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M.COM. SEMESTER-III, Tax Planning&Management

PAPER: MC 302

CONTENTS

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INTRODUCTORY LETTER

Dear Learner

As per Article 265 of the Constitution of India –No tax shall be levied of collected except by the authority of law: The paper 2 : MC-302-Tax Planning and Management has been designed with an aim to familiarize you with major latest provisions of Indian Tax laws and related judicial pronouncement pertaining to Corporate Enterprises. After going through study material, you will learn various tax complications and various aspects of corporate planning that aiming at deriving maximum possible Tax benefits admissible under law.

The syllabus has been divided into four units covering all aspects of direct and indirect tax implication for corporate enterprises. The study material has been prepared to meet the needs of the distance learners. These lesson scripts are to aid you in Learning. You are advised to supplement it with some important books as prescribed in syllabus.

Wishing you the very best of Luck……………………..

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SYLLABUS OF M.COM. (SEMESTER SYSTEM) EXAMINATIONS

PAPER 2: MC. 302 – TAX PLANNING AND MANAGEMENT

Objective: The aim of this course is to familiarize the student with major latest provisions of the Indian tax laws and related judicial pronouncements pertaining to corporate enterprises having implications for various aspects of Corporate planning with a view to derive maximum possible tax benefits admissible under the law.

UNIT - I

Structure of Direct and Indirect Taxes in India.Concepts, Significance and Problems of Tax Planning, Tax Avoidance and Tax Evasion – Recognized methods of Tax Planning: Ensuring maximum claims for deduction for companies with special emphasis on depreciation allowance, expenses of scientific research, amortization of preliminary expenses and amounts not claimed otherwise. Taking advantages of available reliefs, rebates and tax free sources of income.

UNIT - II

Definition of various kinds of companies – Meaning of company under IT Act.Residential status of companies and implications for Tax Planning. Assessment of companies including carry forward and set off of losses.

UNIT - III

Tax implications in planning of business unit as Proprietorship, Partnership, Pvt. Ltd. & Public Ltd. Tax planning in the context of exemptions, incentives, export promotions & various deductions under Chapter – VI of Income Tax Act.Setting up of a new Industrial Establishment: location aspects; nature of business; planning of tax holiday benefits. Specific management decisions such as (1) make or buy; (2) own or lease; (3) repair or replace; (4) expert vs local sale; (5) shut down or continue; (6) exoand or contract.

UNIT - IV

An overview of good and service tax: Introduction to GST, reasons for introducing GST, pros and cons of GST. Registration procedure of trader/service provider under GST.Levy and collection of CGST/SGST under GST.Composite levy scheme of GST.Levy and collection of IGST. Input tax credit and relief to consumers and traders under GST. Applicable rates of tax on various goods and services under GST.

Reference Books:

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Goods and Service Tax Act, 2017.

Lesson-1

Indian Taxation System

Structure

1.0 Objectives

1.1 Introduction

1.2 Types of Taxes

1.3 Revenue Authorities

1.4 Main features of Indian Taxation System

1.5 Taxation in India: Changing Rules, Trends in Taxation

1.6 List of recent changes in Direct Tax

1.7 Important events affecting the administrative set up

1.8 Summary

1.9 Glossary

1.10 References

1.11 Further Readings

1.12 Model Questions

1.0 Objectives

After go through the lesson, you should be able to:

- Understand the Concept of Tax, its major types and applicability.
- discuss the salient features of Indian Taxation System
- explain the Major Revenue Authorities working in India.

1.1 Introduction

Taxes in India are levied by the Centre Government and the State governments. Some minor taxes are also levied by the local authorities such as the Municipality. The authority to levy a tax is derived from the constitution of India which allocates the power to levy various taxes between the Central and the State. An important restriction on this power is Article 265 of the Constitution which states that "No tax shall be levied or collected except by the authority of law". Therefore, each tax levied or collected has to be backed by an accompanying law, passed either by the parliament or state legislative assembly.

A tax may be defined as a "pecuniary burden laid upon individuals or property owners to support the government, a payment exacted by legislative authority. A tax "is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority".

Taxes consist of direct tax or indirect tax, and may be paid in money or as its labour equivalent (often but not always unpaid labour). India has a well developed taxation structure. The tax system in India is mainly a three tier system which is based between the Central, State Governments and the local government organizations. In most cases, these local bodies include the local councils and the municipalities. According to the Constitution of India, the government has the right to levy taxes on individuals and organizations. However, the constitution states that no one has the right to levy or charge taxes except the authority of law. Whatever tax is being charged has to be backed by the law passed by the legislature or the parliament. Article 246 (SEVENTH SCHEDULE) of the Indian Constitution, distributes legislative powers including taxation, between the Parliament and the State Legislature. Schedule VII enumerates these subject matters with the use of three lists;

- List - I entailing the areas on which only the parliament is competent to makes laws,
- List - II entailing the areas on which only the state legislature can make laws, and
- List - III listing the areas on which both the Parliament and the State Legislature can make laws upon concurrently.

Separate heads of taxation are provided under lists I and II of Seventh Schedule of Indian Constitution. There is no head of taxation in the Concurrent List (Union and the States have no concurrent power of taxation). Any tax levied by the government which is not backed by law or is beyond the powers of the legislating authority may be struck down as unconstitutional. The thirteen heads List-I of Seventh Schedule of Constitution of India covered under Union taxation, on which Parliament enacts the taxation law, are as under:

- Taxes on income other than agricultural income;
- Duties of customs including export duties;
- Duties of excise on tobacco and other goods manufactured or produced in India except

(i) alcoholic liquor for human consumption, and (ii) opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or any substance included in (ii);

- Corporation Tax; • Taxes on capital value of assets, exclusive of agricultural land, of individuals and companies, taxes on capital of companies;
- Estate duty in respect of property other than agricultural land;
- Duties in respect of succession to property other than agricultural land;
- Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freight;
- Taxes other than stamp duties on transactions in stock exchanges and futures markets;
- Taxes on the sale or purchase of newspapers and on advertisements published therein;
- Taxes on sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce;
- Taxes on the consignment of goods in the course of inter-State trade or commerce.

1.2 Types of Taxes

Taxes are classified under two categories namely direct and indirect taxes. The largest difference between these taxes is their implementation. Direct taxes are paid by the assessee while indirect taxes are levied on goods and services.

(A) Direct taxes :-Direct taxes are levied on individuals and corporate entities and cannot be transferred to others. These include income tax, wealth tax, and gift tax

- **Income tax: -** As per the Income Tax (IT) Act, 1961 every assessee whose total income exceeds the maximum exempt limit is liable to pay this tax. The tax structure and rates are annually prescribed by the Union Budget. This tax is imposed during each assessment year, which commences on 1st April and ends on 31st March. The total income is calculated from various heads such as business and profession, house property, salaries, capital gains, and other sources. The assesses are classified as individuals, Hindu Undivided Family (HUF), association of persons (AOP), body of individuals (BOI), company, firm, local authority, and artificial judiciary not falling in any other category.

- **Corporation Tax:** The companies and business organizations in India are taxed on the income from their worldwide transactions under the provision of Income Tax Act, 1961. A corporation is deemed to be resident in India if it is incorporated in India or if it‘s control and management is situated entirely in India. In case of non resident corporations, tax is levied on the income which is earned from their business transactions in India or any other Indian sources depending on bilateral agreement of that country.

- **Gift Tax:** Gift tax in India is regulated by the Gift Tax Act which was constituted on 1st April, 1958. It came into effect in all parts of the country except Jammu and Kashmir. As per the Gift Act 1958, all gifts in excess of Rs. 25,000, in the form of cash, draft, check or others, received from one who doesn't have blood relations with the recipient, were taxable. However, with effect from 1st October, 1998, gift tax got demolished and all the gifts made on or after the date were free from tax. But in 2004, the act was again revived partially. Anew provision was introduced in the Income Tax Act 1961 under section 56 (2). According to it, the gifts received by any individual or Hindu Undivided Family (HUF) in excess of Rs. 50,000 in a year would be taxable.

- **Property tax:** It is a tax assessed on real estate. The tax is usually based on the value of the property (including the land) you own and is often assessed by local or municipal governments. This tax is mainly used by municipalities for repairing roads, building schools and snow removal, or other similar services. Rates of property taxes and the kinds of property considered taxable by the local government vary somewhat in different municipalities and states. As such, when purchasing property in a new state, it is important for individuals and businesses to carefully examine the tax laws of their new locality. Generally speaking, the value of property taxes is determined by multiplying the property tax rate by the current market value of the property in question, which is periodically recalculated by municipalities.

(B) Indirect taxes

Indirect taxes are not directly paid by the assessee to the government authorities. These are levied on goods and services and collected by intermediaries (those who sell goods or offer services). Here are the most common indirect taxes in India:

1.2..1 Value Added Tax (VAT):- This is levied by the state government and was not imposed by all states when first implemented. Presently, all states levy such tax. It is imposed on goods sold in the state and the rate is decided by the state governments.

1.2..2 Customs duty:-Imported goods brought into the country are charged with customs duty which is levied by the Central Government.

1.2..3 Octroi:-Goods that move from one state to another are liable to octroi duty. This tax is levied by the respective state governments.

1.2..4 Excise duty:-All goods produced domestically are charged with excise duty. Also known as Central Value Added Tax (CENVAT), this is paid by the manufacturers.

1.2..5 Service Tax:-All services provided domestically are charged with service tax. The tax is paid by all service providers unless specifically exempted.

(C) Goods and Service Tax (GST)

As a significant step towards the reform of indirect taxation in India, the Central Government has introduced the Goods and Service Tax (GST). GST is a comprehensive indirect tax on manufacture, sale and consumption of goods and services throughout India and will subsume many indirect taxes levied by the Central and State Governments. GST will be implemented through Central GST (CGST), Integrated GST (IGST) and State GST (SGST).

Four laws (IGST, CGST, UTGST & GST (Compensation to the States), Act) have received President assent. All the States & UT expected to pass State GST Act, by end of May 2017. GST law is expected to take effect from July 1, 2017.

1.3 Revenue Authorities CBDT

The Central Board of Direct Taxes (CBDT) is a part of the Department of Revenue under the Ministry of Finance. This body provides inputs for policy and planning of direct taxes in India and is also responsible for administration of direct tax laws through the Income Tax Department.

CBEC

The Central Board of Excise and Customs (CBEC) is also a part of the Department of Revenue under the Ministry of Finance. It is the nodal national agency responsible for administering customs, central excise duty and service tax in India.

CBIC

Under the GST regime, the CBEC has been renamed as the Central Board of Indirect Taxes & Customs (CBIC) post legislative approval. The CBIC would supervise the work of all its field formations and directorates and assist the government in policy making in relation to GST, continuing central excise levy and customs functions.

The Indian tax system has witnessed several modifications over the years. There has been standardization of income tax rates with simpler governing laws enabling common people to understand the same. This has resulted in ease of paying taxes, improved compliance, and enhanced enforcement of the laws.

Most of the taxes are levied by central government and some are levied by state government. The classification is made in given below:

Taxes Levied by Central Government

Direct Taxes	Indirect Taxes
Tax on Corporate Income	Excise Duty
Capital Gains Tax	Customs Duty
Personal Income Tax	Service Tax
Gift Tax	Securities Transaction Tax
Double Taxation Avoidance Treaty	

Taxes Levied by State Governments and Local Bodies

Sales Tax/VAT

Stamp duty on transfer of assets Property/building tax levied by local bodies

Agriculture income tax levied by State Governments on income from plantations

Luxury tax levied by certain State Government on specified goods

1.4 Main features of Indian Taxation System

1. Distribution of tax between Centre and State Governments:-Based on this the constitution has also made a provision for division of tax powers between the centre and the states. The area and sphere of taxation of centre and state is clearly demarcated as per constitutional provision. Taxes which are in the purview of central government accounted for 50 percent of its revenue. Some taxes are again levied by the Central government and the proceeds of such taxes are divided between the centre and the state governments.

2. Multiplicity of Tax Structure: India is having a broad based and extensive tax structure. Its main feature is the existence of multiplicity of taxes. There are both union government taxes and state government taxes. The tax structure includes both dried and indirect taxes.

In the case of states indirect taxes play a dominant role, in the composition of tax revenue. Among the direct taxes imposed in India, the most important is income tax. Other prominent taxes are wealth tax capital gains tax, gift tax etc.

The indirect taxes in India Consists of excise duties, customs duties, etc. The important taxes levied by the union government are income tax, corporation tax, central excise duties, wealth tax, gift tax, custom duties etc.

3. Larger share of indirect taxes:-In India in the total tax revenue there is the domination of indirect taxes over direct taxes. Indirect taxes shared 63% in 1950 – 51 where it increased to 77% in 2001-02. If shows that because of the undeveloped character of the economy and glaring inequality in income, the scope of direct taxes is limited.

4. Insufficient Tax Revenue:-In-spite of rising trend in tax revenue, the total revenue remained small when compared to developed countries. The tax GDP ratio generally remained in the range of 9 percent to 10 percent in India where as it is very high in countries like Sweden, France, West Germany, UK, USA, etc. where the share ranges between 30 to 40 percent.

5. Incident of taxation:-In India the incidence of taxation is much higher in urban areas than in rural areas this is because of the predominance of agriculture in rural area and low income of rural households. The urban population depends more on service and business sector and enjoys comparatively higher income and taxpaying capacity.

6. Progressiveness in Tax Structure: Indian tax structure is framed in such a way that all indices of ability to pay are taxed. The direct tax is framed in such a way that as tax base increases, tax rate also rises sharply. Excise duties are levied and collected discriminately, depending on the type of commodity and the class of consumers.

7. Narrow Base: Fiscal experts opine that the tax base is very narrow in India in the case of both direct and indirect taxes. A planning commission estimate shows that only one percent of working population comes under the preview of direct tax.

8. Complexity of Indian Tax Laws: With the intension of broad based tax system, a plethora of changes have been introduced in the tax structure. However both direct and Indirect tax laws are highly complex, with a lot of loopholes which enable the people to avoid as well as to evade taxes. In this context Prof. Kaldore observes ―there are definitional defects in India‘s tax system, which gives elaborate power to tax authorities to interpret tax laws according to their whims and fancies. This has generated wide spread corruption in tax departments‖.

1.5 Taxation in India: Changing Rules, Trends in Taxation

India is presently focused on formalizing its economy, partly due to its long history of tax avoidance, black money, and institutional corruption. Accordingly, authorities are keen to ensure that businesses and traders alike are brought under federal and state tax and regulatory networks.

India’s Tax Incentives for Business, Industry, and Exports

Corporate tax rates are expected to come down in the next five to eight years, as immediate federal tax targets are met and India‘s formal economy widens.India is still liberalizing its economy decades after the first series of reforms were introduced in 1991 – its intention to lower corporate tax rates should be treated as credible, but only possible in the long-term.

At present, large firms and multinational companies in India pay corporate taxes in the range of 30 to 40 percent, depending on the applicability of various cess duties and surcharges. Further, the Union Budget 2018-19 has lowered the corporate income tax (CIT) rate for micro, small, and medium enterprises (MSMEs) to 25 percent, applicable from assessment year (AY) 2019-20.

This lower tax rate for MSMEs targets the quantum of India‘s business sector – at over 95 percent; large multinational firms represent the country‘s minority of top taxpayers. The latest budget made further important tax announcements, namely the return of tax on long-term capital gains and tax relaxations for specific sectors.

India’s evolving tax environment

In India, authorities administer the tax environment at the federal (referred to as ―union‖ locally), state, and district levels.Major changes have been introduced in the administration of its tax rules in the last two years.This includes, but is not limited to, shutting down shell companies, bankruptcy regulation, amending double tax avoidance treaties, clarifying place of doing business rules, real estate regulation, and enforcing the general anti-avoidance rule (GAAR).The policies follow from India‘s adoption of the Base Erosion and Profit Shifting (BEPS) measures heralded by the Organisation for Economic Co-operation and Development (OECD).

Besides strengthening the tax monitoring system, India also initiated indirect tax reform in 2017. The launch of the Goods and Services Tax (GST) in July, last year, replaces multiple indirect taxes.

In fact, the Doing Business Report for 2018, published in October 2017 by the World Bank, ranked India at 119 out of 190 for the metric of paying taxes; the previous year India ranked 172– showing some measure of improvement in India‘s commercial taxation system. India‘s tax structure for business entities includes the following components.

Corporate Income Tax

The corporate tax structure or CIT for foreign companies is different from that for domestic firms. A foreign company is an enterprise with operations and origin in any other country outside India. However, private limited companies (wholly owned subsidiaries) set up by foreign companies are considered domestic companies while computing tax liability in India.

The effective corporate tax charged on foreign companies also depend on taxation agreements made between India and respective foreign countries. For example, corporate tax on a Canadiancompany in India will depend upon the taxation agreement between the governments of India and Canada.Apart from various types of taxes levied on company income, India offers several provisions of tax rebates to companies.

Minimum Alternate Tax

As per the current tax rules, if the tax payable of the company is less than 18.5 percent of its book profit, the book profit will be considered as its total income and a MAT of 18.5 percent is levied.MAT is not applicable to Special Economic Zones (SEZs), infrastructure and power sectors, and investments made by venture capital firms. In the government‘s latest waiver – MAT exemption has been extended to shipping, exploration of mineral oils, operation of aircrafts, and civil construction business in turnkey power projects with retrospective effect from 2001.

Withholding Tax

Also known as Tax Deducted at Source (TDS) in India, this is an obligation where the payer – either resident or non-resident – must withhold tax when making payments of a specified nature, such as rent, commission, salary, professional services, contracts at rates specified under the Income-tax Act, 1961 or Double Tax Avoidance Agreement, whichever is lower.

WHT/TDS rates may be subject to change each fiscal year and should be closely monitored.

Goods and Services Tax

The GST is a uniform tax rate fixed for both goods and services across India, and is payable at the final point of consumption. At each stage of sale or purchase in the supply chain, the tax is collected on value-added goods and services, through a tax credit mechanism (or input credit mechanism).In this way, the GST establishes a single, uniform market across India, and facilitates transparent business transactions.

Strategies to reduce tax burden in India

India looks favorably upon regional trading arrangements, which include Free Trade Agreements (FTAs), Preferential Trade Agreements (PTAs), and Comprehensive Economic Cooperation Agreements (CECAs).

These are arrangements between two or more countries, or between a country and a trading bloc to abolish or reduce tariffs, quotas, and preferences on goods and services traded.

1.6 List of recent changes in Direct Tax

1. Introduction of Section 115BAA (reduction in corporate tax rates) in the Income Tax Act,1961:-

Section 115BAA provided for reduction in corporate tax rate for all existing domestic companies. It, inter alia, provided a concessional tax regime of 22% for all existing domestic companies from FY 2019-20 if they do not avail any specified exemption or incentive. Further, such companies have also been exempted from payment of Minimum Alternate Tax (MAT).

2. Introduction of Section 115BAB (Incentive for new manufacturing domestic companies) in the Income-tax Act,1961

In order to boost Make In India Initiative of the Government, another new provisions was inserted in the Income Tax Act,1961 w.e.f FY 19-20 which allows any new domestic company incorporated on or after 01.10.2019 making fresh investment in manufacturing, an option to pay income-tax at the rate of 15%. This benefit is available to companies which do not avail any exemption/incentive and commences their production on or before 31.03.2023. The effective tax rate for these companies is 17.01% inclusive of surcharge & cess. Also, such companies are not be required to pay MAT.

3. Reduction in MAT Rate

In order to provide relief to the company assessee which continues to avail exemption/deduction and pay tax under MAT, the rate of MAT has also been reduced from 18.5% to 15%

4. Exemption from income-tax to individuals earning income up to Rs.5lakh

The Finance Act, 2019 exempted an individual taxpayer with taxable income up to Rs.5 lakh by providing 100% tax rebate. This was done to provide complete relief from payment of income-tax to individuals earning taxable income up to Rs.5 lakh

5. Abolition of Dividend Distribution Tax (DDT)

In order to increase the attractiveness of the Indian Equity Market and to provide relief to a large class of investors in whose case dividend income is taxable at the rate lower than the rate of DDT, the **Finance Act, 2020** removed the Dividend Distribution Tax under which the companies are not required to pay DDT with effect from 01.04.2020. The dividend income shall be taxed only in the hands of the recipients at their applicable rate.

6. Expansion of scope of TDS/TCS and reduction in TDS rates

For widening the tax base, several new transactions were brought into the ambit of **Tax Deductionat Source (TDS)** and Tax Collection at Source (TCS). These transactions include huge cash withdrawal, foreign remittance, purchase of luxury car, e-commerce participants,sale of goods, acquisition of immovable property, etc. Further, the TDS rates for all non-salaried payment to residents, and tax collected at source rate is reduced by 25 percent of the specified rates for the period 14.05.2020 till

31.03.2021. Such measures would leave more cash in the hands of deductee and would ultimately lead to generation of demand and growth for the economy.

7. Extension of Due Dates

The returns of income which are required to be filed by 31.07.2020 and 31.10.2020 can be filed upto 30.11.2020. Consequently, the date for furnishing tax audit report has also been extended to 31.10.2020.In order to provide relief to small and middle class taxpayers, the date for payment of self-assessment tax in the case of a taxpayer whose self-assessment tax liability is upto Rs.1 lakh has also been extended to 30.11.2020.

8. Extension of Time limit in Capital Tax Savings Instruments

The date for making investment/ construction/ purchase for claiming roll over benefit/ deduction in respect of capital gains under sections 54 to 54GB has also been further extended to 30.09.2020.Similar benefit extended for compliance of section 10AA of the Income-tax Act,1961

1.7 Important events affecting the administrative set up in the Income-tax department:

1939

- Appellate functions separated from inspecting functions.
- A class of officers known as AACs came into existence.
- Jurisdiction of Commissioners of Income tax extended to certain classes of cases and a central charge was created at Bombay.

1940

- Directorate of Inspection (Income-tax) came into being.
- Excess Profits Tax introduced w.e.f. 1-9-1939.

1941

- Income-tax Appellate Tribunal came into existence.
- Central charge created at Calcutta.

1943

- Special Investigation Branches set up.

1946

- A few officers of Class-I directly recruited.
- Demonetisation of high denomination notes made.
- Excess Profits Tax Act repealed.

1947

- Business Profits Tax enacted (for the period 1-4-1946 to 31-3-1949).

1951

- Report of Income-tax Investigation Commission known as Vardhachari Commission received.
- Voluntary Disclosure Scheme introduced.

1952

- Directorate of Inspection (Investigation) set up.
- Inspector of Income-tax declared as an I.T. authority.

1953

- Estate Duty Act, 1953 came into existence w.e.f. 15-10-1953.
- Act XXV of 1953 gave effect to the recommendations of Commission appointed under Taxation of Income (Investigation Commission) Act, 1947.

1954

- Internal Audit Scheme in the Income-tax Department introduced.
- Taxation Enquiry Commission known as John Mathai Commission set up.

1957

- The Wealth tax Act, 1957 introduced w.e.f. 1-4-1957.
- I.R.S.(DT) Staff College started functioning at Nagpur and much later four R.T.Is. stationed at Bombay, Calcutta, Bangalore and Lucknow opened.

1958

- LI>The Gift-tax Act, 1958 introduced w.e.f. 1-4-1958.
- Report of Law Commission received.

1959

- Direct Taxes Administration Enquiry Committee submitted its report.

1960

- Directorate of Inspection (Research, Statistics & Publications)was set up.
- Two grades of Inspectors - selection and ordinary grades - merged into one single grade.

1961

- Direct Taxes Advisory Committee set up - Direct Taxes Administrative Enquiry Committee constituted.
- Income-tax Act, 1961 came into existence w.e.f. 1-4-1962.
- Revenue Audit introduced for the first time in the Department.
- New system for evaluation of work done by Income-tax Officers introduced.

1963, 1964

- Central Board of Revenue bifurcated and a separate Board for Direct Taxes known as Central Board of Direct Taxes (CBDT)constituted under the Central Board of Revenue Act, 1963.
- For the first time an officer from the department became Chairman of the CBDT w.e.f. 1-1-1964.
- The Companies (Profits) Sur -tax Act, 1964 was introduced.
- Annuity Deposit Scheme, 1964 introduced.

1965

- Voluntary Disclosure Scheme came into operation.

1966

- Functional Scheme introduced.
- Special Recovery Unit created.
- Intelligence Wing created and placed under the charge of Directorate of Inspection (Investigation).

1968

- Valuation Cell came into existence in the Income tax Department.
- Report of rationalisation and simplification of tax structure (Bhoothalingam Committee) received.
- Administrative Reforms Commission set up.

1969

- Direct Recruitment to Class II Income-tax Officers made.
- The post of IAC (Audit) created in the Income-tax Department.

1970

- The posts of Addl. Commissioner of Income-tax created and abolished after one year.
- Recovery functions which were hitherto performed by Income- tax Officers, given to Tax Recovery Officers. Prior to that State Government officials exercised the functions of a Tax Recovery Officer.

1971

- A new cadre of posts known as Tax Recovery Commissioners introduced w.e.f. 1.1.1972.
- Report of Direct Taxes Enquiry Committee received.
- Summary Assessment Scheme introduced w.e.f. 1-4-1971.

1972

- A Special Cell within the Directorate of Inspection (Investigation) created to oversee the cases of big industrial houses.
- A new cadre of posts known as IAC(Acq.) created and IAC appointed as Competent Authority with the insertion of new Chapter XXA in the Income Tax Act, 1961 on the acquisition of immovable properties in certain cases of transfer to counter evasion of tax.
- Directorate of Organisation & Management Services (Income- tax) created.
- The post of I.T.O. (Internal Audit) created.
- Bradma Scheme in the Income-tax Department introduced.
- System of Permanent Account Number introduced.
- Valuation Officers given statutory powers under the Income-tax Act, 1961 and Wealth-tax Act, 1957.

1974

- Compulsory Deposit Scheme (Income-tax Payers) Act, 1974 introduced.
- Action Plan for the Income-tax Officers introduced for the first time.
- Concept of M.B.O introduced.

1975

- Voluntary Disclosure Scheme for Income and Wealth implemented.
- Special Cell for dealing with Smugglers' cases created.

1976

- Settlement Commission created and Taxation Laws (Amendment) Act,1975 inserted a new Chapter XIXA in the Income Tax Act w.e.f.1-4-1976.
- Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976 introduced w.e.f. 25-1-1976.

- A new scheme for departmentalization of accounts introduced.
- Chokshi Committee submitted its interim report.

1977

- A new cadre of posts known as IAC (Assessment) created.

1978

- Appellate functions given to a new cadre of Commissioners known as Commissioner (Appeals).
- Directorate of Inspection (Recovery) set up.
- A new directorate known as Directorate of Inspection (Vigilance) came into existence by bifurcating the functions of Directorate of Inspection (Investigation).
- Chokshi Committee submitted its final report.

1979

- A new directorate designated as Directorate of Inspection (Publication & Public Relations) created out of the Directorate of Inspection (RS&P).

1980

- Hotel Receipt Tax Act, 1980 came into force w.e.f. 1.4.1981.

1981

- Economic Administrative Reforms Commission set up.
- Three new Directorates viz. Directorate of Inspection (Intelligence), Directorate of Inspection (Survey) and Directorate of Inspection (Systems) created.
- Within the Directorate of Inspection (Income Tax and Audit), a separate Director of Inspection (Audit) appointed.
- Directorate of Inspection (RS&P) re-organised and Directorate of Inspection (P&PR) re-designated as Directorate of Inspection (Printing & Publications).
- I.R.S.(DT) Staff College, Nagpur, re-designated as National Academy of Direct Taxes.
- Special Bearer Bonds (Immunities & Exemptions) Act promulgated.
- Director General (Special Investigation) and Director General (Investigation) appointed to control the functioning of various Directorates under the control of Central Board of Direct Taxes.
- Five posts of Chief Commissioner (Administration) created.
- A few posts of Commissioner of Income-tax were earmarked as Commissioner of Income- tax (Inv.) and Commissioner of Income- tax (Recovery).

1982

- Special Cell within the Directorate of Inspection (Investigation) converted into a separate Directorate and re-designated as Directorate of Inspection (Special Investigation).
- DIT (Systems) appointed in the Directorate of Income-tax (Organisation and Management Services) to coordinate efforts in introducing electronic data processing in the IT Deptt. A microprocessor based EDP system along with data entry system was installed heralding the era of computerisation.
- Levy of Hotel Receipts Tax discontinued.
- Regional Training Institute at Nagpur started functioning under the control of the National Academy of Direct Taxes.

1983

- The vigilance set up reorganised and the strength of Dy. Director (Vigilance) and Asstt. Director(Vigilance) augmented.
- Computerised systems for processing challans and PAN designed and developed.

1984

- Taxation Laws(Amendment) Act 1984 passed to streamline procedures in the interest of better work management; avoid inconvenience to tax payers; reduce litigation; remove anomalies and rationalise some provisions.

1985

- Post of Director General (Investigation) created for more effective checking of tax evasion.
- E.D.(Amendment) Act 1985 discontinues levy of estate duty on deaths occurring on or after 16.03.1985.
- Compulsory Deposit Scheme (Income Tax Payers) Act 1974 discontinued w.e.f. 1.4.1985.
- Interest Tax Act, 1974 discontinued w.e.f. 31.3.1985
- A new "Reward Scheme" for motivating officers introduced w.e.f. 1.4.1985.

1986

- The I.T. Act and W.T. Act amended by Taxation Laws (Amendment and Miscellaneous Provisions) Act :-
- Established Settlement Commission.
- Introduced Block assets concept for depreciation.
- Four offices of Appropriate Authority for acquiring property in which unaccounted money is invested set up in metropolitan cities.

1987

- Government's approval obtained to set up three new benches of Settlement Commission.
- L.K. Jha Committee set up for simplification and rationalisation of tax laws.
- Office of Directorate General (Tax Exemption) set up at Calcutta.
- The Direct Tax Law(Amendment) Act 1987 introduced uniform previous year and redesignated the following authorities:-
  - ✓ Director of Inspection
  - ✓ Insp. Asstt. Commissioner of I.Tax
  - ✓ Appellate. Asstt. Commissioner
  - ✓ Income tax Officer Gr. A
  - ✓ Income tax Officer Gr. B
  - ✓ Director of Income Tax
  - ✓ Dy. Commissioner of Income Tax.
  - ✓ -Do- (Appeals)
  - ✓ Asstt. Commissioner of I.Tax
  - ✓ Income tax Officer
- Expenditure Tax Act 1987 brought into force.

1988

- Benami Transactions Prohibition Act 1988 introduced.
- The Government announced a "Time Window Scheme" which allowed tax payers 50% rebate of interest u/s 220(2) if they pay the tax and balance interest. The scheme was in operation between 1.7.88 to 30.9.88.
- CIT (Central) placed under the control and supervision of Director General (Investigation).
- Government decided that cadre control for Group 'C' and 'D' posts would be with Chief Commissioner and with CBDT for Group 'A' and 'B'posts.
- Extension of Direct Tax Law to the State of Sikkim by a notification of the President of India dated 7.11.1988.

1989

- Creation of an attached office of DGIT(Management Systems) to supervise Directorate of I.Tax(Research, Statistics, Publication & Public Relations) and Directorate of I.Tax (Organisation and Management Services) from Sept. 1989.

1990

- Gift tax Bill introduced on 31.5.1990.
- Creation of 65 posts of Dy. Commissioner of I.Tax by upgradation of equal number of posts of Asstt. Commissioner of I.Tax.

1991

- Interest Tax Act, 1974 revived.
- Directorate of I.Tax(Systems) started reporting directly to Board.

1992

- Rs. 1400 Presumptive Taxation scheme introduced as a measure to widen tax base.
- The post of Director General of Income-tax (Management Systems) was abolished.

1993

- 40 additional posts of Commissioner of Income-tax (Appeals) created.
- Authority for Advance Rulings set up.
- A comprehensive phased cadre review for Group B, C and D initiated.

1994

- 2068 additional posts in Group B, C and D sanctioned.
- New PAN introduced.
- Regional Computer Centres (RCCs) were set up in Chennai, Delhi and Mumbai.

1995

- New procedure for search assessment introduced.
- 50 years of training commemorated and "Seminar Twenty Five" introduced by National Academy of Direct Taxes.

1996

- 77 posts of Commissioners of Income-tax created.
- Infrastructure for operational needs strengthened.
- Study report on 4th cadre review of Group 'A' officers (IRS) of the Department prepared by Directorate of Income Tax (Organisation and Management Services).

1997

- Rates of Income-tax reduced significantly.
- Legal measures to widen tax base on certain economic indicators introduced in selected cities.
- Presumptive tax scheme discontinued.
- Voluntary Disclosure Scheme 1997 introduced.
- Minimum Alternate Tax introduced.
- National Computer Centre (NCC) was set up in Delhi.

1998

- Sec. 260A introduced enabling direct appeals to High Court.
- 1/6 Scheme & penalty for non-filing of return introduced to widen tax base.
- Gift-tax abolished for gifts made after 1.10.1998.
- Kar Vivad Samadhan Scheme 1998 introduced.
- Silver Jubilee of Regional Training Institutes celebrated.
- Designation of Asstt. Commissioner (Senior Time Scale) changed to Dy. Commissioner and that of Dy. Commissioner (Junior Administrative Grade) to Joint Commissioner.

1999

- Furnishing details of bank account and credit cards in the prescribed form made mandatory for refund purpose.
- Prima-facie adjustments to return done away with; acknowledgments to serve as intimations.
- Samman Scheme introduced in 1999 to honour deserving tax payers.

2000

- The process of implementation of restructuring of the Department commenced to increase efficiency and to deal with increased workload.
- Total sanctioned work force reduced from 61,031 to 58,315.
- Certain rationalisation measures at structural levels introduced.
- Interest-tax Act terminated with effect from 1-4-2000.

2001

- The restructuring of the Department resulted in reducing the stagnation at all levels and large number of personnel were promoted in various grades.
- Jurisdiction pattern was revamped.

- New posts were created at the level of DGIT/DIT in the areas of Research, International Taxation and Infrastructure.

2002

- Computerised processing of returns all over the country introduced.
- Kelkar Committee Report, inter alia, recommended :-
  i. Outsourcing of non-core functions of the department ;
  ii. Reduction in exemptions, deductions, reliefs, rebates etc.
- The National Website of the Income Tax Department (www.incometaxindia.gov.in) was launched to provide a vital interface between the Department and taxpayers.

2003

- The National Website of the Department (www.incometaxindia.gov.in) won the Silver Medal in the category of the 'Government Websites'under the National e-Governance Awards.

2004

- As a measure of widening of tax base, the concept of AIR (Annual Information Return) was introduced.
- Fringe Benefit Tax (FBT) was introduced as a major step towards widening of tax base and bolstering of the Direct Tax Collection.
- Securities Transaction Tax (STT) was introduced.

2005

- Tonnage Tax was introduced for the Shipping Companies.
- Banking Cash Transaction Tax (BCTT) was introduced w.e.f. 01-06-2005.

2006

- A project for enabling electronic filing (e-filing) of Income Tax Returns was launched.
- Tax Return Preparer Scheme (TRPS) was launched to assist individuals and HUF taxpayers to file their Return of Income.
- The institution of Income Tax Ombudsman set up in 12 cities throughout the country to look into tax related grievances of the common public.

2007

- The Refund Banker Scheme was launched in Delhi and Patna charges.
- Sevottam Scheme was launchedto standardize service delivery to the taxpayers.

- The first citizen-friendly single window Aayakar Seva Kendra (ASK)was setup,for centralized receipt and registration of specified categories of documents, including income tax returns.
- The Income Tax Department became the biggest revenue mobiliser for the Government in 2007-08, with its share increasing from 34.76%in 1997-98 to 52.75%in 2007-08.
- All India Tax Network (TAXNET) was setup connecting more than 700 offices in more than500 cities. Consolidation of 36 (RCC) independent regional databases into a single centralized database (PDC or Primary Data Centre) was carried out.
- Integrated Taxpayer Data Management System (ITDMS) for drawing of 360° taxpayer profile was launched.

2008

- Cyber Forensic Labs were setup to identify relevant digital data during search and survey operations, recover hidden or password protected or deleted data and store retrieved data in a manner so that it could be used as evidence in judicial proceedings.
- Electronic filing of Income Tax Returns Project was awarded Silver Award in the category "Outstanding Performance in Citizen Centric Service Delivery" under the National e-Governance Awardsfor the year 2007-08.

2009

- Centralized Processing Centre was setup in Bengaluru for bulk processing of e-filed and paper returns. The Centre operates without any interface with taxpayers in a jurisdiction – free manner.

2010

- Integrated Tax Payer Data Management System (ITDMS) was conferred the Prime Minister's Award for 'Excellence in Governance and Administration'.
- CPC Bengaluru awarded the Gold Award for 'Excellence in Government Process Re-engineering' under the National e-Governance Awards for the year 2010-2011.
- To simplify the 50 years old Income-tax Act, 1961,'The Direct Taxes Code Bill, 2010' was introduced in the Parliament.

2011

- Foreign Tax Division of CBDT was strengthened to effectively handle the increase in tax information exchangeand transfer pricing issues.
- Various IT initiatives were taken for efficient tax administration. These include e-filing and e-payment of taxes, adoption of 'Sevottam' concept by CBEC and CBDT, web based facility for tax payers to track the resolution of refunds and credit for pre-paid taxes and augmentation of processing capacity.
- A new simplified form 'Sugam' was introduced to reduce the compliance burden of small tax payers falling within presumptive taxation.

2012

- Senior Citizens (not having any income from business/profession), were exempted from payment of advance tax.
- TRACES (TDS Reconciliation, Accounting and Correction Enabling System) launched to serve an integrated one-stop platform for the stakeholders to facilitate the services related to TDS operations.

2013

- The Government approved the Cadre restructuring of the Department for the creation of 20,751 additional posts and for carrying out various measures to increase the effectiveness of the Department.
- Briefly, the salient features of the approved restructuring are as under:
  - ✓ a. Number of assessment units (AUs) increased by 1080 from 3420 to 4500, for strengthening the tax-administration;
  - ✓ b. Each Range to have one more Assessing Officer;
  - ✓ c. Increase in the number` of Administrative CsIT deployed on assessment related functions to increase from 228 to 250;
  - ✓ d. 114 Special Ranges to be created, with adequate supporting manpower;
  - ✓ e. Creation of reserves numbering 620 created in the IRS cadre;
  - ✓ f. Bifurcation of the posts of the CITs in the HAG and SAG scales, on functional basis;
  - ✓ g. Upgradation of all existing 116 posts of CCsIT in HAG+ and Apex scales along with an increase of their number by 1 post;
  - ✓ h. Strengthening of the training set-up with creation of three more RTIs;
  - ✓ i. Strengthening the Appellate/Advocacy Structure by increasing the number of CIT Appeals and providing them supporting manpower. Advocacy structure in the ITAT to be strengthened.

2014

- New National Website of the Income Tax Department www.incometaxindia.gov.in launched with enhanced new features and content.
- SIT to investigate Black Money in Swiss Bank Accounts formed
- Tax Administrative Reforms Commission (TARC) headed by Dr. Parthasarathi Shome submitted its report of reviewing the applicability of tax policies and tax laws in the context of global best practices and recommending measures for reforms required in tax administration to enhance its effectiveness and efficiency.

1.8 Summary

Taxes in India are levied by the Centre Government and the State governments. Some minor taxes are also levied by the local authorities such as the Municipality. Taxes are classified under two categories namely direct and indirect taxes. The largest difference between these taxes is their implementation. Direct taxes are paid by the assessee while indirect taxes are levied on goods and services. There are many Direct and Indirect Taxes applicable in India. But at present Goods and Services Tax is applicable instead of all indirect taxes in India. Despite of certain features of Indian Taxation System, some changes in the overall structure of taxes are required in near future for more revenue generation.

1.9 Glossary

1. Direct taxes :-Direct taxes are levied on individuals and corporate entities and cannot be transferred to others. These include income tax, wealth tax, and gift tax

2. Income tax: - As per the Income Tax (IT) Act, 1961 every assessee whose total income exceeds the maximum exempt limit is liable to pay this tax. The tax structure and rates are annually prescribed by the Union Budget. This tax is imposed during each assessment year, which commences on 1st April and ends on 31st March. The total income is calculated from various heads such as business and profession, house property, salaries, capital gains, and other sources.

3. Corporation Tax: The companies and business organizations in India are taxed on the income from their worldwide transactions under the provision of Income Tax Act, 1961. A corporation is deemed to be resident in India if it is incorporated in India or if it‘s control and management is situated entirely in India.

4. Indirect taxes : Indirect taxes are not directly paid by the assessee to the government authorities. These are levied on goods and services and collected by intermediaries (those who sell goods or offer services).

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1.12 Model Questions

1. Explain the Direct Tax and Indirect Taxes applicable in India by taking into consideration Goods and Services Tax.
2. Discuss the Indian Taxation system and its features.

3. Explain the various Revenue Authorities in India.

4. Explain the main features of a good taxation system?

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Latest updates -*Budget 2021 update :It has been proposed to exempt the senior citizens from filing income tax returns if pension income and interest income are their only annual income source. Section 194P has been newly inserted to enforce the banks to deduct tax on senior citizensmore than 75 years of age who have a pension and interest income from the bank.*

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Lesson-2

Concept of Tax Planning, Tax Avoidance, Tax Evasion and Tax Management

Structure

2.0 Objectives

After go through the lesson, you should be able to:

- Understand the concept of Tax Planning, its types and objectives
- Also to know the concept of Tax Evasion, Tax Avoidance and Tax Management and
- To understand the difference between Tax Planning & Tax Management and Tax Avoidance & Tax Evasion.

2.1 Introduction to Tax Planning

Tax planning is the process of analysing a financial plan or a situation from a tax perspective. The objective of tax planning is to make sure there is tax efficiency. With the help of tax planning, one can ensure that all elements of a financial plan can function together with maximum tax-efficiency. Tax planning is a significant component of a financial plan.

Reducing tax liability and increasing the ability to make contributions towards retirement plans are critical for success.

Tax planning comprises various considerations. Considerations such as size, the timing of income, timing of purchases, and planning are concerned with other kinds of expenditures. Also, the chosen investments and the various retirement plans should go hand-in-hand with the tax filing status as well as the deductions in order to create the best possible outcome.

Understanding Tax Planning

Tax planning plays an important role in the financial growth story of every individual as tax payments are compulsory for all individuals who fall under the IT bracket. With tax planning, one will be able to streamline his/her tax payments such that he or she will receive considerable returns over a specific period of time involving minimum risk. Also, effective tax planning will help in reducing a person's tax liability.

Tax planning can be classified into the following:

1. Permissive tax planning: Tax planning which falls under the framework of the law.
2. Purposive tax planning: Tax planning with a specific objective.
3. Long-range/short-range tax planning: Planning executed at the beginning and towards the end of the fiscal year.

Highlights of tax planning:

1. Tax planning is the process of analysing finances from a tax angle, with an aim to ensure maximum tax efficiency.
2. Considerations concerning tax planning will include timing of income, timing of purchases, planning for expenditures, and size.
3. Tax planning is vital for small as well as large businesses since it will be helpful for achieving business-related goals.

Tax planning is a broad term that is used to describe the processes utilized by individuals and businesses to pay the taxes due to local, state, and federal tax agencies. The process includes such elements as managing tax implications, understanding what type of expenses are tax deductible under current regulations, and in general planning for taxes in a manner that ensures the amount of tax due will be paid in a timely manner. One of the main focuses of tax planning is to apply current tax laws to the revenue that is received during a given tax period.

Tax planning is an arrangement of one‘s financial affairs in such a way so that he can minimise his tax liability by claiming maximum deductions, exemptions, rebates and reliefs within the purview of tax laws. But it does not imply taking undue advantage of loopholes in tax laws or evading tax liability. Hence tax planning is defined as the methods used by a tax payer to reduce his burden of taxes in a legal manner. Tax planning may be legitimate provided it is within theframe work of tax laws. Hence tax evasion and tax avoidance must be understood as distinct from tax planning.

Tax Planning in India:

In India, there are a number of tax saving options for all taxpayers. These options allow for a wide range of exemptions and deductions that help in limiting the overall tax liability. The deductions are available from Sections 80C through to 80U and can be claimed by eligible taxpayers. These deductions are made against the quantum of tax liabilities. There are various other sections under the Income Tax Act, 1961 that can reduce your tax liabilities such as exemptions and tax credits.

When tax planning is done inside the frameworks defined by the respective authorities, it is fully legal and in fact a smart decision. However, using shady techniques to avoid tax payments is illegal and you may get into trouble for doing so. Tax saving practices include tax avoidance, tax evasion and tax planning. Out of these tax planning is the only legal manner of reducing your tax liabilities. The government offers the different opportunities to save on taxes with the intention of reducing tax burden on a taxpayer through legal income tax planning methods.

2.2.1 Types of Tax Planning

1. **Short-range and long-range Tax Planning**: The tax planning which is made every year to arrive at specific or limited objectives is called short-range tax planning. Conversely, long-range tax planning alludes to such practices undertaken by the assessee which are not paid off immediately.

2. **Permissive Tax Planning**: Tax planning, wherein the planning is made as per expressed provision of the taxation laws is termed as permissive tax planning.

3. **Purposive Tax Planning**: Purposive tax planning refers to the tax planning method which misleads the law. Under this type, there is no expressed provision of the statute.

Tax planning means intelligently applying tax provisions to manage an individual‘s affairs, in order to avail the tax benefits based on the national priorities, in accordance with the interest of general public and government.

2.2.2. Objectives of Tax Planning

- **Reduction of Tax Liability**: An assessee can save the maximum amount of tax, by properly arranging his/her operations as per the requirements of the law, within the framework of the statute.
- **Minimization of Litigation**: There is a war-like situation between the taxpayers and tax collectors as the former wants the tax liability to be minimum while the latter attempts to extractthe maximum. So, a proper tax planning aims at conforming to the provisions of the tax law, in such a way that incidence of litigation is minimized.
- **Productive Investment**: One of the major objective of tax planning is channelisation of taxable income to different investment plans. It aims at the optimum utilization of resources for productive causes and relieving the assessee from tax liability.
- **Healthy Growth of Economy**: The growth and development of the economy greatly depend on the growth of its citizens. Tax planning measures involve generating white money that flows freely and results in the sound progress of the economy.
- **Economic Stability**: Proper tax planning brings economic stability by various techniques such as mobilizing resources for national projects or availing ways for investments which are productive in nature

2.2 Tax Evasion:

Each tax payer is expected to make voluntarily disclosures of his income and tax liabilities through legal compliance. When a tax payer deliberately or consciously does not furnish material particulars or furnishes inaccurate or false particulars or defrauds the State by violating any of the legal provisions, it shall be termed as tax evasion. Tax evasion is considered as unethical and illegal.

Tax evasion is the illegal evasion of taxes by individuals, corporations and trusts. Tax evasion often entails taxpayers deliberately misrepresenting the true state of their affairs to the tax authorities to reduce their tax liability and includes dishonest tax reporting, such as declaring less income, profits or gains than the amounts actually earned, or overstating deductions. Tax evasion is an activity commonly associated with the informal economy. One measure of the extent of tax evasion (the "tax gap") is the amount of unreported income, which is the difference between the amount of income that should be reported to the tax authorities and the actual amount reported.

2.2.1 Common Methods of Tax Evasion

There are two aspects of not paying taxes when they are due. The first is tax avoidance and the other tax evasion. The difference between the two is that tax avoidance is basically finding a loophole that exempts you from paying taxes and is not strictly illegal, while evasion is not paying the taxes when they are actually due, which is absolutely illegal. These are some of the ways in which people may avoid/evade taxes.

✓ Failing to pay the due

This is the simplest way in which someone may evade taxes. They simply won't pay it to the government, not even when the dues are called for. A person engaged in this sort of tax evasion won't, willingly or unwillingly, pay the tax before or after the due date.

✓ Smuggling:

When certain goods move from one location to another, across international or state borders, a tax or charge may be payable in order to move the goods. However, some individuals may move these goods in surreptitious ways in order to avoid paying those taxes that evading the tax altogether.

✓ Submitting false tax returns

In some cases, when an individual files taxes, they may submit false or incorrect information in order to either lessen the tax that they are supposed to pay or not pay it at all. This is also tax evasion since the complete information is not provided and they may actually be paying less than what they should.

✓ Inaccurate financial statements

The taxes that are payable by an individual or an organisation may be decided on the financial dealing that have taken place during the assessment year. If false financial documents or accounts books are submitted, ones that show incomes less than what was actually earned, the tax may come down.

✓ Using fake documents to claim exemption

The government may have provided certain exemptions and privileges to certain strata or members of society in order to ensure they have a bit more financial freedom to progress. In some cases, members who actually don't qualify for such privileges will get documents created to support their claim of being a part of that group thus claiming exemptions where they are not suited.

✓ Not reporting income

It could be said that this is one of the most common methods of tax evasion. In this case, individual just won't report any income that they receive during a financial year. Not having reported any income, they don't pay any tax thus successfully evading tax all together. The simplest example of this would be a landlord who has kept tenants but has not informed the authorities that he has rented the house and is actually receiving an income from it.

✓ Bribery

There may be a situation where there a certain amount due in taxes which the individual may not be willing to pay. In such a case he or she may actually offer a bribe to officials to not make them pay the tax and to make it 'disappear'.

✓ Storing wealth outside the country

We have all heard tales of Swiss bank accounts. Offshore accounts are accounts maintained outside the country and information about the dealing in these accounts is not disclosed to the income tax department thereby evading any and all taxes due on that wealth.

2.2.2 Penalties for Tax Evasion

There are various penalties that the income tax department can impose on anyone who is found guilty of evading or avoiding taxes. These penalties can also apply to companies that either fail to report and pay their own taxes or fail to deduct taxes at source when they are supposed to.

Some of these may be:

- Collecting 100% to 300% of the tax when income is not disclosed.
- In case of a failure to pay the tax due, the assessing officer may impose a penalty amount but it cannot exceed the amount due in taxes.
- If an individual fails to file tax statements within the time allotted then a penalty of Rs. 200 per day may be charged for every day that the statements are not filed.
- In case someone has concealed details of their income or any fringe benefits that are taxable, the penalty can range from 100% to 300% of the tax amount due.
- In case a person or a company fails to maintain their accounts properly as directed by section 44AA, a penalty of Rs. 25,000 may be levied.
- If a company fails to get itself audited or fails to provide a report of said audit, then a penalty of Rs. 1.5 lakhs or 0.5% of the sales turnover, whichever is less, may be charged.
- If a report from an accountant is not provided as directed then a fine of Rs. 1 lakh may be levied.
- In case an organisation fails to deduct tax where it is supposed to while making payments then the penalty could be payment of the tax due.

2.3 Tax avoidance:

It is on the other hand, is a method of reducing tax liability by availing of certain loop holes and lacunae in the law. It is the art of escaping the burden of tax without breaking the law. However, this kind of tax planning demands a thorough knowledge of the provisions of the tax laws and relevant legal decisions as well as other statutes affecting any aspect of taxation. In this context, it is worth noting that taking advantage of the loopholes in law provides only short run benefits because, as and when the loopholes in the law are made public or sometimes even earlier, legislature steps into plug the loopholes. The term avoidance has also been used in the tax regulationsofsome jurisdictions todistinguish tax avoidance foreseen by the legislators from tax avoidance which exploits loopholes in the law.

How is it done?

Big business houses in India utilize many strategies in order to avoid tax. There is a huge role of tax havens and subsidiaries in these strategies.

The term ‗tax haven' is a country that offers foreign individuals and businesses a minimal tax liability in a politically and economically stable environment, with little or no financial information shared with foreign tax authorities.

The term ‗subsidiary' is a company with stock that is more than 50% controlled by another company, which is usually referred to as the parent company or the holding company.

Movement of assets, shares, deals and money from India to these tax havens through subsidiaries is the most favored and advantageous strategy amongst big business houses in India. Since 2005, many Indian and foreign companies that are set up in India have been using tax havens and subsidiaries in order to avoid tax. We will discuss the strategies used by these large corporations in order to avoid tax, in depth below.

Vodafone

In 2007, Vodafone International Holdings B.V. based in Netherlands, purchased Hutch Essar in India through a complex tax avoidance strategy. The idea of this strategy was to avoid paying capital gains tax in India through non-resident companies in the deal. The non-resident companies were their own subsidiaries operating outside India. Vodafone International Holding B.V. purchased 67% controlling shares of CGP International based in Cayman Islands, which was a subsidiary company of Hutchison Telecommunication International Limited (HTIL). CGP already had a controlling share in Hutch Essar in India before the deal and by the transfer of 67% controlling share of CGP, Vodafone International Holdings B.V., acquired the controlling stake in Hutch Essar India.

Following this deal, Income tax authorities issued show cause notice to Vodafone International Holdings B.V. and in turn VIH filed a writ in High court challenging the same, which was dismissed by high court with a view that Vodafone International Holdings B.V. must pay capital gains tax, as the sale of shares from CGP to VIH B.V. qualifies as capital transfer and attracts capital gains tax of nearly Rs.12000 crores. Pursuant to High Court's dismissal, VIH filed a Special Leave Petition in Supreme Court of India challenging the High Court's order. In 2012, Supreme Court of India held that the High Court's view lacked authority of law and was quashed, as the transaction took place between two non-resident Companies of India. Hence, Vodafone acquired Hutch Essar India without paying capital gains tax.

Reliance India Limited

Before 1995, Reliance was infamously known as zero tax company in India, as it used to pay zero or close to zero tax each year.

A zero tax company is ―a business that shows a book profit and pays dividends to investors but does not pay taxes.‖

It continued to exploit the loopholes in taxation system in India in order to avoid tax through subsidiaries, which used to make raw materials and other components in countries with low tax rates and Indian parent company purchased these raw materials at prices more than the tangible cost thereby reducing their net income and subsidiaries escaped from paying taxes in India.

Reliance enjoyed its successful strategies of Tax Avoidance only till 1996-1997, when in order to combat the menace of ―Zero Tax Companies‖, ―Minimum Alternative Tax‖ was introduced in India and concept of Corporate Income Tax was added. However, that did not deter the Reliance India Limited in their ventures of Tax Avoidance. In order to check the efficiency of Income Tax department in assessing big business houses, in March, 2018, Central Auditor General of India conducted an integrated audit of Reliance India Limited along with its other group entities.

According to the news report (see here), during audit it was found that RIL used many methods to avoid taxation including ―the merger and demerger of group entities, transactions with related parties, layering of transactions with subsidiary companies‖, in order to lower the tax burden.

Google India

Google is the world‗s favourite search engine and has plethora of companies functioning under it. There is one extremely clever and elaborate tax avoidance strategy, which is used by many large corporations including Google, which is called the ***―Double Irish with a Dutch Sandwich‖***.

It is a dubious trick used by Google to avoid taxes through subsidiaries in Netherland and Ireland. In this technique large corporations use a combination of Irish and Dutch subsidiary companies to shift profits to low or no tax jurisdictions. It further involves sending profits first through one Irish company, then to a Dutch company and finally to second Irish company, headquartered in a tax haven. This particular technique allows many corporations to reduce their overall corporate tax rates dramatically. Using this technique, Google has successfully saved billions of dollars.

Similarly, Google India which is a subsidiary of Google International LLC and is an authorised distributor of Google Ireland‗s ‗AdWords‗ programme to Indian advertisers. Google AdWords is Google‗s advertising system in which advertisers bid on certain keywords in order for their clickable ads to appear in Google‗s search results. Google Ireland owns the ‗AdWords‗ technology and as it merely authorized Google India to use it, the revenue will come back to Google Ireland, where google has to pay tax way less than India.

However, for the same transaction, Income Tax Appellate Tribunal, India, ordered Google India to pay tax close to Rs.1457 crores which were avoided in tax by Google India for the assessment years 2007-2006 to 2012-2013.

After losing six years long battle, Google India spokesperson in an interview (see here) said that Google India complies with all tax laws in India and pays all applicable taxes and they will file an appeal, as the ITAT ruling, according to Google, ―*is a clear departure from previous judgments on the issue and is not in line with India's double taxation avoidance agreements*‖.

Tata Industries

Tata Industries sold their shareholding in Idea cellular in 2007 to Birla TMT Holdings through its subsidiary called Apex situated in Mauritius and through this, avoided to pay tax in India. Income Tax officials flagged this deal and determined the capital gains tax in this deal to the tune of INR 1,00,000 crore under Section 93 of Income Tax Act. However, Income Tax Appellate Tribunal held that as there was no transfer of assets by a tax resident of India to a non-resident, and they cannot be taxed on the capital gains that arose on sale of Idea shares by its Mauritius subsidiary.

Tata Industries under its umbrella, has several charitable trusts formed for charitable purposes called Tata Trusts. These charitable trust such as, Jamshedji Tata Trust and Navajbhai Ratan Tata Trust, enjoy tax exemptions under the Income Tax Act. According to Controller and Auditor General‘s report of 2013, Tata trust was earning huge profits instead of utilizing it for charitable purposes and accumulating surplus funds. These surplus funds were then used for creating fixed assets for earning more profits or were transferred to other trusts, rather than for charitable purposes in order to avoid tax.

Proactive steps by Indian Government in order to curb tax avoidance

Tax avoidance strategies used by big business houses around the world cause a great deal of loss to the revenue of many governments around the world, including India. In India, many cases of tax avoidances arose in the last two decades, some of which have been discussed in detail above, which forced the government to work out its laws and treaties with foreign countries in order to curb tax avoidance. Indian Government framed certain rules and guidelines in order to regulate and restrain tax avoidance through Income Tax Act, 1961 and Finance Act, 2015.

General Anti-Avoidance Rule (GAAR) was included in Chapter X-A of Income Tax Act, 1961. GAAR was introduced in Income Tax Act, by the Finance Act, 2012, yet came into effect from 1st day of April, 2017. The sole purpose of introducing GAAR was to curb tax avoidance strategiesthrough a provision ―Section 96. Impermissible avoidance arrangement‖, which was imbedded in Income Tax Act. According to the provision, arrangements or deals made in order to obtain a tax benefit were impermissible.

Amendment of section 6(3) of Finance Act, 2015 was done in order to replace a new test of corporate residence, which provided that if place of effective management (POEM) is found to be situated in India, then a foreign company will be a tax resident of India. Before this amendment, for tax purposes, a company that was not a resident of India was only considered resident, if it was controlled and managed in India.

Indian government in 2017 took various steps in order to align the rules and guidelines as per the Base erosion and profit shifting (BEPS) suggested by The Organisation for Economic Co- operation and Development (OECD), which could curb the menace of tax avoidance, which includes BEPS action plan 13, 1 and 5.

2.4 Tax Management:

Tax planning is a wider term and it includes tax management also. Tax management is an important aspect of tax planning. Planning which leads to filing of various returns in time, compliance of the applicable provisions of law and avoiding of levy of interest and penalties can be termed as efficient tax management. It is an exercise by which defaults are avoided and legal compliance is secured. The filing of returns with all proper documentary evidence for the various claims, rebates, reliefs, deductions and computation of income and tax liability would come under the purview of tax management. The assessee is exposed to certain unpleasant consequences if obligations cast under the tax laws are not duly discharged. Such consequences take shape of levy of interest, penalty, prosecutions, forfeiture of certain rights etc. Therefore any effort in tax planning is incomplete unless proper discharge of responsibilities is made. Tax management includes:

- Compiling and preserving data and supporting documents evidencing transactions, claims etc.
- Making timely payment of taxes.
- TDS and TCS compliance.

- Following procedural requirements.
- Timely filing of returns.
- Responding to notices received from the authorities.
- Preserving record for the prescribed number of years.
- Mentioning PAN, TAN etc. at appropriate places.

2.5 Difference between Tax Planning and Tax Management

Tax Planning	**Tax Management**
The Objective of Tax Planning is to minimize the tax liability	The objective of Tax Management is to comply with the provisions of Income Tax Law and its allied rules
Tax Planning also includes Tax Management	Tax Management deals with filing of Return in
Tax Planning relates to future.	Tax Management relates to Past,. Present, Future, Past – Assessment Proceedings, Appeals, Revisions etc. Present – Filing of Return, payment of advance tax etc. Future – To take corrective action
Tax Planning helps in minimizing Tax Liability in Short-Term and in Long Term.	Tax Management helps in avoiding paymentof interest, penalty, prosecution etc.
Tax Planning is optional.	Tax Management is essential for everyassessee.

2.6 Difference between Tax Avoidance and Tax Evasion

Tax Avoidance	**Tax Evasion**
Where the payment of tax is avoided though by complying with the provisions of law but defeating the intension of the law is known as tax Avoidance.	Where the payment of tax is avoided through illegal means or fraud is termed as tax evasion.
Tax Avoidance is undertaken by taking advantage of loop holes in law	Tax evasion is undertaken by employing unfair means
Tax Avoidance is done through not malafied intention but complying the provision of law.	Tax Evasion is an unlawful way of paying tax and defaulter may punish.
Tax Avoidance looks like a tax planning and is done before the tax liability arises.	Tax evasion is blatant fraud and is done after the tax liability has arisen.

2.8 Problems in Tax Planning

1. New mandatory tax situations: For the most part, important elements of tax rules such as tax slabs and tax rates have remained largely unchanged from last year. However, following recent amendment, there are certain new taxable conditions this year that may not have qualified for tax filing last year. As per our tax planning guide, these are essential to keep in mind in order to avoid running into tax troubles. Income Tax filing for this financial year is mandatory for you if:

a) You deposited more than Rs 1 crore in your current account

b) Your foreign travel expenses incurred for self or any other person exceeded Rs 2 lakhs

c) Your electricity bills amounted to Rs 1 lakh or more

2. For Non-Resident Indians: If you or a family member is currently a non-resident Indian, that is an NRI, your tax planning might also have to factor for the valuable gifts you exchange. As per recent amendment, transfer of gifts made to an NRI will be taxable and liable to be declared by the recipient, that is the NRI. This tax is levied as per the regular income tax slabs and therefore, the value of the gift will determine the rate and amount of tax paid by the NRI. Keep in mind that the definition of a gift in this context can vary from a valuable object, to education expenses to even transfer of property.

3. Scrambling for documents: The first and most avoidable tax problem you might face is the bringing together of all the required documents for your tax purposes. A single missing file can cause immense tax troubles for you. So, as per any tax planning guide, a good practice this year will be to start collecting all the necessary files, invoices, statements and documents that you might need for the filing next year. Right around the tax season, make sure to have at least Form 16 and Form 26AS handy as they contain essential details about your income and taxes deducted.

4. Overpaying: The last thing you would want to do when tax season arrives is to overpay your share of taxes. Therefore, avoid falling into this situation by preparing accounts of your tax liabilities in advance. Also, make a note of all the tax-saving deductions and exemptions applicable to you and you arrive at the correct, considerably reduced taxable income. For instance, term insurance premiums qualify for a deduction under Section 80C of the Income Tax Act, 1961. You can learn more about Term Insurance by browsing the website for the various Term Plans offered by PNB MetLife.

5. Applicable form confusion: While planning for your taxes, you might also find yourself extremely confused by the plethora of forms available. There are about 9 types of ITR forms available in total for tax purposes, but out of these, only six are typically relevant for the average taxpayer: ITR-1, ITR-2, ITR-2A, ITR-3, ITR-4 and ITR-4S. All of these are distinguished based on your residential and citizenship status as well as the type andsources of your overall income. A single incorrect detail can invalidate your entire

Income Tax filing, so make sure to do ample research and find out the right form for you.

2.8 Summary

Tax planning is an arrangement of one‘s financial affairs in such a way so that he can minimise his tax liability by claiming maximum deductions, exemptions, rebates and reliefs within the purview of tax laws. But it does not imply taking undue advantage of loopholes in tax laws or evading tax liability. When a tax payer deliberately or consciously does not furnish material particulars or furnishes inaccurate or false particulars or defrauds the State by violating any of the legal provisions, it shall be termed as tax evasion. Tax evasion is considered as unethical and illegal. It is on the other hand, is a method of reducing tax liability by availing of certain loop holes and lacunae in the law. It is the art of escaping the burden of tax without breaking the law. However, this kind of tax planning demands a thorough knowledge of the provisions of the tax laws and relevant legal decisions as well as other statutes affecting any aspect of taxation. Tax planning is a wider term and it includes tax management also. Tax management is an important aspect of tax planning. Planning which leads to filing of various returns in time, compliance of the applicable provisions of law and avoiding of levy of interest and penalties can be termed as efficient tax management. It is an exercise by which defaults are avoided and legal compliance is secured.

2.9 Glossary

- **Tax evasion** is the illegal evasion of taxes by individuals, corporations and trusts. Tax evasion often entails taxpayers deliberately misrepresenting the true state of their affairs to the tax authorities to reduce their tax liability and includes dishonest tax reporting, such as declaring less income, profits or gains than the amounts actually earned, or overstating deductions.

- **Tax planning** is an arrangement of one's financial affairs in such a way so that he can minimise his tax liability by claiming maximum deductions, exemptions, rebates and reliefs within the purview of tax laws. But it does not imply taking undue advantage of loopholes in tax laws or evading tax liability. Hence tax planning is defined as the methods used by a tax payer to reduce his burden of taxes in a legal manner.

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2.12 Model Questions

1. Define the concept of Tax Planning, its types and objectives.
2. Explain the need, significance and limitations of tax planning?
3. Discuss the concept of Tax Evasion, Tax Avoidance and Tax Management.
4. Distinguish between Tax Planning & Tax Management and Tax Avoidance & Tax Evasion.
5. ―Tax Management is a road that leads to tax planning‖. Do you agree? Give examples also.
6. Discuss the various implications of tax planning?

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Lesson-3

Residential Status of Companies including Set-off and Carry Forward of Losses inCertain Companies

Structure

3.1 Objectives

After go through the lesson, you should be able to:

- Understand the Residential Status of an Individual, HUF, AOP, Firm & Company
- Also to know the tax incidence according to Residential Status of various entities.
- Understand the provisions relating to Set-Off and Carry Forward of Companies.
- Also to know the conditions applicable to claim the benefits of carry forward of losses in certain cases.

3.2 Introduction

All Taxable entities are divided in the following categories for the purpose of determining Residential Status under Income Tax Act,1961.

a. an individual

b. a Hindu Undivided Family (HUF)

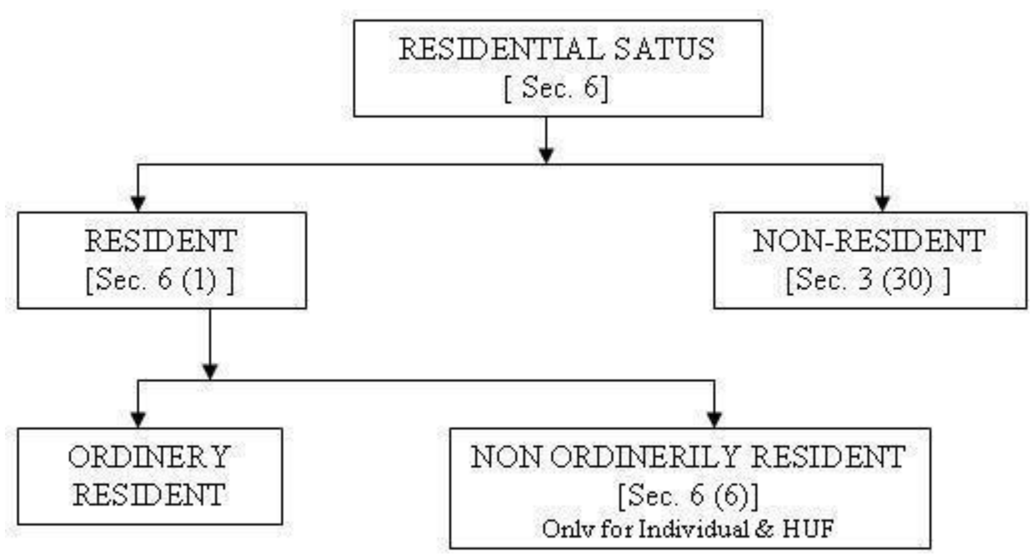
c. a Firm or an Association of Person (AOP)

d. a joint stock company ; and

e. every other person

Tax is levied on total income of assessee. Under the provisions of Income Tax Act, 1961 the total income on each person is based upon his Residential Status. Sec. 6 of the Act divides the assessable persons into three categories:

(i) Resident; (ii) Resident but Not ordinarily Resident; and (iii) Non-Resident.



The concept of Residential Status has nothing to do with nationality or domestic of a person. An Indian, who is a citizen of India can be non-resident for Income Tax purposes, whereas an American who is a citizen of America can be Resident of India for Income Tax purposes. Residential Status of a person depends upon the territorial connections of the person with this country, i.e. for how many days he has physically stayed in India.

The Residential Status of different types of persons is determined differently. Similarly, the Residential Status of the Assessee is to be determined each year with reference to the ―Previous Year‖. The Residential Status of the Assessee may change from Year to Year. What is essential is the Status during the Previous year and not in the assessment year.

3.3 Residential Status of An 'Individual'

An individual may be …

(a) Resident and ordinarily Resident in India

(b) Resident and not-ordinarily Resident in India;

(c) non-resident in India.

(a) Resident and Ordinary Resident [Sec. 6 (1), 6(6)(a)]

To determine the Residential Status of an Individual, Sec. 6 (1) prescribes Two Test. An individual who fulfils any one of the following Two Tests is called Resident under the provisions of this Act. These Tests are :

Test No. 1. Stay in India for 182 days or more.

If an individual has to become Resend of India during any previous year, his / her personal stay in India during that year is a must although the number of days of stay differs in the two tests. It means that if an individual does not stay in India at all in any previous year , he cannot be Resident of India in that year. Stay in India means that the individual should have stayed in India territory and anywhere (cities, villages, hills, even Indian territory waters) for such number of days.

The period of 182 days need not be at a stretch. But physical presence for an aggregate of 182 days in the relevant previous is enough. The Status of Resident is not linked with any particular place or town or house.

The onus to prove the number of days of stay in India lies on the assessee. It is for him to prove, if he desires to be taxed as non-resident or not ordinarily resident.

Test No. 2. Presence for 365 days during the Four preceding Previous Year and 60 days or more in that relevant Previous Year.

A person may be frequent visitor to India. In his case, the residential status will be determined on the basis of his presence in India for 365 days in four years immediately preceding the relevant Previous year. Along with this his presence for 60 days during the relevant previous year is another essential conditions to be fulfilled. The purpose, object or reason of visit to and stay in India has nothing to do with the determination of residential status.

Explanations :

For Indian Citizen going abroad on a Job or as a member of crew of an Indian ship [Explanation]

In case of Indian citizen who is going outside Indian for a Job and his contact for such employment outside India has been approved by the Central Government or he is a member of crew of an IndianShip, Test (a) u/s 6(1) remains same but in Test (b) words ‗60 days' have been replaced to 182 days.

For Indian Citizens and Persons of Indian Origin [Explanation (b)] For suchperson Test (a) remains the same but in Test (b) words _60 days' have been replaced to 182 days.

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

(a) Resident but not Ordinarily Resident [Section 6(6)]

An individual who is resident u/s 6(1) can claim the beneficial status of N.O.R. if he can prove that :

(a) He was non resident in India for 9 previous years out of 10 previous years preceding the relevant previous year.

OR

(b) He was in India for a period or periods aggregating in all to 729 days or less during seven previous years preceeding the relevant previous year.

An individual who is Resident u/s 6(1) can be subdivided into two categories :

(a) Ordinary Resident ; or (b) Not ordinarily Resident (C) Non- Resident [Sec. 2 (30)]

Under Sec. 2(30) of the Income Tax Act, 1961 an assessee who does not fulfill any of the two conditions given in Sec. 6(1) (a) or (b) would be regarded as ―Non-Resident‖ assessee during the relevant previous year for all purposes of this Act.

3.4 Residential Status of 'H.U.F.', 'FIRM', 'A.O.P.'

Section 6(2) of the Act provides that status of these persons shall be determined as per Tests given below :

(a) Resident [Sec. 6 (2)]

It means that if a H.U.F. , FIRM, AOP is controlled from India even partially it will be Resident assessee.

The Control and management of affairs refers to the controlling and directing power, the Head and the Brain. It means that decision making power for vital affairs is situated in India. The control and management means de facto control and management and not merely the right to control or manage.

In case of a Firm, it is said that the control and management of firm is saturated at a place where partners meet to decide the affairs of the firm. If such place is outside India, it will be said that the control and management is outside India.

(b) Non- Resident [Sec. 2 (30)]

a H.U.F. , FIRM, AOP shall be Non-Resident if the control and management affairs is situated wholly outside India.

(c) Not Ordinarily Resident [Sec. 6 (6) b]

H.U.F. will be _Not Ordinarily Resident' if :

(i) its manager (Karta) has not been resident in India in 9 out of 10 previous year preceding the relevant accounting year ; or

(ii) the manage had not , during the 7 previous year preceding the relevant accounting year been present in India for a period or periods amounting in all to 730 days.

While determining the Residential Status of a Firm or HUF Is should be noted that Residential Status of Partners or co-parceners of a HUF is of immaterial consideration. What is important to note is that from where the business is being controlled. There may be a situation where all the partners of a Firm are Resident in India but even then that Firm may be Non-Resident if its full control and management lies outside India.

3.5 Residential Status of A 'Company' [Sec.6(3)]

An Indian Company is always Resident in India. A foreign Company is resident in India, only if, during the previous year, control and management of its affairs is situated wholly in India. Conversely, a Foreign Company is treated as Non-Resident if, during the previous year, Control and Management of its affairs is either wholly or partially situated out of India.

The Table given below highlights the same proposition ---

Place of Control	**Residential Status**	
	AnIndian company	**A Company other than an IndianCompany**
Control and Management of the affairs of a company is situated : - • Wholly in India • Wholly outside India • Partly in Indian and partly outside India	Resident Resident Resident	Resident Non-Resident Non- Resident

Residential status of companies according to its types are given below:-

1. COMPANY [Sec. 2(17)] A "Company" means-

(i) any Indian company, or

(ii) anybody corporate incorporated by or under the laws of a country outside India, i.e.

Foreign Company as defined u/s 2(23A)] 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

(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:

2. INDIAN COMPANY [Sec. 2(26)]

"Indian company" means a company formed and registered under the Companies Act, 1956, and includes-

(i) a company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir [and the Union territories specified in sub-clause (iii) of this clause]);

(ia) a corporation established by or under a Central, State or Provincial Act;

(ib) any institution, association or body which is declared by the Board to be a company under section 2(17);

(ii) in the case of the State of Jammu and Kashmir, a company formed and registered under any law for the time being in force in that State;

(iii) in the case of any of the Union territories of Dadra andNagar 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:

Provided that the registered or principal office of the company, corporation, institution, association or body, in all cases is in India.

Section 6(3). Residential Status of an Indian Company

Indian companies are always treated as Resident in India whether Control and Management is in India or outside India.

3. FOREIGN COMPANY [Sec. 2(23A)]

It means a company which is not a domestic company, i.e. a company registered outside India in any other foreign country.

The Foreign Company may be treated as Domestic Company if such company makes prescribed arrangement in India as per Rule 27.

Rule 27.Prescribed arrangement for declaration and payment of dividends within India.

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

1. 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 1st day of April of such year.

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

3. The Dividend declared , if any, shall be payable only within India to all shareholder Sec.6(3), Residential Status of foreign Company

Foreign Company is treated as Resident in India if its Control and Management is located wholly in India.

Foreign Company is treated as Non-Resident in India if its Control and Management located wholly / partially Outside India.

Sections applicable to Foreign Company are 44BBB, 44D, 115A, 195 etc.

4. DOMESTIC COMPANY

A Domestic Company means an Indian Company or any other company with respect to 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.

Thus, all Indian Company are treated as Domestic Company but all Domestic Company are not Indian Company.

If a Foreign Company makes prescribed arrangements for payment of dividends in India it shall be treated as Domestic Company.

5. **A COMPANY IN WHICH PUBLIC ARE SUBSTANTIALLY INTERESTED [Sec.2(18)]** It includes :

(i) Government Company : A company owned by the Government or the Reserve Bank of India

(ii) A Company having Govt. participation : A Company in which not less than 40% of the shares are held (whether singly or taken together) by the Government or the Reserve Bank of India or a corporation owned by RBI.(i.e. at least 40% of holding should be held by Govt. or RBI)

(iii) Section 25 Companies :Companies registered under section 25 of the IndianCompanies Act, 1956. These are companies which are promoted with special object to promote commerce, art, science, charity or religion or any other useful object (these companies lose the status of a company in which the public are substantially interested at any time they declare dividend).

(iv) A Company declared by the CBDT : It is a company without share capital and which having regard to its object, nature and composition of its membership or other relevant consideration is declared by the Board to be a company in which public are substantially interested for the relevant AY.

(v) Mutual Benefit finance Company : Where principal business of the company is acceptance of deposits from its members and which has been declared by the Central Government to be a Nidhi or Mutual Benefit Society.

(vi) A Company having Co-operative Society participation :It is a company in which at least 50% or more equity shares have been held by one or more co-operative societies throughout the PY.

(vii) A Company is deemed to be a Public Company if it is not a Private Company as defined by the Companies Act, 1956 and is fulfilling either of the following two conditions :

1. A listed Public Company : Its equity share were listed on a recognized stock exchange, as on the last day of the relevant PY ; or

2. Any other Public Company : Its equity shares carrying at least 50% of the voting power (in the case of an industrial company the limit is 40%) were beneficially held throughout the relevant PY by Government, a statutory corporation, a company in which the public are substantially interested or a wholly owned subsidiary of such a company.

Widely Held Company: The Company in which the public are substantially interested is also known as wholly held Company.

Closely Held Company: It is a Company in which the public are NOT substantially interested. This type of company is referred in Sec.2 (22)(e) and Sec. 79.

3.7 Introduction to Set-off and Carry Forward of Losses

As per Income Tax Act 1961, a Person as defined in Section 2(31) can set off and Carry forward the losses incurred. It is a big boon to a Person, because it plays an important role on the financial condition of a Person who has incurred such Losses. Set off means adjusting the lossesagainst the profit of that financial year. In case if there is no adequate profits to set off the entire loss it can be carry forward to next Assessment Years subject to the conditions stated in the Act. If it is not possible for an Assessee to set off the losses under inter source adjustments and inter head adjustments he can carry forward the same to the next Assessment Years.

3.8 Business Loss [Section 72 (1)]

The loss under business head except speculation loss, shall be adjusted against the income from any other head in the same assessment year. If the whole business loss cannot be set-off because of insufficiency of income under other heads in the same assessment year, such business loss shall be carried forward and set-off against the income of any business or profession carried on by the assessee and assessable in that assessment year. Thus a business loss can be carried forward over 8 subsequent assessment years and set-off wherever profits are available provided the same business is continued for which the loss was originally computed. A carried forward non- speculation business loss can be set-off against the income of any business (including speculation business profit) carried on by the assessee.

The other important points to be noted in the carry forward and set-off business loss, are given as follows:

(1) The person who has incurred the loss, alone has the right to carry it forward. The successor except succession by inheritance (business passing from father to son) cannot claim to carry forward the loss incurred by his predecessor in business. Where a company merges with another under the scheme of amalgamation, the past loss of the amalgamating company can be carried forward by the new company.

(2) The business loss which can be carried forward must have been computed by the Assessing Officer on the basis of return filed by the assessee under Section 139.

(3) The unabsorbed business loss of an industrial undertaking which was discontinued due to natural calamities (as discussed u/s 33B), shall be carried forward and set-off against the profit of the reconstructed, re-established business upto a period of 8 years as reckoned from the previous year in which the business is re-started.

(4) The business loss could be carried forward for 8 succeeding previous years to be set off from income under the head ‗Profits and gains of business or profession‘.

(5) Loss from any asset held as stock-in-trade can be set-off from any income from such asset even if it is taxable under the head ‗Other Sources‘.

(6) Unabsorbed Depreciation

With effect from AIY 2002-03 depreciation which remains unadjusted as either there is no income or less income in the relevant previous year, it can be carried forward till it is fully adjusted from any income during the succeeding previous years. It shall be treated as depreciation of the succeeding previous year.

In case there is C/F business as well as C/F unabsorbed depreciation, then his following order should be followed for set off.

(i) Firstly Current depreciation

(ii) Secondly brought forward business loss

(iii) Thirdly brought forward/unabsorbed depreciation.

3.9 Loss of speculation business.

Where for any assessment year the loss under speculation business has not been wholly set-off against the income of another speculation business, such part of speculation loss shall be carried forward to the following assessment year and set-off only against the profits of any speculation business carried on by the assessee and assessable during those assessment, years. The unabsorbed speculation business loss is eligible for carry forward upto eight assessment years immediately succeeding the assessment year for which the loss was computed.

If the assessee leaves one type of speculation business and its unabsorbed loss could not be set-off against the income of any other speculation business which the assessee may start, the carry forward loss of speculation business which is discontinued is eligible for setting off against the assesses income of another speculation business.

3.10 Loss under the head capital gains

(1) It can be carried forward for 8 succeeding previous years to be set off only from income underthe head capital gains in following manner:

(a) Short term capital loss can be set off from either short term capital gain or long term capital gain.

(b) Long term capital loss can be set off only from long term capital gain

(2) No loss under the head Capital Gain shall be carried forward for more than 8 assessment years succeeding the assessment year in which such loss was first computed. [Section 74 (2))

3.11 Loss under the head 'Other Sources' [Section 74A (3)]

Under the head *'Other Sources'* only expenses on maintenance of horses can be set-off from income of same activity if any. **If it** still remains unadjusted, such loss can be carried forward for *4* succeeding previous years to be set off only from stake/prize money received on account of winning a position by these horses in races.

3.12 Carry forward and Set-off Losses of Certain Companies [Section 79]

Where change in shareholding has taken place in a previous year in the case of a company not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set-off against the income of the previous year unless: On the last day of the previous year the shares of the company carrying not less than *51%* of the voting power were beneficially held by person who beneficially held shares of the company carrying not less than *51%* of the voting power on the last day of the year or years in which the loss was incurred. In case change in voting power takes place in a previous year due to death of a shareholder or on account of transfer of shares by way of gift to any relative, the above- mentioned provision shall not be applicable. [Proviso to section 79(a)]

3.13 Order in Which Current and Brought Forward Losses Are To Be Adjusted

In case different types of allowances and losses of current and that of past years are accumulated. The following order is to be observed. It means, if in any year past losses, unabsorbed depreciation, current depreciation, unabsorbed investment allowance etc., are to be allowed against the current business profits, the order to be followed is given as follows:

Out of profits of the current previous year the losses and expenses will be adjusted in following Order.

1. Current depreciation of the year;
2. Current expenditure on scientific research whether capital or revenue;
3. Current loss of another business;
4. Brought forward business losses of earlier years (oldest loss to be adjusted first);
5. B/F unabsorbed depreciation;
6. Brought forward expenditure on promotion of family planning (only in case of companies);
7. Brought forward unabsorbed expenditure on scientific research;Losses in Case of Succession of Business or Profession {Sec. 78(2)}

Sec. 78(2) says that where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance that another person shall not be entitled to carry forward and set-off the losses incurred by his predecessor against the profits earned by him after succession. In case of inheritance, the heir would be entitled to carry forward the loss incurred by the previous owner *i.e.,* the predecessor. The successor in business is normally treated as if he had commenced a new business.

In case there has been a reorganization of business due to succession of a firm by a company or of a sole proprietary concern by a company u/s 47(xiii) or u/s 47(xiv), the accumulated loss and unabsorbed depreciation of the firm and sole proprietary concern shall be deemed to be the loss or depreciation of successor company for the previous year in which succession takes place and the loss and depreciation shall be carried forward as per other provisions of this Act.

In case the provisions as prescribed u/s 47(xiii) or u/s 47(xiv), are not complied with, the amount of loss or depreciation allowed to successor company shall be deemed as income of the company and shall be taxable in the year in which breach of any condition takes place.

3.14 Provisions relating to carry forward and set-off accumulated loss and unabsorbed depreciation in certain cases of amalgamation [Section 72 (A)]

In case a company owning an industrial undertaking amalgamates with another company, the accumulated loss and the unabsorbed depreciation of amalgamating company shall be deemed to be the loss or depreciation of the amalgamated company for the previous year in which amalgamation was effected and the other provisions of this Act relating to set-off and carry forward of loss and unabsorbed depreciation shall apply accordingly provided the following conditions are fulfilled:

(i) that the accumulated loss of the amalgamating company before amalgamation exceeds fifty. per cent of the aggregate of its paid-up share capital;.

(ii) that the amalgamating company was not immediately before its amalgamation financially viable;

(iii) that amalgamation was in public interest

(iv) that such other conditions as Central Government may notify in the Official Gazette to ensure that the benefit under this section would facilitate the rehabilitation; or revival of the business of amalgamating company; and

(v) the Central Government makes declaration to this effect [Section 73A(1)].

The benefit to set-off or carry forward shall not be available to the amalgamated company if it carries on the business of amalgamating company after making any modification or reorganisation and such modification or reorganisation are not approved by prescribed authority. The amalgamated company shall have to furnish, along with return of income, a certificate from the specified authority to the effect that adequate steps have been taken by the company for the rehabilitation or revival of the business of the amalgamating company [Section 72(2)(1).

The Finance Act, 1987 has introduced sub-section (3) under which specified authority shall communicate to the amalgamating company about the fact that it is satisfied with the scheme submitted and it would make such recommendations to the Central Government after amalgamation is affected

Accumulated Loss:- It means so much of loss of the amalgamating company under the head ―profits and grains of business or profession‖ (not being a loss sustained in a speculation business) which the amalgamating company would have been entitled to carry forward and set-off under the provisions of [Section 72(2A) Explanation (a)] amalgamation had not been affected.

Unabsorbed Depreciation:-It means so much of the allowance of depreciation of the amalgamating company which remains to be allowed and which would have been allowed to the amalgamating company under the provision of the Act if the amalgamation had not been affected. [Section 72A Explanation (e)]

3.15 Provisions relating to carry forward and set off of accumulated losses and unabsorbed depreciation on amalgamation and demerger [Section 72A]

1. If there is amalgamation of an industrial company or a shipping company, the accumulated loss and unabsorbed depreciation of amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company and it shall be allowed to carry forward and set off these losses and depreciation as per rules provided and conditions as prescribed in point (2) below are fulfilled.only if:

2. The carry forward and set off these losses and unabsorbed depreciation shall he allowed

(a) the amalgamated company continues to hold at least 3/4th in book value of the assetsof amalgamating company for a minimum period of five years.

(b) the amalgamated company continues to carry on the business of amalgamating company for 5 years from the date of amalgamation.

(c) it fulfils all other conditions as are prescribed.

3. In case the conditions prescribed above are not complied with, the amount of loss or unabsorbed depreciation adjusted by the amalgamated company in any previous year shall be deemed as income of the previous year in which breach takes place.

4. In case of demerger, the accumulated losses of the demerged company shall be allowed to be carried forward by the resulting company in following manner

(a) any amount of loss or unabsorbed depreciation which is directly attributable to the undertaking transferred under demerger, shall be deemed as loss of he resulting company and shall be allowed to be carried forward and set off.

(b) any amount of loss or unabsorbed depreciation which is not directly attributable to the undertaking transferred under demerger, the proportionate loss to be computed in following mannershall be allowed to be carried forward and set off:

Loss of demerged company X $\frac{\text{Value of assets transferred under demerger}}{\text{Total value of assets of demerged company}}$

5. The Central Government may specify the conditions for ensuring the genuine demerger.

3.16 Filling of Return of Loss [Sec. 80]

For any loss to be carried forward and set-off against the income of a subsequent year the return of such loss must be filed under Sec. 139 and the I.T.O must determine the loss on the basis of the return riled. Only such loss is eligible for carry forward which was determined by the I.T.O. on the basis of return filed by the assessee and after determining the loss, the I.T.O. should have informed or notified the loss to the assessee. On the basis of this explanation, the conclusion can be that if no return is filed for the year in which the loss was incurred, the right to carry forward the loss would be lost.

3.17 Special provisions relating to carry forward and set off of loss in case of a company in which public are not substantially interested

As per section 79 of the Income-tax Act, where a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless-

On the last day of the previous year the shares of the company carrying not less thanfifty-one per cent of the voting power were beneficially held by person who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred.

Restriction of section 79 is applicable only in case of loss and is not applicable in case of adjustment of unabsorbed depreciation, unabsorbed capital expenditure on scientific research or family planning expenditure.

Further, the provisions of section 79 are not applicable in case of change in share holding on account of death of shareholder or on account of transfer of shares by way of gift to any relative of the shareholder or change in shareholding in case of an Indian company which is a subsidiary of foreign company, when such foreign company is amalgamated/demerged with another foreign company and 51% or more shareholders of the amalgamating/demerged foreign company continues to be the shareholders of the amalgamated/resulting foreign company.

Meaning of intra-head adjustment

If in any year the taxpayer has incurred loss from any source under a particular head of income, then he is allowed to adjust such loss against income from any other source falling under the same head.

The process of adjustment of loss from a source under a particular head of income against income from other source under the same head of income is called intra-head adjustment, e.g., Adjustment of loss from business A against profit from business B.

Restrictions to be kept in mind while making intra-head adjustment of loss

Following restrictions should be kept in mind before making intra-head adjustment of loss:

- Loss from speculative business cannot be set off against any income other than income from speculative business. However, non-speculative business loss can be set off against income from speculative business.

- Long-term capital loss cannot be set off against any income other than income from **long- term capital gain**. However, short-term capital loss can be set off against long-term or short-term capital gain.
- No loss can be set off against income from winnings from lotteries, crossword puzzles, race including horse race, card game, and any other game of any sort or from gambling or betting of any form or nature.
- Loss from the business of owning and maintaining race horses cannot be set off against any income other than income from the business of owning and maintaining race horses.

Loss from business specified under section 35AD cannot be set off against any other income except income from specified business. (section 35AD is applicable in respect of certain specified businesses like setting up a cold chain facility, setting up and operating warehousing facility for storage of agricultural produce, developing and building a housing projects, etc.).

Meaning of inter-head adjustment

After making intra-head adjustment (if any) the next step is to make inter-head adjustment. If in any year, the taxpayer has incurred loss under one head of income and is having income under other head of income, then he can adjust the loss from one head against income from other head

E.g., Loss under the head of house property to be adjusted against salary income.

Restrictions to be kept in mind while making inter-head adjustment of loss.

Following restrictions should be kept in mind before making inter-head adjustment:

- Before making inter-head adjustment, the taxpayer has to first make intra-head adjustment.
- Loss from speculative business cannot be set off against any other income. However, non-speculative business loss can be set off against income from speculative business.
- Loss under head –Capital gains‖ cannot be set off against income under other heads of income.
- No loss can be set off against income from winnings from lotteries, crossword puzzles, race including horse race, card game, and any other game of any sort or from gambling or betting of any form or nature.
- Loss from the business of owning and maintaining race horses cannot be set off against any other income.
- Loss from business specified under section 35AD cannot be set off against any other income (section 35AD is applicable in respect of certain specified businesses like setting up a cold chain facility, setting up and operating warehousing facility for storage of agricultural produce, developing and building housing projects, etc.)
- Loss from business and profession cannot be set off against income chargeable to tax under the head –Salaries‖.

Carry forward of unadjusted loss for adjustment in next year

Many times it may happen that after making intra-head and inter-head adjustments, still the lossremains unadjusted. Such unadjusted loss can be carried forward to next year for adjustmentagainst subsequent year(s)' income. Separate provisions have been framed under the Income-tax Law for carry forward of loss under different heads of income (refer next FAQ for more provisions in this regard). Provisions under the Income-tax law in relation to carry forward and set off of business loss other than loss from speculative business.

The set-off of loss from house property against income from any other source is restricted to Rs. 2 lakh per annum. [w.e.f. assessment year 2018-19]

If loss of any business/profession (other than speculative business) cannot be fully adjusted in theyear in which it is incurred, then the unadjusted loss can be carried forward for making adjustmentin the next year. In the subsequent year(s) such loss can be adjusted only against income charged to tax under the head –Profits and gains of business or profession‖.

Loss under the head –Profits and gains of business or profession‖ can be carried forward only if the return of income/loss of the year in which loss is incurred is furnished on or before the due date of furnishing the return, as prescribed under section 139(1).

Such loss can be carried forward for eight years immediately succeeding the year in which the loss is incurred.

Above provisions are not applicable in case of unabsorbed depreciation (provisions relating tounabsorbed depreciation are discussed later).

- Loss from business specified under section 35AD cannot be set off against any other income except income from specified business (section 35AD is applicable in respect of certain specified businesses like setting up a cold chain facility, setting up and operating warehousing facility for storage of agricultural produce, developing and building a housing projects, etc.). Such loss can be carried forward for adjustment against income from specified business for any number of years.

Loss from Specified business under section 35AD cannot be carried forward unless it has been determined in pursuance of return filed in accordance with the provisions of Section 139(3).

- Loss from the business of owning and maintaining race horses cannot be set off against any income other than income from the business of owning and maintaining race horses. Such loss can be carried forward only for a period of 4 years.

Provisions framed under the Income-tax law in relation to carry forward and set off of loss from speculative business

If loss of any speculative business cannot be fully adjusted in the year in which it is incurred, then the unadjusted loss can be carried forward for making adjustment in the next year. In the subsequent year(s) such loss can be adjusted only against income from speculative business (may be same or any other speculative business).

Loss from speculative business can be carried forward only if the return of income/loss of the year in which loss is incurred is furnished on or before the due date of furnishing the return, as prescribed under section 139(1).

Such loss can be carried forward for four years immediately succeeding the year in which the loss is incurred.

Above provisions are not applicable in case of unabsorbed depreciation of speculative business (provisions relating to unabsorbed depreciation are discussed later).

Provisions under the Income-tax Law in relation to carry forward and set off of house property loss

If loss under the head ―Income from house property‖ cannot be fully adjusted in the year in which such loss is incurred, then unadjusted loss can be carried forward to next year.

The set-off of loss from house property against income from any other source is restricted to Rs. 2 lakh per annum.

In the subsequent years(s) such loss can be adjusted only against income chargeable to tax under the head ―Income from house property―.

Such loss can be carried forward for eight years immediately succeeding the year in which the loss is incurred.

Loss under the head ―Income from house property‖ can be carried forward even if the return of income/loss of the year in which loss is incurred is not furnished on or before the due date of furnishing the return, as prescribed under section 139(1).

Provisions under the Income-tax law in relation to carry forward and set off of capital loss If loss under the head ―Capital gains‖ incurred during a year cannot be adjusted in the same year, then unadjusted capital loss can be carried forward to next year.

In the subsequent year(s), such loss can be adjusted only against income chargeable to tax under the head ―Capital gains‖, however, long-term capital loss can be adjusted only against long-term capital gains. Short-term capital loss can be adjusted against long-term capital gains as well as short-term capital gains

Such loss can be carried forward for eight years immediately succeeding the year in which the loss is incurred.

Such loss can be can carried forward only if the return of income/loss of the year in which loss is incurred is furnished on or before the due date of furnishing the return, as prescribed under section 139(1).

Meaning of unabsorbed depreciation, unabsorbed capital expenditure on scientific research and unabsorbed capital expenditure on promoting family planning amongst the employees

Apart from several other deductions, while computing income chargeable to tax under the head ―Profits and gains of business or profession‖ a person is allowed to claim deduction on account for depreciation, capital expenditure incurred by him on scientific research and capital expenditure incurred by a company for promoting family planning amongst its employees.

If the income of the year in which these expenses are incurred falls short of these expenses, thenthe unabsorbed expenses can be carried forward to next year in the form of unabsorbeddepreciation or unabsorbed capital expenditure on scientific research or unabsorbed capitalexpenditure on promoting family planning amongst the employees.

Provisions under the Income-tax Law relating to set off of unabsorbed depreciation, unabsorbedcapital expenditure on scientific research and unabsorbed capital expenditure on promoting familyplanning amongst the employees

Depreciation is first deducted from the income chargeable to tax under the head ―Profits and gainsof business or profession―. If such depreciation could not be fully adjusted against such incomechargeable to tax in that previous year, the unabsorbed portion shall be added to the amount ofdepreciation for the following year and shall be deemed to be the part of depreciation for that year(similar treatment would be given to other allowances as mentioned above).However, in the case of set off, following order of priority is to be followed:

- First adjustments are to be made for current scientific research expenditure, family planning expenditure and current depreciation.
- Second adjustment is to be made for brought forward business loss.
- Third adjustments are to be made for unabsorbed depreciation, unabsorbed capital expenditure on scientific research or on family planning.

Carry forward of loss in case of change in the constitution of business Generally, the person incurring the loss is only entitled to carry forward the loss to be adjusted in subsequent year(s). However, in certain cases of reconstitution of the business like amalgamation, demerger, conversion of proprietary firm into company or conversion of partnership firm intocompany, etc., the reconstituted entity is entitled to carry forward the unadjusted loss of predecessor entity (provided that conditions specified in this regard are satisfied).

Provisions relating to carry forward of loss in case of retirement of a partner from a partnershipfirmSection 78 contains provisions relating to carry forward and set off of loss in case of change inconstitution of a partnership firm due to death or retirement of a partner (i.e. when a partner goesout of firm by retirement or death). In such a case, the share of loss attributable to the outgoingpartner cannot be carried forward by the firm.

Restriction of section 78 is applicable only in case of loss and is not applicable in case ofadjustment of unabsorbed depreciation, unabsorbed capital expenditure on scientific research or family planning expenditure.

Special provisions relating to carry forward and set-off of losses in case of change in shareholdingof certain companies

As per section 79 of the Income-tax Act, where a change in shareholding has taken place in aprevious year in the case of a company, not being a company in which the public are substantiallyinterested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless-

On the last day of the previous year the shares of the company carrying not less than fifty-one percent of the voting power were beneficially held by person who beneficially held shares of thecompany carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred.

However, the above condition is not applicable in case of an eligible start up reffered under section80-IAC in case of such start up, loss can be carried forward and set off against the income of theprevious year, if all shareholders of such company (who held shares carrying voting power on thelast day of the year or years in which loss was incurred) continue to hold the shares on last day ofsuch previous year. [Inserted by the Finance Act, 2017]

Restriction of section 79 is applicable only in case of loss and is not applicable in case ofadjustment of unabsorbed depreciation, unabsorbed capital expenditure on scientific research orfamily planning expenditure.

Further, the provisions of section 79 are not applicable in case of change in share holding onaccount of death of shareholder or on account of transfer of shares by way of gift to any relativeof the shareholder or change in shareholding in case of an Indian company which is a subsidiaryof foreign company, when such foreign company is amalgamated/demerged with another foreign company and 51% or more shareholders of the amalgamating/demerged foreign companycontinues to be the shareholders of the amalgamated/resulting foreign company and where anychange in shareholding in the company takes place pursuant to a resolution plan approved underthe IBC.

With an objective to facilitate resolution of distressed companies, the Finance (No. 2) Act, 2019 extend the benefit of section 79 to the following companies, and their subsidiary and the subsidiaryof such subsidiary, where:

(a) When NCLT, on a petition moved by the Central Govt., has suspended the board of directorsand has appointed new directors.

(b) When change in shareholding has taken place in a previous year pursuant to a resolution planapproved by the Tribunal.

Note:

W.e.f., Assessment Year 2022-23, the Finance Act, 2021 provides that section 79 not applicable in case there change in the shareholding has taken place during the previous year on account of relocation referred to in the Explanation to clauses (viiac) and (viiad) of section 47.

3.18 Summary

The Company registered in India is an Indian Company. Indian Company is always treated as Resident in India whether Control & Management is in India or Outside India. If Control & Management of the affairs of the business of Foreign Company is situated wholly in India then its residential status is Resident in India. If its Control & Management of the affairs of the business is situated wholly / partially outside India then its Residential Status is Non-Resident in India.

As per Income Tax Act 1961, a Person as defined in Section 2(31) can set off and Carry forward the losses incurred. It is a big boon to a Person, because it plays an important role on the financial condition of a Person who has incurred such Losses. Set off means adjusting the losses against the profit of that financial year. In case if there is no adequate profits to set off the entire loss it can be carry forward to next Assessment Years subject to the conditions stated in the Act. If it is not possible for an Assessee to set off the losses under inter source adjustments and inter head adjustments he can carry forward the same to the next Assessment Years. The loss under business head except speculation loss, shall be adjusted against the income from any other head in the same assessment year. If the whole business loss cannot be set-off because of insufficiency of income under other heads in the same assessment year, such business loss shall be carried forward and set-off against the income of any business or profession carried on by the assessee and assessable in that assessment year. Thus a business loss can be carried forward over 8 subsequent assessment years and set-off wherever profits are available provided the *same business is continued for which the loss was originally computed.* A carried forward non-speculation business loss can be set-off against the income of any business (including speculation business profit) carried on by the assessee.

3.19 Glossary

1. Resident [Sec. 6 (2)]

It means that if a H.U.F., FIRM, AOP is controlled from India even partially it will be Resident assessee. The Control and management of affairs refers to the controlling and directing power, the Head and the Brain. It means that decision making power for vital affairs is situated in India. The control and management means de facto control and management and not merely the right to control or manage.

2. Unabsorbed Depreciation

With effect from AIY 2002-03 depreciation which remains unadjusted as either there is no income or less income in the relevant previous year, it can be carried forward till it is fully adjusted from any income during the succeeding previous years. It shall be treated as depreciation of the succeeding previous year.

3. Filling of Return of Loss [Sec. 80]

For any loss to be carried forward and set-off against the income of a subsequent year the return of such loss must be filed under Sec. 139 and the I.T.O must determine the loss on the basis of the return riled. Only such loss is eligible for carry forward which was determined by the I.T.O. on the basis of return filed by the assessee and after determining the loss, the I.T.O. should have informed or notified the loss to the assessee.

3.20 References

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3.21 Further Readings

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3.22 Model Questions

1. Explain the Residential Status of an Individual for the purpose of determining Tax Incidence.

2. Explain the tax incidence of a Company according to their types and residential status.

3. Define the term Set-Off of Business Losses and explain the various provisions applicable regarding this under Income Tax Act, 1961.

4. Explain the provisions relating to Carry forward and Set-off Losses of Certain Companies.

5. Discuss the provisions relating to carry forward and set-off accumulated loss and unabsorbed depreciation in certain cases of amalgamation.

6. Discuss the provisions relating to carry forward and set off of accumulated losses and unabsorbed depreciation on amalgamation and demerger.

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Lesson -4

Exempted Incomes and Deductions

Structure

4.0 Objectives

After go through the lesson, you should be able to:

- Understand the various types of Incomes of Assessee under Income Tax Act, 1961
- To know the incomes which are exempted from tax with their types

4.1 Introduction

Income can be classified into three categories as per provisions of this Act. These categories are:

I. Income Forming part of Total Income and subject to Tax :

--These incomes are treated u/s 14 to 80 of the Act and have been explained in detail in Part II of this book.

II Incomes forming part of Total Income but entitled to Rebate or Relief :

-- These incomes are given u/s 86.

III Income Exempted from Tax

-- These incomes do not form part of total income either fully or partially.

4.2 Exempted Incomes

Section 10 of Income Tax Act has given a long list of incomes which are totally exempt from tax and so these incomes are not included in the gross total income of the assessee. In other words, such incomes are totally Tax-Free.

While calculating Total Income in any previous year of any person, any income coming under the following clauses shall be exempted. Majority of exempted incomes are explained below:

1. Agricultural Income [Section 10(1)]

As per section 10(1), agricultural income earned by the taxpayer in India is exempt from tax. Agricultural income is defined under section 2(1A) of the Income-tax Act. As per section 2(1A), agricultural income generally means:

(a) Any rent or revenue derived from land which is situated in India and is used for agricultural purposes.

(b) Any income derived from such land by agriculture operations including processing of agricultural produce so as to render it fit for the market or sale of such produce.

(c) Any income attributable to a farm house subject to satisfaction of certain conditions specified in this regard in section 2(1A).

Any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income.

2. Amount received by a member of the HUF from the income of the HUF, or in case of impartible estate out of income of family estate [Section 10(2)]

As per section 10(2), amount received out of family income, or in case of impartible estate, amount received out of income of family estate by any member of such HUF is exempt from tax.

Example-.HUF earned ` 90,000 during the previous year 2016-17 and it is not chargeable to tax. Mr. A, a co-parcener is earning individual income of ` 20,000 p.m. Besides his individual income, Mr. A receives ` 30,000 from his HUF. Mr. A will pay tax on his individual income but any sum of money received by him from his HUF is not chargeable to tax in the hands of co- parcener whether the HUF has paid tax or not on that income.

3. Share of profit received by a partner from the firm [Section 10(2A)]

As per section 10(2A), share of profit received by a partner from a firm is exempt from tax in the hands of the partner. Further, share of profit received by a partner of LLP from the LLP will be exempt from tax in the hands of such partner. This exemption is limited only to share of profit and does not apply to interest on capital and remuneration received by the partner from the firm/LLP.

4. Certain Interest to Non-Residents [Section 10(4)]

As per section 10(4)(i)**,** in the case of a non-resident any income by way of interest on certain notified securities or bonds (including income by way of premium on the redemption of such bonds) is exempt from tax.

As per section 10(4)(*ii*)**,** in the case of an individual, any income by way of interest on money standing to his credit in a Non-Resident (External) Account in any bank in India in accordance with the Foreign Exchange Management Act, 1999, and the rules made there under is exempt from tax.

Exemption under section 10(4)(ii) is available only if such individual is a person resident outside India as defined in clause (*q*) of section 2 of the said Act or is a person who has been permitted by the Reserve Bank of India to maintain the aforesaid Account.

5. Interest to Non-Resident on Non-Resident (External) Account [Section 10(4)(ii)]

Any income by way of interest on moneys standing to his credit in a Non-Resident (External) Account in any bank in India shall be exempt from tax in case of an individual who is a person resident outside India or is a person who has been permitted by the RBI to maintain the aforesaid account.

The person residing outside India shall have the same meaning as defined under Foreign Exchange Regulation Act, 1973, FEMA, 1999. This exemption shall not be available on any income by way of interest paid or credited on or after 1-4-2005.

6. Interest paid to a person of Indian Origin and who is Non-Resident [Section 10(4B)]

In case of an individual, being a citizen of India or a person of Indian origin, who is non resident, any income from interest on such savings certificates issued by the Central Government, as Government may specify in this behalf by notification in the Official Gazette, shall be fullyexempt. The exemption under this section shall not be allowed on bonds or securities issued on or after 1-6-2002.

This exemption shall be allowed only if the individual has subscribed to such certificates in Foreign Currency or other foreign exchange remitted from a country outside India in accordance with the provisions of the Foreign Exchange Act, 1973, FEMA, 1999 and any rules made there under. For this purpose, a person shall be deemed to be of Indian origin if he or either of parents or any of his grandparents, was born in India or in undivided India.

7. Leave Travel Concession [Section 10(5)]

An employee can claim exemption under section 10(*5*) in respect of Leave Travel Concession. Exemption under section 10(*5*) is available to all employees (*i.e.* Indian as well as foreign citizens). Exemption is available in respect of value of any travel concession or assistance received or due to the employee from his employer (including former employer) for himself and his family members in connection with his proceeding on leave to any place in India. Other provisions to be kept in mind in this regard are as follows:

Where journey is performed by air: Amount of exemption will be lower of amount of economy class air fare of the National Carrier by the shortest route or actual amount spent.

Where journey is performed by rail: Amount of exemption will be lower of amount of air conditioned first class rail fare by the shortest route or actual amount spent. The same rule will apply where journey is performed by any other mode and the place of origin of journey and destination are connected by rail.

Where the place of origin and destination are not connected by rail and journey is performed by any mode of transport other than by air:

The exemption will be as follows:

(a) If recognised public transport exists: Exemption will be lower of first class or deluxe class fare by the shortest route or actual amount spent.

(b) If no recognised public transport exists: Exemption will be lower of amount of air conditioned first class rail fare by the shortest route (considering as if journey isperformed by rail) or actual amount spent.

8. Tax paid by Government or Indian concern on Income of a Foreign Company [Section 10(6A), (6B), (6BB) and (6C)]

(6A) :

(i) Where a foreign company renders technical services to Government of India or to a State Government or to an Indian enterprise and for such services a foreign company is paid income by way of royalty or fees.

(ii) Such fees or royalty is paid by an India concern in pursuance of an agreement entered into before 1-6-2002 and such agreement is approved by Government of India and it is in accordance with the Industrial Policy of the Government of India.

(iii) Since royalty or fees paid to a foreign company accrues in India, so such income is liable to be taxed in India and as per agreement the payer of income in India pays tax liability of the foreign company.

(iv) Tax so paid by Government of India or a State Government or an Indian enterprise will be exempted *i.e.,* it will not be grossed up with the income of the foreign company.

(6B)

The tax liability of a non-resident (Not being a company) or a foreign company if paid by an Indian concern or Government of India or a State Government the same will be exempted and so will not be grossed up with the income of the foreign entity.

(6BB) Tax paid on income received by foreign government or a foreign enterprise on leasing aircraft

In case any income is received by **a** foreign government or a foreign enterprise from an Indian company which is engaged in the operation of aircraft and such income is by way of consideration of acquiring an aircraft or an engine of aircraft (other than payment for providing spares or services in connection with the operation of leased aircraft) on lease under an agreement entered into after 31-3-1996 but before 1-4-2007 and approved by the Central Government in this behalf, and the tax on such income is payable by such Indian company under the terms of agreement, the tax so paid shall be fully exempted. This benefit shall be available only to that foreign enterprise which is non-resident.

(6C)

Any income derived by a foreign company (so notified by Central govt.) by way of royalty or fees for technical services under an agreement for providing services in or outside India in projects connected with security of India shall be fully exempted.

9. Perquisites and Allowances paid by Government to its Employees serving outside India [Section 10(7)]

All the perquisites and allowances paid by the Government to its employees for services rendered outside India, are exempt from tax. This exemption is allowed only to such employees of the Government who are citizens of India.

10. Employees of Foreign Countries working in India under Cooperative Technical Assistance Programme [Section 10(8)]

The persons who are working in India under co-operative technical assistance programmes **ii**accordance with an agreement entered into by the Central Government and the Government of a foreign State, the following incomes of such individuals shall be exempt provided the terms of agreements provide for such exemption

1. the remuneration received by him directly or indirectly from the Government of the foreign State for such duties rendered in India **;** and

2. any other income of such individual which accrues or arises outside India and is not deemed to accrue or arise in India, in respect of which individual is required to pay any income or social security tax to the Government of that foreign State.

11. Income of a Consultant [Section 10(8A)]

Any remuneration or fee received by a consultant from an international organisation who derives its fund under technical assistance grant agreement between such organisation and the Foreign Government, and any other income accruing or arising to him outside India (which is not deemed to accrue or arise in India) and which is subject to income-tax or social security tax in foreign country, shall be fully exempted. The agreement of the service of consultant must be approved by the competent authority.

12. Income of Employees of Consultant [Section 10(8B)]

In case of an individual who is assigned duties in India under technical assistance programme—

1. the remuneration received by him directly or indirectly from any consultant as referred u/s 10 (8A) above and

2. any other income accruing or arising to him outside India (which is not deemed to accrue or arise in India) and which is subject to income-tax or social security tax in foreign country. shall be fully exempted provided

3. such individual is not a citizen of India ; or

4. if citizen but is not ordinarily resident and

5. the contract of service is approved by the competent authority.

13. Income of any member of the family of individuals working in India under co-operative technical assistance programmes [Section 10(9)]

As per section 10(9), the income of any member of the family of any such individual as is referred to in section 10(8)/(8A)/(8B) accompanying him to India, which accrues or arises outside India and is not deemed to accrue or arise in India, in respect of which such member is required to pay any income or social security tax to the Government of that foreign State or country of origin of such member, as the case may be, is exempt from tax

14. Gratuity [Section 10(10)]

A. Death-cum-retirement gratuity received by Government servants [Section 10(10)(i)] Section 10(10)(i) grants exemption to gratuity received by Government employee (*i.e.*, Central Government or State Government or local authority).

B. Gratuity Received by a Non-Government Employee covered by Payment of Gratuity Act, 1972 [Section 10(10)(ii)]

As per section 10(10)(ii), exemption in respect of gratuity in case of employees covered by the Payment of Gratuity Act, 1972 will be lower of following :

- 15 days‘ salary × years of service.

- Maximum amount specified, *i.e.,* Rs.10,00,000
- Gratuity actually received. Note:

1) Instead of 15 days' salary, only 7 days salary will be taken into consideration in case of employees of seasonal establishment.

2) 15 days' salary = Salary last drawn × 15/26

3) Salary for this purpose will include basic salary and dearness allowance only. Items other than basic salary and dearness allowance are not to be considered.

4) In case of piece rated employee, 15 days' salary will be computed on the basis of average of total wages (excluding overtime wages) received for a period of three months immediately preceding the termination of his service.

5) Part of the year, in excess of 6 months, shall be taken as one full year.

C. Gratuity Received by a Non-Government Employee Not covered by Payment of Gratuity Act, 1972 [Section 10(10)(iii)]

As per section 10(10)(iii), exemption in respect of gratuity in case of employees not covered by the Payment of Gratuity Act, 1972 will be lower of following :

- Half month's salary for each completed year of service, *i.e.*,[Average monthly salary × ½]× Completed years of service. .
- Rs. 10,00,000.
- Gratuity actually received. Note:

1) Average monthly salary is to be computed on the basis of average of salary for 10 months immediately preceding the month of retirement.

2) Salary for this purpose will include basic salary, dearness allowance, if the terms of service so provide and commission based on fixed percentage of turnover achieved by the employee.

3) While computing years of service, any fraction of a year is to be ignored.

15. Commuted value of pension received [Section 10(I0A)]

(i) The full amount of commuted value of pension received is exempted if it is received from the Government, a local authority or a statutory corporation.

(ii) Any payment in commutation of pension received under any scheme from any other employer to the extent it does not exceed

1. in a case where the employee receives any gratuity, the commuted value of **1/3rd** of pension which he is normally entitled to receive ; and

2. in any other case the commuted value of **1/2** of such pension.

16. Amount received as leave encashment on retirement [Section 10(10AA)]

(a) Central & State Govt. Employees—any payment received as the cash equivalent of the leave salary in respect of the earned leave at his credit at the time of his retirement shall be fully exempt.

(b) Other Employees—any payment received as the cash equivalent of the leave salary at his credit at the time of superannuation shall be exempt upto least of the following four amounts

(a) Actual amount received

(b) Amount calculated at average salary of 10 months (average salary means average of salary drawn by employee during 10 months immediately preceding the month of his retirement);

(c) Cash equivalent of leave salary due at the time of retirement.

(d) Notified Limit— 3,00,000.

Excess of amount received over the least of the above shall be taxable.

17. Retrenchment compensation paid to workmen [Section10(10B)]

As per section 10(10B), compensation received at the time of retrenchment is exempt from tax to the extent of lower of the following:

(a) An amount calculated in accordance with the provisions of section 25F(*b*) of the Industrial Dispute Act, 1947; or

(b) Maximum amount specified by the Central Government (Rs. 5,00,000);

(c) Actual amount received.

Under the Industrial Dispute Act, a workman is entitled to retrenchment compensation, equal to 15 days‘ average pay for each completed year of continuous service or any part in excess of six months.

Compensation in excess of aforesaid limits is taxable as salary. However, the aforesaid limit is not applicable in cases where compensation is paid under any scheme approved by the Central GovernmentPayment received under Bhopal Gas Leak Disaster (Processing of Claims) Act 1985 [Section 10 (10BB)]

Any amount received under the provision of such Act or any scheme framed there under shall be fully exempted but in case payment is received against a loss or damage, for which deduction has been claimed ealier, it shall be taxable.

18. Compensation received in case of any disaster [Section 10(10BC)]

Any amount received from the Central Government or State Government or a Local Authority by an individual or his legal heirs as compensation on account of any disaster is exempt from tax. However, no deduction is available in respect of the amount received or receivable to the extent such individual or his legal heirs has been allowed a deduction under the Act on account of loss or damage caused due to such disaster. Disaster here means any disaster due to any natural or man- made causes or by accident/negligence which results in substantial loss of human life or damage to property or environment and the magnitude of such disaster is beyond coping capacity of community of the affected area

19. Income by way of tax on perks [Section 10(10CC)]

Perquisites to employees mean any facility provided by the employer to the employees. There are two types of perquisites, *viz.*, monetary and non-monetary. Value of perquisite is charged to tax in the hands of the employees, however, the employer may at his will pay tax (on behalf of employees) on such perquisites. In such a case, the amount of tax paid on such perquisites by the employer on behalf of the employees will be treated as income of the employees and is charged to tax in his (*i.e.*, in employee‘s) hands. However, by virtue of section 10(*10CC*) tax paid by employer (on behalf of employee) on non-monetary perquisites will be exempt from tax in the hands of employees.

20. Any sum received under a life insurance policy [Section 10(10D)]

Any sum received under a life insurance policy, including the sum allocatedby way of bonus on such policy shall be fully exempted in following cases :

1. If any sum received from insurance company on insurance of a dependent handicapped member [under subsection (3) of section 80DD]

2. If any sum received from insurance company when a dependent, or a member of family is suffering from a notified disease [under subsection (3) of section 80DDA]

3. Any sum received under a Key man insurance policy –Key man insurance policy‖ means a life insurance policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected in any manner whatsoever with the business of the first mentioned person ; or

4. Any sum received under an insurance policy issued on or after the 1st day of April, 2003 but before 1-4-2012 in respect of which the premium payable for any of the years during the term of the policy exceeds twenty per cent of the actual capital sum assured.

5. Any sum received under an insurance policy issued on or after 1-4-2012 in respect of which the premium payable for any of the years during the term of the policy exceeds 10% of the actual capital sum assured. Thus, in case of life insurance policies issued on or after 1-4- 2012, the exemption regarding any sum received under a life insurance policy shall be allowed only if premium paid on such a policy does not exceed 10% of the capital sum assured.

22. Payment from Statutory Provident Fund [Section 10(11)]

Statutory Provident Fund	
Employer‘s Contribution	Employer‘s contribution to such fund is not treated as income of the employee
Interest	Interest credited to such fund is exempt in the hands of the employee.
Amount received at the time of termination	Lump sum amount received from such fund, at the time of termination of service is exempt in the hands of employees.

23. Payment from Recognised Fund [Section 10(12)]

The accumulated balance due and becoming payable to an employee participating in a recognised provident fund, is exempt to the extent provided in rule 8 of part A of the Fourth Schedule.

Recognised Provident Fund	
Employer‘s Contribution	Employer‘s contribution to such fund, up to 12% of salary is not treated as income of the employee (*see* Note 1).
Interest	Interest credited to such fund up to 9.5% per annum is exempt in the hands of the employee, interest in excess of 9.5% is charged to tax in the hands of the employee.
Amount received at the time of termination	If certain conditions are satisfied, then lump sum amount received from such fund, at the time of termination of service, is exempt in the hands of employees. (*see* Note 2)

Un-Recognised Provident Fund	
Employer‘s Contribution	Employer‘s contribution to such fund is not treated as income of the employee.
Interest	Interest credited to such fund is exempt in the hands of the employees.
Amount received at the time of termination	(*See* note 3)

Public Provident Fund	
Employer‘s Contribution	Employers do not contribute to such fund
Interest	Interest credited to such fund is exempt.
Amount received at the time of termination	Lump sum amount received from such fund at the time of termination of service is exempt from tax

25. Payment from the National Pension System Trust to an employee [Section 10(12A)]

Any payment from the National Pension System Trust to an employee on closure of account or his opting out of the pension scheme referred to in section 80CCD, to the extent it does not exceed 40% of the total amount payable to him at the time of closure or his opting out of the scheme, is exempt from tax.

26. Pension received by certain winners of gallantry awards [Section 10(18)]

(i) Any amount received by an individual as pension shall be exempt if:

(a) such individual has been in the service of the Central or State Government, and

(b) he/she has been awarded _Param Vir Chakra‘ or _Mahavir Chakra‘ or _Vir Chakra‘ or such other notified gallantry awards.

(ii) Also, any amount received as family pension by any member of the family of an individual referred above shall be fully exempted.

27. Family pension received by family members of armed forces including para military forces [Section 10(19)]

With effect from the 1st day of April, 2005 family pension received by the widow or children or nominated heirs, as the case may be, of a member of the armed forces (including paramilitary forces) of the Union, where the death of such member has occurred in the course of operational duties, in such circumstances and subject to such conditions, as may be prescribed shall be fully exempted.

28. Income from one palace of a former ruler [Section 10(19A)]

Annual value of any one palace or a portion of a palace in the occupation of a former ruler shall be exempted but in case such palace or a portion of a palace is letout, its income shall not be exempted.

29. Income of a local authority [Section 10(20)]

The following income of a local authority is exempt from tax:

a) Income which is chargeable under the head ―Income from house property‖, ―Capital gains‖ or―Income from other sources‖ or

b) Income from a trade or business carried on by it which accrues or arises from the supply of a commodity or service (not being water or electricity) within its own jurisdictional area or

c) Income from business of supply of water or electricity within or outside its own jurisdictional area

30. Income of Research Association [Section 10(21)]

Any income of a research association, approved under section 35(1)(*ii*)/*(iii)* is exempt from tax, if following conditions as specified in section 10(*21*) are satisfied:

1) Income should be applied or accumulated wholly and exclusively for the objects for it established.

2) Funds should not be invested or deposited for any period during the previous year otherwise than in any one or more of the forms/modes specified in section 11(5).

31. Income of a News Agency [Section 10(22B)]

In case there is any income of a news agency set up solely in India for collection and distribution of news and which is so notified in this behalf shall be fully exempted provided such income or accumulated income is used solely for collection and distribution of news and not to be distributed in any manner amongst its members. The approval given under this section shall be withdrawn if the news agency has not applied, accumulated or distributed its income in accordance with the prescribed conditions, the notification issued under this section shall be cancelled.

32. Income of some Professional Institutions [Section 10(23A)]

Any income (other than income from house property and income from rendering any specific service or income by way of interest or dividend on investment) of an professional institution/association is exempt from tax, if the following conditions are satisfied:

1) Professional institution is established in India for the purpose of control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or such other notified profession.

2) The institution applies its income, or accumulates it for application, solely to the objects for which it is established.

3) The institution is approved by the Central Government by general or special order.

33. Income of Mutual Fund [Section 10(23D)]

Any income of following mutual funds (subject to provisions of sections 115R to 115T) is exempt from tax:

- A mutual fund registered under the Securities and Exchange Board of India Act or regulation made there under.
- A mutual fund set-up by a public sector bank, or a public financial institution or authorised by RBI (subject to conditions notified by the Central Government).

34. Exemption of income of a securitisation trust [Section 1O(23DA)] [w.e.f. A.Y. 2014-15]

Any income of a securitisation trust from the activity of securitisation shall be exempt.

35. Income of Investor Protection Fund [Section 10(23EA)]

Any income by way of contributions received from recognised stock exchanges and the members thereof, of a notified Investor Protection Fund set up by recognised stock exchanges in India is exempt from tax.

36. Amount received as subsidy from or through the Tea Board [Section 10(30)]

In the case of a taxpayer, who carries on business of growing and manufacturing tea in India, the amount of any subsidy received from or through the Tea Board under the notified scheme for replantation or replacement of tea bushes or for rejuvenation or consolidation of the area used for cultivation of tea, is exempt from tax (for notified schemes *see* Notification No. S.O. 3616, dated September 27, 1976).

To claim exemption, a certificate from the Tea Board as to the amount of subsidy paid to the taxpayer during the year is to be obtained.

A similar exemption is available under section 10(*31*) in respect of subsidy received by an taxpayer engaged in the business of growing and manufacturing rubber, coffee, cardamom or such other commodities as the Central Government may by notification specify [Section 10(*31*)]

37. Amount received as subsidy from or through the concerned Board [Section 10(31)]

Any amount received as subsidy from or through the concerned Board for replantation or replacement of Rubber, Coffee, cardamom plants or plants for growing of such other commodities or for any other scheme so notified shall be fully exempted.

38. Income of child clubbed u/s 64 (IA) [Section 10(32)]

In case income of a minor child is clubbed with the income of his parent, the parent can claim exemption upto actual income of child clubbed or 1,500 whichever is less in respect of each minor child whose income is included.

39. Income from transfer of capital assets of UTI [Section 10(33)]

Any income arising from the transfer of a capital asset, being a unit of the Unit Scheme, 1964 referred to in Schedule I to the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 and where the transfer of such asset takes place on or after the 1St day of April, 2002 shall be fully exempted.

40. Income by way of dividend from Indian company [Section 10(34)]

Any income by way of dividends referred to in Section 115-0.

41. Exemption of income to a shareholder on buyback of shares of unlisted company [Section 10 (34A) [w.e.f. A.Y. 2014-15]

Any income arising to an assessee being a shareholder, on account of buyback of shares, (not being listed on a recognised stock exchange) by the company as referred to in section 115QA shall be exempt.

42. Income from units of UTI and other mutual funds [Section 10(35)]

Following incomes are not chargeable to tax from the assessment year 2004-05:

- Any income by way of dividends covered by section 115-O [*i.e.,* any dividends from a domestic company other than dividends covered under section 2(*22*)(*e*)]; However, as per section 115BBDA (as inserted by Finance Act, 2016), in the case of resident individual/HUF/firm, dividend shall be chargeable to tax at the rate of 10% if aggregate amount of dividend received during the year exceeds Rs. 10,00,000.

- Any income in respect of units of a mutual fund;
- Income received by a unit holder of UTI;
- Income in respect of units of a specified company.

43. Exemption of income from securitisation trust [Section 10(35A)] [w;e.f A.Y. 2014-15]

Any income received by any person being an investor of the Securitisation Trust from such a trust, by way of distributed income referred to in section 11 5TA shall be exempt.

44. Income from sale of shares in certain cases [Section 10(36)]

Any income arising from the transfer of a long-term capital asset, being an eligible equity share.in a company purchased on or after the 1st day of March, 2003 and before the 1st day of March 2004 and held for a period of twelve months or more.

For the purposes of this clause, ‒eligible equity shares‖ means :any equity share in a company being a constituent of BSE-500 Index of the Stock Exchange. Mumbai as on the 1st of March, 2003 and the transactions of purchase hind sale of such equity share are entered into on a recognised stock exchange in India

(ii) any equity share in a company allotted through a public issue on or after the 1st. day of March, 2003 and listed in a recognised stock exchange in India before the 1st day of March, 2004 and the transaction of sale of such share is entered into on a recognised stock exchange in India.

45. Capital Gain on compulsory acquisition of urban Agricultural Land [Section 10(37)]

In the case of an assessee, being an individual or a Hindu individual family, any income chargeable under the head‖ Capital gain‖ arising from the transfer of agricultural land, shall be exempted, where :

1. Such land is situate in any area referred to in, item (a) or item (b) of sub-clause (iii) of clause (14) of Section 2

2. Such land, during the period of two years immediately preceding the date of transfer, was being used for agricultural purposes by such Hindu undivided family or individual, or a parent of his

3. Such transfer is by way of compulsory acquisition under any law, or a transfer the consideration for which is determined or approved by the Central Government or the Reserve Bank of India

4. Such income has arisen from the compensation or consideration for such transfer received by such assesses on or after the 1st day of April, 2004.

It may be noted in this connection that exemption is available only if compulsory acquisition has taken place on or after 1-4-2004. Exemption is also available if acquisition has taken place before 1-4-2004 but compensation has been received on or after 1-4-2004.

For the purposes of this clause, the expression, compensation or consideration‖ includes the compensation or consideration enhanced or further enhanced by any court, tribunal or other authority.

46. Long Term Capital Gain on transfer of shares and securities covered under Security Transaction Tax (STT) [Section 10(38)]

Long-term capital gains arising on transfer of securities are not chargeable to tax in the hands of any person, if following conditions are satisfied :

1. The asset transferred should be equity shares of a company or units of an equity oriented mutual fund or a unit of a business trust.

2. The transaction should be liable to securities transaction tax, at the time of transfer.

3. Such asset should be a long-term capital asset.

4. Transfer should have taken place on or after October 1, 2004.

Equity oriented mutual fund means a mutual fund specified under section 10(*23D*) and 65% of its investible funds, out of total proceeds are invested in equity shares of a domestic company. *Note:*

(1) With effect from 1-4-2016, exemption from capital gains under Section 10(38) shall be available even in respect of long-term capital gains arising from transfer of units of a business trust which were acquired in lieu of shares of special purpose vehicle as referred to in section 47(xvii) and on which securities transaction tax has been paid.

(2) Exemption from long term capital gains under section 10(38) shall be available w.e.f April 1, 2017 even where STT is not paid, provided that -

- *transaction is undertaken on a recognised stock exchange located in any International Financial Service Centre, and*
- *consideration is paid or payable in foreign currency*

If equity shares listed on a stock exchange are sold after 12 months of purchase, the seller may make long-term capital gain or incur long-term capital loss. Before the introduction of budget 2018, long-term capital gain made on sale of equity shares or equity-oriented units of mutual fund was exempt from tax under Section 10(38)

As per the provisions of the Financial Budget of 2018, if a seller makes long term capital gain of more than Rs. 1 lakh on sale of equity shares or equity-oriented units of mutual fund, the gain made will attract a capital gains tax of 10% long-term capital gains tax. Also, the benefit of indexation will not be available to the seller. These provisions apply to transfers made on or after 1 April 2018.

47. Income from international Sporting event [Section 10(39)]

Any specified income (which is from such international event and which is notified by the Central Govt.) of specified persons from any international event held in India shall be fully exempted if

1. such event is approved by the international body regulating the international sport relating to such event

2. it has participation by more than two countries ; and

3. is notified by the Central Govt. in this regard.

48. Income received as grant by a subsidiary company [Section 10(40)]

Income of any subsidiary company by way of grant or otherwise received from its Indian holding *company which is engaged in the business of generation/ transmission/distribution of power is exempt, if such receipt is for settlement of dues in connection with reconstruction or revival of an existing business of power generation. The exemption is available, if thereconstruction or revival is by way of transfer of business to the Indian company notified under section 80 IA(4)(v)(a). Under section 10(41), any capital gain arising in the above case is not chargeable to tax, if the transfer has taken place before April 1, 2006*

49. Income from transfer of asset of an undertaking engaged in the business of generation, transmission or distribution of power [Section 10(41)]

Income from transfer of capital asset of an undertaking engaged in the business of generation, transmission or distribution of power where such transfer takes place on or before 31.3.2006 and transfer is made to the Indian company as notified u/s 801A.

50. Reverse Mortgage [Sec. 10(43)]

Any amount received by an individual as a loan, either in lump-sum or in installment in a transaction of reverse mortgage referred in clause (xvi) of Section 47 shall be exempted.

51. New Pension System Trust [Sec. 10(44)]

Any income received by any person for, or on behalf of the New Pension System Trust established on 27th February, 2008 shall be exempted.

52. Exemption of Allowance or perquisite to chairman/member of UPSC [Section 10 (45)]

Any allowance or perquisite, as may be notified by the Central Government in the Official Gazette, in this behalf, paid to the chairman or a retired chairman or any other member or retired member of the Union Public Service Commission, shall be exempt.

53. Exemption of 'specified income' of certain bodies or authorities [Section 10(46)]

Any specified income arising to a body or authority or Board or Trust or Commission which :

1. is constituted or established by or under a Central, State or Provincial Act, or has been constituted by the Central Government or a State Government with the object of regulating or administering an activity for the benefit of general public;

2. is not engaged in commercial activity; and

3. is specified by the Central Government by notification in the Official Gazette in this behalf, shall be exempt.

The Central Government has the power to notify the nature and extent of the income of the body or authority or Board or Trust or Commission which shall constitute the specified income.

54. Exemption of Income of notified 'Infrastructure debt fund' [Section 10(47)]

Any income of notified _infrastructure debt fund', which is set up in accordance with the guidelines as may be prescribed, shall be exempt from income-tax.

55. Exemption of Income of a foreign company from sale of Crude Oil in India [Section 10 (48)]

Any income of a foreign Co. received in India in Indian currency on account of sale of crude oil to any person in India shall be exempt if the following conditions are satisfied

1. Such Income is in pursuant to an agreement or an arrangement entered into by the Central Govt. or approved by the Central Govt.;

2. having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Govt. in this behalf; and

3. the foreign company is not engaged in any activity, other than reciept of such income, in India.

56. Exemption of income of National Financial Holdings Company [Section 10(49)] [w.e.f. A.Y. 2014-15]

Any income of the National Financial Holdings Company, being a company set up by the Central Government, shall be exempt.

4.3 Deductions available to various assessees under section 80

Taxes are an integral component in our country, with them accounting for a major portion of the income earned by the government, income which is utilised to provide certain basic provisions to citizens. Individuals who earn more than a certain amount are expected to pay taxes, as per the existing tax slabs. While these taxes can be harsh on the bank balance of a taxpayer, the government also provides certain provisions wherein one can save tax. Tax deductions can helpone reduce the taxable income, lowering their overall tax liability and thereby helping them save on taxes. The deduction one is eligible for depends on a number of factors, with different limits set for different purposes.

Tax Deductions under Section 80C:

Section 80C of the Income Tax Act provides provisions for tax deductions on a number of payments, with both individuals and Hindu Undivided Families eligible for these deductions. Eligible taxpayers can claim deductions to the tune of Rs 1.5 lakh per year under Section 80C, with this amount being a combination of deductions available under Sections 80 C, 80 CCC and 80 CCD.

Some of the key investments which are eligible for this tax deduction are mentioned below.

- Payment made towards life insurance policies (for self, spouse or children)
- Payment made towards a superannuation/provident fund
- Tuition fees paid to educate a maximum of two children
- Payments made towards construction or purchase of a residential property
- Payments issued towards a fixed deposit with a minimum tenure of 5 years

This section provides for a number of additional deductions like investment in mutual funds, senior citizens saving schemes, purchase of NABARD bonds, etc.

Deductions under section 80 D

Section 80D of the Income Tax Act permits deductions on amounts spent by an individual towards the premium of a health insurance policy. This includes payment made on behalf of a spouse, children, parents or self to a Central Government health plan. An amount of Rs 15,000 can be claimed as deduction when paid towards the insurance for spouse, dependent children or self, while this amount is Rs 20,000 if the person is over the age of 60 years.

Both individuals and Hindu Undivided Families are eligible for this deduction, subject to the payment being made in modes other than cash.

- Section 80DD: Section 80DD provides provisions for tax deductions in two cases, with the permitted deduction being Rs 75,000 for normal disability and Rs 1.25 lakh if it is a severe disability. This deduction can be claimed in case of the following expenditures.

- On payments made towards the treatment of dependants with disability

- Amount paid as premium to purchase or maintain an insurance policy for such dependantthe permitted deduction is Rs 75,000 for normal disability and Rs 1.25 lakh for a severe disability. Both Hindu Undivided Families and resident individuals are eligible for this deduction. The dependant, in this case can be either a spouse, sibling, parents or children.

- Section 80DDB: Section 80DDB can be utilised by HUFs and resident individuals and provides provisions for deductions on the expense incurred by an individual/family towards medical treatment of certain diseases. The permitted deduction is limited to Rs 40,000, which can be increased to Rs 60,000 if the treatment is for a senior citizen.

Tax Deductions under Section 80E:

Under section 80 E of the Income Tax Act has been designed to ensure that educating oneself doesn‘t become an additional tax burden. Under this provision, taxpayers are eligible for tax deductions on the interest repayment of a loan taken to pursue higher education. This loan can be availed either by the taxpayer himself/herself or to sponsor the education of his/her ward/child.

Only individuals are eligible for this deduction, with loans taken from approved charitable organisations and financial institutions permitted for tax benefits.

Subsections of Section 80E:

- Section 80EE: Only individual taxpayers are eligible for deductions under Section 80EE, with the interest repayment of a loan taken by them to buy a residential property qualifying for deductions. The maximum deduction permitted under this section is Rs 3 lakhs.

Tax Deductions under Section 80G:

Section 80G encourages taxpayers to donate to funds and charitable institutions, offering tax benefits on monetary donations. All assessees are eligible for this deduction, subject to them providing proof of payment, with the limit of deductions decided based on a few factors.

- 100% deductions without any limit: Donations to funds like National Defence Fund, Prime Minister‘s Relief Fund, National Illness Assistance Fund, etc. qualify for 100% deduction on the amount donated.

- 100% deduction with qualifying limits: Donations to local authorities, associations or institutes to promote family planning and development of sports qualify for 100% deduction, subject to certain qualifying limits.

- 50% deduction without qualifying limits: Donations to funds like the PMs Drought Relief fund, Rajiv Gandhi Foundation, etc. are eligible for 50% deduction.

- 50% deduction with qualifying limit: Donations to religious organisations, local authorities for purposes apart from family planning and other charitable institutes are eligible for 50% deduction, subject to certain qualifying limits.

The qualifying limit refers to 10% of the gross total income of a taxpayer.

Subsections of Section 80G:

Under section 80G has been further subdivided into four sections to simplify understanding.

- Section 80GG: Individual taxpayers who do not receive house rent allowance are eligible for this deduction on the rent paid by them, subject to a maximum deduction equivalent to 25% of their total income Rs. 5000, a month. The lower of these options can be claimed as deduction.

- Section 80GGA: Tax deductions under this section can be availed by all assessees, subject to them not having any income through profit or gain from a business or profession. Donations by such members to enhance social/scientific/statistical research or towards the National Urban Poverty Eradication Fund are eligible for tax benefits.

- Section 80GGB: Tax deductions under this section can be availed by Indian Companies only, with the amount donated by them to a political party or electoral trust qualifying for deductions.

- Section 80GGC: Under this section, funds donated/contributed by an assessee to a political party or electoral trust are eligible for deduction. Local authorities and artificial juridical persons are not entitled to the tax deductions available under Section 80GGC.

Tax Deductions under Section 80 IA:

Section 80 IA provides an avenue for all taxpaying assessees to claim tax deduction on the profits generated through industrial activities. These industrial undertakings can be related to telecommunication, power generation, industrial parks, SEZs, etc.

The following subsections are related to Section 80-IA

- Section 80 IAB: Section 80 IAB can be used by SEZ developers, who can claim tax deductions on their profits through development of Special Economic Zones. These SEZs need to be notified after 1/4/2005 in order for them to be eligible for tax deductions.

- Section 80-IB: Provisions of section 80-IB can be used by all assessees who have profits from hotels, ships, multiplex theatres, cold storage plants, housing projects, scientific research and development, convention centres, etc.

- Section 80-IC: Section 80 IC can be used by all assessees who have profits from states categorised as special. These include Assam, Manipur, Meghalaya, Himachal Pradesh, Uttaranchal, Arunachal Pradesh, Mizoram, Tripura and Nagaland.

- Section 80-ID: All assessees who have profits or gain from hotels and convention centres are eligible for deduction under this section, subject to their establishments being located in certain specified areas.

- Section 80-IE: All assessees who have undertakings in North-East India are eligible for deductions under this Section, subject to certain conditions.

Tax Deductions under Section 80J:

Section 80J was amended to include two subsections, 80JJA and 80 JJAA

- Section 80 JJA: Section 80 JJA relates to deductions permitted on profits and gains from assessees who are in the business of processing/treating and collecting bio-degradable waste to produce biological products like bio-fertilizers, bio-pesticides, bio-gas, etc. All assessees who deal with this are eligible for deductions under this section. Such assessees can claim deduction equivalent to 100% of their profits for 5 successive assessment years since the time their business started.

- Section 80 JJAA: Deductions under Section 80 JJAA can be claimed by Indian companies which have profits from the manufacture of goods in factories. Deductions equivalent to 30% of the salary of new full time employees for a period of 3 assessment years can be claimed. A chartered accountant should audit the accounts of such companies and submit a report showing the returns. Employees who are taken on a contract basis for a period less than 300 days in the preceding year or those who work in managerial or administrative posts do not qualify for deductions.

Tax Deduction under Section 80LA:

Deductions under Section 80LA can be availed by Scheduled Banks which have offshore banking units in Special Economic Zones, entities of International Financial Services Centres and banks which have been established outside India, in accordance to the laws of a foreign nation. These assessees are eligible for deductions equivalent to 100% of the income for the first 5 years, and 50% of income generated through such transactions for the next 5 years, subject to the rules of the land.

Such entities should have relevant permission, either under the SEBI Act, Banking Regulation Act or registration under any other relevant law.

Tax Deduction under Section 80P:

Section 80P caters to cooperative societies, offering tax deductions on their income, subject to certain conditions. 100% deduction is permitted to cooperative societies which have incomes through cottage industries, fishing, banking, sale of agricultural harvest grown by members and milk supplied by members to milk cooperative societies.

Cooperative societies which are involved in other forms of business are eligible for deductions ranging between Rs 50,000 and Rs 1 lakh, depending on the type of work they are involved in.

Deductions which can be claimed by all cooperative societies are listed below.

- Income which a cooperative society makes by renting out warehouses
- Income derived through interest on money lent to other societies
- Income earned through interest from securities or properties

Tax Deduction under Section 80QQB:

Section 80QQB permits tax deductions on royalty earned from sale of books. Only resident Indian authors are eligible to claim deductions under this section, with the maximum limit set at Rs 3 lakhs. Royalty on literary, artistic and scientific books are tax deductible, whereas royalties from textbooks, journals, diaries, etc. do not qualify for tax benefits. In case of an author getting royalties from abroad, the said amount should be brought into the country within a specified time period in order to avail tax benefits.

Tax Deduction under Section 80RRB:

Section 80RRB offers tax incentives to patent holders, providing tax relief to resident individuals who receive an income by means of royalty on their patent. Royalty to the tune of Rs 3 lakhs can be claimed as deductions, subject to the patent being registered after 31/3/2003. Individuals who receive a royalty from foreign shores need to bring said amount to the country within a specific time period in order to be eligible for tax deductions on such royalty.

Tax Deduction under Section 80TTA:

Deductions under Section 80TTA can be claimed by Hindu Undivided Families and Individual taxpayers. This section permits deductions to the tune of Rs 10,000 every year on the interest earned on money invested in bank savings accounts in the country.

Tax Deduction under Section 80U:

Tax deductions under Section 80U can be claimed only by resident individual taxpayers who have disabilities. Individuals who have been certified by relevant medical authorities to be a Person with Disability can claim a maximum deduction of Rs 75,000 per year. Individuals who have severe disabilities are entitled to a maximum deduction of Rs 1.25 lakh, subject to them meeting certain criteria. Some of the disabilities which classify for tax benefits are autism, mental retardation, cerebral palsy, etc.

Summary of Tax Deductions Available under Section 80C to 80U:

Section	Amount of Deduction	Eligible Assessees
80 C	Rs 1.5 lakh (aggregate of 80C, 80CCC and 80CCD)	Individuals/Hindu Undivided Families
80 CCC	Rs 1.5 lakh (aggregate of 80C, 80CCC and 80CCD)	Individuals
80 CCD	Rs 1.5 lakh (aggregate of 80C, 80CCC and 80CCD)	Individuals
80 CCF	Rs 20,000	Individuals/Hindu Undivided Families
80 CCG	Rs 25,000	Resident individuals
80 D	RS 20,000	Individuals/Hindu Undivided Families
80 DD	• Rs 75,000 for general disability • Rs 1.25 lakh for severe disability	Resident Individuals/Hindu Undivided Fami
80 DDB	• Rs 60,000 for senior citizens • Rs 40,000 for others	Resident Individuals/Hindu Undivided Fami
80 E	No limit mentioned	Individuals
80 EE	Rs 3 lakh	Individuals
80 G	Different limits based on donation	All assesses
80 GG	Rs. 5000 per month	Individuals who do not get HRA
80GGA	Depends on quantum of donation	All assessees who do not have income from p business/profession
80 GGB	Depends on quantum of donation	Indian companies

80GGC	**Depends on quantum of donation**	**All assesses apart from local/Artificial judici funded by the government**
80 IA	**No maximum limit defined**	**All assesses**
80 IAB	**No maximum limit defined**	**All assessees who are SEZ developers**
80 IB	**No maximum limit defined**	**All assesses**
80 IC	**No maximum limit defined**	**All assesses**
80 ID	**No maximum limit defined**	**All assesses**
80 IE	**No maximum limit defined**	**All assesses**
80 JJA	**All profits earned for first 5 years**	**All assesses**
80JJAA	**30% of increased wages**	**Indian companies which have income from p**
80 LA	**Portion of their income**	**Scheduled banks, IFSCs, banks established o**
80 P	**Portion of their income**	**Cooperative societies**
80 QQB	**Rs 3 lakh**	**Authors – resident individuals**
80 RRB	**Rs 3 lakh**	**Resident individuals**
80 TTA	**Rs 10,000 per year**	**Individuals/Hindu Undivided Families**
80 U	• **Rs 75,000 for people with disabilities** • **Rs 1.25 lakh for people with severe disabilities**	**Resident individuals**

4.4 Summary

Under Income Tax Act, 1961 various exemptions are available to assessee in the form of exempted incomes for reducing his tax liability and assessee can also claim various deduction under section 80C to 80U. One can claim this as per the fulfilment of conditions and to minimise his tax liability.

4.5 Glossary

1. Agricultural Income [Section 10(1)]

As per section 10(1), agricultural income earned by the taxpayer in India is exempt from tax. Agricultural income is defined under section 2(1A) of the Income-tax Act.

2. Leave Travel Concession [Section 10(5)]

An employee can claim exemption under section 10(*5*) in respect of Leave Travel Concession. Exemption under section 10(*5*) is available to all employees (*i.e.* Indian as well as foreign citizens). Exemption is available in respect of value of any travel concession or assistance received or due to the employee from his employer (including former employer) for himself and his family members in connection with his proceeding on leave to any place in India.

4.6 References

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4.7 Further Readings

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- Ahuja, Girish & Gupta, Ravi: Systematic Approach to Income tax. Goods and Service Tax Act,2017

4.8 Model Questions

1. Discuss the various types of Incomes of Assessee under Income Tax Act, 1961.
2. Discuss in detail the various types of exempted incomes under Income Tax Act, 1961.
3. Explain the various types of Deductions available to assessee under section 80 C to 80U.
4. Explain the various types of deductions available under section 80 IA, & B for promoting industrial development?

Income Tax Deductions for AY 2021-22: The Income Tax Return (ITR) filing season has started. The Central Government recently increased the deadline for ITR filing for the assessment year 2021-22 from July 31 to September 30, 2021, in view of the second wave of Covid-19 pandemic and the subsequent difficulties faced by taxpayers. As you now have more time in hand to file tax returns, take a look at the following list of tax deductions you can claim on various payments, incomes and investments.

You can claim the following deductions in the current assessment year only on payments and investments made in the previous financial year (FY 2020-21). Also, these deductions will not be available for those who opted for the New Tax Regime.

1. Income from House Property

Under Section 24(b), deduction from income from House Property on interest paid on housing loan and housing improvement loan is allowed. According to the Income Tax Rules, the upper limit for deduction of interest paid on housing loans is Rs 2 lakh in the case of a self-occupied property.

For those who have opted to file returns under the New Tax Regime, this deduction from income from house property will not be available from this year.

Also Read | All Income Tax due dates ending in July

2. Payments for LIC premium, provident fund, PPF, Pension schemes

• Under Section 80C, deduction can be claimed on investment/payment for Life Insurance Premium, Provident Fund, PPF, Subscription to certain equity shares, Tuition Fees, National Savings Certificate, Housing Loan Principal etc.

• Under Section 80CCC, deduction towards payments made to annuity plan of LIC or other insurer towards the pension scheme can be claimed.

• Under Section 80 CCD (1), deduction towards payments made to pension scheme of the Central Government can be claimed.

Note: The total combined deduction of only Rs 1.5 lakh under Section 80C, Section 80CCC, Section 80 CCD (1) can be claimed.

3. Payments for Central Government Pension scheme

Under Section 80 CCD (1B), a deduction up to Rs 50,000 towards payments made to the Pension Scheme of the Central Government, excluding deduction claimed under 80CCD (1) can be claimed.

Under Section 80 CCD2, a deduction towards contribution made by an employer to the pension scheme of the Central Government can be claimed. However, there are two conditions:

• In case the employer is a PSU, state Government or others, the deduction limit is 10 per cent of salary.

• In case the employer is Central Government, the deduction limit is 14 per cent of salary.

4. Payment for health insurance premium

Under Section 80 D, deduction towards payments made towards health insurance premiums and preventive health check-up can be claimed. However, there are various limits:

• For Self/Spouse or Dependent Children or patents: Deduction of Rs 25,000 can be claimed. This limit is Rs 50,000 in case any person is a senior citizen. Also, Rs 5000 deduction for preventive health checkups is allowed. However, this amount is not above the overall ceiling of the health insurance premium paid.

• Even if no premium is paid on health insurance coverage, deduction towards medical expenditure incurred on a senior citizen can be claimed. The deduction limit, in this case, is Rs 50,000.

5. Payment for maintenance/treatment of disabled dependent

Also, a deduction up to Rs 75,000 can be claimed in lieu of payments made for maintenance or medical treatment of a disabled dependent or paid/deposited any amount under a relevant approved scheme. However, in the case of persons with severe disability (80$ or more), the deduction limit is Rs 1.25 lakh.

6. Payment for medical treatment

Under Section 80 DD (1B), a deduction up to Rs 40,000 can be claimed for payments made towards medical treatment of self or dependent for specified disease. This deduction limit is Rs 1 lakh in case the person is a senior citizen.

7. Education loan interest payment

Under Section 80E, deduction of total amount paid towards interest payments higher education loan of self or relative can be made.

8. Home loan interest payment

Under Section 80EE, a deduction up to Rs 50,000 can be claimed towards interest payment made against the loan taken for the acquisition of a residential house property. However, this deduction is available only for loans sanctioned between 1st April 2016 to 31st March 2017.

Under 80EEA, a deduction up to Rs 1.5 lakh deduction towards interest payments made on loan taken for acquisition of residential house property for the first time where the loan is sanctioned between 1st April 2019 to 31st March 2022 & deduction should not have been claimed u/s 80EE .

9. Electric vehicle loan interest payment

Under Section 80EEB, a deduction up to Rs 1.5 lakh can be claimed on interest payments of loan for the purchase of an electric vehicle. This is available only for loan sanctioned between 1st April 2019 to 31st March 2023.

10. House rent payment for those not getting HRA

If HRA is not a part of your salary, deduction towards rent paid for a house can be claimed under Section 80 GG. However, only the least of the following is allowed as a deduction:

- Rent paid reduced by 10 per cent of total income before deduction
- Rs 5,000 per month
- 25 per cent of total income before this deduction

The due date for filing ITR for the assessment year 2021-22 is September 30, 2021.

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Lesson-5

Methods of Tax Planning

Structure

5.0 Objectives

After go through the lesson, you should be able to:

- understand the methods of tax planning by way of claiming Depreciation allowance
- explain the rules regarding calculation of Depreciation
- compute the amount relating to amortisation of certain Preliminary expenses and treatment of Scientific Research Expenditure.

5.1 Introduction

A business house can claim various deductions under different sections of Income Tax, 1961. But there are some deductions by which any company can claim under its normal course of business operations. These are explained as below:

1. Depreciation (u/s 32)
2. Expenditure on Scientific Research (u/s 35)
3. Amortisation of certain preliminary expenses (u/s 35AD)

5.2 Depreciation allowance under section 32 of the Income Tax Act, 1961

Depreciation is an allowance on capital assets acquired and put to use and not expenditure unlike repairs to machinery, plant or furniture. It need not be incurred by the assessee during the previous year. The depreciation allowance has to be calculated on the assets of the assessee as per the methods and rates prescribed under the income tax law. Depreciation allowance is one of the deductions allowed from business or professional income chargeable under section 28 or other income chargeable under section 56(2)(ii) or 56(2)(iii) of the Income Tax Act, 1961.

As per section 32 of the Income Tax Act, 1961, depreciation is allowed on tangible assets and intangible assets owned, wholly or partly, by the assesse and used for the purposes of business or profession.

- Depreciation is allowable as expense in Income Tax Act, 1961 on basis of block of assets on Written Down Value (WDV) method. Depreciation on Straight Line Method (SLM) is not allowed.
- Block of assets means group of assets falling within a class of assets for which same rate of depreciation is prescribed.
- GOODWILL & LAND is not eligible for depreciation.
- Depreciation is allowable only to the owner of the asset.
  - A lessee is not the owner of the property therefore depreciation is allowed only to lessor. If furniture or any part is constructed by the lessee then depreciation on that is allowed to lessee.
  - If property purchased under hire purchase contract then depreciation is allowed to the purchaser.
  - In case of co-ownership, depreciation is allowable in ratio of their ownership.
- Asset must be used for the purpose of business or profession.
- If the assesse doesn‘t claim the amount of depreciation as deduction, even then the amount of WDV carried forward to next year is reduced by the depreciation amount.
- If profit is calculated on presumptive basis under section 44AD or 44AE then such reported profit is considering after all the expenses and depreciation allowable under section 32.
- Depreciation under Income Tax Act is different from that of Companies Act, 1956. Therefore depreciation rates prescribed under income tax is only allowable whatever the depreciation is charged in books of accounts.
- If a new addition is made in a existing asset then it is consider as an asset if it increase the capacity of the existing asset or reduce per unit cost otherwise it should be treated as an expense.
- If there are some spare parts/machines and they are not actually used, depreciation is allowable on them because they are used for purpose of business/profession.
- Lower Depreciation – Depreciation can be claimed at lower rate as per income tax act. But for the next year your wdv will be considered as reduced by the percentage of depreciation prescribed. For eg if an asset is of Rs. 1 lakh and 80% depreciation is prescribed for the asset

and you charge only rs. 30,000 as depreciation, in this case next year wdv will be considered as rs. 20,000 only not rs. 70,000.

- **Depreciation is not allowed on GST component if the person wants to claim input tax credit under GST.**

As per section 57(ii) depreciation deduction is available from the income from hire of machinery, plant or furniture *[Section 56(ii)]* or income from buildings (in case of the building is inseparable from the letting of the said machinery, plant or furniture) *[Section 56(iii)]*.

On new plant or machinery, apart from depreciation allowance under section 32(1) and Section 32(2), investment allowance is also available additionally as per the provisions of sections 32AC and 32AD.

Depreciation under the Income Tax Act is allowed as deduction, as a percentage on the written down value (WDV) of block of assets as per the rates prescribed in *New Appendix I* to the Income Tax Rules, 1962.

Block of asset: Section 2(11)

As per section 2(11) of the Income Tax Act, 1961, ‒block of asset‖ means a group of assets falling within a class of assets comprising –

a. Tangible assets, being buildings, machinery, plant or furniture,

b. Intangible assets, being know-how, patents, copyrights, trademarks, licences, franchises, or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed.

For the purpose of classification of assets into blocks, the percentage of depreciation within the class of assets needs to be considered. Each such class of asset with same percentage of depreciation will be identified as a block of asset.

For example buildings are classified into four sub-classes and their rates of depreciation are provided below:

Class of building	**Rateofdepreciation**
1. Buildings which are used mainly for residential purposes except hotels andboarding houses	5
2. Buildings other than those used mainly for residential purposes and not coveredby sub-items (1) above and (3) below	10
3. Buildings acquired on or after the 1st day of September, 2002 for installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities under clause (i) of sub-section (4) of section 80-IA.	100
4. Purely temporary erections such as wooden structures	100

Within the buildings class, each building needs to be classified under the above four sub-classes and to be grouped into individual block of assets based on the percentage of depreciation. Though the rate of depreciation is same for other buildings and furniture i.e. 10% on WDV, they cannot be grouped together in one block of asset. No depreciation allowance under section 32 in the case of business for prospecting etc. for mineral oil on machinery or plant: Section 42 No deduction under section 32 shall be allowed in respect of any machinery or plant if actual cost thereof is allowed as a deduction in one or more years under an agreement entered into by the Central Government under section 42. Additional Depreciation: section 32(1)(iia) If an assessee is engaged in the business of manufacture or production of any article or thing or in the business of generation or generation and distribution of power, an additional depreciation of 20% of the actual cost of new machinery or plant (other than ships and aircrafts) shall be allowed as deduction. Note: 1. No additional depreciation is available if an assessee engaged in the business of generation or generation and distribution of power and following SLM depreciation as per section 32(1)(i); 2. Additional depreciation of 35% is available for the undertaking / enterprise sets up by the assessee on or after 1-4-2015 on new machinery or plant (other than ships and aircrafts) in the backward area notified by the Central Government in this behalf in the states of

An asset put to use for a period less than 180 days

In case of an asset acquired during the previous year and is put to use for the purpose of business or profession for a period less than 180 days in that previous year, the deduction as depreciation allowance shall be restricted to 50% of the amount of such depreciation in case of:

i. SLM depreciation on assets of an undertaking engaged in generation or generation and distribution of power;

ii. WDV method of depreciation on block of assets method on both tangible and intangible assets;

iii. Additional depreciation.

Depreciation deduction in case of amalgamation or demerger

In case of amalgamation or demerger, the total depreciation for the year is to be divided proportionately between the Amalgamating company and the amalgamated company in the case of amalgamation; or Demerged company and the resulting company in the case of demerger as the case may be, basing on the number of days of usage of assets by them [fifth proviso to section 32(1)].

Unabsorbed depreciation: Section 32(2)

If the profits and gains from business or profession is less than the depreciation allowance computed under section 32(1), then such short fall or unabsorbed depreciation allowance shall be added to the depreciation allowance for the following previous year or years and so on and deemed to be part of that allowance.

Calculation of capital gain on sale of depreciable asset

The capital gain/loss from depreciable assets is always treated as short term irrespective of the fact that asset is held for more than 3 years or not.

Calculation of Capital Gain/Loss

Aggregate of WDV of all the assets falling within	
that block at the beginning of the year	XXX
Add: Actual cost of any assets falling within block	

acquired during the previous year XXX

Less: Money received or receivable in respect of any asset in the block which is sold, discarded, demolished

or destroyed during the previous year XXX

WDV at the end of the year XXX

If the above calculations results in a negative WDV then such amount will be considered as short term capital gains. If such amount is positive and no asset exists in the block then such amount will be treated as short term capital loss.

5.3 Amortization of Certain Preliminary Expenses under Section 35 D

Where an assessee, being an Indian company who is resident in India, incurs, any Preliminary expenditure can claim deduction in 5 equal instalment over a period of 5 years beginning with the previous year in which the business commence or the previous year in which the extension of the industrial undertaking is completed or the new industrial unit is commences production or operation. Do remember a foreign is not eligible for deduction u/s 35D even if resident.

The Preliminary Expenses means any Expenditure in connection with : -

(i) preparation of feasibility report;

(ii) preparation of project report;

(iii) conducting market survey or any other survey necessary for the business of the assessee;

(iv) engineering services relating to the business of the assessee:

the expenditure, which is deductible u/s 35, can be divided into 2:

A. In house research 1. Revenue expenditure 2. Capital expenditure 3. Expenditure on approved in house research

B. Payment to outsiders 1. Contribution to approved research association 2. Contribution to approved national laboratory etc. 3. Contribution to Indian scientific research company

(i) Revenue expenditure related to business [Section 35(2)] As per Section 35(1), any revenue expenditure laid out or expended on scientific research related to the business is deductible. Pre-commencement expenses Where any revenue expenditure has been incurred before the commencement of the business on payment of any salary to an employee engaged in such scientific research (perquisites paid to employees is not covered) or on the purchase of materials used in such scientific research, the aggregate of the expenditure so laid out or expended within the 3 years immediately preceding the commencement of the business shall, be allowed in the previous year in which the business is commenced. But it should be certified by the prescribed authority to have been laid out or expended on such scientific research.

(ii) Capital expenditure related to business [Section 35(2)] If capital expenditure incurred on scientific research related to business, the whole of such capital expenditure incurred shall be deducted. But no deduction shall be admissible in respect of expenditure incurred on the acquisition of any land. Pre-commencement expenses where any capital expenditure has been incurred before the commencement of the business, the aggregate of the expenditure so incurred within 3 years immediately preceding the commencement of the business shall be allowed in the previous year in which the business is commenced. But nodeduction shall be admissible in respect of expenditure incurred on the acquisition of any land.

(iii) Expenditure on in house research and development -Section 35(2AB) Where a COMPANY engaged in the business of bio-technology or in any business of manufacture or production of any article or thing, (except Eleventh Schedule article) incurs any expenditure on scientific research (not being expenditure in the nature of cost of any land or building) on in-house research and development facility as approved by the prescribed authority, then, there shall be allowed a deduction of a sum equal 200% of the expenditure so incurred. Notes: - This deduction is only for COMPANIES specified above. - Cost of BUILDING is eligible for 100% deduction u/s 35(2) A.

(i) Contribution to outsiders: Section 35(1)(ii)/(iii) An approved research association which has as its object the undertaking of scientific research 175% of actual expenditure An approved university, college or other institution to be used for scientific research 175% of actual expenditure An approved research association which has as its object the undertaking of research in social science or statistical research 125% of actual expenditure An approved university, college or other institution to be used for research in social science or statistical research 125% of actual expenditure The deduction, to which the assessee is entitled in respect of any sum paid to a research association, university, college or other institution, shall not be denied merely on the ground that, subsequent to the payment of such sum, the approval granted to the association, university, college or other institution has been withdrawn. B. (ii) Contribution to National Laboratory, IIT etc. [Section 35(2AA)] - Where the assessee pays any sum to - A National Laboratory or - A University or - An Indian Institute of Technology or - A specified person as approved with a specific direction that the said sum shall be used for scientific research undertaken under a programme approved in this behalf by the prescribed authority, then—

(a) there shall be allowed a deduction of a sum equal to 200% of the sum so paid ; and (b) no deduction in respect of such sum shall be allowed under any other provision of this Act.

Note: The deduction, to which the assessee is entitled in respect of any sum paid to above institutions, shall not be denied merely on the ground that, subsequent to the payment of such sum, the approval granted to such institution has been withdrawn. .

5.4 Contribution to a company to be used by such company for scientific research [Section 35(1)(iia)]

An amount equal to 125% of any sum paid to a company to be used by it for scientific research: Provided that such payee company— - is registered in India, - has as its main object the scientific research and development, - is approved by the prescribed authority, and - fulfills such other conditions as may be prescribed. An important thing to be kept in mind here is that if a taxpayeris allowed deduction u/s 35(1)(iia), the payee company referred to in the same section shall not claim any weighted deduction of 200% u/s 35(2AB) (Section 35(2AB) has already been discussed). But such payee company can claim deduction to the extent of 100% of the sum-spent u/s 35(1).

What happens when asset purchased for scientific research is sold ? Let me explain the provisions with an illustration. Harvard Limited a manufacturing company purchases a machine on 01 March 2005 for Rs.5,00,000 for its lab to make improvements in its quality of manufacturing. Since the scientific research is related to its business, Rs. 5,00,000 is deductible u/s 35(2). Lets assume that the research is ceased in 2014 and machine is brought into business-proper on 01 November 2014. Market value of machine is Rs. 2,30,000. Depreciated value of block on 01st April 2014 is Rs.10,00,000. This machine is sold for Rs. 1,90,000 04th April 2015. Then, tax treatment is as under: Opening WDV on 01

April 2014 Rs.1000000 Add: Scientific equipment brought into business proper (500000 -500000), since full value was allowed in 2005 0 Less: Depreciation at 15% on 1000000 150000 Closing WDV on 31 March 2015 850000 Less: Sale proceeds ofscientific equipment 190000 Balance 660000 Less: Depreciation at 15% on 660000 99000 Closing WDV on 31 March 2016 561000 Hence no capital gain as block exists. If in the above example, the machine was NOT USED for any other purpose but was sold for Rs. 1,90,000, tax treatment is as under: Sale proceeds 190000 Less: Indexed cost of acquisition 500000*1081/480 1126042 Long term capital loss 936042 Deemed income u/s 41(3)## 190000 ## As per Section 41(3), if capital asset used in scientific research is sold, without having been used for other purposes, and the proceeds of the sale together with the total amount of the deductions made under section 35 exceed the amount of the capital expenditure, the excess or the amount of the deductions so made, whichever is the less, shall be chargeable to income-tax as income of the business or profession of the previous year in which the sale took place. In other words, if capital asset used in scientific research is sold, without having been used for other purposes, the following is taxed u/s 41(3): Surplus i.e. sale proceeds or Deduction allowed earlier u/s 35, whichever is lower. Excess of sale price over cost/indexed cost is taxed as capital gains (deficiency shall be capital loss). That is the reason as to why in the above illustration Rs. 190000 was taxed u/s 41(3), being lower of Rs.190000 (sale proceeds) and Rs.500000 (deduction allowed earlier).

5.5 Carry forward and Set off of deficiency:

If deduction u/s 35 relating to capital expenditure is not fully allowed due to absence/ inadequacy of profits, it shall be carried forward for unlimited years and set off in any subsequent year. Business loss already brought forward will have precedence over this deficiency.

5.6 Treatment of scientific research expenditure in case of amalgamation

Where, in a scheme of amalgamation, the amalgamating company transfers to the amalgamated company (being an Indian company) any asset representing expenditure of a capital nature on scientific research, the provisions of Section 35 shall apply to the amalgamated company as they would have applied to the amalgamating company had the latter not transferred the asset.

5.7 Tax planning, Importance, types

Tax Planning?

Taxes can eat into your annual earnings. To counter this, tax planning is a legitimate way of reducing your tax liabilities in any given financial year. It helps you utilise the tax exemptions, deductions, and benefits offered by the authorities in the best possible way to minimise your liability.

The definition of tax planning is quite simple. It is the analysis of one‘s financial situation from the tax efficiency point-of-view.

Objectives of Tax Planning

Tax planning is a focal part of financial planning. It ensures savings on taxes while simultaneously conforming to the legal obligations and requirements of the Income Tax Act, 1961. The primary concept of tax planning is to save money and mitigate one‘s tax burden. However, this is not its sole objective.

Advantages of tax planning:

1. To minimise litigation: To litigate is to resolve tax disputes with local, federal, state, or foreign tax authorities. There is often friction between tax collectors and taxpayers as the former attempts to extract the maximum amount possible while the latter desires to keep their tax liability to a minimum. Minimising litigation saves the taxpayer from legal liabilities.

2. **To reduce tax liabilities**: Every taxpayer wishes to reduce their tax burden and save money for their future. You can reduce your payable tax by arranging your investments within the various benefits offered under the Income Tax Act, 1961. The Act offers many tax planning investment schemes that can significantly reduce your tax liability.

3. **To ensure economic stability**: Taxpayers' money is devoted to the betterment of the country. Effective tax planning and management provide a healthy inflow of white money that results in the sound progress of the economy. This benefits both the citizens and the economy.

4. **To leverage productivity**: One of the core tax planning objectives is channelising funds from taxable sources to different income-generating plans. This ensures optimal utilisation of funds for productive causes.

Types of Tax Planning

Most people merely perceive tax planning as a process that helps them reduce their tax liabilities. However, it is also about investing in the right securities at the right time to achieve your financial goals.

Following are some of the various methods of tax planning:

1. Short-range tax planning

Under this method, tax planning is thought of and executed at the end of the fiscal year. Investors resort to this planning in an attempt to search for ways to limit their tax liability legally when the financial year comes to an end. This method does not partake long-term commitments. However, it can still promote substantial tax savings.

2. Long-term tax planning

This plan is chalked out at the beginning of the fiscal and the taxpayer follows this plan throughout the year. Unlike short-range tax planning, you might not be offered with immediate tax benefits but it can prove useful in the long run.

3. Permissive tax planning

This method involves planning under various provisions of the Indian taxation laws. Tax planning in India offers several provisions such as deductions, exemptions, contributions, and incentives. For instance, Section 80C of the Income Tax Act, 1961, offers several types of deductions on various tax-saving instruments.

4. Purposive tax planning

Purposive tax planning involves using tax-saver instruments with a specific purpose in mind. This ensures that you obtain optimal benefits from your investments. This includes accurately selecting the appropriate investments, creating an apt agenda to replace assets (if required), and diversification of business and income assets based on your residential status.

How to save taxes?

Taxpayers are provided with several options to reduce their tax liabilities. Various sections of the Indian income tax law offer tax deductions and exemptions, of which, Section 80Cis the most popular tax-saving avenue. For e.g., Deposits in Public Providednt Fund, Five Year Bank Depoists, National Savings Certificate , Investment in ELSS schemes.

The best and the most optimum way to save taxes is by laying out a financial plan whenever there is a revision in your income and sticking to it. Also, it is a good habit to make tax-saving investments at the beginning of the year rather than making hasty and often incorrect investment decisions at the last moment. To do this, it is crucial to be aware of all the exemptions and deductions available to you.

Tax saving options under Section 80C

Section 80C, one of the most prevalent sections in the Income Tax Act, 1961, provides provisions to save up to Rs46,800 (assuming the highest slab of income tax i.e. @30% plus education cess 4%) on tax liabilities each year. One of the best tax-saving avenues under Section 80C is investing in an equity-linked savings scheme, more commonly known as ELSS. Such taxplanning mutual fundsoffer the dual benefit of potential capital appreciation and tax-saving.

Apart from ELSS funds, you can choose to invest in government schemes such as National Savings Certificate (NSC), Public Provident Funds (PPF), tax-saving FDs, etc. Cumulative investments under these securities can offer deductions up to Rs1.5 lakh.

Also Read: ELSS – Tax Saving Investment Option

Tax saving options under Section 80D

Under this section, taxpayers are offered deductions on the premium paid towards health insurance policies. Under Section 80D, a taxpayer can claim the following amounts as deductions:

1. Avail up to Rs25,000 on the premium paid towards health insurance for self, children, or spouse
2. Avail up to Rs50,000 if your parents are also covered under your health insurance plan
3. If either of your parents belongs to the senior citizen bracket, then a maximum deduction of Rs75,000 is allowed

Tax saving options under Section 80E

Section 80E offers tax deductions on the interest paid for an education loan. These deductions can be claimed for eight years starting from the date of repayment. There is no upper limit on the deductible amount. This means that an assessee can claim the entire amount paid as interest from the taxable income.

Claiming HRA Exemption

Under HRA, taxpayers can avail exemption on the cost incurred to stay in a rented accommodation. The taxpayer is mandated to furnish the rent receipts provided by the landlord. The deduction available is the least of the following amounts:

1. Actual HRA received; or
2. 50% of basic salary+DA (dearness allowance) for taxpayers living in metro cities; & 40% of (basic salary + DA) for taxpayers residing in non-metro cities; or
3. Total rent paid less 10% of basic salary + DA Other Exemptions and Deductions

Apart from the deductions and the exemptions mentioned above, you can save taxes in severaldifferent ways. Donations towards charities and qualified organisations are also eligible for tax exemptions.

Under the new tax regime announced with the Union Budget 2020, individuals can opt to pay taxes at reduced rates and redefined income tax slabs by forgoing the various deductions and exemptions.

Income tax planning, if performed under the framework defined by the respective authorities, is an entirely legal and a smart decision. However, you might land yourself in trouble for adopting shady techniques to save taxes. It is the duty and responsibility of every citizen to carry out prudent tax planning. Based on your tax slab, personal choices, and social liabilities, you can choose from distinct tax saver mutual funds and investment avenues offered to you.

5.8 Summary

A business house can claim various deductions under different sections of Income Tax, 1961. But there are some deductions by which any company can claim under its normal course of business operations such as Depreciation (u/s 32), Expenditure on Scientific Research (u/s 35) and Amortisation of certain preliminary expenses (u/s 35AD). One can claim these deductions to minimise his/her tax liability**.**

5.9 Glossary

1. Depreciation is an allowance on capital assets acquired and put to use and not expenditure unlike repairs to machinery, plant or furniture. It need not be incurred by the assessee during the previous year. The depreciation allowance has to be calculated on the assets of the assessee as per the methods and rates prescribed under the income tax law.

2.Revenue expenditure related to business [Section 35(2)] As per Section 35(1), any revenue expenditure laid out or expended on scientific research related to the business is deductible. Pre-commencement expenses Where any revenue expenditure has been incurred before the commencement of the business on payment of any salary to an employee engaged in such scientific research (perquisites paid to employees is not covered) or on the purchase of materials used in such scientific research, the aggregate of the expenditure so laid out or expended within the 3 years immediately preceding the commencement of the business shall, be allowed in the previous year in which the business is commenced.

3.Expenditure on in house research and development -Section 35(2AB) Where a COMPANY engaged in the business of bio-technology or in any business of manufacture or production of any article or thing, (except Eleventh Schedule article) incurs any expenditure on scientific research (not being expenditure in the nature of cost of any land or building) on in-house research and development facility as approved by the prescribed authority, then, there shall be allowed a deduction of a sum equal 200% of the expenditure so incurred.

4.Tax Planning: Taxes can eat into your annual earnings. To counter this, tax planning is a legitimate way of reducing your tax liabilities in any given financial year. It helps you utilise the tax exemptions, deductions, and benefits offered by the authorities in the best possible way to minimise your liability.

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5.12 Model Questions

1. Discuss the methods of tax planning by way of claiming Depreciation allowance, amortisation of certain Preliminary expenses and treatment of Scientific Research Expenditure.
2. What do you mean by Depreciation? Explain the rules regarding to claim the deduction of depreciation?
3. Explain in brief the provisions relating to claim of expenses of scientific research?
4. What are the provisions of law relating to tax consideration of Preliminary Expenses?

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Latest updates till 2021

1. Availing the benefits of Section 80

This is the most common clause that people use to receive tax deductions. According to this section, an individual is eligible for tax deductions if the annual salary they receive is under 1,50,000 per year.

However, a person can also claim a higher tax deduction if they invest in a National Pension Scheme account.

The National Pension Scheme, also known as NPS, is a pension scheme that encourages the working sector to create a pension upon retirement. According to this, one receives a considerable return on their investment as the return rate is around 12%.

2. Investing in ULIPs

Unit Link Insurance Plans (ULIPs) are special insurance plans which also act as a tax-saving instrument. These plans are a hybrid of life insurance and investment. When one hand over money to go into a ULIPs, a significant portion goes towards a life insurance plan, and the rest becomes a part of an equity based fund. Therefore, an individual can get the best of both worlds as well as enjoy tax exemptions and returns, making it one of the best tax saving tips.

- **Future Smart Plan**

This ULIP is eligible for individuals. The plan involves creating a fund for one's future offspring. A child of an insured will receive a sum of money after the death of the individual as well as premium funding in case of a disability.

- **Term Edge Plan**

This plan involves ensuring the employees of a company against certain risks. This plan offers frequent periods to pay the premium as well as receive rebates.

3. Investing in mutual funds

Investing in mutual funds is probably one of the more generic ways for reducing one's taxable income. This is especially true when one invests in Equity Linked Savings Scheme (ELSS). This scheme receives tax deductions on the basis of Section 80C.

It has a lock-in period of only three years, which is lower in comparison to other tax saving options like Private Provident Funds and Bank Fixed deposits. These options usually require a lock-in period of eight years.

In addition to this, there is no imposition of tax on these funds. Research has shown that one can save up to Rs 46,000 by participating in this scheme. It also has the potential to provide the highest returns in comparison to other funds.

4. Attaining tax deductions on salaries

This tax deduction mostly applies to assets that are not permanent. For example, a house on rent. If a person is paying rent for the house they live in at the moment; then they can file for tax deductions under Section 10(13A). This states that an individual can file for tax deductions if they are required to pay for the rent in the house that they reside in but have to show receipts for the same.

HRA is a tax saving scheme that usually comes from one's employer. It is calculated by the actual rent that one pays minus 10% of the salary that one receives. In case an individual lives in a metro city, then 50% of their salary is eligible for tax deductions. 40% of the salary is eligible for the individuals living in other cities.

5. Save taxes through philanthropic activities

Donating to charity also comes with its fair share of tax deductions. This aspect of tax-saving aims to encourage donations to charities and other philanthropic activities. This tax deduction also includes the donations that one might make to the National Relief Funds.

The information regarding this is present in Section 80G. The deductions can be minor to almost 100%. However, it does depend on various factors like charity or other financial conditions.

Additional deductibles that come with Section 80

Section 80 comes with a number of subsections that one can utilize to make the most of exemptions and deductibles. The schemes under this section function as tax saving instruments.

- **Section 80D**

This is applicable to the individuals who create medical insurance. In addition to insuring themselves, one can also add loved ones. Under Section 80D, an individual can obtain a deduction worth Rs 25,000 on the insurance.

It also offers coverage to the person that has parents who are younger than 60 years. This additional deduction involves another Rs.25,000. However, this does not include medical bills.

- **Section 80CCC**

This section involves deductions on funds that go up to 1.5 lakhs per year. In a nutshell, one can expect a deduction for the payment of any amount towards the annuity of an insurer. The plan must go towards creating a pension for the future.

The amount is taxable only when one surrenders the annuity. The interest and bonuses that one receives on this annuity are also taxable.

- **Section 80 CCD**

This section involves the pension fund as well. A person can claim this deductible if they deposit an amount into their pension fund. An individual can attain a maximum deduction if the amount is Rs. 1.5 lakhs or 20% of the GTI of a person if they are self-employed.

For individuals who are employees themselves will receive a tax deduction worth 10% of their salaries.

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Lesson-6

Corporate Tax, Minimum Alternate Tax and Tax on Distributed Profits of Companies

Structure

6.0 Objectives

After go through the lesson, you should be able to:

- Understand the concept of Corporate Tax, Dividend Distribution Tax.
- explain the Corporate Tax Rates and rebates applicable to companies
- clarify the concept and various provisions of Minimum Alternate Tax (MAT)
- discuss the issues regarding Tax on Distributed Profits of the Companies.

6.1 Introduction to Corporate Tax

Corporate tax is a form of tax levied on profits earned by businessmen in a particular period of time. Various rates of corporate taxes are levied for different levels of profits earned by business houses.

Corporate tax is generally levied on the revenues of a company after deductions such as depreciation **Cost of goods sold** and Selling general and administrative expenses have been taken into account.

Corporate tax or company tax is a form of direct tax. Many countries levy corporate tax in order to smooth out the tax process for enterprises. Different countries have different rules that apply to taxing of income.

Corporate Tax in India:

Corporate tax in India is levied on both domestic as well as foreign companies. Like all individuals earning income are supposed to pay a tax on their income, business houses too are supposed to pay as tax a certain portion of their income earned. This tax is known as corporate tax, corporation tax or company tax.

Definition of a Corporate:

Any juristic person having a separate and independent legal entity from its shareholders is termed as a corporate. The income earned by a company is computed and assessed separately from the dividends that it offers to its shareholders. These dividends do not figure out in the tax calculation of the company but are assessed as part of the income of shareholder.

For the purpose of tax calculation, companies in India have been broadly divided into the following two categories.

1. Domestic Corporate:

Any company that is Indian is called as domestic company or if the company is foreign but the control and management is wholly situated in India then also it is termed as a domestic company. An Indian company means a company registered under the Companies Act 1956

2. Foreign Corporate:

Any foreign company is one that is not of Indian origin and has some part of control and management of affairs located outside India

Corporate Tax

In India, taxes on income, wealth, Capital Gains are some of the most significant taxes paid by customers. Corporate houses too, be it domestic or foreign, are required to pay taxes in order to run their business. One of the may taxes that corporates are required to pay to the Indian government is corporate tax or company tax.

What is Corporate Tax?

Corporate tax is a form of direct tax levied on profits earned by businessmen in a particular period of time. Various rates of corporate taxes are levied for different levels of profits earned by business houses. Corporate tax is generally levied on the revenues of a company after deductions such as depreciation, COGS (**Cost of goods sold**) and SG&A (Selling general and administrative expenses) have been taken into account.

Corporate tax or company tax can be assumed as an Income Tax for income earned by businesses. Many countries levy corporate tax in order to smooth out the tax process for enterprises. Different countries have different rules that apply to taxing of income.

Corporate Tax in India

Corporate tax in India is levied on both domestic as well as foreign companies. Like all individuals earning income are supposed to pay a tax on their income, business houses too are supposed to pay as tax a certain portion of their income earned. This tax is known as corporate tax, corporation tax or company tax.

Definition of a Corporate

Any juristic person having a separate and independent legal entity from its shareholders is termed as a corporate. The income earned by a company is computed and assessed separately from the dividends that it offers to its shareholders. These dividends do not figure out in the tax calculation of the company but are assessed as part of the income of shareholder.

Corporate Tax Rates AY 2021-22

Corporate Tax Rates for Domestic Companies AY 2021-22

Range of income	Rate of tax
Up to Rs.400 crore gross turnover	25%
Gross turnover that exceeds Rs.400 crore	30%

Surcharge rates in addition to the rates above

Particulars	Domestic Companies Tax rate
If total income range is between Rs.1 crore and Rs.10 crore	7% as per rate of tax above
If total income range exceeds Rs.10 crore	12% as per rate of tax above

Corporate Tax Rates for Foreign Companies AY 2021-22

Nature of income	Rate of tax
Royalty or fees received for any technical services from the government or an Indian concern under agreements made before April 1, 1976, which is approved by the central government	50%
Any other kind of income	40%

Surcharge rates in addition to the rates above

Particulars	Foreign Companies Tax rate
If total income range is between Rs.1 crore and Rs.10 crore	2% as per rate of tax above
If total income range exceeds Rs.10 crore	5% as per rate of tax above

Health and education cess

To the amount that is the total tax liability, 4% of the income tax that is calculated and the surcharge that is applicable will be added before the health and education cess.

Minimum Alternate Tax (MAT)

The minimum alternate tax rate cannot be less than 15% for both domestic and foreign companies. This is based on the book profits as per section 115JB. MAT is levied at the rate of 9 percent plus surcharge and cess as applicable in case of a company, being a unit of an international financial services center, which derives its income solely in convertible foreign exchange.

Dividend Distribution Tax

Tax that has to be paid by companies on the dividend that is distributed to the shareholders every year. In the shareholders‘ hands, this dividend is exempted up to Rs.10 lakh. However, tax paid by companies is 20.56%.

Liability of Minimum Alternate Tax (MAT)

If the total applicable payable tax of a company on the total income is less than 15% of the profit which is recorded in their books (in addition to surcharge and SHEC), the company will be liable to pay a token tax money in the form of MAT or Minimum Alternate Tax.

However, MAT can also be carried forward and adjustments can be made against regular tax. The MAT can be carried forward for 10 subsequent years.

Application and Exemption of Minimum Alternate Tax (MAT)

The Minimum Alternate Tax or MAT is applicable on all the companies. Foreign companies which have income sources in India are also liable to pay MAT.

However, there are certain exemptions as per the regulations of the MAT. Companies that have a setup for life insurance business will be exempted from the purview of MAT under Section 115B. Companies having income generated through shipping will be exempted from the purview of MAT under Section 115V-O.

What is meant by Income of a Company?

In order to compute corporate tax on the income of a company it is necessary to first learn what all factors make up the total income of any company.

- Profits from business
- Income from property
- Capital gains
- Income from other sources such as foreign dividends, interests etc.

Tax Rebates Applicable on Corporate Tax

Apart from various types of taxes levied on company income, there are several provisions of tax rebates available to companies. A list of all these rebates is detailed below.

- In certain cases, domestic companies can deduct dividend received from other domestic companies
- Special provisions are applicable to venture fund and venture capital enterprises
- Deductions, in some cases are allowed for exports and new undertakings
- New infrastructure and power sources set-up is subject to certain deductions

- Business losses have the provision of being carried over for a maximum of 8 years
- Interest, capital gains and dividends can also be deducted in some cases

Corporate Tax Planning

Corporate tax planning can be understood as strategizing one‘s financial business affairs in such a way so as to maximize profit and minimize payable tax by taking into account the allowed benefits of deductions, rebates and exemptions. Tax management is a risky as well as tricky business and most corporates that have a huge money at stake involve financial experts to take care of their taxation process. In India also there are various financial players that provide consultation and implementation of corporate tax. Due diligence and absolute awareness about all tax laws and corresponding rules and regulations, is a must to ensure healthy tax planning.

Corporate tax planning is different from tax evasionor non-payment. Tax planning refers to the act of planning one‘s finances in such a way that the payable tax amount is reduced while the gains are maximized. One of the most essential features of tax planning in that it is absolutely in-line with the legal and financial rules set by the government of India.

6.2 Dividend Distribution Tax

Corporate tax is tax paid by companies on revenues earned minus certain expenses. Similarly, dividend distribution tax is tax paid by corporates on the dividend that they pay to their shareholders. Corporate dividend tax is a percentage of the dividend paid. Currently, the dividend distribution tax in India is 15%.

Income of a Company for calculation of Corporate Tax

In order to compute corporate tax on the income of a company it is necessary to first learn what all factors make up the total income of any company.

- Profits from business
- Income from property
- Capital gains
- Income from other sources such as foreign dividends, interests etc.

6.3 Corporate Tax Rates

Corporate Tax Rates for Domestic Companies in India:

A domestic company in India refers to any enterprise that has its base location in India and is of Indian origin. Given below is the tax rate applicable to domestic businesses in the country.

- A flat rate of 25% corporate tax is levied on the income earned by a domestic corporate.
- A surcharge of 5% is levied in case the turnover of a company is more than Rs.1 Crore for a specific financial year.

Surcharge on Net Income greater than Rs. 10 Crore is 12%

- 3% educational cess is levied.
- Corporate tax is also levied on the global earnings of the domestic company. This takes into account income earned by the company abroad.

Corporate Tax Rate for Foreign Companies in India:

A foreign company means an enterprise that has operations and origin in any other country except India. The taxation rules are not as simple for foreign enterprises as for domestic businesses. Corporate tax on foreign companies depends a lot on the taxation agreements made between India and other foreign countries. For example, corporate tax on an Australian company in India will depend upon the taxation agreement between the governments of India and Australia.

6.4 Tax Rebates Applicable on Corporate Tax

Apart from various types of taxes levied on company income, there are several provisions of tax rebates available to companies. A list of all these rebates is detailed below.

- In certain cases, domestic companies can deduct dividend received from other domestic companies
- Special provisions are applicable to venture fund and venture capital enterprises
- Deductions, in some cases are allowed for exports and new undertakings
- New infrastructure and power sources set-up is subject to certain deductions
- Business losses have the provision of being carried over for a maximum of 8 years
- Interest, capital gains and dividends can also be deducted in some cases

6.5 Minimum Alternate Tax (MAT)

The MAT was introduced for the first time in the AY 1988-89. It was felt that due tovarious concessions provided in Tax Laws big corporate groups become zero tax companies. Therefore to counter this, a system of MAT was introduced.

The concept of MAT was introduced under ITA to tax companies making high profits and declare dividends to their shareholders but have no significant taxable income because of exemptions, deductions and incentives. The primary cause is not tax evasion or a lack of adequate government policies but the feature of tax system – incentives, deduction and exemptions The intent of introducing MAT was to ensure that no taxpayer with substantial income can avoid tax liability by using exclusions, deductions and incentives. The Companies Act and Income Tax Act deals in different situation hence they both have different provisions regarding allowable expenditures. The expenses disallowed under companies act are also disallowed under income tax act, but there is some expenditure which are disallowed under income tax but still allowed to be deducted while calculating the profits under Companies Act. With the result of such provisions the companies are able to reduce their profits and pay low revenue to the credit of government.

In the case of a non-corporate taxpayers to whom the provisions of Alternate Minimum Tax (AMT) applies, tax payable cannot be less than 18.5% (+SC+EC+SHEC) of "adjusted total income" computed as per section 115JC.

6.6 Provisions of Minimum Alternative Tax on Companies (MAT) [Section 115JA]

1. These provisions are applicable on all those Indian companies whose total income as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after 1-4-1997, is less than 30% of book profits.

2. For the purposes of levying tax on such companies total income as computed under Income- tax Act shall be disregarded and **30% of Book profit** shall be deemed as total income for such previous year.

3. Every such company shall prepare its profits and loss account in accordance with the provisions of part II and III of Schedule VI of the Companies Act 1956.

4. While preparing profit and loss account **depreciation will have to be the same as has been charged for preparing the accounts to be presented at the time of annual general meeting of the company. In case the company** has its accounting year which is different than financial year the amount of depreciation (as mentioned above) shall have to be adjusted.

5. The term Book profit means the net profit as per profit and loss account which is to be increased by the following if these are debited or are not credited to P & L A/c

(a) any amount of income-tax paid or payable and any provision for such tax,

(b) any amount carried to any reserve by whatever name called,

(c) any amount set aside to meet any liability other than ascertained liabilities,

(d) any amount set aside as provision for losses of subsidiary companies,

(e) any amount or amounts of dividend paid or proposed,

(f) any amount of expenditure relating to such incomes which do not form part of total income u/s 10 to 13.

Amount so arrived at shall be reduced by the following:

(i) any amount withdrawn from reserves other than reserve specified u/s 80 HHD, or from provisions, if any such amount is credited to the P & L Account. Any amount withdrawn from a reserve created or provision made on or after 1-4-1997, the amount of said withdrawal shall not be deducted if such amount has not increased the book profits of such year.

(ii) any income which is not to be included in total income as given u/s 10 to 13 but has been credited.

(iii) any amount of loss brought forward or unabsorbed depreciation whichever is less, [B/F loss shall not include unabsorbed depreciation.

(iv) any amount of profits derived by an undertaking from the business of generation and distribution of electricity.

(v) any amount of profits derived by an undertaking set up in industrially backward districts as notified u/s 801A during the period it is eligible for deduction u/s 801A.

(vi) any amount of profits derived by an undertaking set up in infra structural sector as notified u/s 801A during the period it is eligible for deduction u/s 801A.

(vii) any amount of profits of a sick industrial company for the period from the assessment year in which the unit became industrially sick till the assessment year during which the entire net worth of the company equals or exceeds the accumulated losses.

(viii) any amount of profits derived from the export of goods or merchandise to which section 80 HHC is applicable.

Basic provisions of MAT

As per the concept of MAT, the tax liability of a company will be higher of the following:

Tax liability of the company computed as per the normal provisions of the Income-taxLaw, i.e., tax computed on the taxable income of the company by applying the tax rateapplicable to the company. Tax computed in above manner can be termed as normal taxliability.

Tax computed @ 15% (plus surcharge and cess as applicable) on book profit (manner ofcomputation of book profit is discussed in later part). The tax computed by applying 15%(plus surcharge and cess as applicable) on book profit is called MAT.

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. crores in the previous year 2019-20. In this case, it has been assumed that the turnover of Company exceeds Rs. 400 in previous year 2019-20.

Note : * A domestic Company is taxable at the rate of 25% if, its turnover or gross receipt does not exceed Rs. 400 crores in the previous year 2019-20. In this case, it has been assumed that the turnover of Company exceeds Rs. 400 in previous year 2019-20.

6.7 Tax Credit In Respect of Tax Paid Under Mat [Section 115JAA]

1. In case any amount is paid u/s 1 15JA by a company for any assessment year, such company shall be allowed credit of amount of tax so paid in prescribed manner.
2. The tax credit to be allowed shall be an amount equal to difference between the amount of tax paid u/s 1 I5JA and tax payable on his total income as computed under this Act.
3. No interest shall be allowed on the amount of tax credit to be given.
4. Amount of tax credit as determined above shall be allowed to be carried forward up to 4 assessment years succeeding the assessment year in which such credit became due.
5. Tax credit will be allowed in the year in which tax becomes payable on the total income as computed under this Act without applying the provisions of section 1 15JA.

6.8 Special Provision for Payment of Tax by Certain Companies [Sect1on 115JB]

(1) Notwithstanding anything contained in any other provision of this Act, where in the case of an assessee, being a company, the income-tax, payable on the total income as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April. 2001, is less than 7.5% of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of 7.5%.

(2) Every assessee being a company shall for the purposes of this **section, prepare** its profit and loss account for the relevant previous year in accordance with the provisions of Parts II and III of Schedule Vito the Companies Act. 1956.

Provided that while preparing the annual accounts including profit and loss account,—

(i) the accounting policies;

(ii) the accounting standards adopted for preparing such accounts including profit and loss account;

(iii) the method and rates adopted for calculating the depreciation, shall be the same as have been adopted for the purpose of preparing such accounts including profit and loss account and laid before the company at its annual general meeting in accordance with the provisions of section 210 of the Companies Act. 1956. Provided further that where the company has adopted or adopts the financial year under the Companies Act, 1956, which is different from the previous year under this Act,—

(i) the accounting policies;

(ii) the accounting standards adopted for preparing such accounts including profit and loss account;

(iii) the method arid rates adopted for calculating the depreciation, shall correspond to the accounting policies, accounting standards and the method and rates for calculating the depreciation which have been adopted for preparing such accounts including profit and loss account for such financial year or part of such financial year falling within the relevant previous year.

6.9 Tax on Distributed Profits

Upto 31-05-1997, the company was not liable to pay any income tax on the amount of dividends declared, distributed or paid by such company. However, such dividend was included in the income of the shareholders under the head "income from other sources". The finance act, 1997 has introduced changes in this rule.

A) Tax on distributed profits of the Domestic Company

The domestic company shall be liable to pay additional income tax on any amount declared, distributed or paid by such company by way of dividend (whether interim or otherwise) on or after 1-06-1997, whether out of current or accumulated profits. Such additional income tax shall be payable @ 10% of the amount so distributed. This additional tax shall be payable even if no income tax is payable by such company on its total income.

Dividend Distribution Tax (Sec 115 O) is 15% but in case of dividend referred to in Section 2 (22)(e) of the Income Tax Act, it has been increased from 15% to 30%.

B) Exemption of dividend in the hands of shareholders

In view of the income tax now payable by the domestic company, any dividends declared, distributed or paid by such company, on or after 01-06-1997 shall be exempt in the hands of the shareholders.

Time limit for deposit of additional income tax : Such additional tax will have to be paid by the principal officer of the domestic company within 14 days from the date of :

a) Declaration of any dividend

b) Distribution of any dividend

c) Payment of any dividend, whichever is earlier Additional income-tax is not allowed as deduction:

The company shall not be allowed any deduction on account of such additional income tax under any provisions of the income tax act.

6.10 Summary

Corporate tax is a form of tax levied on profits earned by businessmen in a particular period of time. Various rates of corporate taxes are levied for different levels of profits earned by business houses. Corporate tax is generally levied on the revenues of a company after deductions such as depreciation Cost of goods sold and Selling general and administrative expenses have been taken into account. Corporate tax or company tax is a form of direct tax. Many countries levy corporate tax in order to smooth out the tax process for enterprises. Different countries have different rules that apply to taxing of income.

The concept of MAT was introduced under ITA to tax companies making high profits and declare dividends to their shareholders but have no significant taxable income because of exemptions, deductions and incentives. The primary cause is not tax evasion or a lack of adequate government policies but the feature of tax system – incentives, deduction and exemptions The intent of introducing MAT was to ensure that no taxpayer with substantial income can avoid tax liability by using exclusions, deductions and incentives. The Companies Act and Income Tax Act deals in different situation hence they both have different provisions regarding allowable expenditures. The expenses disallowed under companies act are also disallowed under income tax act, but there is some expenditure which are disallowed under income tax but still allowed to be deducted while calculating the profits under Companies Act. With the result of such provisions the companies are able to reduce their profits and pay low revenue to the credit of government.

6.11 Glossary

1. **Corporate tax** is a form of tax levied on profits earned by businessmen in a particular period of time. Various rates of corporate taxes are levied for different levels of profits earned by business houses. Corporate tax is generally levied on the revenues of a company after deductions such as depreciation **Cost of goods sold** and Selling general and administrative expenses have been taken into account.

2. **Domestic Corporate:** Any company that is Indian is called as domestic company or if the company is foreign but the control and management is wholly situated in India then also it is termed as a domestic company. An Indian company means a company registered under the Companies Act 1956

3. **Foreign Corporate**: Any foreign company is one that is not of Indian origin and has some part of control and management of affairs located outside India

4. **Corporate tax planning** can be understood as strategizing one‘s financial business affairs in such a way so as to maximize profit and minimize payable tax by taking into account the allowed benefits of deductions, rebates and exemptions. Tax management is a risky as well as tricky business and most corporates that have a huge money at stake involve financial experts to take care of their taxation process.

6.12 References

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6.13 Further Readings

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6.14 Model Questions

1. Explain the concept of Corporate Tax, Dividend Distribution Tax.
2. Discuss the Corporate Tax Rates and rebates applicable to companies.
3. Discuss the concept and various provisions of Minimum Alternate Tax (MAT).
4. Explain the issues regarding Tax on Distributed Profits of the Companies.

Reduced rate of tax for certain existing domestic companies

To provide a much required boost to the economy, a beneficial CIT rate of 22% (plus surcharge of 10% and applicable health and education cess of 4%) was announced with effect from tax year 2019/20. This beneficial rate is at the option of the company and is applicable on satisfaction of the following conditions, cumulatively:

i. The company has not claimed a tax holiday available to a unit in an SEZ, benefit of accelerated depreciation, or benefit of additional depreciation, investment allowances, expenditure on scientific research, and any deduction in respect of certain income other than deduction in respect of employment of new employees and deduction of certain income of Offshore Banking Units and International Financial Service Centre.

ii. The company has not claimed set-off of loss and unabsorbed depreciation carried forward from any earlier years including set-off of any unabsorbed depreciation and losses relating to loss/depreciation on amalgamation, provided such loss is attributable to the deductions referred to in (i) above. However, the corresponding adjustment in written down value of such block of asset as on 1 April 2019 shall be allowed in the prescribed manner.

iii. The option of seeking the benefit of a reduced CIT rate of 22% is furnished in the prescribed manner before the due date of furnishing of income.

iv. Companies exercising this option have been excluded from the applicability of provisions of minimum alternate tax (MAT) and MAT credit.

Benefit of the above provision of reduced tax rate shall not be available in the year of non- compliance and all the subsequent years and other provisions of the Income-tax Act shall apply as if the option has not been exercised from the year of non-compliance.

Reduced rate of tax for newly set-up domestic manufacturing companies and companies engaged in generation of electricity

The Taxation Laws (Amendment) Act 2019 has announced a beneficial CIT rate of 15% (plus surcharge of 10% and applicable health and education cess of 4%) with effect from tax year 2019/20 for newly set-up domestic manufacturing companies. The benefit of concessional tax rate of 15% has been extended to domestic companies engaged in the business of generation of electricity from tax year 2020/21.

The beneficial rate of 15% (plus surcharge of 10% and applicable health and education cess) can be exercised at the option of the company and is applicable on satisfaction of the following conditions, cumulatively:

i. The company is incorporated on or after 1 October 2019 and commences manufacture or production of any article or thing on or before 31 March 2023.

ii. The 'business' is not formed by splitting up or reconstruction of business already in existence (exception provided for undertaking formed as a result of re-establishment, reconstruction, or revival of business).

iii. Does not use plant and machinery previously used for any purpose in India, and no depreciation has been claimed on the same.

iv. Does not use any building previously used as a hotel or convention centre for which deductions under provisions of the Income-tax Act have been claimed or allowed.

v. The company is not engaged in any business other than the business of manufacture or production of any article or thing and research or distribution of such article or thing manufactured or produced. The following businesses shall not be treated as business of manufacture or production of any article or thing:

- Development of computer software in any form or in any media.
- Conversion of marble blocks or similar items into slabs.
- Bottling of gas into cylinder.
- Printing of books or production of cinematograph films.
- Any other business notified in this behalf.

vi. The company has not claimed a benefit for establishing its unit in an SEZ, benefit of accelerated depreciation, or benefit of additional depreciation, investment allowances, expenditure on scientific research, and any deduction in respect of certain income other than deduction in respect of employment of new employees.

vii. The company has not claimed set-off of loss and unabsorbed depreciation carried forward from any earlier years, including set-off of any unabsorbed depreciation and losses relating to loss/depreciation on amalgamation, provided such loss is attributable to the deductions referred to in (vi) above.

viii. In case difficulty arises in non-fulfilment of certain conditions in this section, the CBDT may issue guidelines for removing the difficulty.

ix. The option of seeking the benefit of a reduced CIT rate of 15% is furnished in the prescribed manner before the due date of furnishing of income.

x. Domestic transfer pricing provision shall be applicable for these companies.

xi. Companies exercising this option have been excluded from the applicability of provisions of MAT and MAT credit.

Benefit of the above provision of reduced tax rate shall not be available in the year of non- compliance and all the subsequent years and other provisions of the Income-tax Act shall apply as if the option has not been exercised from the year of non-compliance. However, such company may exercise an option to be governed under provisions of reduced tax rate of 22% (plus surcharge of 10% and applicable health and education cess).

Minimum alternative tax (MAT)

Companies are liable to pay MAT on their adjusted book profits (other than income from life insurance business) where the tax liability under the normal provisions (excluding surcharge and health and education cess) of the Income-tax Act for the tax year is not more than 15% (excluding surcharge and health and education cess) of such book profits. MAT credit is the amount paid over and above the normal tax liability, which can be carried forward and can be utilised for 15 years. However, MAT credit to the extent of difference between the foreign tax credits allowed against MAT over such credit allowable against the tax under the other provisions of the Income-tax Act shall not be eligible to be carried forward.

It provides for deduction of loss or unabsorbed depreciation, whichever is less. However, if a company has applied for corporate insolvency resolution process under the Insolvency and Bankruptcy Code, 2016, then the aggregate amount of brought forward loss and unabsorbed depreciation shall be allowed.

Further, due to implementation of Indian Accounting Standards (Ind AS), by the government, which are converged with the International Financial Reporting Standards (IFRS), the government amended the MAT provisions of the Income-tax Act, so as to provide the framework for the computation of book profit for the purpose of levying MAT in the case of companies required to comply with Ind AS in the year of adoption and thereafter. This framework was specified on the basis of the recommendations of the MAT Ind AS Committee constituted for this purpose.

MAT provisions are not applicable to foreign companies that do not have a PE in India. However, MAT provisions shall not apply to foreign companies where their total income is solely derived from shipping business, exploration of mineral oils, business of aircraft, civil construction in turnkey projects and income thereon is offered to tax as per specific provisions provided under the Income-tax Act.

Capital gains from transfer of securities, interest, royalties, and FTS accruing or arising to a foreign company (which has a PE in India) have been excluded from chargeability of MAT if tax payable on such income is less than 15% (exclusive of surcharge and health and education cess). Further, expenditure, if any, debited to the profit and loss account corresponding to such income shall be added back to the book profit for the purpose of computation of MAT.

Further, Finance Act 2021, has provided that, in case there is an increase in book profit of the previous year due to income of past year(s) being included in the book profit on account of an advance pricing agreement entered into by the taxpayer or on account of secondary adjustment, the Tax Officer shall, recompute the book profit of the past year(s) and tax payable, if any, by the taxpayer during the tax year in the prescribed manner, if an application in this regard is made to him by the taxpayer. It has been further provided that the provisions of rectification of mistake under the Indian Income-tax Act shall be applicable to the aforesaid computation made by the Tax Officer and the period of four years shall be reckoned from the end of the FY in which the said application is received by the Tax Officer.

The aforesaid provisions shall apply only if the taxpayer has not utilised the credit of tax paid under this section in any subsequent tax year.

The above provisions will take effect from 1 April 2021 and no interest shall be payable to the taxpayer on the refund arising on account of application of the provisions of this section.

Sick companies (i.e. companies whose losses have been wiped out of their net worth and that are doubtful of being revived and nursed back to profitability) are not subject to MAT.

An SEZ developer and a unit in an SEZ are also liable to pay MAT.

Companies exercising the option of lower tax rate of 22% (discussed above) have been excluded from the applicability of provisions of MAT and MAT credit.

The existing tax rates under MAT are provided in the below table:

	MAT rate (%)			
	Indian company		**Foreign company (other thanexempted)**	
Income*	**Basic****	**Effective*****	**Basic****	**Effective*****
Less than INR10 million	15	15.600	15	15.600
More than INR10 million butless than INR100 million	15	16.692	15	15.912
More than INR100 million	15	17.472	15	16.380

* Surcharge of 10% is payable only where total taxable income exceeds INR 10 million.

** Basic rate of MAT is 9% of book profits in case of a corporate and non-corporate taxpayer located in an International Financial Services Centre and deriving income solely in convertible foreign exchange.

*** Effective tax rates include surcharge and health and education cess.

Tonnage tax scheme

The tonnage tax scheme, a presumptive tax provision, can be chosen by a non-resident company that has a place of effective management (PoEM) in India, owns at least one qualifying ship, and whose main objective is to carry on the business of operating _qualifying ships‘. Once the scheme is exercised, there is a lock in period of ten years.

The tonnage tax scheme is in place of CIT and is levied based on tonnage of vessels owned, operated, or chartered by it instead of net income generated by commercial operations. The notional income is taxable at the normal corporate rate applicable for the year even if there is loss in a year.

Under this scheme, separate business and separate accounts are to be maintained. Manner of computation is as follows:

Net tonnage of qualifying ship	**Amount of daily tonnage income**
Up to 1,000	INR 70 for each 100 tons
Exceeding 1,000 but not more than10,000	INR 700 plus INR 53 of each 100 tons exceeding1,000 tons
Exceeding 10,000 but not more than25,000	INR 5,470 plus INR 42 of each 100 tons exceeding10,000 tons
Exceeding 25,000	INR 11,770 plus INR 29 of each 100 tons exceeding25,000 tons

Shipping business of non-residents

Deemed income shall be assessed at 7.5% of the amount paid or payable (whether in or out of India) for carriage of passengers, livestock, mail, or goods shipped from any port in India, and the amount received or deemed to be received in India on account of carriage of passengers, livestock, mail, or goods shipped to any port outside India shall be treated as profits and gains of business.

Treaty rates will apply to non-resident shipping companies if they are lower than the rates under the tonnage tax scheme.

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Lesson-7

Tax Planning Relating to Form of Business and Financial Management Decisions

Structure

7.0 Objectives

After reading this lesson, you will be able to:

- discuss the tax planning w.r.t. form of business
- explain tax planning w.r.t. management decision like Capital Structure
- describe the scope of tax planning in business organisations

7.1 Introduction

This lesson discusses the tax planning with respect to form of business and financial management decisions and specific management decisions such as Capital Structure, Dividend Policy, Bonus Shares, Own or Lease, Instalments or Hire Purchase System, Make or Buy, Shutting down or continue and Asset used for Scientific Research etc.

Scope of Business Organization

The scope of business organization has considerably expanded after the Industrial Revolution. The process of production is now quite complicated. An organization is needed to determine what each person will do and how much authority each will have. The role of business organization in various forms of business ownership is discussed in brief.

(1) **In Sole Proprietorship Form of business**, the organization structure is very simply. The entrepreneur generally introduces his own capital. He alone is the sole organizer, financier, decision taker, operator, and controller and above all responsible for air the success and failures of business, there is generally rule sub-division ofmain work into small groups.

(2) **In a Partnership Form of Business ownership,** each partner provides capital, labour and management according to an agreement the partners determine among themselves the extent to which each partner shall take part in the management. The pattern of division of activities, determination of responsibilities. Delegation of authority etc. depends upon the nature and size ofbusiness. As the partnership business is generally run on small scale, the business organization structure isrelatively simple, temporary and informal.

(3) **In a Company Form of Business,** there is a formal pattern of organization. The work of organization begins even before its incorporation by the promoters. This work of organization continues after incorporation. An organization chart of responsibilities is prepared. The scope of business organization in corporate businessis quite wide and complicated. Importance of Business Organization.

(1) Product Growth:- activities directed towards production are better grouped through organization. It encourages product growth and diversification.

(2) Efficient Use:- Organization helps in the efficient use of factors of production and thus reduces cost of production of goods.

(3) Technological Improvements:- A good organization provides for the optimum-use of technological improvements.

(4) Creative Thinking:- It stimulates independent creative thinking in various departments of production.

(5) Use of Skilled Salesman:- It is useful in providing skilled salesman for satisfying the various needs of the customers.

(6) Quick Decisions:- The business organization makes easy to take quick decisions.

(7) Recognition of the Problem:- The recognition of the problem, selection of the solution, issuing of the necessary orders can be taken with correct Timings in sound organization.

(8) Fixing of Responsibility:- Fixing of responsibility can easily be pin pointed.

(9) Feed Back:- An organization makes possible to take decisions about production on objective facts gathered from the market.

(10) Mark Functions:- All the marketing functions of goods such as buying! Selling, transporting, storage. financing, risks taking product Standardization and grading, etc., are solved by the business organization.

(11) Minimum Cost:- The organization helps to attain the goals and objectives of the business at the minimum cost.

(Insert all the pages of form of business with examples from the notes here)

(Note: Replace the entire chapter of financial management decisions with given below)

7.2 Capital Structure Decisions

Capital structure decisions are considered before making any new investment in any venture. To finance the investment, money has to be raised from the market. It can be raised through various sources of finance viz., loans and debentures, preference share capital and equity share capital. Thus, there are different options to raise money. The option which maximizes return on equity capital is considered as the best option.

Case 1 –

XYZ Ltd., a company engaged in manufacturing of electrical fans is considering a major expansion of its production facility and import of latest technology which is expected to improve its profitability from the present rate of 18% to at least 25% (before interest and tax). The finance manager has given the following proposals to the board:

(Rs. in lakh)

	A	*B*	*C*	*D*
Share Capital	*40*	*20*	*30*	*50*
14% Preference Shares	*20*	*20*	*----*	*10*
16% Non- Convertible Debentures	*----*	*20*	*----*	*40*
Term Loans from Institutions (20%)	*----*	*40*	*70*	*----*
Lease Finance (22%)	*40*	*----*	*----*	*----*
Total	*100*	*100*	*100*	*100*

Additional information:

a. The rate of dividend on equity has not been below 22% in the past and date of dividend declaration is June 30 every year.

b. The tax rate faced by the company is 30.9%.

Your opinion with detailed reasons is sought on the above.

The above case is related to planning and thus, assessment year 2017-18 is applied. Tax rate given is 30.9% which means surcharge is not applicable for XYZ Ltd. There are 4 different options given through which Rs. 100 lakhs can be raised from the market. It has been given that rate of return on equity capital has not been below 22% in the past and thus, the options which gives the return of less than 22% will not be accepted. Further, if there is more than one option which gives rate of return on equity capital 22% or more than 22%, then that option will be considered which maximizes the return. Following table calculated ROR on equity share capital:

	Particulars	A (Rs.)	B (Rs.)	C (Rs.)	D (Rs.)
	Capital Employed	1,00,00,000	1,00,00,000	1,00,00,000	1,00,00,000
	Rate of Return on Capital Employed [in %]	25	25	25	25
	Earnings before Interest and Tax (EBIT) @ 25%	25,00,000	25,00,000	25,00,000	25,00,000
Less	Interest on debt		3,20,000		6,40,000
	Interest on bank loan		8,00,000	14,00,000	
	Interest on lease finance	8,80,000			
	Earnings before Tax (EBT)	16,20,000	13,80,000	11,00,000	18,60,000
Less	Taxes @ 30.9%	5,00,580	4,26,420	3,39,900	5,74,740
	Earnings after Tax (EAT)	11,19,420	9,53,580	7,60,100	12,85,260
Less	CorporateDividendTax (11,19,420/120.358*20.358 and so on.)	1,89,345	1,61,294	1,28,567	2,17,396
	DividendtoPreference shareholders (PSH)	2,80,000	2,80,000		1,40,000
	Net incometoEquity shareholders (ESH) (a)	6,50,075	5,12,286	6,31,533	9,27,864
	Equity share capital (b)	40,00,000	20,00,000	30,00,000	50,00,000
	ROR on ESC (a)/(b) * 100	16.25%	25.61%	21.05%	18.56%

From the above table, it can be seen that there is only option B which gives 25.61% return on equity capital which is equal to or more than 22% which the company is already earning.

Thus, amount of Rs. 100 lakhs will be raised as per the composition given in option B.

Case 2 –

XYZ Ltd., a company has share capital of Rs. one crore and is planning to invest an additional fund of Rs. 80 lacs towards its expansion programme. Suggest the best option from the following tax planning point of view:

Option A: To issue share capital of Rs. 80 lacs.

Option B: To borrow Rs. 20 lacs @ 18% p.a. and to issue debentures of Rs. 20 lacs @ 11% p.a. and the balance amount be collected by issuing shares in the public.

Option C: To issue debentures for Rs. 50 lacs @ 11% p.a. and the balance be collected by issuing shares in public.

Rate of return is 30% before paying any interest and tax and rate of tax is 33.063%.

The above case is related to planning and thus, assessment year 2017-18 is applied. Tax rate given is 33.063% which means surcharge @ 7% is also applicable for XYZ Ltd. There are 3 different options given through which additional Rs. 80 lakhs can be raised from the market. That option will be considered which maximizes the return on equity share capital. Following table calculated ROR on equity share capital:

	Particulars	A (Rs.)	B (Rs.)	C (Rs.)
	Capital Employed	1,80,00,000	1,80,00,000	1,80,00,000
	Rate of Return on Capital Employed [in %]	30	30	30
	EBIT @ 30%	54,00,000	54,00,000	54,00,000
Less	Interest on debt		3,60,000	
	Interest on debentures		2,20,000	5,50,000
	EBT	54,00,000	48,20,000	48,50,000
Less	Taxes @ 33.063%	17,85,402	15,93,637	16,03,556
	EAT	36,14,598	32,26,363	32,46,445
Less	CDT (36,14,598/120.358*20.358) and soon….	6,11,393	5,45,724	5,49,121
	Dividend to PSH			
	Net income to ESH (a)	30,03,205	26,80,639	26,97,323
	Equity share capital (b)	1,80,00,000	1,40,00,000	1,30,00,000
	ROR on ESC (a)/(b) * 100	16.68%	19.15%	20.75%

From the above table, it can be seen that option C gives 20.75% return on equity capital which is the maximum. Thus, additional amount of Rs. 80 lakhs will be raised as per the composition given in option C.

7.3 DIVIDEND POLICY

Amount of profit distributed to shareholders is actual dividend. But as per different clauses of section 2(22), some distributions or payments are termed as ―Deemed dividend‖. Following payments or distributions by a company to its shareholders are deemed as dividends to the extent of accumulated profits (whether capitalized or not) of the company –

a) any distribution entailing release of all (or any part) of the assets of the company;

b) any distribution of debentures, debenture-stock, or deposit certificates in any form (whether with or without interest), and any distribution of bonus shares to preference shareholders of the company;

c) any distribution on liquidation of the company;

d) any distribution on the reduction of capital of the company;

e) any sum of money paid by a closely-held company after May 31, 1987, by way of advance or loan to a shareholder having substantial interest.

The following will not be termed as dividend –

1. Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956;

2. 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).

What are 'Accumulated Profits'?

1. It shall not include capital gains arising till March 1946, or during April 1, 1948 and March 31, 1956.

2. For the purpose of section 2(22)(a), (b), (d) and (e), ‗accumulated profits' include all profits of the company up to the date of distribution or payment referred to in those sub-clauses.

3. For the purpose of section 2(22)(c), ‗accumulated profits' include all profits of the company up to the date of liquidation. However, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Government (or a corporation owned or controlled by the Government) under any law for the time being in force, ‗accumulated profits' does not include profits of the company prior to 3 successive previous years immediately preceding the previous year in which such acquisition took place. For example, if an accounting year of a company is financial year and compulsory acquisition takes place on January 21, 2016, its accumulated profits will exclude profits accumulated up to March 31, 2012.

Distribution of accumulated profits entailing release of company's assets [Sec 2(22)(a)] Under sub-clause (a) of section 2(22), any distribution by a company of its accumulated profits (whether capitalized or not) is dividend if it entails the release of company's assets.

The transfer of such released assets should be in cash or in kind by the company directly or indirectly to the shareholders. Where the distribution is in kind, the market value of the asset (and not the book value) shall be treated as deemed dividend in the hands of shareholders.

Where a company issues redeemable preference shares to equity shareholders as dividend then at the time of issuing such shares, there would be no liability to pay tax but when these bonus shares are redeemed, the amount received at the time of redemption would constitute as dividend distributed and be chargeable to income tax.

One of the conditions laid down in sub-clause (a) of section 2(22) is that distribution must entail release of company's assets to its shareholders. When, therefore, a company distributes ordinary or equity bonus by capitalizing its profits then there is no release of assets and consequently, bonus shares are not taxable as dividend. If, however, bonus shares are issued to preference shareholders, it amounts to distribution of dividend by virtue of sub-clause (b) of section 2(22).

Case –

A company issued redeemable preference shares of Rs. 3 lacs to its equity shareholders as bonus shares on May 1, 2009 by capitalizing general reserve. X, one of the shareholder, received preference shares of Rs. 30,000 as bonus shares. These were redeemed on November 30, 2015.

In this case, no tax on Rs. 30,000 would be attracted at the time of issue of bonus shares. However, when the company redeemed these preference shares and X received Rs. 30,000 on November 30, 2015, in this situation Rs. 30,000 would be treated as dividend on which the company had to pay dividend tax because it amounts to release of company‘s assets (provided the company is in possession of accumulated profits at the time of redemption).

Distribution of accumulated profits in the form of debentures, debenture stock etc. [Sec. 2(22)(b)]

Under this clause, the following two distributions are treated as dividend to the extent of accumulated profits (whether capitalized or not) of the company:

a. Distribution by a company to its shareholders (whether equity or preference) of debentures, debenture stock or deposit certificates in any form (whether with or without interest) or;

b. Distribution by a company to its preference shareholders of bonus shares.

It is important to note that under the above circumstances, distribution amounts to dividend in the hands of recipient even if there is no release of assets at the time of distribution. Hence, market value of bonus shares would be assessable as dividend declared, distributed or paid.

Distribution of accumulated profits at the time of liquidation [Sec. 2(22)(c)]

Under this clause, any distribution made by a company to its shareholders on its liquidation is treated as dividend to the extent of accumulated profits (whether capitalized or not) of the company immediately before its liquidation.

Case –

Suppose on the liquidation of a company, liquidator could pay Rs. 80 on a share of Rs. 100. Out of Rs. 80, Rs. 30 was paid out of accumulated profits of the company.

In this case, Rs. 30 per share shall be deemed to be dividend under section 2(22)(c) and Rs. 50 per share as capital receipt which will be treated as sale consideration while computing capital gains in the hands of the recipient.

Distribution of accumulated profits on reduction of capital [Sec. 2(22)(d)]

Any distribution by a company to its shareholders on the reduction of capital is treated as dividend to the extent the company possesses accumulated profits (whether capitalized or not).

Distribution of accumulated profits by way of advance or loan [Sec. 2(22)(e)]

Under this clause, any loan or advance to a shareholder or concern is treated as dividend as explained below:

Loan to a shareholder or payment on behalf of or for the benefit of shareholder

Loan or advance to a shareholder is treated as dividend if the following conditions are satisfied:

1. Payment by way of loan or advance is given by a company in which the public are not substantially interested.

Note: It does not matter whether the loan is taken at an interest rate or not.

2. Payment is made by way of loan or advance to a shareholder (being a person who is the beneficial owner of at least 10% equity shares in the company giving the loan).

3. The company should possess accumulated profits (excluding capitalized profits) at the time it makes payment of loan or advance.

If the above given conditions are satisfied, the amount of loan or advance is treated as dividend to the extent the company possesses accumulated profits.

This sub-clause covers the following type of payments:

a. Any payment by way of loan or advance to shareholder.

b. Any payment on behalf of a shareholder.

c. Any payment for the benefit of a shareholder.

Loan or advance to a concern

Loan or advance given to a concern is treated as deemed dividend under section 2(22)(e) in the hands of the concern* if the following conditions are satisfied:

1. Loan or advance is given by a company in which the public are not substantially interested.

2. The company should possess accumulated profits (excluding capitalized profits) at the time it makes payment of loan or advance.

3. Loan or advance is given to a concern (i.e., a Hindu undivided family or a firm or an AOP or a body of individuals or a company) in which a shareholder (who is beneficially holding at least 10% equity share capital of the company (giving loan or advance) has substantial interest.

Substantial interest

A person shall be deemed to have a substantial interest in a concern, if he is, at any time during the previous year, beneficially entitled to at least 20% income of such concern (if such concern is a company, then he should beneficially hold at least 20% equity share capital of the company).

*If all the aforesaid conditions are satisfied, then such payment shall be treated as deemed dividend in the hands of the shareholder and not the concern. [ACIT v Bhaumik Colour Pvt. Ltd. (2009) 27 SOT 270 (Mum) (SB) affirmed in CIT v Universal Medical Pvt. Ltd. (2010) 190 Taxmann 144 (Bom) and CIT v Ankitech Pvt. Ltd. (2011) 199 Taxmann 341 (Del)].

Note: This section is applicable even if loan is repaid before the end of the previous year. In other words, the liability is attracted at the moment the loan is given.

Further, it is to be noted that in the examination, both the treatment of taxability of deemed dividend is to be shown till the ruling of High Court is confirmed by Honorable Supreme Court i.e., whenever a company gives loan to a concern and where a shareholder holds at least 10% equity shares in the company giving loan and further, having substantial interest in the concern. In such a case, as per Income-tax Act, 1961, deemed dividend is taxable in the hands of concern but as per High Court and

Tribunal Rulings, it is taxable in the hands of shareholder.

The following payments are not treated as dividend under this clause:

1. Where money-lending is a substantial part of the business of the company (giving loan), the above provisions are not acceptable.

2. If after giving loan or advance to a shareholder, the company declares normal dividend and such dividend is set off against outstanding loan/ advance, the amount so set off will not be taken as dividend.

If, however, the dividend is not so set off but it is paid to a shareholder even when the loan is outstanding against him, it would not be covered by this exception and hence will be taxable as dividend.

Case –

X (P) Ltd. gave a loan of Rs. 2,00,000 to Mr. Z who had 19% shares in the company. The loan is still outstanding. Thereafter, the company declared dividend and has to pay a dividend of Rs. 40,000 to Mr. Z and the same is set-off against the loan.

In this case, Rs. 2,00,000 shall be deemed dividend in the hands of Mr. Z. However, dividend of Rs. 40,000 which has been set-off against such loan would not be liable to tax either in the hands of the company or Mr. Z.

If the amount distributed as dividend is not so set-off against the loan, the company shall be liable to pay dividend distribution tax on Rs. 40,000 also but Mr. Z shall not be liable to tax on such amount under section 10(34).

Further, if such dividend has been declared after the loan is refunded by Mr. Z, then also the company would be liable to pay dividend distribution tax on Rs. 40,000 and such dividend would be exempt in the hands of Mr. Z under section 10(34).

Taxability of dividend

1. Dividend received from a foreign company:

Dividend received from a foreign company is taxable in the hands of shareholders.

2. Dividend received from a domestic company:

a. Actual dividend:

Actual dividend received from a domestic company is exempt in the hands of shareholders under section 10(34). However, the company declaring dividend has to pay corporate dividend tax under section 115-O @ 20.358% (17.647% + 12% + 3%) for the assessment year 2016-17 and 2017-18. Rate of CDT (Corporate dividend tax)is 15% but computation of effective corporate dividend tax rate is makes this rate as 17.647%.

b. Deemed dividend:

i. Deemed dividend under section 2(22)(a), (b), (c) and (d):

If deemed dividend is covered under clause 2(22)(a), (b), (c) or (d), then it is exempt in the hands of shareholders under section 10(34). However, the payer- company has to pay CDT/ DDT (corporate dividend tax/ dividend distribution tax) under section 115-O @ 20.358% for the assessment year 2016-

17 and 2017-18.

ii. Deemed dividend under section 2(22)(e):

Deemed dividend under this clause is taxable in the hands of shareholders under the head ―Income from other sources‖. On such dividends, company paying dividend has to deduct tax at source under section 194 @ 10% on behalf of the assessee and assessee has to include this income as deemed dividend income under the head ―Income from other sources‖ which will be taxable depending upon the tax slab applicable for the assessee.

3. With effect from assessment year 2017-18, aggregate dividend income from domestic companies [except deemed dividend under section 2(22)(e)] in excess of Rs. 10,00,000 is chargeable to tax @ 10% + Surcharge (if applicable) + Cess @ 3% under section 115BBDA. This section is applicable for resident individuals, resident HUFs and resident firms.

7.4 Bonus Share

Bonus shares are given free of cost to the shareholders. But for the purpose of capital gains, cost of acquisition of bonus shares received on or after April 1, 1981 is taken as nil. But cost of acquisition of bonus shares received before April 1, 1981 is taken as fair market value of such shares on April 1, 1981.

Bonus to equity shareholders –

The table given below highlights the tax consequences of bonus shares given to equity shareholders –

Situations	*Tax treatment in the hands ofcompany issuing bonus shares*	*Tax treatment in the hands ofshareholders*
At the time of issue of bonusShares	No tax liability	No tax liability
At the time of sale of bonusshares by shareholder	No tax liability	Capital gains will be computed
At the time of redemption ofbonus shares or at the time of liquidation of theCompany	Undersection 2(22)(a)or2(22)(c), it will be treated asdividenddistributiontotheextentofaccumulatedprofitand, consequently,the payercompany will paycorporatedividend tax.	Out of the amount received atthe time of redemption orliquidation, amount treated as―dividend‖ undersection2(22)(a)/ (c) will be exempt inthe hands ofshareholders;balance amount will be saleConsiderationto computecapital gain.

Note –

While computing capital gains, if securities transaction tax is applicable at the time of transfer, long-term capital gain is not chargeable to tax under section 10(38) and short-term capital gain is taxable under section 111A @ 15% + surcharge, if any + cess @ 3%.

Bonus to preference shareholders –

The table given below highlights the tax consequences of bonus shares given to preference shareholders. Though bonus shares to preference shareholders are rarely issued but if issued, then following are the tax consequences –

Situations	*Tax treatment in the hands of company issuing bonus shares*	*Tax treatment in the hands of shareholders*
At the time of issue of bonus Shares	Treated as deemed dividend under section 2(22)(b) and thus, chargeable to dividenddistribution tax	No tax liability
At the time of sale of bonus shares by shareholder	No tax liability	Capital gainswill be computed
At the time of redemption of bonus shares or at the time of liquidation of the Company	No tax liability	Out of the amount received at the time of redemption or liquidation, amount treated as―dividend‖ under section 2(22)(a)/ (c) will be exempt in the hands of shareholders; balance amount will be sale consideration to computecapital gain.

7.5 Purchasing of an Asset Out of Own Funds or Out of BorrowedCapital

Net cash outflows of both the options shall be compared and the option which minimizes the net cash outflow will be considered as the best option while taking a decision whether to purchase the asset out of own funds or out of borrowed funds.

In case of purchase through own funds, owner can claim the benefit of depreciation, sale value at the terminal year of the project and tax benefit on short term capital loss (or tax loss on short term capital gain). Also, in case of purchase through own funds, gross cash outflow is equal to the cost of the asset.

In case of purchase through borrowed funds, owner can claim the benefit of depreciation, interest payment, sale value at the terminal year of the project and tax benefit on short term capital loss (or tax loss on short term capital gain). However, in case of purchase through borrowed funds, grosscash outflow is the sum total of down payment, interest payment and principal payment every year or at the end of the loan term (as the case may be).

Computation of net cash outflow in both the options is mentioned below –

Purchase of an asset from own funds

	Particulars	*Amount (Rs.)*
	Gross cash outflow [Investment in the Year 0 (end)/ Year 1(beginning)]	XX
Less:	PV of tax savings on account of depreciation	XX
Less:	PV of cash inflow on account of sale	XX
Less:	PV of tax savings on account of STCL (short term capital loss)	XX
Add:	PV of tax loss on account of STCG (short term capital gain)	XX
	Net cash outflow	XXX

Purchase of an asset from borrowed funds

	Particulars	*Amount (Rs.)*
	Down payment	XX
	PV of Interest payment every year	XX
	PV of Principal Payment at the end of term loan	XX
	Gross cash outflow [Investment in the Year 0 (end)/ Year 1(beginning)]	XX
Less:	PV of tax savings on account of depreciation	XX
Less:	PV of tax savings on account of interest payment	XX
Less:	PV of cash inflow on account of sale	XX
Less:	PV of tax savings on account of STCL (short term capital loss	XX
Add:	PV of tax loss on account of STCG (short term capital gain)	XX
	Net cash outflow	XXX

Case –

An assessee who carries on a business acquires a plant and machinery costing Rs. 1,00,000. This plant and machinery is utilized for the business of the company till year ten when it is sold and discarded at the depreciated price. Effective tax benefit depends upon maximum marginal rate of tax. For this purpose, it is assumed that maximum marginal rate of tax is 34.608% [Tax @ 30%+ Surcharge @ 12% + Cess @ 3%]. Cost of capital is 10% and rate of depreciation is 15%. This case study is based on options:

i. Option I – own funds are invested.

ii. Option II – 75% of cost is financed by deposit taken from bank at an interest rate of 9%p.a. and principal will be repaid in year ten.

In this case, decision has to be taken regarding whether the asset of Rs. 1,00,000 should be purchased from own funds or from borrowed funds. It is to be noted that in both the cases, assessee becomes the owner of the asset and thus, depreciation can be claimed in both the options.

Assumption I:

If it is assumed that sales take place at the end of year 10.

Option I: Purchase of assets with own money

	Particulars	Amount (Rs.)
	Gross cash outflow [Investment in the Year 0 (end)/ Year 1(beginning)] (Rs. 1,00,000*1)	1,00,000
Less	PV of tax savings on account of depreciation	18,725
Less	PV of cash inflow on account of sale (Rs. 23,162*.386)	8,930*
Less	PV of tax savings on account of STCL (short term capital loss) [Sec. 50(2) – Single asset block (normal assumption)]	0
Add	PV of tax loss on account of STCG (short term capital gain) [Sec. 50(2) – Single asset block (normal assumption)]	0
	Net cash outflow	72,345

** This figure comes through excel. When it is done on calculator, it comes out to be Rs. 8,940. The difference is because calculator takes the discount value as .386 but excel takes it as 0.3855432894295310. However, both the values are treated as correct values.*

Calculation of tax benefit on depreciation:

Year	Cost/ WDV (Rs.)	Depreciation @ 15% (Rs.)	Tax saving @ 34.608% (Rs.)	PVF (.10)	Total PV (Rs.)
1	1,00,000	15,000	5,191	0.909	4,719
2	85,000	12,750	4,413	0.826	3,647
3	72,250	10,838	3,751	0.751	2,818
4	61,413	9,212	3,188	0.683	2,177
5	52,201	7,830	2,710	0.621	1,683
6	44,371	6,656	2,303	0.564	1,300

7	37,715	5,657	1,958	0.513	1,005
8	32,058	4,809	1,664	0.467	776
9	27,249	4,087	1,415	0.424	600
10	23,162	Nil	Nil	0.386	0
Total					18,725

Applicability of section 32 in 10^{th} year:

		Amount (Rs.)
	WDV in the beginning of 10^{th} year	23,162
Add:	Cost of asset acquired in 10^{th} year	Nil
Less:	Sale during 10^{th} year	23,162 [sold/ discarded at depreciated price]
	WDV at the end of 10^{th} year	Nil
	Depreciation for 10^{th} year	Nil

Applicability of section 50(2) in 10^{th} year [Sec. 50(2) is applied because block ceases to exist on the last day of year 10]:

		Amount (Rs.)
	Sale value	23,162
Less:	WDV at the beginning of 10^{th} year	23,162
	Short term capital loss/ gain	Nil

Option II: With borrowed money

1 (Starting)	1 (End)	2 (End)	3 (End)	10 (End)
25,000	6,750	6,750	6,750	6,750 75,000

Interest payment annually = Rs. 6,750 (75,000*9%)

		Amount (Rs.)
Cash outflow:		
In the beginning (Rs. 25,000*1)		25,000
	Interest*PVAF (10%, 10) [Rs. 6,750*6.145]	41,479
	Principal repayment*PVF (10%, 10) [Rs. 75,000*.386]	28,950
	Gross cash outflow	95,429
Less:	PV of tax benefit on depreciation	18,725
Less:	Sale value at the end of year 10 (23,162*.386)	8,930
Less:	PV of tax benefit on interest [Rs. 6,750*34.608% = 2,336*6.145]	14,355
	Net cash outflow	53,419

Conclusion:

It is better to purchase the asset with borrowed money because it shows less net cash outflow.

Another assumption:

If it is assumed that sales take place in the beginning of 11th year

Option I: Purchase of assets with own money

	Particulars	Amount (Rs.)
	Gross cash outflow [Investment in the Year 0 (end)/ Year 1(beginning)] (Rs. 1,00,000*1)	1,00,000
Less	PV of tax savings on account of depreciation	19,189
Less	PV of cash inflow on account of sale (Rs. 19,687*.386)	7,590
Less	PV of tax savings on account of STCL (short term capital loss) [Sec. 50(2) – Single asset block (normal assumption)]	0
Add	PV of tax loss on account of STCG (short term capital gain) [Sec. 50(2) – Single asset block (normal assumption)]	0
	Net cash outflow	73,221

Calculation of tax benefit on depreciation:

Year	Cost/ WDV (Rs.)	Depreciation @ 15% (Rs.)	Tax saving @ 34.608% (Rs.)	PVF (.10)	Total PV (Rs.)
1	1,00,000	15,000	5,191	0.909	4,719
2	85,000	12,750	4,413	0.826	3,647
3	72,250	10,838	3,751	0.751	2,818
4	61,413	9,212	3,188	0.683	2,177
5	52,201	7,830	2,710	0.621	1,683
6	44,371	6,656	2,303	0.564	1,300
7	37,715	5,657	1,958	0.513	1,005
8	32,058	4,809	1,664	0.467	776
9	27,249	4,087	1,415	0.424	600
10	23,162	3,474	1,202	0.386	464
11	19,687	0	0	0.350	0
Total					19,189

Applicability of section 32 in 10th year:

		Amount (Rs.)
	WDV in the beginning of 10th year	23,162
Add:	Cost of asset acquired in 10th year	Nil
Less:	Sale during 10th year	Nil
	WDV at the end of 10th year	23,162
Less:	Depreciation for 10th year	3,474
	WDV in the beginning of 11th year	19,687

Applicability of section 50(2) in 11th year [Sec. 50(2) is applied because block ceases to exist on the last day of year 11]:

		Amount (Rs.)
	Sale value	19,687
Less:	WDV at the beginning of 11th year	19,687
	Short term capital loss/ gain	Nil

Option II: With borrowed money

1 (Starting)	1 (End)	2 (End)	3 (End)	10 (End)
25,000	6,750	6,750	6,750	6,750
				75,000

Interest payment annually = Rs. 6,750 (75,000*9%)

		Amount (Rs.)
Cash outflow:		
In the beginning (Rs. 25,000*1)		25,000
	Interest*PVAF (10%, 10) [Rs. 6,750*6.145]	41,479
	Principal repayment*PVF (10%, 10) [Rs. 75,000*.386]	28,950
	Gross cash outflow	95,429
Less:	PV of tax benefit on depreciation	19,189
Less:	Sale value at the end of year 10 (Rs. 19,687*.386)	7,590
Less:	PV of tax benefit on interest [Rs. 6,750*34.608% = 2,336*6.145]	14,355
	Net cash outflow	54,295

Conclusion:

It is better to purchase the asset with borrowed money because it shows less net cash outflow.

7.6 Owning or Leasing of An Asset

While taking the decision to purchase the asset or to take the asset on lease, net cash outflows of both the options should be compared and that option is considered as the best option which minimizes net cash outflow. Under Income-tax Act, owner of an asset can claim depreciation under section 32 on the assets purchased. In case of lease, lease rent and lease management is allowed as an expenditure.

Computation of net cash outflow when the asset is taken on lease

Assumption I: If it is assumed that lease rent is paid in the beginning:

	Particulars	*Amount (Rs.)*
	Lease management fee in the beginning [PV factor 1]	XX
	Rent paid in the beginning of Year 1 [PV factor is 1]	XX
Add:	PV of rent paid in subsequent years	
	[Example, Rent at year 2 beginning PV of year 1 end and so on]*	XX
	Gross cash outflow	XX
Less:	Tax savings on account of lease management fee [PV factor 1]	XX
Less:	PV of tax savings on account of rent paid	
	[Example, Rent at year 1 beginning PV factor 1;*	
	Rent at year 2 beginning PV factor of year 1 end and so on]*	XX
	Net cash outflow	XXX

Assumption II: If it is assumed that lease rent is paid in the end (not applicable in real life situations):

	Lease management fee in the beginning [PV factor 1]	XX
	PV of Rent paid at year end	XX
	Gross cash outflow	XX
Less:	Tax savings on account of lease management fee [PV factor 1]	XX
Less:	PV of tax savings on account of rent paid at year end	XX
	Net cash outflow	XXX

Case –

Decide which one is the better alternative – lease or buy – in the following situations:

Tax rate 34.608%; Cost of Capital 10%; Depreciation rate (Income Tax) 15%; Lease rent: Rs. 28,000 per annum for 5 years (per Rs. 1,00,000). Residual value is estimated at Rs. 20,000.

In this case, decision has to be taken regarding whether the asset of Rs. 1,00,000 should be purchased from own funds or on lease rent. It is to be noted that in case of purchase of an asset, assessee becomes the owner of the asset and thus, depreciation can be claimed while in case of lease, assessee does not become the owner of the assets and thus, depreciation cannot be claimed; though lease rent can be claimed as a valid expenditure for the purpose of tax-saving.

Option I: Purchase of assets with own money

It is assumed that sales take place at the end of 5th year

	Particulars	Amount (Rs.)
	Gross cash outflow [Investment in the Year 0 (end)/ Year 1(beginning)] (Rs. 1,00,000*1)	1,00,000
Less	PV of tax savings on account of depreciation	13,361
Less	PV of cash inflow on account of sale (Rs. 20,000*.621)	12,420
Less	PV of tax savings on account of STCL (short term capital loss) [Sec. 50(2) – Single asset block (normal assumption)] [Rs. 32,201*34.608%*.621]	6,921
	Net cash outflow	67,298

Calculation of tax benefit on depreciation:

Year	Cost/ WDV (Rs.)	Depreciation @ 15% (Rs.)	Tax saving @ 34.608% (Rs.)	PVF (.10)	Total PV (Rs.)
1	1,00,000	15,000	5,191	0.909	4,719
2	85,000	12,750	4,413	0.826	3,647
3	72,250	10,838	3,751	0.751	2,818
4	61,413	9,212	3,188	0.683	2,177
5	52,201	0	0	0.621	0
Total					13,361

Applicability of section 32 in 5th year:

		Amount (Rs.)	
	WDV in the beginning of 5th year	52,201	
Add:	Cost of asset acquired in 5th year	Nil	
Less:	Sale during 5th year	20,000	
	WDV at the end of 5th year	32,201	
	Depreciation for 5th year	Nil	[because block ceases to exist on the last dayof 5th year]

Applicability of section 50(2) in 5th year [Sec. 50(2) is applied because block ceases to exist on the last day of year 5]:

	Amount (Rs.)
Sale value	20,000
Less: WDV at the beginning of 5th year	52,201
Short term capital loss/ gain	(32,201)

Option II: Lease rent

Assumption I: Lease rent is paid in the beginning of the year

Year	Lease Rent (Rs.)	PVF (.10)	Total PV (Rs.)
1	28,000	1.000	28,000
2	28,000	0.909	25,455
3	28,000	0.826	23,140
4	28,000	0.751	21,037
5	28,000	0.683	19,124
Total			1,16,756

	Amount (Rs.)
PV of cash outflow	1,16,756
Less: PV of tax benefit on lease rent (Rs. 1,16,756*34.608%)	40,407
Net cash outflow	76,349

Assumption II: Lease rent is paid in the end of the year (though this assumption is not applicable in real life situations because rent is always taken before giving the right to use an asset)

Year	Lease Rent (Rs.)	PVF (.10)	Total PV (Rs.)
1	28,000	0.909	25,455
2	28,000	0.826	23,140
3	28,000	0.751	21,037
4	28,000	0.683	19,124
5	28,000	0.621	17,386
Total			1,06,142

		Amount (Rs.)
	PV of cash outflow	1,06,142
Less:	PV of tax benefit on lease rent (Rs. 1,06,142*34.608%)	36,734
	Net cash outflow	69,408

Conclusion:

Here, conclusion is based on the assumption that lease rent is paid at the beginning of the year. So, it is better to purchase the asset from own funds because it shows less cash outflow [Rs. 67,298] as compared to when the asset is taken on lease [Rs. 76,349].

7.7 Purchase of Assets by Instalment System or Hire System

Under instalment system, assessee becomes the owner of the asset and thus, depreciation can be claimed. Further, interest payment on outstanding instalments are also allowed as deduction. However, in case of hire system, assessee does not become the owner of the assets and thus, depreciation cannot be claimed as deduction. Further, hire charges are allowed as deduction like lease rent.

Case –

A Ltd. wants to acquire an asset costing Rs. 1,00,000. It has two alternatives available. The firstone is buying the asset where the amount is repayable in 5 equal interest-free installments of Rs. 20,000 each. The second one is taking the asset on hire where annual hire charges are Rs. 15,000 for 8 years. Assume the cost of capital at 10%, depreciation @ 15% and tax rate @ 34.608%. Also assume that the asset is sold at Rs. 10,000.

Option I: Purchase of assets with own money

It is assumed that sales take place at the end of 5th year

	Particulars	Amount (Rs.)
	Gross cash outflow [Investment in the Year 0 (end)/ Year 1(beginning)] (Rs. 1,00,000*1)	1,00,000
Less	PV of tax savings on account of depreciation	13,361
Less	PV of cash inflow on account of sale (Rs. 10,000*.621)	6,210
Less	PV of tax savings on account of STCL (short term capital loss) [Sec. 50(2) – Single asset block (normal assumption)] [Rs. 42,201*34.608%*.621]	9,070
	Net cash outflow	71,359

Calculation of tax benefit on depreciation:

Year	Cost/ WDV (Rs.)	Depreciation @ 15% (Rs.)	Tax saving @ 34.608% (Rs.)	PVF (.10)	Total PV (Rs.)
1	1,00,000	15,000	5,191	0.909	4,719
2	85,000	12,750	4,413	0.826	3,647
3	72,250	10,838	3,751	0.751	2,818
4	61,413	9,212	3,188	0.683	2,177
5	52,201	0	0	0.621	0
Total					13,361

Applicability of section 32 in 5th year:

		Amount (Rs.)	
	WDV in the beginning of 5th year	52,201	
Add:	Cost of asset acquired in 5th year	Nil	
Less:	Sale during 5th year	10,000	
	WDV at the end of 5th year	42,201	
	Depreciation for 5th year	Nil	[because block ceases to exist on the last dayof 5th year]

Applicability of section 50(2) in 5th year [Sec. 50(2) is applied because block ceases to exist on the last day of year 5]:

	Amount (Rs.)
Sale value	10,000
Less: WDV at the beginning of 5th year	52,201
Short term capital loss/ gain	(42,201)

Option II: Hire charges

Assumption I: Hire charges are paid in the beginning of the year

Year	Hire Charges (Rs.)	PVF (.10)	Total PV (Rs.)
1	15,000	1.000	15,000
2	15,000	0.909	13,636
3	15,000	0.826	12,397
4	15,000	0.751	11,270
5	15,000	0.683	10,245
6	15,000	0.621	9,314
7	15,000	0.564	8,467
8	15,000	0.513	7,697
Total			88,026

	Amount (Rs.)
PV of cash outflow	88,086
Less: PV of tax benefit on hire charges (Rs. 88,086*34.608%)	30,485
Net cash outflow	57,601

Assumption II: Hire charges are paid in the end of the year (though this assumption is not applicable in real life situations because hire charges are always taken before giving the right to use an asset)

Year	Hire Charges (Rs.)	PVF (.10)	Total PV (Rs.)
1	15,000	0.909	13,636
2	15,000	0.826	12,397
3	15,000	0.751	11,270

4	15,000	0.683	10,245
5	15,000	0.621	9,314
6	15,000	0.564	8,467
7	15,000	0.513	7,697
8	15,000	0.467	6,998
Total			80,024

		Amount (Rs.)
	PV of cash outflow	80,024
Less:	PV of tax benefit on lease rent (Rs. 80,024*34.608%)	27,695
	Net cash outflow	52,329

Conclusion:

Here, conclusion is based on the assumption that hire charges are paid at the beginning of the year. So, it is better to take the asset on hire rather than to go for purchase because net cash outflow in case of taking the asset on hire [Rs. 57,601] is less than the net cash outflow [Rs. 71,359] if case of purchasing the asset.

7.8 Manufacturing or Buying

While taking a decision whether to manufacture the product or to purchase it from outside market, it is necessary to compare the relevant costs to be incurred while manufacturing the component and purchasing cost when purchasing from the market.

While manufacturing the product, relevant cost is All Variable costs + Fixed cost (only if these are incurred additionally).

While buying the product, relevant cost is buying cost.

Case –

A company needs a component in an assembly operation. It is contemplating a proposal to either make or buy the aforesaid component

1. *If the company decides to make the component itself, it would need to buy a machine for Rs. 8 lakhs which would be used for 5 years. Manufacturing costs in each of the 5 years would be Rs. 12 lakhs, Rs. 14 lakhs, Rs. 16 lakhs, Rs. 20 lakhs and Rs. 25 lakhs respectively. The relevant depreciation rate is 15%. The machine will be sold for Rs. 1 lakh at the beginning of the sixth year. This manufacturing cost is incurred in the beginning of each year.*

2. *If the company decides to buy the component from the supplier, the component would cost Rs. 18 lakhs, Rs. 20 lakhs, Rs. 22 lakhs, Rs. 28 lakhs and Rs. 34 lakhs respectively in each of the five years. This cost is incurred at the beginning of each year.*

The relevant discounting rate and tax rate are 15 percent and 34.608 percent respectively. Should the company make the component or buy it from outside?

This case is concerned with the decision to be taken whether the component to be used in the finished product should be manufactured in own factory or purchased from the market.

Option I: Make the component:

	Particulars	Amount (Rs.)
	Gross cash outflow [Investment in the Year 0 (end)/ Year 1(beginning)] [8,00,000*1]	8,00,000
	PV of Gross Cash Outflow of manufacturing costs	63,71,637
	Total PV of Gross Cash Outflow	71,71,637
Less	PV of tax savings on account of depreciation	1,07,894
Less	PV of cash inflow on account of sale [1,00,000*.497]	49700
Less	PV of tax savings on Manufacturing costs [63,71,637*34.608%]	22,05,096
Less	PV of tax savings on account of STCL [2,54,964*.432] [Sec. 50(2) – Single asset block (normal assumption)]	1,10,144
	Net cash outflow	46,98,803

Calculation of tax savings on depreciation:

Year	Cost/ WDV (Rs.)	Depreciation @ 15%(Rs.)	Tax saving @ 34.608% (Rs.)	PVF (.15)	Total PV (Rs.)
1	8,00,000	1,20,000	41,530	0.870	36,113
2	6,80,000	1,02,000	35,300	0.756	26,692
3	5,78,000	86,700	30,005	0.658	19,729
4	4,91,300	73,695	25,504	0.572	14,582
5	4,17,605	62,641	21,679	0.497	10,778
6	3,54,964	0	0	0.432	0
Total					1,07,894

Calculation of present value of manufacturing costs:

Year	Manufacturing Cost (Rs.)	PV (.15)	Total PV of Manufacturing Cost (Rs.)
1	12,00,000	1.000	12,00,000
2	14,00,000	0.870	12,17,391
3	16,00,000	0.756	12,09,830
4	20,00,000	0.658	13,15,032
5	25,00,000	0.572	14,29,383
Total			63,71,637

Applicability of section 32 in 5th year:

		Amount (Rs.)
	WDV in the beginning of 5th year	4,17,605
Add:	Cost of asset acquired in 5th year	Nil
Less:	Sale during 5th year	Nil
	WDV at the end of 5th year	4,17,605
Less:	Depreciation for 5th year	62,641
	WDV in the beginning of 6th year	3,54,964

Applicability of section 50(2) in 6th year [Sec. 50(2) is applied because block ceases to exist on the last day of year 6]:

		Amount (Rs.)
	Sale value	1,00,000
Less:	WDV at the beginning of 6th year	3,54,964
	Short term capital loss/ gain	(2,54,964)

Option II: Buy the component:

Year	Purchasing Cost (Rs.)	PVF (.15)	Total PV (Rs.)
1	18,00,000	1.000	18,00,000
2	20,00,000	0.870	17,39,130
3	22,00,000	0.756	16,63,516
4	28,00,000	0.658	18,41,045
5	34,00,000	0.572	19,43,961
Total			89,87,653

Amount (Rs.)

PV of cash outflow because of buying cost	89,87,653
Less: PV of tax benefit on buying cost (Rs. 89,87,653*34.608%)	31,10,447
Net cash outflow	58,77,206

Conclusion:

It can be seen that net cash outflow [Rs. 46,98,803] in manufacturing the component is less than the net cash outflow [Rs. 58,77,206] in case the component is purchased from the market. So, it is advisable to manufacture the component.

7.9 Shutting Down or Continuing Operations

While taking a decision whether to continue the business or shut down the operations, it is to be remembered that non-speculative business loss can be carried forward and set-off for a maximum period of 8 years. So, before shutting down the operations, an assessee must not forget that non- speculative business loss (if any) will lapse.

7.10 Sale of Assets Used For Scientific Research

If an assessee purchases an asset for scientific research related to its business, the expenditure incurred is deductible during the previous year in which it is incurred. If such asset ceases to be of any use for scientific research purposes, the assessee can sell it or use it in the business for some other purposes.

From tax planning point of view, we should consider whether it is beneficial to sell such asset immediately or it should be sold after using it for some time in the business for some other purposes. Following are the tax implications:

1. Sold the asset without having been used for other purposes:

Where the scientific research asset is sold off without having been used for other purposes, then the net sale price or the cost of the asset, which was earlier allowed as deduction under

section 35, whichever is less, shall be treated as **business income** of the previous year in which such asset is sold. Any excess[1] of the sale price over cost shall be subject to the provisions of the capital gains. This shall apply even if the business is not in existence in that previous year.

2. Sold the asset after having been used for business:

Where the scientific research asset is used in the business after it ceases to be used for scientific research, the actual cost of such asset to be included in the relevant block of asset shall be taken as ***nil***as the full amount has been allowed as deduction under section 35. If this asset is later on sold, the money payable shall be deductible from the block in which such asset was earlier included.

Case –

R purchased an asset for scientific research for Rs. 15,00,000 in the previous year 2008-09. During the previous year 2015-16, the said asset ceased to be used for scientific research. The following information is also submitted to you:

	Amount (Rs.)
Profit from business before depreciation	*5,00,000*
WDV of BOA as on 01-04-2015 (15%)	*10,00,000*

The scientific research asset if used for business shall be eligible for depreciation @ 15%. Compute the total income for the assessment year 2016-17, if the scientific research asset is sold for Rs. 28,00,000 assuming:

a. It is sold without using for business; and

b. It is sold after using for business.

Assume CII for 2008-09 is 582 and for 2015-16 is 1081. If the asset is sold without using for business:

		Amount (Rs.)
	Business income	5,00,000
Less:	Depreciation @ 15% on Rs. 10,00,000	1,50,000
		3,50,000
Add:	Profit on sale of scientific research asset (to the extent of cost of asset) [U/S 41(3)]	15,00,000
	Business income	18,50,000
	Sale consideration	28,00,000
Less:	Indexed cost of acquisition (15,00,000/582*1081)	27,86,082
	LTCG	13,918
	GTI (PGBP + LTCG)	18,63,918

If the asset is sold after using for business:

	Business income	5,00,000
Less:	Depreciation	Nil
	PGBP	5,00,000
	Sale consideration	28,00,000
Less:	WDV of the block on 01-04-2015	10,00,000
	STCG [Sec. 50(1)]	18,00,000
	GTI (PGBP + STCG)	23,00,000

Working note:

	WDV on 01-04-2015	10,00,000
Add:	Scientific research asset put to business use [15,00,000 – 15,00,000 as deduction]	Nil
		10,00,000
Less:	Sale price	10,00,000*
	WDV on 31-03-2016	Nil
	Therefore, depreciation is	Nil

Case –

XYZ Ltd., a paper manufacturing concern, purchases a machine on March 1, 2006 for Rs. 6,10,000 for its laboratory with a view to improving the quality of art paper manufactured by the company.

a. What will be the amount of deduction under section 35 on account of capital expenditure of Rs. 6,10,000 for the assessment year 2006-07.

b. If the research activity for which the aforesaid machine is purchased ceases in 2014 and the machinery is brought into business proper on November 1, 2014 (market value of themachine: Rs. 2,30,000); depreciation is admissible at the rate of 15 per cent; depreciated value of the relevant block of assets on April 1, 2014 is Rs. 14,07,860, the scientific research machine is sold for Rs. 1,90,000 on

April 4, 2015, compute the following:

- *what is the amount of chargeable profit under section 41(3) in assessment year assessment year 2016-17.*
- *what will be the amount of depreciation for the assessment years 2014-15, 2015-16, 2016-17 and 2017-18;*
- *what is the amount of capital gain in assessment year assessment year 2016-17.*

c. If the research activity for which the machine was purchased ceases on November 1, 2014 (market value of the machine: Rs. 2,30,000) and the machine is sold on April 4, 2015 without using it for another purpose, sale price being Rs. 1,90,000, or Rs. 5,40,000, or Rs. 8,10,000 or Rs. 15,00,000. What will be the tax treatment for different sale values?

The CII for 2005-06 is 497, 2014-15 is 1024 and for 2015-16 is 1081.

Tax treatment of the above different situations are –

a. As the scientific research is related to the business of the assessee, the whole of capital expenditure of Rs. 6,10,000 is allowable as deduction under section 35(2)(ia) for the assessment year 2006-07.

b. The machine is brought into business proper on November 1, 2014. In this case, profit arising on sale of machinery is not chargeable under sub-section (3) of section 41. Provision of sub-section (3) of section 41 would not apply as the section covers only such assets which are represented by expenditure of capital nature on scientific research that is sold without having being used for any other purpose.

Tax treatment of depreciation is given below:

		(Rs.)
	WDV on March 31, 2014 [14,07,860/85*100]	16,56,306
Less:	Depreciation for the previous year 2013-14 (15%)	2,48,446
	WDV on 01-04-2014	14,07,860
Add:	Cost of machine transferred from laboratory on Nov. 1, 2014	
	[i.e., 6,10,000 – deduction of 6,10,000 claimed under section 35]	Nil
	WDV on 31-03-2015	14,07,860
Less:	Depreciation for the previous year 2014-15 (15%)	2,11,179
	WDV on April 1, 2015	11,96,681
Less:	Sale proceeds of machine sold on April 4, 2015	1,90,000
	WDV on 31-03-2016	10,06,681
Less:	Depreciation for the previous year 2015-16 (15%)	1,51,002
	WDV on 01-04-2016	8,55,679
Less:	Depreciation for the previous year 2016-17 (15%)	1,28,352
	WDV on 31-03-2017	7,27,327

There will be no capital gain or loss in the previous year 2015-16 in this case because neither the block ceases to exist on March 31, 2016 nor WDV of the block on March 31, 2016 is Zero.

c. Tax treatment should be as under:

Particulars	Sale price (Rs.)			
	1,90,000	5,40,000	8,10,000	15,00,000
Amount chargeable under section 41(3)[i.e., sale proceeds but subject tomaximum of deduction claimed undersection 35 for the assessment year2006-07] as PGBP	1,90,000	5,40,000	6,10,000	6,10,000
Capital gain under section 45:				
Sale proceeds	1,90,000	5,40,000	8,10,000	15,00,000
Less: Indexed cost of acquisition (6,10,000/497*1081)	13,26,781	13,26,781	13,26,781	13,26,781
LTCG	(11,36,781)	(7,86,781)	(5,16,781)	1,73,219

7.11 Summary

This lesson discussed tax planning with reference to financial management decisions and specific management decisions. When a company raises long term loans from financial institutions or by way of public issue of debentures or inviting deposits from the public, it should plan that the expenses incurred on such issues of debentures or expenses towards stamp duty, registration fees, and lawyer‘s fees should be incurred only after the date of the ‗setting- up‘ of the business. The interest paid before the commencement of production but after setting up of the business on loans taken by the company for the acquisition of its plant and machinery and other assets, forms part of the actual cost of the asset and it should be capitalized in actual cost of asset. Thus, the company would be allowed to capitalise the expenditure and claim a higher depreciation and investment allowance. The company should also plan the optimum use of the share capital and the borrowed funds. Note that the borrowings should be utilised as far as possible for the acquisition and installation of assets like, buildings, plant and machinery so that interest can be capitalised for the period after setting up of the acquired assets like buildings, plant and machinery but before the commencement of production. The interest and higher amount of depreciation (due to capitalisation of expense) may be claimed as revenue expenditure pertaining to the business of the company.

7.12 Glossary

1. **Substantial interest :**A person shall be deemed to have a substantial interest in a concern, if he is, at any time during the previous year, beneficially entitled to at least 20% income of such concern (if such concern is a company, then he should beneficially hold at least 20% equity share capital of the company).

2. **Bonus Shares :**Bonus shares are given free of cost to the shareholders. But for the purpose of capital gains, cost of acquisition of bonus shares received on or after April 1, 1981 is taken as nil. But cost of acquisition of bonus shares received before April 1, 1981 is taken as fair market value of such

shares on April 1, 1981.

3. **Net cash outflows :** of both the options shall be compared and the option which minimizes the net cash outflow will be considered as the best option while taking a decision whether to purchase the asset out of own funds or out of borrowed funds.

7.13 References:

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7.14 Further Readings

- Srinivas, E.A.: Corporate Tax Planning, TMG, New Delhi.
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- Ahuja, Girish & Gupta, Ravi: Systematic Approach to Income tax. Goods and Service Tax Act,2017

7.15 Model Questions

1. Explain the comparative features of various forms of organisations from tax point ofview?
2. Explain the factors and incentives have to be kept in mind while selecting the nature of business?
3. Discuss the various tax incentives available to company form of business?
4. Explain the tax considerations involved in Capital Structure Decision?
5. Explain the tax planning in the following cases:
   a. Make or Buy
   b. Own or Lease
   c. Installments or Hire Purchase
   d. Shut Down or Continue
   e. Assets used for Scientific Research
   f. Dividend Policy & Bonus shares

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Lesson-8

An Overview of Goods and Service Tax (GST)

Structure

8.0 Objectives

After going through the lesson, you should be able to:

- To Understand the Concept of GST and its feature
- To know the benefits derived from the GST
- To know the Rates applicable on different commodities under GST

8.1 Introduction of GST

On 5th April, 2017, the introduction of Goods and Services Tax (GST) is a significant reform in the field of indirect tax in India. By amalgamating a large number of Central and State taxes into a single tax, it would mitigate cascading or double taxation in a major way and pave the way for a common national market. From the consumer point of view, the biggest advantage would be in terms of a reduction in the overall tax burden on goods, which is currently estimated to be around 25%-30%. Introduction of GST would also make Indian products competitive in the domestic and international markets. Studies show that this would have a boosting impact on economic growth. Last but not the least, this tax, because of its transparent and self-policing character, would be easier to administer. Existing tax incentive schemes of Central or State governments may be continued by respective government by way of reimbursement through budgetary route. There would befour tax rates namely 5%, 12%, 18% and 28%. Besides, some goods and services would be under the list of exempt items. A cess over the peak rate of 28% on certain specified luxury and sin goods would be imposed for a period of five years to compensate States for any revenue loss on account of implementation of GST. The Council has asked the Committee of officers to fit various goods and services in these four slabs keeping in view the present incidence of tax.

Goods and Services Tax (GST) is an indirect tax applicable throughout India which replaced multiple cascading taxes levied by the central and state governments. It was introduced as The Constitution (One Hundred and First Amendment) Act 2017, following the passage of Constitution 122nd Amendment Bill. The GST is governed by a GST Council and its Chairman is the Finance Minister of India. Under GST, goods and services are taxed at the following rates, 0%, 5%, 12% and 18%. There is a special rate of 0.25% on rough precious and semi-precious stones and 3% on gold. In addition a cess of 15% or other rates on top of 28% GST applies on few items like aerated drinks, luxury cars and tobacco products.

Touted by the government to be India's biggest tax reform in 70 years of independence, the Goods and Services Tax (GST) was finally launched on the midnight of 30 June 2017, though the process of forming the legislation took 17 years (since 2000 when it was first proposed). The launch was marked by a historic midnight (30 June - 1 July 2017) session of both the houses of parliament convened at the Central Hall of the Parliament, but which was immediately boycotted by the opposition by staging a walk out to show their disapproval of the same

8.2 The salient features of GST are as under:

(i) GST would be applicable on ―supply‖ of goods or services as against the present concept of tax on the manufacture of goods or on sale of goods or on provision of services.

(ii) GST would be based on the principle of destination based consumption taxation as against the present principle of origin based taxation.

(iii) It would be a dual GST with the Centre and the States simultaneously levying it on a common base. The GST to be levied by the Centre would be called Central GST (CGST) and that to be levied by the States [including Union territories with legislature] would be called State GST(SGST). Union territories without legislature would levy Union territory GST (UTGST).

(iv) An Integrated GST (IGST) would be levied on inter-State supply (including stock transfers) of goods or services. This would be collected by the Centre so that the credit chain is not disrupted.

(v) Import of goods would be treated as inter-State supplies and would be subject to IGST in addition to the applicable customs duties.

(vi) Import of services would be treated as inter-State supplies and would be subject toIGST.

(vii) CGST, SGST/UTGST& IGST would be levied at rates to be mutually agreedupon by the Centre and the States under the aegis of the GSTC.

(viii) GST would replace the following taxes currently levied and collected by the Centre: a) Central Excise Duty; b) Duties of Excise (Medicinal and Toilet Preparations); c) Additional Duties of Excise (Goods of Special Importance); d) Additional Duties of Excise (Textiles and Textile Products); e) Additional Duties of Customs (commonly known as CVD); f) Special Additional Duty of Customs(SAD); g) ServiceTax; h) Cesses and surcharges insofar as they relate to supply of goods orservices.

(ix) State taxes that would be subsumed within the GSTare: a) StateVAT; b) Central SalesTax; c) PurchaseTax; d) LuxuryTax; e) Entry Tax (Allforms); f) Entertainment Tax (except those levied by the localbodies); g) Taxes on advertisements; h) Taxes on lotteries, betting andgambling; i) State cesses and surcharges insofar as they relate to supply of goods or services.

(x) GST would apply to all goods and services except Alcohol for human consumption.

(xi) GST on five specified petroleum products (Crude, Petrol, Diesel, ATF& Natural gas) would be applicable from a date to be recommended by the GSTC.

(xii) Tobacco and tobacco products would be subject to GST. In addition, the Centre would continue to levy Central Excise duty.

(xiii) A common threshold exemption would apply to both CGST and SGST. Taxpayers with an annual turnover of Rs. 20 lac(Rs. 10 lacfor special category States as specified in article 279A of the Constitution) would be exempt from GST. A compounding option (i.e. to pay tax at a flat rate without credits) would be available to small taxpayers (including to specified category of manufacturers and service providers) having an annual turnover of up to Rs. 50 lac. The threshold exemption and compounding scheme would be optional.

(xiv) The list of exempted goods and services would be kept to a minimum and it would be harmonized for the Centre and the States as well as across States as far as possible.

(xv) Exports would be zero-rated.

(xvi) Credit of CGST paid on inputs may be used only for paying CGST on the output and the credit of SGST/UTGST paid on inputs may be used only for paying SGST/UTGST. In other words, the two streams of input tax credit (ITC) cannot be cross utilized, except in specified circumstances of inter-State supplies for payment of IGST. The credit would be permitted to be utilized in the following manner: a) ITC of CGST allowed for payment of CGST & IGST in that order; b) ITC of SGST allowed for payment of SGST & IGST in that order; c) ITC of UTGST allowed for payment of UTGST & IGST in that order; d) ITC of IGST allowed for payment of IGST, CGST & SGST/UTGST in that order. ITC of CGST cannot be used for payment of SGST/UTGST and vice versa.

(xvii) Accounts would be settled periodically between the Centre and the State to ensure that the credit of SGST used for payment of IGST is transferred by the originating State to the Centre. Similarly the IGST used for payment of SGST would be transferred by Centre to the destination State. Further the SGST portion of IGST collected on B2C supplies would also be transferred by Centre to the destination State. The transfer of funds would be carried out on the basis of information contained in the returns filed by the taxpayers.

(xviii) Input Tax Credit (ITC) to be broad based by making it available in respect of taxes paid on any supply of goods or services or both used or intended to be used in the course or furtherance of business.

(xix) Electronic filing of returns by different class of persons at different cut-off dates.

(xx) Various modes of payment of tax available to the taxpayer including internet banking, debit/ credit card and National Electronic Funds Transfer (NEFT) / Real Time Gross Settlement (RTGS).

(xxi) Obligation on certain persons including government departments, local authorities and government agencies, who are recipients of supply, to deduct tax at the rate of 1% from the payment made or credited to the supplier where total value of supply, under a contract, exceeds two lakhs and fifty thousand rupees (Rs. 2.5 lac).

(xxii) Refund of tax to be sought by taxpayer or by any other person who has borne the incidence of tax within two years from the relevant date.

(xxiii) Obligation on electronic commerce operators to collect ‗tax at source', at such rate not exceeding one per cent. (1%) of net value of taxable supplies, out of payments to suppliers supplying goods or services through their portals.

(xxiv) System of self-assessment of the taxes payable by the registered person.

(xxv) Audit of registered persons to be conducted in order to verify compliance with the provisions of Act.

(xxvi) Limitation period for raising demand is three (3) years from the due date of filing of annual return or from the date of erroneous refund for raising demand for short- payment or non-payment of tax or erroneous refund and its adjudication in normal cases.

(xxvii) Limitation period for raising demand is five (5) years from the due date of filing of annual return or from the date of erroneous refund for raising demand for short-payment or non-payment of tax or erroneous refund and its adjudication in case of fraud, suppression or willful mis-statement.

(xxviii) Arrears of tax to be recovered using various modes including detaining and sale of goods, movable and immovable property of defaulting taxable person.

(xxix) Officers would have restrictive powers of inspection, search, seizure and arrest.

(xxx) Goods and Services Tax Appellate Tribunal would be constituted by the Central Government for hearing appeals against the orders passed by the Appellate Authority or the Revisional Authority. States would adopt the provisions relating to Tribunal in respective SGST Act.

(xxxi) Provision for penalties for contravention of the provision of the proposed legislation has been made.

(xxxii) Advance Ruling Authority would be constituted by States in order to enable the taxpayer to seek a binding clarity on taxation matters from the department. Centre would adopt such authority under CGST Act.

(xxxiii) An anti-profiteering clause has been provided in order to ensure that business passes on the benefit of reduced tax incidence on goods or services or both to the consumers.

(xxxiv) Elaborate transitional provisions have been provided for smooth transition of existing taxpayers to GST regime.

GST Challenges | Goods and Service Tax

GST or Goods and Service Tax is a comprehensive indirect tax on manufacture, sale and consumption of goods and services throughout India, to replace taxes levied by the central and state governments. Goods and Service Tax was introduced as The Constitution (One Hundred and First Amendment) Act 2016, following the passage of Constitution 122nd Amendment Bill. GST will be the biggest reform in Indian taxation since 1947, but various challenges has been estimated for its successful implementation.

- Consent of States: For implementing it is critical that GST bill is passed by the respective state Governments in state assemblies so as to bring majority. This is a herculean task.
- Revenue Neutral Rate (RNR): It is one of Prominent Factor for its success. We know that in GST regime, the government revenue would not be the same as compared to the current system. Hence, through RNR Government is to ensure that its revenue remains the same despite of giving tax credits.

- Threshold Limit in GST: While achieving broad based tax structure under GST, Both empowered committee and Central Government must ensure that lowering of threshold limit should not be a ―taxing‖ burden on small businessmen in the country
- Robust IT Network: Government has already incorporated Goods and service tax network (GSTN). GSTN has to develop GST portal which ensure technology support for registration, return filing, tax payments, IGST settlements etc. Thus there should be a robust IT backbone
- Extensive Training to Tax Administration Staff: GST is absolutely different from existing system. It, therefore, requires that tax administration staff at both Centre and state to be trained properly in terms of concept, legislation and Procedure.
- Numbers of enactments of statutes: There will two types of GST laws, one at a centre level called ‗Central GST (CGST)' and the other one at the state level – ‗State GST (SGST)'. As there seems to have different tax rates for goods and services at the Central Level and at the State Level, and further division based on necessary and other property based on the need, location, geography and resources of each state.
- Additional Levy on GST: The Purpose of additional Levy is to compensate states for loss of revenue while moving to GST. We acknowledge that fundamental purpose of GST is to make ―INDIA‖ as one state where inter-state movement of goods is common. In this situation, it would defeat the very purpose of GST in the country.
- Clubbing Taxes: The biggest challenge of GST implementation is bringing all the indirect taxes under one roof, which is the biggest feature of GST. There has been opposition asking to including purchase tax by a few states. Other states are reluctant about alcohol, tobacco products coming under GST. This is due to the fact that a major chunk of state revenue is derived from these products.
- Statutory Requirements: As the imposition of GST will be delegated to both state and central government, the constitution has to grant powers to both through an amendment. It is seen as a difficult task as the law expects at least two-thirds majority from the members of the parliament and that isn't easy given the current political scenario of the country.
- Make-shift Arrangements: State governments are demanding compensation from the central government as they foresee a major dent in the revenue due to CST losses. This is asked for the first 5 years after the implementation of GST, for which the central government has agreed to 3 years. A final conclusion is yet to be drawn.
- Framework For Tax Disputes: There has to be a uniform legal procedure for tax disputes and litigations to avoid any confusion.
- Defining Inter-State Transactions: With the transportation services available everywhere, the place of sale and consumption may not be the same. This makes it difficult to go forward with revenue allocation. Hence, it becomes important to define procedures to tackle such problems.
- Infrastructure For The Collection Process: Proper infrastructure has to be designed to track the movement of goods and services between states, collection and monitoring revenue, identify defaulters etc.
- Determining GST Rates: This is a major step in ensuring the success of GST. Arriving at rates which are conducive to both the government and public is will be a daunting task.

8.3 Benefits of GST

GST Impact on Gross Domestic Product (GDP) in India

The biggest tax reform i.e. Goods and Services Tax is now a part of the Indian Economy. A new and unified tax structure is followed for indirect taxation on the place of various tax laws like Excise duty, Service Tax, VAT, CST, etc. and for sure the new tax regime is determined to eliminate the cascading effect of tax on transaction of products and services, and it will result in availability of product and services to consumers at a lower price.

In the aftermath of 2 corona pandemics, the economy of India has been ruined and devastated. While giving an address to media first time after taking over as CII President TV Narendran commented that The Indian economy shall need a fiscal stimulus worthy and worth Rs 3 lakh crore along with temporary GST rate cuts and direct cash transfers so as to recover the ongoing loss of business that is mostly worsened by an existing demand slump. The other reason he put forth was to quickly restart the flagging private investment cycle.

–The cumulative impact of the two waves on incomes and consumer sentiment, coupled with the increase in household medical expenses in the second wave, is likely to affect consumer demand for some time,‖

Though, the government has enlarged the domain of the emergency credit scheme, CII recommends it to extend to machine tools and retail sectors also. Other suggestions were to include the enhanced MNREGA allocations; LTC cash voucher scheme, time-bound tax relief duty concession for homebuyers; and adding a further stretching of the Aatmanirbhar Bharat Rozgar Yojana till March 31, 2022. Narendran fixed the GDP growth rate for Financial Year 2022 at 9.5%.

The PHDCCI stated that GST revenue collection, UPI transaction, forex reserves, CPI inflation, WPI inflation, and unemployment rate, etc have registered huge growth in Sept 2021 as compared to the previous month. Also said, the shortage of raw materials and highly recommended prices are affecting private investments in the country.

GDP Data for FY 2021-21 1st Quarter (April to June 2021)

India‘s GDP for the 1st quarter (April-June) of the FY 2021-22 rises by 20.1% as per the information of the government. The country is seen rising within the fastest growth in a quarter. The economic information concerned with the GDP growth rate is computed upon the YOY grounds. Thus a lower rise in the former year heightened to the low base for the present years‘ numbers. So far the country has been affected from covid-19 and due to that, the country gets affected from April to June in the previous year. For the complete FY 2020- 21 the economy of India has been shrunk by 7.3%.

GDP Data for FY 2020-21 4th Quarter (January to March 2021)

Prior to the 2nd wave of the coronavirus, the gross domestic product (GDP) has raised the 1.6% in the 4th quarter (Jan-March) of 2021-21. This had arrived upon the top of the 0.5% rise in the before quarter of October-December.

–GDP at Constant (2011-12) Prices in Q4 of 2020-21 is estimated at Rs 38.96 lakh crore, as against Rs 38.33 lakh crore in Q4 of 2019-20, showing a growth of 1.6 per cent,‖ the Ministry of Statistics & Programme Implementation (MoSPI) said in an official statement on 31st May 2021, continuing that the growth in GDP during FY 2020-21 is estimated at -7.3 per cent as compared to 4.0 percent in FY 2019-20.

GDP Data for FY 2020-21 3rd Quarter (October to December 2020)

Data released by the ministry of statistics and program implementation shows that GDP at constant (2011-12) prices in Q3 of 2019-20 was Rs 36.08 lakh crore. However, in Q3 of 2020-21, it is evaluated at ₹ 36.22 lakh crore which is showing a growth of 0.4 percent. Thus, after two consecutive harrowing quarters, finally, a GDP growth of 0.4 percent reported in the third quarter of 2020-21. With this, the country‘s economy is now out of a technological recession.

Additionally, the NSO has also forecast an 8 percent contraction in 2020-21. It is worth noting that in its first advance estimates from January, it had projected a contraction of 7.7 percent for the current fiscal year against a growth of four percent in 2019-20. If we talk about the details of Q1 and Q2, the economy declined by 24.4 percent in the first quarter due to epidemics and lockdown, and by 7.3 percent due to a disturbance in economic activity in Q2 GDP.

GDP Data for FY 2020-21 2nd Quarter (July to September 2020)

Q2 GDP data slows down by 7.5% despite rising in the share market. The electricity consumption reported the highest growth along with labor participation and e-way bills. RBI posts that India in before month has reported Asia‘s 3rd biggest economy which goes into recession.

In October 8 core industries seeks output at -2.5% vs -0.1% in the September month and - 5.5% in Oct‘19: Coal: 11.6%, Crude Oil: – 6.2%., Natural Gas: – 8.6%, Refinery Products: –17.0 %, Fertilizers: 6.3 %, Steel: – 2.7 %, Cement: 2.8 %, Electricity: 10.5 %. Also, flood inflation will be reduced in the 3rd quarter. The recovery of India is gaining a higher rate.

GDP Data for FY 2020-21 1st Quarter (April to June 2020)

India GDP Q1 data 2020: due to pandemic following the strict lockdown in the 1st quarter if the financial year 2020-21 the net GDP in April-June quarter Q1 has declined by 23.9% as revealed by the Ministry of Statistics and Programme Implementation (MoSPI). With 5.2% the GDP had expanded in the relevant quarter 2019-20. ―Despite local lockdowns, e-way Bills are at 99.9% year-on-year. Have to keep in mind that the pandemic will have its ebb and flow and that is not a short-term uncertainty,‖

GDP Data for FY 2019-20 4th Quarter (January to March 2020) (03/11/2020)

Gross Domestic Product (GDP) in the 4th Quarters during 2019-20 is revealed to be 4.2% slowing to the 11 years low with respect to the 6.1% in 2018-19 said in the report. The RBI had secured the GDP growth for 2019-20 at 5 % as proposed by the National Statistical Office on 1st and 2nd advance approximations published beforehand this year in January and February individually.

Ministry of Statistics & Programme Implementation held that the ―GDP at Constant (2011-12) prices in Q4 of 2019-20 is estimated at Rs. 38.04 lakh crore, as against Rs 36.90 lakh crore in Q4 of 2018-19, showing a growth of 3.1 percent,‖

GDP Data for FY 2019-20 3rd Quarter (October to December 2019)

Finally, the India gross domestic product figures have been revealed for the 3rd quarter (October to December 2019) and it has come to 4.7 per cent down from the 5.1 per cent in the 2nd quarter of (July to September 2019).

The lowered GDP for the third quarter has been acknowledged by the chief of the economic affairs Atanu Chakraborty and has blamed the NBFC crisis and weak rural growth for this slowdown. He has stated that the Indian GDP will once again rise to a high level as per the growth in certain industries.

GDP Data for FY 2019-20 2nd Quarter (July to September 2019)

Adding to the woes of the Indian Prime Minister and the Finance Ministry, the GDP (Growth Domestic Product) of India has further dropped down to 4.5% in the second quarter of FY 2019-29 from the earlier 5% GDP of the first quarter.

The same trend of the GDP felling has been going on for seven quarters now. While the first quarter of 2019-20 witnessed a GDP of 5%, the second quarter reported a fall of 0.5 per cent. During the same period last year, i.e. the second quarter of FY 2018-19, the GDP growth of the country was 7.1 per cent. Compared to that, the latest reported GDP is 2.6 per cent lower, which is also the lowest in the last six years.

GDP Data for FY 2019-20 1st Quarter (April to June 2019)

As per the recent data by CRISIL, the Indian economy may not see a rise over above 6.3% for the fiscal year 2020. The current data have opposed the previous suggestion of 6.9% GDP for the year.

The news is in the air due to the disclosure of the lowest 5% GDP of the country in recent years. As per the statement by crisil, ―We expect growth to get some lift from the low base effect of 6.3 per cent in the second half of the FY19.‖

There is a lowered 0.6% of GDP for the given financial years due to slowdown in the overall economy and revelation by the economics department responsible for foir the maintenance of the financial health of India.

GDP Data for FY 2018-19 Last Quarter (January to March 2019)

India‗s GDP has been recorded at 7.7 percent in the quarter of January – March, with a fast approach towards better number than 7.0 in the previous quarter. With some expectations for 6.7 percent in the financial year 2018, to the 7.3 percent and 7.5 percent in the FY 19 and FY 20 respectively. There is some hindrance to the GDP number due to GST as speculated by the experts but still, many economists are likely to maintain around 6.5 percent.

So here in this article, we will see the GST impact on the Indian Economy.

GST Positive Impact on GDP

Now, There is only one tax rate for all which will create a unified market in terms of tax implementation and the transaction of goods and services will be seamless across the states.

The same will reduce the cost of the transaction. In a survey, it was found that 10-11 types of taxes levied on the road transport businesses. So the GST will be helpful to reduce transportation cost by eliminating other taxes.

After GST implementation the export of goods and services will become competitive because of nill effect of cascading effect of taxes on goods and products. In a research done by NCAER, it was suggested that GST would be the key revolution in Indian Economy and it could increase the GDP by 1.0 to 3.0 percent.

GST is more transparent in comparison to the previous law provision so it will generate more revenue to the Government and will be more effective in reducing corruption at the same time. Overall GST will improve the tax Compliances.

In a report issued by the Finance Ministry, it was mentioned that Make In India programme will be more benefited by the GST structure due to the availability of input tax credit on capital goods.

As the GST will subsume all other taxes, the exemption available for manufacturers in regards of excise duty will be taken off which will be an addition to Government revenue and it could result in an increase in GDP.

The GST regime has although a very powerful impact on many things including the GDP also. The Gross Domestic Product has the tendency to loom on the shoulders of revenue generated by the economy in a year. Still, a worthwhile point includes that the GST has the capability to extend the GDP by a total of 2 percent in order to complete the ultimate goal of increasing the per-capita income of every individual. Also, the GST scheme will certainly improve the indirect revenues to the government as the tax compliance will be further enhanced and rigid, extending the tax paying base which will add to the revenue. The increased income of the government will redirect towards the developmental projects and urban financing creating an overall implied scenario.

GST Negative Impact on GDP

In a report, DBS bank noted that initially, GST will lead to the rise in inflation rate which will remain for a year but after that GST will affect positively on the economy.

As we know Real Estate also plays an important role in Indian economy but some expert thinks that GST will impact the Real Estate business negatively as it will add up the additional 8 to 10 percent to the cost and reduce the demand about 12 percent.

GST is applied in the form of IGST, CGST AND SGST on the Center and State Government, but some economists say that there is nothing new in the form of GST although these are the new names of Central Excise, VAT, CST and Service Tax etc.

As every coin has two faces in the same way we tried here to familiarize the things related to GST with both perspective i.e. positively and negatively in this article. Despite having some factor which is being expected to affect the Economy adversely there are so many other things which are expected with a positive impact on GDP

(A) Make in India

(i) Will help to create a unified common national market for India, giving a boost to Foreign investment and ―Make in India‖ campaign;

(ii) Will prevent cascading of taxes as Input Tax Credit will be available across goods and services at every stage of supply;

(iii) Harmonization of laws, procedures and rates of tax;

(iv) It will boost export and manufacturing activity, generate more employment and thus increase GDP with gainful employment leading to substantive economic growth;

(v) Ultimately it will help in poverty eradication by generating more employment and more financial resources;

(vi) More efficient neutralization of taxes especially for exports thereby making our products more competitive in the international market and give boost to Indian Exports;

(vii) Improve the overall investment climate in the country which will naturally benefit the development in the states;

(viii) Uniform SGST and IGST rates will reduce the incentive for evasion by eliminating rate arbitrage between neighbouring States and that between intra and inter-state sales;

(ix) Average tax burden on companies is likely to come down which is expected to reduce prices and lower prices mean more consumption, which in turn means more production thereby helping in the growth of the industries . This will create India as a –Manufacturing hub‖.

(B) Ease of Doing Business

(i) Simpler tax regime with fewer exemptions;

(ii) Reductions in the multiplicity of taxes that are at present governing our indirect tax system leading to simplification and uniformity;

(iii) Reduction in compliance costs - No multiple record keeping for a variety of taxes- so lesser investment of resources and manpower in maintaining records;

(iv) Simplified and automated procedures for various processes such as registration, returns, refunds, tax payments, etc;

(v) All interaction to be through the common GSTN portal- so less public interface between the taxpayer and the tax administration;

(vi) Will improve environment of compliance as all returns to be filed online, input credits to be verified online, encouraging more paper trail of transactions;

(vii) Common procedures for registration of taxpayers, refund of taxes, uniform formats of tax return, common tax base, common system of classification of goods and services will lend greater certainty to taxation system;

(viii) Timelines to be provided for important activities like obtaining registration, refunds, etc;

(ix) Electronic matching of input tax credits all-across India thus making the process more transparent and accountable.

(C) Benefit to Consumers:

(i) Final price of goods is expected to be lower due to seamless flow of input tax credit between the manufacturer, retailer and service supplier;

(ii) It is expected that a relatively large segment of small retailers will be either exempted from tax or will suffer very low tax rates under a compounding scheme- purchases from such entities will cost less for the consumers;

(iii) Average tax burden on companies is likely to come down which is expected to reduce prices and lower prices mean more consumption.

8.4 Rate of Tax under GST

The Goods and Services Tax (GST) has been one of the key things that has caught the attention of the market given its implications on earnings of companies. The government has kept a large number of items under 18% tax slab. The government categorised 1211 items under various tax slabs. Here is a low-down on the tax slab these items would attract:

Gold and rough diamonds do not fall under the current rate slab ambit and will be taxed at 3% and 0.25% respectively.

No Tax Goods and Services Goods

No tax will be imposed on items like Jute, fresh meat, fish chicken, eggs, milk, butter milk, curd, natural honey, fresh fruits and vegetables, flour, besan, bread, prasad, salt, bindi. Sindoor, stamps, judicial papers, printed books, newspapers, bangles, handloom, Bones and horn cores, bone grist, bone meal, etc.; hoof meal, horn meal, Cereal grains hulled, Palmyra jaggery, Salt - all types, Kajal, Children's' picture, drawing or colouring books, Human hair Services

Hotels and lodges with tariff below Rs 1,000, Grandfathering service has been exempted under GST. Rough precious and semi-precious stones will attract GST rate of 0.25 per cent.

5% Tax Rates Goods

Items such as fish fillet, Apparel below Rs 1000, packaged food items, footwear below Rs 500, cream, skimmed milk powder, branded paneer, frozen vegetables, coffee, tea, spices, pizza bread, rusk, sabudana, kerosene, coal, medicines, stent, lifeboats, Cashew nut, Cashew nut in shell, Raisin, Ice and snow, Bio gas, Insulin, Agarbatti, Kites, Postage or revenue stamps, stamp-post marks, first-day covers Services

Transport services (Railways, air transport), small restraurants will be under the 5% category because their main input is petroleum, which is outside GST ambit.

12% Tax Rate Goods

Apparel above Rs 1000, frozen meat products , butter, cheese, ghee, dry fruits in packaged form, animal fat, sausage, fruit juices, Bhutia, namkeen, Ayurvedic medicines, tooth powder, agarbatti, colouring books, picture books, umbrella, sewing machine, cellphones, Ketchup & Sauces, All diagnostic kits and reagents, Exercise books and note books, Spoons, forks, ladles, skimmers, cake servers, fish knives, tongs, Spectacles, corrective, Playing cards, chess board, carom board and other board games, like ludo, ServicesState-run lotteries, Non-AC hotels, business class air ticket, fertilisers, Work Contracts will fall under 12 per cent GST tax slab

18% Tax Rate Goods

Most items are under this tax slab which include footwear costing more than Rs 500, Trademarks, goodwill, software, Bidi Patta, Biscuits (All catogories), flavoured refined sugar, pasta, cornflakes, pastries and cakes, preserved vegetables, jams, sauces, soups, ice cream, instant food mixes, mineral water, tissues, envelopes, tampons, note books, steel products, printed circuits, camera, speakers and monitors, Kajal pencil sticks, Headgear and parts thereof, Aluminium foil, Weighing Machinery [other than electric or electronic weighing machinery], Printers [other than multifunction printers], Electrical Transformer, CCTV, Optical Fiber, Bamboo furniture, Swimming pools and padding pools, Curry paste; mayonnaise and salad dressings; mixed condiments and mixed seasonings Services

AC hotels that serve liquor, telecom services, IT services, branded garments and financial services will attract 18 per cent tax under GST, Room tariffs between Rs 2,500 and Rs 7,500, Restaurants inside five-star hotels

28% Tax Rates Goods

Bidis, chewing gum, molasses, chocolate not containing cocoa, waffles and wafers coated with chocolate, pan masala, aerated water, paint, deodorants, shaving creams, after shave, hair shampoo, dye, sunscreen, wallpaper, ceramic tiles, water heater, dishwasher, weighing machine, washing machine, ATM, vending machines, vacuum cleaner, shavers, hair clippers, automobiles, motorcycles, aircraft for personal use, will attract 28 % tax - the highest under GST system.

ServicesPrivate-run lotteries authorised by the states, hotels with room tariffs above Rs 7,500, 5-star hotels, race club betting, cinema will attract tax 28 per cent tax slab under GST.

8.5 Summary

Introduction of GST would also make Indian products competitive in the domestic and international markets. Studies show that this would have a boosting impact on economic growth. Last but not the least, this tax, because of its transparent and self-policing character, would be easier to administer. Existing tax incentive schemes of Central or State governments may be continued by respective government by way of reimbursement through budgetary route.

There would be four tax rates namely 5%, 12%, 18% and 28%. Besides, some goods and services would be under the list of exempt items. A cess over the peak rate of 28% on certain specified luxury and sin goods would be imposed for a period of five years to compensate States for any revenue loss on account of implementation of GST. Goods and Services Tax (GST) is an indirect tax applicable throughout India which replaced multiple cascading taxes levied by the central and state governments. It was introduced as The Constitution (One Hundred and First Amendment) Act 2017, following the passage of Constitution 122nd Amyendment Bill. The GST is governed by a GST Council and its Chairman is the Finance Minister of India. Under GST, goods and services are taxed at the following rates, 0%, 5%, 12% and 18%. There is a special rate of 0.25% on rough precious and semi-precious stones and 3% on gold. In addition a cess of 15% or other rates on top of 28% GST applies on few items like aerated drinks, luxury cars and tobacco products.

8.6 Glossary

1. Goods and Services Tax (GST) is an indirect tax applicable throughout India which replaced multiple cascading taxes levied by the central and state governments. It was introduced as The Constitution (One Hundred and First Amendment) Act 2017, following the passage of Constitution 122nd Amendment Bill. The GST is governed by a GST Council and its Chairman is the Finance Minister of India. Under GST, goods and services are taxed at the following rates, 0%, 5%, 12% and 18%.

2. Revenue Neutral Rate (RNR): It is one of Prominent Factor for its success. We know that in GST regime, the government revenue would not be the same as compared to the current system. Hence, through RNR Government is to ensure that its revenue remains the same despite of giving tax credits.

3. Threshold Limit in GST: While achieving broad based tax structure under GST, both empowered committee and Central Government must ensure that lowering of threshold limit should not be a ―taxing‖ burden on small businessmen in the country

4. Robust IT Network: Government has already incorporated Goods and service tax network (GSTN). GSTN has to develop GST portal which ensure technology support for registration, return filing, tax payments, IGST settlements etc. Thus there should be a robust IT backbone

5. Extensive Training to Tax Administration Staff: GST is absolutely different from existing system. It, therefore, requires that tax administration staff at both Centre and state to be trained properly in terms of concept, legislation and Procedure.

6. Numbers of enactments of statutes: There will two types of GST laws, one at a centre level called ‗Central GST (CGST)' and the other one at the state level – ‗State GST (SGST)'. As there seems to have different tax rates for goods and services at the Central Level and at the State Level, and further division based on necessary and other property based on the need, location, geography and resources of each state.

7. Additional Levy on GST: The Purpose of additional Levy is to compensate states for loss of revenue while moving to GST. We acknowledge that fundamental purpose of GST is to make –INDIA‖ as one state where inter-state movement of goods is common. In this situation, it would defeat the very purpose of GST in the country.

8. Clubbing Taxes: The biggest challenge of GST implementation is bringing all the indirect taxes under one roof, which is the biggest feature of GST. There has been opposition asking to including purchase tax by a few states. Other states are reluctant about alcohol, tobacco products coming under GST. This is due to the fact that a major chunk of state revenue is derived from these products.

9. Statutory Requirements: As the imposition of GST will be delegated to both state and central government, the constitution has to grant powers to both through an amendment. It is seen as a difficult task as the law expects at least two-thirds majority from the members of the parliament and that isn‘t easy given the current political scenario of the country.

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8.11 Model Questions

1. Discuss in detail the Concept of GST and its features.
2. What are the benefits derived from the GST to different communities?
3. What are the Rates applicable on different commodities under GST

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Lesson -9

Various Provisions of Model GST Law including Registration Process of GST

Structure

9.0 Objectives

After going through the lesson, you should be able to:

- Understand the features and other provisions of Model GST Law

- Recognize the recent developments in the GST
- discuss the Procedure for obtaining Registration number under GST

9.1 Introduction

Introduction of GST would be a significant step in the field of indirect tax reforms in India. By amalgamating a large number of Central and, State taxes into a single tax and allowing set-off of prior-stage taxes, it would mitigate the ill effects of cascading and pave the way for a common national market. For the consumers, the biggest gain would be in terms of a reduction in the overall tax burden on goods, which is currently estimated at 25%-30%. Introduction of GST would also make our products competitive in the domestic and international markets. Studies show that this would instantly impact on economic growth. There may also be revenue gain for the Centre and the States due to widening of tax base, increase in trade volumes and improved tax compliance. Last but not the least, this tax, because of its transparent character, would be easier to administer.

9.1.1 Genesis

The idea of moving towards the GST was first mooted in the Budget for 2006-07. The Ernpowered Committee of State Finance Ministers (EC) which had formulated the design of State VAT was requested to come up with a roadmap and structure for the GST. Joint Working Groups of officials having representation of the States as well as the Centre were set up to examine various aspects of the GST and draw up reports specificity on exemptions and thresholds, taxation of services and taxation of inter-State supplies. Based on discussions within and between it and the Central Government, the Empowered comrnittee released its First Discussion Paper on the GST in November, 2009. This spells out the features of the proposed GST and has formed the basis for discussion between the Centre and the States so far.

9.2 Salient Features of GST

The salient features of GST are as under:

1. The GST would be applicable on the supply of goods or services as against the present concept of tax on the manufacture and sale of goods or provision of services. It would be a destination based consumption tax.

2. It would be a dual GST with the Centre and States simultaneously levying it on a common tax base. The GST to be levied by the Centre on intra State supply of goods and services would be called Central GST (CGST) and that to be levied by the States would be called State, GST

3. The GST would apply to all goods other than alcoholic liquor for human consumption and five petroleum products, viz. petroleum crude, motor spirit (petrol), high speed diesel, natural gas and aviation turbine fuel. It would apply to all services barring a few to be specified.

4. Tobacco and tobacco products would be subject to GST. In addition, the Centre could levy Central Excise duty on these products.

5. The GST would replace the following taxes currently levied and collected by the Centre:

   a. Central Excise duty

   b. Duties of Excise (Medicinal and Toilet Preparations)

   c. Additional Duties of Excise (Goods of Special Importance)

d. Additional Duties of Excise (Textiles and Textile Products)

e. Additional Duties of Customs (commonly known as CVD)

f. Special Additional Duty of customs

g. Service Tax

6. State taxes that would be subsumed under the GST are:

a. State VAT

b. Central Sales Tax

c. Luxury Tax

d. Entry Tax in lieu of octroi

e. Entertainment Tax (not levied by the local bodies)

f. Taxes on advertisements

g. Purchase Tax

h. Taxes on lotteries, betting and gambling

i. State cesses and surcharges insofar as they relate to supply of goods and services

7. An Integrated GST (IGST) would be levied and collected by the Centre on inter- State supply of goods and services. Accounts would be settled periodically between the Centre and the States to ensure that the SGST ' portion of IGST is transferred to the destination State where the goods or services are eventually consumed.

8. Tax payers shall be allowed to take credit of taxes paid on inputs (input tax credit) and utilize the same for payment of output tax. However, no input tax credit on account of CGST shall be utilized towards payment of SGST and vice versa. The credit of IGST would be permitted to be utilized for payment of IGST, CGST and SGST in that order.

9. HSN (Harmonized System of Nomenclature) code shall be used for classifying the goods under the GST regime. Taxpayers whose turnover is above Rs. 1.5 crores but below Rs. 5 crores shall use 2 digit code and the taxpayers whose turnover is Rs. 5 crores and above shall use 4 digit code.

10. Exports shall be treated as zero-rated supply. No tax is payable on export goods but credit of the input tax related to the supply shall be admissible to exporters.

11. Import of goods and services would be treated as inter-State supplies and would be subject to IGST in addition to the applicable customs duties.

12. The laws, regulations and procedures for levy and collection of CGST and SGST would be harmonized to the extent possible.

IV. GST and Centre-State Financial Relations

Currently, the fiscal powers between the Centre and the States are clearly demarcated in the Constitution with almost no overlap between the respective domains. The Centre has the powers to levy tax on the manufacture of goods (except alcoholic liquor for human consumption, opium, narcotics etc.) while the States have the powers to levy tax on the sale of goods. In the case of inter State sales, the Centre has the power to levy a tax (the Central Sales Tax) but, the tax is collected and retained entirely by the States. As for services, it is the Centre alone that is empowered to levy service tax.

Introduction of the GST would require amendments in the Constitution so as to simultaneously empower the Centre and the States to levy and collect this tax. The assignment of simultaneous jurisdiction to the Centre and the States for the levy of GST would require a unique institutional mechanism that would ensure that decisions about the structure, design andoperation of GST are taken jointly by the two. For it to be effective, such a mechanism also needs to have Constitutional force.

V. Amendment of the Constitution and Other Legislative Requirements

(a) Constitution (One Hundred and Twenty Second) Amendment Bill, 2014

5. To address all these and other issues, a Constitution Amendment Bill was introduced in the Lok Sabha and the Bill (122nd Amendment Bill) has since been passed by the Lok Sabha (May, 2015). The Bill is currently under consideration of the Rajya Sabha. The salient features of the Bill are as under:,

(i) The GST shall be levied on all goods and services except alcoholic liquor for human consumption.

(ii) The tax shall be levied as dual GST separately by the Union and the States.

(iii) Parliament will have power to make laws with respect to GST imposed by the Union (CGST) and the State Legislatures will have power to make laws with respect to GST imposed by the States (SGST).

(iv) Parliament will have exclusive power to make laws with respect to GST where the supply of goods and/or services takes place in the course of inter State trade or commerce (IGST).

(v) The Government of India will have exclusive power to levy and collect GST on inter-State trade or commerce. This tax shall be apportioned between the Union and States on the recommendations of the GST Council by Parliament by law.

(vi) Petroleum& petroleum products would be subject to GST. However, it has been decided that these products would be kept out of the purview of GST in the initial years of implementation. In the case of tobacco and tobacco products, the Centre alone would have the power to levy excise duty in addition to the GST.

(vii) Taxes on entertainments and amusements to the extent levied and collected by a Panchayat or a Municipality or a Regional Council or a District Council shall not be subsumed under GST.

(viii) Parliament may, by law, provide for compensation to States for revenue loss arising out of the implementation of the GST, based on the recommendations of the GST Council. Such compensation would be for a period of 5 years.

(ix) A GST Council would be constituted comprising the Union Finance Minister (who will be the Chairman of the Council), the Minister of State (Revenue) and the State Financial Taxation Ministers to recommend on

(a) the taxes, cesses and surcharges to be subsumed under GST;

(b) the goods and services that maybe subjected to or exempted from the GST;

(c) the date from which the specified petroleum products would be subject to GST;

(d) model GST laws, principles of levy, apportionment of IGST and the principles that govern the place of supply;

(e) the threshold limit of turnover below which the goods and services may be exempted from GST;

(f) the rates including floor rates with bands of GST;

(g) any special :rate or rates for a specified period to raise additional resources during any natural calamity or disaster; and

(h) special provision with respect to the North-East States, J&K, Himachal Pradesh and Uttrakhand.

The mechanism of GST Council would ensure some degree of harmonization on different aspects of GST between the Centre and the States as well as among States. It is being specifically provided that the GST Council, in its discharge of various functions, shall be guided by the need for harmonized structure of GST and for the development of a harmonized, national market for goods and services.

The GST Council may decide about the modalities to resolve disputes arising out of its recommendation.

6. The Constitution Amendment Bill is expected to be passed by the Rajya Sabha in the ensuing monsoon session of Parliament. After ratification of the amendment bill by 50% of State legislatures and receipt of assent by the President, the process of enactment would be complete. (b) Other Legislative Requirements

7. Suitable legislation GST Bill for the levy of GST (Central GST Bill, Integrated introduced and state GST Bills) drawing powers from the constitution can be in Parliament or the state Legislatures only after the enactment of requires the constitution Amendment bill unlike the constitutional Amendment which 2/3rd majority, the GST Bills would need to be passed by a simple way. The levy of the tax can commence has been enacted only after the GST law by the respective date of legislatures. Also, unlike the state VAT, the commencement of this levy would need to be synchronized, across centre and the states. This is because the IGST model cannot effectively function unless the centre and all the state participate simultaneously.

9.3 Work on the various Aspects of GST: Recent Developments and work

(a) Model GST Law: The Model GST Law jointly states' drafted by the tax officials of the centre and has been placed on the website of the Ministry of Finance for suggestions/comments. The model CGST/SGST sections legislation contains 162 provisions spread over 25 chapters and 4 schedules. The draft sets out the of taxable event, taxable person, time of supply, valuation of supply and input tax credit' The draft also deals with the various administrative procedural and aspects such as, registration, filing of returns, assessment, payment of tax' maintenance of accounts, refunds and recovery, inspection' search, seizure and arrest, offences and penalties, prosecution, appeals and revision, advance ruling and transitional provisions.

9‘Under the GST regime, of goods tax is payable by the taxable person on the supply and/or services' Liability to pay tax arises when the taxable person crosses the threshold exemption, i.e. Rs.10 lakhs. The CGST / SGST is payable on all intra-state supply of goods and.lor services and IGST is payable on all inter-state supply of goods and for services. Intra state supply of goods and for place services of refers to those transactions where the location of the supplier and the supply ate in the same State. Inter-state supply of goods and/or place services refers to those transactions where the location of the supplier in different states. The CGST /SGST and IGST are payable at the rates specified in the schedules to the respective Acts.

The draft IGST law contains 33 sections divided into 11 chapters. The interalia, sets out the rules for determination of the place of supply of goods. Where the supply involves movement of goods, the place of supply shall be the location of goods at the time at which the movement of goods for delivery to the recipient. Where the supply does not involve movement of goods, the place of supply shall be the location of such goods at the time of delivery to the recipient. Where the goods are assembled or installed at site, the place of supply shall be the place of such installation or assembly. The goods are supplied on board a conveyance the place of supply shall be the location at which such goods are taken on board.

The draft also sets out in detail the rules for determination of the place of supply of services. As per the draft, the place of supply of services (other than some specified exceptions) made to a registered person shall be the location of such person and that made to a person other than a registered person shall be the location of the recipient where the address on record exists. In other cases, i,e. where the address on record is not available, the place of supply shall be the location of the supplier of service. The draft law has also set out rules for determining the place of supply of certain services like immovable property, restaurant and catering, training and performance appraisal, admission to a cultural scientific or educational event, organization of a fair, exhibition etc., transportation of goods, passengers, telecommunications, banking, insurance and financial services.

The draft IGST law deals with cross utilization of IGST credit. It has been provided that on utilization of IGST credit for payment of CGST, the Central Government shall transfer an amount equal to the credit so utilized from the IGST account to CGST account. Likewise, on utilization of IGST credit for payment of SGST, the Central Government shall transfer an amount equal to the credit so utilized from the IGST account to SGST account. The draft provides for apportionment of tax collected under this act and settlement of funds. It has also been provided that certain provisions of the CGST Act such as registration, valuation, time of supply, exemption, ITC, audit, assessment, demands, adjudication, refund, search, seizure and arrest, prosecution, appeals, shall apply mutatis mutandis to this Act.

11. The Model Law has been drafted keeping in view certain policy objectives, such as, clarity in tax laws, tax laws which are easy to administer, ' tax laws which are non-adversarial and tax payer-friendly, and which improves "ease of doing business". An attempt has been made to provide a fair dispute resolution mechanism for tax payers under GST.

9.4 Minimal interface

11.1 The physical interface between the tax payer and the tax authorities would be minimal under GST. Certain important provisions in this regard are:

(i) Registration will be granted on line and shall be deemed to have been granted if no deficiency is communicated to the applicant within 3 common working days.

(ii) Taxable person shall himself assess the taxes payable (self-assessment) and credit it to the account of the Government.

(iii) Payment of tax shall be made electronically through internet banking. Smaller taxpayers shall be allowed to use the systems generated challan and pay tax at the bank counter.

(iv) The tax payer shall furnish the details of sales and purchases electronically without any physical interface with the tax authorities.

(v) Tax payers shall file, electronically, monthly returns of sales and purchases, ITC availed, tax payable, tax paid and other prescribed particulars. Composition tax payers shall file, electronically, quarterly returns. Omission/incorrect particulars can be self-rectified before the filing of annual return

(vi) Matching, reversal and reclaim of input tax credit shall be done electronically on the GSTN portal without any tax payer contact. This would prevent, inter alia, input tax credit being taken on the basis of fake invoices or twice on the same invoice.
(vii) Tax payers shall be allowed to keep and maintain accounts and other records in electronic form. Input tax credit etc. The provisions of input tax credit have been prone to litigation.

9.5 Input Tax Credit

The Model GST law provides an elaborate mechanism for availment and utilization of ITC and seeks to impart clarity so as to minimize disputes. The important provisions of the law are:

(i) Tax payer is allowed to take credit of taxes paid on inputs (input tax credit), as self assessed, in his return. (ii) Taxpayer can take credit of taxes paid on all goods and services, other than a few in the negative list, and utilize the same for payment of output tax. (iii) creditof taxes paid on inputs shall be allowed where the inputs are used for business purposes or making taxable supplies. (iv) Full input tax credit shall be allowed on capital goods on its receipt as against the current central Government practice of staggering the credit in two equal instalments. (v) Unutilized input tax credit can be carried forward. (vi) The facility of distribution of input tax credit amongst group companies has been provided for.

9.6 Refund Provisions

Refund provisions have been simplified and made more taxpayer friendly. Some of the important provisions of the Model GST law are:

(i) Time limit for claiming refund has been increased from one year to two years.

(ii) Refund claim along with documentary evidence is to be filed online without any physical interface and the tax refund will be directly credited to the nominated bank account of the applicant.

(iii) Refund shall be granted within 90 days from the date of receipt of application. Interest is payable if refund is not sanctioned within the stipulated period of 90 days.

(iv) If the refund claim is less than Rs. 5 lakhs, there is no need for the claimant to furnish any documentary evidence that he has not passed on the incidence of tax to any other person. Only a self-certification to this effect would suffice.

(v) Refund of input tax credit shall be allowed in case of exports or where the credit accumulation is on account of inverted duty structure (i.e. where the tax rate on output is higher than that on inputs).

(vi) In case of refund claim on account of exports, 80% of the claim shall be paid immediately on a provisional basis without verification of documentary evidence.

9.7 Demands

Keeping in mind complaints of long delays in issuance of adjudication orders, a new concept of sunset clause for tax disputes has been introduced. The important provisions in this regard are:

(i) Adjudication order shall be issued within 3 years of filing of annual return in normal cases.

(ii) The time limit is 5 years (of filing of annual return) in fraud/suppression cases. (iii) There are no separate time lines for issue of SCN and adjudication order, as at present under Central Laws.

(iv) Provisions for settlement of cases have been made available to taxpayers at every stage, right from audit/investigation to the stage of passing of adjudication order and even thereafter.

(v) Penalty is minimal if the tax short paid / non-paid is deposited along with interest at the stage of audit/investigation.

(vi) The officer shall in his order set out the relevant facts and the basis of his decision.

(vii) The amount of tax, interest and penalty demanded in the order shall not be in excess of the amount specified in the notice.

(viii) No demand shall be confined on grounds other than the grounds specified in thenotice.

9.8 Audit

The manner of conducting audit has been a sore point with the taxpayers. In the Model GST law, certain disciplines have been brought in, as enumerated below, to streamline the process of audit :

(i) It is not necessary that in all cases the tax authorities would have to visit the place of business of the taxpayer for conducting audit. The audit can even be conducted at the office of the tax authorities.

(ii) Tax payer shall be informed sufficiently in advance, not less than 15 working days, prior to the conduct of audit.

(iii) The audit shall be carried out in a transparent manner and completed generally within a period of 3 months from the date of commencement of audit.

(iv) On conclusion of audit, the proper officer shall without delay notify the taxable person of the findings, the taxable person's rights and obligations and reasons for the findings.

9.9 Penalty disciplines

Another area of dissatisfaction of the taxpayers has been the propensity of the tax authorities to impose disproportionately high penalties for breaches of law which may not be that serious. In order to address this concern, certain general disciplines, as mentioned below, have been incorporated in the Model GST Law.

(i) No substantial penalties shall be imposed for minor breaches of tax regulations or procedural requirements.

(ii) No penalty shall be imposed in respect of any omission or mistake in documentation which is easily rectifiable and obviously made without fraudulent intent or gross negligence.

(iii) Penalty shall be commensurate with the degree and severity of the breach.

(iv) No penalty shall be imposed without issue of Show Cause Notice and without giving personal hearing.

(v) Reasoning is to be given in the order, specifying the nature of the breach and the applicable laws or procedure.

(vi) In case of voluntary disclosure of breach, the tax authorities may consider this fact as a potential mitigating factor when establishing a penalty for that person.

9.10 Alternate dispute resolution mechanism

The various modes of dispute resolution like advance ruling and settlement commission have been continued under GST raw.

(i) Advance ruling can be sought in respect of more subjects than allowed at present' The subjects are: classification of goods/or services, method of valuation' rate of tax, admissibility of input tax credit, liability to pay tax, liability to take registration and whether a particular transaction amounts to a supply under GST law.

(ii) The facility of appeal, which is not there under the central law has been provided in the Model GST Law. The applicants, if aggrieved by the advance ruling' would henceforth get the opportunity to fire an appear before the Appellate Authority for revision of the ruling.

(iii) The provision of settlement commission has been included in IGST Law only.

9.11 Transitional provisions

In the Model GST law, elaborate transitional provisions have been made to enable smooth migration of tax payers from the present regime to GST. The important provisions in this regard are;

(i) The existing taxpayers shall be issued a certificate of registration valid for 6 upon furnishing of prescribed information, registration shall be granted on a final basis.

(ii) The amount of cenvat credit carried forward in a return shall be allowed to be taken as input tax credit subject to certain conditions. un-availed cenvat credit on capital goods, not carried forward in a return, shall also be allowed to be taken as ITC subject to certain conditions.

(iii) credit of eligible duties and taxes in respect of inputs held in stock shall be allowed to a registered taxable person subject to fulfilment of certain conditions.

(iv) credit of eligible duties and taxes in respect of inputs held in stock shall be allowed to a taxable person switching over from the composition scheme to the normal scheme

(v) No tax is payable on the goods removed/dispatched earlier but returned to the place of business after the introduction of GST. This is subject to the 12 condition that the goods ate returned within a period of 6 months after the introduction of GST.

(vi) Likewise, no tax shall be payable on the inputs, semi-finished goods and finished goods removed/dispatched earlier for job work or for carrying out certain processes and returned to the place of business after the introduction of GST. This is subject to the condition that the inputs / goods are returned within a period of 6 months after the introduction of GST.

(vii) pending refund claims shall be disposed of in accordance with the provisions of earlier law and the amount of refund shall be paid to the claimant in cash, subject to certain conditions.

(viii) pending claim of Cenvat credit /input tax credit shall be disposed of in accordance with the provisions of earlier law and the amount of refund shall be paid to the claimant in cash, subject to certain conditions.

(ix) No tax shall be payable on the supply of goods and /or services made before the introduction of GST where a part of consideration for the said supply is received on or after the introduction of GST, but the fu1l duty or tax payable on such supply has already been paid under the earlier law.

(x) No tax shall be payable on the goods sent on approval basis before the introduction of GST but are rejected and returned to the seller on or after the introduction of GST if such goods are returned within 6 months from the introduction of GST.

9.12 Other provisions of Model GST Law

The Model Law contains several other provisions which are taxpayer friendly and are meant for facilitating trade. The provisions worth mentioning here are:

(i) Valuation of goods shall be done on the basis of transaction value i.e. the invoice price, which is the current practice under the Central Excise and Customs Laws.

(ii) Tax payments for all months shall be made in the succeeding month. Tax dues of March are thus to be paid in April and not March, as at present in the Central Government. Composition taxpayers filing quarterly returns and thereby 1/3rd paying tax on a quarterly basis will be required to pay tax in the month succeeding the quarter-end.

(iii) Taxpayers are allowed to issue supplementary or revised of a supply made earlier.

(iv) Taxpayers are allowed to file the details of sales and purchases, and the various returns through Tax Return preparers.

(v) The facility of provisional assessment to tax payers in cases where he is unable to determine the value or rate of tax has been allowed.

(vi) New modes of payment of tax arc being introduced, viz. through credit and debit cards, National Electronic Fund Transfer NEFT) and Real Time Gross Settlement (RTGS).

(vii) The Commissioner has been empowered to grant extension of time for payment of certain tax dues or allow payment of such amount in monthly instalments to the tax payer.

(viii) The facility of job work has been continued under the GST regime.

(ix) E-Commerce companies shall collect tax at source in relation to any supplies made through their online platforms at the rate notified by the Government. This would eliminate the issues around the levy of entry tax on ecommerce transactions.

(x) Exports shall be treated as zero rated supply. No tax is payable on exports but credit of the input tax related to that supply is admissible.

(xi) Provision has been made for the Government to provide remission of tax on supplies which are found to be deficient in quantity due to any natural causes.

(xii) A separate schedule (schedule II) has been provided to clarify certain types of supply as either supply of goods or of services. For example, supply of intangibles, works contract supplies, lease transactions and restaurant supplies arc categorized as supply of services.

(b) GST Rules and Regulations

Preparation of GST Rules and Regulations is another major area of work which needs to be completed well in advance before the implementation of the GST. This is to be jointly drafted by the officials of the Central Government and State Governments. The CBEC has set up a Working Group for this purpose.

IT preparedness

Putting in place a robust IT network is an absolute must for implementation of GST. A Special Purpose Vehicle called the GSTN has been set up to cater to the needs of GST. The GSTII shall provide a shared' IT infrastructure and services to Central and State Governments, tax payers and other stakeholders for implementation of GST. The functions of the GSTN would, inter alia, include:

(i) facilitating registration;

(ii) forwarding the returns to Central and State authorities;

(iii) computation and settlement of IGST;

(iv) matching of tax payment details with banking network;

(v) providing various MIS reports to the Central and the State Governments based on the tax payer return information;

(vi) providing analysis of tax payers' profile; and

(vii) running the matching engine for matching, reversal and reclaim of input tax credit.

The GSTN is developing a common GST portal and applications for registration, payment, return and MlS/reports. The GSTN would also be integrating the common GST portal with the existing tax administration IT systems and would be building interfaces for tax payers. Further, the GSTN is developing back-end modules like assessment, audit, refund, appeal etc. for 19 States and UTs (Model II States). The CBEC and Model I States (15 States) are themselves developing their GST back-end systems. Integration of GST frontend system with back-end systems will have to be completed and tested well in advance for making the transition smooth. (e) Training and Workshops

A detailed calendar has since been drawn up for training the Central and State Government officers and staff on GST law, regulations and procedure. Some 10 officers from the Central Government and 15 officers from the State Governments have been identified as Source Trainers who would be training a pool of some 300 Master Trainers of the Central Government/State Governments who, in turn, would be training some 1600 Trainers drawn from the Central Government and State Governments. The Trainers would then train some 70,000 Central/State Government tax officials at the field level. Presentations and training materials are being prepared for this purpose. Training courses would be held at the various locations of the country.

Training of trade and industry on GST law and procedure is equally important. It has been decided to hold seminars/workshops in 50 cities spread across the country to prepare the trade and industry on GST law, rules, regulations and procedure. Sectoral seminars/workshops for specific sectors such as IT, E-commerce, telecommunications and financial services are proposed to be organised at New Delhi, Bangalore and Mumbai. Further, the GSTN would be imparting training to the officials and trade & industry on GST IT systems. Creating consumer awareness about the benefits of GST is also part of the work plan to be completed before the introduction of GST.

The target date for introduction of GST is 1st April 2017. Introduction of this transformational tax reform is expected to broaden the tax base, increase tax compliance and reduce economic distortions caused by inter-State variations in taxes. GST will boost economic activity and will benefit everyone. It will streamline the tax administration, avoid harassment of the business and result in higher revenue collection for the Centre and States. Compliance costs for the industry will go down. Last but not the least, it will create more jobs.

9.13 Structure of registration number

Each taxpayer will be allotted a State wise PAN-based 15-digit Goods and Services

Taxpayer Identification Number (GSTIN).

In the GSTIN, the State Code as defined under the Indian Census 2011 would be adopted. In terms of the Indian Census 2011, each State has been allotted a unique two digit code e.g. „09‟ for the State of Uttar Pradesh and „27‟ for the State of Maharashtra.

13th digit would be alpha-numeric (1-9 and then A-Z) and would be assigned depending on the number of registrations a legal entity (having the same PAN) has within one State. For example, a legal entity with single registration within a State would have „1‟ as 13th digit of the GSTIN. If the same legal entity goes for a second registration for a second business vertical in the same State, the 13th digit of GSTIN assigned to this second entity would be „2‟.This way 35 business verticals of the same legal entity can be registered within a State.

14th digit of GSTIN would be kept BLANK for future use.

In GST regime, multiple registrations within a State for business verticals of a taxable person would be allowed. This provision should be subject to following specific stipulations –

9.14 Procedure for obtaining Registration

For obtaining registration, all the taxable persons shall interact with tax authorities through a common portal called GST Common Portal2 that would be set up by Goods and Services Tax Network (GSTN). The portal will have backend integration with the respective IT systems of the Centre and States.

A new applicant would be allowed to apply for registration without prior enrollment. Once a complete application is submitted online, a message asking for confirmation will be sent through email and SMS to the authorized signatory of the applicant. On receipt of such confirmation from the authorized signatory, Acknowledgement Number would be generated and intimated to the applicant. Once the application is approved and GSTIN is generated, the same along with Log-in ID and temporary Password will be sent to the authorized signatory.

This credential will be permanently used to access the GST Common Portal subsequently. Provision for capturing e-mail and Mobile Number of authorized representative of the taxpayer has also been incorporated in the proposed GST Registration Form. It would be the responsibility of the taxpayer to keep this information updated.

Online verification of PAN of the Business / Sole Proprietor/ Partner/Karta/Managing Director and whole time directors/Member of Managing Committee of Association, Managing trustee/authorized signatory etc. of the business would be mandatory and without such verification, registration application will not be allowed to be submitted.

Tax Return Preparer (TRP): A taxable person may prepare his registration application /returns himself or can approach the TRP for assistance. TRP will prepare the said registration document / return in prescribed format on the basis of the information furnished to him by the taxable person. The legal responsibility of the correctness of information contained in the forms prepared by the TRP will rest with the taxable person only and the TRP shall not be liable for any errors or incorrect information. If so provided in the GST law, TRPs would be approved by the tax administration of the Centre and the States and will also be provided appropriate training by them, as per common curriculum to be devised by EC/ GST Council.

Facilitation Centre (FC) shall be responsible for the digitization and / or uploading of the forms and documents including summary sheet duly signed by the Authorized Signatory and given to it by the taxable person. After uploading the data on common portal using the ID and Password of FC, a print-out of acknowledgement will be taken and signed by the FC and handed over to the taxable person for his records. The FC will scan and upload the summary sheet duly signed by the Authorized Signatory. This is the system in vogue for submitting TDS returns by more than 2 million tax deductors to the Income Tax Department.

New Applicants

The process highlighted in the paragraphs below is applicable for new applicants for registration, both mandatory and voluntary.

New applicant can apply for registration:

(1) at the GST Common Portal directly; or

(2) at the GST Common Portal through the Facilitation Center (FC)

Multiple applications can be filed at one go where a taxable person seeks registration in more than one State or for more than one business vertical located in a single / multiple State(s).

Following scanned documents are required to be filed along with the application for Registration –

Relevant Box No. in the Registration Form	Document required to be uploaded	Reason for requirement
2. Constitution of Business	• Partnership Deed in case of Partnership Firm ; • Registration Certificate in case of other businesses like Society, Trust etc. which arenot captured in PAN.	• In case of Companies, GSTN would strive for online verification of Company Identification Number (CIN) from MCA21. • Constitution of business/applicant as per PAN would be taken except for businesses such as Society, Trust etc. which are not captured in PAN. • Partnership Deed would be required to be submitted in case of Partnership Firms.
11. Details of the Principal Place of business	• In case of Own premises – any document in support of the ownership of the premises like Latest Tax Paid Receipt or Municipal Khata copy or Electricity Bill copy • In case of Rented or Leased premises – a copy of the valid Rent/ Lease Agreement with any document in support of the ownership of the premises of the Lessor like Latest Tax Paid Receipt or Municipal Khata copy or Electricity Bill copy	• This is required as an evidence to show possession of business premises. If the documentary evidence in Rent Agreement or Consent letter shows that the Lessor is different from that shown in the document produced in support of the ownership of the property, then the case must be flagged as a ―Risk Case‖, warranting a post registration visit for verification. GST Law Drafting Committee

	• In case of premises obtained from others, other than by way of Lease or Rent – a copy of the Consent Letter with any document in support of the ownership of the premises of the Consenter like Municipal Khatacopy or Electricity Bill copy. • Customer ID or account ID of the owner of the property in the record of electricity providing company, wherever available should be sought for address verification.	may add penalty provision for providing wrong lease details.
12. Details of Bank Account(s)	Opening page of the Bank Passbook held in the name of the Proprietor / Business Concern – containing the Account No., Name of the Account Holder, MICR and IFS Codes and Branch details	This is required for all the bank accounts through which the taxpayer would be conducting business.
17. Details of Authorised Signatory	For each Authorised Signatory: Letter of Authorisation or copy of Resolution of the Managing Committee or Board of Directors to thateffect	This is required to verify whether the person signing as Authorised Signatory is duly empowered to do so.
Photograph	• Proprietary Concern – Proprietor • Partnership Firm/LLP – Managing/ Authorized Partners (personal details of all partners is to be submitted but photos of only ten partners including that of Managing Partner is to be submitted) • HUF – Karta	
	• Company – Managing Director or the Authorised • Person • Trust – Managing Trustee • Association of Person or Body of Individual – Members of Managing Committee (personal details of all members is to be submitted but photos of only ten members including that of Chairman is to be submitted) • Local Body – CEO or his equivalent • Statutory Body – CEO or his equivalent • Others – Person in Charge	

For Field No 16 (i.e. Details of Proprietor / all partners / Karta / Managing Director and whole-time Director / Members of the Managing Committee of Association of Persons / Board of Trustees etc.) and Field No 17 (i.e. Details of the Authorized Signatory), verification of PAN with CBDT database and GSTN database will be carried out online before the submitted application is sent to the State/ Centre. In case of mismatch the applicant will be given an opportunity to correct the same.

In some North-eastern States, individuals (Proprietorship firms) are exempt from Income Tax. However, to obtain GSTIN they will have to obtain a PAN before they can apply for registration under GST. Further Government departments will also be required to obtain PAN if they are required to obtain registration under GST. Under *GST regime, registration will not be allowed without a valid PAN.*

If applicant files application through the Facilitation Center, then the above procedure shall be followed by him through the FC by making available the requisite documents to the FC. The User ID and Password of taxable person will however be forwarded by portal to the e-mail furnished by the taxable person (that of primary authorized signatory) and by SMS to the mobile number furnished by taxable person or by post, if the taxable person so desires. It will not be sent to FC.

The GST common portal shall carry out preliminary verification / validation, including real time PAN validation with CBDT portal, Adhaar No validation with UIDAI, CIN (CompanyIdentification) with MCA and other numbers issued by other Departments through inter-portal connectivity before submission of the application form. Taxpayers would have the option to sign the submitted application using valid digital signatures (if the applicant is required to obtain DSC under any other prevalent law then he will have to submit his registration application using the same). In the absence of digital signature, taxpayers would have to send a signed copy of the summary extract of the submitted application form printed from the portal to a central processing center to be operated by GSTN. The location details of this central processing center would be intimated to the applicant along with the application acknowledgement number. The application will be processed even without waiting for receipt of the signed copy of the summary extract. If the signed copy is not received within 30 days, a reminder will be sent through e-mail and SMS to the authorized signatory through the portal. If the copy is not received within 30 days after such reminder being sent, the system will prompt the concerned tax authority to initiate the action for cancellation of the registration. Such cancellation will have prospective effect i.e. from the date of cancellation. GST portal would acknowledge the receipt of application for registration and issue an Acknowledgement Number which could be used by the applicant for tracking his application. Such Acknowledgement Number would not contain the details of jurisdictional officers.

The application form will be passed on by GST portal to the IT system of the concerned State/ Central tax authorities for onward submission to appropriate jurisdictional officer (based on the location of the principal place of business) along with the following information –

(1) Uploaded scanned documents;

(2) State specific data and documents;

(3) Details if the business entity is already having registration in other States. This should also include GST compliance rating4;

(4) Details of the PAN(s) of individuals mentioned in the application which are part of the other GST registrations;

(5) Acknowledgment number

(6) Details of any record of black-listing or earlier rejection of application for common PAN(s).

(7) Last day for response as per the 3 common working day limit for both tax authorities as set out through Holiday Master.

On receipt of application in their respective system, the Centre / State authorities would forward the application to jurisdictional officers who shall examine whether the uploaded documents are in order and respond back to the common portal within 3 common workingdays, excluding the day of submission of the application on the portal, using the Digital Signature Certificates.

An indicative process for processing of the application by the concerned tax authorities will be drafted and shared separately. Submission of latitude and longitude data in respect of principal place of business will be of help in automatic identification of jurisdictional officer in case of geographically distributed officials mapped on a digital map. However, submission of latitude and longitude would be optional.

The applicant shall be informed of the fact of grant or rejection of his registration application through an e-mail and SMS by the GST common portal. Jurisdictional details would be intimated to the applicant at this stage.

In case registration is granted, applicant can download the Registration Certificate from the GST common portal. GST law may provide that GST Registration certificate shall be displayed at the principal place of business of the taxpayer.

The GST common portal will provide a risk profile to the tax authorities based on theriskparameters made available by the tax authorities. The Central/State tax authorities will also have their own risk profile based on their own risk parameters. It was noted that submission of Adhaar No. cannot be made compulsory. Non –submission of Adhaar No. could be one of the risk parameters for deciding about the post registration physical verification. On the basis of both risk profiles, the jurisdictional officer of tax authorities will take a decision about post registration verification of the application if so provided in the GST Law.

GST Law Drafting Committee may provide for appropriate provision for imposition of substantial penalty in cases of fraudulent registrations.

9.15 Summary

Introduction of GST would also make our products competitive in the domestic and international markets. Studies show that this would instantly impact on economic growth. There may also be revenue gain for the Centre and the States due to widening of tax base, increase in trade volumes and improved tax compliance. The GST would be applicable on the supply of goods or services as against the present concept of tax on the manufacture and sale of goods or provision of services. For the smooth operations of GST regime, proper provisions regarding Audit of accounts, transitional provisions, procedure for obtaining registration underGST and other provisions are applicable. Rates of GST on different commodities are different such as items are grouped as under: Zero tax rate, 5%tax rate, 12% tax rate, 18% tax rate & 28% tax rate etc. This law mainly aims to reduce the formalities of all other allied laws and to make business simpler.

9.16 Glossary

1. **HSN (Harmonized System of Nomenclature)** code shall be used for classifying the goods under the GST regime. Taxpayers whose turnover is above Rs. 1.5 crores but below Rs. 5 crores shall use 2 digit code and the taxpayers whose turnover is Rs. 5 crores and above shall use 4 digit code.

2. **Model GST Law:** The Model GST Law jointly states' drafted by the tax officials of the centre and has been placed on the website of the Ministry of Finance for suggestions/comments. The model CGST/SGST sections legislation contains 162 provisions spread over 25 chapters and 4 schedules. The draft sets out the of taxable event, taxable person, time of supply, valuation of supply and input tax credit' The draft also deals with the various administrative procedural and aspects such as, registration, filing of returns, assessment, payment of tax' maintenance of accounts, refunds and recovery, inspection' search, seizure and arrest, offences and penalties, prosecution, appeals and revision, advance ruling and transitional provisions.

3. **Tax Return Preparer (TRP):** A taxable person may prepare his registration application /returns himself or can approach the TRP for assistance. TRP will prepare the said registration document / return in prescribed format on the basis of the information furnished to him by the taxable person. The legal responsibility of the correctness of information contained in the forms prepared by the TRP will rest with the taxable person only and the TRP shall not be liable for any errors or incorrect information. If so provided in the GST law, TRPs would be approved by the tax administration of the Centre and the States and will also be provided appropriate training by them, as per common curriculum to be devised by EC/ GST Council.

9.17 References

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9.18 Further Readings

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9.19 Model Questions

1. Discuss the Salient Features of Model GST Law.
2. Explain the various provisions of GST Law.
3. Discuss the process of obtaining registration under GST in detail.

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43rd GST Council meeting took place on 28th May 2021 (Friday) at 11 A.M. via video conferencing and will be chaired by Union FM Nirmala Sitharaman.

Budget 2021: Updates as on 1st February 2021

1. Section 16 amended to allow taxpayers' claim of input tax credit based on GSTR-2A and 2B. Henceforth, ITC on invoices and debit notes may be availed only when the details of such invoice or debit note have been furnished by the supplier in the statement of outward supplies, and such details have been communicated to the recipient of such invoice or debit note.
2. Section 50 of the CGST Act is being amended to provide for a retrospective charge of interest on net cash liability, with effect from 1st July 2017.
3. With respect to orders received on detention and seizure of goods and conveyance, 25% of penalty needs to be paid for making an application for appeals under section 107 of the CGST Act. Date of applicability is yet to be notified.
4. GST audit requirement by specific professionals such as CAs and CMAs has been removed from the GST law. Section 35 and 44 have been amended in this regard. As per the amendment, only GSTR-9 annual returns on a self-certification basis need to be filed on the GST portal by taxpayers, completely removing the requirement for GSTR-9C, i.e. the reconciliation statement. However, the financial year and date of applicability are yet to be clarified by the government.
5. section 7 of the CGST Act was amended to include a new clause under the definition of supply. Activities or transactions involving the supply of goods or services by any person, other than an individual, to its members or constituents or vice-versa, for cash, deferred payment or other valuable consideration falls under supply and will be liable to tax. Earlier, this supply would have been considered as only supply of goods under schedule II. So, the scope is expanded now for levy.
6. Seizure and confiscation of goods and conveyances in transit are now made a separate proceeding from the recovery of tax from Section 74.
7. Self-assessed tax referred to under section 75 of the CGST Act shall also cover the outward supplies/sales as reported in the GSTR-1 under Section 37 of the CGST Act, but which has been missed out while reporting in the GSTR-3B under Section 39.
8. The provisional attachment shall remain valid for the entire period starting from the initiation of any proceeding till the expiry of a period of one year from the date of order made thereunder.
9. Section 129 is delinked from Section 130. Accordingly, proceedings relating to detention, seizure and release of goods and conveyances in transit will be separate from the levy of penalty for the confiscation of goods and conveyance.
10. The Jurisdictional Commissioner can now call for information from any person relating to any matter dealt with in connection with the Act under Section 151, together with section 168. Further, section 152 is amended to provide an opportunity of being heard before using information obtained under Sections 150 or 151 of the Act
11. The IGST Act was also amended in Section 16, that defines a zero-rated supply.

    Three amendments were made – (1) To state that supply to SEZ units /developers will be zero-rated only if it is authorised operations. (2) Only notified persons or supplies of goods/services can avail the status of zero-rated when IGST is paid. (3) Foreign exchange remittance will be linked in case of export of goods with the refund.

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Lesson-10

Chargeability, Composition and Levy of CGST, SGST and IGST Including Input Tax Credit Rules under GST

Structure

10.1 Objectives

After going through the lesson, you should be able to:

- Understand the Concept of Levy and Collection of CGST/SGST
- Define the term _taxable person under CGST/IGST‘
- Explain the procedure of Levy and Collection of IGST

- discuss the Composite Levy Scheme Rules under GST
- identify the conditions and restrictions of the Levy Scheme
- elaborate the merits and demerits of the levy scheme
- define the Input Tax Credit rules under GST
- discuss the different Entitlement to Claim Input Tax Credit
- localize the circumstances under which ITC is available.

10.2 Introduction

Chapter III of the CGST/SGST Act, 2016 provides for the levy and collection of CGST and SGST vide section 7 of the Act. Chapter III of the IGST Act, 2016 provides for the levy and collection of IGST vide section 4 of the Act. Section 7 of the CGST/SGST Act, 2016 and Section 4 of the IGST Act, 2016 are the charging sections of the respective Act.

10.3 Levy and Collection of CGST/SGST

Section 7 of Chapter III of the CGST/SGST Act, 2016 provides:

Section 7(1)

There shall be levied a tax called the Central/State Goods and Services Tax (CGST/SGST) on all intra-State supplies of goods and/or services at the rate specified in the Schedule to this Act and collected in such manner as may be prescribed.

Section 7(2)

The CGST/SGST shall be paid by every taxable person in accordance with the provisions of this Act.

Section 7(3)

Notwithstanding anything contained in sub-section (2), the Central or a State Government may, on the recommendation of the Council, by notification, specify categories of supply of goods and/or services the tax on which is payable on reverse charge basis and the tax thereon shall be paid by the person receiving such goods and/or services and all the provisions of this Act shall apply to such person as if he is the person liable for paying the tax in relation to such goods and/or services.

Article 265 of the Constitution of India mandates that no tax shall be levied or collected except by the authority of law. Section 7 is the charging provision of the CGST/SGST Act. For the purpose of charging CGST/SGST following points are important:

Tax to be levied called CGST and SGST: - Imposition of CGST by Parliament of India and SGST by the respective State.

Taxable event is Supply: - Supply has been defined in section 2(92) read with section 3 of the Act. Section 3 extensively deals with meaning and scope of supply.

It includes Sale, Transfer,Barter,Exchange, License, Rental, Lease, Disposal

Schedules I and II also enumerate various kinds of supplies. GST would be applicable on supply of goods as against the present system of levy of duty or tax on the manufacture or on sale of goods. The levy is therefore on supply of goods. It should be noted that even transactions of simple transfer, barter and exchange amount to supply for the purposes of GST law.

Tax shall be payable on intra-state supplies:-The meaning of intra-State supply is contained in Section 3A of the IGST Act, 2016. A supply would be an intra-State supply if the location of the supplier and the place of supply, both are within the same State. Thus place of supply and location of supplier are two important aspects to characterize the nature of supply as intra- state (to levy CGST and SGST) or interstate (to levy IGST).

Section 5 and 6 of the IGST Act, 2016 provides for provisions to determine the place of supply of goods and services respectively.

Section 2(65) of the CGST/SGST Act, 2016 defines the location of supplier of service. As per this section, location of supplier of service means:

Place of Business (Registered with GST) from where supply is made;

Location of fixed establishment (Other than the registered place of business) form where supply is made; As per Section 2(46) of the CGST/SGST Act, 2016 ―fixed establishment‖ means a place (other than the place of business) which is characterized by a sufficient degree of permanence and suitable structure in terms of human and technical resources to supply services, or to receive and use services for its own needs;

In case supply is made from multiple places, the location of supplier is the place which is most directly concerned with provision of the supply; In the absence of any such place, the location is the usual place of residence of the supplier.

Goods and Services:- As per Section 2(48) of the CGST/SGST Act, 2016, ―goods'' means every kind of movable property other than actionable claim and money but includes securities, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under the contract of supply; Explanation – For the purpose of this clause, the term ‗moveable property' shall not include any intangible property. As per Section 2(88) of the CGST/SGST Act, 2016, ―services‖ means anything other than goods. Explanation: Services include intangible property and actionable claim but does not include money.

Taxable Person: Meaning of ‗taxable person: Section 9 of the CGST/SGST Act, 2016 defines the term ―taxable person‖. A taxable person is defined as any person who carries on any business in India and who is registered or who is required to be registered. Schedule III of the Act, lists out persons who are liable to get registered. A person who is required to be registered will be considered as a taxable person only if his aggregate turnover in a financial year exceeds Rs. 10 lacs (Rs. 5lacs in case of North Eastern States including Sikkim). In this regard, North Eastern States would mean – Arunachal Pradesh, Assam, Meghalaya, Manipur, Mizoram, Nagaland and Tripura including Sikkim.

It is also important to understand that the threshold for registration and threshold for payment of tax are different. While the threshold for payment of tax is Rs. 10 lacs and Rs. 5 lacs as indicated above, the threshold for registration is Rs. 9 lacs and Rs. 4 lacs respectively.

As per Para 5 of Schedule III, following persons shall be taxable persons irrespective of the threshold /value of aggregate turnover:

a. Person effecting an inter-State supply;

b. Person required to pay tax under reverse charge mechanism;

c. Casual taxable persons in terms of Section 2(21) - a casual taxable person means a person who occasionally undertakes transactions involving supply of goods and/or services in the course or furtherance of business whether as principal, agent or in any other capacity, in a taxable territory where he has no fixed place of business.

d. Non-resident taxable person in terms of Section 2(69) - a non-resident taxable person means a taxable person who occasionally undertakes transactions involving supply of goods and/or services whether as principal or agent or in any other capacity but who has no fixed place of business in India.

e. Any person who is required to deduct tax under Section 37. This would include the following:

Department or establishment of a Central or State Government; or Local authority; or

Governmental agency; or

Such other person or category of persons, as may be notified by the Central or State Government on recommendation of the Council.

f. Person who supplies goods and / or services on behalf of another registered taxable person.

g. Input service distributor in terms of Section 2(56). An Input service distributor means an office of the supplier of goods and / or services receiving or issuing tax invoices including debit/ credit notes for the purposes of distributing SGST / CGST / IGST to the supplier of goods and / or services having the same PAN.

h. Person supplying goods and / or services (other than branded services) through an electronic commerce operator.

i. Electronic commerce operators: In terms of Section 43B(e) of the Act, an electronic commerce operator means any person who directly or indirectly owns or operates or manages an e-platform that is engaged in enabling the supply of goods and / or services or information. It would however, not include person supplying goods and / or services on their own behalf.

j. An aggregator who supplies services under his brand name / trade name. In terms of Section 43B(a) of the Act, an aggregator is defined to mean a person, who owns and manages an electronic platform, and by means of the application and a communication device, enables a potential customer to connect with the persons providing service of a particular kind under the brand name or trade name of the said aggregator.

k. Job worker, in respect of goods supplied by the job worker after completion of job work (refer Section 43A).

l. Such other persons or class of person as the Central Government or State Government may notify on recommendations from the Council.

ii. The following are specifically excluded from the meaning of 'taxable person':

a. Agriculturist as per Section 2(8) read with Section 2(103).

b. Person registered but where the aggregate turnover is less than the thresholds indicated above [Rs. 10 Lakhs/ Rs. 5 Lakhs].

c. Employees providing any services under an employer-employee relationship or workers covered under Contract Labour Abolition Act, 1971.

d. Persons engaged wholly in supply of goods and / or services which are not liable to tax under this Act. This exclusion will not apply to a person supplying exempt goods and /or services.

e. Where any person is liable to pay tax on services under reverse charge mechanism, if the value of services received is less than a specified amount during the year and if the said services are received for personal use (other than in the\ course of or furtherance of business).

10.4 Levy and Collection of IGST

Section 4 of Chapter III of the IGST Act, 2016 provides:

Section 4(1)

- There shall be levied a tax called the Integrated Goods and Services Tax
- on all supplies of goods and/or services
- made in the course of inter-State trade or commerce
- at the rate specified in the Schedule to this Act and
- collected in such manner as may be prescribed. Section 4(2)
- The Integrated Goods and Services Tax
- shall be paid by every taxable person
- in accordance with the provisions of this Act Section 4(3)

Notwithstanding anything contained in sub-section (2), the Central Government may, on recommendation of the Council, by notification, specify categories of supply of goods and/or services the tax on which is payable on reverse charge basis and the tax thereon shall be paid by the person receiving such goods and/or services and all the provisions of this Act shall apply to such person as if he is the person liable for paying the tax in relation to such goods and/or services.

Notwithstanding anything contained in sub-section (1) but subject to such conditions as may be notified in this behalf, no tax under this Act shall be payable by any taxable person in respect of such supplies of goods and/or services as are specified in Schedule to the Act.

As per section 2(2) of IGST Act, 2016, any words or expressions which are used in this Act, but are not defined should be assigned the meaning as given to such words or expressions in CGST Act, 2016. Thus meaning of Goods/Services, Supply, Taxable person and Location of supplier can be referred as per part A.

Tax to be levied called IGST: - Every inter-state supply will attract IGST.

Tax shall be payable on inter-state supplies: - The meaning of inter-state supply is defined in section 3 of the IGST Act, 2016. A supply would be an inter-State supply if the location of the supplier and the place of supply, both are indifferent States.

Thus place of supply and location of supplier are two important aspects to characterize the nature of supply as intra-state (to levy CGST and SGST) or interstate (to levy IGST).

Section 5 and 6 of the IGST Act, 2016 provides for provisions to determine the place of supply of goods and services respectively.

10.5 Introduction to Composition Scheme Rules under GST

Composition Scheme Rules under GST provide for all the procedural compliance w.r.t. intimation for Composition Scheme, effective date for levy, conditions and restrictions on levy, validity of levy and rate of tax.

10.6 Intimation and Effective date for Composition Levy

1. For persons already registered under pre-GST regime

Any person being granted registration on a provisional basis (registered under VAT Act, Service Tax, Central Excise laws etc) and who opts for Composition Levy shall file an intimation in **FORM GST CMP-01**, duly signed, before or within 30 days of appointed date. If intimation is filed after the appointed day, the registered person:

a) Will not collect taxes

b) Issue bill of supply for supplies

FORM GST CMP- 03 must also be filed within 60 days of exercise of option:

a) Details of stock

b) Inward supply of goods received from unregistered persons held by him on the date proceeding the day of exercise of option

2. For persons who applied for fresh register under GST to opt scheme

For fresh registration under the scheme, intimation in **FORM GST REG- 01** must be filed.

3. Registered under GST and person switches to Composition Scheme

Every registered person under GST and opts to pay taxes under Composition Scheme, must follow the following:

a) Intimation in **FORM GST CMP- 02** for exercise option

b) Statement in **FORM GST ITC- 3** for details of ITC relating to inputs lying in stock, inputs contained in semi-finished or finished goods within 60 days of commencement of the relevant financial year

10.7 Effective date for composition levy

a) The option to pay tax under Composition Scheme shall be effective:

- For persons already registered under pre-GST regime: **Appointed Day**
- Registered under GST and person switches to Composition Scheme: **Filing of Intimation**

b) For persons who applied for fresh register under GST to opt scheme Option to pay tax under Composition Scheme shall be effective from:

- where the application for registration has been submitted within thirty days from the day he becomes liable for registration, such date.
- In the above case, the effective date of registration shall be the date of grant of registration.

10.8 Conditions and Restrictions for Composition Levy

1. The person opting for the scheme must neither be a casual taxable person nor a non- resident taxable person.

2. The goods held by him in stock on the appointed date must not be purchased from a place outside his state. The goods should therefore not be classified as:

1. Inter- state purchase
2. Imported Goods
3. Branch situated outside the State
4. Agents or Principal situated outside the State

3. Where the taxpayers deals with unregistered person, tax must be paid or no stock must be held

4. Mandatory display on invoices of the words –composition taxable person, not eligible to collect tax on supplies‖.

5 Mandatory display of the words –Composition Taxable Person‖ on every notice and signboard displayed at a prominent place.

6. He is not a manufacturer of such goods as may be notified by the Government during the preceding financial year.

10.9 Taxable Persons Excluded from the Composition Scheme

Following taxable persons are not granted permission to opt for the scheme who:

- Supplies goods not leviable under the Act
- Supplies services
- Makes a supply of goods other than intra state i.e. interstate or import/ export
- Makes a supply of goods through Electronic Commerce Operator i.e. Ecommerce and liable to collect taxes
- Manufactures such goods as may be notified

Further, it is also if in case a taxable person has different business segments having same PAN as held by the taxable person, he must register all such businesses under the scheme.

If an individual has different business segments such as:

1. Textile
2. Electronics and accessories
3. Groceries

Then he must register all the above segments collectively under the composite scheme or simply opt not for the scheme.

No Tax, No Credit

- **No Credit of Input Tax:-** There has been no provision of input credit on B2B transactions. Thus, if any taxable person is carrying out business on B2B model, such person will not be allowed the credit of input tax paid from the output liability. Also, the buyer of such goods will not get any credit of tax paid, resulting in price distortion and cascading. This will further result into a loss of business as buyers might avoid purchases from a taxpayer under composition scheme. Scheme holder cannot claim input tax credit even if he makes taxable purchases from a regular taxable dealer. Ideally, the taxable amount would be added to the composite tax payer‘s cost.

- **No Collection of Tax:-**Though the rate of composition tax is kept very nominal at 0.5% or 1% or 2.5%, a taxpayer under composition scheme is not allowed to recover such tax from his buyer, as he is not allowed to raise a tax invoice. Consequently, the burden of such tax is kept on the taxpayer himself and this must be paid out of his own pocket. Thus, the fundamental principle of limited compliance and tax burden on small taxpayer is defeated here.

10.10 Merits of the Levy Scheme

Below are some of the prominent reasons why you should choose to get registered as a supplier under the composition scheme:

- **Limited Compliance:** Lesser compliance w.r.t. furnishing of returns, maintenance of books of records, issuance of invoices more focus on business
- **Limited Tax Liability**: on comparison with regular taxpayers, person taxed under Composite Scheme will be liable to pay tax at a rate not more than 2.5% instead of a standard rate of 18%
- **High Liquidity:** Unlike normal tax payers, tax payers under Composite Scheme will be liable to pay taxes at a lower rate resulting in lesser chunk on his working capital

10.11 Demerits of the Levy Scheme

The demerits of registering under Composite Scheme by a taxable person are as follows:

- **Limited Territory for Business:** A taxpayer registered under the composition scheme is barred from carrying out inter-state transactions and cannot affect import-export of goods and services.
- **No Credit of Input Tax:** Under the scheme, the credit of input tax paid on the purchases of inputs from a normal tax payer will not be allowed. The buyer of goods supplier by scheme holder will also not enjoy input tax credit resulting in price distortion, cascading, loss of business to scheme holders.
- **No Collection of Tax:** Though the rate of tax for a scheme holder is lower the burden of such tax is kept on the taxpayer himself, leading to higher cost of sales.
- **Penal Provision:** As per the Model GST Law, if the taxpayer who has previously been given registration under composition scheme is found to be not eligible to the composition scheme or if the permission granted earlier was incorrectly granted, then such taxpayer will be liable to pay the differential tax along with a penalty
- **Not applicable to the supplier supplying goods through E-commerce**

10.12 Introduction to Input Tax Credit

Input tax is the GST incurred on any purchase or acquisition of goods and services by a taxable person for the purpose of making a taxable supply in the course or furtherance of business. These purchases or acquisitions would include:

(a) goods or services purchased or acquired locally

Example 1: Goods purchased locally would include a company buying raw materials, components and parts, trading stocks and packaging materials from a GST registered person where the registered person would charge GST on the goods purchased.

(b) imported goods;

Example: Imported goods would include machineries imported from Japan, raw materials from Hong Kong and clothes from China. Example: Goods removed from warehouses licensed under section 65 of the Customs Act, 1967.

(c) imported services;

Example: Imported services would include consultancy services supplied from a consultant based in Australia and rights and licenses provided by a company based in the United States to a recipient in Malaysia.

Flat Rate Addition

Input tax will include any flat rate addition which an approved person under a flat rate scheme would include in the consideration for any taxable supply of goods made by him in a prescribed activity under the scheme.

10.13 Entitlement to Claim INPUT TAX

A person is entitled to claim input tax if he is making a taxable supply and satisfies the following criteria:

(a) input tax has been incurred;

(b) input tax is allowable;

(c) he is a taxable person, i.e. a person who is or is liable to be registered;

(d) goods or services acquired in the course or furtherance of business; and

(e) goods or services made in Malaysia or any supply made outside Malaysia which would be a taxable supply if made in Malaysia.

Example : Shoez Sdn. Bhd. is a GST registered shoe manufacturer and purchased leather from Kulit Sdn. Bhd, a registered person worth RM50,000 and incurred GST at RM 2,000. Shoez Sdn. Bhd. is entitled to claim input tax of RM 2,000 on the purchase of leather.

Some of the technical aspects of the scheme of Input Tax Credit are as under:

A. Any registered person can avail credit of tax paid on the inward supply of goods or services or both, which is used or intended to be used in the course or furtherance of business.

B. The pre-requisites for availing credit by registered person are:

a. He is in possession of tax invoice or any other specified taxpaying document.

b. He has received the goods or services. ―Bill to ship‖ scenarios also included.

c. Tax is actually paid by the supplier. d. He has furnished the return. e. If the inputs are received in lots, he will be eligible to avail the credit only when the last lot of the inputs is received. f. He should pay the supplier, the value of the goods or services along with the tax within 180 days from the date of issue of invoice, failing which the amount of credit availed by the recipient would be added to his output tax liability, with interest [rule 2(1) & (2) of ITC Rules]. However, once the amount is paid, the recipient will be entitled to avail the credit again. In case part payment has been made, proportionate credit would be allowed.

C. Documents on the basis of which credit can be availed are:

a. Invoice issued by a supplier of goods or services or both

b. Invoice issued by recipient alongwith proof of payment of tax

c. A debit note issued by supplier

d. Bill of entry or similar document prescribed under Customs Act

e. Revised invoice

f. Document issued by Input Service Distributor

D. No ITC beyond September of the following FY to which invoice pertains or date of filing of annual return, whichever is earlier

E. The Input Service Distributor (ISD) may distribute the credit available for distribution in the same month in which, it is availed. The credit of CGST, SGST, UTGST and IGST shall be distributed as per the provisions of Rule 4(1) (d) of ITC Rules. ISD shall issue invoice in accordance with the provisions made under Rule 9(1) of Invoice Rules.

F. ITC is not available in some cases as mentioned in section 17(5) of CGST Act, 2017. Some of them are as follows:

a. motor vehicles and other conveyances except under specified circumstances.

b. goods and/or services provided in relation to:

i. Food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, except under specified circumstances;

ii. Membership of a club, health and fitness centre;

iii. Rent-a-cab, life insurance, health insurance except where it is obligatory for an employer under any law;

iv. Travel benefits extended to employees on vacation such as leave or home travel concession;

c. Works contract services when supplied for construction of immovable property, other than plant & machinery, except where it is an input service for further supply of works contract;

d. Goods or services received by a taxable person for construction of immovable property on his own account, other than plant & machinery, even when used in course or furtherance of business;

e. Goods and/or services on which tax has been paid under composition scheme;

f. Goods and/or services used for private or personal consumption, to the extent they are so consumed;

g. Goods lost, stolen, destroyed, written off, gifted, or free samples;

h. Any tax paid due to short payment on account of fraud, suppression, mis-declaration, seizure, detention.

10.14 Special circumstances under which ITC is available:

a. A person who has applied for registration within 30 days of becoming liable for registration is entitled to ITC of input tax in respect of goods held in stock (inputs as such and inputs contained in semi-finished or finished goods) on the day immediately preceding the date from which he becomes liable to pay tax.

b. A person who has taken voluntary registration under section 23(3) of the CGST Act, 2017 is entitled to ITC of input tax in respect of goods held in stock (inputs as such and inputs contained in semi-finished or finished goods) on the day, immediately preceding the date of registration.

c. A person switching over to normal scheme from composition scheme under section 10 is entitled to ITC in respect of goods held in stock (inputs as such and inputs contained in semi-finished or finished goods) and capital goods on the day immediately preceding the date from which he becomes liable to pay tax as normal taxpayer.

d. Where an exempt supply of goods or services or both become taxable, the person making such supplies shall be entitled to take ITC in respect of goods held in stock (inputs as such and inputs contained in semi-finished or finished goods) relatable to exempt supplies. He shall also be entitled to take credit on capital goods used exclusively for such exempt supply, subject to reductions for the earlier usage as prescribed in the rules.

e. ITC, in all the above cases, is to be availed within 1 year from the date of issue of invoice by the supplier.

f. In case of change of constitution of a registered person on account of sale, merger, demerger etc, the unutilized ITC shall be allowed to be transferred to the transferee.

g. A person switching over from composition scheme under section 10 to normal scheme or where a taxable supply become exempt, the ITC availed in respect of goods held in stock (inputs as such and inputs contained in semi-finished or finished goods) as well as capital goods will have to be paid.

h. In case of supply of capital goods or plant and machinery, on which ITC is taken, an amount equivalent to ITC availed minus the reduction as prescribed in rules (5% for every quarter or part thereof) shall have to be paid. In case the tax on transaction value of the supply is more, the same would have to be paid.

10.15 Summary

There shall be levied a tax called the Central/State Goods and Services Tax (CGST/SGST) on all intra-State supplies of goods and/or services at the rate specified. TheCGST/SGST shall be paid by every taxable person in accordance with the provisions of this Act.

Taxable event includes Sale, Transfer, Barter, Exchange, License, Rental, Lease, Disposal etc. A taxable person is defined as any person who carries on any business in India and who is registered or who is required to be registered. Agriculturists and the persons whose turnover does not exceed the specified limit will not be considered as taxable person. The Levy and Collection of IGST has also made with the specific procedure under this act.

Composition Scheme Rules under GST provide for all the procedural compliance w.r.t. intimation for Composition Scheme, effective date for levy, conditions and restrictions on levy, validity of levy and rate of tax. The effective dates for persons already registered under pre- GST regime: Appointed Day and the Registered under GST and person switches to Composition Scheme: Filing of Intimation. Different categories of forms are filled to avail the benefits of this scheme. The scheme has also some merits and demerits. It preserves liquidity and to impose limited tax liability but the major demerits of the scheme is that there is no provision of input tax credit. Despite of this, the scheme receives favourable responses from the different filed of business houses.

Input tax is the GST incurred on any purchase or acquisition of goods and services by a taxable person for the purpose of making a taxable supply in the course or furtherance of business. Input tax will include any flat rate addition which an approved person under a flat rate scheme would include in the consideration for any taxable supply of goods made by him in a prescribed activity under the scheme. A person is entitled to claim input tax if he is making a taxable supply and satisfies the following criteria: (a) input tax has been incurred; (b) input tax is allowable; (c) he is a taxable person, i.e. a person who is or is liable to be registered; (d) goods or services acquired in the course or furtherance of business; and (e) goods or services made in Malaysia or any supply made outside Malaysia which would be a taxable supply if made in Malaysia. A person switching over to normal scheme from composition scheme under section 10 is also eligible for ITC.

10.16 Glossary

1. Taxable event is Supply: - Supply has been defined in section 2(92) read with section 3 of the Act. Section 3 extensively deals with meaning and scope of supply. It includes Sale, Transfer, Barter, Exchange, License, Rental, Lease, Disposal. Schedules I and II also enumerate various kinds of supplies. GST would be applicable on supply of goods as against the present system of levy of duty or tax on the manufacture or on sale of goods. The levy is therefore on supply of goods.

2. Tax shall be payable on intra-state supplies: -The meaning of intra-State supply is contained in Section 3A of the IGST Act, 2016. A supply would be an intra-State supply if the location of the supplier and the place of supply, both are within the same State. Thus place of supply and location of supplier are two important aspects to characterize the nature of supply as intra- state (to levy CGST and SGST) or interstate (to levy IGST).

3. Goods and Services:- As per Section 2(48) of the CGST/SGST Act, 2016, ‒goods‘‘ means every kind of movable property other than actionable claim and money but includes securities, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under the contract of supply; Explanation – For the purpose of this clause, the term ‗moveable property‘ shall not include any intangible property. As per Section 2(88) of the CGST/SGST Act, 2016, ‒services‖ means anything other than goods.

4. Taxable Person: Meaning of ‗taxable person: Section 9 of the CGST/SGST Act, 2016 defines the term ‒taxable person‖. A taxable person is defined as any person who carries on any business in India and who is registered or who is required to be registered. Schedule III of the Act, lists out persons who are liable to get registered. A person who is required to be registered will be considered as a taxable person only if his aggregate turnover in a financial year exceeds Rs. 10 lacs (Rs. 5lacs in case of North Eastern States including Sikkim). In this regard, North Eastern States would mean – Arunachal Pradesh, Assam, Meghalaya, Manipur, Mizoram, Nagaland and Tripura including Sikkim.

5. Input tax is the GST incurred on any purchase or acquisition of goods and services by a taxable person for the purpose of making a taxable supply in the course or furtherance of business.

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10.19 Model Questions

1. Explain the procedure of Collection and Levy of CGST/SGST.
2. Explain the procedure of Collection and Levy of IGST.
3. What is taxable person? Which person is not included in the taxable person?
4. Define the Composite Levy Scheme Rules under GST.
5. What are the conditions and restrictions of the Levy Scheme?
6. Discuss the merits and demerits of the scheme
7. Discuss in detail the Input Tax Credit Rules under GST.
8. What is the procedure of Entitlement to Claim Input Tax?
9. What are the Special circumstances under which ITC is available?

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