court's decision in the case of Commissioner of Income-tax v. Ahmedabad Maskati Cloth Dealers Co-operative Warehouses Society Ltd. (1986, 162 ITR 142) had since been approved by the Supreme Court in the case of South Arcot District Co-operative Marketing Society Ltd. (infra). The Gujarat High Court had, inter alia, held that the words 'facilitating the marketing of commodities' would not lend colour to the words 'godowns or warehouses' so as to enlarge their meaning.

CASE 10

P Co-operative Society engaged in procession of agriculture produce and running its activities without aid of power furnishes following details of income, compute taxable income and tax liability for the purpose of A.Y. 2026-27 if it does not opt to be taxed under section 115BAD and if opts to be taxed under section 115BAD.

- Income from processing of agricultural produce of its member	38,500
- Income from marketing of the agricultural produce	12,000
- Dividend from another co-operative society	41,400
- Income from letting of godown	24,000
- Commission income	91,000

Solution:**Statement showing computation of Total income and tax liability**

Particulars	Remarks	Not opt to be taxed under section 115BAD	Opts to be taxed under section 115BAD
Income from letting of godown [a]		24,000	24,000
Income from processing of agricultural produce of its member		38,500	38,500
Income from marketing of the agricultural produce		12,000	12,000
Commission income		91,000	91,000
Income from PGBP [b]		1,41,500	14,1,500
Dividend from another co-operative society		41,400	41,400
Income from other Source [c]		41,400	41,400
Gross Total Income [a+b+c]		2,06,900	2,06,900
Deduction under section 80C to 80U			
Deduction under section 80P			
Income of agricultural produce	38,500*100%	38,500	Nil
Income from marketing of the agricultural produce	12,000*100%	12,000	Nil
Commission income	Exempt up to 50,000	50,000	Nil
Letting out of godowns	24,000*100%	24,000	Nil
Dividend income	41,400*100%	41,400	Nil
Total Income		41,000	2,06,900
Tax on total income		At Slab rate	At 22%
Up to 10,000 = 10% (10%*10,000)=1,000 10,000-20,000=20%(20%*10,000) =2,000 20,000-41,000=30% (30%*21,000)=6,300		9,300	45518
Add: Surcharge		NA	NA
Tax and Surcharge		9,300	45,518
Add: HEC@4%		372	1,821
Tax Payable (Rounded off)		9,670	47,340

Illustration 16:

Delhi Co-operative Society derived the following incomes during the previous year 01.4.2025 to 31.3.2026

(1)	Marketing of agricultural produce of its members	10,000
(2)	Interest from members on delayed payment of the price of goods purchased	1,000
(3)	Processing (without aid of power) of agricultural produce of its members	8,000
(4)	Supplying milk to the Government (raised by its members)	15,000
(5)	Agency business	25,000
(6)	Dividends from other Co-operative Societies	15,000
(7)	Income from letting of godowns	20,000
(8)	Income from House Property	30,000

Solution:**Option 1: Assessee has not opted for Section 115BAD****Computation of total income of Delhi Co-operative Society**

Particulars	Amount (Rs.)	Amount (Rs.)
Income from House Property	30,000	
Letting of godowns	20,000	50,000
Income from Business		
Marketing of agricultural product	10,000	
Processing of goods	8,000	
Supplying milk	15,000	
Agency business	25,000	58,000
Income from other sources		
Interest from members	1,000	
Dividends	15,000	16,000
Gross Income		1,24,000
Deductions under Section 80P		
Letting of godowns	20,000	
Marketing of agricultural produce	10,000	

Processing of goods	8,000	
Supplying milk	15,000	
Agency business	25,000	
Dividends	15,000	(93,000)
Total income		31,000

Notes:

- (1) Interest from members Rs. 1,000 is not deductible as it is not from the credit facilities provided to the member and for this purpose society cannot be said to be a credit society [Rodier Mill Employees' Co-operative Stores Ltd. V. CIT (1982) 135 ITR 355].
- (2) The gross total income of the society exceeds Rs. 20,000 hence deduction regarding income from house property is not available.

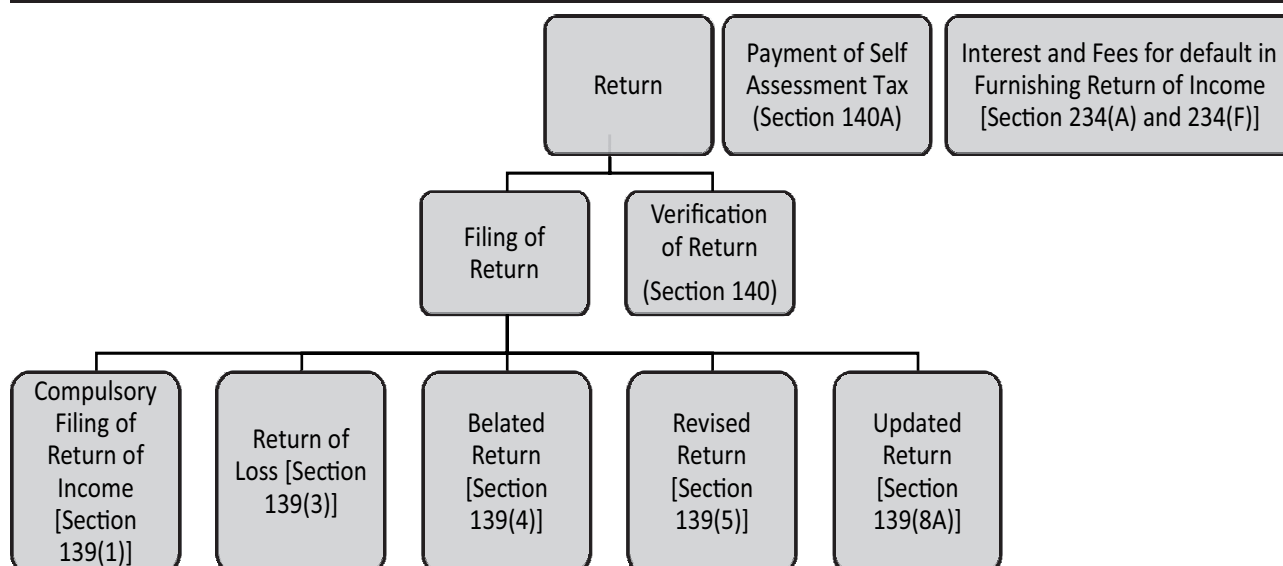
Option 2: Assessee has opted for Section 115BAD**Computation of total income of Delhi Co-operative Society**

Particulars	Amount (Rs.)	Amount (Rs.)
Income from House Property	30,000	
Letting of godowns	20,000	50,000
Income from Business		
Marketing of agricultural product	10,000	
Processing of goods	8,000	
Supplying milk	15,000	
Agency business	25,000	58,000
Income from other sources		
Interest from members	1,000	
Dividends	15,000	16,000
Gross Income		1,24,000
Deductions under Section 80P		NA
Total income		1,24,000

Notes:

- (1) Interest from members Rs. 1,000 is not deductible as it is not from the credit facilities provided to the member and for this purpose society cannot be said to be a credit society [Rodier Mill Employees' Co-operative Stores Ltd. V. CIT (1982) 135 ITR 355].
- (2) The gross total income of the society exceeds Rs. 20,000 hence deduction regarding income from house property is not available.
- (3) Deduction under section 80P is not allowed u/s 115BAD.

INCOME TAX RETURNS



ITR stands for Income Tax Return. It is a prescribed form through which the particulars of income earned by a person in a financial year and taxes paid on such income are communicated to the Income-tax Department. It also allows carry-forward of loss and claim refund from income tax department. Different forms of returns of income are prescribed for filing of returns for different Status and Nature of income. These forms can be downloaded from <https://www.incometax.gov.in/iec/foportal>

Under the Income Tax Law, different forms of returns are prescribed for different classes of taxpayers. The return forms are known as ITR forms (Income Tax Return Forms). The forms of return prescribed under the Income-tax Law for filing of return of income for the assessment year 2025-26 (i.e., financial year 2024-25) are as follows:

Return Form	Brief Description
ITR - 1	Also known as SAHAJ is applicable to resident other than not ordinarily resident) having total income up to Rs.50 lakh, having Income from Salaries, one house property, other sources (Interest etc.), and agricultural income up to Rs.5,000
ITR - 2	It is applicable to an individual or an Hindu Undivided Family not having income chargeable to income-tax under the head "Profits or gains of business or profession"
ITR - 3	It is applicable to an individual or a Hindu Undivided Family who has any income chargeable to tax under the head business or profession

Return Form	Brief Description
ITR - 4	Also known as SUGAM is applicable Individuals, HUFs and Firms (other than LLP) being a resident having total income upto Rs.50 lakh and having income from business and profession which is computed under sections 44AD, 44ADA or 44AE.
ITR - 5	This Form can be used by a person being a firm, LLP, AOP, BOI, artificial juridical person referred to in section 2(31)(vii), cooperative society and local authority. However, a person who is required to file the return of income under section 139(4A) or 139(4B) or 139(4C) or 139(4D) shall not use this form (i.e., trusts, political parties, institutions, colleges)
ITR - 6	It is applicable to a company, other than a company claiming exemption under section 11 (exemption under section 11 can be claimed by charitable/religious trust).
ITR - 7	It is applicable to a persons including companies who are required to furnish return under section 139(4A) or section 139(4B) or section 139(4C) or section 139(4D) (i.e., trusts, political parties, institutions, colleges).
ITR - V	It is the acknowledgement of filing the return of income.

Manner and Mode of Filing Return of Income

The applicable return of income shall be furnished by a person mentioned in column (ii) of the Table below to whom the conditions specified in column (iii) apply, in the manner specified in column (iv) thereof:

SL. No.	Person	Condition	Manner of furnishing return of income
(i)	(ii)	(iii)	(iv)
1	Individual or Hindu undivided family	(a) Accounts are required to be audited under section 44AB of the Act;	(A) Electronically under digital signature; or (B) Transmitting the data electronically in the return under electronic verification code;
		(b) A super senior citizen (whose age is 80 years or above at any time during the previous year) who furnishes the return either in ITR-1 or ITR-4	(A) Electronically under digital signature; or (B) Transmitting the data electronically in the return under electronic verification code; or (C) Transmitting the data in the return electronically and thereafter submitting the verification of the return in Form ITR-V; or (D) Paper form;

SL. No.	Person	Condition	Manner of furnishing return of income
(i)	(ii)	(iii)	(iv)
		(c) In any other case	(A) Electronically under digital signature; or (B) Transmitting the data electronically in the return under electronic verification code; or (C) Transmitting the data in the return electronically and thereafter submitting the verification of the return in Form ITR-V;]
2	Company	In all cases.	Electronically under digital signature.
3	A person required to furnish the return in Form ITR-7	(a) In case of a political party;	Electronically under digital signature;
		(b) In any other case	(A) Electronically under digital signature; or
			(B) Transmitting the data in the return electronically under electronic verification code; or (C) Transmitting the data in the return electronically and thereafter submitting the verification of the return in Form ITR-V.
4	Firm or limited liability partnership or any person (other than a person mentioned in SL. 1 to 3 above) who is required to file return in Form ITR-5	(a) Accounts are required to be audited under section 44AB of the Act;	Electronically under digital signature;
		(b) In any other case.	(A) Electronically under digital signature; or
			(B) Transmitting the data in the return electronically under electronic verification code; or (C) Transmitting the data in the return electronically and thereafter submitting the verification of the return in Form ITR-V

Compulsory Filing of Income Tax Return [Section 139(1)]

As per the provision of section 139(1) of the Income Tax Act, 1961, it is compulsory to file a return of income or loss for every previous year of or before the due date in the prescribed form as under:

Person	Compulsorily filing of Return of Income or Loss
Company and Firm	In any case
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 this Act during the previous year exceeded the maximum amount which is not chargeable to income-tax

Further a person, being a resident other than not ordinarily resident in India within the meaning of clause (6) of section 6, who is not required to furnish a return under this sub-section and who at any time during the previous year,—

- (a) holds, as a beneficial owner or otherwise, any asset (including any financial interest in any entity) located outside India or has signing authority in any account located outside India; or
- (b) is a beneficiary of any asset (including any financial interest in any entity) located outside India,

shall furnish, on or before the due date, a return in respect of his income or loss for the previous year.

“beneficial owner” in respect of an asset means an individual who has provided, directly or indirectly, consideration for the asset for the immediate or future benefit, direct or indirect, of himself or any other person.

“beneficiary” in respect of an asset means an individual who derives benefit from the asset during the previous year and the consideration for such asset has been provided by any person other than such beneficiary.

Further also a person referred to in clause (b), who is not required to furnish a return under this sub-section, and who during the previous year—

- (i) has deposited an amount or aggregate of the amounts exceeding one crore rupees in one or more current accounts maintained with a banking company or a co-operative bank; or
- (ii) has incurred expenditure of an amount or aggregate of the amounts exceeding two lakh rupees for himself or any other person for travel to a foreign country; or
- (iii) has incurred expenditure of an amount or aggregate of the amounts exceeding one lakh rupees towards consumption of electricity; or
- (iv) fulfils such other conditions as may be prescribed,

shall furnish a return of his income on or before the due date in such form and verified in such manner and setting forth such other particulars, as may be prescribed.

Accordingly, the CBDT has vide Notification No. 37/2022 Dated 21.04.2022 inserted Rule 12AB to provide that a person, other than a company or a firm, who is not required to furnish return of income u/s 139(1) and who fulfil any of the following conditions during the previous year has to file their return of Income on or before the due date as specified in the prescribed form and manner.

- (i) if his total sales, turnover or gross receipts, as the case may be, in the business exceeds sixty lakh rupees during the previous year; or

- (ii) if his total gross receipts in profession exceeds ten lakh rupees during the previous year; or
- (iii) if the aggregate of tax deducted at source and tax collected at source during the previous year, in the case of the person, is twenty-five thousand rupees or more; or
- (iv) the deposit in one or more savings bank account of the person, in aggregate, is rupees fifty lakh or more during the previous year:

Provided that in the case of an individual resident in India who is of the age of sixty years or more, at any time during the relevant previous year, the provision of clause (iii) shall have effect as if for the words “twenty-five thousand”, the words “fifty thousand” had been substituted.

Due Date for Filing Income Tax Return [Section 139(1)]

Due Date for Filing Income Tax Return [Section 139(1)]		
	Assessee	Due Date
(i)	Company or a Firm	31st October of the Assessment Year
(ii)	a person (other than a company) whose accounts are required to be audited under this Act or under any other law for the time being in force	
(iii)	a partner of a firm whose accounts are required to be audited under this Act or under any other law for the time being in force or the spouse of such partner if the provisions of section 5A applies to such spouse	
(iv)	in the case of an assessee, including the partners of the firm or the spouse of such partner (if the provisions of section 5A applies to such spouse), being such assessee, who is required to furnish a report referred to in section 92E	30th November of the Assessment Year
(v)	in the case of any other assessee	31st day of July of the Assessment Year

Note: The Provisions related to Return of Loss, Belated Return, Revised Return, Defective Return & Updated Returns as well as Interest and Fees for Default in furnishing Return of Income etc. has been discussed in detail in Lesson No. 2.

VERIFICATION OF RETURN OF INCOME [SECTION 140]

Circumstances	Authorized Person
In the case of an individual	(i) by the individual himself; (ii) where he is absent from India, by the individual himself or by some person duly authorised by him in this behalf; (iii) where he is mentally incapacitated from attending to his affairs, by his guardian or any other person competent to act on his behalf; and (iv) where, for any other reason, it is not possible for the individual to verify the return, by any person duly authorised by him in this behalf

	Note: In the situation (ii) and (iv) above, the person verifying the return holds a valid power of attorney from the individual to do so, which shall be attached to the return
In the case of a Hindu undivided family	By the karta, and, where the karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of such family;
In the case of a firm	By the managing partner thereof, or where for any unavoidable reason such managing partner is not able to verify the return, or where there is no managing partner as such, by any partner thereof, not being a minor;
In the case of a limited liability partnership	By the designated partner thereof, or where for any unavoidable reason such designated partner is not able to verify the return, or where there is no designated partner as such, by any partner thereof or any other person, as may be prescribed for this purpose
In the case of a local authority	By the principal officer thereof
In the case of a political party	by the chief executive officer of such party (whether such chief executive officer is known as secretary or by any other designation)
In the case of any other association	By any member of the association or the principal officer thereof
In the case of any other person	By that person or by some person competent to act on his behalf

Self-Assessment Tax (Section 140)

Where any tax is payable on the basis of any return required to be furnished under section 139 or section 142 or section 148 or section 153A or, as the case may be, section 158BC, after taking into account:

- (i) the amount of tax, if any, already paid under any provision of this Act;
- (ii) any tax deducted or collected at source;
- (iia) any relief of tax claimed under section 89;
- (iii) any relief of tax or deduction of tax claimed under section 90 or section 91 on account of tax paid in a country outside India;
- (iv) any relief of tax claimed under section 90A on account of tax paid in any specified territory outside India referred to in that section;
- (v) any tax credit claimed to be set off in accordance with the provisions of section 115JAA or section 115JD; and
- (vi) any tax or interest payable according to the provisions of sub-section (2) of section 191,

the assessee shall be liable to pay such tax together with interest and fee payable under any provision of this Act for any delay in furnishing the return or any default or delay in payment of advance tax, before furnishing the return and the return shall be accompanied by proof of payment of such tax, interest and fee.

Illustration 1

State with reasons whether return of income is to be filed in the following cases for the Assessment Year 2026-27:

- i. Mr. Y, a resident individual, aged 80 years, has a total income of Rs. 2,85,000. He has claimed deduction of Rs. 1,50,000 under section 80C. Long-term capital gains of Rs. 80,000 is not taxable by virtue of the exemption available upto specified threshold under section 112A. Assume that he has opted for the old provisions of the Income-tax Act.
- ii. Would your answer change if Mr. Y has incurred Rs. 1,02,000 towards payment of electricity bills for F.Y. 2025-26?
- iii. XYZ, a partnership firm, has a loss of Rs. 10,000 during the previous year 2025-26.
- iv. A registered association, eligible for exemption under section 10(23B), has income from house property of Rs. 6,60,000.
- v. Mr. X, aged 45 years, an employee of ABC (P) Ltd, draws a salary of Rs. 5,90,000 and has income from fixed deposits with bank of Rs. 10,000.

Solution:

- i. No. As per the provisions of section 139(1), every person, whose total income without giving effect to the provisions of Chapter VI-A exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr. Y before giving effect to deduction of Rs. 1,50,000 under section 80C is Rs. 4,35,000, which is less than the basic exemption limit of Rs. 5,00,000 applicable to an individual aged 80 years or more. Therefore, Mr. Y need not furnish his return of income for the A.Y. 2026-27.
- ii. Yes, the answer would change, since Mr. Y has incurred expenditure of an amount exceeding ` 1 lakh towards the consumption of electricity and he is not liable to file return of income under section 139(1). In such a case, he would have to file his return for A.Y. 2026-27 on or before the due date u/s 139(1).
- iii. Yes. As per section 139(1), it is mandatory for a firm to furnish its return of income or loss on or before the specified due date. Therefore, M/s XYZ has to furnish its return of loss for the A.Y. 2026-27 on or before the due date under section 139(1), even if it has incurred a loss.
- iv. Yes. As per section 139(4C), every institution referred to, inter alia, in section 10(23B), whose total income without giving effect to the provisions of section 10 exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date u/s 139(2). In the above case, the registered association has income from house property of Rs. 6,60,000 before exemption under section 10, which exceeds the basic exemption limit of Rs. 3,00,000. Therefore, it is under an obligation to furnish its return of income for the A.Y. 2026-27.
- v. Yes, As per the provisions of section 139(1), every person, whose gross total income exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. Mr. X's salary income is Rs. 5,40,000 (i.e., Rs. 5,90,000 less standard deduction of Rs. 50,000). The gross total income of Mr. X is Rs. 5,50,000 (Rs. 5,40,000 + Rs. 10,000) which exceeds the basic exemption limit of Rs. 4,00,000 applicable to an individual as per default regime of section 115BAC. Therefore, Mr. X has to furnish his return of income for the A.Y. 2026-27.

Illustration 2

The Assessing Officer issued a notice under section 142(1) on the assessee on 24th February, 2026 calling upon him to file return of income for Assessment Year 2025-26. In response to the said notice, the assessee furnished a return of loss and claimed carry forward of business loss and unabsorbed depreciation. State whether the assessee would be entitled to carry forward as claimed in the return.

Solution:

As per the provisions of section 139(3), any person who has sustained loss under the head 'Profit and gains of business or profession' is allowed to carry forward such a loss under section 72(1) or section 73(2), only if he has filed the return of loss within the time allowed under section 139(1). Also, the provisions of section 80 specify that a loss which has not been determined as per the return filed under section 139(3) shall not be allowed to be carried forward and set-off under, inter alia, section 72(1) (relating to business loss) or section 73(2) (losses in speculation business) or section 74(1) (loss under the head "Capital gains") or section 74A(3) (loss from the activity or owning and maintaining race horses) or section 73A (loss relating to a "specified business"). However, there is no such condition for carry forward of loss from house property under section 71B or unabsorbed depreciation under section 32.

In the given case, the assessee has filed its return of loss in response to notice under section 142(1). As per the provisions stated above, assessee furnished return in response to notice under section 142(1) after the due date specified under section 139 (1) and therefore, the benefit of carry forward of business loss under section 72(1) or section 73(2) or section 73A shall not be available. The assessee shall, however, be entitled to carry forward the unabsorbed depreciation as per provisions of section 32(2).

Illustration 3

State whether the following assessee have to file return of income and if so, the due date for the assessment year 2026-27:

- (i) A registered trade union having income from let out property of Rs. 2,00,000.
- (ii) A public trust hospital having an aggregate annual receipt of Rs. 510 lacs and availing exemption of Rs. 3,10,000 under section 10(23C) with total income of Rs. 2,40,000

Solution

- (i) A registered trade union is having income from house property, which is exempt under section 10(24). Section 139(4C) mandates filing of return only when the total income exceeds the maximum amount which is not chargeable to tax without giving effect to the provisions of section 10. In this case, even without giving effect to section 10(24), the total income of the registered trade union is below basic exemption limit and therefore, there is no mandatory requirement to file the return of income.
- (ii) Since the total income without giving effect to the exemption under section 10(23C) is Rs. 5,50,000, which exceeds Rs. 3,00,000, the trust has to file its return of income by 31st October, 2026.

TECHNOLOGICAL ASPECTS IN TAX COMPLIANCES

The transition to electronic filing (e-filing) and digital services represents a significant leap forward in tax administration. E-filing refers to the submission of tax returns and related documents through online platforms, rather than traditional paper-based methods. This shift has brought about several advantages that enhance the overall tax administration experience.

E-filing systems offer taxpayers a convenient and efficient way to submit their tax returns. Instead of mailing paper forms or visiting tax offices in person, taxpayers can file their returns from the comfort of their homes or offices. This convenience is particularly beneficial during peak tax seasons, reducing the need for long queues and wait times at tax offices. Digital services extend beyond e-filing. Tax authorities now offer various online services that enable taxpayers to perform a range of functions electronically. These services include checking the status of a return, making tax payments, updating personal information, and accessing tax records. The availability of these services online means that taxpayers can manage their tax affairs more efficiently and at their own convenience.

E-filing systems are also designed to reduce errors and improve accuracy. Many platforms incorporate built-in validation checks that automatically detect common mistakes or inconsistencies before submission. This proactive approach helps ensure that returns are filed correctly and reduces the likelihood of issues that might arise from errors or omissions. From the perspective of tax authorities, e-filing provides several benefits as well. It streamlines the processing of returns, reducing the need for manual data entry and allowing for faster processing times. Electronic submissions are also easier to manage and analyze, enabling tax authorities to process large volumes of returns more efficiently. Additionally, e-filing systems enhance data security. Electronic submissions are encrypted and transmitted through secure channels, reducing the risk of data loss or unauthorized access compared to handling paper documents. This increased security helps protect sensitive taxpayer information and ensures that it is transmitted and stored safely.

Enhanced Compliance and Enforcement

Technology has significantly enhanced compliance and enforcement in tax administration by providing tools and systems that improve monitoring, detection, and response to non-compliance. Enhanced compliance and enforcement are critical for ensuring that taxpayers meet their obligations and that tax laws are enforced effectively. One of the key technologies supporting enhanced compliance is data analytics. By analyzing large volumes of data from tax returns, financial statements, and other sources, tax authorities can identify patterns and anomalies that may indicate non-compliance or fraudulent behavior. For example, data analytics can detect discrepancies between reported income and known financial activities, flagging cases for further investigation. Advanced technologies also support more targeted and effective enforcement actions. For instance, predictive analytics can help tax authorities assess the risk of non-compliance and prioritize audits or investigations accordingly. This risk-based approach allows tax authorities to focus their resources on high-risk areas, improving the overall effectiveness of enforcement efforts. In addition to data analytics, technology also supports enhanced compliance through automated systems and tools. Automated systems can streamline the monitoring of tax payments, ensuring that payments are processed accurately and on time. They can also detect and flag potential issues, such as missing or incorrect information, for further review.

Benefits of Technological Innovations in Tax Compliance

The adoption of technological innovations in tax compliance has yielded several benefits for both taxpayers and the tax administration in India:

- **Increased Efficiency:** Automation and digitization have streamlined tax processes, reducing the time and effort required for compliance.
- **Enhanced Transparency:** Technology has improved the transparency of transactions, making it easier to detect and prevent tax evasion.
- **Better Compliance:** With simplified processes and user-friendly platforms, taxpayers are more likely to comply with tax regulations.
- **Reduced Litigation:** Technology-driven dispute resolution mechanisms have expedited the settlement of tax disputes.
- **Data-Driven Decision Making:** Advanced analytics and AI have enabled data-driven decision-making, improving the effectiveness of tax administration.

Tax e-services available at Income Tax Portal https://incometaxindia.gov.in/Pages/tax-services.aspx	
Return Filing	
Registration of Taxpayer on e-Filing website	
File Income tax Return	
File SFT Return	
View e-Filed Returns/ Forms	
Outstanding Tax Demand Status	
Submit Response to Outstanding Tax Demand	
How to Submit Request for Rectification	
Status of Tax Refund	
How to Request for Refund Re-issue? (in case of refund failure)	
Download Intimation 143(1)	
Register as Legal Heir (applicable in case of any deceased taxpayer)	
Response to Defective Notice	
Compliance Module	
Tax Payments	
Challan Status Inquiry	
Pay Tax Online	
View Tax Credit Statement (Form 26AS)> Online view through E-filing Website	
View Your Tax Credit > Online view through internet banking	
View Your Tax Credit > Online view through TRACES	
View Your Tax Credit > Status of TDS/TCS Statement	
TDS Certificate (Form 16A) Verification by the Taxpayer	
PAN	
Apply for PAN	
Status of PAN > Protean (formerly NSDL eGov)	
Status of PAN > UTITSL	
Know Your PAN	
Instant e-PAN	
Link Aadhaar	

TDS Related
Apply for TAN Online
Change Your TAN Data
Know Your TAN
Status of TAN
Online TAN Registration
Online Filing of TDS Return
TDS/TCS Statement > Default Status
TDS/TCS Correction Statement
Applications form for AIN Allotment
e-TDS/e-TCS / File Validation Utility (FVU)
TDS/TCS Statement > Protean (formerly NSDL eGov) Form 24G Preparation Utility
TDS/TCS Statement > Status of Form 24G
Online TDS Statement Corrections > Online corrections
Online TDS Statement Corrections > Tag / Replace challan
Consolidated demand
View default summary
Statement and challan status
Online PAN Verification
Form 16A Download by The Deductor
Downloads > Forms 16B
Downloads > Form 27D
Downloads > Transaction based report for non-resident
Downloads > Consolidated statement file
Downloads > Justification report
Downloads > TAN-PAN Consolidated file
Downloads > Aggregate TDS compliance report
Downloads > E -tutorials and FAQs
Tax Information's Network-Facilitation Centre Locator

Note: "Students may refer to Lesson 13 titled "Procedural Compliance" of Paper 7 " Tax laws and Practice" of Executive Programme for procedural compliances related provisions including TDS and TCS."

LESSON ROUNDUP

- The term 'Hindu undivided family' has not been defined in the Income-tax Act. However, in general parlance it means an undivided family of Hindus. Creation of a HUF is a God-gifted phenomenon. As soon as a married Hindu gets a child, a new HUF comes into existence. It is not at all necessary that every HUF must have joint property or family income.
- A Hindu Joint Family consists of Coparceners & members.
- The gross total income of the family for the relevant previous year shall be computed under the relevant heads (as per the provisions of the Income-tax Act) as it is computed for other assessee.
- 'Partition' signifies division of property. In the cases of property capable of physical division, share of each member is determined by making physical division thereof. It must be noted that a division of income without physical division of property does not amount to partition.
- **Partnership Firm:** Under Section 2(23) of the Income-tax Act, the terms "firm", "partner", and "partnership" have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.
- As per the scheme, a partnership firm shall be assessed as a firm if the following conditions are satisfied:
 - The partnership is evidenced by an instrument i.e. partnership deed.
 - The individual shares of the partners are specified in that instrument.
- A copy of the partnership deed certified by all the partners in writing (other than the minors) is submitted along with the return of income in respect of which assessment as a firm is first sought.
- As per Section 10(2A) of the Act, any person who is a partner of a firm which is assessed as such, his share in the total income of the firm will not be included in computing his total income. Partner includes a minor admitted to the benefits of partnership as per Section 2(23) of the Act.
- When all the partners in the predecessor firm are replaced by new partners in the successor firm, it is known as succession of one firm by another firm. If a firm is dissolved and some of the partners take over the firm's business or carry on a similar business with or without new partners, it would be a case of succession by a new firm.
- Where a change has occurred in the constitution of a firm on account of death or retirement, the firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.
- **Alternate Minimum Tax:** From the assessment year 2012-13 onwards, where the regular income tax payable for a previous year by a person other than a company is less than the alternate minimum tax payable for such previous year then the adjusted total income shall be deemed to be the total income of such person for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% + SC plus health and education cess (HEC) @ 4%. AMT is applicable if adjusted total income exceeds Rs. 20 lakh.
- **Association of persons:** "Association of persons" means an association in which two or more persons join in a common purpose or common action to produce income, profits or gains.

- For the formation of an AOP the association need not necessarily be on the basis of a contract, consent and understanding may be presumed.
- Section 167B makes the following provisions as regards the incidence of charge of tax on the association of persons.
- Where shares of members are determinate, tax is chargeable on the income of the association of persons at the same rate as applicable to an individual. However, where the total income of any member of the association of persons for the previous year (excluding his share of income from the association of persons) exceeds the maximum amount not chargeable to tax in the case of an individual, tax will be charged on the total income of the AOP at the maximum marginal rate of 30%, i.e., the highest slab applicable to an individual.
- Where the shares of the members are indeterminate, tax will be charged on the total income of the AOP at the maximum marginal rate, that is, the rate of tax as well as surcharge, if any, applicable to the highest slab of income in the case of an individual as specified in the Finance Act of the relevant year.
- Section 67A seeks to provide for the method of computing a member's share in the income of an association of persons or a body of individuals, wherein the shares of the members are determinate, in the same manner as provided for in Sub-sections (1) to (3) of Section 67 for computing a partner's share in a firm.
- Co-operative Society means a co-operative society registered under the Co-operative Societies Act, 1912, or under any other law for the time being in force in any State for the registration of co-operative societies. The income of a co-operative society is computed in the same manner as provided for other assessee.
- Section 80P provides for certain deductions from the gross total income of a Co-operative Society.
- The provision related to Filing of Return of Income.
- Due Date of Filing of Return of Income.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation.)

Multiple Choice Questions "MCQs"

1. Alternative Minimum Tax (AMT) is applicable if adjusted Total Income of individual, AOP, artificial juristic person, Firm etc. exceeds:
 - (a) 15 lakhs
 - (b) 20 lakhs
 - (c) 25 lakhs
 - (d) 10 lakhs
 Answer: (b)
2. Share in the profits of the firm is taxable in the hands of partner under the head:
 - (a) Salary
 - (b) Business & Profession

(c) Income from other sources

(d) Exempt from tax

Answer: (d)

3. Salary, fees, bonus received by a partner from the firm is Taxable in the hands of partner under the head:

(a) Salary

(b) Business & Profession

(c) Income from other sources

(d) Exempt from tax

Answer: (b)

4. Income earned from sale of "Stridhan" is taxable in the hands of:

(a) HUF

(b) Husband of such woman

(c) Such woman herself

(d) None of above

Answer: (c)

5. Personal earning including income from Self Acquired Property of a member of the HUF is included in Income of:

(a) HUF income

(b) Son's income

(c) Individual's income

(d) None of these

Answer: (c)

Practical Questions

Question 1: X furnishes the following particulars for the previous year relevant to A/Y 2026-27.

Profit and Loss A/c for the year ending 31-03-2026

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To salary to staff	22,000	By gross profit	2,50,000
To entertainment expenses	13,000		
To general expenses	11,000		
To bad debts	4,500		
To reserve for bad debts	10,000		
To advertising expenses	7,000		

To interest on X capital A/c	3,000		
To acquisition of patent's rights	28,000		
To Telephone expenses	12,000		
To depreciation	10,000		
To provision or Income Tax	4,000		
To Net Profit	1,25,500		
Total	2,50,000	Total	2,50,000

Other information :

- Salary to staff includes salary paid to a relative which is unreasonable to the extent of Rs. 3,100.
- Provision for income tax is excessive to the extent of Rs.3,000
- Depreciation according to the income tax provision comes to Rs.9,500
- During the previous year 2025-26 the following payment were made and the same have not been debited to profit and loss account of 2025-26.
 - Rs.3,000 paid on 10-6-2025 on account of outstanding customs duty of the previous year 2024-25, and
 - Rs.5,000 paid on 15-6-2026 on account of outstanding custom duty of the previous year 2025-26
- Patents were acquired on 4-11-2025

Find out the taxable income of X for the A/Y 2026-27. Due date of filling return of income of assessment year 2025-26 and 2026-27 is 31st July of the relevant A/Y. Covered u/s 115BAC

Question 2: Y (age: 34years) is a businessman in Delhi. Determine his net income and tax liability on the basis of the following profit and loss account for the year ending 31, 2026. Not covered u/s 115BAC

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Opening stock	1,04,000	Sales	92,51,000
Purchases	80,08,750	Closing stock	2,10,000
Salaries and wages	1,75,000		
Rent and rates	1,31,000		
Commission	21,500		

Household expenses	20,000		
Income tax for 2025-26	36,100		
Advertisement	5,000		
Postage and telegram	4,000		
Interest on own capital	84,000		
Reserve for bad debts	3,400		
Depreciation on furniture	18,000		
Net profit	8,50,250		
Total	94,61,000	Total	94,61,000

Other particulars :

1. Closing stock and opening stock has consistently been valued at 10 % below cost price.
2. Depreciation on furniture as per tax provisions is Rs. 17,200.
3. Amount of sales includes a sum of Rs. 41,250 representing the value of goods withdrawn for the use of Y's family members. These goods were purchased at cost of Rs. 27,850. Market value of these goods is Rs. 45,240.
4. Household expenses include a contribution of Rs. 1,000 towards public provident fund.
5. On September 20, 2025 Y has received a gift of Rs. 96,000 from a friend settled in UK.

Question 3: Mr. Inder Kumar Sharma furnishes the following manufacturing profit and loss account for the previous year ending 31-3-2026. Covered u/s 115BAC

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Stock	11,000	By Sales	2,84,500
To Purchases	80,000	By Stocks	26,400
To manufacturing wages	65,900		
To Factory Rent Rates and Taxes	30,000		
To Depreciation	15,000		
To Gross profit	1,09,000		
Total	3,10,900	Total	3,10,900

Profit and Loss Account			
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Office Salaries	27,000	By Gross profit B/D	1,09,000
To Establishment Expenses	6,100	By Rent of staff quarters	19,000
To Interest on Capital	3,300	By Refund of income-tax penalty	2,000
To Fire Insurance	200	By sale of a machinery	25,000
To Bad debts	7,000	By Recovery of Bad debts, not allowed as deduction earlier	6,000
To Income tax	6,000	By Sundry Receipts	35,000
To Expense on Sales tax proceedings	2,000		
To Expenses of income-tax proceedings	13,000		
To Diwali Expenses	4,000		
To Legal Expenses	7,000		
To Medical Expenses of proprietor	3,000		
To Staff Welfare Expenses	2,000		
To Repair of Staff quarters	4,000		
To Security Deposit for telex connection	10,000		
To Bonus payable to Employees	20,000		
To Provision for Tax: Custom Duty	25,000		
To Municipal taxes for staff quarters	4,000		
To General Reserve	26,00		
To Entertainment expenses	16,000		
To Net profit	10,400		
Total	1,96,000	Total	1,96,000

You are required to compute the taxable profits from business after taking the following into consideration:

- (i) Purchase include a petty purchase of Rs. 21,000. Its payment was made by a crossed cheque.
- (ii) Assessee has always valued the stock at cost price but since 2025-26 he has valued it at market price which was in excess of the cost price by 10%.
- (iii) Office salaries paid include Rs. 10,400 to the proprietor of the business
- (iv) Diwali expense include gifts of Rs. 1,000 made to the relatives.
- (v) The written down value (WDV) of the block consisting of machinery as on 01-04-2025 is Rs. 59,000. Machinery whose WDV as on 1-4-2025, was Rs. 5,000 was sold for Rs. 25,000 during the year.
- (vi) The written down value (WDV) of the block consisting of factory buildings as on 01-04-2025 is Rs. 90,000.
- (vii) Custom Duties amounting to only Rs. 20,000 were paid on or before 31-07-2026.

Theoretical Questions

1. Explain the provision related to Special Tax Regime u/s 115BAC for Computation of Total Income and Tax Liability
2. Explain the provision related to Special Tax Regime u/s 115BAD for Computation of Total Income and Tax Liability
3. Explain the provision related to Special Tax Regime u/s 115BAE for Computation of Total Income and Tax Liability
4. Explain the concept of Rebate u/s 87A?
5. What is Marginal Relief with respect to computation of total income and tax liability of an assessee?
6. Explain the provision related to filing of Return of Income.
7. What are the various modes of filing of Return of Income?
8. What are the due dates of Filing of Return of Income?

LIST OF FURTHER READINGS

- **Direct Taxes Law and Practice**
Author: Dr. Vinod K. Singhania & Dr. Kapil Singhania
Publisher: Taxmann
- **Direct Taxes Ready Reckoner with Tax Planning**
Author: Dr. Girish Ahuja & Dr. Ravi Gupta
Publisher: Wolters Kluwer

OTHER REFERENCES (INCLUDING WEBSITES AND VIDEO LINKS)

- **Income Tax Act, 1961:** <https://www.incometaxindia.gov.in/Pages/acts/income-tax-act.aspx>
- **Income Tax Rules, 1962:** <https://www.incometaxindia.gov.in/Pages/rules/income-tax-rules-1962.aspx>
- **Circulars:** <https://www.incometaxindia.gov.in/Pages/communications/circulars.aspx>
- **Notifications:** <https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx>

Computation of Total Income, Tax Liability and Filing of Return of Companies

Lesson 2

KEY CONCEPTS

- Indian Company ■ Domestic Company ■ Foreign Company ■ Widely held Companies ■ Closely held Company
- Residential Status of Company ■ Place of Effective Management (POEM) ■ Book Profits ■ Minimum Alternate Tax (MAT)
- MAT Credit ■ Filing of Return ■ Verification of Return of Income

Learning Objectives

To understand the:

- What are the constitutional provisions for Companies with regard to Income tax?
- The provisions related to Tax Incidence on Companies
- Determining the Residential Status of Companies
- Guiding Principles for determining the Place of Effective Management (POEM)
- Scope of Total Income of Companies
- Computation of Book Profits
- The provisions of Minimum Alternate Tax 'MAT', Applicability and Computation
- The provision related to MAT credit
- Computation of total income and tax liability as per the normal provisions of the Income Tax Act, 1961 including MAT
- Computation of total income and tax liability as per concessional tax regime u/s 115BAA or 115BAA as the case may be
- Filing of Income Tax Return
- Verification of Income Tax Return

Lesson Outline

- Background
- Tax Incidence on Companies
- Corporate Tax Rate
- Minimum Alternate Tax 'MAT'
- Meaning of Book Profit
- MAT Credit
- Filing of Income Tax Return
- Verification of Income Tax Return
- Lesson Round-Up
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

Sections	Income-tax Act, 1961
Section 2(17)	Meaning of the term 'Company'
Section 2(26)	Indian Company
Section 2(22A)	Domestic Company
Section 2(23A)	Foreign Company
Section 2(18)	Company in which the public are substantially interested
Section 6(3)	Residential Status of Company
Section 115BA	Tax on Income of certain manufacturing Domestic Companies
Section 115BAA	Tax on Income of certain Domestic Companies
Section 115BAB	Tax on Income of new manufacturing Domestic Companies
Section 115JB	Minimum Alternate Tax
Section 115JB(2)	Meaning of Book Profit
Section 115JAA	MAT Credit
Section 139(1)	Due Date of Filing of Income Tax Return
Section 139(4)	Belated Return
Section 139(5)	Revised Return
Section 139(6)	Particulars to be furnished along with return of Income in case of an assessee engaged in Business or Profession
Section 139(9)	Defective Return
Section 139(8A)	Updated Return
Section 140B	Tax on Updated Return
Section 234A	Interest for Default in furnishing Return of Income
Section 234F	Fee for default in Furnishing Return of Income
Section 140	Verification of Income Tax Return
Rules	Income Tax Rules, 1962
Rule 27	Prescribed arrangements for declaration and payment of dividends within India
Rule 12AA	Person prescribed for verification of Return of Income

BACKGROUND

Before we begin to examine and understand the taxability and tax incidence on companies, we must understand the meaning of company and its types that are in existence today's scenario post the Companies Act, 2013.

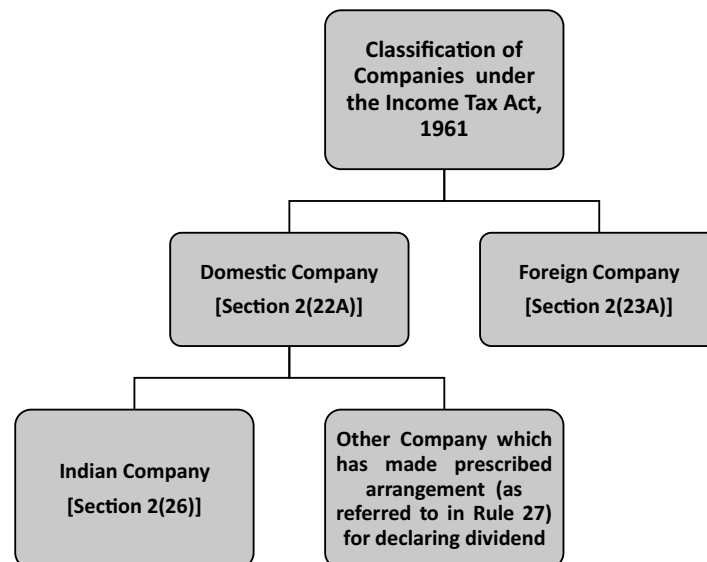
MEANING OF 'COMPANY'

The expression "Company" has a much more extensive definition under the Income-Tax Act, 1961. The company is appraised as a 'Person' for all matter under the Income-Tax Act, 1961 [Section 2(31)(iii)].

Meaning of Company [Section 2(17) of the Income-tax Act, 1961]

- (i) any Indian company, or
- (ii) any body corporate incorporated by or under the laws of a country outside India, or
- (iii) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922 or which is or was assessable or was assessed under this Act as a company for any assessment year commencing on or before the 1st day of April, 1970, or
- (iv) any institution, association or body, whether incorporated or not and whether Indian or Non-Indian, which is declared by general or special order of the Board to be a company:

Provided that such institution, association or body shall be deemed to be a company only for such assessment year or assessment years (whether commencing before the 1st day of April, 1971 or on or after that date) as may be specified in the declaration.

**Domestic Company [Section 2(22A)]**

Domestic company means:

- i) an Indian Company; or
- ii) any other Company, which in respect of its income liable to tax under the Act, has made prescribed arrangements for the declaration and payment, within India, of the dividends (including dividends on preference shares) payable out of such income.

From this definition, it is clear that –

- I. All Indian companies are domestic companies while
- II. All domestic companies need not necessarily be Indian companies. In other words, a non-Indian company would be considered as a domestic company if it makes the prescribed arrangements for the declaration and payment of dividends in India on which tax is deductible under Section 194.

Prescribed arrangements for declaration and payment of dividends within India [Rule 27]

The arrangements to be made by a company for the declaration and payment of dividends (including dividends on preference shares) within India shall be as follows:

- a. **The share-register of the company for all shareholders shall be regularly maintained at its principal place of business within India** in respect of any assessment year from a date not later than the first day of April of such year;
- b. The **general meeting** for passing the accounts of the previous year relevant to the assessment year and for declaring any dividends in respect thereof shall be **held only at a place within India**;
- c. The **dividends declared**, if any, shall be **payable only within India** to all shareholders.

Indian Company [Section 2(26)]

Section 2(26) of the Income-tax Act, 1961 defines the expression 'Indian Company' as a company formed and registered under the Companies Act, 2013 and the registered office or the principal office should be in India and it also includes:

- a) a company formed and registered under any law relating to companies formerly in force in any part of India [other than Jammu and Kashmir, and the Union Territories specified in (d) below];
- b) any corporation established by or under a Central, State or Provincial Act;
- c) any institution, association or body which is declared by the Board to be a company under Section 2(17) of the Income-tax Act, 1961;
- d) in the case of any of the Union Territories of Dadra and Nagar Haveli, Goa, Daman and Diu and Pondicherry, a company formed and registered under any law for the time being in force in that Union Territory.

Therefore, a Company, Corporation, Institution, Association or Body will be treated as an Indian Company only if its registered office or principal office, as the case may be, is in India.

Foreign Company [Section 2(23A)]

Foreign company means a company which is not a domestic company.

However, all non-Indian companies are not necessarily foreign companies. If a non-Indian company has made the prescribed arrangements for declaration and payments of dividends within India, such a non-Indian company must be treated as a "domestic company" and not as a "foreign company".

Company in which public are substantially interested (A widely-held company)

Domestic Companies are further classified into the following categories:

- Companies in which public are substantially interested - Widely-held Companies
- Companies in which public are not substantially interested - Closely held Companies

Section 2(18) of the Income-tax Act defines the expression “**Company in which the public are substantially interested**”. A company is said to be one in which public are substantially interested in the following cases:

A Company owned by Government / RBI	If it is a company owned by the Government (either central or state but not foreign) or the Reserve Bank of India or in which not less than 40 per cent of the shares, whether singly or taken together, are held by the Government or the Reserve Bank of India or a corporation owned by the Reserve Bank of India; or
Section 8 Company	If it is a company which is registered under Section 8 of the Companies Act, 2013; or
A company having no share capital declared by CBDT	If it is a company, having no share capital and if, having regard to its objects, the nature and composition of its membership and other relevant considerations, it is declared by an order of the Board (CBDT) to be a company in which the public are substantially interested. However, such a company shall be deemed to be one in which the public are substantially interested only for the assessment year(s) as may be specified in the declaration; or
Nidhi/ Mutual Benefit Society	If it is mutual benefit finance a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under Section 406 of the Companies Act, 2013 to be a Nidhi or Mutual Benefit Society; or
A company owned by Co-operative Society	If it is a company in which shares, (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits, i.e., preference shares) carrying not less than 50 per cent of the voting power have been allotted unconditionally to or acquired unconditionally by, and are throughout the relevant previous year beneficially held by, one or more cooperative societies; or
Listed Company	If it is a company which is not a private company as defined in Companies Act, and equity shares of the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in the profits, i.e., preference shares) were, as on the last day of the relevant previous year, listed in a recognised stock exchange in India;
Public Company owned by Govt. and/ or public limited Company	If it is a company which is not a private company within the meaning of the Companies Act, and the shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 50 per cent (40 per cent in case of an industrial company) of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant accounting year beneficially held by (a) the Government, or (b) a corporation established by a Central or State or Provincial Act, or (c) any company in which the public are substantially interested or a wholly owned subsidiary company.

Note: Industrial Company means an Indian company where business consists mainly in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power.

It may be noted that, a public company under the Companies Act, need not necessarily fall within the meaning of a company in which the public are substantially interested under the Income-tax Act, 1961 because a public

company under the Companies Act, may be considered as one in which the public are not substantially interested under the Income-tax Act, 1961 after considering the nature and extent of shareholding.

Illustration 1:

State with reason whether in the following cases Companies are widely held or closely held:

(a) The shares of ABC Private Limited are held as follows:

i	A corporation owned by RBI	15 %
ii	Central Govt.	18%
iii	R.B.I.	10%
iv	Mr. Raman	28%
v	Mr. Bhuvan	27%

(b) 85% equity shares of Progressive Private Limited were held by the public and its affairs during the relevant previous year were controlled by seven persons.

Solution:

(a) Shares held by Govt., RBI and Corporation owned by RBI = $18\% + 10\% + 15\% = 43\%$.

As shares held by CG along with RBI are more than 40%, therefore, ABC Pvt. Ltd. is a Govt. Participating company. Hence it is a company in which Public is substantially interested, i.e., widely held.

(b) As none of the criteria mentioned in Section 2(18) are met in case of Progressive Pvt. Ltd. (such as Govt. Participating, Section 8 Company or Nidhi etc.) therefore, it is a closely held company.

Closely Held Company

A Company in which the public is not substantially interested is known as a closely held Company.

The distinction between a closely held and widely held company is significant from the following viewpoints.

- (i) Section 2(22) (e), which deems certain payments as dividend, is applicable only to the shareholders of a closely-held company; and
- (ii) A closely held company is allowed to carry forward its business losses only if the conditions specified in Section 79 are satisfied.

TAX INCIDENCE ON COMPANIES

The incidence of Income tax depends upon the residential status of a company in India during the relevant previous year. A Company may be either resident or non-resident in India, i.e., company cannot be ordinary or not-ordinary resident.

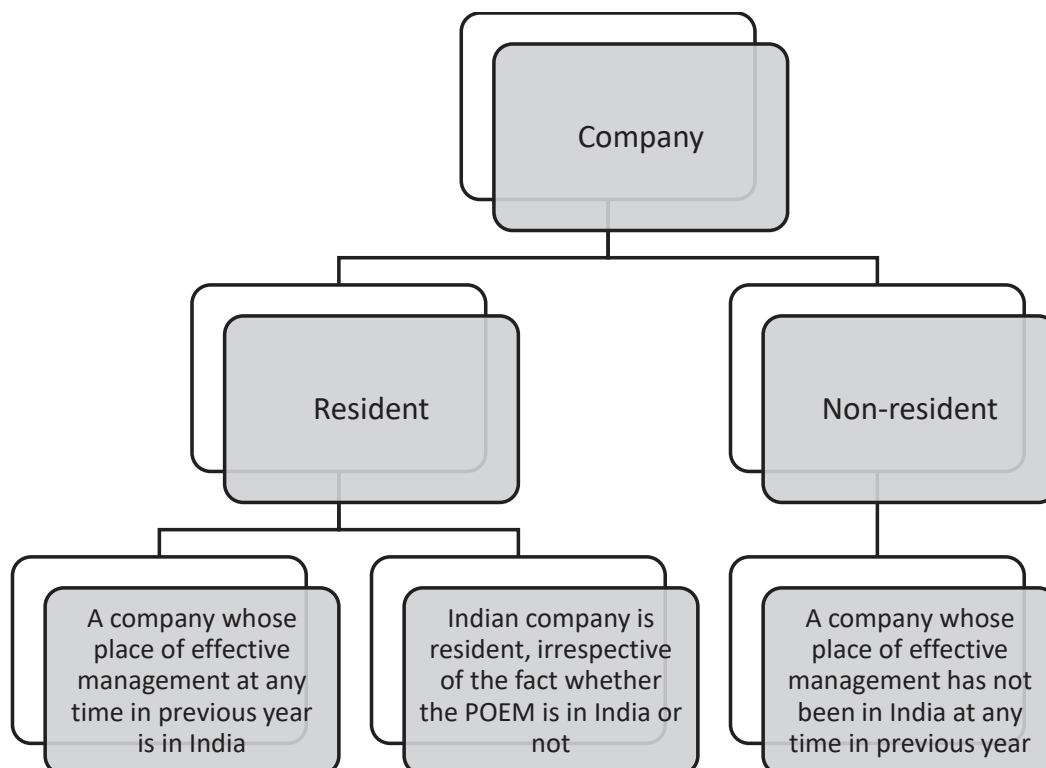
According to Section 6(3) of the Act, a company is said to be resident in India (resident company) in any previous year, if:

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

If any of the above two tests is satisfied the company would be a resident company in India during that previous year.

A foreign company is resident in India if its Place of Effective Management (POEM) during the previous year is in India. For this purpose, the Place of Effective Management means a place where Key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance are made.

Accordingly, all Indian companies are always resident in India regardless of the place of its place of effective management. However, in the case of a foreign company the place of effective management is the basis on which the company's residential status is determinable.



Note: Vide Circular No 08 of 2017 dated 23rd February, 2017, it has been clarified that the POEM provisions shall not apply to a company having turnover or gross receipts of Rs. 50 crore or less in a financial year. So, in those cases, the criteria for determining the residential status would be Control and Management of the affairs.

Please refer details: https://www.incometaxindia.gov.in/communications/circular/circular25_2017.pdf

Guiding Principles for determining Place of Effective Management [POEM]

The process of determination of POEM would be primarily based on the fact as to whether or not the company is engaged in active business outside India. The PoEM concept is one of substance over form and since “residence” is to be determined for each year, POEM will also be required to be determined on year to year basis. An entity may have more than one place of management, but it can have only one place of effective management at any point of time.

The test of PoEM is based on whether the entity is earning only passive income and its operations are so structured that it is present or active in a country without paying applicable taxes. Thus, a company having key managerial people stationed in India with substantial asset base in India and selling goods through a subsidiary

may yet claim that it has no PE in India and being incorporated outside India, it could end up paying very little tax. The concept of PoEM thus examines whether the company is in fact a tax resident of a foreign state with substantial operations outside India or whether the incorporation or having different places of business is only a device to evade tax by being a non-resident.

As per the PoEM guidelines, a company shall be said to be engaged in “active business outside India” if the passive income is not more than 50% of its total income and

- (i) less than 50% of its total assets are situated in India; and
- (ii) less than 50% of total number of employees are situated in India or are resident in India; and
- (iii) the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Explanation: For the aforesaid purpose:

The income shall be	As computed for tax purpose in accordance with the laws of the country of incorporation; or as per books of account, where the laws of the country of incorporation do not require such a computation.
The value of assets	● In case of an individually depreciable asset, shall be the average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year; and ● In case of a pool of fixed assets being treated as a block for depreciation, shall be the average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year; ● In case of any other asset, shall be its value as per books of account.
The number of employees	the number of employees shall be the average of the number of employees as at the beginning and at the end of the year and shall include persons, who though not employed directly by the company, perform tasks similar to those performed by the employees.
Pay roll	the term “pay roll” shall include the cost of salaries, wages, bonus and all other employee compensation including related pension and social costs borne by the employer.
Head Office	“Head Office” of a company would be the place where the company senior management and their direct support staff are located or, if they are located at more than one location, the place where they are primarily or predominantly located. A company head office is not necessarily the same as the place where the majority of its employees work or where its board typically meets.
Passive income	“Passive income” of a company shall be aggregate of, income from the transactions where both the purchase and sale of goods is from / to its associated enterprises; and income by way of royalty, dividend, capital gains, interest or rental income. Note : any income by way of interest shall not be considered to be passive income in case of a company which is engaged in the business of banking or is a public financial institution, and its activities are regulated as such under the applicable laws of the country of incorporation.

Senior Management	“Senior Management” in respect of a company means the person or persons who are generally responsible for developing and formulating key strategies and policies for the company and for ensuring or overseeing the execution and implementation of those strategies on a regular and on- going basis. While designation may vary, these persons may include : (i) Managing Director or Chief Executive Officer; (ii) Financial Director or Chief Financial Officer; (iii) Chief Operating Officer; and The heads of various divisions or departments.

The conditions of having earned passive income of less than 50% and having less than 50% of assets, employees and payroll expenses have to be satisfied cumulatively. Thus, merely because say 95% of the income of a company is from royalty but 90% of its assets are outside India, it need not be scrutinized for PoEM since other conditions are not met. The company would be engaged in active business outside India. The idea is to identify such companies who may be trying to evade taxes by merely having incorporation or a set of directors operating from outside India while in substance it is carrying out activity in India and earning incomes which should be subject to tax in India.

The place of effective management in case of a company engaged in active business outside India shall be presumed to be outside India if the majority meetings of the board of directors of the company are held outside India. However, it is established that the Board of directors of the company are standing aside and not exercising their powers of management and such powers are being exercised by either the holding company or any other person (s) resident in India, then the place of effective management shall be considered to be in India. For the purpose of determining whether the company is engaged in active business outside India, the average of the data of the previous year and two years prior to that shall be taken into account. In case the company has been in existence for a shorter period, then data of such period shall be considered.

The determination of POEM would be a two stage process as follows:

First Stage: Identification or ascertaining the person or persons who actually make the key management and commercial decision for conduct of the company business as a whole.

Second Stage: Determination of place where these decisions are in fact being made.

Note: The place where these management decisions are taken would be more important than the place where such decisions are implemented. For the purpose of determination of POEM it is the substance which would be conclusive rather than the form.

Some of the guiding principles for determining the POEM

- (a) The location where a company's Board regularly meets and makes decisions may be the company place of effective management provided, the Board retains and exercises its authority to govern the company; and in substance, make the key management and commercial decisions necessary for the conduct of the company business as a whole. Mere formal holding of board meetings at a place would by itself not be conclusive for determination of POEM being located at that place.

Note : A company's board may delegate some or all of its authority to one or more committees such as an executive committee consisting of key members of senior management. In these situations, the location where the members of the executive committee are based and where that committee develops and formulates the key strategies and policies for mere formal approval by the full board will often be considered to be the company's place of effective management.

- (b) The location of a company's head office will be a very important factor in the determination of the company's place of effective management because it often represents the place where key company decisions are made. The following points need to be considered for determining the location of the head office of the company:

If the company's senior management and their support staff are based in a single location and that location is held out to the public as the company's principal place of business or headquarters then that location is the place where head office is located. If the company is more decentralized (for example where various members of senior management may operate, from time to time, at office located in the various countries) then the company's head office would be the location where these senior managers:

- i. are primarily or predominantly based; or
- ii. normally return to following travel to other locations; or
- iii. meet when formulating or deciding key strategies and policies for the company as a whole.

In situations where the senior management is so decentralised that it is not possible to determine the company's head office with a reasonable degree of certainty, the location of a company's head office would not be of much relevance in determining that company's place of effective management.

- (c) The use of modern technology impacts the place of effective management in many ways. It is no longer necessary for the persons taking decision to be physically present at a particular location. Therefore, physical location of board meeting or executive committee meeting or meeting of senior management may not be where the key decisions are in substance being made. In such cases the place where the directors or the persons taking the decisions or majority of them usually reside may also be a relevant factor. It may be clarified that day-to-day routine operational decisions undertaken by junior and middle management shall not be relevant for the purpose of determination of POEM.

If the above factors do not lead to clear identification of POEM then the following secondary factors can be considered:

- i. Place where main and substantial activity of the company is carried out; or
- ii. Place where the accounting records of the company are kept.

The determination of POEM is to be based on all relevant facts related to the management and control of the company, and is not to be determined on the basis of isolated facts that by itself do not establish effective management, as illustrated by the following examples:

- i. The fact that a foreign company is completely owned by an Indian company will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- ii. The fact that there exists a Permanent Establishment of a foreign entity in India would itself not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- iii. The fact that one or some of the Directors of a foreign company reside in India will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- iv. The fact of, local management being situated in India in respect of activities carried out by a foreign company in India will not, by itself, be conclusive evidence that the conditions for establishing POEM have been satisfied.

- v. The existence in India of support functions that are preparatory and auxiliary in character will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- vi. The place where day to day, operational decisions are taken would not be PoEM.

Further, based on the facts and circumstances if it is determined that during the previous year the POEM is in India and also outside India then POEM shall be presumed to be in India if it has been mainly /predominantly in India.

Example 1: M/s A Co. is a sourcing entity for an Indian multinational group, incorporated in Country X as a wholly owned subsidiary of B Co., an Indian company. The company's only assets comprise its warehouses and the stock stored within them, all of which are located in Country X. Additionally, all of its employees are based in Country X. . The average income wise breakup of the company's total income for three years is:

- i. 30% of income is from transaction where purchases are made from parties which are non-associated enterprises and sold to associated enterprises;
- ii. 30% of income is from transaction where purchases are made from associated enterprises and sold to associated enterprises;
- iii. 30% of income is from transaction where purchases are made from associated enterprises and sold to non-associated enterprises; and
- iv. 10% of the income is by way of interest.

Interpretation: In this case passive income is 40% of the total income of the company. The passive income consists of :

- i. 30% income from the transaction where both purchase and sale is from/to associated enterprises; and
- ii. 10% income from interest.

Hence, M/s A Co. satisfies the first requirement of the test of active business outside India. Since no assets or employees of M/s A Co. are in India the other requirements of the test are also satisfied, accordingly the company is engaged in active business outside India.

Example 2: With other facts remaining same as that in Example 1, with the sole variation being that M/s A Co. has total 50 employees. 47 employees, managing the warehouse, storekeeping and accounts of the company, are located in country X. The Managing Director (MD), Chief Executive Officer (CEO) and sales head are resident in India. The total annual payroll expenditure on these 50 employees is Rs. 5 crore, out of which, the annual payroll expenditure in respect of MD, CEO and sales head is of Rs. 3 crore.

Interpretation: Although the first limb of active business test is satisfied by A Co. as only 40% of its total income is passive in nature. Further, more than 50% of the employees are also situated outside India. All the assets are situated outside India. However, the payroll expenditure in respect of the MD, the CEO and the sales head being employees resident in India exceeds 50% of the total payroll expenditure. Therefore, A Co. is not engaged in active business outside India.

Example 3: The basic facts are same as in Example 1. Further facts are that all the directors of the A Co. are Indian residents. During the relevant previous year 5 meetings of the Board of Directors are held of which two were held in India and 3 outside India with two in country X and one in country Y.

Interpretation: A Co. is engaged in active business outside India as the facts indicated in Example 1 establish. The majority of board meetings have been held outside India. Therefore, the POEM of A Co. shall be presumed to be outside India.

Example 4: The facts are same as in Example 1 but it is established by the Assessing Officer that although A Co.'s senior management team signs all the contracts, for all the contracts above Rs. 10 lakh the A Co. must submit its recommendation to B Co. and B Co. makes the decision whether or not the contract may be accepted. It is also seen that during the previous year more than 99% of the contracts are above Rs. 10 lakh and over past years also the same trend in respect of value contribution of contracts above Rs. 10 lakh is seen.

Interpretation: These facts suggest that the effective management of the A Co. may have been usurped by the parent company B Co. Therefore, PoEM of A Co. may in such cases be not presumed to be outside India even though A Co. is engaged in active business outside India and majority of board meeting are held outside India.

For Detailed POEM Guidelines:

<http://www.incometaxindia.gov.in/news/circular06/2017.pdf>

SCOPE OF TOTAL INCOME OF COMPANIES

According to Section 5(1) of the Act, the total income of any previous year of a resident company would consist of:

- (i) Income received or deemed to be received in India during the previous year by or on behalf of such company;
- (ii) Income which accrues or arises or is deemed to accrue or arise to it in India during the previous year;
- (iii) Income which accrues or arises to it outside India during the previous year.

Under Section 5(2) of the Act, the total income of any previous year of **non-resident company** would consist of:

- (i) Income received or deemed to be received in India in the previous year by or on behalf of such company;
- (ii) Income which accrues or arises or is deemed to accrue or arise to it in India during the previous year.

CORPORATE TAX RATES

Domestic Company	Assessment Year 2026-27
Where it has opted for Section 115BA [other than those opted under section 115BAA and section 115BAB] [This regime shall be available only for the manufacturing companies in corporate in India on or after 01-03-2016.]	25%
Where it opted for Section 115BAA [This benefit shall be available when total income of the company is computed without claiming specified deductions, incentives, exemptions and additional depreciation available under the Income-tax Act.]	22%

Domestic Company	Assessment Year 2026-27
Where it opted for Section 115BAB [This regime shall be available only for the manufacturing companies incorporated in India on or after 01-10-2019 & commences manufacture of article or thing before 31.3.2024). Hence, old companies will not be able to take the benefit of this section.]	15%
Where it has not opted for Section 115BAA and the Total Turnover or Gross receipts of the company in the previous year 2023-24 does not exceeds 400 crore rupees	25%
Any other domestic company	30%
Foreign Company - Royalty received from Government or an Indian concern in pursuance of an agreement made with the Indian concern after March 31, 1961, but before April 1, 1976, or fees for rendering technical services in pursuance of an agreement made after February 29, 1964 but before April 1, 1976 and where such agreement has, in either case, been approved by the Central Government	50%
Foreign Company – Any other income	35%

Add:

(a) Surcharge:

Type of Company	10 Crores > Total Income > 1 Crore	Total Income > 10 Crore*
Domestic Company	7%	12%
Foreign Company	2%	5%
Company opting for taxability under Section 115BAA / 115BAB	Flat 10% irrespective of amount of total income	

*Note: Where income exceeds Rs. 10 crore, the total amount payable as income-tax and surcharge shall not exceed total amount payable as income-tax on total income of Rs. 10 crore by more than the amount of income that exceeds Rs. 10 crore.

(b) Health and Education Cess: The amount of income-tax and the applicable surcharge, shall be further increased by health and education cess calculated at the rate of 4% of such income-tax and surcharge.

Domestic companies have to pay tax at the specified rate on profit earned during the previous year. Generally the tax rate applicable on domestic companies is 30%. It is 25% if the total turnover or gross receipt does not exceed Rs. 400 crore during the preceding previous year.

In addition to the above tax rate, there are three other sections i.e. **Section 115BA / 115BAA / 115BAB** of the Income tax Act, 1961. Domestic Companies have the option to choose to pay tax in any of these sections only on fulfillment of certain conditions. The conditions are appended below:

Criteria	Tax on Income of certain manufacturing Domestic Companies [Section 115BA]	Tax on income of certain Domestic Companies [Section 115BAA]	Tax on Income of new manufacturing Domestic Companies [Section 115BAB]
Tax Rates	25% + SC as applicable + HEC @ 4%	22% + SC @ 10% + HEC @ 4	15% + SC @ 10% + HEC @ 4%
Set-up and engaged	Company has been set- up & registered on or after 01-03-2016 and engaged in business of manufacture/ production of any article/ thing and research in relation to, or distribution of, such article or thing manufactured	Applicable on Domestic Companies	● Company should be set-up as a domestic company engaged in manufacturing / production of any article and include research or distribution of such article. The company has been set-up and registered on or after 1st Oct 2019 and must commence manufacturing on or before 31st March, 2024. ● Is not formed by splitting up or reconstruction of business already in existence (exception provided for undertaking formed as a result of reestablishment, reconstruction or revival of business referred to in section 33B of the Act). ● Does not use any building previously used as a hotel or convention centre, as the case may be, in respect of which deduction under section 80-ID has been claimed and allowed.

Following Deduction not allowed while calculating total Income	● Section 10AA: Deduction from special economic zone unit. ● Section 32AD: Investment allowance towards new plant and machinery made in notified backward areas. ● Section 33AB: Deduction for Tea, Coffee and Rubber manufacturing. ● Section 33ABA: Deposits made by companies engaged in production or extraction of petroleum and natural gas in India towards the site restoration fund. ● Deduction under section 35(1) (ii)(ia)(iii) or 35(2AA) (2AB) ● Section 35AD: Capital expenditure by any specified business. ● Section 35CCC: Expenditure on an agriculture extension project. ● Section 35CCD: Expenditure on skill development project ● Section 80C to 80U (profit based) other than u/s 80JJAA or 80M. ● Additional depreciation u/s 32.	● Section 10AA: Deduction from special economic zone unit. ● Section 32AD: Investment allowance towards new plant and machinery made in notified backward areas. ● Section 33AB: Deduction for Tea, Coffee and Rubber manufacturing. ● Section 33ABA: Deposits made by companies engaged in production or extraction of petroleum and natural gas in India towards the site restoration fund. ● Deduction under section 35(1)(ii)(ia)(iii) or 35(2AA)(2AB) . ● Section 35AD: Capital expenditure by any specified business. ● Section 35CCC: Expenditure on an agriculture extension project. ● Section 35CCD: Expenditure on skill development project ● Section 80C to 80U (profit based) other than u/s 80JJAA or 80M. ● Additional depreciation u/s 32.	● Section 10AA: Deduction from special economic zone unit. ● Section 32AD: Investment allowance towards new plant and machinery made in notified backward areas. ● Section 33AB: Deduction for Tea, Coffee and Rubber manufacturing. ● Section 33ABA: Deposits made by companies engaged in production or extraction of petroleum and natural gas in India towards the site restoration fund. ● Deduction under section 35(1)(ii)(ia)(iii) or 35(2AA)(2AB) . ● Section 35AD: Capital expenditure by any specified business. ● Section 35CCC: Expenditure on an agriculture extension project. ● Section 35CCD: Expenditure on skill development project. ● Section 80C to 80U (profit based) other than u/s 80JJAA or 80M. ● Additional depreciation u/s 32.

Set-off of loss	No set off of any loss c/f from any earlier AY if such loss is attributable to any of the deductions referred above	No set off of any loss c/f from any earlier AY if such loss is attributable to any of the deductions referred above	No set off of any loss c/f from any earlier AY if such loss is attributable to any of the deductions referred above.
MAT	Applicable	Not Applicable	Not Applicable
Availability of set-off of MAT credit brought forward from earlier years	Applicable	No brought forward MAT credit	No brought forward MAT credit available
Exercise of Options	This Option has to be exercised upto due date of income tax return filing.	This Option has to be exercised upto due date of income tax return filing.	This Option has to be exercised upto due date of income tax return filing.
Opt-out options	Company cannot opt out once this option has been exercised ,except when the company choose to opt for Section 115BAA.	Company exercises the option under Section 115BAA for a given assessment year, it cannot withdraw it for the same or subsequent assessment years.	Company exercises the option under Section 115BAB for a given assessment year, it cannot withdraw it for the same or subsequent assessment years.

MINIMUM ALTERNATE TAX (MAT)

At times it may happen that a taxpayer, being a company, may have generated income during the year, but by taking the advantage of various provisions of Income-tax Law (like exemptions, deductions, depreciation, etc.), it may have reduced its tax liability or may not have paid any tax at all. Due to increase in the number of zero taxpaying companies, MAT was introduced. The objective of introduction of MAT is to bring into the tax net “zero tax companies” which in spite of having earned substantial book profits and having paid handsome dividends, do not pay any tax due to various tax concessions and incentives provided under the Income-tax Law. Since the introduction of MAT, several changes have been introduced in the provisions of MAT and today it is levied on companies as per the provisions of section 115JB.

MAT Applicability

If the income tax payable by a company on its total income as computed under the normal provisions of the Income Tax Act in respect of any previous year relevant to the assessment year, is less than 15% of such book profit plus surcharge plus health and education cess, then such book profit shall be treated as total income of the company and the tax payable for the relevant previous year **shall be deemed to be 15%** (add surcharge and cess) of such book profit. This non- absolute provision will override any other provision of the Income-tax Act.

Note: MAT is levied at the rate of 9% (plus surcharge and cess as applicable) in case of a company, being a unit of an International Financial Services Centre and deriving its income solely in convertible foreign exchange.

MAT is applicable to:

- companies, including foreign companies with a permanent establishment (PE) or business connection in India.
- Companies in SEZ are not exempt from MAT (w.e.f. AY 2020-21).
- It does not apply to certain foreign companies (e.g., those not having a PE in India and covered under special exemptions).

MAT provision shall not apply to:

- any income arising to a company from life insurance business.
- Domestic Company who has exercised the option referred to under sections 115BAA or 115BAB.
- a foreign company resident of a country with which India has a Double Taxation Avoidance Agreement (DTAA) and such company does not have a permanent establishment in India.
- the foreign company is a resident of a country with which India does not have an agreement (DTAA) and such company is not required to seek registration under any law for the time being in force relating to companies.
- a foreign company, whose total income comprises of profits and gains arising from business referred to in section 44B, 44BB, 44BBA, or 44BBB and such income has been offered to tax at the rates specified in those sections.

MEANING OF BOOK PROFITS

As per Explanation 1 to section 115JB(2) “book profit” for the purposes of section 115JB means net profit as shown in the statement of profit and loss prepared in accordance with Schedule III to the Companies Act, 2013 as increased and decreased by certain items prescribed in this regard. The items to be increased and decreased are as follows:

Computation of Book Profits (Table A)	Amount
Net profit as per statement of profit and loss prepared in accordance with Schedule III to the Companies Act, 2013	
Add: Following items (if they are debited to the statement of profit and loss)	
Income-tax paid/payable and the provision thereof	
Amounts carried to any reserves by whatever name called (Other than reserve specified under Section 33AC)	
Provisions for unascertained liabilities	
Provisions for losses of subsidiary companies	
Dividends paid/proposed	
Expenditure related to incomes which are exempt under section 10 [other than section 10(38)] section 11 and section 12	

Computation of Book Profits (Table A)	Amount
The amount or amounts of expenditure relatable to, income, being share of the taxpayer in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86	
The amount or amounts of expenditure relatable to income accruing or arising to a taxpayer being a foreign company, from: (a) the capital gains arising on transactions in securities; or (b) the interest, dividend royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII if the income-tax payable on above income is less than the rate of MAT	
The amount representing notional loss on transfer of a capital asset, being share or a special purpose vehicle to a business trust in exchange of units allotted by that trust referred to in clause (xvii) of section 47 or the amount representing notional loss resulting from any change in carrying amount of said units or the amount of loss on transfer of units referred to in clause (xvii) of section 47	
Expenditure relatable to income by way of royalty in respect of patent chargeable to tax under section 115BBF	
Amount of depreciation debited to P & L A/c	
Deferred tax and the provision thereof	
Provision for diminution in the value of any asset	
The amount standing in revaluation reserve relating to revalued asset on the retirement or disposal of such an asset if not credited to statement of profit and loss	
The amount of gain on transfer of units referred to in clause (xvii) of section 47 computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through statement of profit and loss as the case may be	
Less: Following items (if they are credited to the statement of profit and loss)	
Amount withdrawn from any reserve or provision if credited to P&L account	
Incomes which are exempt under section 10 [other than section 10(38)] section 11 and section 12	
Amount of depreciation debited to statement of profit and loss (excluding the depreciation on revaluation of assets)	
Amount withdrawn from revaluation reserve and credited to statement of profit and loss to the extent it does not exceed the amount of depreciation on revaluation of assets	

Computation of Book Profits (Table A)	Amount
The amount of income, being the share of the taxpayer in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86, if any such amount is credited to the statement of profit and loss	
The amount of income accruing or arising to a taxpayer being a foreign company, from: (a) the capital gains arising on transactions in securities; or (b) the interest, dividend royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII if such income is credited to the statement of profit and loss and the income-tax payable on above income is less than the rate of MAT.	
The amount (if any, credited to the statement of profit and loss) representing (a) notional gain on transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust referred to in clause (xvii) of section 47; or (b) notional gain resulting from any change in carrying amount of said units; or (c) gain on transfer of units referred to in clause (xvii) of section 7, The amount representing notional gain on transfer of units referred to in clause (xvii) of section 47 computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through statement of profit and loss, as the case may be.	
Income by way of royalty in respect of patent chargeable to tax under section 115BBF	
Aggregate amount of unabsorbed depreciation and loss brought forward in case of: a) A company and its subsidiary and the subsidiary of such subsidiary, where, the Tribunal, on an application moved by the Central Government under Section 241 of the Companies Act, 2013 has suspended the Board of Directors of such company and has appointed new directors who are nominated by the Central Government under Section 242 of the said Act; A company against whom an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under Section 7 or Section 9 or Section 10 of the Insolvency and Bankruptcy Code, 2016	
Amount of brought forward loss or unabsorbed depreciation, whichever is less as per books of account (in case of a company other than the company undergoing insolvency proceedings)	
Profits of a sick industrial company till its net worth becomes zero/positive	
Deferred tax, if credited to statement of profit and loss	
Book profit to be used to compute MAT	

The amount of Income-tax shall include:

- i. Any interest charged under this Act;
- ii. Surcharge, if any, as levied by the Central Acts from time-to-time;
- iii. Education Cess on Income-tax, if any, as levied by the Central Acts from time-to-time; and
- iv. Secondary and Higher Education Cess on Income-tax, if any, as levied by the Central Acts from time-to-time.

Withdrawals made from reserves created or provisions made on or after the 1-4-1997, shall be deducted only if the book profit of the year of creation of such reserve has been increased by the amount transferred to such reserve or provisions (out of which the said amount was withdrawn).

Meaning of book profit for Indian Accounting Standards (Ind AS) compliant companies

- (1) As per newly inserted section 115JB(2A) by the Finance Act, 2017, “book profit” for Ind AS compliant company for the purpose of section 115JB means the book profit as computed in accordance with Explanation 1 to section 115JB(2) as mentioned above:-
 - (a) increased by all amounts credited to other comprehensive income (OCI) in the statement of profit and loss that will not be re-classified to profit or loss;
 - (b) decreased by all amounts debited to other comprehensive income (OCI) in the statement of profit and loss that will not be re-classified to profit or loss;
 - (c) increased by all amounts or aggregate of amounts debited to the statement of profit and loss on distribution of non-cash assets to shareholders in a demerger of companies in accordance with Appendix A of Ind AS 10; and
 - (d) decreased by all amounts or aggregate of amounts credited to the statement of profit and loss on distribution of non-cash assets to shareholders in a demerger of companies in accordance with Appendix A of Ind AS 10.
- (2) Any item credited/debited to OCI that will not re-classified to profit or loss should be ignored for the purpose of computing book profit if that item is:
 - i. Revaluation surplus for fixed assets and intangible assets under Ind AS 16 and Ind AS 38; or
 - ii. Gains or losses from investments in equity instruments measured at fair value through other comprehensive income (FVTOCI) as per Ind AS 109.

But, the book profit of the previous year in which the asset or investment as referred to in above points (i) and (ii) is retired, disposed, realised or otherwise transferred shall be increased or decreased by the amounts of above points (i) and (ii) to the extent relatable to the disposed asset or investment.

- (3) In the case of a resulting company, where the assets and liabilities of the undertaking or undertakings being received by it are recorded at values different from values appearing in the books of account of the demerged company immediately before demerger, any change in such value shall be ignored for the purpose of computation of book profit of the resulting company.

So, for the computation of book profit of an Ind AS compliant company, may proceed as follows:

Particulars	Amount
Book profit as computed in Table A	
Adjustments as mentioned in point (3) above	

Particulars	Amount
Adjustments for revaluation gain/loss for fixed assets & intangible assets in the year of their disposal or transfer	
Adjustments for gains or losses from investments in equity instruments measured at FVTOCI in the year if their disposal or transfer	
Adjustments for any other OCI items that will not be re-classified to profit or loss	
Book profit to be used to compute MAT	

MAT CREDIT [SECTION 115JAA]

MAT Credit for taxes paid as per Section 115JB in earlier years (in which MAT liability was more than tax liability as per normal provisions of the Act) is available in the Assessment year in which Tax payable on the total income computed under the normal provisions of this Act is more than tax payable u/s 115JB for that Assessment year.

MAT Credit to be set off in an AY = Regular Income tax payable - Minimum alternate tax as per section 115JB

Circular No. 24/*2017 Dated 25th July, 2017

Clarifications on computation of book profit for the purposes of levy of Minimum Alternate Tax (MAT) under section 115JB of the Income-tax Act, 1961 for Indian Accounting Standards (Ind AS) compliant companies.

Central Government notified the Indian Accounting Standards (Ind AS) which are converged with International Financial Reporting Standards (IFRS) vide Companies (Indian Accounting Standards) Rules, 2015. Consequently, the Finance Act, 2017, has amended the provisions of section 115JB of the Income-tax Act, 1961 ('the Act') for Ind AS compliant companies w.e.f. 1st day of April, 2017 (A.Y. 2017-18).

The Central Board of Direct Taxes ('the Board') has received representations from various stakeholders seeking clarifications on certain issues arising therefrom. The matter was referred to an expert committee. The Committee after duly considering the representations from stakeholders has recommended issuance of clarifications by way of FAQs for these issues.

The matter has been considered by the Board and the following clarifications are issued:

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

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

It is further clarified that for financial instruments where gains and losses are recognised through

Other Comprehensive income (OCI), the amended provisions of MAT shall continue to apply.

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

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

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

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

For example, companies which adopt Ind AS with effect from 1st day of April 2016 are required to prepare their financial statements for the year 2016-17 as per requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as of 1st day of April 2015 and restate the financial statements for the comparative period 2015-16. In such a case, the first time adoption adjustments as of 31st day of March 2016 should be considered [i.e. the start of business on 1st day of April 2016 (or, equivalently, close of business on 31st day of March 2016)] for computation of MAT liability for previous year 2016-17 (Assessment year 2017-18) and thereafter.

Question 4: As per Indian GAAP, proposed dividend was required to be recognized in the financial statements for the year for which it pertained to even though these were declared in the subsequent year. Section 115JB of the Act already provides for adjustments for dividend for computation of book profit. As per Ind AS, the amount of proposed dividend (including dividend distribution taxes) is required to be recognized in the year in which it has been declared rather than the year for which it pertains to. Accordingly, on transition to Ind AS, the amount of proposed dividend for FY 2015-16 which was recognized in profit and loss account in FY 2015-16 is required to be reversed and credited to Retained Earnings. For the computation of MAT, whether these balances would form part of the transition amount and thus be adjusted over a period of 5 years?

Answer: Adjustment of proposed dividend (including dividend distribution taxes) shall not form part of the transition amount.

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

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

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

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

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

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

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

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

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

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

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

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

Particulars	Erstwhile Indian GAAP	Ind-AS (considering fair value/revaluation on adjustment on PPE)	Fair Value/Revaluation Adjustments and corresponding depreciation
WDV/Deemed Cost as on 1 April 2015	100	1000	900

Depreciation @ 10% for F.Y. 2015-16	10	100	90
WDV as on 1 April 2016	90	900	810
Depreciation @ 10% for F.Y. 2016-17	9	90	81
WDV as on 1 April 2017	81	810	729*
Sale value as on 1 April 2017	900	900	
Profit on sale credited to P&L	819	90	
Adjustment for MAT - revaluation amount after adjustment of the depreciation	0	729*	
Profit on sale to be considered for MAT	819	819	

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

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

Question 12: Existing clause (iii) of explanation to section 115JB(2) of the Act provides for deduction of lower of the amount of loss brought forward or unabsorbed depreciation as per books of account for computation of book profits. In case where, on adjustment of transition amount, the losses as per books of account gets wiped off, whether deduction for the said amount would be available for assessment year 2017-2018 onwards?

Answer: For assessment year 2017-2018, the deduction of lower of depreciation or losses shall be allowed based on the position as on 31 March 2016. For the subsequent periods, the position as per books of account drawn as per Ind AS shall be considered for computing lower of loss brought forward or unabsorbed depreciation.

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

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

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

Question 14: Companies which follow accounting year other than March, 2017 ending for Companies Act purposes and are required to transition to Ind AS will have to prepare financial statements for MAT purposes for FY 2016-17 partly under Indian GAAP and partly under Ind AS. How should such companies compute MAT on transition to Ind AS?

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

For example, a Company following December ending will be required to prepare, accounts for MAT purposes under Indian GAAP for 9 months upto December 2016 and under Ind AS for 3 months thereafter. The transition amount will be calculated with reference to 1st January, 2017.

Concessional Rate of MAT for IFSC unit

In case of a company, being a unit in IFSC and deriving its income solely in convertible foreign exchange, the minimum alternate tax shall be chargeable at the rate of 9% instead of 15%.

Calculation of MAT for IFSC unit vis-a-vis other companies

Particulars	Standard MAT	IFSC MAT
Book Profit	₹ 10,00,00,000	₹ 10,00,00,000
MAT Rate	15%	9%
MAT Amount	₹ 1,50,00,000	₹ 90,00,000
Add: Cess @ 4%	₹ 6,00,000	₹ 3,60,000
Total MAT Payable	₹ 1,56,00,000	₹ 93,60,000

This shows a significant tax saving for IFSC units.

Carried Forward of MAT Credit

Credit of MAT in respect of tax excess paid under Section 115JB will be available and it can be carried forward for **15 Assessment Years** succeeding the assessment year in which the credit became allowable.

The amount of MAT credit shall not be allowed to be carried forward to the subsequent year to the extent such credit relates to the difference between the amount of foreign tax credit (FTC) allowed against MAT and FTC allowable against the tax computed under regular provisions of the Act.

MAT Provisions for Converted LLPs and Exemptions

- Companies converted to Limited Liability Partnerships (LLPs) are not eligible to claim MAT credit.
- MAT is not applicable to companies opting for tax regimes under Section 115BAA.

Illustration 2:

Number of years for which credit of MAT excess paid under section 115JB can be carried forward is –

- 7 Assessment years
- 8 Assessment years
- 15 Assessment years
- 9 Assessment years.

Solution: (c) 15 Assessment years

Illustration 3:

A domestic company ABC Ltd furnishes the following particulars for AY 2026-27 and solicits your advice on the application of section 115JB. You are also required to compute the total income and tax payable.

Particulars		Amount (Rs.)
	Profits as per P&L Account as per Companies Act, 2013	1,95,00,000
	This includes:	
a)	Excess realized on sale of land held as investment	30,00,000
b)	Depreciation on SLM basis	1,00,00,000
c)	Provision for losses of subsidiaries	60,00,000
	Depreciation allowable per Income Tax Rules, 1962	1,50,00,000
	STCG on sale of land mentioned above	40,00,000
	B/f losses	50,00,000
	Unabsorbed Depreciation	60,00,000

The Company has also represented to you that the excess realized on sale of land cannot form part of the book profits u/s 115 JB. You will have to deal with the issue assuming that the Co. is not required to comply with Ind. AS. The annual turnover of ABC Ltd. was INR 40 Crores.

Solution:**Computation of Total Income**

Particulars		Amount (Rs.)	Amount (Rs.)
	Net Profit per P&L Account		1,95,00,000
Less:	Excess realized on sale of land (treated separately)		(30,00,000)
			1,65,00,000
Add:	Depreciation on SLM Basis	1,00,00,000	
	Provisions for losses of subsidiaries	60,00,000	
			1,60,00,000
	Total		3,25,00,000
Less:	Depreciation allowable per Income-tax Act		(1,50,00,000)
	Business Income		1,75,00,000

Less:	Set-off of B/F losses		(50,00,000)
	Net Business Income		1,25,00,000
	Capital Gains		40,00,000
	Total Income		1,65,00,000
Less:	Unabsorbed Depreciation		(60,00,000)
	Total Income per as Income-tax Act, 1961		1,05,00,000

Computation of Book Profit u/s 115JB

Particulars		Amount (Rs.)	Amount (Rs.)
	Net Profit per P&L Account		1,95,00,000
Add:	Depreciation on SLM Basis	1,00,00,000	
	Provisions for losses of subsidiaries	60,00,000	1,60,00,000
			3,55,00,000
Less:	Depreciation		(1,00,00,000)
	Business Income		2,55,00,000
Less:	B/f Business Loss as it's less than Unabsorbed Depreciation		(50,00,000)
	Book Profits		2,05,00,000

- (a) Note that the profit on sale of land held as investment is not excluded from the P&L for purposes of computing the Book Profits.
- (b) Note that the least of the B/f loss and the Unabsorbed Depreciation is reduced to compute Book Profits.

Income Tax Liability under Normal Provisions

Tax Liability @ 25% as the Turnover is < 400 Crores		26,25,000
Add:	Surcharge @ 7% as the Income is > 1 Cr.	1,83,750
	Total Tax Payable	28,08,750
Add:	Health and Education Cess @ 4%	1,12,350
	Total Income Tax Liability	29,21,100

Income Tax Liability per MAT Provisions		
15% of Book Profits		30,75,000
Add:	Surcharge @ 7% as the Income is > 1 Cr.	2,15,250
	Total Tax Payable	32,90,250
Add:	Health and Education Cess @ 4%	1,31,610
	Total Income Tax Liability	34,21,860

Note:

- (a) Since 15% of book profits exceeds the tax payable per Income-tax Act, 1961, the book profit would be deemed to be the total income and the tax payable on such total income, which is INR 34,21,860 (rounded off) would become the liability for AY 2026-27 for the Company.
- (b) With regards to the company's representation, in respect of the capital gains, whether liable for book profit tax u/s 115JB, it may be noted that since the excess realised on sale of land which was held as investment, has been included in the net profit computed per Sch. III of the Companies Act, 2013, it shall form part of Book Profits (Bombay HC Judgement in CIT vs. Veekay Lal Investment Co Pvt Ltd.).

Illustration 4:

Mona Ltd., a resident Co., earned a profit of INR 15,00,000/- after debit / credit of the following amounts:

Items debited

- a) Provisions for the losses of Subsidiaries; INR 70,000
- b) Provision for doubtful debts; INR 75,000
- c) Provision for Income Tax; INR 105,000
- d) Provision for Gratuity basis actuarial valuation; INR 200,000 e) Depreciation; INR 360,000
- f) Interest to Financial Institution (unpaid before filing of return); INR 100,000
- g) Penalty for infraction of law; INR 50,000

Items credited

- a) Profits from unit(s) established in SEZ; INR 500,000
- b) Share in income of an AOP as a member; INR 175,000
- c) Long Term Capital Gains; INR 300,000

Other Information

- a) Depreciation includes INR 150,000 on account of revaluation of fixed assets
- b) Depreciation per Income Tax Rules is INR 280,000
- c) Balance of P&L Account on the assets side of B/S as on last day of p/y was INR 10,00,000; of which the unabsorbed depreciation was INR 400,000

- d) Capital Gains has been invested in specified assets u/s 54EC
- e) The AOP, of which the Co. is a member has paid the tax at maximum marginal rate
- f) Provision for Income Tax includes INR 45,000 as interest

You are required to compute the MAT u/s 115JB of the Income Tax Act, 1961 for AY 2026-27, assuming that the Co. is not required to comply with IND AS.

Solution:

Computation of Book Profit u/s 115JB

Particulars		Amount (Rs.)	Amount (Rs.)
	Net Profit per P&L Account		15,00,000
<i>Add:</i>	Provisions for subsidiaries' losses	70,000	
	Provision for doubtful debts	75,000	
	Provision for Income Tax	1,05,000	
	Depreciation	3,60,000	
			6,10,000
			21,10,000
<i>Less:</i>	Share in income of an AOP	1,75,000	
	Depreciation (excl. Reval. Amounts)	2,10,000	
	Unabsorbed Business Losses	4,00,000	
			(7,85,000)
	Book Profits		13,25,000
	MAT Liability @ 15%		19,87,50
<i>Add:</i>	Health and Education Cess @ 4%		7,950
	MAT Liability (rounded off)		20,6700

Note:

- Interest to FI's / Banks which are unpaid prior to filing of return and penalties are not specified items u/s 115JB and hence not added back
- Provision for Gratuity Liability based on actuarial valuation is an ascertained liability and hence should not be added back to ascertain book profits (CIT vs. Echjay Forgings P. Ltd.)

3. Capital Gains reflected in the P&L will form a part of the book profits even if the investments u/s 54EC have been made. Therefore, these cannot be reduced. (CIT vs. Veekaylal Investment Co. P. Ltd.)
4. Share of the AOP's income as a member is reduced as the AOP has already paid the tax at maximum marginal rate

Illustration 5:

The table below highlights and explains the modus of MAT Credit, and how it is utilised and carried forward.

MAT CREDIT UTILISATION AND C/F					
A.Y.	Normal Tax Liability	Liability (MAT)	Tax Payable	Credit utilised	Credit c/f
2014-15	100	300	300	-	200
2015-16	120	90	120	30	170
2016-17	150	110	150	40	130
2017-18	180	200	200	-	150
2018-19	200	190	200	10	140
2019-20	300	280	300	20	120
2020-21	250	230	250	20	100
2021-22	225	175	225	50	50
2022-23	250	240	250	10	40
2023-24	275	270	275	5	35
2024-25	350	315	350	35	0

CASE LAW

ABC (P) Ltd. is in the business of manufacturing Plastic. For the assessment year 2026-27, it paid tax@15% on its book profit computed under section 115JB. The Assessing Officer though satisfied that it is liable to pay book profit tax under section 115JB, wants to charge interest under sections 234B and 234C as no advance tax was paid during the financial year 2024-25. The company seeks your opinion on the proposed levy of interest.

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

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

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

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

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

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

Therefore, even though ABC (P) Ltd. is assessed on the basis of its book profit under section 115JB for A.Y.2026-27, it is liable to pay advance tax. Since ABC (P) Ltd. has not paid any advance tax during the financial year 2024-25, the levy of interest under section 234B and 234C is valid.

FILING OF RETURNS BY COMPANIES [SECTION 139]

Compulsory Filing of Income Tax Return [Section 139(1)]

As per section 139(1) of the Income Tax Act, 1961, it is compulsory for companies to file a return of income or loss for every previous year of or before the due date in the prescribed form.

Due Date for Filing Income Tax Return for Companies		
Assessee		Due Date
(i)	Company	31st October of the Assessment Year
(ii)	Company who is required to furnish a report referred to in Section 92E	30th November of the Assessment Year

Exemption from filing Income Tax Return by Foreign Companies in certain cases

In order to reduce the compliance burden of certain types of tax payers, the central government has been empowered to notify the class or classes of person who will be exempt from the filing of Income tax return subject to satisfying the certain conditions.

Accordingly, vide notification no. 49/2023 dated 14th July, 2023 exempted non-corporate non-resident and foreign company having income chargeable under income tax act, 1961 during the previous year from any investment set-up in an International Financial Services Center (IFSC) located in India from the requirement of furnishing a return of income u/s 139(1) from AY 2019-20 onwards.

Conditions for claiming exemption for filing Income Tax Return

- Any income tax due on the said class of persons has been deducted at source and remitted to the central government by the investment fund at the rates in force and
- There is no other income during the previous year for which the said class of person is otherwise liable for filing income tax return.

Further, the exemption from the requirement for filing the income tax return would not be available to such

notified class of person where a notice u/s 142(1) or section 148 or section 153C has been issued for filing the income tax return to such notified class of person.

Return of Loss [Section 139(3)]

If any person who has sustained a loss in any previous year under the head “Profits and gains of business or profession” or under the head “Capital gains” and claims that the loss or any part thereof should be carried forward under sub-section (1) of section 72, or sub-section (2) of section 73, or sub-section (2) of section 73A or sub-section (1) or sub-section (3) of section 74, or sub-section (3) of section 74A, he may furnish, within the time allowed under sub-section (1), a return of loss in the prescribed form and verified in the prescribed manner and containing such other particulars as may be prescribed.

Compulsory Filing of Return of Loss for on or before the due date to carry forward and set-off certain losses

As per the provision of section 80 of the Income Tax Act, 1961 it is mandatory to file return of loss on or before the due date specified u/s 139(1) in order to carry forward the following losses:

- Business Loss [Section 72(1)]
- Speculation Business Loss [Section 73(2)]
- Loss from specified business [Section 73A(2)]
- Loss under the head Capital Gains [Section 74(1)]
- Loss from the activity of owning and maintaining race horses [Section 74A(3)]

However, loss under the head house property under section 71B and unabsorbed depreciation u/s 32 can be carried forward for set-off even if the return of loss has not been filed before the due date.

Belated Return [Section 139(4)]

Any person who has not furnished a return within the time allowed to him under sub-section (1), may furnish the return for any previous year at any time before:

- three months prior to the end of the relevant assessment year or
- before the completion of the assessment,

whichever is earlier.

Revised Return [Section 139(5)]

If any person, having furnished a return under sub-section (1) or sub-section (4), discovers any omission or any wrong statement therein, he may furnish a revised return at any time before:

- three months prior to the end of the relevant assessment year or
- before the completion of the assessment,

whichever is earlier.

Particulars to be furnished along with return of Income in case of an assessee engaged in Business or Profession [Section 139(6)]

The prescribed form of the returns shall, in the case of an assessee engaged in any business or profession, also require him to furnish the following:

the report of any audit referred to in section 44AB [Such tax audit report is required to be furnished one month prior to the due date of filing of return of Income u/s 139(1)]

- the particulars of the location and style of the principal place where he carries on the business or profession and all the branches thereof
- the names and addresses of his partners, if any, in such business or profession and,
- if he is a member of an association or body of individuals,
 - I. the names of the other members of the association or the body of individuals and the extent of the share of the assessee and
 - II. the shares of all such partners or the members, as the case may be, in the profits of the business or profession and any branches thereof.

Defective Return [Section 139(9)]

Where the Assessing Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of fifteen days from the date of such intimation or within such further period which, on an application made in this behalf, the Assessing Officer may, in his discretion, allow; and if the defect is not rectified within the said period of fifteen days or, as the case may be, the further period so allowed, then, notwithstanding anything contained in any other provision of this Act, the return shall be treated as an invalid return and the provisions of this Act shall apply as if the assessee had failed to furnish the return:

Provided that where the assessee rectifies the defect after the expiry of the said period of fifteen days or the further period allowed, but before the assessment is made, the Assessing Officer may condone the delay and treat the return as a valid return.

Updated Return [Section 139(8A)]

1. **Option to Furnish Updated Return** Any person, whether or not he has furnished a return under sub-section (1) or sub-section (4) or sub-section (5), for an assessment year may furnish an **updated return of his income** or the income of any other person in respect of which he is assessable under this Act, for the previous year relevant to such assessment year at any time **within forty-eight months** from the end of the relevant assessment year.
2. **Non-applicability of the provision of Updated Return:** if the updated return:
 - a) is a return of a loss; or
 - b) has the effect of decreasing the total tax liability determined on the basis of return furnished under sub-section (1) or sub-section (4) or sub-section (5); or
 - c) results in refund or increases the refund due on the basis of return furnished under sub-section (1) or sub-section (4) or sub-section (5),

Provided further that a person shall not be eligible to furnish an updated return under this sub-section, where:

- a) a search has been initiated under section 132 or books of account or other documents or any assets are requisitioned under section 132A in the case of such person; or
- b) a survey has been conducted under section 133A, other than sub-section (2A) of that section, in the case of such person; or

- c) a notice has been issued to the effect that any money, bullion, jewellery or valuable article or thing, seized or requisitioned under section 132 or section 132A in the case of any other person belongs to such person; or
- d) a notice has been issued to the effect that any books of account or documents, seized or requisitioned under section 132 or section 132A in the case of any other person, pertain or pertain to, or any other information contained therein, relate to, such person,

for the assessment year relevant to the previous year in which such search is initiated or survey is conducted or requisition is made and any assessment year preceding such assessment year.

Provided also that no updated return shall be furnished by any person where any notice to show-cause under section 148A has been issued in his / her case after thirty-six months from the end of the relevant assessment year:

Provided also that the fourth proviso shall not apply where an order is passed under sub-section (3) of section 148A determining that it is not a fit case to issue notice under section 148

3. Circumstances in which updated return can not be Furnished:

- a) Where a person has furnished an updated return for the relevant assessment year or
- b) Where any proceeding for assessment, re-assessment, re-computation or revision of income is pending or has been completed for the relevant assessment year in his case.
- c) the Assessing Officer has information in respect of such person for the relevant assessment year in his possession under the Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976 or the Prohibition of Benami Property Transactions Act, 1988 or the Prevention of Money-laundering Act, 2002 or the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 and the same has been communicated to him, prior to the date of furnishing of return under this sub-section; or
- d) information for the relevant assessment year has been received under an agreement referred to in section 90 or section 90A in respect of such person and the same has been communicated to him, prior to the date of furnishing of return under this sub-section; or
- e) any prosecution proceedings under the Chapter XXII have been initiated for the relevant assessment year in respect of such person, prior to the date of furnishing of return under this sub-section; or
- f) he is such person or belongs to such class of persons, as may be notified by the Board in this regard

Note: If any person has sustained a loss in any previous year, he shall be allowed to furnish an updated return where such updated return is a return of income.

Tax on Updated Return [Section 140B]

Where No Return of Income is Furnished earlier [Section 142B(1)]

Where no return of income under sub-section (1) or sub-section (4) of section 139 has been furnished by an assessee and tax is payable, on the basis of return to be furnished by such assessee under sub-section (8A) of section 139, after taking into account,

- (i) the amount of tax, if any, already paid as advance tax;

- (ii) any tax deducted or collected at source;
- (iii) any relief of tax claimed under section 89;
- (iv) any relief of tax or deduction of tax claimed under section 90 or section 91 on account of tax paid in a country outside India;
- (v) any relief of tax claimed under section 90A on account of tax paid in any specified territory outside India referred to in that section; and
- (vi) any tax credit claimed to be set off in accordance with the provisions of section 115JAA or section 115JD,

the assessee shall be liable to pay such tax together with interest and fee payable under any of the provisions of this Act for any delay in furnishing the return or any default or delay in payment of advance tax, along with the payment of additional income-tax computed in accordance with sub-section (3), before furnishing the return and the return shall be accompanied by proof of payment of such tax, additional income-tax, interest and fee.

Where Return of Income is Furnished earlier [Section 142B(2)]

Where, return of income under sub-section (1) or sub-section (4) or sub-section (5) of section 139 (referred to as earlier return) has been furnished by an assessee and tax is payable on the basis of return to be furnished by such assessee under sub-section (8A) of section 139:

- (a) after taking into account
 - (i) the amount of relief or tax referred to in sub-section (1) of section 140A, the credit for which has been taken in the earlier return;
 - (ii) tax deducted or collected at source, in accordance with the provisions of Chapter XVII-B, on any income which is subject to such deduction or collection and which is taken into account in computing total income and which has not been included in the earlier return;
 - (iii) any relief of tax or deduction of tax claimed under section 90 or section 91 on account of tax paid in a country outside India on such income which has not been included in the earlier return;
 - (iv) any relief of tax claimed under section 90A on account of tax paid in any specified territory outside India referred to in that section on such income which has not been included in the earlier return;
 - (v) any tax credit claimed, to be set off in accordance with the provisions of section 115JAA or section 115JD, which has not been claimed in the earlier return; and
- (b) as increased by the amount of refund, if any, issued in respect of such earlier return,

the assessee shall be liable to pay such tax together with interest payable under any provision of this Act for any default or delay in payment of advance tax along with the payment of additional income-tax, as computed in accordance with sub-section (3), as reduced by the amount of interest paid under the provisions of this Act in the earlier return, before furnishing the return and the return shall be accompanied by proof of payment of such tax, additional income-tax, interest and fee.

Additional Income Tax Payable at the time of Updated Return [Section 140B(3)]

Time of Furnishing updated Return	Additional Income Tax Payable
If such return is furnished after expiry of the time available under sub-section (4) or sub-section (5) of section 139 and before completion of the period of twelve months from the end of the relevant assessment year	25% of aggregate of tax and interest payable as determined

Time of Furnishing updated Return	Additional Income Tax Payable
if such return is furnished after the expiry of twelve months from the end of the relevant assessment year but before completion of the period of twenty-four months from the end of the relevant assessment year.	50% of aggregate of tax and interest payable as determined
If such return is furnished after the expiry of twenty-four months from the end of the relevant assessment year but before completion of the period of thirty-six months from the end of the relevant assessment year.	60% of aggregate of tax and interest payable as determined
If such return is furnished after the expiry of thirty-six months from the end of the relevant assessment year but before completion of the period of forty-eight months from the end of the relevant assessment year.	70% of aggregate of tax and interest payable as determined

Note: Computation of “additional income-tax”, tax shall include surcharge and cess on such tax.

Interest for Default in furnishing Return of Income [Section 234A]

Interest will be levied in case of failure to file Income tax return on or before the due date as specified above. Simple interest @ 1% per month or part of the month is payable for the period commencing from the date immediately following due date and ending on the following dates:

- Where the return is furnished after the due date – Interest will be levied till the date of furnishing the return of Income.
- Where no return is furnished - Interest will be levied till the date of completion of assessment.

The interest will be calculated on the amount of the tax on the total income as reduced by the amount of:

- advance tax, if any, paid;
- any tax deducted or collected at source;
- any relief of tax allowed under section 89;
- any relief of tax allowed under section 90 on account of tax paid in a country outside India;
- any relief of tax allowed under section 90A on account of tax paid in a specified territory outside India referred to in that section;
- any deduction, from the Indian income-tax payable, allowed under section 91, on account of tax paid in a country outside India; and
- any tax credit allowed to be set off in accordance with the provisions of section 115JAA or section 115JD.

Fee for default in Furnishing Return of Income [Section 234F]

Where a person required to furnish a return of income under section 139, fails to do so within the time prescribed, he shall pay, by way of a fee, a sum of Rs. 5,000. However, the fee payable under this section shall not exceed one thousand rupees if the total income of the person does not exceed five lakh rupees.

VERIFICATION OF RETURN OF INCOME IN CASE OF COMPANIES [SECTION 140]

Circumstances	Authorized Person
In the situation not covered below	The Managing Director of the Company
Where for any unavoidable reason such managing director is not able to sign the return or where there is no managing director	Any director of the company or any other person as may be prescribed for this purpose. The person prescribed for the verification of return of Income shall be the person appointed by the adjudicating authority i.e. National Company Law Tribunal for discharging the duties and functions of an interim resolution professional, a resolution professional, or a liquidator, as the case may be, under the Insolvency and Bankruptcy Code, 2016 and the rules and regulations made thereunder. [Rule 12AA of the Income Tax Rules] <i>Note on Penalty Imposition Authority:</i> The Finance Act, 2025, mandates that any penalty imposed on or after the 1st day of April, 2025, under sections 271C, 271CA, 271D, 271DA, 271DB, and 271E (related to default in TDS/TCS compliance, etc.) shall be imposed by the Assessing Officer.
Where the company is not resident in India	The Managing Director of accompany of any person who holds the valid power of attorney from such company to do so.
Where the company is being wound up under the order of court of otherwise	Liquidator
Where any person has been appointed as a receiver of any assets of the company	Liquidator
Where the management of the company has been taken over by the Central Government or any State Government under any law	The Principle officer of the company
Where an application for corporate insolvency resolution process has been admitted by the adjudicating authority under the Insolvency and Bankruptcy Code, 2016	Insolvency Professional appointed by such adjudicating authority

LESSON ROUNDUP

- **'Indian Company'** as a company formed and registered under the Companies Act, 2013 and the registered office or the principal office should be in India and it also includes:
 1. a company formed and registered under any law relating to companies formerly in force in any part of India [other than Jammu and Kashmir, and the Union Territories specified in (4) below];
 2. any corporation established by or under a Central, State or Provincial Act;
 3. any institution, association or body which is declared by the Board to be a company under Section 2(17) of the Income-tax Act, 1961;
 4. in the case of any of the Union Territories of Dadra and Nagar Haveli, Goa, Daman and Diu and Pondicherry, a company formed and registered under any law for the time being in force in that Union Territory;
- **Domestic company** means an Indian company or any other company which, in respect of its income liable to tax under the Income Tax Act, has made the prescribed arrangements for the declaration and payment within India, of the dividends (including dividends on preference shares) payable out of such income.
- **Foreign company** as a company which is not a domestic company.
- Company in which the public is not substantially interested is known as a **closely held company**.
- According to Section 6(3) of the Act, a company is said to be resident in India (resident company) in any previous year, if it is an Indian company; or its place of effective management, (POEM), in that year, is in India.
- The provision related to tax incidence on Companies as well as Tax Rates.
- **Minimum Alternate Tax** will be applicable if the income tax payable by a company on its total income as computed under the normal provisions of the Income Tax Act in respect of any previous year relevant to the assessment year, is less than 15% of such book profit plus surcharge plus health and education cess, then such book profit shall be treated as total income of the company and the tax payable for the relevant previous year shall be deemed to be 15% (add surcharge and cess) of such book profit. This non-absolute provision will override any other provision of the Income-tax Act.
- **Credit of MAT** in respect of tax excess paid under Section 115JB will be available and it can be carried forward for 15 Assessment Years succeeding the assessment year in which the credit became allowable.
- The Provisions related to due date of Filing of Return in case of Companies.
- The Provisions related to Belated Return, Revised Return, Defective Return etc.
- The Provisions related to Updated Returns, circumstances under which updated return can be filed, additional tax to be paid in case of filing of updated return, and the time limit is extended up to forty-eight months from the end of the relevant assessment year.
- Note that Sections 206AB and 206CCA, which mandated special rates for TDS and TCS in the case of non-filers of income tax returns, have been omitted by the Finance Act, 2025

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation.)

Multiple Choice Questions “MCQs”

1. Tax credit in respect of MAT paid as per section 115JB will be allowed only in the previous year in which the tax payable on the total income at the normal rate is –
 - (a) More than the tax payable under section 115JB
 - (b) Less than the tax payable under section 115JB
 - (c) Equal to the tax payable under section 115JB
 - (d) All of the above.

Answer: (a) More than the tax payable under section 115JB

2. Rate of MAT in case of a unit located in International Financial Service Centre
 - (a) 15%
 - (b) 9.5%
 - (c) 15.5%
 - (d) 9%

Answer: (d)

3. Metro Ltd., a domestic company, is assessed with a total income of Rs. 11.25 crore. The surcharge payable by the company shall be at the rate of –
 - (a) 2%
 - (b) 5%
 - (c) 10%
 - (d) 12%.

Answer: (d) 12%

4. Provisions of Section 115JB are applicable in case of –
 - (a) Domestic companies only
 - (b) Foreign companies only
 - (c) All companies
 - (d) Closely held companies.

Answer: (c) All companies.

5. For computing the Book Profit under section 115JB, which of the following is not added back to the profits?
 - (a) Income-Tax
 - (b) Provision for Tax

(c) Dividend Distribution Tax U/S 115-O

(d) Securities Transaction Tax

Answer: (d) Securities Transaction Tax

6. A domestic company whose turnover for the previous year 2021-22 Rs. 420 crores; for previous year 2023-24 Rs. 380 crore and for previous year 2024-25 Rs. 120 crores. Its total income (computed) for the assessment year 2026-27 is Rs. 30 crores. The rate of income tax applicable for such company (without cess) is:

(a) 30%

(b) 22%

(c) 15%

(d) 25%

Answer: (d) 25%

7. Provisions of Minimum Alternate Tax (MAT) are applicable to the companies which are:

(a) Indian companies

(b) Foreign companies in certain situations

(c) LLP

(a) (i) and (iii) (b) (i) and (ii)

(c) All the three (d) None of the above

Answer: (b)

8. At present, MAT Provisions are given in section of Income Tax Act, 1961

(a) 115J

(b) 115A

(c) 115JA

(d) 115JB

Answer: (d)

9. MAT provisions are applicable to

(a) Public Co

(b) Private company

(c) Domestic Co

(d) All companies

Answer: (d)

10. As per Explanation 1 to section 115JB(2) “book profit” for the purposes of section 115JB means net profit as shown in the statement of profit and loss prepared in accordance with of the Companies Act as increased and decreased by certain items prescribed in this regards

- (a) Schedule V
- (b) Schedule III
- (c) Schedule II
- (d) Schedule I

Answer: (b)

11. MAT Credit to be set off _

- (a) Regular Income tax - Minimum alternate tax
- (b) Regular Income tax + Minimum alternate tax
- (c) Regular Income tax /Minimum alternate tax
- (c) Zero

Answer: (a)

12. Credit of MAT in respect of tax excess paid under Section 115JB will be available and it can be carried forward for _____

- (a) 15 Financial Year
- (b) 15 Assessment Year
- (c) 15 Calendar Year
- (d) 15 Year of Receipt

Answer: (b)

Theoretical Questions

1. Explain the term “Return of Loss” under the Income Tax Act, 1961
2. State the loss which cannot be carried forward if the return has not been furnished within the time limit as specified u/s 139(1)
3. What is Updated Return? Who is eligible to file updated return?
4. What are the circumstances under which Updated Return cannot be filed?
5. What is the time-limit under which updated return can be filed? Also state the provision of additional tax be paid in case of filing the updated return?
6. Explain the concept of Minimum Alternate Tax (MAT) and carried forward provision with respect to MAT.
7. What is Book Profit for the purpose of computation of MAT?
8. Explain briefly the applicability of Section 115BAA and Section 115BAB of the Income Tax Act, 1961?
9. Define the Guiding Principles of Place of Effective Management?

10. How to Determine the residential status of Companies?
11. Explain the difference between Revised Return and Updated Return?
12. State Briefly the concept of Belated Return and Defective Return.
13. What is the due date of filing of return in case of Foreign Company?

Practical Questions

1. XYZ a company incorporated in the year 2015-16 purchased a new plant and machinery for Rs. 20 lakhs on 01.04.2025. The total Income of the company for the AY 2026-27 before allowing additional depreciation on new plant and machinery is Rs. 40 lakhs. XYZ has not opted for concessional tax regime u/s 115BAA or 115BA. Compute the tax liability of XYZ for the AY 2026-27 assuming the turnover for the previous year 2023-24 was Rs. 300 crore. Ignore the MAT provision.
2. The profits as per the statement of Profit and Loss account of ABC Limited, an Indian company for the year ended 31.03.2026 is Rs. 380 Lakhs arrived at after making the following adjustments:

Particulars	Rs. (In Lakhs)
Depreciation on Assets	200
Reserve for currency exchange fluctuation	100
Provision for Taxation	80
Proposed Dividend	240

Additional Information

- (a) Provision for tax includes Rs. 4 lakhs on interest payable on Income tax.
- (b) Depreciation includes Rs. 80 lakhs towards revaluation on Assets
- (c) Rs. 100 credited in P&L was drawn from revaluation reserve.
- (d) P&L balance in balance sheet at assets side shown as on 31.03.2025 was Rs. 60 lakhs which includes unabsorbed depreciation of Rs. 20 lakhs.

Compute the book profits u/s 115JB for the year ended 31.03.2026.

True and False

1. As per section 115JB(5A) MAT shall not apply to any income accruing or arising to a company from life insurance business referred to in section 115B. **(True)**
2. As per section 115JB(5A) MAT shall apply to any income accruing or arising to a company from life insurance business referred to in section 115B. **(False)**
3. If in any year the company pays liability as per MAT, then it is entitled to claim credit of MAT paid over and above the normal tax liability in the subsequent year(s). **(True)**

LIST OF FURTHER READINGS

- **Direct Taxes Law and Practice**
Author: Dr. Vinod K. Singhania & Dr. Kapil Singhania
Publisher: Taxmann
- **Direct Taxes Ready Reckoner with Tax Planning**
Author: Dr. Girish Ahuja & Dr. Ravi Gupta
Publisher: Wolters Kluwer

OTHER REFERENCES (INCLUDING WEBSITES AND VIDEO LINKS)

- **Income Tax Act, 1961:** <https://www.incometaxindia.gov.in/Pages/acts/income-tax-act.aspx>
- **Income Tax Rules, 1962:** <https://www.incometaxindia.gov.in/Pages/rules/income-tax-rules-1962.aspx>
- **Circulars:** <https://www.incometaxindia.gov.in/Pages/communications/circulars.aspx>
- **Notifications:** <https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx>

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Income Tax Implication on Specified Transactions

Lesson 3

KEY CONCEPTS

■ Dividend Income ■ Buy Back of Shares ■ Slump Sale ■ Transfer of Shares ■ Reduction of Share Capital ■ Equalization Levy ■ Carbon Credit ■ Amalgamation

Learning Objectives

To understand the:

- Tax implication on Dividend Income
- What is buy back of shares and the tax implication in case of buy back of shares
- What is slump sale and tax implication in case of slump sale?
- Tax implication in case of transfer of shares
- The tax implication on Reduction of Share Capital
- The Concept of Equalization Levy
- The Concept of Carbon Credit
- Tax Implication in case of Restructuring of Business (Amalgamation / Merger / Demerger)

Lesson Outline

- Introduction
- Taxation on Dividend Income
- Buy Back of Shares
- Tax Implication on Buy Back of Shares
- Slump Sale
- Tax Implication on Slump Sale
- Tax implication on Transfer of Shares
- Tax implication on Reduction of Share Capital
- Equalization Levy
- Carbon Credit
- Amalgamation / Merger
- Demerger
- Questions for Practice
- Lesson Round Up
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

Sections (Income Tax Act, 1961)	Details
Section 2(22)(a) to (f)	Dividend Income
Section 57(i)	Deduction of interest expenses for earning a dividend income
Section 80M	Deduction in respect of certain Inter Corporate Dividend
Section 10(34B)	Exemption for inter-corporate dividend distribution within IFSC Units engaged in the aircraft leasing business
Section 2(42C)	Slump Sale
Section 50B	Special provision for computation of capital gains in case of slump Sale
Section 50CA	Special provision for full value of consideration for transfer of share other than quoted share
Section 115BBG	Carbon Credit
Section 165/165A	Equalization Levy
Section 2(1B)	Amalgamation
Section 2 (19AA)	Demerger
Section 72A	Carry Forward and Set Off of Accumulated loss and unabsorbed depreciation of the amalgamating company

TAXATION OF DIVIDEND INCOME**Dividend Income**

For the purposes of inclusion in the total income of an assessee-

- (a) any dividend declared by a company or distributed or paid by it within the meaning of sub-clause (a) or sub-clause (b) or sub-clause (c) or sub-clause (d) or sub-clause (e) or sub-clause (f) of clause (22) of Section 2 shall be deemed to be the income of the previous year in which it is so declared, distributed or paid, as the case may be;
- (b) any interim dividend shall be deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the member who is entitled to it.

Dividend can be categorized into two categories Actual Dividend and Deemed Dividend u/s 2(22)(a) to (f).

Dividend is taxable in hands of Shareholders at Normal Rates and Exempt in the hands of Company.

Taxability in hands of Shareholders

In hands of Resident Shareholder, the Dividend so received is Taxable at Normal Rates (Default Regime or Optional Regime) whereas in hands of Non-Resident Shareholder the Dividend received is taxable at Special Rates as per Section 115A and deduction of interest u/s 57(i) is allowed up to a maximum of 20% of such dividend income

Taxability of Dividend in the hands of Company

Dividend so declared is Exempt in hands of Company. Earlier DDT/CDT u/s 115-O was applicable, No Deduction u/s 57 allowed.

Nature of Dividend	Taxability (at Normal Rates)
Final	In the year of declaration at the AGM by Company
Deemed	In the year of distribution paid by the Company
Interim	In the year of receipt by the shareholders

Section 2(22): Dividend Includes:

Distribution by a Company to Shareholders					Loan or Advance by Company not covered u/s 2(18)	Buyback of Shares
Section 2(22)(a)	Section 2(22)(b)		Section 2(22)(c)	Section 2(22)(d)	Section 2(22)(e)	Section 2(22)(f)
Any of the Assets (100% or Part of the Assets)	Debentures, debenture-stock, deposit certificate with or without interest.	Bonus shares to preference shareholders	Any money or asset on its liquidation to Equity Shareholder	Any money or asset on Reduction of its capital to Equity Shareholder	To Shareholder (min 10% equity holding) or concern in which such shareholder has substantial interest or to any person for benefit of such shareholder	any payment by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 68 of the Companies Act, 2013

but "dividend" does not include—

- (i) a distribution made in accordance with sub-clause (c) or sub-clause (d) in respect of any share issued for full cash consideration, where the holder of the share is not entitled in the event of liquidation to participate in the surplus assets;
- (ia) a distribution made in accordance with sub-clause (c) or sub-clause (d) in so far as such distribution is

attributable to the capitalised profits of the company representing bonus shares allotted to its equity shareholders after the 31st day of March, 1964, and before the 1st day of April, 1965 ;

- (ii) any advance or loan made to a shareholder or the said concern by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company ;
- (iii) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off;
- (v) any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

Tax Implication in case of Dividend Income

Upto 31.03.2020

Dividend Received by shareholders from Domestic Company were exempt u/s 10(34) and Domestic Companies declaring (distributing) dividend were liable to Corporate Dividend Tax (CDT) / Dividend Distribution Tax (DDT) u/s 115-O. Finance Act, 2020 abolished the DDT (Dividend Distribution Tax) and moved to classical system of taxation where dividend is taxed in hands of shareholders.

From 01.04.2020

Dividend received by shareholders from Domestic Companies is taxable in hands of shareholders only and DDT was abolished.

Domestic Company	All Indian Co's and other (Foreign) Co's who have made prescribed arrangements for declaration & distribution of Dividend in India
Indian Company	Any Company formed & Registered by Companies Act, 2013 or earlier Acts
Foreign Company	A Company which is not a Domestic Company

Dividend Distribution Tax 'DDT' [Section 115-O]: It was a tax on dividend (interim or final) declared, distributed or paid by a company (whether out of current or accumulated profits). Dividend distribution tax is in addition to income tax on total income. However, **the provisions of section 115-O (1) shall not be applicable w.e.f. April 1, 2020 as dividend shall now taxable in the hands of the recipient [As amended by Finance Act, 2020].**

The Finance Act, 2020 has abolished the DDT and move to the classical system of taxation wherein dividends are taxed in the hands of the investors. Therefore, the provision of Section 115-O shall not be applicable if the dividend is distributed on or after 01-04-2020. **Thus, if the dividend is distributed on or after 01-04-2020 the domestic companies shall not liable to pay DDT and, consequently, shareholders shall be liable to pay tax on such dividend income.** As dividend would now be taxable in the hands of the shareholder, various provisions of the Act have been revived such as allowability of expenses from dividend income, deductibility of tax from dividend income, treatment of inter-corporate dividend, etc.

As per the Finance Act, 2020 amended Section 57(i), effective from April 1, 2021 states that a taxpayer can claim a deduction of interest expenses for earning a dividend income (other than any payment by a company on purchase of its own shares from a shareholder i.e. buy-back of shares) and Interest on money borrowed for investing in the shares can be claimed as a deduction **subject to a maximum of 20% of dividends or income** in respect of units of a mutual fund i.e.

- a) **Actual expenses or**
- b) **20% of Dividend or Income**

whichever is lower.

In nut shell, taxpayer cannot claim a deduction of any expense against dividend income, except interest expense on cash borrowed for investment (in Shares, UTI or MF) and the dividend income will be taxable. It is immaterial of the sum received at applicable income tax slab rates.

Inter-corporate Dividend relief: As the taxability of dividend has been shifted from companies to shareholders w.e.f. 01.04.2020, the Government has introduced **a new section 80M** under the Act to remove the cascading effect where a domestic company receives a dividend from another domestic company. However, nothing has been prescribed where a domestic company receives dividend from a foreign company and further distribute the same to its shareholders. **[As Amended by Finance Act, 2020].**

The taxability in such cases shall be as under:

Domestic company receives dividend from another domestic company: The provisions of **section 80M** removes the cascading effect by providing that inter-corporate dividend shall be reduced from total income of company receiving the dividend if same is further distributed to shareholders one month prior to the due date of filing of return of Income.

Section 80M	Deduction in respect of certain Inter Corporate Dividend (ICD)
Meaning of ICD	When a company receives dividend by virtue of its shareholding in another company is known as ICD.
Applicability	To domestic companies who have declared dividend and are also in receipt of the dividend from another domestic company.
Coverage (Period)	Dividend distributed on or after the 1st of April 2020 (AY 2021-22 onwards).
Amount of Deduction (Rs.)	A. Amount of dividend received from domestic companies
	B. Amount of dividend distributed 1 month prior to the due date of filing return
	Amount of Deduction = A or B Whichever is lower

CASE 1

DP Ltd (A Domestic Company) provides you the information related to AY: 2026-27. Dividend received from ACC Ltd. (A Domestic Company) Rs. 12,00,000 (Interest paid for borrowed money for investment in ACC Ltd Rs. 3,00,000 and dividend collection charges paid would be Rs. 7,000). Income from Mutual Fund (HDFC Equity Oriented) Rs. 3,00,000 (Interest paid for borrowed money for investment in MF Rs. 16,000 and other charges paid would be Rs. 4,000). DP Ltd company has distributed the dividend to shareholders:

Particulars	FY	Date of Payment	Amount
Interim Dividend	2025-26	23-07-2025	2,50,000
Interim Dividend	2025-26	29-11-2026	90,000

You are required to compute Taxable Dividend Income and Deduction under section 80M and Section 57 of Income Tax Act.

Solution:**Computation of Taxable Dividend Income and deduction u/s 57**

Particulars		Amount
Dividend received from ACC Ltd		12,00,000
Less: Deduction u/s 57 in terms of Interest		
(a) Actual Amount	3,00,000	
(b) 20% of income (i.e. 20% of 12,00,000)	2,40,000	
a or b whichever is lower		(2,40,000)
Dividend income received		9,60,000
Income from Mutual Fund (HDFC Equity oriented)		3,00,000
Less: Deduction u/s 57 in terms of Interest		
(a) Actual Amount	16,000	
(b) 20% of income (i.e. 20% of 3,00,000)	60,000	
a or b whichever is lower		(16,000)
Income received		2,84,000

Computation of Deduction u/s 80M

Due date of filling of return	30.09.2025
(a) Amount of dividend received from domestic companies (As per above)	9,60,000
(b) Amount of dividend distributed 1 month prior to the due date of filing return (i.e. 30-9-2025)	2,50,000
Amount of Deduction u/s 80M = A or B Whichever is lower	2,50,000

Note: Dividend collection charges and other charges are not allowed as a deduction.

Exemption for inter-corporate dividend distribution within IFSC Units engaged in the aircraft leasing business [Section 10(34B)]

The Finance Act 2023 has introduced a new clause (34B) in Section 10 of the Act, which will come into effect from the assessment year 2025-26. This clause exempts dividend income earned by an IFSC unit primarily engaged in aircraft leasing business. However, the exemption is subject to the condition that the company paying the dividend should also be an IFSC unit and engaged in the aircraft leasing business.

Taxability of Dividend in hands of Recipient

Section 10(34), which provides an exemption to the shareholders in respect of dividend income, **is withdrawn from Assessment Year 2021-22**. Thus, dividend received during the financial year 2020-21 and onwards shall now be taxable in the hands of the shareholders. Consequently, Section 115BBDA which provides for taxability of dividend in excess of Rs. 10 lakhs have no relevance as the entire amount of dividend shall be taxable in the hands of the shareholder.

The taxability of dividend and tax rate thereon shall depend upon many factors like residential status of the shareholders, relevant head of income. In case of a non-resident shareholder, the provisions of Double Taxation Avoidance Agreements (DTAAs) and Multilateral Instrument (MLI) shall also come into play.

Taxable in the hands of Resident Shareholder

Dividend income is taxable under the head 'Income from other sources' irrespective of fact that person held securities either as a trader or as an investor.

The assessee can claim deduction of only interest expenditure which has been incurred to earn that dividend income to the extent of 20% of total dividend income. No deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person for the purpose of realizing such dividend.

The dividend income shall be chargeable to tax at normal tax rates as applicable in case of an assessee except where a resident individual, being an employee of an Indian company or its subsidiary engaged in Information technology, entertainment, pharmaceutical or bio-technology industry, receives dividend in respect of GDRs issued by such company under an Employees' Stock Option Scheme. In such a case, dividend shall be taxable at concessional tax rate of 10% without providing for any deduction under the Income-tax Act. However, the GDRs should be purchased by the employee in foreign currency.

Taxability in case of non-resident shareholders including FPIs

A non-resident generally invests in India either directly as private equity investors or as Foreign Portfolio Investors (FPIs). A non-resident person can also be a promoter of an Indian Company. A non-resident person generally holds shares of an Indian company as an investment and, therefore, any income derived by way of dividend is taxable under the head other sources.

As regards FPIs, securities held by them are always treated as a capital asset and not as stock-in-trade. Thus, in case of FPIs also, the dividend income shall always be taxable under the head other sources.

The dividend income, in the hands of a non-resident person (including FPIs and non-resident Indian citizens (NRIs)), is taxable at the rate of 20% without providing for deduction under any provisions of the Income-tax Act. However, dividend income of an investment division of an offshore banking unit shall be taxable at the rate of 10%.

If the withholding tax rate as per DTAA is lower than the rate prescribed under the Finance Act then tax shall be deducted at the rate prescribed under DTAA.

BUY BACK OF SHARES**Special provisions relating to Tax on Distributed Income of Domestic Company for Buy -Back of Shares**

The Finance Act (No. 2), 2024, effective from October 1, 2024, introduces significant changes to the tax implications in case of share buybacks of shares by domestic companies. Previously, under Section 115QA of the Income Tax Act, companies faced an additional tax liability of 20% plus applicable surcharges and education cess, resulting in an effective tax rate of 23.296% on the buyback of their shares. However, with the

new amendments, the tax burden has shifted from the company to the shareholders. **Now, payments made by a company for the buyback of its own shares will be treated as dividend income, as specified in the newly added clause (f) of Section 2(22). This change means shareholders will now be taxed on these proceeds as income from other sources.** The amendment also includes a new proviso to Section 115QA, stating that its provisions will not apply to buybacks occurring on or after October 1, 2024. Consequently, companies will be responsible for deducting tax at source (TDS) at a rate of 10% for resident shareholders and at applicable rates for non-residents. Additionally, shareholders can treat the cost of shares as a capital loss, which may be carried forward for eight subsequent financial years.

Tax Implication of Buy Back of Shares

Finance Act, 2024 has provided that w.e.f 01.10.2024, following changes will be made:

Existing (upto 30.09.2024)	Amended (01.10.2024 Onwards)
Domestic Company buying back were liable to pay DDT/CDT on Distributed Income to shareholders u/s 115QA @ 23.296% (20% + 12% Surcharge + 4% HEC) within 14 Days of payment to Shareholders In case of Non-Payment of Tax u/s 115QA within 14 days, Interest @ 1% p.m. or part of month thereof was applicable from 15th day onwards.	Companies are not liable to pay tax on buyback u/s 115QA. Company is liable to deduct TDS u/s 194 w.e.f. 01.10.2024
Shareholders were not required to pay any tax on amount received against buy back of shares from Domestic Company as per exemption u/s 10(34). Shareholders were required to pay any tax on amount received against buy back of shares from any company other than Domestic Company as per Section 46A.	Shareholders are liable to tax at Normal Rates and are required to treat the entire amount received under buy back as "Income from Other Sources" u/s 2(22)(f). No Deduction u/s 57 allowed on such income. Section 46A not applicable.
Cost of shares (to shareholders) which has been bought back will not be considered at all in any calculation of income.	Cost of shares (to shareholders) which has been bought back will be treated as long / short term capital loss, depending upon period of holding.

(*Amendments w.e.f. 01.10.2024 – Section 115QA, 115QB, 10(34A), 2(22)(f), 46A, 194)

The above can be understood with help of below example:

Example: X Ltd balance sheet as on 31st March XXXX is as below:			
Liabilities	Amount	Assets	Amount
Equity Share Capital (1,20,000 shares of Rs 10 each)	12,00,000	Machinery	10,00,000
Securities Premium	3,00,000	Other Assets	8,00,000
Retained Earnings	5,00,000	Bank	2,00,000
Total	20,00,000	Total	20,00,000

The cost of each share for shareholder was Rs 11 per share (assumed). Company decided to buy-back its 20,000 shares and agreed to pay (a) Rs 1 Lacs, (b) Rs 2 Lacs, (c) Rs 3 Lacs, (d) Rs 4 Lacs,

What will be tax treatment in the hands of shareholder receiving this consideration and in hands of the company.

Solution:

The cost of shares proposed to be bought back is Rs 2,20,000 (20,000 x 11). w.e.f. 01.10.2024, calculation of capital gain in hands of shareholder is as below:

S. No.	Particulars	Case (a)	Case (b)	Case (c)	Case (d)
A	Proceeds received on buyback by shareholder	1,00,000	2,00,000	3,00,000	4,00,000
	Income from other Sources	1,00,000	2,00,000	3,00,000	4,00,000
B	Cost of acquisition for the shareholder	2,20,000	2,20,000	2,20,000	2,20,000
	Capital (Loss)	-2,20,000	-2,20,000	-2,20,000	-2,20,000

In the hands of Company which has bought-back shares there will be no requirement of paying Tax on distributed income on buy-back u/s 115QA.

Now w.e.f. 01/10/2024, Finance Act (No. 2) shifted the burden of tax payment from domestic company to the shareholder as the payment received by the shareholder will consider as dividend income and taxable in the hands of shareholder. Accordingly, new clause (f) inserted after clause (e) in section 2(22) in the definition of dividend, which are stated below: [(f) any payment by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 68 of the Companies Act, 2013 (18 of 2013);

SLUMP SALE

Section 2 (42C) of the Income Tax Act, 1961 “slump sale” means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.

“Undertaking” shall have the meaning assigned to it in Explanation 1 to clause (19AA).

The determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees shall not be regarded as assignment of values to individual assets or liabilities.

Understanding of provisions with regard to Slump Sale

For sale to be constituted as Slump Sale, following conditions must be satisfied –

- There must be sale of one or more undertakings,
- Sale must be for lump sum consideration and not in part or in installments,
- There must not be values assigned to individual assets and liabilities,

- For determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees shall not be regarded as assignment of values to individual assets or liabilities,
- The undertaking must be sold as going concern
- There must be an undertaking owned by the assessee,
- When one or more undertaking is transferred, then there has to be transfer of assets as well as liabilities, if only assets are transferred and not the liability then the same will not amount to slump sale

Special provision for computation of Capital Gains in case of Slump Sale [Section 50B]

Any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

Provided that any profits or gains arising from the transfer under the slump sale of any capital asset being one or more undertakings owned and held by an assessee for not more than thirty-six months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

In relation to capital assets being an undertaking or division transferred by way of such sale, the “net worth” of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for the purposes of sections 48 and 49 and no regard shall be given to the provisions contained in the second proviso to section 48.

Every assessee, in the case of slump sale, shall furnish in the prescribed form 83 along with the return of income, a report of an accountant as defined in the Explanation below sub-section (2) of section 288, indicating the computation of the net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division, as the case may be, has been correctly arrived at in accordance with the provisions of this section.

The Bombay High Court while dealing with the concept of ‘slump sale’ generally clarified that one of the principle tests for determination of whether a transaction would be a ‘slump sale’ is whether there is continuity of business. Thus, the concept of ‘going concern’ is one of the most important conditions to be satisfied when analyzing whether a transaction can be regarded as a slump sale.

Explanation 1: “Net worth” shall be the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in its books of account.

Provided that any change in the value of assets on account of revaluation of assets shall be ignored for the purposes of computing the net worth.

Explanation 2: For computing the net worth, the aggregate value of total assets shall be:

- (a) in the case of depreciable assets, the written down value of the block of assets determined in accordance with the provisions contained in sub-item (C) of item (i) of sub-clause (c) of clause (6) of section 43;
- (b) in the case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD, Nil; and
- (c) in the case of other assets, the book value of such assets.

Related Rule(s)**Form of report of an accountant under sub-section (3) of section 50B**

The report of an accountant which is required to be furnished by every assessee before the specified date referred to in section 44AB” in case of slump sale, under sub-section (3) of section 50B shall be in Form No. 3CEA.

Related Form(s)

Form No. 3CEA - Report of an accountant to be furnished by an assessee under sub-section (3) of section 50B of the Income -tax Act, 1961 relating to computation of capital gains in case of slump sale.

SLUMP SALE AND CAPITAL GAIN TAX

When Slump Sale take place, there will be capital gain tax attracted and this is covered by Section 50B of the Income Tax Act, 1961. Let us understand this provisions in detail –

- Whenever there is a profit or gain due to slump sale, it will be deemed to be income of that particular year,
- Capital gain tax payable in case of slump sale can be divided into –
 - a. Capital gain arising from transfer of short-term capital assets – Capital assets being one or more undertakings owned and held by an assessee for not more than thirty-six months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer of short-term capital assets and
 - b. Capital gain arising from transfer of long-term capital assets – Capital assets being one or more undertakings owned and held by an assessee for more than thirty-six months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer of long-term capital assets
- Capital Assets may be divided into –
 - a. Depreciable assets,
 - b. Assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD and
 - c. Other assets
- Determination of “Net Worth” is an important part in case of determination of liability for purpose of Income Tax, Net worth of the undertaking or the division shall be -
 - a. Cost of acquisition and the cost of improvement,
 - b. Aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in its books of account,

Further any change in the value of assets on account of revaluation of assets shall be ignored for the purposes of computing the net worth.

Calculation of “Net Worth” is a very important part for determining capital gain tax payable because tax payable is difference between sale consideration and the net worth of the undertaking.

- Computation for determining amount of tax payable shall be done separately for each sale of undertaking or more undertakings as the case may be,
- One of the major benefits which is taken away by Section 50B is that indexation benefit is not available in case of slump sale,

- Section 50B is a special provision for purpose of computation of capital gain in case of slump sale thus this section overrides all the provisions of the Income Tax Act, 1961 because specific provisions overrides general provision. This particular provision is specifically for computation of capital gain in case of slump sale.

CASE LAWS

In case of CIT vs. Equinox Solution Pvt. Ltd (Supreme Court) it was held that Section 45 and 50(2): If an undertaking is sold as a running business with all assets and liabilities for a slump price, no part of the consideration can be attributed to depreciable assets and assessed as a short-term capital gain u/s 50(2). If the undertaking is held for more than three years, it constitutes a “long-term capital asset” and the gains are assessable as a long-term capital gain.

Example -1

ABC Limited, a public company incorporated under the Companies Act, has two units – one engaged in manufacture and the other involved in service. As the company is planning restructuring of the company, it has decided to sell its service unit as a going concern by way of slump sale for Rs. 38,500 to a new company called XYZ Limited, in which it holds 74% equity shares.

The balance sheet of ABC limited as on 31st March 2026, being the date on which service unit has been transferred, is given hereunder –

Balance sheet as on 31.03.2026

Liabilities	Amount in Rs.	Assets	Amount in Rs.
Paid up Share Capital	30,000	Fixed Assets	
General Reserve	15,000	Manufacturing Unit	17,000
Share Premium	5,000	Service Unit	20,000
Revaluation Reserve	12,000	Debtors	
Current Liabilities		Manufacturing Unit	14,000
Manufacturing Unit	4,000	Service Unit	11,000
Service Unit	9,000	Inventories	
		Manufacturing Unit	9,500
		Service Unit	3,500
Total	75,000	Total	75,000

Company has furnished following additional information -

- The Service unit is in existence since May, 2019.
- Fixed assets of Service unit include land which was purchased at Rs. 4,000 in the year 2016 and revalued at Rs. 6,000 as on March 31, 2026.
- Fixed assets of Service unit are at Rs. 14,000 (Rs. 20,000 minus land value Rs.6,000) is written down value of depreciable assets as per books of account. However, the written down value of these assets under section 43(6) of the Income-tax Act is Rs.9,000.

Ascertain the tax liability, which would arise from slump sale to ABC Limited.

Answer:

- Capital Gains = “Slump sale consideration” **minus** “Net worth of the Undertaking or division”
- “Net worth” = Aggregate value of total assets of the undertaking or division transferred **minus** Value of Liabilities of the undertaking or division transferred as appearing in its books of account.
- For computing the “net worth”, non-depreciable assets are to be taken at their book values and in case of depreciable assets, the written down value of such assets shall be computed as per section 43(6)(c).

In the present case, the capital gains are long term since period of holding of software unit shall be from May 2019 to March 2026.

Computation of Net Worth of Service Unit-

Particulars	Amount in Rs.
Depreciable assets (W.D.V. as per Income Tax Act)	9,000
Land	4,000
Debtors	11,000
Inventory	3,500
Total assets	27,500
Less: Current liability	9,000
Net worth	18,500
Computation of capital gain on transfer of service unit –	
Full value of sale consideration	38,500
Less: Net worth of service unit	18,500
Long Term capital gain	20,000

ISSUE OF SHARES AT PREMIUM**Relevant provision of Section 56 with regard to Share Premium Amount**

Section 56(2)(viib) was introduced in 2012 as Angel Tax, to curb the unaccounted black money in circulation, w.r.t., companies being closely held Indian Companies receiving any consideration on issue of shares (equity or preference)

Section 56(2)(viib) of the Act, reads as follows -

- (viib) where a company, not being a company in which the public are substantially interested, receives in any previous year, from any person, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares:

Provided that this clause shall not apply where the consideration for issue of shares is received –

- (i) by a venture capital undertaking from a venture capital company or a venture capital fund or specified fund; or

- (ii) By a startup recognised by DPIIT with conditions; or
- (iii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf.

Provided further that where the provisions of this clause have not been applied to a company on account of fulfilment of conditions specified in the notification issued under clause (ii) of the first proviso and such company fails to comply with any of those conditions, then, any consideration received for issue of share that exceeds the face value of such share shall be deemed to be the income of that company chargeable to income-tax for the previous year in which such failure has taken place.

Further, this section is not applicable to 'startup', CBDT has referred to 'startups' as defined in the notification issued in February 2019 by Department of Industrial Policy and Promotion ('DIPP'), whereby an entity shall be considered as a 'startup'. This exemption is available up to 5 years from its date of incorporation / registration and if it is a private limited company.

For concessional share allotment at less than book value (under rule 11U & 11UA) held bonus shares do not fall under the same; right shares and original first-time allotment falls in the same however if new shares allotted to existing shareholders pro rata as per exiting holdings no adverse inference/addition possible.

Important part as far as this section is concerned is determination of fair market value of shares, this is determined as below –

$$(a) \text{ the fair market value of unquoted equity shares} = \frac{(A-L)}{(PE)} \times (PV),$$

where,

A = book value of the assets in the balance-sheet as reduced by any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

L = book value of liabilities shown in the balance-sheet, but not including the following amounts, namely:—

- (i) the paid-up capital in respect of equity shares;
- (ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
- (iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
- (iv) any amount representing provision for taxation, other than amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;
- (v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
- (vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

PE = total amount of paid up equity share capital as shown in the balance-sheet; PV = the paid up value of such equity shares; or

Explanation: For the purposes Section 56(2)(viib)

- (a) Fair market value of the shares shall be the value—
 - (i) as may be determined in accordance with such method as may be prescribed; or
 - (ii) 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,

whichever is higher;

- (aa) “specified fund” means a fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category II Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012 made under the Securities and Exchange Board of India Act, 1992 [Inserted by Finance Act, 2019]
- (ab) “trust” means a trust established under the Indian Trusts Act, 1882 or under any other law for the time being in force; [Inserted by Finance Act, 2019]
- (b) “Venture capital company”, “Venture capital fund” and “Venture capital undertaking” shall have the meanings respectively assigned to them in clause (a), clause (b) and clause (c) of Explanation to Section 10(23FB);

“unquoted shares and securities” means shares and securities which is not a quoted shares or securities;

“merchant banker” means category I merchant banker registered with the Securities Exchange Board of India established under section 3 of the Securities Exchange Board of India Act, 1992 (15 of 1992)

“balance-sheet” in relation to any company means the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company appointed under Companies Act and where the balance-sheet on the valuation date is not drawn up, the balance-sheet (including the notes annexed thereto and forming part of the accounts) drawn up as on a date immediately preceding the valuation date which has been approved and adopted in the annual general meeting of the shareholders of the company

“valuation date” means the date on which the property or consideration as the case may be, is received by the assessee.

“Share premium” is the amount by which the issue price of a share exceeds the nominal value and under the Companies Act, the value of the share premium must be credited to a securities premium account.

This section is applicable only to closely held companies and not to companies in which public is substantially interested. Income Tax Act does not define closely held companies but Section 2(18) of the Income Tax Act, 1961 defines ‘a company in which the public is substantially interested’ to include :-

- a. a company owned by the Government or the RBI or more than forty percent of the shares are owned by Government or the RBI or a corporation owned by the RBI.
- b. a company registered under section 25 of the Companies Act, 1956.
- c. a company not having share capital and declared by the Board to be such company
- d. Mutual Benefit Finance Company – business of acceptance of deposits from members and notified by the Central Government u/s 620 of the Companies Act, 1956.

- e. a company, whose more than 50% Equity Shares (not being Preference Shares) held by one or more Co-operative Societies throughout the previous year.
- f. a company not being a Private Company as defined in the Companies Act, 1956, whose Equity Shares were listed on the 31 March of the previous year in a Recognised Stock Exchange.
- g. a 'Government Company' not being a 'Private Company'.

The Section 56(2)(viib) does not distinguish between an Indian or a Foreign Company. Section 2(17) defines "company" to include a body corporate incorporated by or under the laws of a country outside India.

Note: Abolition of Angel Tax: The Finance Act, 2024, abolished Section 56(2)(viib). This marked a significant policy shift aimed at boosting the startup ecosystem and reducing regulatory hurdles for fundraising. The provisions of this clause shall not apply on or after the 1st day of April, 2025. [As amended by Third Proviso to Section 56(2)(viib)].

CASE LAWS

In case of Vodafone India Services Private Limited v. Union of India [2014] 50 taxmann.com 300 (Bombay HC) it was held that the issue of shares at a premium by the company to its non-resident holding company does not give rise to any income from an admitted International Transaction. Thus, no occasion to apply Chapter X of the Act can arise in such a case.

Example –

ABC Private Limited is a closely held company, its board of directors decided to issue 500 shares face value of which is Rs. 100 per share, fair market value of which is Rs. 150 per share at a premium of Rs. 200 per share. Please advise whether section 56 will be attracted and tax payable, in following circumstances –

In case the investor/subscribers to the shares of above-named company are

- a. Resident Indian,
- b. Non-resident Indian,
- c. Venture Capital undertaking.

Further, what will be your answer, if the shares are issued at fair market value.

Answer:

In case the investors/subscribers are Resident Indian than tax liability will be issue price Rs. 300 (i.e. Rs. 100 face value plus Rs. 200 share premium) minus Rs. 150 (fair market price) = Rs. 150 per share. Total tax needs to be paid on Rs. 75,000/-.

In case the investors/subscribers are non-resident Indian and venture capital undertaking than no tax liability has they are exempted under Section 56 of the Act.

In case the shares were issued at fair market value instead at face value or at premium than no tax liability would have occurred.

TRANSFER OF SHARES**Special provision for full value of consideration for transfer of share other than quoted share [Section 50CA]**

Where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such manner as may be prescribed, the value so determined shall, for the purposes of section 48, be deemed to be the full value of consideration received or accruing as a result of such transfer.

Provided that the provisions of this section shall not apply to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.

Explanation: For the purposes of this section, “quoted share” means the share quoted on any recognised stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business.

Example 1: Mr. Ram is working in a company and has salary income. In the month of June, 2025 he purchased equity shares of ABC India Limited which is listed on BSE and sold the same in January, 2026. In this case shares are capital assets for Mr. Ram. He purchased shares in June, 2025 and sold them in January, 2026, i.e., after holding them for a period of less than 12 months.

Hence, shares will be treated as Short Term Capital Assets.

In case Mr. Ram had sold the shares in the month of September, 2026 i.e., after holding them for a period of more than 12 months. Then in this case it will be treated as Long Term Capital Assets.

Section 111A is applicable in case of STCG arising on transfer of equity shares or units of equity oriented mutual-funds or units of business trust which are transferred on or after 1-10-2004 through a recognised stock exchange and such transaction is liable to securities transaction tax.

If the conditions of section 111A are satisfied then the STCG charged to Tax at Special Concessional Rates under section 111A. Such gain is charged to tax at 15% or 20% (plus surcharge and HEC as applicable).

Date of Transfer	Concessional Tax Rate (Special Rates)
Up to 22.07.2024 (Prior to 23.07.2024)	15%
On or After 23.07.2024	20%

Example 2: Mr. D is in employment. In the month September, 2023 he had purchased unlisted shares of XYZ Limited and sold the same in May 2025. In this case, shares are sold in assessment year 2026-27. Hence, period of holding for unlisted shares to be considered as 24 months.

Mr. D purchased shares in September 2023 and sold it on May 2025, i.e., after holding them for a period of less than 24 months. Hence, shares will be treated as Short Term Capital Assets.

Mode of Computation [Section 48]

The income chargeable 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:

- (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;

Provided that in the case of an assessee, who is a non-resident, capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as was initially utilised in the purchase of the shares or debentures, and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so, however, that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every reinvestment thereafter in, and sale of, shares in, or debentures of, an Indian company :

Provided further that where long-term capital gain arises from the transfer (which takes place before the 23rd day of July, 2024) of a long-term capital asset, other than capital gain arising to a non-resident from the transfer of shares in, or debentures of, an Indian company referred to in the first proviso, the provisions of clause (ii) shall have effect as if for the words “cost of acquisition” and “cost of any improvement”, the words “indexed cost of acquisition” and “indexed cost of any improvement” had respectively been substituted:

Provided also that nothing contained in the first and second provisos shall apply to the capital gains arising from the transfer of a long-term capital asset being an equity share in a company or a unit of an equity-oriented fund or a unit of a business trust referred to in section 112A.

Provided also that nothing contained in the second proviso shall apply to the long-term capital gain arising from the transfer of a long-term capital asset, being a bond or debenture other than:

- (a) capital indexed bonds issued by the Government; or
- (b) Sovereign Gold Bond issued by the Reserve Bank of India under the Sovereign Gold Bond Scheme, 2015:

Provided also that in case of an assessee being a non-resident, any gains arising on account of appreciation of rupee against a foreign currency at the time of redemption of rupee denominated bond of an Indian company held by him, shall be ignored for the purposes of computation of full value of consideration under this section:]

Provided also that where shares, debentures or warrants referred to in the proviso to clause (iii) of section 47 are transferred under a gift or an irrevocable trust, the market value on the date of such transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer for the purposes of this section:

Provided also that no deduction shall be allowed in computing the income chargeable under the head “Capital gains” in respect of any sum paid on account of securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004.

[Rule 115A] read with 1st Proviso to Section 48

For the purpose of computing capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company, in the case of an assessee who is a non-resident Indian, the rate of exchange shall be:

- (a) for converting the cost of acquisition of the capital asset, the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilised in the purchase of the said asset, as on the date of its acquisition;
- (b) for converting expenditure incurred wholly and exclusively in connection with the transfer of the capital asset referred to in clause (a), the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilised in the purchase of the said asset, as on the date of transfer of the capital asset;

- (c) for converting the full value of consideration received or accruing as a result of the transfer of the capital asset referred to in clause (a), the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilised in the purchase of the said asset, as on the date of transfer of the capital asset;
- (d) for reconverting capital gains computed in the foreign currency initially utilised in the purchase of the capital asset into rupees, the telegraphic transfer buying rate of such currency, as on the date of transfer of the capital asset.

Explanation: For the purposes of this rule:

- (i) “telegraphic transfer buying rate” shall have the same meaning as in the Explanation to rule 26;
- (ii) “telegraphic transfer selling rate”, in relation to a foreign currency, means the rate of exchange adopted by the State Bank of India constituted under the State Bank of India Act, 1955, for selling such currency where such currency is made available by that bank through telegraphic transfer.]

REDUCTION OF SHARE CAPITAL

Under the provisions of the Companies Act, 2013 and rules made thereunder, a company may go for reduction of share capital in any of the following manner –

- a. Extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up; or
- b. Either with or without extinguishing or reducing liability on any of its shares,
 - (i) cancel any paid-up share capital which is lost or is unrepresented by available assets; or
 - (ii) pay off any paid-up share capital which is in excess of the wants of the company, alter its memorandum by reducing the amount of its share capital and of its shares accordingly
- c. Buy Back of Shares.
- d. In case the securities premium account is applied by the company except on following –
 - (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
 - (b) in writing off the preliminary expenses of the company;
 - (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
 - (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
 - (e) for the purchase of its own shares or other securities under section 68.

Section 2(22)(d) of the Income Tax Act, 1961 exclusively deals with deemed dividend arising in the event of reduction of share capital. It states that any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits whether such accumulated profits have been capitalised or not. It thus seeks to tax distribution of accumulated profits under the guise of returning/ reducing capital.

When a company has an excess of accumulated profits over and above its requirement, it may use such accumulated profits to reduce its share capital instead of capitalising it. In other words, the company may, out of its accumulated profits, pay off any share capital which is in excess of what it wants. In such cases there is evidently a release of assets.

Any such distribution by a company on reduction of its capital is 'dividend' to the extent to which the company possesses accumulated profits whether capitalised or not.

However, where the reduction is greater than the accumulated profits, then it is a case of genuine reduction of capital. Any capital so returned is genuinely a capital receipt in the hands of the shareholders and is accordingly exempt from tax.

Section 56 states that dividend income is chargeable to tax under the head 'Income from Other Sources' (IFOS). In the case of CIT v Jai Hind Investment Industries (P) Ltd (1993) 202 ITR 316 (Cal) it is stated that when the amount paid by the company has been treated as dividend, there is no scope for reduction of face value of shares from such dividend.

Further, section 57 additionally states that the only deduction allowable from such dividend income is the interest expense to the extent of 20% of the total dividend income.

Capital Gain Tax

In *Kartikeya V. Sarabhai v CIT* (1997) Supreme Court it was held that reduction of share capital by a company and paying off the balance to the shareholders would result in extinguishment of rights in the shares held by the shareholder and would amount to transfer. On reduction of share capital, the rights of the shareholders in the dividend and net assets are extinguished. Therefore, capital gains would arise.

In *G. Narasimham* (Supreme Court) 1998, it was held that the amount distributed by the company on reduction of its share capital has two components, namely:

- a. Distribution attributable to accumulated profits and
- b. Distribution attributable to the capital

The Supreme Court held that out of the amount received on reduction of share capital, the amount attributable to accumulated profits will be deemed as dividend u/s 2(22)(d) and balance amount is the sale proceeds of the shares so reduced.

Conclusion

In simple words, the income of the shareholder, in the event of reduction of share capital by a company, is to be computed as follows:

Particulars	Amount
Fair Market Value of assets received (if any)	Rs. xxx
Add: Cash received	Rs. xxx
Total amount received on reduction of capital	Rs. xxx
Less: Deemed Dividend u/s 2(22)(d)	Rs. xxx
Sale Proceeds of the shares so reduced	Rs. xxx
Less: Cost of Acquisition of the shares held	Rs. xxx
Capital Gains / Loss (Long Term / Short Term)	Rs. xxx / (xxx)

The taxation of the above incomes is as follows:

Particulars	Head	Tax Rates
Deemed Dividend u/s 2(22)(d)	IFOS	At normal rates
Long Term Capital Gains u/s 112	CG	At Specified Rate of STCG / LTCG

QUESTIONS FOR PRACTICE

Illustration 1

ABC Ltd. is engaged in manufacturing of chemicals and plastics since 1980. Depreciated value of block of asset (depreciation rate: 15%) on April 1, 2025 is Rs.15,00,000. The company purchased Plant X (rate of depreciation 15%) on June 15, 2025 for Rs. 4,18,000 (It is not eligible for additional depreciation). It is put to use on the same day. The company sold Plant Y (rate of depreciation 15%) on December 16, 2025 for (a) Rs. 11,70,000 (b) Rs. 14,70,000 (c) Rs. 25,70,000. The company transfers plastics division by way of slump sale on December 31, 2025 for Rs. 6.60 lakhs (expenditure on transfer: Rs. 1.60 lakhs). The following information in respect of plastics division is noted from the company's records and certified by the chartered accountant of the company in Form 3CEA –

Actual cost of assets acquired in 2016-17 6,40,000

Depreciation claimed under the Income-tax Act upto AY 2017-18 60,000

Depreciation that would have been allowable for the assessment years 2017-18 to 2025-26 as if the asset was the only asset in the relevant block 90,000

Find out the amount of depreciation and capital gain chargeable to tax for the assessment year 2026-27.

Solution:

If Plant Y is transferred for

Particular	Rs. 11.70 lakhs	Rs. 14.70 lakhs	Rs. 25.70 lakhs
Depreciated value of the block of assets on April 1, 2025	15,00,000	15,00,000	15,00,000
Add: Actual cost of Plant X acquired during the year	4,18,000	4,18,000	4,18,000
Less: Sale proceeds of Plant Y (it cannot exceed Rs. 15 lakhs + Rs. 4.18 lakhs)	11,70,000	14,70,000	19,18,000
Balance (a)	7,48,000	4,48,000	0
Less: Actual cost minus depreciation of assets of paper division transferred by way of slump sale [i.e. Rs. 6,40,000 – Rs. 60,000 – Rs. 90,000 = Rs. 4,90,000, it cannot however, exceed (a)] (b)	4,90,000	4,48,000	-
Written down value of the block on March 31, 2026	2,58,000	Nil	Nil
Depreciation for the previous year 2025-26 @ 15%	38,700	Nil	Nil
Depreciated value of the block on April 1, 2026	2,19,300	Nil	Nil

If Plant Y is transferred for			
Capital gain on transfer of Plant Y as per section 50	Rs. 11.70 lakhs	Rs. 14.70 lakhs	Rs. 25.70 lakhs
Sale consideration of Plant Y	N.A.	N.A.	25,70,000
Less: Cost of acquisition as per section 50 (i.e., Rs. 15 lakhs + Rs. 4.18 lakhs)	–	–	19,18,000
Less: Sale proceeds of Plant Y (it cannot exceed Rs. 15 lakhs + Rs. 4.18 lakhs)	11,70,000	14,70,000	19,18,000
Short term capital gain	–	–	6,52,000
Capital gain on transfer of depreciable assets of plastic division			
Sale proceeds	6,60,000	6,60,000	6,60,000
Less: Cost of acquisition and cost of improvement [being the net worth mentioned at (b)] (benefit of indexation is not available)	4,90,000	4,48,000	Nil
Expenses on transfer	1,60,000	1,60,000	1,60,000
Long term capital gain	10,000	52,000	5,00,000

Illustration 2:

Z gets 1000 partly convertible debentures (face value Rs. 100) of A Ltd. (cost being Rs. 200 per debenture) at the time of original allotment to him on May 16, 2004. As per terms of allotment, A Ltd. converts 60 % portion of each debenture into 2 equity shares (Unlisted) of face value of Rs. 10 on July 1, 2012. On May 10, 2025, Z transfers 2000 equity shares in A Ltd. @ Rs. 600 per share and 1,000 (non-convertible portion) debentures @ Rs. 310 per debenture. Find out the amount of capital gains chargeable to tax for the assessment year 2026-27.

Solution: Immediately after conversion of debentures into equity shares, Z holds the following –

No. of scrip	Type of scrip	Face value (per scrip) (Rs.)	Total cost (Rs.)
2000	Equity shares	10	1,20,000*
1000	Debentures	40	80,000**
Total			2,00,000

*60% of original investment of Rs. 2,00,000 i.e. Rs. 1,20,000

**Rs. 2,00,000 – Rs. 1,20,000

Computation of Capital Gains

Particulars	Debentures (Rs.)	Shares (Rs.)
Sale consideration	3,10,000	12,00,000
Less: Cost of Acquisition	80,000	1,20,000
Long term capital gains	2,30,000	10,80,000

Illustration 3: A Ltd. has two undertaking X and Y. The following information is available.

Particular	(Rs. in thousand)		
Assets	Unit X	Unit Y	Total
Rate of Depreciation	Plant R and S 15%	Plant P and Q 15%	
Depreciated value as on April 1, 2023	-	600	600
Add: Actual cost of old plant R & S acquired on June 1, 2023	400	-	400
Less: Sale proceed of plant P transferred on November 30, 2023	-	900	900
Written down value on March 31, 2024	400	-	100
Less: Depreciation 2023-24	60	-	15
Depreciated Value on April 1, 2024	340	-	85
Less: Depreciation on 2024-25	51	-	12.75
Depreciated Value on April 1, 2025	289	-	72.25

On April 1, 2025, Unit X is transferred to B Ltd., an Indian company, in a scheme of de-merger. What will be written down value and actual cost in the hands of A Ltd. and B Ltd.?

Solution:

Written down value in the hands of A Ltd.

Depreciated value of assets on April 1, 2025: 72,250

Less: Written down value of assets transferred to B Ltd.: 2,89,000

Written down value on April 1, 2025 Nil

Note: by virtue of section 47(vib) income is not taxable under the head capital gains. Written down value in the hands of B Ltd. = Rs. 2,89,000

Illustration 4: Company X is proposed to be merged with company Y. The following are the particulars of the former company.

Unabsorbed depreciation: Rs. 2,50,65,000

Unabsorbed business losses: Rs. 1,15,10,000

Consider which of the benefit can be availed by company Y and advise the latter on the condition to be fulfilled to claim each such benefit.

Solution:

There is no indication in the question whether merger of company A and B satisfy conditions of section 2(1B) and 72A.

Answer to the given question can be given under following three situations:

- (a) If merger is not amalgamation within the meaning of section 2(1B) or
- (b) If merger is an amalgamation within the meaning of section 2(1B) but it does not fulfill the conditions of section 72A or
- (c) If merger satisfy conditions of section 2(1B) as well as 72A

Under the aforesaid situations, the position regarding the set off of unabsorbed loss/allowances by company B will be as under:

Whether company Y can set off the unabsorbed loss/allowances of company X	Situation (a)	Situation (b)	Situation (c)
Unabsorbed depreciation of Rs. 2,50,65,000	No	No	Yes
Unabsorbed business losses of Rs. 1,15,10,000	No	No	Yes

As is evident from the aforesaid chart, all unabsorbed business losses / allowances can be set off if the merger satisfies requirement of section 72A. Alternatively, in order to retain the advantage of claiming set-off of unabsorbed loss / allowances, the business of company Y may be taken over by Company X in that case, all unabsorbed loss / allowance can be set off by company X, even if the merger does not satisfy the condition of section 2(1B) and 72.

Illustration 5: Company A, which has an accumulated business loss of Rs. 5,00,000 and unabsorbed depreciation of Rs. 3,00,000 wants to reorganize its business by amalgamating with a rival company B, which is engaged in the same line of production but with a smaller capital, but has an efficient management set-up and more modern machinery. Company B is agreeable to the amalgamation.

What are the alternative courses available to the companies for effecting the merger and how would you advise them as to the best course of action?

Solution:

The alternative of merger that are available to company A and B are

- i) Merger of A into B, whereby A goes out of existence
- ii) Merger of B into A whereby B goes out of existence
- iii) Merger of A and B into a new company, whereby a new company say C, is formed and both A and B go out of existence.

All the three mergers can take place under one of the following situations.

- If merger is not amalgamation within the meaning of section 2(1B) or
- If merger is an amalgamation within the meaning of section 2(1B) but it does not fulfill the conditions of section 72A or
- If merger satisfy conditions of section 2(1B) as well as 72A

Under the aforesaid situations, the position regarding the set off of unabsorbed loss of Rs. 5,00,000 and unabsorbed depreciation of Rs. 3,00,000 will be as under:

Whether set off the unabsorbed loss/ depreciation is possible	Situation (a)	Situation (b)	Situation (c)
Merger of A into B, whereby A goes out of existence	No	No	Yes
Merger of B into A whereby B goes out of existence	Yes	Yes	Yes
Merger of A and B into a new company, whereby a new company say C, is formed and both A and B go out of existence.	No	No	Yes

To conclude, it can be said that the conditions of section 72A are satisfied, any of the three alternatives for mergers can be adopted as in all the cases the loss can be set off by the amalgamated company. However, if conditions of section 72A are not satisfied, alternative (ii) should be adopted as in this case, company A would be able to carry forward and set off of business loss and depreciation even if the merger does not satisfy the requirement of section 2(1B). This kind of merger also known as reverse merger.

CARBON CREDIT [SECTION 115BBG]

Meaning of Carbon Credit	"carbon credit" in respect of one unit shall mean reduction of one tonne of carbon dioxide emissions or emissions of its equivalent gases which is validated by the United Nations Framework on Climate Change and which can be traded in market at its prevailing market price. - It is a tradable permit or certificate to an industrial undertaking for reduction of the emission keeping in mind of global warming.
Coverage and Applicability	Where the total income of an assessee includes any income by way of transfer of carbon credits.
Tax Rate	- Concessional rate of 10% (+SC+HEC) on the gross amount of such income. - No expenditure or allowance in respect of such income shall be allowed.

EQUALISATION LEVY

ABOLISHED w.e.f., 01.04.2025

In a significant policy development, the Government of India announced the abolition of the 6% Equalisation Levy on online advertisements, w.e.f., 1st April, 2025, following the earlier withdrawal of 2% Equilization Levy on e-commerce transactions in August 2024, marking a complete rollback of India's unilateral digital tax regime.

Up to 31.03.2025

With digital commerce continuing to transform the global economy, traditional tax frameworks have encountered major challenges to tackle tax leakages arising from cross-border digital transactions, which transformed global

value chains, enabling multinational companies to integrate operations across jurisdictions without a physical presence, posing major challenges to international taxation, leading to concerns over Base Erosion and Profit Shifting ('BEPS').

In response to these concerns, the Organization for Economic Co-operation and Development ('OECD'), in collaboration with G20, introduced 15 BEPS Action Plans.

Recognizing these challenges, India, introduced the Equalization Levy in 2016 as a unilateral measure to tax the payments made to non-resident entities for online advertising services at the rate of 6%. In 2020, the scope of the levy was expanded to include e-commerce transactions at the rate of 2%, thereby extending its reach to a broader spectrum of digital activities conducted by foreign companies without a physical presence in India.

Equalisation Levy was introduced in 2016 vide Section 165 to 172 of the Finance Act, 2016, aiming to target the rapid growth of the information and communication technology which resulted in substantial expansion of the supply and procurement of digital goods and services globally, including India, and the digital economy is growing at approximately 10% per annum, faster than the economy as a whole.

These new business models have brought along with themselves, challenges. The typical issues / concerns around taxation vis-à-vis e-commerce are:

- a) difficulty in characterizing the nature of payment and establishing a link / nexus between taxable transaction, activity and taxing jurisdiction.
- b) the difficulty in locating the transaction, activity and identifying the tax payer.

The Organization for Economic Cooperation and Development (OECD), has recommended several options to tackle these challenges.

Charge of equalisation levy on specified services [Section 165]

In order to address these challenges as stated above, Chapter VIII of the Finance Act, 2016 titled "Equalization Levy" provides for an equalization levy of 6% on the amount of consideration for specified services, received / receivable by a non- resident, not having permanent establishment in India, from a resident in India, who carries out business / profession, or from a non-resident who has a permanent establishment in India.

The equalisation levy shall not be charged in the following cases:

- (a) where the e-commerce operator making or providing or facilitating e-commerce supply or services has a permanent establishment in India and such e-commerce supply or services is effectively connected with such permanent establishment;
- (b) the aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from a person resident in India and carrying on business or profession, or from a non-resident having a permanent establishment in India, does not exceed one lakh rupees; or
- (c) where the payment for the specified service by the person resident in India, or the permanent establishment in India is not for the purposes of carrying out business or profession.

Note: The provisions of this section shall not apply to any consideration for any specified service received or receivable by a person on or after the 1st day of April, 2025. [Amendment vide Finance Act, 2025].

Charge of equalisation levy on e-commerce supply of services [Section 165A]

As amended by Finance Act, 2020, an equalization levy of 2% shall be charged on or after 01.04.2020 on the consideration by **an e-commerce operator** from e-commerce supply made or provided by it:

- (a) to a person resident in India;
- (b) to a non-resident in the specified circumstances as referred to in sub-section (3);
- (c) to a person who buys such goods or services or both using internet protocol address located in India.

Where e-commerce operator means a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both. E-commerce supply or services means-

- (i) online sale of goods owned by the e-commerce operator;
- (ii) online provision of services provided by the e-commerce operator;
- (iii) online sale of goods or provision of services or both, facilitated by the e-commerce operator;
- (iv) any combination of activities listed in clause (i), (ii) or clause (iii).

The equalisation levy shall not be charged on e-commerce operator -

- (i) where the e-commerce operator making or providing or facilitating e-commerce supply or services has a permanent establishment in India and such e-commerce supply or services is effectively connected with such permanent establishment;
- (ii) where the equalisation levy is leviable under section 165; or
- (iii) sales, turnover or gross receipts, as the case may be, of the e-commerce operator from the e-commerce supply or services made or provided or facilitated as referred to in sub-section (1) is less than two crore rupees during the previous year.

Note: The provisions of this section shall not apply to any consideration received or receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it on or after the 1st day of August, 2024. [Amendment vide Finance Act, 2024].

Collection and recovery of equalisation levy on specified services [Section 166]

Every person, being a resident and carrying on business or profession or a non-resident having a permanent establishment in India shall deduct the equalisation levy from the amount paid or payable to a non-resident in respect of the specified service at the rate specified, if the aggregate amount of consideration for specified service in a previous year exceeds one lakh rupees.

The equalisation levy so deducted during any calendar month shall be paid by every assessee to the credit of the Central Government by the seventh day of the month immediately following the said calendar month

Collection and recovery of equalisation levy on e-commerce supply or services [Section 166A]

The equalisation levy, shall be paid by every e-commerce operator to the credit of the Central Government for the quarter of the financial year ending with the date specified in column (2) of the Table below by the due date specified in the corresponding entry in column (3) of the said Table:

S. No.	Date of ending of the quarter of financial year	Due date of the financial year
1	30th June	7th July
2	30th September	7th October
3	31st December	7th January
4	31st March	31st March

Furnishing of statement [Section 167]

167	Furnishing the statement	Every assessee or e-commerce operator shall, within the time prescribed after the end of the FY, submit a statement in the prescribed Form # 1, on or by 30th June immediately following the FY, setting forth all details for specified services pertaining to that FY
	Revised Statement	If the assessee or e-commerce operator notices omissions / errors / wrong details, he can furnish a revised statement before the expiry of 2 years from the end of the FY in which the specified service was provided.
	Notice by the Assessing Officer (A.O.)	Where any assessee or e-commerce operator has failed to file the statement within the prescribed time, the A.O. is empowered to issue a notice calling for the statement and in which case the statement has to be furnished within 30 days of date of serving of such notice.
168	Processing of the Statement	The statement shall be processed, and the amount payable along with interest if any, shall be computed towards the Equalization Levy. The net amount payable by or refundable to the assessee or e-commerce operator has to be worked out and an intimation must be served upon the assessee. However, no intimation is to be sent after the expiry of one year, from the end of the FY in which the statement is furnished.
169	Rectification of mistake	With a view to rectifying a mistake apparent on the record, the A.O. may amend the intimation and such intimation must be amended within one year from the end of the FY in which the intimation sought to be amended was issued.
170	Interest on delayed payments	Every assessee or e-commerce operator who fails to deposit to the credit of the Central Government, the applicable Equalization Levy, within 7th of the month following the month in which it was deducted, the assessee shall be liable to pay Interest @ 1% of such levy for every month / part of the month of delay.
171	Penalty	If the assessee or e-commerce operator fails to deduct the Equalization Levy, in addition to the Equalization Levy and Interest, penalty equal to the amount of Equalization Levy that he failed to deduct would be applicable. If the assessee fails to remit the Equalization Levy so deducted to the credit of the Government by 7th of the following month, a penalty of INR 1000 per day would be leviable, subject to a maximum of the equalization levy that he was to deduct.
172	Penalty for delay in furnishing the statement	If the assessee fails to furnish the statement within 30th June of the following FY, or within 30 days of the notice served by the A.O., a penalty of INR 100 per day is leviable on the assessee.

An assessee aggrieved by an order of the A.O., may appeal to the Commissioner of Income Tax (Appeals) within 30 days of receipt of date of order. An assessee aggrieved by an order of the Commissioner, may appeal to the Appellate Tribunal within 60 days of receipt of date of order.

Illustration 6:

DEF Ltd. is in the business of manufacture and sale of formal apparels and in order to expand its footprints globally, has launched a massive online campaign. For the purpose of the online advertisements, it utilized the services of GHI Ltd., based out of Singapore. During the PY, DEF Ltd. paid a consideration of INR 20,00,000 to GHI Ltd. for such services.

Entail the implications if:

- (a) GHI Ltd. has no permanent establishment in India.
- (b) GHI Ltd. has a permanent establishment in India.

Solution:

- (a) In case GHI Ltd. has no permanent establishment in India, the consideration paid to GHI Ltd. by DEF Ltd. would attract Equalization Levy to be deducted @ 6%. Hence, INR 120,000 has to be deducted by DEF Ltd. and deposited to the credit of the Central Government within 7th of the following month. Non-deduction of equalization levy would attract a disallowance u/s 40(a)(ib) of 100% of the amount paid, while computing business income.

- (b) In case GHI Ltd. has a permanent establishment in India, Equalization Levy would not be attracted.

Therefore DEF Ltd. need not deduct Equalization Levy from the payment of consideration to GHI Ltd. However, tax has to be deducted u/s 195 in respect of such payments towards TDS. Non-deduction of TDS would attract a disallowance u/s 40(a)(i) of 100% of the amount paid, while computing business income.

CASE 1

Mr. DP has advertised on Facebook for his business purpose. For that, he has to pay Rs. 2,00,000 to Facebook for said advertising services. Discuss the tax implications under chapter VIII read with Section 10(50) of Income Tax Act, 1961.

Solution:

Mr. DP deduct Equalization Levy = 6% of 2,00,000 = Rs. 12,000 and Pay balance Rs. 1,88,000 to Facebook, the said advertisement. As per section 10(50) of the Income tax Act, 1961, Rs. 2,00,000 shall be exempted in the hands of Facebook.

CASE 2

Mama web online portal owned by Kremal corp. (US Based Company) providing online platform to Indian and foreign customers. Goods and services provided to Indian customer's amounts to Rs. 20 crores were provided to Non-resident amounting to Rs. 70 crores (other than u/s 165 & 165A). However, online services provided to Indian Customer XL Virtual by way of online advertisement amounts to Rs. 10,00,000. Discuss the tax implications in relation to Equalization Levy?

Solution:

1. If Mama web online portal has PE in India. In above case, Equalization Levy is not applicable and company is required to pay tax as per normal income tax provisions.
2. If Mama web online portal does not have PE in India. In above case, Equalization Levy is applicable.
 - EL payable by Mama Web online portal to Govt. = 2% * 20 Crores = Rs. 4,00,000
 - XL Virtual is required to deduct Equalization Levy for online advertisement = 6% of 10,00,000 = Rs. 60,000

CASE 3

Nozy Inc., a USA based company, is carrying on the business of manufacture and sale of Cosmetic". In order to increase its Indian Market share, Company launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of Kuka Inc., a Ghana based company which also owns and operates a digital platform. The gross receipt of Kuka Inc from provision of such services during the P.Y. 2025-26 is Rs 3 crores. During the previous year 2025-26, Nozy Inc. paid Rs. 5 lakhs to Kuka Inc. for such services. Discuss the tax implications in line with reference to Equalization Levy If –

- (a) Nozy Inc. and Kuka Inc. have no PE in India
- (b) Nozy Inc. has a PE in India but Kuka Inc. has not PE in India
- (c) Kuka Inc. has a PE in India and the advertisement services are effectively connected with such PE

Solution:**(1) Nozy Inc. and Kuka Inc. have no PE in India**

- Equalization levy would not be applicable. Therefore, the Nozy Inc. is not required to deduct equalization levy @ 6%
- Equalization levy @2% under section 165A is leviable on Rs. 5 lakhs as the amount of consideration received by Kuka Inc, an e-commerce operator from e-commerce services provided by it to Nozy Inc., a non-resident in the specified circumstance (i.e. sale of advertisement) which targets a customer, who is resident in India, since the gross receipt of Kuka Inc. in the P.Y. 2025-26 exceeds Rs. 2 crores.

(2) Nozy Inc. has a PE in India but Kuka Inc. has not

- Equalization levy @6% is leviable on Rs 5,00,000 received by Kuka Inc., a non-resident not having a PE in India.
- Hence, Nozy Inc. is required to deduct equalisation levy of Rs 30,000 (6% * 5 lakhs) as Services provided by Nozy Inc., a non-resident having no permanent establishment in India.
- Since, equalisation levy is attracted on the amount of Rs 5 lakhs, the said amount is exempt from income-tax by virtue of section 10(50) of the Income-tax Act, 1961.

(3) Kuka Inc. has a PE in India and the advertisement services are connected with such PE

- Equalisation levy would not be applicable as the non-resident service provider Kuka Inc., has a PE in India and the service is effectively connected to the permanent establishment in India.
- Hence, Nozy Inc. is not required to deduct equalisation levy on Rs 5 lakhs, being the amount paid towards online advertisement services to Kuka Inc, in this case.
- Since equalisation levy is not applicable in this case hence no exemption under section 10(50) of the Income-tax Act, 1961 would be available.

ASPECTS OF AMALGAMATIONS, MERGERS AND DEMERGERS

The Indian Income Tax Act, 1961 ("ITA") contains several provisions that deal with the taxation of certain specific transactions. In the Indian context, M&A can be structured in different ways and the tax implications vary based on the structure that has been adopted for a particular acquisition. The methods in which an acquisition can be undertaken are:

1. Slump Sale: A slump sale is a sale of a business/ undertaking by a seller as a going concern to an acquirer, without specific values being assigned to individual assets;

2. Merger: This entails a court approved process whereby one or more companies merge with another company or two or more companies merge together to form one company;
3. Demerger: This entails a court approved process whereby the business / undertaking of one company is demerged into a resulting company;
4. Share Purchase: This envisages the purchase of the shares of the target company by an acquirer;
5. Asset Sale: An asset sale is another method of transfer of business, whereby individual assets / liabilities are cherry picked by an acquirer.

Section 2(1B) of the Income Tax Act defines the term “Amalgamation” as

“**amalgamation**”, in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that:

- (i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;
- (ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
- (iii) shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,

other-wise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company;

(Example: Say, X Ltd merges with Y Ltd in a scheme of amalgamation and immediately before the amalgamation, Y Ltd held 20% of shares in X Ltd, the above mentioned condition will be satisfied if shareholders holding not less than 75% in the value of remaining 80% of shares in X Ltd i.e. 60% thereof, become shareholders in Y Ltd by virtue of amalgamation) otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company.

Section 2(19AA) of the Income Tax Act defines the term “Demerger” as

“**demerger**”, in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956 (1 of 1956), by a demerged company of its one or more undertakings to any resulting company in such a manner that:

- (i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;
- (ii) all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
- (iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger:

Provided that the provisions of this sub-clause shall not apply where the resulting company records the value of the property and the liabilities of the undertaking or undertakings at a value different from the

value appearing in the books of account of the demerged company, immediately before the demerger, in compliance to the Indian Accounting Standards specified in Annexure to the Companies (Indian Accounting Standards) Rules, 2015;

- (iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company;
- (v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;
- (vi) the transfer of the undertaking is on a going concern basis;
- (vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of Sec. 72A by the Central Government in this behalf.

Explanation 1: For the purposes of this clause, “undertaking” shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Explanation 2: For the purposes of this clause, the liabilities referred to in sub-clause (ii), shall include-

- a) the liabilities which arise out of the activities or operations of the undertaking;
- b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and
- c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger

Explanation 3: For determining the value of the property referred to in sub-clause (iii), any change in the value of assets consequent to their revaluation shall be ignored.

Explanation 4: For the purposes of this clause, the splitting up or the reconstruction of any authority or a body constituted or established under a Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified in the Official Gazette, by the Central Government.

Explanation 5: For the purposes of this clause, the reconstruction or splitting up of a company, which ceased to be a public sector company as a result of transfer of its shares by the Central Government, into separate companies, shall be deemed to be a demerger, if such reconstruction or splitting up has been made to give effect to any condition attached to the said transfer of shares and also fulfils such other conditions as may be notified by the Central Government in the Official Gazette.

Explanation 6: For the purposes of this clause, the reconstruction or splitting up of a public sector company into separate companies shall be deemed to be a demerger, if such reconstruction or splitting up has been made to transfer any asset of the demerged company to the resulting company and the resulting company-

- i. is a public sector company on the appointed day indicated in such scheme, as may be approved by the Central Government or any other body authorised under the provisions of the Companies Act, 2013

(18 of 2013) or any other law for the time being in force governing such public sector companies in this behalf; and

- ii. fulfils such other conditions as may be notified by the Central Government in the Official Gazette in this behalf;

(19AAA) “demerged company” means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company;

Capital Gains

Under Section 47(vi) and (vii) transfer does not include any transfer in a scheme of amalgamation of a capital asset by the amalgamating company to the amalgamated company if the latter is an Indian company. From the assessment year 1993-94, any transfer of shares in an Indian company held by a foreign company to another foreign company in pursuance of a scheme of amalgamation between the two foreign companies will not be regarded as a transfer for the purpose of levying tax on capital gains. This provision will apply if $\geq 25\%$ of the shareholders of the amalgamating company continue to remain shareholders of the amalgamated foreign company and such transfer does not attract tax in the country in which the amalgamating company is situated.

Further, the term “transfer” does not include any transfer by a shareholder in a scheme of amalgamation, of a capital asset, being shares held by him in the amalgamating company, if the transfer is made in consideration of allotment to him, shares in the amalgamated company, and the amalgamated company is an Indian Company. Even, per se, amalgamation doesn’t entail exchange or relinquishment of assets, and hence, capital gains tax is not attracted. The same was upheld in the case CIT vs. Rasik Lal Manek. However, the benefit doesn’t continue if the shareholders of amalgamating company are allotted something more than the share in the amalgamated company, viz., bonds / debentures etc. as this was upheld in the case of CIT vs. Gautam Sarabhai Trust.

Tax Treatment		
Shareholders	Amalgamating Company	Amalgamated Company
According to Section 47, It is not considered to be “Transfer” hence, no capital gain would be attracted when shares are allotted to shareholders of amalgamating company.	According to Section 47, No capital gain will be attracted on transfer of capital assets by amalgamating company to amalgamated company.	As per section 49(1), Cost of Acquisition of the assets becomes the property of the amalgamated company. PGBP losses and unabsorbed depreciation of amalgamating company can be carried forward and set off by amalgamated company.

Carry Forward and Set Off of Accumulated loss and unabsorbed depreciation of the amalgamating company [Section 72A]

A special provision is made which relaxes the provision relating to carrying forward and set off of accumulated business loss and unabsorbed depreciation allowance in certain cases of amalgamation. Where there has been an amalgamation of:

- (i) a company owning an industrial undertaking or a ship or a hotel with another company, or
- (ii) an amalgamation of a banking company with a specified bank,
- (iii) one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business.

then the accumulated losses or the unabsorbed depreciation of the amalgamating company shall be deemed

to be the loss or the unabsorbed depreciation of the amalgamated company for the PY in which the transfer was effected. Consequently, the amalgamated company can carry forward such loss for 8 AY's immediately succeeding the relevant AY in which the amalgamation was effected.

However, the above relaxations shall not be allowed if:

- (a) the amalgamated company is engaged in the business in which the accumulated loss or depreciation remains unabsorbed for ≥ 3 years;
- (b) the amalgamated company has held continuously as on date of the amalgamation $\geq 3/4$ ths of the book value of fixed assets 2 years prior to the date of amalgamation;
- (c) the amalgamated company holds continuously for ≥ 5 years from the date of amalgamation, $\geq 3/4$ ths of the book value of fixed assets of the amalgamating company so acquired;
- (d) the amalgamated company continues the business of the amalgamating company for ≥ 5 years from the date of amalgamation.

If any of the above conditions are not complied with, then the set off of loss / depreciation, made in any PY, in the hands of the amalgamated company, shall be deemed to be the income of the amalgamated company chargeable to tax for the year of non-compliance.

Treatment of Expenditure	
Preliminary Expenses	The benefit of amortization of preliminary expenses under section 35D are ordinarily available only to the assessee who incurred the expenditure. However, the benefit will not be lost in case the undertaking of an Indian company which is entitled to the amortization is transferred to another Indian company in a scheme of amalgamation within the 10 years/ 5-year period of amortization. In that event, the deduction in respect of previous year in which the amalgamation takes place and the following previous year within the 10 years / 5 years period will be allowed to the amalgamated company and not to the amalgamating company.
Capital Expenditure on Scientific Research & Know-how	In case of an amalgamation, if the amalgamating company transfers to the amalgamated company, which is an Indian company, any asset representing capital expenditure on scientific research, provision of section 35 would apply to the amalgamated company as they would have applied to amalgamating company if the latter had not transferred the asset. The same principle applies in essence for the expenditure on know-how.
Expenditure on Amalgamation	Section 35DD provides that where an assessee being an Indian company, incurs any expenditure, wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, the assessee shall be allowed, a deduction of an amount equal to one- fifth of such expenditure for each of the five successive previous years beginning with the PY in which such amalgamation / demerger takes place.

Students may refer to Lesson No. 7, titled "Taxation and stamp duty aspects of Corporate Restructuring" of paper 6 "Corporate Restructuring, Valuation & Insolvency" under professional programme for aspects relating to taxation of Corporate Restructuring

LESSON ROUNDUP

- Dividend income are taxable under the head 'Income from other sources' irrespective of fact that person held securities either as a trader or as an investor.
- Assessee can claim a deduction of interest expenses for earning a dividend income (other than any payment by a company on purchase of its own shares from a shareholder i.e. buy-back of shares) and Interest on money borrowed for investing in the shares can be claimed as a deduction subject to a maximum of 20% of dividends or income in respect of units of a mutual fund
- **"Slump Sale"** means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.
- Any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains.
- **"Buy-back"** means purchase by a company of its own shares in accordance with the provisions of any law for the time being in force relating to companies.
- Any amount of distributed income by the company on buy-back of shares in the hands of a shareholder.
- **"Carbon Credit"** in respect of one unit shall mean reduction of one tonne of carbon dioxide emissions or emissions of its equivalent gases which is validated by the United Nations Framework on Climate Change and which can be traded in market at its prevailing market price.
- **Merger:** This entails a court approved process whereby one or more companies merge with another company or two or more companies merge together to form one company;
- **Demerger:** This entails a court approved process whereby the business / undertaking of one company is demerged into a resulting company;
- **Share Purchase:** This envisages the purchase of the shares of the target company by an acquirer;
- **Asset Sale:** An asset sale is another method of transfer of business, whereby individual assets / liabilities are cherry picked by an acquirer.

TEST YOURSELF

These are meant for recapitulation only. Answer to the questions are not to be submitted for evaluation.

1. X Limited has transferred its unit C to Y Ltd. by way of slump sale on November 30, 2025. The balance sheet of X Ltd. as on that date is given below:

Liabilities	(in Lakh)	Assets	(in Lakh)
Paid up Capital	1700	Fixed Assets	
Reserve and Surplus	620	Unit A	150
Liabilities:		Unit B	150
Unit A	40	Unit C	550
Unit B	110	Other Assets	
Unit C	90	Unit A	520
		Unit B	800
		Unit C	390
Total	2560	Total	2560

Compute the capital gains arising from slump sale of unit C and tax on such capital gains with the help of the following information.

- Lumpsum consideration on transfer of unit C – Rs. 880 Lakhs

- Fixed assets of Units C include land which was purchased at Rs. 60 lakhs in August 2022 and revalued at Rs. 90 lakhs on March 31, 2025.
- Other fixed assets are reflected at Rs. 460 lakhs (i.e. 550 lakhs less value of land) which represent written down value of those assets as per books. The written down value of these assets u/s 43(6) of the Act is Rs. 410 lakhs.
- Unit C was set up by X ltd in July, 2006.

ELABORATIVE QUESTIONS

1. Discuss the tax implication in case Dividend Income?
2. Whether interest expenses incurred can be claimed as deduction while computing dividend income? If Yes, upto what limit? Explain the provision in details with examples.
3. What is slump sale? Explain the provisions related to computation of capital gains in case of slump sale transactions.
4. What are the points / criteria to fall the transaction under slump sale?
5. What is buy back of shares? What is the tax implication in case of buy back of shares?
6. Explain the provisions related to tax on distributed income of domestic company for buy back of shares
7. Discuss the reduction of share capital and its tax implication?
8. What is inter-corporate dividend? Explain the provision in brief along with examples?
9. What is Amalgamation? Explain the provision related to tax implication in case of Amalgamation as well as the provision related to carried forward and set-off of losses in case of Amalgamation

LIST OF FURTHER READINGS

- **Direct Taxes Law and Practice**
Author: Dr. Vinod K. Singhania & Dr. Kapil Singhania
Publisher: Taxmann
- **Direct Taxes Ready Reckoner with Tax Planning**
Author: Dr. Girish Ahuja & Dr. Ravi Gupta
Publisher: Wolters Kluwer

OTHER REFERENCES (INCLUDING WEBSITES AND VIDEO LINKS)

- **Income Tax Act, 1961:** <https://www.incometaxindia.gov.in/Pages/acts/income-tax-act.aspx>
- **Income Tax Rules, 1962:** <https://www.incometaxindia.gov.in/Pages/rules/income-tax-rules-1962.aspx>
- **Circulars:** <https://www.incometaxindia.gov.in/Pages/communications/circulars.aspx>
- **Notifications:** <https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx>

KEY CONCEPTS

■ Tax Audit ■ Sales / Turnover / Gross Receipts ■ Books of Accounts ■ Accountant

Learning Objectives

To understand the:

- What is “Tax Audit”
- Detailed understanding of Tax Audit
- Objectives of Tax Audit
- Applicability of Tax Audit
- Requirement of Tax Audit
- Meaning of Sales, Turnover, Gross Receipts
- Maintenance of Books of Account
- Definition of Accountant
- Qualification & Disqualification of Tax Auditor
- Forms of Tax Audit Report
- Analysis of Form 3CD
- Signing of Tax Audit Report
- Consequences of Non-compliance
- E-Filing of Tax Audit Report

Lesson Outline

- Regulatory Framework
- Introduction
- Objectives of Tax Audit
- Tax Auditor
- Tax Audit Report
- Analysis of various clauses in Tax Audit Report
- Penalty for non-compliance
- Lesson Round Up
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

Sections	Income Tax Act, 1961
Section 44AB	Audit of Accounts of certain persons carrying on Business or Profession
Section 44AD	Presumptive Taxation Scheme for Business
Section 44ADA	Presumptive Taxation Scheme for Professionals
Section 44AE	Business of plying, hiring or leasing goods carriages
Section 44BB	Business of exploration of mineral oils
Section 44BBB	Foreign companies engaged in the business of civil construction, etc., in certain turnkey power projects
Section 44AA	Maintenance of Books of Accounts
Explanation to Section 288(2)(iv)	Definition of Accountant
Section 271A	Penalty for non-maintenance of Book of Accounts
Section 271B	Failure to Furnish Tax Audit Report
Rules	Income Tax Rules, 1962
Rule 6G	Report of audit of accounts to be furnished under section 44AB
Rule 6F	Books of account and other documents to be kept and maintained under section 44AA(3) by persons carrying on certain professions
Relevant Forms	
Form 3CA	Audit report in a case where the accounts of the business or profession of a person have been audited under any other law
Form 3CB	Audit report in the case of a person referred to in clause (b) of sub - rule (1) of rule 6G
Form 3CD	Statement of particulars

INTRODUCTION

The term “audit”, in its general sense, refers to a systematic examination, review, or inspection of books of accounts, records, documents, and systems to ensure accuracy, compliance, and transparency. It is a tool to evaluate the correctness and reliability of financial and operational information.

The term “Audit” is borrowed from the Latin word “Audire”, i.e. to hear. In ancient times when the person who has possession of business suspected fraud, they assign particular individuals to inspect the accounts, such individuals were appointed as an accountant and perceived what they had to say in respect of accounts.

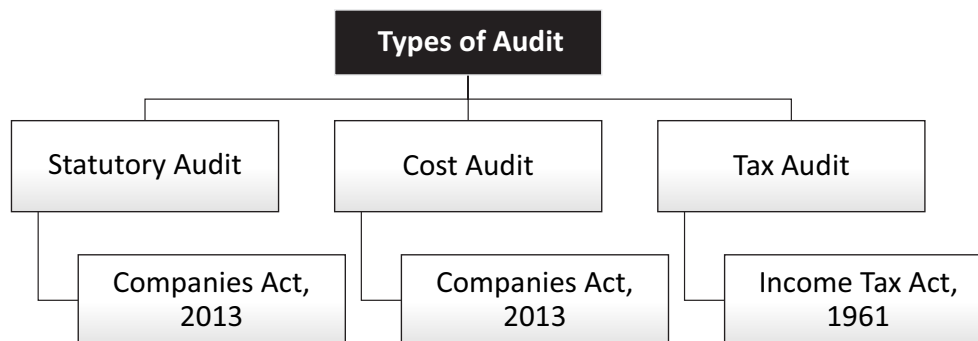
Audit is an independent examination of financial information of any entity, whether profit-oriented or not, irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.

The objective of an audit is to enable the auditor to express an opinion as to whether the financial statements give a “true and fair view” of the financial position and results of operations of the entity for the period under review.

Auditing, or a financial audit, is an official examination and verification of a business’s financial records. The main goal of auditing is to make sure that a company’s financial statements are accurate and are following regulatory guidelines. Auditing also gives investors, creditors, and other stakeholders reasonable assurance that they can rely on a company and its integrity.

Various statutes and regulatory frameworks prescribe different types of audits based on their objectives and areas of focus. For example:

- Under the Companies Act, 2013, a statutory audit is mandatory for every company, where a statutory auditor examines the financial statements to express an opinion on whether they present a true and fair view.
- The Cost and Works Accounting rules, as governed by the Cost Accounting Records and Audit Rules, require certain companies engaged in specified sectors to conduct a cost audit, which verifies cost records and ensures cost compliance.
- Similarly, under the Income-tax Act, 1961, a tax audit is mandated under Section 44AB for certain taxpayers to verify income declarations and ensure proper maintenance of books of accounts for tax purposes.



These audits serve distinct purposes. While statutory audits focus on financial reporting, tax audits aim at tax compliance, and cost audits evaluate cost efficiency and pricing. Collectively, they help in improving governance, ensuring statutory compliance, and fostering stakeholder trust.

The provisions of Tax Audit were first introduced in the Finance Act, 1984. Tax audit is an examination or review of accounts of any business or profession carried out by taxpayers from an income tax perspective. Any business entity or an individual exceeding certain threshold limits of turnover is liable to get the accounts audited.

Section 44AB of the Income Tax Act, 1961, outlines provisions related to tax audits, aiming to ensure the accuracy and transparency of financial records maintained by taxpayers. Enforced to curb fraudulent practices, it mandates the proper maintenance of books of accounts and other relevant financial documents. The objective is to verify the accuracy of the reported income, tax liability, and deductions claim. This process aids in promoting fair and honest financial practices, ultimately contributing to the integrity of the tax system.

Objective of Tax Audit

- The primary objective of a tax audit is to verify the compliance of businesses and professionals with the provisions of the Income Tax Act. This involves a thorough examination of books of accounts, financial statements, and other relevant records to ensure that provisions of income tax act, rules made thereunder are being complied with. It aims to identify any discrepancies or non-compliance issues.
- Ensuring the accuracy of financial statistics is a crucial aspect of tax audits. The audit process comprises a thorough evaluation of the financial statements to ensure that they correctly represent and fairly show the financial status of the business or profession. This rigorous scrutiny improves the reliability of financial reporting and increases the overall credibility of financial data provided to interested parties such as the government, investors, and lenders. The audit provides credibility to the financial information provided to the stakeholders.

An important objective of tax audits is to prevent tax evasion and ensure that taxpayers fulfill their tax obligations honestly. By scrutinizing the financial transactions and reporting practices of businesses and professionals, tax audits act as a deterrent to potential tax evasion schemes. Identifying and rectifying discrepancies helps maintain the integrity of the tax system, promoting fairness and equity among taxpayers.

- Tax audits contribute significantly to enhancing transparency in financial transactions. Through a systematic examination of financial records, the audit process sheds light on the organization's economic activities. This transparency is essential not only for tax authorities but also for other stakeholders, fostering trust and confidence in the financial system.
- Tax audits aim to facilitate tax administration by providing tax authorities with accurate and reliable information. This enables tax authorities to assess and collect the appropriate taxes owed by businesses and professionals. The information obtained through audits also assists in formulating and implementing tax policies that are responsive to the evolving economic landscape.
- While tax audits are often viewed as a compliance mechanism, they also serve as a risk mitigation tool for taxpayers. Identifying and rectifying potential issues during the audit process can prevent future disputes with tax authorities, reducing the likelihood of penalties, fines, or legal complications. This proactive approach helps businesses and professionals maintain financial stability and compliance.

Ensure Compliances of the provisions of Income Tax Act

Tool of preventing Tax evasion

Facilitating tax authorities with accurate and reliable information

Risk mitigating tools for taxpayers

Credibility to the financial information provided to the stakeholders

AUDIT OF ACCOUNTS OF CERTAIN PERSONS CARRYING ON BUSINESS OR PROFESSION [SECTION 44AB]

As per the provisions of section 44AB of the Income Tax Act, 1961,

Every person, –

- (a) carrying on business shall, if his total sales, turnover or gross receipts, as the case may be, in business exceed or exceeds one crore rupees in any previous year:

Provided that in the case of a person whose –

- (a) aggregate of all amounts received including amount received for sales, turnover or gross receipts during the previous year, in cash, does not exceed five per cent of the said amount; and
- (b) aggregate of all payments made including amount incurred for expenditure, in cash, during the previous year does not exceed five per cent of the said payment,

this clause shall have effect as if for the words "one crore rupees", the words "ten crore rupees" had been substituted:

Provided further that for the purposes of this clause, the payment or receipt, as the case may be, by a cheque drawn on a bank or by a bank draft, which is not account payee, shall be deemed to be the payment or receipt, as the case may be, in cash; or

- (b) carrying on profession shall, if his gross receipts in profession exceed fifty lakh rupees in any previous year; or
- (c) carrying on the business shall, if the profits and gains from the business are deemed to be the profits and gains of such person under section 44AE or section 44BB or section 44BBB, as the case may be, and he has claimed his income to be lower than the profits or gains so deemed to be the profits and gains of his business, as the case may be, in any previous year; or
- (d) carrying on the profession shall, if the profits and gains from the profession are deemed to be the profits and gains of such person under section 44ADA and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his profession and his income exceeds the maximum amount which is not chargeable to income-tax in any previous year; or
- (e) carrying on the business shall, if the provisions of sub-section (4) of section 44AD are applicable in his case and his income exceeds the maximum amount which is not chargeable to income-tax in any previous year,

get his accounts of such previous year audited by an accountant before the specified date and furnish by that date the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed:

[Provided that this section shall not apply to a person, who declares profits and gains for the previous year in accordance with the provisions of sub-section (1) of section 44AD or sub-section (1) of section 44ADA:]

Provided further that this section shall not apply to the person, who derives income of the nature referred to in section 44B or section 44BBA, on and from the 1st day of April, 1985 or, as the case may be, the date on which the relevant section came into force, whichever is later:

Provided also that in a case where such person is required by or under any other law to get his accounts audited, it shall be sufficient compliance with the provisions of this section if such person gets the accounts of such business or profession audited under such law before the specified date and furnishes by that date the report of the audit as required under such other law and a further report by an accountant in the form prescribed under this section.

Explanation. – For the purposes of this section,

- (i) “accountant” shall have the same meaning as in the Explanation below sub-section (2) of section 288;
- (ii) “specified date”, in relation to the accounts of the assessee of the previous year relevant to an assessment year, means date one month prior to the due date for furnishing the return of income under sub-section (1) of section 139.

Applicable Rules

Rule 6G: Report of audit of accounts to be furnished under section 44AB

- (1) The report of audit of the accounts of a person required to be furnished under section 44AB shall, –
 - (a) in the case of a person who carries on business or profession and who is required by or under any other law to get his accounts audited, be in Form No. 3CA;
 - (b) in the case of a person who carries on business or profession, but not being a person referred to in clause (a), be in Form No. 3CB.
- (2) The particulars which are required to be furnished under section 44AB shall be in Form No. 3CD.
- (3) The report of audit furnished under this rule may be revised by the person by getting revised report of audit from an accountant, duly signed and verified by such accountant, and furnish it before the end of the relevant assessment year for which the report pertains, if there is payment by such person after furnishing of report under sub-rules (1) and (2) which necessitates recalculation of disallowance under section 40 or section 43B.

DETAILED ANALYSIS OF SECTION 44AB

Applicability

Tax Audit u/s 44AB of the Income-tax Act is applicable in the following cases:

- (a) **Persons carrying on Business:** Tax Audit is required if: Turnover/Sales/Gross Receipts exceed ₹1 crore in the previous financial year. However, the limit of Rs. 1 crore is enhanced to ₹10 crore if:
 - i. Cash receipts (including for sales, turnover, or other receipts) does not exceed 5% of total receipts AND
 - ii. Cash payments (including expenditure) does not exceed 5% of total payments.

Note: **Non-account payee cheques/drafts are treated as cash for the purpose of this section.*

- (b) **Persons carrying on a Profession:** Tax Audit is required if Gross receipts exceed ₹50 lakhs in the previous year.
- (c) **Persons opting for Presumptive Taxation:** Assessee carrying on **specified businesses** as referred in following sections and declares income lower than the prescribed under those respective sections:
 - (i) Section 44AE - Business of plying, hiring or leasing goods carriages,

- (ii) Section 44BB – Business of exploration of mineral oils,
- (iii) Section 44BBB - foreign companies engaged in the business of civil construction, etc., in certain turnkey power projects

Tax audit is required if the taxpayer claims income lower than the presumptive rate as specified under the respective sections of the Income Tax Act.

- (d) **Persons covered under Section 44ADA (Professionals under presumptive scheme):** Tax audit is required if assessee carrying on profession having income exceeding basic exemption limits and declaring income lower than prescribed under section 44ADA, in any previous year,

- Income is declared lower than 50% of gross receipts, AND
- Total income exceeds the basic exemption limit.

*NOTE: As per the Finance Act 2025, the basic exemption limit under the new tax regime (115BAC) is now Rs 4,00,000/-, w.e.f. 1st April, 2025

- (e) **Persons under Section 44AD (Small businesses under presumptive scheme):** Tax audit is required if assessing carrying on business for whom provisions of section 44AD(4) are applicable and his income exceeds the basic exemption limit in any previous year.

- Taxpayer opts out of 44AD,
- Declares lower income than the presumptive 8% (or 6% for digital receipts), AND
- Total income exceeds the basic exemption limit.

SUMMARY – APPLICABILITY OF TAX AUDIT	
Category of Person	Threshold Limit of Tax Audit
Business	
Carrying on Business (not opting for Presumptive Taxation Scheme)	Total sales, turnover, or gross receipts exceed Rs. 1 crore in any FY or If cash transactions are up to 5% of total gross receipts and payments, the threshold limit of turnover for a tax audit is increased to Rs. 10 crores (w.e.f. FY 2020-21). In other words, more than 95% of business transactions should be done through banking channels to avail the increased threshold. Payment or receipt by a cheque or by a bank draft which is not account payee, would be deemed to be made in cash.
Carrying on business eligible for presumptive taxation under Section 44AE, 44BB or 44BBB	Claims profits or gains lower than the prescribed limit under the presumptive taxation scheme.
Carrying on business eligible for presumptive taxation under Section 44AD	Declares taxable income below the limits prescribed under the presumptive tax scheme and has income exceeding the basic threshold limit.

Profession	
Carrying on profession	Total gross receipts exceeds Rs 50 lakh in a year
Carrying on the profession eligible for presumptive taxation under Section 44ADA	Claims profits or gains lower than the prescribed limit under the presumptive taxation scheme and Income exceeds the basic exemption limit

Non-Applicability of Tax Audit

Tax Audit under section 44AB is not applicable in the following cases:

- A person, who declares profits and gains for the previous year in accordance with section 44AD(1) - Presumptive Taxation for Business OR section 44ADA(1) - Presumptive Taxation for Profession
- Not applicable to persons earning income under Section 44B (non-resident shipping) or Section 44BBA (non-resident aircraft business).
- If accounts are audited under any other law (e.g., Companies Act), then that audit is sufficient, provided the tax audit report (Form 3CA/3CD) is also furnished by the due date.

Tax Audit Exemption under Section 44AB (for Business & Profession)					
Section	Eligible Persons	Condition for Exemption	Turnover/Gross Receipts Limit	Deemed Income Rate	Applicability of Tax Audit
44AD	Individuals, HUFs, Partnership Firms (not LLPs)	Must declare income $\geq 8\%$ (cash) or $\geq 6\%$ (digital) of turnover	Up to ₹2 Cr (₹3 Cr if cash receipts $\leq 5\%$)	6% / 8%	Tax Audit is applicable in case Assessee claim his income less than the deemed income as computed in the respective sections
44ADA	Resident Individuals, Partnership Firms (not LLPs)	Must declare income $\geq 50\%$ of gross receipts	Up to ₹50 Lakhs (₹75 Lakhs if cash receipts $\leq 5\%$)	50%	
44AE	Any assessee owning ≤ 10 goods vehicles	Deemed income @ ₹1,000 per ton/month (Heavy vehicle) or ₹7,500/month (Other vehicles)	No limit on receipts, but vehicle limit: ≤ 10	Fixed per vehicle under the act	
44BB	Non-resident providing oil/mineral exploration services	Declares income @ 10% of gross receipts	No turnover limit	10%	
44BBB	Foreign company in turnkey power project	Declares income @ 10% of gross receipts	No turnover limit	10%	

44AB – Proviso	Any person carrying on business	If total turnover ≤ ₹10 Cr AND cash receipts/payments each ≤ 5% of total	₹10 Cr	NA	

Specified Date

The specified date is one month prior to the due date for filing the return under Section 139(1). The due date for furnishing return of income under section 139(1) for different categories of taxpayers is:

- **31st July** – For Individuals, HUFs, etc. not liable for audit
- **31st October** – For Assessee liable to Audit
- **30th November** – For Assessee required to furnish Transfer Pricing report under Section 92E

AY 2026-27	Due Date
Filing ITR Due Date for (Assessee who are required to furnish report under section 92E)	30 th November, 2026
Due date of filing the Income Tax Return by Businesses whose Books of Account are required to be audit	31 st October, 2026
Due date for eligible taxpayers to submit Income Tax audit reports on the e-filing portal	30 th September, 2026
Due Dates for Tax Audit Report (3CA-3CD/3CB-3CD) (“filing of Tax Audit Report for all categories of assessee whose account are required to be audited”)	The date one month prior to the due date for furnishing the return of income under sub-section (1) of section 139

Note:

- Specified Date = ITR Due Date – 1 month, if the ITR due date is 31st October, the Specified Date would be 30th September
- Report is to be furnished in Form 3CA/3CB + 3CD on or before this date.
- If tax audit is done under any other law (e.g., Companies Act), audit under Section 44AB is deemed complied if Audit is done before the specified date, and Tax audit report (Form 3CA/3CD) is also submitted before the specified date.

WHO CAN CONDUCT TAX AUDIT “ACCOUNTANT”

Definition of Accountant

As per the Explanation to section 288 of Income-tax Act, 1961, “accountant” means a chartered accountant as defined in clause (b) of subsection(1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) who holds a valid certificate of practice under sub-section (1) of section 6 of that Act, but does not include [except for the purposes of representing the assessee under sub-section (1)] –

- in case of an assessee, being a company, the person who is not eligible for appointment as an auditor of the said company in accordance with the provisions of sub-section (3) of section 141 of the Companies Act, 2013 (18 of 2013); or

(b) *in any other case, –*

- (i) *the assessee himself or in case of the assessee, being a firm or association of persons or Hindu undivided family, any partner of the firm, or member of the association or the family;*
- (ii) *in case of the assessee, being a trust or institution, any person referred to in clauses (a), (b), (c) and (cc) of sub-section (3) of section 13;*
- (iii) *in case of any person other than persons referred to in sub-clauses (i) and (ii), the person who is competent to verify the return under section 139 in accordance with the provisions of section 140;*
- (iv) *any relative of any of the persons referred to in sub-clauses (i), (ii) and (iii);*
- (v) *an officer or employee of the assessee;*
- (vi) *an individual who is a partner, or who is in the employment, of an officer or employee of the assessee;*
- (vii) *an individual who, or his relative or partner –*
 - (I) *is holding any security of, or interest in, the assessee:*
Provided that the relative may hold security or interest in the assessee of the face value not exceeding one hundred thousand rupees;
 - (II) *is indebted to the assessee:*
Provided that the relative may be indebted to the assessee for an amount not exceeding one hundred thousand rupees;
 - (III) *has given a guarantee or provided any security in connection with the indebtedness of any third person to the assessee:*
Provided that the relative may give guarantee or provide any security in connection with the indebtedness of any third person to the assessee for an amount not exceeding one hundred thousand rupees;
- (viii) *a person who, whether directly or indirectly, has business relationship with the assessee of such nature as may be prescribed;*
- (ix) *a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.*

Analysis of definition & eligibility of 'Tax Auditor'

Qualification

A Chartered Accountant as defined under Chartered Accountant Act, 1949 who holds a valid certificate of practice.

Disqualification

I. In case of an assessee being a Company

The following persons shall not be eligible for appointment as a tax auditor of a company:

- (a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

- (b) an officer or employee of the company;
- (c) a person who is a partner, or who is in the employment, of an officer or employee of the company;
- (d) a person who, or his relative or partner -
 - (i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company, however, the relative may hold security or interest in the company not exceeding Rs. 1000 or such sum as may be prescribed;
 - (ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of such amount as may be prescribed; or
 - (iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for such amount as may be prescribed;
- (e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;
- (f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;
- (g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;
- (h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
- (i) a person who, directly or indirectly, renders any service referred to in section 144 of the Companies Act, to the company or its holding company or its subsidiary company.

Services referred in section 144 are:

- (a) accounting and book keeping services;
- (b) internal audit;
- (c) design and implementation of any financial information system;
- (d) actuarial services;
- (e) investment advisory services;
- (f) investment banking services;
- (g) rendering of outsourced financial services;
- (h) management services; and
- (i) any other kind of services as may be prescribed:

II. In any other case

The following persons shall not be eligible for appointment as a tax auditor of the assessee other than the Company:

- (a) The assessee himself

- (b) Partner of the firm or member of the association or HUF, where assessee being a firm, association or HUF.
- (c) Where the assessee being a trust or institution, the following person:
 - i. the author of the trust or the founder of the institution;
 - ii. any person who has made a substantial contribution to the trust or institution, that is to say, any person whose total contribution up to the end of the relevant previous year exceeds "one lakh rupees" (for the relevant previous year) or "ten lakh rupees" (in aggregate up to the end of the relevant previous year);
 - iii. where such author, founder or person is a Hindu undivided family, a member of the family;
 - iv. any trustee of the trust or manager (by whatever name called) of the institution;
- (d) The person other than mentioned in (a), (b) & (c), who is competent to verify the return under section 139 -
 - i. In case of an Individual – the Individual himself, if he is absent from India, some other person authorized by him, if he is mentally incapacitated, by his guardian or other competent person, if not possible to verify the return, by any person duly authorized by the him;
 - ii. In case of HUF – by the Karta, and, where the karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of such family;
 - iii. In the case of a company - by the managing director thereof
 - iv. In case of a firm - by the managing partner thereof, in his absence, any partner not being a minor;
 - v. In the case of a limited liability partnership - by the designated partner thereof, in his absence, any designated partner;
 - vi. In case of a local authority - by the principal officer thereof;
 - vii. In the case of a political party - by the chief executive officer of such party;
 - viii. In the case of any other association - by any member of the association or the principal officer thereof;
 - ix. In the case of any other person - by some person competent to act on his behalf.
- (e) any relative of any of the persons referred to in (a), (b), (c) & (d) above;
- (f) an officer or employee of the assessee;
- (g) an individual who is a partner, or who is in the employment, of an officer or employee of the assessee;
- (h) an individual who, or his relative or partner -
 - i. is holding any security of, or interest in the assessee of the face value exceeding Rs 1,00,000;
 - ii. is indebted to the assessee for an amount exceeding Rs. 1,00,000;
 - iii. has given a guarantee or provided any security in connection with the indebtedness of any third person to the assessee for an amount exceeding Rs. 1,00,000;
- (i) a person who, whether directly or indirectly, has business relationship with the assessee of such nature as may be prescribed;

- (j) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.

Removal of Tax Auditor

Removal of Tax Auditor can be done by the management where there are valid grounds or justification for such removal. For examples: where the tax auditor has delayed the submission of tax audit report for unreasonable period and if it is found that there is no possibility of getting the audit report uploaded before the specified date, the management may be justified in removing the tax auditor.

Tax auditor cannot be removed merely on the ground that he has given an adverse audit report or assessee as an apprehension that the tax auditor is likely to give an adverse audit report.

Question 1.

Mr. CA & Associates (a Chartered Accountant firm) carries out the Statutory Audit of M/s Orange Pvt. Ltd. Whether Mr. CA & Associates can be appointed as Tax Auditor of M/s Orange Pvt. Ltd?

Answer: As per section 44AB, only an 'accountant' is eligible to be appointed as Tax Auditor and as per the *Explanation* to section 288, there is no disqualification placed on the statutory auditor of a company, accordingly Mr. CA & Associates can be appointed as the Tax Auditor of the M/s Orange Pvt. Ltd.

MEANING OF IMPORTANT TERM

Meaning of Sales, Turnover and Gross Receipts

Calculating gross receipts and sales turnover is essential for determining the applicability of a tax audit under Section 44AB. Section 44AB applies to every person carrying on business, if his sales, turnover or gross receipts from the business exceeds the prescribed limits (Rs. 1 crore or in certain specified cases, Rs. 10 crore) and to a person carrying on a profession, if his gross receipts from the profession exceeds the prescribed limits (Rs. 50 lakhs) in the previous year.

It is important to note that the terms "sales", "turnover" or "gross receipts" are not defined under the Income tax act. So, the meaning of these terms has to be properly considered for determining the applicability of section 44AB.

The Income-tax Act does not define the term "sales," "turnover," or "gross receipts," so their meaning is interpreted based on Accounting standards, ICAI (Institute of Chartered Accountants of India) Guidelines, and Judicial precedents provided by judicial bodies.

Turnover for Business

Turnover as per Books of Accounts

The terms "Sales", "Turnover" or "Gross Receipts" are commercial terms, and should be construed in accordance with the method of accounting regularly employed by the Assessee.

Section 145(1) provides that the Income chargeable under the head "Profits & Gains of Business or Profession" or "Income from Other Sources" should be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. The method of accounting followed by the assessee is also relevant for the determination of Sales, Turnover and Gross Receipts.

Section 44AB applies only if the sales or turnover exceeds the prescribed limit according to the accounts maintained by the assessee.

Inclusions in Turnover

For the purpose of Tax Audit, the term “turnover” includes the following:

- GST/Sales Tax/VAT/Excise Duty, if included in the sales price, in accordance with the method of accounting followed by the assessee.(Note: If GST / Sales Tax /VAT/ and / Excise duty recovered are credited separately to GST / Sales Tax / VAT Account or Excise Duty Account (being separate accounts) and payment to the authority are debited in the same account, they would not be included in the turnover.)
- Cash Assistance against Exports under any scheme of Government of India.
- Gross Interest received by a money lender.
- Commission, Brokerage, Service and other Incidental charges received in the business of Chit Funds.
- Reimbursement of expenses incurred (e.g. packing, freight, forwarding, insurance, travelling etc.) [Note: if such reimbursements are credited to a separate account in the books, only the net surplus on this account should be added to the turnover.]
- Net exchange rate difference on Export Sales.
- Hire charges of Cold Storage.
- Liquidated Damages.
- Insurance Claim – except for Fixed Assets.
- Sale proceeds of Scrap, Wastage etc. unless treated as part of sale or turnover, whether or not credited to Miscellaneous Income Account.
- Gross Receipts including Lease Rent in the business of Operating Lease.
- Lease Rent or Interest on financing in the business of Finance Lease.
- Hire charges and Instalments received in the course of Hire Purchase.
- Advance Received or Forfeited from Customers.
- Value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession.

Note: If the assessee is doing more than one business activity, the turnover of all business activities should be taken together.

Exclusion from Turnover

- Trade Discounts allowed in sales / tax invoice which reduces the sale price, can be excluded from the turnover. However, Cash Discounts allowed otherwise than that allowed in a cash memo is in the nature of a financing charges, and is not related to turnover, the same should not be deducted from the turnover.
- Turnover Discounts which is generally allowed to a customer if the sales made to him exceed a particular quantity. Since, this being dependent on the turnover, as per the trade practice, it is in the nature of Trade Discounts.
- Special Rebate allowed to a customer, if it is in the nature of Trade Discounts.
- Sales Return.

- Sale proceeds of Fixed Assets.
- Sale proceeds of Property held as Investment Property.
- Sales proceeds of shares, debentures, securities etc. held as investments

Gross Receipts for Profession

In case of professionals, the term “Gross Receipts” in profession would include all the receipts arising from carrying on of the profession. Such receipts may be in cash or kind.

Out of Pocket Expenses

- Normally in case of solicitors, advocates, or chartered accountants or company secretaries, out-of-pocket expenses received in advance are credited to a separate client’s account and utilized for making payments for stamp duties, registration charges, fees, counsel’s fees, travelling charges etc. on behalf of the clients.
- These amounts, if collected separately either in advance or otherwise, should not form part of the ‘gross receipts’.
- However, if such out of pocket expenses are not specifically collected but included in the consolidated fees, the whole amount so collected shall form part of Gross Receipts.

Reimbursements vs Recoveries

- If the assessee is merely reimbursed for certain expenses incurred, it will not form of his gross receipts.
- However, if in case of charges recovered, which are not by way of reimbursement of the actual expenses incurred, they will form part of his gross receipts.

Advance Received

Amount received by way of advance which services are yet to be rendered will not form part of the gross receipts, as such advances are the liabilities of the assessee, and cannot be treated as his income till the services are rendered.

Special Aspects - Speculative Transactions

Turnover or Gross Receipts in case of speculative transactions in shares, securities and derivatives may be determined as per following principles:

- In case of speculative transactions, there can be positive and negative differences arising by settlement of various such contracts during the year.
- Each transaction resulting into an independent transactions.
- The amount paid on account of negative difference is not related to the amount received on account of positive difference.
- In such transactions, though the Contract Notes are issued for full value of the purchased or sold asset, the entries in the books of account are made only for the differences.
- Accordingly, the aggregate of both positive and negative differences is to be considered as the turnover of such transactions for determining the liability to tax audit u/s 44AB.

QUESTION FOR PRACTICE**Question 1.**

M/s Yellow Pvt. Ltd. has a total gross receipt in previous year of Rs. 10,00,00,000 and aggregate of payments made during the previous year was Rs. 6,00,00,000. Out of which total cash receipts were Rs. 49,00,000 and amount paid in cash was Rs. 28,00,000. Whether M/s Yellow Pvt. Ltd is required to conduct Tax Audit as per the provisions of section 44AB of Income Tax Act?

Answer:

The normal threshold limit for tax audit is Rs 1 crore for business, however, where the total cash receipts and cash payment does not exceed 5% of the gross total receipt and total payments, the limits for the applicability of Tax Audit extend to Rs. 10 crore.

In this given case, cash receipt and cash payments are less than 5% of total gross receipts and total payments, accordingly the limits for tax audit for M/s Yellow Pvt. Ltd. is Rs. 10 crore. Since the gross receipts do not exceed Rs. 10 crore, M/s Yellow Pvt. Ltd. is not required to get his accounts audited under section 44AB.

Question 2.

Mr. R is in trading business and having turnover of Rs. 90 lakhs, and simultaneously he is providing some professional services whose total gross receipts were Rs. 55 lakhs in previous year. Whether, tax audit is applicable on Mr. R.

Answer:

Where the Assessee has both professional receipts and turnover from business, each of them will be separately considered for the purpose of determining the tax audit applicability. Since, Mr. R has professional receipts more than Rs. 50 lakhs, tax audit is applicable to the assessee and it is necessary to get his accounts audited for his profession and as well as for his business.

Question 3.

Mr. Prakash is a trader with a total turnover of ₹1.2 crore in FY 2024–25. He received ₹1 crore by bank transfer and ₹20 lakh in cash. Determine applicability of tax audit u/s 44AB.

Answer:

Cash receipts = ₹20 lakh → ₹ 16.67% of turnover > 5%.

Hence, ₹10 crore threshold not applicable.

Accordingly, Tax audit is required (turnover > ₹1 crore and cash receipts > 5% of total receipts).

Question 4.

Star Enterprises had turnover of ₹6 crore, received 98% digitally, and made payments 97% digitally. Determine applicability of tax audit u/s 44AB.

Answer: Both cash receipts and payments < 5%

Eligible for enhanced limit → No tax audit required (Since gross receipts / turnover < Rs.10 crore).

Question 5.

Mr. Shiva, a Company Secretary in Practice, earned ₹65 lakhs from professional services in FY 2024–25, all through UPI / digital payments / bank transfers. Determine applicability of tax audit u/s 44AB.

Answer: Tax audit required (professional receipts > ₹50 lakhs).

CASE STUDY 1

Mr. Kishore runs a kirana shop with ₹80 lakh turnover in the city of Indore. Business is not good, and despite trying very hard, he could only achieve a net profit @ 4% of the turnover. Being a tax consultant, he seeks your help in analyzing the current situation, and advising what would be his due date to file the Income tax return, and applicable compliances. He has been filling returns by taking the benefit of Section 44AD for the past 10 financial years. You are required to advise him regarding furnishing returns under the Income Tax Act for the FY 2025-2026.

Solution:**Case Summary:**

- Name: Mr. Kishore
- Type of business: Kirana store (eligible business)
- Location: Indore (non-metro; doesn't affect analysis)
- Turnover for FY 2024–25: ₹80 lakhs
- Net profit declared: 4% = ₹3.2 lakhs
- Used Section 44AD for past 10 years
- Now reporting income < 8% (cash) or 6% (digital)

Applicability of Provisions:

Section 44AD – Presumptive Scheme:

- If gross receipts ≤ ₹2 crore, and the taxpayer declares profit ≥ 8% (cash) or 6% (non-cash) → No need for books or audit.
- If the taxpayer declares profit < 6%/8%, and his income exceeds basic exemption limit, then:
 - He must maintain books of account as per Section 44AA
 - And get them audited u/s 44AB

Analysis of the Current Situation:

Declared Profit is 4% of ₹80 lakh = ₹3.2 lakhs

- Basic exemption limit for Mr. Kishore (assuming <60 years): ₹2.5 lakhs
- His income > basic exemption, but profit < 6%/8%
- Section 44AD(4) applies (exit from presumptive → audit triggered)

Therefore, Tax Audit is MANDATORY u/s 44AB(e)

- If Mr. Kishore opts out of Section 44AD this year (by declaring lower income), he cannot opt back in for the next 5 assessment years (Section 44AD(4)).
- He will be required to maintain books and get audit done for those years if his income exceeds the exemption limit.
- Since audit is mandatory (due to lower income and income > exemption limit), the due date for filing ITR is: 31st October 2026 (for AY 2026–27)

Compliances Required

- Maintain Books of Account as per Section 44AA.
- Get Accounts Audited under Section 44AB.
- Pay Advance Tax by 15th March 2026 (entire amount).
- File ITR by 31st October 2026.
- Avoid penalties under:
 - Section 271A (₹ 25,000 for non-maintenance of books)
 - Section 271B (₹ 1,50,000 or 0.5% of turnover for non-audit)
- Professional Advise to Mr Kishore: Being a Company Secretary, it is our duty to properly advise the clients on the best possible scenario for the benefit of the client:
 - If he wants to continue under Section 44AD, he must declare at least 6% or 8% profit.
 - If he declares lower profit, he must be ready for audit and books maintenance, and cannot opt for 44AD for next 5 years.
 - Consider whether the compliance burden and loss of presumptive benefit are worth declaring lower profit.

CASE STUDY 2

Mr. Prakash, a 32-year-old freelance web developer based in Pune, earned ₹48 lakhs in gross professional receipts during FY 2025-26. He incurred ₹20 lakhs in expenses and declared ₹12 lakhs as net profit. He has been opting for Section 44ADA since FY 2020–21. This year, however, he wants to declare actual profit, which is less than 50% of gross receipts.

Advise Mr. Prakash on:

- Whether he can declare lower profit
- Applicability of books of account and tax audit
- Relevant due dates for filing return and audit report
- The ITR form he should use

Solution:

- Section 44ADA allows professionals (eligible u/s 44AA(1)) to declare income at **50%** of gross receipts up to ₹50 lakhs.
- Mr. Prakash's gross receipts are ₹48 lakhs (within limit).
- However, since he wants to declare 25%, which is less than 50%, and his income exceeds ₹2.5 lakh, Section 44ADA(4) triggers Section 44AB(d).

Conclusion:

- Tax Audit is mandatory
- He must maintain books of account as per Section 44AA
- Due date for Tax Audit: 30th September 2025
- Due date for ITR filing: 31st October 2025
- ITR Form: ITR-3
- Advance Tax (100% to be paid): 15th March 2025

MAINTENANCE OF BOOKS OF ACCOUNTS [SECTION 44AA]

The Income Tax Act has specified the books of accounts that are required to be maintained for the purpose of Income Tax. These have been prescribed under section 44AA and Rule 6F.

As per the section 44AA, an assessee is required to maintain books of accounts/ accounting records, if the income from business or profession exceeds Rs. 1,20,000 or turnover/gross receipts exceeds Rs. 10,00,000 in any of the 3 preceding years.

For a newly set up business/profession whose income from business/profession is expected to exceed Rs. 1,20,000 in a year or gross receipts are expected to exceed Rs. 10,00,000.

Further, in case business/profession is being carried out by the individual or HUF the limits are to be read as under:

- a. For Income - Rs. 2,50,000
- b. For Turnover/Gross Receipt - Rs. 25,00,000.

This provides a relief to small tax payers.

Further, specified professionals are required to maintain their books of accounts irrespective of their gross receipts and income except where a presumptive taxation scheme under Section 44ADA is opted.

Specified professionals include any person engaged in:

- Legal,
- Medical,
- Engineering,
- Architectural, Technical Consultancy, Interior decoration, Film artist, Authorized Representative, Accountancy Profession, Company secretary, or Information Technology.

A Business entity opting for presumptive tax scheme under section 44AD, 44AE, 44BB, or 44BBB is required to maintain books of account in accordance with following norms:

(a) Businesses eligible for presumptive tax scheme under section 44AD:

- For resident individuals or HUFs - if the income of the assessee exceeds the maximum exemption limit and he has opted for the presumptive scheme in any of the last 5 previous years but does not opt for the same in the current year.

- For resident partnership firm - The taxpayer has opted for the scheme in any of the last 5 previous years but does not opt for the same in the current year.
- (b) Businesses eligible for presumptive tax scheme under Section 44AE: if the taxpayer (engaged in plying, hiring, or leasing goods carriage) claims that the profits are lower than the deemed profits.
- (c) Businesses eligible for Presumptive Tax Scheme under Section 44BB - if the taxpayer (non-resident assessee engaged in the exploration of mineral oil) claims that the profits are lower than the deemed profits.
- (d) Businesses eligible for Presumptive Tax Scheme under Section 44BBB - if the taxpayer (a foreign company engaged in civil construction) claims that the profits are lower than the deemed profits.

List of books of accounts required to be maintained

Rule 6F of the Income-tax Rules prescribes the following books of accounts to be maintained under section 44AA(3):

- For specified professions other than company secretary and information technology (where gross receipts exceed Rs. 1,50,000 in any of the 3 years immediately preceding the previous year) -
 - a) Cash book
 - b) Journal, if books of accounts are maintained according to the mercantile system of accounting
 - c) Ledgers
 - d) Carbon copies of bills and carbon copies or counterfoil of receipts issued by the assessee of value exceeding Rs. 25 (must be machine numbered or serially numbered)
 - e) Original bills issued to the assessee and receipts in respect of the expenditures incurred by him.
 - f) Signed vouchers, if bills and receipts are not issued and the amount of expenditure does not exceed Rs. 50 if the cash book does not contain adequate particulars in respect of these expenditures
- For medical professions, the following additional books are required to be maintained:
 - Daily case register in Form 3C.
 - Inventory under broad heads of stock of drugs, medicines, and other consumable accessories used for the purpose of profession, as on the first and last day of the previous year.
- For specified professions (in every other case), and non-specified professions & businesses where gross receipts exceed Rs. 1,50,000 in any of the 3 years immediately preceding the previous year - Such books of account which may enable the Assessing Officer to compute the taxable income.

Where books of account and other documents should be kept and maintained?

Books of account and other documents should be kept and maintained by the person at the place where he is carrying on the profession or, where the profession is carried on at more than one place, at the principal place of his profession.

However, where the person keeps and maintains separate books of account in respect of each place where the profession is carried on, such books of account and other documents may be kept and maintained at the respective places at which the profession is carried on.

Period of maintenance

Books of account and documents should be kept and maintained for a period of 6 years from the end of the relevant assessment year.

However, if the assessment in relation to any assessment year has been reopened under Section 147 within the prescribed period, all the books of account and other documents which were kept and maintained at the time of reopening of the assessment should be kept and maintained until the assessment so reopened has been completed.

Penalty for non-compliance

If an assessee fails to maintain or retain books of account and other documents for the specified period in accordance with this provision, a penalty may be imposed under Section 271A of Rs. 25,000.

Question 1.

Which of the following persons are required to maintain books of accounts irrespective of the gross receipts and income except where a presumptive taxation scheme under Section 44ADA is opted?

- (a) Specified Professions
- (b) Non-Specified Professions
- (c) Business eligible for presumptive taxation scheme under Section 44AD, 44AE, 44BB, or 44BBB
- (d) All of the above

Answer: (a) Specified Professionals.

Specified professionals are required to maintain their books of accounts irrespective of their gross receipts and income except where a presumptive taxation scheme under Section 44ADA is opted. Specified professionals include any person engaged in Legal, Medical, Engineering, Architectural, Technical Consultancy, Interior decoration, Film artist, Authorized Representative, Accountancy Profession, Company secretary, or Information Technology.

Question 2.

Purple Ltd. engaged in the business of manufacturing paper is required to maintain books of accounts if _____.

- (a) Income from business exceeds Rs. 2,50,000 or Gross turnover exceeds Rs. 25 lakhs, in any of the 3 years immediately preceding the previous year.
- (b) Income from such business exceeds Rs. 1,20,000 or Gross turnover exceeds Rs. 10 lakhs, in any of the 3 years immediately preceding the previous year.
- (c) Either (a) or (b)
- (d) None of the above

Answer: (b) Income from such business exceeds Rs. 1,20,000 or Gross turnover exceeds Rs. 10 lakhs, in any of the 3 years immediately preceding the previous year.

A Business entity is required to maintain books of account if the income from such business exceeds Rs. 1,20,000 or Gross turnover exceeds Rs. 10 lakhs, in any of the 3 years immediately preceding the previous year.

Changes Introduced via Finance Act, 2025

- I. Section 115BAC (New Tax Regime)
 - a. Basic exemption limit increased:
 - i. AY 2025-26: ₹ 3 lakh
 - ii. AY 2026-27: ₹ 4 lakh (as per phased amendments)
- II. Section 87A (Rebate)
 - a. Rebate up to ₹ 60,000 for resident individuals if total income $\leq$ ₹ 12 lakh under the new regime.
 - b. Rebate up to ₹ 12,500 under the old regime if income $\leq$ ₹ 5 lakh.

Impact on Tax Audit Applicability

Despite the increase in basic exemption limits and rebate thresholds:

1. Tax audit applicability remains unchanged.
2. Audit is triggered by turnover/gross receipts, not by:
 - Basic exemption limit under Section 115BAC
 - Rebate eligibility under Section 87A
 - Tax regime opted (old or new)

Even if a taxpayer's net income is below the exemption limit, they may still be subject to audit if their turnover/gross receipts exceed the prescribed thresholds.

Hence, it is important to note, that changes in Section 115BAC and Section 87A affect tax computation, not audit applicability. Taxpayers must assess audit requirements based solely on turnover and presumptive income declarations.

TAX AUDIT REPORT

The tax audit report has to be furnished in the forms prescribed below:

Category of Taxpayer	Form for Audit Report	Annexure to Audit Report
If the books of account of the assessee are required to be audited under any other law i.e. Companies Act, 2013 (statutory audit of companies), LLP Act (audit of LLPs), Co-operative Societies Act, etc. Example: A company whose accounts are already audited under the Companies Act will furnish its tax audit report in Form 3CA .	Form 3CA	Form 3CD
In any other case i.e. The person is not required to get accounts audited under any other law but is still liable to tax audit under Section 44AB (say, due to turnover crossing the threshold). Example: A sole proprietor whose turnover is ₹1.5 crore and not liable to audit under any other law will file tax audit report in Form 3CB.	Form 3CB	Form 3CD

Form No. 3CA/3CB is a format of audit report, whereas Form 3CD is a Statement of particulars required to be furnished under Section 44AB of the Income-tax Act.

Form 3CD – Statement of Particulars - Regardless of whether Form 3CA or 3CB is used, the assessee must also submit Form 3CD. This is a detailed questionnaire (44 clauses) containing particulars as already mentioned before in this chapter. Form 3CD acts as an annexure to the audit report and is mandatory in all tax audit cases.

The Tax Auditor has to furnish his report in specified Audit Forms which are explained in detail:

FORM 3CA

Tax Audit Report is to be furnished in Form 3CA, in a case where the accounts of the person carrying business of profession are required to be audited under any other laws for the time being in force like the Companies Act, 2013 or the LLP Act, 2008. In this report, auditor is not required to express his opinion towards the true and fairness of accounts, he is only required to annex a copy of audit report given by statutory auditor as well as audited accounts along with his report in Form 3CA. The tax auditor is required to express his opinion whether the prescribed particulars furnished in Form 3CD by the assessee are true and correct, subject to observations if any.

Format of Form 3CA – a specimen format of Form 3CA is given below:

FORM NO. 3CA

[See rule 6G(l)(a)]

Audit report under section 44AB of the Income -tax Act, 1961, in a case where the accounts of the business or profession of a person have been audited under any other law

*I/we report that the statutory audit of M/s (Name and address of the assessee with Permanent Account Number or Aadhaar Number) was conducted by *me/us/M/s. in pursuance of the provisions of the Act, and *I/we annex hereto a copy of *my/our/their audit report dated along with a copy of each of

- (a) the audited *profit and loss account/income and expenditure account for the period beginning from to ending on
- (b) the audited balance sheet as at, ...; and
- (c) documents declared by the said Act to be part of, or annexed to, the *profit and loss account/income and expenditure account and balance sheet.

2. The statement of particulars required to be furnished under section 44AB is annexed herewith in Form No. 3CD.

3. In *my/our opinion and to the best of *my/our information and according to examination of books of account including other relevant documents and explanations given to *me/us, the particulars given in the said Form No.3 CD are true and correct subject to the following observations/qualifications, if any:

- a.
- b.
- c.

.....

**(Signature and stamp/Seal of the signatory)

Place:

Name of the signatory

Date:

Full address

Notes :

1. * Delete whichever is not applicable
2. This report has to be signed by a person eligible to sign the report as per the provisions of section 44AB of the Income-tax Act, 1961.
3. Where any of the requirements in this Form is answered in the negative or with qualification, give reasons therefor.
4. The person who signs this audit report shall indicate reference of his membership number/certificate of practice/authority under which he is entitled to sign this report.

FORM 3CB

Tax Audit Report is to be furnished in Form 3CB, in a case where the accounts of the person carrying business of profession are not required to be audited under any other laws for the time being in force. A proprietorship entity or partnership firm with a turnover of more than 1 crore and not opting for the presumptive income scheme is not required to get its accounts audited under any other law except income tax. So, it will furnish Form 3CB. In this report, tax auditor is required to express his opinion as to whether or not the accounts audited by him give a true and fair view of the state of affairs or profit & loss account of the assessee. The tax auditor is required to express his opinion whether the prescribed particulars furnished in Form 3CD by the assessee are true and correct, subject to observations if any.

Format of Form 3CB – a specimen format of Form 3CB is given below:

FORM NO. 3CB

[See rule 6G(l)(b)]

Audit report under section 44AB of the Income-tax Act 1961, in the case of a person referred to in clause (b) of sub-rule (1) of rule 6G

1. *I/we have examined the balance sheet as on, ..., and the *profit and loss account/income and expenditure account for the period beginning from to ending on, attached herewith, of (Name), ... (Address), ... (Permanent Account Number).
2. *I/we certify that the balance sheet and the *profit and loss/income and expenditure account are in agreement with the books of account maintained at the head office at and ** branches.
3. (a) *I/we report the following observations/comments/discrepancies/inconsistencies; if any:
 - (b) Subject to above, –
 - (A) *I/we have obtained all the information and explanations which, to the best of *my/our knowledge and belief, were necessary for the purpose of the audit.
 - (B) In *my/our opinion, proper books of account have been kept by the head office and branches of the assessee so far as appears from*my/ our examination of the books.
 - (C) In *my/our opinion and to the best of *my/our information and according to the explanations given to *me/us, the said accounts, read with notes thereon, if any, give a true and fair view :-

- (i) in the case of the balance sheet, of the state of the affairs of the assessee as at 31st March; and
- (ii) in the case of the *profit and loss account/income and expenditure account of the *profit/loss or *surplus/deficit of the assessee for the year ended on that date.

4. The statement of particulars required to be furnished under section 44AB is annexed herewith in Form No.3CD.

5. In *my/our opinion and to the best of *my/our information and according to explanations given to *me/us, the particulars given in the said Form No.3 CD are true and correct subject to following observations/qualifications, if any:

- a.
- b.
- c.

**(Signature and stamp/Seal of the signatory)

Place:

Name of the signatory

Date:

Full address

Notes:

1. *Delete whichever is not applicable.
2. **Mention the total number of branches.
3. ***This report has to be signed by person eligible to sign the report as per the provisions of section 44AB of the Income-tax Act, 1961.
4. The person, who signs this audit report, shall indicate reference of his membership number/certificate of practice number/authority under which he is entitled to sign this report.

FORM 3CD – Statement of Particulars required to be furnished under section 44AB

The form includes the statement of particulars /information required to be provided under section 44AB as Annexure to the audit report in Form 3CA & Form 3CB.

Clause wise analysis of Form 3CD			
Sl. No.		Particulars	Reporting requirements
PART A			
1		Name of the assessee	(a) Name of the assessee as specified in the PAN (b) If trade name is different, the same should be reported. (c) Name of branch along with the name of the assessee.

2		Address	(a) Address must be the same as informed by the assessee to the Income tax department. (b) Address of branch must be given (c) In case of a company, registered office address must be given (d) In case of other assessee, principal place of business must be given
3		Permanent Account Number (PAN) or Aadhar number	PAN number or Aadhar number of the Assessee must be given.
4		Whether the assessee is liable to pay indirect tax like excise duty, service tax, sales tax, goods and services tax, customs duty, etc. If yes, please furnish the registration number, GST number or any other identification number allotted for the same	The Auditor is required to examine the applicability of indirect taxes to the assessee and mention the registration numbers obtained by the assessee.
5		Status	This refers to the different classes of assesses included in the Act – individual, Hindu Undivided Family (HUF), company, firm (includes LLP), Association of Persons (AOP), Body of Individuals (BOI), local authority and artificial juridical person.
6		Previous year from ____ to ____	This relates to the financial year pertaining to the audit. This period is typically from the 1st April to 31st March of the next year but care has to be taken in case of closure of businesses, new businesses, amalgamations, demergers, etc.
7		Assessment Year	Assessment year relevant to the previous year for which the accounts are to be audited.
8		Indicate the relevant clause of section 44AB under which the audit has been conducted	The applicable clause [(a) to (e)] of Section 44AB under which tax audit is being conducted should be selected.
8A		Whether the assessee has opted for taxation under section 115BA/ 115BAA/ 115BAB/ 115BAC/ 115BAD/ 115BAE	Section 115BA/ 115BAA/ 115BAB/ 115BAD/ 115BAE provide option to the assessee to pay tax at special rates and forego certain deductions, exemptions etc. The auditor has to verify and mention whether the assessee has opted for taxation under any of the aforesaid sections.

PART B			
9	(a)	If firm or association of persons, indicate name of partners/members and their profit sharing ratios.	Where the assessee is a firm or association of persons (AOP) or Body of Individuals (BOI), the names of partners of the firm or members of AOP/BOI and their profit sharing ratios have to be mentioned. In case a person acts in a representative capacity, the name of the beneficial partner/member should be mentioned.
	(b)	If there is any change in the partners or members or in their profit sharing ratio since the last date of the preceding year, the particulars of such change	All changes that occur during the entire previous year, no matter how often, must be mentioned.
10	(a)	Nature of business or profession (if more than one business or profession is carried on during the previous year, nature of every business or profession)	Where the assessee is in more than one business, the information has to be furnished in respect of all business. Where the assessee is in profession, the nature of each type of service need to be mentioned.
	(b)	If there is any change in the nature of business or profession, the particulars of such change	If there are any changes in the nature of business or profession to be carried out, the same needs to be mentioned. Temporary discontinuance of business need not to be mentioned.
11	(a)	Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed.	Rule 6F prescribes the books of account and other documents to be maintained by a person carrying certain professions as specified in section 44AA(1). Section 44AA(2) provides that persons carrying on business or profession except the persons as mentioned in section 44AA(1), shall keep and maintain books of account or other documents so as to enable Assessing Officer to compute his total Income in accordance with the provisions of Income-tax Act, if his total sales, turnover or income from business or profession exceed the prescribed limits under section 44AA(2), in any of the three immediately preceding three years.

	(b)	Lists of books of account maintained and the address at which the books of account are kept. (In case books of account are maintained in a computer system, mention the books of account generated by such computer system. If the books of account are not kept at one location, please furnish the addresses of locations along with the details of books of account maintained at each location.)	Location of books of account to be provided in this clause. In case the books of account are kept at more than one locations, then details of each location along with details need to be disclosed. In case where books of account are maintained in computer system, the location of server need to be disclosed. In case where books of account are stored on cloud, IP address of the same must be disclosed.
	(c)	List of books of account and nature of relevant documents examined	List of books of account along with other relevant documents, the auditor has examined
12		Whether the profit or loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant section (44AD, 44ADA, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, 44BBC, Chapter XII-G [Shipping business], First Schedule [Insurance business] or any other relevant section)	The amount of profit & gains of the business or profession that relates to the presumptive scheme of taxation under any of the given sections must be reported in this clause.
13	(a)	Method of accounting employed in the previous year	As per section 145 of Income-tax Act, 1961, income chargeable under head 'Profit and gains of business or profession' or 'Income from other sources' must be computed in accordance with either cash or mercantile system of accounting. If there is any change in the method of accounting, that is to be reported and the effect thereof on the increase or decrease on the profits need to be stated under this clause. The Income Tax Act has prescribed certain Income Computation and Disclosure Standards (ICDS). The effect of these ICDS must be taken in the computation of tax to arrive at the net tax liability – The increase in profit, decrease in profit and net effect is mentioned as per each ICDS.
	(b)	Whether there had been any change in the method of accounting employed vis-a-vis the method employed in the immediately preceding previous year.	
	(c)	If answer to (b) above is in affirmative, give details of such change, and the effect thereof on the profit or loss.	
	(d)	Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2)	
	(e)	If answer to (d) above is in the affirmative, give details of such adjustments	

	(f)	Disclosure as per ICDS	The ICDS also contain certain disclosure requirements. i) ICDS I – Accounting Policies ii) ICDS II – Valuation of Inventories iii) ICDS III – Construction Contracts iv) ICDS IV – Revenue Recognition v) ICDS V – Tangible Fixed Assets vi) ICDS VII – Government Grants vii) ICDS IX – Borrowing Costs viii) ICDS X – Provisions, Contingent Liabilities and Contingent Assets
14	(a)	Method of valuation of closing stock employed in the previous year.	The tax auditor needs to determine the method of valuation of closing stock. If there is any change in the basis of determining cost, market value or net realizable value the same needs to be provided along with the effect thereof on the profit and loss.
	(b)	In case of deviation from the method of valuation prescribed under section 145A, and the effect thereof on the profit and loss	
15		Give the following particulars of the capital asset converted into stock-in-trade:	An asset held as a capital asset would attract income under the head capital gains at the time of its sale and an asset held as stock-in-trade would attract income under the head profits and gains of business. When it is decided to treat a capital asset as part of the stock of the business, it is treated as a 'transfer' for income tax purposes and will attract capital gains subject to certain conditions and exceptions.
	(a)	Description of capital asset;	
	(b)	Date of acquisition;	
	(c)	Cost of acquisition;	
	(d)	Amount at which the asset is converted into stock-in-trade.	
16		Amounts not credited to the profit and loss account, being –	The auditor is supposed to ensure all the items falling under Section 28 of the Income Tax Act, 1961 that have not been credited to the profit and loss account. This clause intends to capture and report those incomes which ordinarily wouldn't be a business income but is deemed to be business income by virtue of the Income Tax Act. For example, compensation received on account of termination of employment, profit on sale of import license, remuneration received by a partner from a partnership firm, etc. Even export benefits like pro forma credits, duty drawbacks, refund of customs, etc. would be covered under this clause if not credited to the profit and loss account.
	(a)	The items falling within the scope of section 28;	
	(b)	The proforma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax where such credits, drawbacks or refunds are admitted as due by the authorities concerned;	
	(c)	Escalation claims accepted during the previous year;	
	(d)	Any other item of income;	

	(e)	Capital receipt, if any.	A tax auditor should use his professional judgment to determine whether a receipt is capital or revenue.
17		Where any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of the State Government referred to in section 43CA or 50C, please furnish details of property, consideration received or accrued and value adopted or assessed or assessable	If assessee has sold or transferred any land, building or both during the previous year for a consideration less than the value assessed by the authority as referred to in section 43CA or 50C, the auditor is required to furnish the details of property along with consideration received or accrue and value adopted or assessed.
18		Particulars of depreciation allowable as per the Income Tax Act, 1961 in respect of each asset or block of asset, as the case may be, in the following form:-	The tax auditor is required to examine that depreciation to be charged as per the 'block of assets system' subject to certain conditions.
	(a)	Depreciation of asset/block of assets	The tax auditor is required to examine the classification of assets into various blocks, this can be done through judicial pronouncements, assessment history of assessee etc. After ascertaining the classification, the rates of depreciation are to be determined as per the income tax rules, relevant clarifications from department and judicial decisions. For the purpose of determination of actual cost, the auditor needs to examine various legal provisions, relevant accounting standards, guidance notes etc. The depreciation and written down value are calculated correctly by checking the WDV at the beginning of the year and adjusted in respect of additions/deletions during the year.
	(b)	Rate of depreciation	
	(c)	Actual cost of written down value, as the case may be	
	(ca)	Adjustment made to the written down value- (i) under the proviso to sub-section (3) of section 115BAA (for assessment year 2020-21 only); (ii) under the first proviso to sub-section (3) of section 115BAC or the proviso to sub-section (3) of section 115BAD (for assessment year 2021- 22 only); (iii) under the second proviso to sub-section (3) of section 115BAC (for assessment year 2024-25 only).	
	(cb)	Adjustment made to written down value of Intangible asset due to excluding value of goodwill of a business or profession	
	(cc)	Adjusted written down value	
	(d)	Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustment on account of: (i) Central Value Added Tax credits claimed and allowed under the Central Excise Rules, 1944, in respect of	

		assets acquired on or after 1st March 1994, (ii) change in rate of currency, and (iii) subsidy or grant or reimbursement, by whatever name called.	
	(e)	Depreciation allowable	
	(f)	Written down value at the end of the year	
19		Amounts admissible under sections: 33AB, 33ABA, 35(1)(i), 35(1)(ii), 35(1)(ia), 35(1)(iii), 35(1)(iv), 35(2AA), 35(2AB), 35ABA, 35ABB, 35AD, 35CCA, 35CCC, 35CCD, 35D, 35DD, 35DDA, 35E and any other relevant section.	These sections allow for special deductions for prescribed businesses. The tax auditor checks whether the assessee has complied with all the necessary conditions to claim a deduction under these sections. Some of these sections may require a certificate by a Chartered Accountant certifying the eligibility.
20	(a)	Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend	The assessee would be allowed a deduction in respect of a payment made to an employee in the nature of a bonus or commission only if such bonus or commission was payable exclusively to such employee in relation to the services rendered by him.
	(b)	Details of contribution received from employees for various funds as referred to in section 36(1)(va)	These funds include superannuation funds created for the benefit of the employee. The contributions made by the employer to such funds shall be allowed as a deduction only if they are made within the due date as specified in the applicable law.
21	(a)	Please furnish the details of amounts debited to profit and loss account, being in the nature of capital, personal, advertisement, expenditure, expenditure incurred at clubs being entrance fees, cost of club services, expenditure by way of penalty or fine for violation of any law etc.	The nature of these expenses are such that they may either be fully disallowed or only allowed subject to certain conditions.
	(b)	Amounts inadmissible under section 40(a)(i), 40(a)(ia), 40(a)(ic), 40(a)(ia), 40(a)(iib), 40(a)(iii), 40(a)(iv), 40(a)(v)	In section 40(a) certain amount shall not be deducted in computing the income chargeable under 'Profit and gain of business or profession'. Under this clause, tax auditor is required to report the details of payment on which TDS is not deducted and also the payment on which tax was deducted but not deposited before the due date of filing of income tax return under section 139(1).

		In sub clause 40(a)(iib), (i) any amount paid by way of a royalty, license fees, service fees, service charge or any other fees which is levied exclusively on or (ii) appropriated from a state government is inadmissible expenditure. Salary paid outside India or to a non-resident in respect of which tax has not been deducted or tax has not been deposited after deduction is not allowed as deduction u/s 40(a)(iii). Section 40(a)(iv) provides that any payment to a provident fund or other fund for the benefit of employees shall be inadmissible unless the assessee has ensured that TDS shall be deducted from any payment made from fund which are chargeable under head Salaries. As per section 40(a)(v), tax paid by employer on non-monetary perquisites provided to employees shall be disallowed while computing income.
(c)	Amounts debited to profit and loss account being, interest, salary, bonus, commission or remuneration inadmissible under section 40(b)/40(ba) and computation thereof;	This is applicable to firm, AOP or BOI assessee where payments are made to the partners/members in the nature of salary, remuneration, interest, etc. The Act has prescribed certain limits upto which such expenditure can be allowed in the hands of the firm/AOP/BOI and if the expenditure exceeds this limit, the same is not allowed as a deduction.
(d)	Disallowance/ deemed income under section 40A(3)	The auditor is required to verify the payment exceeding Rs. 10,000 made to a person in a day otherwise than by an account payee cheque or bank draft or through electronic clearing system except for the cases prescribed under Rule 6DD.
(e)	Provision for payment of gratuity not allowable under section 40A(7);	The deduction under this section is allowed in relation to a provision created for payment of contribution to an approved gratuity fund only if such sum is actually payable during the year.
(f)	Any sum paid by the assessee as an employer not allowable under section 40A(9);	Any payment incurred by an employer towards setting up or formation of any fund, trust, company, AOP, BOI, Society, etc. will not be allowed as a deduction.

	(g)	Particulars of any liability of a contingent nature;	The assessee is required to furnish details of any liability of a contingent nature debited to the profit and loss account.
	(h)	Amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of total income;	The section prescribes a method of calculation of an amount of expenditure which will be disallowed as it is deemed to be incurred towards earning exempt income.
	(i)	Amount inadmissible under the proviso to section 36(1)(iii)	Where the assessee borrows a loan for business purposes, the interest thereon would normally be allowed as a deduction. However, if such loan was used to acquire an asset, the interest shall not be allowed for the period between the date of borrowing of the loan to the date on which the asset was put to use.
22		(i) Amount of interest inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006 (ii) Total amount required to be paid to to a micro or small enterprise, as referred to in section 15 of the MSMED Act, during the previous year; (iii) Of amount referred to in (ii) above, amount – (a) paid up to time given under section 15 of the MSMED Act; (b) not paid up to time given under section 15 of the MSMED Act and inadmissible for the previous year.	Section 23 of MSMED Act, 2006 provides that Interest payable or paid by the buyer shall not be allowed as deduction while computing the Income under Income Tax Act, 1961. As per MSMED Act, 2006, where a buyer fails to make payment to the supplier being the micro and small enterprise, as required under section 15, the buyer shall be liable to pay compound interest with monthly rests to the supplier on that amount at the rate three times of the bank rate notified by RBI.
23		Particulars of payments made to persons specified under section 40A(2)(b)	Under this clause, the particulars of payments stated to be made to persons covered under section 40A(2)(b) should be examined.
24		Amounts deemed to be profits and gains under section 32AC or 32AD or 33AB or 33ABA or 33AC.	These sections allow for a special deduction to certain assessee subject to certain conditions. In case of a breach of these conditions, the whole or a part of the deduction allowed earlier would be included as deemed income.

25		Any amount of profit chargeable to tax under section 41 and computation thereof.	This section relates to deemed profits arising out of, where a deduction has been allowed in an earlier year in respect of an expenditure, but the assessee has received some benefit whether by cash or by reduction in actual liability in the current year, such benefit will be chargeable to tax under this section. Where an asset has been sold by an assessee engaged in the power generation and distribution and such sale consideration exceeds the written down value. Where an asset used in scientific research has been sold for a consideration greater than its original cost Where a bad debt that was allowed earlier is subsequently recovered. Where an amount has been withdrawn from a special reserve created by a financial company on which deduction was earlier allowed Where such amounts/benefits as above have been received even after the closure of business.
26		In respect of any sum referred to in section 43B, the liability for which: -	As per section 43B, deduction in respect of certain expenditure is allowed only if the actual payment is made within the time limits specified. Where opening outstanding balance was not allowed in any previous year and was paid during the year or not paid during the year. Where expenditure was incurred during the previous year and was paid on or before the due date of filing return of income under section 139(1) or not paid on or before the aforesaid date.
	(a)	Pre-existed on the first day of the previous year but was not allowable in the assessment of any preceding previous year and was (a) paid during the previous year; (b) not paid during the previous year;	
	(b)	Was incurred during the previous year and was (a) paid on or before the due date for furnishing the return of income of the previous year under section 139(1); (b) not paid on or before the aforesaid date (State whether sales tax, customs duty, excise duty, or any other indirect tax, levy, cess, impost, etc., is passed through the profit and loss account.)	
27	(a)	Amount of Central Value Added Tax credits availed of or utilised during the previous year and its treatment in the profit and loss account and treatment of outstanding Central Value Added Tax credits in the accounts.	The details of the CENVAT/GST credit availed or utilized and its treatment in profit and loss account is reported in this clause.

	(b)	Particulars of income or expenditure of prior period credited or debited to the profit and loss account.	This clause would be relevant only for the persons following the mercantile system of accounting.
29A	(a)	Whether any amount is to be including in income chargeable under the head 'income from other sources' as referred to in clause (ix) of sub-section (2) of section 56? (Yes/No)	Section 56(2)(ix) provides for the taxability of advance received in the course of negotiation for transfer of a capital asset, if such amount is forfeited and the negotiations do not result in transfer of such capital asset.
	(b)	If yes, please furnish the following details: (i) Nature of income (ii) Amount thereof	
29B	(a)	Whether any amount is to be included as income chargeable under the head 'income from other sources' as referred to in clause (x) of sub-section (2) of section 56? (Yes/No)	Section 56(2)(ix) provides that if any person receives from any person money, immovable property, or other property and conditions in the clause are satisfied, then it shall be treated as income of recipient.
	(b)	If yes, please furnish the following details: (i) Nature of income (ii) Amount thereof	
30		Details of any amount borrowed on hundi or any amount due thereon (including interest on the amount borrowed) repaid, otherwise than through an account payee cheque [Section 69D]	Details of amount borrowed on Hundi are to be reported under this clause.
30A	(a)	Whether primary adjustment to transfer price, as referred to in sub-section (1) of 92CE, has been made during the previous year? (Yes/No)	The transfer pricing provisions under the Income Tax Act in general aim to value transactions with associated enterprises at an arm's length price. This clause aims to capture such relevant information within the tax audit report.
	(b)	If yes, please furnish the following details:- (i) Under which clause of sub-section (1) of 92CE primary adjustment is made? (ii) Amount (in Rs.) of primary adjustment (iii) Whether the excess money available with the associated enterprise is to be repatriated to India as per the provisions of sub-section (2) of section 92CE? (Yes/No) (iv) If yes, whether the excess money has been repatriated within the prescribed time (Yes/No) (v) If no, the amount (in Rs.) of imputed interest income on such excess money which has not been repatriated within the prescribed time.	

30B	(a)	Whether the assessee has incurred expenditure during the previous year by way of interest or of similar nature exceeding one crore rupees as referred to in sub-section (1) of section 94B? (Yes/No)	Where an Indian Company borrows a sum of money from an associated enterprise, the deduction in respect of interest payable on such borrowed amount under the Income-tax Act shall be restricted to 30% of EBITDA (Earnings before interest, tax, depreciation and amortisation). The interest in excess of 30% shall be allowed to be set off in subsequent years subject to certain conditions. This clause places a check for compliance in this regard.
	(b)	If yes, please furnish the following details:- (i) Amount (in Rs.) of expenditure by way of interest or of similar nature incurred: (ii) Earnings before interest, tax, depreciation and amortization (EBITDA) during the previous year (in Rs.): (iii) Amount (in Rs.) of expenditure by way of interest or of similar nature as per (i) above which exceeds 30% of EBITDA as per (ii) above: (iv) Details of interest expenditure brought forward as per sub-section (4) of section 94B (v) Details of interest expenditure carried forward as per sub-section (4) of section 94B	
30C	(a)	Whether the assessee has entered into an impermissible avoidance arrangement, as referred to in section 96, during the previous year? (Yes/No)	An impermissible avoidance arrangement would be an arrangement where the main purpose is to obtain a tax benefit and is not at arm's length, results in tax evasion (directly or indirectly), lacks commercial substance or is carried out in a manner that does not otherwise occur if the arrangement was for bona fide purposes. The tax auditor is required to report the impermissible avoidance arrangements as referred to in section 96 entered into by the assessee and to quantify the tax benefit arising in aggregate to all parties to such arrangements.
	(b)	If yes, please specify:- (i) Nature of the impermissible avoidance arrangement: (ii) Amount (in Rs.) of tax benefit in the previous year arising, in aggregate, to all the parties to the arrangement”;	
31	(a)	Particulars of each loan or deposit in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year: (i) name, address and PAN or aadhar number of the lender or depositor, (ii) amount of each loan or deposit taken or accepted, (iii) whether the same was squared up during the previous year, (iv) maximum amount outstanding at any time during the previous year, (v) whether the same was taken or accepted by cheque or bank draft or use of ECS through a bank account.	Under this clause certain particulars of each loan or deposit in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year need to be reported. Reporting is required where each loan or deposit is Rs. 20,000 or more.

		(vi) in case the loan or deposit was taken or accepted by cheque or bank draft, whether the same was taken or accepted by an account payee cheque or an account payee bank draft.	
	(b)	Particulars of each specified sum in an amount exceeding the limits specified in section 269SS taken or accepted during the previous year: (i) name, address and PAN or Aadhar number (if available) of the person from whom specified sum is received, (ii) Amount of each loan or deposit taken or accepted (iii) whether the specified sum was taken or accepted by cheque or bank draft or use of ECS through a bank account. (iv) in case the specified sum was taken or accepted by cheque or bank draft, whether the same was taken or accepted by an account payee cheque or an account payee bank draft. (particulars at (a) & (b) need not be given in the case of a Government company, a banking company or a corporation established by the Central, State or Provincial Act.)	Under this clause, particular of any specified sum taken or accepted in relation to immovable property need to be reported.
	(ba)	Particulars of each specified sum in an amount exceeding the limits specified in section 269ST taken or accepted during the previous year: Name, address and PAN (if available) of the person from whom specified sum is received, amount of specified sum taken or accepted, whether the specified sum was taken or accepted by cheque or bank draft (specify if account payee) or use of ECS through a bank account	The sub-clauses (ba), (bb), (bc) & (bd) of clause 31 deal with the reporting of transactions in excess of limits specified in section 269ST. Section 269ST provides that a person is not allowed to receive more than Rs. 2 lakh from either: (i) From a person in a day (in total); (ii) In respect of single transaction; or (iii) In respect of transactions relating to a single event/occasion; If such amount is paid through any mode other than an account payee cheque / bank draft or use of ECS through a bank account. The non-compliance with this section needs to be reported under this clause.
	(bb)	Particulars of each receipt in an amount exceeding the limit specified in section 269ST, in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event	

		or occasion from a person, received by a cheque or bank draft, not being an account payee cheque or an account payee bank draft, during the previous year:- (i) Name, address and Permanent Account Number (if available) of the payer; (ii) Amount of receipt (in Rs.)	
	(bc)	Particulars of each payment made in an amount exceeding the limit specified in section 269ST, in aggregate to a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion to a person, otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year:- (i) Name, address and PAN (if available) of the payee; (ii) Nature of transaction; (iii) Amount of payment (in Rs.); (iv) Date of payment;	
	(bd)	Particulars of each payment in an amount exceeding the limit specified in section 269ST, in aggregate to a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion to a person, made by a cheque or bank draft, not being an account payee cheque or an account payee bank draft, during the previous year:- (i) Name, address and PAN (if available) of the payee; (ii) Amount of payment (in Rs.)	
	(c)	Particulars of each repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T made during the previous year: Name, address, PAN (if available) of payee, amount of repayment, maximum amount outstanding at any time during the previous year, whether the repayment was made by cheque or bank draft (specify if account payee) or use of ECS through a bank account	As per section 269T, where repayment of the loan or deposit is made to a person, if the aggregate amount of loan or deposits held by such person either held in his name or jointly on the date of such repayment together with interest, payable on such deposits is Rs 20,000 or more. Under this sub-clause particulars of each repayment of loan or deposit exceeding the limits as specified in section 269T need to be reported.
	(d)	Particulars of repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T received otherwise than by a cheque or bank draft or use of ECS through a bank account during the previous year: Name, address, PAN (if available) of the payer, amount of	Under this clause, tax auditor needs to provide the details of repayment received from a person in respect of loan or deposit exceeding the limits of section 269ST otherwise than by a cheque or bank draft or use of ECS through a bank account during the previous year.

		loan or deposit or any specified advance received otherwise than by a cheque or bank draft or use of ECS through a bank account during the previous year.	
	(e)	Particulars of repayment of loan or deposit or any specified advance in amount exceeding the limit specified in section 269T received by a cheque or bank draft which is not an account payee cheque or account payee bank draft during the previous year: Name, address, PAN (if available), of the payer, amount of loan or deposit or any specified advance received by a cheque or a bank draft which is not an account payee bank cheque or bank draft during the previous year.	Under this clause, tax auditor needs to provide the details of repayment received from a person in respect of loan or deposit exceeding the limits of section 269T otherwise than by an account payee cheque or bank draft or use of ECS through a bank account during the previous year.
32	(a)	Details of brought forward loss or depreciation allowance to the extent available	The tax auditor is required to provide the details of brought forward losses or depreciation allowance. Such amounts need to be revised for any change arising out of a rectification order, assessment order, etc.
	(b)	Whether a change in the shareholding of the company has taken place during the previous year due to which the losses incurred prior to the previous year cannot be allowed to be carried forward in terms of section 79.	The tax auditor needs to obtain the details of changes in voting power pattern year-on-year and verify the reasons for any such changes before determining the allowability of losses eligible to be carried forward.
	(c)	Whether the assessee has incurred any speculation loss referred to in section 73 during the previous year. If yes, please furnish details of the same.	The tax auditor is required to verify the books of account and other relevant documents to ascertain whether the assessee is carrying any speculation business. Under this sub-clause auditor is required to furnish the details regarding speculation loss referred to in section 73, if any incurred by the assessee during the previous year.
	(d)	Whether the assessee has incurred any loss referred to in section 73A in respect of any specified business during the previous year, if yes, please furnish details of the same.	The tax auditor is required to verify whether the assessee is carrying on specified business as referred to under section 35AD. In case the assessee is carrying any specified business, the auditor is required to furnish the details of the loss incurred, if any, in respect of any specified business during the previous year.

	(e)	In case of a company, please state that whether the company is deemed to be carrying on a speculation business as referred in explanation to section 73, if yes, provide details of speculation loss if any incurred during the previous year.	As per Explanation to section 73, where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources", or a company the principal business of which is the business of trading in shares or banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares. The tax auditor is required to provide the details regarding the speculation losses incurred, if any, as referred to in Explanation to section 73.
33		Section-wise details of deductions, if any, admissible under Chapter VIA or Chapter III (Section 10A, 10AA).	The tax auditor need to provide the section wise details of deductions admissible under income tax act, and it fulfills the conditions, if any, specified under the relevant provisions, rules, circulars, or any other guidelines issued in this behalf.
34	(a)	Whether the assessee is required to deduct or collect tax as per the provisions of Chapter XVII-B or Chapter XVII-BB, if yes, please furnish details	These sections are related to TDS & TCS compliances. The tax auditor is required to verify the expenditure on which tax was required to be deducted, or income on which TCS was required to be collected, whether such tax was actually deducted / collected and paid to the government on time. And also need to verify whether the assessee has furnished the periodical TDS / TCS returns on time. In case of a failure to comply on time, the details of interest/penalty in respect of such late payments need to be disclosed.
	(b)	Whether the assessee is required to furnish the statement of tax deducted or tax collected. If yes, please furnish the details.	
	(c)	Whether the assessee is liable to pay interest under section 201(1A) or section 206C(7). If yes, please furnish details.	

35	(a)	In the case of a trading concern, give quantitative details of principal items of goods traded: (i) Opening Stock; (ii) purchases during the previous year; (iii) sales during the previous year; (iv) closing stock; (v) shortage/excess, if any	The tax auditor is required to examine whether the enterprise is a trading concern or not and should obtain certificates from the assessee in respect of principal items of goods traded, opening stock, sales and closing stock and the details of shortage/excess/damage items and the reasons thereof.
	(b)	In the case of a manufacturing concern, give quantitative details of the principal items of raw materials, finished products and by-products: A. Raw Materials: (i) opening stock; (ii) purchases during the previous year; (iii) consumption during the previous year; (iv) sales during the previous year; (v) closing stock; (vi) yield of finished products; (vii) percentage of yield; (viii) shortage/excess, if any. B. Finished products/by-products: (i) opening stock (ii) purchases during the previous year; (iii) quantity manufactured during the previous year; (iv) sales during the previous year; (v) closing stock; (vi) shortage/excess, if any.	The tax auditor is required to examine whether the enterprise is a manufacturing concern or not and should obtain certificates from the assessee in respect of principal items of raw materials, finished goods and by-products and quantitative information.
36A		a) Whether the assessee has received any amount in the nature of dividend as referred to in sub-clause (e) of clause (22) of section 2? (Yes/No) (b) If yes, please furnish the following details:- (i) Amount received (in Rs.); (ii) Date of receipt	The tax auditor should obtain a certificate from the assessee containing a list of closely held companies in which he is the beneficial owner of shares carrying not less than 10% of the voting power and list of concerns in which he has a substantial interest. The auditor is required to verify whether the assessee has received any amount in the nature of dividend as referred to in sub-clause (e) of clause (22) of section 2 and provide the amount and date of receipt such amount.

36B	(a)	Whether the assessee has received any amount for buyback of shares as referred to in sub-clause (f) of clause (22) of section 2? (Yes/No)	
	(b)	If yes, please furnish the following details: (i) Amount received (in Rs.) (ii) Cost of acquisition of shares bought back]	
37		Whether any cost audit was carried out, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/ quantity as may be reported/identified by the cost auditor.	The tax auditor should determine whether cost audit was carried out and if yes, a copy of cost audit report should be obtained. The tax auditor is required to take note of the disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/identified by the cost auditor.
38		Whether any audit was conducted under the Central Excise Act, 1944, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/ quantity as may be reported/identified by the auditor.	The tax auditor should determine whether any audit was carried out under the Central Excise Act, 1944 and if yes, a copy of audit report should be obtained. The tax auditor is required to take note of the disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/identified by the auditor.
39		Whether any audit was conducted under section 72A of the Finance Act, 1994 in relation to valuation of taxable services, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/ quantity as may be reported/identified by the auditor.	The tax auditor should determine whether any audit was carried out under section 72A of Finance Act, 1994 and if yes, a copy of audit report should be obtained. The tax auditor is required to take note of the disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/identified by the auditor.
40		Details regarding turnover, gross profit, etc. for the previous year and preceding previous year: 1. Total turnover 2. Gross profit/turnover 3. Net profit/turnover 4. Stock-in-trade/turnover 5. Material consumed/ finished goods produced	These ratios have to be calculated only for those assesseees who are engaged in manufacturing or trading activities.

41		Please furnish details of demand raised or refund issued during the previous year under any tax laws other than Income-tax Act, 1961 and Wealth Tax Act, 1957 along with details of relevant proceedings	The assessee may be assessed under various tax laws other than Income-tax act, like indirect tax laws, professional tax laws etc resulting into a demand/refund order issued by the government authorities. The details of orders of such authorities need to be disclosed under this clause.
42	(a)	Whether the assessee is required to furnish statement in Form No. 61 or Form No. 61A or Form No. 61B? (Yes/No)	The forms mentioned in this clause relate to Specified Financial Transactions where reporting needs to be done in respect of certain prescribed transactions when they are entered into by such assessee as are prescribed in Section 285BA.
	(b)	If yes, please furnish Income-tax Department Reporting Entity Identification Number, Type of form, Due date for furnishing, Date of furnishing (if furnished), Whether the form contains information about all details/ transactions which are required to be reported. If not, please furnish list of the details/ transactions which are not reported	
43	(a)	Whether the assessee or its parent entity or alternate reporting entity is liable to furnish the report as referred to in sub-section (2) of section 286 (Yes/No)	The report mentioned in this clause relates to providing information in respect of the international group of entities of which the assessee is a part and where the parent entity of such international group is not resident in India.
	(b)	If yes, please furnish the following details: (i) Whether report has been furnished by the assessee or its parent entity or an alternate reporting entity (ii) Name of parent entity (iii) Name of alternate reporting entity (if applicable) (iv) Date of furnishing of report	
44		Break-up of total expenditure of entities registered or not registered under the GST	This clause attempts to provide a break-up of the total expenditure into various fields that are relevant from the GST point of view like expenditure in relation to exempt goods / services under GST, payments to entities under the Composition Scheme, Payments to entities not registered under GST etc. A similar schedule is available as a part of the Income Tax return forms to be filled up by those not liable for tax audit.

Signature in Form 3CA / 3CB / 3CD

- The forms is to be signed and the stamp /seal of the Signatory is to be affixed.
- The forms shall be signed by a person eligible to sign the Reports as per the provisions of section 44AB of the Income Tax Act, 1961.
- Name of the Signatory is to be provided with his full address including place and date of report signing.
- In the e-filing utility, Membership number, Firm Registration Number should be provided by the Tax Auditor.
- UDIN is mandatorily required to be generated.

Revision of Audit Report

Inserted in 2020, Sub-rule (3) allows revision of a tax audit report in a specific case:

If the assessee makes any payment after the audit report is furnished, which affects disallowances under:

- Section 40 (e.g., disallowance for TDS default)
- Section 43B (e.g., late payment of PF, ESI, GST, etc.)

He can revise the audit report to reflect the updated position.

Time limit: The revised report must be submitted before the end of the relevant assessment year.

Summary Table		
Rule	Description	Form No.
6G(1)(a)	Already audited under another law	Form 3CA
6G(1)(b)	No audit under any other law	Form 3CB
6G(2)	Detailed particulars (mandatory in all cases)	Form 3CD
6G(3)	Revised audit report allowed in some cases	Same forms, before end of A.Y.

Question for Practice**Question 1.**

Which form is used when an assessee is not required to get accounts audited under any other law, but is liable for tax audit under Section 44AB?

Answer: Form 3CB

Question 2.

Form 3CD is

- An audit report
- A statement of particulars
- Used only by companies
- Optional if Form 3CB is used

Answer: Option (b) – A statement of particulars

Question 3.

An LLP gets its books audited under the LLP Act. What form should be used for tax audit?

- a) Form 3CA
- b) Form 3CB
- c) Form 3CD
- d) Form 3CC

Answer: Option (a) – Form 3CA

Question 4.

Which section allows revision of tax audit report due to payment affecting Section 40/43B?

- a) Section 139
- b) Section 44AB
- c) Rule 6G(3)
- d) Section 143

Correct Answer: c) Rule 6G(3)

FAILURE TO FURNISH TAX AUDIT REPORT [SECTION 271B]

According to section 271B, if any person who is required to comply with section 44AB fails to get his accounts audited in respect of any year or years as required under section 44AB or furnish such report as required under section 44AB, the Assessing Officer may impose a penalty. The penalty shall be lower of the following amounts:

- (a) 0.5% of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such year or years.
- (b) Rs. 1,50,000.

However, according to section 271B, no penalty shall be imposed if reasonable cause for such failure is proved.

The word 'reasonable cause' has not been defined under the Income-tax Act. The initial burden is on the assessee to show that reasonable cause existed for the failure referred to in the concerned provision. Thereafter, the officer dealing with the matter has to consider whether the explanation offered by the assessee was on account of reasonable cause.

Reasonable cause can be reasonably said to be a cause which prevents a man of average intelligence and ordinary prudence from acting under normal circumstances, without negligence or inaction or want of bona fides.

'Reasonable cause' as applied to human action is that which would constrain a person of average intelligence and ordinary prudence. It can be described as a probable cause. It means an honest belief founded upon reasonable grounds of the existence of a state of circumstances, which, assuming them to be true, would

reasonably lead any ordinary prudent and cautious man placed in the position of the person concerned to come to the conclusion that the same was the right thing to do.

Following are some instances of “reasonable cause” as laid down by Tribunals and Courts:

- Resignation of Tax Auditor and consequent delay.
- Bona fide interpretation of the term ‘turnover’ based on expert advice.
- Death or physical inability of the person in charge of the accounts.
- Labour problems such as strike, lock out for a long period.
- Loss of accounts because of fire, theft etc. beyond the control of the assessee.
- Non-availability of accounts on account of seizure.
- Natural calamities, commotion etc.
- Resignation of the accountant and his consequent non-cooperation.
- Official e-filing portal failure.

CASE LAWS

21st March, 2005

**Staywell Hotels P. Ltd. vs Commissioner of
Income-Tax And Anr**

Madhya Pradesh High Court

Discretionary Power of Assessing Officer for imposing penalty under section 271B: The use of the expression “may” in Section 271B confers discretion on the Assessing Officer to impose penalty for the breach of Section 44AB. This, therefore, contemplates as to whether the explanation sought from the assessee in not complying the requirement of Section 44AB is to be accepted or not by the Assessing Officer. In other words, though compliance with Section 44AB is mandatory for the assessee its non-compliance within time attracts rigour of Section 271B, i.e., penalty. However, on a sufficient cause being shown, the Assessing Officer is vested with the discretion to condone the delay and relieve the assessee from payment of penalty amount. It then depends upon the facts of each case as to whether a case for acceptance of explanation is made out by the assessee or not. [Staywell Hotels P. Ltd. vs Commissioner of Income-Tax.

E-FILING OF TAX AUDIT REPORT – FORM 3CA-3CD / 3CB-3CD

I. Pre-requisites for e-filing

The following are the prerequisites for filing of Form 3CA-3CD/3CB-3CD:

- Taxpayer and CA are registered on the e-Filing portal with valid user ID and password
- Status of PAN of taxpayer and CA is active
- Taxpayer has assigned CA for form 3CA-CD
- CA and Taxpayer have a valid and active Digital Signature Certificate

II. Process to submit Tax Audit Report

Following are the steps to file tax audit report 3CA-3CD/3CB-3CD:

Step 1: Taxpayer needs to add Chartered Account to whom he/she wants to assign the form. Taxpayer may add CA by navigating through Authorised Partners → My Chartered Accountant → Add CA. Alternatively, taxpayer may navigate through e-File → Income Tax Forms → File Income Tax Forms → Form 3CA3CD/Form3CB-3CD.

Step 2: After successfully adding CA, taxpayer needs to assign the tax audit. Taxpayer is requested to navigate to e-File → Income Tax Forms → File Income Tax Forms and select Form 3CA-3CD/3CB-3CD, as applicable under category “Persons with Business / Professional Income”. Form can be assigned to CA by selecting CA Name, AY and Filing Type. If CA is not added, you can navigate to Authorised Partners → My Chartered Accountant to add CA.

Step 3: After successfully assignment of form to CA, form shall be available in the CA's worklist → For Your Action. CA can either reject or accept the assignment. In case CA rejects the assignment, form need to reassign from the taxpayer end.

Step 4: In case CA accepts the assignment, CA is required to fill all the necessary details in the offline utility and generate JSON.

Step 5: CA needs to upload the JSON under Worklist → For Your Action → Pending for Upload and verify the same using DSC.

Step 6: Form uploaded by CA shall be available under Taxpayer's worklist → For Your Action → Pending for Acceptance. Taxpayer may either approve or reject the tax audit report. Form submission will be completed after taxpayer's approval.

III. Procedure to approve Tax Audit Report

Form uploaded by CA shall be available under “For your action” tab in Taxpayer's Worklist. Taxpayer may either approve or reject the tax audit report. Once taxpayer approve the form and verify the same, filing of form is considered as Completed.

RELEVANT CASE LAWS

2024	<i>Chavakkad Service Co-Operative Bank Ltd. vs. Income Tax Officer</i>	<i>Kerala High Court</i>

HC deleted penalty as delay in obtaining audit report from statutory auditors under Societies Act is a reasonable cause

Facts of the Case: The assessee co-operative society filed its returns of income but failed to file the audit report within the prescribed time limit. However, the audit report was made available before the Assessing Authority at the time of finalisation of the assessments. The Assessing Authority completed the assessments by relying on the said audit reports. While passing the assessment orders, the Assessing Authority initiated penalty proposals under section 271B for alleged breach of the procedure contemplated under section 44AB.

The CIT(A) upheld the penalty proceedings which was further confirmed by the Tribunal. Aggrieved by the order, an appeal was filed to the Kerala High Court.

Decision: The High Court held that the Co-operative Societies, being regulated by the provisions of the Kerala Co-operative Societies Act and Rules, accounts had to be mandatorily audited in terms of the said statutory

provisions and the delay in submitting the audit reports before the Income Tax Authorities was occasioned solely since there had been a corresponding delay in receiving the audit reports from the statutory auditors appointed under the Kerala Co-operative Societies Act and Rules.

The issue to be examined is whether the delay in obtaining the audit reports from the statutory auditors under the Kerala Co-operative Societies Act and Rules can be seen as a reasonable cause for the delayed submission of the audit reports before the Assessing Authority under the IT Act.

It can be seen from a perusal of the statutory framework that the assessee Co-operative Societies had virtually no control over the completion of the audit by the statutory auditors. It was also noted that nothing on record would suggest that the delay occasioned by the statutory auditors in finalising the audit reports was in any way attributable to the conduct of the assessees in these appeals. It was also found that the audit reports were made available before the Assessing Authority at the time of completion of the assessment. Hence, there was really no prejudice caused to the Department in the matter of finalisation of the assessment.

In the present appeals, the Assessing Authority did not even look into the aspect of 'reasonable cause'. It proceeded to confirm the penalty on the assessees on the assumption that the penalty under section 271B was automatic whenever there was a delay in submitting the audit report beyond the prescribed due date.

Also, it is found from a perusal of the CBDT Circular No.3/2009 dated 21-5-2009 issued in exercise of the powers under section 139C that under certain circumstances, the Board has permitted a belated production of the audit reports by assessees such as the appellants, as and when called for by the Income Tax authorities. The said Circular would align with the Scheme of penalty under the Income Tax Act especially in the context of sections 271B and 273B that deal with penalty for non-compliance with the provisions of section 44AB.

The Circular suggested that a penalty need not be imposed on assessees if no prejudice is caused to the Department on account of any belated furnishing of an audit report. The Circular, being of a binding nature, insofar as the Department is concerned, the Assessing Authority, First Appellate Authority, and the Appellate Tribunal ought to have taken due note of it while deciding on whether or not a penalty was called for in relation to the assessees.

Thus, the assessee cannot be seen as someone who did not establish a reasonable cause for the belated filing of the audit reports before the Assessing Authority. Therefore, the peremptory phraseology used in section 273B mandated that no penalty under section 271B be imposed on them.

2025

***Shrishaila Mallikarjun Traders v. Income-tax
Officer***

ITAT Bangalore

Section 271B of The Income-Tax Act, 1961 - Penalty for failure to Get Accounts Audited

Where due to sudden illness of main partner and unexpected departure of accountant who was responsible for maintaining accounts of firm, assessee could not get accounts audited as per provisions of section 44AB and file audit report within time, assessee had demonstrated that there was a reasonable cause for failure to submit audit report on or before extended due date, therefore, penalty levied under section 271B was to be cancelled.

Students may refer Lesson 10, titled "Audit Principles and Techniques" of paper 3 "Compliance Management, Audit & Due Diligence" under professional programme for aspects relating to "Audit Principles and Techniques".

LESSON ROUNDUP

- The provisions of Tax Audit were first introduced in the Finance Act, 1984. Tax audit is an examination or review of accounts of any business or profession carried out by taxpayers from an income tax perspective. Any business entity or an individual exceeding certain threshold limits of turnover is liable to get the accounts audited.
- Section 44AB of the Income Tax Act, 1961, outlines provisions related to tax audits, aiming to ensure the accuracy and transparency of financial records maintained by taxpayers.
- The provision related to applicability of Tax Audit for person carrying on Business, Profession, person opting for presumptive taxation scheme (Section 44AD / 44ADA / 44AE / 44BB / 44BBB)
- Specified Due Date for furnishing Tax Audit Report - The specified date is one month prior to the due date for filing the return under Section 139(1).
- Definition of Accountant - *“accountant” means a chartered accountant as defined in clause (b) of subsection(1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) who holds a valid certificate of practice under sub-section (1) of section 6 of that Act, but does not include...*
- Meaning of Sales, Turnover and Gross Receipts - The terms “Sales”, “Turnover” or “Gross Receipts” are commercial terms, and should be construed in accordance with the method of accounting regularly employed by the Assessee.
- Maintenance of Books of Accounts - The Income Tax Act has specified the books of accounts that are required to be maintained for the purpose of Income Tax. These have been prescribed under section 44AA and Rule 6F.
- *Specified professionals include any person engaged in Legal, Medical, Engineering, Architectural, Technical Consultancy, Interior decoration, Film artist, Authorized Representative, Accountancy Profession, Company secretary, or Information Technology*
- Rule 6F of the Income-tax Rules prescribes the list of books of accounts to be maintained under section 44AA(3).
- The tax audit report has to be furnished in the forms prescribed below:
 - **Form No. 3CA/3CB** is a format of audit report.
 - **Form 3CD** – Statement of Particulars.
- **Penalty for Non-Compliance** - If any person who is required to comply with section 44AB fails to get his accounts audited in respect of any year or years as required under section 44AB or furnish such report as required under section 44AB, the Assessing Officer may impose a penalty. The penalty shall be lower of the following amounts:
 - (a) 0.5% of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such year or years.
 - (b) Rs. 1,50,000.

TEST YOUR SELF**Practical Question****Question 1.**

Mrs. Seema runs a women's boutique in Jaipur and has turnover of ₹1.6 crore in FY 2023–24. She received 98% of the receipts via UPI, debit card, and online transfer. Her profit is declared at 6.5% of turnover. Determine whether she is eligible for presumptive taxation under Section 44AD and whether tax audit is applicable. Also advise her ITR form and due date.

Question 2.

Mr. Ajay owns 7 goods carriages used for transport business. During FY 2023–24, he earned total freight income of ₹24 lakhs. He wants to declare actual profit of ₹4.5 lakhs, which is lower than deemed profit under Section 44AE. Analyse whether Section 44AE applies, if tax audit is needed, due date for audit and ITR, and form to be used.

Question 3.

Mr. Ramesh started a general store in July 2023. In the first year (FY 2023–24), he achieved turnover of ₹55 lakhs and declared a profit of 5% (i.e., ₹2.75 lakhs). He opts for presumptive taxation for the first time. Advise whether audit is applicable, which section applies, ITR form to use, and any caution for future years if he exits presumptive scheme.

Question 4.

M/s J & Co. is a partnership firm providing digital marketing services. During FY 2023–24, its gross receipts were ₹62 lakhs, with actual profit of ₹23 lakhs. The firm opts for presumptive taxation under Section 44ADA. State whether books/audit are required ITR form to be filed, and due date of return. Will audit be applicable if they choose to declare lower income in future?

Theoretical Question

1. What is Tax Audit? Explain the provision of section 44AB with respect to applicability of Tax Audit?
2. Explain the situation / circumstances wherein the Tax Audit is not applicable?
3. What is the specified date for obtaining Tax Audit Report?
4. Who is qualified to conduct Tax Audit as explained in explanation to section 288(2)(iv) of the Income Tax Act, 1961?
5. Explain the term 'Sales', 'Turnover', 'Gross Receipt' with respect to determining the applicability of Tax Audit.
6. Who is required to maintain Books of Accounts u/s 44AA? Also give brief details with respect to consequences of non-compliance of maintenance of books of accounts.
7. Briefly outline the list of books of accounts to be maintained as per rule 6F of the Income tax Rules, 1962.
8. What are the consequences for failure to furnish Tax Audit Report?

LIST OF FURTHER READINGS

- **Professional Guide to Tax Audit**
Author: G. Sekar
Publisher: Commercial Law Publishers (India) Pvt. Ltd.
- **Direct Taxes Law and Practice**
Author: Dr. Vinod K. Singhania & Dr. Kapil Singhania
Publisher: Taxmann
- **Direct Taxes Ready Reckoner with Tax Planning**
Author: Dr. Girish Ahuja & Dr. Ravi Gupta
Publisher: Wolters Kluwer

OTHER REFERENCES (INCLUDING WEBSITES AND VIDEO LINKS)

- Income Tax Act, 1961: <https://www.incometaxindia.gov.in/Pages/acts/income-tax-act.aspx>
- Income Tax Rules, 1962: <https://www.incometaxindia.gov.in/Pages/rules/income-tax-rules-1962.aspx>
- Circulars: <https://www.incometaxindia.gov.in/Pages/communications/circulars.aspx>
- Notifications: <https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx>

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KEY CONCEPTS

■ Assessment ■ Self-Assessment ■ Summary Assessment ■ Scrutiny Assessment ■ Best Judgement Assessment
■ Income Escaping Assessment ■ Faceless Assessment ■ Time limit to complete assessment ■ Rectification of Mistakes ■ Demand Notice

Learning Objectives

To understand the:

- Understanding the framework
- Familiarize with different types of Assessments
- What is Faceless Assessment?
- Reference to Valuation officer
- Direction for Special Audit
- What is Summary Assessment?
- Power of Commissioner to issue direction
- When can order for Re-Assessment be issued?
- Application of Rectification procedures
- Demand Notice

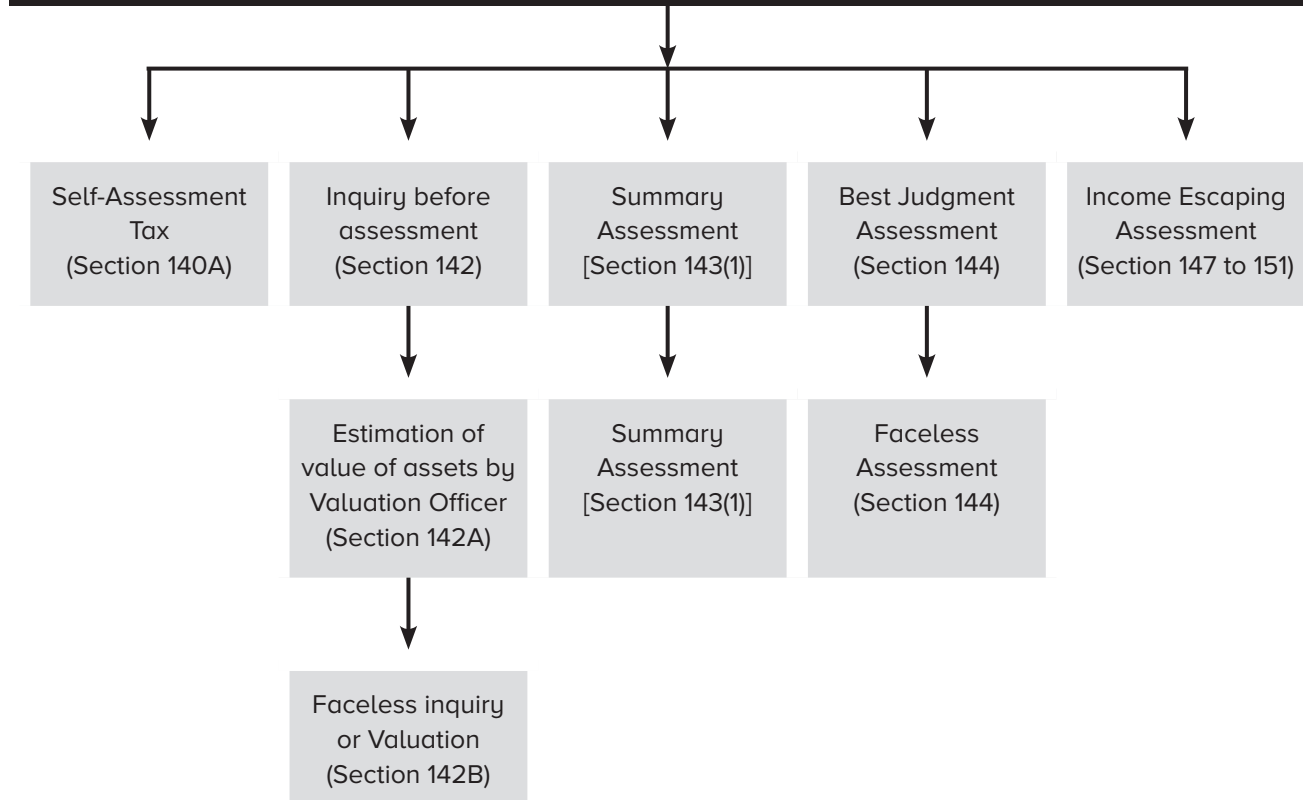
Lesson Outline

➤ Assessment	➤ Time Limit to complete the Assessment, Re-assessment & Re-computation
➤ Types of Assessment	➤ Faceless Assessment of Income Escaping Assessment
➤ Self-Assessment	➤ Rectification of Mistakes
➤ Inquiry before Assessment	➤ Demand Notice
➤ Summary Assessment/Processing of Return	➤ Lesson Round-Up
➤ Scrutiny Assessment	➤ Test Yourself
➤ Best Judgement Assessment	➤ List of Further Readings
➤ Income Escaping Assessment	➤ Other References
➤ Faceless Assessment	

REGULATORY FRAMEWORK

Sections	Income-tax Act, 1961
Section 140A	Self-Assessment
Section 142	Inquiry before Assessment
Section 142A	Estimation of value of an Assets by Valuation Officer
Section 142B	Faceless Inquiry and Valuation
Section 143(1)	Summary Assessment/Processing of Return
Section 143(2)	Notice of Scrutiny Assessment
Section 143(3)	Order of Scrutiny Assessment
Section 144	Best Judgement Assessment
Section 144A	Power of Joint Commissioner to issue direction
Section 144B	Faceless Assessment
Section 144B(4)	Authorities for various units
Section 147	Income Escaping Assessment or Re-Assessment
Section 148	Issue of notice where income has Escaped Assessment
Section 148A	Conducting inquiry, providing opportunity before issue of notice u/s 148
Section 148B	Prior Approval for Assessment, Reassessment or Re-computation in certain cases
Section 149	Time limit for issue of notice u/s 148
Section 150	Unlimited time limit to issue notice
Section 151	Specific Authority for issue of notice u/s 148 and u/s 148A
Section 151A	Faceless Assessment of Income Escaping Assessment
Section 152(1)	Tax Rate applicable for escaped income
Section 152(2)	Dropping of Assessment Proceeding
Section 153	Time limit for completion of Assessments and Re-assessments
Section 154	Rectification of Mistakes
Section 156	Demand Notice

CHAPTER OVERVIEW



INTRODUCTION

Every assessee has to submit his income details to the income tax department by filing his Income tax return. After submission of return of income, the next step is the processing of the income tax return by the income tax department. While processing, department verifies and examines the correctness of the income details provided by assessee. This process of examining the income tax return by the Income Tax Department is called "Assessment".

However, there are certain cases wherein if assessee does not submit his return of income then still assessment can be done by assessing officer.

Different types of assessment under the Income Tax act are summarized below

No.	Assessment U/s	Types of Assessment
1	140A	Self-Assessment
2	143(1)	Summary Assessment / Refund Order or Demand Order
3	143(3)	Scrutiny Assessment / Regular Assessment
4	144	Best Judgement Assessment
5	144B	Faceless Assessment
6	147	Income Escaping Assessment

SELF-ASSESSMENT [SECTION 140A]

Section 140A of income tax act deals with “Self-Assessment Tax” wherein a person himself assesses his tax liability on the income earned during the particular previous year and submit income tax return to the Income tax department.

It mandates that taxpayers to calculate and pay the remaining tax due after considering advance tax, TDS, TCS, and other credits before filing their Income Tax Return (ITR).

If there is any tax liability, the same must be paid before submitting the return under section 139. Failure to pay this tax may result in interest under **Section 234A, 234B, and 234C** and penalties.

Total tax payable by the assessee is calculated after considering the following.

- I. the amount of tax already paid under any provision of the Income Tax Act, 1961;
- II. any tax deducted or collected at source;
- III. any relief of tax or deduction of tax claimed under section 90 or section 91 on account of tax paid in a country outside India;
- IV. any relief of tax claimed under section 90A on account of tax paid in any specified territory outside India referred to in that section;
- V. any tax credit claimed to be set off in accordance with the provisions of section 115JAA or section 115JD;
- VI. any relief of tax claimed u/s 89;
- VII. any tax or interest payable as per provision of section 191(2).

Adjustments required to compute Self-Assessment Tax Payable u/s 140A:

How to compute Self-Assessment Tax	
Tax on Net income (Including Surcharge and HEC)	**
Add: (Adjustment)	
● Fees under section 234F	**
● Interest Under Section 234A/234B/234C (Based on Income declared in return of income)	**
Total Tax, Interest and Fees	***
Less: (Adjustment)	**
● Taxes (Advance Tax, TDS, TCS)	**
● Credit (MAT credit u/s 115JAA/AMT credit u/s 115D)	**
● Relief (u/s 90/90A/91A)	**
● Others [Any tax/interest payable u/s 191(2)]	**
Self-Assessment Tax (SAT) payable under section 140A	**

Adjustment of Self-Assessment Tax (SAT)	
Amount paid as SAT < Income Tax computed as per Return	Amount so paid shall be adjusted 1. First with Fees and Interest 2. Balance with Tax Payable

Note:

- If there is delay in furnishing ROI (Return of Income) assessee required to pay late u/s 234F along with Interest as mention above.
- After regular assessment under section 143 and 144, whatever amount paid under section 140A (Self-Assessment tax) shall be deemed to be paid towards such regular assessment.
- If any amount payable under the income tax act towards tax, interest and fee which assessee fails to pay, he shall be deemed to be an assessee in default.

Illustration 1:

Whether delayed payment of Self-Assessment Tax (SAT) along with Interest could be termed as Evasion of Tax?

It was held that judgment in Confident Projects (India) (P.) Ltd. 2021 (2) TMI 75 – Karnataka High Court S.P. Velayutham (2022) (2) TMI 50 – Madras High Court and M/s. Health Bio Teach Ltd. others 2023 (9) TMI 1229 – Punjab and Haryana court have categorically held that a delay in the payment of **self-assessment tax does not constitute tax evasion** if the tax, along with applicable interest, is paid before the issuance of a notice.

Illustration 2:

Tax Calculation and Self-Assessment Tax Liability

Mr. AG, an individual taxpayer in India, has filed his income tax return for the financial year 2024-25. His tax calculations are as follows: Net Income Tax (Including Surcharge and HEC): ₹2,48,000, Interest under Section 234A/234B/234C (Total) = ₹31,320, Fees under Section 234F: ₹5,000. He is entitled for tax credit on account of Advance tax paid during FY 2024-25: ₹19,000 and TDS/TCS ₹7,200. Determine tax payable under section 140A. Does it make any changes if Mr AG pays ₹1,72,000 instead of actual Self-Assessment Tax (SAT) payable under section 140A. He also thought of paying only ₹28000 now. How does it deal with?

Solution:

Computation of Self-Assessment Tax (SAT) payable under section 140A

Tax on Net income (Including Surcharge and HEC)	2,48,000
Add: (Adjustment)	
● Fees under section 234F	5,000
● Interest Under Section 234A/234B/234C <i>(Based on Income declared in return of income)</i>	31,320
Total Tax, Interest and Fees	2,84,320
Less: (Adjustment)	
● Taxes (Advance Tax, TDS, TCS) [19000+7200]	26,200
● Credit (MAT credit u/s 115JAA/AMT credit u/s 115D)	-
● Relief (u/s 90/90A/91A)	-
● Others [Any tax/interest payable u/s 191(2)]	-
Self-Assessment Tax (SAT) payable under section 140A	2,58,120

- Mr. AG needs to pay ₹2,58,120 as Self-Assessment Tax under Section 140A before filing his income tax return to avoid further interest and penalties.
- If he pays Rs.1,72,000 then, (Tax Payment – Interest & Fees) shall be adjusted. Hence, (1,72,000 – 31,320 -5,000) = **Rs. 1,35,680 treated as Payment of Tax.**
- If he pays Rs. 28,000, then (Tax Payment – Interest & Fees) shall be adjusted. Hence, (28,000-5,000 Fees-23,000 Interest (Max. Adjusted) [out of 31320+5000] =Nil treated as Payment of Tax

Question for Practice:

Tax Calculation and Self-Assessment Tax Liability

1. Mr. KK, an individual taxpayer in India, has filed his income tax return for the financial year 2024-25. His tax calculations are as follows: Net Income Tax (Including Surcharge and HEC): ₹2,40,000, Interest under Section 234A/234B/234C (Total) = ₹26,340, Fees under Section 234F: ₹5,000. He is entitled for tax credit on account of Advance tax paid during FY 2024-25: ₹17,000 and TDS/TCS ₹5,000. Determine tax payable under section 140A. Does it make any changes if:
 - (a) Mr KK pays ₹1,68,000 instead of actual Self-Assessment Tax (SAT) payable under section 140A.
 - (b) He also thought of paying only Rs.22,000 now. How does it deal with?
 - (c) If Z fails to pay (*wholly/Partly*) such tax, interest or fee in accordance with the provisions.

[Answer: (1) 2,49,340 (a) 1,36,660 (b) Nil, (c) Treated as Assessee in Default]
2. Mr. Dutt, a self-employed professional running a consultancy firm, filed his income tax return for the financial year. Due to unexpected business expenses and cash flow issues, he was unable to pay the full Self-Assessment Tax (SAT) at the time of filing. While he was aware of the pending tax liability, he assumed he could clear the dues after stabilizing his financial position. A few months later, as his financial situation improved, Mr. Dutt voluntarily paid the outstanding tax along with the applicable interest under Sections 234A, 234B, and 234C. His payment was made before the concerned authority issued any notice regarding the pending SAT. But it will be treated as Tax Evasion from Mr.Dutt side by concern authority. It is tenable in law? Discuss with proper justification.

[Self-assessment tax does not constitute tax evasion if the tax, along with applicable interest, is paid before the issuance of a notice.]

INQUIRY BEFORE ASSESSMENT [SECTION 142]

Introduction	● The Income Tax Department issues notices for various reasons, such as non-filing of returns, discrepancies in filed returns, incomplete information, underreported income, suspected tax evasion, or reassessment proceedings. ● These notices are sent when required details are missing from the taxpayer's end. ● Specifically, a notice under Section 142(1) serves as a preliminary inquiry, requesting information from the assessee before an assessment is made under the Income Tax Act.

Notice u/s 142(1)		
Issued/ Served by	- Assessing Officer - Prescribed Income Tax Authority not below the rank of Income Tax officer as authorised by CBDT (Rule 12F)	
To	Any person who has made a return under section 139 or in whose case the time allowed under section 139(1) for furnishing the return has expired	
Purpose	To furnish return of his income (In case return not filed) To produce books of accounts/Documents as required by A.O. (But not more than 3 years prior to PY) To furnish in writing, information on such points/matters (including a statement of all assets and liabilities of the assessee, whether included in the accounts or not) as the A.O. may require subject to prior approval of Joint Commissioner.	
Audit, Special Audit and Inventory Valuation [Section 142 (2A), (2B), (2C), (2D)]		
Why?	If at any stage of the proceedings before him, at the opinion of Assessing Officer, having regard - To the nature and complexity of the accounts, - Volume of the accounts - Doubts about the correctness of the accounts, - Multiplicity of transactions in the accounts or - Specialized nature of business activity of the assessee, and - The interests of the revenue Assessing Officer may direct [with previous approval of Principal Chief Commissioner (PCC) or Chief Commissioner (CC) or the Principal Commissioner (PC) or Commissioner (C)] to Assessee.	
AO direct to assessee	- To get books of accounts audited by Chartered Accountant (CA) - To get Inventory Valued by Cost and Management Accountant (CMA) Key points: - CA and CMA to be nominated by PCC or CC or PC or C - Opportunity of being heard is to be given to the assessee before directing to get the accounts audited or inventory valued.	
Special Audit or Inventory Valuation	Who is empowered to direct?	AO is empowered to direct the special audit to be carried out in the case of any particular assessee even if the accounts of the assessee have already been audited under any other law for the time being in force or otherwise.
	Expenses borne by CG	Expenses incidental to, audit (including the remuneration of the accountant, cost accountants, qualified assistants, semi-qualified and other assistants should be paid by Central Government.

	Expenses determined by	Principal Chief Commissioner (PCC) or Chief Commissioner (CC) or the Principal Commissioner (PC) or Commissioner (C) <i>[i.e. PCC or CC or PC or C] as per Rule 14B</i>
Time Limit of Submission of Audit report/ Inventory Valuation/ Both	- It must be furnished to the AO by the assessee within the period specified by the Assessing Officer in his order. - The AO is, however, entitled, suo motu or on receipt of an application made in this behalf by the assessee for any good and sufficient reason to extend the time-limit by such further period or periods as he deems fit. - Further, the aggregate of the period originally fixed and the period or periods so extended should not exceed 180 days in any case. - This time of 180 days must be reckoned from the date on which the Assessing Officer's direction is received by the assessee.	
Consequence of failure to get special audit done	- AO is entitled to make a Best Judgment Assessment under section 144 in addition to imposing penalty or taking such steps as may be necessary under the law. - If CA/CMA declined to undertake the audit of the assessee's accounts, the assessee could not be held responsible. The Supreme Court held that if, for a frivolous reason, the Chartered Accountant declined to undertake the audit of the assessee's accounts, the assessee could not be held responsible. [Swadeshi Polytex Ltd. v. ITO [1983] 144 ITR 171 (SC)]	
Assessee to be given an opportunity of being heard		
Opportunity of being heard for	Any material gathered on the basis of – - Any inquiry under section 142(2); or - Any audit or inventory valuation under section 142(2A) which is proposed to be utilized for the purposes of the assessment.	
Not required in case of Best Judgment Assessment	If, however, the assessment is in nature of a best judgment assessment under section 144, it is not obligatory for the Assessing Officer to give the assessee an opportunity to be heard, before passing the assessment order on the basis of the inquiry conducted under section 142(2) or audit report or inventory valuation report under section 142(2A).	

Analysis of Section 142 - Inquiry Before Assessment

1. Issue of notice to the assessee to submit return (if not submitted earlier):

If the person fails to furnish his return of income as per the timelines given in section 139(1) Assessing officer may serve a notice after the end of the relevant assessment year requiring such person to furnish his return of income.

The Assessing Officer may ask to produce, or cause to be produced, such accounts or documents and to furnish in writing and verified in the prescribed manner information in such form and on such points or matters (including a statement of all assets and liabilities of the assessee, whether included in the

accounts or not]. However, the previous approval of the Joint Commissioner shall be obtained before requiring the assessee to furnish a statement of all assets and liabilities not included in the accounts. Further, the Assessing Officer shall not require the production of any accounts relating to a period more than three years prior to the previous year.

2. **Make Inquiry and give opportunity of being heard u/s 142(2):** For the purpose of obtaining full information in respect of the income or loss of any person, the Assessing Officer may make such inquiry as he considers necessary.
3. **Give direction to get Books of Accounts Audited u/s 142(2A) to (2D):**
 - I. **AO Direction for Audit – Section 142(2A) :** Having regard to the nature and complexity of the accounts volume of the accounts, doubts about the correctness of the accounts, multiplicity of transaction in the accounts or specialised nature of business activity of the assessee and the interests of the revenue, assessing officer is of the opinion that it is necessary so to do order for the audit, then with the previous approval of the Principal Chief Commissioner or Chief Commissioner, Principal commissioner or commissioner the Assessing Officer may direct an assessee to get his accounts audited by an accountant and furnish reports on the same and the stock valued by a cost accountant and furnish a reports on the same. Before initiate of such direction an opportunity of being heard is to be given to the assessee.
 - II. **As per Section 142(2B)** If the accounts of assessee is already audited under any of the Act, still the fresh direction can be given for the same.
 - III. **As per section 142 (2C)** Every report under sub-section (2A) shall be furnished by the assessee to the Assessing Officer within the period as specified by the Assessing Officer. However, the Assessing Officer may, Suo motu, or on an application made in this behalf by the assessee and for any good and sufficient reason, extend the said period by such further period or periods as he thinks fit but **shall not exceed 180 days** from the date on which the direction under sub-section (2A) is received by the assessee.
 - IV. **As per section 142 (2D),** the expenses of, and incidental to, such audit (including the remuneration of the accountant] shall be determined by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner in accordance with such guidelines as may be prescribed and the **expenses so determined shall be paid by the Central Government.**
4. **Opportunity of being heard:** The Assessing offer must provide an opportunity of being heard in respect of any material gathered as per inquiry u/s 142(2) and as per direction of audit and inventory valuation u/s 142(2A), however no such opportunity is provided if the assessment is made under section 144.
5. **Consequence if not following the direction given by AO u/s 142(1) and 142(2A):** If the assessee fails to give the reply of notice received u/s 142(1) [Notice to submit return] or audit of account u/s 142(2A) it may result of the following:
 - a. Best Judgement assessment u/s 144.
 - b. Penalty u/s 272(1)(b) which is Rs.10,000.
 - c. Prosecution u/s 276D
 - d. Issue warrant for search u/s 132.

CASE STUDY

Swadeshi Polytex Ltd. V. ITO

What happen if Audit report of the inventory valuation report is not submitted by the Chartered Accountant and Cost accountant in the given time frame:

In the case of Swadeshi Polytex Ltd. v. ITO (1983) 144 ITR 171 (SC) it was held that if the Chartered accountant decline to undertake the said assignment or does not complete the audit in the given time frame the assessee could not be held responsible hence best judgement assessment can not be done by the assessing officer.

Reliance Textiles Ltd.

The Principal Commissioner of Income Tax, acting under section 142(2A) of the Income Tax Act, nominated M/s. VK & Associates, a firm of Chartered Accountants, to audit the accounts of Reliance Textiles Ltd. for the financial year 2023-24. Reliance Textiles Ltd. was ready and willing to produce all necessary records and cooperate fully with the audit process. However, Mr. Pandey, the partner in charge of the audit at M/s. VK & Associates, informed the Assessing Officer and Reliance Textiles Ltd. that their firm would not be able to undertake the audit. The reason cited by Mr. Pandey was a minor disagreement with Reliance Textiles Ltd.'s management regarding a charitable donation made by the company, which Mr. Pandey believed should have been disclosed differently in the accounts. The Assessing Officer considered this a failure on the part of Reliance Textiles Ltd. to comply with the directions under section 142(2A) and initiated proceedings for a best judgment assessment under section 144(b). Reliance Textiles Ltd. appealed the Assessing Officer's decision, arguing that the refusal to audit was solely on the part of the nominated Chartered Accountant and for a frivolous reason. The matter eventually reached the Supreme Court, drawing on the precedent set in *Swadeshi Polytex Ltd. v. ITO*.

The Supreme Court, referring to its earlier decision, held that Reliance Textiles Ltd. could not be held responsible for the Chartered Accountant's refusal to audit the accounts for a frivolous reason. The Court stated that in such a scenario, there was no default or failure on the assessee's part to comply with the direction issued under section 142(2A). Consequently, the best judgment assessment made by the Assessing Officer was set aside. The Supreme Court directed the Principal Commissioner to appoint another Chartered Accountant within one month to conduct the audit of Reliance Textiles Ltd.'s accounts.

This case study illustrates that **an assessee is not liable for the consequences of failing to get their accounts audited if the nominated Chartered Accountant refuses to do so for a frivolous reason, despite the assessee being willing to cooperate.** In such situations, the responsibility lies with the tax authorities to nominate another auditor to ensure the audit is conducted.

Analysis of the Case

1. Under what circumstances did the Supreme Court consider an assessee *not* liable for failure to get accounts audited when a nominated Chartered Accountant refused?
2. What specific section of the Income Tax Act empowers a Principal Chief Commissioner or Commissioner to nominate a Chartered Accountant for auditing an assessee's accounts?
3. In the scenario described, even though the assessee was willing to provide records, what was the initial consequence considered due to the Chartered Accountant's refusal?
4. What was the Supreme Court's ultimate decision regarding the Best Judgment Assessment made by the Assessing Officer in the described case?

5. What specific action did the Supreme Court direct the Assessing Officer to take after setting aside the Best Judgement Assessment?
6. What was the primary condition highlighted by the Supreme Court for an assessee to be considered *not* in default when a nominated auditor refuses?
7. Which specific sections of the Income Tax Act are directly referenced in the context of the Chartered Accountant's refusal and the assessee's potential liability?
8. What does "best judgement assessment" under section 144(b) typically imply when an assessee fails to comply with directions?
9. In the case discussed, what was the crucial factor that shifted the responsibility away from the assessee despite the non-completion of the audit?
10. What time frame was given to the Assessing Officer to appoint a new Chartered Accountant after the initial refusal?

Solution:

1. The Supreme Court held that if a nominated Chartered Accountant declined to undertake the audit **for a frivolous reason**, the assessee could not be held responsible for the failure to get the accounts audited.
2. Section 142(2A) of the Income Tax Act empowers a Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner to nominate a Chartered Accountant for auditing an assessee's accounts.
3. The initial consequence considered due to the Chartered Accountant's refusal was that it could be interpreted as a failure on the assessee's part to comply with the directions under section 142(2A), potentially leading to a Best Judgment Assessment.
4. The Supreme Court set aside the Best Judgment made by the Assessing Officer.
5. The Supreme Court directed the Assessing Officer to appoint another Chartered Accountant within one month to get the accounts audited.
6. The crucial condition was that the Chartered Accountant's refusal was for a frivolous reason; the assessee's willingness to produce records was also a significant factor.
7. The specific sections referenced are section 142(2A) (nomination of auditor) and section 144(b) (best judgment assessment for non-compliance).
8. Best judgement assessment under section 144(b) typically implies that the Assessing Officer will make an assessment of income and tax to the best of their judgment when an assessee fails to comply with relevant directions or requirements.
9. The crucial factor was the frivolous reason for the Chartered Accountant's refusal, coupled with the assessee's demonstrated willingness to cooperate by producing records.
10. The Assessing Officer was given one month to appoint another Chartered Accountant.

CASE 1

The Assessing Officer issued a notice under Section 142(1) to an assessee on 15th March 2025, asking him to file a return of income for Assessment Year 2024-25. The assessee, in response, filed a return showing a business loss and claimed the carry forward of the loss and unabsorbed depreciation. Would the assessee be eligible to carry forward the business loss and unabsorbed depreciation as per the Income Tax Act?

Solution:

In this case, the assessee filed a return of loss in response to a Section 142(1) notice, which was submitted after the due date specified under Section 139(1). As per the Income Tax Act: Business loss cannot be carried forward under Section 72(1), Section 73(2), or Section 73A, since the return was not filed within the due date. However, the unabsorbed depreciation can still be carried forward as per Section 32(2).

ESTIMATION OF VALUE OF ASSETS BY VALUATION OFFICER (VO) [SECTION 142A]

Reference to Valuation Officer (VO)	Who will refer to V.O?	The Assessing Officer can refer a case to a Valuation Officer
	For Reason	To estimate the value (including FMV) of any ● Asset, ● Property, or ● Investment for assessment or reassessment.
	Key Point	This reference can be made whether or not the Assessing Officer is satisfied with the assessee's accounts.
Estimation based on	● Considering evidence from the assessee and any other evidence. ● The assessee must be given an opportunity to be heard. ● If the assessee is not cooperative, the Valuation Officer can estimate the value based on their best judgment.	
Valuation Report Submission	By	The Valuation Officer
	To	Assessing Officer and the Assessee
	Period	Within 6 months from the end of the month in which the reference is made.
Use of Valuation Report in Assessment	● Upon receiving the report, the Assessing Officer may take it into account during assessment or reassessment. ● The assessee must be given an opportunity to be heard before the report is considered.	

Analysis of Section 142A - Estimation of Value of Assets by Valuation Officer (VO)

1. The Assessing Officer may, for the purposes of assessment or reassessment, make a reference to a Valuation Officer to estimate the value, including fair market value, of any asset, property or investment and submit a copy of report to him.

2. The Assessing Officer may make a reference to the Valuation Officer whether or not he is satisfied about the correctness or completeness of the accounts of the assessee.
3. The Valuation Officer, on a reference made, shall, for the purpose of estimating the value of the asset, property or investment, have all the powers that he has under section 38A of the Wealth Tax Act, 1957.
4. The Valuation Officer shall, estimate the value of the asset, property or investment after taking into account such evidence as the assessee may produce and any other evidence in his possession gathered, after giving an opportunity of being heard to the assessee.
5. The Valuation Officer may estimate the value of the asset, property or investment to the best of his judgment, if the assessee does not co-operate or comply with his directions.
6. The Valuation Officer shall send a copy of the report of the estimate made to the Assessing Officer and the assessee, within a period of six months from the end of the month in which a reference is made.
7. The Assessing Officer may, on receipt of the report from the Valuation Officer, and after giving the assessee an opportunity of being heard, take into account such report in making the assessment or reassessment.

CASE 1

During an Income Tax Assessment of Mr. Gupta, the Assessing Officer (AO) needed to determine the Fair Market Value (FMV) of an investment declared by Mr. Gupta. A.O referred to Valuation Officer to properly estimate the FMV of this investment, the AO has the authority to refer the case to a Valuation Officer (VO). This power to make a reference to the VO is available to the AO whether or not the AO is satisfied with Mr. Gupta 's financial accounts. The purpose of the reference is specifically for the estimation of value. The VO, upon receiving the reference from the AO, will proceed to estimate the value of Mr. Gupta 's investment. In making this estimation, the VO will consider evidence presented by Mr. Gupta, as well as any other relevant evidence they may find. It is important to note that Mr. Gupta must be given an opportunity to be heard by the VO during this valuation process. This ensures fairness and allows Mr. Gupta to present his perspective on the value of the investment. In the event that Mr. Gupta is uncooperative during the valuation, the VO retains the authority to estimate the value based on their best judgment. Once the VO has completed the valuation, they are required to submit a valuation report to both the AO and Mr. Gupta. This report must be submitted within 6 months from the end of the month in which the AO initially made the reference to the VO. After receiving the valuation report from the VO, the AO may take the findings of this report into account when finalizing Mr. Gupta 's assessment or considering a reassessment. However, it is crucial that before the AO considers the VO's report in the assessment, Mr. Gupta must once again be given an opportunity to be heard by the AO. This allows Mr. Gupta to respond to the VO's valuation and its potential impact on his tax liability.

Questions for Practice:

1. Under what circumstances can an Assessing Officer (AO) refer a case to a Valuation Officer (VO) according to Section 142A?
2. What is the primary purpose for which an Assessing Officer would make a reference to a Valuation Officer?
3. Does the Assessing Officer need to be dissatisfied with the assessee's accounts to make a reference to the Valuation Officer? Explain your answer.
4. What are the key considerations a Valuation Officer takes into account when estimating the value of an asset, property, or investment?

5. What opportunity must be provided to the assessee during the Valuation Officer's estimation process?
6. What recourse does a Valuation Officer have if the assessee is uncooperative during the valuation process?
7. To whom does the Valuation Officer submit the valuation report upon completion?
8. What is the timeframe within which the Valuation Officer is expected to submit the valuation report?
9. How can the Assessing Officer utilize the valuation report received from the Valuation Officer?
10. What procedural safeguard is in place for the assessee after the Assessing Officer receives the valuation report but before it is considered in the assessment?

Solution:

1. An Assessing Officer (AO) can refer a case to a Valuation Officer (VO) under Section 142A **to estimate the value, including Fair Market Value (FMV)**, of any asset, property, or investment for the purpose of assessment or reassessment.
2. The primary purpose of referring a case to a Valuation Officer is to obtain an expert estimate of the value of an asset, property, or investment when the Assessing Officer deems it necessary for accurate assessment or reassessment.
3. No, the Assessing Officer does not need to be dissatisfied with the assessee's accounts to make a reference to the Valuation Officer. The reference can be made regardless of the Assessing Officer's satisfaction with the accounts.
4. While estimating value, a Valuation Officer considers evidence provided by the assessee, any other relevant evidence, and ensures the assessee is given an opportunity to be heard.
5. During the Valuation Officer's estimation process, the assessee must be given an opportunity to be heard regarding the valuation of their asset, property, or investment.
6. If the assessee is uncooperative, the Valuation Officer is authorized to estimate the value of the asset, property, or investment based on their best judgment.
7. The Valuation Officer is required to submit the valuation report to both the Assessing Officer and the assessee upon its completion.
8. The Valuation Officer must submit the valuation report **within six months** from the end of the month in which the reference was made by the Assessing Officer.
9. Upon receiving the valuation report, the Assessing Officer may take the findings and conclusions of the report into account while conducting the assessment or reassessment of the assessee's income.
10. Before the Assessing Officer considers the valuation report in the assessment, the assessee must be provided with an opportunity to be heard regarding the content and implications of the valuation report.

CASE 2

While examining the accounts of KK Ltd., the Assessing Officer (AO) exercised his powers under Section 142(2A) and directed the company to get its accounts audited. KK Ltd. challenged this order, claiming that the AO did not provide an opportunity to be heard before passing the order. Is the action of the Assessing Officer valid, or was it required to give the company a prior opportunity before issuing the order?

Solution:

As per the proviso to Section 142(2A), the Assessing Officer (AO) must give the assessee a reasonable opportunity to be heard before directing an audit of the accounts. In this case, since KK Ltd. was not given such an opportunity, the AO's order is not valid.

FACELESS INQUIRY AND VALUATION [SECTION 142B]

Key Features of Scheme	Scheme	Faceless Inquiry & Valuation Scheme
	Who will notify?	- The Central Government is empowered to notify in Official Gazette a scheme for faceless processes for eliminating physical interface. Notification No. 19/2022 dated 30.3.2022 has been issued for faceless inquiry and valuation.
	Objectives	- To impart greater efficiency, transparency, and accountability To eliminate physical interface where technologically feasible, optimizing resource utilization, and To introduce team-based processes with dynamic jurisdiction.
Purpose (Coverage)	Faceless Inquiry & Valuation (Based on Automated Allocation) for the purpose of - Issuing notice under section 142(1) or - Making inquiry to obtain full information in respect of the income or loss of any person under section 142(2) or - Directing the assessee to get the accounts audited by an accountant or inventory valuation by a cost accountant under section 142(2A) or - Making a reference to the valuation officer to estimate the value of any asset, property or investment under section 142A.	
Automated allocation means	Automated allocation uses algorithms, including AI and machine learning , for randomized case allocation to optimize resource use. The process is similar to the faceless assessment under Section 144B .	

Section 142B empower the Central Government to notify the scheme for faceless processes for eliminating physical interface.

Faceless Scheme [Section 142B(1)]: The Central Government is empowered to make a scheme [faceless enquiry and valuation scheme] by notification in the official gazette for the purpose of:

- [a] Issue notice u/s 142[1] or
- [b] Making enquiry to obtain full information in respect of income or loss of any person u/s 142[2] or
- [c] directing the assessee to get his accounts audited by an accountant u/s 142[2A] or
- [d] making a reference to the valuation officer to estimate the value of any asset, property or investment u/s 142A.

The objective of the scheme is to impart greater efficiency, transparency and accountability by

- [a] eliminating the interface between the income-tax authority or Valuation Officer and the assessee or any person to the extent technologically feasible;
- [b] optimising utilisation of the resources through economies of scale and functional specialisation;
- [c] introducing a team-based issuance of notice or making of enquiries or issuance of directions or valuation with dynamic jurisdiction.

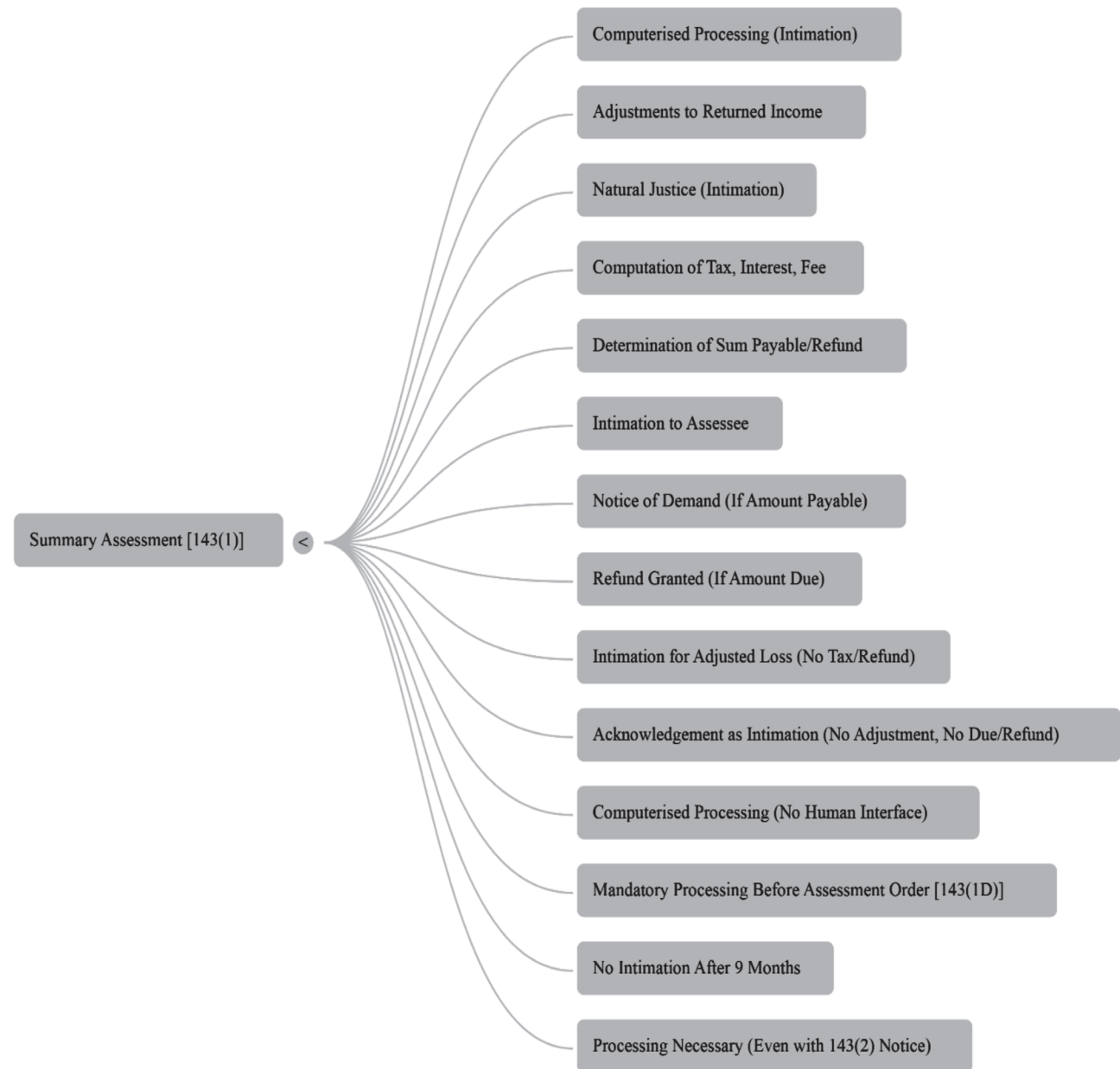
CASE 1

Miss. Chaya, receives a notice from the Income Tax Department. This notice is issued under Section 142(1) of the Income Tax Act, requiring her to furnish certain information regarding her income. Under the new Faceless Inquiry & Valuation Scheme, notified by the Central Government on 30.3.2022, this process will be largely faceless. Instead of interacting physically with a specific assessing officer, Miss. Chaya's case will be subject to automated allocation. This means an algorithm, potentially using AI and machine learning, will randomly assign his case to a team of tax officials. This randomized allocation aims to optimize resource use and promote transparency and accountability. The objective of this scheme is to eliminate physical interface between Miss. Chaya and the tax authorities where technologically feasible. This is intended to bring greater efficiency, transparency, and accountability to the process of inquiry. The Faceless Inquiry & Valuation Scheme covers various actions the Income Tax Department might take. Besides issuing notices under Section 142(1), it also applies to:

- Making inquiries to obtain full information about income or loss under Section 142(2).
- Directing Miss. Chaya to get his accounts audited or inventory valued under Section 142(2A).
- Making a reference to a valuation officer to estimate the value of his assets under Section 142A.

The process is similar to the faceless assessment under Section 144B. This suggests that Miss. Chaya will likely be required to respond to the notice and provide the necessary information electronically, without needing to appear in person. The entire inquiry process, even if it involves further requests for information or clarifications, will ideally be conducted without direct physical interaction, leveraging technology for communication and document exchange.

In essence, the Faceless Inquiry & Valuation Scheme, under which Miss. Chaya's notice falls, aims to modernize and streamline tax inquiries and valuations by introducing a system based on automated allocation, team-based processes, and minimal physical interface, ultimately striving for a more efficient, transparent, and accountable tax administration.

SUMMARY ASSESSMENT/ PROCESSING OF RETURN [SECTION 143(1)]

Summary Assessment [Section 143 (1)]	- When a taxpayer files a return under Section 139 or in response to a notice under Section 142(1), it undergoes an automated summary assessment (also called “Intimation”) checks for errors, incorrect claims and inconsistencies with reference to preceding previous filed returns without human intervention. - The assessment is completed on the basis of return submitted by the assessee. - Assessing Officer can complete an assessment without passing a regular assessment order.

AO makes adjustments in	● Arithmetical error in the return ● Incorrect Claim apparent from the records ● Inconsistency in the return, with respect to the information in the return of any preceding previous year ● Disallowance of loss claimed, if return of the previous year for which set off of loss is claimed was furnished beyond the due date specified ● Disallowance of loss claimed/expenses/Deductions/ Increase in income indicated in audit report but excluded in income in return ● Disallowance of deduction claimed under section 10AA or under any of the provisions of Chapter VI-A under the heading “C.—Deductions in respect of certain incomes”, if the return is furnished beyond the due date specified ● Addition of income appearing in Form 26AS or Form 16A or Form 16 which has not been included in computing the total income in the return
Opportunity	● Before making any adjustment, an opportunity shall be provided to the assessee to explain and rectify the same within 30 days of issuance of such intimation and the response so received shall be considered before making such adjustments.
Tax liability	● The total tax liability is determined after considering TDS, advance tax, deductions, and reliefs. ● If additional tax is due, a Notice of Demand is issued, requiring payment within 30 days. ● If a refund is due, it is processed accordingly.
Processing Time	● The intimation must be sent to the taxpayer within 9 months from the end of the financial year in which the return was filed. ● If no changes are needed, the return acknowledgment itself is considered as the intimation under Section 143(1).
Mandatory Processing	● Even if a scrutiny notice is issued under Section 143(2), the return must first be processed under Section 143(1) to ensure compliance.

Analysis of Section 143(1) - Summary Assessment/ Processing of Return

Summary assessment is the assessment without human intervention. Assessment under section 143(1) is like preliminary checking of the income tax return. Where a return has been made under section 139(1) or in response to notice issued u/s 142(1) such return shall be processed in the following manner.

The total income or loss is computed after making the following adjustments (if any),

- i. any arithmetical error in the return; or
- ii. an incorrect claim, if such incorrect claim is apparent from any information in the return; or
- iii. inconsistency in the return, with respect to the information in the return of any preceding previous year
- iv. disallowance of loss claimed, if return of the previous year for which set-off of loss is claimed was furnished beyond the due date specified under section 139(1); or
- v. disallowance of expenditure or increase in income indicating in the audit report but not taken into account in computing the total income in the return; or
- vi. disallowance of deduction claimed u/s 10AA, or under any of the provision of chapter VI-A under the

heading “C, -- Deduction in respect of certain income” if the return is furnished beyond the due date specified under section 139(1); or

After making the aforesaid adjustments, income tax department sends an intimation under section 143(1) in which comparative income tax computation [i.e., as provided by an assessee in income tax return and as computed u/s 143(1), which serves as demand notice if there is a tax liability otherwise simply an intimation about processing of return of income.

If there is no change in income and expense as per filed return of income and correspondingly no tax, interest and fees is payable and no refund is due to him, **but there is a loss declared in return by the assessee which is adjusted**, in that case also the **Intimation** shall be sent to assessee. **[First proviso]**

No such intimation is shall be sent to assessee **after the expiry of 9 months from the end of the financial year** in which the return is made. **[Second Proviso]**

If Intimation received by the assessee wherein demand determined then such intimation is treated as “**Notice of Demand**” and the said amount must be **paid within 30 days of receiving such intimation** otherwise he will be treated as an assessee in default.

SCRUTINY ASSESSMENT [SECTION 143(2) / 143(3)]

Notice of Scrutiny Assessment [Section 143(2)]

If Assessee files his return of income u/s 139 or in response to a notice received u/s 142(1), The assessing officer not below the rank of ITO shall serve a notice on the assessee if AO considers it necessary to ensure that,

- i. The assessee has not understated the income or
- ii. Has not computed excessive loss or
- iii. Has not short paid the tax

However, no such notice can be issued after the expiry of 3 months from the end of the financial year in which the return is furnished.

For example: If assessee files his return of income for FY 2024-25 in July 2025, since return of income for FY 2024-25 is filed in FY 2025-26 which ends on 31st March 2026, hence notice must be issued within 3 months from the date 31st March 2026 i.e., upto 30th June 2026.

If assessee does not complying with the notice issued u/s 143(2), may entail an ex-parte, best judgement assessment u/s 144.

Order of Scrutiny Assessment [Section 143(3)]

Scrutiny Assessment [Section 143(3)] Purpose	Unlike summary assessment, which is automated, regular (scrutiny) assessment involves a detailed examination of a taxpayer's return by the Assessing Officer (AO) to verify its accuracy. This is done to ensure that the taxpayer has: ● Not understated income, ● Not overstated losses, or ● Not underpaid taxes in any way.
Notice for Scrutiny	● If the AO finds it necessary, he issues a scrutiny notice to the taxpayer. ● This notice cannot be served later than 3 months from the end of the financial year in which the return was filed. (Section 143(2)).

Assessment Process Section 143(3)	● The taxpayer must provide evidence to support the return. ● The AO may also collect other relevant material for verification. ● Based on this, the AO finalizes the assessment by passing an order: ○ Determining the total income/loss of the taxpayer. ○ Specifying the amount of tax payable or refund due.
Special Cases – Tax-Exempt Institutions	● Research associations, news agencies, and certain institutions claiming exemptions under Section 10 must file their returns. ● The AO cannot deny exemption without informing the Central Government or the relevant authority. ● If an institution violates the exemption conditions, a recommendation for withdrawal of approval can be sent to the Central Government after giving the entity a chance to respond.

Assessee may appear on the date as specified in notice and provides the necessary document, material and evidence to Assessing Officer or provide the same in electronic form as well, based on material & evidences furnished by the assessee, assessing officer shall determine the income or loss of assessee by way of passing an order u/s 143(3) along with determination of tax payable or refundable to assessee.

What will happen if the organizations register u/s 10(21)/10(22B)/10(23A)/10(23B) violate any conditions prescribed in the given sections:

- There are many such organizations wherein the government has given exemption under section 10(21)/10(22B)/10(23A)/10(23B), to enjoy such exemption organizations need to fulfil some conditions prescribed in 10(21)/10(22B)/10(23A)/10(23B).
- If these organizations violate any such condition, then Assessing officer cannot disallow such exemption.
- AO must inform to Government, Prescribed authority about the same and wait for government instruction/ notification.
- Assessing officer can disallow the exemption u/s 143(3) if government or prescribed authority has rescinded the notification withdrawing the exemption.

What will happen if the trust or any institutions referred 10(23C) or institutions referred in section 11 violate any conditions prescribed in the given sections:

- If Assessing officer has a reason to believe that any institution or trust referred u/s 10(23C) or section 11 has committed any specified violation as defined in section 12AB (4) of income tax act.
- Then Assessing officer shall send a reference to Principal commissioner of income tax/ Commissioner of income tax to withdraw the approval granted and wait for the instruction.
- If Principal commissioner of income tax / Commissioner of income tax pass an order in writing, cancelling the registration then assessing officer makes an assessment and passes the order u/s 143(3).

Points to remember:

- Assessment under section 143(3) should be completed (order passed) within 12 months from the end of relevant assessment year.

- ii. Time period to complete the assessment **does not include** the period between the date on which assessing officer makes a reference to Principal commissioner of income tax/ Commissioner of income tax and the date of which copy of order received by such assessing officer.
- iii. The assessment under section 143(3) on or after 01-04-2021 shall be made as per the provision of section 144B (Faceless Assessment)

What are those specified violations on the basis of which Principal commissioner of income tax / Commissioner of income tax cancelling the registration:

- a. where any income derived from property held under trust, wholly or in part for charitable or religious purposes, has been applied, other than for the objects of the trust or institution; or
- b. the trust or institution has income from profits and gains of business which is not incidental to the attainment of its objectives or separate books of account are not maintained by such trust or institution in respect of the business which is incidental to the attainment of its objectives; or
- c. the trust or institution has applied any part of its income from the property held under a trust for private religious purposes, which does not enure for the benefit of the public; or
- d. the trust or institution established for charitable purpose created or established after the commencement of this Act, has applied any part of its income for the benefit of any particular religious community or caste; or
- e. any activity being carried out by the trust or institution is not genuine; or is not being carried out in accordance with all or any of the conditions subject to which it was registered; or

CASE 1

Mr. Rohan filed his income tax return for the financial year 2023-2024 in September 2024 under Section 139. Upon filing, his return underwent an automated summary assessment, also known as “Intimation,” without any direct intervention from an Assessing Officer. This process involved checks for arithmetical errors and incorrect claims apparent from the records. During this automated check, the system identified a potential arithmetical error in the calculation of his total income as well as an incorrect claim regarding a deduction that was not supported by the information provided in his return. Before making any adjustments to Mr. Rohan’s declared income, the Assessing Officer (through the automated system) issued intimation to him, providing an opportunity to explain and rectify the discrepancies within 30 days of the issuance of the intimation. Mr. Rohan received this intimation and reviewed the identified issues. He realized that he had indeed made a calculation error and the claimed deduction was not applicable to him. He submitted a response to the tax department rectifying the arithmetical error and withdrawing the incorrect claim within the stipulated 30-day period. The Assessing Officer considered Mr. Rohan’s response and then determined his final tax liability after considering the applicable TDS, advance tax, deductions, and reliefs. Based on the corrected calculations, it was determined that Mr. Rohan owed some additional tax. Consequently, a Notice of Demand was issued, requiring him to pay the balance amount within 30 days. Alternatively, if Mr. Rohan’s corrected return had resulted in an excess payment, a refund would have been processed accordingly.

The intimation regarding the summary assessment was sent to Mr. Rohan within 9 months from the end of the financial year in which he filed his return. Had no errors or inconsistencies been found, the return acknowledgment itself would have been considered as the intimation under Section 143(1). It’s important to note that even if the tax department had decided to conduct a more detailed scrutiny of Mr. Rohan’s return by issuing a notice under Section 143(2), the initial step would still have been the processing of his return under Section 143(1) to ensure basic compliance. This highlights the mandatory nature of the summary assessment process. In this case, since the issues were addressed during the initial intimation and response phase, a further scrutiny might not have been necessary. The Assessing Officer completed the assessment without passing a regular assessment order.

CASE 2

“Science Forward,” (non-profit research association) which claims tax exemption under Section 10 of the relevant tax regulations. Science Forward diligently filed its annual tax return for the financial year 2023-2024 on 30th September 2024. However, after reviewing the return, the Assessing Officer (AO) found some inconsistencies in the reported income and expenditure, raising concerns about potential understatement of income or overstatement of losses. Consequently, within three months from the end of the financial year 2024-2025, the AO issued a scrutiny notice to Science Forward under Section 143(2). This notice informed Science Forward that their return had been selected for a detailed examination under Section 143(3), also known as a scrutiny assessment. Upon receiving the notice, Science Forward was required to provide evidence and documentation to support the claims made in their tax return. The AO, in addition to examining the submitted documents, also collected other relevant material to verify the accuracy of the return. This might include looking into their financial records or project-related expenses.

After a thorough examination of the evidence and other collected material, the AO concluded that Science Forward had indeed violated some of the conditions attached to their tax-exempt status. Before proceeding to deny the exemption, the AO was obligated to inform the Central Government or the relevant authority about the potential violation. Furthermore, if the AO considered recommending a withdrawal of Science Forward’s approval for tax exemption, the AO would first have to provide Science Forward with an opportunity to respond to the findings. Finally, based on the evidence and after following the due process, the AO would pass an order under Section 143(3), determining the total income or loss of Science Forward and specifying the amount of tax payable, if any, due to the violation of exemption conditions. This entire process exemplifies a regular scrutiny assessment initiated to ensure tax compliance beyond a simple automated summary.

CASE 3

Consider the following scenario under the Income-tax Act, 1961:

Bloomfield Trust, registered under section 10(23C) (iv) as a charitable trust, is undergoing assessment under section 143(3). The Assessing Officer discovers that the trust has diverted a significant portion of its income for purposes other than charitable activities, violating the conditions for exemption under section 10(23C) (iv). Bloomfield Trust argues that it has rectified the diversion and should still be eligible for the exemption. Does the Assessing Officer have the authority to deny the exemption claimed by Bloomfield Trust under section 10(23C) (iv)?

Solution:

As per the second proviso to Section 143(3) of the Income Tax Act, if an educational institution that is exempt under Section 10(23C) (iv) has committed a “specified violation,” the Assessing Officer (AO) must refer the case to the Principal Commissioner or Commissioner for withdrawal of its approval or registration. One key **“specified violation”** under Section 10(23C) occurs when the **income of the institution is used for purposes other than its stated objectives**. The AO cannot finalize the assessment (i.e., determine the institution’s taxable income or loss) without considering the order of the Principal Commissioner or Commissioner regarding the cancellation of approval. If the Principal Commissioner or Commissioner cancels the institution’s approval, the AO can assess its income without granting the tax exemption under Section 10(23C). Suppose Bloomfield Trust is institution approved under Section 10(23C) (vi) but has been found to misuse its income. The AO refers the matter to the Principal Commissioner or Commissioner. If they decide to cancel its approval, the AO can assess its income without allowing the Section 10 exemption and treat it as a regular taxable entity.

CASE 4

Kaku Ltd. filed its return of income for Assessment Year 2024-25 on 26th September 2024. The return was selected for regular assessment under Section 143(3), and a notice under Section 143(2) was served on the company on 3rd July 2025. The company duly responded to the notice. Determine whether the service of the notice was within the prescribed time limit. If the notice was not served on time, can the assessment order be challenged by the assessee?

Solution:

The notice under Section 143(2) must be served within three months from the end of the financial year in which the return was filed. Tai Ltd. filed its return on 26th September 2024, so the notice should have been served by 30th June 2025. However, the notice was served on 3rd July 2025, making it time-barred.

BEST JUDGEMENT ASSESSMENT [SECTION 144]

A.O. shall make a best judgments assessment	Fails to file a return as required under Section 139 and has not submitted a revised or updated return. Fails to comply with a notice under Section 142(1) or a direction under Section 142(2A). Fails to respond to a notice under Section 143(2) after filing a return. In such cases, the AO will assess the total income or loss based on available information and determines the tax liability.
Opportunity to Respond	- Before completing the assessment, the AO must give the assessee an opportunity to explain why such an assessment should not be made, except when a prior notice under Section 142(1) has already been issued. - In nut shell, where a notice under section 142(1) has been issued prior to the making of an assessment under this section, it is not necessary to give such an opportunity.
Key Points	
Where assessment u/s 143(3) or u/s 144 is made	- Tax or interest paid u/s 143(1) shall deemed to have been paid towards regular assessment. - If no refund is due or amount refunded in excess of amount refundable on regular assessment, Whole or excess amount so refunded shall be deemed to be tax payable by the assessee.

Analysis of Section 144 – Best Judgement Assessment

Best judgement assessment is a procedure where the assessing officer determines the Income and tax liability based on their own judgement and knowledge, generally best judgement assessment can be done in case of the following scenario:

- If assessee fails to furnish return of income u/s 139(1) or u/s 139(4) i.e., belated return, or u/s 139(5) i.e., Revised return, or u/s 139(8A) i.e., updated return to correct the errors and omissions.
- If assessee fails to comply with notice issued u/s 142(1) i.e., notice requiring the taxpayer to submit certain information, books of accounts, or documents.

- iii. If assessee fails to comply with direction issued u/s 142(2A) i.e., Direction for Special Audit and Inventory valuation.
- iv. If assessee fails to comply with notice u/s 143(2) i.e., Scrutiny Notice.

Before initiating proceeding u/s 144 assessing officer must issue show cause notice by giving an opportunity of being heard to the assessee (please note no such opportunity of being heard given if assessee fails to comply with notice given u/s 142(1) i.e., notice requiring the taxpayer to submit certain information, books of accounts, or documents). Further, no refund can be granted under section 144.

The assessment under section 144 should be completed (order passed) within 12 months from the end of relevant assessment year.

Assessing officer determined the income to the best of his judgement, judgement of the assessing officer cannot be arbitrary and has to be based on some evidence. Ad hoc addition in income is not allowed.

CASE STUDY

Mr. Vivek was required to file his income tax return for the financial year 2023-24 by the due date as per Section 139. However, he failed to file his return and did not submit any revised or updated return. As a result of this failure, the Assessing Officer (AO) decided to initiate a Best Judgment Assessment under Section 144. Before finalizing the assessment, the AO was required to give Mr. Vivek an opportunity to explain why such an assessment should not be made. Let's assume the AO issued a notice to Mr. Vivek asking for an explanation. However, if the AO had already issued a notice to Mr. Vivek under Section 142(1) earlier, for example, asking for certain documents or information related to his income, and then the AO would not be required to give a separate opportunity to respond before making the best judgment assessment under Section 144.

Let's assume, for the sake of this case study, that the AO did not issue a notice under Section 142(1) prior to deciding on the Best Judgment Assessment and thus gave Mr. Vivek an opportunity to respond. If Mr. Vivek failed to provide a satisfactory explanation or did not respond at all, the AO would then proceed to assess Mr. Vivek's total income or loss based on the available information they possessed and determine his tax liability. Now, let's consider a situation where Mr. Vivek had paid some advance tax of ₹10,000 under Section 143(1) before the Best Judgment Assessment was made. According to the rules, this ₹10,000 would be considered to have been paid towards his final tax liability determined under the Best Judgment Assessment (which is a type of regular assessment).

Conversely, if, based on the AO's best judgment assessment, Mr. Vivek's actual tax liability turned out to be lower than the ₹10,000 he had already received as a refund under Section 143(1) (perhaps based on some preliminary calculations he had submitted before failing to file the full return), then the excess amount refunded would be considered as tax payable by Mr. Vivek.

Practice Questions?

1. Under what circumstances can an Assessing Officer (AO) make a best judgment assessment according to Section 144?
2. What is the primary responsibility of the AO when making a best judgment assessment?
3. What information does the AO utilize when determining income or loss under Section 144?
4. What procedural step is generally required by the AO before finalizing a best judgment assessment?

5. Under what specific circumstance is the AO *not* required to provide the assessee an opportunity to respond before a Section 144 assessment?
6. If an assessee has already paid tax or interest under Section 143(1) and a best judgment assessment is later made, how is the prior payment treated?
7. What happens if an assessee receives a tax refund that exceeds the amount refundable after a regular assessment following a best judgment assessment?
8. Explain the relationship between failing to file a tax return under Section 139 and a best judgment assessment.
9. Describe what it means to fail to comply with a notice under Section 142(1), and how it relates to Section 144.
10. How does failing to respond to a notice under Section 143(2) after filing a return potentially lead to a best judgment assessment?

Solution:

1. An Assessing Officer (AO) can make a best judgment assessment when an assessee fails to file a required tax return under Section 139 (and has not submitted a revised one), fails to comply with a notice under Section 142(1) or a direction under Section 142(2A), or fails to respond to a notice under Section 143(2) after filing a return.
2. The primary responsibility of the AO when making a best judgment assessment is to assess the total income or loss of the assessee based on the available information and then determines the corresponding tax liability.
3. When determining income or loss under Section 144, the AO will utilize the available information they possess related to the assessee's financial affairs and tax obligations.
4. Generally, before completing a best judgment assessment, the AO is required to provide the assessee with an opportunity to explain why such an assessment should not be made.
5. The AO is not required to give the assessee an opportunity to respond before a Section 144 assessment if a prior notice under Section 142(1) has already been issued to the assessee.
6. If tax or interest has already been paid by the assessee under Section 143(1) and a best judgment assessment is later made, the amount already paid is considered to have been paid towards the regular assessment.
7. If an assessee receives a tax refund that is in excess of the amount refundable based on the regular assessment following a best judgment assessment, the whole or the excess amount refunded is considered to be tax payable by the assessee.
8. Failing to file a tax return as required under Section 139 (and not submitting a revised or updated return) is one of the specific conditions under which an AO is authorized to initiate a best judgment assessment under Section 144.
9. Failing to comply with a notice under Section 142(1) refers to not providing the information or documents requested by the AO during the assessment process; this non-compliance can lead to a best judgment assessment under Section 144.
10. If an assessee files a tax return but then fails to respond to a notice issued under Section 143(2) (which is for scrutiny assessment), the AO can proceed to make a best judgment assessment under Section 144 due to the lack of cooperation.

POWER OF JOINT COMMISSIONER TO ISSUE DIRECTION [SECTION 144A]

1. Joint commissioner may **on his own motion** or **reference made by AO** or **on the application of assessee** call to examine the records of any proceeding in which assessment is pending.
2. If it is necessary then joint commissioner may issue such direction as he thinks fit for the **guidance of assessing officer** (Assistant commissioner / Deputy Commissioner / Income tax Officer i.e. AC/DC/ITO)
3. Direction given by Joint commissioner **binding** on the assessing officer.
4. If any direction issued which is **pre-judicial** to the assessee then an **opportunity of being heard** to be given to the assessee
5. **No appeal** can be filed against the direction issued by the joint commissioner.
6. Appeal can be filed against the **order** passed by the assessing officer based on the direction of the joint commissioner.

FACELESS ASSESSMENT [SECTION 144B]

The Faceless Assessment Scheme, introduced by the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020, came into effect from April 1, 2021. It aims to make tax assessment transparent, efficient, and technology-driven by eliminating physical interaction between taxpayers and tax officers.

1. Fully digital process for tax assessment through the Income Tax portal www.incometax.gov.in.
2. It is conducted under Section 144B for regular assessments, best judgment assessments, and reassessments.
3. No physical meetings between taxpayers and tax officers.
4. All notices, documents, and communications happen electronically.

The Central Government introduced a faceless assessment scheme for income escaping assessment. This applies to:

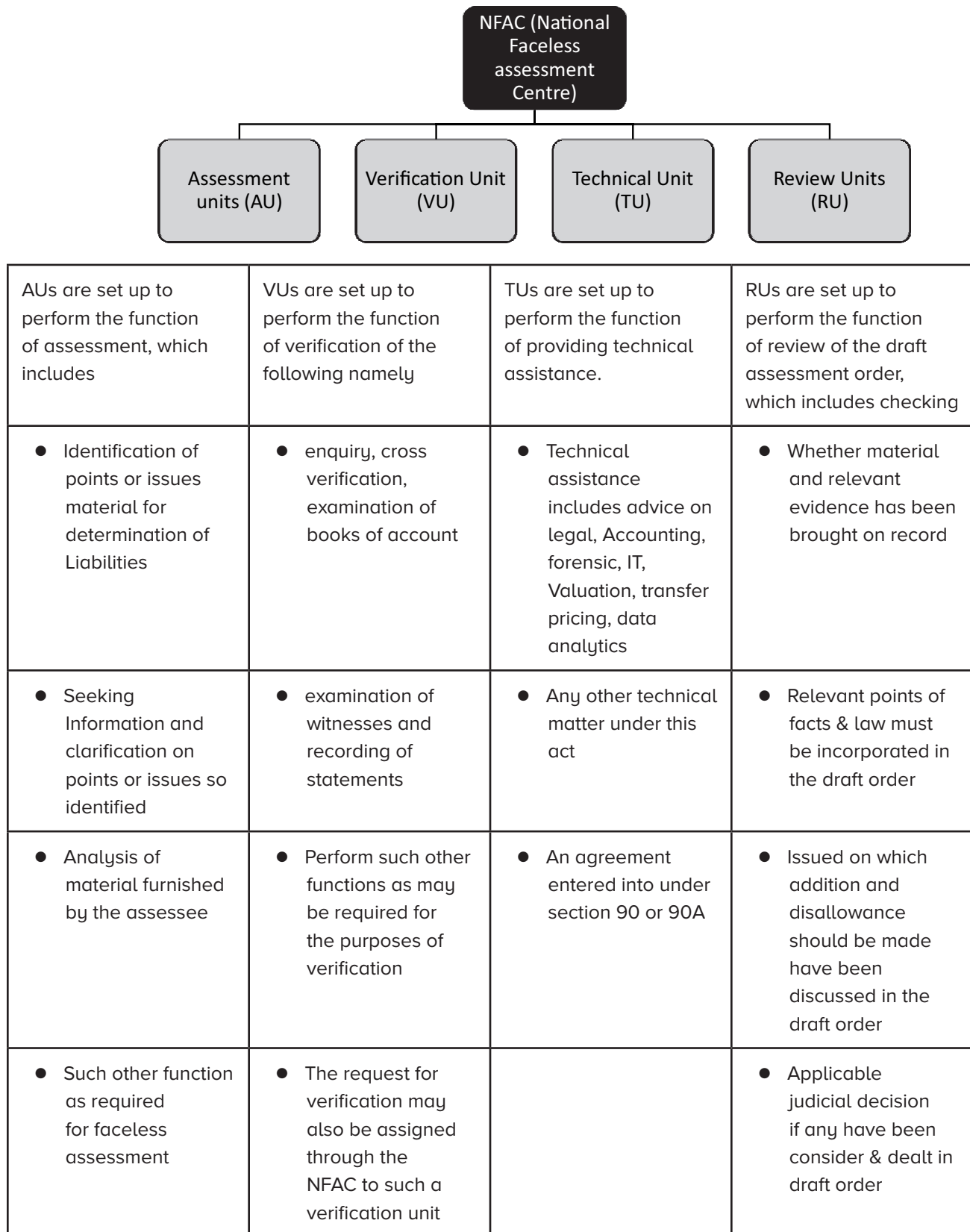
- Assessment, reassessment, or re-computation under Section 147
- Issuance of notice under Section 148
- Show-cause notices and orders under Section 148A
- Sanction for issuing notices under Section 151.

Before we move on to faceless assessment, it is important to understand that how faceless assessment is managed by income tax department, NFAC (National faceless assessment centre) is created having its headquarters in Delhi.

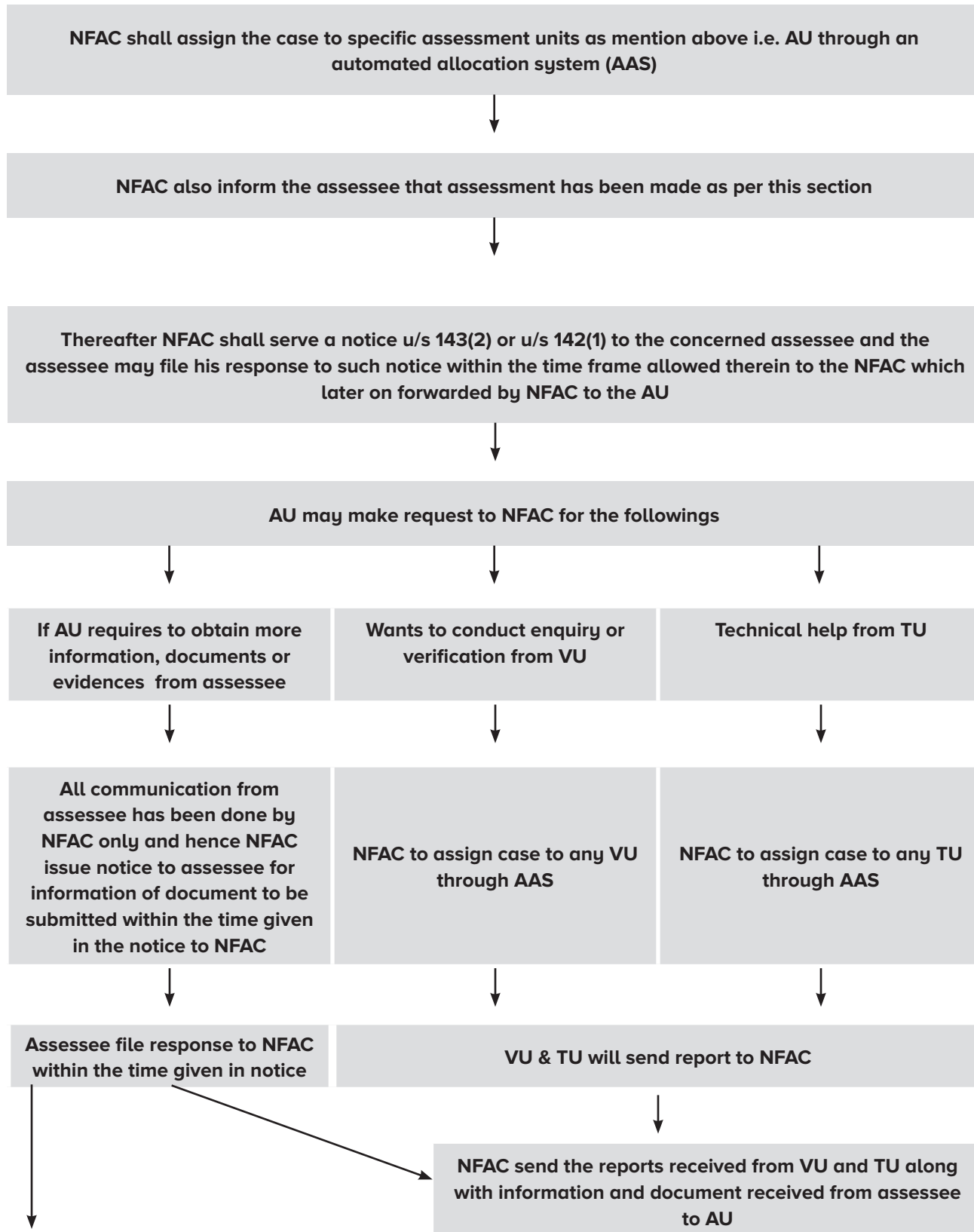
The **National Faceless Assessment Centre (NFAC)** is a digital platform established by the **Income Tax Department, Government of India** to facilitate a **faceless, paperless, and contactless assessment process** for taxpayers. It eliminates the need for physical interaction between taxpayers and assessing officers, promoting transparency and efficiency in the assessment process.

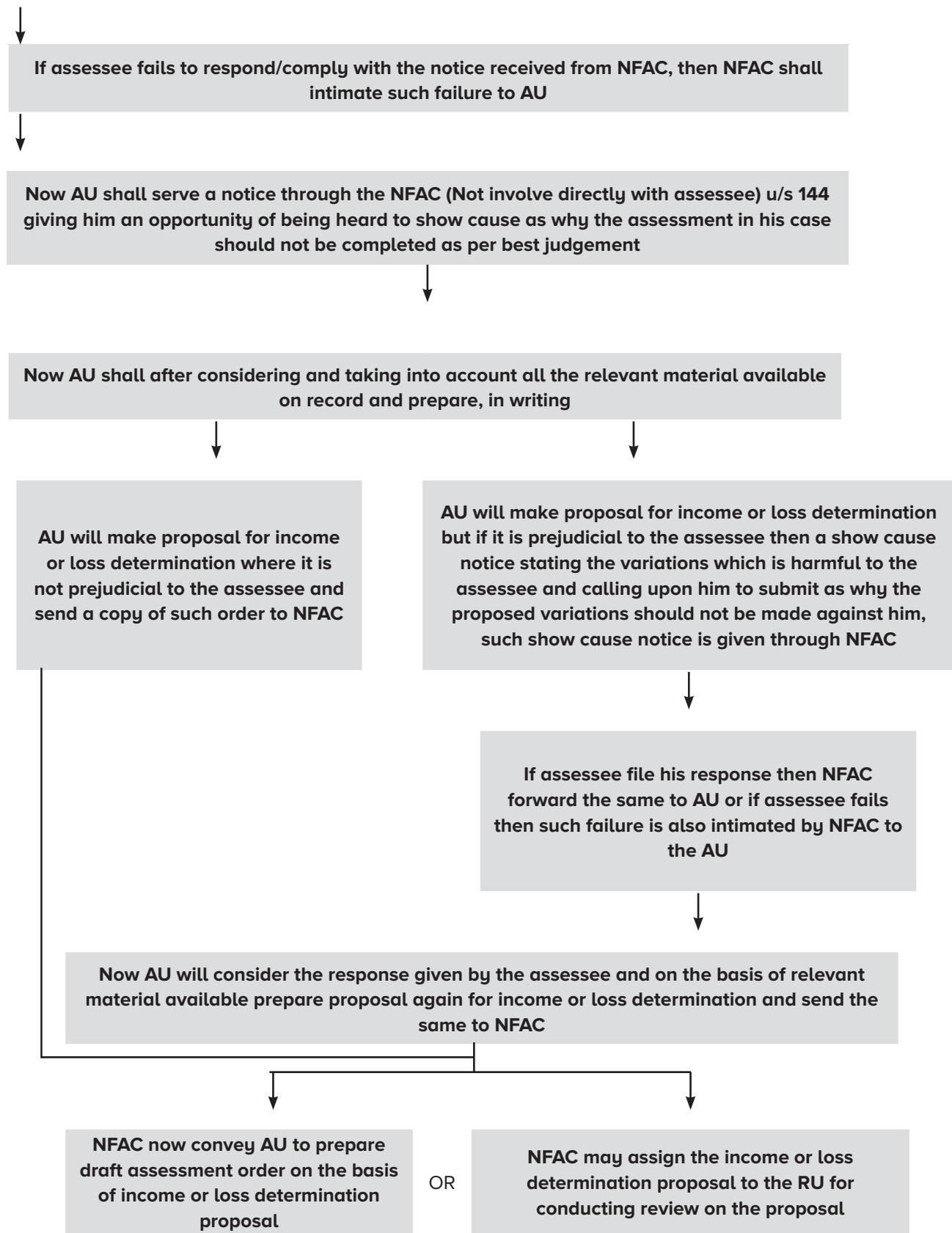
The National Faceless Assessment Centre (NFAC) is headquartered in Delhi, India. However, multiple **Regional Faceless Assessment Centres (RFACs)** and other supporting units such as **Assessment Units (AU)**, **Verification Units (VU)**, **Technical Units (TU)**, and **Review Units (RU)** operate from different locations across India.

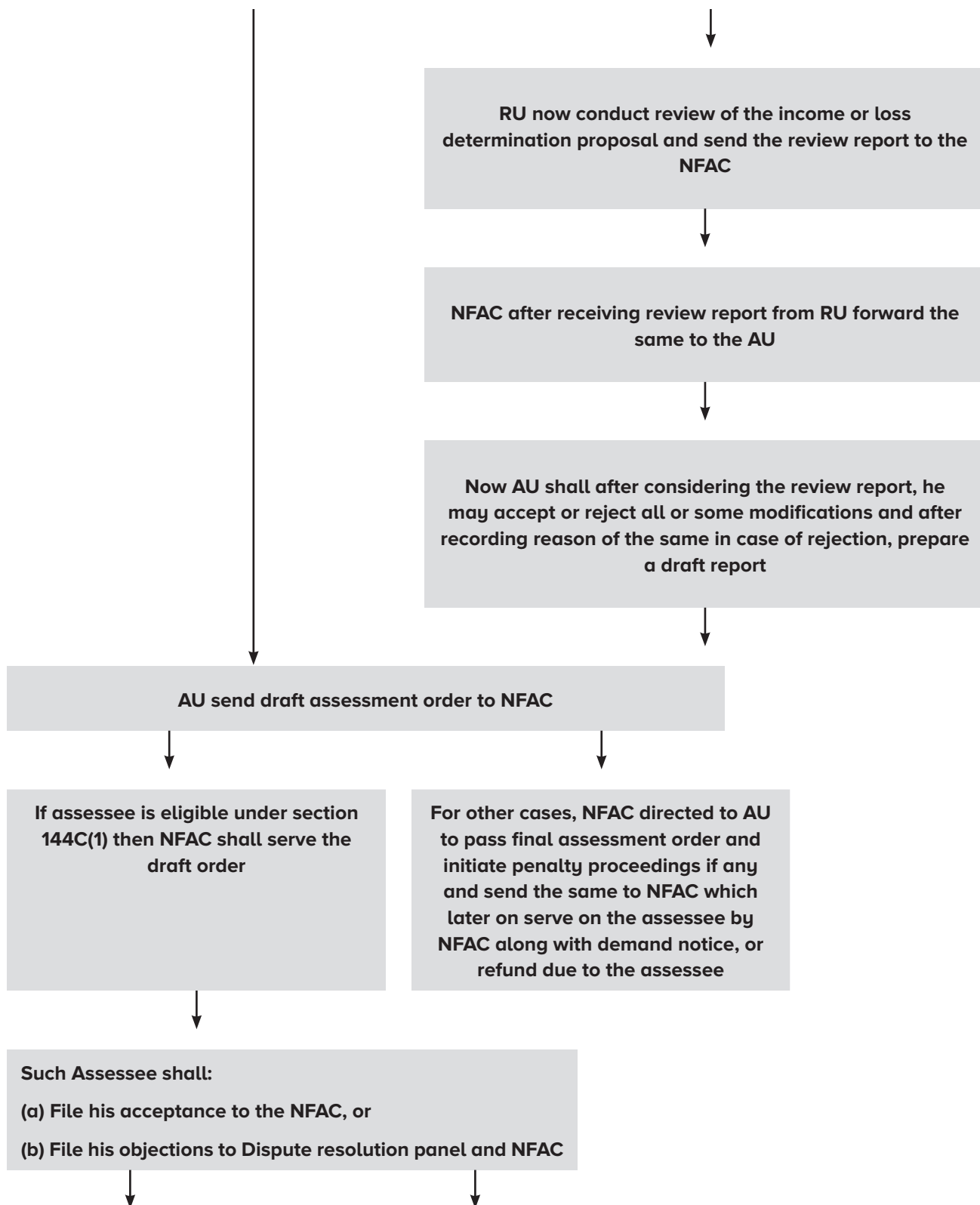
For the purpose of faceless assessment CBDT may set up the following centres and units specifying their functions and jurisdiction **[Section 144B(3)]**

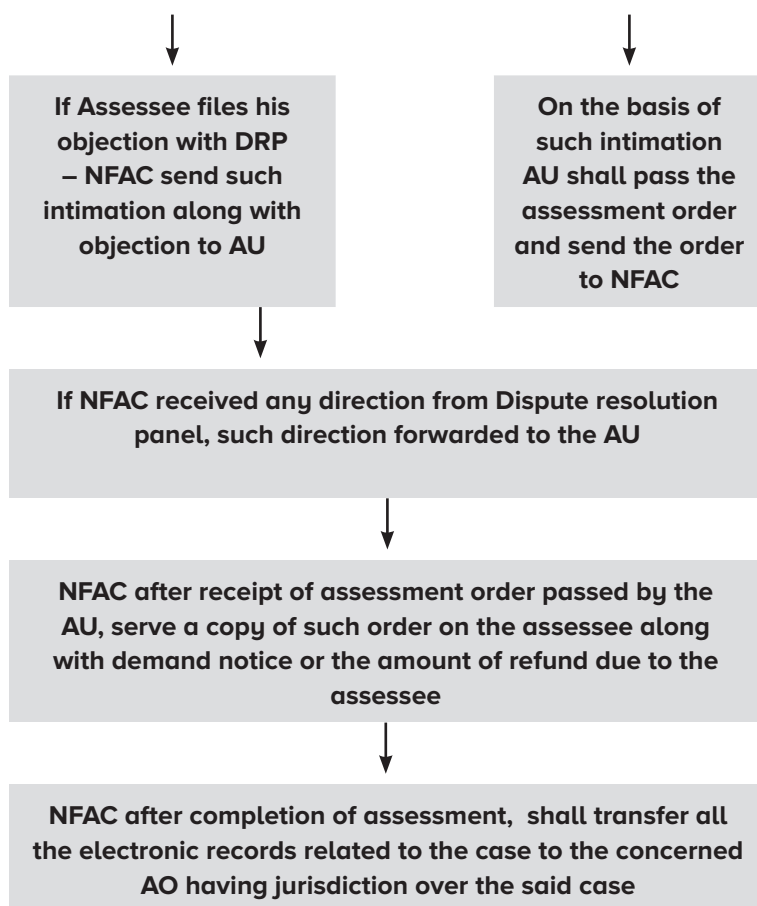


To understand the entire concept in Flow Chart Form









Procedure for Faceless Assessment [Section 144B(1)]

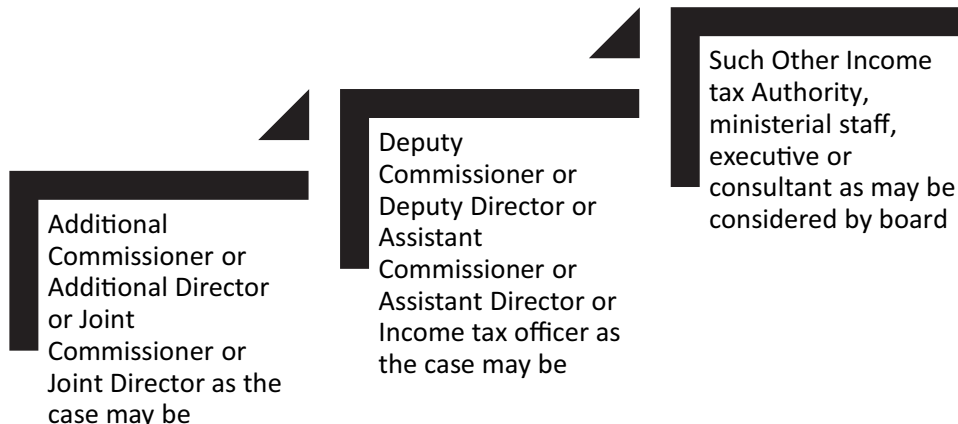
Section 144B(1) provides that assessment under section **143(3)**, i.e., **regular assessment / scrutiny assessment** or **best judgment assessment under section 144** or **income escaping assessment under section 147** in respect of such territorial area or persons or classes of persons or incomes or class of incomes or cases or class of cases, as specified by the CBDT under section 144B(2), has to be made in faceless manner in accordance with the following procedure.

Clause	Provision
(i)	Serving of Notice: The National Faceless Assessment Centre (NFAC) has to serve a notice on the assessee under section 143(2) i.e., notice for scrutiny assessment or under section 142(1) i.e., notice to file ITR or provide additional information and documents.
(ii)	Filing of response to the notice by the Assessee: The assessee is required to file his response to the notice within the date specified therein to the NFAC, which later on forwarded to assessment unit (AU)
(iii)	Assigning the selected case to a specific assessment unit: The NFAC has to assign the case selected for the purposes of faceless assessment under this section to a specific assessment unit through an automated allocation system (AAS).

Clause	Provision
(iv)	Request by Assessment Unit to NFAC for obtaining information/conducting enquiry: Where a case is assigned to the assessment unit, it may make a request to the NFAC for: ● obtaining such further information, documents or evidence from the assessee or any other person, as it may specify; ● conducting of certain enquiry or verification by verification unit; and ● seeking technical assistance from the technical unit.
(v)	Notice or requisition to the assessee or any other person for obtaining the information: The NFAC has to issue appropriate notice or requisition to the assessee or any other person for obtaining the information, documents or evidence requisitioned by the assessment unit.
(vi)	Assessee to file response to the notice within specified time: The assessee would be required to file response to the notice within the time specified therein or such time as may be extended on the basis of an application in this regard, to the NFAC.
(vii)	Request for conducting inquiry or verification to be assigned to Verification Unit by NFAC: Where a request for conducting of certain enquiry or verification by the verification unit has been made by the assessment unit, the request would be assigned by the NFAC to a verification unit through an automated allocation system.
(viii)	Request for seeking technical assistance to be assigned to Technical Unit by NFAC: Where a request for seeking technical assistance from the technical unit has been made by the assessment unit, the request would be assigned by the NFAC to a technical unit through an automated allocation system.
(ix)	Report received from the Verification Unit/Technical Unit to be sent to Assessment Unit: The NFAC has to send the report received from the verification unit or the technical unit to the concerned assessment unit.
(X)	Serving notice u/s 144 for failure on the part of the assessee to comply with notice seeking information / direction: Where the assessee fails to comply with the notice seeking information or evidence or notice issued under section 142(1) or with a direction issued under section 142(2A) for special audit, the NFAC has to serve upon such assessee a notice under section 144 giving him an opportunity to show-cause, on a date and time to be specified in the notice, why the assessment in his case should not be completed to the best of its judgment.
(xi)	Assessee to file response to a notice under section 144: The assessee has to, within the time specified in the notice or such time as may be extended on the basis of an application in this regard, file his response to the NFAC which shall forward the same to the assessment unit.
(xii)	Intimation to Assessment Unit, of failure on the part of the assessee to file response to notice issued u/s 144: Where the assessee fails to file response to the notice within the time specified therein or within the extended time, if any, the NFAC has to intimate such failure to the assessment unit.

Clause	Provision
(xiii)	Making of Income or loss determination proposal by the Assessment Unit: The assessment unit has to, after taking into account all the relevant material available on the record and prepare in writing an Income or loss determination proposal (a) If the variation is not prejudicial to the assessee: Assessment unit send a copy of such income or loss determination proposal to NFAC. (b) In other cases, if variation is prejudicial to the assessee: a show cause notice stating the variation which is harmful for the assessee issued through NFAC and call upon him to submit as to why the proposed variation should not be made.
(xiv)	Assessee response against show case notice as per (xiii) above: (a) If assessee file his response: then NFAC forward the same to assessment unit (b) If Assessee fails to file response: NFAC intimate such failure to assessment unit
(xv)	Making of draft assessment order by the Assessment Unit: The assessment unit has to, after taking into account all the relevant material available on the record prepare draft order in accordance with the income or loss determination proposal NFAC has to examine the draft assessment order in accordance with the risk management strategy specified by the CBDT, including by way of an automated examination tool
(xvi)	Review of the draft assessment order by Review Unit: The review unit would conduct review of the draft assessment order referred to it by the NFAC whereupon it may decide to: ● concur with the draft assessment order and intimate the NFAC about such concurrence; or ● suggest such variation, as it may deem fit, in the draft assessment order and send its suggestions to the NFAC.
(xvii)	Procedure to be followed by NFAC on receiving concurrence from Review Unit: The NFAC, upon receiving the concurrence of the review unit, has to follow the procedure laid down in subclause [a] or [b] of clause [xvi].
(xviii)	Procedure to be followed by NFAC on receiving suggestion for variations from Review Unit: Upon receiving suggestions for variation from the review unit, the NFAC has to assign the case to an assessment unit,
(xix)	Assessment Unit to send draft assessment order to NFAC: After considering the variations suggested by the review unit, the assessment unit has to send the draft assessment order to the NFAC.
(xx)	Procedure to be followed by NFAC on receiving draft assessment order: Upon receiving the draft assessment order NFAC shall convey to the assessment unit to pass final order and initiate penalty proceedings, if any and send it to the NFAC. Upon receiving the final assessment order NFAC shall serve a copy of such order and notice for initiating penalty proceeding if any on the assessee, along with the demand notice specifying the sum payable by, or refund of any amount due to, the assessee on the basis of such assessment.

Clause	Provision
(xxi)	Procedure to be followed by NFAC in case of assessee defined u/s 144C: In case if proposed variation is prejudicial to the interest of eligible assessee as defined in 144C(1) the NFAC shall serve such draft order to the eligible assessee.
[xxii]	Action by eligible assessee: If any draft order received by assessee he shall, (a) File his acceptance of the variation proposed in such draft order to NFAC (b) In case if assessee is not satisfied with the proposed variation he may file his objection with (i) Dispute resolution panel, and (ii) NFAC.
[xxiii]	Intimation by NFAC to assessment unit: (a) If NFAC received acceptance from eligible assessee, NFAC shall intimate the same to assessment unit to complete the assessment. (b) If NFAC do not received acceptance from eligible assessee, NFAC shall intimate the same to assessment unit to complete the assessment on the basis of draft order.
[xxiv]	Assessment order passed by assessment unit: After receipt of intimation from NFAC, assessment unit pass the assessment order in accordance with the relevant draft order with in the time frame under section 144C(4) and initiate penalty proceedings and send the order to NFAC.
[xxv]	NFAC to forward directions of DRP to Assessment Unit: Where the eligible assessee files his objections with the Dispute Resolution Panel, the NFAC has to, upon receipt of the directions issued by the Dispute Resolution Panel under section 144C(5), forward such directions to the concerned Assessment Unit
[xxvi]	Assessment Unit to prepare a draft assessment order: In conformity of the directions issued by the DRP under section 144C(5), the Assessment Unit has to prepare a draft assessment order in accordance with section 144C(13) and send a copy of such order to the NFAC.
(xxvii)	Finalisation of assessment by the NFAC: Upon receipt of the draft assessment order, the NFAC would finalise the assessment within the time allowed under section 144C(13), and serve a copy of such order and notice for initiating penalty proceedings, if any, to the assessee, along with the demand notice, specifying the sum payable by, or refund of any amount due to, the assessee on the basis of such assessment
(xxviii)	Transfer of electronic records of the case to the jurisdictional AO after completion of assessment: After completion of assessment, the NFAC should transfer all the electronic records of the case to the Assessing Officer having jurisdiction over the said case for such action as may be required under the Income-tax Act, 1961.

AUTHORITIES FOR VARIOUS UNITS [SECTION 144B(4)]**Key Points**

- All communications between NFAC, AU, VU, TU, RU and assessee should be in electronic mode only, but verification conducted by VU may be in other mode as specified by the board.
- In case if any variation is proposed by AU, then opportunity of being heard should be provided to assessee, in that case assessee may request for personal hearing, Income tax authority of such unit shall allow such hearing which shall be conducted through Video conferencing or video telephony.
- Examination of records or statement of assessee shall be conducted by income tax authority only through video conferencing and in case if assessee does not have such facility then CBDT shall establish such facility at various locations.
- In case if AU is of the opinion that the assessee is having specialised nature of business, having doubt about correctness and complexity of the accounts, volume of accounts, multiplicity of the transaction in the accounts then AU may refer the case to NFAC stating the provision u/s 142(2A) i.e., Special Audit may be invoked.
- If any request received from AU for special audit u/s 142(2A), then principle Chief Commissioner of income tax or the Principal Director General of income tax who is In-charge of the NFAC if considered appropriate may forward the case to principal chief commissioner of income tax or chief commissioner of income tax, Principal commissioner of income tax or commissioner of income tax having jurisdiction over such case and inform the AU accordingly.
- The Principle Chief Commissioner of income (PCCIT) tax or the Principal Director General of Income Tax (PDGIT) who is In-charge of the NFAC if they considered appropriate may transfer the case to the Assessing officer having jurisdiction over such case. (It is general happen when PCCIT or PDGIT thinks about personal hearing rather than faceless)

INCOME ESCAPING ASSESSMENT OR RE-ASSESSMENT I.E., RE-OPENING OF CASES [SECTION 147]

Background	The Finance Act, 2021, revised the procedure for assessing or reassessing escaped income, effective from April 1, 2021. Key changes included: ● Modification of Sections 148 & 149 and introduction of Section 148A, which mandated pre-notice inquiry and opportunity for the taxpayer to respond. ● Abolition of separate search assessments under Sections 153A & 153C, merging them into the general reassessment scheme.

Introduction of Block Assessment (Effective September 1, 2024):	● Search & requisition cases will no longer fall under Sections 147-153. ● New Chapter XIV-B (Sections 158B to 158BI) will govern all search cases initiated on or after September 1, 2024. ● For searches conducted between April 1, 2021, and August 31, 2024, the old provisions of Sections 147-151 (before the 2024 amendment) will continue to apply.

There are certain cases wherein if any income chargeable to tax have escaped assessment or if income has been assessed at low rate, or if assessee has excessive loss or allowance like depreciation then assessing officer is empowered to assess or re-assess income of such assessment year subject to the provisions of section 148 to 153.

Sections	Title of the Section
147	Income escaping assessment
148	Issue of Notice if income has escaped assessment
148A	Conducting inquiry subject to provide opportunity before issuing such notice
148B	Prior approval required for assessment, re-assessment or re-computation
149	Time limit for Notice
150	Provision for cases where assessment is in pursuance of an order on appeal
151	Sanction for issue of notice
151A	Faceless assessment for income escaping assessment
152	Other Provision
153	Time limit for completion of assessment, re-assessment or re-computation

Analysis

If the Assessing Officer (AO) believes that any income of a taxpayer has escaped assessment for a particular year, they can:

1. Assess or reassess the escaped income.
2. Recompute any loss, depreciation, or other deductions for that year.

Additionally, if during the reassessment process, the AO discovers other income that has escaped assessment; they can assess that too, even if prior notice procedures under Section 148A were not followed.

If AO wants to make assessment u/s 147 then it is mandatory for AO to serve notice u/s 148, and before issue of notice u/s 148, assessing officer has to follow the procedure given u/s 148A. Notice u/s 148 will be served with order u/s 148A (3). Hence the proper sequence is (1) Check procedure first u/s 148A (2) Then Issue notice u/s 148 then :

- Require the assessee to file a return of income (his own or of another person for whom he is assessable).
- The return must be filed within the time mentioned in the notice, but the time allowed cannot exceed 3 months from the end of the month in which notice is issued. However: No notice can be issued unless the AO has “information” suggesting escapement of income.
- If information is received under the scheme notified u/s 135A (Faceless Scheme), then AO must obtain prior approval of the specified authority before issuing notice.

Section 148 (2) – Nature of return

- The return filed in response to the notice is treated like a return under Section 139, and all provisions of the Act apply.
- If such a return is furnished after the time limit in the notice, it will not be deemed a return u/s 139.

Section 148 (3) – What qualifies as “information” for escapement

The law defines information that enables the AO to reopen:

1. Risk management strategy information formulated by CBDT.
2. Audit objection that an earlier assessment order is not in accordance with law.
3. Information from tax treaties (Section 90 / 90A).
4. Information under Section 135A scheme (faceless).
5. Information requiring action in consequence of a Tribunal or Court order.
6. Survey information [u/s 133A, except 133A(2A)] on or after 1 Sept 2024.

(3) Then complete assessment u/s 147.

During the assessment if AO **finds some other income which is escaped for same assessment year** then fresh notice u/s 148 and procedure given in section 148A is not required to follow again to assess the income by assessing officer.

Example: AO having information related to the escaped income under Profit and Gains from Business and Profession ‘PGBP’ head of Mr. Suresh for AY 2023-24. AO follow all the procedures laid down u/s 148A and accordingly served a notice u/s 148. During the assessment AO also finds that Mr. Suresh having capital gain for same assessment year which was not assessed earlier. In this case AO may assess income from capital gain also without following procedure of section 148 and 148A.

Suppose in above example if AO finds that capital gain is related to AY 2022-23 then he has to follow procedure of section 148 & 148A.

**CONDUCTING INQUIRY, PROVIDING OPPORTUNITY BEFORE ISSUE OF NOTICE U/S 148
[SECTION 148A]**

Inquiry Before Issuing Notice (Section 148A)	Before issuing a notice under Section 148, the Assessing Officer (AO) must: 1. Have information suggesting that income has escaped assessment. 2. Send a notice to the assessee, explaining why reassessment is being considered. 3. Allow the assessee to respond within the specified time mentioned in the notice not exceeding 3 months 4. Decide whether to proceed with reassessment after considering the assessee’s response and obtaining prior approval from the specified authority (as defined in Section 151). 5. This process does not apply if the AO has received information under a scheme notified under Section 135A.

Time Limit to Issue Notice under Section 148A [Section 149(2)]	A notice to show cause under Section 148A (prior inquiry) cannot be issued if: • More than 3 years have passed from the end of the relevant assessment year (except in special cases). • Beyond 5 years unless the escaped income (as per AO's information) is Rs. 50 lakh or more.
Authority granting sanction for issue of Notice u/s 148A	Specified authority for the purposes of sections 148 and 148A shall be the Additional Commissioner or the Additional Director or the Joint Commissioner or the Joint Director, as the case may be. w.e.f. 01.09.2024

Analysis of Section 148A – Conducting inquiry, providing opportunity before issue of notice under Section 148

The assessing officer before issuing notice u/s 148

- i. Conduct any enquiry with approval from specified authority
- ii. Provides an opportunity of being heard to assessee by serving upon him a notice to show cause as to why notice u/s 148 should not be issued on the basis of information which suggest that income has escaped assessment.
- iii. Consider the reply given by assessee, AO decide whether or not it is a fit case to issue notice u/s 148 by passing an order u/s 148A subject to prior approval from specified authority.
- iv. Assessee can not file appeal against the order issued u/s 148A.
- v. Section 148A is not applicable in the following cases (It means AO can send direct notice u/s 148 without following the procedures laid down u/s 148A)
 - (a) If search-initiated u/s 132 or books of accounts or any assets requisitioned u/s 132A (Applicable after 01-04-2021)
 - (b) If AO satisfied after taking approval from principal commissioner or commissioner that any assets or books of accounts requisitioned u/s 132 or 132A in case of any other person is actually belongs to the assessee.
 - (c) If AO received any information under the scheme notified u/s 135A.

ISSUE OF NOTICE [SECTION 148]

Issuance of Notice for Escaped Income (Section 148)	Before making the assessment, reassessment or re-computation u/s 147 1. The AO issues a notice on the assessee under Section 148, attaching a copy of the 148A order requiring him to furnish his return of income. 2. The assessee must submit a return of income within the specified time (within 3 months from the end of the months in which notice received) 3. If the return is filed late, it will not be considered a valid return under Section 139, and the AO may proceed with a best judgment assessment.

Conditions for Issuing Notice	A notice under Section 148 can be issued only if: ● The AO has reliable information that income has escaped assessment. ● If information is obtained under a scheme notified under Section 135A, prior approval from the specified authority is needed.
“Information” Suggesting Escaped Income	The AO must have at least one of the following: ● Risk-based alerts under Board’s strategy. ● Audit objections indicating assessment errors. ● Information from tax treaties (Section 90/90A). ● Faceless information collection (Section 135A). ● Tribunal/Court orders requiring action. ● Survey findings (Section 133A, except TDS/TCS verification) from 01.09.2024 onward.

Analysis of Section 148

Before making the assessment, reassessment or re-computation u/s 147 the AO shall serve on the assessee a notice u/s 148 along with a copy of order passed u/s 148A requiring him to furnish return of income. Such ROI should be filed within 3 months from the end of the months in which notice received.

If assessee request to AO to extend the time limit, then Return of Income (ROI) must be filed within the extended time period. If notice issued u/s 148 requiring assessee to file ROI then it shall be presumed that assessee was required to file his ROI u/s 139, it means assessee can not claim that his income is below the basic exemption limit hence ROI is not required to be filed.

If return is filed late, it will not be considered a valid return under **Section 139**, and the AO may proceed with a **best judgment assessment**

The assessee is required to file ROI u/s 148 even if he has already filed his ROI as per normal provision. Return filed u/s 148 can not be revised as return can be revised only if return is filed u/s 139(1) or 139(4).

Conditions to be fulfilled before issue of notice

Notice can be issued only when

- i. If AO is having such information which suggest that the income chargeable to tax has escaped assessment
 - (a) Any information in accordance with the risk management strategy formulated by CBDT
 - (b) Any audit objection which suggests that assessment has not been made as per the provision of this act; or
 - (c) Any information received under DTAA u/s 90 or 90A; or
 - (d) Any information made available to AO under the scheme notified u/s 135A; or

- (e) Any information which requires action is consequence of the order of Tribunal or a Court.
- ii. The AO has obtained prior approval from specified authority (Refer Section 151 for Sanction authority)
- iii. AO has complied with the procedure given u/s 148A (not required in case of search)

Cases where it shall be deemed that AO having information which suggest the income has escaped assessment-

- (a) If search-initiated u/s 132 or books of accounts or any assets requisitioned u/s 132A (Applicable after 01-04-2021)
- (b) A survey is conducted u/s 133A (other than TDS/TCS survey)
- (c) If AO satisfied after taking approval from principal commissioner or commissioner that any assets or books of accounts requisitioned u/s 132 or 132A in case of any other person is actually belongs to the assessee.

Example: Search conducted u/s 132 on 20th September in the premises of Mr. Kaka. During the search AO found some document related to Mr. Deepak. In this case AO of Kaka will forward such documents to the AO having jurisdiction of Mr. Deepak. In this case it is deemed that respective AO having information and notice u/s 148 can be issued.

Prior approval for assessment, reassessment or re-computation in certain cases [Section 148B]

Where search-initiated u/s 132 in case of assessee or any other person or survey conducted as per section 133A, than assessment or reassessment shall not be made by AO below the rank of joint commissioner except with the prior approval of Joint Commissioner or Joint Director or Additional Commissioner or Additional Director.

Time limit for issue of Notice u/s 148 [Section 149]

Category	Amount Involved	Time Period	Specific Authority
Normal Provision	< 50 Lakh	Up to 3 years and 3 months from the end of relevant assessment year	Specified authority for the purposes of sections 148 and 148A shall be the Additional Commissioner or the Additional Director or the Joint Commissioner or the Joint Director, as the case may be. w.e.f. 01.09.2024
Special Provision	= > 50 Lakhs	Up to 5 years and 3 months from the end relevant assessment year	

Analysis of Section 149 - Time limit for issue of Notice u/s 148

Notice u/s 148 case be issued for the relevant assessment year

- (a) Up to 3 years and 3 months from the end of relevant assessment year
- (b) Up to 5 years and 3 months from the end relevant assessment year if income of assessee has escaped assessment wherein amount to or is likely to amount to Rs. 50 Lakhs or more for that year.

UNLIMITED TIME LIMIT TO ISSUE NOTICE [SECTION 150]**Unlimited time period for issue of notice for assessment in pursuance of order on appeal**

Notice u/s 148 can be issued at any time if assessment, re-assessment or re-computation to be carried out to give effect to any findings or directions in order passed by CIT Appeal, ITAT, High court, supreme court or any court under any other law for this year to another year.

This provision is applicable when the order passed by above contains a direction;

- Which states to exclude income from one assessment year to include in another assessment year; or
- Which states to exclude income from one assessee and include in another assessee.

This provision shall not apply in any case where assessment, re-assessment, or re-computation relates to an assessment year in respect of which assessment, re-assessment, or re-computation could not have been made at the time the order which was the subject matter of appeal, reference or revision was made by reason of any other provision limiting the time within which any action for assessment, re-assessment, or re-computation may be taken.

Analysis of Section 150 - Unlimited Time Limit to Issue Notice

Normally, notices under Section 148 must follow the time limits in Section 149. However, Section 150 overrides Section 149 in certain cases. If an assessment, reassessment, or recomputation is required to give effect to a finding or direction in an order passed by:

- Appellate authority
- Reference authority
- Revision authority
- Any court in any legal proceeding.

In such cases, a notice under Section 148 can be issued at any time, even beyond normal time limits.

Section 151 – Sanction for issue of notice

Specified authority for the purposes of sections 148 and 148A shall be

- Additional Commissioner or
- the Additional Director or
- the Joint Commissioner or
- the Joint Director

FACELESS ASSESSMENT OF INCOME ESCAPING ASSESSMENT [SECTION 151A]

Faceless assessment scheme may be notified by Central Government and as per such scheme,

- (a) Assessment, re-assessment or re-computation u/s 147
- (b) Issuance of notice u/s 148.

Will be through automated allocation and in a faceless manner, in accordance with section 144B with reference to making faceless assessment of total income or loss of assessee.

TAX RATE APPLICABLE FOR ESCAPED INCOME [SECTION 152(1)]

In the case of any assessment, re-assessment or re-computation u/s 147 respective year tax rate shall apply.

Example: If assessment, re-assessment or re-computation u/s 147 made for AY 2017-18 in AY 2021-21 then tax rates for AY 2017-18 is applicable as income was escaped for AY 2017-18.

DROPPING OF ASSESSMENT PROCEEDING [SECTION 152(2)]

Where the proceedings are initiated u/s 147 the same may be dropped by Assessing Officer if assessee satisfying Assessing officer that –

- (a) After assessing the income u/s 147 there will be no impact or no effect on his tax liability, even after taking into account the income which is escaped for assessment; and
- (b) Assessee has not gone in any appeal, revision against such original assessment order.

TIME LIMIT TO COMPLETE ASSESSMENT AND REASSESSMENT [SECTION 153]

The following time limits are provided by section 153 to complete the assessment and reassessment

Section		Assessment	Time limit for Completion
153(1)	143(3)	Scrutiny Assessment	In respect of order of assessment related to For AY 2022-23 and Onwards - 12 Months from the end of the AY in which the income was first assessable For AY 2021-22 - 9 Months from the end of the AY in which the income was first assessable For AY 2020-21 - 18 Months from the end of the AY in which the income was first assessable For AY 2019-20 - 12 Months from the end of the AY in which the income was first assessable For AY 2018-19 - 18 Months from the end of the AY in which the income was first assessable For AY 2017-18 and earlier years - 21 Months from the end of the AY in which the income was first assessable
	144	Best Judgement Assessment	
Note: In case of updated return u/s 139(8A) is furnished then time limit is 48 months from the end of the financial year in which such return was furnished.			
153(2)	147	Income Escaping Assessment	12 months from the end of the financial year in which notice u/s 148 was served
153(3)		Fresh Assessment u/s 143/144/147 or on fresh order u/s 92CA (Transfer pricing officer) where the original assessment or order u/s 92CA has been set aside, cancelled and sent back to AO by an order u/s 254, 263, 264.	12 Months from the end of the financial year in which (a) Order u/s 254 received by Principal chief commissioner of income tax, Chief commissioner of income tax, Principal commissioner of income tax or Commissioner of income tax (b) Order u/s 263/264 passed by Commissioner or Income Tax/Principal commissioner of income tax, Chief commissioner of income tax, Principal Chief commissioner of income tax.

Section		Assessment	Time limit for Completion
153(3A)		Where any assessment or re-assessment is already pending for earlier year on the date of initiation of search u/s 132 or making of requisition u/s 132A	All above time limits are extended by fresh 12 months
153(4)		Where reference made to TPO (Transfer pricing officer) u/s 92CA	Additional time period of 12 months is available for completion of assessment hence revised time limit for all the above assessment is as follows
		Completion of assessment u/s 143(3) and 144	For AY 2022-23 and Onwards - 24 Months from the end of the AY in which the income was first assessable
			For AY 2021-22 - 21 Months from the end of the AY in which the income was first assessable
			For AY 2020-21 - 30 Months from the end of the AY in which the income was first assessable
			For AY 2019-20 - 24 Months from the end of the AY in which the income was first assessable
			For AY 2018-19 - 30 Months from the end of the AY in which the income was first assessable
			For AY 2017-18 and earlier years - 33 Months from the end of the AY in which the income was first assessable
		<i>Note : In case of updated return u/s 139(8A) is furnished then time limit is 24 months from the end of the financial year in which such return was furnished.</i>	
	147	Income Escaping Assessment	24 months from the end of the financial year in which notice u/s 148 was served
		Fresh Assessment u/s 143/144/147 or on fresh order u/s 92CA (Transfer pricing officer) where the original assessment or order u/s 92CA has been set aside, cancelled and sent back to AO by an order u/s 254, 263, 264.	24 Months from the end of the financial year in which (a) Order u/s 254 received by Principal chief commissioner of income tax, Chief commissioner of income tax, Principal commissioner of income tax or Commissioner of income tax (b) Order u/s 263/264 passed by Commissioner or Income Tax/Principal commissioner of income tax, Chief commissioner of income tax, Principal Chief commissioner of income tax
		Where any assessment or re-assessment is already pending for earlier year on the date of initiation of search u/s 132 or making of requisition u/s 132A	Additional time period of 12 months is available for completion of assessment, reassessment referred u/s 153(1), 153(1A), 153(2), 153(3), 153(3A)

Section		Assessment	Time limit for Completion
153(5)		Effect to be given by AO/ Transfer pricing officer u/s 250/254/260/263/264 (Otherwise than fresh assessment/orders)	3 Months from END OF THE MONTHS in which order u/s 250/254/260/262 is received by CCIT/CIT/PCCIT/ PCIT or order u/s 263/264 passed by CIT/PCIT/CCIT/ PCCIT
		Additional period of 6 months may be allowed - if AO/TPO apply that order could not be given effect within 3 months	
		IF AO/TRP requires to verify any document submitted by assessee - Time limit is 12 months as given in section 153(3)	
		IF AO/TRP requires to give opportunity of being heard to assessee - Time limit is 12 months as given in section 153(3)	
		IF TPO wants to give effect to an order or direction u/s 263 or order u/s 92CA to AO - Time limit is 2 months from the end of the month in which such order of the TPO received by AO.	
153(6)(i)		Where assessment/ reassessment made because of giving effect to any findings or direction in any order u/s 250/254/260/262/263/264 or by order of any court (Refer section 150 for unlimited time period)	12 Months from the end of the months in which such order is received or passed by the PCCIT/PCIT/CCIT/ CIT
153(6)(ii)		Where assessment made on partner due to assessment made on firm u/s 147	12 months from the end of the months in which the assessment order in case of firm was passed.

Following time limits are to be excluded for the purpose of Section 153 - Time Limit to complete Assessment and Reassessment

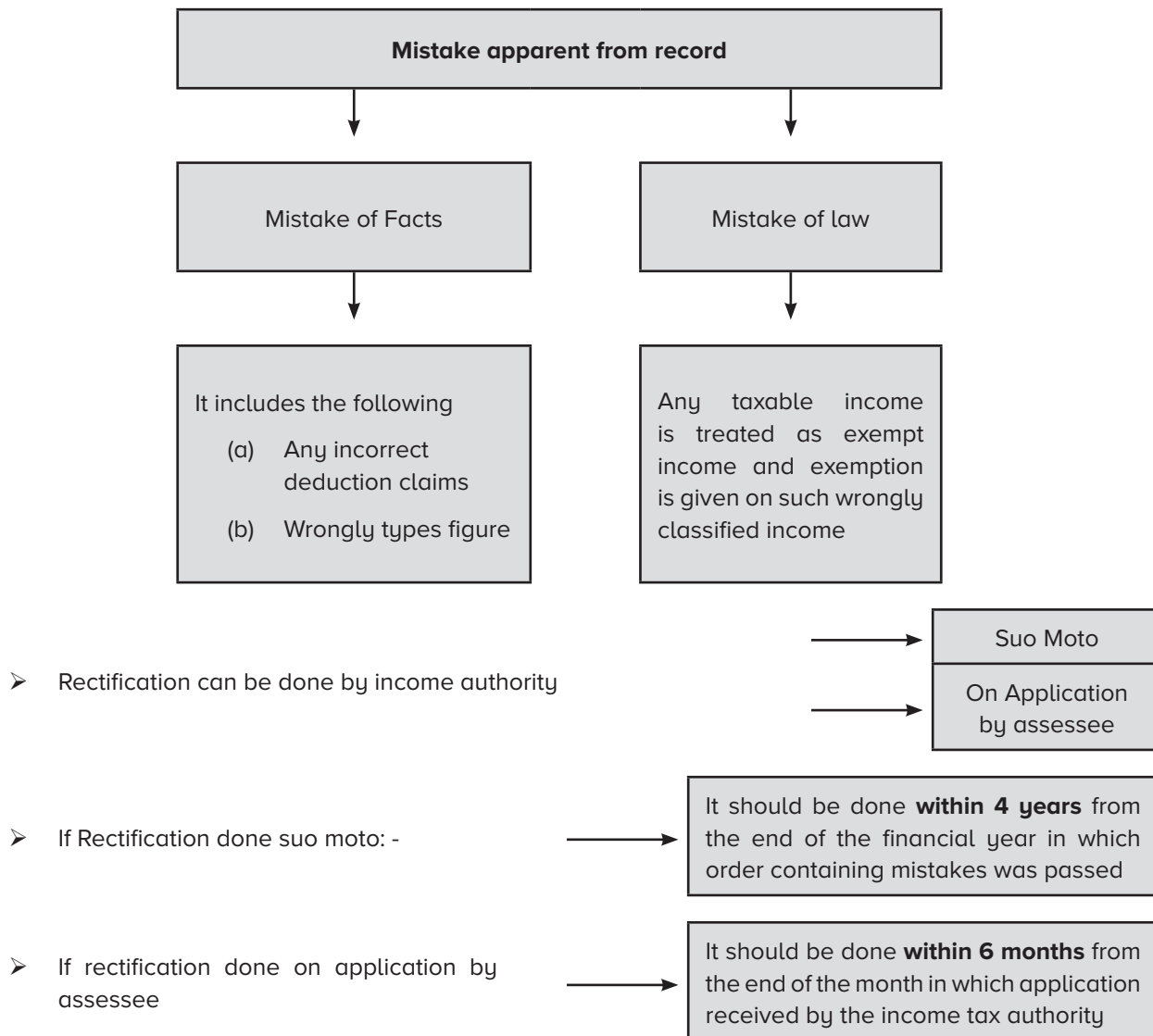
S. No.	Particular	Period exclude	
		From	To
1	Contravention of provision 10(21), 10(22B), 10(23A), 10(23B)	Date on which AO inform Central Government	Till the date on which Government notification received by AO withdrawing the approval
2	Direction u/s 142(2A) - Special Audit and Inventory valuation	Date on which AO gives direction	Last date to furnish report by assessee or, Date on which order set aside by court for such direction received by Principal Commissioner/ Commissioner of Income Tax

S. No.	Particular	Period exclude	
		From	To
3	Reference to valuation officer u/s 142A	Date on which AO gives reference	Date on which AO received report
4	If assessee furnish declaration claiming for any question of law arising in his case if pending with AO (Section 158A- Covered in Appeal Chapter)	Date of which AO received declaration	Date on which ITAT passed order for acceptance or rejection of such declaration.
5	Application made to Board for Advance ruling	Date of which application made	Date on which rejection order received by Principal Commissioner/ Commissioner of Income Tax
6	In case of reference for exchange of information u/s 90/90A	Date of which reference made	Date of which information received by CIT/PCIT or 1 year whichever is less
7	In case of Search u/s 132 or requisition u/s 132A	From the Date of search-initiated u/s 132 or requisition made u/s 132A	Date on which Books of accounts, documents, money, bullion handed over by authorized officer to Assessing officer having jurisdiction over assessee. (However, period should not be more than 180 Days)
8	Reference made by AO to CIT/PCIT if any trust or institution u/s 12AB(4) violates specified conditions.	Date of which reference made by AO to CIT/PCIT	Date on which copy of order or CIT/PCIT received by the AO
9	The time period for which assessment proceeding is stayed by any court. The period commencing on the date on which stay on the assessment proceeding was granted by an order or injunction of any court and ending on the date on which certified copy of the order vacating the stay was received by the jurisdictional Principal Commissioner or Commissioner.		
10	Time lost for giving opportunity for re-opening the proceeding as defined in section 129		

Note: After exclusion all the above time limits, the period referred to in section 153(1)/ (2)/ (3) available to AO for making the order of assessment/reassessment or re-computation is less than 60 days – Then such remaining shall extended to 60 days.

RECTIFICATION OF MISTAKES [SECTION 154]

If any authority passes any assessment order in which there is any mistake which is apparent from the record, then such income tax authority [AO/CIT/CIT(A)/Joint commissioner (Appeal)] can rectify a mistake which is apparent on record

**Analysis of Section 154 - Rectification of Mistakes**

- Rectification order shall be made within four years from the end of the financial year in which the order sought to be amended was passed
- Opportunity of being heard is required if rectification results into increasing the tax liability or reducing the refund.
- Notice of demand (section 156) to be issued in case rectification results into enhancing the tax liability or reducing the refund
- Refund to be given in case rectification results into reduction in tax liability.

DEMAND NOTICE [SECTION 156]

- Demand Notice to be serve on the assessee – If any tax, interest, penalty or any other sum payable under income tax act due to order passed by income tax authority.
- Deemed Notice of demand – In case if any amount is payable under section 143(1) i.e., Intimation received, u/s 200A(1) i.e., the deductor or u/s 206CB(1) i.e., The collector, the same shall be treated as notice of demand, separate demand notice/s 156 not required ion this case
- Payment of Tax – Assessee should paid the said amount within 30 days from the date of receipt of notice of demand
- Consequences if not paid in 30 days – If assessee fails to pay the demand within 30 days then recovery proceeding shall be initiated and assessee shall be treated as assessee in default
- Assessee is liable to pay interest u/s 220 and penalty u/s 221 – If not paid in 30 days.

TEST YOURSELF

(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)

Multiple Choice Questions

1. Under which section of the Income Tax Act can an assessment be reopened if income has escaped assessment?
 - a) Section 139
 - b) Section 142
 - c) Section 144
 - d) Section 147

Answer : d

2. What is the time limit for rectification under Section 154 of the Income Tax Act?
 - a) 1 year from the end of the financial year
 - b) 2 years from the end of the financial year
 - c) 3 years from the end of the financial year
 - d) 4 years from the end of the financial year

Answer : d

3. What is the time frame for completing a reassessment under Section 147 if it is initiated based on the information that income has escaped assessment?
 - a) 1 Year
 - b) 2 Years
 - c) 3 Years
 - d) No Time limit

Answer : c

4. If a taxpayer fails to comply with the requirement of information requested during the assessment, which of the following sections is likely to be invoked?

- a) Section 139
- b) Section 143(3)
- c) Section 144
- d) Section 147

Answer: c

5. What happens if an assessment order is not passed within the stipulated time limit?

- a) The assessment is automatically void
- b) The assessment is treated as completed
- c) The taxpayer is penalized
- d) Additional time is automatically granted for completion

Answer: b

6. Which section mandates the assessment of income to be carried out by the Assessing Officer after scrutiny?

- a) Section 142
- b) Section 143
- c) Section 144
- d) Section 147

Answer: b

7. What is the purpose of issuing a notice under Section 142(1)?

- a) To assess the tax liability directly
- b) To obtain information for the completion of the assessment
- c) To impose penalties
- d) None of the above

Answer: b

8. An assessment order made under Section 143(3) cannot be revised under which of the following sections?

- a) Section 154
- b) Section 263
- c) Section 264
- d) Section 147

Answer: a

9. What is the primary objective of an assessment under Section 144 (Best Judgment Assessment)?
- To provide taxpayer with additional time
 - To estimate the income of a taxpayer when they do not comply with request for information
 - To rectify any mistakes made in previous assessment
 - To re-evaluate tax slabs and rates

Answer: b

10. Which of the following statements is correct regarding the assessment process?
- The assessment can be done without verifying the taxpayer's record
 - The taxpayer must be given an opportunity to present their case
 - Reassessment is a continuation of the original assessment
 - Best judgement assessment is always to the prejudicial of the taxpayer

Answer: b

Practice Question

Q1. What is a summary assessment under Section 143(1) of the Income Tax Act?

A summary assessment under Section 143(1), also known as an intimation, is an automated initial processing of income tax returns filed by taxpayers. This process is conducted without human intervention and primarily focuses on identifying apparent errors and inconsistencies based on the information provided in the return and the records available with the Income Tax Department. It is a preliminary step and does not involve a detailed scrutiny of the taxpayer's affairs.

Q2. What kind of adjustments can be made during a summary assessment?

During a summary assessment, the Assessing Officer (through the automated system) can make adjustments for the following reasons:

- **Arithmetical errors:** Mistakes in calculations within the income tax return.
- **Incorrect claims apparent from the records:** Claims that are clearly inconsistent with the information already available with the tax authorities.
- **Disallowance of loss claimed/expenses/deductions or increase in income indicated in the audit report but not included in the return:** Situations where the audit report submitted by the taxpayer suggests a different income, expense, loss, or deduction figure than what was reported in the income tax return.
- Inconsistencies apparently from returns filed from earlier years

Q3. Does the taxpayer get an opportunity to respond before adjustments are made during a summary assessment?

Yes, before any adjustments are made to the income tax return during a summary assessment, the taxpayer is provided with an opportunity to explain the apparent error or inconsistency or to rectify the same. The Income Tax Department issues an intimation regarding the proposed adjustments, and the taxpayer is typically given 30 days from the issuance of such intimation to submit their response. The Assessing Officer is obligated to consider the taxpayer's response before finalizing any adjustments.

Q4. How is the final tax liability determined after a summary assessment?

After processing the income tax return and considering any adjustments made (and the taxpayer's response, if any), the total tax liability is calculated. This calculation takes into account various factors such as the tax deducted at source (TDS), advance tax payments, eligible deductions, and tax reliefs claimed by the taxpayer.

Q5. What happens if there is additional tax payable or a refund due after the summary assessment?

If, after the summary assessment, it is determined that there is additional tax payable by the taxpayer, a Notice of Demand is issued. This notice will specify the amount of tax due and typically requires the taxpayer to make the payment within 30 days. Conversely, if the summary assessment indicates that a refund is due to the taxpayer, the Income Tax Department will process the refund accordingly.

Q6. What is the timeline for receiving an intimation under Section 143(1)?

The Income Tax Department is required to send the intimation (summary assessment order) to the taxpayer within 9 months from the end of the financial year in which the income tax return was filed. This timeframe ensures that the initial processing of returns is completed in a timely manner.

Q7. What happens if no errors or inconsistencies are found during the summary assessment?

If, upon the initial automated processing of the income tax return, no arithmetical errors, incorrect claims apparent from records, or discrepancies with the audit report are identified, then the acknowledgment of the return filed by the taxpayer is itself considered as the intimation under Section 143(1). No separate intimation document might be issued in such cases.

Q8. Is a summary assessment mandatory even if the tax return is selected for a more detailed scrutiny?

Yes, even if an income tax return is selected for scrutiny under Section 143(2) (which involves a more in-depth examination of the taxpayer's records), the return must first undergo the summary assessment process under Section 143(1). This initial processing ensures that all filed returns are subjected to a basic level of automated checks for compliance before any further action is taken.

SELF-TEST QUESTIONS

1. Explain the purpose of self-assessment tax under Section 140A. When is it typically paid, and what happens if an assessee fails to pay this tax?
2. Describe the circumstances under which an Assessing Officer (AO) can issue a notice under Section 142(1). What kind of information or documentation might the AO request through this notice?
3. What is the role of a Valuation Officer under Section 142A? Under what conditions can an Assessing Officer refer a case to a Valuation Officer for the estimation of asset value?
4. Outline the key objectives of the Faceless Inquiry & Valuation Scheme under Section 142B. How does it aim to improve the efficiency and transparency of tax inquiries?
5. Describe the process of summary assessment under Section 143(1). What types of adjustments can be made during this initial assessment, and is it mandatory?

6. What distinguishes a scrutiny assessment under Section 143(3) from a summary assessment? What is the time limit for issuing a scrutiny notice?
7. Under what conditions can an Assessing Officer make a Best Judgment Assessment under Section 144? Does the AO need to provide an opportunity to be heard before making such an assessment?
8. Explain the concept of faceless assessment, particularly in the context of best judgment assessments under Section 144B. What are the main features of this scheme?
9. What are the initial steps an Assessing Officer must take under Section 148A before issuing a notice for income escaping assessment under Section 148? What kind of information must the AO possess?
10. What are the time limits for issuing a notice under Section 148 for income escaping assessment? How do these time limits differ based on the amount of escaped income?

Application based Questions

1. Critically analyse the significance of the Faceless Assessment Scheme in modernizing the income tax assessment procedures in India. Discuss its potential benefits and challenges for both taxpayers and the Income Tax Department.
2. Compare and contrast the different types of income tax assessments (Self-Assessment, Summary Assessment, Scrutiny Assessment, and Best Judgment Assessment). Under what circumstances is each type of assessment typically initiated, and what are the key procedural differences between them?
3. Evaluate the safeguards provided to taxpayers during the assessment process, particularly concerning inquiries under Section 142, referrals to the Valuation Officer under Section 142A, and Best Judgment Assessments under Section 144. Are these safeguards adequate to ensure fairness and prevent arbitrary assessments?
4. Discuss the implications of the revised procedures for assessing income escaping assessment under Sections 147 to 151 (as amended by the Finance Act, 2021 and subsequent amendments). How do these changes affect the rights and obligations of both the Assessing Officer and the taxpayer?
5. Analyze the role of technology in transforming income tax assessment procedures in India. How have initiatives like faceless assessment and automated summary assessments impacted the efficiency, transparency, and taxpayer experience in the assessment process?

LIST OF FURTHER READINGS

- **Direct Taxes Law and Practice**
Author: Dr. Vinod K. Singhania & Dr. Kapil Singhania
Publisher: Taxmann
- **Direct Taxes Ready Reckoner with Tax Planning**
Author: Dr. Girish Ahuja & Dr. Ravi Gupta
Publisher: Wolters Kluwer

OTHER REFERENCES (INCLUDING WEBSITES AND VIDEO LINKS)

- Income Tax Act, 1961: <https://www.incometaxindia.gov.in/Pages/acts/income-tax-act.aspx>
- Income Tax Rules, 1962: <https://www.incometaxindia.gov.in/Pages/rules/income-tax-rules-1962.aspx>
- Circulars: <https://www.incometaxindia.gov.in/Pages/communications/circulars.aspx>
- Notifications: <https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx>

KEY CONCEPTS

■ Appeal ■ Faceless Appeal ■ Revision of Order ■ Penalty ■ Offence ■ Prosecution

Learning Objectives

To understand the:

- The orders which are appealable before different appellate authorities.
- The time limit for filing an appeal before different appellate authorities.
- What are the provisions for filing Appeals before different appellate authorities?
- The relevant rules with respect to filing of an appeal.
- The relevant Forms with respect of filing an appeal.
- Circumstances where the order passed by the assessing officer shall be deemed to be erroneous in so far as it is prejudicial to the interest of Revenue.
- Revision of Orders prejudicial to the interest of assessee.
- Time limit for revision of order
- What is the ground and quantum of penalties imposed?
- What is the ground and quantum of Prosecution imposed?

Lesson Outline

- Introduction
- Appeal before Joint Commissioner (Appeal)
- Appeal before Commissioner (Appeals)
- Appealable order before Joint Commissioner [Appeals]
- Appealable order before Commissioner [Appeals]
- Period of limitation to prefer an Appeal
- Payment of tax before filing Appeal
- Procedure for filing an Appeal
- Powers of the Joint Commissioner or Commissioner [Appeals]
- Faceless Appeals
- Appeal before Appellate Tribunal
- Appealable orders before Appellate Tribunal
- Procedure for filing Appeal Appellate Tribunal
- Order of Appellate Tribunal
- Procedure of Appellate Tribunal
- Appeal Before High Court
- Appeal Before Supreme Court
- Revision of orders by Commissioner of Income Tax
- Revision of orders prejudicial to the interest of Revenue
- Revision of orders in the Interest of Assessee
- Circumstances in which no revision can be made
- Offence and Penalties
- Offence and Prosecution
- Lesson Round-Up
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

Sections	Income-tax Act, 1961
Section 246	Appealable order before Joint Commissioner (Appeals)
Section 246A	Appealable order before Commissioner (Appeals)
Section 249(1)	Procedure for filing of Appeal to Joint Commissioner (Appeals) or Commissioner (Appeals)
Section 249(2)	Period of Limitation to prefer an Appeal before Joint Commissioner (Appeals) or Commissioner (Appeal)
Section 249(4)	Payment of Tax before filing Appeal before Joint Commissioner (Appeals) or Commissioner Appeal
Section 250	Procedure an Appeal before Joint Commissioner (Appeals) or Commissioner Appeal
Section 250(6B)	Faceless Appeal Scheme
Section 251	Powers of the Commissioner (Appeals)
Section 252	Appellate Tribunal
Section 253(1), (2)	Appealable Orders to Appellate Tribunal
Section 253(3), (4) & (6)	Procedure for filing appeal before Appellate Tribunal
Section 254	Order of Appellate Tribunal
Section 255	Procedure of Appellate Tribunal
Section 260A	Appeal to High Court
Section 261	Appeal to the Supreme Court
Section 263	Revision of orders prejudicial to the Interest of Revenue
Section 264	Revision of orders prejudicial to the Interest of Assessee
Relevant Rules	Income Tax Rules, 1962
Rules 45	Form of appeal to Joint Commissioner (Appeals) or Commissioner (Appeals)
Rule 46A	Production of additional evidence before the Joint Commissioner (Appeals) and Commissioner (Appeals)
Rules 47	Form of appeal and memorandum of cross-objections to Appellate Tribunal
Relevant Forms	
Form No. 35	Form of Filing an appeal to Joint Commissioner (Appeals) or Commissioner (Appeals)
Form No. 36	Form of Filing an appeal before Income Tax Appellate Tribunal
Form No. 36A	Memorandum of Cross Objection

INTRODUCTION

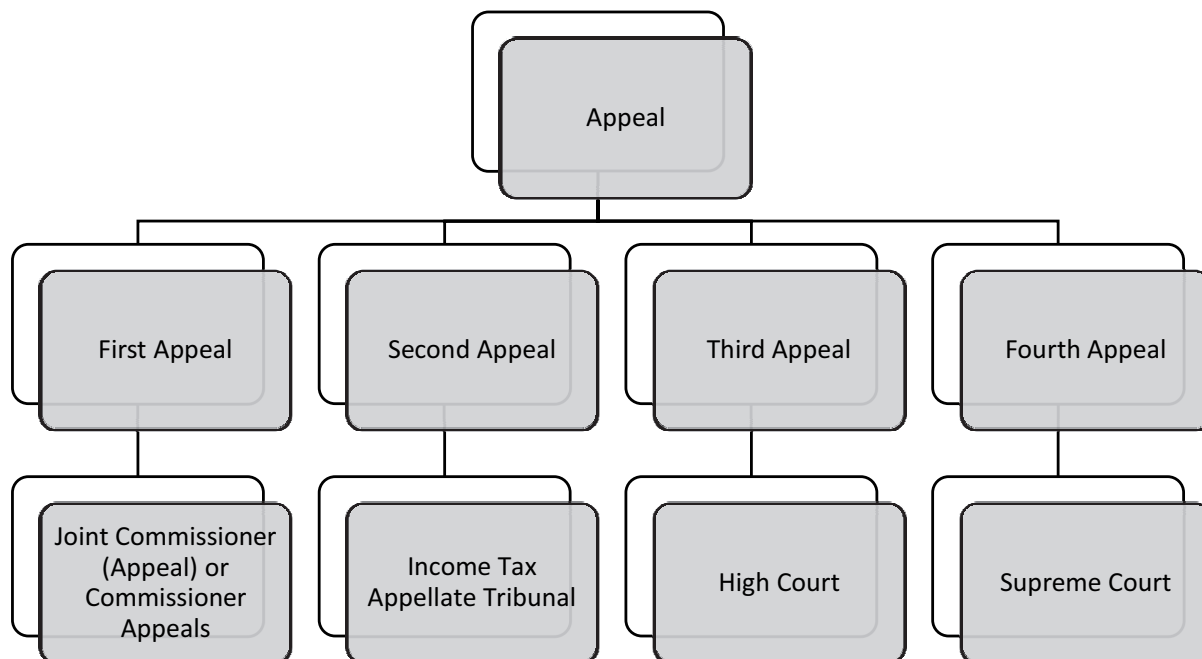
The right to appeal arises where the taxpayer is aggrieved by the order passed by the income-tax authority. Where the Assessing Officer accepts the return filed by the tax payer and passes an order making no modification, an appeal does not lie against that order as the taxpayer cannot be said to be aggrieved of that order.

An appeal is a complaint to a superior authority of an injustice done by inferior authority. The party complaining is called “Appellant” and the other party is known as “Respondent”

The right to appeal must be given by express enactment in the Act. Therefore, in case there is no provision in the Act for filing an appeal regarding a particular matter, no appeal shall lie. The right to appeal arises where the taxpayer is aggrieved by the order passed by the income-tax authority. However, where the Assessing Officer accepts the return filed by the tax payer and passes an order making no modification, an appeal does not lie against that order as the taxpayer cannot be said to be aggrieved of that order. Similarly, where an appellate authority accepts the contention of the taxpayer and allows the appeal, there is no further appeal by the assessee against that order.

The assessee may prefer an appeal against the orders of the Assessing Officer to the Joint Commissioner (Appeals) or Commissioner (Appeals) as the case may be, in accordance with the relevant provisions under Section 246 or 246A and appeal against the order of the Joint Commissioner (Appeals) or Commissioner (Appeals) can be preferred by the Assessee or the Income Tax Authority and such appeal lies with the Appellate Tribunal.

The Finance (No.2) Act, 1998 has amended the provisions regarding remedy against order of Tribunal. Where earlier the assessee or the CIT, if not satisfied with the order of Tribunal, could only request the Tribunal to refer that matter to the High Court. After 1.10.98 as provided by Finance (No.2) Act, 1998 the assessee or CIT if not satisfied with the order of the tribunal can appeal directly to the High Court, if High Court is satisfied that the case involve a substantial question of law and if the assessee or Commissioner of Income-tax is not satisfied with the order passed by the High Court they may file an appeal against the order of the High Court to the Supreme Court. However, it should be noted that in the case of question of fact tribunal is the final & binding authority and its decision is final.



APPEALABLE ORDERS BEFORE JOINT COMMISSIONER (APPEALS) (SECTION 246)

Any assessee aggrieved by any of the following orders of an Assessing Officer (below the rank of Joint Commissioner) may appeal to the Joint Commissioner (Appeals) against:

- (a) an order being an intimation under section 143(1), where the assessee objects to the making of adjustments, or any order of assessment under sub-section (3) of section 143 or section 144, where the assessee objects to the amount of income assessed, or to the amount of tax determined, or to the amount of loss computed, or to the status under which he is assessed;
- (b) an order of assessment, reassessment or re-computation under section 147;
- (c) an order being an intimation under sub-section (1) of section 200A;
- (d) an order under section 201;
- (e) an order being an intimation under sub-section (6A) of section 206C;
- (f) an order under sub-section (1) of section 206CB;
- (g) an order imposing a penalty under Chapter XXI; and
- (h) an order under section 154 or section 155 amending any of the orders mentioned in clauses (a) to (g):

However, no appeal shall be filed before the Joint Commissioner (Appeals) if an order referred to in this sub-section is passed by or with the prior approval of, an income-tax authority above the rank of Deputy Commissioner.

Further, the Board or an income-tax authority so authorised by the Board, may transfer any appeal which is pending before a Joint Commissioner (Appeals) and any matter arising out of or connected with such appeal and which is so pending, to the Commissioner (Appeals) who may proceed with such appeal or matter, from the stage at which it was before it was so transferred. However, where an appeal is transferred the appellant shall be given an opportunity of being reheard.

APPEALABLE ORDERS BEFORE COMMISSIONER (APPEALS) (SECTION 246A)

Appeal can be filed before Commissioner (Appeals), when a tax payer is adversely affected by following orders as passed by various Income tax authorities:

- against an order passed by a Joint Commissioner under Clause (ii) of Sub-section (3) of Section 115VP or an order against the assessee where he denies his liability to be assessed under the Income Tax Act, or an intimation under section 143 (1) or (1B) or section 200A(1) or section 206CB(1), where the assessee or deductor or collector objects to making of adjustment or any order of assessment under section 143(3) except an order passed in pursuance of directions of Dispute Resolution Panel or Section 144 where assessee object to the amount of income assessed or amount of tax determined or amount of loss computed or status under which he is assessed;
- against an order of assessment, re-assessment or re-computation under Section 147 except an order passed in pursuance of directions of dispute resolution panel or Section 150;
- an order of assessment or reassessment under Section 153A except an order passed in pursuance of directions of dispute resolution panel;
- an order of assessment or re-assessment under section 92CD(3);
- against an order of rectification of mistake under Section 154 or Section 155 having effect of enhancing assessment or reducing refund or order refusing to allow claim made by assessee under these sections;
- against an order under Section 163 treating the assessee as the agent of a non-resident;

- against an order under Section 170(2) or 170(3) relating to succession of business otherwise on death;
- against an order made under Section 171;
- against an order under Section 185;
- against an order cancelling the registration of firm under section 186(1) or (2);
- against an order under Section 237;
- against an order under Section 239A;
- against an order under Section 201 or 206C(6A);
- A person deemed to be an assessee in default for not collecting the whole or any part of tax or after collecting the tax, failing to pay the same, may appeal before Commissioner (Appeals) on or after April 1, 2007.
- against an order imposing a penalty under Section 221, 271, 271A, 271AAA, 271AAB, 271F, 271FB, 272AA, Section 272, 272B, 272BB or Section 273;
- an order of imposing or enhancing penalty under Section 275(1A);
- against an order of assessment made by an assessing officer u/s section 158BC(c) or Section 158BC(1) (c), in respect of search initiated under Section 132 or books of account, other documents or any assets requisitioned under Section 132A;
- against an order imposing a penalty under Sub-section (2) of Section 158BFA;
- against an order imposing penalty under Section 271B or Section 271BB;
- against an order made by a Joint Commissioner imposing a penalty under Section 271C, Section 271CA, Section 271D or Section 271E;
- against an order made by a Joint Commissioner imposing a penalty under Section 272AA and by a Joint Commissioner or Joint Director under Section 272A;
- against an order imposing a penalty under Chapter XXI of Income-tax Act;
- against an order made by an Assessing Officer other than a Joint Commissioner under the provisions of this Act, in case of specified person or classes of persons.

PROCEDURE FOR FILING AN APPEAL BEFORE JOINT COMMISSIONER (APPEALS) OR COMMISSIONER APPEAL [SECTION 249(1)]

Relevant Form and document to be filed:

- (a) Form 35 (including statement of facts and grounds of appeal) - in duplicate. However, e-filing has been made mandatory for persons for whom e-filing of return of income is mandatory w.e.f 1/3/2016.
- (b) One copy of order appealed against
- (c) Notice of demand in original
- (d) Copy of challans of fees. The details of the challan (i.e., BSR code, date of payment of fee, serial number and amount of fee) are required to be furnished in case of e-filing of form of appeal. The appeal should be filed in Form No. 35 and verified in the prescribed manner. In this form, details such as name and address of the tax payer, Permanent Account Number (PAN), assessment year, details of the order against which appeal is filed etc. are to be filled in.

Form No. 35 is the prescribed form under Rule 45(1). The form of appeal, the grounds and the verification appended to the form 35 should be furnished electronically under digital signature or through electronic verification code as per provisions applicable to the signing of return under Section 140. It also requires the memorandum of appeal, statement of facts and the grounds of the appeal must be in duplicate and should be accompanied by a copy of the order appealed against and the notice of demand in original, if any.

Against the column “Relief claimed in appeal”, amount of reductions sought in income or any other relief sought in appeal is to be mentioned.

In the column “Statement of Facts”, relevant facts in respect of each subject matter of appeal are to be mentioned in brief. Nature of business or profession, account books maintained etc. may also be mentioned in this column.

Against column “Grounds of appeal”, points on which relief is sought in appeal are to be mentioned in narrative form. For example, in an appeal against addition to the returned income by applying a gross profit rate on estimated turnover, the ground of appeal may be, “the Ld. Assessing Officer was not justified in rejecting the results as per regular books of account and in estimating the income by applying an adhoc rate of gross profit.”

Prescribed Fees

Prescribed fees to be paid before filing appeal to the Joint Commissioner (Appeals) OR Commissioner (Appeals) depends upon total income as determined by the Assessing Officer. Fees as under are to be paid and proof of payment of fee is to be attached with Form No. 35.

Sl. No.	Assessed Income (i.e. total income as computed / determined by the Assessing Officer)	Fees
1	Rs. 1,00,000 or less	Rs. 250
2	More than Rs. 1,00,000 but not more than Rs. 2,00,000	Rs. 500
3	More than Rs. 2,00,000	Rs. 1000
4	Any other case	Rs. 250

Appeal fee can be paid in any branch of authorised bank/ State Bank of India/Reserve bank of India along-with challan. E-payment can also be made.

PERIOD OF LIMITATION TO PREFER AN APPEAL BEFORE JOINT COMMISSIONER (APPEALS) OR COMMISSIONER APPEAL [SECTION 249(2)]

The appeal has to be presented within the period of limitation as given below:

- 1. Appeal by person denying liability to deduct tax in respect of payments payable to non-resident or a foreign company [Section 249(2)(a)] :** Where the appeal relates to any tax deducted at source from payment made to a non-resident, (other than a company) or to a foreign company, any interest, other than interest on securities or any other sum chargeable under the provisions of the Income-tax Act (not being salaries), within 30 days from the date of payment of tax deducted at source to the credit of the Central Government.
- 2. Appeal against assessment to penalty [Section 249(2)(b)]:** Where the appeal relates to any assessment or penalty order the appeals have to be presented within 30 days of the date of service of the notice of demand relating to that assessment or penalty order.
- 3. Other appeals [Section 249(2)(c)]:** In any other case, the appeal has to be presented within 30 days of the date on which intimation of the order sought to be appealed against is served on the appellant.

In computing the period of limitation for an appeal or an application, the day on which the order is served has to be excluded.

If the assessee was not furnished with a copy of the order along with the notice of the order, or demand, the time required for obtaining a copy of such order is also to be excluded and the date will be extended by that period. It may be noted that even where the assessee has not been supplied with copy of the order concerned, the time taken in making an application which does not comply with all the legal requirements cannot be excluded under the provisions of Section 268. If the application for obtaining the copy of the order has not been properly stamped or has been made by a person not authorised to do so, the time which has elapsed between the making of the invalid application and putting the application in order would not be excluded in computing the period of limitation.

If any appeal is filed after the period of limitation, Joint Commissioner (Appeals) OR the Commissioner (Appeals) may admit the appeal after the said period if he is satisfied that the appellant had sufficient cause for not presenting the appeal within that period (Section 249(3)). Such delayed appeals must be accompanied by a condonation petition showing and explaining the reason/cause of the appellant for not being able to file the appeal within the period of limitation and praying for condemnation of the delay. The power to condone the delay is discretionary and the discretion must be judiciously exercised. The discretion is to be exercised where sufficient cause for not presenting the appeal within the time is made out by the appellant. The period for filing an appeal cannot be extended simply because the appellant's case is hard and calls for sympathy or merely out of benevolence to the party seeking relief. The sufficient cause must be a cause which is beyond the control of the party seeking the condonation of the delay. Illness is sufficient cause, if it can be shown that the man was utterly disabled to attend to any duty. The cause for delay in filing the appeal which, by due care and attention could have been avoided cannot be a sufficient cause. Negligence on the part of the servants or agent entrusted with the filing of the appeal cannot be considered as a sufficient cause. The change of legal situation brought about by a decision of the Supreme Court may be valid ground for condoning delay. The words "sufficient cause" should receive a liberal interpretation so as to advance substantial justice where no negligence nor inaction nor want of bona fide is imputable to the applicant.

An appeal presented after the period of limitation is still an "appeal" and an order dismissing it as time barred is one passed in appeal [under Section 250 and not under Section 249(3)]. An appeal lies therefrom to the Appellate Tribunal and thereafter to the High Court on a question of law.

Provided further that where an application has been made under sub-section (1) of section 270AA, the period beginning from the date on which the application is made, to the date on which the order rejecting the application is served on the assessee, shall be excluded.

PAYMENT OF TAX BEFORE FILING APPEAL [SECTION 249(4)]

No appeal against any order passed by the Assessing Officer can be admitted by the Joint Commissioner (Appeals) OR Commissioner (Appeals) unless as the assessee has paid the tax due on the income returned by him where a return has been filed by the assessee or where the assessee has not furnished the return of income, he has paid an amount equal to the amount of advance tax which was payable by him.

If the appellant wants exemption from the payment of such tax, he has to make an application to the Joint Commissioner (Appeals) OR Commissioner (Appeals) who is empowered to waive this requirement in appropriate cases if he is satisfied that there are good and sufficient reasons for doing so.

In such cases, the Joint Commissioner (Appeals) OR Commissioner (Appeals) is required to record such reasons in writing. It may be noted that Income-tax law requires only the payment of tax before the filing of the appeal and not the payment of any penalty or any other sum payable by the assessee on the basis of the order appealed against.

SUBMISSION OF PAPER BOOK

The appellant or the respondent, i.e., the opposite may submit a paper book. A paper book is to be submitted in duplicate and should contain documents or statements or other papers referred to in the assessment order or the appellate order on which appellant/respondent wants to rely.

- The paper book should be duly indexed and page numbered.
- It should be filed at least a day before the hearing of the appeal.
- It should be filed along-with the proof of service of copy of the paper book to the opposite party at least a week before.
- Each paper in the paper book is to be certified as true copy by the party filing the same.

The delay in filing the paper book may be condoned in genuine cases of delay.

The ITAT can also on its own direct the preparation of paper book in triplicate by and at the cost of appellant or the respondent as it may consider necessary for disposal of appeal.

Additional evidence, if any, should be filed separately and should not form part of the paper book.

PROCEDURE IN APPEAL (SECTION 250)

Joint Commissioner (Appeals) OR Commissioner (Appeals) shall fix a day and place for the hearing of the appeal and shall give notice of the same to the appellant and to the Assessing Officer against whose order the appeal is preferred.

The following shall have the right to be heard at the hearing of the appeal:

- (a) The appellant, either in person or by an authorised representative.
- (b) The Assessing Officer,

The Joint Commissioner (Appeals) OR Commissioner (Appeals) shall have the power to adjourn the hearing of the appeals from time to time. He may, before disposing of any appeal, make such further enquiry as he deems fit, or may direct the Assessing Officer to make further enquiry and report as he deems fit, or may direct the Assessing Officer to make further enquiry and report the result of the same to the Joint Commissioner (Appeals) OR Commissioner (Appeals) as the case may be.

The Joint Commissioner (Appeals) OR Commissioner (Appeals) may, at the hearing of an appeal, allow the appellant to go into any ground of appeal not specified in the grounds of appeal if he is satisfied that the omission of that ground from the form of appeal was not willful or unreasonable. His order disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reasons for the decision. In every appeal, the Joint Commissioner (Appeals) OR Commissioner (Appeal), where it is possible, may hear and decide such appeal within a period of one year from the end of the financial year in which such appeal is filed before him Joint Commissioner (Appeals) OR Commissioner (Appeal) under Section 246A(1). On the disposal of the appeal, Joint Commissioner (Appeals) OR the Commissioner (Appeals) shall communicate the order passed by him to the assessee and to the Chief Commissioner or Commissioner.

Rule 46A Production of additional evidence before the Joint Commissioner (Appeals) and Commissioner (Appeals)

The appellant shall not be entitled to produce before the Joint Commissioner (Appeals) or, as the case may be, the Commissioner (Appeals), any evidence, whether oral or documentary, other than the evidence produced by him during the course of proceedings before the Assessing Officer, except in the following circumstances:

- a) where the Assessing Officer has refused to admit evidence which ought to have been admitted ; or

- b) where the appellant was prevented by sufficient cause from producing the evidence which he was called upon to produce by the Assessing Officer ; or
- c) where the appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence which is relevant to any ground of appeal ; or
- d) where the Assessing Officer has made the order appealed against without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground of appeal.

However, no additional evidence shall be admitted unless the Joint Commissioner (Appeals) or, as the case may be, the Commissioner (Appeals) records in writing the reasons for its admission and a reasonable opportunity be given to the assessing officers to examine the evidence or document or to cross-examine the witness produced by the appellant or to produce any evidence or document or any witness in rebuttal of the additional evidence produced by the appellant.

Decision and Order of Joint Commissioner (Appeals) or CIT (Appeals)

After the hearing is concluded, Joint Commissioner (Appeals) OR Commissioner (Appeals) passes order in writing, disposing of the appeal and stating the decision on each ground of appeal with reasons. In case of assessment and penalty, Joint Commissioner (Appeals) OR Commissioner (Appeals) may confirm, reduce or enhance it (including assessment in respect of which proceedings before the Settlement Commission abates). Before enhancing any assessment or penalty, it has to provide reasonable opportunity to the tax payer for showing cause against such enhancement. However, if such an appeal is against an order of assessment made under section 144, the Commissioner (Appeals) may set aside the assessment and refer the case back to the Assessing Officer for making a fresh assessment. (effective from 01-10-2024)

While disposing of an appeal, the Joint Commissioner (Appeals) OR Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which order appealed against was passed, even if such matter was not raised by the tax payer.

FACELESS APPEAL [SECTION 250(6B)]

Following amendments have been made by the Finance Act, 2020 in section 250 of the Income Tax Act, 1961 which deals with the appeals before CIT (Appeals) to provide for the legal basis to the Faceless Assessment Scheme. In section 250 of the Income-tax Act, the sub-sections 6(B) has been inserted as under:

“(6B) The Central Government may make a scheme, by notification in the Official Gazette, for the purposes of disposal of appeal by Commissioner (Appeals), so as to impart greater efficiency, transparency and accountability by:

- (a) eliminating the interface between the Commissioner (Appeals) and the appellant in the course of appellate proceedings to the extent technologically feasible;
- (b) optimising utilisation of the resources through economies of scale and functional specialisation;
- (c) introducing an appellate system with dynamic jurisdiction in which appeal shall be disposed of by one or more Commissioner (Appeals).”

Notification of the Scheme of Faceless Appeals

Accordingly, the Central Government has notified the Scheme called the Faceless Appeal Scheme, 2020 vide CBDT Notification No. 76/2020 and No.77/ 2020 dated 25.09.2020 to provide for e-appeal and for the online hearing and disposal of appeals related to income-tax disputes by the Commissioner (Appeals). This scheme shall become effective from 25.09.2020 and shall apply to all the pending appeals and any further new appeals filed under the Income Tax Act. CBDT has further notified the Faceless Appeal Scheme 2021, effective from

28-12-2021. The new scheme is notified in supersession of the earlier Faceless Appeal Scheme, 2020. Under Faceless Appeals, all Income Tax appeals will be finalised in a faceless manner under the faceless ecosystem.

Under the Faceless Appeals, everything from e-allocation of appeal, e-communication of notice / questionnaire, e-verification / e-enquiry to e-hearing and finally e communication of the appellate order, the entire process of appeals will be online, dispensing with the need for any physical interface between the appellant and the Department. There will be no physical interface between the taxpayers or their counsel/s and the Income Tax Department.

File Appeal

A taxpayer can file an appeal through his registered account on the Income Tax e-filing portal. All notices, letters and orders are issued using unique Document Identification Number (DIN) through electronic mode only.

Scope of the Scheme

The appeal under this Scheme shall be disposed of in respect of such territorial area or persons or class of persons or incomes or class of incomes or cases or class of cases, as may be specified by the Board.

Faceless Appeal Centers

For the purposes of this Scheme, the Board set up

- i. National Faceless Appeal Centre to facilitate the conduct of e-appeal proceedings in a centralised manner, which shall be vested with the jurisdiction to dispose appeal in accordance with the provisions of this Scheme;
- ii. Appeal units, as it may deem necessary to facilitate the conduct of e-appeal proceedings, to perform the function of disposing appeal, which includes admitting additional grounds of appeal, making such further inquiry as thinks fit, directing the (National Faceless Assessment Centre) or the Assessing Officer, as the case may be, for making further inquiry, seeking information or clarification on admitted grounds of appeal, providing opportunity of being heard to the appellant, analysis of the material furnished by the appellant, and such other functions as may be required for the purposes of this Scheme;

and specify their respective jurisdiction.

Procedure of Conduct of Faceless Appeals

Under the newly substituted 'Faceless Appeal Scheme, 2021', the appeal of the taxpayer before the CIT (Appeal), shall be disposed of as per the following procedure, namely:

- (1) **Assignment of Appeal:** The National Faceless Appeal Centre shall assign the appeal for disposal to a Commissioner (Appeals) of a specific appeal unit through an automated allocation system;
- (2) **Communications through NFAC:** All communication between the Commissioner (Appeals) and the appellant or any other person or the Assessing Officer with respect to the information or documents or evidence or any other details, as may be necessary under this Scheme shall be through the National Faceless Appeal Centre.
- (3) **Assignment of Appellate Proceedings:** On assignment of an appeal, the Commissioner (Appeals):
 - a) May **condone the delay in filing appeal** if the appeal is filed beyond the time permitted under Section 249 of the Act and record the reasons for such condonation or otherwise in the appeal order passed by him;

- b) Shall through the NFAC **give notice to the appellant asking him to file his submission** within the date and time specified in such notice and also send a copy of such notice to the Assessing Officer either directly or through the NFAC, as the case may be;
 - c) May through the NFAC **obtain such further information, document or evidence from the appellant** or any other person, as the case may be;
 - d) May through the NFAC **obtain a report of the Assessing Officer either directly or through the NFAC**, as the case may be, on grounds of appeal or information, document or evidence furnished by the appellant;
 - e) May, through the NFAC, request the Assessing Officer directly or through the NFAC, as the case may be, **for making further inquiry under Section 250(4) of the Act and submit a report** thereof;
 - f) Shall, through the NFAC **serve a notice upon the appellant** or any other person, as the case may be, **or the Assessing Officer** directly or through the NFAC, as the case may be, **to submit such information, document or evidence or report**, as the case may be, as may be specified by the Commissioner (Appeals) or relevant to the appellate proceedings, on a specified date and time;
- (4) **Response to Notice:** The appellant shall file a response against the notice received. The NaFAC/AO shall furnish a report in response to the notice within the specified time or extended time as may be allowed based on an application made to the NFAC.
- (5) **Forwarding of Response to AU:** The NFAC shall forward the response of the appellant or report of NaFAC/AO to the Commissioner (Appeals) in Appeal Unit (AU). However, where no response/report, as the case may be, has been filed/received, then the NFAC shall inform the Commissioner (Appeals) in AU, about the same.
- (6) **Raising of Additional Grounds of Appeal:** The appellant may file additional grounds of appeal to the Commissioner (Appeals) through the NFAC, in such form, as may be specified by the NFAC, specifying therein the reason for omission of such ground in the appeal filed by him. The Commissioner (Appeals) in AU shall through NFAC, send the additional ground of appeal to NaFAC/AO. The NaFAC/AO shall furnish their comments to the Commissioner (Appeals) in AU through NFAC, within the specified or extended time limit.
- (7) **Admission or Rejection of Additional Grounds of Appeal:** The Commissioner (Appeals) in AU shall, after taking into consideration the comments, if any, received from the NaFAC/AO, as the case may be,
- (a) if is satisfied that the omission of additional ground from the form of appeal was not wilful or not unreasonable, admit such ground; or
 - (b) in any other case, not admit the additional ground, for reasons to be recorded in writing in the appeal order passed by him.

The NFAC shall intimate the admission or rejection of the additional ground to the appellant.

- (8) **Submission of Additional Evidence:** The appellant may furnish additional evidence to the Commissioner (Appeals) through the NFAC, in such form as may be specified by the NFAC, specifying therein how his case is covered by the exceptional circumstances specified in sub-rule (1) of Rule 46A. The Commissioner (Appeals) in AU shall, through NFAC, send the additional evidence to NaFAC/AO, for furnishing a report on the admissibility of additional evidence in accordance with Rule 46A of the Rules. The NaFAC/AO shall furnish their remand report to the Commissioner (Appeals) in AU through NFAC, within the specified or extended time limit.

Before taking into account the additional evidence, the Commissioner (Appeals) in AU shall provide an opportunity to the NaFAC/AO to examine such evidence or to cross-examine witnesses produced by the appellant or to produce any evidence or document or any witness in rebuttal. Accordingly, the NFAC shall serve a notice to the NaFAC/AO.

The NaFAC/AO may request the Commissioner (Appeals) in AU through NFAC to direct the production of any document or evidence by the appellant or the examination of any witness. Based on the examination, the NaFAC/AO shall furnish the report to the Commissioner (Appeals) in AU through NFAC.

Accordingly, the Commissioner (Appeals) in AU, shall serve a notice to the Appellant through NFAC. NFAC shall send the appellant's response to such notice to the Commissioner (Appeals) in AU.

- (9) **Admission or Rejection of Additional Evidence:** The Commissioner (Appeals) in AU may, after considering the additional evidence furnished by the appellant and the remand report, if any, furnished by the AO/NaFAC, as the case may be, admit or reject the additional evidence, for reasons to be recorded in writing, and the same shall form a part of the appeal order passed by him.
- (10) **Enhancement of assessment/ penalty/ reduce the amount of refund:** Where the Commissioner (Appeals) in AU intends to enhance assessment or reduce the amount of refund, then he shall prepare a show-cause notice containing the reasons for such proposed action and send such show-cause notice to the appellant through NFAC.

The appellant shall, within the specified or extended time, furnish his response to the NFAC. The NFAC shall send the appellants' response to the Commissioner (Appeals) in AU. In case a response is not received, the NFAC shall inform about the same to him.

- (11) **Passing of the Final Appeal Order:** The Commissioner (Appeals) shall, thereafter:
 - (a) prepare in writing, an appeal order in accordance with the provisions of Section 251 of the Act, stating the points for determination, the decision thereon and the reason for decision; and
 - (b) send such order after signing the same digitally to the NFAC along with the details of the penalty proceedings, if any, to be initiated therein;
- (12) **Communication of Final Appeal Order:** The NFAC shall, upon receipt of the final appeal order,
 - (a) communicate such order to the appellant;
 - (b) communicate such order to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner as per sub-section (7) of section 250 of the Act;
 - (c) communicate such order to the Assessing Officer either directly or through the National Faceless Assessment Centre, as the case may be, for such action as may be required under the Act;
 - (d) where initiation of penalty has been recommended in the order, serve a notice on the appellant calling upon him to show cause as to why penalty should not be imposed upon him under the relevant provisions of the Act.

The appeal may be transferred at any stage of the appellate proceedings, if considered necessary, by an order in accordance with Section 120 of the Act, to such Commissioner (Appeals) as may be specified in the order.

No personal appearance in the Appeal Centres or Units & Vested Right of Personal Hearing through Video Conferencing

- (1) A person shall not be required to appear either personally or through authorised representative in connection with any proceedings under this scheme before the income-tax authority at the National Faceless Appeal Centre or appeal unit set up under this Scheme.

- (2) The appellant or his authorised representative, as the case may be, may request for personal hearing so as to make his oral submissions or present his case before the Commissioner (Appeals), through the National Faceless Appeal Centre, under this Scheme.
- (3) The concerned Commissioner (Appeals) shall allow the request for a personal hearing and communicate the date and time of the hearing to the appellant through the National Faceless Appeal Centre.
- (4) Such hearing shall be conducted through video conferencing or video telephony, including the use of any telecommunication application software which supports video conferencing or video telephony, to the extent technologically feasible, in accordance with the procedure laid down by the Board.
- (5) Any examination or recording of the statement of the appellant or any other person shall be conducted by Commissioner (Appeals) under this Scheme, exclusively through video conferencing or video telephony, including the use of any telecommunication application software which supports video conferencing or video telephony, to the extent technologically feasible, in accordance with the procedure laid down by the Board.
- (6) The Board shall establish suitable facilities for video conferencing or video telephony, including telecommunication application software which supports video conferencing or video telephony at such locations as may be necessary, so as to ensure that the appellant, or his authorised representative, or any other person is not denied the benefit of this Scheme merely on the ground that such appellant or his authorised representative, or any other person does not have access to video conferencing or video telephony at his end.

Penalty proceedings to be initiated by same Commissioner (Appeals): The Commissioner (Appeals) has been authorized to send a notice to the appellant through the NFAC to initiate any penalty proceedings. The same Commissioner (Appeals) who has completed the appeal proceedings is authorized to conduct penalty proceedings.

No exemption from paying tax in case of a non-filer of return: Proviso to Section 249(4)(b) provides that where an assessee has not filed the return of income, the CIT(A) shall not admit appeal unless an amount equal to the advance tax payable by him has been paid. However, for good and sufficient reasons recorded in writing, the CIT(A) may exempt the assessee from the requirement of payment of such tax.

Orders passed by Commissioner (Appeals) to be digitally signed: Under the new Faceless Appeal Scheme, all the orders (appeal order, penalty order, or rectification order) shall be signed digitally by the Commissioner (Appeals) before sending to National Faceless Appeal Centre.

How to file Rectification

An application for rectification of appellate order passed by CIT (Appeals), where there is “mistake apparent from record” u/s 154 of IT Act, may be filed through the registered account on the Income Tax e-filing portal.

Grievance redressal mechanism

To redress the grievances of taxpayer in respect of faceless appeal proceedings a dedicated email id *samadhan.faceless.appeal@incometax.gov.in* is in place.

For detailed reading of Faceless Appeal Scheme, 2021 students are advised to visit the following **weblink**: <https://incometaxindia.gov.in/pages/faceless-scheme.aspx>

POWERS OF THE JOINT COMMISSIONER (APPEALS) OR COMMISSIONER (APPEALS) (SECTION 251)

In disposing of an appeal, Joint Commissioner (Appeals) or the Commissioner (Appeals) shall have the following powers:

1. In an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment. However, where such appeal is against an order of assessment made under section 144, he may set aside the assessment and refer the case back to the Assessing Officer for making a fresh assessment.
2. In an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it so as to either enhance or reduce the penalty.
3. In any other case, he may pass such orders in the appeal as he deems fit.

The Joint Commissioner (Appeals) or Commissioner (Appeals) shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction.

While disposing an appeal, Joint Commissioner (Appeals) or the Commissioner (Appeals) may consider and decide the facts arising out of the proceedings which in respect of order appealed against were carried notwithstanding that such matter was not raised before the Joint Commissioner (Appeals) or Commissioner (Appeals) by the appellant.

In an appeal against the order of assessment in respect of which the proceedings before the Settlement Commission abates under the section 245HA, the Commissioner (appeals) can confirm, reduce, enhance or annul the assessment after taking into consideration of the following -

1. the material and other information produced by the assessee before the Settlement Commission
2. the results of the enquiry held by the Settlement Commission
3. the evidence recorded by the Settlement commission in the course of proceedings before it
4. such other material as may be brought on his record.

APPELLATE TRIBUNAL (SECTION 252)

The Central Government constituted an Appellate Tribunal consisting of as many judicial and accountant members as it thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal by this Act. The Income Tax Appellate Tribunal (ITAT) is constituted and works under the Ministry of Law. It is thus a body outside the administrative control of the Central Board of Direct Taxes.

The Appellate Tribunal is not an Income-tax Authority in the sense of being an integral part of the department. On the contrary, by its constitution, powers and jurisdiction, not to speak of the manner of their recruitment, the Tribunal is an independent arbitral tribunal. The proceedings before it are advisory. It has also the trappings of a judicial body in the sense that it has to deal with the Department on the one side, and the assessee on the other in as much as they face each other as opposing parties. In such a situation the Tribunal has to decide only those issues which are properly raised before it by the one or the other party in the appeal or in the cross objections. Under the Act, the Tribunal has got to decide an appeal and not merely give it a disposal by dismissing it for default of appearance. This, however, does not mean that the Tribunal has got to take upon themselves the responsibility of finding facts or points of law which are not urged by the Department or the assessee, as the case may be. *CIT v. A. C. Paul (1983) 142 ITA 811 (Mad.)*.

The Tribunal is the final Authority and ordinarily, if after considering the matters in the proper perspective and after surveying all material which is available to it, the Tribunal arrives at some conclusion one way or the other, that conclusion would have to be respected, unless it can be regarded as impossible or perverse. *CIT v. Lalchand Bhabutmal Jain (1985) 151 ITR 360 (Bom.)*.

APPEALABLE ORDERS BEFORE ITAT [SECTION 253(1) AND (2)]

Any assessee aggrieved by any of the following orders may appeal to the Appellate Tribunal against such order.

1. An order passed by Commissioner (Appeals) under Section 154 ordering a rectification of mistake, or Section 158BFA or under Section 250 in connection with the disposal of an appeal or Section 271 imposing a penalty for failure to furnish return etc. or section 270A or Sections 271A or 272A or section 271AAB, or section 271AAC, or section 271AAD or section 271J or section 272A;
2. An order passed by a Joint Commissioner (Appeals) under section 154, section 250, section 270A, section 271, section 271A, section 271AAC, section 271AAD or section 271J
3. An order passed by an assessing officer under Clause (c) of Section 158BC, in respect of search initiated under Section 132 or books of account other documents or any assets requisitioned under Section 132A, after the 30th day of June, 1995 but before the 1st day of January, 1997.
4. An order passed by a Principal Commissioner or Commissioner under Section 12AA or 12AB relating to registration of trust or Section 80G(5)(vi) or under Section 263 relating to revision of orders prejudicial to revenue or section 270A or under section 271 or under Section 272A penalty for failure to answer question, sign statements, allow inspection etc., on or under Section 154 rectifying a mistake, or an order passed by a Chief Commissioner, or a Director General or a director under Section 272A.
5. An order passed by an Assessing Officer under Sub-section (1) of Section 115VZC.
6. An order passed by an Assessing Officer under section 143(3) or section 147 or section 153A or section 153C in pursuance of the directions of the Dispute Resolution Panel or an order passed under section 154 in respect of such order
7. An order passed by an Assessing Officer under section 143(3) or section 147 or section 153A or section 153C with the approval of the Principal Commissioner or Commissioner as referred to section 144BA(12) or an order passed under section 154 or section 155 in respect of such order.
8. An order passed by the prescribed authority under sub-clause (vi) or sub-clause (via) of clause (23C) of section 10.
9. An order passed by prescribed authority under section 10(23C)(iv) and 10(23C)(v) shall also be appealable before the Appellate Tribunal.
10. An order passed of penalty under section 271J as imposed by Commissioner (Appeals).

The Commissioner may, if he objects to any order passed by Joint Commissioner (Appeal) or Commissioner (Appeals) under Section 154 or 250, direct the Assessing Officer to appeal to the Appellate Tribunal against the order.

PROCEDURE FOR FILING APPEAL BEFORE APPELLATE TRIBUNAL [SECTION 253(3), (4) & (6)]

Every appeal to the Appellate Tribunal shall be filed within 2 months from the end of the months in which the order sought to be appealed against is communicated to the assessee or to the Commissioner, as the case may be.

The Assessing Officer or the assessee, as the case may be, on receipt of notice that an appeal against the order has been preferred by the other party may, within thirty days of the receipt of notice, file a memorandum of cross objections, verified in the prescribed manner, against any part of the order. The Appellate Tribunal has to dispose of the such memorandum as if it were an appeal presented within the specified period.

The Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross-objections after the

expiry of the relevant period if it is satisfied that there was sufficient cause for not presenting it within that period.

An appeal to the Appellate Tribunal shall be in the prescribed form 36. In case of appeal by the taxpayer, the form of appeal, the grounds of appeal and the form of verification are to be signed and verified by the person authorised to sign the return of income under section 140. and be accompanied by a fees of:

- (a) Rs. 500 where the assessed income/loss is 1,00,000 rupees or less.
- (b) Rs. 1,500 where the assessed income/loss is more than one hundred thousand rupees but not more than two hundred thousand rupees.
- (c) One percent of the assessed income, subject to a maximum of ten thousand rupees where the assessed income is more than two hundred thousand rupees,
- (d) Rs. 500 in any other case, except in case of an appeal filed by the department or a memorandum of cross objections.

An application for stay of demand has to be accompanied by a fee of Rs. 500.

Form of appeal and memorandum of cross-objections to Appellate Tribunal

An appeal to the Appellate Tribunal shall be made in Form No. 36 . In making an appeal to the Tribunal, the following documents shall be sent in triplicate.

- (a) The memorandum of appeal.
- (b) The grounds of appeal.
- (c) Copy of the order appealed against (including one certified copy).
- (d) Copy of the grounds of appeal and statement of facts filed before the Joint Commissioner (Appeal) or Commissioner (Appeals).
- (e) Copy of the order of the Assessing Officer. (In case of appeal against penalty order – copies of relevant assessment order, In case of appeal against order under section 143(3), read with section 144A - copies of the directions of the Joint Commissioner under section 144A, In case of appeal against order under section 143, read with section 147 - copies of original assessment order, if any)
- (f) Challan for payment of requisite fee.

Where the appellant desires to refer to any documents or evidence he is permitted to file the same with Tribunal in the form of a paper book within one month from the date of filing the appeal. Though the prescribed period in one month, it will be preferable to file the same along with the appeal. Where an appellate order by the Commissioner (Appeals) is passed as a consolidated order for a number of years, appeals to the Tribunal shall be filed separately for each year.

On filing of the appeal to the ITAT by the taxpayer or by the Assessing Officer (as the case may be) the opposite party will be intimated about the appeal and the opposite party has to file a memorandum of cross objection with the ITAT. A memorandum of cross-objections to the Appellate Tribunal shall be made in Form No. 36A and where the memorandum of cross-objection is made by the assessee, the form of memorandum of cross-objections, the grounds of cross-objections and the form of verification appended thereto shall be signed by the person specified.

Submission of Paper Book

The appellant or the respondent may submit a paper book. A paper book is to be submitted in duplicate and should contain documents or statements or other papers referred to in the assessment order or the appellate order on which appellant/respondent wants to rely.

The paper book should be duly indexed and page numbered. It should be filed at least a day before the hearing

of the appeal. It should be filed along-with the proof of service of copy of the paper book to the opposite party at least a week before. Each paper in the paper book is to be certified as true copy by the party filing the same. The delay in filing the paper book may be condoned in genuine cases of delay.

The ITAT can also on its own direct the preparation of paper book in triplicate by and at the cost of appellant or the respondent as it may consider necessary for disposal of appeal. Additional evidence, if any, should be filed separately and should not form part of the paper book.

Filing of Additional Evidence

Filing of additional evidence of any kind, either oral or documentary cannot be filed before the ITAT. However, if the Tribunal requires production of any document, examination of any witness or filing of any affidavit to enable it to pass orders, it may allow such document to be produced, witness to be examined, affidavit to be filed and such evidence to be adduced.

ORDER OF APPELLATE TRIBUNAL (SECTION 254)

The Appellate Tribunal may, after giving both the parties to appeal an opportunity of being heard, pass such orders on any appeal as it may think fit. [section 254(1)]. Sub-section (2A) provides that in every appeal, the Appellate Tribunal, where it is possible may hear and decide such appeal within a period of four years from the end of the financial year in which such appeal is filed under Section 253(1). Sub-section (2B) provides that the cost of any appeal to the Appellate Tribunal shall be at the discretion of the Tribunal.

The Tribunal's decision would have binding effect within the jurisdiction and has a persuasive value outside its jurisdiction.

The ITAT may, on an application made by the taxpayer and after considering the merits of the application, pass an order of stay in any proceedings relating to an appeal filed under section 253(1). The stay shall be granted by the ITAT only when the assessee has 'deposited' or 'furnished security' to the extent of 20% of his tax liabilities (i.e. tax, interest, fee, penalty or any other sum payable under the provisions of this Act). (Inserted by the Finance Act, 2020, Applicable w.e.f. Assessment Year 2020 -21)

Section 254(2A) pertaining to stay of demand by the Appellate Tribunal has been modified as follows:

1. Initially the Tribunal can pass an order of the stay only for a period not exceeding 180 days from the date of the order staying the demand subject to the condition that the assessee deposits not less than twenty per cent of the amount of tax, interest, fee, penalty, or any other sum payable under the provisions of this Act, or furnishes security of equal amount in respect thereof.
2. The Tribunal shall dispose of appeal within the aforesaid period.
3. If appeal is not disposed of within the aforesaid period, the period of stay may be extended. The total period of stay cannot be more than 365 days reckoned from the beginning of the period. Extension is possible only if assessee makes an application and has complied with the condition referred to in the first proviso and delay is not attributable to assessee.
4. Appeal shall be disposed of by the Tribunal within the extended period.
5. If appeal is not disposed of within the extended period or periods, the order of stay shall stand vacated after the expiry of such period or periods, even if the delay in disposing of the appeal is not attributable to the assessee.

The Appellate Tribunal shall send a copy of any orders passed to the assessee and to the Commissioner. On question of fact, the order passed by the Appellate Tribunal on appeal shall be final. An order made by the Appellate Tribunal shall be sufficiently comprehensive and self-contained. It should be possible to ascertain from the order all the relevant facts and the questions arising on the appeal. It should also

disclose what were the contentions of the parties and should state why and for what reasons those contentions were repelled.

No limitation has been placed on the powers of the Commissioner (Appeals) or the Appellate Tribunal under Section 251(1) or 254(1). The only limitation on their appellate jurisdiction is that they cannot go into the question of propriety of ex-parte proceeding or a best judgment assessment. The quantum of assessment, the quantum of tax or the question of registration of a firm can always be gone into. **Vishnu Kumar Gupta v. CIT (1983) 143 ITR 169 (All)**. However, the power of stay is not likely to be exercised in a routine way or as a matter of course in view of the special nature of taxation and revenue laws. Only when a strong prima facie case is made out, the Tribunal will consider whether to stay the recovery proceedings. Stay will be granted only in deserving and appropriate cases and where the Tribunal is satisfied that the entire purpose of the appeal will be frustrated or rendered nugatory by allowing the recovery proceedings to continue during the dependency of the appeal before it.

Section 254(1) empowers the Appellate Tribunal to give its decision on the grounds urged and it can pass appropriate orders. It is not open to the Tribunal itself to raise a ground or permit the party who had not appealed to raise a ground which will work adversely on the appellants.

Under Section 254(2), the Appellate Tribunal has got ample power to rectify a mistake apparent from record suo moto. If the mistake is brought to the notice of the Tribunal by the parties to the appeal, the Tribunal is empowered to rectify the same. *Addl. CIT v. ITAT (1983) 139 ITR 615 (AP)*.

The third proviso to sub-section (2A) provides that if such appeal is not decided within the period allowed originally or the periods so extended or allowed, the order of stay shall stand vacated after expiry of such period or periods.

The intention behind these provisions has been very clear that the Appellate tribunal cannot grant stay either under the original order or any other subsequent order, beyond the period of 365 days in aggregate.

If the Tribunal is unable to decide the appeal on the basis of materials before it, it may admit fresh evidence and decide the appeal. It may also keep the appeal pending and direct any one of the subordinate authorities to ascertain further facts.

Rectification of Appellate Order

The ITAT may, at any time within 6 months from the end of the month in which the order was passed, rectify any mistake apparent from record, amend any order passed by it if the mistake is brought to its notice by the taxpayer or Assessing Officer. However, where such amendment has the effect of enhancing an assessment or reducing a refund or otherwise increasing a liability of the taxpayer, it shall not be made unless the Appellate Tribunal has given a notice to the taxpayer of its intention to do so and has allowed the taxpayer a reasonable opportunity.

Faceless Proceedings before ITAT

To impart greater efficiency, transparency and accountability for the purpose of disposal of appeals by the Appellate Tribunal, the Central Government make a scheme by:

- a) Eliminating the interface between the Appellate Tribunal and parties to the appeal in the course of appellate proceedings to the extent technologically feasible;
- b) Optimizing utilization of the resources through economics of scale and functional specialization;
- c) Introducing an appellate system with dynamic jurisdiction.

The Central Government may, for the purpose of giving effect to the scheme, issue notification in the Official Gazette, to direct that any of the provisions of this Act shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified in the notification.

PROCEDURE OF APPELLATE TRIBUNAL (SECTION 255)

The powers and functions of the Appellate Tribunal may be exercised and discharged by benches constituted by the President of the Appellate Tribunal from amongst the members thereof. The bench shall consist of one judicial member and one accountant member.

The President or any other member of the Appellate Tribunal, authorised in this behalf by the Central Government, may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member and which pertains to an assessee whose, total income as computed by the Assessing Officer in the case does not exceed Rs. 60,00,000. The President may, for the disposal of any particular case, constitute a Special Bench consisting of three or more members, one of whom shall necessarily be a judicial member and one an accountant member.

If the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority if there is a majority. But if the members are equally divided, they shall state the point or points on which they differ and the case shall be referred by the President of the Appellate Tribunal for hearing on such point or points by one or more of the other members of the Appellate Tribunal. Such point or points shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case including those who first heard it.

The Appellate Tribunal shall have the power to regulate its own procedure and the procedure of Benches thereof in all matters arising out of the exercise of its powers or of the discharge of its functions including the places at which the Benches shall hold their sittings.

The Appellate Tribunal shall have, for the purpose of discharging its functions, all the powers which are vested in the Income-tax authorities under Section 131, and any proceeding before the Appellate Tribunal shall be deemed to be a judicial proceeding and for the purpose of Section 196 of the Indian Penal Code, the Appellate Tribunal shall be deemed to be a Civil Court for all purposes of Section 195 and Chapter XXXV of the Code of Criminal Procedure.

The Appellate Tribunal is a final fact-finding authority and if it arrives at its own conclusions or facts after the consideration of the evidence before it, the Court will not interfere. It is necessary, however, that every fact 'for' and 'against' the assessee must have been considered with due care and the Tribunal must have given its finding in a manner which would have clearly indicated what were the questions which arose for determination, what was the evidence pro and contra in regard to each one of them, and what were the findings reached on the evidence on record before it.

The ITAT may, at any time within 6 months from the end of the month in which the order was passed, rectify any mistake apparent from record, amend any order passed by it if the mistake is brought to its notice by the taxpayer or Assessing Officer. However, where such amendment has the effect of enhancing an assessment or reducing a refund or otherwise increasing a liability of the taxpayer, it shall not be made unless the Appellate Tribunal has given a notice to the taxpayer of its intention to do so and has allowed the taxpayer a reasonable opportunity.

FACELESS PROCEEDINGS BEFORE ITAT

To impart greater efficiency, transparency and accountability for the purpose of disposal of appeals by the Appellate Tribunal, the Central Government is empowered under section 253(8) to make a scheme by:

- a) Eliminating the interface between the Appellate Tribunal and parties to the appeal in the course of appellate proceedings to the extent technologically feasible;

- b) Optimizing utilization of the resources through economics of scale and functional specialization;
- c) Introducing a team based appellate system for appeal to Tribunal with dynamic jurisdiction.

The Central Government may, for the purpose of giving effect to the scheme, issue notification in the Official Gazette, to direct that any of the provisions of this Act shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified in the notification. However, no such direction can be issued after 31.03.2025. As soon as may be after the notification is issued, be laid before each House of Parliament.

PROVISION FOR AVOIDING REPETITIVE APPEALS (SECTION 158A)

Section 158A makes provision for avoiding procedure when assessee claims identical question of law is pending before High Court or Supreme Court.

1. **Applicability of the Provisions:** This is applicable in case of an assessee who claims that any question of law arising in his case for an assessment year which is pending before the Assessing Officer or any appellate authority is identical with a question of law arising in his case for another assessment year which is pending before the High Court on a reference under section 256 or before the Supreme Court on a reference under section 257 or in appeal under section 260A before the High Court or in appeal under section 261 before the Supreme Court. [Section 158A(1)]
2. **Submission of a Declaration by Assessee:** He may furnish to the Assessing Officer or the appellate authority, as the case may be, will give an online declaration in the Form 8 and verified in the prescribed manner, that if the Assessing Officer or the appellate authority, as the case may be, agrees to apply in the relevant case the final decision on the question of law in the other case, he shall not raise such question of law in the relevant case in appeal before any appellate authority or in appeal before the High Court under section 260A or in appeal before the Supreme Court under section 261. [Section 158A(2)]
3. **Report to be sought from the Assessing Officer:** Where a declaration under sub-section (1) is furnished to any appellate authority, the appellate authority shall call for a report from the Assessing Officer on the correctness of the claim made by the assessee. Where the Assessing Officer makes a request to the appellate authority to give him an opportunity of being heard in the matter, the appellate authority shall allow him such opportunity. [Section 158A(3)]
4. **Admission or Rejection of the Claim of Assessee:** The Assessing Officer or the appellate authority, as the case may be, may, by order in writing, — (i) admit the claim of the assessee if he or it is satisfied that the question of law arising in the relevant case is identical with the question of law in the other case; or (ii) reject the claim if he or it is not so satisfied. [Section 158A(4)]
5. **Order when claim admitted:** Where a claim is admitted under sub-section (3) (a) the Assessing Officer or, as the case may be, the appellate authority may make an order disposing of the relevant case without awaiting the final decision on the question of law in the other case; and (b) the assessee shall not be entitled to raise, in relation to the relevant case, such question of law in appeal before any appellate authority or in appeal before the High Court under section 260A or the Supreme Court under section 261.
6. **Applicability of decision of High Court and Supreme Court :** When the decision on the question of law in the other case becomes final, it shall be applied to the relevant case and the Assessing Officer or the appellate authority, as the case may be, shall, if necessary, amend the order referred to in clause (a) of sub-section (4) conformably to such decision.
7. An order under sub-section (3) shall be final and shall not be called in question in any proceeding by way of appeal, reference or revision under this Act.

PROCEDURE WHERE AN IDENTICAL QUESTION OF LAW IS PENDING BEFORE HIGH COURTS OR SUPREME COURT (SECTION 158AB)

Section 158AA of the Act provides that where the Commissioner or Principal Commissioner is of the opinion that any question of law arising in the case of an assessee (relevant case) is identical with a question of law arising in his case for another assessment year (other case) which is pending in appeal before the Supreme Court against an order of High Court which was in favour of assessee, he may direct the Assessing Officer to make an application to the Appellate Tribunal stating that an appeal on the question of law in the relevant case may be filed when the decision on the question of law becomes final in the other case, subject to the acceptance of the same by the assessee. However no such direction shall be given on or after the 1st day of April, 2022.

If such a principle could be applied to cases where a question of law is common and where a decision of the jurisdictional High Court, on the same question of law is available, the filing of appeal in such cases can be avoided to reduce the amount of litigation.

Therefore, to provide a procedure when an appeal by revenue is pending on an identical question of law, section 158AB is introduced with effect from 1st April 2023. The detail procedures are as follows.

1. **Deferment of any appeal against an identical question of law pending before High Court or Supreme Court:** This provision provides that, where the collegium (comprising of two or more Chief Commissioners or Principal Commissioners or Commissioners, as may be specified by the Board) is of the opinion that:
 - (a) any question of law arising in the case of an assessee for any assessment year (such case being herein referred to as the relevant case) is identical with a question of law arising,
 - (i) in his case for any other assessment year; or
 - (ii) in the case of any other assessee for any assessment year; and
 - (b) such question is pending before the jurisdictional High Court under section 260A or the Supreme Court in an appeal under section 261 or in a special leave petition under article 136 of the Constitution, against the order of the Appellate Tribunal or the jurisdictional High Court, as the case may be, which is in favour of such assessee,

the collegium may, decide and inform the Principal Commissioner or Commissioner not to file any appeal, at this stage, to the Appellate Tribunal under section 253(2) or to the jurisdictional High Court under section 260A(2) in the relevant case against the order of the Joint Commissioner (Appeals) or the Commissioner (Appeals) or the Appellate Tribunal, as the case may be.
2. **Direction to Assessing Officer:** On receipt of communication from the collegium, the Principal Commissioner or the Commissioner shall, direct the Assessing Officer to make an application to the Appellate Tribunal or the jurisdictional High Court, as the case may be, in the prescribed form as may be prescribed within a period of 120 days from the date of receipt of the order of the Joint Commissioner (Appeals) or the Commissioner (Appeals) or of the Appellate Tribunal, as the case may be, stating that an appeal on the question of law arising in the relevant case may be filed when the decision on such question of law becomes final in the other case.
3. **Acceptance of question law by the assessee:** The Principal Commissioner or Commissioner shall direct the Assessing Officer to make an application only if an acceptance is received from the assessee to the effect that the question of law in the other case is identical to that arising in the relevant case. In case no such acceptance is received, the Principal Commissioner or Commissioner shall, notwithstanding anything contained in section 253(3) or section 260A (2)(a), proceed in accordance with the provisions contained in section 253(2) or section 260A(2)(c).

4. Where the order of the Joint Commissioner (Appeals) or the Commissioner (Appeals) or the order of the Appellate Tribunal, as the case may be, is not in conformity with the final decision on the question of law in the other case, as and when such order is received, the Principal Commissioner or Commissioner may direct the Assessing Officer to appeal to the Appellate Tribunal or the jurisdictional High Court, as the case may be.
5. **Time limit for filing appeal:** The appeal in relevant case as stated at 4 above shall be filed within a period of 60 days to the Appellate Tribunal or 120 days to the High Court, as the case may be, from the date on which the order of the jurisdictional High Court or the Supreme Court in the other case is communicated to the Principal Commissioner or the Commissioner, in accordance with the procedure specified by the CBDT.

APPEAL BEFORE HIGH COURT (SECTION 260A & 260B)

Sections 260A and 260B are inserted w.e.f. October 1, 1998. Section 260A provides that an appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal if the High Court is satisfied that the case involves a substantial question of law. The Commissioner of Income-Tax cannot direct the Assessing Officer to file an appeal to the High Court against the order of the ITAT in those cases in which the tax effect does not exceeds Rs.200 lakhs (revised from Rs.100 lakhs vide CBDT Circular No.9/2024 dated .17.09.2024).

The Chief Commissioner or the Commissioner or an assessee aggrieved by any order passed by the Appellate Tribunal may file an appeal to the High Court and such appeal shall be filed within 120 days from the date on which the order appealed against is received by the assessee or the Chief Commissioner or Commissioner and shall be filed in the form of memorandum of appeal precisely stating the substantial question of law involved. The High Court has the power to condone the delay and admit an appeal after the expiry of the period of 120 days, if it is satisfied that there was sufficient cause for not filing the appeal within the period.

If the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate that question. The appeal shall be heard only on the question so formulated, and the respondents shall at the hearing of the appeal, be allowed to argue that the case does not involve such question. However, the High Court may for reasons to be recorded, hear the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.

The High Court shall decide the question of law so formulated and deliver such judgment thereon containing the grounds on which such decision is founded and may award such cost as it deems fit.

The High Court may determine any issue which has not been determined by the Appellate Tribunal or has been wrongly determined by the Appellate Tribunal on such substantial question of law.

Where the High Court delivers a judgment in an appeal filed before it under Section 260A, effect shall be given to the order passed on the appeal by the Assessing Officer on the basis of a certified copy of judgment [Section 260(1A)].

Section 260B provides that an appeal filed under Section 260A shall be heard by a bench of not less than two judges of the High Court and shall be decided in accordance with the opinion such Judges or the majority, if any. Where, however, there is no such majority, the part of law upon which they differ shall be referred to one or more of the Judges of the High Court and shall be decided according to the opinion of the majority of the Judges who have heard the case including those who first heard it.

The High Court also has power to stay a proceeding for recovery of demand arising out of the assessment order pending disposal of appeal.

APPEAL BEFORE SUPREME COURT (SECTION 261)

The aggrieved party is entitled to appeal to the Supreme Court against the judgment delivered by the High Court on the reference application made to it by the Tribunal (under Section 256) against an order made under Section 254 before the 1st day of October, 1998 or an appeal made to High Court in respect of an order passed under Section 254 on or after that date provided the High Court certifies the case to be fit for appeal to the Supreme Court. The right of appeal is, therefore, conditional and may be availed of only if the High Court gives a certificate of such fitness.

The Commissioner of Income-Tax cannot direct the Assessing Officer to file an appeal to the Supreme Court against the order of the High Court in those cases in which the tax effect does not exceeds Rs.500 lakhs (revised from Rs.200 lakhs vide CBDT Circular No.9/2024 dated 17.09.2024).

The High Court could certify the case as a fit one for appeal and grant leave to the Supreme Court if a substantial question of law is involved or if the question is likely to come up in successive year or if the question is otherwise of great public or private importance.

An application of fitness for appeal to the Supreme Court has to be made within 60 days from the date of High Court's judgment (under Article 132 of the Schedule to the Limitation Act, 1963). The time required for taking a certified copy of the High Court's judgment is to be excluded in computing such period of limitation.

If the High Court refuses to certify a case to be fit for appeal to the Supreme Court, an application may be made to the Supreme Court (under Article 136 of the Constitution) for special leave to appeal against the decision of the High Court.

The provisions of the Code of Civil Procedure, 1908 relating to the appeal to the Supreme Court are applicable in the case of appeals under Section 261 in the same manner as they are applicable in the case of appeals from decrees of a High Court. [Section 262(1)]

Where the judgment of the High Court is changed or reversed in the appeal, effect is given to the order of the Supreme Court [Section 262(3)]. The law declared by the Supreme Court is binding on all courts within the territory of India under Article 141 of the Constitution.

On the receipt of a copy of judgment, the Appellate Tribunal has to pass such orders as are necessary to dispose of the case conformably to such judgment.

To award the cost of an appeal is at the discretion the Supreme Court [Section 262(2)]. It would be open to the Court not to award costs even to the party which has succeeded in the appeal before it. If the Supreme Court awards costs to a party and the party has not complied with the order, a petition may be made to the appropriate High Court for execution of the order of the Supreme Court (Section 266). The High Court may transmit the order for execution to any court subordinate to it (Section 266).

Section 257 enables the Appellate Tribunal to make a direct reference to the Supreme Court if the Tribunal is of the opinion that, on account of a conflict in the decision of High Court in respect of any particular question of law, it is expedient that a reference should be made directly to the highest court.

SUMMARY				
Particulars	246 / 246A	254	260A	261
Appellate Authority	JCIT / CIT (A)	ITAT	High Court	Supreme Court

Time limit for Appeal related to assessment / penalty and any other case	30 days from the receipt of the order serving of demand in case assessment / penalty and in any other case service of intimation of order sought to be appealed against	2 month from the end of the month in which the order sought to be appealed against is communicated	120 days from the date of receipt of order appealed against	-
Time limit for disposal of appeal	1 Year from the end of the FY	4 Year from the end of the FY	As per Court procedure	As per Court procedure
Application of prescribed Form	35	36	As per Court procedure	As per Court procedure
Fees to be Paid				
Returned Income up to Rs. 1 lakh	Rs. 250	Rs. 500	As per Court procedure	As per Court procedure
More than Rs. 1 lakh up to Rs. 2 lakhs	Rs. 500	Rs. 1500	As per Court procedure	As per Court procedure
More than Rs. 2 lakhs	Rs. 1000	1% of income (Max Rs 10,000)	As per Court procedure	As per Court procedure
Appeal for other than Income	Rs. 250	Rs. 500	As per Court procedure	As per Court procedure

REVISION BY THE COMMISSIONER OF INCOME TAX (SECTIONS 263 AND 264)

The right to file such appeals against the orders of the Assessing Officer is not available to the Department. It is for this reason that the Commissioner has been vested with revisional powers under Section 263, where the order of the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue. But such revisional power can be exercised only in respect of orders which are not the subject matter of appeals. The reason is that once an assessment order is appealed against, the Commissioner (Appeals) has got the powers to enhance the assessment under Section 263 and a right of appeal up to the Tribunal is provided to the assessee against the orders of the Assessing Officer. In the following cases Commissioner of Income-tax can revise an order passed by the Assessing Officer:

REVISION OR ORDER BY THE COMMISSIONER OF INCOME TAX		
Revision of orders prejudicial to the interest of Revenue (Section 263)	Revision of order in the interest of Assessee (Section 264)	Circumstances in which no revision can be made (Section 264(4))

Revision can be only of the order of Assessing Officer	Revision of order of subordinate authority only (Section 264(1) and Explanation 2)	If the order is appealable to Commissioner (Appeals), such order cannot be revised until the time within which such appeal may be made expires.
Order erroneous and prejudicial to the interest of revenue (Section 263(1))	Suo moto revision (Section 264(1) and (2))	The order is appealable to the Commissioner or the Appellate Tribunal, revisional power cannot be exercised until the time within which such appeal may be made expires.
Assessee to be given an opportunity of being heard	Revision on application by the assessee (Section 264(1), (3) & (5))	

REVISION OF ORDERS PREJUDICIAL TO THE INTEREST OF REVENUE (SECTION 263)

Under section 263(1), the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may call for and examine the record of any proceeding under this Act, and if he considers that any order passed therein by the Assessing Officer or the Transfer Pricing Officer, as the case may be is erroneous in so far as it is prejudicial to the interests of the revenue, he may, after giving the assessee an opportunity of being heard and after making or causing to be made such inquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, including an order

- (a) enhancing or modifying the assessment, or cancelling the assessment and directing a fresh assessment or
- (b) an order modifying the order under section 92CA or
- (c) an order cancelling the order under section 92CA and directing a fresh order under the said section.

An order passed by the Assessing Officer or the Transfer Pricing Officer, as the case may be shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, if, in the opinion of the Principal Commissioner or Commissioner,

- (a) the order is passed without making inquiries or verification which should have been made;
- (b) the order is passed allowing any relief without inquiring into the claim;
- (c) the order has not been made in accordance with any order, direction or instruction issued by the Board under section 119; or
- (d) the order has not been passed in accordance with any decision which is prejudicial to the assessee, rendered by the jurisdictional High Court or Supreme Court in the case of the assessee or any other person.

The term “record” shall include and shall be deemed always to have included all records relating to any proceeding under this Act available at the time of examination by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

In case the order referred to in section 263(1) above passed by the Assessing Officer or the TPO has been the subject matter of any appeal, the powers of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner; shall extend and shall always be deemed to have extended to such matters as had not been considered and decided in such appeal.

No order shall be made under sub-section (1) after the expiry of **two years from the end of the financial year** in which the order sought to be revised was passed.

In computing the period, the period of 2 years, time taken in giving an opportunity to the assessee to be reheard under the proviso to section 129 and any period during which any proceeding under this section is stayed by an order or injunction of any court shall be excluded.

It may be noted that the limit of two years does not apply to a revisional order which had been passed in consequences of or to give effect to, any finding or direction contained in an order of the Appellate Tribunal, the High Court or the Supreme Court. Such revisional order may be passed at any time (Section 263(3)).

The word “**erroneous**” includes cases where there has been a failure to make the necessary enquiries. The Commissioner of Income-tax may consider an order of the Assessing Officer to be erroneous not only if it contains some apparent error of reasoning or of law or of fact on the face of it but also because it is a stereotype order which simply accepts what the assessee has stated in his return and fails to make enquiries which are called for in the circumstances of the case. The Assessing Officer is not only an adjudicator but also an investigator. He cannot remain passive in the face of a return which is apparently in order but calls for further enquiry. It is his duty to ascertain the truth of the facts stated in return when the circumstances of the case are such as to provoke enquiry.

The words “**prejudicial to the interests of revenue**” appearing under Section 263(1) have not been defined in the Act, but they must mean that the order of the Assessing Officer or the Transfer Pricing Officer, as the case may be is such, that it is not in accordance with law in consequence whereof the lawful revenue due to the State has not been realised or cannot be realised.

The Allahabad High Courts’ decision in **Commissioner of Income-tax v. Sunder Lal (1974, 96 ITR 310)** was followed by it in **Commissioner of Income-tax v. Kashi Nath & Co. 1988, 170 ITR 28** holding that the power of the Commissioner of income-tax under Section 263 of the Income-tax Act is quasi-judicial in character. He must give reasons in support of his conclusion that the assessment order is erroneous in so far as it is prejudicial to the interests of the Revenue. If he does not give the reasons, the order can be vitiated. For example, if the Commissioner is of the opinion that the Assessing Officer had allowed deductions in excess of what they were due in a particular case, such order is erroneous and prejudicial to the interests of the revenue. Hence, it may be revised by the Commissioner of Income Tax.

In **Malabar Industrial Co. Ltd. v. Commissioner Income Tax (1992) 198 ITR 611** the Kerala High Court held that the words ‘prejudicial to the interests of the revenue’ are of wide import and they should not be limited to a case where the order passed by the Income-tax Officer (now Assessing Officer) can be considered to be one prejudicial to the revenue administration as such. The question whether an order of the Income-tax Officer is prejudicial to the interests of revenue would depend on the facts of each case and there can be no universal formula applicable to finding out any such prejudicial error. The High Court followed the rule laid down by the Supreme Court in *Tara Devi Aggarwal v. CIT* (1973, 88 ITR 523) but dissented from the rule laid down by the Madras High Court in *Venkatakrishna Rice Co. v. CIT* (1987, 163 ITR 129).

The Commissioner can revise an order passed by the Assessing Officer or the Transfer Pricing Officer, as the case may be only if it is erroneous and prejudicial to the interests of the revenue; if the order sought to be revised is not prejudicial to the interest of the revenue the Commissioner has no jurisdiction to revise it. The failure of the Assessing Officer to deal with the claim of the assessee in the assessment order may be an error, but an erroneous order by itself is not enough to give jurisdiction to the Commissioner to revise it under Section 263. It must be further shown that the order was prejudicial to the interests of the revenue.

REVISION OF ORDER IN THE INTEREST OF ASSESSEE (SECTION 264)

An assessee aggrieved with the order of the Assessing Officer shall file an appeal before Joint Commissioner (Appeals) / Commissioner (Appeals) under Section 246A and thereafter to the Appellate Tribunal under Section 253. Further, each and every order of the Assessing Officer is not appealable to the appellate authorities under Sections 246A and 253. The assessee may seek justice in such cases by making an application under section

264 to the Commissioner of Income Tax. For example, revision lies to the Commissioner against the levy of penal interest for not furnishing the return of total income within the prescribed time against which no appeal has been provided.

In the case of any order other than an order to which section 263 applies passed by an authority subordinate to him, the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may, either of his own motion or on an application by the assessee for revision, call for the record of any proceeding under this Act in which any such order has been passed and after making such inquiry may pass such order thereon as he thinks fit.

The revisional order passed under Section 264 cannot be prejudicial to the interest of the assessee. The whole subject matter is discussed below -

1. Revision of order of subordinate authority only (Section 264(1) and Explanation 2)

The Principal Commissioner or Commissioner of Income Tax may revise any order of an authority subordinate to him. Deputy Commissioner, Income Tax Officers and Inspectors of Income Tax are subordinate to the Principal Commissioner or Commissioner according to Section 118.

2. Suo moto Revision (Section 264(1) and (2))

The Principal Commissioner or Commissioner may, suo moto call for the record of any proceeding under this Act in which any, order has been passed by any authority subordinate to him.

He may make such enquiry and may pass such order as he thinks fit but such order cannot be prejudicial to the assessee [Section 264(1)]. Such exercise of the authority is a purely departmental affair and the assessee may know nothing about this.

While acting suo moto, the Principal Commissioner / Commissioner may revise the order of his subordinate authority within one year from the date of the order sought to be revised [Section 264(2)]. If the order has been made more than one year back, such order cannot be revised by him.

3. Revision on application of the Assessee [Section 264(1), (3) & (5)]

The assessee is entitled to make an application to the Principal Commissioner or Commissioner of Income- tax for the revision of any order passed by an authority subordinate to him. Such an application can be made within one year from the date on which the order in question was communicated to him or from the date on which he otherwise came to know of it, whichever is earlier [Section 264(3)]. The Principal Commissioner or Commissioner is empowered to admit a belated application if he is satisfied that the assessee was prevented by sufficient cause from making the application within the prescribed time.

The application for revision by the assessee is always to be accompanied by a fee of Rs. 500 [Section 264(5)]. On receipt of the revision application, the Principal Commissioner or Commissioner may call for the record. He may make such enquiry and pass such order as he deems fit. Such an order should not be prejudicial to the assessee [Section 264(1)].

It is obligatory on the Principal Commissioner or Commissioner to pass an order under Section 264 within a period of one year from the end of financial year in which the application is made for revision. In computing the period of limitation, the time taken in giving an opportunity to the assessee to be re-heard (under Section 129) and any period during which any proceeding under this Section is stayed by an order or injunction of any court is excluded.

Though an order has, to be passed within one year, an order in revision may be passed at any time in consequence of or to give effect to any findings or directions contained in an order of the Appellate Tribunal, High Court or the Supreme Court.

There are two important points of distinction between the cases: (i) where the Principal Commissioner or Commissioner makes suo moto revision; and (ii) where he makes a revision on the application of the assessee. While acting suo moto, he can pass the revisional order only within one year from the date of the order sought to be revised. There is no such time limit when the revisional order is passed on the basis of application filed by the assessee. Once the application is made within the period of limitation prescribed therefor, or after the condonation of delay, the order may be passed at any time thereafter. Secondly, while acting suo moto, the Commissioner acts in the exercise of his administrative jurisdiction and, hence, he is not bound to give a hearing to the assessee. In fact the review is purely a departmental affair in such cases. On the other hand, when he is moved by the assessee for the said purposes, the jurisdiction conferred on him is a judicial one and, hence, he must give an opportunity to the assessee to put forward his case.

4. Nature of the order (Section 264)

The Principal Commissioner or Commissioner may pass such order as he thinks fit provided such order is not prejudicial to the assessee. This is so whether the Commissioner acts suo moto, or on the revision application of the assessee. An order of the Principal Commissioner or Commissioner passed in revision can be said to be prejudicial to the assessee only when he is, as a result of it, placed in a different and worse position than that in which he was placed by the order under review. If the Principal Commissioner or Commissioner effects a reduction of income under one head and an increase under another but, on the whole reduces the assessment, his order cannot be said to be prejudicial to the assessee. Though the Principal Commissioner or Commissioner may not change the order of the subordinate authority to the prejudice of the assessee, he may not give the relief asked for by the assessee. An order of the Principal Commissioner or Commissioner declining to interfere with the order of the subordinate authority cannot be deemed to be an order prejudicial to the assessee (Explanation 1 to Section 264). The power to pass such orders as he deems fit is not an arbitrary one to be exercised according to his fancy. He must act according to the rules of reason and justice, not according to private opinion, according to law not humour. His discretion is not to be arbitrary, vague and fanciful, but legal and regular. It is a power coupled with duty to exercise it in the interest of justice to the assessee.

CIRCUMSTANCES IN WHICH NO REVISION CAN BE MADE [SECTION 264(4)]

The Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner shall not revise any order under section 264 in the following cases—

- (a) where an appeal against the order lies to the Deputy Commissioner (Appeals) or to the Joint Commissioner (Appeals) or the Commissioner (Appeals) or to the Appellate Tribunal but has not been made and the time within which such appeal may be made has not expired, or, in the case of an appeal to the Joint Commissioner (Appeals) or the Commissioner (Appeals) or to the Appellate Tribunal, the assessee has not waived his right of appeal; or
- (b) where the order has been made the subject of an appeal to the Joint Commissioner (Appeals) or the Commissioner (Appeals) or to the Appellate Tribunal.

Remedy against the Revisional Order

An order of the Commissioner passed under Section 264 is not appealable to the Tribunal. Nor does a reference lie against such an order to the High Court since a reference to the High Court lies only against an order passed by the Tribunal. Since the order of the Commissioner is judicial or quasi-judicial in character, it is within the ambit of the High Court's jurisdiction under Article 226 of the Constitution and a petition for a writ of certiorari to quash an unjust or illegal order of the Commissioner is maintainable.

Faceless Revision of Order (Section 264A)

- (i) The Central Government may make a scheme, by notification in the Official Gazette, for the purposes of revision of orders under section 263 or section 264, so as to impart greater efficiency, transparency and accountability by:
 - (a) eliminating the interface between the income-tax authority and the assessee or any other person to the extent technologically feasible;
 - (b) optimising utilisation of the resources through economies of scale and functional specialisation;
 - (c) introducing a team-based revision of orders, with dynamic jurisdiction.
- (ii) Every notification has to be laid down before each House of Parliament as soon as may be after the notification is issued

Faceless effect of Order (Section 264B)

- (i) The Central Government may make a scheme, by notification in the Official Gazette, for the purposes of giving effect to an order under section 250, 254, 260, 262, 263 or 264, so as to impart greater efficiency, transparency and accountability by:
 - (a) eliminating the interface between the income-tax authority and the assessee or any other person to the extent technologically feasible;
 - (b) optimising utilisation of the resources through economies of scale and functional specialisation;
 - (c) introducing a team-based giving of effect to orders, with dynamic jurisdiction.
- (ii) Every notification has to be laid down before each House of Parliament as soon as may be after the notification is issued

MONETARY LIMIT FOR REGULATING FILING AN APPEALS BY INCOME TAX AUTHORITIES (SECTION 268A)

Appeal shall be filed before appellate Tribunal, High Court and Supreme Court by income tax authority only where the tax effect of appeal exceeds the monetary limits as specified in the per CBDT Circular No.9/2024 dated 17.09.2024). Therefore, the Commissioner of Income-Tax cannot direct the Assessing Officer to file an appeal to the ITAT against the order of the Commissioner of Income-Tax (Appeals) in those cases in which the “tax effect” exceed the monetary limits stated below.

Appeal in Income tax matter	Revised Monetary Limit for Filing Appeal (w.e.f. 17th September 2024)
Before ITAT	INR 60,00,000
Before High Court	INR 2,00,00,000
Before Supreme Court	INR 5,00,00,000

“**Tax effect**” means the difference between the tax on the total income assessed and the tax that would have been chargeable had such total income been reduced by the amount of income in respect of the issues against which appeal is intended to be filed (hereinafter referred to as “disputed Issues”). However, the tax will not include any interest thereon, except where chargeability of interest itself is in dispute. In case the chargeability of interest is the issue under dispute, the amount of interest shall be the tax effect. In cases where returned

loss is reduced or assessed as income, the tax effect would include notional tax on disputed additions. In case of penalty orders, the tax effect will mean quantum of penalty deleted or reduced in the order to be appealed against.

The Assessing Officer shall calculate the tax effect separately for every assessment year in respect of the disputed issues in the case of every taxpayer. If in the case of a taxpayer the disputed issues arise in more than one assessment year, appeal can be filed in respect of such assessment year or years in which the tax effect in respect of the disputed issues exceeds the monetary limit specified above. No appeal shall be filed by department in respect of an assessment year or years in which the tax effect is less than the monetary limit specified above.

However, in case of a composite order of any High Court or appellate authority, which involves more than one assessment year and common issues in more than one assessment year, appeal shall be filed in respect of all such assessment years even if the tax effect is less than the prescribed monetary limits in any of the year(s), if it is decided to file appeal in respect of the year(s) in which tax effect exceeds the monetary limit prescribed. In case where a composite order / judgment involves more than one taxpayer, each taxpayer shall be dealt with separately.

Adverse judgments relating to the following issues should be contested on merits notwithstanding that the tax effect entailed is less than the monetary limits specified above or there is no tax effect.

- (i) Where the Constitutional validity of the provisions of an Act or Rule is under challenge, or
- (ii) Where Board's order, Notification, Instruction or Circular has been held to be illegal or ultravires, or
- (iii) Where Revenue Audit's objection in the case has been accepted by the Department.
- (iv) Writ matters
- (v) Matters pertaining to other direct taxes, i.e., other than Income-Tax
- (vi) Where the tax effect is not quantifiable or not involved, such as case of registration of trust or institution under section 12A.
- (vii) Where the addition relates to undisclosed foreign assets/bank accounts.

CONDONATION OF DELAY IN FILING APPEAL OR REVISION APPLICATION WHERE PERIOD OF LIMITATION IS PROVIDED

A delay in the making of an application or the filing of an appeal for which a period of limitation is prescribed under the Act is condoned only if there is a specific provision in the relevant section itself enabling such condonation. The details of relevant provisions with decisions of different authority are given below for reference.

S. No.	Section	Remarks
(i)	154	Application for rectification has to be filed before AO/JCIT(A)/CIT(A) within the prescribed period. There is no provision or condonation of delay.
(ii)	254(2)	There is no power for condonation of delay, if rectification application is filed before Tribunal beyond the statutory period. [refer- Ms. Shamsunissa Begum v. Dy. CIT [2017] 83 taxmann.com 96 (Bang. - Trib.); Bharat Petroleum Corp. Ltd. v. Asstt. CIT [2014] 49 taxmann.com 397

S. No.	Section	Remarks
(iii)		Dispute Resolution Panel has no power to condone the delay in filing objection beyond stipulated period of thirty days from date of receipt of draft assessment order. [refer- Inno Estates (P.) Ltd. v. DRP [2018] 96 taxmann.com 646
(iv)	264	The Commissioner has power to condone the delay in filing revision applications u/s 264. ((refer- EBR Enterprises v. UOI [2018] 89 taxmann.com 194 (Bom.)
(v)	249	Commissioner (Appeals) may admit an appeal after the expiry of period provided in section 249(2) if he is satisfied that appellant had sufficient cause for not presenting the appeal within that period. [refer- Saiyana Warehouse (P.) Ltd. v. Asstt. CIT [2014] 51 taxmann.com 60 (Mad.)]
(vi)	253	Tribunal may admit an appeal, or cross-objection, after the expiry of prescribed period, if it is satisfied that there was sufficient cause for not presenting it within that period.
(vii)	269G & 269H	Condonation of delay beyond statutory period in filing appeal to the tribunal / High Court is provided on showing sufficient cause.
(viii)	256(1), 256(2A) and 260A(2A)	Condonation of delay beyond statutory period in references / appeal to the High Court is provided where there is a satisfaction about sufficient cause of such delay.
(ix)	Rule 46A of IT Rules	Condonation of delay for admission of additional evidence before CIT(A) provides on showing sufficient cause.
(x)	Rule 24 of ITAT Rules	Providing for restoration of ex-parte appeal on showing sufficient cause. (refer-Dr. Gopal Dass Agarwal v. CIT [2019] 101 taxmann.com 187(All.)),
(xi)	Rule 25 of the ITAT Rules	Providing for restoration of appeal on showing sufficient cause for non-appearance of respondent.

OFFENCES AND PENALTIES

An assessee should note that compliance with legal formalities is less costly than the payment of penalties or interest on tax dues. There are several formalities to be complied with to avoid any penalty. In this connection, reference may be made to the following table summarizing the defaults and penalties therefor.

Chapters XVII and XXI of Income-tax Act, 1961, contain various provisions empowering an Income-tax Authority to levy penalty in case of certain defaults. The various types of penalties are briefly described in the table given below:

Section	Type of Default	Quantum of Penalty	
		Minimum Penalty	Maximum Penalty
1	2	3	4
140A(3)	Failure to pay the self-assessment tax or interest and fee or part thereof or both under Section 140A(1)	Such amount as the Assessing Officer may impose	Tax in arrears
158BFA	Determination of undisclosed income of block period	Minimum 100% of tax leviable in respect of undisclosed income	Maximum 300% of tax leviable in respect of undisclosed income
221(1)	Failure to make payment of tax and interest payable under Section 220(2) within the prescribed time limit	Such amount as the Assessing Officer may impose	Tax in arrears
234E	Failure to file statement within time prescribed in section 200(3) or in proviso to section 206C(3)	Fees of Rs. 200 per day during which failure continues	Amount of tax deductible or collectible
234F	Failure to file income tax return within the time as mentioned under section 139	Fees of Rs. 5,000 if return is furnished after due date specified under section 139(1) Note: Fees of Rs. 1,000 if total income of the person does not exceed Rs. 5,00,000	
234G	Fee for default in submission of statement/certificate prescribed under section 35/ Section 80G	Rs. 200 per day	
234H	Fee for default in intimating the Aadhaar Number	Rs. 1,000	
270A	Penalty for under reporting and misreporting of income	50% of tax payable on underreported income	However, if under-reported income is in consequence of any misreporting thereof by any person, the penalty shall be equal to 200% of the amount of tax payable on under-reported income

Section	Type of Default	Quantum of Penalty	
		Minimum Penalty	Maximum Penalty
1	2	3	4
271A	Failure to keep, maintain or retain books of account etc. as required under Section 44AA	Rs. 25,000	Rs. 25,000
271AA(1)	Failure to keep and maintain information and document in respect of international transaction or specified domestic transaction or fails to report such transactions or maintains or furnishes an incorrect information or document.	A sum equal to 2% of the value of each international transaction or specified domestic transaction.	
271AA(4)	If any person fails to furnish the information and the document as required under sub-section (4) of section 92D.	Rs. 5,00,000	
271AAB	Undisclosed income found during search where search has been initiated on or after 15.12.2016.	30% or 60% of undisclosed income, as the case may be.	
271AAC	Penalty where income includes any income referred to in Section 68, Section 69, Section 69A, Section 69B, Section 69C or Section 69D.	10% of tax payable on undisclosed income	
271AAD	If during any proceedings under the Act, it is found that in the books of accounts maintained by assessee, there is a false entry; or Any entry relevant for computation of total income of such person has been omitted to evade tax liability.	100% of such false entries or omitted entry	
271B	Failure to get accounts audited under Section 44AB or furnish audit report along with return of income.	One-half per cent of Total Sales, Turnover or Gross Receipts	Rs. 1,50,000
271BA	Failure to furnish report under Section 92E.	Rs. 1,00,000	
271C	Failure to deduct tax at source or failure to pay wholly or partly the tax u/s 115-0(2) or second proviso to Section 194-B.	A sum equal to the amount of tax omitted to be deducted or paid	
271CA	Failure to collect tax at source	100% of tax sought to be collected	
271D	Taking any loan or deposit or specified sum in contravention of Section 269SS. “Specified sum” means any sum of money receivable, whether as advance or otherwise, in relation to transfer of an immovable property, whether or not the transfer takes place.	A sum equal to the amount of loan or deposit or specified amount so taken or accepted.	

Section	Type of Default	Quantum of Penalty	
		Minimum Penalty	Maximum Penalty
1	2	3	4
271DA	Receiving of an amount of Rs. 2,00,000 or more otherwise than an A/c payee cheque/ draft/ECS, in contravention of provisions of Section 269ST	A sum equal to the amount of such receipt. However, penalty shall not be imposed, if such person proves that there were good and sufficient reasons for the contravention.	
271DB	Failure to provide facility for accepting payment through prescribed electronic modes of payment as referred to in section 269SU (w.e.f. 1.11.2019)	Rs. 5,000 rupees for every day of default	
271E	Repayment of deposit or specified advance in contravention of Section 269T "Specified advance" means any sum of money in the nature of advance, by whatever name called, in relation to transfer of an immovable property, whether or not transfer takes place.	A sum equal to the amount of deposit or specified amount	
271FA	Failure to Furnish Statement of Financial Transaction or Reportable Account in Section 285BA(2)	Rs. 500 per day during which such failure continues	
271FA	Failure to Furnish Annual Information Return in Section 285BA(5)	Rs. 1,000 per day of default	
271FAA	Furnishing of inaccurate information in statement of financial transaction or reportable account. Failure to furnish annual information return within the period specified in notice u/s 285BA(5)	Rs. 50,000 Failure to furnish annual information return within the period specified in notice u/s 285BA(5)	
271FAB	Section 9A provides that fund Rs. 5,00,000 management activity carried out by an eligible offshore investment fund through an eligible fund manager acting on behalf of such fund shall not constitute business connection in India (subject to certain conditions). The provision requires that eligible investment fund shall furnish within 90 days from the end of the financial year a statement, in respect of its activities in a financial year, in the prescribed form containing information relating to fulfilment of specified conditions and such other information or documents as may be prescribed. Penalty to be levied if investment fund failed to comply with the requirement.	Rs. 5,00,000	

Section	Type of Default	Quantum of Penalty	
		Minimum Penalty	Maximum Penalty
1	2	3	4
271G	Failure to furnish information or document in respect of international transaction or specified domestic transaction under Section 92D(3).	A sum equal to 2% of the value of each international transaction or specified domestic transaction.	
271GA	Section 285A provides for reporting by an Indian concern if following two conditions are satisfied: (a) Shares or interest in a foreign company or entity derive substantial value, directly or indirectly, from assets located in India; and (b) Such foreign company or entity holds such assets in India through or in such Indian concern. In this case, the Indian entity shall furnish the prescribed information for the purpose of determination of any income accruing or arising in India under Section 9(1) (i). In case of any failure, the Indian concern shall be liable to pay penalty.	(a) a sum equal to 2% of value of transaction in respect of which such failure has taken place, if such transaction had effect of, directly or indirectly, transferring right of management or control in relation to the Indian concern; (b) a sum of Rs. 5,000 in any other case.	
271GB	1. Failure to furnish report under section 286(2) 2. Failure to produce the information and documents within the period allowed under section 271GB(6) 3. Failure to furnish report or failure to produce information/ documents under section 286 even after serving order under section 271GB(1) or 271GB(2) 4. Failure to inform about inaccuracy in report furnish under section 286(2) Or furnishing of inaccurate information or document in response to notice issued under section 286(6).	● Rs. 5,000 per day upto 30 days and Rs. 15,000 per day beyond 30 days. ● Rs. 5,000 for every day during which the failure continues. ● Rs. 50,000 for every day for which such failure continues beginning from the date of serving such order. ● Rs. 5,00,000.	
271H	Fails to furnish statement within the time prescribed in sub-section (3) of section 200 or proviso to section 206C(3) or furnishes incorrect information. However, no penalty shall be payable if tax along with interest has been deposited and the statement has been furnished within one year from the time prescribed.	Rs. 10,000	Rs. 1,00,000

Section	Type of Default	Quantum of Penalty	
		Minimum Penalty	Maximum Penalty
1	2	3	4
271-I	As per section 195(6) of the Act, any person responsible for paying to a nonresident or to a foreign company, any sum (whether or not chargeable to tax), shall furnish the information relating to such payment in Form 15CA and 15CB. Penalty shall be levied in case of any failure.	Rs. 1,00,000	
271J	Furnishing incorrect information in a report or certificate under the provisions of this Act (or rules made thereunder) by a Chartered Accountant or a Merchant Banker or a Registered Valuer.	Rs. 10,000 for each such report or certificate. However, if the concerned person proves that there was reasonable cause for the aforesaid failure, then penalty shall not be imposable.	
272A(1)	Refusal or failure by legally binding person in respect of subject matter of assessment, to: ● answer questions ● sign statement ● attend to give evidence or produce books of account, etc., in compliance with summons under section 131(1) ● comply with notices u/s 142(1)/143(2) or failure to comply with direction issued u/s 142(2A).	Rs. 10,000 for each failure/default.	
272A(2)	Failure to comply with a notice issued under Section 94, to give notice of discontinuance of business/ profession under Section 176(3); fails to furnish returns/ statements specified in Sections 133, 206, 206C, or 285B; fails to allow inspection of (i) register mentioned in Section 134, or (ii) entry in such register, or (iii) allow copies thereof to be taken, fails to furnish return of income under Section 139(4A) or, fails to deliver declaration under Section 197A; fails to furnish certificate under Section 203 or section 206C, fails to deduct and pay tax under Section 226; fails to deduct or pay tax u/s 192(2C), fails to deliver a copy of declaration u/s 206C(1A); fails to deliver the copy of statement within the time specified u/s 200(3) or the proviso to 206C(3); fails to deliver within the time specified u/s 206A(1). However, no penalty shall be payable where statement required u/s 200(3) or proviso to section 206C(3) on or after 1st July 2012.	Rs. 100 for every day of default	

Section	Type of Default	Quantum of Penalty	
		Minimum Penalty	Maximum Penalty
1	2	3	4
272AA	Failure in compliance with Section 133B	Any amount subject to a maximum of Rs.1,000	Rs. 1,000
272B	Failure to comply with provisions relating to PAN or Aadhar as referred to in section 139A/139A(5)(c)/ (5A)/ (5C)	Rs. 10,000 for each default	
272BB	Failure in compliance with Section 230A	Rs. 10,000 for each failure/default	

Note : No penalty is imposable for any failure under sections 271(1)(b), 271A, 271AA, 271B, 271BA, 271BB, 271C, 271CA, 271D, 271E, 271F, 271FA, 271FAB, 271FB, 271G, 271GA, 271GB, 271H, 271-I, 272A(1)(c) or (d), 272A(2), 272AA(1), 272B, 272BB(1), 272BB(1A), 272BBB(1), 273(1)(b), 273(2)(b) and 273(2)(c) if the person or assessee proves that there was reasonable cause for such failure (section 273B).

Section 273AA provides that a person may make application to the Principal Commissioner/Commissioner for granting immunity from penalty, if (a) he has made an application for settlement under section 245C and the proceedings for settlement have abated; and (b) penalty proceeding have been initiated under this Act. The application shall not be made after the imposition of penalty after abatement.

OFFENCES AND PROSECUTION

Rigorous Imprisonment

Section	Nature of Default	Punishment	Fine
275A	Dealing with seized assets in contravention of the order made by the officer conducting search	Up to 2 years	No Limit
275B	Failure to comply with the provision of section 132(l)(iib)	Up to 2 years	No Limit
276	Removal, concealment, transfer or delivery of property to tax recovery	Up to 2 years	No Limit
276A	Failure to comply with the provisions of section 178(1) & (3) by liquidator of a company	Any period up to 2 years but not less than 6 months in absence of special and adequate reasons	-

Section	Nature of Default	Punishment	Fine
276B	Failure to pay tax to the Government's treasury or failure to pay to the Government tax payable by him as required by section 115-O(2) or second proviso to section 194B	3 months to 7 years	No Limit
276BB	Failure to pay to the Government, tax collected u/s 206C	3 months to 7 years	No Limit
276C(1)	Willful attempt to evade tax penalty or interest imposable or under reports his income under the Act - If tax evaded exceeds Rs. 25,00,000	3 months to 7 years	No Limit
	Willful attempt to evade tax penalty or interest imposable or under reports his income under the Act - If tax evaded less than Rs. 25,00,000	3 months to 2 years	No Limit
276C(2)	Willful attempt to evade the payment of any tax, penalty or interest	3 months to 2 years	No Limit
276CC	Willful failure to file return of income in time u/s 139(1), or section 139(8A) or in Response to notice u/s.142(1) or section 148 or section 153A (Non- Cognizable as per Section 279A) - where tax sought to be evaded exceeds Rs. 25 lakh	6 months to 7 years	No Limit
	Willful failure to file return of income in time u/s 139(1), or section 139(8A) or in Response to notice u/s.142(1) or section 148 or section 153A (Non- Cognizable as per Section 279A) - Any other cases	3 months to 2 years	No Limit
276CCC	Willful failure to furnish in due times the return of total income which is required to be furnished u/s. 158BC.	3 months to 3 years	No Limit

Section	Nature of Default	Punishment	Fine
276D	Willful failure to produce books of account and documents u/s. 142(1) or willful failure to comply with a direction to get the accounts audited u/s. 142(2A)	Any period upto 1 year	No Limit
277	Making a false statement in verification or delivering a false account or statement (non-cognizable as per Sec.279A) - where tax sought to be evaded exceeds Rs. 25 lakh	6 months to 7 years	No Limit
	Making a false statement in verification or delivering a false account or statement (non-cognizable as per Sec.279A) – any other case	3 months to 2 years	No Limit
277A	Falsification of books of account or document, etc., to enable any other person to evade any tax, penalty or interest chargeable/leviable under the Act	3 months to 2 years	No Limit
278	Abetment to make a false statement or declaration. (non-cognizable as per, Sec. 279A) - where tax sought to be evaded exceeds Rs. 25 lakh	6 months to 7 years	No Limit
	Abetment to make a false statement or declaration. (non-cognizable as per, Sec. 279A) – any other case	3 months to 2 years	No Limit
278A	Punishment for second and subsequent offences u/s sections 276B, 276BB, 276C(1), 276CC, 276DD, 276E, 277 or 278	6 months to 7 years	No Limit
280(1)	Disclosure of particulars by public servants in contravention of section 138(2)	Up to 6 months	No Limit

No punishment if proved that there was reasonable cause for failure (Section 278AA)

If there is a reasonable cause, it can be offered as a defense against penalty, prosecution, etc. Any failure under section 276A, 276AB or 276B is not punishable if he proves that there was reasonable cause for such failure.

Reasonable cause can be reasonably said to be a cause which prevents a man of average intelligence and ordinary prudence, acting under normal circumstances, without negligence or inaction or want of bona fides.

‘Reasonable cause’ as applied to human action is that which would constrain people of average intelligence and ordinary prudence. It means an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which, assuming them to be true, would reasonably lead any ordinary prudent and cautious man, placed in the position of the person concerned, to come to the conclusion that the same was the right thing to do.

Provision for Bank Guarantee (Section 281B)

- Section 281B of the Act has been amended so as to provide that Assessing Officer AO’ shall revoke provisional attachment of property made under sub-section (1) of the aforesaid section in a case where the assessee furnishes a bank guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.
- To determine the FMV of the property, the AO may, make a reference to the Valuation Officer, who may be required to submit the report of the estimate of the property to the AO within a period of thirty days from the date of receipt of such reference.

LESSON ROUNDUP

- The right to appeal must be given by express enactment in the Act. Therefore, in case there is no provision in the Act for filing an appeal regarding a particular matter, no appeal shall lie. The right to appeal arises where the taxpayer is aggrieved by the order passed by the income-tax authority.
- The assessee may prefer an appeal against the orders of the Assessing Officer to the Joint Commissioner (Appeal) or Commissioner (Appeals), in accordance with the relevant provisions under Section 246 / Section 246A and appeal against the order of the Joint Commissioner (Appeal) or Commissioner (Appeals) can be preferred by the Assessee or the department and such appeal lies with the Appellate Tribunal.
- The Central Government shall constitute an Appellate Tribunal consisting of as many judicial and accountant members as it thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal by this Act.
- Section 260A provides that an appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal if the High Court is satisfied that the case involves a substantial question of law.
- The aggrieved party is entitled to appeal to the Supreme Court against the judgment delivered by the High Court.
- Chapters XVII and XXI of Income-tax Act, 1961, contain various provisions empowering an Income-tax Authority to levy penalty in case of certain defaults.

TEST YOURSELF

(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)

Multiple Choice Questions (MCQs)

1. The appeal against the order of Appellate Tribunal can be filed to High Court:
(a) for any matter in the order
(b) only if any question of fact is involved
(c) only if any substantial question of law is involved
(d) None of the above
Answer: c
2. An Appeal to High Court against the order of ITAT is to be filed within a period of from the date on which the ITAT's order is communicated to the tax payer
(a) 30 Days
(b) 60 Days
(c) 90 Days
(d) 120 Days
Answer: d
3. Where total income assessed by the Assessing Officer was Rs. 4,50,000 and the assessee wishes to file an appeal to Income Tax Appellate Tribunal against the order of Commissioner (Appeals). The fee for filing such appeal shall be:
(a) Rs. 1,500
(b) Rs. 2,500
(c) Rs. 4,500
(d) Rs. 10,000
Answer: c

Practical Questions

1. An Assessee, who is aggrieved by an order passed u/s 263 by the Commissioner of Income Tax, is desirous to know the remedial course and the time limit against the order under the Income Tax Act, 1961.
2. Examine the circumstances where the appellant shall be entitled to produce additional evidence 'oral or documentary' before the 'Commissioner of Income Tax Appeal' other than the evidence produced during the proceedings before the assessing officer.
3. What is the time-limit for passing an rectification order by ITAT u/s 254.
4. Can an assessee make an additional/new claim before an appellate authority which was not claimed by the assessee in the return of income (though he was legally entitled to) otherwise than by filing a revised return of Income.

5. What do you understand by the term 'Appeal'? Explain in brief the stages of appeal under Income Tax?
6. What are the appealable order against which an appeal can be made before Joint Commissioner Appeal u/s 246?
7. What are the appealable order against which an appeal can be made before Commissioner Appeal u/s 246A?
8. What is Faceless Appeal? Explain in brief the procedure of conduct of faceless appeal.
9. What is revision of order u/s 263 and 264 of the Income Tax Act, 1961. Also explain the situation where revision cannot be made?

LIST OF FURTHER READINGS

- Direct Taxes Law and Practice
Author : Dr. Vinod K. Singhania & Dr. Kapil Singhania
Publisher : Taxmann
- Direct Taxes Ready Reckoner with Tax Planning
Author : Dr. Girish Ahuja & Dr. Ravi Gupta Publisher : Wolters Kluwer

OTHER REFERENCES (INCLUDING WEBSITES AND VIDEO LINKS)

- **Income Tax Act, 1961:** <https://www.incometaxindia.gov.in/Pages/acts/income-tax-act.aspx>
- **Income Tax Rules, 1962:** <https://www.incometaxindia.gov.in/Pages/rules/income-tax-rules-1962.aspx>
- **Circulars:** <https://www.incometaxindia.gov.in/Pages/communications/circulars.aspx>
- **Notifications:** <https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx>

Transfer Pricing & General Anti Avoidance Rules “GAAR”

Lesson 7

Learning Objectives

To understand the:

The objective of this lesson is to enable the students to understand:

Transfer Pricing

- The need for transfer pricing provisions in the Income tax Act, 1961
- Meaning and significance of the term “arm’s length price” “associated enterprise” “International Transaction” “Specified domestic transactions”.
- Determine the arm’s length price using different methods prescribed under the income tax laws.
- Meaning of safe harbor and rules of safe harbor under the income tax law
- Benefits of entering into advance pricing Agreements

General Anti Avoidance Rules

- The need of GAAR provisions in India
- What is impermissible avoidance agreements
- What is specific anti avoidance rules
- Some case study on invoking the provision of GAAR
- The exclusion of GAAR / circumstances where GAAR cannot be invoked
- Penalties provision
- GAAR / SAAR

Lesson Outline

(I) TRANSFER PRICING

- Introduction & Importance
- Transfer Pricing Provisions in India
- Practical difficulties in Application of ARMs Length Price?
- Associated Enterprise ‘AE’
- Meaning of International Transaction
- Transfer Pricing – Applicability to Domestic Transaction
- Specified Domestic Transaction (Section 92BA)
- Transfer Pricing Methods
- Selection of Transfer Pricing Methods
- Reference to Transfer Pricing Officer
- Advance Pricing Agreement [Section 92CC]
- Roll Back Provision in APA
- Transfer Pricing Documentation
- Safe Harbour Rules [Section 92CB]
- Penalties
- Questions for Practice

(II) GENERAL ANTI AVOIDANCE RULES

- Introduction and Background
- Need of GAAR
- Tax Evasion v/s Tax Avoidance
- Chapter X-A of Income Tax Act, 1961
- Impermissible Avoidance Agreement
- Current Scenario with Specific Anti Avoidance Rules (SAAR)
- GAAR v/s SAAR
- BEPS & GAAR
- Exclusion from GAAR
- Misc. Aspects of GAAR Provisions
- Penalties
- GAAR Checklist
- Case Study
- Lesson Round-Up
- Test Yourself
- List of Further Readings

(I) TRANSFER PRICING**REGULATORY FRAMEWORK**

Sections (Income Tax Act, 1961)	Details
Section 92A	Associated Enterprises
Section 92B(1)	International Transaction
Section 92B(2)	Deemed International Transaction
Section 92BA	Specified Domestic Transaction
Section 92C	Transfer Pricing Method
Section 92CA	Reference to Transfer Pricing Officer
Section 92CC	Advance Pricing Agreement
Section 92CD	Filing of modified return for any assessment year relevant to a previous year to which APA applies
Section 92CE	Secondary Adjustment in Certain International Transactions
Section 92D	Transfer Pricing Documentation
Section 92E	Report from an Accountant
Section 92CB	Safe Harbour Rules
Rules (Income Tax Rules, 1962)	Details
Rule 10B	Determination of Arm's Length Price Under Section 92C
Rule 10AB	Other Method of Determination of Arm's Length Price
Rule 10C	Selection of Transfer Pricing Method
Rule 10CA	Computation of Arm's Length Price in Certain Cases
Rule 10D	Information and documents to be kept and maintained under section 92D

INTRODUCTION

The increasing participation of multi-national groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multi-national group. The profits derived by such enterprises carrying on business in India can be controlled by the multi-national group, by manipulating the prices charged and paid in such intragroup transactions, thereby, leading to erosion to tax revenues.

With a view to provide a detailed statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises, chapter of Transfer pricing consisting of section 92 to 92F has been introduced.

In the present age of globalization, diversification and expansion, most of the companies are working under the umbrella of group engaged in diversified fields/sectors leading to large number of transactions between related parties.

Related Party transaction means the transaction between/among the parties which are associated by reason of common control, common ownership or other common interest.

The mechanism for accounting, the pricing for these related transactions is called Transfer Pricing.

Transfer Price refers to the price of goods/services which is used in accounting for transfer of goods or services from one responsibility center to another or from one company to another associated company. Transfer price affects the revenue of transferring division and the cost of receiving division. As a result, the profitability, return on investment and managerial performance evaluation of both divisions are also affected.

This may be understood well by the following example:

1. AT & Companies is a group of Companies engaged in diversified business. One of its units i.e. Unit X is engaged in manufacturing of automotive batteries. Another Unit Y is engaged in manufacturing of Industrial Trucks. Unit X is supplying automotive batteries to Unit Y. In such cases transfer price mechanism is used to account for the transfer of automotive batteries.
2. AT Co. is expert in providing electrical and electronic services. It is engaged in providing support to its associated company as well as it is engaged in outsourcing contract. If AT Co. provides some services to its associated company, the transaction should be accounted at price calculated using transfer price mechanism.

IMPORTANCE OF TRANSFER PRICING

Transfer pricing mechanism is very important for following reasons:

1. **Helpful in correct pricing of Product/Services:** An effective transfer pricing mechanism helps an organization in correctly pricing its product and services. Since in any organization, transaction between associated parties occurs frequently, it is necessary to value all transaction correctly so that the final product/ services may be priced correctly.
2. **Helpful in Performance Evaluation:** For the performance evaluation of any entity, it is necessary that all economic transactions are accounted. Calculation of correct transfer price is necessary for accounting of inter related transaction between two Associated enterprises.
3. **Helpful in complying Statutory Legislations:** Since related party transaction have a direct bearing on the profitability or cost of a company, the effective transfer pricing mechanism is very necessary.

TRANSFER PRICING PROVISIONS IN INDIA

Increasing participation of multi-national groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same group. Hence, there was a need to introduce a uniform and internationally accepted mechanism of determining reasonable, fair and equitable profits and taxes in India. Accordingly, the Finance Act, 2001 introduced law of transfer pricing in India through Sections 92 to 92F of the Income Tax Act, 1961 which guides computation of the transfer price and suggests detailed documentation procedures. Year 2012 brought a big change in transfer pricing regulations in India whereby government extended the applicability of transfer pricing regulations to specified domestic transactions which are enumerated in Section 92BA. This would help in curbing the practice of transferring profit from a taxable domestic zone to tax free domestic zone.

As stated earlier, the fundamental of transfer pricing provision is that transfer price should represent the arm's length price of goods transferred and services rendered from one unit to another unit.

In general, arm's length price means fair price of goods transferred or services rendered. In other words, the transfer price should represent the price which could be charged from an independent party in uncontrolled conditions. Arm's length price calculation is very important for a company. In case the transfer price is not at arm's length, it may have following consequences

- A. Wrong performance evaluation
- B. Wrong pricing of final product (In case where the goods/services are used in the manufacturing of final product).
- C. Non compliances of applicable laws and thus attraction of penalty provisions.

The same may be explained with the following examples

Company A and Company T is working under the common umbrella of AT & Company. Company A manufactures a product which is raw material for Company T.

Case	Criteria	Effect on Company A	Effect on Company T
1	Company A charges price more than the Arm's length price from Company T	The revenue of company A will increase.	The total cost of company T will increase. This will result into wrong pricing of its product which may further lead to non- competitiveness of its product.
2	Company A charges price less than the Arm's length price from Company T	The revenue of company A will decrease. The parent company may close the company A treating it as loss making entity.	The total cost of company T will decrease. Therefore, the company T may charge lower price which may lead to loss at a group level.
3	Company A charges Arm's Length price from Company T	The revenue of company A will be representing true and fair view of its operation.	Company T will be paying the price as equivalent to market price of Company A product and its cost will be correct. On the basis of the cost arrived after considering the arm's length price of company A product, company T will be able to take correct price decision.

“The concept of associated enterprises and International transaction is very important for applying the transfer pricing provisions. Section 92A and Section 92B deals with these two important concepts of chapter X of Income Tax Act, 1961.”

PRACTICAL DIFFICULTIES IN APPLICATION OF ALP

There are, however, certain practical difficulties in applying the ALP, which are described hereunder:

True comparison difficult in certain cases – The commercial and financial conditions governing a transaction between independent enterprises are, by and large, never similar to those existing between associated enterprises. As a result, there cannot be a true comparison. The economies of scale and integration of various business activities of the associated enterprise may not be truly appreciated by arm's length principle. Further, associated enterprises may enter into transactions which independent enterprises may not enter into, like say,

licensing of valuable intangible or sharing the benefits of research. The owner of an intangible may be hesitant to enter into licensing arrangements with independent enterprises for fear of the value of the intangible being degraded. In contrast, he may be prepared to offer terms that are less restrictive to associated enterprises because the use of the intangible can be closely monitored. Further, there is no risk to the overall group's profit from a transaction of this kind between members of an MNC group. In such situations, where independent enterprises seldom undertake transactions of the type entered into by associated enterprises, the ALP is difficult to apply because there is little or no direct evidence of what conditions would have been established by independent enterprises.

Availability of data and reliability of available data – There may be difficulty in getting adequate and reliable information and data in order to apply arm's length principle. The comparison of controlled and uncontrolled transactions between associated and independent enterprises usually requires a large quantum of data. Easily accessible information may be incomplete and difficult to interpret while the relevant and required information may be difficult to obtain due to geographical constraints or secrecy and confidentiality aspects. In other cases, information about an independent enterprise which could be relevant may not exist at all. Due to these difficulties, the tax administration and tax payers may have to exercise reason and judgment when applying the ALP.

Absence of market price - There must be a reasonably reliable and comparable uncontrolled market price. The ALP does not meet this condition because of the nature of the market place. A market price is an outcome of unique negotiations. It may be possible to know the price range, but it is very difficult to know the actual market price unless a market transaction actually takes place.

Absence of comparable market price for “intangible” transactions - The ALP reaches a comparable uncontrolled market price that is reasonably reliable for standard transactions where the price range is narrow and market price is certain. However, the ALP generally fails to achieve a comparable market price for transactions involving intangibles because they are unique. The unique nature of these transactions creates a very wide price range.

Administrative burden - In certain cases, the arm's length principle may result in an administrative burden for both the taxpayer and the tax administrations of evaluating significant numbers and types of cross-border transactions.

Time lag - Although an associated enterprise normally establishes the conditions for a transaction at the time it is undertaken, at some point the enterprise may be required to demonstrate that these are consistent with the arm's length principle. The tax administration may also have to engage in the verification process perhaps some years after the transactions have taken place. It may result in substantial cost being incurred by the tax payer and the tax administration. It is also difficult to appreciate the business realities which prevailed at the time when the transactions were entered into. This may lead to bias against the tax payer.

ASSOCIATED ENTERPRISES (AE)

Associated Enterprises has been defined in Section 92A of the Act. It prescribes that “associated enterprise”, in relation to another enterprise, means an enterprise –

- (a) Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- (b) In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

Thus, from above definition we may understand that

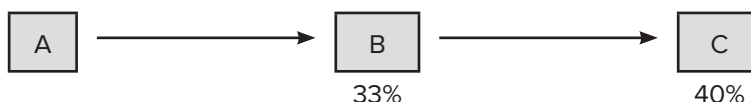
The basic criterion to determine an AE is the participation in management, control or capital (ownership) of one enterprise by another enterprise whereby the participation may be direct or indirect or through one or more intermediaries, control may be direct or indirect.

Deemed Associated Enterprises

(1) Two enterprises shall be deemed to be associated enterprises if, at any time during the previous year:

(a) *one enterprise holds, directly or indirectly, shares carrying not less than **26% of the voting power in the other enterprise**; or*

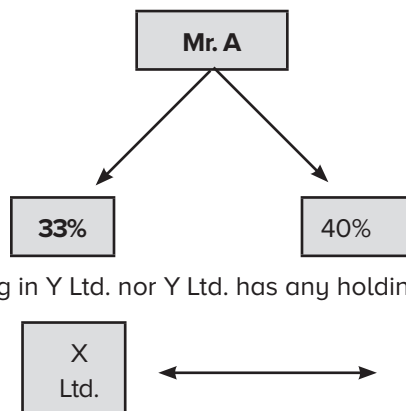
Example: A Ltd. holds 33% of voting power in B Ltd. and B Ltd. holds 40% voting power in C Ltd.



In above situation, A Ltd. holds 33% of voting power in B Ltd. directly and 40% of voting power in C Ltd. indirectly (i.e. through B Ltd.). Therefore, both B Ltd. & C Ltd. are deemed associated enterprises of A Ltd.

(b) *any person or enterprise holds, directly or indirectly, shares carrying not less than **26% of the voting power in each of such enterprises**; or*

Example: Mr. A holds 40% of shareholding in both X Ltd. and Y Ltd. where



neither X Ltd. has any holding in Y Ltd. nor Y Ltd. has any holding in X Ltd.

In this situation, since Mr. A directly holds 40% of shareholding in both X Ltd. and Y Ltd., X Ltd. & Y Ltd. will be deemed associated enterprises.

(c) *a **loan advanced** by one enterprise to the other enterprise constitutes not less than **51% of the book value of the total assets** of the other enterprise; or*

Example: Book value of total assets of Y Ltd. is Rs. 100 crores. X Ltd. advances loan of Rs. 60 crores to Y Ltd.

Since, in this case, X Ltd. advances loan of Rs. 60 Crores to Y Ltd, which is 60% of the book value of total assets of Y Ltd. Hence, X Ltd. & Y Ltd. are deemed associated enterprises.

(d) *one enterprise guarantees not less than **10% of the total borrowings** of the other enterprise; or*

Example: P Inc. has total loan of 1 million dollars from XYZ Bank of America. Out of that, A Ltd., an India company, guarantees 20% of total borrowings in case of any default made by P Inc.

In such scenario, since, A Ltd. guarantees 20% of total borrowings of P Inc., P Inc. and A Ltd. are deemed associated enterprises.

- (e) **more than half of the board of directors** or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are **appointed by the other enterprise**; or

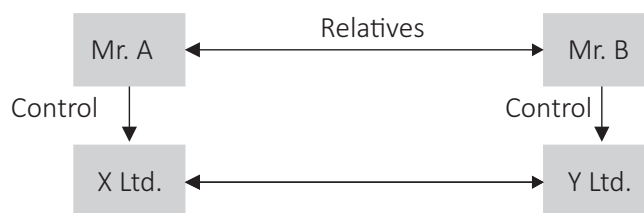
Example: X Ltd. has 15 directors on its Board. Out of that, Y Ltd. has appointed 8 directors. In such case, X Ltd. and Y Ltd. are deemed associated enterprises.

- (f) **more than half of the directors** or members of the governing board, or one or more of the executive directors or executive members of the governing board, of **each of the two enterprises** are **appointed by the same person or persons**; or

Example: Mr. A appointed 9 directors out of 15 directors of X Ltd. and appointed 2 executive directors on the board of Y Ltd. In such case, since a common person i.e. Mr. A appointed more than half of the directors in X Ltd. and appointed 2 executive directors in Y Ltd., both X Ltd. and Y Ltd. are deemed associated enterprises.

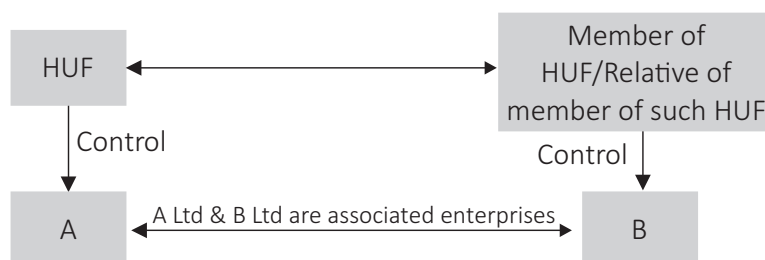
- (g) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or
- (h) **90% or more of the raw materials** and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are **supplied by the other enterprise**, or
- (i) the **goods or articles manufactured or processed** by one enterprise, are **sold to the other enterprise** and the prices and other conditions relating thereto are influenced by such other enterprise; or
- (j) where one enterprise is **controlled by an individual**, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or

Example: Mr. A and Mr. B are relatives. Mr. A has control over X Ltd. and Mr. B has control over Y Ltd. Therefore, both X Ltd. and Y Ltd. will be deemed associated enterprises.



X Ltd. & Y Ltd. are deemed to be associated enterprises

- (k) where one enterprise is **controlled by a Hindu undivided family**, the other enterprise is controlled by a member of such Hindu undivided family, or by a relative of a member of such Hindu undivided family, or jointly by such member and his relative; or



- (l) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than **10% interest in such firm, association of persons or body of individuals**.

In Summary, two enterprises will be deemed as Associated Enterprises if

Quantum of Interest	Criteria applied for Associated Enterprises
26% or more	Shareholding with voting power – either direct or indirect
51% or more	Advancement of loan by one entity to other constituting 51% or more of the book value of the total assets of the other entity
51% or more	Based on the board of directors appointed by the governing board of the entity in the other
90% or more	Based on the quantum of supply of raw materials and consumables by one entity to the other
10% or more	Total Borrowing Guarantee by one enterprises for other
10% or more	Interest by a firm or association of persons (AOP) or by a body of Individuals (BOI) in other firm AOP or firm or BOI

- (m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed

MEANING OF INTERNATIONAL TRANSACTION

Meaning of International Transaction [Section 92B(1)]

As per section 92B of the Act, an international transaction means:

- (i) a transaction between two or more associated enterprises, either or both of whom are non- residents; and
- (ii) transaction in the nature of:
 - (a) sale/ purchase/ lease of tangible property; or
 - (b) sale/ purchase/ lease of intangible property; or
 - (c) provision of services; or
 - (d) lending/borrowing money; or
 - (e) any other transaction having a bearing on profits, income, losses or assets of such enterprises; or
 - (f) mutual agreement or arrangement between two or more associated enterprise for the allocation

or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

(1) Deemed international transaction [Section 92B(2)]

Where, in respect of a transaction entered into by an enterprise with a person other than an associated enterprise (hereinafter referred to as “other person”),

- there exists a prior agreement in relation to the relevant transaction between the other person and the associated enterprise or,
- where the terms of the relevant transaction are determined in substance between such other person and the associated enterprise; and
- either the enterprise or the associated enterprise or both of them are non-residents,

then such transaction entered into between the enterprise and the other person shall be **deemed to be an international transaction** entered into between two associated enterprises, **whether or not such other person is a non-resident.**

Example:

If A Ltd., an Indian company, has entered into an agreement for sale of product X to Mr. B, an unrelated party and Mr. B has entered into an agreement for sale of product X with C Inc., a non-resident entity, which is a specified foreign company in relation to A Ltd., then, the transaction between A Ltd. and Mr. B shall be deemed to be an international transaction entered into between two associated enterprises, irrespective of whether or not Mr. B is a non-resident.

Explanation. – For the removal of doubts, it is hereby clarified that –

- (i) the expression “international transaction” shall include –
 - (a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;
 - (b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;
 - (c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;
 - (d) provision of services, including provision of market research, market development, marketing management, administration, technical services, repairs, design, consultation, agency, scientific research, legal or accounting service;
 - (e) a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;
- (ii) the expression “intangible property” shall include –

- (a) marketing related intangible assets, such as, trademarks, trade names, brand *names*, *logos*;
- (b) technology related intangible assets, such as, process patents, patent applications, *technical documentation such as laboratory notebooks, technical know-how*;
- (c) artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;
- (d) data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;
- (e) engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schema-tics, blueprints, proprietary documentation;
- (f) customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;
- (g) contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;
- (h) human capital related intangible assets, such as, trained and organised work force, employment agreements, union contracts;
- (i) location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;
- (j) goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;
- (k) methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;
- (l) any other similar item that derives its value from its intellectual content rather than its physical attributes.

According to section 92B(2), a transaction between an enterprise and an unrelated person shall be deemed to be a transaction between associated enterprises if in relation to that transaction -

- (i) there exists a prior agreement between such other person and the associated enterprise; or
- (ii) the terms of the relevant transaction are determined in substance between such unrelated person and the associated enterprise.

The Finance Act, 2014 clarifies that unrelated person can be resident or not resident.

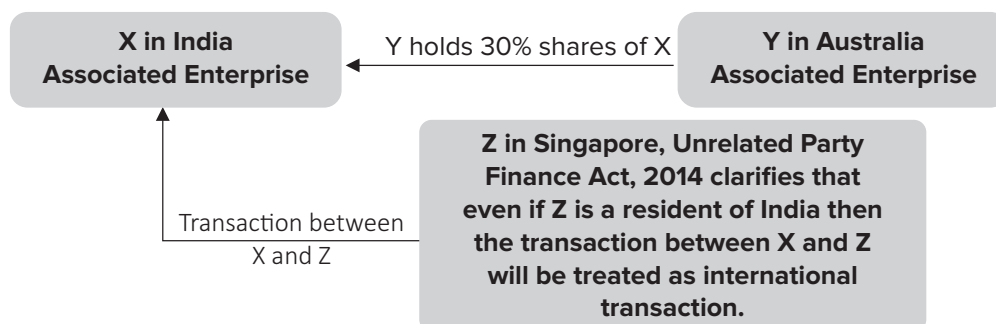


Illustration:

Enterprise X of India and enterprise Y of Australia are associated enterprises. Enterprise Z of Singapore is not an associated enterprise of enterprise X. Enterprise Y and enterprise Z enter into an agreement for determining the terms of transactions between enterprise X and enterprise Z. The transaction as may be entered between enterprise X and enterprise Z which is governed by such an agreement existing between Y and Z shall be deemed to be a transaction between two associated enterprises.

According to section 92B(2), a transaction between X India and Z Singapore shall be deemed to be a transaction between associated enterprises if in relation to that transaction -

- (i) there exists a prior agreement between the Z Singapore and the Y Australia; or
- (ii) the terms of the relevant transaction are determined in substance between Z Singapore and the Y Australia.

For a transaction to be an international transaction, it should satisfy the following two conditions cumulatively:

- (1) it must be a transaction between two associated enterprises and
- (2) at least one of the two enterprises must be a non-resident.

If both the associated enterprises are non-residents, then the Chapter of Transfer Pricing shall apply only if income of one of the non-residents is assessable under the Indian Income-tax Act.

TRANSFER PRICING – APPLICABILITY TO DOMESTIC TRANSACTIONS

Honorable Supreme Court in the case of CIT v. Glaxo SmithKline Asia (P) Ltd., (2010) 195 Taxman 35 (SC) has advised that it needs to be considered whether the regulations should be applied to domestic transactions in cases where such transactions are not revenue-neutral. The facts and ruling of Honourable Supreme Court is as follows:

CASE LAWS***CIT v. Glaxo SmithKline Asia (P) Ltd., (2010) 195 Taxman 35 (SC)*****Facts**

1. Glaxo SmithKline Asia (P) Ltd (GSK) entered into an agreement with Glaxo Smith Kline Consumer Healthcare Ltd (“GSKCH”) whereby GSKCH would provide all administrative services relating to marketing, finance, Human Resource (HR) to GSK for cost +5% markup.
2. The AO disallowed a part of the charges reimbursed on the ground that they were excessive and not for business purposes. On appeal by GSK, CIT (Appeals) upheld the decision of AO.
3. GSK appeal to Income Tax Appellate Tribunal (ITAT) and ITAT ruled that AO has no power to disallow any expenditure as excessive or unreasonable unless the case falls within the scope of Section 40A(2). The revenue appeal to high court and revenue appeal was dismissed by High Court.
4. For subsequent years AO continued to follow the same approach and GSK continued to get relief from ITAT. Having regard to the delay on the part of revenue to give effect to ITAT order, GSK filled a writ petition before the High Court and High Court issued direction to the Revenue to issue refund of taxes along with applicable interest.

Supreme Court Ruling

1. The revenue filed a Special Leave Petition (SLP) before the Honorable Supreme Court and Supreme Court held that since the exercise is revenue neutral and both the parties are not related parties in terms of Section 40A(2) of Income tax act, no interference is called for and the SLP filled by the Revenue is dismissed.
2. The Honorable Supreme Court then stated that the larger issue is whether Transfer Pricing provisions should be limited to cross-border transactions or whether the Transfer Pricing Regulations be extended to domestic transactions. In domestic transactions, the under-invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage such as where one of the related entities is (i) loss making or (ii) liable to pay tax at a lower rate and the profits are shifted to such entity;
3. The Supreme Court further held that the complications arise in cases where the fair market value is required to be assigned to transactions between related parties u/s 40A(2). The Central Board of Direct taxes (CBDT) should examine whether Transfer Pricing provisions can be applied to domestic transactions between related parties u/s 40A(2) by making amendments to the Act. The AO can be empowered to make adjustments to the income declared by the assessee having regard to the fair market value of the transactions between the related parties and can apply any of the generally accepted methods of determination of arm's length price, including the methods provided under Transfer Pricing provisions. The law can also be amended to make it compulsory for the taxpayer to maintain Books of Accounts and other documents on the lines prescribed in Rule 10D and obtain an audit report from his Chartered Accountant (CA) that proper documents are maintained;
4. Finally, it was held that though the Court normally does not make recommendations or suggestions, in order to reduce litigation occurring in complicated matters, the question of extending Transfer Pricing regulations to domestic transactions require expeditious consideration by the Ministry of Finance and the CBDT may also consider issuing appropriate instructions in that regard.

SPECIFIED DOMESTIC TRANSACTIONS [SECTION 92BA]**Meaning of Specified Domestic Transaction**

For the purposes of this section and sections 92, 92C, 92D and 92E, “specified domestic transaction” in case of an assessee means any of the following transactions, not being an international transaction, namely: –

- (i) any transaction referred to in section 80A;
- (ii) any transfer of goods or services referred to in sub-section (8) of section 80-IA;
- (iii) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA; or
- (iv) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable;
- (v) any business transacted between the persons referred to in sub-section (4) of section 115BAB
- (vi) any business transacted between the assessee and other person as referred to in sub-section (4) of section 115BAE
- (vii) any other transaction as may be prescribed,

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of INR 20 crores.

Eligible Business in (1) and (2) below means Business referred to in sections 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE & 10AA

- (1) Where any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the eligible business, and, in either case, the consideration for such transfer recorded in the accounts of the eligible business does not correspond to the market value of such goods or services on the date of transfer, then, for the purpose of deduction under this section, the profits and gains of such eligible business shall be computed as if the transfer had been made at the market value of such goods or services as on that date.

Explanation – For the purposes of this sub-section, “market value”, in relation to any goods or services, means –

- (i) the price that such goods or services would ordinarily fetch in the open market; or
 - (ii) the arm’s length price as defined in section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.
- (2) Where it appears to the Assessing Officer that owing to close connection between the assessee carrying on the eligible business and any other person, or for any other reason, the course of business transacted between them produces to the assessee more than the ordinary profits which might be expected to arise in such business, the Assessing Officer shall in computing the profits and gains of such business for the purpose of computing deduction under this section, take the amount of profits as may be reasonably deemed to have been derived therefrom.

Provided that the amount of profits from such transaction shall be determined having regard to arm’s length price as defined in section 92F.

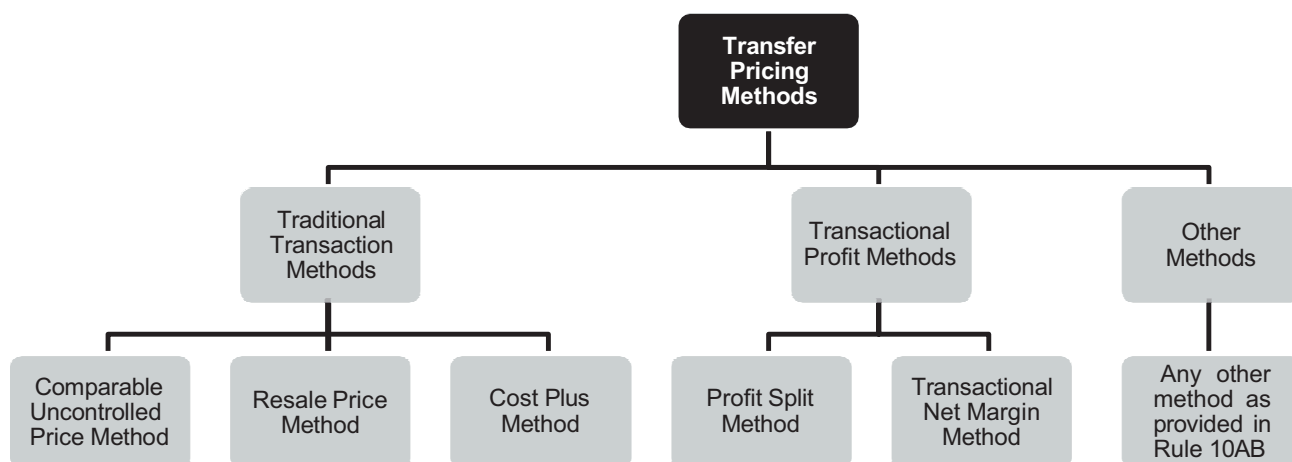
TRANSFER PRICING – METHODS

Section 92C of Income Tax Act defines the methods which are to be used in determination of Arm’s Length prices for International Transaction and specified domestic transaction.

Computation of Arm’s Length Price

The arm’s length price in relation to an international transaction/specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely:-

- (A) Comparable Uncontrolled Price Method (CUP)
- (B) Resale Price Method (RPM)
- (C) Cost Plus Method (CPM)
- (D) Profit Split Method (PSM)
- (E) Transactional Net Margin Method (TNMM)
- (F) Such other method as may be prescribed by the Board.



The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed.

Provided that if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed 1% of the latter in respect of wholesale trading and 3% of latter in other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price.

Provided also that where more than one price is determined by the most appropriate method, the arm's length price in relation to an international transaction or specified domestic transaction, shall be computed in such manner as may be prescribed.

Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that-

- (a) the price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with sub-sections (1) and (2); or
- (b) any information and document relating to an international transaction or specified domestic transaction have not been kept and maintained by the assessee in accordance with the provisions contained in section 92D(1) and the rules made in this behalf; or
- (c) the information or data used in computation of the arm's length price is not reliable or correct; or
- (d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under section 92D(3),

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction or specified domestic transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him:

Provided that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

Where an arm's length price is determined by the Assessing Officer, the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined:

*Provided that no deduction under **section 10A/10AA/10B** or under **Chapter VI-A** shall be allowed in respect of*

the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section:

However, where the total income of an associated enterprise is computed under this sub-section on determination of the arm's length price paid to another associated enterprise from which tax has been deducted or was deductible under the provisions of Chapter XVIIIB, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.

Illustration:

Unilever in U.S.A. holds 27% equity shares of Hindustan Lever in India. Unilever provides knowhow to Hindustan Lever for which Hindustan Lever pays a royalty of Rs. 100 lakhs to Unilever. As per DTAA the tax rate on royalty is 10%. Hindustan Lever deducts TDS of Rs. 10 lakhs and remits Rs. 90 lakhs to Unilever. Hindustan Lever files its return of income of Rs. 300 lakhs after claiming expenditure of Rs. 100 lakhs on royalty. Unilever also files return of income in India as under:

Royalty	100 lakhs
Tax as per DTAA	10 lakhs
Less: TDS	10 lakhs
Tax payable	Nil

The Assessing officer on the basis of information available with him determines the arm's length price of royalty to be Rs. 40 lakhs. Discuss the tax implications.

Answer:

1. Hindustan Lever and Unilever are associated enterprises as per section 92A.
2. Since Unilever is a non-resident and is providing knowhow to Hindustan Lever for which royalty is being paid, there is an INTERNATIONAL TRANSACTION as per section 92 B.
3. Section 92C empowers the Assessing officer to determine the taxable income of Hindustan Lever on the basis of information in his possession on the basis of arm's length price of Rs. 40 lakhs.
4. The Assessing officer will accordingly assess the income of Hindustan Lever at Rs. 360 lakhs after disallowing the royalty of Rs. 60 lakhs. Penalty for under-reporting of income shall be levied.
5. As per the first proviso to section 92C(4), deduction under section 10AA or under Chapter VI - A otherwise allowable to Hindustan Lever shall not increase on account of additions of Rs. 60 lakhs.
6. As per Second Proviso to section 92C(4), Unilever cannot claim that its income should be Rs. 40 lakhs instead of Rs. 100 lakhs and cannot claim refund of TDS of Rs. 6 lakhs.

Rule 10B

Determination of Arm's Length Price Under Section 92C

Note: In these rules, ‘uncontrolled transaction’ means a transaction between enterprises other than associated enterprises, whether resident or non-resident.

For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner:

(a) Comparable Uncontrolled Price Method (CUP Method):

Comparable Uncontrolled Price (“CUP”) method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.

An Uncontrolled price is the price agreed between the unrelated parties for the transfer of goods or services. If this uncontrolled price is comparable with the price charged for transfer of goods or services between the Associated Enterprises, then that price is Comparable Uncontrolled Price (CUP). This is the most direct method for the determination of the Arms’ length price.

Methods of CUP

CUP can be either

- (a) Internal CUP or
- (b) External CUP

Internal CUP is available, when the tax payer enters into a similar transaction with unrelated parties, as is done with a related party as well. This is considered a very good comparable, as the functions performed, processes involved, risks undertaken and assets employed are all easily comparable – more so, on “an apple to apple basis”.

The external CUP is available if a transaction between two independent enterprises takes place under comparable conditions involving comparable goods or services. For example, an independent enterprise buys or sells a similar product, in similar quantities under similar term from/to another independent enterprise in a similar market will be termed as external CUP.

Applicability of the CUP Method

Comparable Uncontrolled Price method is treated as most reliable method of transfer pricing calculation but it is not easy to find the uncontrolled price. The CUP is believed to be the most reliable/best method, if one could identify and map it. CUP method can be applied without any difficulty in following circumstances.

- (1) Interest payment on a loan
- (2) Royalty payment
- (3) Software development where products are often licensed to a third party
- (4) Price charged for homogeneous items like traded goods

Step-1 Determine the price charged or paid for the property transferred or services provided in a comparable uncontrolled transaction.

Step-2 Such price is then adjusted to account for the functional differences between the international transaction & the comparable uncontrolled transaction, which could materially affect the price in the open market.

Step-3 Such adjusted price is the arm’s length price.

Illustration:

Happy Ltd., a US company has a subsidiary, Khushi Ltd. in India. Happy Ltd. sells computer monitors to Khushi Ltd. for resale in India. Happy Ltd. also sells computer monitors to Raja Ltd., another computer reseller. It sells 50,000 computer monitors to Khushi Ltd. at INR 11,000 per unit. The price fixed for Raja Ltd. is INR 10,000 per unit. The warranty in case of sale of monitors by Khushi Ltd. is handled by Khushi Ltd. However, for sale of monitors by Raja Ltd., Happy Ltd. is responsible for the warranty for 3 months. Both Happy Ltd. and Khushi Ltd. offer extended warranty at a standard rate of INR 1,000 per annum. On these facts, how is the assessment of Khushi Ltd. going to be affected?

Solution:

Happy Ltd., the foreign company and Khushi Ltd., the Indian company are associated enterprises since Happy Ltd. is the holding company of Khushi Ltd. Happy Ltd. sells computer monitors to Khushi Ltd. for resale in India. Happy Ltd. also sells identical computer monitors to Raja Ltd., which is not an associated enterprise. The price charged by Happy Ltd. for a similar product transferred in comparable uncontrolled transaction is, therefore, identifiable. Therefore, Comparable Uncontrolled Price (CUP) method for determining arm's length price can be applied.

While applying CUP method, the price in comparable uncontrolled transaction needs to be adjusted to account for difference, if any, between the international transaction (i.e. transaction between Happy Ltd. and Khushi Ltd.) and uncontrolled transaction (i.e. transaction between Happy Ltd. and Raja Ltd.) and the price so adjusted shall be the arm's length price for the international transaction.

For sale of monitors by Raja Ltd., Happy Ltd. is responsible for warranty for 3 months. The price charged by Happy Ltd. to Raja Ltd. includes the charge for warranty for 3 months. Hence arm's length price for computer monitors being sold by Happy Ltd. to Khushi Ltd. would be:

Particulars	No.	(Per Unit) Rs.
Sale price charged by Happy Ltd. to Raja Ltd.	50,000	10,000
Less: Cost of warranty included in the price charged to Raja Ltd. (INR 1,000 x 3 /12)		250
Arm's length price		9,750
Actual price paid by Khushu Ltd. to Happy Ltd.		11,000
Difference per unit		1,250
No. of units supplied by Happy Ltd. to Khushi Ltd.		
Addition required to be made in the computation of total income of Khushi Ltd. (1,250 x 50,000)		6,25,00,000

No deduction under chapter VI-A would be allowable in respect of the enhanced income of INR 6.25 crores.

Note: It is assumed that Khushi Ltd. has not entered into an advance pricing agreement or opted to be subject to Safe Harbour Rules.

(b) Resale Price Method

Step-1	The price at which the property purchased or services obtained by the enterprise from an associated enterprise are sold to an unrelated enterprise is first determined.
Step-2	Such resale price is reduced by normal gross profit margin accruing to the enterprise from the purchase and resale of similar goods in a comparable uncontrolled transaction, If there is no comparable uncontrolled transaction, then take the Gross profit of an unrelated person from purchase and resale of similar goods.
Step-3	Then reduce the expenses incurred by the enterprise in connection with purchase of property.
Step-4	The price so arrived at in step-3 is adjusted to account for the functional differences in the international transaction & the comparable uncontrolled transaction which could materially affect the Gross Profit margin in the open market.
Step-5	The adjusted price arrived at in step-4 is the arm's length price.

For example, Tetra Pack Austria holds 30% shares of Alfa Laval India Ltd. Alfa Laval India Ltd. imports 1,000 towel dispensers from Tetra Pack Austria at a price of Rs. 2,900 per unit and these are sold to Hyatt Regency at a price of Rs. 3,000 per unit. Alfa Laval India Ltd. has bought similar products from Ultimate Industries Ltd. and sold to Taj Palace at a gross profit of 12% on sales. Tetra Pack Austria offers a quantity discount of Rs.10 per unit whereas Ultimate Industries Ltd. does not offer such quantity discount. Alfa Laval India Ltd. incurred freight of Rs. 10 and customs of Rs. 25 per unit in case of purchases made from Tetra Pack Austria.

Now, arm's length price is determined as under:

Resale Price of goods purchased from Tetra Pack Austria	Rs. 3,000
Less: Normal Gross Profit Margin @ 12%	Rs. 360
Less: Expenses connected with purchases (freight and customs duty paid)	Rs. 35
Less: Quantity discount allowed by Tetra Pack Austria	Rs.10
Arm's Length Price	Rs. 2,595
Price paid to tetra Pack Austria 1,000 units X 2,900	Rs. 29,00,000
Arm's Length Price 1,000 units X 2,595	Rs. 25,95,000
Increase in income of Alfa Laval India Ltd.	Rs. 3,05,000

(c) Cost Plus Method

Step 1:	Determine the direct and indirect costs of production in respect of property transferred or services provided to an associated enterprise.
Step 2:	Determine the normal gross profit mark up to such costs which will arise from transfer of similar goods or services to an unrelated enterprise or in a comparable uncontrolled transaction.
Step 3:	The normal gross profit markup determined in Step 2 should be adjusted to account for the functional differences if any between the international transaction and comparable uncontrolled transaction which could materially affect such profit mark up in the open market.

Step 4:	The cost referred to in Step 1 shall be increased by the adjusted profit markup arrived in Step 3.
Step 5:	The sum so arrived at is the arm's length price.

For example, Alto Ltd. Germany holds 35% shares in Beta Ltd. India. Beta Ltd. develops software and does both onsite and offsite consultancy services for various customers. Beta Ltd. during the year billed Alto Ltd. Germany for 100 man-hours at the rate of Rs. 2,000 per man-hour. The total cost (direct and indirect) for executing this work amounted to Rs. 1,75,000.

However, Beta Ltd. billed C Ltd. India at the rate of Rs. 3,000 per man-hour for the similar level of manpower and earned a Gross Profit of 50% on its cost.

The transactions of Beta Ltd. with Alto Ltd. and C Ltd. are comparable subject to the following differences:

- (i) While Beta Ltd. derives technology support from Alto Ltd., there is no such support from C Ltd. The value of technology support received from Alto Ltd. may be put at 20% of normal gross profits.
- (ii) As Alto Ltd. gives business in large volumes, Beta Ltd. offered to Alto Ltd. a quantity discount which may be valued at 10% of normal gross profits.
- (iii) In the case of rendering services to Alto Ltd., Beta Ltd. neither runs any risk nor incurs any marketing costs. On the other hand, in the case of services to C Ltd., Beta Ltd. has to assume all the risks and costs associated with the marketing function which may be estimated at 10% of normal gross profits.
- (iv) Beta Ltd. offered one month credit to Alto Ltd. The cost of providing such credit may be valued at 3% of gross profits. No such credit was given to C Ltd.

Now, arm's length price under the cost plus method shall be determined as under:

Price charged to C Ltd.	3,000
Gross Profit mark up in case of C Ltd.	50%
Less: Differences to be adjusted for:	
(i) Technology support from Alto Ltd. (20% of 50%)	10%
(ii) Quantity discount to Alto Ltd. (10% of 50%)	5%
(iii) Risk Factor (10% of 50%)	5%
Add: Cost of credit to Alto Ltd. (50% of cost @ 3% being GP)	30%
	1.50%
Arm's Length Gross Profit Mark-up	31.50%
Cost incurred by Beta Ltd. (Direct and Indirect cost)	1,75,000
Arm's Length Billed Value (1,75,000 + 31.5%)	2,30,125
Less Billed Income (Actual) (2,000 x 100 man hours)	2,00,000
Increased Income	30,125

(d) Profit Split Method

Rule 10B (1) (d) of Income tax Rules, 1962 prescribes Profit Split Method, which may be applicable mainly in international transactions or specified domestic transaction involving transfer of unique intangibles or in multiple international transactions or specified domestic transaction which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which:

- (i) The combined net profit of the associated enterprises arising from the international transaction or specified domestic transaction in which they are engaged, is determined;
- (ii) The relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;
- (iii) The combined net profit is then split amongst the enterprises in proportion to their relative contributions, as computed above;
- (iv) The profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction or specified domestic transaction.

However, the combined net profit as determined in sub-clause (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction or specified domestic transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under sub-clauses (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction or specified domestic transaction.

Two step Approach of Profit Split Method

Step 1: Allocation of sufficient profit to each enterprise to provide a basic compensation for routine contributions. This basic compensation does not include a return for possible valuable intangible assets owned by the associated enterprises. The basic compensation is determined based on the returns earned by comparable independent enterprises for comparable transactions or, more frequently, functions.

Step 2: Allocation of residual profit (i.e. profit remaining after step 1) between the associated enterprises based on the facts and circumstances. If the residual profit is attributable to intangible property, then the allocation of this profit should be based on the relative value of each enterprise's contributions of intangible property.

Example on the Profit Split Method (Residual Analysis Approach)

Company A is an Indian Company and deals in telecommunication products. It has developed a Microprocessor and it holds the patent for manufacturing of the microprocessor. Company B which is an overseas subsidiary of Company A is engaged in manufacturing of Mobile equipment at Australia. Company A supply the microprocessor to company B for using it in Mobile equipment and company B in turn after manufacturing the mobile sends the mobile to company “A” in India. Company A sells all the mobile in India.

Both companies contribute to the success of the mobile equipment through their design of the microprocessor and the equipment. As the nature of the products is very advanced and unique, the group is unable to locate any comparable with similar intangible assets. Therefore, neither the traditional methods i.e. CUP Method, RSP Method nor the TNMM is appropriate in this case.

Nevertheless, the group is able to obtain reliable data on hand phone contract manufacturers and equipment wholesalers without unique intangible property in the telecommunication industry. The manufacturers earn a mark-up of 10% while the wholesalers derive a 25% margin on sales.

Company A's and Company B's respective share of profit is determined in 2 steps using the profit split method (residual analysis approach).

Step 1 – Determining the basic return

The simplified accounts of Company A and Company B are shown below:

Particulars	Company B (Rs. in Lakhs)	Company A (Rs. in Lakhs)
Sales	100	125
Cost of Goods Sold	(60)	(100)
Gross Margin	40	25
Sales, General & Administration Expenses	(5)	(15)
Operating Margin	35	10

The total operating profit for the group is Rs. 45 Lakhs.

Company B

Particulars	Amount (Rs. in Lakhs)
Cost of goods sold	60
Margin @10%	6
Transfer price based on Comparable (without considering Intangibles)	66

Company A

Particulars	Amount (Rs. in Lakhs)
Sales to third party customers	125
Resale margin of wholesalers comparables (without intangibles) @25%	31.25
Gross Margin	31.25

Particulars	Company B (Rs. in Lakhs)	Company A (Rs. in Lakhs)
Sales	66	
Cost of Goods Sold	(60)	
Gross Margin	6	31.25
Sales, General & Admin Expenses	(5)	(15)
Routine operating margin	1	16.25

The total operating margin of the group is Rs.17.25 Lakhs.

Step 2: Dividing the residual profit

The residual profit of the group is = Rs. 45 Lakhs – Rs.17.25 Lakhs = Rs. 27.75 Lakhs

On further study of the two companies, two particular expense items, R&D expenses and marketing expenses, are identified as the key intangibles critical to the success of the mobile equipment. The R&D expenses and marketing expenses incurred by each company are:

Company A 12 Lakhs (80%)

Company B 3 Lakhs (20%)

Assuming that the R&D and marketing expenses are equally significant in contributing to the residual profits, based on the proportionate expenses incurred:

Company A's share of residual profit ($80\% \times 27.75$) = Rs. 22.20 Lakhs Company B's share of residual profit ($20\% \times 27.75$) = Rs. 5.55 Lakhs Therefore, the adjusted operating profit of

Company A is = Rs. 22.20 L + Rs.16.25 L = Rs. 38.45 Lakhs Company B is = 5.55 + 1 = Rs. 6.55 Lakhs.

The adjusted tax accounts are as follows:

Particulars	Company B (Rs. in Lakhs)	Company A (Rs. in Lakhs)
Sales	71.55	125
Cost of Goods Sold	(60)	(71.55)
Gross Margin	11.55	53.45
Sales, General & Admin Expenses	(5)	(15)
Operating Margin	6.55	38.45

Hence, the transfer price determined using the profit split method (residual analysis approach) should be Rs. 71.55 Lakhs

(e) Transactional Net Margin Method (TNMM)

Rule 10B (1) (e) of Income Tax Rules, 1962 prescribes, Transactional net margin method, by which,

- (i) The net profit margin realized by the enterprise from an international transaction or specified domestic transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
- (ii) The net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- (iii) The net profit margin referred to in (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction or specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;
- (iv) the net profit margin realized by the enterprise and referred to in (i) is established to be the same as the net profit margin referred to in (iii);
- (v) The net profit margin thus established is then taken into account to arrive at an arms length price in relation to the international transaction or specified domestic transaction.

Example

Nikhil & Co is an India manufacturer of dishwashers. All Nikhil & Co's dishwashers are sold to an overseas associated enterprise, Company G, and bears Company G's brand. Company G, a household electrical appliances brand name, sells only dishwashers manufactured by Nikhil & Co.

The CUP method is not applied in this case because no reliable adjustments can be made to account for differences with similar products in the market. After the appropriate functional analysis, Nikhil & Co was able to identify an Indian manufacturer of home electrical appliances, Company H, as a suitable comparable company. However, Company H performs warranty functions for its independent wholesalers, whereas Nikhil & Co does not. Company H realizes a net mark up (i.e. operating margin) of 10%.

As the costs pertaining to the warranty functions cannot be separately identified in Company H's accounts and no reliable adjustments can be made to account for the difference in the functions, it may be more reliable to examine the net margins in this case.

Solution

The transfer price for Nikhil & Co's sale of dishwashers to Company G is computed using the TNMM as follows:

Nikhil & Co's cost of goods sold	Rs. 5,000
Nikhil & Co's operating expenses	Rs. 1,500
Total costs	Rs. 6,500
Add: Net markup @ 10% (10% x 6,500)	Rs. 650
Transfer price based on TNMM	Rs. 7,150

Other Method of Determination of Arm's Length Price [Rule 10AB]

For the purposes of section 92C(1)(f), the other method for determination of the arms' length price in relation to an international transaction or a specified domestic transaction shall be any method which takes into

account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.

SELECTION OF TRANSFER PRICING METHOD

Rule 10C of the Indian Income Tax Rules, 1962 states that:

In selecting a most appropriate method, the following factors shall be taken into account namely,

- (a) The nature and class of the international transaction or specified domestic transaction.
- (b) The class or classes of Associated Enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises.
- (c) The availability, coverage and reliability of data necessary for application of the method.
- (d) The degree of comparability existing between the international transaction or specified domestic transaction and the uncontrolled transaction and between the enterprises entering into such transactions.
- (e) The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction or specified domestic transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions.
- (f) The nature, extent and reliability of assumptions required to be made in the application of a method.

The starting point to select the most appropriate method is the functional analysis which is necessary regardless of what transfer pricing method is selected. Each method may require a deeper analysis focusing on aspects relating to various methods. The functional analysis helps to:

- Identify and understand the intra-group transactions;
- Have a basis for comparability;
- Determine any necessary adjustments to the comparables;
- Check the accuracy of the method selected; and
- Over time, to consider adaptation of the policy if the functions, risks or assets have been modified.

Functional analysis also forms part of the documentation. The major components of a functional analysis are:

1. Identification of Functions Performed: For the purpose of determining comparability, functions of the entities play an important role.
2. Identification of Risk Undertaken: A risk-bearing party should have a chance of higher earnings than a non-risk bearing party, and will incur the expenses and perhaps related loss if and when risk materializes.
3. Identification of Assets used or contributed: The functional analysis must identify and distinguish tangible assets and intangible assets as this is very important for functional analysis.

The functional analysis provides answers to identify which functions risks and assets are attributable to the various related parties. In some cases, one company may perform one function but the cost thereof is incurred/ paid by the other party to the transaction. The functional analysis could emphasize that situation. The functional analysis includes reference to the industry specifics, the contractual terms of the transaction, the economics

circumstances and the business strategies. A checklist with columns for each related party and if needed for the comparable parties could be used to summarize the functional analysis and give a quick idea of which party performs each relevant function, uses what assets and bears which risk. But this short-cut overview should not be used by tax auditors to count the number of enumerated functions, risks and assets in order to determine the arm's length compensation. It should be used to consider the relative importance of each function, risk and asset. Once the functional analysis is performed and the functionality of the entity as regards the transactions subject to review (or the entity as a whole) has been completed, it can be determined what transfer pricing method is most suitable to determine the arm's length price for the transactions under the review (or the operating margin for the entity under review).

There is no universally accepted method or model which describes the technique for choosing a transfer pricing method. Traditionally comparable Uncontrolled Pricing Method, Profit Split Method, Resale Price Methods are being used in transfer pricing. Other method as TNMM may also be used after the functional analysis and global practices analysis.

Computation of Arm's Length Price in Certain Cases [Rule 10CA]

- (1) Where in respect of an international transaction or a specified domestic transaction, the application of the most appropriate method referred to in sub-section (1) of section 92C results in determination of more than one price, then the arm's length price in respect of such international transaction or specified domestic transaction shall be computed in accordance with the provisions of this rule.
- (2) A dataset shall be constructed by placing the prices referred to in sub-rule (1) in an ascending order and the arm's length price shall be determined on the basis of the dataset so constructed:
- (3) Where the dataset constructed in accordance with sub-rule (2) consists of six or more entries, an arm's length range beginning from the thirty-fifth percentile of the dataset and ending on the sixty-fifth percentile of the dataset shall be constructed and the arm's length price shall be computed in accordance with sub-rule (4) and sub-rule (5).
- (4) If the price at which the international transaction or the specified domestic transaction has actually been undertaken is within the range referred to in sub-rule (3) , then, the price at which such international transaction or the specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price.
- (5) If the price at which the international transaction or the specified domestic transaction has actually been undertaken is outside the arm's length range referred to in sub-rule (3), the arm's length price shall be taken to be the median of the dataset.
- (6) In a case where data set consists of less than six entries, the arm's length price shall be the arithmetical mean of all the values included in the dataset:

Provided that, if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed 1% of the latter in respect of wholesale trading and 3% of the latter in other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price.

- (7) For the purposes of this rule, –
 - (a) “the thirty-fifth percentile” of a dataset, having values arranged in an ascending order, shall be:

$$\text{Total entries in data set} \times 35/100$$

If this number is a fractional number, the next higher number which is a whole number shall be taken and the value in the data set placed at this whole number shall be the thirty fifth percentile.

If this number is a whole number, then the arithmetical average of value in data set at this number and value in data set at next higher number shall be the thirty fifth percentile.

- (b) "the sixty-fifth percentile" of a dataset, having values arranged in an ascending order, shall be: Total entries in data set x 65/100

If this number is a fractional number, the next higher number which is a whole number shall be taken and the value in the data set placed at this whole number shall be the sixty fifth percentile.

If this number is a whole number, then the arithmetical average of value in data set at this number and value in data set at next higher number shall be the sixty fifth percentile.

- (c) "the median" of the dataset, having values arranged in an ascending order, shall be: Total entries in data set x 50/100

If this number is a fractional number, the next higher number which is a whole number shall be taken and the value in the data set placed at this whole number shall be the median.

If this number is a whole number, then the arithmetical average of value in data set at this number and value in data set at next higher number shall be the median.

Illustration 1: The following prices have been determined as arm's length prices using comparable uncontrolled transactions method:

1. 90	5. 102	9. 112	13. 118	17. 124
2. 98	6. 104	10. 114	14. 119	18. 126
3. 100	7. 107	11. 116	15. 120	19. 128
4. 101	8. 110	12. 117	16. 122	20. 130

Answer:

Since the above prices do not relate to unrelated enterprises, the prices of last two years shall not be considered.

Total entries in data set = 20

Thirty fifth percentile = $20 \times 35 / 100 = 7$

Since this is a whole number, the arithmetical mean of value at 7 and 8 shall be the Thirty Fifth percentile = $107 + 110 / 2 = 108.50$

Sixty Fifth percentile = $20 \times 65 / 100 = 13$

Since, this is a whole number, the arithmetical mean of value at 13 and 14 shall be the sixty fifth percentile = $118 + 119 / 2 = 118.50$

Median = $50 / 100 \times 20 = 10$

Since this is a whole number, the arithmetical mean of value at 10 and 11 shall be the median = $114 + 116 / 2 = 115$

If the assessee exports goods to associated enterprise in the range of 108.50 to 118.50, then the price at which goods are exported shall be the ALP. Let's say goods are exported to associated enterprise at Rs. 109, then the actual transaction price is the ALP and no adjustment is required. However, if goods are exported to associate enterprise at say Rs. 100 (10 lakh goods), then ALP shall be Rs. 115 and income of the annexure shall be increased by 15×10 lakh goods = Rs. 150 lakh

Illustration 2: If in the above illustration, the ALP on the basis of CUP method were determined as under:

Price 1: Rs. 100	Price 2: Rs. 102	Price 3: Rs. 90	Price 4: Rs. 110	Price 5: Rs. 115

Since entries in the data set are less than 6, to arithmetical mean of these prices shall be the ALP Thus, ALP shall be $100+102+90+110+115/5 = 517/5 = 103.40$

In the above illustration, the addition on account of transfer price shall be $103.40 - 100 * 10$ lakh goods = Rs. 34 lakhs

Illustration 3: In a given case the dataset of 20 prices arranged in ascending order is as under:

S. No.	Profits (in Thousand)	S. No.	Profits (in Thousand)
1	42.00	11	48.45
2	43.00	12	48.48
3	44.00	13	48.50
4	44.50	14	49.00
5	45.00	15	49.10
6	45.25	16	49.35
7	47.00	17	49.50
8	48.00	18	49.75
9	48.15	19	50.00
10	48.35	20	50.15

Applying the formula, the data place of the thirty-fifth and sixty-fifth percentile is determined as follows:
Thirty-fifth percentile place = $20 * (35/100) = 7$.

Sixty-fifth percentile place = $20 * (65/100) = 13$.

Since the thirty-fifth percentile place is a whole number, it shall be the average of the prices at the seventh and next higher, i.e.; eighth place. This is $(47+48)/2 = \text{Rs. } 47,500$.

Similarly, the sixty-fifth percentile will be average of thirteenth and fourteenth place prices. This is $(48.5+49)/2 = \text{Rs. } 48,750$

The median of the range (the fiftieth percentile place) = $20 * (50/100) = 10$

Since the fiftieth percentile place is a whole number, it shall be the average of the prices at the tenth and next higher, i.e.; eleventh place. This is $(48.35+48.45)/2 = \text{Rs. } 48,400$.

Thus, the arm's length range in this case shall be from Rs. 47,500 to Rs. 48,750.

Consequently, any transaction price which is equal to or more than Rs. 47,500 but less than or equal to Rs. 48,750 shall be considered to be within the arm's length range.

REFERENCE TO TRANSFER PRICING OFFICER

Section 92CA of Income Tax Act deals with Reference to Transfer Pricing Officer by assessing officer. It provides that Assessing Officer with prior approval of the Principal Commissioner or Commissioner may refer the computation of Arm's Length Price in an International Transaction or specified domestic transaction to transfer pricing officer if he considers it necessary or expedient to do so. On reference by Assessing officer, Transfer Pricing Officer (TPO) shall serve a notice to the Assessee requiring him to produce the evidence in support of computation made by him of Arm's Length Price in relation to an International transaction or specified domestic transaction.

Who is Transfer Pricing Officer (TPO)

For the purpose of Section 92CA “Transfer Pricing Officer” means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorized by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.

Determination of Arm's Length Price by Transfer Pricing Officer

Transfer Pricing Officer after hearing the evidences, information or documents as produced by assessee and after considering such evidence as he may require on any specified points and after taking into account all relevant materials which he has gathered, shall, by order in writing, determine the arm's length price in relation to the international transaction/specified transaction and send a copy of his order to the Assessing Officer and to the assessee.

On receipt of the order from Transfer Pricing officer, the Assessing Officer shall proceed to compute the total income of the assessee in conformity with the arm's length price as determined by the Transfer Pricing Officer.

Where any other international transaction other than an international transaction referred under sub-section (1), comes to the notice of the Transfer Pricing Officer during the course of the proceedings before him, the provisions of this Chapter shall apply as if such other international transaction is an international transaction referred to him under sub-section (1).

Where in respect of an international transaction or a specified domestic transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the Transfer Pricing Officer during the course of the proceeding before him, the provisions of this Chapter shall apply as if such transaction is an international transaction referred to him under sub-section (1).

Extension of Time Limit to Transfer Pricing Officer in Certain Cases

As per the existing provisions, the Transfer Pricing Officer (TPO) has to pass his order sixty days prior to the date on which the limitation for making assessment expires. It is noted that at times seeking information from foreign jurisdictions becomes necessary for determination of arm's length price by the TPO and at times proceedings before the TPO may also be stayed by a court order.

Sub-section (3A) of section 92CA has been amended to provide that where assessment proceedings are stayed by any court or where a reference for exchange of information has been made by the competent authority, the time available to the Transfer Pricing Officer for making an order after excluding the time for which assessment proceedings were stayed or the time taken for receipt of information, as the case may be, is less than sixty days, then such remaining period shall be extended to sixty days.

Rectification of Arm's Length Price Order by Transfer Pricing Officer

If any mistake is observed which is apparent from record, the Transfer Pricing Officer may amend any order passed by him and the provisions of Section 154 w.r.t. rectification of mistake shall apply accordingly. Where any amendment is made by the Transfer Pricing Officer, he shall send a copy of his order to the Assessing

Officer who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer.

Powers of Transfer Pricing Officer

1. Power to call evidences/Information from Assessee:

As per Section 92CA(2), the Transfer Pricing Officer may issue a notice to the Assessee and ask him to furnish records, evidences, information in support of the computation of Arm's Length Price relating to the International Transaction or specified domestic transaction.

2. Power to amend the Order made in regard to computation of Arm length price for the transaction referred to him:

As stated earlier, if any mistake is observed which is apparent from record, the Transfer Pricing Officer may amend any order passed by him and the provisions of section 154 w.r.t. rectification of mistake shall apply accordingly

3. Power to proceed if the report under Section 92E is not furnished for some International transactions or Specified domestic transaction:

Section 92CA(2B) in the Act provides that w.e.f. 1st June, 2002 if the assessee has not furnished Form 3CEB mentioned u/s 92E and the transfer pricing officer observe International transaction or specified domestic transactions during the course of the proceedings before him, he may proceed with deeming that such transaction has been referred to him under this section 92CA provided that the provision of this section shall not empower the Assessing Officer either to assess or reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year, proceedings for which have been completed before the 1st day of July, 2012

4. Power to proceed into the cases not referred to him:

The jurisdiction of the Transfer Pricing Officer shall extend to the determination of the Arm's Length Price (ALP) in respect of other international transactions or specified domestic transaction which are noticed by him subsequently, in the course of proceedings before him. These transactions would be in addition to the transactions referred to the TPO by the Assessing Officer.

5. Power to exercise all of the following powers specified in Sections 131(1)(a) to 131(1)(d) or 133(6) or 133A of Income Tax Act:

Power u/s 131(1)(a) to 131(1)(d) or 133(6) or 133A

TPO have the same powers as are vested in a Court, when trying a suit in respect of the following matters, namely: –

- (a) discovery and inspection;
- (b) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;
- (c) compelling the production of books of account and other documents; and
- (d) Issuing commissions.

6. Power u/s 133(6)

Under Section 133(6), TPO may require any person, including a banking company or any officer thereof, to furnish information in relation to such points or matters, or to furnish statements of accounts and

affairs verified in the manner specified by him giving information in relation to such points or matters as his opinion will be useful for, or relevant to, any enquiry or proceeding under this Act.

7. Power u/s 133A - Power of Survey

In course of the proceedings, a TPO may carry out the survey as per section 133A of Income Tax Act.

8. Power to levy penalty for failure to furnish information

According to section 271G, if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by section 92D(3), the Assessing Officer or the Transfer pricing officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2 per cent of the value of the international transaction or specified domestic transaction for each such failure.

9. Power of Board to Make Safe Harbour Rules

- (1) The determination of arm's length price under section 92C or section 92CA shall be subject to safe harbour rules.
- (2) The Board may, for the purposes of sub-section (1), make rules for safe harbour.

Explanation – For the purposes of this section, “safe harbour” means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.

The **Finance Act, 2025**, has introduced the “**block transfer pricing assessment**” scheme to the transfer pricing regulations, aiming & focused at streamlining the assessment process, reducing litigation and reducing administrative burden for Assessee and Transfer Pricing Officer (TPO).

The scheme allows taxpayers to opt for a block assessment of their transfer pricing for a period of three years (**Multi-Year ALP Determination**). Previously, transfer pricing assessments were conducted on an annual basis, which often led to repetitive audits for transactions that were consistent over several years.

The assessee can now opt for the **Arm's Length Price (ALP)** determined by the TPO for an international transaction in one assessment year to be applied for similar transactions (same ALP) for the **two subsequent assessment years**.

This amendment significantly aims to reduce the administrative and compliance burden of undergoing a new transfer pricing assessment every year, especially for transactions that are consistent in nature.

The scheme is voluntary and must be exercised proactively by the assessee by making an application to the TPO in a prescribed manner and within a specified time. The TPO has the discretion/authority to validate the application and shall within one month from the end of the month of exercising the option, declare in writing.

Note: The taxpayer must demonstrate that the nature of the transactions, the associated enterprises involved, and the underlying facts and circumstances remain materially similar across subsequent two years. The requirement to maintain annual transfer pricing documentation and conduct benchmarking analysis remains unchanged.

The changes are effective from April 1, 2026, AY 2026-27 and subsequent years.

ADVANCE PRICING AGREEMENT (SECTION 92CC)

As per Section 92CC(1), the Central Board of Direct Taxes (Board), with the approval of the Central Government, may enter into an Advance Price Agreement with any person, determining the arm's length price or specifying the manner in which arm's length price is to be determined, in relation to an international transaction to be entered into by that person.

Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority (Board) on an appropriate transfer pricing methodology for fixing the arm's length price for a set of transactions over a fixed period of time in future.

The attribution of profits to the PE of a non-resident under clause (i) of sub-section (1) of section 9 of the Act in accordance with rule 10 of the Rules also results in avoidable disputes in a number of cases. In order to provide certainty, the attribution of income in case of a non-resident person to the PE is also required to be clearly covered under the provisions of the Safe Harbour Rules and the Advance Pricing Agreement. In view of the above an amendment has been made vide Finance Act, 2020 in section 92CB and section 92CC of the Act to cover determination of attribution to PE within the scope of Safe Harbour Rules and the Advance Pricing Agreement.

Calculation of Arm's Length Price under Advance Pricing Agreement

Arm's Length Price under Advance Pricing Agreement shall be calculated as per method enumerated in section 92C (1) or any other method with such adjustment and variation as may be necessary and expedient so to do.

Section 92C (1) prescribes that the arm's length price in relation to an international transaction or specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe (see rule 10B) namely: –

- (a) Comparable uncontrolled price method;
- (b) Resale price method;
- (c) Cost plus method;
- (d) Profit split method;
- (e) Transactional net margin method;
- (f) Such other method as may be prescribed by the Board.

Notwithstanding anything contained in Section 92C or Section 92CA, if the Advance Pricing Agreement has been entered between an assessee and Board in respect of one international transaction, the arm's length price will be calculated as per the provisions of Advance Pricing Agreement.

Validity of Advance Pricing Agreement

The Advance Pricing Agreement shall be valid for a period as specified in the Advance Pricing Agreement. However, this period will not be more than 5 consecutive previous years.

Bindingness of Advance Pricing Agreement

Advance Pricing Agreement shall be binding on:

- (a) the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and
- (b) on the Principal Commissioner or Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction

However, the advance pricing agreement shall not be binding if there is a change in law or facts having bearing on the agreement so entered.

Declaring an Advance Pricing Agreement Void Ab Initio

The Board may, with the approval of the Central Government, by an order, declare an agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts.

Effect of Declaring an Advance Pricing Agreement Void Ab Initio

If an agreement is declared void ab initio –

- (a) All the provisions of the Act shall apply to the person as if such agreement had never been entered into; and
- (b) Notwithstanding anything contained in the Act, for the purpose of computing any period of limitation under this Act, the period beginning with the date of such agreement and ending on the date of order for declaring an Advance Pricing Agreement void ab initio shall be excluded. Provided that where immediately after the exclusion of the aforesaid period, the period of limitation, referred to in any provision of this Act, is less than sixty days, such remaining period shall be extended to sixty days and the aforesaid period of limitation shall be deemed to be extended accordingly.

Procedure and Scheme of Advance Pricing Agreement

The Board may, for the purposes of this section, prescribe a scheme specifying therein the manner, form, procedure and any other matter generally in respect of the Advance Pricing Agreement. Where an application is made by a person for entering into Advance Pricing Agreement, the proceeding shall be deemed to be pending in the case of the person for the purposes of the Act.

ROLL BACK PROVISION IN ADVANCE PRICING AGREEMENT

Finance Act, 2014 has amended section 92CC by inserting sub-section (9A) whereby agreement referred to in section 92CC(1) may, subject to such condition and procedures as may be prescribed, provided for determining the arm's length price in relation to the international transaction entered into by the person during any period not exceeding four previous years preceding the first of the previous year in which the APA has been entered into. This move may substantially reduce the litigation.

Provisions relating to Advance Pricing Agreements (APAs) were introduced in the Indian Income-tax Act, 1961 (the Act) with effect from 1 July 2012, vide Finance Act, 2012. These provisions did not then include rollback provisions. The provision to provide for a rollback mechanism was brought into the Act vide Finance Act 2014 with effect from 1 October 2014. Thereafter, in March 2015, the Central Board of Direct Taxes (CBDT) announced detailed rules explaining the rollback provisions and the procedure for giving effect to them (the Rules).

- Roll back is available for the roll back years,
- and a 'roll back year' has been defined to mean any previous year falling within the period of four previous years, preceding the first of the previous year covered in the APA (i.e. the regular APA).

For example – If the applicant files an APA application on or before 31st March 2015 covering a period of up to 5 years from financial year (FY) 2015-16 to FY 2019-20 and applies for a roll back, the roll back years can cover the period from FY 2011-12 to FY 2014-15. Similarly, if the applicant has filed an APA application covering a period of 5 years from FY 2013-14 to FY 2017-18 and applies for a roll back, the roll back years can cover the period from FY 2009-10 to FY 2012-13.

“Multiple Year Data” and Range Concept (vide amendment to Rule 10B of Income-tax Rules, 1962)

With an intent to align the Indian Transfer Pricing regulations with international best practices, by way of introduction of “Range concept” and allowing the use of “Multiple Year data” for determining the arm's length price, the Central Board of Direct Taxes (CBDT) on October 19, 2015 has prescribed rules for applicability of

range concept and multiple year data. The rules would be applicable to international transaction or specified domestic transaction entered into by taxpayers on or after April 1, 2014.

- The rules specify the use of current year data i.e. the year in which taxpayer has undertaken the international transactions or specified domestic transactions (“SDT”) as the case may be has been entered into, for the purpose of comparability analysis. However, in cases wherein current year data is not available at the time of furnishing the return of income, data pertaining to up to two preceding financial years may be used for comparability analysis.
- This would be applicable only in cases where Resale Price Method (“RPM”), Cost Plus Method (“CPLM”) or Transactional Net Margin Method (“TNMM”) has been used as the most appropriate method for computation of ALP.
- If at the time of audit proceedings, the data for the Current Year of the comparable transactions / enterprises becomes available, then such data for the Current Year shall be used for determining the comparability of an uncontrolled transaction(s) with the international transaction(s) or the SDT(s), even if the Current Year data was not available at the time of filing of the return of income by the taxpayer.

Application of the Range Concept

If the price at which the international transaction or specified domestic transaction is undertaken is within the (thirty-fifth percentile to sixty-fifth percentile of the dataset), the transaction shall be deemed to be at the ALP. However, if it is outside the range (mentioned above), the ALP of the transaction shall be taken to be the median of the dataset.

- A minimum of six comparables would be required in the dataset for applying the concept of range.
- An arm’s length range beginning from the thirty-fifth percentile of the dataset (arranged in ascending order) and ending on the sixty-fifth percentile will be considered.

The range concept would not be applied in cases where the most appropriate method selected for determining the ALP is ‘profit split method’ or ‘other method.’

Further, if the dataset consists of less than six comparables, or the most appropriate method selected for determining the ALP is profit split method or other method, the ALP will be determined based on the arithmetical mean of all the prices/data included in the dataset. Further, the benefits of three percent variations which was earlier permissible while adopting the arithmetic mean continues to be available.

Where during the course of any proceeding for the assessment of income, the Assessing Officer, on the basis of material or information or document in his possession, is of the opinion that –

1. The price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with Section 92C (1)/92C (2); or
2. Any information and document relating to an international transaction or specified domestic transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf ; or
3. The information or data used in computation of the arm’s length price is not reliable or correct; or
4. The assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of Section 92D.

In all such cases, the Assessing Officer may proceed to determine the arm’s length price in relation to the said international transaction or specified domestic transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him. Provided that an opportunity of being heard is to be given by assessing officer to Assessee by serving a notice calling upon him to show cause, on a

date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer. Where an arm's length price is determined by assessing Officer under this Section, the Assessing Officer may re-compute the total Income of the Assessee having regard to the arm's length price so determined.

If Arm's length price is determined by Assessing officer under this provision no deduction under section 10A or section 10AA or section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of Income under this Section.

In this case, the income of other associated enterprises from which tax was deducted or deductible, shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.

Determination of Arm's Length Price ("ALP") where application of the most appropriate method results in more than one price, the ALP shall be computed as follows:

- A dataset shall be constructed by placing the prices/data in an ascending order.
- If a comparable has been identified on the basis of data relating to:
 - (A) Current Year, then the data for the immediately preceding two financial years can be considered, provided the comparables has undertaken the same or similar comparable uncontrolled transaction in those preceding two years.
 - (B) Financial year immediately preceding the current year, then the data for the immediately preceding two financial years can be considered, provided the comparables has undertaken the same or similar comparable uncontrolled transaction in those preceding year.

The price in respect of comparable uncontrolled transaction shall be determined using the weighted average of the prices/data for"

1. The current year and preceding two financial years or
2. Two financial years immediately preceding the current year In accordance to the following:
 - Where the prices have been determined using RPM, the weighted average of the prices shall be computed with weights being assigned to the quantum of sales.
 - Where the prices have been determined using CUP, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs.
 - Where the prices have been determined using TNMM, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs incurred or sales effected or assets employed or as the case may be.

Filing of Modified Return for Any Assessment Year relevant to Previous Year to which APA applies

As per Section 92CD of Income Tax Act, 1961, w.e.f. 1st July, 2012 notwithstanding anything to the contrary contained in Section 139, where any person has entered into an agreement and prior to the date of entering into the agreement, any return of income has been furnished under the provisions of Section 139 for any assessment year relevant to a previous year to which such agreement applies, such person shall furnish, within a period of three months from the end of the month in which the said agreement was entered into, a modified return in accordance with and limited to the agreement. Save as otherwise provided in Section 92CD, if modified return is furnished under Section 139, all other provision of the Act shall apply accordingly.

Thus, Section 92CD provides an opportunity to taxpayer to avoid the litigation even for the years for which return has already been filed.

Reassessment of Total Income in the cases where Modified return has been filed but the Assessment/ Reassessment proceedings have been completed before the expiry of period allowed for furnishing of modified return.

As per Section 92CD(3), if the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the agreement applies have been completed before the expiry of period allowed for furnishing of modified return under Section 92CD, the Assessing Officer shall, in a case where modified return is filed under this section, pass an order modifying the total income of the relevant assessment year determined in such assessment or reassessment, as the case may be, having regard to and in accordance with the agreement.

Application of APA in the pending assessment or reassessment for an assessment year relevant to the previous year to which the agreement applies and modified return has been filed under Section 92CD.

Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the agreement applies are pending on the date of filing of modified return in accordance with the provisions of sub-section (1), the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the agreement taking into consideration the modified return so furnished.

Extension of limitation period in the cases where modified return is filed under Section 92CD

As per Section 92CD (5), notwithstanding anything contained in Section 153 or Section 153B or Section 144C –

- (a) The order under Section 92CD (3) shall be passed within a period of one year from the end of the financial year in which the modified return under sub-section (1) is furnished;
- (b) The period of limitation as provided in Section 153 or Section 153B or Section 144C for completion of pending assessment or reassessment proceedings referred to Section 92CD(4) shall be extended by a period of twelve months.

This may be observed from above provision that Advance Pricing Agreement, although styled as “advance” agreements, may be a good arm in the resolution of transfer pricing issues pending from prior years –and in some cases it can provide an effective means for resolving existing transfer pricing audits or adjustments.

By virtue of Advance Pricing Agreement, the taxpayer is assured about the Tax Liability arising out of International transaction. No surprises or challenges will arise if the agreement is followed. The scope of certainty includes tax treatment of covered transactions as to amount and characterization, elimination of potential penalties for substantial tax understatement and a limitation of record-keeping requirements.

Secondary Adjustment in certain International Transactions [Section 92CE]

Secondary adjustment will be applicable in the following situations:

- (a) Where a primary adjustment to transfer price has been made suo moto by the assessee in his return of income.
- (b) Where a primary adjustment to transfer price made by the Assessing Officer has been accepted by the assessee.
- (c) Where the primary adjustment to transfer price is determined by the advance pricing agreement entered into by the assessee under section 92CC,
- (d) Where the primary adjustment to transfer price is made as per the safe harbour rules framed under section 92CB.
- (e) Where the primary adjustment to transfer price is arising as a result of resolution of an assessment by way of mutual agreement procedure under DTAA entered into under section 90/90A.

Secondary adjustment is not required, if following conditions are satisfied [Threshold limit]:

- (i) The amount of primary adjustment in case of an assessee in any previous year does not exceed Rs 1 crore ; or
- (ii) The primary adjustment is made in respect of the assessment year 2016-17 (or any earlier previous year)

No refund of taxes paid, if any, by virtue of provisions of this sub-section as they stood immediately before their amendment by the Finance (No.2) Act, 2019 shall be claimed and allowed.

Quantification of Secondary adjustment "on Part" [Section 92CE(2)]

As a result of primary adjustment to the transfer price, there is an increase in the total income or the reduction in the loss, as the case may be, of the assessee.

The difference between the arm's length price determined by the primary adjustment and the price at which International transaction has actually been undertaken, is "excess money".

The excess money or Part is not repatriated to India by the associated enterprise within the prescribed time (in general terms, repatriation means effectively reversing the funds so that the amounts of the parties involved are in line with the economic intend of the primary adjustment). The excess money or Part (which is not repatriated to India) shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on which such advance shall be computed as the income of the assessee in the manner as may be prescribed.

Explanation: For the removal of doubts, it is hereby clarified that the excess money or part thereof may be repatriated from any of the associated enterprises of the assessee which is not a resident in India.

Section 92CE(2A): Without prejudice to the provisions of sub-section (2), where the excess money or part thereof has not been repatriated within the prescribed time, the assessee may, at his option, pay additional income-tax at the rate of eighteen percent on such excess money or part thereof, as the case may be.

Section 92CE(2B): The tax on the excess money or part thereof so paid by the assessee under sub-section (2A) shall be treated as the final payment of tax in respect of the excess money or part thereof not repatriated and no further credit therefor shall be claimed by the assessee or by any other person in respect of the amount of tax so paid.

Section 92(2C): No deduction under any other provision of this Act shall be allowed to the assessee in respect of the amount on which tax has been paid in accordance with the provisions of sub-section (2A).

Section 92(2D): Where the additional income-tax referred to in sub-section (2A) is paid by the assessee, he shall not be required to make secondary adjustment under sub-section (1) and compute interest under sub-section (2) from the date of payment of such tax.

Note: 1 "Primary Adjustment" to a transfer price means the determination of the transfer price in accordance with the arm's length principle resulting in the total income or reduction in the loss, as the case may be, of the assessee.

Note: 2 "Secondary Adjustment" means an adjustment in books of accounts of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise is consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

TRANSFER PRICING – DOCUMENTATION

The legal framework for maintenance of information and documentation by a taxpayer is provided in Section 92D of Income Tax Act, 1961 which lays down that every person who enters into an international transaction or specified domestic transaction during a previous years shall maintain such information and documents ,

prescribed by the Board, as will assist the Assessing Officer/ Transfer Pricing Officer to compute the income arising from that transaction, having regard to the arm's length price.

OECD in its transfer pricing guidelines stated that “Taxpayers should make reasonable efforts at the time the transfer pricing is established to determine whether the transfer pricing is appropriate for tax purposes in accordance with the arm's length principle. Tax administrations should have the right to obtain the documentation prepared or referred to in this process as means of verifying compliance with the arm's length principle. Moreover, the need for the documents should be balanced by the costs and the administrative burdens, particularly where this process suggests the creation of documents that would not otherwise be prepared or referred to in the absence of tax considerations.

Rule 10D (1) lays down thirteen different types of information and documents that a person has to keep and maintain. Broadly, these information and documents may be classified into three types:

- (i) *Enterprise-wise documents* – These are documents that describe the enterprise, the relationships with other associated enterprise, the nature of business carried out, etc. This information is, largely, descriptive [clauses (a) to (c)].
- (ii) *Transaction-specific documents* – These are documents that explain the international transaction in greater detail. It includes information with regard to each transaction (nature and terms of the contract, etc.), description of the functions performed, assets employed and risks assumed by each party to the transaction, economic and market analyses, etc. This information is both descriptive and quantitative in nature [clauses (d) to (h)].
- (iii) *Computation related documents* – These are documents which describe and detail the methods considered, actual working assumptions, policies etc., adjustments made to transfer prices and any other relevant information, data, document relied for determination of arm's length price [clause (i) to (m)].

The various types of information and documents to be maintained by the person in respect of an international transaction or specified domestic transaction are prescribed in Rule 10(D) of the Income Tax Rules, as under:

- (a) A description of the ownership structure of the enterprise and details of shares or other ownership interest held therein by other enterprises;
- (b) A profile of the multinational group of which the assessee enterprises i.e. taxpayer is a part and the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions or specified domestic transactions, as the case may be, have been made by the taxpayer and the ownership linkages among them;
- (c) A broad description of the business of the taxpayer and the industry in which it operates and the business of the associated enterprises;
- (d) The nature, terms and prices of international transaction or specified domestic transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;
- (e) A description of the functions performed, risks assumed and assets employed or to be employed by the taxpayer and by the associated enterprise involved in the international transaction or specified domestic transaction;
- (f) A record of the economic and market analysis, forecasts, budgets or any other financial estimates prepared by the taxpayer for its business as a whole or separately for each division or product which may have a bearing on the international transaction or the specified domestic transactions entered into by the taxpayer;

- (g) A record of uncontrolled transactions taken into account for analysing their comparability with the international transaction or specified domestic transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be relevant to the pricing of the international transactions or the specified domestic transactions, as the case may be;
- (h) A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction or specified domestic transactions;
- (i) A description of the methods considered for determining the arm's length price in relation to each international transaction or specified domestic transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;
- (j) A record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method and adjustments, if any, which were made to account for differences between the international transaction or specified domestic transactions and the comparable uncontrolled transactions or between the enterprises entering into such transaction;
- (k) The assumptions, policies and price negotiations if any which have critically affected the determination of the arm's length price;
- (l) Details of the adjustments, if any made to the transfer price to align it with arm's length price determined under these rules and consequent adjustment made to the total income for tax purposes;
- (m) Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

Rule 10D(2) provides that in a case where the aggregate value of international transactions does not exceed INR 1 crore, it will not be an obligation for the assessee to maintain the above information and documents.

However, it is provided that the assessee has to substantiate that the income arising from the international transactions with associated enterprises, as disclosed by the accounts, is in accordance with Section 92. i.e., In case, where the aggregate value of the international transactions is less than INR 1 crore, the assessee has to maintain adequate records & evidence to support the transactions carried are at Arm's Length Price.

Rule 10D(3) also prescribes that the above information is to be supported by authentic documents which may include the following:

- (a) Official publications, reports, studies and data bases of the government of the country of residence of the associated enterprise or of any other country;
- (b) Reports of market research studies carried out and technical publications of institutions of national or international repute;
- (c) Publications relating to prices including stock exchange and commodity market quotations;
- (d) Published accounts and financial statements relating to the business of the associated enterprises;
- (e) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transaction similar to the international transactions or specified domestic transactions, as the case may be;
- (f) Letters and other correspondence documenting terms negotiated between the taxpayer and associated enterprise;

- (g) Documents normally issued in connection with various transaction under the accounting practices followed.

Provided that where an international transaction or a specified domestic transaction continues to have effect over more than one previous year, fresh documentation need not be maintained separately in respect of each previous year, unless there is any significant change in the nature or terms of the international transaction or the specified domestic transaction, as the case may be, in the assumptions made, or in any other factor which could influence the transfer price, and in the case of such significant change, fresh documentation as may be necessary shall be maintained bringing out the impact of the change on the pricing of the international transaction or the specified domestic transaction.

Burden of Proof

It is noteworthy that the information and documentation requirements referred to above are linked to the burden of proof laid on the taxpayer to prove that the transfer price adopted is in accordance with the arm's length principle. One of the conditions to be fulfilled for discharging this burden by the taxpayer is maintenance of prescribed information and documents in respect of an international transaction or a specified domestic transaction entered into with associated enterprise. A default in maintaining information and documents in accordance with the rules is one of the conditions which may trigger a transfer pricing audit under Section 92C(3). Any default in respect of the documentation requirement may also attract penalty of a sum equal to two percent of the value of the international transaction or specified domestic transaction entered into by such person. (Section 271AA)

Submission of Documents with the Tax Authorities

Section 92D also provides that information and documentation may be requisitioned by the Assessing Officer or the Appellate Commissioner on a notice of ten days which period may be extended by another period of 10 days.

Non-Applicability of Documentation Requirement

As per Rule 10D(2) of the Income tax rules, 1962 waived off the requirement of maintenance of information and document in case of those person who has entered into an international transactions the aggregate value of which, as recorded in the books of account does not exceeds 1 crores. However, the concerned taxpayer may be required to substantiate on the basis of available material that the income arising from the international transaction is computed in accordance with the arm's length rule. Further, there is no exemption for such assesseees in obtaining and furnishing audit report under section 92E of the Act. i.e. even if the aggregate value of the international transaction during the previous year is not exceeding 1 crore, the assessee is required to obtain and furnish audit report.

Retention Period of Documents Kept under Rule 10D

Rule 10D of the Income tax rules, 1962 states that the prescribed information and documents are required to be maintained for a period of eight years from the end of the relevant Assessment years.

Report from an Accountant [Section 10E]

Section 92E of the Act stated that every person who has entered into an international transaction or specified domestic transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed.

“Specified date” shall have the same meaning as assigned to due date in Explanation 2 below subsection (1) of section 139 as per which, “In case of an assessee being a company, which is required to furnish a report referred to in section 92E, the due date means the 30th day of November of the assessment year.”

As per section 92F(i) “accountant” shall have the same meaning as in the Explanation below sub-section (2) of section 288.”

SAFE HARBOUR RULES [SECTION 92CB]

The determination of arm’s length price under section 92C or section 92CA shall be subject to safe harbour rules as prescribed under section 92CB of the Act. The term “Safe Harbour means “circumstances under which the income-tax authorities shall accept the transfer pricing declared by the assessee.” The Rule provides minimum operating profit margin in relation to operating expenses a taxpayer is expected to earn for certain categories of international transactions or specified domestic transfer pricing, that will acceptable to the income tax authorities as arm’s length price (ALP). The rule also provides acceptable norms for certain categories of financial transactions such as intra-group loans made or guarantees provided to non- resident affiliates of an Indian tax payers. The safe harbor rules, optional for a taxpayer, contains the conditions and circumstances under which norms / margins would be accepted by the tax authorities and the related compliance obligations.

Safe harbour carry certain benefits which are described below:

- *Compliance Simplicity:* Safe harbour tend to substitute simplified requirements in place of existing regulations, thereby reducing compliance burden and associated costs for eligible taxpayers, who would otherwise be obligated to dedicate resources and time to collect, analyze and maintain extensive data to support their inter-company transactions.
- *Certainty & Reduce Litigation:* Electing safe harbour may grant a greater sense of assurance to taxpayers regarding acceptability of their transfer price by the tax authorities without onerous audits. This conserves administrative and monetary resources for both the taxpayer and the tax administration.
- *Administrative Simplicity:* Since tax administrations would be required to carry out only a minimal examination in respect of taxpayers opting for safe harbour, they can channelize their efforts to examine more complex and high-risk transactions and taxpayers.

The attribution of profits to the PE of a non-resident under clause (i) of sub-section (1) of section 9 of the Act in accordance with rule 10 of the Rules also results in avoidable disputes in a number of cases. In order to provide certainty, the attribution of income in case of a non-resident person to the PE is also required to be clearly covered under the provisions of the Safe Harbour Rules and the Advance Pricing Agreement. In view of the above an amendment has been made vide Finance Act, 2020 in section 92CB and section 92CC of the Act to cover determination of attribution to PE within the scope of Safe Harbour Rules and the Advance Pricing Agreement.

Filling of form 3CEFA / 3CEFB

Any taxpayer who has entered into an eligible international transaction or specified domestic transaction and who wishes to exercise the option to be governed by the safe harbour rules is required to file a specified form (Form 3CEFA for International Transaction or Form 3CEFB for Specified Domestic Transaction). Form 3CEFA / 3CEFB requires the taxpayer to declare the following:

- Transaction entered with an AE is an eligible international transaction or specified domestic transaction;
- Quantum of the international transaction specified domestic transaction;
- Whether the AEs country or territory is a no tax or low tax country or territory; and
- Operating profit margin/transfer price.

TRANSFER PRICING – PENALTY FOR CONTRAVENTION***A. Penalty for concealment of income or for furnishing inaccurate particulars of such income under Section 271(1)(c)***

If the Assessing Officer or Commissioner (Appeals) or the Commissioner in the course of any proceedings under this Act, is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of such income, he may direct that such person shall pay by way of penalty in addition to tax, if any, payable by him, a sum which shall not be less than, but which shall not exceed three times, the amount of tax sought to be evaded by reason of the concealment of particulars of his income or the furnishing of inaccurate particulars of such income.

Explanation 7 to Section 271(1)(c) - Where in the case of an assessee who has entered into an international transaction or specified domestic transaction defined in section 92B, any amount is added or disallowed in computing the total income under sub-section (4) of section 92C, then, the amount so added or disallowed shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) or the Commissioner that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that Section, in good faith and with due diligence.

B. Penalty for failure to furnish information or document - Section 271G

As per Section 271G of Income Tax Act, If any person who has entered into an international transaction fails to furnish any such information or document as required by sub-section (3) of section 92D, the Assessing Officer or the Transfer Pricing Officer as referred to in Section 92CA or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of the international transaction or specified domestic transaction for each such failure.

C. Penalty for failure to keep and maintain information and document in respect of International transaction or specified domestic transaction - Section 271AA

Without prejudice to the provisions of Section 271 or Section 271BA, if any person in respect of an International transaction or specified domestic transaction fails to keep and maintain any such information and document as required by sub-section (1) or sub-section (2) of Section 92D, the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of each international transaction or specified domestic transaction entered into by such person.

D. Penalty for failure to furnish report under Section 92E - Section 271BA

If any person fails to furnish a report from an accountant as required by Section 92E, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of one hundred thousand rupees.

E. Penalty for failure to answer questions, sign statements, furnish information, returns or statements etc. - Section 272A

If any person, –

- (a) being legally bound to state the truth of any matter touching the subject of his assessment, refuses to answer any question put to him by an income-tax authority in the exercise of its powers under this Act; or
- (b) refuses to sign any statement made by him in the course of any proceedings under this Act, which an income-tax authority may legally require him to sign; or

- (c) to whom a summons is issued under sub-section (1) of Section 131 either to attend to give evidence or produce books of account or other documents at a certain place and time omits to attend or produce books of account or documents at the place or time,

he shall pay, by way of penalty, a sum of ten thousand rupees for each such default or failure.

QUESTIONS FOR PRACTICE

Question 1:

- (a) What are the methods under which the arm's length price, relating to an international transaction, is determined under Section 92C?
- (b) (i) A Ltd. is an Indian Company which is a 100% subsidiary of B Ltd., a Foreign Company. B Ltd. sells its products to A Ltd. at \$ 15 per unit. At the same time, it sells its products to an unrelated party at \$ 20 per unit. How will the arm's length price be determined in this transaction?
- (ii) In the above question, if A Ltd. is the sole selling agent of the products of B Ltd. and if A Ltd. resold the goods at \$ 20, how will the arm's length price be computed?

Answer:

- (a) The Arm's Length Price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method as per section 92C:
- 1) Comparable Uncontrolled Price Method
 - 2) Resale Price Method
 - 3) Cost Plus Method
 - 4) Profit Split Method
 - 5) Transactional Net Margin Method
 - 6) Price charged or paid on similar uncontrolled transaction between non- associated enterprises.
- (b) (i) A & B are associated enterprises, in view of section 92A(2)(a).

Arm's Length Price can be determined on the basis of Comparable Uncontrolled Price Method.

Hence, arm's length price	\$ 20
A Ltd. has booked expenses at	\$ 15
Applying arm's length price expenses amount to	\$ 20

But transfer pricing cannot result in reduction of income, therefore, no adjustment required.

- (ii) A & B are associated enterprises, in view of section 92A(2)(i).

Arm's Length Price can be determined on the basis of Resale Price Method.

Particulars	Amount in \$
Resale price of the product	\$ 20
Less: Normal Gross Profit (assume 10%)	\$ 2

Arm's Length Price	\$ 18
A Ltd. has booked expenses at	\$ 15
Applying arm's length price expenses amount to	\$ 18

But transfer pricing cannot result in reduction of income, therefore, no adjustment required.

Question 2:

Anush Motors Ltd., an Indian company declared income of Rs. 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2025:

- (i) 10,000 cars sold to Rida Ltd. which hold 30% shares in Anush Motors Ltd. at a price which is less by \$200 each car than the price charged from Shingto Ltd.
- (ii) Royalty of \$1,20,00,000 was paid to Kyoto Ltd. for the use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same knowhow to another Indian company for \$ 90,00,000.
- (iii) Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd. a German Company was outstanding on 31.3.2019. The total book value of assets of Anush Motors Ltd. on the date was Rs. 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the act effecting all these transactions and compute the income of the company chargeable to tax for Assessment Year 2026-27 keeping in mind that the value of 1\$ and of 1 EURO was Rs. 50 and Rs. 55 respectively throughout the year.

Answer:

- (i) Anush Motors Ltd. and Rida Ltd. are Associated Enterprises since Rida Ltd. holds 30% shares of Anush Motors Ltd.
- (ii) Kyoto Ltd. and Anush Motors Ltd. are Associated Enterprises since the manufacturing of cars by Anush Motors Ltd. is dependent on the know-how provided by Kyoto Ltd.
- (iii) Loan advanced by Dorf Ltd. = Euro 1000 crores X Rs. 55 = Rs. 55,000 crores. Since loan advanced by Dorf Ltd. is not less than 51% of the book value of assets of Anush Motors Ltd., Dorf Ltd. and Anush Motors Ltd. are Associated Enterprises.

Income of Anush Motors Ltd. shall be computed as under by applying the law of transfer pricing:

Particulars		Amount in (Cr.)
	Declared Income	Rs. 300 crores
Add:	10,000 cars X \$ 200 X Rs. 50 (Comparable Uncontrolled Price Method)	Rs. 10 crores
Add:	Royalty \$ 30,00,000 X Rs. 50 (Excess payment of Royalty CUP Method)	Rs. 15 crores
Add:	Interest excess charged	Rs. 550 crores
	55,000 crores X 1% p.a.	Rs. 875 crores

Question 3:

X Ltd., an Indian company is engaged in manufacturing electronic components. 74 % of shares in X Ltd. are held by Y Inc., incorporated in USA. X Ltd. Limited has borrowed funds from Y Inc. at London Inter-Bank Offer Rate (LIBOR) plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US \$. The borrowings allowed under the External Commercial Borrowings (ECB) guidelines issued under Foreign Exchange Management Act (FEMA) are LIBOR plus 200 points. Discuss whether the borrowing made by X Ltd. is at arm's length.

Answer:

The borrowings allowed under ECB issued under FEMA is LIBOR plus 200 basis points i.e. 6%. The assessee had borrowed at LIBOR plus 150 basis points i.e., 5.5%. Since the rate of borrowing is less than the limit prescribed under FEMA, technically it cannot be called as borrowing at arm's length price.

However, since Indian Company is borrowing the money from foreign company at a lower rate, application of arm's length price will result in decrease in income of Indian Company. Therefore, chapter of transfer pricing shall not apply.

Question 4:

X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by them. The Assessing Officer after verification of transaction of Rs. 300 lacs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountant's report, adjusted its income by making an addition of Rs. 30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd. seek your expert opinion.

Answer

Section 92D provides that every person who has entered into an international transaction **or specified domestic transaction** shall keep and maintain such information and document in respect thereof, as may be prescribed. And section 92E provides that every person who has entered into an international transaction **or specified domestic transaction** during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed.

Further, section 271AA prescribes the penalty for failure to keep and maintain information and documents. Section 271AA provides as under:

Without prejudice to the provisions of section 270A or section 271BA, if any person in respect of an international transaction **or specified domestic transaction**, –

- (i) fails to keep and maintain any such information and document as required by sub-section (1) or sub-section (2) of section 92D;
- (ii) fails to report such transaction which he is required to do so; or
- (iii) maintains or furnishes an incorrect information or document,

the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to **2% of the value of each international transaction or specified domestic transaction entered into by such person.**

As per section 271 BA, penalty for failure to furnish report from the chartered accountant shall also be levied. Section 271 BA provides as under:

If any person fails to furnish a report from an accountant as required by section 92E, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of Rs. 1,00,000.

In the above case, the Assessing Officer is justified in issuing show cause notice to levy various penalties but he cannot make the adjustment in income suo-moto without giving an opportunity of being heard to the assessee. Further, if Assessing Officer wants to make a variation in the returned income on the basis of order of Transfer Pricing Officer, then, he shall have to follow the procedure as per section 144C.

Question 5:

I. Limited, an Indian Company supplied billets to its holding company U Limited, UK during the previous year 2019-20. I. Limited also supplied the same product to another UK based company V. Limited an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance and freight amount to Euro 200 per MT. Compute the arm's length price for the transactions with U Limited.

Answer:

The arm's length price shall be determined as per the Comparable Uncontrolled Price Method as under:

Particulars	Euro
Price charged from unrelated party V Ltd.	700
Less: Adjustment for functional differences in the transaction with unrelated party and the international transaction on account of freight & insurance	200
Arm Length Price	500

Since actual transaction has taken place at Euro 500, no adjustment is required on account of transfer pricing.

Question 6:

State the Consequences that would follow if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?

Answer:

In case the Assessing Officer makes adjustment to Arm's Length Price in an international transaction which result in increase in taxable income of the assessee, the following consequences shall follow:

- (1) No deduction under section 10AA or Chapter VI-A shall be allowed from the income so increased.
- (2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from whom tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:

- (1) In case the assessee is an eligible assessee under 144C, he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.
- (2) In any other case, he can file an appeal under section 246A to the commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.
- (3) The assessee can opt to file an application to the Commissioner of Income-tax for revision under section 264 of the order of the Assessing Officer.

Question 7:

XE Ltd. is an Indian Company in which Zilla Inc., a US company, has 28% shareholding and voting power.

Following transactions were effected between these two companies.

- (i) XE Ltd. sold 1,00,000 pieces of T-shirts at \$2 per T-shirt to Zilla Inc. The identical T-shirt were sold to unrelated party namely Kennedy Inc., at \$3 per T-shirt.
- (ii) XE Ltd. borrowed \$ 2, 00,000 from a foreign lender based on the guarantee of Zilla Inc. For this XE Ltd. paid \$ 10,000 as guarantee fee to Zilla Inc. To an unrelated party for the same amount of loan, Zilla Inc. collected \$ 7000 as guarantee fee.
- (iii) XE Ltd. paid \$15,000 to Zilla Inc. for getting various potential customers details to improve its business. Zilla Inc. provided the same services to unrelated parties for \$10,000.

Assume the rate of exchange asl \$= Rs. 64

XE Ltd. is located in a Special Economic Zone (SEZ) and income before transfer pricing adjustments was Rs. 1,200 lakhs.

Compute the adjustments to be made to the total income of XE Ltd. State whether it can claim deduction under section 10AA for the income enhanced by applying transfer pricing provisions.

Answer:

XE Ltd, the Indian company and Zilla Inc., the US Company are deemed to be associated enterprises as per section 92A(2), since Zilla Inc. holds shares carrying not less than 26% of the voting power in XE Ltd.

As per section 92B, the transactions entered into between these two companies for sale of products, lending or guarantee and provision of services relating to market research are included within the meaning of "international transaction". Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm's length price. In this case, from the information given, the arm's lengths price has to be determined taking the comparable uncontrolled price method to be the most appropriate method.

Particulars	Rs. (in lakhs)
Amount by which total income of XE Ltd. is to be enhanced on account of adjustment in the value of international transactions:	
(i) Difference in price of T-Shirt@ \$ 1 each for 1,00,000 pieces sold to Zilla Inc. (\$ 1 x 1,00,000 x 64)	64.00
(ii) Difference for excess payment of guarantee fee to Zilla Inc. for loan borrowed from foreign lender (\$ 3,000 x 64)	1.92
(iii) Deference for excess payment for service to Zilla Inc., (\$5,000 x 64)	3.20
Total	69.12

XE Ltd. cannot claim deduction under section 10AA in respect of Rs. 69.12 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4). Deductions under Chapter VI-A and section 10AA are not available in respect of income enhanced because of transfer pricing.

Question 8:

"Assessing Officer can complete the assessment of income from international transaction in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of assessee.

Discuss the correctness or otherwise with reference to the provisions of Income-tax Act, 1961.

Answer:

The statement is not correct.

Section 92CA(4) provides that on receipt of the order of the Transfer Pricing Officer determining the arm's length price of an international transaction, the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.

The order of the Transfer Pricing Officer is binding on the Assessing Officer. Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer by accepting the contention raised by the assessee.

Question 9:

NANO Inc., a German Company holds 45% of equity in Hitech Ltd., an Indian Company. Hitech Ltd. is engaged in development of software and maintenance of the same for customers across the globe. Its clientele includes NANO Inc. During the financial year, Hitech Ltd. had spent 2400 man hours for developing and maintaining software for NANO Inc. with each hour being billed at Rs. 1,300. Cost incurred by Hitech Ltd. for executing work for NANO Inc. amounts to 20 lakhs.

Hitech Ltd. had also undertaken developing software for Modi Industries, for which Hitech Ltd. had billed at Rs. 2,700 per man hour. The persons working for Modi Industries and NANO Inc. were part of the same team and were of matching credentials and caliber. Hitech Ltd. made a gross profit of 60% on Modi Industries' work. Hitech Ltd.'s transactions with NANO Inc. are comparable to the transactions with Modi Industries, subject to the following differences:

- i. NANO Inc. gives technical knowhow support to Hitech Ltd., which can be valued at 8% of the normal gross profit. Modi Industries does not provide any such support.
- ii. Since the work for NANO Inc. involved huge number of man hours, a quantity discount of 14% of normal gross profits was given.
- iii. *Hitech Ltd. had offered 90 days credit to NANO Inc., the cost of which is measured at 2% of the normal billing rate. No such discount was offered to Modi Industries.*

Compute arm's length price as per cost plus method and the amount of increase in total income of Hitech Ltd.

Answer:

Cost plus method:

Step 1: Determine the direct and indirect costs of production in respect of property transferred or services provided to an associated enterprise.

Step 2: Determine the normal gross profit mark up to such costs which will arise from, transfer of similar goods or services to an unrelated enterprise or in a comparable uncontrolled transaction.

Step 3: The normal gross profit markup determined in Step 2 should be adjusted to account for the functional differences if any between the international transaction and comparable uncontrolled transaction which could materially affect such profit mark up in the open market.

Step 4: The cost referred to in Step 1 shall be increased by the adjusted profit mark-up arrived in Step 3.

Step 5: The sum so arrived at is the arm's length price. Computation of Arm's Length Price as per Cost Plus Method

Particulars		Rs.
Gross Profit Mark up in case of Modi Industries [an unrelated Party]	60.0%	
Less: Differences to be adjusted		
- Value of technical know-how (8% of 60%)	4.8%	
- Quantity discount to Nano Inc. (14% of 60%)	8.4%	
	46.8%	
Add: Cost of credit to Nano Inc., an associated enterprise (2% of 100%)	2.0%	
Arm's length gross profit mark up	48.8%	
Cost incurred by Hitech Ltd. for executing Nano Inc's work. (100% - 48.8% = 51.2% (See Note)		20,00,000
Add: Adjusted gross profit (Rs. 20,00,000 x 48.8 / 51.2)		19,06,250
Arm's length billed value		39,06,250
Less: Actual Billed Value in the case of Nano Inc (Rs. 1300 x 2400 man hours)		31,20,000
Total Income of Hitech Ltd to be increased by		7,86,250

Since Nano Inc. holds shares carrying not less than 26% of the voting power of Hitech Ltd.

Note: In the question, it is given that Hitech made a gross Profit of 60% on Modi Industries work. It means 60% on gross sale price. Therefore, Arm's Length Gross Profit mark up of 48.8% should also be on sales price. Therefore, equation shall be:

S.P. - 48.8% of S.P.	= 20,00,000
51.2% of S.P.	= 20,00,000
S.P.	= 20,00,000 / 51.2%
S.P.	= 39,06,250

(II) GENERAL ANTI AVOIDANCE RULES**REGULATORY FRAMEWORK**

Sections (Income Tax Act, 1961)	Details
Section 95	Applicability of General Anti-Avoidance Rule
Section 96	Impermissible Avoidance Arrangement
Section 97	Arrangement to lack commercial substance
Section 98	Consequences of impermissible avoidance arrangement
Section 99	Treatment of connected person and accommodating party
Rules (Income Tax Rules, 1962)	Details
Rule 10U	Application of General Anti Avoidance Rule

BACKGROUND

Since the liberalization of the Indian economy, increasingly sophisticated forms of tax avoidance are being adopted by the taxpayers and their advisers. The problem has been further compounded by tax avoidance arrangements spanning across several tax jurisdictions. This has led to severe erosion of the tax base. Further, appellate authorities and courts have been placing a heavy onus on the Revenue when dealing with matters of tax avoidance even though the relevant facts are in the exclusive knowledge of the taxpayer and he chooses not to reveal them. This emphasises upon the need of having a general anti-avoidance rule, which will act as a dampener to such transactions in line with best practices around taxation internationally.

General Anti-Avoidance Rule (GAAR) is a concept which generally empowers the Revenue Authorities in a country to deny the tax benefits of transactions or arrangements which do not have any commercial substance or consideration other than achieving the tax benefit. Denial of tax benefits by the Revenue Authorities in different countries, often by disregarding the form of the transaction, has been a matter of conflict between the Revenue Authorities and the taxpayers.

Traditionally, the principles regarding what constitutes an impermissible tax avoiding mechanism have been laid down by the Courts in different countries, with a series of decisions of the English Courts starting from the Duke of Westminster's case.

In India also, the ruling of the Supreme Court in McDowell's case was a watershed. This ruling itself has been interpreted by different courts including the Supreme Court in various subsequent decisions. In its recent ruling in the famous Vodafone case, the Supreme Court has stated that GAAR is not a new concept in India as the country already has a judicial anti-avoidance history. With the increasing globalisation of economies and growth in cross border transactions, some countries have introduced legislation which has empowered the Revenue Authorities to question transactions and arrangements and disregard their form to deny tax benefit unless the taxpayer can establish the commercial legitimacy of the transaction.

However, different countries have taken different approaches in this regard. Australia was in the forefront of introducing a GAAR as early as 1981. Mature economies like Canada, New Zealand, Germany, France and South Africa have also introduced a GAAR. Emerging economies have also started introducing GAAR with the phenomenal growth of their economies. However, some of the leading nations like USA and UK have taken a cautious approach. It is common for taxpayers to arrange their affairs in a way that will give them tax benefits, which are through genuine and legitimate actions.

Over the past few years, it has been noticed that the Revenue Authorities have attempted to deny tax benefits, whether under the tax treaty or domestic law, by disregarding the form and looking through the transactions. However, genuine transactions consummated in a tax efficient manner need to be distinguished from sham transactions or colourable devices used for evading tax. The approach of Revenue Authorities has resulted in protracted litigation and uncertainty. The Revenue Authorities’ attempts in this regard have not succeeded in most cases, especially in the Supreme Court, the most recent being in the Vodafone case.

In India, there are specific anti-avoidance provisions in the domestic tax laws as well as ‘limitation of benefits’ clauses in some tax treaties. Additionally, the Government introduced GAAR provisions. The GAAR provisions override the provisions of the tax treaties signed by India.

NEED FOR GAAR

1. Tax avoidance, like tax evasion, seriously undermines the achievements of the public finance objective of collecting revenues in an efficient, equitable and effective manner. Sectors that provide a greater opportunity for tax avoidance tend to cause distortions in the allocation of resources. Since the better-off sections are more endowed to resort to such practices, tax avoidance also leads to cross-subsidization of the rich. Therefore, there is a strong general presumption in the literature on tax policy that all tax avoidance, like tax evasion, is economically undesirable and inequitable. On considerations of economic efficiency and fiscal justice, a taxpayer should not be allowed to use legal constructions or transactions to violate horizontal equity.
2. In the past, the response to tax avoidance has been the introduction of legislative amendments to deal with specific instances of tax avoidance. Since the liberalization of the Indian economy, increasingly sophisticated forms of tax avoidance are being adopted by the taxpayers and their advisers. The problem has been further compounded by tax avoidance arrangements spanning across several tax jurisdictions. This has led to severe erosion of the tax base. Further, appellate authorities and courts have been placing a heavy onus on the Revenue when dealing with matters of tax avoidance even though the relevant facts are in the exclusive knowledge of the taxpayer and he chooses not to reveal them.

The above clearly defines and emphasises upon the need of having a general anti-avoidance rule, which will act as a dampener to such transactions in line with best practices around taxation internationally.

TAX EVASION V/S TAX AVOIDANCE

It is important to highlight the distinction between Tax Evasion and Tax Avoidance. The Organisation for Economic Cooperation and Development (OECD) has defined tax evasion as “A term that is difficult to define but which is generally used to mean illegal arrangements where liability to tax is hidden or ignored i.e. the tax payer pays less tax than he is legally obligated to pay by hiding income or information from tax authorities”. In case of tax evasion deliberate steps are taken by the tax payer in order to reduce the tax liability by illegal or fraudulent means. Tax avoidance, on the other hand is defined by the OECD as “term used to describe an arrangement of a tax payer’s affairs that is intended to reduce his liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow”. The key distinction being that in tax avoidance the key facts or details are not hidden by the tax payer but are on record. In Australia, the Ralph Review of Business Taxation has characterized tax avoidance as misuse or abuse of the law that is often driven by structural loopholes in the law to achieve tax outcomes that were not intended by Parliament but also includes the manipulation of law and focus on form and legal effect rather than the substance.

Another term which is sometimes used while analysing tax evasion and tax avoidance is tax planning. The OECD defines tax planning as “arrangement of a person’s business and /or private affairs in order to minimise tax liability”. It may be noted that, in practice in some cases, the dividing line between tax planning and tax

avoidance, or between permissible tax avoidance and impermissible tax avoidance, may not be clear. It may be noted that the GAAR is not an antidote for ‘tax evasion’, but for ‘tax avoidance’. The GAAR cannot deal with tax evasion since it cannot deal with what is not reported. The Government has recognised that the GAAR is meant for tackling tax avoidance.

CHAPTER X-A

Chapter X-A under Income Tax Act, 1961 (‘Act’) has been inserted to include General Anti-Avoidance Rules (‘GAAR’) to be applicable from April 1, 2012. However, the protest from industry which feared arbitrary usage of power by tax officers forced the government to defer its implementation and to constitute an Expert Committee under the chairmanship of Dr. Parthasarathi Shome to frame guidelines for GAAR after consultations with all the stakeholders. Following the report of Dr. Shome Committee, various amendments were carried out under the tax law and clarifications were provided by CBDT through issue of Circular. With effect from April 1, 2017, GAAR have finally become effective. (w.e.f. AY 2018-19)

Key Sections

Section 95 of the Act is the basic section that provides for declaring an arrangement entered into by a tax payer as an impermissible avoidance arrangement. It may be noted that section 95 of the Act overrules the entire Act and shall have operation notwithstanding anything contained in the Act.

Even in cases where relief is available under Double Taxation Avoidance agreement (‘DTAA’), the tax payer will still be continued to be monitored by the provisions of GAAR by virtue of section 90(2A) of the Act. CBDT vide Circular No. 7 of 2017, dated 27-1-2017 further clarified that anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by Limitation of Business (‘LOB’) in the treaty, there shall not be an occasion to invoke GAAR.

Rule 10U of the Income Tax Rules, 1962 (‘Rules’) restrict applicability of GAAR only in cases where tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does exceed a sum of rupees three crore.

Rule 10U of Income-tax Rules, 1962 (Rules) inter alia provides that the provisions of GAAR will not apply to arrangements where:

- the tax benefit arises prior to 1 April 2017
- a Foreign Institutional Investor, who is an assessee under the Act, has not taken benefit of an agreement referred to in section 90 or section 90A as the case may be; and who has invested in listed securities, or unlisted securities, with the prior permission of the competent authority,
- a person, being a non-resident, in relation to investment made by him by way of offshore derivative instruments or otherwise, directly or indirectly, in a Foreign Institutional Investor;
- the tax benefit in the relevant assessment year does not exceed INR 3 crore

It is to be noted that the threshold of INR 3 crore is not taxpayer specific and it has to be determined with regard to all the parties to the arrangement. Further, the Rules also provide that the tax benefit shall be with reference to the amount of tax, and in the case of an increase in loss, it will be with reference to the tax that would have been chargeable had the increase in loss referred to therein been the total income.

Note: GAAR Provisions are applicable w.e.f. AY 2018-19, where Tax Benefits in aggregate by all the enterprises out of an arrangement exceeds INR 3 Crores. GAAR overrides the provisions of DTAA’s

Note: “Tax Benefits” means any avoidance or reduction or deferral of tax or increase in refund or reduction in total income or increase in losses under Domestic Law or DTAA.

Section 99 of the Act provides that for the purposes of determining whether a ‘tax benefit’ exists:

- A. the parties who are connected persons in relation to each other may be treated as one and the same person;
- B. any accommodating party may be disregarded;
- C. the accommodating party and any other party may be treated as one and the same person;
- D. the arrangement may be considered or looked through by disregarding any corporate structure.

The term connected person is defined as any person who is connected directly or indirectly to another person and to include several specific categories of persons set out therein. Thus, in addition to the specific categories, it may still be possible for a person to be a connected person on the basis of the general test.

IMPERMISSIBLE AVOIDANCE AGREEMENT

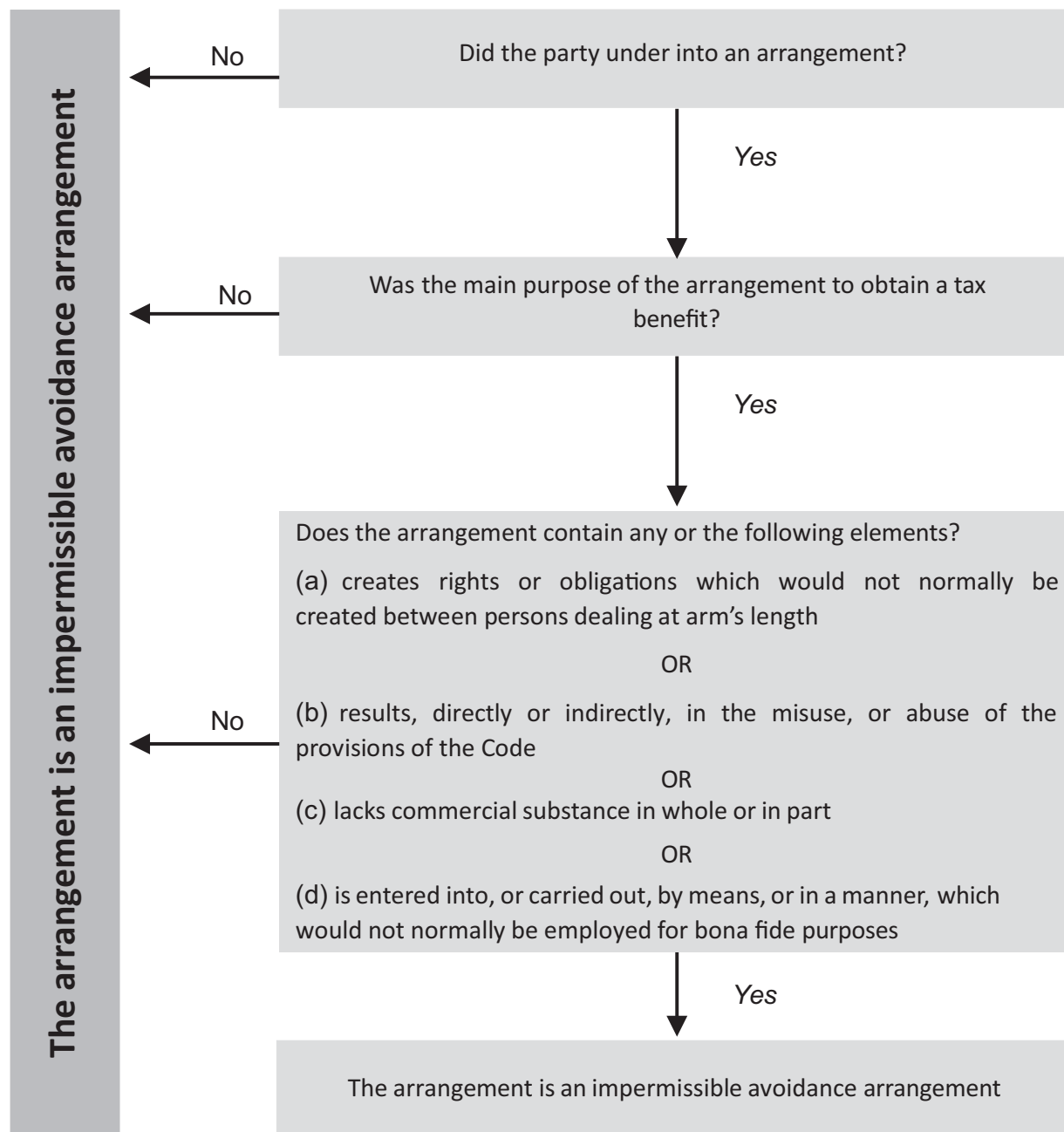
Section 96 of the Income Tax Act, 1961 refers to and defines an “Impermissible Avoidance Arrangement” – An impermissible avoidance arrangement means an arrangement, the main purpose of which is to obtain a tax benefit, and it –

- (a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm’s length;
- (b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;
- (c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or
- (d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.

Hence, there are a couple of tests that should be conducted and if both the results are positive, then a would be declared as an “Impermissible Avoidance Arrangement”.

1. The main purpose / intent of the arrangement is to obtain a tax benefit
2. The arrangement should have one or more below mentioned specified elements:
 - a. The arrangement creates rights, or obligations, which are not ordinarily created between persons dealing at arm’s length; or
 - b. The arrangement results, directly or indirectly, in the misuse, or abuse, of the provisions of the Act; or
 - c. The arrangement lacks commercial substance or is deemed to lack commercial substance under section 97 of the Act, in whole or in part; or
 - d. The arrangement is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.

Section 96(2) of the Act makes a rebuttable presumption that an arrangement shall be presumed to have been entered for main purpose of obtaining tax benefit where main purpose of even a single step or of part of that arrangement, is to obtain a tax benefit, notwithstanding the fact that main purpose of whole arrangement is not to obtain tax benefit. Let us look at a diagrammatic representation below for a clearer interpretation:



Section 97 of the Income Tax Act, 1961, provides certain situations where the arrangement will be deemed to lack commercial substance.

✓ Where the substance of the arrangement is inconsistent with, or differs significantly from its form

- Clause (a) of section 97(1) codifies the doctrine of substance over form. It implies that where substance of an arrangement is different from what is intended to be shown by the form of the arrangement, then tax consequence of a particular arrangement should be assessed based on the 'substance' of what took place. In other words, it reflects the inherent ability of the law to remove the corporate veil and look beyond form.

- √ Where the arrangement involves
 - Round trip financing - Section 97(2) of the Act defines round trip financing to include any arrangement in which, through a series of transactions, funds are transferred among the parties to the arrangement and such transactions do not have any substantial commercial purpose other than obtaining the tax benefit.
 - An accommodating party - Section 97(3) of the Act defines an accommodating party to be a party which is included in an arrangement mainly for obtaining tax benefit to the taxpayer. Such party may or may not be a connected party to the taxpayer.
 - Elements that have the effect of offsetting / cancelling each other (e.g. cross gifts).
 - Transactions that are conducted through one or more persons which disguise the value / location / source / ownership / control of funds.
- √ Where arrangement involves the location of an asset or of a transaction or of the place of residence of any party and such location is without any substantial commercial purpose.
 - It means if a particular location is selected for an asset or transaction or residence, and such selection has no substantial commercial purpose, then such arrangement shall be deemed to lack commercial substance.
- √ Where arrangement does not affect significantly the business risks or net cash flows of any party to the arrangement and only attributes tax benefits
 - Clause (d) of section 97(1) of the Act was inserted on recommendation of Dr. Shome Committee. It implies that besides having a commercial purpose, the taxpayer should also have commercial substance in the arrangement, which means a change in economic position of the taxpayer by altering the business risks or net cash flow to him.

As per section 98(1), if an arrangement is declared to be an impermissible avoidance arrangement, then the consequences may include denial of tax benefit or a benefit under a tax treaty. The consequence shall be determined, in such manner as is deemed appropriate, depending upon the facts and circumstances of the case.

It should also be noted that the question of whether the main purpose of the arrangement is to obtain a tax benefit is a factual question. The application of the *main purpose test* is largely a *fact intensive exercise* and will depend substantially on the documentation and the conduct of the parties as well as the surrounding facts and circumstances. Some points that must be kept in mind are set out below:

- a) The 'main purpose' test involves ascertaining the 'main' purpose of the arrangement. This is different from demonstrating the 'substance' of an entity or an arrangement. In other words, this test goes to the root of why an arrangement is undertaken, and not how it is undertaken.
- b) It is sufficient for the Department to show that the main purpose of the part of the arrangement was to obtain a tax benefit. However, the converse is not true, and it is not sufficient for the taxpayer to defend an arrangement by establishing a non-tax purpose for only a part of the arrangement. Therefore, while evaluating an arrangement from a GAAR perspective, one must look at every step or part of the arrangement to assess whether the 'main purpose' test is satisfied.
- c) Obtaining a non-tax benefit or other economic benefit will usually support a taxpayer's position that the main purpose of the arrangement is not to obtain a tax benefit. However, since this is a 'main purpose' test, it will be necessary that such benefit is substantial.

Further, it has been stated that the provisions of GAAR will not apply in cases where a taxpayer avails of specific incentives available to him under tax law and thereby mitigates his tax liability. Similarly, in response to a specific question on this issue, Circular 7 of 2017 clarified that GAAR will not interplay with the right of a

taxpayer to select or choose a method of implementing a transaction. There might arise certain scenarios in which this issue might arise. For e.g., setting up of a unit in a SEZ or undertaking a buyback as opposed to declaring a dividend. *Clarity does not exist on how the revenue will view such arrangements from the GAAR perspective, but as long as the ‘main purpose’ is not to obtain a tax benefit, the provisions of GAAR may not be invoked in such a case.*

Note: “Arrangement” covers all the transaction whether enforceable or not, in whole or in part being a agreement or a scheme or an understanding in the nature of transaction.

CURRENT SCENARIO WITH SPECIFIC ANTI AVOIDANCE RULES (SAAR)

It is not that anti-abuse provisions do not already exist in the law. The Indian tax law has several anti-avoidance provisions, introduced over the years. These are, however, specific rules to cover specific classes of structures/ transactions. For instance, there are rules to prevent unaccounted money being received as share capital or loans, interest, dividend and bonus stripping transactions, understatement of consideration for transfers of immovable property, excessive payments to related parties, expenditure in cash, transfer pricing for international transactions or specified domestic transactions etc.

One key change that impacts a SAAR is the **abolition of the 6% equalisation levy** on online advertisements, effective from April 1, 2025. This move is significant as it removes a specific tax on digital services provided by non-residents, simplifying the tax landscape in this area.

Bond washing Transaction u/s 94(1)

Under this type of transaction, an assessee who is an owner of securities, in order to avoid tax liability on account of Interest Income, transfers them to another person before the Record date and again Buys back after the record date. In this way, he is not liable to pay tax on interest income as he is not owner of the securities on the record date and is able to shift the liability of Income tax in favour of the transferee. But Section 94(1), has plugged the tax avoidance by deeming the interest as income of the transferor and not the transferee

This will tell you how the SAAR’s were operative in curbing instances of tax avoidance, the essence was similar and the intent too, just that there were many such provisions for specific circumstances.

Provisions relating to clubbing of Income which prevent mere shifting of Income from one person to another for minimising the tax burden as per Section 64 of the Income Tax Act, 1961

Let us read the case of Mr. Raja here, who is beneficially holding 21% equity shares of Essem Minerals Pvt. Ltd. and Mrs. Raja is employed as Manager (in accounts department) in Essem Minerals Pvt. Ltd. at a monthly salary of Rs. 84,000. Mrs. Raja is not having any knowledge, experience or qualification in the field of accountancy. In this situation, Mr. Raja is having substantial interest in Essem Minerals Pvt. Ltd. and remuneration of Mrs. Raja is not justifiable (i.e., she is employed without any technical or professional knowledge or experience) and, hence, salary received by Mrs. Raja from Essem Minerals Pvt. Ltd. will be clubbed with the income of Mr. Raja and will be taxed in the hands of Mr. Raja.

This will again reiterate and tell you how the SAAR’s were operative in curbing instances of tax avoidance, the essence was similar and the intent too, just that there were many such provisions for specific circumstances.

Provisions targeting avoidance of income tax by certain transactions in securities, such as dividend stripping as per Section 94 of the Income Tax Act, 1961

Let us take an example of Mr. A who is interested in buying the shares of XYZ Co. Ltd. and whose price as on 25th Feb was Rs 200. The Company has announced that it will pay dividend of Rs 40/ share to its shareholders on 31st March. Now, Mr A buys 1000 shares @ Rs 200 each and receives dividend of Rs 40000. On 5th April, the moment the stock price fell owing to dividend distribution, he sold the shares @ Rs 150 / share and hence incurred a loss of Rs 50000/- (Rs 50/share). He claims this Short-Term Capital Loss in his tax return to save tax

against the other short-term capital gains. He also enjoys the dividend exemption of Rs 40000 he received on shares. This way he booked a tax-free profit of Rs 40000 (dividend income) and a loss of Rs 50000 which he can additionally set off against the other short-term capital gain and save more taxes. This practice of buying and selling shares to avoid tax free profits and avoid taxes is called dividend stripping. Owing to this, there was a huge loss in terms of tax revenue to the Government and to prevent this, they introduced a section 94(7) by virtue of which, if one buys a share within 3 months of the record date and sells it within 3 months after the record date, then the capital loss to the extent of dividend received will not be allowed to be set off.

This will again reiterate and tell you how the SAAR's were operative in curbing instances of tax avoidance, the essence was similar and the intent too, just that there were many such provisions for specific circumstances.

GAAR VS. SAAR

Similar to GAAR, there exist certain anti-avoidance rules which are particular to an issue. They are referred to as Specific Anti-Avoidance Rules (SAAR). Since the time the provisions of GAAR were introduced into public domain through draft and committee reports, it has been argued by the stakeholders that GAAR should not apply where SAARs exist i.e. there are specific anti-avoidance rules already present in the Act relating to that case. However, this argument was not accepted and a circular specifically addressed this issue by clarifying that the provisions of SAAR and GAAR can co-exist and are applicable, as may be necessary in the facts and circumstances of the case.

Hence, the position on this issue is a policy one and not a legal one and a defense to the invocation of GAAR in cases where a SAAR exists will need to be based on the factors such as existence of arrangement, tax benefit, main purpose, tainted element/s etc.

The following are some distinguishing features between GAAR and SAAR.

SAAR [Specific Anti Avoidance Rules]

- These are specific and help reduce time and costs involved in tax litigation
- These provide certainty to any tax payer while formalising specific arrangements
- These don't provide any discretion to the tax authorities
- There is always a possibility that the tax payers find loopholes and circumvent these limited application, specific provisions

GAAR [General Anti-Avoidance Rules]

- These involve necessarily granting the discretion to the tax authorities to invalidate the arrangements as impermissible tax avoidance.
- They have a far broader application and hence interpreted in a more extensive manner.
- GAAR has the potential to counter more effectively and outsmart the tax payers in their “out of the box thinking” and their approach in devising new means of tax avoidance.

Broad Provisions

Essentially, the GAAR is a broad set of provisions which grants powers to authorities to ‘invalidate any arrangement’, for tax purposes, if it is entered into by the assessee with the main purpose of obtaining a ‘tax benefit’. A tax benefit would include a benefit relating to Income-tax. Apart from the ‘tax benefit’ test, the arrangement also has to satisfy at least one out of four additional tests discussed in the ensuing paragraphs.

The principal condition for invalidating an arrangement under the GAAR provisions is that the arrangement (or

any step thereof) must have been entered into with the main purpose of obtaining ‘tax benefit’. This condition in most cases, is likely to get satisfied automatically at the assessment stage itself. Given that, under the proposed law, specific presumption is to that effect, GAAR provisions will be attracted automatically unless the taxpayer is able to prove otherwise.

This would cast an onerous burden on the taxpayer in such cases which will have to be discharged with appropriate positive evidence. The onus is therefore clearly seen to shift to the tax payer to prove that there hasn’t been any tax avoidance.

Once the test of the main purpose of tax benefit is satisfied, the taxpayer is required to undergo further scrutiny to pass various other critical tests to avoid the application of the GAAR provisions and prevent the possible action of invalidating the arrangement.

These critical tests, include whether

- (a) the arrangement is not carried out in a manner normally not employed for bonafide purposes or
- (b) it is not at arm’s length or
- (c) it results in direct or indirect misuse/abuse of the provisions of the Code or
- (d) it lacks commercial substance.

Further, in accordance with the enlarged definition of the test of ‘lack of commercial substance’, it would also be necessary for the taxpayer to pass certain further tests such as: whether there is a significant effect upon the business risks or net cash flow of the concerned parties, the test of substance over form, whether the arrangement involves ‘round trip financing’ or any accommodating or tax indifferent party or any element having effect of offsetting each other and so on. Most of these tests are highly subjective, which only adds to the complexity.

If any one of these tests is satisfied, then the CIT would assume the authority to apply the GAAR Provisions.

Applicability

It may be noted that the GAAR provisions would be applicable to all taxpayers irrespective of their residential or legal status (i.e. resident or non-resident, corporate entity or non-corporate entity). The provisions also apply to all transactions and arrangements irrespective of their nature (i.e. business or non-business) if, the tax benefit accrues to the taxpayer and he fails to establish that the main purpose of entering into that transaction/ arrangement was not to obtain tax benefit. For GAAR provisions, it is also not relevant whether transactions/ arrangements are entered into with group concerns or third parties and whether they are domestic or cross-border transactions.

For calculation of threshold of INR 30 million (that is, Rs 3 Crores as per the Rules), only the tax benefit enjoyed in Indian jurisdiction due to the arrangement or part of the arrangement is to be considered. Such benefit is assessment year specific. GAAR is with respect to an arrangement or part of the arrangement and limit of INR 30 million cannot be read in respect of a single taxpayer only.

CASE STUDY

VODAFONE

Sequence of Events

- The Hutchison Group (Hong Kong) had acquired interests in mobile telecommunications industry in India from 1992 onwards and over a long period of time, a large and complicated ownership structure evolved. The Hutchison Group had an interest in the Indian operating company Hutchison Essar Ltd (HEL) through a number of overseas holding companies. HEL had further step-down operating subsidiaries in India.

- The majority of the share capital of HEL, which was under the direct or indirect control of Hutchison Group, was held by various Mauritius/Indian companies, which in turn were held by Mauritian/Cayman Islands companies.
- Hutchison held certain call and put options (representing 15% of the shareholding of HEL) over companies controlled by other persons. These options were in favour of 3Global Services Pvt. Ltd. (3GSPL), an Indian company, against consideration of credit support.
- In late 2006, Hutchison Telecommunications International Ltd., Cayman Islands (HTIL) received various offers from potential buyers to acquire its equity interest in HEL including one from Vodafone Group Plc, who made a nonbinding offer for 67% of HEL for a sum of USD 11.076 billion, based on an enterprise value of USD 18.8 billion of HEL.
- A sale purchase agreement (SPA) was entered into on 11 February, 2007 between VIH and HTIL, under which VIH was to acquire the sole share of CGP Investment (Holdings) Ltd., a Cayman Islands company (CGP).
- Subsequently, on 20 February, 2007 VIH filed an application under Press Note 1 of 2005 for an approval from Foreign Investment Promotion Board (FIPB) and for FIPB to make a noting of the transaction. On 7 May, 2007, FIPB granted approval to VIH and on 8 May, 2007, VIH paid over the consideration

The Issue

The controversy in this case centered on the taxability in India of the offshore transfer of shares in CGP, a Cayman Islands Company by the Hutchison Group to the Vodafone Group.

The Indian Revenue Authorities contended that in view of the substantial underlying assets in India, in the form of HEL and its business, the transfer was not of the share of CGP but in substance that of the underlying Indian assets. Accordingly, the capital gain arising from the transfer was taxable in India and VIH was liable to withhold tax from the consideration payable to HTIL.

The issues, therefore, before the Supreme Court were as follows:

- a) Were the gains arising on the sale of CGP taxable in India?
- b) Where was the situs of the shares of CGP?
- c) Did the transaction result in transfer of any asset in India?
- d) Was VIH liable to withhold Indian tax from the consideration?

The Supreme Court ruling was as follows:

- 1) ***Gains arising on sale of the share of CGP were not taxable in India***
- 2) ***The share of CGP was situated outside India (i.e., in the Cayman Islands)***
- 3) ***The transaction did not result in the transfer of any asset in India***
- 4) ***VIH was not liable to withhold tax from payment of the sale consideration for acquisition of CGP***

Key extracts / inferences from Supreme Court Judgement

In its ruling, the Supreme Court made significant observations relating to tax avoidance, international tax structures and anti-avoidance regulations. The Court laid down some key principles on this subject and reiterated other. These are as follows:

General

- a) The concept of GAAR is not new to India, which already has a judicial anti-avoidance rule, like some other jurisdictions
- b) The English Courts have in its their rulings in the Duke of Westminster’s case⁴⁸ and subsequent decisions in Ramsay’s case⁴⁹ and Craven v. White⁵⁰ laid down principles on anti-avoidance. The cardinal Westminster principle states that given that a document or a transaction is genuine, the Court cannot go behind it to some supposed underlying substance. Interpreting and following this cardinal principle, the English Courts have held in subsequent rulings that the Revenue cannot start with the question as to whether the transaction was a tax deferment or saving device but that the revenue should apply the ‘look at’ test to ascertain its true legal nature. It is the task of the Court to ascertain the legal nature of the transaction and while doing so it has to look at the entire transaction as a whole and not to adopt a dissecting approach. It has been a cornerstone of law that a taxpayer is entitled to arrange his affairs so as to reduce his tax liability; the fact that the motive for a transaction is to avoid tax does not invalidate it unless a particular enactment so provides. Genuine strategic planning is permissible.
- c) In *McDowell’s* case, the Supreme Court held that tax planning may be legitimate provided it is within the framework of law. However, a colourable device cannot be a part of tax planning. The separate ruling given one of the Hon’ble judges (Reddy, J.) was in relation to tax evasion through colourable devices by resorting to dubious methods and subterfuges. Nowhere is it mentioned that tax planning is illegitimate or impermissible and, moreover, Reddy, J himself noted that he agreed with the majority ruling.
- d) Reading *McDowell’s* case in the above manner, in cases of treaty shopping or tax avoidance there is no conflict between the ruling of the Apex Court in *McDowell’s* case and in its subsequent rulings in *Azadi Bachao Andolan’s* case or *Mathuram Agrawal’s* case.
- e) Courts have evolved doctrines such as piercing the corporate veil, substance over form etc. enabling taxation of underlying assets in cases of fraud, sham, tax avoidant etc. However genuine tax planning is not ruled out.
- f) The question of providing ‘look through’ in the statute or in a treaty is a matter of policy. It is to be expressly provided in the statute and cannot be read into the section by interpretation. Similarly, LOB has to be expressly provided for in the treaty.

International Transaction

The law of corporate taxation is generally founded on the ‘separate entity principle’ by which a company is treated as a separate person capable of legal independence vis-a-vis its shareholders/participants. The fact that a parent company exercises shareholder’s influence on its subsidiaries does not imply that the subsidiaries are to be deemed residents of the State in which the parent company resides. It is a common practice for foreign investors to invest in Indian companies through an interposed foreign holding or operating company, such as a Cayman Islands or Mauritius based company for both tax and business purposes. This is to avoid the lengthy approval and registration processes required for a direct transfer of an equity interest in a foreign invested Indian company.

Holding structures are recognized incorporate as well as tax laws. Special Purpose Vehicles (SPVs) and Holding Companies have a place in legal structures in India – under company law, SEBI Regulations or under the income tax law. When it comes to taxation of a Holding Structure, at the threshold, the burden is on the Revenue

to allege and establish abuse, in the sense of tax avoidance in the creation and/or use of such structure(s). In the application of a judicial anti-avoidance rule, the Revenue may invoke the ‘substance over form’ principle or the ‘piercing the corporate veil’ test only after it is able to establish, on the basis of the facts and circumstances surrounding the transaction, that the impugned transaction is a sham or tax avoidant. For example, if a structure is used for circular trading or round tripping or to pay bribes, then such a transaction, though having a legal form, should be discarded by applying the test of fiscal nullity.

There is a conceptual difference between a “preordained transaction” created for tax avoidance purposes and one which evidences “investment to participate” in India. Strategic Foreign Direct Investment coming to India as an investment destination should be seen in a holistic manner. When doing so, the Revenue/Courts should keep in mind the following

- the concept of participation in investment;
- the duration of time during which the Holding Structure exists;
- the period of business operations in India;
- the generation of taxable revenues in India;
- the timing of the exit;
- the continuity of business on such exit.

The corporate business purpose of a transaction is evidence of the fact that the transaction is not undertaken as a colourable or artificial device. The stronger the evidence of a device, the stronger the corporate business purpose that must exist to overcome the evidence of a device.

Section 9(1)(i) of the Act, applies to transfer of capital assets situate in India. It does not cover indirect transfer of a capital asset. Reading so, the words capital asset situated in India in section 9(1)(i) would be rendered nugatory. Similarly, the words, ‘underlying asset’ do not find a place in the said section. By contrast, the Code proposes to tax offshore share transactions in specified cases. This shows that indirect transfer cannot be read into section 9(1)(i) of the Act.

Shareholdings in companies incorporated outside India is property situated outside India. When such shares become the subject matter of an offshore transfer between two non-residents, there is no liability for capital gains tax in India. A transaction has to be viewed from a commercial and realistic perspective and it has to be determined whether it is a ‘share sale’ or an ‘asset sale’ because the tax consequences of a share sale would be different from the tax consequences of an asset sale. A transaction involving transfer of shares lock, stock and barrel cannot be broken up into separate individual components, assets or rights such as the right to vote, right to participate in company meetings, management rights, controlling rights, control premium, brand licences and so on, as shares constitute a ‘bundle of rights’. Even when the purchaser pays a consideration to the vendor based on the enterprise value of the Indian assets, valuation cannot be the basis of taxation. Section 9 cannot be applied only on the basis that the value of foreign company’s shares were made up by the underlying Indian assets.

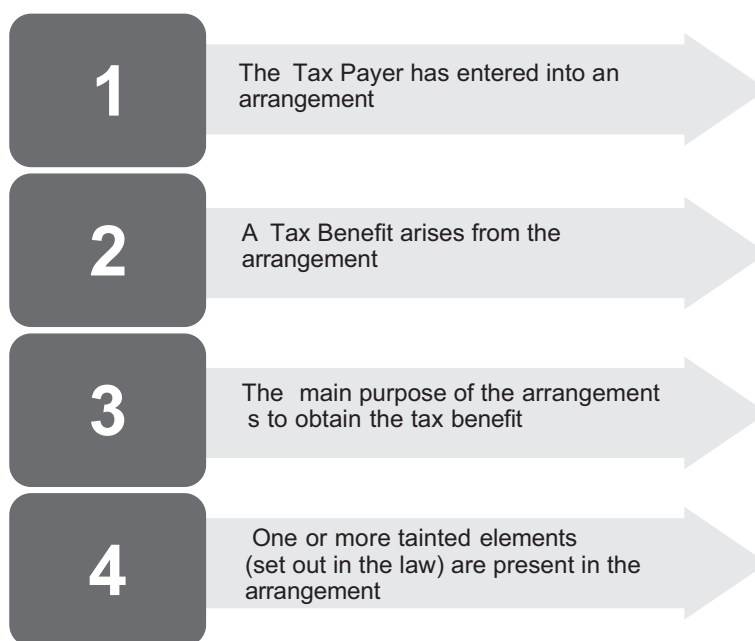
FDI flows towards location with a strong governance infrastructure which includes enactment of laws and how well the legal system works. Certainty is integral to rule of law. Certainty and stability form the basic foundation of any fiscal system. Tax policy certainty is crucial for taxpayers (including foreign investors) to make rational economic choices in the most efficient manner. It is for the Government of the day to have them incorporated in the Treaties and in the laws so as to avoid conflicting views. Investors should know where they stand. It also helps the tax administration in enforcing the provisions of the taxing laws.

Some Examples

- 1) A choice is being made by a company between leasing an asset and purchasing the same asset. The company would claim a deduction for leasing rentals rather than depreciation if it had their own asset. Would the lease rent payment be disallowed as an expense under GAAR?

Solution: GAAR provisions, would not, prima facie, apply to a decision of leasing (as against purchase of an asset). However, if it is a case of circular leasing, i.e. the taxpayer leases out an asset and through various sub-leases, takes it back on lease, thus creating a tax benefit without any change in economic substance, Revenue would examine the matter for invoking GAAR provisions.

- 2) ‘A’ company borrowed money from a company ‘B’ and used that to buy shares in three 100% subsidiary companies of ‘A’. Though the fair market value of the shares was Rs. Y, ‘A’ paid Rs. 6Y for each share. The amount received by the said subsidiary companies was transferred back to another company connected to ‘B’. The said shares were sold by “A” for Rs. Y/5 each and a short-term capital loss was claimed and this was set-off against other long-term capital gains.



Solution: By the above arrangement, the taxpayer has obtained a tax benefit and created rights or obligations which are not ordinarily created between persons dealing at arm's length. Revenue would invoke GAAR with regard to this arrangement, as it is quite evident that the transaction lacks any commercial substance and is merely fabricated to avoid tax, and all the conditions exhibited below are met.

Exclusions from GAAR

Rule 10U of the Income-tax Rules provides for certain exclusions from the provisions of GAAR, which are discussed below:

- a) *Monetary Threshold:* As discussed above, there is a monetary threshold of INR 3 crores for the applicability of GAAR. The threshold has to be seen with respect to each assessment year. Also, the threshold is not taxpayer-specific and it has to be determined with regard to all the parties to the arrangement.

- b) *Exemption to Foreign Institutional Investors (FII) and Foreign Portfolio Investors:* The Rules provide that the provisions of GAAR are not applicable to an FII subject to certain conditions.
- c) *Exclusion for P-Notes/Investments in FIIs:* The provisions of GAAR shall not apply to a person who is a non-resident in relation to investment made by him by way of offshore derivative instruments or otherwise, directly or indirectly in a FII. The term ‘offshore derivative instruments’ mainly indicates investments made by way of P-Notes. Further, there is no threshold in respect of this investment. Even de minimis stakes are grandfathered by this clause.
- d) any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from transfer of investments made before the 1st day of April, 2017 by such person

The Consequences

Section 95 of the Act dealing with the applicability of GAAR opens with a non-obstante clause i.e. the clause should prevail despite anything to the contrary in the provision mentioned in such clause. Hence, the consequences in relation to tax arising from an arrangement can be determined, regardless of the consequences that would otherwise arise in respect of the arrangement under the normal provisions of the Act.

The Act provides that the power to determine the consequences shall include (but not be limited to):

- a) disregarding, combining or recharacterizing any step in, or part of or whole of the impermissible avoidance arrangement;
- b) treating the impermissible avoidance arrangement as if it had not been entered into or carried out;
- c) disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;
- d) deeming persons who are connected persons in relation to each other to be one and the same person for the purposes of determining tax treatment of any amount;
- e) reallocating amongst the parties to the arrangement— (i) any accrual, or receipt, of a capital nature or revenue nature; or (ii) any expenditure, deduction, relief or rebate;
- f) treating— (i) the place of residence of any party to the arrangement; or ii) the situs of an asset or of a transaction, at a place other than the place of residence, location of the asset or location of the transaction as provided under the arrangement; or
- g) considering or looking through any arrangement by disregarding any corporate structure. It is also provided that, while determining the consequences, any equity can be recharacterized as debt or vice versa, any accrual or receipt of a capital nature can be treated as revenue or vice versa & any expenditure, deduction, relief or rebate might be recharacterized. The provision clearly specifies that the consequences are not limited to the list provided and that they can be determined in any manner deemed appropriate by the tax authorities depending on the circumstances of the case. The power given to the tax authorities to determine the consequences of an impermissible avoidance arrangement are extremely open ended. However, it must be kept in mind that the consequences determined must be in relation to tax. It would be necessary for the tax authorities to show that the determination of the tax consequences is appropriate with regards to the circumstances of the case. This would imply that the tax consequences must be aimed at counteracting the tax benefit that would have arisen from the arrangement in the absence of GAAR, rather than punishing the taxpayer.

Another question that arises is whether corresponding adjustments are permissible. It has been represented that corresponding adjustments should be permitted while determining the consequences of GAAR.

MISCELLANEOUS ASPECTS OF THE GAAR PROVISIONS**Onus of Proof**

The onus of proof relating to the invocation of GAAR is on the tax authorities. As discussed in the beginning, the onus lies on the tax authorities to demonstrate that

- There is an arrangement
- The arrangement leads to a ‘tax benefit’
- The main purpose of the arrangement is to obtain a tax benefit
- The arrangement has one or more of the tainted elements

Despite of the onus being on the tax authorities to prove the above points relating to a taxpayer, the taxpayer is not totally immune from having to establish the bona fides of his case.

SAAR v. GAAR

Similar to GAAR, there exist certain anti-avoidance rules which are particular to an issue. They are referred to as Specific Anti-Avoidance Rules (SAAR). Since the time the provisions of GAAR were introduced into public domain through draft and committee reports, it has been argued by the stakeholders that GAAR should not apply where SAARs exist i.e. there are specific anti-avoidance rules already present in the Act relating to that case. However, this argument was not accepted and a circular specifically addressed this issue by clarifying that the provisions of SAAR and GAAR can co-exist and are applicable, as may be necessary in the facts and circumstances of the case. Hence, the position on this issue is a policy one and not a legal one and a defence to the invocation of GAAR in cases where a SAAR exists will need to be based on the factors such as existence of arrangement, tax benefit, main purpose, tainted element/s etc.

Judicial anti-avoidance in a GAAR era

After the coming into force of GAAR, a question might arise whether the judicial anti-abuse doctrines can continue to be invoked by the tax authorities. A view can be taken that once GAAR is enacted, it is not permissible for the tax authorities to use these judicial principles to target the abusive transactions since the provisions of GAAR are now codified in the statute. A codifying statute is one which restates legal subject matter previously contained in earlier statutes. The courts generally presume that a codifying statute supersedes prior case law. Since GAAR is intended to codify the general principles of anti-avoidance doctrine, it follows that it should solely govern all abusive situations to the complete exclusion of the judicial principles that were in force prior to GAAR coming into force.

PENALTIES

The penalty provisions of the Act seek to levy penalty in cases of under-reporting of income and misreporting of income. In cases of under-reporting of income, penalty @ 50% is leviable, while in the cases of misreporting of income, penalty @ 200% is applicable. Under-reporting of income is, inter-alia, objectively defined to be the difference between assessed income and income determined as per provisions of the Act. If the provisions of GAAR are held to be applicable, the penalty of under-reporting i.e. 50% could apply automatically, but the penalty for misreporting cannot be said to be automatic. This is because the taxpayer can be said to have misreported his income only in a few specified circumstances. (viz. misrepresentation or suppression of facts, failure to record investments or any receipts in the books etc.) Thus, as long as the case of the taxpayer does not fall in any of the specified circumstances, the penalty for misreporting of income cannot apply even if provisions of GAAR are held to be applicable.

Procedural Aspects

The statute contains a provision that requires the Assessing Officer to make a reference to the Principal Commissioner or Commissioner, at any stage of the assessment or reassessment proceedings before him

having regard to the material available if he considers it necessary to declare an arrangement as impermissible avoidance arrangement and to determine the consequences based on the provisions of GAAR. The Assessing Officer is required to issue a notice in writing to the taxpayer seeking any objections before making any reference to the Commissioner. Before issuing a notice to the taxpayer, the Commissioner is required to form an opinion and list out the reasons of issuance of the notice. The provisions of GAAR also demand a reference to an Approving Panel if the Commissioner is not satisfied with the explanation offered by the taxpayer. The Approving Panel which will consist of three members – a retired High Court judge, a tax officer with the rank of Chief Commissioner and an outside expert will also have the power to cause further enquiries to be made as well as to call for records to the matter. Since the process of declaring an arrangement as an impermissible avoidance arrangement must originate with the Assessing officer, the powers of the Commissioner or the Approving Panel are limited to those arrangements in respect of which a reference has been made by the Assessing Officer. It must be noted that no appeal lies against the directions issued by the Approving Panel.

The **Finance Act, 2025**, allows tax authorities to issue reassessment notices under GAAR for tax years that have already passed the regular time limits for reassessment. Previously, there was a risk that if the GAAR panel took too long to approve an arrangement as an “impermissible avoidance arrangement,” the relevant assessment years could become time-barred

The law now explicitly recognizes the GAAR Panel's direction as “information” that income has escaped assessment. This new provision effectively removes the need for a prior hearing before issuing a reassessment notice in GAAR-linked cases, allowing the tax department to act more swiftly.

Advance Ruling

An advance ruling can be sought on the question of whether an arrangement which is proposed to be undertaken by any person being a resident or a non-resident is an impermissible avoidance arrangement. Such an advance ruling can be sought by both residents and non-residents and only in respect of arrangements proposed to be entered into by the person.

GAAR CHECKLIST

GAAR CHECKLIST

1. Do any of the exclusions in Rule 10U(1) apply?
 - Is the tax benefit in the relevant assessment year less than INR 3 crore?
 - Is the taxpayer an foreign portfolio investor who qualifies under Rule 10U(1)(b)?
 - Is the investment made by non-resident, by way of an offshore derivative investment or otherwise, in on foreign portfolio investor?
 - Does the income arise from transfer of investments made before 1 April, 2017?
2. Is there an arrangement?
3. Has the assessee entered into the arrangement?
4. Is there a tax benefit arising out of the arrangement?
5. Is the main purpose of the arrangement to obtain tax benefit?
6. Is the tainted element test satisfied?
 - Does the arrangement create rights, or obligation which are not ordinarily created between persons dealing of arm's length?
 - Does the arrangement results, directly or indirectly, in the misuse or abuse of the provision of the Act.

- Does the arrangement lack commercial substance?
- Is the arrangement deemed to lack commercial substance under section 97?
- Is the arrangement entered into, or carried out, by means, or in a manner which are not ordinarily employed for bona fide purpose?

The imminent dangers of particular concern are sections 96(2), and 102(10).

The former reads:

(2) An arrangement shall be presumed, unless it is proved to the contrary by the assessee, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.

The words “tax benefit” are extremely critical to the entire Chapter and section 102(10) defines this expression to mean:

(10) “tax benefit” includes, --

- (a) a reduction or avoidance or deferral of tax or another amount payable under this act; or
- (b) an increase in a refund of tax or another amount under this act; or
- (c) a reduction or avoidance or deferral of tax or other amount that would be payable under this act, as a result of a tax treaty; or
- (d) an increase in a refund of tax or other amount under this act as a result of a tax treaty; or
- (e) a reduction in total income; or
- (f) an increase in loss,

In the relevant previous year or any other previous year;

A simple perusal of both these provisions indicate the enormous potential for undue trouble and consequential harassment of assessee.

The potential for gross misuse can be illustrated by the following examples: -

Example No.1:

A company wants to expand its production capacity. It can either set up a new plant or take over a sick unit manufacturing the same goods. As a result of the merger, the loss of the sick company will potentially reduce its liability. Under GAAR, such a merger can be treated as an “impermissible avoidance arrangement”. The CBDT circular on GAAR, issued on 27.01.2017, brazenly points out that even if the scheme is approved by the Courts/NCLT, the Department can ignore it if the Courts/NCLT has not “explicitly and adequately” considered the tax implications. This is highly objectionable. Under the Companies Act, 2013, a merger cannot be completed without notice to the Income-tax Department. Past experience shows that every merger is objected to if it results in some tax reduction. If the courts approve it, the remedy of the Department is to go on appeal to the higher forum and not invoke GAAR.

Example No.2:

Suppose a company sets up a unit in Special Economic Zone and one of the objectives is to take advantage of the tax exemption. Can this corporate decision be effectively nullified by GAAR? If so, it could be viewed as a dampener to the ease of doing business as any tax payer would want to maximise his investments by effectively planning his tax liabilities.

Example No.3:

An investment is made from Mauritius with the intention of taking the benefit of a treaty. Can the Department ignore the treaty provisions and invoke GAAR?

The answer to Q. No.3 seems to suggest that GAAR will not interfere with the rights of the tax payer to choose a method of implementing a transaction. But this answer is meaningless because of the wide language of sections 96(2) and 102(10). Will the Department refrain from interfering even if the assessee's legitimate choice results in lower taxes?

These are troubling questions which require grave consideration. An aggressive and abusive application of GAAR will seriously impact foreign direct investment and also domestic investment. It is therefore an imperative business need to clarify that GAAR will not apply in cases where mergers are approved by court or where benefits that are legitimately permissible under the Act are taken advantage of, or where there is a reduction in tax as a consequence of international tax treaties.

In-fact, it must be observed carefully that the very words “impermissible avoidance arrangement” by definition means that there are and can be permissible avoidance arrangements. It is imperative that the CBDT issues guidelines setting out such permissible arrangements which will not attract GAAR. One would honestly hope for clarity around the specific arrangements that are and aren't possible under the Act for a more meaningful implementation and one that doesn't jeopardise the genuine tax planning strategies in a bid to protect the interests of the Revenue.

Clarifications on implementation of GAAR provisions under the Income Tax Act, 1961 [Circular No. 7 of 2017]**Question No. 1: Will GAAR be invoked if SAAR applies?**

Answer: It is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legislation. The provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case.

Question No. 2: Will GAAR be applied to deny treaty eligibility in a case where there is compliance with LOB test of the treaty?

Answer: Adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by LOB in the treaty, there shall not be an occasion to invoke GAAR.

Question No. 3: Will GAAR interplay with the right of the taxpayer to select or choose method of implementing a transaction?

Answer: GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction.

Question No. 4: Will GAAR provisions apply where the jurisdiction of the FPI is finalised based on non-tax commercial considerations and such FPI has issued P-notes referencing Indian securities? Further, will GAAR be invoked with a view to denying treaty eligibility to a Special Purpose Vehicle (SPV), either on the ground that it is located in a tax friendly jurisdiction or on the ground that it does not have its own premises or skilled professional on its own roll as employees.

Answer: For GAAR application, the issue, as may be arising regarding the choice of entity, location etc., has to be resolved on the basis of the main purpose and other conditions provided under section 96 of the Act. GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction. If the jurisdiction

of FPI is finalized based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply.

Question No. 5: Will GAAR provisions apply to (i) any securities issued by way of bonus issuances so long as the original securities are acquired prior to 01 April, 2017 (ii) shares issued post 31 March, 2017, on conversion of Compulsorily Convertible Debentures, Compulsorily Convertible Preference Shares (CCPS), Foreign Currency Convertible Bonds (FCCBs), Global Depository Receipts (GDRs), acquired prior to 01 April, 2017; (iii) shares which are issued consequent to split up or consolidation of such grandfathered shareholding?

Answer: Grandfathering under Rule 10U(1)(d) will be available to investments made before 1st April 2017 in respect of instruments compulsorily convertible from one form to another, at terms finalized at the time of issue of such instruments. Shares brought into existence by way of split or consolidation of holdings, or by bonus issuances in respect of shares acquired prior to 1st April 2017 in the hands of the same investor would also be eligible for grandfathering under Rule 101(1)(d) of the Income Tax Rules.

Question No. 6: The expression “investments” can cover investment in all forms of instrument - whether in an Indian Company or in a foreign company, so long as the disposal thereof may give rise to income chargeable to tax. Grandfathering should extend to all forms of investments including lease contracts (say, air craft leases) and loan arrangements, etc.

Answer: Grandfathering is available in respect of income from transfer of investments made before 1st April, 2017. As per Accounting Standards, ‘investments’ are assets held by an enterprise for earning income by way of dividends, interest, rentals and for capital appreciation. Lease contracts and loan arrangements are, by themselves, not ‘investments’ and hence grandfathering is not available.

Question No. 7: Will GAAR apply if arrangement held as permissible by Authority for Advance Ruling?

Answer: No. The AAR ruling is binding on the PCIT / CIT and the Income Tax Authorities subordinate to him in respect of the applicant.

Question No. 8: Will GAAR be invoked if arrangement is sanctioned by an authority such as the Court, National Company Law Tribunal or is in accordance with judicial precedents etc.?

Answer: Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement.

Question No. 9: Will a Fund claiming tax treaty benefits in one year and opting to be governed by the provisions of the Act in another year attract GAAR provisions? An example would be where a Fund claims treaty benefits in respect of gains from derivatives in one year and in another year sets-off losses from derivatives transactions against gains from shares under the Act.

Answer: GAAR provisions are applicable to impermissible avoidance arrangements as under section 96. In so far as the admissibility of claim under treaty or domestic law in different years is concerned, it is not a matter to be decided through GAAR provisions.

Question No. 10: How will it be ensured that GAAR will be invoked in rare cases to deal with highly aggressive and artificially pre-ordained schemes and based on cogent evidence and not on the basis of interpretation difference?

Answer: The proposal to declare an arrangement as an impermissible avoidance arrangement under GAAR will be vetted first by the Principal Commissioner / Commissioner and at the second stage by an Approving Panel, headed by judge of a High Court. Thus, adequate safeguards are in place to ensure that GAAR is invoked only in deserving cases.

Question No. 11: Can GAAR lead to assessment of notional income or disallowance of real expenditure? Will GAAR provisions expand the scope of charging provisions or scope of taxable base and/or disallow the expenditure which is actually incurred and which otherwise is admissible having regard to diverse provisions of the Act?

Answer: If the arrangement is covered under section 96, then the arrangement will be disregarded by application of GAAR and necessary consequences will follow.

Question No. 12: A definite timeline may be provided such as 5 to 10 years of existence of the arrangement where GAAR provisions will not apply in terms of the provisions in this regard in section 97(4) of the IT Act.

Answer: Period of time for which an arrangement exists is only a relevant factor and not a sufficient factor under section 97(4) to determine whether an arrangement lacks commercial substance.

Question No. 13: It may be ensured that in practice, the consequences of a transaction being treated as an 'impermissible avoidance arrangement' are determined in a uniform, fair and rational basis. Compensating adjustments under section 98 of the Act should be done in a consistent and fair manner. It should be clarified that if a particular consequence is applied in the hands of one of the participants, there would be corresponding adjustment in the hands of another participant.

Answer: Adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner. In the event of a particular consequence being applied in the hands of one of the participants as a result of GAAR, corresponding adjustment in the hands of another participant will not be made. GAAR is an anti-avoidance provision with deterrent consequences and corresponding tax adjustments across different taxpayers could militate against deterrence.

Question No. 14: Tax benefit of INR 3 crores as defined in section 102(10) may be calculated in respect of each arrangement and each taxpayer and for each relevant assessment year separately. For evaluating the main purpose to be obtaining of tax benefit, the review should extend to tax consequences across territories. The tax impact of INR 3 crores should be considered after taking into account impact to all the parties to the arrangement i.e. on a net basis and not on a gross basis (i.e. impact in the hands of one or few parties selectively).

Answer: The application of the tax laws is jurisdiction specific and hence what can be seen and examined is the Tax Benefit' enjoyed in Indian jurisdiction due to the 'arrangement or part of the arrangement'. Further, such benefit is assessment year specific. Further, GAAR is with respect to an arrangement or part of the arrangement and therefore limit of Rs. 3 crores cannot be read in respect of a single taxpayer only.

Question No. 15: Will a contrary view be taken in subsequent years if arrangement held to be permissible in an earlier year?

Answer: If the PCIT/Approving Panel has held the arrangement to be permissible in one year and facts and circumstances remain the same, as per the principle of consistency, GAAR will not be invoked for that arrangement in a subsequent year.

Question No. 16: No penalty proceedings should be initiated pursuant to additions made under GAAR at least for the initial 5 years.

Answer: Levy of penalty depends on facts and circumstances of the case and is not automatic. No blanket exemption for a period of five years from penalty provisions is available under law. The assessee, may at his option, apply for benefit u/s 273A if he satisfies conditions prescribed therein.

CASE STUDY

1. M/s ABC Ltd. is an Indian Company. It sets up a unit in a SEZ for manufacturing of cement. It claims 100% deduction of profits, earned from that unit during the financial year and subsequent years per Sec 10AA of the Act.

Would GAAR be invoked in that case?

Solution: *There is an arrangement of setting up a unit in a SEZ which results in tax benefits. However, this is clearly a case of tax mitigation wherein the assessee is taking advantage of a benefit offered to him vide adherence to the conditions so imposed, and the consequences that emanate from it, that is setting up a business in an SEZ area. Hence, the Revenue would not ideally invoke GAAR in this situation.*

2. M/s XYZ Ltd. has 2 factories, one which produces certain goods in a non SEZ area and one in a SEZ area. It diverts produce from the non SEZ factory and shows the same as being manufactured in the SEZ factory, whilst it is only packaging the goods therein. Would GAAR apply in this case?

Solution: *This is a clear case of misrepresentation of facts by showing production of non SEZ units as within the SEZ unit, and hence falls in the bracket of tax evasion and not tax avoidance. Hence, GAAR would not be invoked in this case as GAAR intends to tackle only tax avoidance and not tax evasion.*

3. DEF Ltd. has 2 factories and moves the produce of the non SEZ factory at a price considerably lower than the fair market value, to the SEZ Factory. This lowers the cost of production of the SEZ Factory and the goods are sold from therein after insignificant value addition. Consequently, the SEZ Factory shows higher profits and that entitles the assessee to claim a higher deduction from the computation of Income. Can GAAR be invoked?

Solution: *There is no misrepresentation of facts in this situation and hence there is no tax evasion. In this case the company has tried to shift the profits from a taxable zone to a zone with tax benefits and hence would be dealt with by the transfer pricing regulations. Hence, GAAR will not be invoked in this case.*

LESSON ROUNDUP

- **Transfer Pricing Provisions in India:** The Finance Act, 2001 introduced law of transfer pricing in India through Sections 92 to 92F of the Income Tax Act, 1961 which guides computation of the transfer price and suggests detailed documentation procedures.
- Arm's length price means fair price of goods transferred or services rendered. In other words, the transfer price should represent the price which could be charged from an independent party in uncontrolled conditions. Arm's length price calculation is very important for a company.
- Associated Enterprises has been defined in Section 92A of the Act. It prescribes that “associated enterprise”, in relation to another enterprise, means an enterprise -
 - (a) Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
 - (b) In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

- **"International Transaction"** means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.
- **Specified Domestic transactions:** Finance Act, 2012 has made a very important change and it has extended the applicability of Transfer Pricing Provisions to specified domestic transaction w.e.f. 1st April, 2012.
- **Methods for determination of Arm's Length Price:** Section 92C of Income Tax Act defines the methods which are to be used in determination of Arm's Length prices for International Transaction and specified domestic transaction.
 - (A) Comparable Uncontrolled Price Method (CUP)
 - (B) Resale Price Method (RPM)
 - (C) Cost Plus Method (CPM)
 - (D) Profit Split Method (PSM)
 - (E) Transactional Net Margin Method (TNMM)
 - (F) Such other method as may be prescribed by the Board.
- **Reference to TPO:** Section 92CA of Income Tax Act deals with Reference to Transfer Pricing Officer by assessing officer. It provides that Assessing Officer with prior approval of the Principal Commissioner Commissioner may refer the computation of Arm's Length Price in an International Transaction to transfer pricing officer if he considers it necessary or expedient to do so.
- **Advance Pricing Agreement:** As per Section 92CC of Income Tax Act, 1961, w.e.f. 1st July, 2012, the Central Board of Direct Taxes (Board), with the approval of the Central Government, may enter into an Advance Price Agreement with any person, determining the arm's length price or specifying the manner in which arm's length price is to be determined, in relation to an international transaction to be entered into by that person. Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority(Board) on an appropriate transfer pricing methodology for fixing the arm's length price for a set of transactions over a fixed period of time in future.
- **Documentation:** The legal framework for maintenance of information and documentation by a taxpayer is provided in Section 92D of Income Tax Act, 1961 which lays down that every person who enters into an international transaction or specified domestic transactions shall maintain prescribed information and documents.
- **Certificate:** Form 3CEB contains a certificate from the Accountant that in his opinion proper information and documents as prescribed have been maintained by the taxpayer.
- **Penalty:** Contravention of Transfer Pricing provisions as contained in Chapter X of the Income tax Act, 1961 may invite hefty penalties.
- There was an imminent need of a comprehensive legislation to arrest tax avoidance, and hence GAAR was introduced.

- GAAR however doesn't seek to address Tax Evasion but tackles only tax avoidance.
- Chapter X-A under Income Tax Act, 1961 ('Act') has been inserted to include General Anti-Avoidance Rules ('GAAR') to be applicable from April 1, 2012. Following the report of Dr. Shome Committee, various amendments were carried out under the tax law and clarifications were provided by CBDT through issue of Circular. With effect from April 1, 2017, GAAR have finally become effective.
- Sections 95 to 99 of the Income Tax Act, 1961 read along with the Rule 10 U of the Income Tax Rules seek to address GAAR, how it is attracted and the conditions that need to be fulfilled etc.
- The complexity in the legislation is pronounced in the Supreme Court judgement in the case of Vodafone and it reiterates that the concept is quite complex as there is a thin line between the tax planning and tax avoidance and for that matter between tax avoidance and tax evasion.
- The onus of proof vis-à-vis invoking GAAR rests on the tax authorities.
- Penalties have been provided as one of the consequences of invoking GAAR.
- The provisions currently are quite open ended in some specific places and gives a very high control and power on the tax authorities to invoke GAAR and that may cause a huge unnecessary impact on the businesses especially those that can be brought within the net even though they may have resorted to tax planning.
- SAAR and GAAR can co-exist where applicable and necessary.
- An advance ruling can be sought on the question of whether an arrangement which is proposed to be undertaken by any person being a resident or a non-resident is an impermissible avoidance arrangement.
- GAAR provisions are applicable to all taxpayers irrespective of their residential or legal status (i.e. resident or non-resident, corporate entity or non-corporate entity).
- The Indian GAAR overrides tax treaties, which is consistent with the OECD commentary on anti-avoidance rules.
- For calculation of threshold of INR 30 million (that is, Rs 3 Crores as per the Rules), only the tax benefit enjoyed in Indian jurisdiction due to the arrangement or part of the arrangement is to be considered
- Section 96(2) of the Act makes a rebuttable presumption that an arrangement shall be presumed to have been entered for main purpose of obtaining tax benefit where main purpose of even a single step or of part of that arrangement, is to obtain a tax benefit, notwithstanding the fact that main purpose of whole arrangement is not to obtain tax benefit.
- Section 97(2) of the Act defines round trip financing to include any arrangement in which, through a series of transactions, funds are transferred among the parties to the arrangement and such transactions do not have any substantial commercial purpose other than obtaining the tax benefit.

TEST YOURSELF

These are meant for recapitulation only. Answer to the questions are not to be submitted for evaluation.

1. What is the role of Transfer Pricing Officer? Is it possible for the Assessing Officer to pass the assessment order pertaining to the Assessment Year 2019-20 without considering arm's length price determined by the Transfer Pricing Officer?

2. Explain, with the help of a simple example, the determination of arm's length price where more than one such price is arrived at by the Transfer Pricing Officer by following the most appropriate method.
3. Explain how the arm's length price in relation to an international transaction is computed under the comparable uncontrolled price method as per Rule 10B of the Income-tax Rules, 1962.
4. What is the time limit for completion of assessment in case reference is made to Transfer Pricing officer?
5. What is Transfer Price? Briefly state the importance of Transfer Pricing System.
6. Why do transfer pricing systems exist? What are the criteria to be considered in assessing a system of transfer pricing?
7. Compute the arm's length price (ALP) in the following cases:
 - (a) Medical Instruments Ltd. is a 100% Indian subsidiary of a US company. The parent company sells one of its products to the Indian subsidiary at a price of US \$ 100 per unit. The same product is sold to unrelated buyers in India at a price of US \$ 125 per unit.
 - (b) The US parent company sells the same product to an unrelated company in India @ US \$ 80 per unit.

Answer/Hint:

- (a) ALP = \$ 125 per unit, but transfer pricing provision will not apply as by applying ALP, there will be reduction in taxable income in India; (b) ALP = \$ 80 per unit
8. ABC Ltd. is a company incorporated in India. It sets up a unit in a special economic zone (SEZ) in FY 2013-14 for manufacturing of chemicals. It claims 100% deduction of profits earned from the unit in FY 2020-21 and subsequent years as per section 10AA of the Act. Is GAAR applicable in such a case?
 9. Explain the Concept of GAAR? How it is different from SAAR?
 10. What is impermissible avoidance agreements?
 11. Write short Note:
 - a) GAAR v/s SAAR
 - b) GAAR & BEPS
 - c) Need of GAAR
 12. What are the transactions / cases from exclusions from GAAR

LIST OF FURTHER READINGS

- Taxmann's: Income Tax Act – www.incometaxindia.gov.in
- Taxmann's: Income Tax Rules – www.incometaxindia.gov.in
- Dr. Vinod K. Singhania & Dr. Kapil Singhania: Direct Tax Laws and Practice
- Dr. Girish Ahuja & Dr. Ravi Gupta: Direct Tax Laws and Practice
- Circular's: <https://www.incometaxindia.gov.in/Pages/communications/circulars.aspx>
- Notification's: <https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx>

Double Taxation Avoidance Agreement

Lesson 8

KEY CONCEPTS

■ Tax Treaty ■ Double Taxation ■ Source Rule Based Taxation ■ Residence Rule Based Taxation

Learning Objectives

To understand the:

- What is Tax Treaty?
- Source Rule v/s Residence Rule based Taxation
- Types of Double Taxation
- Objectives and Need of DTAA
- Provisions relating to double taxation relief
- Double taxation relief where there is no DTAA

Lesson Outline

- Introduction
- Double Taxation
- Juridical Double Taxation
- Economic Double Taxation
- Type of DTAA
- Double Taxation Relief
- Bilateral Relief from Double Taxation
- Unilateral Relief from Double Taxation
- Calculation of Relief from Double Taxation
- Necessity for DTAA
- Objectives of Tax Treaties
- Interpretation of Tax Treaties
- Case Law
- Lesson Roundup
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

Sections	Income Tax Act, 1961
Section 90	Agreements with Foreign Countries or Specified Territories
Section 90A	Adoption by Central Government of Agreement between Specified Associations for Double Taxation Relief
Section 91	Double Taxation Relief when there is no agreement exists
Rules	Income Tax Rules, 1962
Rule 21AB	Information to be provided by the Assessee not being a resident in India and Tax Residency Certificate for residents

INTRODUCTION

In today's scenario, the taxation is one of the important factors that has to be taken into consideration for any investment decision in any countries. Many countries have entered into Tax Treaties (also called Double Tax Avoidance Agreements, or DTAA's) with other countries to avoid or mitigate *double taxation*. Such treaties may cover a range of taxes including *Income or Revenue Taxes, GST, Value Added Taxes*, or other taxes.

The stated goals for entering into a Tax Treaty often include *reduction of double taxation, eliminating tax evasion, and encouraging cross-border trade efficiency*. It is generally accepted that Tax Treaties improve certainty for taxpayers and tax authorities in their international dealings. The application of the Tax Treaty signifies that the parties intend to create rights and obligations enforceable under international law.

A "tax treaty" is a Bilateral Agreement made by two countries to resolve issues involving Double Taxation of Passive as well as Active Income. Tax treaties generally determine the amount of tax that a country can levy to a taxpayer's income, capital.

"A tax treaty is also called a Double Tax (Avoidance) Agreement (DTAA)"

Article 2 of Vienna Convention on Law of Treaties, 1969 defines a "treaty" as an international **agreement** concluded between States **in written form and governed by international law**, whether embodied in a **single instrument or in two or more related instruments** and whatever its particular designation

(Vienna Convention on Law of Treaties, 1969: https://legal.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf)

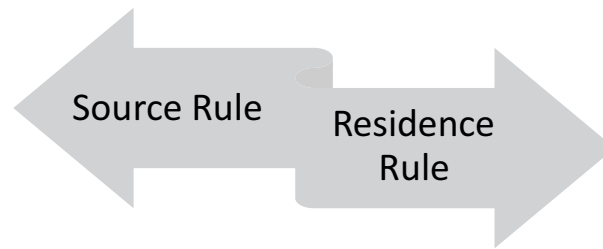
"Tax Treaty" represents various compromises agreed upon by the respective Contracting States depending upon the economic expediency of a particular country.

Tax, in the country of source is considered as a cost, whereas the same is an obligation in the country of residence. Double Tax Avoidance Agreements come into play to mitigate hardship caused by subjecting the same income to double taxation. DTAA's attempt to eliminate double taxation at a tolerable level

Where a taxpayer is resident in one country but has a source of income situated in another country, it will be a situation of double taxation for the taxpayer.

The taxability of a foreign entity in any country around the globe depends upon two distinct factors, namely, whether it is doing business **with that country or in that country**.

The term used to determine the jurisdiction/nexus for taxation is "connecting factors". There are two types of connecting factors, namely, "Residence" and "Source". It means a company can be subject to tax either on its residence link or its source link with a country.



The **Source Rule** holds that income is to be taxed in the country in which it originates irrespective of whether the income accrues to a resident or a non-resident whereas the **Residence Rule** stipulates that the power to tax should rest with the country in which the taxpayer resides.

If both rules apply simultaneously to a business entity and it were to suffer tax at both ends, the cost of operating on an international scale would become prohibitive and would deter the process of globalisation. It is from this point of view that Double Taxation Avoidance Agreements (DTAA) becomes very significant.

'In India the residential status is the key point for determination of Income Tax'

As per the provisions of Section 5 read with Section 6/7/9 of the Income Tax Act, 1961. In case of Residents their global income (i.e., Indian Income as well as Foreign Income) is taxable in India whereas in case of Non-Residents only Indian Income (source-based income) is taxable. So, we can say that in India residence rule is applied for residents whereas source rule is applied for Non-residents. The residential status of a person is determined based on the provisions of Section 6 of Income Tax Act, 1961.

DTAAs lay down the allocation rules for taxation of the income by the source country and the residence country. Such rules are laid for various categories of income, such as, interest, dividend, royalties, capital gains, business income etc. Each such category is dealt with by separate article in the DTAA.

Many a times, it is seen that in case of residents, the income tax has been paid in other countries on their income abroad (i.e., Foreign Income) and on the same income they are also required to pay tax in India. It is a universally accepted principle that the same income should not be subjected to tax twice. In such cases, there are provisions of providing relief from double tax under Income Tax Act, 1961.

DOUBLE TAXATION

Double taxation occurs when an assessee is required to pay two or more taxes for the same income, asset, or financial transaction in different countries. Double taxation occurs mainly due to overlapping tax laws and regulations of the countries where an individual operates his business. Double taxation Agreement is the systematic imposition of two or more taxes on the same income. The double liability is often mitigated by tax agreements, known as treaties, between countries.

Juridical Double Taxation

Juridical double taxation refers to circumstances where a taxpayer is subject to tax on the same income (or capital) in more than one jurisdiction. For example, a resident of Canada who is also considered to be a resident of the United States would be potentially subject to concurrent full taxation in both countries. Bilateral Tax Treaties generally tend to eliminate (or at least reduce) the possibility of juridical double taxation.

For example, X Ltd. is a resident of India. It has set up a branch in USA. Here, India would be the country of residence for X Ltd. whereas USA would be the country of source. USA would tax the profits earned by the branch of X Ltd. located in USA, whereas X Ltd. would be taxed on worldwide basis in India on the basis of residence, including profits of its USA branch.

However, X Ltd. can claim relief in respect of taxes paid in USA while filing its tax return in India under the *Indo-USA Double Taxation Avoidance Agreement*.

If, instead of USA, X Ltd. has a branch in Hong Kong, then it can claim unilateral relief under section 91 of the Act, 1961 in respect of taxes paid by its Hong Kong branch as India does not have a tax treaty with Hong Kong as the tax treaty with China does not apply to Hong Kong.]

(*Bilateral & Unilateral Tax Relief discussed in subsequent paras of this chapter)

Country wise Double Taxation Avoidance Agreements entered by INDIA :

<https://incometaxindia.gov.in/pages/international-taxation/dtaa.aspx>

Economic Double Taxation

Economic Double Taxation refers to the taxation of two different taxpayers with respect to the same income (or capital).

Economic Double Taxation explained via example, corporate profits may be taxed first when earned by the corporation (corporation tax) and again when the profits are distributed to shareholders as a dividend or other distribution (dividend tax), when income earned by a corporation is taxed both to the corporation and to its shareholders when distributed as a dividend. (*Dividend Distribution Tax is abolished vide Finance Act, 2020*)

TYPES OF DTAA'S

- Limited DTAA's – DTAA's which are limited to certain types of income only.
- Comprehensive DTAA's – DTAA's cover almost all types of incomes covered under any model convention.

DOUBLE TAXATION RELIEF

Relief from Double Taxation can be provided in two ways

1. BILATERAL RELIEF
2. UNILATERAL RELIEF

BILATERAL RELIEF FROM DOUBLE TAXATION

Under Section 90, the Indian government offers protection against double taxation by entering into a DTAA with another country, based on mutually acceptable terms. India has entered into DTAA's with 90+ Countries. Such relief may be offered under two methods:

1. **Exemption method** - A particular income is taxed in one of the both countries and exempted in the other country.
2. **Tax Credit method** - The income is taxed in both the countries as per their respective taxation laws read with the treaty/DTAA and the country of residence will allow the tax credit / reduction for the tax charged in the country of source.

For example: Mr. A (an Indian resident) has received salary from a US company for job in US. Since Mr. A is a resident so his global Income will be taxable. In this case source country is US (since the service has been rendered in US) and resident country is India. So, at the time of computation of tax liability of Mr. A, the tax paid in US will be allowed as set off against his total tax liability but limited to the tax payable on such foreign income at Indian tax rates as per Income Tax Law.

India follows Tax Credit Method in majority of its DTAA's

In case where Bilateral agreement has been entered u/s 90 with a foreign country then the assessee has an option either to be taxed as per the Double Taxation Avoidance Agreement (hereinafter referred as “DTAA”) or as per the normal provisions of Income Tax Act 1961, whichever is more favourable to assessee. [CIT Vs ITC Ltd. (2002)]

For example: As per DTAA between Indian and Germany, tax on Interest is specified @ 10% whereas under Income Tax Act 1961, it depends on slab rates for individuals & HUF and flat rates (generally 30%) for other assessee. Hence one can follow DTAA and pay tax @ 10% only.

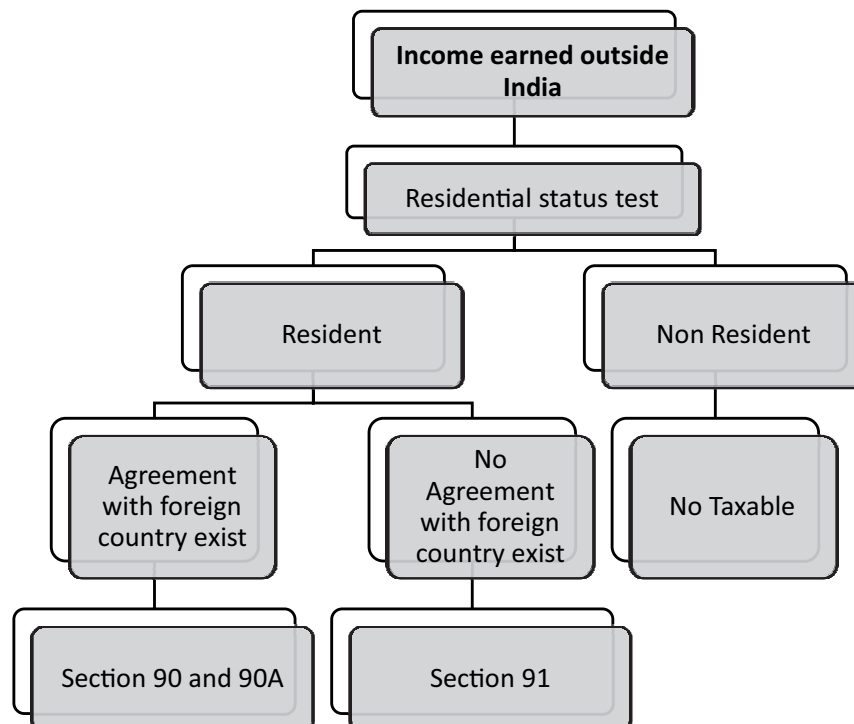
UNILATERAL RELIEF FROM DOUBLE TAXATION

Under Section 91, the Indian government can relieve an assessee from double taxation irrespective of whether there is a DTAA between India and the other country concerned. Unilateral relief may be offered to a tax payer if:

- (1) The person or company has been a resident of India in the previous year.
- (2) The same income must be accrued to and received by the tax payer outside India in the previous year.
- (3) The income should have been taxed in India and in another country with which there is no tax treaty.

The person or company has paid tax under the laws of the foreign country in question.

Sections 90, 90A and 91 of the Income-tax Act, 1961 provide for double taxation relief in India. The application of section 90/90A and 91 can be explained with the help of the following diagram.



As can be seen from the above diagram that section 90/90A is applicable in cases where India has entered into an agreement with other country and section 91 is applicable in case where there is no such agreement.

Both Section 90 and 90A of Income Tax Act, 1961 provides Bilateral Relief of Double Taxation.

AGREEMENTS WITH FOREIGN COUNTRIES OR SPECIFIED TERRITORIES OUTSIDE INDIA – BILATERAL RELIEF [SECTION 90]

Section 90 of the Income Tax Act, 1961 empowers the Central Government to enter into an agreement with foreign country or specified territory outside India for the purpose of providing relief from double taxation.

Section 90 is associated with relief measures for assessee involved in paying taxes twice i.e., paying taxes in India as well as in Foreign Countries or a territory outside India. It also contains provisions which will certainly enable the Central Government to enter into an agreement with the Government of any country outside India or a definite territory outside India. Section 90 is intended for granting relief with reference to any of the following **(Objectives)** relevant situations that may occur:

- Income on which tax has been paid both under Income Tax Act, 1961 and Income Tax prevailing in that country or definite territory.
- Income tax chargeable under Income Tax Act, 1961 and according to the corresponding law in force in that country or specified territory to boost mutual economic relations, trade and investment.
- For the prevention of double taxation of income under Income Tax Act, 1961 and under the equivalent law in force in that country or specified territory.
- For exchange of information regarding the avoidance of evasion or avoidance of income tax chargeable as per Income Tax Act or under the law in force in that country or specified territory, or investigation of cases of evasion or avoidance.
- For recovery of income tax under Income Tax Act and under the law in force in that country of the specified territory.

The double tax relief as per Section 90 can be claimed only by the residents of the countries who have entered into the agreement. If a resident of other countries wants to claim relief related to the phenomenon of double taxation, then they have to obtain a Tax Residence Certificate (TRC) from the Government of the particular country.

Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India for granting relief of tax, avoidance of double taxation, then, the provisions of Income Tax Act, 1961 shall apply to the assessee to whom such agreement applies, to the extent they are more beneficial to him. However, the provisions of chapter XA of the act shall apply to the assessee even if such provisions are not beneficial to him.

In case of an assessee, not being a resident in India, the benefit of double taxation agreement or tax treaty shall be applicable only when a tax residency certificate is obtained of his resident in any country outside India or specified territory outside India from the Government of that country or specified territory. [Section 90(4)]

ADOPTION BY CENTRAL GOVERNMENT OF AGREEMENT BETWEEN SPECIFIED ASSOCIATIONS FOR DOUBLE TAXATION RELIEF [SECTION 90A]

The Central Government is empowered by section 90A to enter into an agreement with any specified association in the specified territory outside India and the Central Government has been authorized to make such provisions as may be necessary for adopting and implementing such agreement.

The provisions may be made **(Objective)** for granting relief in respect of:

- income on which tax have been paid both under Income Tax Act, 1961 and Income-Tax Act prevailed in that specified territory; or
- income-tax chargeable under Income-tax Act, 1961 and under the corresponding law in force in that specified territory to promote mutual economic relations, trade and investment; or

- for the avoidance of double taxation of income under Income-tax Act, 1961 and under the corresponding law in force in that specified territory outside India; or
- for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under Income Tax Act, 1961 or under the corresponding law in force in that specified territory, or investigation of cases of such evasion or avoidance, or
- for recovery of Income-tax under Income Tax Act, 1961 and under the corresponding law in force in that specified territory outside India.

Where the Central Government has entered into an agreement with the specified association of any specified territory outside India for granting relief of tax, avoidance of double taxation, then, the provisions of Income Tax Act, 1961 shall apply to the assessee to whom such agreement applies, to the extent they are more beneficial to him.

However, the provisions of chapter X-A of the act shall apply to the assessee even if such provisions are not beneficial to him.

Where the assessee, being not resident in India, the benefit of double taxation agreement or tax treaty shall be applicable only when a tax residency certificate is obtained of his resident in any country outside India or specified territory outside India from the Government of that country or specified territory. [Section 90A(4)].

In addition to such certificate Section 90(5)/90A(5) requires the assessee to provide such other documents and information as may be prescribed for claiming benefits of the DTAA

“Specified Association” means any institution, association or body whether incorporated or not, functioning under any law for the time being in force India or the laws of specified territory outside India and which may be notified as such by the Central Government.

“Specified Territory” means any area outside India which may be notified as such by the Central Government for the purpose of section 90A of the Income Tax Act, 1961.

Where any “term” used in avoidance of double taxation agreement entered into under section 90(1) and 90A(1) is defined under the said agreement, the said term shall be assigned the meaning provided in the said agreement. Where, however, the term is not defined in avoidance of double taxation agreement, but is defined in the Act, it shall be assigned the meaning as defined in the act or explanation, if any, issued by the Central Government.

Information to be provided by the Assessee not being a resident in India and Tax Residency Certificate for residents [Rule 21AB]

1	The assessee, not being resident in India, shall provide the following information in Form No. 10F, namely: i. Status (individual, company, firm etc.) of the assessee; ii. Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others) iii. Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident; iv. Period for which the residential status, as mentioned in the certificate; and v. Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (iv) above, is applicable.

2	The assessee may not be required to provide the information or any part thereof referred to in sub-rule (1) if the information or the part thereof, as the case may be, is contained in the tax residency certificate.
2A	The assessee shall keep and maintain such documents as are necessary to substantiate the information provided under sub-rule (1) and an income-tax authority may require the assessee to provide the said documents in relation to a claim by the said assessee of any relief under an agreement.
3	An assessee, being a resident in India, shall, for obtaining a certificate of residence for the purposes of an agreement referred to in section 90 and section 90A, make an application in Form No. 10FA to the Assessing Officer.
4	The Assessing Officer on receipt of an application referred to in sub-rule (3) and being satisfied in this behalf, shall issue a certificate of residence in respect of the assessee in Form No. 10FB.

#Circular No. 333 dated 2.4.1982, issued by CBDT provides that a specific provision of the DTAA will prevail over the general provisions of the Income-tax Act, 1961. However, where there is no specific provision in the treaty, then the Income-tax Act will apply. Generally, DTAA only provides for distribution of taxing rights between the residence and the source state. The computation mechanism is usually not provided under DTAA and the same is governed by the domestic tax law of each country

Statement:

The DTAA's entered into by the Govt. of India override the Domestic Law

The above Statement is Correct.

Section 90(2) provides that where a DTAA is entered into by the Government, the provisions of the Income Tax Act, 1961 would apply to the extent they are more beneficial to the assessee.

In case of any conflict between the provisions of the DTAA and the Income Tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee [**CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)**].

DOUBLE TAXATION RELIEF WHERE THERE IS AN NO DTAA AGREEMENT [SECTION 91]

If any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no agreement under section 90 for the relief or avoidance of double taxation, income-tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

If any non-resident person is assessed on his share in the income of a registered firm assessed as resident person in India in any previous year and such share includes any income accruing or arising outside India during that previous year (and which is not deemed to accrue or arise in India) in a country with which there is no agreement under section 90 for the relief or avoidance of double taxation and he proves that he has paid income tax by deduction or otherwise under the law in force in that country in respect of the income so included he shall be entitled:

- to a deduction from the Indian Income Tax payable by him or a sum calculated on such doubly taxed income so included

- at the Average Indian Tax Rate or
- the Average Foreign Tax Rate,

Whichever is lower or at the Indian Tax Rate if both the rates are equal.

Indian Tax on Doubly Taxed Income :

$$\frac{\text{Tax on Total Income in India} \times \text{Doubly Taxed Income}}{\text{Total Income in India}}$$

Foreign Tax on Doubly Taxed Income :

$$\frac{\text{Tax Paid in Foreign Country} \times \text{Doubly Taxed Income}}{\text{Total Income in Foreign Country}}$$

CALCULATION OF RELIEF FROM DOUBLE TAXATION

The process which is generally adopted by the authorities in order to grant bilateral relief under Section 90 and 90A is (i.e., when there is DTAA Agreement):

Compute the total income of person liable to tax in India in accordance with the provision of the Income-tax Act.

Allow relief as per the terms of the tax treaty entered into with the other contracting country or specified territory, as the case may be, where the income has suffered double taxation.

The process which is generally adopted by the authorities in order to grant bilateral relief under Section 91 is (i.e., when there is NO DTAA Agreement)

Step 1	Calculate tax on total income inclusive of the foreign income on which relief is available. Claim any relief allowable under the provision of this Act but before relief due under sections 90, 90A and 91
Step 2	Add surcharge (if applicable @ applicable rates) + HEC @ 4%.
Step 3	Calculate the average rate of tax by dividing the tax computed under Step 2 with the total income (inclusive of such foreign income).
Step 4	Calculate the average rate of tax of the foreign country by dividing income tax actually paid in the said country after deducting all relief due. This should be done before deduction of any relief due in the said country in respect of double taxation by the whole amount of the income as assessed in the said country
Step 5	Claim the relief from the tax payable in India at the rate calculated at Step 3 or Step 4, whichever is less.

Illustration 1:

Mr. Raja, an individual resident retired employee of the XY Label Ltd aged 61 years, is a well-known Singer deriving income of INR 1,10,000 from Stage Shows Abroad. Tax of INR 11,000 was deducted in the country where the Shows were performed. India does not have any Double Tax Avoidance Agreement with that Country. His income in India amounted to INR 6,10,000.

In view of tax planning, he has deposited INR 1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC INR 32,000. He also contributed INR 28,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of INR 26,000 to insure the health of her mother, a non-resident aged 80 years, who is not dependent on her. Compute the tax liability of Mr. Raja for the Assessment year 2026-27, assuming that he has opted out of the default tax regime under Section 115BAC.

Solution:**Computation of tax liability of Mr. Raja for the A.Y. 2026-27 under normal provisions of the Act**

Particulars	Amount (INR)	Amount (INR)
INDIAN INCOME		6,10,000
FOREIGN INCOME		1,10,000
GROSS TOTAL INCOME		7,20,000
Less: Deductions under chapter VI-A		
Deposit in PPF (Section 80C)	1,50,000	
Contribution to Approved Pension Fund of LIC (Section 80CCC)	32,000	
Aggregate Deduction u/s 80C and 80CCC restricted to 1,50,000 (Section 80CCE)		(1,50,000)
Contribution to CGHS (Section 80D)	28,000	
Medical Insurance Premium on health of Mother, Non-Resident – 26,000 (restricted to 25,000)	25,000	(53,000)
TOTAL INCOME		5,17,000
Tax On Total Income		
Income Tax (As per Slab Rates for AY 2026-27)		13,400
Add: HEC @ 4%		536
Total Tax		13,936

Average Rate of Tax in India (i.e. $13,936 / 5,17,000 \times 100$)	2.296%	
Average Rate of Tax in Foreign Country (i.e. $11,000 / 1,10,000 \times 100$)	10%	
Relief under Sec. 91 on 1,10,000 @ 2.696% (lower of Avg Indian Tax Rate or Avg Foreign Tax Rate)	2.296%	(2,966)
TAX Payable in INDIA (13,936 – 2966)		10,970

NECESSITY FOR DTAA

1. The need for Double Taxation Avoidance Agreement (DTAA) arises because of rules in two different countries regarding chargeability of income based on receipt and accrual, residential status etc.
2. Double taxation is frequently avoided through DTAA entered into by two countries for the avoidance of double taxation on the same income.
3. The DTAA eliminates or mitigates the incidence of double taxation by sharing revenues arising out of international transactions by the two contracting states of the agreement.
4. As there is no clear definition of income and taxability thereof, which is accepted internationally, an income may become liable to tax in two countries.
5. In such a case, the possibilities are as under:
 - The income is taxed only in one country.
 - The income is exempt in both countries.
 - The income is taxed in both countries, but credit for tax paid in one country is given against tax payable in other country.

If the two countries do not have DTAA then in such a case, the domestic law of the country will apply. In the case of India, the provisions of Section 91 of the Income Tax act will apply. The CBDT has clarified vide circular no. 333 dated 2nd April, 1982 that in case of a conflict in the provisions of the agreement of Tax Avoidance of double taxation and the Income Tax Act, the provisions contained in the Agreement for Double Tax Avoidance will prevail.

OBJECTIVES OF TAX TREATIES

There are two influential model tax conventions - the United Nations Model Convention and OECD Model Convention. In addition, many countries have their own model tax treaties, which are often not published but are provided to other countries for the purpose of negotiating tax treaties.

The United Nations Model Convention draws heavily on the OECD Model Convention. Objectives for signing a tax treaty also play a significant role in its interpretation as they determine the context in which a particular treaty is signed. Organisation for Economic Co-operation and Development 'OECD' and UN Model Conventions have different objectives to achieve as mentioned below:

1. **OECD Model Convention:** Principal objective of double taxation conventions is to promote, by eliminating international double taxation, exchange of goods and services, movement of capital and person. Also to prevent tax avoidance and evasion.

2. UN Model Convention: The principal objectives of UN Model Conventions are as follows:

- To Protect tax payer from double taxation
- To encourage free flow of international trade and investment
- To encourage transfer of technology
- To prevent discrimination between taxpayer
- To provide a reasonable element of legal and fiscal certainty to investors and traders
- To arrive at an acceptable basis to share tax revenues between two states
- To improve the co-operation between taxing authorities in carrying out their duties.

3. Indian Tax Treaties: The principal objectives of Indian Tax Treaties are as follows:

- a) for granting relief in respect of:
 - income on which tax have been paid both under Income Tax Act, 1961 and Income-Tax Act prevailed in that country; or
 - income-tax chargeable under Income Tax Act, 1961 and under the corresponding law in force in that country to promote mutual economic relations, trade and investment; or
- b) for the avoidance of double taxation of income under Income Tax Act, 1961 and under the corresponding law in force in that country; or
- c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under Income Tax Act, 1961 or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or
- d) for recovery of income-tax under Income Tax Act, 1961 and under the corresponding law in force in that country.

CONCEPT OF PERMANENT ESTABLISHMENT

As per the provisions of the Income-tax Act, 1961, the taxability of business profits is determined by existence of business connection in India under section 9(1)(i) of the Income Tax Act, 1961.

Whereas, Under the DTAA, taxability of business profits is determined by existence of a Permanent Establishment (PE) in India.

It may be noted that the scope of business connection under section 9(1)(i) is wider than that of a PE.

Article 5(1) of the DTAA usually provides that for the purpose of this convention, the term 'Permanent Establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

The term PE is also defined under section 92F(iia) to include a fixed place of business through which the business of the enterprise is wholly or partly carried on.

According to Article 5(2), the term PE includes a Place of Management, Branch, Factory, Office, Workshop, Warehouse, Sales Office, Mine, Oil or Gas Well any other place of extraction of natural resources.

- Permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
- Every DTAA has a specific clause, which will deal with an explanation of permanent establishment for the purpose of such DTAA.

- Business Income of a non-resident will not be taxed in India, unless such non-resident has a permanent establishment in India.
- Taxability of income under business connection and permanent establishment is explained here below

Illustration:

The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Examine the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements.

Solution:

Double Taxation Avoidance Agreements (DTAAs) generally contain an Article, providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment.

As per Section 92F(iii), the term “Permanent Establishment” includes a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs, however, provide that business income is taxable only if there is a permanent establishment in India.

As per Section 90(2), the provisions of the Income-tax Act, 1961 or the DTAA, whichever is beneficial, shall apply. The PE concept is narrower than the business connection concept. Therefore, in a case where the Indian Government has entered into DTAA with a country, unless and until the PE test is satisfied, the business income would not be taxable in the source country.

However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

ARTICLE 64**EMERGENCE OF A NEW PEREMPTORY NORM OF GENERAL INTERNATIONAL LAW (“JUS COGENS”)**

If a new peremptory norm of general international law emerges, any existing treaty which is in conflict with that norm becomes void and terminates.

(Vienna Convention on Law of Treaties, 1969: https://legal.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf)

Significant Articles covered in the Model Conventions

Article 1	Persons Covered The OECD and UN Model Convention covers or applies to persons who are resident of one or both of the contracting states
Article 2	Taxes Covered The OECD and UN Conventions would apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

Article 4	Residence A taxpayer has to demonstrate that he is a resident of one or both Contracting States to be able to gain access to a tax treaty and avail the benefits thereunder. The term “resident of a contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein. Where by reason of the provisions of as stated above, an individual is a resident of both contracting States, then his status shall be determined as follows: (a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests); (b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode; (c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national; (d) if he is a national of both States or of neither of them, the competent authorities of the contracting States shall settle the question by mutual agreement. Where by reason of the provisions, a person other than an individual is a resident of both contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated. <i>Note:</i> A person shall be entitled to a tax treaty benefits only if he is a resident of one of the contracting states. Article 4 of the tax treaty deals with residential status of a person, it does not provide rules for determination of the residence. Instead, it refers to the determination of residence in accordance with the provisions of domestic tax law of the respective contracting states. Therefore, the primary requirement is for a person to qualify as a resident under the law of the concerned contracting state.
Article 5	Permanent Establishment Discussed earlier in this chapter
Article 6	Income from immovable property;
Article 7	Business profits Business profits of an enterprise can only be taxed by the Residence State. Right of Source State to tax business profits of an enterprise only exists if a PE exists in its jurisdiction. As per the approach under the OECD Model Convention, once a PE is proven, the Source State can tax only such profits as are attributable to the PE. The UN Model Convention amplifies this attribution principle by a limited Force of Attraction rule (FOA).
Article 8	Income from the operation of ships or aircraft in international traffic and boats in inland waterways transport

Article 9	Profits of associated enterprises and transfer pricing
Article 10	Dividends
Article 11	Interest Generally, the interest is taxed in the Source State at a given rate on gross basis. However, if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged cannot exceed a specified percentage of the gross amount of the interest. The OECD Model specifies the percentage as 10%, but the UN Model leaves this percentage to be established through bilateral negotiations.
Article 12	Royalties As per the OECD Model, royalties arising in the Source State and beneficially owned by a resident of the Residence State are taxable only in the Residence State. However, the UN Model provides that royalties may be taxed in the Residence State. Hence, the UN Model departs from the principle of exclusive right to tax provided to Residence State in the OECD Model. Thus, under the UN Model, the Source State may also tax royalties. However, if the beneficial owner is a resident of the Residence State, the tax charged by the Source State cannot exceed the specified percentage of the gross amount of royalties. This specified percentage is to be established through bilateral negotiations.
Article 12A	Fees for Technical Services The UN Model has a specific article pertaining to Fees for Technical Services (FTS). Paragraph 1 of Article 12A provides that the FTS may be taxed in the Residence State but does not provide that the FTS is exclusively taxable in the Residence State. Paragraph 2 establishes the right of the country in which FTS arises to tax in accordance with its domestic law, subject to the limitation on the maximum rate of tax on gross amount of the fees, if the beneficial owner is a resident of the other Contracting State. The maximum rate of tax is to be established through bilateral negotiations.
Article 12B	Income from Automated Digital Services (ADS) Article 12B was added to the United Nations Model Tax Convention in its 2021 update to preserve the domestic law taxing rights for States from which payments for automated digital services are made. There is no article in the OECD Model corresponding to Article 12B. Examples of ADS – supply of user data, online search engines, social media platforms, online gaming, digital content services, online advertising services etc (As Per Para 6)
Article 13	Capital Gains This is the most commonly used Article and it provides for the taxation of income arising from transfer of a capital asset, including transfer of shares. The right to tax income from capital gains may be exclusively with the Residence State, or shared between the Residence and Source States.

Article 14	Independent Personal Services Article 14 is only present in the UN Model. It was deleted from the OECD Model on 29-4-2000 on the basis of OECD Report (2000) on “Issues Related to Article 14 of the OECD Model Tax Convention”. The Effect of deletion of Article 14 is that income derived from Professional Services etc., is now dealt with as ‘Business Profits’ (Article 7) under the OECD MC.
Article 15	Income from Employment
Article 16	Directors’ fees and remuneration of top-level managerial officials
Article 17	Income derived by artistes (entertainers) and athletes
Article 18	Pensions and social security payments
Article 19	Income derived by Government Employees
Article 20	Income derived by students, business trainees and apprentices
Article 21	Other income; in other words, income not dealt with in Articles 6-20 This Article deals with taxation of items of income which are not specifically taxable under any other specific Article. Key differences are as under: • OECD approach envisages that the exclusive right to tax is with the Residence State. UN Model contains an additional paragraph, Article 21(3), which provides that Source State may also tax other income. • Article 21(2) of both OECD and UN Model provides that for income effectively connected with a PE maintained in a Contracting State by a resident of the other Contracting State, taxation is governed by the provisions of Article 7 (Business Profits). Additionally, UN Model provides that if the aforesaid income is effectively connected with a fixed base situated in a Contracting State by a resident of the other Contracting State, taxation would be governed by the provisions of Article 14 (Independent personal services).
Articles 23A & 23B	Elimination of Double Taxation
Article 25	Mutual Agreement Procedure There may be a situation wherein a tax payer may believe that the treatment accorded by either or both Contracting States is not in accordance with the provisions of the tax treaty. In such a case, there is a need for dispute resolution which is addressed by this Article

Students are advised to go through the Significant Articles covered in the Model Conventions through following links for additional knowledge:

- https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf
- https://www.oecd.org/en/publications/2017/12/model-tax-convention-on-income-and-on-capital-condensed-version-2017_g1g8769b.html

INTERPRETATION OF TAX TREATIES

Tax treaties are signed between two independent nations by competent authorities under delegated powers from the respective Governments. Thus, an international agreement has to be respected and interpreted in accordance with the rules of International Law as laid down in the Vienna Convention on Law of Treaties (VCLT). VCLT is a multilateral Treaty signed and ratified by several countries, which codifies the international law for interpretation of tax treaties

These rules of interpretation are not restricted to tax treaties but also apply to any treaty between two countries. Therefore, any dispute between two nations in respect of Article 25 relating to Mutual Agreement Procedure of the OECD/UN Model Conventions has to be solved in the light of the VCLT.

However, when it comes to application of a tax treaty in the domestic forum, the appellate authorities and the Courts are primarily governed by the laws of the respective countries for interpretation.

In India, even before insertion of Section 90(2) by the Finance (No.2) Act, 1991, with retrospective effect from 1-4-1972, CBDT had clarified vide Circular No. 333 dated 2-4-1982 that where a specific provision is made in the DTAA, the provisions of the DTAA will prevail over the general provisions contained in the act and where there is no specific provision in the DTAA, it is the basic law, i.e., the provisions of the Act, that will govern the taxation of such income.

The Income-tax Act, 1961 provides that where the Indian Government has entered into DTAA's which are applicable to the taxpayers, then, the provisions of the act shall apply to the extent they are more beneficial to the taxpayer. Internationally, this situation is known as "Monist View" wherein International and National laws are part of the same system of law, where DTAA overrides domestic law. Some other countries which follow such a system are: Argentina, Italy, Netherlands, Belgium and Brazil.

The other prevalent view is known as "Dualistic View" wherein International Law and National Law are separate systems and DTAA becomes part of the national legal system by specific incorporation/legislation. In case of Dualistic View, DTAA's may be made subject to provisions of the National Law. Some of the countries that follow Dualistic View are Australia, Austria, Norway, Germany, Sri Lanka, and UK.

Interpretation of any statute, more so International tax treaties requires that we follow some rules of interpretation. In subsequent paragraphs, we shall deal with rules of interpretation of tax treaties.

The interpretation of tax treaties bears certain similarities to that of domestic tax legislation. For example, the meaning of the words, the context in which they are used, and the purpose of the provision are generally important in interpreting both treaties and domestic tax legislation. There may be a tendency for tax authorities and Courts to interpret tax treaties in the same way as domestic tax legislation. There are, however, several important differences between tax treaties and domestic tax legislation:

- (a) Because two contracting States are involved in every treaty, questions of interpretation should be resolved by reference to the mutual intentions and expectations of both of them;
- (b) Tax treaties are addressed to a broader audience than domestic legislation, namely, to both the Governments and taxpayers of each country;
- (c) Tax treaties are often not drafted using the same terms as domestic legislation. For example, the United Nations Model Convention uses the term "enterprise," which is not used in the domestic legislation of many countries;
- (d) Tax treaties are primarily relieving in nature, as discussed above; they do not impose tax;
- (e) The United Nations and OECD Model Conventions and Commentaries thereon have no counterparts in the context of domestic tax legislation.

As tax treaties are treaties, their interpretation is governed by the Vienna Convention on the Law of Treaties (Vienna Convention), which applies to all treaties, not just tax treaties. Many countries have signed it and are bound by its terms. However, even countries that have not done so may be bound by its provisions because they represent a codification of customary international law, which is binding on all nations.

The basic / general rule of interpretation in Article 31 (1) of the Vienna Convention provides as follows:

A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.

The context under Article 31 (2) includes the text of the treaty and any agreements between the parties made in connection with the conclusion of the treaty and any instrument made by one of the parties and accepted by the other party.

For example, the United States produces a technical explanation for each of its tax treaties, and Canada publicly announced its acceptance of the United States technical explanation of the United States-Canada treaty.

In addition, under Article 31 (3), subsequent agreements between the parties and subsequent practice with respect to the interpretation of the treaty and any applicable rules of international law must be taken into account together with the context. Therefore, for example, if the competent authorities of the two States enter into an agreement concerning the interpretation of the treaty, the agreement should be taken into account for purposes of interpreting the treaties in the same way as if it were included in the treaty itself.

Under Article 32 of the Vienna Convention, other elements, referred to as supplementary means of interpretation, which include the preparatory work of the treaty and the circumstances of its conclusion, are only to be considered to confirm the meaning established pursuant to Article 31, or to establish the meaning if Article 31 produces an ambiguous, obscure, absurd or unreasonable result.

It is important that tax treaties be interpreted the same way in both countries (the principle of common interpretation) because otherwise income may be taxed twice or not at all. Assume, for example, that S, a resident of country A, performs services in country B for more than 183 days for the benefit of corporation C. The services result in the creation of some work product used by corporation C. S receives a payment from corporation C that is characterized under the laws of country B as compensation for performing services in country B. In contrast, Country A characterizes the payment as a royalty for allowing corporation C to use S's work product. Under the tax treaty between the two countries, fees for personal services are taxable in the source State and royalties are taxable exclusively in the residence State (as they are under Article 12 (Royalties) of the OECD Model Convention). Under these circumstances, S will be subject to double taxation unless the competent authorities of the two countries can resolve the matter.

In addition to the provisions of the Vienna Convention, tax treaties based on the United Nations and OECD Model Conventions contain an internal rule of interpretation. Article 3 (2) (General definitions) of the United Nations and OECD Model Conventions provides that any undefined terms used in a treaty should be given the meaning that they have under the domestic law of the country applying the treaty unless the context requires otherwise. Thus, the application of Article 3 (2) involves a three-stage process:

- (a) Does the treaty provide a definition of the term?
- (b) If the treaty does not provide a definition, what is the domestic meaning (not necessarily the definition under domestic law) of the term?
- (c) Does the context of the treaty require a meaning different from the domestic meaning?

The determination of the meaning of a term under domestic law also may be difficult. Domestic tax legislation is generally imposed on the legal consequences of transactions and the legal status of persons under the general law.

Article 3 (2) explicitly recognizes that the domestic meaning of a term used in a treaty may be derived from the general domestic law rather than the domestic tax law. Where, however, the domestic tax law provides a meaning for an undefined treaty term, Article 3 (2) provides that the meaning of the term under a country's tax law prevails over the meaning under other domestic laws. An undefined term, however, may have more than one meaning for purposes of a country's tax law. In this situation the domestic meaning that is most appropriate should be used in the context of the treaty.

Another important and controversial issue of interpretation in connection with Article 3 (2) of the United Nations and OECD Model Conventions is whether a term has its meaning under domestic law at the time that the treaty was entered into (the static approach) or its meaning under the domestic law as amended from time to time (the ambulatory approach). Article 3 (2) of the OECD Model Convention was amended in 1995 to make it clear that Article 3 (2) should be applied in accordance with the ambulatory approach. A similar conforming amendment was made to the United Nations Model Convention 2001. The ambulatory approach allows treaties to accommodate changes in domestic law without the need to renegotiate the treaty. A drawback of this approach is that it effectively permits a country to amend unilaterally its tax treaty with another country by changing certain parts of its domestic law.

http://www.un.org/esa/ffd/wp-content/uploads/2015/10/TT_Introduction_Eng.pdf

CASE LAWS

22.04.2021

Ranjit Kumar Vuppu Vs ITO

ITAT Hyderabad

DTAA exemption cannot be denied merely for non-availability of Tax Residency Certificate 'TRC'

Facts of the Case: The assessee, a Non-resident individual, filed his return of income for the A.Y 2014-15 on 31.07.2014 admitting total income of Rs.10,04,580. During the assessment proceedings u/s 143(2) of the act pursuant to selection of his return of income for scrutiny under CASS, the assessee was required to furnish certain information and the said information was furnished by the assessee.

On verification of Form-16 issued by the assessee's employer, i.e., IBM India (P) Ltd. for the A.Y 2014-15, the Assessing Officer found that during the relevant A.Y, the gross salary of the assessee was Rs. 31,11,185/-. The Assessing Officer observed that the employer had deducted the tax at source of Rs.7,76,564/-.

Further, on verification of the total income filed by the assessee along with the return of income for the A.Y 2014-15, the Assessing Officer found that the assessee has claimed double taxation relief under section 90 of the Income Tax act and admitted NIL total income but claimed TDS of Rs. 7,66,567/- in his return. Therefore, the assessee was required to furnish the following details:

- a) Tax Residency Certificate to claim the relief under section 90 for the salary received outside India with respect to the services rendered outside India,
- b) Copy of the Assignment letter between the Employer and employee.

In response, the assessee submitted a reply dated 9.9.2016 given as under:

"As the assessee has spent less than 60 days in India during the FY 2013-14, he qualifies as a Non-resident under section 6(1) of the Act. Therefore, the foreign allowance of Rs.20,72,238/- was not offered to tax in India in the return of income as the same was received by him outside India for the services rendered outside India and shall not form part of total income under section 5(2) of the Income tax Act, 1961."

The Assessing Officer, however, held that the claim of the assessee could not be allowed for the following reasons:

- Despite giving many opportunities, the assessee could not produce the Tax Residency Certificate of Belgium for claiming the Double Taxation relief under section 90 as it is statute u/s 90(4) of the Income tax Act, 1961 w.e.f. from A.Y. 2013-14.
- The assessee has failed to furnish the supporting evidences for receiving the foreign allowances outside India to come under purview of section 5(2) of the Income tax Act, 1961. Moreover, the assessee has neither produced any bank account outside India to prove any credits received outside India. Though the assessee stated that certain amounts which are received through travel card pertains to allowance received outside India, the same is not acceptable as the receipts received through travel card does not prove to be receipts received outside India as it is mobile card which can be used anywhere. Further, the employer has not confirmed the same either in letter submission or in Form 16 that these receipts paid through travel card.
- Further the assessee has also failed to prove that the receipts which are reflecting in Form 16 are the salary receipts earned outside India, as there is no evidence of the assessee being resident of Belgium.
- Employer in Form No. 16 has deducted tax at source of Rs.7,76,564/- on the gross salary, i.e., Rs.31,11,185/- received by assessee in India. However, as per section 5(2) of the I.T. Act, 1961, the total income of any previous year of a person who was a non-resident included all income from whatever sources derived, which was received or deemed to be received in India in such year by or on behalf of such person or accrue or arises to him in India during such year. Hence the total salary income and allowance received by employee is taxable.
- Further, the assessee has stated which is reproduced as under:
- “Hence at the time of payment of salary, as the residential status of the assessee was unknown to his employer, IBM has treated the entire salary paid to assessee as taxable in India and taxes were deducted at source on the entire salary”. As the Act has put primary responsibility and onus on the deductor employer to deduct taxes, IBM with abundant caution and following a conservative basis has deducted taxes on the entire salary paid to the assessee”.

Judgement: It has been held that the AO has disallowed the exemption claimed by the assessee under Article 15(1) of the India-Austria DTAA only for want of Tax Residence Certificate (TRC) from Austria. The submission of the assessee in this regard was that despite best possible efforts he was not able to procure TRC from country of residence and the situation may be treated as “impossibility of performance”. I find merits in the submission of the assessee. Normally it is a herculean task to obtain certificates from alien countries for compliance of domestic statutory obligations. In such circumstances the taxpayer cannot be obligated to do impossible task and penalized for the same. If the assessee provides sufficient circumstantial evidence in such cases, the requirement of section 90(4) ought to be relaxed. Further, it is obvious that where there is a conflict between the Treaty and the Act, the Treaty shall overrule the Act. In the case of the assessee, by virtue of the Treaty, the assessee is liable to tax in Austria for the services rendered in Austria and not in India. Therefore, though the act mandates Tax Residency Certificate of Austria, non-production of the same before the Ld. Revenue Authorities shall not enable the Ld. Revenue Authorities not to grant the benefit of the Treaty to the assessee. Therefore, the Ld. Revenue Authorities have erred in not granting the benefit of the Treaty to the assessee just for the reason that the assessee has not submitted the Tax Residency Certificate from Austria.

Abdul Razak A. Memon's case [2005] 276 ITR 306, the AAR observed that “there can be little doubt that while interpreting treaties, regard should be had to material *contemporanea expositio*, which means that a statute is best explained by following the construction put upon it by judges at the time it was made, or soon after. This proposition is embodied in Article 32 of the Vienna Convention, and is also referred to in the decision of the Hon'ble Supreme Court in *K. P. Varghese v. ITO* [1981] 131 ITR 597.”

Johnson Matthey Public Limited Company vs. CIT (International Taxation) (2024) 465 ITR 649 (Delhi)

Facts of the Case: The assessee was a tax resident of the United Kingdom and engaged in manufacturing specialty chemicals. It entered into global corporate guarantee for the purpose of securing loans taken by its Indian subsidiaries from foreign banks. It received guarantee charges for extending such guarantee

Issue: Whether the amount received as “Guarantee Fees” by a foreign company from its Indian subsidiaries fall within the definition of “interest”?

Relevant Provision: As per section 2(28A), “interest” means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized.

Article 12(5) of India-UK DTAA defines “interest” to mean income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from Government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures but, subject to the provisions of paragraph 9 of this Article, shall not include any item which is treated as a distribution under the provisions of Article 11(Dividends) of this Convention.

Analysis and Decision: The High Court concur with the views of the Tribunal that the word “interest” as defined in Article 12(5) of the Treaty and section 2(28A) of the Act, shall be understood contextually. Article 12(5) of the DTAA and section 2(28A) of the Act extend the scope of such payments. However, payment or re-payment pursuant to any loan to be qualified as “interest”, necessarily have to be within the context of loan and shall relate to the parties to the privity of contract. In this context only, the expressions “claims of any kind”, “service fee or other charge” have to be understood. The word “interest” does not take into its fold any payments made to stranger to the privity of loan transactions, though such payments have to be made incidentally in relation to such loan.

Undoubtedly, assessee is a stranger to the privity of loan transactions in as much as the contract of loan is a different from the contract of guarantee, as such in our considered opinion, the expression of “debt claims of any kind” or “the service fee or other charge in respect of moneys borrowed or debt incurred” does not stand extended to the payment of guarantee commission received by the assessee in India.

“interest” is defined to mean amounts payable in respect of any undisputedly the appellant had not borrowed any monies. The debt, if any, which could be said to have been incurred was clearly not one owed to the Indian subsidiaries. The income that it received from its Indian subsidiaries was solely in consideration of any liability that could possibly befall in case its Indian subsidiaries were to default in their repayment obligations.

Judgement: Accordingly High Court held that guarantee fee would neither fall within the ambit of Article 12 of India-UK DTAA nor section 2(28A) of the Act.

LESSON ROUNDUP

- A tax treaty is also called a Double Tax Agreement (DTA). 'Treaty' means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation.
- Double taxation occurs when an assessee is required to pay two or more taxes for the same income, asset, or financial transaction in different countries.
- Juridical double taxation refers to circumstances where a taxpayer is subject to tax on the same income (or capital) in more than one jurisdiction.
- Economic double taxation refers to the taxation of two different taxpayers with respect to the same income (or capital).
- The DTAA's can be two types:
Comprehensive DTAA: Comprehensive DTAA's are those which cover almost all types of incomes covered by any model convention. Many a time a treaty covers wealth tax, gift tax, surtax etc. too.
Limited DTAA: Limited DTAA's are those which are limited to certain types of incomes only, e.g. DTAA between India and Pakistan is limited to shipping and aircraft profits only.
- The Vienna Convention on Law of Treaties provides basic rules of interpretation of any international agreement.

TEST YOURSELF

(These are meant for recapitulation only. Answer to the questions are not to be submitted for evaluation)

1. Explain Double Taxation? Discuss the connecting factors which lead to Double Taxation.
2. Explain the General Rule of Interpretation under Vienna Convention of Law and Treaties.
3. Explain the objectives and need for entering into DTAA.
4. Briefly explain the Juridical and Economic double taxation.
5. Explain the Source v/s Residence Based Taxation.
6. Mr X resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to examine whether the credit for the tax paid on the foreign income will be allowed against his income-tax liability in India.
7. Mr. Raju, aged 38 years, a resident in India furnishes the following particulars of income earned by him in India and Country A for the previous year 2025-26. India does not have a double taxation avoidance agreement (DTAA) with Country A

Particulars	Amount (INR)
Professional Income from Delhi	8,50,000
Agricultural Income from Country A	1,30,000
Royalty Income from Country A (gross)	6,25,000
Expenses incurred for earning royalty	75,000
Business Loss Country A	1,10,000

LIST OF FURTHER READINGS

- OTHER REFERENCES (INCLUDING WEBSITE AND VIDEO LINK)**

- 421

[illegible]

Annexure

Reports and Certificates under Income Tax Law

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
33AB(2)	Audit Report in case of tea/coffee/rubber development account - The requirement for an audit report ensures that the deductions claimed by a taxpayer for investments or expenditures related to tea/coffee/rubber business are accurate and supportable.	Audit report under section 33AB(2) of the Income-tax Act, 1961, in a case where the accounts of the business or profession of a person have been audited under any other law	5AC	3AC	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007759.pdf
33ABA(2)	Relates to deductions in respect of certain types of expenditure incurred by businesses involved in the production, extraction of petroleum or natural gas - The requirement for an audit report in cases where a taxpayer claims certain deductions related to investments for site restoration required in petroleum and gas extraction/production.	Audit report under section 33ABA(2) of the Income-tax Act, 1961, in a case where the accounts of the business of a person have been audited under any other law	5AD	3AD	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007760.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
35D(4)/ 35E(6)	Section 35D relates to preliminary expenses incurred during the startup phase – an audit report requires to ensure that the preliminary expenses claimed as deductions are genuine, properly documented, and compliant with the provisions of income tax. Section 35E relates to deduction towards expenditure incurred on prospecting for or extraction/production of certain minerals. An audit report is required for claiming deduction for these expenditures.	Audit Report under section 35D(4)/35E(6) of the Income-tax Act, 1961	6AB	3AE	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007761.pdf
44AB	Mandates tax audit of certain categories of taxpayers – Audit is required if turnover /gross receipts exceed the prescribed limit i.e., one crore. (Limit changed to 10 crores if amount received/paid in cash does not exceeds 5% of total sales/expenditure)	Audit report under section 44AB of the Income -tax Act, 1961, in a case where the accounts of the business or profession of a person have been audited under any other law	6G	3CA	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007765.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
	Tax audit of certain categories of taxpayers like Proprietorship, partnership firm which is not required to get their accounts audited under any other law – Report on Audit of accounts should be given in Form 3CB.	Audit report under section 44AB of the Income -tax Act 1961, in the case of a person referred to in clause (b) of sub - rule (1) of rule 6G	6G	3CB	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007766.pdf
	It covers comprehensive details about the taxpayer's business, financial transactions, and compliance with tax regulations, The same is required along with Form 3CA AND 3CB as the case may be.	Statement of particulars required to be furnished under section 44AB of the Income-tax Act, 1961	6G	3CD	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007767.pdf
44DA(2)	Section 44DA deals with non-resident Indian or a foreign company received income by way of Royalty or Fees for technical services, such income shall be computed after deduction of expenditure incurred for the business of such permanent establishment or fixed place of profession in India – Audit report is required to verify the correctness of expenditure incurred	Audit Report under sub-section (2) of section 44DA of the Income-tax Act, 1961	6GA	3CE	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007768.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
	on such permanent establishment or fixed place of profession in India as income is calculated post deduction of expenditure incurred wholly and exclusively for such permanent establishment or fixed place of profession in India.				
50B(3)	Section 50B refers to the slump sale wherein lumpsum consideration received against one or more of the undertakings transferred without assigning individual value of each asset and liability – Report of accountant is required relating to computation of capital gains in case of slump sale to minimize the disputes.	Report of an accountant to be furnished by an assessee under sub-section (3) of section 50B of the Income-tax Act, 1961 relating to computation of capital gains in case of slump sale	6H	3CEA	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007769.pdf
92E	Section 92E of Income Tax Act related to Transfer pricing provisions which requires that all international transactions and specific domestic transaction should be conducted at Arm's length prices – A Report from Accountant is	Report from an accountant to be furnished under section 92E relating to international transaction(s) and specified domestic transaction(s)	10E	3CEB	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000009614.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
	required wherein all Individual involved in international transaction or Specific Domestic Transaction must obtain a report from Accountant which ensures that such transactions are conducted at Arm's length prices which ensures compliance with transfer pricing guidelines.				
9A	Section 9A prescribed certain conditions regarding taxation of Income earned by eligible investment funds in India which operates its business in India through 'Business Connection' by appointing fund manager – Report from accountant is required to ensure that remuneration paid to such fund manager (Fund manager might be a non-resident entity) is comparable to the price if the same is paid to other unrelated parties. Such report ensures the following: ● it verifies that such transaction is at Arm's length price	Report from an accountant to be furnished for purposes of section 9A relating to arm's length price in respect of the remuneration paid by an eligible investment fund to the fund manager	10V (13)	3CEJ	https://incometaxindia.gov.in/forms/income-tax%20rules/itr62form3cej.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
	It ensures to compliance of transfer pricing regulations.				
9A	Section 9A prescribed certain conditions regarding taxation of Income earned by eligible investment funds in India which operates its business in India through 'Business Connection' by appointing fund manager – Report from an accountant is required which ensures that the entity meets the criteria to qualify the entity as eligible investment funds (EIF). Such EIF should not be deemed to have a business connection in India just on the basis that it operates through a fund manager. Such EIF should arise its income from its investment only.	Report from an accountant to be furnished for purpose of section 9A regarding fulfilment of certain conditions by an eligible investment fund	10V (13)	3CEJA	https://incometaxindia.gov.in/forms/income-tax%20rules/103520000000076116.pdf
35(2AB)	As per section 35(2AB) a 100% deduction of all revenue and capital expenditure incurred on in-house scientific research and development (Excluding land) is allowed to a company engaged in business of	Report from an accountant to be furnished under sub section (2AB) of section 35 of the act relating to in-house scientific research and development facility	6(7A) (c)	3CLA	https://incometaxindia.gov.in/forms/income-tax%20rules/itr62form3cla.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
	manufacturing and production of any article (Other than article mentioned in 11th schedule of the act) – Report from an accountant is required to verify the correctness and genuineness of expenses claimed as R&D expenditure as 100% deduction is allowed u/s 35(2AB).				
9(1)(i)	Section 9 of the Income tax act specifically talks about the Income which is deemed to accrue or arise in India. This is generally covering non-resident assessee (Including Individuals and Entities) who are deriving income in India directly or through some business connections in India – Report from an accountant is required to substantiate the income which is deemed to accrue or arise in India. This report also states how the organization's income in India will be deemed to accrue or arise. This report serves as a bridge between the taxpayers and the tax authorities.	Income attributable to asset located in India under section 9 of the Income Tax Act 1961	11UC (2)	3CT	https://incometaxindia.gov.in/forms/income-tax%20rules/itr62form3ct.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
2(48)	Every infrastructure capital company or infrastructure capital fund or infrastructure debt fund or public sector company shall submit within two months from the end of each financial year referred to in sub-clause (i) or sub-clause (ii) of clause (iv) of sub-rule (3), or, as the case may be, in sub-clause (i) or sub-clause (ii) of clause (v) of sub-rule (3), a certificate from an accountant specifying the amount invested in each year in Form No. 5BA. Report from an Accountant is required to check and verify the details of investment made out of the funds realised by issue of zero-coupon bond	Certificate of an accountant under sub-rule (6) of rule 8B	8B(6)	5BA	https://incometaxindia.gov.in/forms/income-tax%20rules/103520000000089819.pdf
142(2A)	Section 142(2A) talks about special Audit and Inventory valuation. If at any stage of the proceedings, AO has an opinion with regards, To the nature and complexity of the accounts,	Audit report under clause (i) of section 142(2A) of the Income-tax Act, 1961	14A	6B	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007128.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
	● Volume of the accounts ● Doubts about the correctness of the accounts, ● Multiplicity of transactions in the accounts or ● Specialized nature of business activity of the assessee, and ● The interests of the revenue AO may direct [with previous approval of Principal Chief Commissioner (PCC) or Chief Commissioner (CC) or the Principal Commissioner (PC) or Commissioner (C)] to Assessee to verify books of accounts from Accountant. - Report from accountant in form no 6B is required if special audit required to be conducted as per the direction by AO.				

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
10(23C)(iv)/(v)/(vi)/(via) and 12(A)(1)(b)(ii)	As per section 10(23C) every charitable or religious trust or any other trust, educational institution, hospitals are required to spend 85% of its Income generated during the financial year, in case if the same is not spent within the same financial year, then it shall be deemed to be the income of that previous year. A c c o u n t a n t required to file Form 10B/10(BB) online with Income tax department stating the comprehensive details of the entity along with the unspent amount (if minimum 85% not spent) which is accumulated and set apart for application to charitable or religious purpose.	Audit report under clause (b) of the tenth proviso to clause (23C) of section 10 and sub-clause (ii) of clause (b) of sub-section (1) of section 12A of the Income-tax Act, 1961, in the case of a fund or trust or institution or any university or other educational institution or any hospital or other medical institution which is required to be furnished under clause (b) of the tenth proviso to clause (23C) of section 10 or a trust or institution which is required to be furnished under sub-clause (ii) of clause (b) of section 12A	16CC/17B	10B/10BB	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007798.pdf
13B	Every electoral trust receiving voluntary contribution required to get the accounts to be audited by an accountant -Audit report to be given in Form 10BC	Audit report under (sub-rule (12) of rule 17CA) of the Income-tax Rules, 1962, in the case of an electoral trust	17CA (12)	10BC	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000009097.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
80-IA(7)/80-IB/80-IC/80-IE	Section 80-IA applicable on deduction in respect of profit and gains of business engaged in infrastructure development, Section 80-IB for eligible business, Industrial undertakings engaged in manufacture or production of article or thing or operation of cold storage plan Section 80-IC relates to Special provisions in respect of certain undertakings or enterprises in certain special category States Section 80-IE relates to Special provisions in respect of certain undertakings in North-Eastern States Assessee claiming deduction in respect of eligible business / undertaking / enterprise etc. Audit report is required to be filed by all assessee in form no 10CCB	Audit report under section 80-IA(7)/80-IB/80-IC/80-IE	18BBB(1)	10CCB	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007813.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
80-IA(6)	Assessee claiming deduction in respect of profits and gains derived from the business of Housing or other activities which are an integral part of a Highway Project.	Certificate under sub-rule (3) of rule 18BBE of the Income-tax Rules, 1962	18BBE(3)	10CCC	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007819.pdf
80LA(3)(i)	Section 80LA provides tax benefits in the form of deduction w.r.t certain income of offshore banking units of an International Financial Services Centre or working from Special economic zone. 100% deduction is allowed for any 10 consecutive years out of the 15 Years. Report from Accountant is required to be filed along with the return. This report serves as a certification that the assessee meets the criteria as given in section 80LA	Report under section 80LA(3) of the Income-tax Act, 1961	19AE	10CCF	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007822.pdf
80JJAA(2)(c)	Section 80JJAA talks about deduction in respect of hiring of new employees, this deduction enjoyed by all the taxpayers having a factory. Such assessee is eligible for deduction of	Report under section 80JJAA of the Income-tax Act, 1961	19AB	10DA	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007823.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
	30% of additional employee cost/wages for 3 years - Report from accountant is required to verify the correctness and genuineness of deduction claimed for additional cost paid to such newly hired workmen.				
10(23FF)	Income of the nature of capital gains, arising or received by - (name of the specified fund), on account of transfer of share of a company resident in India, by the specified fund to the extent attributable to units held by non-resident (not being a permanent establishment of a non-resident in India) which is exempt under clause (23FF) of section 10 of the Act and the total income exempt under the said clause	Certificate to be issued by accountant under clause (23FF) of section 10 of the Income-tax Act, 1961	2DD(3)	10-IJ	https://incometaxindia.gov.in/forms/income-tax%20rules/103520000000087061.pdf
195(6)	Section 195(6) applicable wherein if any amount payable to non-resident, then the person responsible to make such payment is required to furnish such information	Certificate from accountant for amount payable in foreign currency	37BB (i) (ii)(a)	15CB	https://incometaxindia.gov.in/Pages/downloads/forms.aspx

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
	in a prescribed manner -Certificate from accountant is required for such remittance.				
201(1)	As per section 201(1) if any person incurred any expenditure wherein TDS is required to be deducted and such person makes default in the deduction or payment of TDS shall be treated as 'Assessee in default', further assessee should not be treated as assessee in default if payee and payer have satisfied certain condition and a Certificate from an accountant is furnished in the format prescribed u/s 201(1).	Form for furnishing a c c o u n t a n t certificate under the first proviso to sub-section (1) of section 201 of the Income-tax Act, 1961	31ACB(1)	26A	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007373.pdf
206C(6A)	Section 206C(6A) provides that is any person does not collect the whole or part of the tax (TCS) or collect the same but does not deposit it to the government then he shall be deemed to be an assessee in default. Assessee should not be treated as assessee in default if certain conditions are satisfied and	Certificate of accountant under first proviso to sub-section (6A) of section 206C of the Income-tax Act, 1961 for certifying the furnishing of return of income, payment of tax etc. by the buyer/ licensee/lessee	37J(1)	27BA	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007866.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
	a Certificate from an accountant is furnished in the format prescribed u/s 206C(6A).				
115JB(4)	Section 115JB applicable on all companies including foreign companies which specifically provides for calculation of tax payable as per MAT (Minimum Alternate Tax) regime, if total tax payable under normal provision is less than the 15% of Book Profit – Report from Accountant is required in form 29B which certifies that book profit is calculated in accordance with the provision of Income Tax Act, such report should be submitted at least 1 month before the due date of furnishing return of income u/s 139(1) or in response to a notice u/s 142(1)	Report under section 115JB of the Income-tax Act, 1961 for computing the book profits of the company	40B	29B	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007874.pdf
115JC(3)	Section 115JC applicable on all persons other than companies which specifically provides for calculation of tax payable as per AMT (Alternate Minimum Tax) regime, if total	Report under section 115JC of the Income-tax Act, 1961 for computing Adjusted Total Income and Alternate Minimum Tax of the person other than a company	40BA	29C	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007875.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
	tax payable under normal provision is less than the 18.5% of Adjusted Total Income – Report from Accountant is required in form 29C which certifies that adjusted total income is calculated in accordance with the provision of Income Tax Act, such report should be submitted on or before the due date of furnishing return of income u/s 139(1).				
10A(5)	Manufacturer assessee deriving Profits and Gains from an undertaking by the export of articles or things or computer software. Details relating to the claim by the exporter for deduction under section 10AA of the Income-tax Act, 1961	Report under section 10AA of the Income-tax Act, 1961	16D	56F	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007933.pdf
72A(2)(b)(iii)	Corporate assessee being an Amalgamated company to furnish Certificate from the principal officer of the amalgamated company and duly verified by an accountant regarding achievement of the prescribed level of production and continuance of such level of production in subsequent years	Certificate from the principal officer of the amalgamated company and duly verified by an accountant regarding achievement of the prescribed level of production and continuance of such level of production in subsequent years	9C(b)	62	ITR62FORM62https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007947.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
115U(2)	Section 115U provides that any income accrue/arise/ received by a person out of the investment made in a venture capital company or venture capital fund shall be taxable in the same manner as if the person made direct investment in such venture capital company (It means income of the fund is not taxed in the hands of the funds since such funds passed this income to its unit holder hence such unit holder will be taxed as per the respective tax slabs – Report from an Accountant is required to verify whether the income distributed by such venture capital company or fund is correctly reported and complying all the provision of this act.	Statement of income paid or credited by Venture Capital Company or Venture Capital Fund to be furnished under section 115U of the Income-tax Act, 1961	12C(2)	64	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007950.pdf
115UA(4)	As per Section 115UA, any income distributed by a business trust to its unit holders shall be deemed to be of the same nature and in the same proportion in the hands of the	Statement of income distributed by a business trust to be furnished under section 115UA of the Income-tax Act, 1961	12CA (2) (i)	64A	https://incometaxindia.gov.in/forms/income-tax%20rules/itr62form64a.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
	unit holder as it had been received by, or accrued to, the business trust— Report from an Accountant is required to verify that the income which is passed on to the unit holder is accurately reported.				
115UB(7)	As per Section 115UB any income accruing or arising to, or received by, a person, being a unit holder of an investment fund, out of investments made in the investment fund, shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to, or received by, such person had the investments made by the investment fund been made directly by him – Report from an accountant is required to verify that the income so distributed to the investor is accurate and in compliance of the provision of Income Tax Act.	Statement of income paid or credited by investment fund to be furnished under section 115UB of the Income- tax Act, 1961	12CB(1)(ii)	64D	https://incometaxindia.gov.in/forms/income-tax%20rules/itr62form_64d.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
115TCA(4)	As per section 115TCA any income accruing or arising to, or received by, a person being an investor of a securitisation trust, out of investments made in the securitisation trust, shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to, or received by, such person, had the investments by the securitisation trust been made directly by him – Report from an accountant is required to verify that the income so distributed is in accordance with the provision of Income Tax Act.	Statement of income paid or credited by a securitisation trust to be furnished under section 115TCA of the Income-tax Act, 1961	12CC(2) (i)	64E	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000026281.pdf
115VW(ii)	Audit report in case of Tonnage Tax Scheme– A concept of tonnage tax scheme brought in Finance Act 2004 so that Indian shipping industry can be promoted, and an option given to such shipping companies to assess their income as per the normal provision or as per tonnage tax regime - Audit report	Audit Report under clause (ii) of section 115VW of the Income-tax Act, 1961	11T	66	https://incometaxindia.gov.in/forms/income-tax%20rules/103120000000007952.pdf

Section	Details	Reports / Certificates	Rule	Form No.	Weblink
	from accountant is required to verify the correctness of the tax payable under tonnage tax scheme.				

[illegible]

WARNING

Regulation 27 of the Company Secretaries Regulations, 1982

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or any Committee formed by the Council in this regard, may suo-moto or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity of being heard, suspend or debar him from appearing in any one or more examinations, cancel his examination result, or registration as a student, or debar him from re-registration as a student, or take such action as may be deemed fit.

It may be noted that according to regulation 2(ia) of the Company Secretaries Regulations, 1982, 'misconduct' in relation to a registered student or a candidate enrolled for any examination conducted by the Institute means behaviour in disorderly manner in relation to the Institute or in or around an examination centre or premises, or breach of any provision of the Act, rule, regulation, notification, condition, guideline, direction, advisory, circular of the Institute, or adoption of malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with writing of any examination conducted by the Institute, or tampering with the Institute's record or database, writing or sharing information about the Institute on public forums, social networking or any print or electronic media which is defamatory or any other act which may harm, damage, hamper or challenge the secrecy, decorum or sanctity of examination or training or any policy of the Institute.

PROFESSIONAL PROGRAMME
ADVANCED DIRECT TAX LAWS & PRACTICE
GROUP 1 • ELECTIVE PAPER 4.5

*(This Test Paper is for recapitulate and practice for the students. Students need not to submit responses/
answers to this test paper to the Institute)*

Time allowed: 3 hours

Maximum Mark: 100

Answer all Questions

Question No. 1

Rust Ltd. is engaged in the business of manufacturing copper bottles. As a Company Secretary you are the key person and heading the taxation wing of the Company. The CFO of the Company approached you for the tax computation for the AY 2026-27. The following information are shared with you:

Profit and Loss Account shows a net profit of Rs. 72,00,000 for the year ended 31st March 2026, after debiting/crediting the following items:

- a) One time license fee of Rs. 12,00,000 paid to a foreign Company for obtaining franchise on 1st July, 2025.
- b) Rs. 12,000 and Rs. 18,000 paid in cash on 15th October 2025 by two separate voucher to a contractor who carried out certain repair work in the office premises.
- c) Rs. 2,50,000 being expenses incurred on the travelling of the wife of Managing Director, who accompanied him on tour to Beijing on invitation of Trade and Commerce Chamber, China.
- d) Dividend of Rs. 5,50,000/- received from a foreign Company, in which Rust Ltd. hold 28% in nominal value of share capital of the Company. Rs. 50,000 spent on earning this income.
- e) Depreciation on tangible fixed assets Rs. 1,50,000.
- f) Rs. 15,00,000 and Rs. 2,50,000 being amounts waived by a bank out of principal and arrear interest, respectively, in one-time settlement. The loan was obtained for meeting working capital requirements two year back.
- g) Provisions for gratuity based on actuarial valuation is Rs. 15,00,000. Actual gratuity paid Rs. 5,00,000/- was debited to provision for gratuity account.
- h) The opening and closing stock of the year were Rs. 18,00,000 and Rs. 18,72,000 respectively and were undervalued by 10% on cost.

Additional Information:

- i. During the year, the Company purchased 5,000 nos. of shares of RK (Pvt.) Ltd. at Rs. 20 per share. The Fair Market Value of such shares on the date of transaction was Rs. 40 per share.
- ii. A debt of Rs. 8,00,000 was claimed as bad debts in F.Y. 2020-21, but the Assessing officer allowed only Rs. 4,00,000 as bad debt. In FY 2025-26, Rs. 3 lakh was recovered from that debt, was not given in books of accounts.

- iii. Provision for audit fee of Rs. 1,00,000/- was made in the books for the year ending 31st March 2026 without deducting tax at source. Such fee was paid to the auditors in September, 2026 after deducting tax u/s 194J and the tax so deducted was deposited on 7th October 2026.
- iv. Depreciation on tangible fixed assets as per Income Tax Law is: Rs. 1,75,000

You are required to:

- a) Calculate the Total Income of the Company and reasons/rational for your treatment of above adjustment in the tax computation.

(18 marks)

- b) Ascertain the tax payable by Rust Ltd. on the Total income of the financial year 2025-26. Ignore MAT Provisions & provisions of section 115BAA.

*(7 marks)***Question No.2**

KP (P) Ltd., a domestic Company having two undertakings engaged in manufacture cement and steel, decided to hive off cement division to SA(P) Ltd, a domestic Indian Company by way of demerger. The net book value of assets of KP(P) Ltd. was Rs. 60 Crore before demerger. The net book value of assets transferred to SA(P) Ltd. was Rs. 15 Crore. The demerger was made in February 2026. In the scheme of demerger, it was fixed that for each equity shares of Rs. 10 each (fully paid up) of KP(P) Ltd, two equity shares of Rs. 10 each (Fully paid) were to be issued.

Tirlok held 25,000 equity shares in KP(P) Ltd. which were acquired in the Financial Year 2003-04 for Rs. 6,00,000. Tirlok received 50,000 equity shares from SA(P) Ltd. Consequent to demerger, he sold all the shares of SA(P) Ltd. for Rs. 8,00,000 in March 2026.

In this background you are requested to answer the following:

- (a) Does the transaction of demerger attract any Income Tax Liability in the hands of KP(P) Ltd. and SA(P) Ltd.
- (b) State the conditions in brief, which are to be satisfied under the Act for a demerger.
- (c) Compute the capital gain that could arise in the hands of Tirlok on receipt of shares of SA(P) Ltd.
- (d) Compute the Capital gains that could arise in the hands of Tirlok on sale of shares of SA(P) Ltd.
- (e) Will the sale of shares by Tirlok affect the tax benefit availed by KP(P) Ltd, and/or SA (P) Ltd?

CII for FY 2003-04: 109 CII for FY 2025-26: 376

*(3 marks each)***Question No.3**

- a) Examine the circumstances where the appellant shall be entitled to produce additional evidence, oral or documentary, before the Commissioner of Income Tax (Appeals) other than the evidence produced during the proceedings before the Assessing Officer.
- b) Company A and Company B who has entered into Advance Pricing Agreement (APA) and eligible for rollback provisions merged to form Company AB. Is the Company AB eligible for rollback provisions as it was formed on the merger of Company A and Company B?
- c) The gross total income of Yuvraj Co. Ltd., Indore was Rs. 70 Lakh which is wholly attributable to a unit located in SEZ since April, 2012. Adjustments to total income made by the Assessing Officer by

applying the transfer pricing provisions enhanced their total income by Rs. 50 Lakh. What is the total income of the year chargeable to tax and explain why?

(5 marks each)

Attempt all the parts of either Q. No. 4 or Q. No. 4A

Question No.4

- a) Under the provisions of a tax treaty between India and Dubai, any capital gains arising from the sale of shares of Sun India Ltd, an Indian Company would be taxable only in Dubai if the transferor is a resident of Dubai except where the transferor holds more than 10% interest in the capital stock of Sun India Ltd. A company, Gama Inc, being resident in Dubai, makes an investment in Sun India Ltd. through two wholly owned subsidiaries (Fama Inc. and Gama Inc.) located in Dubai. Each subsidiary holds 9.95% shareholding in the Indian Company, the total adding to 19.9% of equity of Sun India Ltd. The subsidiaries sell the shares of Sun India Ltd. and claim exemption as each is holding less than 10% equity shares in the Indian Company. Can GAAR be invoked to deny treaty benefit?
- b) XYZ Ltd., a non-banking finance company was engaged in the business of leasing and hire purchase. It purchased motor cars from Yamaha motors and leased out these vehicles to its customers. The lease agreement with the customer stated that XYZ Ltd. was empowered to repossess the vehicle, in case the lessee committed a default. Registration of the vehicle in the name of lessee, during the period of lease is mandatory as per the Motor Vehicles Act, 1988. XYZ Ltd. Claimed Rs. 10,00,000 as depreciation on the vehicles leased out for the year ending 31.3.2019. The claim was rejected by the Assessing Officer on the ground that the assessee had merely financed the purchase of motor cars and was neither the owner nor the user of these assets. Is the action of the Assessing Officer valid? Discuss.
- c) Mr. Aman is proprietor of M/s. Kunal Textile which is engaged in garment manufacturing business. The entire block of Plant & Machinery chargeable to depreciation @ 15%, has 15 different machinery items as at 31-03-2020. One of the machinery used for packing had become obsolete and was discarded by Mr. Aman in July 2017. Assessee filed its return for AY 2021-22 claiming total depreciation of Rs. 50 lacs which includes Rs 5.00 lacs being the depreciation claimed on the machinery item discarded by Mr. Aman. The A.O. disallowed the claim of depreciation of Rs 5.00 lacs during the course of scrutiny assessment. Comment on the validity of action taken by A.O.

(5 marks each)

OR (Alternate to Q. No. 4)

Question No.4A

- i. When can uncontrolled transactions be said comparable to international transactions? Which data can be used for the comparability of an uncontrolled transaction with an international transaction? Furnish your answer in the context of transfer pricing provisions.
- ii. "The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions". Explain the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements (DTAA).
- iii. Discuss the provision of section 44AB with respect to applicability of Tax Audit?

(5 marks each)

Question No.5

- a) Ram Manohar & Sons HUF, consisting of Karta Ram Manohar, his wife, two sons and daughter, is running Ragistan Departmental Stores. Both the sons, who are having professional/technical qualifications as a Chartered Accountant and as an Automobile Engineer started in partnership, a garage for the repairing of motor cars, with a clear understanding that the technical side of the business be looked after by the Engineer, while the general administration and finance part be taken care by the Chartered Accountant. They had taken an interest-free loan of Rs. 15,00,000 from the HUF for starting the venture. The business of garage resulted in a net profit of Rs. 12,50,000 for the year ended 31st March, 2019. The Assessing Officer proposes to assess the income from the business of motor garage in the hands of the HUF. Examine the validity of the proposition of the Assessing Officer in the light of a decided case law, if any.

(5 marks)

- b) Examine the correctness of the following statements in the context of provisions contained in the Income-tax Act, 1961 relevant for the previous year 2025-26:
- The additions to income made by invoking the provisions of section 68 are subject to normal rates of tax as applicable to the assessee.
 - The provisions of AMT are applicable to all persons other than companies.
 - Resident and ordinary resident having no income chargeable to tax, but having interest in property outside India is not required to file a return of income u/s 139(1).

(10 marks)

Attempt all the parts of either Q. No. 6 or Q. No. 6A**Question No.6**

- a) Narmada is an individual resident retired from the service of Prasar Bharati aged 61 years, is a well known dramatist deriving income of Rs. 2,20,000 from theatrical works played abroad. Tax of Rs. 11,000 was deducted in the country where the play's were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to Rs. 9,60,000. In view of tax planning, she has deposited Rs. 1,30,000 in PPF and paid contribution to approved Pension Fund of LIC Rs. 45,000. She also contributed Rs. 27,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of Rs. 28,000 to insure the health of her mother a non-resident aged 85 years, who is not dependent on her. Compute the tax liability of Narmada for the assessment year 2026-27, assuming that she does not opt for section 115BAC.

(5 marks)

- b) Ayush Motors Limited an Indian Company declared income of Rs. 300 crore computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the previous year 2025-26.
- 10,000 cars sold to Rida Ltd., US company, which holds 30% shares in Ayush Motors Ltd. at a price which is less by \$ 200 each car than the price charged from Shingto Ltd. an independent buyer.
 - Royalty of \$ 1,20,00,000 was paid to Kyoto Ltd. a US Company, for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. has provided the same know-how to another Indian company for \$ 90,00,000. Kyoto Ltd. is the sole owner of technology used by Ayush Motors Ltd. in its manufacturing process.

- iii. Loan of EURO 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31st March, 2026. The total book value of assets of Ayush Motors Ltd. on the date was Rs. 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in detail the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for assessment year 2026-27 keeping in mind that the value of 1 \$ and of 1 EURO was Rs. 63 and Rs. 84, respectively, throughout the year.

(10 marks)

OR (Alternate to Q. No. 6)

Question No. 6A

Shilpa Ltd. is engaged in the business of manufacturing fabrics since 1st April, 2012 and earned a profit of Rs. 750 lakh for the previous year ended 31st March, 2026 after debiting or crediting the following items :

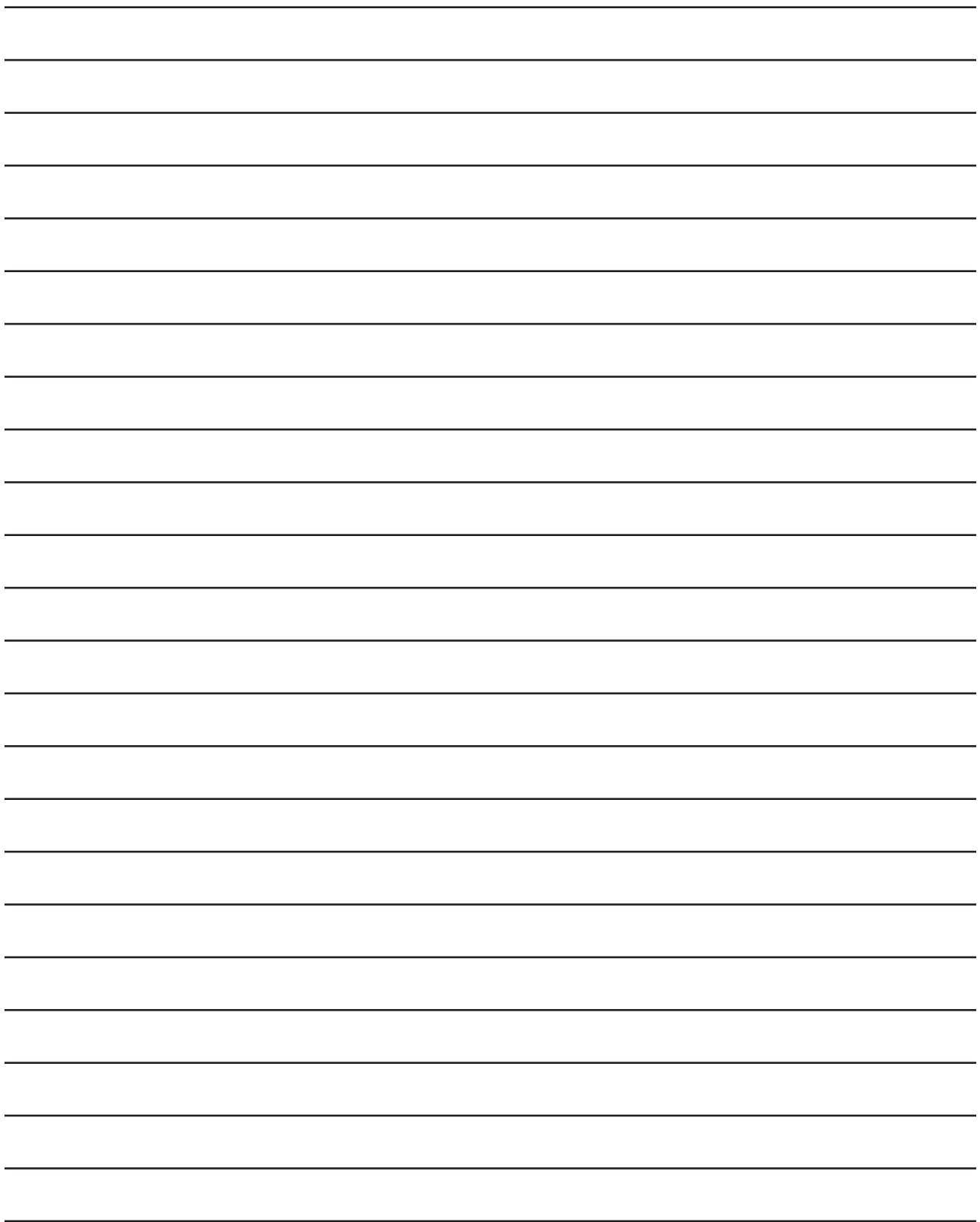
- a) Industrial power tariff concession of Rs. 4.80 lakh, received from Karnataka State Government was credited to Profit and Loss account.
- b) An amount of Rs. 52 lakh is charged as depreciation on the basis of useful life of assets as per the provisions of Indian Companies Act.
- c) An amount of Rs. 12 lakh being received as dividend from Domestic Company.
- d) The company has provided Rs. 18 lakh being sum paid to workers on agreement to be entered with the workers union towards periodical wage revision once in every three years.
- e) Loss of Rs. 17 lakh, due to destruction of a machine purchase cost worth Rs. 24 lakh by fire due to short circuit and Rs. 3 lakh received as scrap value. The insurance company did not admit the claim of the company on charge of gross negligence.
- f) Long term capital gain of Rs. 3 lakh on sale of equity shares on which Securities Transaction Tax was paid at the time of acquisition and sale.
- g) Provision for gratuity based on actuarial valuation was Rs. 320 lakh. Actual gratuity paid debited to gratuity provision account was Rs. 160 lakh.
- h) Advertisement charges Rs. 2.30 lakh, paid by cheque for advertisement published in the souvenir of a political party registered with the Election Commission of India.
- i) Interest given on advance money received from a buyer on 31st March, 2026 was Rs. 2 lakh, on which tax has not be deducted at source.

Additional Information:

- i. Normal depreciation computed as per the Income Tax Rules is Rs. 71 lakh.
- ii. GST Rs. 8 lakh collected from its customers was paid by the company on the due dates. On an appeal, the High Court directed the GST department to refund Rs. 3 lakh to the company. The company in turn refunded Rs. 2 lakh to the customers from whom it was collected and the balance Rs. 1 lakh is still lying under the head 'Current Liabilities'.

You are required to compute the Total Income for the assessment year 2026-27. Also explain the reasons for treatment of each item by applying the relevant provisions of Income-tax Law.

(15 Marks)



[illegible]