CHAPTER V
COMPUTATION OF INCOME

Sec. 20: Heads of Income.–Save as otherwise provided in this Ordinance, all incomes shall, for the purpose of charge of income tax and computation of total income, be classified and computed under the following heads of income, namely:-

(a) Salaries.
(b) Interest on securities.
(c) Income from house property.
(d) Agricultural income.
(e) Income from business or profession.
(f) Capital gains.
(g) Income from other sources.

Sec. 20. Seven Heads of Income.–The total income of an assessee (subject to statutory exemptions) is chargeable under s. 16(1). The scope of total income, which varies with the factor of residence, is defined in s. 17. This section enumerates the seven heads, under which the income of an assessee falls to be charged. Since the provisions for computing income and the permissible deductions vary with the different heads of income, each of the seven heads is dealt with by a separate set of sections (ss. 21 to 34).

In short s. 16(1) charges total income, s. 17 defines its range, s. 20 classifies it, ss. 21-34 quantify it.

The only effect of this section is to classify profits and gains under different heads according to the character of the source, for the purpose of providing for each head appropriate provisions for computing the amount of income–*C.I.T.* v. *Chunilal Mehta 1938 I.T.R. 521, 529 (P.C.).*

The whole scheme of the charging provisions of the 1922 Act was reviewed by the Supreme Court of India in *United Commercial Bank Ltd.* v. *C.I.T. [1957] 32 I.T.R. 688*, and by the Bombay High Court in *Kamdar,* In re *1946 I.T.R. 10, 40-1.* In the Bombay case, Kania, J., summed up the effect of s. 6 of the 1922 Act, which corresponded to s. 20 of this Ordinance, in these words: "Section 6 does not attempt to define income or prescribe limitations on income ... The section begins with the words 'Save as otherwise provided by this Act' so as not to exclude the operation of any other section permitting a deduction ..... Sections 6 to 13 are thus not the charging sections but are inserted in the Act for computation of the net income of the assessee. This construction is in accord with the view that under the Act (Ordinance) income, and not several incomes, is taxed"–*C.I.T.* v. *Chugandas & Co. [1960] 38 I.T.R. 241, 268.*

Heads of income are mutually exclusive.–Under the Income tax Ordinance, 1984, the income of an assessee is one and secs. 21 to 34 of the Ordinance direct the modes in which income tax is to be levied. No one of these sections can be treated to be general or specific for the purpose of any one particular source of income, they are all specific and deal with the various heads in which an item of income, profits and gains of an assessee falls. These sections are mutually exclusive and where an item of income falls specifically under one head it has to be charged under that head and no other – *United Commercial Bank Ltd.* v. *C.I.T. [1957] 32 I.T.R. 688.*

Income-tax is only one tax.–The income-tax is only one tax, levied on the sum total of the income classified and chargeable under the various heads. It is not a collection of distinct taxes levied separately on each head of income. In other words, assessment to income-tax is one whole and not a group of assessments of different heads or items of income –*United Commercial Bank Ltd.* v. *C.I.T. [1957] 32 I.T.R. 688 (S.C. of India).* This principle, which was definitely established in England by the House of Lords in *London County Council* v. *Att.-Gen (4 T.C. 265, 293-4)* and *Salisbury House Estate Ltd.* v. *Fry 15 T.C. 266.* is even more clearly applicable to the Indian and Bangladeshi than to the English Acts or Ordinance.

Three important consequences follow from the principle that the income-tax is only one tax and there are not as many taxes as there are heads of income:-

(1) *Total income.*–A man may be chargeable on his total income though his income under each head may be well below the taxable limit.

(2) *Set-off of loss.*–A loss sustained in any year under any of the heads may be set off against income under any other head in that year (s. 37). A loss sustained in respect of a source of income under any one head should be set off against income from other sources chargeable under the same head, in order to arrive at the net figure chargeable under that head (s. 37). For instance, where an assessee carries on both a business and a profession, any loss in business should be deducted from the professional earnings before arriving at the figure of income taxable under sec. 28. (See further notes to s. 36).

(3) *Charge under specific head is obligatory and exhaustive.*–Income which is specifically made chargeable under a distinct head cannot be brought to charge under a different head in lieu of, or in addition to being charged under its specific head –*Kothari* v. *C.I.T. [1951] 20 I.T.R. 579.* This is now established by the Indian Supreme Court's decision in –*United Commercial Bank Ltd.* v. *C.I.T. [1957] 32 I.T.R. 688 (S.C. of India)*, where it was held that "Interest on securities" is a specific head of charge (s. 22) and therefore it cannot be charged as profits of business (s. 28) even if the securities are held as trading assets. (See under s. 22, "Securities held as trading assets"). "Income from property" (buildings or lands appurtenant thereto) is also a specific head of charge, and the tax is payable under s. 24 in respect of the *annual value* of such property. Consequently, the income derived from the

mere ownership of the property cannot be charged under s. 28 as business profit even if the property is acquired for the purpose of trade. (See under s. 24, "Property held as a business asset").

Charge under the specific head is not only proper but obligatory on the department which has no option in the matter –*United Commercial Bank Ltd.* v. *C.I.T. [1957] 32 I.T.R. 688 (S.C. of India)*. Income cannot be assessed under a wrong head merely because the assessee has returned it under a wrong head –*Bihar State Co-op. Bank Ltd.* v. *C.I.T. [1960] 39 I.T.R. 114 (S.C. of India)*. If a case appears to fall within either of two heads of income, it is the right of the assessee to claim that he should be taxed under that one which leaves him with a lighter burden –*Kothari* v. *C.I.T. [1951] 20 I.T.R. 579*. When a specific head of income covers the case, the residuary head, "Income from other sources," cannot be called in aid –*C.I.T.* v. *Basant Rai Takhat Singh 1933 I.T.R. 197, 201 (P.C.); Bihar State Co-op. Bank Ltd.* v. *C.I.T. [1960] 39 I.T.R. 114 (S.C. of India)*.

Expenses attributable to income under one head can be allowed only so far as the provisions applicable to that head permit, and if the expenses are not allowable under that head they cannot be deducted from income under another head –*Mitchel and Edon* v. *Ross 40 T.C. 1 (H.L.)*.

Sec. 21. Salaries.–(1) The following income of an assessee shall be classified and computed under the head "Salaries", namely:-

(a) any salary due from an employer to the assessee in the income year, whether paid or not;

(b) any salary paid or allowed to him in the income year, by or on behalf of an employer though not due or before it became due to him; and

(c) any arrears of salary paid or allowed to him in the income year by or on behalf of an employer, if not charged to income-tax for any earlier income year.

(2) Where any amount of salary of an assessee is once included in his total income of an income year on the basis that it had become due or that it had been paid in advance in that year, that amount shall not again be included in his income of any other year.

Sec. 21. Salaries.–Every kind of remuneration of every kind of servant, public or private and however highly or lowly placed he may be, is covered –*Bhagwati Shankar, In re, 1944 I.T.R. 193, 198*. Even the remuneration payable to an employee of Foreign Government falls within this section.

Overtime allowance.–A question arose before the High Court Division of the Supreme Court in the case of *C.T. Khulna* v. *Abdus Salam* whether overtime is a salary paid to the Government officer is to be exempted from income tax being a

salary of which income tax would be deemed to have been paid by the Government. It was held that overtime payment will not be subject to tax in the hands of the assessee but like other salary income of the Government it will be included in the assessee's total income for determining the higher incidence of tax for higher income.

Relationship of employer and employee.–No payment can fall to be taxed under this section unless the relationship of employer and employee exists between the payer and the payee *C.I.T.* v. *Mills Store Co. 1941 I.T.R. 642, 650-1.* Every *servant* is an employee; but an *agent* may or may not be an employee *Lakshminarayan Ram Gopal & Son Ltd.* v. *Govt. of Hyderabad [1954] 25 I.T.R. 449 (S.C. of India).* Some general principles Governing the concept of "employment" have been discussed by the Allahabad High Court in *Jeewanlal* v. *C.I.T. [1953] 24 I.T.R. 217* and by the Punjab High Court in *Daya Chand Hardayal* v. *C.I.T. [1953] 24 I.T.R. 318.* A distinction must be made between income from employment which is taxable under this section, and income from an office not amounting to employment which is taxable under s. 33 or income from a business or profession which is taxable under s. 28.

Income from office not amounting to profit.–Chagla, J., said in *C.I.T.* v. *Lady Navajbai Tata (1947 I.T.R. 8, 15).* "The fact that a person may hold an office and that he should receive a remuneration by virtue of that office does not necessarily bring about a relationship of master and servant between him and the person who pays him the remuneration, or the relationship of an employer and an employee." A director of a company *holds an office under the company but as a director he is not a servant or an employee of the company* and therefore the fees he receives are taxable under s. 33 and not under this section *C.I.T.* v. *Lady Navajbai Tata 1947 I.T.R. 8.*

But under sec. 2(28) the definition of "employee" as given therein includes a director. It has been provided that an employee, is relation to a company, includes the managing director or any other director or other person, who irrespective of his designation, performs any duties or functions in connection with the management of the affairs of the company. So a director who is not connected with the management of affairs of the company may not be called employee. For the purpose of determining value of perquisites of an employee under Rule 33, employee includes a whole time director of one company. But the amended Rule 33(2) has excluded from the definition of "employee" a shareholder director of a company. (See further *note* to Rule 33 *post*).

Remuneration paid to an employee is taxable under this section, notwithstanding that under the terms of the agreement between the parties the employee is under no obligation to render any services.

A co-owner of a property may employ another co-owner on the business of the joint ownership, and the extra amount paid to the co-owner so employed would be taxable under this section *(Major Conville* v. *C.I.T. 1935 I.T.R. 404).* But a partner cannot be an employee of the firm *(Magnus* v. *C.I.T. [1958] 33 I.T.R. 538).*

"Salaries" and business profits.–There is a distinction between a manager and a managing agent of a limited company: (a) a managing agent, unlike a manager,

is entitled *as of right* to manage the company's affairs, the right being granted by an agreement with the company, though, like a manager, he must exercise his powers subject to the superintendence, control and direction of the directors; and (b) a managing agent may be an individual, a company, a firm, or other association, whereas the manager can only be an individual. The remuneration paid to a *manager* of a limited company would be assessable as salary, even though he may be wrongly designated as managing agent and his remuneration may be fixed at a certain percentage of the company's profits *(C.I.T.* v. *Varshani [1953] 24 I.T.R. 328)*. On the other hand, the decision of the Indian Supreme Court in *(Lakshminarayan Ram Gopal & Son Ltd.* v. *Govt. of Hyderabad [1954] 25 I.T.R. 449)*, establishes that the rendering of continuous and various services as *managing agents* to a company would, generally speaking, amount to a business, and the agents' remuneration would be taxable as business profits and not as salary, even if the services are rendered to only one company *(Qamar Shaffi Tyabji* v. *C.E.P.T. [1960] 39 I.T.R. 611 (S.C. of India))*.

In cases where the relationship of employer and employee does not exist, the profits derived from the *selling agency* of a manufacturing concern would be assessable as business profits and not as "salaries".

Receipts from persons other than employer.–Perquisites or profits received from persons other than the employer, would be taxable under Sec. 33 not under this section, even if they accrue to the employee by reason of his employment. Voluntary grants, tips and gratuities received by waiters, taxi drivers and other servants would be perquisites or profits of office or employment but taxable under Sec. 33.

It has been established by the House of Lords in Cooper v. Blakiston (5. T.C. 347) that a profit, perquisite or emolument may come as a gift to the employee but it would be taxable. There is *no* distinction between voluntary and contractual payments in this section. All gratuities, bonuses and other voluntary payments by an employer of services rendered or to be rendered are taxable under this section – *(Carter* v. *C.I.T. [1963] 49 I.T.R. 773)*, but testimonials and personal gifts are exempt.

Payments made after cessation of employment.–The section taxes not only payments by an employer during employment, but also payments by a former employer after the employment has come to an end.

Remuneration for services may take the form of a payment at the end of the employment, and the payment does not cease to be remuneration for services because it is payable to the employee or his representatives after the services come to an end–*(Westminster Bank Ltd.* v. *Barford [1959] 37 I.T.R. 477)*. A sum payable to an employee director at the conclusion of the term of his directorship–*(Henry* v. *Foster 18 T.C. 605)*, or a payment made to any other employee after the employment has terminated–*(Carter* v. *C.I.T. [1963] 49 I.T.R. 773)*, is taxable under this section. It is the profit of the year in which the sum is due or paid and is not distributable over the whole term of service.

"Salary due ... whether paid or not".–The section contemplates a tax on salaries (including perquisites, profits, etc. which are due, whether paid or not, as well as on salaries which are paid, whether due or not –*(C.I.T.* v. *Lady Navajbai Tata 1947 I.T.R. 8, 14)*. The tax is attracted at the earliest possible point of time which in this case is the date when the salaries accrue or become due. Clause (b) brings to charge in the year of receipt such amounts as are voluntarily paid and are not due at all from the employer, as well as advance payment of salary [sec. 2(58)(d)], but not a mere loan which may be recovered from salary later.

Where any salary paid in advance is assessed in the year of payment, it cannot be taxed later when it becomes due (Sub-Sec. (2)). Likewise, if arrears of salary have been assessed on the "due" basis in the past, they are not liable to tax again when they are paid [Sec. 17(2)]. But when they have not been assessed on that basis, they are liable to be assessed in the year in which they are paid.

Payment in Commutation of Salary or Pension.–A lump sum paid in commutation, reduction or substitution of salary, pension or other profits of employment, is nonetheless taxable as income under this section but exemption has been given in Para A of Sixth Schedule.

Tax-free Salary.–Where a salary is paid tax-free, the employee has to include in his total income the gross salary, i.e. the aggregate of the net salary received plus the amount of tax paid on his behalf by the employer. It makes no difference whether the tax is borne by the employer voluntarily or under a contractual obligation.

Salary income of the employees of the Government is exempt from tax since July, 1973 (vide Circular No. 2(8) 89 I.T. IV (73) dt. 1.5.74). Tax on such salary is deemed to have been paid by the Government and the employees are not required to pay any tax on the tax (tax on tax) deemed to have been paid by the Government and as such their net salary is the gross salary.

Salary of the employees of the autonomous bodies, nationalised banks, insurance companies, Local authority, taken-over concerns, University and nationalised institutions was also exempt by the Board where tax was being borne by their employers. But in their cases also no tax was being charged on the tax paid by their employers, i.e. there was no tax on tax in their cases. But this exemption has been withdrawn by the Board since the assessment year 1998-99 (vide S.R.O. No. 181-Law/98 dt. 19.8.98). The employees of these organisations will now be required to include in their salary income the tax paid by their employees, i.e. their gross salary will be included into their total income.

Voluntary forgoing –Application of salary.–The voluntary forgoing by an employee of the salary due to him is normally mere application of the income and the salary is nonetheless taxable –*(See under s. 16(1), "Application of income ...")*. It would be taxable on the further ground that this section brings to charge salary which is *due, whether paid or not*. But where in reality there is no agreement to pay any salary, the apparent forgoing of a fictional salary would not attract tax.

Deductions by employer.–Compulsory deductions from salary are also instances of mere application of income *(Magraw* v. *Lewis 18 T.C. 222)*. A sum received by way of salary or wages would be taxable as such although for some reason or another the person who receives it has not got the full right to apply it just as he likes. The fact that a portion of the salary has to be devoted compulsorily to some purpose by the operation of some statute or under a contractual obligation, does not prevent it from being assessable as income under this head, for it is only a case of application of income –*(Smyth* v. *Stretton 5 T.C. 36)*.

An employee was bound under the contract of service to allow his employer to deduct a certain amount which was returnable by way of superannuation benefit or in a lump sum with interest in the event of death or retirement. Held, the *full* salary was exigible to tax. *(Bell* v. *Gribble 4 T.C. 522; Bruce* v. *Hatton 8 T.C. 180)* (But such compulsory deductions made from the salary to secure retirement benefits are entitled to a rebate of income-tax in the circumstances set out in Para 6 of part B of Sixth Schedule).

Exemptions from tax.–Income chargeable under the head "Salaries" is exempted from tax in the cases specified under paragraphs 7(a)(b)(c), 8 and 9 of Part A of Sixth Schedule. Other exemptions are provided by Notifications issued by the Board under Sec. 44(4)(b) which are stated as under.

1. নথি নং-৮(৫২) দ্বিঃ সঃ ১৭ (কর অব্যাহতি-২) ৯৭ তাং ২৩/৮/৯৭ - নথি পত্র নং ৫ - সংশোধিত প্রজ্ঞাপন নং ২৯৭ - এল/৭৮ তাং ১/১১/৭৮. In the case of *C.I.T.* v. *Justice Shahabuddin Ahmed-1990 BTD XVIII 107* it was held, that since the salary and allowances of the Honourable Justices of the Supreme Court have been exempted by P.O. 21, 1973, such salary and allowances shall not be added to whole income for sale purpose as no provisions of the statutory law can govern the provisions of sub-constitutional legislation. The above Circular followed the decision.

2. S.R.O. 440 L/76 dt. 18.12.76 read with S.R.O. 297-L-78 dt. 1.11.98–Salaries of (i) Prime Minister, Minister, State Minister, Deputy Minister, and persons having similar status (ii) Member of the Parliament, (iii) Chairman and Members of the Planning Commission, Member of the Law Committee are exempt from tax but shall be added to total income for rate purpose.

3. The assessee a retired judge of the Bangladesh Supreme Court (H.C. Division) was appointed on retirement as Chairman of Bangladesh Press Council under Ministry of Information by Government on contract basis on terms and conditions as described below:

"তিনি হাই কোর্টে বিচারপতি থাকা কালীন যে সুযোগ সুবিধা পাইতেন তাহা প্রাপ্য হইবেন।"

The Tribunal (I.T.A. Nos. 1400 and 1401 of 1996-97) Dhaka Bench found that under the Supreme Court Judges (Remuneration and Privileges) Ordinance, 1978 no income tax shall be payable in suspect of salary payable to a judge and the contract was signed by the Secretary, Ministry of Information on behalf of the President of

Bangladesh. It was held that the tax assessed on salary income of the assessee was not legal hence deleted.

4. S.R.O. 207/Law/97 dt. 8.9.97

বাংলাদেশ সরকারের সহিত কোন বিদেশী সরকার বা বিদেশী সরকার কর্তৃক গঠিত সংস্থার সহিত সমপাদিত দ্বিপাক্ষিক চুক্তির ভিত্তিতে বৈদেশিক সাহায্য নির্ভর উন্নয়ন প্রকল্পে নিয়োজিত সংশ্লিষ্ট সাহায্যকারী অপর দেশের নাগরিকদের বাংলাদেশে কার্যকালীন সময়ে তাহাদের নিজ দেশ বা সংস্থা হইতে প্রাপ্ত বেতন, ভাতা আয়কে প্রদেয় কর হইতে অব্যাহতি প্রদান।

5. S.R.O. 35-Law/97 dt. 3.2.97

Private Sector Power Generation Policy of Bangladesh- এর ব্যবস্থা অনুসারে উক্ত পলিসিতে নির্ধারিত শর্ত পূরন সাপেক্ষে দেশের সকল কোমপানীতে কার্যরত বিদেশী ব্যক্তিগনের আয়কে বাংলাদেশে তাহাদের আগমনের তারিখ হইতে তিন বৎসরের জন্য কর প্রদান অব্যাহতি প্রদান।

Relief against higher tax rate when salary is paid in arrears or in advance.–Where by reason of payment of salary in arrears or in advance, or salary for more than twelve months payment of compensation, provident fund balance, etc., an assessee's income becomes assessable at a higher rate in a particular year than that at which it would otherwise have been assessed, the Deputy Commissioner is empowered by Sec. 172 to grant appropriate relief.

Rebate of Income-tax on contributions to provident and superannuation funds.– Rebate of income-tax is allowed on contributions to provident and superannuation funds subject to the conditions set out in Para 4, 5 and 6 in Part B of Sixth Schedule.

Deduction of tax at source.–Tax is deductible at source from income chargeable under the head "Salaries" (s. 50). If such deduction has been made at source, the employee cannot be called upon to pay the tax himself as he will be deemed to have paid himself (Sec. 48) although the employer may have defaulted in paying the tax deducted to the Government (s. 57).

Definitions within the definition of Salary.–Section 2(58) contains definitions within a definition. This sub-section defines "salary" as including, among other things, perquisites and profits in lieu of salary. Sub-Secs. 45 and 50 go on to give inclusive definitions of "perquisite" and "profits in lieu of salary".

Annuity, pension or gratuity Cl. (b).–Annuities paid by employers are taxable as salary. Annuities paid by a person other than the employer *(Duncan's Executors* v. *Farmer 5 T.C. 417, e.g.),* annuities paid under an insurance policy or other contract or under the provisions of a deed or will, are taxable as "Income from other sources" under s. 33. Annuities and pensions paid by the employer are chargeable under s. 21 whether they are paid voluntarily or under a contractual obligation –*(C.I.T.* v. *Katrak 1937 I.T.R. 527).* Pension received in any income year in which the assessee was in Bangladesh for a period of one hundred and eighty two days is exempt from tax-Para 8 of Part-A of Sixth Schedule. A gratuity is a payment in return for services rendered and is as much taxable as contractual salary *(C.I.T.* v.

Katrak 1937 I.T.R. 527). However, Para 20 of Part A of Sixth Schedule exempts gratuity from tax.

"Fees, commissions, perquisites or profits".–For the purposes of this section, there is no difference between commission which is wholly dependent upon work done and fixed salary upon a monthly footing. Fees, commissions, perquisites or profits may be in lieu of, or in addition to, regular remuneration, and include honoraria or purely voluntary payments. They are all as much taxable as regular salary or wages. But in order that a payment may be taxable as salary it is not enough that an employee would not have received it unless he had been an employee,–the payment must be a reward or return for his acting as an employee: "The Court must be satisfied that the service agreement was the *causa causans* and not merely the *causa sine qua non* of the receipt of the profit" *(Hochstrasser* v. *Mayes 38 T.C. 673, 707, 709 (H.L.), [1961] 42 I.T.R. 457, 472, 474)*. Thus in *(Hochstrasser* v. *Mayes 38 T.C. 673 [1961] 42 I.T.R. 457)* where an employee entered into a collateral agreement with his employer for housing assistance, under which the employer indemnified the employee against the loss incurred on sale of his house when he was transferred to a new place of work, the amount paid under the indemnity was held by the House of Lords to be not taxable as profit from employment.

A special allowance or benefit, or perquisite within Para 5 of Part A of Sixth Schedule is exempted.

In the leading case of *Ryall* v. *Hoare 8 T.C. 521*, the director of a company personally guaranteed a loan on an overdraft account to the company and the company gave the director a commission of 2 per cent on the amount guaranteed. It was held to be a profit of employment. Such commission would be taxable under s. 21 if the director is an employee of the company and under s. 33 if the director is merely an office-holder. Another instance of commission taxable under s. 21 would be commission voluntarily paid by a company to its employee director for negotiating the sale of a branch of the company's business *(Mudd* v. *Collins 9 T.C. 297)*.

Where a company allots its shares to its employees at face value when the market rate is higher, the difference between the par value actually paid for the shares and the market value is taxable as a profit of employment *(Abbott* v. *Philbin 39 T.C. 82 (H.L.), [1962] 44 I.T.C. 144; and Bentley* v. *Evans 39 T.C. 132)*.

Cl.(b). "Perquisite".–"perquisite" is defined in the Oxford English Dictionary as "any casual emolument, fee or profit attached to an office or position, in addition to salary or wages." Perquisites and profits may take a variety of forms: e.g., extra payment, voluntary or stipulated, for something done outside the duties of office *(Mudd* v. *Collins 9 T.C. 297)*; a money allowance for plain clothes given to a detective officer *(Ferqusson* v. *Noble 7 T.C. 176)*; lodging allowance *Nagley* v. *Spilsbury 37 T.C. 178;* Payment by the employer of lighting, heating and telephone charges and other outgoings in respect of the employee's residence *(Nicol* v. *Auslin 19 T.C. 531)*; insurance premia paid by the employer on an endowment policy ensuring an annuity to the employee on his retirement *(Richardson* v. *Lyon 25 T.C. 497)*; lump sum bonus *(Weston* v. *Hearn 25 T.C. 425)* or bonus calculated with reference to the

net profits of the company *(M'Donald* v. *Shand 8 T.C. 420);* voluntary or contractual benefit-payment made to professional football-players by way of addition to remuneration for their services *(Corbett* v. *Duff 23 T.C. 763, 1942 I.T.R. Suppl. 55);* a lump sum paid to a director in consideration of his withholding his intended resignation *(Cameron* v. *prendergast 1940 I.T.R. Suppl. 75, 23 T.C. 122 (H.L.));* allowance paid to meet the extra cost of living in a foreign country *(Robinson* v. *Corry 18 T.C. 411, 422)* or for the maintenance and education of the employees' children *(C.I.T.* v. *Manry 1942 I.T.R. 205).* But in order that the employee may be taxable, the perquisite must accrue to *him.*

Where goods presented by an employer are taxed as a perquisite in the hands of the employee, the value to be taxed is not their cost to the employer but their value to the employee, i.e., the price the employee would get if he sold them second-hand *(Wilkins* v. *Rogerson 39 T.C. 344 (C.A.), [1963] 4 I.T.R. 395).*

Under Sec. 2(95) "perquisite" includes certain items, in *addition* to what that word means under the general law. In *Tennant* v. *Smith* the House of Lords held that a benefit which was not capable of being converted into money–*e.g.* the right to occupy premises rent-free–was not a perquisite. This sub-section marks a departure from that principle of general law. The various benefits and amenities set out in this sub-section should all be regarded as perquisites, *whether they are convertible into money or not.*

Clauses (a) and (b) bring to charge as a perquisite the value of rent-free accommodation or the value of any concession in the matter of rent respecting any accommodation provided to the assessee by his employer.

Cl. (c) brings to charge any sum payable by the employer, whether directly or indirectly, to effect an insurance on the life of employee, or to effect a contract for an annuity for the benefit of the employee or of the spouse or any of dependent child.

Cl. (d) taxes the value of any benefit provided free of cost or at a concessionaire rate, such as, medical expenses, subject to certain limitation.

Cl. (e) brings to charge any sum paid by an employer in respect of any obligation of an employee, such as, club bills etc.

"Rule 33 sub-sec. (1). **Valuation of perquisites, allowances benefits.**–(1) For the purpose of computing the income chargeable under the head "salary", the value of perquisites, allowances and benefits includable in the said income shall be determined in accordance with the provisions of the rule 33A to rule 33J, whichever is applicable.

(2) For the purpose of determining the value of perquisites, allowances and benefits under sub-rule (1),–

(a) "basic salary" means the pay and allowances payable monthly or otherwise, but does not include–

(i) dearness allowance or dearness pay unless it enters into the computation of superannuation or retirement benefits of the employee concerned;

(ii) employer's contribution to a recognised provident fund or a fund to which the Provident Funds Act. 1925 (XIX of 1925), applies and the interest credited on the accumulated balance of an employee in such fund:

(iii) allowances which are exempt from the payment of tax: and

(iii) allowances, perquisites, annuities and benefits referred to in sub-rule (1):

(b) "employee" includes a director of a company working whole time for one company.

Note.–Certain amendments have been made in the rules by S.R.O. No. 200-Law/2000 dt. 3rd July 2000 as noted below:

(i) in rule 33(2)(b) the definition of employee as amended excluded share-holder director of a company from the definition of "employee". But without making any amendment in sec. 2(28) giving definition of "employee", this amendment in the rule does not appear to be lawful and it should not have any legal effect as being *ultra vires* the Ordinance.

(ii) amendments have been made in rule 33(a) and 33(c) by increasing the exemption limit (See respective rules).

(iii) rule 33 has been substituted which reads as "where the conveyance is provided by the employer for the use of the employee partly or exclusively for personal or private purposes, there shall be included in the employee's income, an amount equal to five per cent of the employee's basic salary."

(iv) rule 33(f) has been omitted.

33A. **House rent allowance receivable in cash.**–Where the house rent allowance is receivable by the employee in cash, the amount, if any by which the house rent allowance so receivable exceeds fifty per cent of the basic salary of Taka 5,000 (increase to Tk.10,000) per month, whichever is less, shall be included in his income.

33B. **Rent free accommodation.**–(1) Where the employee is provided with rent free unfurnished accommodation, the rental value of the accommodation or twenty per cent of the basic salary of the employee, whichever is less, shall be included in his income.

(2) Where the employee is provided with rent free furnished accommodation, the rental value or the accommodation or twenty five per cent of the basic salary of the employee, whichever is less, shall be included in his income.

(3) Where the accommodation is provided to the employee at a concessional rate, the difference between the rent actually paid by him and the amount determined to be includable in an employees' salary under sub-rules (1) or (2) shall be added to his income.

33C. **Conveyance allowance receivable in cash with no conveyance facility.**–Where no conveyance is provided by the employer and the conveyance allowance is receivable by the employee in cash, the allowance so receivable in excess of Taka. 5,000 (increase to Tk.12,000) shall be included in his income.

33D. **Conveyance provided exclusively for personal or private use.**–Where the conveyance is provided by the employer for the use of the employee exclusively for personal or private purposes, there shall be included in the employee's income, an amount equal to seven and a half per cent of the employee's basic salary.

(*Note.*– See amended rule as given before).

33E. **Additional conveyance allowances.**–Where any allowance is receivable by an employee in addition to the perquisite mentioned in rule 33D, the whole amount of such allowance plus the amount determined under rule 33D shall be included in his income.

33F. **Conveyance used partly for personal and partly for business purposes.**–Where the conveyance is used by the employee partly for his personal and partly for business purposes, there shall be included in his income, an amount equal to five per cent of the employee's basic salary. *(The rule has been omitted by an amendment vide S.R.O. No. 200-Law/2000 dt. 3rd July 2000).*

33G. **Free or concessional passage for travel abroad or within Bangladesh.**–(1) Where free or concessional passage for travel abroad or within Bangladesh is provided by the employer to an employee (including

the members of his house-hold and dependants), there shall be included in the income of the employee,–

(i) Where the passage is provided in accordance with the terms of employment, an amount equal to the sum by which the cash payments, if any, made by the employer exceeds the actual expenditure incurred by the employee; and

(ii) Where the passage is not in accordance with the terms of employment, the whole or the amount paid in cash, if any, or if no cash payment is made, the amount which would have been expended by the employee had the free or concessional passage, as the case may be, not been provided by the employer.

Provided that where free concessional passage for travel abroad is availed or by the employee more than once in two years, the whole of the amount paid to him in cash, if any, for such additional passage or if no cash payment is made, the amount which would have been expended by him, had the additional passage not been provided by the employer, shall be included in his income.

(2) Where the transport is provided free of cost or at a concessional rate by an undertaking engaged in the transport of passengers or the carriage of goods to any employee of the undertaking (including the members of his household and dependants) in any conveyance owned or chartered by the undertaking for the purpose of the transport of the passengers or carriage of goods, nothing shall be added in his income.

33H. **Entertainment allowance.**–Where any amount is payable to the employee by way of entertainment allowance, the whole of the amount so payable shall be included in his income. No addition on this account shall, however, be made if free, tea, coffee, beverages or the like thereof are provided at the office premises during the course of work.

33I. **Medical expenses.**–Where any amount is payable to the employee by way of hospitalisation or medical expenses, the amount, if any, by which the sum receivable by him exceeds the actual expenditure incurred by him shall be included in his income.

33J. **Other benefits.**–Where any benefit or annuity not covered by the provisions of rule 33A to rule 33I is provided to the employee, the members of his household or his dependants, there shall be included in his income an amount equal to the amount which would have been expended

by the employee in obtaining such benefit or annuity from an independent source in the same or near locality, had it not been so provided, as reduced by the amount, if any, expended wholly, necessarily and exclusively in the performance or the duties of the office held by him or actually paid by him in cash.

Sec. 2(50) –Profits in lieu of salary.–

Cl. (a)–Compensation for termination of employment or modification of terms of employment.–Compensation for loss of employment or modification of terms of employment is a capital receipt under the general law. But this clause brings to charge as profits in lieu of salary any compensation due or received from an employer or former employer at or in connection with the termination of employment or modification of its terms. See *ante* under s. 16 "Compensation for loss of office or employment, or for cessation of business".

Cl. (b) –**Payments from provident fund.**–This clause provides that any payment due to or received by an assessee from a provident or other fund (not being an approved superannuation fund) is, to the extent to which it does not consist of contributions by the assessee or interest on such contributions, a profit of employment. Thus, generally speaking, only the sum representing the employer contributions and the interest on such contributions *(C.I.T. v. Bombay Burma Trading Corpn. 1933 I.T.R. 152)* is brought to tax. It is immaterial whether the payment from the fund is made during or at the termination of the employment.

The words "due to or received by an assessee" show that like all other types of remuneration taxable as salary, payments from provident funds are also taxable on accrual or on receipt basis. But in case the employee is paid the accumulated balance standing to his credit in a recognised provident fund, he would be entitled in certain circumstances to the exemption granted by Para 6 of Part B of First Schedule. Since payment from a provident or other fund may be taxed as the income of the year in which it is due or paid, it may result in assessment of the employee at a rate higher than would have been the case otherwise, in which event relief may be granted under Para 5 of Part B of Sixth Schedule.

Exemption is granted in respect of the following receipts which may otherwise be taxable as salary:-

(a) gratuity received (Para 20 of Part A of Sixth Schedule);

(b) any payment from a provident fund to which the Provident Funds Act, 1925, applies (Para 4 of Part A of Sixth Schedule);

(c) the accumulated balance due to an employee participating in a recognised provident fund, provided in (Para 6 of Part B of First Schedule); and

(d) any payment from an approved superannuation fund made by way of refund of contributions on the death of a beneficiary (Para 6 of Part A of Sixth Schedule).

Sec. 22. Interest on securities. –The following income of an assessee shall be classified and computed under the head "Interest on securities", namely:-

(a) interest receivable by the assessee on any security of the Government; and

(b) interest receivable by him on debentures or other securities of money issued by or on behalf of a local authority or a company.

Scope of the section. Sec. 22.–This section deals with interest on securities issued by (i) the Government, (ii) a local authority and (iii) a company. Debentures or other securities for money issued by a local authority or a company fall within this section. All other securities, e.g. securities issued by a foreign Government, are outside the ambit of this section, and the interest thereon would fall to be charged under Sec. 28 (income from business or profession) or under section 33 (income from other sources) –*Central Exchange Bank Ltd.* v. *C.I.T. [1955] 27 I.T.R. 167*. The shares of a company cannot be called securities for money–*Singer* v. *Williams 7 T.C. 419*. Dividends on shares are taxable under the residuary head, Sec. 33 (See Sec. 33).

Securities held as trading assets.–Interest on securities is a separate head of charge, dealt with by this section. Therefore, as the Supreme Court of India held in *United Commercial Bank Ltd.* v. *C.I.T. [1957] 32 I.T.R. 688*, even if the securities are held as trading assets or dealt with in the course of business, *e.g.* by a banker or dealer in securities, the interest must be charged under the specific head and computed in accordance with the provisions of this section, and not under s. 28 as business profits *See also Kothari* v. *C.I.T. [1951] 20 I.T.R. 579*. (See under s. 20, "Income-tax is only one tax", and under sec. 24 "Property held as a business asset"). Similarly, interest on tax-free securities which is exempt from charge under this section cannot be taxed as business profits under s. 28 even if the securities are held as trading assets–*Hyghes* v. *Bank of New Zealand 1938 I.T.R. 541 (C.A.), 636 (H.L.)*.

Interest "receivable".–Under this section the tax is payable in respect of interest "receivable" by the assessee on securities. The Bombay High Court held in *Lalbhai Dolpatbhai* v. *C.I.T. ([1952] 22 I.T.R. 13)* that the word "receivable" has reference to the quantum of interest taxable and not to the date of taxability, and that if interest is actually received some time after it becomes due and "receivable", the date of taxability is the date when it is received and not the date when it becomes due. Chagla, C.J., said: "Interest or securities only becomes income when it is actually received and not when it is due or capable of being received by the assessee". The Madras High Court has taken the same view in *Karumuthu Chettian* v. *C.I.T. ([1953] 24 I.T.R. 593)*. It is said, "the expression interest receivable", in our opinion, is used to denote that in computing the income for the purpose of this section the amount of interest calculated as per the terms of the security or the debenture should be taken into account, though, in fact, the assessee might have received a lesser amount in view of the deduction provided for under sec. 18(3) of the old Act."

Securities sold cum-interest: No apportionment of interest.–Interest on securities does not accrue from day to day but on certain fixed days, i.e. it is deemed to arise on the day when it is due for payment. Where securities are purchased at a price expressed as a capital sum plus interest computed from the last date of payment of interest to the date of sale, the purchaser is assessable on the whole amount of interest received by him on the next due date and he is not entitled to any deduction in respect of the interest paid by him to the vendor *(Haveli Shah Sardari Lal* v. *C.I.T. 1936 I.T.R. 297)*. For the same reason, the seller of securities cum-interest is not assessable on the amount he receives in respect of interest from the purchaser. "The truth of the matter is that the seller does not receive 'interest', and 'interest' is the subject-matter of taxation. He receives the price of the expectancy of interest, and that is not the subject of taxation."–*Wigmore* v. *Thomas & Sons Ltd. 9 T.C. 577, 581.*

Even if the sale takes place on the eve of the payment of interest, the purchaser would still be chargeable in respect of the interest –*Thompson* v. *Trust & Loan Co. of Canada 16 T.C. 394*, and not the seller. This rule must, however, be read subject to the provisions of s. 106 which hits those who seek to avoid tax by systematic sales of securities cum-interest. Under that section the Deputy Commissioner of Taxes may, in certain circumstances, deem the interest on securities to accrue from day to day and tax the seller on that basis. *(Vide,* further, notes to s. 106 *post)*.

The principle that interest on securities must be regarded as wholly the income of the person who happens to be the owner at the time when the interest becomes due, irrespective of whether he was the owner throughout the period for which the interest is paid.

Tax-free securities–Exemption in respect of interest from securities.–Interest on the securities of the Government which are issued and declared as tax-free is exempt from income-tax. The security holders are not liable to pay any tax on the interest from such securities and the interest will not be included in the computation of total income of the assessee–Para 24 of Part A of Sixth Schedule.

Under Paragraph 12 of Part A of Sixth Schedule interest of other securities issued by Government, but not declared as tax-free, is exempt up to the amount not exceeding five thousand taka (Para 12 of Part A of Sixth Schedule). This exemption is applicable only in the case of individual assessee.

Under Para 13 of Part A of Sixth Schedule interest on debentures which are approved by the Securities and Exchange Commission is exempt from tax upto twenty thousand taka. This exemption is available for all classes of assesses excepting company.

It has been also provided that if any assessee has both interest on securities as referred to in Para 12 and interest on debentures the total exemption shall not exceed twenty thousand taka.

Tax-free Commercial Securities.–Where tax-free commercial securities are issued by companies, the income therefrom is not actually free from tax, but the tax is

paid by the company issuing such securities on behalf of the security holders. The amount of income which is received by the security holders is, therefore, the net amount to which the tax paid by the companies will be added for the purpose of assessment.

Deduction of tax at source.–The person responsible for paying interest on securities must deduct tax (s. 51) at the maximum rate. Sub-section (2) of Sec. 51 permits payment of interest without deduction of tax or with deduction of tax at a lesser rate where a certificate is granted by the Deputy Commissioner of Taxes to the effect that the total income of the assessee will be minimum liable to tax or will be liable to tax at a rate less than the maximum.

The provision for deduction of tax at source shall not apply in cases of interest on debentures issued by a local authority or a company.

Relief for arrear of interest on securities.–When interest on securities relating to more than one year is received in one income year and for which the income is to be assessed at a rate higher than that at which it would otherwise have been assessed the Deputy Commissioner of Taxes may spread such income from interest on securities over such period to which it relates and make assessment accordingly (See 172 (d)).

Sec. 23. Deductions from interest on securities.–(1) In computing the income under the head "Interest on securities", the following allowances and deduction shall be made, namely:-

(a) any sum deducted from interest by way of commission or charges by a bank realising the interest on behalf of the assessee;

(b) any interest payable on money borrowed for the purpose of investment in the securities by the assessee:

[Provided that no allowance or deduction on account of any interest or commission paid under clause (a) or (b), as the case may be, in respect of, or allocable to the securities of Government which have been issued with the condition that interest thereon shall not be liable to tax, shall be made in computing the income under section 22].

(2) Notwithstanding anything contained in sub-section (1), no deduction shall be allowed under this section in respect of any interest payable outside Bangladesh on which tax has not been paid or deducted in accordance with the provisions of Chapter VII.

Permissible deductions.–This section permits two deductions from interest on securities–(i) collection charges and (ii) interest on moneys borrowed for investment in the purchase of securities.

(i) *Collection charges.*–When the interest is collected through bank the amount of bank commission or bank charges as claimed by the bank for realising the interest on securities on behalf of the assessee. An assessee who is collecting the interest himself on his own behalf cannot charge a fee for his labours and claim to deduct it from the interest received–*United Commercial Bank Ltd.* v. *C.I.T. [1953] 24 I.T.R. 425.*

(ii) *Interest on money borrowed for investment.*–The section permits a deduction in respect of any interest *payable* (whether paid or not) on money borrowed by the assessee for the purpose of investment in securities. The result is that income-tax is payable on the amount of the interest on securities less the interest which the assessee has to pay on the money borrowed to make the investment –*(C.I.T.* v. *Madras Provincial Co-op. Bank Ltd. 1942 I.T.R. 490, 499).* To entitle the assessee to the deduction, the money must have been borrowed for the purpose of investment in the securities and not for any general or other purpose. Where moneys are borrowed for the purpose of business and not of investment in securities, even if the moneys are invested in securities for a period under legal compulsion, no deduction can be claimed under this section–*(Indian Steamship Co. Ltd.* v. *C.I.T. [1953] 24 I.T.R. 448).* The deduction is permitted without any qualification or exception if the interest on the borrowed money is payable in Bangladesh.

Proviso to Sec. 23.–An assessee who pays no tax on securities which are issued tax-free or are otherwise exempt from tax, cannot claim a deduction under this section in respect of the interest paid by him on moneys borrowed for the purpose of investment in such securities, so as to adjust such a deduction against the interest on taxable securities or to claim a loss under the head of interest on securities–*(C.I.T.* v. *Madras Provincial Co-op. Bank Ltd. 1942 I.T.R. 490).*

Sub-sec. 2. Interest payable outside Bangladesh.–This sub-section provides that if the interest is payable outside Bangladesh and is chargeable under this Ordinance in the hands of the lender (e.g. under s. 17), it is not a permissible deduction unless tax has been paid or deducted at source in respect of such interest. This restriction on the deduction of interest payable to the lender outside Bangladesh and chargeable under this Ordinance is evidently inserted to counteract evasion of the tax payable by the lender in respect of the interest he receives.

It is not always necessary that securities will accrue profit. There may be a loss under this head if the interest paid on borrowed capital for investment in securities exceeds the interest received on securities. Such a loss can be set-off against income under other heads.

Income from House Property- Sec. 24 and 25

Sec. 24. Income from house property.–(1) Tax shall be payable by an assessee under the head "Income from house property" in respect of

the annual value of any property consisting of any building and lands appurtenant thereto of which he is the owner, other than such portions of the property as he may occupy for the purposes of any business or profession carried on by him, the income from which is assessable to tax under this Ordinance.

(2) Where any such property as is referred to in sub-section (1) is owned by two or more persons and their respective shares are definite and ascertainable, such persons shall not constitute and shall not be deemed to be, an association of persons; and for the purpose of computation of the income of an assessee in respect of that property, only such part of such income as is proportionate to the share of the assessee shall be reckoned as his income from that property.

Sec. 25. Deductions from income from house property.–(1) In computing the income under the head "income from house property" the following allowances and deductions shall be made, namely:

(a) any sum payable to Government as land development tax or rent on account of the land comprised in the property;

(b) the amount of any premium paid to insure the property against risk of damage or destruction;

(d) where the property is subject to mortgage or other capital charge for the purpose of extension or reconstruction or improvement, the amount of any interest payable on such mortgage or change;

(e) where the property is subject to an annual charge not being a capital charge, the amount of such charge;

Explanation.–The expression "annual charge", as used in this clause, includes any tax leviable, in respect of property or income from property, by local authority or Government but does not include the tax leviable under this Ordinance;

(f) where the property is subject to a ground rent, the amount of such rent;

(g) where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capita;

(h) an amount equal to one-fifth of the annual value of the property in respect of expenditure for repairs, collection of

rent, water and sewerage, electricity and salary of darwan, security guard, pump-man, lift-man and caretaker and all other expenditure related to maintenance and provision of basic services, in case evidences of such expenditure are not furnished by the assessee:

Provided that the amount of total deductions under this clause shall be upto one-fourth of the annual value of the property if evidences of the above expenditure are produced and found correct on verification;

(j) where, the whole of the property is let out and it was vacant during a part of the year, a sum equal to such portion of the annual value of the property as is proportionate to the period of the vacancy;-and

(k) where, the property is let out in parts, a sum equal to such portion of the annual value appropriate to the vacant part as is proportionate to the period of the vacancy of such part.

(2) Notwithstanding anything contained in sub-section (1), no deduction shall be allowed under this section in respect of any interest or annual charge payable outside Bangladesh on which tax has not been paid or deducted in accordance with the provisions of Chapter VII.

Sec. 24. House property.–This section is confined to "buildings and lands appurtenant thereto" which may be conveniently called "house property" –*Probhat Chandra Barua* v. *C.I.T. 5 I.T.C. 1 57 I.A. 228 (P.C.).* Income derived from a Zamindari or from vacant plots of land falls to be charged not under this head, but under s. 33 ("Income from other sources"). Even in respect of house property no tax is payable under this section if the owner occupies the property for his residence purpose or for the purposes of his business or profession the profits of which are assessable to tax. The tax under this section is upon the owner, legal or beneficial, and not upon the occupant. It is levied not upon the actual income from the property but upon notional income represented by the annual value.

Property situate abroad.–Income from house property situate abroad should be assessed according to the provisions of this section, even though the property may have been acquired in the course of business–*Annamalai Chettiar* v. *C.I.T. 1944 I.T.R. 254.*

Annual value.–The annual value of property, which is the subject of charge, is defined in s. 2(3) as "the sum for which the property might reasonably be expected to let from year to year", that is, the sum for which the landlord could let the premises having regard to all the prevailing circumstances such as local conditions and the demand for house in that particular locality. Sub-Cl. (ii) provides that if the annual rent is in excess of the annual value, then annual rent shall be the annual value.

Though the tax under this head is a tax on income, it is not a tax upon rents but upon the inherent capacity of the hereditament to yield profit. The tax is charged on the artificial or notional income, even if in fact the owner receives no income whatever or even if there is no possibility of his receiving any income from the property. In *D.M. Vakil* v. *C.I.T. 1946 I.T.R. 298, 302* and *also Sir Currimbhoy Ebrahim Baronetcy Trust* v. *C.I.T. [1963] 48 I.T.R. 507*, the trustees of a will were taxed on the annual value of the trust property, though by the provisions of the will they could not let the property to any one but were obliged to give it rent-free for occupation to certain beneficiaries. Kania, Ag. C.J. said, "The liability arises from the fact that the assessee is the owner of the property ..... The liability to tax does not depend on the power of the owner to let the property, as it also does not depend on the capacity of the owner to receive the *bona fide* annual value of the property."

Where the property is let and rent is received by the landlord the annual value may be more or less than the actual rent received *(Jamndas Prabhudas* v. *C.I.T. [1951] 20 I.T.R. 160)*, for the annual value is only a hypothetical sum. As Rankin, C.J., said in *Krishna Lal Sil*, In re *I.L.R. 60 Cal. 357, A.I.R. 1932 Cal. 886, 6 I.T.C. 293, 297*, "the house may have been let cheap or dear, the lease may be eighty years old or a thing of yesterday, personal relations or business relations may have led to exceptional terms as to rent. But in general at least, the actual terms obtained by the landlord in the particular case are some evidence of 'the sum for which the property might reasonably be expected to let from year to year.'"

In so far as the actual bargain made by the landlord with his tenant may be considered as *prima facie* though not conclusive evidence of the annual value, it is necessary to take into account the whole of the consideration exacted by the landlord for the right to use and occupy the property. For instance, where the tenant agrees to pay the municipal taxes payable by the landlord, the total consideration paid by the tenant is the net rent plus the municipal taxes, and that is the figure which may be taken as evidence of the annual value–*Lalla Mal Samgham Lal* v. *C.I.T. 1936 I.T.R. 250 (F.B.)*. Similarly, any premium originally paid by the lessee would have to be taken into account, and also the interest thereon–*Davies* v. *Abbott 11 T.C. 575*.

If the property is let for a certain period of years at an increasing or decreasing rent, the annual value may be arrived at by averaging, but averaging is not the only legitimate method of calculation in such cases *(I.R.* v. *Dickson's Executors 14 T.C. 69)*. Where the property consists of a number of stalls let out at a small daily rental, the annual value of each of the stalls must be ascertained, and the amount of the annual values of the stalls taken in the aggregate would be liable to assessment under this section. Whether the annual value is the daily letting value multiplied by 365 is a question of fact to be determined by the Deputy Commissioner of Taxes upon the circumstances of the case.

In cases where the actual consideration received by the landlord from his tenant does not represent the annual value, evidence of such annual value may be afforded by the rents paid for similar and similarly situated properties in the locality–*Lalla Mal Samgham Lal* v. *C.I.T. 1936 I.T.R. 250 (F.B.)*. The actual sum expended in the erection of the building is also a relevant, though a remote,

consideration–*Diwan Chand* v. *C.I.T. 1933 I.T.R. 218.* Valuation by the municipality or other local authority may be *prima facie* taken to be the correct annual value, but evidence may be given to show that it is wrong–*Jamnadas Prabhudas* v. *C.I.T. [1951] 20 I.T.R. 160.* Annual value of house property should be computed on the basis of bilateral lease agreement and not on the basis unconfronted Inspector's report–(I.T.A. No. 4410 of 1994-95).

In a case assessee let-out her property at Tk. 48,000 annually to a party who sub-let it at an annual rent of Tk. 1,80,000. I.T.O. Completed assessment taking BAV at Tk. 48,000. IJCT reopened the case under sec. 34A (old Act) and directed to make a fresh assessment taking BAV at Tk. 1,80,000. Appellate Division of the Supreme Court Set-aside the assessment with observation that an enquiry may be made to ascertain whether the lessee are embraced within the definition of business, and if it is found to include business, the lessee may be separately assessed as such, and the owner will be assessed under the head, "income from property" taking annual value at Tk. 48,000–*Zebunnesa* v. *C.I.T. (North) Dhaka. 1983 BTD XV 37.*

In arriving at the annual value, no deduction should be made on account of rates or taxes payable by the owner to the municipality or the Government, or on account of other outgoings.

Actual rent higher than annual value.–Sub. Cl. (ii) of Cl. (a) of Sec. 2(3).–The assessment under this head covers the whole liability to tax under this Ordinance as far as ownership of the premises is concerned. A hereditament may be let in fact at a higher rent than the amount (*viz.* the annual value) which is assessed under this section. In that case, the excess is a profit which will be taken as annual value for the purpose of computation of income under this section-Sub. Cl. (ii) of Cl. (a) of Sec. 2(3). Under this clause the excess of the actual rent over the annual value has been brought to charge.

Self–occupied property.–Under the old Act the owner of the property occupying it for the purpose of his residence would be liable to tax which provided the mode of computing the annual value of such self-occupied property for residence of the owner. Under this Ordinance the owner of the self-occupied property for residence is not liable to pay any tax for such property.

Meaning of self-occupied property for residence.–Relying on the judgment in the case of King v. the inhabitants of North Curry, Lord William J., in the Calcutta Stock Exchange Association Ltd. in re [1935] 8 I.T.R. 105, 110-111 (Cal) defined residence in the following manner:-

"In my opinion, the word residence in its simple ordinary meaning signifies the place where a human being eats, drinks and sleeps or where his family and servants eat, drink and sleep and where there is some permanence of such eating, drinking and sleeping.

In the same case the words 'own residence' have been discussed also and from the observation of Honourable Justice of the Calcutta High Court, it is clear that

the property being occupied by assessee's family also shall form part of his own residence.

The Learned Appellate Tribunal, Chittagong Addl. Branch in I.T.A. Nos. 306 of 1987-88 and 1179 of 1988-89 decided on 30.5.90 – 1996 BTD XXIV 56-60 discussed the meaning of family and came to a conclusion that the major sons and their families who again belong to the larger family of the assessee residing in separate rooms and flats and the assessee having derived no benefit from the flats for the use of his major sons other than the satisfaction of discharging parental obligation which is most common in our society, the entire building should be considered as a self-occupied property for his residence.

Property occupied for purposes of assessee's business or profession.–If the property, or a portion of it, (i) is occupied by the assessee for the purposes of his own business, profession or vocation, and (ii) the profits of such business, profession or vocation are assessable to tax, the annual value in respect of such property or portion of it is not taxable under this section. Nor is a notional rent allowed to the assessee in respect of the premises in computing the profits of the business, profession or vocation under s. 28. Depreciation on such property would be allowed under s. 29(1)(XVIII). Occupation by the assessee may be mediate and not immediate. In *C.I.T.* v. *National Storage Pr. Ltd. [1963] 48 I.T.R. 577* a company which was formed to carry on the business of storing films and which gave its vaults on leave and licence for storage of films and rendered substantial services to the licensees, was held to occupy the vaults for the purpose of its business. Residential quarters constructed by the assessee for, and let to, his employees, would be outside the scope of this section where the letting out is incidental to the assessee's business– *Jamshedpur Engineering & Machine Mfg. Co. Ltd.* v. *C.I.T. [1957] 32 I.T.R. 41.*

The fact that the amount received by the assessee from the business, profession or vocation for the purposes of which the premises are occupied is small compared to his income under other heads is wholly irrelevant in considering the question of exemption of the premises from charge under this section. The profits of such business, profession or vocation would necessarily have to be taxed under s. 28. If the Deputy Commissioner of Taxes wrongly brings the profits to charge under s. 33 instead of s. 28, that cannot deprive the assessee of the exemption from charge under this section *(Upper India Chamber of Commerce* v. *C.I.T. 1947 I.T.R. 263).*

Property held as a business asset.–Since a specific head of charge is provided for income from the ownership of house property, rents or other income from the ownership of house property cannot be brought to tax under any other head. Assessment under this head is not only proper but obligatory. (See under s. 20, "Income-tax is only one tax"). It makes no difference that the property constitutes the stock-in-trade of a business *(O.R.M. SP. SV. Firm* v. *C.I.T. [1960] 39 I.T.R. 327)*; or that it is the assessee's business to let out house properties *(Salisbury House Estate Ltd* v. *Fry 15 T.C. 266 (H.L.))*; the rents cannot be taxed under s. 28 as business income. House-owning, however profitable, is not a trade or business within the meaning of the Ordinance *(Salisbury House Estate Ltd.* v. *Fry 15 T.C. 266. 329 (H.L.))*. The fact that the owner is a company incorporated for the very purpose of

owning house property is immaterial: ownership itself is the criterion of assessment under this section and in no case does the Ordinance regard the income derived from ownership of buildings as profits of business *(Ballygunge Bank Ltd.* v. *C.I.T. 1946 I.T.R. 409)*. The Supreme Court of India held in *East India Housing & Land Development Trust Ltd.* v. *C.I.T. (1961 42 I.T.R. 49)* that a company incorporated with the object of promoting and developing markets was assessable under this section and not under s. 28 in respect of the rental income of market shops and stalls. In the case of *Commercial Properties Ltd.* v. *C.I.T. (A.I.R. 1928 Cal. 456 I.L.R. 55)* the assessee was a company of which the sole object and business was to acquire land, build houses and let the premises to tenants and its sole assets consisted of house properties. Held, the income from the properties was taxable under this section and not under s. 28 as profits of business. But there is a departure from this principle in a case where the assessee company is engaged in acquiring houses and letting them out on monthly rental for the purpose of earning profit upon which the company declared dividend and distributed it to its shareholders. Rental income of the assessee was held as income from business activities–*C.T. (Chittagong Zone)* v. *M/s. Free School Street Properties Ltd. (S.C. of Bangladesh) 1982 BTD X 173.*

However, as the House of Lords held in *Governors of Rotunda Hospital, Dublin* v. *Coman (7 T.C. 517)* and the Bombay High Court in *C.I.T.* v. *National Storage Pr. Ltd. (1963 48 I.T.R. 577)*, where the subject which is let or given on licence is not bare tenement but is a complex one, e.g. a well-equipped theatre, safe deposit vaults or vaults for storing and preserving films, including special devices, facilities and services, the income cannot be said to be derived from mere ownership of house property but may be assessable as income from business. Likewise, where a whole commercial concern is let out–e.g. a hotel, a jute press or a rice factory, including the building–the income may be assessed as income from business. See further, *post* under s. 28, "Income from letting out a business asset").

If an immoveable property is outside the ambit of this section, e.g. if it is land on which no building has been erected, any income derived from such land would be chargeable as profits of business under s. 28 if the land is held or acquired in the course of business, and in other cases under the residuary head (s. 33).

When the owner of property covered by this section grants licences to others to come upon his property, he is merely exercising his rights of ownership in the property just as much as when he grants a lease; and the licence-fees received by him cannot be charged as profits of business under s. 28 in addition to or in lieu of assessment under this section on the annual value *(C.I.T.* v. *National Storage Pr. Ltd. [1963] 48 I.T.R. 577)*.

Composite rent for premises and services or other rights.–If the owner of a property carries on upon the property some activities which result in profits and gains arising, not from the ownership of the property but from the owner's user thereof, those profits and gains may be chargeable under s. 28 as income from business, or under s. 33 as income from other sources *(C.I.T.* v. *National Storage Pr. Ltd. [1963] 48 I.T.R. 577)*. Thus if an owner holds a property for a business purpose and receives from his tenants rents which include charges for supplying fuel, cleaning

the premises or rendering other services, the owner would be chargeable under this section in respect of the annual value of the property and under s. 28 in respect of the profits he makes by rendering the services to the tenants *(Salisbury House Estate Ltd.* v. *Fry 15 T.C. 266 (H.L.))*. Similarly, where the demise includes goodwill, user of trade marks or other rights *(Shop Investments Ltd.* v. *Sweet 23 T.C. 38 [1940])*, the composite rent received from the tenant must be disintegrated by a separation of the element which relates to the hereditament from that which is attributable to the goodwill, etc.; and the latter part of the rent alone can be brought to charge as business profits under s. 28, or as income from other sources under s. 33 if the transaction does not amount to business. But the part assessable under s. 28 or 33 is not necessarily the balance of the composite rent after deduction of the amount assessable under this section (viz. the annual value of the property). In a case the Taxes Appellate Tribunal, Division Bench, Dhaka relying on the judgment in the case of *Kannai Properties Ltd.* v. *C.I.T. I.T.R. 1971* held that the building being let out for commercial purpose and the tenants carrying on commercial and business activity, income from the same should be assessed as business income under section 28–I.T.A No. 1995, 1996 and 1997 of 1995-96 decided on 8.8.98–1998 BTD XXVI 80 (Trib.).

Composite rent for machinery, plant or furniture and also building.–If an assessee lets on hire machinery, plant or furniture belonging to him and also buildings, the income from such letting may be assessable as business income (s. 28). If, however, it is not chargeable as business income, and the letting of the buildings is inseparable from the letting of the machinery, plant or furniture, the income must necessarily be assessed as income from other sources under s. 33(c) and in such a case there is no room for disintegrating the rent or assessing a part of the rent as income from house property (s. 24) –*C.I.T.* v. *Jagannatha Govindas [1962] 45 I.T.R. 61*.

Tax is in respect of ownership-owner.–The tax under this section is in respect of the ownership and not the occupation or possession of house property. Where the property is held in trust, the assessment under this section may be either on the trustee *(Sir Curmibhoy Ebrahim Baronetcy Trust* v. *C.I.T. [1963] 48 I.T.R. 507)* or on the beneficiary. (See also ss 95 and 97). Under the law of insolvency the estate of the insolvent vests in the Official Assignee, therefore the Official Assignee can be charged under this section as the "owner". But if a Receiver is appointed by the Court, the property does not vest in the Receiver and consequently no assessment can be made on the Receiver under this section *(Raja P.C. Lall Chowdhary* v. *C.I.T. 1948 I.T.R. 213)*, except in accordance with Sec. 95. Where the property is mortgaged, it is the mortgagor alone and not the mortgagee who can be charged as the owner *(Raja P.C. Lall Chowdhary* v. *C.I.T. 1948 I.T.R. 123)*. The Patna High Court has held that even in the case of a mortgage in English form executed in India the charge under this section must be on the mortgagor. That the mortgagor is the person liable to tax under this section is clear from the provisions of s. 25(1)(iii).

The owner of a building must be assessed under this section, even if he is not the owner but only the lessee of the land on which the building stands. This is made clear by the allowance in respect of ground rent under s. 25(1)(d). The person who builds a superstructure upon the land of another remains the owner of the

superstructure *(C.I.T. v. Madras Cricket Club 1934 I.T.R. 209)*. In *Ballygunge Bank Ltd. v. C.I.T. (1946 I.T.R. 409)* the assessee obtained a lease, for a period of forty years, of a plot of land, and built houses thereon. The lease-deed provided that upon the expiration of the period of the lease the houses should belong to the lessor. The Calcutta High Court held that during the currency of the lease of the land the assessee was the owner of the buildings and was assessable as such under this section. But the person who is a short-term lessee of a building is not assessable as "owner" under this section *(Gooptu Estates Ltd. v. C.I.T. 4 I.T.C. 146, 149)*. If he derives any income from sub-letting or re-letting, or from assignment of the lease, it may be assessable as "income from other sources" under s. 33 or 28.

The section applies even to those owners who are under certain restrictions with regard to the disposition of the properties *(Nawab Bahadur of Murshidabad v. C.I.T. [1955] 28 I.T.R. 510, 525)*. The word "owner" refers to *the owner of the property itself, and not the owner of its annual value (C.I.T. v. Dewan Krishna Kishore 1941 I.T.R. 695 (P.C))*. The Privy Council held that since an impartible estate is owned by the joint family though its income belongs to the estate-holder for the time being, in respect of house property comprised in an impartible estate the assessment should be on the Hindu undivided family as the owner and not on the holder who receives the income *(C.I.T. v. Dewan Krishna Kishore 1941 I.T.R. 695 (P.C.))*. Property belonging to the firm was assessable in the hands of the firm and not of its parties–1974 BTD 66 (Trib.).

The question of ownership is to be determined with reference to the accounting year; it is immaterial that the assessee has ceased to be the owner in the assessment year *(Behari Lal Mullick v. C.I.T. A.I.R. 1927 Cal. 553, 2 I.T.C. 328)*.

Title to ownership in dispute.–The mere existence of a dispute regarding the title to ownership of a certain property cannot of itself hold up an assessment even if a suit has been filed; otherwise it would be open to an assessee to delay assessment indefinitely by arranging for the institution of collusive proceedings. The Deputy Commissioner of Taxes has *prima facie* the power to decide whether the person sought to be taxed is the owner of the property (In re *Keshardeo Chamria 1937 I.T.R. 246, 258, affirmed, 1939 I.T.R. 394 (P.C.))*. In a case the title of the property is in the name of the wife of the assessee who made gift by a deed to her husband and children. From the finding of facts the Tribunal found that his wife is only a name-lender and the assessee is held to be the real owner of the property–*A.W. Mallik v. C.T. Dhaka (Sourth Zone) 1992 BTD 77-83*.

Assessment of co-owners. Sec. 24(2).–Where property is owned by two or more persons and their respective shares are definite and ascertainable, the co-owners should not be assessed in respect of their income from such property as an association of persons, but each co-owner must be assessed individually in respect of his share of the income *(C.I.T. v. Indira Balkrishna [1960] 39 I.T.R. 546 (S.C. of India))*. This sub-section would apply, for instance, in a case where the property is held by co-owners as tenants-in-common, or where a block of flats is held on "ownership" basis–i.e. each flat belongs to an individual owner. Even if the property is jointly possessed, jointly managed and jointly developed and there is not even a distribution

of the income earned, the provisions of this section would still be attracted if the shares of the co-owners are definite and ascertainable *(Abdul Rahman* v. *C.I.T. 1944 I.T.R. 302, 308)*.

Thus though the property may be possessed jointly by co-heirs under the Mahomedan law, the shares of co-heirs under that law are definite and ascertainable, and therefore each of the heirs must be separately assessed in respect of his share of the income taxable under this head *(Nizam-ud-din Amir-ud-din, In re, 1943 I.T.R. 443; See also Abdul Azeez & Bros.* v. *C.I.T. [1961] 41 I.T.R. 662 (Co-donees) and Biswa Ranjan Sarvadhikary* v. *I.T.O. [1963] 47 I.T.R. 927 (family members governed by Dayabhaga School of Hindu Law)*. But if litigation is pending to determine the question as to who are the heirs according to the personal law of inheritance, the assessment may be made as on an association of persons. The term "definite" means "fixed, exact and clear." And in a case where it cannot be said even as to how many heirs will eventually share the property, it is impossible to hold that the share of any heir is ascertainable and "definite" i.e. fixed or clear, so as to attract the provisions of this section *(Abdul Rahman* v. *C.I.T. 1944 I.T.R. 302)*.

Where the income of an individual includes under Sec. 43, the income from house property transferred to the spouse or a minor child, such individual is deemed to be the owner of the house property.

Exemptions and Relief.–Income from property held under trust for religious or charitable purpose is exempt from tax–sub-paragraph (1) of Para 1 of Part A of Sixth Schedule. Any income in respect of a building used for residential purpose construction of which was completed during the specified period is exempt for a period of five years upto a certain amount–Cls. (a-h) of Paragraph 14 of Part A of Sixth Schedule.

Relief in respect of irrecoverable rents has been granted by Circular S.R.O. 454-L/80 dt. 31.12.80 in respect of irrecoverable rent if the following conditions are fulfilled–(i) the tenancy is bonafide; (ii) the defaulting tenant has vacated the house or steps have been taken to compel him to vacate the house; (iii) the defaulting tenant is not in occupation of any other property of the assessee; (iv) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Deputy Commissioner of Taxes that legal proceedings would be useless, and (v) the annual value of the property to which the unpaid rent relates has been included in the assessed income of the year during which that rent was due and income tax has been duly paid on such assessed income.

Deductions–Sec. 25(1).–In computing income from House Property the following allowances as provided for in this sub-section are allowed from the annual value. This list of allowances is exhaustive.

(a) **Land Revenue.**–Any sum payable as land development tax or rent which is commonly known as land revenue to the Government on account of the land that comprised the property. This does not include municipal or local rates or taxes as imposed.

(b) **Insurance Premiums.**–Any annual premium paid to insure the property against risk of damage or destruction through any cause is allowed under this clause. It is only the actual premium paid that can be claimed as an allowance.

Cls. (d), (e) & (f) –Mortgage, capital or annual charge, ground rent and interest on borrowed capital.–These clauses provide for allowances in respect of (a) interest on any mortgage *(Cf. Gordhandas Mathuradas Matani* v. *C.I.T. [1963] 49 I.T.R. 449)* or other capital charge, (b) the amount of any annual charge which is not a capital charge, (c) the amount of any ground rent to which the property might be subject and (d) the amount of interest payable on any capital borrowed for acquiring, constructing, repairing, renewing or reconstructing the property. All these are permissible allowances without proof of actual payment of the amounts allowed *(C.I.T.* v. *Chowringhee Properties Ltd. 1947 I.T.R. 405 (P.C.))*.

Capital or annual charge.–The allowance under this section in respect of a charge on the property marks a departure from the general principle that no exemption from tax or deduction in the computation of income is permissible in cases of mere application of income *(C.I.T.* v. *State Bank of India [1957] 31 I.T.R. 545)*. (See under s. 16). "Application of income and its diversion by overriding title"). In order that the assessee may be entitled to a deduction under cl. (d) or (e) a charge must exist in law *(Bhagwan Radha Krishnaji* v. *C.I.T. [1962] 46 I.T.R. 74)* and it must be a legally enforceable charge, but it is immaterial for what purpose the charge was created *(Basant Lal* v. *C.I.T. 1933 I.T.R. 141)*, or whether it was created voluntarily or as a result of some legal obligation *(C.I.T.* v. *Bhayya 1949 I.T.R. 515)*. In *Prince Khanderao Gaekwar* v. *C.I.T. (1948 I.T.R. 294)* it was held that a legally enforceable charge created by the owner on his property for the payment of an annual sum to his mother would be an admissible deduction even if the charge was created voluntarily out of natural love and affection. Likewise, a voluntary charge created to secure payment of alimony to a wife is allowable under this clause *(C.I.T.* v. *State Bank of India [1957] 31 I.T.R. 545)*. But if the charge is not legally enforceable,–it cannot be the subject of an allowance under this section *(Basant Lal* v. *C.I.T. 1933 I.T.R. 141)*. Further, there must be an existing charge. Where under a statute or an agreement, a charge is not to arise unless and until default is made in payment of the amount due, and in fact there is no such default, there cannot be said to be any charge on the property and the benefit of this clause cannot be claimed *(Metro Theatre, Bombay, Ltd.* v. *C.I.T. 1946 I.T.R. 638)*.

Cl. (c) and Explanation thereto define "annual charge" and "capital charge" respectively an annual charge means a charge to secure an annual liability *(New Piecegoods Bazar Co. Ltd.* v. *C.I.T. 1950 I.T.R. 516 (S.C. of India))*; while a capital charge means a charge to secure the discharge of a liability of a capital nature. Thus if a debt is charged on the property, that would be a capital charge; but if the interest on the debt is charged on the property, that would be an annual charge. In either case the purpose for which the money was borrowed is immaterial. Annual charge involves two concepts: (a) an annual liability to pay and (b) the creation of a charge, express or implied, on the house property for the discharge of that liability: a liability which is in

law enforceable by seizure and sale of any property of the assessee but which is not charged on the particular house property would not amount to an annual charge *(Veerappa Chettiar* v. *C.I.T. [1959] 35 I.T.R. 322 (Mad.))*. If the charge is a capital one, only the amount of the interest thereon is allowed by cl. (d); while if the charge is an annual one, the amount of the charge itself is made the subject of the allowance under cl. (e).

In the explanation to cl. (c) annual charge as used in this clause includes any tax leviable in respect of property or income from property, by local authority or Government but does not include the tax leviable under this Ordinance.

Where the owner of the property is Hindu undivided family, a mortgage or other charge created by the family would secure an allowance under this sub-section. It was so held in *C.I.T.* v. *Bhayya (1949 I.T.R. 515. See also Kunwar Krishna Chandra* v. *C.I.T. [1961] 42 I.T.R. 137)* where the charge was in favour of a deceased coparcener's widow who was a member of the family but had no proprietary interest in the family properties. However, the family cannot claim an allowance in respect of a mortgage or charge created by any individual member or members on his or their shares only of such property.

Cl. (h)–Repairs, Collection charge etc.–Under this clause an amount equal to one-fifth, of the annual value of the property in respect of expenditure for repairs, collection of rent, water and sewerage, electricity and salary of darwan, security guard, pumpman, liftman and caretaker and other expenses required for maintenance of the house and to provide for basic services is granted even if no evidence for such expenditure is produced. The allowance, will be increased upto one-fourth of the annual value where evidences in support of the expenditures are produced and found correct. The allowance under this cl. has been increased to one-fourth of the annual value of the property by the Finance Act, 2000 by substitution of this clause. The newly inserted clause provides that an amount equal to one fourth of the annual value of the property in respect of expenditure for repairs, collection of rent, water and sewerage, electricity and salary of darwan, security guard, pump-man, lift-man and caretaker and all other expenditure related to maintenance and provision of basic services. The owner is entitled to the allowance of one-fourth of the annual value under this clause irrespective of the question whether any sum is actually expended for repairs and other purposes as mentioned, and also irrespective of any vacancies.

Irrecoverable rents.–It has been noted that tax under this section is imposed on the notional income of the property of the owner who might have less or no income whatsoever from property. So it does not matter whether rent is received or not. He has to pay tax even for unrealised rents also. But certain relief has been granted under item No. 18 of S.R.O. 454-6/80 dt. 31st December, 1980 by which the amount of rent payable by a tenant which is proved to be lost and irrecoverable is exempt from tax and is excluded in computing the total income of the assessee provided the following conditions are fulfilled:-

(i) the tenancy is bonafide;

(ii) the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;

(iii) the defaulting tenant is not in occupation of any other property of the assessee;

(iv) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Deputy Commissioner of Taxes that legal proceedings would be useless; and

(v) the annual value of the property to which the unpaid rent relates has been included in the assessed income of the year during which that rent was due and income-tax has been duly paid on such assessed income.

The concession given here appears to be an exemption but it is actually a deduction as that part of rent which will be irrecoverable and which has already been charged in the preceding year will be deducted from the total income in the subsequent year.

Annual charge or interest payable abroad–Sec. 25(2).–Annual charge or interest which would otherwise be deductible under this section (s. 25), is disallowed if it is payable abroad unless deduction of tax at source under the Chapter VII has been made or tax has been paid on such annual charge or interest in Bangladesh. The object of this sub-section is to counteract evasion of tax by the recipient of such interest on annual charge.

Sec. 26. Agricultural income.–(1) The following income of an assessee shall be classified and computed under the head "Agricultural income", namely:-

(a) any income derived by the assessee which comes within the meaning of "agricultural income" as defined in section 2(1);

(b) the excess amount referred to in section 19(17);

(c) the excess amount referred to in section 19(19).

(2) Agricultural income derived from the sale of tea grown and manufactured by the assessee shall be computed in the prescribed manner.

(3) Where the Board, by notification in the official Gazette, so directs, agricultural income from the sale of rubber, tobacco, sugar or any other produce grown and manufactured by the assessee may be computed in the manner prescribed for the purpose.

Sec. 27. Deductions from agricultural income.–(1) In computing the income under the head "Agricultural income", the following allowances and deductions shall be made, namely:-

(a) any land development tax or rent paid in respect of the land used for agricultural purposes;

(b) any tax, local rate or cess paid in respect of the land used for agricultural purposes, if such tax, rate or cess is not levied on the income arising or accruing, or deemed to accrue or arise, from agricultural operations or is not assessed at a proportion or on the basis of such income;

(c) (i) subject to sub-clauses (ii), the cost of production, that is to say, the expenditure incurred for the following purposes, namely:-

(a) for cultivating the land or raising livestock thereon;

(b) for performing any process ordinarily employed by a cultivator to render marketable the produce of the land;

(c) for transporting the produce of the land or the livestock raised thereon to the market; and

(d) for maintaining agricultural implements and machinery in good repair and for providing upkeep of cattle for the purpose of cultivation, processing or transportation as aforesaid;

(ii) where books of accounts in respect of agricultural income derived from the land are not maintained, the cost of production to be deducted shall, instead of the expenditure mentioned in sub-clause (i), be sixty per cent of the market value of the produce of the land;

(iii) no deduction on account of cost of production shall be admissible under this clause if the agricultural income is derived by the owner of the land from the share of the produce raised through any system of sharing of crop generally known as *adhi, barga or bhag*;

(d) any sum paid as premium in order to effect any insurance against loss of, or damage to, the land or any crop to be raised from, or cattle to be reared on, the land;

(e) any sum paid in respect of the maintenance of any irrigation or protective work or other capital assets; and such maintenance includes current repairs and, in the case of protective dykes and embankments, all such work as may be necessary from year to year for repairing any damage or destruction caused by flood or other natural causes;

(f) a sum calculated at the rate as provided in the Third Schedule on account of depreciation in respect of irrigation

or protective work or other capital assets constructed or acquired for the benefit of the land from which agricultural income is derived or for the purpose of deriving agricultural income from the land, if the required particulars are furnished by the assessee;

(g) where the land is subject to a mortgage or other capital charge for purposes of reclamation or improvement, the amount of any interest paid in respect of such mortgage or charge;

(h) where the land has been acquired, reclaimed or improved by the use of borrowed capital, the amount of any interest paid in respect of such capital;

(i) where any machinery or plant which has been used by the assessee exclusively for agricultural purposes has been discarded, demolished or destroyed in the income year, the amount actually written off on that account in the books of accounts of the assessee,–

(i) subject to the maximum of the amount by which the written down value of the machinery or plant exceeds the scrap value thereof if no insurance, salvage or compensation money has been received in respect of such machinery or plant; and

(ii) subject to the maximum of the amount by which the difference between the written down value and the scrap value exceeds the amount of insurance, salvage or compensation money received in respect of such machinery or plant;

(j) where any machinery or plant which has been used by the assessee exclusively for agricultural purposes has been sold or transferred by way of exchange in the income year, the amount actually written off on that account in the books of accounts of the assessee, subject to the maximum of the amount by which the written down value of the machinery or plant exceeds the amount for which it has been actually sold or transferred; and

(k) any other expenditure, not being in the nature of capital expenditure or personal expenditure, laid out wholly and

exclusively for the purpose of deriving agricultural income from the land.

(2) Notwithstanding anything contained in sub-section (1), no deduction shall be allowed under this section in respect of any interest on which tax has not been paid or deducted in accordance with the provisions of Chapter VII.

Agricultural income–Sec. 26.–Originally there was no corresponding section in the Income-tax Act, 1922 as agricultural income was exempt from tax. In 1976 a new section (Sec. 9A) was inserted in the 1922 Act by which agricultural income became chargeable to tax. Under that section both the cultivator and the landlord would have been liable to pay tax for agricultural income–cultivator would have to pay for his income from agricultural produce and the landlord for his income in respect of all rent and revenue, including any local cess or rates derived from land. This section subjects to tax only the income of the cultivator from agricultural produce directly derived from land by cultivation and from agricultural operations ordinarily carried on by the cultivator–(See *"Income from agricultural produce and from manufacturing process" ante* Sec. 2(1)).

Sub-section (1) of this section subjects to tax (i) agricultural income as is defined in Sec. 2(1) [See *ante* Agricultural income]; (ii) excess over written-down value upto the value of original cost of the plant and machinery used for agricultural purpose as and when disposed of [See Sec. 19(17) *ante*] and (iii) balancing charges for insured asset, like building, plant or machinery used for agricultural purposes, when discarded or destroyed [See Sec. 19(19) *ante*].

Sub-Secs. (2) and (3).–These sub-sections subject to tax agricultural income from the sale of tobacco, sugar and other products, tea grown and manufactured by the assessee which will be computed in the manner prescribed in Rule 31 and agricultural income from the sale of rubber, tobacco, sugar and other products grown and manufactured by the assessee which will be computed in the manner prescribed in Rule 30 and 32. In short, agricultural income consists of income from agricultural produce and from manufacturing process. So where the agricultural income is partly agricultural and partly from manufacture, the profits on the sales of manufactured products would have to be apportioned and the profits referable to the manufacturing process would be taxable as business profits while the balance referable to agricultural activities would be agricultural income to be taxed under this section (See further, "Income from agricultural produce and from manufacturing process).

Disintegration of income when income is partly from agricultural produce and partly from manufacturing process.–Board has prescribed rules which have laid down the manner how to determine income from business and agricultural income when income is partly agricultural and partly non-agricultural. It has also simplified the task of apportionment of profits in such cases.

Rule 30.–In the case of income, which is partially "agricultural income" and partially income from "business", in determining that part of income which is from

"business" the market value of any agricultural produce which has been raised by the assessee or received by him in kind and which has been used as raw material in such business or the sale proceeds of which are included in the accounts of the business shall be deducted and no further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of the produce in kind.

The above rule has been framed to supplement the provisions as laid down in sub-section (3) for computation of agricultural income when the income from the sale of products has both agricultural and non-agricultural elements, particularly, in the cases of tobacco, sugar and other products since specific rules have been framed for tea and rubber.

Rules 31 and 32.–Computation of income from sale of tea and rubber.–Income derived from the sale of tea and rubber grown and manufactured by the seller in Bangladesh shall be computed as if 40% of such income was derived from business and 60% of such income was derived from agriculture. The apportionment of profits in both the cases have been simplified by these rules.

In computing such income of tea from business an allowance shall be available and to be deducted in respect of the cost of planting bushes in replacement of bushes that have died or has become useless in an area already planted unless such area has previously been abandoned.

In addition to that allowance a further allowance shall be given in computing such income from tea or rubber in respect of the expenditure incurred in the income year by the assessee in connection with the development of new areas for bringing them under tea or rubber cultivation. The third proviso to Rule 31 and first proviso to Rule 32 have, therefore, provided that in the computation of income, both agricultural and non-agricultural, from tea and rubber respectively an allowance has been given in respect of the development of new areas either for tea or rubber cultivation from income of the produce before apportionment of profit.

Permissible deductions–Sec. 27.–Agricultural income shall be computed after making the following allowances–

(i) any land revenue, rent or tax paid in respect of the land used for agricultural purposes the income of which is subject to tax under Sec. 26 as agricultural income;

(ii) any tax, local rate or cess paid in respect of such land but such tax, rate or cess as mentioned in this clause shall not be deemed to authorise the allowance of any sum paid on account of tax, rate or cess levied on the income arising or accruing or deemed to arise or accrue from agricultural operations or assessed at a proportion of or otherwise on the basis of such income;

(iii) any expenditure incurred for the following purposes shall be taken as the cost of production which will be deducted:

(a) expenditure incurred in cultivating such land or raising livestock thereon;

(b) expenditure incurred in performing any process which is ordinarily carried on by the cultivator to render the produce of such land fit to be taken to the market;

(c) expenditure incurred in transporting such produce or livestock to the market; and

(d) expenditure incurred in maintaining agricultural implements and machinery in good repair and in providing for the upkeep of cattle, for the purpose of such cultivation, process or transport;

Provided that where no books of account have been maintained in respect of agricultural income, the allowances admissible for the cost of production as referred to in sub-clauses (a), (b), (c) and (d) above shall be sixty percent of the market value of the produce;

Provided further that where the agricultural income is derived according to the local 'barga', 'adhi' or 'bhag' system, the cost of production shall be limited to the share of 'bargadar' or 'bhagehasi' according to the local 'barga' or 'bhag' system, as the case may be and no further deduction shall be allowed towards the cost of production;

(iv) any expenditure incurred by way of premium paid in order to effect on insurance, against loss of or damage either to the crop or the land from which crops is to be raised or on which cattle is to be reared;

(v) any expenditure incurred towards the maintenance of any irrigation or protective work or other capital assets including current repairs of embankments and protective dams which may need repairing from year to year for damage caused by flood or other natural causes;

(vi) depreciation allowance at the rate prescribed in the Third Schedule in respect of irrigation or protective work or other capital assets required for the purpose deriving agricultural income from the land, in which case particulars of capital assets over which depreciation is charged are to be furnished;

(vii) an allowance in respect of any interest on any mortgage or other capital charge for the purpose of reclamation or improvement of the land paid in respect of such mortgage or charge;

(viii) the amount of interest paid on any capital borrowed for acquiring, reclamation or improvement of the land;

(ix) this clause grants a balancing depreciation in respect of any machinery or plant exclusively used by the assessee for agricultural purposes which has been discarded, demolished or destroyed in the income year the amount by which the written-down-value of the machinery or plant exceeds the scrap value if no insurance money or compensation has been received in respect of such machinery or plant. In case such assets are insured and the assessee receives insurance money or compensation the amount by which the difference

between the written-down-value and the scrap value that exceeds the amount of insurance money or compensation. It will be, therefore, the excess of written-down-value over the amount he receives by way of insurance money or compensation and the scrap value thereof;

(x) similarly, when such machinery or plant used by the assessee exclusively for agricultural purposes has been sold or transferred by way of exchange, the excess of the written-down-value as shown in the books of accounts over the sale-proceeds of such machinery or plant.

The benefit under the clauses (IX) and (X) cannot be claimed unless the amount of loss (balancing depreciation) has been actually written off in the books of accounts.

(xi) any other miscellaneous expenditure laid out wholly and exclusively incurred for the purpose of deriving agricultural income from land, but such expenditure must not be of a capital or personal nature.

Any expenditure by way of interest as referred to in clauses (VII) and (VIII) shall not be allowed unless tax on such interest has been paid or deducted as per the provisions of Chapter VII–Sub-Sec. 2.

An exemption for agricultural income for a sum not exceeding forty thousand taka has, however, been given in Paragraph 29 of Part A of Sixth schedule. It has been provided that an assessee, being an individual, whose only source of income is agriculture is exempt from tax for his income from agriculture upto forty thousand taka.

Income from business or profession

Sec. 28(1):–Income from business or profession–(1) The following income of an assessee shall be classified and computed under the head "Income from business or profession", namely: –

(a) profits and gains of any business or profession carried on, or deemed to be carried on, by the assessee at any time during the income year;

(b) income derived from any trade or professional association or other association of like nature on account of specific services performed for its members;

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

(d) the amount, the value of the benefit and the trading liability referred to in section 19(15);

(e) the excess amount referred to in section 19 (16);

(f) the excess amount referred to in section 19 (18);
(g) the sale proceeds referred to in section 19 (20);
(h) the amount of income under section 19 (23).

Explanation.– Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business (hereinafter referred to as "speculation business") shall be deemed to be distinct and separate from any other business.

(2) Notwithstanding anything contained in this Ordinance,–

(a) the profits and gains of any business of insurance and the tax payable thereon shall be computed in accordance with the provisions of the Fourth Schedule;

(b) the profits and gains from the exploration and production of petroleum (including natural gas) and the tax payable thereon shall be computed in accordance with the provisions of Part A of the Fifth Schedule;

(c) the profits and gains of any business which consists of, or includes, the exploration and extraction of such mineral deposits of a wasting nature (not being petroleum and natural gas) as may be specified in this behalf by the Government, carried on by an assessee in Bangladesh shall be computed in accordance with the provisions of Part B of the Fifth Schedule.

(3) Notwithstanding anything to the contrary contained in any other provisions of this Ordinance, in the case of Bangladesh Shilpa Bank, Bangladesh Shilpa Rin Sangstha, Investment Corporation of Bangladesh and any commercial bank including the Bangladesh Krishi Bank and Rajshahi Krishi Unnayan Bank, the income by way of interest in relation to such categories of bad or doubtful debts as the Bangladesh Bank may classify in the income year in which it is credited to its profit and loss account for that year or, as the case may be, in which it is actually received whichever is earlier.

Business or profession–Sec. 28(1): Scope. –Cl. (a) of this sub-section taxes the profits and gains of any business or profession carried on by the assessee. Under s. 2(49) "profession" includes vocation. In order that the section may apply, it is necessary that the business, profession or vocation should be carried on for some time during the accounting year, though not necessarily throughout that year. (See below under "Business should have been 'carried on' in the accounting year"). The section aplies only to those businesses the profits of which are assessable under the

Ordinance, though it is immaterial whether any taxable profits have actually been earned or not (*C.I.T.* v. *Somasundram Chettiar A.I.R. 1928 Mad. 487*). Businesses outside Bangladesh and businesses within Bangladesh are equally within the ambit of the section (*C.I.T.* v. *Indo-Mercantile Bank Ltd. [1959] 36 I.T.R. 1, 8-9 (S.C. of India)*.

This section does not require that the business should be carried on by the assessee personally. The owner of the business would be chargeable under this section though he may carry on the business not personally but through a manager or other servant or agent who is remunerated by a share of profits (*C.I.T.* v. *Hind Commission Agents [1963] 48 I.T.R. 615)*. The partner's share of the profit of a firm carrying on business is assessable under this section *(Mohanlal Hiralal* v. *C.I.T. [1952] 22 I.T.R. 448. See also Shantikumar Morarji* v. *C.I.T. [1955] 27 I.T.R. 69)*. Where a business is acquired for the benefit of a company which is going to be incorporated and the promoters carry on the business and earn profits during the period prior to the incorporation, if the company accepts the action of the promoters and receives from them the past profits made prior to its incorporation, the company may be assessed under this section in respect of such profit *(C.I.T.* v. *Bijli Cotton Mills Ltd. [1953] 23 I.T.R. 278, Contra, C.I.T.* v. *Tea Producing Co. of India Ltd. [1963] 48 I.T.R. 200)*. The tax is leviable on the person to whom the profits accrue or by whom the profits are received: no tax can be levied on a benamidar in whose name the business transactions are effected and who is not really entitled to the profits *(C.I.T.* v. *Thaver Bros. 1934 I.T.R. 230)*.

Where the Court intervenes and deprives the owner of the right to carry on his own business and authorises some one else to carry on the business, the owner would not be chargeable under this section, since he cannot be regarded as "carrying on" the business *(Saifudin Alimohamed* v. *C.I.T. [1954] 25 I.T.R. 237)*. Likewise, interim income payments made by the Government to a colliery company after nationalisation of the coal industry were held by the House of Lords not to arise from the carrying on of any business *(I.R.* v. *Butterley Co. Ltd. 36 T.C. 411)*. Guardians for minors or receivers or trustees may be assessed under the section in respect of the profits of the business carried on by them *(C.I.T.* v. *Balwantrai Jethalal Vaidya [1958] 34 I.T.R. 187; Razzak* v. *C.I.T. [1963] 48 I.T.R. 276; Saifudin Alimohamed* v. *C.I.T. [1954] 25 I.T.R. 237; Ramaswamy Iyengar* v. *C.I.T. [1960] 40 I.T.R. 377)*.

"Profits and gains"–Under s. 2(34) "income" includes profits and gains.

The charge is not on gross receipts but on profits and gains properly so called *(Probhat Chandra Barua* v. *C.I.T. 4 I.T.C. 1, (P.C.))*. Gross receipts or sale proceeds, however, include profits if the business of the year ends in profit, and therefore profits would be received at the time and place at which the gross receipts or sale proceeds are received *(Keshav Mills Ltd.* v. *C.I.T. [1953] 23 I.T.R. 230 (S.C. of India)*. The word 'profits' is to be understood," said Lord Halsbury in *Gresham life Assce. Society* v. *Styles (3 T.C. 185, 188 (H.L.))*, "in its natural and proper sense-in a sense which no commercial man would misunderstand". This principle was approved by the Privy Council in *Pondicherry Rly. Co.* v. *C.I.T. (5 I.T.C. 363, 370)* and by the Supreme Court of India in *Badridas Daga* v. *C.I.T. [1958] 34 I.T.R. 10, 15)*, *Calcutta*

Co. Ltd. v. *C.I.T. and C.I.T.* v. *Shirinbai Kooka.* Subject to the special requirements of this Ordinance, the profits to be assessed are the real profits *(C.I.T.* v. *Shoorji Vallabhadas & Co. [1962] 46 I.T.R. 144, 148 S.C. of India)* and they must be ascertained on ordinary principles of commercial trading and commercial accounting. However, the Ordinance has laid down certain rules to be applied in determining how the tax is to be assessed, and even if the result should be to tax as profits and gains what cannot properly be so called, the requirements of the Ordinance must nevertheless be complied with *(Gresham Life Assce. Society v. Styles 3 T.C. 185, 194 (H.L.).*

As Lord Parker said in *Usher's Wiltshire Brewery Ltd.* v. *Bruce (1915 A.C. 433, 458 (H.L.), 6 T.C. 399, 429)*, profits and gains imply "something in the nature of a credit and debit account, in which the receipts appear on the one side and the costs and expenditure necessary for earning these receipts appear on the other side. Indeed, without such account it would be impossible to ascertain whether there were really any profits on which the tax could be assessed ..... Where a deduction is proper and necessary to be made in order to ascertain the balance of profits and gains, it ought to be allowed ... provided there is no prohibition against such an allowance" *(Badrida Daga* v. *C.I.T. [1958] 34 I.T.R. 10, 15 (S.C. of India)).* Profits should be computed after deducting the losses and expense incurred for the purpose of the business, profession or vocation, though such losses and expenses may not be expressly allowed under Sec. 29, unless the losses and expenses are expressly or by necessary implication disallowed by the Ordinance s. 30, "List of allowances is not exhaustive", *See post.*

Profits chargeable under this head should be computed in accordance with the method of accounting regularly employed by the assessee,–e.g. accrual or receipt basis,–provided the real profits can properly be deduced from such method (s. 35). Reference may be made to the notes to s. 35 under the following headings:

"Computation of business profits",
"Profits of an isolated venture",
"Profit of trade in land and building",
"Opening value of stock-in-trade: Cost of acquisition",
"Cost where 'right' shares or bonus hares are issued",
"Capital investments converted into stock-in-trade",
"Valuation of trading stock in hand at cost or market value",
"Valuation of work in progress",
"Regular basis of valuation must be adhere to",
"Valuation of stock withdrawn from business",
"Sale at concessional price",
"Sale to limited company consisting of vendor as shareholder",
"Undervaluation or arbitrary valuation",

The gains of a trade are that which is gained by the trading, for whatever purposes it is used, –whether it is gained for the benefit of individual or gained for the benefit of a community by a public body *(C.I.T.* v. *Vyas & Dhotiwala [1959] 35*

I.T.R. 55 (S.C. of India)). Where a publishing house produced certain publications to assist a charitable association, and there was an understanding that all the profits of the venture were to be paid over to the association and in fact they were so paid over, the Revenue was nevertheless held entitled to tax the profits *(Hutchinson & Co. Ltd.* v. *Turner 31 T.C. 495. See further ante under s. 16, "Application of income ...".*

Isolated venture.– See under ss. 17 and 29, "Single transaction".

Receipt of profits in cash or kind.–Profits may be realised in money or in money's worth, in cash or in kind. (See under s. 16), "Income in money's worth or equivalent of cash").

Voluntary payments.–All revenue receipts arising from business or the exercise of a profession including vocation are chargeable under this section *(Leahy* v. *Hawkins 34 T.C. 28; Temperley* v. *Smith [1957] 31 I.T.R. 511, 37 T.C. 18)* even if they are of a casual and non-recurring nature. Payments voluntarily made by persons who are under no obligation to pay anything at all would be income receipt in the hands of the recipient if they are received in the course of business or in the exercise of a profession or vocation. Thus an amount paid to a lawyer by a person who was not a client but who was benefitted by the lawyer's professional services to another *(Susil c. Sen, In re, 1941 I.T.R. 261),* or shares gifted by a client to a partner of a firm of accountants who had assisted in the floatation of the company or tips given to a taxi owner-driver *(Calvert* v. *Wainwright 1948 I.T.R. Suppl. 54)*, would be taxable under this section. Customary offering made to the head of a faith by his devotees would be taxable, either under this section or under s. 33. "Voluntary payments":

Business or profession including vocation.–Business is defined by s. 2(14) as including "any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture". "Profession' involves the idea of an occupation requiring either purely intellectual skill, or if any manual skill, as in painting and sculpture, or surgery, skill controlled by the intellectual skill of the operator, as distinguished from an operation which is substantially the production or sale, or arrangements for the production or sale, of commodities" *(Stanwill & Co.* v. *C.I.T. [1952] 22 I.T.R. 316 (profession of auctioneer))*. A company may carry on a profession even as an individual *(I.R.* v. *Peter McIntyre Ltd. 12 T.C. 1006, 1014)*. All professions are businesses, but all businesses are not professions *(Christopher Barker & Sons* v. *I.R. [1919] 2 K.B. 222, 228)*. Thus the word "business" is a word of wider import than the word "profession," and "vocation" is a word of still wider signification than "business". In other words, what does not amount to "profession" may amount to "business", and what does not amount to "business" may amount to "vocation" *(Upper India Chamber of Commerce* v. *C.I.T. 1947 I.T.R. 263)*. In *Partridge* v. *Mallandaine* the word "vocation" was held to be "analogous to 'calling,' a word of wide signification, meaning the way in which a man passes his life" *(Krishna Menon* v. *C.I.T. [1959] 35 I.T.R. 48 (S.C.))*. A practice of religion may amount to "vocation" *(Govindlalji Ranchhodlalji* v. *C.I.T. [1958] 34 I.T.R. 92)*. It is not necessary to consider whether a particular activity amounts to business or profession or vocation, since for the purposes of assessment under the Ordinance profits from these three sources are treated and taxed alike under the same head. The section uses

here only the words "business" or "profession", since "profession" includes vocation under the Ordinance (s. 2(49)).

"Trade" is, not only in the dictionary sense but in legal usage, a term of the widest scope; it may mean the occupation of a small shopkeeper equally with that of a commercial magnate and may also mean a skilled craft *(Smith Barry* v. *Cordy 28 T.C. 250, 258 (C.A.))*. The word "business" has even a wider content than the word "trade" *(Hesketh Estates Ltd.* v. *Craddock 25 T.C. 1, 7)*. The trend of judicial decisions has been in the direction of enlargement rather than restriction of the connotation of trade and business *(Smith Barry* v. *Cordy 28 T.C. 250, 259 (C.A.).; See also Mazagaon Dock Ltd.* v. *C.I.T. [1958] 34 I.T.R. 368, 376-8 (S.C. of India)*.

The words used in the definition of business (s. 2(14)) are wide, but underlying each of them is the fundamental idea of the continuous exercise of an activity *(C.I.T.* v. *Haw Wallace & Co. 6 I.T.C. 178, 181 (P.C.)*. In the words of S.R. Das, J., "The word 'business' connotes some real, substantive and systematic or organised course of activity or conduct with a set purpose" *(Narain Swadeshi Wvg. Mills* v. *C.E.P.T. [1954] 26 I.T.R. 765, 773 (S.C. of India))*. An activity carried on under strict statutory control may nevertheless be business *(City board, Mussoorie* v. *C.I.T. [1962] 46 I.T.R. 1214)*. The frequency or repetition of the activity, though at times a decisive factor, is by no means an infallible test *(Upper India Chamber of Commerce* v. *C.I.T. 1947 I.T.R. 263, 279)*, and a transaction though repeated may not amount to a trade or an adventure in the nature of trade *(Williams* v. *Davies 26 T.C. 371)*. Conversely, an isolated adventure may fall within the definition of "business".

The assessee company is engaged in acquiring houses and letting them out on monthly rental for the purpose of earning profit upon which the company declared dividend and distributed it to its shareholders. The rental income of the assessee was held to be the income from business activities since the nature of the activities of the assessee was business or trading–*C.I.T. (Chittagong Zone) v. Ms. Free School Street Properties Ltd. (S.C. of Bangladesh) 1982 BTD X 173.*

The assessee company incorporated under the Companies Act having a housing estate can also be said to be an assessee carrying on a business.

Agricultural lands were purchased by assessees for agricultural purposes but subsequently were converted to non-agricultural purposes and into building sites. Sites were sold year after year realising more profits and the surplus realised on sale of sites were to be assessed as business income and not capital gains–*C.I.T., Karnataka v. R. Ramaiah and Other–1987 BTD XV 57.*

In a hotel business a part of the hotel building was let out on rental basis for show room, laundry shop, barbery shop. The rental income received from letting out of show room, laundry shop barbery shop etc. was held to be income from business–I.T.A. No. 19 of 1997–98 (Taxes Appellate Tribunal, Dhaka Bench-2), করাদালত, জানুয়ারী, ১৯৯৯।

Combined income from house property and from business from the same property– Assessee let out her property at an anual rent of Tk.48,000 to the lessee

who sub-let the same to another party at Tk.1,80,000. Assessment was made taking B.A.V. at Tk.1,80,000. The Appellate Division set aside the assessment with the observation that an enquiry be made to ascertain whether the activities of the lessee are embraced within the definition of business and if it is found to include business, the lessee may be separately assessed as such for business income and the owner will be assessed under the head, Income from Property on the B.A.V. of Tk.48,000 – *Zebunnessa* v. *C.I.T. Dhaka (S.C. of Bangladesh) 1983 BTD XI 37.*

"Adventure in the nature of trade"–A Single and isolated transaction may fall within the definition of business, as being an adventure in the nature of trade; but to bring it within, the transaction must bear clear indicia of "trade"–*Venkataswami Naidu & Co.* v. *C.I.T. [1959] 35 I.T.R. 594, 608 (S.C. of India).* In *Balgownie Land Trust Ltd.* v. *I.R. 14 T.C. 684,* 691 it has been said, "A Single plunge may be enough, provided it is shown to the satisfaction of the Court that the plunge is made in the waters of trade; but the sale of a piece of property–if that is all that is involved in the plunge–may easily fall short of anything in the nature of trade. Transactions of sale are characteristic of trade, but they are not necessarily distinctive of it; much depends on the circumstances."

The case law on the elusive boundary-line separating transactions on capital account from transactions constituting adventure in the nature of trade, is dealt with under sec. 16, "Capital sales and business sales".

Series of purchase and sale of plots were made and income from first few sales were treated as capital gains. Subsequently bigger plot was purchased and sold as eight plots and the assessee was unaware of the size of plots or size of houses to be constructed. The assessee had the only idea to purchase right in land and sell out such rights at profitable bargain. Series of transactions were entered into year after year with the intention to earn profit. When the whole history of the dealings in land of the assessee was considered it appeared that the surplus realised by the assessee from more ventures occurring with greater frequency was profit earned by the assessee from her trading activity being part of a regular profit making scheme and the adventure was in the nature of trade–*SMt. Bhanumati A. Sanghari* v. *C.I.T. Bombay [1981] BTD 223.*

Concern.–The word "concern" is a very wide word, and appears to imply an adequate degree of business organisation for the purpose of carrying on the undertaking *(Scott* v. *Rusell 30 T.C. 394, 421 (H.L.)).*

Profit motive not essential.–It is not essential to the carrying on of a trade or business that the person carrying it on should make a profit, or even that he should desire or wish to make a profit *(Krishna Menon* v. *C.I.T. [1959] 35 I.T.R. 48, 52-3 (S.C. of India) (vocation)).* In this case the assessee was spending his time in studying and teaching Vedanta philosophy. One of his disciples used to come to him from England and received instructions in Vedanta who subsequently transferred his entire bank balances voluntarily to his credit. Held, that teaching was vocation, if not a profession as there was no motive to earn but nonetheless the amount was held as income. Thus co-operative societies *(I.R.* v. *Incorporated Council of Law Reporting 3*

T.C. 105, 113) or mutual insurance companies *(General Family Pension Fund* v. *C.I.T. 1946 I.T.R. 488)* must be held to carry on business, although they may not make and may not want to make any profits.

Income from letting out a business asset.–In *C.E.P.T.* v. *Shri Lakshmi Silk Mills Ltd. ([1951] 20 I.T.R. 451, 455)* the assessee was doing the business of manufacturing silk cloth and also dyeing silk yarn. During the relevant accounting year the assessee could not work the dyeing plant owing to the difficulty of obtaining silk yarn on account of the last War, and after allowing the plant to remain idle for some time the assessee let it out on a monthly rent. The Supreme Court of India observed that the dyeing plant did not cease to be a commercial asset merely because it could not be used as a commercial asset by the *assessee himself* at the time it was let out, and held that the rent received from the lessees was assessable as income from business. Mahajan, J., delivering the judgment of the Court, said, "... If the commercial asset is not capable of being used as such, then its being let out to others does not result in an income which is the income of the business, but we cannot accept the view that an asset which was acquired and used for the purpose of the business ceased to be a commercial asset of that business as soon as it was temporarily put out of use or let out to another person for use in his business or trade. The yield of income by a commercial asset is the profit of the business irrespective of the manner in which that asset is exploited by the owner of the business. He is entitled to exploit it to his best advantage and he may do so either by using it himself personally or by letting it out to somebody else" *(C.I.T.* v. *Sarveshwar Nath Nigam [1963] 48 I.T.R. 853)*. Following this decision, the Bombay High Court held in C.I.T. v. National Mill Co. Ltd. (In Liq.) *([1958] 34 I.T.R. 155)* that income derived by the liquidator of a company from the letting out of the company's business assets would be income from business where it is found that liquidation had not resulted in cessation of the company's business. Likewise, income derived from letting out an entire oil mill *(Lakshmi Industries (Pr.) Ltd.* v. *C.I.T. [1961] 41 I.T.R. 645)* or a cinema theatre *(C.P. Pictures Ltd.* v. *C.I.T. [1962] 46 I.T.R. 1181)* may constitute business income, where the letting is temporary and not permanent. On the same principle, in some earlier cases the fixed annual rental derived from leasing out a rice mill *(C.I.T.* v. *Managalagiri, etc., Rice Factory Ltd. A.I.R. 1926 Mad. 1032 (F.B.), 2 I.T.C. 251)*, a jute press *(In re Sadhucharan Roy Choudhry 1935 I.T.R. 114)* and a hotel *(C.I.T.* v. *Bostto Bros. Ltd. 1940)* were held to be assessable as business income.

But when the assessee's *business has come to a close*, the property which at one time was a commercial asset would cease to be so, and the income from letting out such an asset would not be business income. In *Narain Swadeshi Wvg. Mills* v. *C.E.P.T. ([1954] 26 I.T.R. 765)* the assessee firm let out its plant and machinery on rent at a time when the assessee's business had entirely closed. It was held by the Supreme Court that the letting out did not amount to carrying on a business and the rent received was not business income.

On this point no general principle can be laid down which would be applicable to all cases; each case must be decided on its own circumstances according to ordinary commonsense principles *(Narain Swadeshi Wvg. Mills* v. *C.E.P.T. [1954] 26 I.T.R. 765, 773 (S.C. of India)*. The letting out of a business asset even during the

continuance of the business may not, in some cases, constitute a business activity and the rent may not constitute business profits *(Parry & Co. Ltd.* v. *C.I.T. [1951] 20 I.T.R. 504)*.

Illegal business.–The illegality of a business, profession or vocation does not exempt its profits from tax: the Revenue is not concerned with the taint of illegality in the income or its source. (See under s. 16, "Income tainted with illegality").

Business of a company.–To ascertain the business of a company, one must look at the objects specified in the memorandum of association of the company; but every act covered by the memorandum is not necessarily done in the course of business. Nothing contained in the memorandum of a company can justify a charge under this section in respect of income which falls appropriately under the more specific heads such as "Interest on securities" (s. 22) and "Income from house property" (s. 24) *(United Commercial Bank Ltd.* v. *C.I.T. [1957] 32 I.T.R. 688 (S.C. of India)*. A company like any other assessee may be engaged at the same time in more businesses than one *(C.I.T.* v. *Larkana Jacobabad (Sind) Light Rly Ltd. 1946 I.T.R. 395, 404)*. The assessee used to produce the feature films either by itself or by entering into an agreement with third parties as a joint venture. The assessee, a private limited company entered into a partnership with one Mr. Nagi Reddy for production of two pictures. With regard to the expenditure incurred for the dissolution of the firm during the accounting year the question was whether the partnership entered into for the production of the above-said two pictures is a separate business and not a joint business and the expenditure claimed for the dissolution will be allowable out of the share of profit made from the firm by the assessee company.

It was held relying on the judgement of –*C.I.T. v. Scindia Steam Narigation Co. Ltd. [1961] 42 I.T.R. 585*, that the production of feature films by entering into a partnership with third parties is one of the activities of the assessee-company in earning the income. Both by joint ventures as well as on its own efforts the assessee is dong its business. Therefore, the production of features films by entering into partnership with third parties cannot be said to be a separate business and the share-income earned by the assessee company by entering into partnership with a third party is one of the items of its business income. In the course of the business, the assessee-company incurred the dissolution expenses which is deductible as revenue expenditure from the business income including the share income of the assessee–*Vijay Production (P) Ltd.* v. *C.I.T. (Madras)* reported in B.T.D. 1999 XXVII P-1-11.

Assessee company engaged in acquiring houses and letting them out on monthly rental for the purpose of earning profit upon which the company declared dividend. Held, that the rental income of the assessee was income from business activities–*C.I.T. v. Free school Street Property Ltd.–1982 BTD 173.*

Income derived by a company by letting out a multi-storied commercial building was held by the Tribunal as business income to be assessed under s. 28–1988 BTD XXVI 89–99.

Agricultural lands were purchased which were converted into building sites. Surplus realised on sale of the sites was to be assessed as business income and not as capital gains–*C.I.T. Karnataka* v. *R. Ramaiah & Other–1987 BTD XV 57.*

Business of a firm and individual assessments on partners.–It is open to a firm to do business in a line which is not mentioned in the partnership deed *(C.I.T.* v. *Dhanalakshmi Corpn. [1955] 46 I.T.R. 1031).* Where a business is carried on by a firm, in the individual assessments on the partners their shares of the firm's business profits should be taken *under this section* either for the purpose of determining the rate of tax or for the purpose of charge, since each partner "carries on" the business albeit in partnership–*C.I.T.* v. *Muthuraman chettiar [1962] 44 I.T.R. 710 (S.C. of India).* (See further notes to s. 85 *post*) The question of set-off of partners' shares of losses incurred by firms is dealt with by ss. 37 and 42.

Dividend income.–Under the general law, where an assessee receives dividends in respect of shares held by him as his stock-in-trade, the dividend income is assessable under this section as part of the business profits and not as income from Other Sources *(C.I.T.* v. *Ahmuty & Co. Ltd. [1955] 27 I.T.R. 63).* But in view of s. 33(a) all dividend income is assessable as income from Other Sources even if the shares are held as stock-in-trade.

Computation of profits of a single business with branches.–Where an assessee carries on one and the same business at a number of places, for the purpose of this section there is only one business, and the net profits of the business have to be ascertained by pooling together the profits earned in all the branches and deducting therefrom all the expenses: the fact that some of the branches are in foreign territories will make no difference if the assessee is resident in Bangladesh *(C.I.T.* v. *C. Parakh & Co. (India) Ltd. ([1956] 29 I.T.R. 661 (S.C. of India)).*

Several businesses.–The profit of each *distinct* business must be computed separately *(South Indian Industrials Ltd.* v. *C.I.T. 1935 I.T.R. 11, 21, (S.B.)).* In case of several businesses the onus is on the assessee to prove that the expenditure incurred in the year in which the business was carried on and the expenditure was incurred for that distinct business–*C.I.T. v. Rabindranathon Nair (Kerala) reported in 1991 BTD XIX P. 1.* But the tax is chargeable under this section, not on the separate income of every distinct business, but on the aggregate of the profits of all the businesses carried on by the assessee *(C.I.T.* v. *Muthuraman Chettiar [1962] 44 I.T.R. 710 (S.C. of India).* "Any business" in cl.(a) means each and every business, *i.e.* all the businesses of the assessee put together *(C.I.T.* v. *Arunachalam Chettiar 1 I.T.C. 278 (S.B.), I.L.R. 47 Mad).* Not only are the profits of the separate and distinct businesses to be lumped together but such aggregate of business profits is to be added to professional earnings in order to arrive at the total income taxable under this head.

The case-law on the question whether two activities constitute separate businesses or one and the same business, is dealt with *post* under s. 37.

Secs. 37 to 39 deal with the questions of set-off of business loss against profit from another business or against income under other heads, and carry-forward of business loss to a subsequent year.

Business should have been "carried on" or "deemed to be carried on" in the accounting year.–Cl.(a) of Sec. 28(1) makes it clear that in order to attract the application of the clause it is necessary that the business should have been carried on by the assessee at any time during the accounting year but not necessarily throughout the year *(C.I.T.* v. *National Syndicate [1961] 41 I.T.R. 225, 234 (S.C. of India))*.

The following propositions emerge from the authorities:–

(A) If the business was carried on in the accounting year, its profits would be liable to tax, *although it may not be carried on in the assessment year (Maharajah of Pithapuram* v. *C.I.T. 1945 I.T.R. 221 (P.C.))*. Under the English statute, what is charged is the income of the assessment year, though measured by the income of the preceding year or years. Therefore in England the continued existence of the source of profits in the assessment year is a requisite of chargeability, and a business which is non-existent in the assessment year cannot be taxed though it may have yielded profits in the previous year. But under this Ordinance the income of the "Income year" is not the standard or measure by which to compute the income of the assessment year but is itself the subject-matter of the tax; therefore it is immaterial whether the business is existent or defunct in the assessment year. (See under s. 16(1), "Tax is on income of the income year".

Commencement of business.–Business of acquiring immovable property and giving it on lease and license basis or on lease with all appurtenant amendments commences when property was made ready and assessee is in a position to offer services to licensess. Expenses thereafter are allowable as deduction. It was not correct to treat the assessee as having commenced business only when the licensee or lessee occupied the premises and started paying rent–*C.I.T. v. Sarabtai Management Corporation Ltd. (S.C. of India) 1995 BTD XXIII*. See also post under the head "Deduction and allowances".

(B) If the business was *carried on during some part of the accounting year but not throughout the year*, the source of income would be in existence in the year and the profits would be taxable though collected after the closure of the business *(I.R.* v. *Oban Distillery Co. Ltd. 18 T.C. 33)*. In such a case if the accounts are maintained on accrual basis, no difficulty can arise, because the profits must necessarily accrue during the time that the business was being carried on, and after the closure of the business there can remain nothing to accrue or to be taxed. If the accounts are maintained on cash or receipt basis, the profits which are received during the accounting year but after the closure of the business would still be liable to tax on the receipt basis *(In re Kamdar 1946 I.T.R. 10)*.

(C) If the business is *discontinued before the commencement of the accounting year*, the profits of the business received in the accounting year cannot be taxed, because the source of income does not exist in the accounting year at all. In such a case if the accounts are maintained on accrual basis the profits must necessarily have accrued and been charged during the continuance of the business and nothing would be left to be assessed in any year subsequent to the closure of the business. Even if the accounts are maintained on receipt basis and some of the profits

are received in the accounting year, such profits would not be taxable under this section, where no business is "carried on" at any time in the accounting year. There are dicta of Chagla, J., in *Kamdar's case (1946 I.T.R. 10, 59)* to the effect that such receipts, though not taxable under this section would be taxable as "income from Other Sources" (s. 33). But the correct view of the authors Kanga and Palkhivala, is that such receipts are not liable to tax at all. Assuming the receipts are income, they are income from business, and if they are not taxable under this section which deals with the specific head of business, they cannot be brought to charge under any other section, for this section is exhaustive of the capacity of business profits to be taxed *(Carson* v. *Cheyney's Executor 38 T.C. 240 (H.L.) [1960] 38 I.T.R. 115)*. Sec. 33 deals with "income from *Other Sources"* and not with the untaxed residue of income from sources which have specific separate heads provided for them (see also *ante* under s. 20 "Income-tax is only one tax").

Sec. 19(6) has however settled the difference in issue wherein it has been provided that where any income is derived by an assessee from any business or profession which has been discontinued at any time before the commencement of the income year in which it accrued or arose shall be deemed to have been carried on before the commencement or during the course of the said income year. The decisions to the contrary under the English law would not apply to cases under this Ordinance.

Business may be passive or dormant.–Period of lull and inactivity.– Business is not confined to being busy; in many businesses long intervals of inactivity and passivity occur; and a concern may still be a going concern though a very quiet and dormant one *(I.R.* v. *South Behar Rly. Co. Ltd., 12 T.C. 657, 712 (H.L.))*. A company may not obtain or be able to execute a single business contract for a period of months or even years, yet it may be deemed to carry on its business if during the period of lull and inactivity it performs its internal functions, that is to say, retains its registered office, holds its meetings year after year, pays directors' fees and incurs other expenses *(Kirk & Randall Ltd.* v. *Dunn 8 T.C. 663)*. The question whether the business is being carried on must depend in each case on its own facts and not on any general theory of law. Where the sole activity of a company was to receive a monthly payment under an agreement by which a newspaper which the company owned was amalgamated with another newspaper, the company could not be said to carry on a trade *(Morning Post Ltd.* v. *George 1942 I.T.R. Suppl. 20, 23 T.C. 514)*.

Trading activity carried on after sale of business.–The vendor of a business may be held to "carry on" a trading activity even after the sale of the business *(Shree Dhootpapeshwar Panuel (Pr.) Ltd.* v. *C.I.T. [1962] 46 I.T.R. 503)*. Thus if a person sells his business to a company and it is agreed that the company should carry out the unexecuted contracts of the business on behalf and as the agent of the vendor, the vendor would be carrying on a new business of executing the uncompleted contracts through the agency of the company *(Southern* v. *Cohen's Executors 23 T.C. 566 (C.A.), 1942 I.T.R. Suppl. 8)*. In this case the assessee sold his business to a company and under the agreement it was provided that all orders undertaken by the vendor prior to the date of sale but remaining unexecuted at that date should be executed by the company as an agent for the vendor and in respect of

any such order the company should be paid a sum equivalent to 25% of gross profit and the remaining profit should be paid to the vendor. The sum received by the vendor was held as a profit in his hands and not a capital payment forming part of the purchase-price. Where a dealer in pianos on hire-purchase terms formed a company to acquire and run his business and the company agreed to collect on his behalf and as his agent all the sums which might become due thereafter under the hire-purchase agreements, it was held that at the date of the sale the vendor commenced a trade of carrying through uncompleted and outstanding hire-purchase agreements and this new trade was "carried on" through the agency of the new company.

Business carried on in the course of administration, or winding up or liquidating a concern.–The liquidator of a company in merely realising the assets of the company *(Liquidators of Person Ltd.* v. *C.I.T. [1954] 25 I.T.R.R. 265, 275 (S.C.))* or in merely letting out the plant, machinery or other assets of the company when the normal business activities have come to a close, cannot be said to carry on any business. On the other hand, the liquidator may carry on the company's business in so far as is necessary for the winding up or may realise the assets of the company in such a way as to involve the carrying on of trade *(C.I.T.* v. *national Mills Co. Ltd. (In Liq.) [1958] 34 I.T.R. 155)*. Similarly, in the case of a firm or other business concern, the trading activities may be continued even after dissolution in order to facilitate the winding up *(Muthukaruppan Chettiar* v. *C.I.T. 1943 I.T.R. 540; J. & R. O'Kane & Co.* v. *I.R. 12 T.C. 303 (H.L.))*. The legal representatives of a deceased person *(Dubash's Executors* v. *C.I.T. [1951] 19 I.R.R. 182 (S.C. of India)* or trustees for creditors *(Armitage* v. *Moore 4. T.C. 199)* may carry on the business for some time in the course of winding up the estate; or they may choose not to continue the business but may merely realise the estate to the best advantage *(Marshall's Executors* v. *Joly 20 T.C. 256)*. Thus where the executors of a deceased money-lender merely collected the outstanding dues and did not advance any fresh loans, they were held not to carry on any business of money-lending. Expenditure incurred or a loss suffered after discontinuance of a business would not be deductible under this head, unless the business is "carried on" after the dissolution in order to facilitate the winding up *(Muthukaruppan Chettiar* v. *C.I.T. 1943 I.T.R. 540)*. This must be read subject to the rule laid down in *Kamdar,* In re *(1946 I.T.R. 10)*, noted above, viz. that profits made and expenditure incurred in the accounting year after cessation of business must be taken into computation if the business was carried on during some part of the accounting year and the accounts are kept on cash basis.

Income of trade or professional asociations from specific services.–Cl.(b):–It is well-settled that the *surplus* accruing to a *mutual* association is not income or profit at all for the purposes of income-tax, the test of mutuality being complete identity between the contributors to the common fund and the participators in the surplus (See *ante* under "Mutual concerns"). To this general principle an exception is provided by s. 2(34)(c) under which the profit or surplus of any business of insurance carried on by a mutual insurance company or by a co-operative society is included in the definition of income. The second exception to the general principle governing mutual associations is provided by this clause under which a trade, professional or similar association (even though of a mutual character)

performing specific services for its members is deemed to carry on business in respect of those services and the income arising therefrom is liable to tax accordingly *(Calcutta Stock Exchange Assn. Ltd.* v. *C.I.T. [1956] 29 I.T.R. 687, reversed on another point, C.I.T.* v. *Calcutta Stock Exchange Assn. Ltd. [1959] 36 I.T.R. 222 (S.C. of India))*.

This clause applies only to a "trade, professional or similar association". A trade association is not the same thing as a trading association. A trade association means an association of tradesmen or businessmen for the protection or advancement of their common interests; an association carrying on a business may not be a trade association *(C.I.T.* v. *Royal Western India Turf Club Ltd. [1953] 24 I.T.R. 551, 566 (S.C. of India))*. This clause does not apply to social clubs and therefore the surplus accruing to a social club even from specific services rendered to members would be governed by the general principles relating to mutual concerns. Again, this clause taxes the profit accruing only from *specific* services rendered by an association to its members *(Ismailia Grain Merchants Assn. Ltd.* v. *C.I.T. [1957] 31 I.T.R. 433)*: any surplus arising to a mutual association in other ways, e.g. from entrance fees or members' periodic subscriptions, would be outside the scope of this clause *(Surat District Cotton Dealers' Assn.* v. *C.I.T. [1959] 35 I.T.R. 121)* and would be non-taxable on the general principles governing mutual concerns which have been dealt with *ante* under s. 16. A trade association's income arising from non-mutual activities may be taxable under cl.(a) of this section or s. 33 even though it may not fall within this clause *(Delhi Stock Exchange Assn. Ltd.* v. *C.I.T. [1961] 41 I.T.R. 495 (S.C. of India))*.

In *C.I.T.* v. *Chamber of Commerce, Alleppey ([1955] 27 I.T.R. 535)*, the fees and contributions received by a Chamber of Commerce for specific services were held assessable under s. 10(6) of the 1922 Act corresponding to this clause. In Native Share & Stock Brokers' Assn. v. C.I.T. *(1946 I.T.R. 628)* a stock brokers' association provided a definite scheme for the admission, control and supervision of authorised clerks in the employ of its members and received an annual fee of Rs.100 for each authorised clerk. The fees were held by the Bombay High Court to be taxable as being remuneration definitely related to specific services performed by the association for its members, it being immaterial that the services might to some extent redound to the benefit of all members and not only of those who paid the fees. This decision was approved by the Supreme Court of India in *C.I.T.* v. *Calcutta Stock Exchange Assn. Ltd. ([1959] 36 I.T.R. 222)* Where the facts were similar though not indentical. Sinha, J., delivering the judgement of the Court, observed that it is immaterial that the services performed are trivial and the remuneration paid is large. The members of the assessee Calcutta Stock Exchange Co. Ltd., had to pay to the stock exchange entrance fees and subscription for employing "authorised assistants" and fees for including new companies in the stock exchange list for rendering special services to its members. The question being whether these three sums of money received as entrance fees, subscriptions and application fees from members were assessable to income-tax under sec. 10(6) of I.T. Act. 1922 (corresponding to cl.(b) of sec. 28(1) of I.T. Ordinance, 1984) and it was held by the S.C. of India that each of the aforesaid

sums of money accrued to the assessee on account of its performing specific services for its members and hence assessable.

Cl.(c) Value of any benefit or perquisite arising from business or profession.–The value of benefits or perquisites arising from business or profession including vocation are chargeable under this section. Such benefits or perquisites may be converted into money or not but these are to be received in the course of business or in the exercise of profession or vocation. Thus if a legal adviser of a company is provided with a rent fees quarter by the company he would be chargeable under this section for such perquisite.

Cl.(d) Recoupment of loss or expenditure or remission of liability.–This clause refers to sub-section 15 of sec. 19(see ante sec. 19(15)). The sub-section provides that where an allowance is granted in any year in respect of any loss or expenditure or bad debt or trading liability and subsequently during any income year the assessee receives either in cash or in any other manner whatsoever; any amount in respect of such loss or expenditure, or the assessee is benefited by the remission or cessation of the trading liability, the amount received or the amount of the liability which is either extinguished or paid within a specified period, that amount would be chargeable as business profits of that income year or after the expiry of the period as mentioned in the specified clause of sec. 19(15)). This sub-section expressly provides for chargeability even if the business or profession in respect of which the allowance or deduction had been made is not in existence in the year in which the liability arises under this sub-section but for the purpose of section 28 the business or profession shall be deemed to be carried on by the assessee in that year.

Under the general law, where an allowance is granted in any year in respect of any revenue expenditure incurred by the assessee, any part of the amount of expenditure refunded in a subsequent year would be a revenue gain (See under sec. 16), "Whether remission of a debt is income." This principle is given statutory effect by the sub-section.

But under the general law, even if a trading liability has been allowed as a business expense, upon remission of such liability in any subsequent year the amount remitted cannot be taxed as the income of the year of remission nor can the accounts of the year in which the trading liability was allowed be re-opened and adjusted (See under sec. 16). This principle of the general law is superseded by the sub-section under which the amount remitted is taxed as the income of the year of remission or after the expiry of the specified period of three years.

This sub-section creates a liability to tax only in cases where an allowance has already been granted. In other words, the revenue merely taxes as income what it had earlier allowed as a deduction. As regards trading liability, it is only upon remission or on the expiry of the period of three years this sub-section comes into operation.

Cls.(e) and (f): Balancing charge. –These clauses have referred to the provisions of sub-sections (16) and (18) of sec. 19 regarding balancing charge. Where a building, machinery, plant or furniture is sold, discarded, demolished or destroyed,

the depreciation allowance and the balancing allowance under s. 29(1)(viii) and (xi) would recoup the assessee the entire capital loss on the asset. But where the assessee is able to recover more than the written-down-value out of the "moneys payable" in respect of the asset, together with the amount of scrap value, if any, a balancing chare is levied by this sub-section on the excess recovered to the extent of the total of depreciation allowances granted in the past. In other words, the revenue takes back what it had given by way of depreciation allowance in the earlier years, for otherwise the result would be to recoup the assessee an amount in excess of his original cost *(C.I.T.* v. *Express Newspapers Ltd. [1960] 40 I.T.R. 38, 61).*

The word "sold" which occurs in this sub-section includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force; and "moneys payable" includes the sale price or insurance, salvage or compensation moneys.

This sub-section which brings to charge the excess of the sale price over the written down value *(Motor House (Gujarat) Ltd.* v. *C.I.T. [1963] 48 I.T.R. 419);* applies not only to cases where some of the assets are sold but also to cases where the whole business undertaking is sold *(Akbar Mfg. & Press Co. Ltd. (in Liq.)* v. *C.I.T. [1957] 31 I.T.R. 99).* If, however, the sale price exceeds the original cost, such excess over the original cost would not be chargeable under this sub-section, though it may be chargeable as capital gains.

Under the corresponding provisions of the 1922 Act it was held in several cases that the balancing charge could not be levied if the sale was effected in any year subsequent to the year of the closure of the business. But those cases are superseded by this sub-section which makes it clear that liability to a balancing charge would arise even if it is sold, discarded, demolished or destroyed, even if the business is not in existence in that accounting year (Explanation-2).

The charge under this sub-section arises in the year in which the sale price, or the insurance, salvage or compensation moneys, become due *(C.I.T.* v. *Moon Mills Ltd. [1962] 46 I.T.R. 771).*

The Bombay High court held in *Rogers & Co.* v. *C.I.T.* that when as a matter of pure business reorganisation a firm was converted into a private limited company and the partners of the firm became the shareholders in the company, holding shares in the same proportion as their shares in the firm, the transaction was not covered by the second proviso to s. 10(2)(vii) of the 1922 Act, which corresponded to this sub-section, and the firm could not be taxed on the difference between the price at which the assets were transferred and their written down value, since virtually the transfer was by the assessee to himself in his corporate character. The Patna High Court dissented from this view and held that in such a case, since the company was a separate legal entity, charge under the second proviso was attracted *(Sir Kameshwar Singh* v. *C.I.T. [1963] 48 I.T.R. 483).* It was submitted by some authors of Income-tax that the Patna view is correct.

No balancing charge on amalgamation not involving sale.–Where under an amalgamation a company is merged into another and the assets of that company

are transferred to and vest in the other company under s. 2(2) of the Ordinance, the amalgamation would involve a transfer, but not a "sale" within the ordinary meaning of that word or within the extended meaning of sale in Para 11 of Third Schedule which is made applicable to this sub-section. Consequently, no balancing charge would be payable under this sub-section upon such an amalgamation.

Cl.(g): Balancing charge in respect of assets for scientific research.–The provisions of this clause are analogous to the provisions in respect of depreciable assets which are dealt with above under cls. (e) and (f). When the asset is sold and the proceeds recoup the assessee the whole or part of the capital cost which has been allowed as a deduction under sec. 29(1)(XIX) and (XX) the amount so recouped is deemed to be income under this clause. See further under sub-section (20) of sec. 19 re. "unexplained investments".

Cl.(h): Export value of garments transferred out of export quota be deemed to be income.–Where during any income year, the exporter of garments transfers to any person the export quota or a portion of it as allocated by the Government, income from such portion of the export value of garments exportable against the quotas so transferred shall be determined at three percent of the export value of garments and such amount shall be chargeable to tax under the head, Income from Business or Profession.

Explanation to sec. 28(1): Speculation business-sec. 2(61) defines speculation business as meaning.–When a business is carried on in "speculative transaction" as meaning a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips. This definition is exhaustive. Therefore, in any case where actual delivery or transfer of the commodity or scrip takes place, the transaction would *not* amount to a speculative transaction, however highly speculative in its nature it may be. Certain transactions, *e.g.* hedging contracts entered into by manufacturers and merchants in the course of business to guard against loss through future price fluctuations *(C.I.T.* v. *Central India General Agents Pr. Ltd. [1963] 49 I.T.R. 647)* are excluded from the definition of "speculative transactions".

"The definition of speculation business makes it clear that the intention of the parties is made immaterial and irrelevant. If a contract is settled otherwise than by the actual delivery or transfer of the commodity or scrips it will be a speculative transaction notwithstanding the fact that at the time the transaction was entered into the parties intended to effect delivery of the commodity or scrips"–*C.I.T. Andhra Pradesh-III* v. *Puttaiah Seshaiah and Co.* (Reported in 1986) BTD xiv 15).

When a business is carried on in speculative transactions, that business is deemed to be distinct and separate from any other business. Sec. 37 enacts that losses in speculation business, unlike other business losses, cannot be set off against any other income except profits of another speculation business; and likewise, a loss in speculation business carried forward to a subsequent year can be set off only against profits of any speculation business of such subsequent year.

Sub-sec. 2(a): Profits of insurance business.–In the case of insurance business of any kind, carried on by any person, the operation of the sections dealing with the specific heads of income and of sec. 62 which deals with credit for tax deducted at source, is excluded by this section (s. 28) to the extent to which the provisions of those sections are inconsistent with the rules contained in the Fourth Schedule to the Ordinance and the profits and gains of insurance business from all sources are to be computed in accordance with those rules–*Bombay Mutual Life Assoc. Society* v. *C.I.T. (1951) 20 I.T.R. 189.* This principle applies even to Mutual associations and co-operative societies carrying on insurance business. Thus the computation of the insurance company's total income from different sources would be governed by the Fifth Schedule and not by the provisions for different heads laid down in sec. 22-33. An insurance company, instead of making its return of income under various heads laid down in sec. 20 submits one unit of income arrived at in accordance with the rules laid down in the Fourth Schedule which does not provide for the computation of income under different heads–*C.I.T.* v. *B.B. & C.I. Rly. Co-operative Mutual Death Benefit Society Ltd. (1949) I.T.R. 509.*

Sub–sec. 2(b): Profits and gains from the exploration and production of petroleum. –In the case of business of exploration and production of petroleum carried on by the assesse in association with the Government the profits and gains of such business shall be computed separately from his income, profits or gains from any other business. In such computation some additional allowances as provided for in Part A of the Fifth Schedule subject to the provisions of allowances of section 29, shall be deducted. The section has no operative effect except so far as it is rendered applicable by a provision specified in an agreement between the assessee and the Government for allowances which may be in lieu or in addition to the allowances admissible under this Ordinance. This section, read with such an agreement with the Government, would permit an assessee to claim allowances which may on general principles be inadmissible, *e.g.* allowances relating to diminution or exhaustion of wasting capital assets or allowances in respect of expenditure which would be regarded as on capital account on the ground that it brings into existence an asset of enduring benefit or constitutes initial expenditure incurred in setting the profit-earning machinery in motion.

Sub-section 2(c): Profits and gains from the exploration and extraction of mineral deposits. –Where any person carries on the business of the exploration or extraction of mineral deposit of a wasting nature other than oil or gas in Bangladesh the profits and gains of such business shall be computed separately from other business and in the computation of such profits and gains the allowances as provided for in sec. 29 but subject to the provisions of Part B of the Fifth Schedule which provide for some specific allowances, shall be deducted.

Some tax-exemption has also been provided for where the assessee is also engaged in the business of refining or concentrating in Bangladesh the mineral deposit extracted by the assessee in Bangladesh.

Sub-section (3): Income from interest of banks.–Any income by way of interest of Bangladesh Shilpa Bank, Bangladesh Shilpa Rin Sangstha, Bangladesh

Krishi Bank and any other commercial bank in relation to the clarified classes of bad or doubtful doubt as is credited to the profit and loss account shall be chargeable to tax in the year in which it is credited either on receipt basis or on accrual basis, whichever is earlier. This sub-section has brought to charge mainly the financial institutions for interest on such bad or doubtful debts as will be specified by the Bangladesh Bank. Such financial institutions will have to suffer from both the sides when any interest has been credited in the profit and loss account on accrual basis in respect of bad debts which have become irrecoverable. Clause (XV) of sec. 29(1) has of course, provided for deduction for an established irrecoverable debt for all classes of assessees under certain conditions.

Sec. 29. Deductions from income from business or profession.–(1) In computing the income under the head "Income from business or profession", the following allowances and deductions shall be allowed, namely:–

(i) the amount of any rent paid for the premises in which the business or profession is carried on:

Provided that if a substantial part of the premises is used by the assessee as a dwelling–house, the amount shall be a proportionate part of the rent having regard to the proportionate annual value of the part so used;

(ii) the amount paid for the repair of the hired premises in which the business or profession is carried on if the assessee has undertaken to bear the cost of such repair:

Provided that if a substantial part of the premises is used by the assessee as a dwelling–house, the amount shall be a proportionate part of the sum paid for such repair having regard to the proportionate annual value of the part so used;

(iii) the amount of any interest paid or any profit shared with a bank run on Islamic principles in respect of capital borrowed for the purposes of the business or profession:

Provided that if any part of such capital relates to replenishing the cash or to any other asset transferred to a newly set up industrial undertaking or to an extension of an existing industrial undertaking whose income is exempted from payment of tax, the amount shall be proportionate part of the interest so paid or the profit so shared having regard to the proportion of such capital so used;

(iv) any sum paid or credited to any person maintaining a profit and loss sharing account or deposit with a bank run on Islamic principles

by way of distribution of profits by the said bank in respect of the said account of deposit;

(v) an amount not exceeding ten percent of the total income carried to any special reserve created by such financial institution and for such purposes as may be approved by the Government in this behalf, if the aggregate amount standing in such reserve does no exceed the paid up share capital of the institution;

(vi) the amount paid on account of current repairs to buildings, machinery, plant or furniture used for the purposes of the business or profession;

(vii) the whole or the proportionate part of the amount of any premium paid for insurance, against risk of damage, destruction or loss of buildings, machinery, plant or furniture, stocks or stores according as the whole or part thereof is used for the purposes of the business or profession;

(viii) in respect of depreciation of building, machinery, plant or furniture, being the property of the assessee and used for the purposes of business or profession, the allowances as admissible under the Third Schedule;

(ix) in the case of a ship, being a passenger vessel plying ordinarily on inland waters, or a fishing trawler, which is entitled to a special depreciation allowance under paragraph 8 of the Third Schedule, an investment allowance of an amount equivalent to twenty percent of the original cost to the assessee for the year in which the ship or the trawler is first put to use for public utility;

(x) in the case of any machinery or plant (other than office appliances and road transport vehicles) which is entitled to accelerated depreciation under paragraph 7 of the Third Schedule, an investment allowance, for the year in which the undertaking starts commercial production, at the following rates, namely:–

(a) if the undertaking is set up in areas specified in this behalf by the Board,	.....	an amount equivalent to 25 percent of the actual cost to the assessee;
(b) in other cases,	.....	an amount equivalent to 20 percent of the actual cost to the assessee;

(xa) Where an assessee being a company registered under [the Companies Act, 1913 (VII of 1913) or ...] invests any amount in the purchase of any new plant or machinery for installation in an industrial undertaking set up in Bangladesh and owned by it for the purpose of balancing, modernisation or replacement of the plant or machinery already installed therein, an investment allowance at the rate of twenty-five percent of the amount so invested;]

(xi) where any building, machinery or plant which, after having been used by the assessee for the purpose of his business, has been discarded, demolished or destroyed in any income year or any such asset has been sold, transferred by way of exchange or compulsorily acquired by a legally competent authority or exported outside Bangladesh in any income year, an obsolescence allowance to the extent and computed in the manner specified in paragraph 10 of the Third Schedule;

(xii) in the case of any animal which has been used by the assessee for the purpose of business or profession otherwise than as stock-in-trade, has died or become permanently useless for such purpose, an amount equivalent to the difference between the original cost of the animal to the assessee and the sum, if any, realised by sale or other disposition of the carcass, as the case may be, of the animal;

(xiii) any sum paid on account of land development tax or rent, local rates or municipal taxes in respect of such premises or part thereof as is used by the assessee for the purpose of business or profession;

(xiv) any sum paid in the income year to an employee as bonus or commission for services rendered where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission and is reasonable with reference, except in the case of payment of festival bonus, to–

(a) the general practice in similar business or profession,
(b) the profits of the business or profession in that year, and
(c) the pay and other conditions of service of the employee:

[Provided that no deduction on account of bonus, other than festival bonus, to its employees shall be allowed to a banking company under this clause if such banking company is allowed deduction from its income under clause (xviiiaa);]

(xv) the amount of any debt or part thereof which is established to have become irrecoverable and has actually been written off as such in the

books of accounts of the assessee for the income year if the debt or part thereof has been taken into account in computing the income of the assessee of that income year or an earlier income year and, in the case of the business of banking or money-lending carried on by the assessee, represents money lent in the ordinary course of business;

(xvi) where any amount of debt or part thereof which has actually been written off as irrecoverable in the books of accounts of the assessee in any income year but has not been allowed on the ground that it has not then become irrecoverable, so much of such debt or part thereof as has been established to have become irrecoverable in any subsequent income year shall be allowed as a deduction in that income year;

(xvii) where any such debt or part thereof is written off as irrecoverable in the books of accounts of the assessee for an income year and the Deputy Commissioner of Taxes is satisfied that such debt or part thereof became irrecoverable in an earlier income year not falling beyond a period of four years immediately preceding the income year in which it was written off, the Deputy Commissioner of Taxes may, notwithstanding anything contained in this Ordinance, allow such debt or part thereof as a deduction for such earlier income year if the assessee accepts such finding of the Deputy Commissioner of Taxes and re-compute the total income of the assessee for such earlier income year and make the necessary amendment; and the provisions of section 173 shall, so far as may be, apply thereto the period of four years referred to in sub-section (4) of that section being reckoned from the end of the year in which the assessment relating to the income year in which the debt or part thereof is written off was made;]

xviiia) in respect of provision for bad and doubtful debt made by Bangladesh Shilpa Bank or Bangladesh Shilpa Rin Songstha for overdue loan, a sum equal to five per cent. of such overdue loan or the amount of actual provision for such bad or doubtful debt in the books of the assessee, whichever is the less:

Provided that the deduction shall be allowed only in respect of the assessment years 1987-88, 1989-90 and 1990-91.

Provided further that if any amount out of the amount so allowed is ultimately recovered, the same shall be deemed to be a profit of the year in which it is recovered;

(xviiiaa) in respect of provision for bad and doubtful debt and interest thereon made by a commercial bank including the Bangladesh Krishi Bank and the Rajshahi Krishi Unnayan Bank, a sum equal to [three per cent.] of the total outstanding loan including interest thereon or the amount of actual provision for such bad or doubtful debt and interest thereon in the books of the assessee, whichever is less:

Provided that the provisions of this clause shall ap... in respect of such loan as the Bangladesh Bank may, from time to time, classify as bad or doubtful debt;

[Provided further that the deduction shall be allowed only in respect of the assessment years 1990-91, 1991-92, 1992-93, ...-94, 1994-95, [1995-96, 1996-97, 1997-98, 1998-99 [1999-2000, 2000-2001 and 2001-2002];

[Provided further that if any amount out of the amount so ...wed is ultimately recovered, the same shall be deemed to be a profit of the year in which it is recovered:]

[Provided further that no deduction under this clause shall be allowed in respect of–

(a) any amount representing grant allowed by the Government in the form of 15-years Special Treasury Bonds;

(b) any loan advanced to any government organization, body corporate, local authority, autonomous body, or any other loan guaranteed by the Government; and

(c) any debt representing loans advanced to any director of the bank, is nominees or dependants;]

(xix) any expenditure, not being in the nature of capital expenditure, laid out or expended on scientific research in Bangladesh related to the business carried on by the assessee;

(xx) any expenditure of a capital nature laid out or expended on scientific research in Bangladesh related to the business carried on by the assessee;

Provided that where a deduction is allowed for any income year under this clause in respect of expenditure represented wholly or partly by any asset, no deduction shall be allowed under clause (viii) or (ix) for the same income year in respect of that asset;

any sum paid to a scientific research institute, association or other body having as its object the undertaking of scientific research, or to a University, College, Technical School or other Institution for the purpose of scientific research or technical training related to the class of business carried on by the assessee, if such Institute, association or body, or such University, College, Technical School or Institution is for the time being, approved by the Board for the purpose of this clause.

Explanation.–In this clause and in clauses (xix) and (xx),–

(a) 'scientific research" means any activities in the field of natural or applied science for the extension of knowledge;

(b) references to expenditure incurred on scientific research do not include any expenditure incurred in the acquisition of rights in, or arising out of, scientific research, but save as aforesaid, include all expenditure incurred for the prosecution of, or the provision of facilities for the prosecution of, scientific research;

(c) reference to scientific research related to a business or class of business includes–

(i) any scientific research which may lend to or facilitate an extension of that business or, as the case may be, all businesses of that class;

(ii) any scientific research of a medical nature which has a special relation to the welfare of workers employed in that business or, as the case may be, business of that class;

(xxii) any expenditure not being in the nature of capital expenditure, laid out or expended on any educational institution or hospital established for the benefit of the employees of the assessee, their families and dependents or on the training of industrial workers, if–

(a) no charge is made for services rendered by such institution or hospital or for the training of the workers; and

(b) no deduction or allowance is claimed for such expenditure under any other clause of this section;

(xxiii) any expenditure in the nature of capital expenditure laid out or expended on the construction and maintenance of any educational institution or hospital established by the assessee for the benefit of his

employees, their families and dependents, or on any institute for the training of industrial workers, if–

(a) no charge is made for the services rendered by such institution or hospital or for the training of the workers; and

(b) no deduction or allowance is claimed under any other clause of this section for the same income year in respect of expenditure represented either wholly or partly by any asset;

(xxiv) any expenditure laid out or expended on the training of citizens of Bangladesh in connection with a scheme approved by the Board for purposes of this clause;

(xxv) any expenditure, not being in the nature of capital expenditure or personal expenses, incurred by an assessee in connection with visits abroad as a member of a trade delegation sponsored by the Government;

(xxvi) any sum paid on account of annual membership subscription to a registered trade organization within the meaning of the Trade Organisations Ordinance, 1961 (XLV of 1961), or to a professional institution recognised by the Board in this behalf;

(xxvii) any expenditure, not being in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purpose of the business or profession of the assessee.

Where any premises, building, machinery, plant or furniture is not wholly used for the purposes of business or profession, any allowance or deduction admissible under this section shall be restricted to the fair proportional part of the amount which would be allowable if such premises, building, machinery, plant or furniture was wholly so used.

Explanation.–For the purposes of this section, the expression "plant" includes ships, vehicles, books, scientific apparatus and surgical and other instruments or equipments used for the purpose of business or profession.

Section 29(1): Deductions from income from business or profession–General principles.–This section refers to cls. (i) to (xxvii) which expressly provide for certain deductions. These provisions for deductions should be liberally construed *(New Shorrock Sp. & Mfg. Co. Ltd.* v. *C.I.T. [1956] 30 I.T.R. 338)*. Before dealing with the express allowances, it will be convenient to note certain

general principles regarding allowances and deductions permissible in computing business profits.

Allowance for the purpose of business.–The Supreme Court of India in the case of C.I.T. v. Malayalan Plantations Ltd. [1964] 53 I.T.R. 140 held that the expression, "for the purpose of business" is wider in scope than the expression "for the purpose of earning profits". It was held that the expression, "for the purpose of business" may take in not only the day to day running of the business, but also the rationalisation of its administration and modermisation of its machinery. It may include measures for the preservation of business and for the protection of its assets. It was further held that the expenditure shall be for the purpose of the business, that is to say, the expenditure incurred shall be for the carrying on of the business and the assessee shall incur it in his capacity as a person carrying on the business (case to be followed East India Agencies Pvt. Ltd. v. C.I.T. –reported in 1993 BTD XXI P.O. 242-244) (See also "under purpose of the assessee's own business").

Expenditure not with a view to earn profit only.–"Under Sec. 37 of the Income-tax Act, 1961 (corresponding to Cl. xxvii of sec. 29 of I.T. Ordinance 1984, i.e. residuary clause) there is no requirement that an expenditure or outgoing must be incurred or laid out with a view to earn profit nor is there any requirement that the expenditure must be incurred in order to meet an obligation arising out of a commercial contract or out of any provision of law or custom. All that section 29 (xxvii) requires is that the expenditure must be incurred or laid out wholly and exclusively for the purpose of the assessee's business –*C.I.T., Central v. Georgepolus (Madras) reported in 1987 BTD XV P.I.*

Quantum of expenditure–whether subject to revision by Department.– There is no specific provision in Sec. 10(2) (xv) (corresponding to sec. 29 (xxvii of I.T. Ordinance, 1984) to justify the adoption of a subjective test of reasonableness by the taxing authorities once they accept that a particular business expenditure comes within its ambit of deductibility. No doubt while the taxing authorities are considering whether a particular expenditure falls within the provisions of the said section, they are competent to examine whether that particular item was incurred bonafide or not, by having regard to the quantum or other surrounding circumstances, or to information which the taxing authorities could gather from sources connected with such business. But these considerations apply only before acceptance by the Income tax Authorities as permissible expenditure under Sec. 10(2) (corresponding to sec. 29(1) of I.T. Ordinance, 1984). Once the Income tax authorities have accepted that such an expenditure is permissible expenditure, within the ambit of the said provisions of law, they are incompetent to increase or reduce the amount adopting their own standard of reasonableness–*Newtone Studios Ltd. v. C.I.T. [1955] 28 I.T.R. 378.*

List of allowances is not exhaustive.–The list of allowances enumerated in sec. 29 and 37 is not exhaustive: an item of loss or expenditure incidental to business may be deducted in computing "profits and gains" even if it does not fall within any of these sections, for the tax is on *"profits and gains" properly so called and*

computed on ordinary commercial principles (Motipur Sugar Factory Ltd. v. *C.I.T. [1955] 28 I.T.R. 128).* This is definitely established by the Privy Council case, *C.I.T.* v. *Chitnavis (59 I.A. 290, 297, 6 I.T.C. 453)*, where a bad debt was held to be an admissible deduction, though there was no special allowance for bad debts in the 1922 Act as it then stood. Lord Russell, delivering the judgment of the Board, said: "Although the Act nowhere in terms authorizes the deduction of bad debts of a business, such a deduction is necessarily allowable. What are chargeable to income-tax in respect of a business are the profits and gains of a year; and in assessing the amount of the profits and gains of a year account must necessarily be taken of all losses incurred, otherwise you would not arrive at the true profits and gains." In *Badridas Daga* v. *C.I.T. ([1958] 34 I.T.R. 10, 15) and Calcutta Co. Ltd.* v. *C.I.T. ([1959] 37 I.T.R. 1, 9)*, the Supreme Court quoted the observations of Lord Russell with approval and held that an item of loss or expenditure not falling within any of the express deductions may be allowed if it is deductible on ordinary principles of commercial accounting. See further under s. 28, "Profits and Gains".

The scheme of these sections is that profits and gains must be computed subject to certain express allowances and to certain express or implied prohibitions of deductions, but a deduction which is neither within the terms of the prohibition nor such that the *expressed and specific allowance must be taken as the exclusive definition of its area (C.I.T.* v. *Haji Jamal Nurmahomed 1 I.T.C. 396)*, must be allowed if it is, on the facts of the case, a proper debit item to be charged against incomings of the trade in ascertaining the true profits *(Usher's Wiltshire Brewery Ltd.* v. *Bruce 6 T.C. 399, 436)*. In other words, in determining whether a particular item (not covered by Sec. 29(i) to 29 (xxvii) may or may not be deducted from profits, it is necessary first to inquire whether the deduction is expressly or by necessary implication prohibited by the Ordinance and then, if it is not so prohibited, to consider whether it is of such a nature that it should be charged against incomings in a computation of the "profits and gains" properly so called *(Atherton* v. *British Insulated & Helsby Cables Ltd. 10 T.C. 155, 191 (H.L.))*. These principles were reaffirmed by the Supreme Court of India in the above-mentioned cases, *Badridas Daga* v. *C.I.T. ([1958] 34 I.T.R. 10, 15)* wherein it has been said that deductions which can be legitimately claimed as business expense or loss and for which there is no specific provision under sec. 10(2) can be claimed and allowed as a deduction under sec. 10(1) and as observed in *Calcutta Co. Ltd.* v. *C.I.T. ([1959] 37 I.T.R. 1, 9-10)*. In the first case a loss due to embezzlement by an employee, and in the second case a contractual liability to undertake a development scheme at a future date, were allowed as deductions in computing business profits without reference to any statutory provision for deduction. That deductions may be permitted on ordinary principles of commercial trading is also well established in England where, however, the scheme of the Act is different *(Morgan* v. *Tate & Lyle Ltd. [1954] 26 I.T.R. 195, 197 (H.L.))*.

But an assessee is not permitted to make all deductions which a prudent trader would make in ascertaining his own profits *(Indian Molasses Co. (Pr.) Ltd.* v. *C.I.T. [1959] 37 I.T.R. 66, 75-6 (S.C. of India))*. In this case meaning of "expenditure" has been given. Expenditure, which is deductible for income-tax purpose, is one

which is towards a liability actually existing at the time, but the putting aside of money which may become expenditure on the happening of an event, is not expenditure.

"Where the assessee follows the mercantile system of accounting the quantification of ascertainment cannot postpone accrual of a statutory liability. Whether the assessee is entitled to a particular deduction or not, in the case of a statutory liability, it will depend on the provision of law relevant therefor and not on the view which the assessee might have of his right, nor can the existence or absence of entries in his books of account be decisive or conclusive in the matter. On the other hand, if the liability is based on some contractual obligation, it arises only when it is ascertained. Unless the liability has become some ascertained sum of money, it no doubt exists but proceedings have yet to be taken to determine the exact amount. A vague liability to make the payment cannot be entered into the accounts"–*Swadeshi Cotton Mill Co. Ltd.* v. *C.I.T. Kanpur-1994 BTD XXII.*

Losses incidental to trade: Embezzlement, theft, destruction of assets, overdrawings by employees.– There is a distinction between business expenditure and business loss. Finlay, J., said in *Allen* v. *Farquharson Bros. & Co.* that expenditure or disbursement means "something or other which the trader pays out; I think some sort of volition is indicated. He chooses to pay out some disbursement; it is an expense; it is something which comes out of his pocket. A loss is something different. That is not a thing which he expends or disburses. That is a thing which, so to speak, comes upon him *ab extra.*" Non-capital expenditure incurred for the purposes of the business would fall to be deducted under the omnibus residuary s. 29(xxvii). But business losses, though they fall outside the purview of sec. 29 are allowable, as stated above, on ordinary commercial principles of computing profits, provided (i) the losses are of a *Non-capital* nature *(Bharucha* v. *C.I.T. [1963] 49 I.T.R. 135)* and (ii) they are not merely connected with the trade but are *really incidental* to the trade itself *(Anamalai Timber Trust Ltd.* v. *C.I.T. [1963] 47 I.T.R. 814)*. These principles were affirmed by the Supreme Court (India) in Badridas *Daga* v. *C.I.T. ([1958] 34 I.T.R.)*.

Loss of stock-in-trade by fire *(Motamal Jethumal* v. *C.I.T. 1947 I.T.R. 155)* or by ravages of white ants or by enemy action during war *(Pohoomal Bros* v. *C.I.T. [1958] 34 I.T.R. 64 (1987 BTD XV 200))* (which has been followed by the Appellate Tribunal, Dhaka Bench) is allowable as a trading loss; and if the assessee, for reasons beyond his control, cannot prove the exact amount of stock-in-trade destroyed, the loss may be estimated from such materials as are available. The Tribunal, Dhaka Bench, relying on the judgement of –*C.I.T. v. Samuel Osborn (India) I.T.R. 135 of 1982* page 199 allowed losses due to variation in rate of foreign exchange–1984 BTD XII 95. Relying on the judgement of – *Pohoomal Bros. v. C.I.R. Appellate Tribunal Chittagong Bench* allowed claim of loss for goods and cash blocked in other country being not capital loss. But loss arising from the sinking of a ship due to collision would not be deductible, as it would be on capital account *(Legg & Son* v. *I.R. 12 T.C. 391)*.

If owing to the negligence or dishonesty of *employees*, some of the receipts of the business do not find their way into the till or some of the bills are not collected, the loss is deductible as being of a non-capital nature and really incidental to the trade itself, for it springs directly from the necessity of deputing certain duties to employees *(Curtis* v. *Oldfield 9 T.C. 319, 330)*. An amount embezzled by the assessee's employee *(Badridas Daga* v. *C.I.T. [1958] 34 I.T.R. 10 (S.C. of India)*, or shortage in cash in a money-lending business found on making up the accounts of the day *(Bansilal Abirchand* v. *C.I.T. 6 I.T.C. 318)*, is deductible in computing the business profits. The Supreme Court's decision in *(Badridas Daga* v. *C.I.T. ([1958] T.R. 10)* is the leading authority on the question of allowance in respect of moneys embezzled by employees.

Loss caused by embezzlement is allowable as a deduction in the year in which the amount becomes irrecoverable *(Associated Banking Corpn. of India Ltd.* v. *C.I.T. [1958] 34 I.T.R. 557, 566)* or the loss is ascertained. However, the year in which such loss can be allowed as a deduction would depend on the facts of each case *(Associated Banking Corpn. of India Ltd.* v. *C.I.T. [1960] 40 I.T.R. 210)*. When a businessman writes-off the amount it is *prima facie* evidence that the amount has become irrecoverable and it is for the Department to rebut that inference.

But where a trader is robbed of his profits by a *stranger* to the business, *e.g.* where thieves break into a money-lender's strong-room and steal cash *(Ramaswami Chettiar* v. *C.I.T. 4 I.T.C. 438. See also Nainital Bank Ltd.* v. *C.I.T. [1962] 46 I.T.R. 540)*, or where dacoits enter into a general merchant's office and rob the cashier and the *munim* of the total realisations of the day *(Gododia & Co., In re, 1934 I.T.R. 552)*, or where money is stolen from the assessee at a railway station *(C.I.T.* v. *Chakka Narayana [1961] 43 I.T.R. 249)* or from his employee who is carrying it to bank *(Ram Gopal Sarup* v. *C.I.T. [1963] 47 I.T.R. 611)*, the loss has been held not to be deductible, where it is not really incidental to the business. But if the loss by theft or robbery is *incidental* to the business, –*e.g.* where under statutory rules the assessee has to send money to various purchasing centers for distribution among cultivators and the money is robbed on the way *(Motipur Sugar Factory Ltd.* v. *C.I.T. [1955] 28 I.T.R. 128)*, or where a bank which is statutorily bound to maintain a certain amount of cash at the close of business every day is robbed of such cash by dacoits after banking hours *(Nainital Bank Ltd.* v. *C.I.T. [1961] 43 I.T.R. 90)*, –the loss would be allowable. Theft committed by an employee who breaks into the business premises *after office hours*, stands on the same footing as that by an ordinary burglar and the loss cannot be allowed *(Bansidhar Onkarmal* v. *C.I.T. 1949 I.T.R. 247)*.

If embezzled moneys which are allowed as a deduction in any year are subsequently recovered, they should be brought in as a revenue receipt in the year of recovery. (See s. 16 and under s. 16, "Recovery of embezzled sums".

Losses arising from payments made in advance to employees would form a proper deduction if the advance payment was made with reasonable business prudence *(Roebank Printing Co. Ltd.* v. *I.R. 13 T.C. 864, 875)*. But where a managing director was allowed to over-draw heavily moneys in advance on account of the commission payable to him, it was held that the financial indulgence shown to him by

the company went far beyond anything which could be justified by or could be consistent with any trading interest of the company and the loss resulting from such indulgence was disallowed. Similarly, where the management of a company had practically abdicated in favour of a manager who was allowed to do what he liked with the company's funds and accounts, with the result that his own personal affairs and those of the company were inextricably confused, the resultant loss to the company was held not to be deductible as a trading loss.

Allowances are cumulative and not mutually exclusive.–The allowances specified in section 29(i) to (xxvii) are disjunctive and cumulative and not alternative or mutually exclusive *(Ratan Singh* v. *C.I.T. A.I.R. 1926 Mad. 462, 2 I.T.C. 294)*. For instance, an assessee who is entitled to depreciation allowance under s. 29 (viii) in respect of a certain asset would be further entitled to deduct under s. 29(vi) the cost of repairs to the same asset. But if an allowance is specifically dealt with by one of the clauses it cannot be claimed under Cl. (XXVII) which is the residuary clause, for otherwise the effect would be to nullify the express or implied conditions on which the allowance is granted by the specific clause (See under s. 29(1) (xxvii) "Expenditure should not be covered by Cls. (i) to (xxvi)."

No allowance in respect of exhaustion of capital or wasting assets.–No deduction can be claimed from the income in respect of diminution or exhaustion of the capital asset from which the income is derived *(British South Africa Co.* v. *C.I.T. 1946 I.T.R. Suppl. 17, 32 (P.C.))*. Lord Shaw, delivering the judgment of the Privy Council in *(Kauri Timber Co. Ltd.* v. *Comr. of Taxes (1913 A.C. 771, 778, 780-1))*, said. "The Principle to be applied is clearly a general one to the effect that the consumption of capital cannot be treated in the ascertainment of profits as a revenue debit ... "The exhaustion of capital, however it might be treated on strict actuarial principles or according to certain principles of economics, may for the purposes of taxation be treated as profit. That profit may be temporary, and so when it ceases the capital may be gone, and with the going of the capital there will also go the subject and the possibility of the tax." Thus where a man purchases an annuity, the entire amount is taxable as income without regard to the capital paid away and exhausted to purchase the annuity *(Kamakshya Narain Singh* v. *C.I.T. 1943 I.T.R. 513, 523 (P.C.))*. Similarly, where capital has been embarked in a wasting subject-matter such as mines and quarries, or nitrate grounds, or burial ground in the case of a cemetery company, or timber bearing lands *(Kauri Timber Co. Ltd.* v. *Comr. of Taxes 1913 A.C. 771 (P.C.))*, or a leasehold interest for a term of years, no allowance is permissible in respect of the diminution or exhaustion of the wasting assets. As Lord Wright pointed out in *Kamakshya Narain Singh* v. *C.I.T.*, "There is under the Indian Act no provision for allowance for amortisation in respect of the minerals being exhausted", though the Ordinance does allow for diminution in the value of buildings, machinery, plant, furniture and animals under Cls. (viii) and (xii) of s. 29.

The principle of non-allowance in respect of exhaustion of capital does not apply in cases where the article sold is that which it is the business of the assessee to acquire and sell. Thus where the acquisition and realisation of mining rights was in

the course of a company's trade, the cost of acquiring mining rights was allowed as a trading expense *(British South Africa Co.* v. *C.I.T. 1946 I.T.R. Suppl. 17, 32 (P.C.))*.

To the principle that no deduction is allowable in respect of diminution or exhaustion of a wasting capital asset, an exception is provided by Part A and B of fifth Schedule which in certain circumstances grants special allowance in respect of depletion of mineral oil to a person carrying on the business of extracting or producing mineral oils in association with the Government.

Expenses and losses claimed should have been incurred in the accounting year.–Deductions can be permitted in respect of only those expenses and losses which are incurred in the relevant accounting year; losses and expenses incurred *before the commencement* of that year cannot be the subject of any allowance *(C.I.T. v. Basant Rai Takhat Singh 1933 I.T.R. 197 (P.C.)). As Lord Russel said in C.I.T. v. Chitnavis (59 I.A. 290, 297, 6 I.T.c. 453, 457 (P.C.))*, "You may not, when setting out to ascertain the profits and gains of one year, deduct a loss which had, in fact, been incurred before the commencement of that year. If you did, you would not arrive at the true profits and gains of the year. For the purpose of computing yearly profits and gains, each year is a separate self-contained period of time in regard to which profits earned or losses sustained before its commencement are irrelevant." The year in which a loss or expense should be claimed as a deduction was considered in the following cases *(Lord's Dairy Farm Ltd.* v. *C.I.T. [1955] 27 I.T.R. 700; Associated Banking Corpn. of Indian Ltd.* v. *C.I.T. [1960] 40 I.T.R. 210)*.

If the assessee fails to debit a particular item of expenditure in the accounts of the year in which it is incurred but keeps the item in a suspense account and after some years debits it to the profit and loss account, the amount of the expense cannot be permitted as a deduction in such subsequent year *(National Petroleum Co.* v. *C.I.T. 1945 I.T.R. 336)*, unless such deduction is warranted by the hybrid system of accounting regularly followed by the assessee *(Gappumal Kanhiyalal* v. *C.I.T. [1961] 42 I.T.R. 446)*. Where the accounts are kept on receipt basis, allowance must be granted in the year of disbursement irrespective of the question when the liability to pay the same arose, and where the accounts are kept on the mercantile basis, allowance must be granted in the year in which the liability is incurred irrespective of the question whether the disbursement has been made or not. In a mercantile system the net profit or loss is calculated after taking into account all the income and all the expenditure relating to the period, whether such income has been actually received or not and whether such expenditure has been actually paid or not–*(Addl. C.I.T., Kanpur* v. *Glass Manufacture Bulb Industries reported in 1983 BTD XI)*.

Similarly, expenditure incurred *subsequent* to the relevant accounting year cannot be allowed as a deduction *(I.R.* v. *Anglo Brewing Co. Ltd. 12 T.C. 803)*, though the necessity for the expenditure may have arisen in the accounting year. The House of Lords held in *(Naval Colliery Col. Ltd.* v. *I.T. (12 T.C. 1017))*, where the question was of the cost of reconditioning mines, that expenditure is deductible in the year in which it is made and not in the year in which it becomes necessary. Likewise, amounts not actually expended but representing at current prices the assessee's

contractual liability to effect replacements of equipment used in the trade but owned by a third party, cannot be allowed–*(Pter Merchant Ltd.* v. *Stadeford 30 I.T.C. 1017).*

Single Transaction.–In the case of a single transaction, *e.g.*, where a moneylender takes over land from his debtor in satisfaction of a debt and sells portions of the land piecemeal at different times, the loss resulting from the transaction as a whole is deductible in the year in which the last portion of the land is sold *(C.I.T.* v. *A.K.A.R. family 1941 I.T.R. 347).* Likewise, if the profits of a single venture are taxed in the year in which the venture comes to an end, the expenditure incurred by the assessee in respect of that venture during prior years must be allowed *(Gustad Irani* v. *C.I.T. [1957] 31 I.T.R. 92).* (See further *ante* under "Single transaction").

Anticipated losses in future.–"Anticipated loss in a future year or period, however, inevitable it may be thought to be, is not and cannot be, a loss on the trading of the present year, upon which it has not in fact fallen" *(C.I.T.* v. *Chari & Ram 1949 I.T.R. 1, 6).* Where contracts are entered into in the accounting year, say, for the purchase of raw materials *(Edward Collins & Sons Ltd.* v. *I.R. 12 T.C. 773)* or the hire of ships on time charter *(Whimister & Co.* v. *I.R. 12 T.C. 813),* and the contracts are to be executed in the subsequent year or years, the loss apprehended to arise under the contracts as a result of a fall in the market, however probable or certain the loss may be, cannot be claimed as a deduction from the profits of the accounting year, for the loss is not actually suffered in that year. The only exception to this rule is that involved in the principle of valuation of trading stock in hand at cost or market value whichever is lower. (See *post* under s. 35, "Valuation of trading stock in hand at cost or market value".)

Expenditure should have been incurred in connection with the assessee's own business.–A deduction would be allowed only in those cases where the expenditure is incurred for the purposes of the assessee's own business *(C.I.T.* v. *Bosotto Bros. Ltd. 1940 I.T.R. 41).* A parent company cannot be allowed a deduction in respect of a loss or expenditure incurred by or for the purposes of a subsidiary company *(Odhams Press Ltd.* v. *Cook 1941 I.T.R. suppl. 92 (H.L.)).* But if the expense is primarily incurred for the purposes of the assessee's business, an allowance should be made even if the expenditure also inures to the benefit of a third party. (See under ..., "Benefit to third party". The business of a company was wound-up by order of court and assets of the company were sold by liquidator and money realised was invested in fixed deposits with banks. Realisation of assets by liquidator cannot be called business activities. So expenses incurred by liquidator towards salaries, legal fees, liquidation expenses, etc. are not business expenditure. Interest earned from fixed deposits is income from Other Sources and the expenditure incurred by liquidator since not related to earning of interest cannot be deductible under Sec. 29 or 57 (corresponding to sec. 34 of I.T. Ordinance) –Reported in 1994 BTD XXII 288-289.

A brewery company acquired licensed premises for the purpose of their business as brewers and as a necessary incident to the more profitable carrying on of their brewery business. The licensed premises were let by the company to publicans

who were "tied" to purchase their beer etc. from the company. The company claimed that in computation of their business profits, repairs, insurance charges and other expenses voluntarily incurred by them in connection with the tied houses and loss suffered by letting the licensed premises to the publicans at rents lower than the full annual value, should be allowed. The House of Lords held that the expenses claimed were admissible deductions as being incurred as a matter of commercial expediency for the purposes of the company's trade, and nonetheless so because incidentally they inured to the benefit of a third party, *i.e.*, the publican. *(Usher's Willshire Brewery Ltd.* v. *Bruce 6 T.C. 399)*. Lord Atkinson said *(6 T.C. at 427)*: I confess I am unable to see upon what principle money designedly spent by the brewer with the sole and exclusive object of maintaining this market place for his own goods, and promoting, through the action of the salesman, the sale of those goods therein, ceases to be an expenditure wholly and exclusively for his (the brewer's) trade because, incidentally, it may benefit the salesman."

Apportionment of expenditure.–The general principle as laid down in the case of Commissioner of Taxation v. Kirk reported in 1900 AC 588 (P.C.) that where an assessee sells goods of his own manufacture his profits do not accrue solely at the place where the sales take place but the profit must be apportioned for other stages also and a part should be considered as accruing at the place where the goods are manufactured and a part at the place where they are sold. Consequently, there should be apportionment of expenditure and deduction and it appears that Rule 34 contemplated such apportionment. In the case of *American Bureau of Shipping* v. *C.T. (South zone) Chittagong* the total income of the non-resident assessee organisation had various parts. An expenditure is to be incurred for co-ordinating by the head office and also the other expenses incurred by the head office in examining the survey report etc. It was held in that case that when the non-resident is liable to pay tax for Bangladeshi income expenditure incurred outside the country for the necessity of the head office outside Bangladesh such type of expenditure like plan approval, meeting expenses will be allowed under sec. 10(2) (xvi) of 1922 I.T. Act (corresponding to Cl. (xvvii) of sec 29)(1) and therefore, only that part of income which is received by them after deducting the expenditure incurred by the head office in U.S.A. for earning the actual profit need be taxed and not whole of the total income received by them at the regional office. There should be apportionment of expenditure and deduction– reported in *KARADALAT* 1998.

No allowances in respect of non-assessable business–Allowances should be confined to appropriate business.–It has been noted above that s. 28 can apply only to those businesses the profits of which are assessable under the Ordinance, though it is immaterial whether any taxable profits have actually been earned or not *(Provident Investment Co. Ltd. A.I.R. 1932 Bom 94)*. Thus the question of allowances under Cls.(i) to (xxvii) of sec. 29 arises only where the profits of a business are assessable to tax.

If an assessee carries on a single business, and *no part* of its profits is liable to tax under the Ordinance, no question can arise of claiming any allowances at all. Thus if the profits of a business are non-taxable as being exempted income or by

reason of their place of accrual abroad *(Macanabb* v. *C.I.T. 1936 I.T.R. 306)*, no allowances relating to such a non-assessable business can be claimed.

Where an assessee carries on a single business and *a part* of the profits of the business is not liable to tax, the view of the Bombay and Rangoon High Courts is that no allowance in respect of expenses incurred in earning the non-taxable profit can be made – *(Provident Investment Co. Ltd. A.I.R. 1932 Bom. 94; C.I.T.* v. *N.S.A.R. Concern 1938 I.T.R. 194)*; but an allowance in so far as it relates to assessable profits only should be permitted – *(Harkishan Lal* v. *C.I.T. A.I.R. 1930 Lah. 982*. On the other hand, the Madras High Court has held *(Indian Bank Ltd.* v. *C.I.T. [1961] 41 I.T.R. 552)*, relying on *Hughes* v. *Bank of New Zealand (1938 I.T.R. 541 (C.A.), 636 (H.L.))*, that the deduction should be allowed in its entirety although a part of the expense deducted may have been incurred for the purpose of earning the non-taxable profits, provided the assessee is carrying on one indivisible trade. Lord Thankerton said in *The Bank of New Zealand's* case *(1938 I.T.R. 636, 644 (H.L.))*: "It does not require the presence of a receipt on the credit side to justify the deduction of an expense". In *(C.I.T.* v. *C. Parakh & Co. (India) Ltd. ([1956] 29 I.T.R. 661))* where a part of the profits of the business was entitled to relief from double taxation under the Agreement with Pakistan, the Supreme Court allowed a deduction of the *entire* managing agency commission from the Indian profits.

If an assessee carries on several *distinct* businesses, *the profits of each business must be computed separately* and allowances must be confined to the appropriate business, *i.e.*, allowances can be claimed in computing the profits of only that business to which they relate *(South Indian Industrials Ltd.* v. *C.I.T. 1935 I.T.R. 11, 21 (S.B.))*. A bad debt of one business cannot be deducted in computing the profits of another *(Arunachalam Chettiar* v. *C.I.T. 1936 I.T.R. 173, 184 (P.C.))*. Similarly, if one of the businesses is assessable under the Ordinance while another is not, the allowances referable to the non-taxable business cannot be deducted in computing the profits of the taxable business *(C.I.T.* v. *Somasundaram Chettiar A.I.R. 1928 Mad. 487 (F.B.))*.

No allowances in respect of business not yet set up at the date of expenditure.–In the case of a new business the accounting year commences on the date when the business is set up *(See s. 2 (35))*. A business is set up when it is established or set on foot. There may be an interregnum between the *setting up* of a business and its actual *commencement (Western India Vegetable Products Ltd.* v. *C.I.T. [1954] 26 I.T.R. 151)*. Expenditure incurred prior to setting up cannot be allowed since it would fall outside the accounting year and outside the ambit of s. 28 which applies only to a business which is "carried on" *(C.I.T.* v. *C. Parakh & Co. (India) Ltd. [1956] 29 I.T.R. 661 (S.C.))*. But expenditure incurred after the business is set up may be allowed under Cl. (i) to Cl. (xxvii) of sec. 29 even if it is incurred before the business has actually commenced *(Western India Vegetable Products Ltd.* v. *C.I.T. [1954] 26 I.T.R. 151)*.

(See also "commencement of business" under the head, "Business should have been carried on in the accounting year ante).

In a case the assessee had no income from indenting business but had expense in that year which mean that there was loss in his business the income from which is to be computed u/s. 10 of I.T. Act. He earned income from interest on fixed deposit which is to be computed u/s. 12 of I.T. Act. 1922. So his loss from business was set-off against his income from interest under Sec. 24 of I.T. Act–*1988 BTD 143 (Tribunal, Dhaka Bench)*. (See also sec. 37 post).

No allowances in respect of discontinued business.–It has been noted above that (a) in order to attract the application of s. 28 the business should have been carried on in the accounting year (See *above under "Business should have been 'carried on' in the accounting year"*), and (b) allowance can be deducted only from the profits of the specific business of which the allowances relate (See *above under "... allowances must be confined to appropriate business"*). It follows from these two propositions that no expenditure or other allowance can be claimed in respect of a business which has been discontinued before the commencement of the accounting year *(Sherwani Bros. Co. Ltd.* v. *C.I.T. [1953] 23 I.T.R. 51)*. Allowances *e.g.* interest on money borrowed, depreciation, write-off allowance, and bad debts, which relate to a business closed before the commencement of the accounting year, cannot be deducted from, or set-off against, the profits of a separate existing business *(South Indian Industrials Ltd.* v. *C.I.T. 1935 I.T.R. 11 (S.B.))*. See Tribunal's decision noted under the head, "no allowance in respect of business not yet set up at the date of expenditure". See further under Cl. (xxvii) of sec. 29. Business should have been 'carried on' by the assessee.–Expenditure incurred before setting up or after discontinuance of business.

If, however, a business is carried on for some time in the accounting year, s. 28 is attracted and, where the accounts are maintained on cash basis, deductions and allowances for that year must be permitted though they arise after the discontinuance of the business *(In re Kamdar 1946 I.T.R. 10 (F.B.))*.

Where one business activity has been discontinued and another continues to exist, it is a mixed question of fact and law whether the discontinued activity was separate and distinct from the existing business, or whether it was merely a branch of the existing business and the two constituted one and the same business. In the latter case the allowances pertaining to the discontinued activity can be deducted in computing the profits of the existing business *(A.L.A.R. Arunachalam Chetty* v. *C.I.T. I.L.R. 52 Mad. 296 (S.B.))*, but not in the former case *(South Indian Industrials Ltd.* v. *C.I.T. 1935 I.T.R. 11 (S.B.))*. See also under s. 28, "several business" and notes to s. 37.

Burden of proof.–Where an assessee seeks to deduct from his business profits certain items as allowances, the onus of proving that such allowances are permissible falls on him *(C.I.T.* v. *Calcutta Agency Ltd. [1951] 19 I.T.R. 191, 196 (S.C.))*. If the amount of an expense in respect of which deduction is allowable is actually paid to the wife of the assessee, the assessee's right to the allowance cannot be defeated by raising the presumption that the wife is the *benamidar* of the husband: "the ordinary presumption of law is that the apparent state of affairs is real unless the

contrary is proved" *(Hazarimal Hiralal* v. *C.I.T. [1952] 21 I.T.R. 113)*. See further under s. 83, "Burden of proof", *post*.

Allowance for rent Sec. 29(1) Cl. (i)—Scope of the clause.—This clause provides an allowance for rent paid for premises in which the business or profession is carried on. The proviso of this clause expressly provides that when any *substantial* part of the premises is used as a dwelling house by the assessee, the proportional annual value of the part so used must be deducted from the rent and the balance would be allowed under this clause.

Premises in which business is carried on.—The rent allowed under this clause is in respect of premises used for the purposes of carrying on the business, profession or vocation. If the premises are taken on lease for business purposes for a term of years and, while the lease has still some years to run, the business ceases to be carried on in those premises but is carried on elsewhere, the rent paid for the premises after the business has ceased to be carried on there would not fall within this clause but would nevertheless be allowable under s. cl. (xxvii) *(Hyett* v. *Lennard 23 T.C. 346, 1940 I.T.R. Suppl. 133)*. The facts of this case were that the assessee who was carrying on business of ladies tailor at a number of branch shops and he took on lease of premises for a term of thirty five years at an annual rent of £3,500 and opened a branch of his business there. After some time business of the branch proved unprofitable and he sub-let the premises at a rent of £2,500. His claim for deduction of 1,000, the difference between the sum he was liable to pay under the head lease and the sum receivable by him under the sub-lease was a proper deduction in computing the amount of profits or gains chargeable in income-tax. However, the rent paid for the period during which the business is not carried on in the premises would not be allowable even under Sec. 29 cl. (xxvii) if the lease could have been terminated when the business ceased to be carried on in the premises *(Pohoomal Bros* v. *C.I.T. [1958] 34 I.T.R. 64)*. If a business in a developing stage acquires on lease premises (say, warehouse accommodation) larger than is necessary at the moment, the rent for such premises which are not actually used would fall, not under this clause, but under cl. (xxvii) *(I.R.* v. *Falkirk Iron Co. Ltd. 17 T.C. 625, 631)*.

Cl.(i) Rent.—If the assessee himself is the owner of the premises and occupies them for the purposes of his business, no notional rent would be allowed to him under this clause, for a man cannot be his own tenant. Where, however, a firm takes on lease premises belonging to one of the partners and pays rent to the landlord-partner, the rent should be allowed to the firm under this clause. It would be "an ordinary landlord and tenant agreement in which one of the partners happens to be the landlord and the partnership are the tenants" *(C.I.T.* v. *Dahanukar [1959] 36 I.T.R. 459)*.

Rent would be a proper deduction under this clause, though the property in respect of which it is paid may be exempt from taxation in the hands of its owner *(Cadbury Bros. Ltd.* v. *Sinclair 18 T.C. 157)*.

If the agreement is to pay the owner of premises a share of profits, such a fluctuating item may not be treated as rent in the absence of special circumstances

pointing to a contrary conclusion *(Gopinath Vir Bhan* v. *C.I.T. 1938 I.T.R. 243)*. However, if the lease provides for a fixed rent and further provides that, in the event of deficiency of a certain margin of profit after deducting the fixed rent, the lessor would grant a rebate in the rent and refund any amount overpaid, the full amount of the fixed rent, or the abated rent, as the case may be, would be an allowable deduction under this clause. What is allowed under this clause is the rent payable for the period during which the business is carried on in the premises. Where the assessee takes an assignment of a lease and pays, voluntarily or under legal obligation, the arrears of rent fallen due before the assignment, no allowance can be claimed under this clause in respect of such arrears of rent nor can the sum be allowed under Cl. (xxvii) as revenue business expenditure *(C.I.T.* v. *Maharajadhiraja of Darbhanga 1933 I.T.R. 94, 110-11 (P.C.))*.

If a part of the rent is calculated to recoup to the landlord the capital cost of construction, the whole of the rent would nevertheless be an admissible allowance under this clause, because for the purposes of the allowance the amount is to be looked at only from the point of view of the payer *(Racecourse Betting Control Board* v. *Wild 22 T.C. 182 [1938])*. But if the lessee has covenanted under the lease to effect capital improvements to the demised premises, the cost of the improvements cannot be allowed as rent *(Subbiah Nadar* v. *C.I.T. [1953] 23 I.T.R. 58)*.

If an assessee pays rent under a lease-deed which provides that in the event of deficiency of a certain margin of profits being found at the end of the year, instead of the full rent being charged a smaller sum shall be charged and if anything has been overpaid it shall be returned, the full or abated rent, as the case may be, would be allowable as a business expense *(Union cold Storage Co. Ltd.* v. *Adamson 16 T.C. 293 (H.L.))*.

Sec. 105 of the Transfer of Property Act makes a distinction between rent and premium payable under a lease. Payment of rent is of recurring nature and what is allowed under this clause is rent for premises taken on lease and not premium payable at the commencement or on renewal or termination of the lease; such premium would ordinarily be a capital expense *(Mac Taggart* v. *Strump 10 T.C. 17)*. It is not open to the assessee to apportion the premium by spreading it over the term of the lease, and to claim an allowance in respect of the aggregate of the rent and the aliquot portion of the premium. "So far as the provisions of the Income-tax Acts go, there is no machinery for converting a premium, paid to the lessor in order to obtain a lease, into an equivalent as rent or annual outgoing. However, if the premium merely represents the payment of rent in advance, it would be allowable under this clause".

Cl. (ii) Repairs to buildings.–This section grants an allowance in respect of the amount expended by the assessee on repairs to the premises. If the assessee is a tenant, the condition of allowance is that he should have "undertaken to bear the cost of repairs to the premises" *(Southern Agencies Ltd.* v. *C.I.T. [1962] 45 I.T.R. 602)*. If the assessee occupies the premises otherwise than as a tenant, e.g. as the owner, licensee or mortgagee-in-possession, he is entitled to a deduction under this section in respect of *current* repairs to the premises.

As regards the meaning of the expression "current repairs", see under cl. (vi), "Current repairs".

Cl.(iii) Interest on borrowed capital.–This clause makes an allowance in respect of interest paid or any profit shared with a bank run on Islamic Principles in respect of capital borrowed for the purposes of the business or profession. In cases of genuine business borrowings the Department cannot disallow any part of the interest on the ground that the rate of interest is unreasonably high (East India Industries (Madras) Ltd. v. C.I.T. (1957) 31 I.T.R. 803. But if the alleged borrowing is actually an illusory and colourable transaction, the assessee cannot be allowed the benefit of this clause *(Govan Bros.* v. *C.I.T. [1963] 48 I.T.R. 930)*. In the case of *C.I.T.* v. *Bombay Samachar Ltd. (1969) 74 I.T.R. 723* the Bombay High Court was of the opinion and the Calcutta High Court followed in the case of (*C.I.T.* v. *C.L. Bajori (reported in 1984 BTD xii 60-85)*) that the only condition required to be satisfied in order to enable the assessee to claim deduction in respect of interest of borrowed capital under Sec. 10(2)(iii) (corresponding to Sec. 29(1)(iii) of I.T. Ordinance, 1984) were, firstly that the money must have been borrowed by the assessee, secondly, it must have been borrowed for the purpose of business and thirdly, the assessee must have paid interest on the said amount and claimed it as a deduction. It was not the requirement of the provision that the assessee must further show that the borrowing of the capital was necessary for the purpose of business so that if at the time of borrowing, the assessee had sufficient amount of its own, the deduction could not be allowed. The fact that the assessee had ample resources at its disposal and need not have borrowed that amount was not a relevant matter for consideration as observed by the Bombay High Court. If the conditions as mentioned above are fulfilled the Income-tax authorities are bound to allow the amount which has been paid as interest and they have no power to reduce the amount paid as interest to anything considered reasonable by them on subjective or objective standards–*East India Industries (Madras) Ltd.* v. *C.I.T. (Madras) (1957) 31 I.T.R. 803*. Where an assessee has invested his own capital in his business and also borrows moneys for the purpose of his business, any subsequent withdrawal for his personal use would be presumed to be out of his capital and would not entitle the Department to disallow a part of the interest paid, unless there is evidence to show that a particular amount borrowed was utilised for his private purposes *(C.I.T.* v. *Gopikrishna Muralidhar [1963] 47 I.T.R. 469)*. It was even observed by the S.C. of Bangladesh in the case of *(C.I.T. Titas Gas Transmission & Distribution Co. Ltd. (reported in BTD 1983 xxi 80))* that no where cl. (iii) of Sec. 10(2) speaks about utilisation of capital borrowed.

The interest paid on capital borrowed for expanding a business is allowable under this clause, although the assets brought into existence with the help of the borrowed capital may not be actually used for the purposes of the business in the relevant accounting year *(Calico Dyeing & Printing Works* v. *C.I.T. [1958] 34 I.T.R. 265)*. In this case the assessee firm which carried on the business of bleaching, dyeing and printing cloth borrowed money in the year of account in order to extend its business, purchased land and erected additional plant and machinery and paid interest on the borrowed capital. It was held in that case that the assessee was entitled to the deduction claimed, even though the plant and machinery were not used in the year of

account ... all that the assessee has to show is that the capital which was borrowed was used for the purposes of the business of the assessee in the relevant year of account. It does not matter whether the capital is borrowed in order to acquire a revenue asset or a capital asset. It is immaterial whether the borrowing is for the purpose of acquiring a capital asset or stock-in-trade *(Calico Dyeing & Printing Works* v. *C.I.T. [1958] 34 I.T.R. 265)*, or for paying trading debts.

If the money is borrowed for the purposes of a business which is *not at all assessable* under the Ordinance, no deduction can be claimed under this clause in respect of the interest on such borrowing *(Conville* v. *C.I.T. 1936 I.T.R. 137)*. Where an assessee carries on a *single* business, and a *part* of the profits of the business is non-assessable under the Ordinance, one view is that interest on money borrowed for the purpose of earning the non-taxable profits cannot be allowed under this clause *(In re Provident Investment Co. A.I.R. 1932 Bom. 94, 6 I.T.C. 21)*; but it can be allowed only in so far as the borrowing is for the purpose of earning taxable profits *(Harkishan Lal* v. *C.I.T. A.I.R. 1930 Lah. 982, 4 I.T.C. 431)*. The other view is that interest *should be allowed in its entirety* although a part of the borrowing may have gone to earn the non-assessable profits, provided the assessee is carrying *on one indivisible trade (Indian Bank Ltd.* v. *C.I.T. [1961] 41 I.T.R. 552)*. This view rests on the principle that it does not require the presence of a receipt on the credit side to justify the deduction of an expense *(Hughes* v. *Bank of New Zealand 1938 I.T.R. 636, 644 (H.L.)*. Where several *distinct businesses are carried on,* the profits of each business must be computed separately and the allowance under this clause can be claimed in computing the profits of *only that business for which the capital was borrowed.* Interest on money borrowed for the purposes of a non-assessable business cannot be allowed against the profits of another separate business which is assessable *(C.I.T.* v. *Somasundaram Chettiar A.I.R. 1928 Mad. 487 (F.B.)*. (See under s. 29, "No allowances in respect of non-assessable business: Several businesses–Allowances should be confined to appropriate business".

Interest paid by a company for borrowing loan from another company is also allowable. It is not necessary for the company giving loan to have license for money lending as observed by the Dhaka Appellate Tribunal.

No allowance can be claimed under this clause if the borrowing was for the purposes of a business discontinued before the commencement of the accounting year, nor can the interest on such borrowing for a defunct business be deducted from, or set off against, the profits of a separate existing business. (See under s. 29, "No allowances in respect of discontinued business".

This clause applies only where capital has been *borrowed.* A company's share-capital is not capital borrowed; therefore guaranteed interest paid by a company to its shareholders on the capital contributed by them is not deductible under this clause. Interest payable to the Government on account of deficiency in advance payment of tax *(Balmer Lawrie & Co. Ltd.* v. *C.I.T. [1960] 39 I.T.R. 751)*, is not deductible, for in such a case there is not borrowing of capital. Similarly, where the assessee is an association of individuals, and the members of the association invest their capital in the business and are paid a certain rate of interest thereon, no

allowance can be made under this clause in respect of such interest, for the capital *invested* by the co-owners of the business cannot be considered to be "capital borrowed" *(Main Channu Factories Union* v. *C.I.T. 1936 I.T.R. 203).* A mere purchase of a capital asset on a long-term credit with a stipulation for payment of interest on the unpaid balance of the price, does not amount to the borrowing of capital within the meaning of this clause *(Bombay Steam Navigation Co. (1953) Pr. Ltd.* v. *C.I.T. [1963] 48 I.T.R. 476. But such interest should be allowed under s. cl.(xvii). See post. "interest on unpaid purchase price".*

In a Madras case a father and son carried on business in partnership, and the father died leaving a will authorising his executors to keep the moneys belonging to his estate in the business of which the son became the sole owner upon the father's death. It was held that the amount credited to the estate in the books of the concern was borrowed capital and the interest thereon was allowable under this clause *(C.I.T.* v. *Ramsay Unger 1947 I.T.R. 87).* But mere entries in the books of account cannot operate to secure allowance for interest credited to persons who have no legal right to the capital in respect of which the interest is credited *(Muthappa Chettiar* v. *C.I.T. 1945 I.T.R. 311. Cf. Dalooram Jayanarain* v. *C.I.T. [1962] 44 I.T.R. 379).*

"Paid"–In order to claim an allowance in respect of interest paid on borrowed capital, it must be interest "paid" during the year of account. An allowance may be granted under this clause in respect of interest actually paid where the assessee follows the cash basis of accounting, or in respect of interest accrued due where the mercantile basis of accounting is adopted.

Disallowance of interest in certain cases.–Sec. 30(b) enacts that where the assessee is a firm, no allowance can be made in respect of any interest paid to a partner. But interest paid by a partner to the firm would be included in the firm's total income *(Ram Mahadeo Prasad* v. *C.I.T. [1953] 24 I.T.R. 176).* Section 22(2) prohibits allowance of interest payable outside Bangladesh if no tax is paid or deducted at source from such interest. Under the proviso to this clause it has been provided that no interest on borrowed capital shall be proportionately allowed for that part of such capital as will be transferred to replenish the cash or to any other assets to a newly set-up industrial undertaking or to an existing industrial undertaking whose income is exempted from payment of tax. In other words, interest on borrowed capital or profit shared in case of bank run on Islamic principles for that part of the amount of borrowed money shall be proportionately allowed which will be used for the purpose of business or profession.

Cl. (iv): Sum paid by bank by way of distribution of profit.–Any bank run on Islamic principles generally does not pay interest on deposits to the depositors: It shares profit or loss if any, with its depositors and such profit or loss is distributed by credit or debit as the case may be, to either depositor's deposit account or through the profit and loss sharing account, if so maintained. This clause makes an allowance for any such share of profit, instead of interest, when distributed by way of credit to the depositors' deposit account like any other commercial bank or to the profit and loss sharing account.

Cl. (v): Allowance for transfer of income to special reserve.–This clause makes an allowance for such financial institution in respect of a sum not exceeding ten percent of its total income as carried to any special reserve fund by such financial institution for specific purpose as may be approved by the Government. The only condition as mentioned in the clause is that in such a case the aggregate amount of such special reserve shall not exceed the paid-up share capital of the institution. So the financial institution shall be allowed to transfer the specified portion of its profit to the special reserve fund for purposes as may be approved by the Government and till the period such fund does not exceed the paid-up share capital of such institution.

Cl. (vi): Current repairs.–Cl.(ii) deals with repairs of buildings and this clause grants deduction in respect of current repairs of machinery, plant or furniture used for the purposes of business or profession.

As repairs to business premises by a tenant are expressly provided in Cl.(ii) this clause may be confined to cases where the assessee is the owner of his business premises. But as regards machinery, plant and furniture, this clause would be applicable whether the assessee is the owner of these assets or has only the use or demise of them.

What the clause allows is the cost of current repairs only and not of renewal or reconstruction. Buckley, L.J., said in *Lurcott* v. *Wakely & Wheller ([1911] 1 K.B. 905, 923-4)* "'Repair' and 'renewal' are not words expressive of a clear contrast. Repair always involves renewal; renewal of a part; of a subordinate part ... Repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal, as distinguished from repair, is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject-matter under discussion" *(Dehri Rohtas Light Rly. Co. Ltd.* v. *C.I.T. [1962] 46 I.T.R. 533)*. Thus constructing, in place of the old, a new chimney *(O'Grady* v. *Bullcroft Main Collieries Ltd. 17 T.C. 93)*, a new reservoir *(Margrett* v. *Lowestoft Water & Gas Co. 19 T.C. 48)*, a new embankment *(Phillips* v. *Whieldon Santitary Potteries Ltd. 33 T.C. 213)*, or a new roof as a part of the extension and improvement of the building as a whole *(Willam Lawrie* v. *I.R. 34 T.C. 20)*, would be renewal or reconstruction and not "current repairs", where, having regard to the size and importance of the work, the thing reconstructed is itself regarded as "the entirety". Likewise, the expenses of extensive renovation of a cinema house, designed to increase its value and running capacity, were disallowed as not being current repairs *(Humayun Properties Ltd.* v. *C.I.T. [1962] 44 I.T.R. 73)*. On the other hand, where in the context of the facts of the case, a chimney was regarded as a subsidiary part of the factory premises, the cost of its reconstruction was allowed as repairs *(Samuel Jones & Co. (Devonvale) Ltd.* v. *I.T. 32 T.C. 413)*. Likewise, the expense of renovating the flooring *(Bansilal Abirchand Spg. & Wvy. Molls* v. *C.I.T. [1957] 31 I.T.R. 427)*, or the comparatively small cost of fitting new bodies in trucks used in transport business *(C.I.T.* v. *Sheikhupura Transport Co. Ltd. [1961] 41 I.T.R. 336)*, or the cost to a railway company of reconditioning engine boilers and replacing fire-boxes *(Dehri Rohtas Light Rly. Co. Ltd.* v. *C.I.T. [1962] 46 I.T.R. 533)*, would be allowable. Ordinarily, the substitution in a machine of new parts for old and worn-out parts is in the nature of current repairs

or revenue expenditure, even if the old parts are required to be replaced after a very long period, say sixty years *(New Shorrock Sp. & Mfg. Co. Ltd.* v. *C.I.T. [1956] 30 I.T.R. 338)*. But the cost of any substitution of new parts which substantially change the identity of the machine, effect a substantial improvement or result in a substantial extension of the period of serviceableness, would be capital expenditure and would not be allowable under this clause as the cost of current repairs *(Ratan Singh* v. *C.I.T. 2 I.T.C. 294)*. However, these tests cannot be regarded as absolute, because the question is really one of fact and of degree *(Corera & Bros.* v. *C.I.T. [1963] 49 I.T.R. 188)*. The cost of resurfacing with concrete the approach roads which had fallen into a bad state due to several years of wear and tear would be current repairs *(C.I.T.* v. *Ranjit Singh [1955] 28 I.T.R. 14)*. Cost of construction of roads in area around factory was held to have been wholly and exclusively laid out for business and the expenditure was not capital expenditure because no tangible or intangible asset was acquired by the assessee nor was there any addition to or expansion of the profit-making apparatus of the assessee *(L.H. Sugar Factory and Oil Mils (P) Ltd. v. C.I.T. (S.C. of India))* reported in 1982 BTD X P. 1-3. Likewise, the periodical renewal by sections of the rails and sleepers of a railway line as they wear out by use constitutes merely current repairs and not reconstruction *(Rhodesia Rlys. Ltd.* v. *I.T. Collector 1933 I.T.R. 227 (P.C.))*. But substituting steel rails for iron rails would be capital expenditure *(Highland Rly* v. *Balderston 2 T.C. 485)*. The contrast is "between the cost of relaying the line so as to restore it to its original condition and the cost of relaying the line so as to improve it ..... While the former is recognised as a legitimate charge against income, the *extra* cost incurred in the latter case in the improvement of the line is equally recognised as a proper charge against capital", as Lord Macmillan observed in *(Rhodesia Rlys. Ltd.* v. *I.T. Collector)*.

In *Ramkishan Sunderlal* v. *C.I.T. ([1951] 19 I.T.R. 324)* the Allahabad High Court held that "current repairs" means "*petty* repairs usually carried out periodically and will not include repair or renewal costing a large sum of money which has to be spent after a machine has been run for a number of years". It is submitted by the learned authors Kanga and Pakhivala that this definition of "current repairs" is unduly restricted. In the above-mentioned case the Allahabad High Court held that expenditure incurred in changing some of the cables of a flour mill plant could not be allowed as a deduction. In a later case *(In re L.H. Sugar Ractories & Oil Mills [1952] 21 I.T.R. 325)* the same High Court disallowed the expenditure incurred by the assessee company in the re-roofing of labourers' quarters by using new tiles in place of old ones. It was further submitted that in both the cases the expenditure should have been allowed either as current repairs under this clause or as revenue expenditure under cl. (xxvii). The above interpretation put on the expression "current repairs" by the Allahabad High Court was dissented from by the Madras High Court in *C.I.T.* v. *Sri Rama Sugar Mills Ltd. (Corera & Bros* v. *C.I.T. [1963] 49 I.T.R. 188)* which was a case of replacement of an old boiler and which is considered below under cl. (xxvii). It was also dissented from by the Patna High Court in *(C.I.T.* v. *Darbhanga Sugar Co. Ltd. (Dehri Rohtas Light Rly Co. Ltd.* v. *C.I.T. [1962] 46 I.T.R. 533))* and by the Bombay High Court in *(New Shorrock Spg. & Mfg. Co. Ltd.* v. *C.I.T.)*. In the last-mentioned case the expression "current repairs" was held to denote repairs which are attended to when the need for them arises from the businessman's

view-point and which are not allowed to fall into arrears or to be accumulated *(Humayun Prperties Ltd. v. C.I.T. [1962] 44 I.T.R. 73 (Cal.))*.

Since this clause allows only *current* repairs, the cost of *arrears* of repairs done in one year may not be held deductible under this clause but it may nevertheless be an admissible deduction under cl. (xxvii). See under that clause, "Current and Accumulated repairs ....".

Building, machinery, plant or furniture used for the purposes of the business" denote use for such purposes during the accounting year. As the Supreme Court of India laid down in *(The Liquidators of Pursa Ltd.* v. *C.I.T. ([1954] 25 I.T.R. 265))* the words of the statute would not be satisfied if the assets are not at all used at any time during the accounting year cost of repairs in respect of assets which have been discarded before the accounting year or not used at all during that year would not be allowable under this clause. But the word "used" should be understood in a wide sense so as to embrace passive as well as active user. When machinery is kept ready for use at any moment in a particular factory under an express contract from which taxable profits are earned, the machinery can be said to be used for the purposes of the business which earns the profits even if it is not actually worked *(C.I.T.* v. *Dalmia Cement Ltd. 1945 I.T.R. 415)*. Cases where the assets are not exclusively used for business purposes are dealt with below:

It is also *not necessary* that the machinery, plant etc. should be used *throughout the accounting year* or during the whole of that year *(C.I.T.* v. *National Syndicate [1961] 41 I.T.R. 225 (S.C.))*. Even if they are worked for only a part of the year, the assessee should be granted the full allowances permissible under this clause, and not merely an amount proportional to the period of user *(C.I.T.* v. *Dalmia Cement Ltd. 1945 I.T.R. 415)*.

Partial allowance for assets partly used for business.–Where any building, machinery, plant or furniture is not exclusively used for the business of the assessee but is also used for other purposes, the allowance should not be the full allowance due under clauses (vi), (vii) and (viii) but should be confined, under this sub-section, to an amount proportional to the business user *(C.I.T.* v. *Sobharam Jokhiram [1960] 39 I.T.R. 299)*. This sub-section cuts down the allowance where the user is only partly for business purposes, but it does not apply to cases where the assets are used exclusively for business purposes but only for a part of the accounting year *(C.I.T.* v. *Dalmia Cement Ltd. 1945 I.T.R. 415, 419)*.

Cl. (vii) Premium for insurance of buildings machinery, plant or furniture, stocks or stores.–This clause grants deductions in respect of insurance of buildings, machinery, plant or furniture, stocks or stores used for the purposes of business or profession.

"Used for the purposes of business" obviously means used *for the purposes of the assessee's own business* the profits of which are being charged–*(Liquidators of Pursa Ltd.* v. *C.I.T. (1954) 25 I.T.R. 265, 275 (S.C. of India))*. If the insured assets are used for the business of the assessee the payment of the premiums must be allowed under this clause, even though the payment may also inure to the benefit of somebody

else. But if the business is carried on by a third party, the owner of the premises, plant and machinery or furniture, which are used in such business cannot claim an allowance in respect of their insurance charges, for though the insured assets are owned by him, they are not used by him for the purposes of his business–*(Union Cold Storage Co. Ltd.* v. *Gones 8 T.C. 725 (C.A.))*. The allowance of premium so paid shall be restricted to the proportional part of premium paid for the above assets used for the purposes of assessee's own business.

Insurance against damage, destruction and loss.–This clause grants a deduction in respect of premiums for insurance of machinery, plant and furniture of buildings and of stocks and stores. Premiums paid in respect of other kinds of insurance may be admissible deductions under cl. (xxvii). See under cl. (xxvii), "Insurance premiums".

In an earlier English case fire or marine insurance premiums had been held to be inadmissible as deductions *(Union Cold Storage Co.* v. *Jones 8 T.C. 725)*; but a contrary view was taken in later cases *(Green* v. *Gliksten & Son Ltd. 14 T.C. 364, 378 (H.L.))*. The principle of these later cases is here given statutory recognition.

The following conditions must concur in order to attract the application of this clause:–(i) The insurance must be against risk of damage or destruction of machinery, plant or furniture, or building or stocks or stores, (ii) such assets must be used for the purposes of the business or profession, the profits of which are under assessment; and (iii) the premium claimed as an allowance must be "paid". Where the assessee's method of accounting is mercantile, the premium would be "paid" in the year in which the liability to pay is *ascertained (Kanpur Tannery Ltd.* v. *C.I.T. [1958] 34 I.T.R. 863)*. For the definitions of "plant and furniture" (See Para 11 of Third Schedule and the notes thereunder which also defines "plant as including ships, vehicles, books, scientific apparatus and surgical equipment). It is not easy to give a definition of "machinery" which will be applicable in all cases. The determination, in any given case, of what is or is not "machinery" must, to a large extent, depend upon the special facts of that case *(Corpn. of Calcutta* v. *Cossipore Municipality A.I.R. 1922 P.C.)*.

Cls. (viii), (ix)-Depreciation allowances.–Under these clauses the assessee is entitled to normal depreciation allowance on building machinery, plant or furniture, investment allowance on ship and on machinery or plant (other than office appliances and road transport vehicles), respectively.

Besides, the assessee is entitled to accelerated depreciation allowance on machinery and plant under Paragraphs 7 and 7A of Third Schedule under certain circumstances and special depreciation allowance on ships under Para 8 of that Schedule. The aggregate of all deductions in respect of depreciation made under this sub-section or the earlier income-tax laws should not, in any case exceed the actual cost to the assessee of the buildings, machinery, plant or furniture.

The balancing allowance which is granted in the year in which the asset is sold, discarded or destroyed, is dealt with by Paragraph 10(c) of Third Schedule. The investment allowance in the case of ship under Cl.(ix) and for machinery or plant

under Cl.(x) of this section is in addition to and does not form part of the depreciation allowance. Besides some other depreciation allowances like accelerated depreciation allowance and special depreciation allowance have been provided for in Paragraphs 7, 7A and 8 of Third Schedule.

Conditions of allowance.–The general scheme of the Ordinance is that the income is to be charged regardless of the exhaustion, or diminution in the value, of capital. To this somewhat hard principle of taxation an exception is afforded by this clause which grants an allowance in respect of depreciation in the value of certain capital assets.

(1) Depreciation allowance is confined to buildings, machinery, plant and furniture. –The assets in respect of which depreciation allowance is claimed must be either buildings, machinery, plant or furniture; depreciation in the value of any other capital asset cannot be deducted from business profits. The determination in any given case of what is or is not "machinery" must, to a large extent, depend upon the special facts of that case *(Burnley Steamship Co. v. Aikin 3 T.C. 275)*. A harbour bed is not plant *(Dumbarton Harbour Board v. Cox 7 T.C. 147)*. The word "plant" would not include, for the purposes of this Ordinance, animals or the human body *(Earl of Derby v. Aylmer 6 T.C. 665)*. Plant in its ordinary sense includes whatever apparatus is used by a businessman for carrying on his business: not his stock-in-trade which he buys or makes for sale, but all goods and chattels, fixed or moveable, which he keeps for employment in his business with some degree of durability *(Hinton v. Maden & Ireland Ltd. 38 T.C. 391, 417-424 (H.L.), [1960] 39 I.T.R. 357, 372-3, 381)*. Thus knives and lasts, of which the average life was three years, were held by the House of Lords in *Hinton v. Maden & Ireland Ltd. (38 T.C. 391, [1960] 39 I.T.R. 357)* to be plant. Plant would include part of a plant, e.g. the engine of a vehicle, and machinery would include part of a machinery *(Mr. Mohd. Ali v. C.I.T. [1960] 38 I.T.R. 413)*. "Plant" is defined by Paragraph 11(2) in Third Schedule and in Expln. to sub-sec. (2) as including ships, vehicles, books, scientific apparatus and surgical equipment used for the purposes of business.

(2) User in the accounting year.–The allowance is in respect of only those buildings, machinery, plant and furniture which are *used* (and are not merely capable of being used) for the purposes of the assessee's business the profits of which are being charged *(Liquidators of Pursa Ltd. v. C.I.T. [1954] 25 I.T.R. 265, 272 (S.C.))*. The assets must be so used during the whole or at least some part of the accounting year *(Liquidators of Pursa Ltd. v. C.I.T. [1954] 25 I.T.R. 265, 272 (S.C.))*. The allowance is granted, not for depreciation as such, but for depreciation as a consequence of earning the income or while employed in the earning of income. But the word "used" embraces passive as well as active user *(State of Madras v. Glenburn Estatues Ltd. [1962] 44 I.T.R. 643)* and depreciation may be allowed in certain cases even though the machinery has not been actually worked during the accounting year. "The word 'used' in Section 10(2)(vi) of the Income-tax Act should be understood in a wide sense so as to embrace passive as well as active user, where machinery is kept ready for use at any moment in a particular factory, under an express agreement from which taxable profits are earned, the machinery can be said to be used for the purpose

of business which earns the profit although it is not actually worked and depreciation allowance can be given in respect of such machinery under section 10(2)(vi) of the Income-tax Act, 1922 *C.I.T. Bombay* v. *Viswanath Bhaskar Sathe [1937] 5 I.T.R. 621.*

The cases where it was held that even if the machinery, plant etc. were not used throughout the year but were used only for a part of the year. The assessee should nevertheless be granted the full depreciation allowance permissible under this clause–*C.I.T.* v. *Dalmia Cement Ltd. 1945 I.T.R. 415.* If, however, the assets are not wholly used for business purposes but are also used for other purposes, the assessee would be entitled to only a proportionate part of the depreciation allowance–Sub-Para (2) of Paragraph 2 of Third Schedule. Depreciation in full on the machinery used in seasonal factories are allowable –*State of Madras* v. *Glesburn Estates Ltd. –(Madras) 1962 44 I.T.R. 643.*

Depreciation allowance cannot be granted for the accounting year in which the building, machinery, plant is disposed of (s. cl.(a) of Paragraph 10 of Third Schedule). For such accounting year the necessary relief by way of balancing allowance is available under Para 10(c) of Third Schedule.

The assets may be actually worked, not by the owner entitled to depreciation, but by a lessee or licensee *(C.I.T.* v. *Sarveshwar Nath Nigam [1963] 48 I.T.R. 853)*: depreciation allowance will be granted under this section to the owner who has let on hire his building, machinery, plant or furniture, if the letting amounts to or is in course of business and the assets are used for the purposes of the business, *viz* letting *(C.I.T.* v. *Bosotto Bros. Ltd. 1940 I.T.R. 41).* (See further under s. 28, "Income from letting out a business asset". Where an assessee lets on hire machinery, plant or furniture belonging to him, without or together with buildings, and the letting does not constitute a business activity, the assessee is entitled, under s. 34(2) to other deductions from the rental income which would be assessable as income from Other Sources (s. 33(c).

(3) "Owned by the assessee"– Paragraph 2(1) of Third Schedule.–It is only in respect of the property of the assessee that depreciation allowance can be granted under this section. No depreciation allowance is granted in respect of any capital expenditure which the assessee may be obliged to incur on the property of others *(Poona Electric Supply Co. Ltd.* v. *C.I.T. 1946 I.T.R. 618).* An assessee would not be entitled to depreciation allowance if he is not the owner of the building, machinery, plant or furniture, as the case may be, but has only the use or demise of them *(Union Cold Storage Co. Ltd.* v. *Simpson 22 T.C. 547 (C.A.))* or has hired them under a hire-purchase agreement *(Sardar Tara Singh* v. *C.I.T. [1963] 47 I.T.R. 756).*

(4) Prescribed particulars.–The prescribed particulars must be duly furnished by the assessee. If they are not furnished, the Deputy Commissioner of Taxes would be justified in refusing to grant any allowance *(Muthukaruppan Chettiar* v. *C.I.T. 1939 I.T.R. 76)* (See also sub-Para (3) of Paragraph 2 of Third Schedule). Where the assessee does furnish the particulars but the Deputy Commissioner of Taxes disbelieves them, the Deputy Commissioner of Taxes cannot decline to grant

any allowance at all–*Muthakaruppan Chettiar* v. *C.I.T. 1939 I.T.R. 76, 89-90.* Where an assessee does furnish the particulars but the Deputy Commissioner of Taxes disbelieves them, the Deputy Commissioner of Taxes Cannot decline to grant any allowance but should call for evidence and arrive at his own finding regarding the original cost. In such a case the assessment may be postponed until the assessee has had an opportunity of producing evidence in support of his claim and if that evidence is not satisfactory, until the Deputy Commissioner of Taxes ascertains the correct value–*Bisheshar Prasad Parashotom Das* v. *C.I.T. 7 I.T.C.74.*

Depreciation allowance is not a statutory deduction. This is to be allowed only when claimed with full particulars. But it is the sweet will of the assessee to claim or not to claim the allowance–*Beco Engineering Co. Ltd. [1984] 148 I.T.R. 478.*

(5) Depreciation allowances not to exceed original cost.–The aggregate of all the depreciation allowances made year after year should not in any case exceed the original cost to the assessee of the buildings, machinery, plant or [illegible] the aggregate of all such allowances equals the original cost of the asset, the benefit of this section ceases to be available to the assessee in respect of that asset (Sub-Para (1) of Paragrah 9 of Third Schedule).

Fixed percentage of depreciation allowance, irrespective of actual wear and tear.–The assessee is entitled as of right to the full amount of the allowance prescribed by Paragraph 3 of Third Schedule, irrespective of the actual wear and tear caused to the assets in question. As the several items of allowance mentioned in Cls (i) to (xxvii) of Sec. 29(1) are cumulative and not mutually exclusive an assessee is entitled under this section to depreciation allowance in respect of a certain asset although he may also have been allowed under Cls. (ii) or (vi) cost of repairs to the same asset *(Ratan Sinh* v. *C.I.T. A.I.R. 1926 Mad. 462).*

Railways and tramways.–A Notification issued under s. 60 of I.T. Act, 1922 provides that in case of a railway or a non-electric tramway, in lieu of the allowances for repairs and depreciation and of the balancing allowance, a deduction may be granted, at the option of the assessee, in respect of the actual expenditure incurred on repairs, replacements and renewals.

An assessee company which ran a railway over a distance of 25 miles on one line and of 15 miles on a branch line, spent Tk.35,000 and Tk.14,095 during the accounting year relevant to the assessment year 1953-54 in replacing old and worn-out sleepers on the railway line by new ones ... for those years. Held, that the amount spent for replacement of worn out sleepers were revenue expenditure r/s. 10(2)(v) of I.T. Act, 1922–*C.I.T.* v. *Dehri Rohtas Light Railway Co. Ltd. –P.T.D. 62(2).*

Basis of allowance–Written down value or actual cost.–Paragraph 3 of Third Schedule prescribes different percentages of depreciation allowance for different classes of assets. In the case of ocean-going ships, the prescribed percentages of depreciation allowance is to be calculated on the actual cost of the asset to the assessee. In all other cases it is to be calculated on the written-down value of the asset. Written-down value is defined in Sub-Para (5) of Paragraph 11 of Third

Schedule. In the case of assets *acquired in the accounting year*, the written down value means the *actual cost* to the assessee.–Cl.(a) of Sub-Para 5.

In the case of assets *acquired before the accounting year*, the written down value means the actual cost of acquisition less the aggregate of al deductions for depreciation *actually allowed* (and not merely allowable to the assessee in past years) –Cl. (b) Sub-Para (5) (See further sub-para (6) for the purposes of Cl. (5) *post* under Third Schedule.

Where a non-resident's world income is computed after allowing full depreciation and a portion of such world income is the total income subjected to taxation, only a proportionate part of the depreciation can be said to be "actually allowed" *(Hukumchand Mills Ltd. v. C.I.T. [1963] 47 I.T.R. 494).*

It is obvious that since "the written down value" would diminish year after year and the depreciation allowed is a percentage on the written down value, the amount of depreciation allowance would also diminish year after year.

As the prescribed percentage of allowance is different for different types of assets, and the written down value may also vary with several assets of the same type, the allowance for each asset may have to be computed separately, and then the total of the several items of allowance may be deduced as one lump sum under this clause *(Charente Steamship Co. Ltd. v. Wilmot 24 T.C. 97).*

Actual cost of the assessee–Sub-Cls. (5) and (6) of Para 11 of Third Schedule.–There are three purposes for which it is necessary to ascertain the original actual cost to the assessee of the asset in respect of which depreciation allowance is claimed: (i) The cost is the basis of allowance in respect of ocean-going ships. (ii) The written–down value is calculated with reference to the cost in the case of other assets. (iii) Under Sub-Paragraph (1) of Paragraph 9 of Third Schedule the aggregate of all depreciation allowances must not exceed the original cost to the assessee, and therefore it would be necessary to ascertain the original cost in order to decide whether the assessee is no longer entitled to the benefit of this clause.

The unabsorbed depreciation carried toward will not be deemed to be depreciation allowed for the purpose–*C.I.T. v. Kamala Mills Ltd. (1949) I.T.R. 130.*

The actual cost to the assessee is what he in fact expends or lays out for acquiring the asset in the income year–Sub Cl. (a) of Sub-Paragraph 5. Thus the actual cost of a cinema theatre would include the payment made to a third party for assistance in preparing plans for the construction, and for securing permits, priorities, import licenses and foreign exchange for the materials *(Habib Hussein v. C.I.T. [1963] 48 I.T.R. 859).* The original cost of an asset may increase after the year of installation or erection, as a result of further liabilities arising later *(Habib Hussein v. C.I.T. [1963] 48 I.T.R. 859).* If a factory is shifted to a new site, the mere expense of transporting the plant cannot be treated as part of its cost and would not qualify for depreciation allowance *(Sitalpur Sugar Works Ltd. v. C.I.T. [1963] 49 I.T.R. (S.C.) 160).*

Where an assessee acquires the business of another, the original cost to be considered for the purposes of this section is the original cost to the person who is being actually assessed (i.e. the value at which the assets are taken over by him) and not the original cost of those assets to the previous owner of the business *(C.I.T. v. Saraspur Mills Co. Ltd. 6 I.T.C. 1)*. This is established by the decisions of the Privy Council in *C.I.T. v. Buckingham & Carnatic Co. (1935 I.T.R. 384)* and of the Supreme Court of India in *(Jogta Coal Co. Ltd. v. C.I.T. (1959 36 I.T.R. 521))*. The Privy Council further held in *India Iron & Steel Co. v. C.I.T. (1943 I.T.R. 328)* that where the successor to the business was assessed on his own profits as well as on the profits of his predecessor (s. 88), in calculating the predecessor's profits depreciation should be determined with reference to the cost to him (the predecessor), and in calculating the successor's profits depreciation should be determined with reference to the cost to him (the successor) (Under this Ordinance the depreciation would be on the basis of the cost (to the predecessor or to the successor, as the case may be) less the depreciation previously allowed to the assessee). This rule would apply whether the transfer of business takes place at the end of a fiscal year *(C.I.T. v. Buckingham & Carnatic Co. Ltd. 1935 I.T.R. 384 (P.C.))* or in the middle of a fiscal year *(Indian Iron & Steel Co. Ltd. v. C.I.T. 1943 I.T.R. 328 (P.C.))*. Where the assessee has succeeded another person by inheritance, the written-down value of an asset shall be computed as if no succession had taken place cl. (d) of sub-para 6.

Cases where the actual cost is not actual.–In the following cases it may be said that the actual cost is not actual and for the purpose of depreciation that will be the written-down-value as per sub-paragraphs 5 and 6 of paragraph 11. It is doubtful whether depreciation will be calculated on the reduced value of these assets year after year. (i) Where the assets being passenger motor vehicles or sedan cars, not plying for hire, written down value, where written-down value means actual cost as per provisions of sub-cls. (5) and (6) of Para 11 of Sixth Schedule, to the assessee of such vehicles shall be deemed not to exceed seven lakh fifty thousand taka which has been raised to ten cash taka by the F.A. 2000 even if the actual cost is higher–cl. (a) of sub-para (6) of Paragraph 11 of Third Schedule.

(ii) Where the assessee acquires the assets which were previously used by any other person for the purpose of his business or profession the actual cost of such assets to the assessee shall be, except in case of succession of business by inheritance where provisions of Sec. 88 apply for the purpose of assessment, shall be deemed not to exceed the fair value of the assets, the assessee in such cases may be required to pay more or less than the fair market value–cl. (c) of sub-para 6 of paragraph 11.

(iii) Where an asset is acquired by the assessee otherwise than by purchase, for instance by bequest "the original cost thereof to the assessee" in Sec. 10 (2) (vi) of the Income-tax Act means and is the real value of the property at the time when the assessee acquired it less the expenditure necessary for the purpose of completing title. In the case of acquisition by bequest the probate charges actually paid by the assessee would be included in such expenditure. The words "original cost thereof" refer to the assessee as defined in Sec. 2(2) of the Act, that is to say, the person by whom income-tax is payable–*C.I.T. v. Solomon & Sons [1933] 1 I.T.R. 324.*

(iv) Cl. (b) of sub-para (6) of Paragraph 11 provides that the actual cost of an asset to the assessee should in every case be reduced by that portion of the cost thereof if any, as has been made directly or indirectly by any other person or authority which has superseded the general rule of law that in computing the actual cost for the purpose of depreciation it is immaterial whether some one else has recouped the assessee what he has spent on the asset–*C.I.T.* v. *Pout Electric Co. Ltd. 1946 I.T.R. 622*. This clause provides that while acquiring the asset the assessee receives any amount of grant or subsidy or rebate or commission or loan, being not repayable with or without interest, from Government or any other authority or person, such amount shall be excluded from the value of the asset to arrive at the actual cost.

Where the assessee has acquired the asset, being plant and machinery, for the purpose of his business or profession for installation in Bangladesh from a country outside Bangladesh with money borrowed in foreign currency, he may be required to pay more or less than the actual price of the asset because of a change in the rate of exchange after the acquisition of such assets and before full and final payment of the foreign loan, and as such in a case there is an increase or reduction in the liability of the assessee in terms of Bangladesh currency. The amount by which the liability aforesaid is so increased or reduced during the income year shall be added to or deducted from, as the case may be, from the actual cost of the assets and the amount arrived at after such addition or deduction shall be the actual cost of the asset to the assessee.–cl. (c).

Where the whole or any part of the liability as aforesaid is met, directly or indirectly by others, and not by the assessee, the liability so met shall not be taken into account for the purpose of cl. (c) above -cl. (f).This provision is wider than the provision of cl. (b) which reduced the cost only to the extent to which the assessee was reimbursed but this clause applies to cases when the acquisition of the asset is made with foreign loan.

Where the assessee makes an arrangement to make payment of the liability created in the acquisition of asset from a country outside Bangladesh by entering into a contract with an authorised dealer for providing him with a specified sum in a foreign currency on or after a stipulated future date at a specified rate of exchange, the amount of addition to or deduction from the actual cost shall be computed with reference to the rate of exchange specified in the contract while discharging the liability–C. (g).

Fictitious figure of cost.–The original cost of any particular asset is a question of fact, and if the circumstances show that an assessee has arranged to put a fictitious price on his assets it is open to the Income-tax authorities to refuse to accept that price and to ascertain what the actual original cost was *(Pindi Kashmir Transport Co. Ltd.* v. *C.I.T. [1954] 26 I.T.R. 595)*.

The Deputy Commissioner of Taxes is not bound to base his calculation of the written-down value for the relevant assessment year on the written down value accepted in the preceding year. If a wrong figure was taken in earlier years as the figure of actual cost, the Deputy Commissioner of Taxes should determine for himself

the actual figure of original cost in ascertaining the written down value for the relevant assessment year *(Maharana Mills (Pr.) Ltd.* v. *I.T.O. [1959] 36 I.T.R. 350 (S.C.))*. If he doubts the written-down value of the previous year it is open to him to check-up the previous calculation and if he finds any mistake it is open to him to make fresh calculation in accordance with the law applicable including the rules made thereunder. In case of any arithmetical mistake in an earlier assessment year in the account of the written-down value of the properties of the assessee which resulted in a corresponding mistake in the assessment of the relevant assessment year he can take the corrected figure for the purpose of the assessment and it cannot be said that the mistake was not apparent from the record. Even if he discovers that the very basis of the different earlier assessments was erroneous because of an initial mistake in determining the written-down-value it cannot be said that this would not be a mistake apparent from the record. And in order to determine the correct written-down-value the Income tax authority makes correct calculations and in that case he can go back not only at the written-down value of the previous year but he can go up to the figure of the original cost and take into consideration the actual cost, determining it for himself and also take into considerations the allowances granted in the past and then make his own computations as to the written-down value for the assessment year with which he is concerned–*Maharana Mills Private Ltd.* v. *Income-tax Officer [1959] 36 I.T.R. 350 (S.C. of India)*. Likewise, any arrangement between the assessee and the Department in one year to treat the value entered in the assessee's balance sheet as the original cost would not stop the assessee from challenging the arrangement in any subsequent year and claiming depreciation allowance on the written down value computed with reference to the actual cost *(Allahabad Milling Co.* v. *C.I.T. 6 I.T.C. 286)*.

Balancing allowance or Obsolescence Allowance in respect of sold or discarded property–Cl. XI of Sec. 29 (1) and Cl. (c) of Paragraph 10 of Third Schedule.–This clause grants a balancing allowance or obsolescence allowance in respect of building, machinery or plant which has been disposed of by the assessee. "Plant" is defined by Sub-Para (2) of Paragraph 11 of Third Schedule and is dealt with *ante* under "Depreciation allowance is confined to buildings, machinery, plant and furniture". In order to attract the operation of this clause the building, machinery or plant should be *such as has been used for the purposes of the business or profession* for at least a part of the accounting year *(Liquidators of Pursa Ltd.* v. *C.I.T. [1954] 25 I.T.R. 265 (S.C. of India)*. (See *ante* under cl. (b) or Paragraph 10 of Third Schedule, "User in the accounting year". By contrast, cl. (b) of Paragraph 10 of Third Schedule levies a balancing charge when the receipt exceeds the written down value even if the asset is not used in the accounting year and even if the business is not in existence in that year.

It is immaterial whether the assets are sold while the business continues or after its closure and merely for the purpose of winding it up *(C.I.T.* v. *National Syndicate [1961] 41 I.T.R. 225 (S.C.))*. Cases where the property is partly used for business purposes and partly for other purposes are dealt with by Sub-Para (2) of Paragraph 2 of Third Schedule under "user in the accounting year". Each discarded or sold item must be considered separately, although the several sums to be allowed

under this clause are finally added together so that the amount deductible appears in the assessment as one lump sum *(Charente Steamship Co. Ltd.* v. *Wilmot 24 T.C. 97)*.

In respect of property which is discarded or destroyed, the allowance can be granted only for that accounting year in which the property has been actually discarded or demolished or destroyed. Since this clause applies only if the property is used in the relevant accounting year *(Liquidators of Pursa Ltd.* v. *C.I.T. [1954] 25 I.T.R. 265 (S.C. of India))*, where a property is discarded in one year and sold in a subsequent year, the assessee must claim the allowance in the year in which the property is discarded, and cannot wait till the property is sold and claim the allowance in the subsequent year in which the sale takes place. In respect of property which is disposed of the amount of the allowance is the excess of the written down value over the sale proceeds; (The word, "Sale-proceeds" his been defined in Sub-Para (2) of Paragraph 11 of Third Schedule) while in the case of property which is discarded or demolished or destroyed, it is the excess of the written down value over the insurance, salvage or compensation moneys together with the amount of scrap value if any, (Paragraph 10 (c)). The benefit of this clause cannot be claimed if the asset is disposed of or discarded, demolished or destroyed in the very accounting year in which it is first brought into use; nor can depreciation be claimed in such a case (Paragraph 10(a)). Balancing allowance cannot be granted in any case unless the amount claimed by way of allowance is actually written off in the books of the assessee.

In order to entitle the assessee to an allowance under this clause it is necessary that the business to the assets of which the allowance relates, should be carried on for at least some part of the relevant accounting year, otherwise s. 28 itself would have no application *(See under s. 28, "Business should have been 'carried on' in the accounting year")*. If the business has been discontinued earlier, the allowance cannot be claimed against the profits of another separate and independent business carried on by the assessee *(Ganga Glass Works* v. *C.I.T. [1951] 19 I.T.R. 126)*.

Sale-proceeds.–definitions–(See Post Sub-Para (3) of Paragraph 11 of Third Schedule).

Set off and carry toward of depreciation allowance–Sub-Para (2) of Paragraph 9.–The tax is chargeable under s. 28 on the aggregate of profits of all the businesses carried on by the assessee. Therefore, if the profits of a particular business are insufficient to absorb the depreciation allowance permitted by this section, the allowance (like any other business loss) can be set-off under s. 37 against the profits of any other business *(Suppan Chettiar & Co.* v. *C.I.T. 4 I.T.C. 211)*. If, however, there are no profits chargeable under this head or if the profits chargeable under this head are insufficient to cover the depreciation allowance, the amount of the allowance may be set off under s. 42(b) against profits chargeable under any other head for that year *(Suppan Chettiar & Co.* v. *C.I.T. 4 I.T.C. 211)*. If still some part of the depreciation allowance remains unabsorbed, it may be carried forward under this sub-section to the following year and set off against that year's profits, and so on for succeeding years. The carried forward depreciation allowance is deemed to be part of, and stands on exactly the same footing as, the current depreciation for the assessment

year; therefore, the unabsorbed depreciation of past years can (unlike a carried forward business loss) be set off against income chargeable under *any* head *(Jaipuria China Clay Mines Pr. Ltd.* v. *C.I.T. [1962] 46 I.T.R. 707)*, See also sub-para 2 of Paragraph 9 of Third Schedule, and it is adjustable against the total world income and not the total income in cases where the current depreciation is so adjustable *(Hukamchand Mills Ltd.* v. *C.I.T. [1962] 44 I.T.R. 411)*.

The right of carry-forward granted by this sub-paragraph presupposes the continuance of business in the year to which the allowance is carried forward. The depreciation of a discontinued business cannot be set off against the profits of an existing business *(South Indian Industrials Ltd.* v. *C.I.T. 1935 I.T.R. 11)*. (See *supra* "No allowances in respect of discontinued business". Further the business must be continued by the assessee himself; the unabsorbed depreciation allowance cannot be assigned to the transferee of the business *(Indian Iron & Steel Co.* v. *C.I.T. 1943 I.T.R. 328 (P.C.))*. The Privy Council held in *Indian Iron & Steel Co.* v. *C.I.T (1943 I.T.R. 328)* that if a business is acquired by another, the unabsorbed depreciation allowance of the previous owner becomes a capital loss and cannot be carried forward by the successor in business and set off against such successor's profits in any year subsequent to the change in ownership *(See also Bengal Flour Mills Co. Ltd. In re, 1941 I.T.R. 568)*. Nor can the previous owner claim to carry forward the unabsorbed depreciation allowance of the business which he has assigned to another *(David Sassoon & Co. Ltd. In re, 1940 I.T.R. 7)*.

Unabsorbed depreciation and carried forward loss.–Sec. 42(6) and Sub–Para (2) of Paragraph 9 of Third Schedule.–This sub-section deals with the carry-forward of unabsorbed depreciation allowance; while s. 38 (b) deals with the carry-forward of loss incurred under the head "Business or Profession". there are four features which distinguish the two:

(a) In a year in which the income is insufficient to absorb the full depreciation, the total income is taken as nil; while if there is a loss to be carried forward, the assessment order must show the positive figure of the loss for future guidance.

(b) The unabsorbed depreciation is deemed to be part of the depreciation allowance for a subsequent year and will enter into the computation of the income of such subsequent year. Carried forward loss does not enter into such computation, but after the subsequent year's income is determined the carried forward loss is deducted therefrom. In the undernoted case it was held that the unabsorbed depreciation of the past years should be added to the depreciation of the current year and the aggregate be deducted from the total income of the previous year (income year) relevant for the assessment year concerned–*Jaipuria China Clay Mines (Private Ltd.)* v. *C.I.T. (1962) 46 I.T.R. 707.*

(c) The unabsorbed depreciation, as stated above, can be set off against any income of a subsequent year under any head or under heads other than business; Whereas the carried forward loss can be set off only

against the profits of any business or profession *(Jaipuria China Clay Mines Pr. Ltd.* v. *C.I.T. [1962] 46 I.T.R. 707; and Rampura Tribmer and Turmy Co. Ltd. (Alld) 1973 89 I.T.R. 150).* The unabsorbed depreciation could even be set-off against income under the head, "Income from Properties–"*C.I.T.* v. *Giridhar Lal Hariballavads Co. Ltd. (1964) 51 I.T.R. 693.*

(d) This sub-section allows the carry-forward of depreciation allowance to any subsequent year without any time limit; while under s. 38(b) a loss can be carried forward only for a period of six years.

Sec. 42 (7) requires that losses should be first carried forward and set off against the profits of a business in a subsequent year, and it is only if any balance of profits still remains that the depreciation allowance of past years should be set off against such balance of profit *(See Laxmichand Maiporia, etc., Mills, In.re, 1950 I.T.R. 919, 924).* This enures to the benefit of the assessee for the right of carry-forward given by this sub-section in respect of depreciation allowance can be availed of in later years when losses can no longer be carried forward under s. 38(b). But this provision applies only if there are both unabsorbed depreciation allowance and also carried forward loss of a past year. However, if there is only a carried forward loss from an earlier year, the *current* depreciation for the accounting year should first be deducted from the business profits and it is only if there is a balance of profit left that the carried forward loss should be set off against it *(Aluminium Corpn. of India Ltd.* v. *C.I.T. [1958] 33 I.T.R. 367).* See further *post* (s. 42(b)).

Other kinds of depreciation allowances.–Paragraphs 7, 7A and 8 of Third Schedule have granted some depreciation allowances which do not form part of the depreciation allowances as provided for in cl.(viii) of sec. 29(i).

Paragraph-7: Accelerated depreciation allowance on Machinery and Plant.– This paragraph grants accelerated depreciation in respect of plant and machinery used in industrial undertaking at three different rates on the basis of the area, as specified by the Bond, in which such industrial undertaking is set-up, provided–

(a) the machinery or plant is not an office appliance or a road transport vehicle;

(b) the asset is 'new', new means not having been previously used in Bangladesh; and as held in the case of –*C.I.T.* v. *Coehin Co. [1963] 49 I.T.R. 310*, new means unused; reconditioned is not new;

(c) the industrial undertaking must be set-up during the period from the first day of July, 1977 and the thirty first day of June, 2000 (both days inclusive);

(d) the industrial undertaking is owned and managed by a Bangladeshi Company, or a body corporate formed under any law having its registered office in Bangladesh;

(e) this provision will be applicable only to such classes of industries as the Board would notify;

(f) the depreciation will be applicable to the year or from the year as the case may be, in which the industrial undertaking starts commercial production;

(g) the particulars as required for the purpose of entitlement to or claiming accelerated deprecation allowance have been furnished; and

(h) that an application in the prescribed form for such depreciation allowance and verified in the prescribed manner is made to the Board within four months from the end of the month of the commercial production. This application shall be accompanied by a declaration in writing of the assessee that the undertaking is neither enjoying tax-holiday nor has made any application for such exemption of its income to the Board.

The machinery or plant, as mentioned in the paragraph, on which accelerated depreciation has been allowed under this paragraph shall not be entitled to any other depreciation allowance under this Ordinance.

Rate of accelerated depreciation allowance.–

(i) If the industrial undertaking is set-up in areas, as specified by the Board, that is in less-developed areas, the rate of depreciation will be 100% of the actual cost of the machinery or plant to the assessee for this year in which the undertaking starts commercial production.

(ii) If the industrial undertaking is set-up elsewhere, that is, in developed areas, depreciation at the rate of 80% of the actual cost of machinery or plant to the assessee for the year in which the undertaking starts commercial production; and for the next following year 20% of the actual cost of machinery or plant will be allowed as accelerated depreciation.

The machinery or plant on which accelerated depreciation has been allowed under this paragraph shall not be entitled to any other depreciation allowances under this Ordinance or under the Income-tax Act, 1922.

Explanation.–The explanation to the Paragraph 7(i) inserted in 1993 has widened the scope for the application of the provision of accelerated depreciation to the expansion of an existing industrial undertaking if such expansion constitutes:

(a) an identifiable unit for production of similar or other goods or class of goods; and

(b) a similar unit carrying on an identifiable industrial process. But the expansion does not mean formation of an undertaking by splitting up or reconstruction of an existing undertaking or by transfer of

machinery or plant of an existing industrial undertaking in Bangladesh to a new industrial business.

Paragraph–7A: Accelerated depreciation allowance on machinery and plant for expansion of an undertaking.–This paragraph has provided for accelerated depreciation allowance on machinery and plant, excluding office appliances and road transport vehicles only for expansion of an existing undertaking on conditions as under:

(a) the period of expansion shall be between first day of July, 1995 and thirteenth day of June, 2000;

(b) the aforesaid machinery or plant shall be new not having previously been used in Bangladesh;

(c) the provision shall apply to the expansion of an existing undertaking enjoying tax-holiday under sec. 46A: or to an undertaking engaged in the treatment and disposal of toxic and environmentally hazardous wastes or in the research and development in any industrial undertaking owned and managed by a company.

The machinery or plant on which such depreciation is allowed shall not be entitled to any other depreciation allowance subject to cl. (x) of sec. 29(i) allowing investment allowance. The term "expansion unit" has the similar meaning as given in the provision of Paragraph 7, as mentioned in that Paragraph and similar conditions as mentioned in Paragraph 7 shall have to be fulfilled for such allowance.

Rates of depreciation allowance.–

(i) For the first year in which the expansion unit starts commercial production or operation the rate will be 80% of the actual cost of machinery or plant to the assessee;

(ii) for the next following year 20% of the actual cost of the machinery or plant to the assessee.

Paragraph–8: Special depreciation allowance on ships.–This Paragraph granted special depreciation allowances for a ship, being a passenger vehicle, ordinarily plying on inland water and a ship, not ordinarily plying on inland water and in both the case the ship has been brought to use in Bangladesh for the first time during the period between first day of July, 1982 and Thirteenth day of June, 1995 and shall be registered in Bangladesh.

For the first year depreciation allowance is allowed on original cost at 40%; 30% for the second year and 30% for the third year. Besides this special depreciation allowance the ship is not entitled to any other depreciation allowance.

Cl. (ix): Investment allowance for ship or fishing trawler plying on inland water.–A ship, being a passenger vehicle, and a fishing trawler plying ordinarily on inland water which is first put to use in Bangladesh for public utility service which is entitled to special depreciation allowance under paragraph 8 as above

is also entitled to investment allowance of an amount of 20% of the original cost to the assessee for the year in which it is first put to use.

Cl.(x): Investment allowance for machinery or plant.–Any machinery or plant, not being office appliances and road transport vehicles, which is entitled to accelerated depreciation allowance by fulfilling certain conditions as provided for in Paragraph-7 of the Third Schedule (as discussed above) is further entitled to an investment allowance for the year in which the undertaking starts commercial production The rate of such allowance varies depending on the area in which the undertaking is set-up. The rate of allowance is 25% of the actual cost if the undertaking is set-up in less developed area, as specified by the Board, and 20% of the actual cost if it is set-up in developed areas.

Cl.(xa): Investment allowance for modernisation or replacement of plant or machinery in existing industrial undertaking.–A further sum of twenty five percent of investments if made in plant or machinery will be allowed as investment allowance on the following conditions–

(i) the assessee shall be a company registered under the Companies Act, 1913 or 1994;

(ii) the investment shall be made in the purchase of new plant or machinery for installation in an industrial undertaking in Bangladesh;

(iii) the purpose of installation of such plant or machinery shall be either for balancing or modernisation of the industrial undertaking or for replacement of existing plant or machinery in the industrial undertaking set-up in Bangladesh.

The purpose is to encourage investments not only in new industries but for improvement in the conditions of existing industries also.

Cl.(xi): Obsolescence allowance or Balancing allowance.–Discussed under "Balancing allowance or obsolescence allowance"–See *ante* under "Income from Business or Profession".

Cl.(xii): Write-off allowance for animals.–This clause grants an allowance in respect of animals which have died or become permanently useless. The amount of the allowance is the difference between the actual cost (Paragraph 10 of Sixth Schedule) of the animal and the price realised on the sale of the animal itself or its carcass. Thus the allowance under this clause would recoup the assessee the entire capital expenditure in respect of animals.

Cl. (xi) of Sec. 29(i) provides a balancing allowance for "plant" and this clause provides a write off allowance for animals. This would indicate that for the purposes of the present Ordinance, "plant" does not include animals.

Two conditions are necessary under this clause,–first, the animals must have been used for the purposes of the assessee's own business the profits of which are being charged, and secondly, the animals should not have constituted the stock-in-

trade of the business. For business user, see under s. 29, "Used for the purposes of the business".

No allowance can be claimed under this clause in any year subsequent to the year of closure of the business in which the animals were used *(In re Ganeshilal Bhattawala 1938 I.T.R. 489)*. (See under s. 29, "No allowances in respect of discontinued business".

Cl. (xiii): Land development tax or rent, local rates and municipal taxes.–This clause authorises a deduction on account of land-revenue, local rates and municipal taxes in respect of such part of the premises as is used for the purposes of the business or profession. In any case where land-revenue, a local rate or municipal tax is not wholly referable to premises occupied for business purposes, the assessee, on establishing the portion of the revenue, rate or tax which is so referable, would be entitled to deduct such portion under this clause *(C.I.T.* v. *Gurupada Dutta 1946 I.T.R. 100, 105 (P.C.))*. See also "under partial allowance for assets partially used for business".

Any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or vocation or assessed at a proportion of or otherwise on the basis of any such profits or gains is not allowable under this clause; it is only if the levy is irrespective of profits that it would be an admissible deduction. It is well-settled principle that the destination of profits has got nothing to do *prima facie* with the question whether they are liable to income-tax–*Howrah Amta Light Rly. Co.* v. *C.I.T. A.I.R. 1928 Cal 579.*

****Cl. (xiv) Bonus and Commission.**–Subject to the specified conditions, a bonus or commission paid to an employee is allowable under this clause. One condition is that the sum paid to the employee as bonus or commission should not have been payable to him as profits or dividend if it had not been paid as bonus or commission, this is to prevent a private company or an association from escaping tax by distributing its profits, by way of bonus, among the members as employees of their own concern, instead of distributing the moneys as dividend or profits. But unless the same sum as is paid by way of bonus or commission would otherwise have been payable to the employee as profits or dividend, the assessee cannot be deprived of the benefit of this clause. Thus where the shareholders of a private company are also employees in their own company and receive a bonus by reference to their salaries and not to their shareholding in the company, the bonus would be an admissible deduction under this clause, for in such a case the employees may get more or less by way of bonus than they would have got by way of dividend *(Loyal Motor Service* v. *C.I.T. 1946 I.T.R. 647)*.The other condition of allowance under this clause is that the amount of the bonus or commission must be *reasonable*, having regard to (a) the pay of the employee and the conditions of his service, (b) the profits of the business of the year, and (c) the general practice in similar businesses. If the conditions of this clause are not fulfilled, the assessee would not be entitled to claim a deduction under the residuary Cl. (xvvii), in respect of the bonus or commission; otherwise the result would be nullification of the express conditions laid down by this clause which *specifically* deals with the subject–matter *(Subodchandra Popatlal* v. *C.I.T. [1953] 24*

I.T.R. 566. See further under Cl. (xxvii), "Expenditure should not be covered by Cl. (i) to (xvi)".

The conditions laid down in this clause do not apply to salaries. It applies to all cases of bonus and commission irrespective of the question whether the payment is voluntary or under a contractual obligation. Therefore even in the case of a contractual obligation to pay bonus or commission, the allowance should be restricted to such amount as is reasonable having regard to the three factors mentioned in this clause–*Subodhchandra Popatlal* v. *C.I.T. [1953] 24 I.T.R. 566. Contra, Raja Ram Kumar Bhargava* v. *C.I.T. [1963] 47 I.T.R. 680 (clause held inapplicable to commission which represented contractual salary).* Conversely, the mere fact that bonus or commission is paid *ex gratia* or in excess of the contractual basis would not necessarily mean that it is unreasonable–*Shyamlal Pragnarain* v. *C.I.T. [1955] 27 I.T.R. 404.* In determining the reasonableness of the amount of bonus or commission, the taxing authorities should take *all the three factors* into account at the same time and not merely one or two of them–*Subodhchandra Popatlal* v. *C.I.T. [1953] 24 I.T.R. 566.*

The question of reasonableness has to be decided from the point of view of commercial expediency and normal business prudence and not by the subjective standard of the assessing authorities–*Mysore Fertiliser Co.* v. *C.I.T. [1956] 30 I.T.R. 734; Madura Knitting Co.* v. *C.I.T. [1956] 30 I.T.R. 764. See also C.E.P.T.* v. *Rayaloo Iyer & Sons [1961] 41 I.T.R. 671 (S.C. of India).*

Where the owner of a business engaged managers on the terms that after giving a certain percentage of the profits to the owner, the managers were to retain the balance of profits to themselves as remuneration, it was held that the owner was not entitled to deduct as "bonus" or "commission" under this clause the share of profits paid to the managers–*Nrisingha chandra Nandy, In re, 1936 I.T.R. 428.*

The Madras High Court held in *Associated Printers (Madras) Pr. Ltd.* v. *C.I.T. ([1961] 43 I.T.R. 281). (In this case the bonus was allowed under s. 10(2)(xv) of 1922 Act corresponding to cl. (xvii) the present Ordinance)* that an employer who maintains his accounts on the mercantile basis would be entitled to a deduction in respect of bonus in the year in which the employees' claim for bonus is admitted by the employer or is settled by an agreement between the parties or is adjudicated upon by an award. In *C.I.T.* v. *Nagri Mills Co. Ltd.,([1958] 33 I.T.R. 681)* the Bombay High Court upheld the claim of the assessee to deduct bonus from the profits of the accounting year to which the bonus related, although the award granting bonus was made after the end of that accounting year. The decision should have been different if the real point in favour of the Department–*viz.*, that the liability to pay bonus not having arisen in the accounting year, no deduction could be claimed for that year even under the mercantile system of accounting–had been urged before the Court *(See C.I.T.* v. *Burmah Oil Co. (Burma concessions) Ltd. [1958] 34 I.T.R. 750, Associated Printers (madras) Pr. Ltd.* v. *C.I.T. [1961] 43 I.T.R. 281 and Satyanarayan Tea Co. (Pr.) Ltd.* v. *C.I.T. [1963] 47 I.T.R. 932).* However, if the employees' right to bonus is admitted by the employer in the accounting year to which the bonus relates, an amount representing a fair estimate of the liability may be allowed as a deduction in

that year, although there may be a dispute about the quantum of bonus or the ascertainment of the quantum may come later.

This clause has put an extra restriction in the case of allowance of Bonus and Commission for banking company. If any banking company enjoys the benefit of allowance in respect of provision for bad and doubtful debts and interests there on under cl. (xviiiaa) no allowance shall be granted under this clause for bonus, excepting festival bonus, to such banking company.

Cls. (xv), (xvi) and (xvii): Bad debts and irrecoverable loans.–

(a) The provisions of allowance of bad debts are embodied in these clauses. The conditions under cl. (xv) are that, except where the debt represents a loan granted in the ordinary course of banking or money-lending business where there can be no allowance of bad debts where the business accounts are maintained on cash basis (a) the amount of the debt or loan, or part thereof which is claimed as a deduction should be established to have become bad; (b) the amount should be written-off as irrecoverable in the accounts of the assessee for that accounting year in which the claim for a deduction is made for the first time; (c) the debt should have been taken into account in computing the income of the assessee of the accounting year or of an earlier accounting year or should represent money lent in the ordinary course of the business of banking or money lending; and (d) the debt or loan should be in respect of a business which is carried on by the assessee in the relevant accounting year–cl. (xv).

(b) If the claim for deduction in the year in which the debt is written-off is disallowed by the Deputy Commissioner of Taxes on the ground that the claim is premature, it may be allowed under this clause in a subsequent year though the debt would not be written off in such subsequent year–cl. (xvi).

(c) If the debt is disallowed in the year in which it is written-off on the ground that it had become bad in an earlier year (not beyond four years), the period of four year to be calculated from the end of the year, the income of which is to be assessed), the assessment of such earlier year should be rectified under s. 173 and an allowance should be given in respect of the bad debt –cl. (xvii).

Conditions of allowance.–These clauses grant an allowance in respect of bad debts of a business or profession and in respect of irrecoverable loans in the case of banking or money-lending business. A bad debt presupposes the existence of a debt, and in cases in which there never was any debt owing to the assessee, no question can arise of invoking these clauses– *(National Petroleum Co. Ltd.* v. *C.I.T. 1945 I.T.R. 336; Muthukaruppan Chettiar* v. *C.I.T. 1943 I.T.R. 38; Southern Agencies Ltd.* v. *C.I.T. [1962] 45 I.T.R. 602).* A debt, not enforceable in law, may still be covered by these clauses–*(C.I.T.* v. *Pranlal Kesurdas [1963] 49 I.T.R. 931).*

Four conditions govern the grant of an allowance under these clauses:–

I. The debt or loan should be in respect of a business which is *carried on* by the assessee in the relevant accounting year.

II. The debt should have been taken into account in computing the income of the assessee of the accounting year or of an earlier accounting year or should represent money lent in the ordinary course of the business of banking or money-lending.

III. The amount of the debt or loan, or part thereof, which is claimed as a deduction, should be established to have become bad in the accounting year.

IV. The amount should be written off as irrecoverable in the accounts of the assessee for that accounting year in which the claim for a deduction is made for the first time.

What constitutes write-off of a debt has been said in the case of *Vithaldas H. Dhanjibhai Bardanwall (Gujrat) 1981, 130 I.T.R. 95*, "where the assessee had posted the relevant debt entries in the profit and loss account and ... credit entries in the bad debt reserve account, thereby clearly expressing ... intention to treat the concerned bad debt as irrecoverable bad-debt he has complied with the statutory requirement of sec. 36(2)(i)(b) (corresponding to cl. (xv) of sec. 29(1) of I.T. Ordinance, 1984) and no further duty can be foisted on him to also close the existing ledger accounts of the concerned parties.

The bad debts written-off in the above manner were held to ... written-off.

The above conditions are dealt with below seriatim.

I. No. allowance for the bad debts of a discontinued business.–In order to entitle an assessee to allowance for bad debts under this clause the debts should be in respect of a business which is carried on by the assessee in the accounting ... allowance can be claimed in respect of the bad debts of a business which has been discontinued before the commencement of the accounting year, nor can the bad debts of a discontinued business be deducted from the profits of a separate existing business *(Sir Kameshwar Singh* v. *C.I.T. 1947 I.T.R. 246; B.C.G.A. (Punjab) Ltd.* v. *C.I.T. 1937 I.T.R. 279; South Indian Industrials Ltd.* v. *C.I.T. 1935 I.T.R. 11)*. See under s. 29, "No allowances in respect of discontinued business", and under s. 28, "business should have been 'carried on' in the accounting year".

Debts allotted on family partition or dissolution of firm.–Generally speaking, where a firm is dissolved or a family business is disrupted on partition and the debts due to the partnership or family business are divided between the partners or the members of the family, what the partners or members get by way of a share in the assets of the old business becomes capital in their hand, and if any of the debts become irrecoverable the loss would be in the nature of a capital loss *(Chimanlal Rameswarlal* v. *C.I.T. 1940 I.T.R. 408)*.

Under s. 10(2)(xi) of the 1922 Act it was held that where on the dissolution of a firm *(Sheth* v. *C.I.T. [1962] 46 I.T.R. 1052)* or the disruption of a joint family *(C.I.T.* v. *Dharmaraja Nadar 1948 I.T.R. 281 (debt due to joint family brought after partition into the separate business of a coparcener and treated as a debt of his business)* one of the members took over the business with all its assets and liabilities and carried it on as the successor, he was entitled to an allowance when a debt, incidental to the business and originally due to the firm or family, became bad. In another case of *C.J. Seth* v. *C.I.T. (Madras) 1962) I.T.R. xiv 1052* the assessee was carrying on business as a working partner of a firm and on the retirement of another partner he continued the business with the same stock-in-trade himself taking over the entire assets and liabilities of the firm in which case it was held that it was a case of succession to the business and there was continuity in regard to the assets and liabilities of the firm. The assessee was, therefore, entitled to write-off debts which had become barred, even though such debts originally belonged to the firm. But the position under this clause would be different since such a debt would not fulfil the requirement of cl. (xv), *viz.* that the debt should have been "taken into account in computing *the income of the assessee*". However, this requirement does not apply where there is a change in the constitution of a firm, the firm with the changed constitution cannot be treated as an entity different from the old firm and a debt of the old firm can be allowed as a deduction from the income of the firm with the changed constitution–*C.I.T.* v. *T. Jagat Ram Om Prokash (1979) 116 I.T.R. 266)*, and where the bad debt consists of a loan advanced in the ordinary course of banking or money-lending business Therefore, under this clause, as under the corresponding provision of the 1922 Act, an allowance is permissible where the loans advanced in a banking or money lending business become the circulating capital of the successor. Thus where a firm or a joint family is carrying on money-lending business, and one of its members upon dissolution or partition carries on his own separate money-lending business, and his share of the loans advanced by the firm of joint family is taken over and adopted by him as the stock-in-trade or circulating capital of his own separate business, he would be entitled to an allowance if and when any of the loans so taken over becomes thereafter irrecoverable *(C.I.T. AR. M.M. Firm 1945 I.T.R. 220 where a loan which had already become bad prior to the dissolution of a money-lending firm was taken over by a partner who started a new money-lending business. Allowance was refused on the ground that no loss was suffered by the new business in the relevant accounting year.* It is not necessary that the debtor should inter into a *novatio* or fresh agreement of any kind to pay to the new concern the debt owing by him to the defunct firm or family business. This is established by the decision of the Supreme Court of India in *(C.I.T.* v. *Sankara Ayyar ([1951] 20 I.T.R. 597)).*

ILLUSTRATONS

1. The assessee carried on a money-lending business in partnership with K. In 1940 the firm obtained a decree against M in respect of a loan advanced to him and recovered in execution proceedings a part of the decretal amount. In September 1942 the partners dissolved the firm and divided the assets equally between them. The assessee entered the sum representing his half share of the balance due from M in the books of his own separate money-lending business. In the relevant accounting year

(16th December 1942 to 15th December 1943) there were both receipts and expenditure in respect of this debt and the balance of the debt was written off in that year as irrecoverable. Held, the assessee was entitled to an allowance, for the old loan had been treated as part of the stock-in-trade of the new business (*C.I.T.* v. *Sankara Ayyar [1951] 20 I.T.R. 597 (S.C.)).*

2. Upon the partition of a joint Hindu family carrying on money lending business, the members agreed to carry on the family business as partners and the loans advanced by the family to various debtors were taken over by the new firm as part not of capital but of their stock-in-trade. Held, a loss arising by reason of any of such loans subsequently becoming irrecoverable, must be deducted as a bad debt in computing the profits of the partnership business *(Deoki Nandan & Sons* v.*C.I.T. 1941 I.T.R. 202).*

3. The outgoing partner of a money-lending firm received as part of his share certain promissory notes executed by the debtors of the partnership, and started his own money-lending business. The promissory notes were renewed in favour of the outgoing partner who was also taxed on the interest received thereunder. Held, he was entitled to a deduction in respect of the promissory notes which represented bad debts and which were actually written off as irrecoverable. *(C.I.T.* v. *Talupuru Chetty 1946 I.T.R. 227).*

II. Debts taken into account in computing income and loans in course of banking or money-lending business.–In the case of a banking or money-lending business the assessee is entitled to allowance under this clause in respect of irrecoverable loans advanced in the ordinary course of business, regardless of the method of accounting employed. The reason is that money is the stock-in-trade is always a trading loss irrespective of the method of accounting employed.

In the case, however, of other bad debts, an allowance can be made only if two conditions are fulfilled–(a) the debt should have been taken into account in computing the income of the accounting year or of an earlier accounting year and (b) such computation should have been of the income of the assessee himself and not of a predecessor in business or of any other person. The second condition has been dealt with above under "Debts allotted on family partition or dissolution of firm". The first condition would be satisfied only if the mercantile or other non-cash system of accounting is followed. Where accounts are kept on the mercantile basis, the tax is charged on profits which may not have been realised; and if the professional or business debts become irrecoverable, an allowance for such bad debts would become necessary in order to arrive at the true profits and gains. But if the accounts are maintained on cash basis, no question can arise of any allowance for bad debts, for unless a debt is actually realised it would not come in to swell the profits.

Under the 1922 Act also, one of the conditions of allowance was that the accounts of the business should be maintained on the mercantile or other non-cash basis. If this condition and the further condition that the debt should be really incidental to the business were satisfied, the allowance was granted, even if the debt had not been taken into account in computing the income of the year of allowance or

of any earlier year. A debt can be allowed as a bad debt under Sec. 10(i)(xi) of Income-tax Act, 1922 only, if it is a debt incidental to the business, a debt can be incidental to the business only if it arises out of a transaction, which was necessary in furtherance of the business and was within the range of the business activities. Everything associated or connected with the business cannot be said to be incidental thereto. Not merely should there be a close proximity of the debt to the business as such , but it should also be an integral and essential part of the carrying on or the business–*C.I.T. (Madras)* v. *Soma Somasundaran Mills Ltd. (Reported in P.T.D. 1964 (N.C.) 115)*. Under clause (xv) it is not enough that the debt is incidental to the business. – it is further necessary that the debt should have been taken into account in computing the assessee's income of any year, in other words, the debt should have been brought in as a trading receipt to swell the profit or reduce the loss of any year. Thus the scope and ambit of this clause is restricted to one species of trade debts only, unlike the corresponding provision of the earlier Act. However, a bad debt which is incidental to the business and which may not be deductible under this clause because it was not taken into account in computing income, may still be allowed as a business loss on ordinary principles of commercial accounting in computing the profits of the business under s. 28. (See under s. 28. Profits and gains, and under s. 29. "List of allowances is not exhaustive", and "Losses incidental to trade ...".

The loss sustained by the bankruptcy of the banker with whom the assessee maintains an account for the purposes of his business would be a bad debt in respect of and arising out of the business, and was held allowable under the corresponding provision for bad debts in the 1922 Act *(C.I.T.* v. *Hajee Abdul Gany Ayoob 1941 I.T.R. 339)*. It would not be deductible under this clause since such a debt would not be taken into account in computing income; but nevertheless such a bad debt would be allowable as a loss incidental to business in computing profits under s. 28 on ordinary principles of commercial accounting. But if the debt due to the assessee is not incidental to the business or if the loan advanced by the assessee is not in the course of business, no allowance can be claimed in respect of such a debt or loan, and the loss must be treated as a capital loss *(A.V. Thomas & Co. Ltd.* v. *C.I.T. [1963] 48 I.T.R. (S.C.) 67)*. Thus a solicitor who does not combine the business of money-lending with professional practice would not be entitled to any allowance in respect of loans advanced to clients even though he may be in the habit of making such loans; but he would be entitled to an allowance in respect of moneys owing to him by a client for professional costs or other disbursements made by the solicitor in the course of the legal business transacted on behalf of the client *(I.R.* v. *Hagart & Burn-Murdoch 14 T.C. 433 (H.L.), 1929 A.C. 386)*. The loss incurred by a bookseller *(C.I.T.* v. *Subramanya Pillai 1950 I.T.R. 85)*, a timber merchant *(Madan Gopal Bagla* v. *C.I.T. [1956] 30 I.T.R. 174 (S.C.))*, a freight broker *(Janakiram* v. *C.I.T. [1962] 45 I.T.R. 430)* or a money-lender *(Brij Mohan Laxmi Narain* v. *C.I.T. [1959] 3 I.T.R. 147)*, who stands surety for another cannot be allowed as a bad debt of his business; but it would be allowable as a business loss on ordinary principles of commercial accounting under s. 28, if the guarantee is entered into pursuant to a trade custom of which *mutual accommodation* is the essence, i.e. traders standing surety for one

another *(C.I.T.* v. *Jagannath Kissonlal [1961] 41 I.T.R. 360 (S.C.); C.I.T.* v. *Ramaswamy Chettiar 1946 I.T.R. 236).*

In *C.I.T.* v. *Abdullabhai Abdulkadar ([1961] 41 I.T.R. 545 (S.C. of India))*, where a commission agent who had business connection with a non-resident was assessed and paid the tax as the agent of the non-resident in respect of the non-resident's income, and was unable to recover from the non-resident the amount of tax, the agent was held not entitled to claim it as a bad debt.

In *Reid's Brewery Co.* v. *Male (3 T.C. 279, [1891] 2 Q.B.I.)*, moneys advanced by a brewery company to their customers were held to be allowable when they became bad debts, the Commissioners having found that "such loans and advances were essentially necessary" to the profitable carrying on of the brewery business and that the loans were in accordance with the custom and usual practice of manufacturing brewers *(See also C.I.T.* v. *Mysore Sugar Co. Ltd. [1962] 46 I.T.R. 649 (S.C.))*. Likewise, advances made by a firm owning an oil mill to other oil mills in the course of its normal trading activity were held allowable as bad debts *(C.I.T.* v. *Dhanalakshmi Corpn. [1962] 46 I.T.R. 1031)*. In *C.I.T.* v. *Mysore Sugar Co. Ltd. ([1962] 46 I.T.R. 649)* moneys advanced by a sugar manufacturer seasonally to sugar cane growers to be adjusted against the price of the next crop, were held by the Supreme Court of India to represent only advance payment of price of sugar-cane and to be deductible when they became irrecoverable. In such cases arising under this Ordinance the deduction, if not allowed under this clause, would in any event be allowable under s. 28 as a business loss to be taken into account in computing the profits on ordinary principles of commercial accounting. But if the real nature of the transaction is investment of capital rather than a loan–*e.g.*, where the assessee buys shares in a company in order to provide the company with finances–the resulting loss would be a capital loss and cannot be allowed *(Stott* v. *Hoddinott 7 T.C. 85)*.

The loss of income or of capital, when arising from investments and not in connection with business assets, is not deductible as a bad debt under this clause *(A.V. Thomas & Co. Ltd.* v. *C.I.T. [1963] 48 I.T.R. (S.C.) 67; Bharucha* v. *C.I.T. [1963] 49 I.T.R. 135; C.I.T.* v. *Dharmaraja Nadar 1948 I.T.R. 281, 293)*. But loss of arrears of interest on unpaid sale-price in respect of business assets sold by the assessee, would be deductible *(Sitalpore sugar Works Ltd.* v. *C.I.T. [1954] 25 I.T.R. 548)*.

When a money-lender received lands in satisfaction of a loan, kept them for several years as part of his capital stock and not as stock-in-trade of his money-lending business, and subsequently sold the lands at a price below the amount which had been due from the debtor, it was held that the difference could not be allowed as a bad debt in the year of sale *(Gurucharan Prasad* v. *C.I.T. [1951] 19 I.T.R. 42)*.

Where the assessee attaches some property of a defaulting debtor in order to realise the debt from him but makes no attempt to dispose of the property on the plea that it is unsaleable and claims a deduction of the debt, the debts cannot be said to have become bad until the assessee made some attempt to realise the debt by selling the property *(Shamsher Ali Abul Hossain Nagpur (1945), 13 I.T.R. 240))*.

A bad debt due to a firm from a retired partner cannot be allowed as a trading loss *(Amarchand Madhavji & Co.* v. *C.I.T. 1935 I.T.R. 462)*. If a money-lender engages in another business in partnership and has to pay the entire loss, his partner being unable to pay his share of the loss, that would be a capital loss and cannot be deducted in computing the profits of the money-lending business. The partner's share of the loss cannot be allowed as a bad debt of the money-lending business *(Arunachalam Chettiar* v. *C.I.T. 1936 I.T.R. 173 (P.C.))*. If a man has a business of money-lending, it does not follow that every single transaction which he enters into, which involves the lending of money, must be taken as part of the money-lending business. A money-lending, like other people, may invest his capital or accumulated profits in forms of investment which are, in law, loans, *e.g.*, Government or Municipal loans, mortgages and debentures, and if he invests in such a manner and suffers a loss on the investment the loss is a loss of capital and cannot be set off against the profits or gains *(Sir Chinnubhai Madhavlal* v. *C.I.t. 1937 I.T.R. 210)*.

ILLUSTRATION

The assessee was a zamindar and money-lender. He took bonds and promissory notes from his tenants in lieu of arrears of rents and the Department treated the bonds and promissory notes as assets of the assessee's money-lending business, and taxed the interest accrued thereon as profits of money-lending. The Department disallowed the claim of the assessee for deduction of the amount of some promissory notes as bad debts. Held, the Department could not be allowed to blow hot and cold at the same time, and as the bonds and promissory notes had been treated as part of the money-lending transactions of the assessee, the claim for deduction of the irrecoverable loans should be allowed *(Deonuti Prasad Singh* v. *C.I.T. 1947 I.T.R. 165)*.

"Bad debts" is a commercial term for trade debts (5) and cannot include loans made to one's own employee or moneys overdrawn by an employee on commission account, which are entirely private matters independent of the business *(In re Chhitar Mal Ram Dayal 3 I.T.R. 54)*. Moneys embezzled or overdrawn by an employee do not constitute a debt incidental to a business or a loan in the ordinary course of a money-lending business, and cannot be allowed under this clause, though they may be deductible, apart from the provisions of Cls. (i) to (xxvii), on ordinary principles of commercial accounting. See under s. 29, "Losses incidental to trade: Embezzlement, theft, destruction of assets, overdrawings by employees, etc.

III. Debts and loans should have become irrecoverable in the accounting year.–The allowance under this clause is confined to debts and loans which have become irrecoverable in the accounting year. A debt or loan which had in fact become irrecoverable before the commencement of a particular year cannot properly be deducted in ascertaining the profits of that year, because the loss has not been sustained in that year *(C.I.T.* v. *Chitnavis 6 I.T.C. 453 (P.C.); Bank of Bihar Ltd.* v. *C.I.T. [1962] 45 I.T.R. 427 (S.C. of India))*. A part of a debt or loan may be allowed as a deduction under this clause.

The expression "bad debts" refers to debts of which the chance of recovery is nil or slender *(Hongkong & shanghai Banking Corpn.* v. *C.I.T. [1955] 28 I.T.R.*

199; Devi Films Ltd. v. *C.I.T. [1963] 49 I.T.R. 874).* "So long as there is any ray of hope left to recover a debt, however dim it may be, and so long as a debt is in the process of realisation it cannot be said that it has become irrecoverable" *(C.I.T.* v. *Sankara Ayyar [1951] 20 I.T.R. 597 (S.C. of India)).* Where the debts are owing by close relations who are solvent, and the assessee through motives of relationship abstains from recovering the debts, he cannot claim to deduct them as bad debts *(Prag Narain* v. *C.I.T. 6 I.T.C. 110).* But a deduction may be allowed, despite the solvency of the debtor, where the irrecoverability arises from a *novatio* effected bonafide for commercial reason *(Kamakshi Chettiar* v. *C.I.T. [1960] 39 I.T.R. 104).* If the creditor has taken any security or has been able to recover some property from the debtor, no part of the debt can be written off as a bad debt until the security or property has been realised or valued *(Shamsher Ali Abdul Hussain* v. *C.I.T. 1945 I.T.R. 240).* A debt which is not statute-barred does not necessarily become bad at the date when the debtor absconds *(Harnand Rai Harbhagat Rai* v. *C.I.T. 1936 I.T.R. 366)* or is in difficulties *(Som Chand Maluk Chand* v. *C.I.T. 1936 I.T.R. 382).* A debt due from a limited company may be treated as a bad debt even while the company is still a going concern *(F.E. Dinshaw* v. *C.I.T. 1934 I.T.R. 31 (P.C.)).*

If the Deputy Commissioner of Taxes takes the view that a certain debt has not yet become bad but has been written off in the books of accounts of that year and such debt has not been allowed on the ground that it has not yet become irrecoverable, so much of the debt as has been established to become irrecoverable in any subsequent year shall be allowed as a deduction in that year–Cl. (xvi). In that case the Deputy Commissioner of taxes should not, as a general rule differ from a previous decision on the point that the debt had been prematurely written off in the earlier year in which it was claimed; but he may do so if fresh facts have come to light entitling the Officer to come to a conclusion different from that of his predecessor *(Kairam Ganpat Rai* v. *C.I.T. 1941 I.T.R. 332).* The Department must treat the accounts of a continuing business in a consistent manner and if a certain debt is treated as a good debt in a certain year and the interest thereon is charged in that year, it is not open to the Department to hold subsequently that it had become bad before that year *(Hanutram Bhuramal* v. *C.I.T. 1938 I.T.R. 290. Contra, Kantilal Chimanlal Shah* v. *C.I.T. [1954] 26 I.T.R. 303).*

Time-barred debt.–The age of a debt is no doubt a relevant matter to be taken into consideration, but a time-barred debt is not necessarily bad; neither is a debt which is not time-barred necessarily good *(C.I.T.* v. *Chitanavis 6 I.T.C. 453, 458 (P.C.)).* But in the absence of other evidence, a debt may be assumed to become bad when it becomes statute-barred *(Bansidar Podda* v. *C.I.T. 1934 I.T.R. 20).*

Insolvency of debtor.–The mere fact of insolvency of a debtor is not conclusive evidence of the irrecoverability of a debt *(C.I.T.* v. *Mathuralal Kapoorchand & Co. (M.P.) 1983 141)* and so a debt does not necessarily become irrecoverable wholly or in part merely because the debtor has become insolvent. In cases of the debtor's insolvency the date when the debt becomes bad or the extent to which it becomes bad would depend upon the facts and circumstances of each case *(Alagananda Mudaliar* v. *C.I.T. 1940 I.T.R. 69).* Where an assessee seeks to write off

as irrecoverable a loan due from a debtor who had become insolvent some years ago, the onus is on the assessee to prove by evidence to the satisfaction of the Deputy commissioner of Taxes that the debt actually became irrecoverable in the particular year in which the deduction is claimed *(Puran Mal* v. *C.I.T. 2 I.T.C. 236)*. In some cases the only date on which it can be said that a debt has become finally a bad debt is when the Official Assignee or Receiver declares a final dividend and that portion of the debt will be bad which remains outstanding after the final dividend has been declared. *(Deoki Nandan & Sons* v. *C.I.T. 1941 I.T.R. 202; C.I.T.* v. *Hajee Abdul Gany Ayoob 1941 I.T.R. 339)*.

IV. Bad debts should be written off in the assessee's accounts.–There was a conflict of opinion under the 1922 Act as to whether a bad debt could be allowed when it was not written off in the assessee's books. This section makes it clear that the assessee's written off the debt as irrecoverable in his accounts is a condition precedent to allowance. The principle that emerges from Cl. (xv) is that the debt should *in all cases* be written off by the assessee in the year in which he claims a deduction for the first time in respect of that debt. Express provision is made for cases where the Department holds the writing off of the debt to be too early or too late. If the Deputy Commissioner of Taxes holds that the debt has been prematurely written off, the debt may be allowed as a deduction in a subsequent year though it would not be written off in such subsequent year (Cl. (xvi)). If, on the other hand, the Deputy Commissioner of Taxes holds that the debt had become bad in an earlier accounting year, not falling beyond a period of four immediately preceding accounting years, the Deputy Commissioner of Taxes should rectify under s. 173(4) the assessment of such earlier year and allow the deduction for that year (Cl. (xvii)).

A debt may be written off as irrecoverable in the individual accounts of the debtors in the assessee's books or by making appropriate entries in other accounts, e.g. by debiting the profit and loss account and crediting the doubtful debts account *(C.I.T.* v. *Jwalal Prasad Tiwari [1953] 24 I.T.R. 537)*.

Final adjustment in the year of recovery.–The allowance under this clause is necessarily based upon a mere estimate. Ultimately a larger or smaller portion of the debt or loan may be recovered than was estimated to be recoverable at the time of making the allowance under there clauses. In such a case the excess would be taxed as profit of the year in which it is realised, to make up for the excessive allowance in a former year, whether the business or profession in respect of which the deduction has been allowed is in existence in that year or not (s. 19(15)). Similarly the deficiency would be deductible as a business expense in order to supplement the inadequacy of the allowance *(Cf. Chidambaram Chettiar* v. *C.I.T. [1960] 39 I.T.R. 320)*.

Cls. (xviiia) and (xviiiaa).–In the computation of income from business or profession various clauses under Sec. 29(1) have granted deduction but such deduction can be permitted in respect of only those expenses and losses which are incurred in the relevant accounting year (See ante under the head, "Expenses and losses claimed should have been incurred in the accounting year"). But under these clauses provisions have been made for deduction for ascertained losses but these

provisions will apply only to financial institutions and banks for bad and doubtful debts.

Cl. (xviiia): Provision for bad and doubtful debts made by Bangladesh Shilpa Bank or Bangladesh Shilpa Rin Songstha.–This clause grants a special deduction of a sum equal to five percent of overdue loan or the actual amount of provision for bad and doubtful debts of such loan, whichever is less provided the assessee should be the financial institutions like Bangladesh Shilpa Bank or Bangladesh Shilpa Rin Sangstha. Such deductions are permissible only in respect of the assessments for the assessment years 1987-88 to 1990-91. The application of the provision of this clause has, therefore, now been restricted as assessments of these years have now been time-barred in general cases.

The deduction so allowed under this clause in respect of such overdue loan if recovered, shall be deemed to be the income of the year of recovery (See also Sec. 19(15)(a)(c).

(Cl. xviiiaa): Provision or bad and doubtful debts made by a commercial bank, Bangladesh Krishi Bank including Rajshahi Krishi Unnayan Bank.–A similar provision has been made in this clause for deduction for provision of bad and doubtful debts and interest thereon of a sum equal to three percent of the total outstanding loan including interest thereon or the amount of actual provision made in their books of accounts for such bad and doubtful debts including interest thereon, whichever is less.

Any commercial bank including Bangladesh Krishi Bank and Rajshahi Krishi Unnayan Bank are entitled to this kind of deduction under this clause. This provision shall apply only in respect of such loan as Bangladesh Bank may classify as bad or doubtful debt. The deduction will be available for the assessment years 1995-96 to 1999-2000 or till the assessment year when the amount of bad and doubtful debts will be set-off by the amount of provision made by the assessee in their books of accounts as per the guidelines given by the Bangladesh Bank in this regard.

The deduction so allowed in respect of outstanding loan under this clause if and when so recovered shall be deemed to be the profit of the year in which it is recovered.

Fourth proviso under this clause have put some restrictions in the allowance for deductions for provisions for bad and doubtful debts arising out of outstanding loan. It has been provided in that proviso that no deduction under this clause shall apply (i) in respect of any loan representing grant allowed by the Government in the form of 15 years Special Treasury Bonds, (ii) any loan advanced to any Government organisation or other corporate, local authority or autonomous bodies or any other loan guaranteed by the Government and (iii) any debts representing loan advanced to any director of the bank or to his nominees or dependents.

Cls. (xix), (xx) and (xxi): Expenditure on scientific research.–These clauses grant deduction in respect of the following:

(a) revenue expenditure laid out by the assessee himself on scientific research in Bangladesh *related to the business;*

(b) expenditure of a capital nature on scientific research related to the business carried on by the assessee in Bangladesh;

(c) any sum paid to any research institute or a scientific research association which has its object the undertaking of scientific research or to a university, college, technical school or other institution for the purpose of scientific research or technical training related to the class of business carried on by the assessee, provided such university, college, technical school or institution is approved by the National Board of Revenue for the purpose of this clause.

"Scientific research" is defined in Explanation to Cls. (xix) and (xx). The difference between capital expenditure and revenue expenditure is dealt with post under cl. (xxvii) of this section.

The Ordinance grants allowance in respect of four types of capital expenditure–(a) cost of building, machinery, plant and furniture which is allowed to be written-off by way of depreciation and balancing allowances, (b) capital expenditure on scientific research which is allowed under Cls. (xx) of this section, (c) capital expenditure on the extraction or production of mineral oils and other mineral deposits which is allowed as depletion allowance under part A and B of Fifth Schedule, and (d) capital expenditure laid out on construction and maintenance of any educational institution or hospital for the employees of the assessee.

If sufficient profit is not available to be charged with the capital expenditure on scientific research in any income year and a portion remains unabsorbed such excess should be treated like unabsorbed depreciation but there seems to be no specific provision in this regard in the Ordinance.

Where the asset representing scientific research expenditure of a capital nature ceases to be used for scientific research no allowance should be permissible under the general law after the year of cessation but there was provision in this regard in the Income -tax Act, 1922. In the Ordinance there is also no provision as to how the excess of unabsorbed expenditure will be set-off after the asset ceases to be used for scientific research but used in the business of the assessee. The Income-tax Act, 1922 had all the provisions as to how to meet the situation in such circumstances.

Where a deduction is allowed in clause (xx) by way of capital expenditure for any income year no allowance for depreciation under cl. (viii) and investment allowance under cl. (ix) will be granted for the same income year in respect of the same asset. The written-down-value of the asset used in the business after it ceases to be used for scientific research will be the actual cost of the assets minus the deductions allowed under this clause.

Cl. (xxii): Expenditure on educational institution or hospital for the benefit of the employees.–Any expenditure made on any educational institution or hospital established for the benefit of the employees, their families and dependents

and expenditure on any institution for the training of industrial worker will be eligible for deduction provided:–

(a) the expenditure will not be of the nature of capital expenditure;

(b) no charge will be made by the assessee for rendering such services to the employees including their families and dependents through such institution or hospital or for giving training to the industrial workers; and

(c) no claim for deduction shall be made for such expenditure under any other clause of this section.

Provision has already been made under cls. (xx) and (xxi) under the head, "expenditure on scientific research" for expenditure on any scientific research of a medical nature particularly related to the welfare of the workers employed in the business of the assessee (See sub-clause (ii) of the Explanation to cls. (xxix) and (xx)).

Cl. (xxiii): Capital expenditure on educational institution or hospital for the benefit of the employees.–Expenditure of revenue nature has been allowed for any educational institution or hospital established for the benefit of the employees under the above clause. This clause grants deduction for expenditure of capital nature expended on the construction and maintenance of any educational institution or hospital established for the benefit of the employees, their families and dependents and also on any institution established for training of industrial workers. To claim deductions for such expenditure similar conditions have been there–(a) no charge shall be made by the assessee for rendering services through such institution to the employees including their families and dependents or for giving training to the industrial workers and (b) no deduction shall be claimed for such expenditure under any other clauses of this section for the same income year.

Cl. (xxiv): Expenditure on the training of Bangladeshi Citizens.–Any expenditure for the training in a scheme approved by the Board for the purpose of this clause will be deductible expense. Persons receiving the training shall be Bangladeshi nationals.

Cl. (xxv): Expenditure incurred in a trade delegation to a foreign country.–Any expenditure incurred by the assessee in connection with visit abroad as a member of trade delegation approved by the Government provided such expenditure shall not be of a capital or personal nature.

Cl. (xxvi): Member's subscription to trade organisation.–Annual subscription paid by a member to a registered trade organisation or to a professional institution shall be an allowable expense. A registered trade organisation means it will be registered under the Trade Organisation Ordinance, 1961 and in case of a professional institution it will be recognised by the Board for this purpose. See further under the head "payments to Business Associations and Professional Societies"–*Post.*

Cl. (xxvii): Residuary head of revenue expenditure.–This is the residuary section extending the allowance to items of business expenditure not covered by the preceding clauses/clause. This section covers cases of business *expenditure* only, and not of business *losses* which are, however, deductible on ordinary principles of commercial accounting. See "Losses incidental to trade ...".

General principles governing the admissibility of business expenditure under Cl. (xxvii).–This clause is a residuary clause under which only such business expenditure of a revenue character is admissible as cannot be claimed under any other clauses of Sec. 29 (1). Conversely, any expenditure which is specifically allowable under any other clauses of this section except cl. (xxvii) cannot be claimed or allowed under this clause such as, bonus which is admissible under cl. (viv) is not allowable under this clause–*(C.I.T.* v. *Tube Investments of India Ltd. (Madras) 1981, 129 I.T.R. 75).*

Meaning of "Expenditure".–"Expenditure" primarily denotes the idea of "spending" or "paying out or away". It is something which is gone irretrievably–*(Indian Molasses Co. (Pr.) Ltd.* v. *C.I.T. [1959] 37 I.T.R. 66, 76, 80 (S.C. of India))* that is, once paid it cannot be recovered.

Whether contingent liabilities constitute "expenditure".–This section allows a deduction only in respect of expenditure. Generally speaking, a contingent liability is not "expenditure," and therefore cannot be the subject of deduction *even under the mercantile system of accounting; (Indian Molasses Co. (Pr.) Ltd.* v. *C.I.T. [1959] 37 I.T.R. 66, 76, 80 (S.C. of India)).* The case-law on the point has been reviewed by the Madras High Court in *Senthikumara Nadar & Sons* v. *C.I.T. ([1957] 32 I.T.R. 138).* A claim made by a third party against the assessee but not admitted by the assessee *(C.I.T.* v. *Mathulal Baldeo Prasad [1961] 42 I.T.R. 517 and Associated Printers (madras) Pr. Ltd.* v. *C.I.T. [1961] 43 I.T.R. 281)* or an amount deposited in Court by the purchaser at a Court sale as security to safeguard the interest of a third party claiming a share in the property, or an unascertained liability to pay damages at a future date, represents merely a contingent liability and cannot be allowed. However, as the House of Lords laid down in *(Owen* v. *Southern Railway of Peru Ltd. (36 T.C. 602, [1957] 32 I.T.R. 737))*, where a number of similar contingent obligations arise from trading,–*e.g.* payment of retiring benefits or deferred remuneration to employees–a provision for such contingent liabilities may be allowed as a deduction but only in case where a *sufficiently accurate estimate can be made.* Lord Mac Dermott said, "As a general proposition it is, I think, right to say that in computing his taxable profits for a particular year a trader who is under a definite obligation to pay his employees for their services in that year an immediate payment and also a future payment in some subsequent year, may properly deduct not only the immediate payment but the present value of the future payment provided such present value can be satisfactorily determined or fairly estimated" *36 T.C. 602, 635-6. See also Indian Molasses Co. (Pr.) Ltd.* v. *C.I.T. [1959] 37 I.T.R. 66, 77 (S.C. of India).* See further under s. 29, "Expenses and losses claimed should have been incurred in the accounting year".

In *Calcutta Co. Ltd.* v. *C.I.T. ([1959] 37 I.T.R. 1)* the Supreme Court held that if a liability has been definitely incurred in the accounting year, *e.g.* an unconditional contractual liability, it cannot be regarded as contingent merely because it is to be discharged at a future date and the cost of discharging it is not definite but has to be estimated. In that case the Supreme Court of India allowed the estimated cost of discharging a contractual liability to undertake a development scheme within reasonable time in the future, as a proper deduction in computing the commercial profits, apart from the express statutory provisions for deductions.

Whether profit forgone is "expenditure".–The question whether any expenditure can be said to be incurred when the assessee merely forbears from making a profit out of commercial considerations must be determined upon the facts of each case. In *Usher's Wiltshire Brewery Ltd.* v. *Bruce (6 T.C. 399)*, a brewery company acquired freehold or leasehold interest in several licensed premises in the ordinary course of its trade and let them to publicans who were "tied" to purchase their beer etc. from the company. In consideration of the tie, the company charged the publicans a rent less than the full annual value of the licensed premises. The House of Lords held that the company was entitled to deduct the difference between the actual rents which it received from its tied tenants and the potential rents which could otherwise have been obtained from free tenants, *viz.* the full annual values, as money wholly and exclusively *laid out or expended* for the purposes of the brewer's trade. Lord Loreburn said, "On ordinary principles of commercial trading, such loss arising from letting tied houses at reduced rents is obviously a sound commercial outlay".

The Supreme Court of India held in *(C.I.T.* v. *Chandulal Keshavlal & Co. ([1960] 38 I.T.R. 601))* that where the managing agents of a company give up the whole or a part of the managing agency commission which has accrued to them and is therefore assessable as income under the mercantile system of accounting, and the commission is found to be remitted for purely business considerations or on grounds of commercial expediency, the amount not received would be allowable as expenditure wholly and exclusively incurred for the purpose of business *(See further post under "Remission by managing agents of commission due to them)*. Likewise, if a bank decides not to recover loans from customers whose ornaments, pledged with the bank, had been lost by dacoity, the amount of the unrecovered loans may constitute allowable expenditure *(Nainital Bank Ltd.* v. *C.I.T. [1962] 46 I.T.R. 540. See also C.I.T.* v. *Mysore Sugar Co. Ltd. [1962] 46 I.T.R. 649 (S.C. of India))*.

Apportionment of expenditure. –An item of expenditure may be disintegrated, and the assessee, on establishing that a portion of it is allowable under this section, would be entitled to a deduction in respect of such portion. The expenditure which does not bring into existence an asset or an advantage for the enduring benefit of the business is an expenditure which is properly attributable to revenue and not to capital–*I.T. Appellate Tribunal, Bombay* v. *Chhaganmal A.I.R. (33) 1946*. In this case the union rate was not wholly referable to premises occupied for the purpose of business, the assessee on establishing the portion of the rate which is so referable would be entitled to deduct such portion under See 10(2)(ix).

CONDITIONS OF ALLOWANCE

The following conditions should concur in order that a particular item of expenditure may be deductible under this section: –

(1) The expenditure should not be of the nature described in cls. (i) to (xxvi).

(2) It should have been incurred *in the accounting year*.

(3) It should be in respect of a business which was *carried on* by the assessee and *the profits of which are to be computed* and assessed, and should be incurred after the business is set up.

(4) It should *not* be in the nature of *personal* expenses of the assessee.

(5) It should have been laid out or expended *wholly and exclusively* for the purpose of such business.

(6) It should *not* be in the nature of *capital* expenditure.

The section is thus limited in scope. It does not permit an assessee to make all deductions which a prudent trader would make in ascertaining his own profits. (See under list of allowances is not exhaustive).

I. Expenditure should not be covered by Cls. (i) to (xxvi). – If an allowance is specifically dealt with by one of the preceding sections, it cannot be claimed under this section which is the residuary section, for otherwise the effect would be to nullify the express or implied conditions on which the allowance is granted by the specific section *(Subodhchandra Popatlal* v. *C.I.T. [1953] 24 I.T.R. 566; Southern Agencies Ltd.* v. *C.I.T. [1962] 45 I.T.R. 602)*. (See also under the head "general principles governing the admissibility of business expenditure).

II. Expenditure should have been incurred in the accounting year.–See under s. 29, "Expenses and losses claimed should have been incurred in the accounting year", and "Anticipated losses in future" *ante* under this section, "Whether contingent liabilities constitute 'expenditure'.

III. Business should have been "carried on" by the assessee. Expenditure incurred before setting up or after discontinuance of business.–In order to be deductible under this section, the expenditure should be incurred for the purpose of the business which is *carried on in the accounting year* and the *profits of which are under assessment (Ram Chandra munna Lal* v. *C.I.T. 1949 I.T.R. 394; Grain Chamber Ltd.* v. *C.I.T. [1962] 46 I.T.R. 217)*. Expenditure incurred *before the business is set up* cannot be allowed. (See under s. 29, "No allowances in respect of business not yet set up at the date of expenditure). Nor can expenditure be allowed if the business was *discontinued before the commencement of the accounting year,* for to a business so discontinued this section has no application at all. The expenses of a discontinued business are not allowed to be set off against the profits of a separate existing business, nor are they allowed to be carried forward to the following years (s. 38). (See under s. 29, "No. allowances in respect of discontinued business).

The words "for the purposes of the business or profession" in this section refer to the business or profession described in s. 28, viz. the business or profession carried on by the assessee the profits of which are to be computed and taxed. (See also under the head, "Allowance for the purpose of business). Voluntary payments made to employees after winding up *(Mysore Standard Bank Ltd. (In Liq.)* v. *C.I.T. [1962] 46 I.T.R. 278. See under s. 28, "business carried on in the course of administration, or winding up or liquidating a concern)*, or legal cost incurred in suing for dissolution of a firm *(Ram Chandra Munna Lal* v. *C.I.T. 1949 I.T.R. 394, 402-3)*, would not be admissible deductions under this section. (See under s. 28, "Business should have been 'carried on' in the accounting year").

Further, the expenditure is allowed only if it is incurred in connection with the assessee's own business the profits of which are under assessment. A parent company cannot be allowed a deduction in respect of a loss or expenditure incurred by or for the purposes of its subsidiary company *(Odhams Press Ltd.* v. *Cook 1941 I.T.R. Suppl. 92 (H.L.))*. (See under s. 29, "Expenditure should have been incurred in connection with the assessee's own business").

IV. **Disallowance of "personal expenses".**–Personal expenses of the assessee–moneys expended for a domestic or private purpose, as distinct from the purpose of trade or profession–are not deductible, although they may be necessitated by the business or professional activities. Where a person assessed in respect of profits derived from letting her house furnished claimed to be allowed as a deduction the amount of rent paid by her for another furnished house in which she lived while her own was let, the deduction was disallowed as the expense was of a personal nature *(The assessment in such cases would be under s. 33)*. The assessee contracted an illness as a result of his professional activities and claimed to deduct the medical expenses which he had to incur. Held, they were personal expenses and could not be said to have been laid out for the purposes of the profession *(Norman* v. *Golder 1945 I.T.R. Suppl. 21)*. (Cf. under the head, "Salaries" (s. 21) Expenses wholly, necessarily and exclusively incurred in the performance of duties", where cases of personal expenses of employees are dealt with.)

V. "Wholly and exclusively for the purposes of the business":

Purpose of business.–Before the corresponding section in the 1922 Act was amended in 1939, allowance was given in respect of any non-capital expenditure "incurred solely for the purpose of earning such profits or gains." Under the present law the expenditure should be laid out "wholly and exclusively for the purposes of the business." The two expressions are not synonymous; the latter is wider than the former. Expenditure may be for the purpose of the business although it may not be incurred for the purpose of earning the profits of the business *(Binodiram Balchand* v. *C.I.T. [1963] 48 I.T.R. 548; See also C.I.T. Central* v. *Georgepalus reported in 1987 B.T.D)*.

"Wholly and exclusively".–This section requires that the expenditure should be *wholly and exclusively* laid out for the purpose of the business, but *not* that it should be *necessarily* laid out for such purpose. Therefore expenses wholly and

exclusively laid out for the purposes of the trade should, subject to the fulfilment of the other conditions, be allowed under this section even though the outlay is unnecessary or unnecessarily large *(Newtone Studios Ltd.* v. *C.I.T. [1955] 28 I.T.R. 378; Raman & Raman Ltd.* v. *C.I.T. [1962] 46 I.T.R. 400).*

The judgment of the Supreme Court of India in *Eastern Investments Ltd.* v. *C.I.T. ([1951] 20 I.T.R. 1)* establishes that in the absence of fraud, the questions whether a transaction had the effect of diminishing the assessee's taxable income, whether it was a prudent or wise transaction, and whether it was necessary for the assessee to enter into that transaction, are irrelevant in determining whether expenditure relating to that transaction should be allowed.

General Principles

The following principles are useful in determining whether expenditure is wholly laid out for the purpose of trade:

(1) "Character as a trader".–One of the tests to be applied is whether the expenditure or loss is incurred by the assessee *in his character as a trader*, or whether it is incurred in some other character, *e.g.*, as a house-holder or house-owner. If it is incurred in the assessee's character as a trader, then alone would it be deductible as being for the purpose of the business *(Morgan* v. *Tate & Lyle Ltd. [1954] 26 I.T.R. 195, 219 (H.L.); C.I.T.* v. *Maharajadhiraja Sir Kameshwar Singh of Darbhanga 1942 I.T.R. 214, 218 (P.C.))*. It is not enough that the expenditure is merely connected with the trade, –it must be really incidental to the trade itself.

(2) "Voluntarily expended on grounds of commercial expendiency".–As Viscount Cave, L.C., observed in *(Atherton* v. *British Insulated & Helsby Cables Ltd.)*, "A sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of *commercial expediency* and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purposes of the trade" *(See also Tata Sons Ltd.* v. *C.I.T. 1950 I.T.R. 460, 470)*. This test was quoted with approval and applied by the Supreme Court of India in *(Eastern Investments Ltd.* v. *C.I.T.)* and in *(C.I.T.* v. *Chandulal Keshavlal & Co.)*. This case was followed by the Appellate Tribunial, Chittagong Bench vide. I.T.A. No. 5705 and 5706 reported in 1985 BTD xxiii 7-11. Question arose whether disallowance of aid towards Khowai Project as per Government directives was right. It was argued that the payment was made with a view to buying peace with the local administration for smooth carrying on of the business of the assessee which is cultivation, manufacture and sale of tea. Relying on the judgement given in the case of *(Atherton v. British Insulated and Helsby Cables Ltd. [1925])* which was followed with approval by the S.C. of India in *(Eastern Investments v. C.I.T. [1951] 20 I.T.R. P.I.)* it was observed that it was enough to show that the money was expended not of necessity and with a view to gaining direct and immediate benefit but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business ... and in order to avoid any confrontation and to maintain good relation with the Government machinery ... the payment of money was not in the nature of voluntary contribution but an

involuntary payment made for the purpose of business purely on the grounds of commercial expediency. The payment, therefore, should rank for deduction as a business expenditure.

(3) Department's subjective standard of reasonableness.–The Madras High Court held in *(Newtone Studios Ltd. v. C.I.T. ([1955 28 I.T.R. 378))* that it is not open to the Department to adopt a subjective standard of reasonableness and disallow a part of business expenditure as being unreasonably large. (See also under the head "Quantum of expenditure- whether subject to revision by Department"-ante).

(4) "Direct concern and direct purpose".–In order to ascertain whether the expenditure has been incurred wholly and exclusively for the purpose of the business, one must look to the *direct concern and direct purpose* for which the money is laid out and not to the remoter or indirect results which may possibly motivate or flow from the expenditure.

(5) Purpose of the assessee's own business.–The purpose must be the purpose of the *assessee's own business the profits of which are being computed and assessed.* As the House of Lords laid down in *(Odhams Press Ltd.* v. *Cook [1941] I.T.R. Suppl. 92 (H.L.)),* limited companies are separate taxable persons, and the loss or expenditure incurred for the purpose of a subsidiary company's business cannot be allowed in computing the profits of the parent company. (See under s. 29, and "Allowance for the purpose of business-ante and "Expenditure should have been incurred in connection with the assessee's own business."

(6) Benefit to third party.–Lord Summer stated in *Usher's Wiltshire Brewery Ltd.* v. *Bruce* that where the whole and exclusive purpose of the expenditure is the purpose of the expender's trade and the object which the expenditure serves is the same, the mere fact that to some extent the expenditure *enure to a third party's benefit* or that the expender incidentally obtains some advantage in some character other than that of a trader, cannot in law defeat the effect of the finding as to the whole and exclusive purpose *(Moore* v. *Stewarts & Lloyds Ltd. 6 T.C. 501, 507).* The same principle was laid down by the Supreme Court of India in *C.I.T.* v. *Chandulal Keshavlal & Co. ([1960] 38 I.T.R. 601).* It was held in that case if the expense is incurred for fostering the business of another or was wholly gratuitous outside the course of business then the expense is not deductible. *In deciding whether the payment of money is a deductible* expenditure one has to take into consideration question of commercial expediency and the principles of ordinary commercial trading. If the payment or expenditure is incurred for the purpose of the trade of the assessee it does not matter that the payment may inure to the benefit of a third party–*(C.I.T.* v. *Chandalal Keshavlal & Co. [1960] 38 I.T.R. 601 (S.C. of India)).* (See under s. 29, "Expenditure should have been incurred in connection with the assessee's own business".

(7) Unremunerative expenditure.–Expenditure *need not be incurred solely for the purpose of earning profits in the year of account (Anglo-Persian Oil Co. Ltd.* v. *C.I.T. 1933 I.T.R. 129).* (See also under the head "not with a view to earn profits only-*ante*). Cost of repairs or of advertisements *(Central India Spg., etc., Co.* v. *C.I.T.*

1943 I.T.R. 266, 286. See the other cases of advertisements, cited post) would be deductible though the repairs and advertisements have the result of enabling income to be earned in future years as well as in the year in which the expenditure is incurred. The word "solely" in see 10(2)(ix) is related to the object of expenditure, the earning of profits and gains and not to the profits and gains of the particular year in which the expenditure is made and deducted–*Central India Spinning, Weaving and Manufacturing Co. Ltd.* v. *C.I.T. [943] 11 I.T.R. 266.* It has also been further held that expenditure on advertisement is admissible irrespective of whether it is of capital nature or of revenue nature–*(Mahan Meakin Breweries Ltd. 1979, 118 I.T.R. 101).* Expenditure incurred by a rubber company for superintendence, weeding, etc., of its whole estate was held to be deductible, though only a part of the estate produced rubber, the other part being in the process of cultivation *(Vallambrosa Rubber Co. Ltd.* v. *Farmer 5 T.C. 529; Travancore Rubber & Tea Co. Ltd.* v. *C. Ag. I.T. [1961] 41 I.T.R. 751 (S.C. of India)).*

It is *not necessary* that the expenditure allowable in a particular year should *result in any profits at all in that year.* Viscount Cave, L.C., said in *Ward & Co. Ltd.* v. *Comr. of Taxes (1923 A.C. 145, 148 (P.C.),* "Their Lordships put aside the circumstance that the expenditure was not of such a nature as to produce income in the actual tax-year in which it was incurred. In every trade, much of the expenditure in each year–such as expenditure in the purchase of raw material, in the repair of plant or the advertisement of goods for sale–is designed to produce results wholly or partly in subsequent years; but, nevertheless, such expenditure is constantly allowed as a deduction for the year in which it is incurred." A payment made to an employee may be an admissible deduction although it may not be in respect of services rendered in the trading year. Similarly, rent paid for premises taken on lease for a term of years after the business has ceased to be carried on there would be allowable *(Phoomal Bros.* v. *C.I.T. [1958] 34 I.T.R. 64).* (See also under the head, "Allowance for rent"–*ante*).

Expenditure may be allowable though it *may not turn out profitably at all at any time.* The statute does not require the party claiming the deduction to show that any profit was in fact earned by the expenditure in question. This principle has been re-affirmed by the Supreme Court (India) in *(Eastern Investments Ltd.* v. *C.I.T. ([1951] 20 I.T.R. 1, 4, followed in Ormerods (India) Pr. Ltd.* v. *C.I.T. [1959] 36 I.T.R. 329)).* Lord Thankerton said in *Hughes* v. *Bank of New Zealand (1938 I.T.R. 636, 644 (H.L.)),* "Expenditure in course of the trade which is unremunerative is none the less a proper deduction if wholly and exclusively made for the purposes of the trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense."

(8) Treatment in assessee's accounts.–The way in which an item of expenditure is treated in the assessee's accounts is not conclusive against or in favour of the assessee. The sum representing cost of service connection received by an electric supply company from different customers is a capital receipt and not a revenue receipt in the hands of the company, although in the books of account it has

treated the receipt as revenue receipt in determining whether the receipt is of capital nature or revenue nature the substance of the matter has to be looked into.

Payments out of profits and payments ascertained by reference to profits.–When a trader makes a payment which is computed in relation to profits, the question that arises is: Does the payment represent a mere division of profits with another party, or is it an item of expenditure the amount of which is ascertained by reference to profits. The payment would be allowable in the second case, but not in the first. Where by obligation income is diverted before it reaches the assessee it is deductible but such consequence does not follow where the income is applied to discharge an obligation after it reaches the assessee. If the payment as made by an assessee falls under the first category it is a deductible expense–*C.T.* v. *Chittagong Jute Manufacturing Co. Ltd. reported in 1993 B.T.D. xxi page 18 (See also under sec. 16,* "Application of profit and diversion of profit"). See also the case of – *Meghna Petroleum Ltd.* v. *C.T. (East Zone) S.C. of Bangladesh reported in 1998 BTD XXVI 74.*

In *Pondicherry Rly. Co. Ltd.* v. *C.I.T. (5 I.T.C. 363)*, a railway company, in consideration of a ninety-nine-year concession from the French Colonial Government, agreed to make over to the Colonial government during the whole duration of the concession one half of the company's net profits to be ascertained in a prescribed manner. The Privy Council held that the company was not entitled to any deduction in respect of the half share of its profits made over to the French authorities *(Foolowed by Bom. H.C. in C.I.T.* v. *Macdonald & Co. 1935 I.T.R. 459)*. Lord Macmillan said, "A payment out of profits and conditional on profits being earned cannot accurately be described as a payment made to earn profits. It assumes that profits have first come into existence. But profits on their coming into existence attract tax at that point and the Revenue is not concerned with the subsequent application of the profits". But, as Lord Macmillan himself explained in the subsequent case of *(Union Cold Storage Co. Ltd.* v. *Adamson)*, the first sentence in the above-quoted passage must be read with reference to the facts of the *Pondicherry* case where the obligation was, first of all, to ascertain the profits in a prescribed manner, after providing for all outlays incurred in earning them, and then to divide them. In the later Privy Council case of *Indian Radio & Cable Communications Co. Ltd.* v. *C.I.T. (1937 I.T.R. 270, 277-8)*, Lord Maugham said, "It is not universally true to say that a payment the making of which is conditional on profits being earned cannot properly be described as an expenditure incurred for the purpose of earning such profits. The typical exception is that of a payment to a director or a manager of a commission on the profits of a company. It may, however, be worth pointing out that an apparent difficulty here is really caused by using the word 'profits' in more than one sense. If a company having made an apparent net profit of 10,000 has then to pay £1,000 to directors or managers as the contractual recompense for their service during the year, it is plain that the real net profit is only £9,000".

Thus remuneration or commission payable to directors, managers, agents or other employees, and ascertained by reference to profits, is deductible as a business expense *(Badridas Bansidhar* v. *C.I.T. [1954] 25 I.T.R. 353; C.I.T.* v. *Bombay burma*

Trading Corpn. 1941 I.T.R. 155)). Payments made by an assessee to business rivals in consideration of their agreeing not to quote lower rates than the assessee in respect of certain tenders, the payments being computed on the basis of an artificial estimate of profits expected to accrue from the execution of the works, are allowable *(Munshi Gulab Singh & Sons* v. *C.I.T. 1946 I.T.R. 66)*. If a share of profits is paid by the assessee to a financier under a loan agreement entered into for reasons of commercial expediency *(Dharamvir Dhir* v. *C.I.T. [1961] 42 I.T.R. 7 (S.C.))* or if the managing agents of a company agree to pay a share of the commission and other remuneration recovered by them from the company to a financier in consideration of his advancing a loan to the company *(C.I.T.* v. *Tata Sons Ltd. 1939 I.T.R. 195)*, the payment would be allowable as a business expense. Beaumont. C.J., said, "The question whether the payment of part of a commission to a third person can be regarded as expenditure incurred solely for the purpose of earning that commission is a question which must be answered on the facts of each case and on commercial basis" *(C.I.T.* v. *Tata Sons Ltd. 1939 I.T.R. 195, 203)*. But where the agency business was purchased by a third party who agreed to pay the share of remuneration payable to the lenders, it was held that the payment assumed a different character and could not be deducted as a business expense, for it was regarded as having been made in consideration of the acquisition of the right and opportunity to earn profits *(Tata Hydro-Electric Agencies Ltd.* v. *C.I.T. 1937 I.T.R. 202 (P.C.))*.

Remuneration to a retiring director or employee.–The amount of gratuity paid by the assessee to employee or director on retirement in appreciation of his long and valuable service to the company was not allowable unless the payments made are as a matter of practice which affected the quantum of salary or there was an expectation of getting a gratuity or the sum was paid on the ground of commercial expediency–*Goordon Woodroffe Leather Manufacturing* v. *Commissioner of Income tax (Madras) reported in 1963 P.T.D. 324 (S.C. of India)*.

"Joint venture".–Where a share of profits is paid to a third party under an agreement which amounts to a joint venture and which makes the third party a participator in the success of the undertaking, the case is really one of division of profits and not of any business expenditure *(Pondicherry Rly. Co.* v. *C.I.T. 5 I.T.C. 363, 370 (P.C.); C.I.T.* v. *Bombay Burma Trading Corpn. 1941 I.T.R. 155, 175-6)*, and none the less so if the payment is made under a decree passed in favour of a co-sharer in the joint venture. In *Indian Radio &Cable Communications Co. Ltd.* v. *C.I.T.* the assessee company agreed to pay one-half of its net profits for a certain number of years to another company as part of the consideration in respect of a number of years to another company as part of the consideration in respect of a number of different advantages which the assessee company derived from the agreement. The Privy Council held that the agreement represented a joint adventure for a term of years, and that the payment of a moiety of profits was inadmissible as a deduction. Where an assessee paid a ginning company its normal ginning charges and, in addition, paid one-third of his profits in consideration of the company agreeing not to gin cotton for any one else, it was held that the payment of the share of profits was not a business expense and that under the arrangement the ginning company entered upon the enterprise as a joint adventure with the assessee *(Gopinath*

Vir Bhan v. *C.I.T. 1938 I.T.R. 243. C.I.T.* v. *Bombay Burma Trading Corpn. 1941 I.T.R. 155, 174-5).* The amount paid by way of bonus by an insurance company to its participating policy-holders was also taxable in its entirety.

In *British Sugar Manufacturers Ltd.* v. *Harris* the assessee company agreed with two other companies to pay them a specified percentage of its "net profits" to be computed upon a *conventional* basis, in consideration of their giving to the assessee company the full benefit of their technical and financial knowledge and experience. The Court of Appeal held that it was not a case of a joint adventure, or of payment of a share of profits *simpliciter*, but that the payment represented remuneration for services rendered and was deductible before the real net profits could be ascertained *(Followed in Badridas Bansidhar* v. *C.I.T. [1954] 25 I.T.R. 353).* In *Vithaldas Thakordas & Co.* v. *C.I.T. (1946 I.T.R. 822)* the assessee firm agreed to pay two annas in the rupee of "the net profits" to a widow as consideration for being allowed the use of the goodwill of her deceased husband's business. Held, there was no joint adventure, and the fee or charge for the use of the goodwill, though fixed by reference to "net profits", was allowable as a business expense. Chagla, J., said, "In every case the Court has got to consider what are the real profits that attract the tax; and even though the language used in the material documents may be 'net profits' the Court must look to the substance of the transaction and not to the form" *(Ibid. at 831).* In other words, a payment out of what the document calls "net profits" may actually be a payment out of apparent or conventional profits, in which event the real taxable profits can be ascertained only after the payment is deducted *(Vithaldas Thakordas & Co.* v. *C.I.T. 1946 I.T.R. 822, 832; C.I.T.* v. *Bombay Burma Trading Corpn. Ltd. 1941 I.T.R. 155, 174).*

Legal and accountancy expenses.–The expense of keeping an accountant or, in the case of a large business, keeping a whole accountants' department would be a proper deduction. The expense of investigating and preparing accounts to ascertain the taxable balance of profits is a business expense. Fees paid to income-tax advisers for services in connection with assessment proceedings are likewise allowable as the Madhya Pradesh High Court held in *Binodiram Valehand* v. *C.I.T.* Amounts paid to tax-consultants and chartered accountants for handling income-tax assessments, including conducting appeals before the A.A.C. and the Tribunal, were held to be expenses for the purpose of business and therefore, deductible under Sec. 10(2)(xv) (corresponding to Cl. (xxvii) of Sec. 29 (1) of I.T. Ordinance, 1984–*(C.I.T.* v. *Dalmia Dadri Cement Ltd. (Del.) 1980, 125 I.T.R. 510; Addl. C.I.T. v. Calcutta Landing and Shipping co. Ltd. (Cal.) 1970 77 I.T.R. 575).* Taxes Appellate Tribunial Chittagong Bench in I.T.A. No. 338 of 1981-82 relying on the judgement in the case *Binodiram Balchand* v. *C.I.T. (M.P.)* reported in Taxation VI 7 (1983) held the same view that fees paid to the Income tax Adviser for conducting tax eases is a business expenditure–1985 BTD xiii 140.

Litigation expenses in legal proceedings such as, appellate proceedings before the Income-tax authorities with petitions in the High Court and legal opinion obtained in connection with those proceedings with a view to reducing tax liability would be a permissible deduction–*Modi Sugar Mills Ltd. (1973) 90 I.T.R. 201.*

Litigation expenses and compensation for termination of disadvantageous agreement entered into to provide finance for business were held an allowable revenue expenditure–*Western India Oil Distributing Co. Ltd. (1970) 77 I.T.R. 1401.*

Litigation expenses incurred by a money–lender in connection with a loan advanced or capital invested or a similar trading transaction, is deductible as being for a business purpose, for money is the stock-in-trade of the money-lender *(C.I.T.* v. *Sir Kameshwar Singh 1942 I.T.R. 214 (P.C.))*. But where a money-lender takes colourable mortgages not in the course of his money-lending business but with the fraudulent intention of saving the property from the creditors of the mortgagor, the legal expenses incurred in resisting annulment of such mortgages would not be allowable as business expenditure *(Kaluram Kankaria, In re 1947 I.T.R. 209)*.

Legal costs incurred in the course of the normal carrying on of business *(Usher's Wiltshire Brewery Ltd.* v. *Bruce 6 T.C. 399 (H.L.))*, or to avoid a business liability, *e.g.* for alleged breach of a trading contract *(C.I.T.* v. *Maharajadhiraja Sir Kameshwar singh of Darbhanga 1942 I.T.R. 214 (P.C.))*, or to defend the assessee's title to his assets, *e.g.* land and buildings *(Mahabir Parshad & Sons* v. *C.I.T. 1945 I.T.R. 340)*, or to secure the termination of a disadvantageous trading relationship *(Scamell & Nephew Ltd.* v. *Rowles 1940 I.T.R. Suppl. 41 (C.A.))*, are allowable as being incurred for the purpose of business. Similarly, legal expenses incurred by a director of a company in defending a suit brought to challenge the validity of his election to the directorship are allowable under s. 33 which contains a provision corresponding to this section *(C.I.T.* v. *Sir Purshottamdas Thakurdas 1946 I.T.R. 305)*. Legal expenses incurred in connection with bonus shares were held to be allowable revenue expenditure–*Bombay Burmah Trading Corpn. Ltd. (Bom.) 1984, 145 I.T.R. 793.*

Legal costs incurred by a partner in proceedings for dissolution of the partnership and rendition of accounts, cannot be deducted as expenditure laid out for the purpose of the partnership business *(Ram Chandra Munna Lal* v. *C.I.T. 1949 I.T.R. 394, 402; Raghunath Prasad* v. *C.I.T. [1955] 28 I.T.R. 45)*. But legal costs incurred by a company in resisting a winding-up petition by some shareholders and thus preventing extinction of its business would be allowable as revenue business expenditure *(C.I.T.* v. *Jagatjit Distilling & Allied Industries Ltd. [1961] 41 I.T.R. 328)*.

Legal costs incurred in resisting a third party's claim for rents and royalties under a contract which had been entered into by the assessee in the course of his business was disallowed on the ground that the expenditure was not incurred for the purpose of "earning the profits of the business" but to prevent a liability arising in future; but so far as this ground of the decision goes, the case does not seem to be good law–*Mangiram Blangor & Co. in re. 1941 I.T.R. 573, 588)*.

So far as expenses incurred in *civil* litigation are concerned, the general tests are, whether the legal expenses were incurred by the assessee *in his character as a trader* and the liability fell on him as a trader, and whether the *transaction* in respect of which the proceedings are taken arose out of and was *incidental to the assessee's*

business or profession *(C.I.T.* v. *Maharajadhiraja Sir Kameshwar Singh of Darbhanga 1942 I.T.R. 214 (P.C.))*. The Nagpur High Court held in *I.T. Appellate Tribunal* v. *Chhaganmal Mangilal (1946 I.T.R. 206)*, after an exhaustive review of the authorities, that legal costs incurred in defending a suit to restrain user of a trade mark were allowable as being wholly and exclusively incurred for the purpose of the trade. The plaintiff's costs in such a suit would be equally deductible *(Central India Spg., etc., Co.* v. *C.I.T. 1943 I.T.R. 266)*. Likewise, legal costs incurred by an assessee *carrying on the business of company promotion* in defending, and a sum paid in settlement of, civil actions for damages for alleged (but not proved) fraudulent statements in a prospectus, have been allowed *(Golder* v. *Great Boulder Proprietary Gold Mines Ltd. 33 T.C. 75)*. On the other hand, legal costs incurred by the assessee *in his character as a house-holder* in defending a suit for damages brought by a person injured by the falling in of the assessee's chimney, or costs incurred *in his character as a house-owner* in connection with a charge over the property owned by him and used for the purposes of his business *(Small* v. *Easson 12 T.C. 351)*, are not allowable as a business expenses.

The position is however different as regards legal expenses incurred in *criminal* proceedings where the defence cannot easily be dissociated from the purpose of saving the accused from a possible conviction and sentence, which is not a business purpose *(C.I.T.* v. *Hirjee [1953] 23 I.T.R. 427 431 (S.C. of India))*. In *C.I.T.* v. *Hirjee* the Supreme Court held that expenses incurred by an *individual* assessee in defending himself in a criminal proceeding (which ended in an acquittal) on a charge of selling goods at excessive prices in contravention of the law, were not allowable, since there was a possibility of the proceeding terminating in the conviction and *imprisonment* of the assessee and therefore the purpose of the expenditure could not be regarded as wholly and exclusively a business purpose. Patanjali Sastri, C.J., said, "If, as the High Court realised, in every criminal prosecution where the matter is defended to protect the good name of a business or a professional man, the fear of possible fine or imprisonment must always be there, it must ordinarily be difficult for any Court to say that the expenses incurred for the defence, even if they are not to be regarded as the 'personal expenses' of the person accused, constituted 'expenditure laid out or expended wholly and exclusively for the purposes of the business'. The deductibility of such expenses under s. 10(2)(xv) [of the 1922 Act] must depend on the nature and purpose of the legal proceeding in relation to the business whose profits are under computation, and cannot be affected by the final outcome of that proceeding. Costs and penalties incurred by a company in proceedings launched against it by public authorities for infractions of the law, *e.g.* for breaches of customs, excise and other regulations, have been disallowed *(Juggilal Kamlapat Cotton Spg. & Wvg. Co. Ltd.* v. *C.I.T. [1955] 28 I.T.R. 78)*, and even costs incurred by a firm of accountants in *successfully* defending a member of the firm against a charge of conspiracy to defraud the revenue with reference to a case professionally handled by the firm have been disallowed. Likewise, before s. 10(2)(xv) of the 1922 Act was amended in 1939, expenses incurred by newspaper company in defending its editor and printer against a charge of contempt of Court, and expenditure incurred by a firm of liquor merchants in defending its partners against charges under the Excise Act, were held to be inadmissible, on the ground that they were not expenditure incurred

for the purpose of earning the profits of the business. Of course in a criminal case expenses incurred by a company in defending its director and employees for the offence of bribery were held to be an allowable item under Sec. 10(2)(xvii) of I.T. Act. 1922 on the ground that these were incurred in defending the good name of the business and had arisen in the ordinary course of business–Luxmiji Sugar Mills Co. (P) Ltd. ... (Del) 1975, 98 I.T.A. 568. Nor are we satisfied, as at present advised, that a distinction drawn in the Bombay case *(J.B. Advani & Co. Ltd.* v. *C.I.T. 1950 I.T.R. 557)* between the legal expenses of a successful and unsuccessfu defence is sound.

Since the Income-tax Ordinance is not concerned with the legality of transactions but taxes the profits of an illegal business, an infraction of the law (which consists of administrative regulations) should not be taken in all cases as defeating the right of the assessee to claim a deduction for costs or penalties incurred as a result of the infraction. For instance, where goods are confiscated (without a personal penalty) under the Sea Customs Act, the proceedings are *in rem* and no personal liability whatever attaches to the importer, and there is no question of saving him from any conviction or sentence; in such cases if the importer exercises his option of paying a fine in lieu of confiscation merely in order to salvage his stock-in-trade, a deduction should, as observed by the author N.A. Palkhivala, be allowed in respect of the fine despite the infraction of the law, particularly if no moral turpitude is involved. However, the Supreme Court of India held in *Haji Aziz & Abdul Shakoor Bros.* v. *C.I.T.* that in such cases no deduction should be allowed. It is suggested by the learned authors Sir G.B. Kanga and W.A. Palkhivada with respect, that the matter requires reconsideration *(Cf. Baluswamy Iyer* v. *C.I.T. [1955] 28 I.T.R. 235).*

This decision is not in consonance with the decision of Supreme Court (India) in the case of *C.I.T.* v. *Peara Singh (1980) 124 I.T.R. 40* wherein the respondent, who was carrying on smuggling business was apprehended by the Indian Police and a sum of Rs. 65,000 in currency notes which he was carrying was confiscated by the customs authorities. When the question arose before the Supreme Court (India) for consideration whether the sum would be deducted under Sec. 10 of I.T. Act 1922 the Supreme Court observed that the confiscation of currency notes was a loss occasioned in pursuing the business of smuggling and it was a loss which sprang directly from the carrying of the business and was incidental to it and its deduction had to be allowed under Sec. 10.

In the case of *C.I.T.* v. *S.C. Kothari (1971) 82 I.T.R. 794 (S.C. of India)* the Supreme Court observed that "if the business is illegal neither the profits earned the nor losses incurred would be enforceable in law. But that does not take the profits out of the taxing statute. Similarly, the taint of illegality of the business cannot detract from the losses being taken into account for computation of the amount which can be subjected to tax as profits under Sec. 10(1) of I.T.Act, 1922.

In the same judgement, the Learned judges of the Supreme Court (India) pointed out that there was a distinction between the above case and those cases where an amount had been paid by way of penalty for a breach of law and in the latter cases where a penalty was levied for committing a breach of law, payment of such penalty cannot be accounted for under Sec. 10 of the I.T. Act, 1922. (The cases were

discussed in the case of *C.I.T* v. *British India Corporation* reported in BTD 1990 Vol. xviii 66-88).

For a discussion of the question whether legal costs are of a capital or revenue nature, see below under "Legal or other expenses incurred in preserving or maintaining assets".

Expenditure tainted with illegality.–In *Raj Woolen Industries* v. *C.I.T. ([1961] 43 I.T.R. 36)* the Punjab High Court extended the principle on which penalties and fines are disallowable and held that even ordinary expenditure, incurred in connection with a purely commercial transaction which may constitute an infringement of the law, should be disallowed. It was found by the Learned authors Kanga and Packhivala that the Punjab case was wrongly decided *(See C.I.T.* v. *Pranlal Kesurdas [1963] 49 I.T.R. 931, 939, and Sree Meenakshi Mills Ltd.* v. *C.I.T. [1963] 49 I.T.R. 156, 163)*. The question arose in the case of *C.I.T.* v. *Ramkrishna Mills Ltd. (1974) 93 I.T.R. 49)*, whether the payment which infringed the provision of sec. 348 of the Companies Act could be allowed as a deduction and it was held that still the payment is deduction under sec. 10(2)(xvii) *(Reported in 1990 BTD xviii 83)*. Apart from the question whether on the facts of that case the transaction was at all illegal, the ratio of that case would lead to the unacceptable conclusion that in illegal businesses the tax can be levied not on income but on the gross trading receipts *(See under s. 28, "Profits and gains")*. Revenue expenses incurred by the assessee in his character as a trader and wholly and exclusively for the purpose of his business, stand on a different footing from penalties and fines. In the case of prize competitions carried on in breach of the gaming laws, can the tax be charged on the gross entry fees without deduction of the staff salaries and other expenses directly connected with he illegal activity *(See the cases cited under "ncome tainted with illegality)*. There is no suggestion in Minister of finance v. Smith *(1927 A.C. 193 (P.C.))* that a bootlegger is taxable in respect of the total sale proceeds without deduction of the cost of purchases made in breach of the dry law.

Expenditure incurred to oppose nationalization or to prevent extinction of business. –In *Morgan* v. *Tate & Lyle Ltd. ([1954] 26 I.T.R. 195, 35 T.C. 367)* (also reported in BTD 1990 (xviii) 96) a company enaged in sugar refining incurred expenses in a propaganda campaign to oppose the threatened nationalization of the industry. The House of Lords held by a majority that the expenditure was allowable as being incurred wholly and exclusively for the purpose of the business, since its object was to preserve the very existence of the company's trade and so to enable the company to carry on and earn profits in the trade. Expenses incurred in a propaganda campaign to preserve the assets of an assessee from seizure upon threatened nationalization or to prevent extinction of a liquor business upon threatened prohibition, would be allowable under this section.

In *C.I.T.* v. *Royal Calcutta Turf Club ([1961] 41 I.T.R. 414)* the Supreme Court of India held that expenditure incurred by a Turf Club in running a school for training jockeys, when in the absence of efficient jockeys the Club might have to close down its business of holding race meetings, was on revenue account. Legal costs incurred by a company in resisting a winding-up petition by some shareholders

and thus preventing extinction of its business would be allowable as revenue business expenditure–*(C.I.T. v. Jagatjit Distilling & Allied Industries Ltd. [1961] 41 I.T.R. 328)*.

Expenditure for a political purpose.–Payments for a political cause may be for the purposes of advancing the trade of the assessee and enabling him to protect his assets and earn profits; but unless these are the *sole* purposes of the expenditure, no allowance can be claimed under this section. Expenditure mainly in connection with matters unconnected with the trading operations of the assessee, was held to be incurred not solely for a business purpose and was disallowed.

Damages or compensation paid by the assessee.–An expenditure is allowable when it is incurred in the assessee's *character as a trader*, –and this test is particularly useful when considering the question of damages paid by the assessee to a third party. For instance, where a railway or other transport company incurs liability for damages to persons injured by accident, the dameages are allowable, for they are incurred in the assessee's character as a businessman and are inseparably connected with and incidental to the conduct of the business from year to year *(Strong v. Woodifield 5 T.C. 215, 219 (H.L.))*. On the other hand, as the House of Lords held in *Strong v. Woodifield*, damages incurred by an inn-keeper on account of injuries caused to a visitor staying at the inn by the falling in of a chimney, or damages paid by a grocer to a man who is injured while walking in the street by the falling of a window shutter of the grocer's shop, would not be allowable as a business expense, for the liability falls upon the tax-payer in his character *not as a trader but as a householder* and the disbursement is not really incidental to the trade.

Compensation payable as a result of negligence, of the assessee or his employees, in carrying on the business is allowable *(Anamalai Timber Trust Ltd. v. C.I.T. [1963] 47 I.T.R. 814)*. In this case the assessee was a timber merchant who was required to hire elephants to handle timber. The *'mahuts'* who were engaged by the assessee inflicted such injuries on an elephant that the animal died and the assessee had to pay damages. Moneys paid by a firm of accountants in settlement of a claim for damages arising out of the negligence of their employees would be a proper deduction. Similarly, damages paid for inability to perform a trading contract are allowable *(Hind Mercantile Corpn. Ltd. v. C.I.T. [1963] 49 I.T.R. 23)*. But liability for damages occasioned by deliberate and dishonest breaches of contract *(Madk & Co. v. C.I.T. 1943 I.T.R. 454)*, or an amount paid by a director of a company in liquidation for compounding misfeasance proceedings started against him by the liquidator *(Executors of Sardar narain Singh, In re, 1943 I.T.R. 478)*, or payment under a decree passed against a company for misfeasance committed by its directors, has been held not to be deductible as business expenditure. As already submitted above, since the Income-tax Ordinance is not concerned with the legality of transactions but taxes the profits of an illegal business, an infraction of the law by itself is *not* sufficient in *all* cases to justify a disallowance. In any event, if a sum is paid in settlement of a civil action for damages on the ground of fraud committed in the course of the assessee's business, such a sum may be allowed as a business

expense, for the mere fact of a settlement would not be proof of any infraction of the law *(Golder* v. *Great Boulder Proprietary Gold Mines Lt. 33 T.C. 75)*.

A payment of a fine of Rs. 5000 for transgressing the terms of business agreement was not allowed as business expense–*C.I.T.* v. *Himalaya Rosin Turpentine Mfg. Co.* –1953, 24 I.T.R. 132). In another case the assessee entered into contract with the Government for supply of onions subject to a payment of penalty at 2 anas per pound on the quantity if failed to supply in time. The assessee failed to supply the quantity in time, the Government cancelled the contract and imposed a penalty of one anna per pound. Subsequently, the Government extended the date on application by the assessee provided the assessee paid liquidated damages at 2 per cent. Held, the payment was not by way of penalty but a payment in the normal course of assessee's business and the payment was allowable–*Central Trading Agency (1965) 56 I.T.R. 561*, A similar decision is found in the case of –*C.I.T.* v. *Srirajagopal Transport (P) Ltd. (1983) 144 I.T.R. 573)*.

In *Nainital Bank Ltd.* v. *C.I.T. ([1962] 46 I.T.R. 540)* customers' ornaments pledged with a bank were stolen by dacoits and the loss should have fallen on the pledgors since the bank had taken the reasonable care expected of a bailee. But out of a desire to maintain the goodwill and confidence of the customers, the bank voluntarily made good to them the value of the lost ornaments. The Allahabad High Court held that the expenditure incurred in compensating the customers was allowable as having been incurred on grounds of commercial expediency wholly and exclusively for the purpose of the banking business.

A payment made to get rid of a servant or managing agents *(Greaves Cotton & Co. Ltd.* v. *C.I.T. [1963] 48 I.T.R. 111)* in the interest of the trade, or damages paid to a dismissed servant, would be deductible as expenditure wholly and exclusively incurred for the purpose of business. See below under "Compensation paid to directors, agents and other employees on termination of their services", where the question whether such payment is a capital or revenue disbursement is discussed.

Remuneration, pensions, gratuities etc. paid to directors and employees.–As stated above, expenditure may be voluntary but nonetheless incurred for the purpose of the business. Lord Cave, L.C., said in *Atherton* v. *British Insulated & Helsby Cables Ltd. (10 T.C. 155, 191 (H.L.))* that pensions, gratuities and other voluntary payments made to employees for the sound commercial purpose of enabling the company to retain the services of the staff and of increasing their efficiency, may be deductible as being wholly and exclusively laid out for the purpose of the trade. But a gratuity paid to a single employee when it was not the practice of the employer to grant such a benefit in any circumstances was held by the Supreme Court of India to be not deductible *(Gordon Woodroffe Leather Mfg. Co. Ltd.* v. *C.I.T. [1962] 44 I.T.R. 551)*. Boarding and conveyance allowances paid to employees in order to retain their services and to increase their efficiency are allowable as expenditure laid out solely for the purpose of the business *(Jagarnath Therani* v. *C.I.T. 2 I.T.C. 4)*. Purely personal gifts, say, on New Year day, made to employees would not be deductible *(C.I.T.* v. *Hemraj Kanji 1933 I.T.R. 304)*, but if voluntary payments are made to employees at the commencement of the business year and they

can be reasonably found to be payments necessarily made by the assessee as part of his servants' wages, they would be allowable as business expense.

Voluntary pensions and lump sum payments made by a company to its employees on its winding up are not allowable as being made for the purpose of the trade *(Mysore Standard Bank Ltd. (In Liq.)* v. *C.I.T. [1962] 46 I.T.R. 278. See also under s. 28, "Business carried on in the course of administration, or winding up or liquidating a concern")*. However, payment of retrenchment compensation and payment in lieu of notice made by an employer under a legal obligation and before the cessation of business, are allowable as being for the purpose of business. But remuneration paid to employees of a branch office for a period during which the business is not carried on at the branch would not be allowable if the contracts of service could have been terminated when the business ceased to be carried on there *(Pohomal Bros.* v. *C.I.T. [1958] 34 I.T.R. 64)*.

If directors' or managing agents' remuneration is earned and is payable in the country and the directors or managing agents carry on the business of the company in the country, the full remuneration must, generally speaking, be allowed in computing the company's profits, notwithstanding the fact that some trading activities of the company might be carried on outside the country and might result in profits not taxable under the Ordinance *(C.I.T.* v. *C. Parakh & Co. (India) Ltd. [1956] 29 I.T.R. 661 (S.C.))*.

Remuneration paid to director but there was no provision in the Articles for such payment. Articles did not exclude specifically excluding application of Table A. Remuneration paid could not be disallowed though Articles were neither modified nor amended but resolution was passed by the company sanctioning payment retrospectively. The payment was not unauthorised payment–*Sagar Automotives (P) Ltd.* v. *C.I.T. (M.P.) reported in BTD 1988 XVI p.1)*.

Special allowance paid to employee to meet necessary expenses.–In cases where a special allowance is bonafide paid by the assessee to his agent or employee specifically to meet expenses wholly and necessarily incurred in the performance of his duties, the assessee is entitled to a deduction in respect of the special allowance without proof of the amount actually spent by the employee and despite the fact that the special allowance may be exempt from tax in the hands of the employee *(Ciba Dtes Ltd.* v. *C.I.T. [1954] 25 I.T.R. 102)*.

Cl. (xvvii): Employer's contributions to provident and other funds.– Allowance in respect of an employer's contributions to a provident or other fund established for the benefit of his employees is governed by the following principles:

(A) If the fund is *not settled upon trust* but merely comprises sums set apart in the books of the employer, the employer would not be parting with his proprietary rights in such sums, and no allowance can be made under these clauses, nor under cl. (xxvii) for no "expenditure" can be said to have been incurred; but the employer would be entitled to an allowance in respect of his share as and when an employee is actually paid the amount standing to his credit in the fund *(C.I.T.* v. *Bombay Burma Trading Corpn. Ltd. 1933 I.T.R. 152)*. The same considerations would apply where

the employer purports to settle the fund upon trust but the trust is void and ineffective *(Allahabad Bank Ltd.* v. *C.I.T [1953] 24 I.T.R. 519 (S.C. of India)* because of uncertainty as regards the beneficiaries.

(B) If the employer transfers a *lump sum to trustees* upon trust to be held as a provident or other fund for the benefit of his employees, the case would not be covered by this clause. On general principles, as well as under Para 11(1) of Part B of First Schedule, such a nucleus of a provident fund would be capital expense. But Para 11(2) provides that as and when an employee is paid the accumulated balance due to him from such a provident fund, such portion of the balance as represents the employer's share in the amount originally transferred to the trustees should be allowed under cl. (xvvii) as business expense incurred in the year in which the accumulated balance is paid to the employee, provided that the employer has made effective arrangements to secure the deduction of tax at source from such portion of the balance when paid to the employee.

(C) If a provident or other fund held upon trust is already in existence, the employer's *periodic payments to such a trust fund* would be covered by this clause if it is a provident, superannuation or gratuity fund recognised or approved under the First Schedule. The employer's periodic contributions to a trust fund not so approved or recognised may be allowed under cl. (xxvii), provided the employer has made effective arrangements to secure the deduction of tax at source from any payments made from the fund *(Hindustan Commercial Bank Ltd.* v. *C.I.T. [1962] 46 I.T.R. 910)*. The employer's contributions to the provident fund held in trust would be so allowable even if the rules of the provident fund provide that in certain contingencies the employer would be able to get back his contributions *(Burma Corpn. Ltd.* v. *C.I.T. 4 I.T.C 49)*. but it is necessary that the periodic sums should be actually transferred to the trustees so that the employer loses all proprietary rights therein. The employer is "not entitled to any deduction in respect of the sums merely carried in the account, as the mere creation of a book liability whether in favour of the employees or trustees is not equivalent to a payment".

Under Para 11(2) an allowance can be granted only in the year in which payment is made to an employee from the fund.

Paragraph 3 sets out the limits for contributions to recognised provident funds.

Excessive remuneration and remuneration to family members.– Remuneration paid to employees is allowable as a deduction, provided the payment is made solely and exclusively for the purpose of the business. Where a member of a joint family renders services to the family business, and the family pays him remuneration for commercial considerations, the whole remuneration is allowable as much as remuneration paid to an outsider *(Jitmal Bhuramal* v. *C.I.T. [1962] 44 I.T.R. 887 (S.C. of India)*. Where the owner of a business paid large sums by way of remuneration to his sons who were employed in the business, the payments were disintegrated into the amount of a fair wage and a balance which was considered as paid on account of family feeling, and only the former was allowed *(Natesa Lyer* v. *C.I.T. [1962] 46 I.T.R. 802)*. (See also under "Principles governing the reasonableness

of remuneration"). But the mere fact that the employee is a relative of the assessee, or of the person in management and control, would not justify disallowance of a portion of the salary *(Veeriah Reddiar* v. *C.I.T. [1960] 38 I.T.R. 152).*

Jethabhai Hirji & Co. v. *C.I.T. (1949 I.T.R. 533)* is an authority for the proposition that even if a certain amount is actually paid to an employee and the agreement under which it is paid is proved to exist, it is nevertheless open to the Department to find upon the other facts and circumstances that only a part of such payment should be allowed as expenditure wholly and exclusively incurred for the purposes of the assessee's business *(J.K. Woolen Mfrs. Pr. Ltd.* v. *C.I.T. [1963] 48 I.T.R. 346).*

Principles governing the reasonableness of remuneration.–In considering whether the expenditure to remunerate a person for services is allowable under Sec. 10(2)(xv), the I.T.O. must have regard to all the circumstances, such as, the nature and special character of the service, the practice, if any, in the trade for payment of a percentage of profit to an employee in similar circumstances, the qualification of the employee for rendering the service, the amount, if any paid by the assessee to another person for rendering similar service, the normalcy of the amount having regard to the practice in the trade, the existence of any other extraordinary and abnormal circumstances in the arrangement or special reasons or circumstances which may suggest that the transaction was abnormal and the like–*C.I.T.* v. *Chari and Chari Ltd. (S.C. of India) 1965, 57 I.T.R. 400-404.*

Similarly, under the general law, remuneration of a company's servants and directors is normally allowable as a proper business expense; but if excessive remuneration is paid out of non-commercial considerations–*e.g.* remuneration paid to the children of the virtual owner of a private limited company–the excess may be disallowed *(J.K. Woolen Mfrs. Pr. Ltd.* v. *C.I.T. [1963] 48 I.T.R. 346).* Remuneration may be paid to directors in accordance with the articles of association of a company and in pursuance of a resolution of the company, and the vouchers for such payments may be produced, but the Department may still find as a fact on the other evidence before it, –*e.g.*, where two persons were the sole shareholders and the sole directors of a private limited company, –that the sums so paid to the directors were not wholly and exclusively laid out for the purposes of the company's trade, in which event only the amount actually laid out for the purposes of the company's trade would be allowed *(Aspro Ltd.* v. *Comr. of Taxes 1936 I.T.R. 264 (P.C.)).* But as the Madras High Court held in *Newtone Studios Ltd.* v. *C.I.T. ([1955] 28 I.T.R. 387, followed in Raman & Raman Ltd.* v. *C.I.T. [1962] 46 I.T.R. 400),* if the remuneration is paid out of purely commercial considerations, it should be allowed as expenditure incurred wholly and exclusively for the purpose of business and it would not be open to the Department to adopt a subjective standard of reasonableness and disallow a part of the remuneration as being unreasonably large. The same view has been taken by the other High courts *(Walchand & Co. Pr.* v. *C.I.T. [1963] 48 I.T.R. 638).*

Guarantees, Subscriptions and other payments made to secure business.–A sum paid by the assessee as a surety when it so no part of the assessee's business to stand surety cannot, generally speaking, be allowed as a business expense

(Madan Gopal Bagla v. *C.I.T. [1956] 30 I.T.R. 174 (S.C. of India)*, but it would be a proper allowance where the guarantee is entered into pursuant to a trade custom of which *mutual accommodation* is the essence, i.e. traders standing surety for one another *(C.I.T.* v. *Jagannmath Kissonlal [1961] 41 I.T.R. 360 (S.C. of India)*. Where a firm of contractors became guarantors for the sponsors of an exhibition with the sole object of thereby obtaining contracts for work at the exhibition and had to pay a certain amount under the guarantee, it was held to be an allowable business expense *(Morley* v. *Lawford & Co. 14 T.C. 229 (C.A.))*. Similarly, if an architect buys shares in a company as a condition and with the sole object of securing professional work from the company, the loss arising on a subsequent sale of the shares may be regarded as being incurred for the purpose of the profession but would be disallowed as being of a capital nature *(Stott* v. *Hoddinott 7 T.C. 85)*. Subscriptions paid by a book-publisher to schools which agree to prescribe the text-books published by him would be deductible as a business expenses, for in effect the subscriptions are payments made to secure business *(Munshi Gulab Singh & Sons* v. *C.I.T. 1946 I.T.R. 66)*. However, in an English case *(Bourne & Hollingsworth Ltd.* v. *Ogden 14 T.C. 349)* where the assessee company paid subscriptions to a hospital on the informal understanding that the employees of the company would be admitted and treated by the hospital when necessary and the Department found as fact that subscriptions were not expenditure incurred wholly and exclusively for the purpose of the business.

Subscriptions to business association and professional societies.–A member of a business association is entitled to a deduction in respect of his contributions to the association provided the moneys are expended by the association wholly and exclusively for the purpose of the business carried on by the member. To the extent to which the association devotes its funds to other purposes, no deduction can be allowed to a member in respect of his payments to the association, just as the member spending for such other purposes on his own account would not have been entitled to a deduction. Where the objects of an association were to maintain a conciliation Board for settling disputes between members and their employees *(Lochgelly Iron & Coal Co. Ltd.* v. *Crawfor 6 T.C. 267)*, or to raise and keep up prices and enable its members to earn larger profits by the members agreeing to adhere to fixed prices, thereby preventing competition among themselves *(C.I.T.* v. *Darbhanga Sugar Co. Ltd. [1957] 32 I.T.R. 64)*, payments to the association which were attributable to these objects were allowed as expenses wholly and exclusively incurred for the purpose of the members' business. But the proportionate part of the subscription which was applied by the association in promoting and defending the general interests of the trade *(Adam Steamship Co. Ltd.* v. *Matheson 12 T.C. 399)*, or contributing to the funds of a larger trade federation of which the association was a member *(Adam Steamship Col Ltd.* v. *Matheson 12 T.C. 399)*, was disallowed.

A member's contribution to a mutual insurance association is in the nature of an insurance premium and is therefore a deductible business expense. Similarly, payments to an association formed for the purpose of indemnifying its members against liability for compensation in respect of accidents to workmen in their employ are admissible deductions as being insurance premiums *(Thomas Merthyr Colliery Co. Ltd.* v. *Davis 1933 I.T.R. 12)* even if such payments are partly applied by the

association in accumulating a fund which might in certain events be returnable to the members wholly or in part. Insurance moneys received in respect of loss of profits due to deficiency or stoppage of output are a trading receipt; and similarly subscriptions paid to effect such insurance should be allowed as a business expense. See below under "Insurance premiums".

Burden of proof.–It is not sufficient that under the rules and regulations of a business association, its funds are applicable to trading objects. The assessee may be required to prove, by producing the accounts of the association, that its funds or a part thereof were actually so expended, before the subscription or a part thereof to the association may be allowed as a deduction.

Professional societies.–Subscriptions to professional societies and associations are inadmissible as deductions from salaries, since s. 21 does not provide for an allowance corresponding to this section. But under this section, subscriptions to professional societies, like subscriptions to business associations, should be allowed to the extent to which the moneys are actually expended by the society wholly and exclusively for the purposes of the profession.

Insurance premiums.–Premiums for insurance of buildings; machinery, plant, furniture, stocks or stores are allowable under specific clause (cl. vii). Premiums for other kinds of insurance would be deductible under this clause. Premiums paid by a company under a policy insuring its employees or expert advisers against death or injury *(Murphy* v. *Thomas E. Gray & Co. 1941 I.T.R.)*, or insuring the company against liability for compensation in respect of accidents to its workmen *(Thomas Merthyr Colliery Co. Ltd.* v. *Davis 1933 I.T.R. 12)*, or against loss of trading license *(Usher's Wiltshire Brewery Ltd.* v. *Bruce 6 T.C. 399 (H.L.)*, are allowable under thisclause.

It has been erroneously held in some cases that moneys paid for insurance against loss of profits in the event of deficiency or stoppage of output caused by strikes etc. were not allowable, for they were incurred not in relation to the trade but in relation to the absence of the trade and therefore could not be said to be laid out for the purpose of the trade. The correct view is that premiums paid to effect insurance against loss of profits should be allowed as a business expense, just as moneys received under such an insurance policy are brought in as a trading receipt *(See Rex* v. *B.C. Fir & Cedar Lumber Co. 1932 A.C. 441, 444, 447 (P.C.))*.

Leases.–Rent paid for premises where business is actually carried on is deductible under s. 29(1). Where a business in a developing stage acquires on lease premises (say warehouse accommodation) larger than is necessary at the moment, the rent for such premises which are not actually used for the purpose of the business would be deductible under this clause though not under cl. (1). If premises are taken on lease for a certain period for the purpose of the business and subsequently the assessee, finding it unprofitable to carry on business there, shifts and carries on business elsewhere while the lease has still some years to run, the rent paid under the lease for the remainder of the term would be deductible under this clause *(Hyett* v. *Lennard 23 T.C. 346, 350, 1940 I.T.R.)* (See also cl.(i) ante); and if the premises are

sublet to another, the difference between the rent realised from the sub-tenant and the rent paid to the headlessor would be so deductible. However, the rent paid during the period the business is not carried on in the premises would not be deductible under this section if the lease could have been terminated when the business ceased to be carried on in the premises *(Pohoomal Bros* v. *C.I.T. [1958] 34 I.T.R. 64)*. Where a brewery company takes on lease licensed premises and sublets them at lower rents to publicans who are "tied" to purchase their beers etc. from the brewery company, the company is entitled to a deduction in respect of the difference between the rent paid by it and the rent together with premium, if any, recovered from its tied tenants, if it is found that the acquisition of licensed premises by the company is for the more profitable carrying on of the brewery business (See also cl. (c) ante). If, however, an assessee, say a money-lender, takes a lease of a whole building with the intention of re-letting it to different sub-tenants except a part which the assessee occupies for the purpose of his own business, the loss arising from the transaction would not be incidental to the business and therefore cannot be allowed under this clause *(Muthukaruppan Chettiar* v. *C.I.T. 1943 I.T.R. 38)*.

Interest on unpaid purchase price.–Interest on unpaid price of any business assets should be allowed as expenditure wholly and exclusively incurred for the purpose of business. Such interest cannot be treated as capital expenditure even if the unpaid price relates to capital assets *(Calico Dyeing & Printing Works* v. *C.I.T. [1958] 34 I.T.R. 265 and Coelho* v. *State of Madras [1960] 40 I.T.R. 686, where interest on moneys borrowed to purchase capital assets was held deductible)*.

Miscellaneous expenditures.–Payment made to procure the benefit of the payee's technical and financial knowledge and experience *(British Sugar Mfrs. Ltd.* v. *Harris 1939 I.T.R. 101 (C.A.)*, commission paid to the guarantors of the assessee's temporary indebtedness arising in the ordinary course of carrying on the business *(Ascot Gas Water Heaters* v. *Duff 24 T.C. 171)*, commission paid to managing agents during the currency of their agreement with the company for twenty years but for a year during which a controller appointed by the Government did the work which the managing agents would have normally done, rebate given to customers in accordance with normal business practice *(Harihar Cotton Pressing Factory* v. *C.I.T. [1960] 39 I.T.R. 594)*, a loss incurred as a result of fluctuations in the rate of currency exchange *(Radio Pictures Ltd.* v. *I.R. 22 T.C. 106 (C.A.) See also under "Profits on currency exchange")*, costs of advertisement *(Central India Spg., etc., Co.* v. *C.I.T. 1943 I.T.R. 266, 286)*, tax on business levied by a local authority *(Simbholi Sugar Mills Ltd.* v. *C.I.T. [1962] 45 I.T.R. 125, 132)*, payments made by the purchaser of a business, in order to preserve goodwill, in discharge of the vendor's liabilities *(Cooke* v. *Quick Shoe Repair Service 30 T.C. 460)*, expenditure incurred on repair and maintenance of residential quarters constructed by the assessee for and let to his employees, where such letting was incidental to the assessee's business *(Jamshedpur Engineering & Machine Mfg. Co. Ltd.* v. *C.I.T. [1957] 32 I.T.R. 41)*. Contribution by the company to the recoginsed provident fund, even if it contravenes articles of association of the company–*C.I.T.* v. *British India Corpn. (reported in BTD 1990 XVIII 16)*; expenditure on study cum tour by a doctor–*C.I.T.* v. *Dr. P.N. Sen (reported in BTD 1944 XXII, 100)*; expenditure on foreign tour for obtaining technical know-how of

manufacture of products–*(Sagaj Iron and Engg. (P) Ltd. (1974) 96 I.T.R. 240)* followed by the Appellate Tribunal, Dhaka (reported in 1994 BTD xxii 100); expenses claimed for Jamuna Surcharge and Development levy and Surcharge were held deductible by the Appellate Tribunal, Dhaka Bench (I.T.A. No. 462 of 1992-93) reported in BTD 1995 XXIII 84 overriding N.B.R. Circular; Interest payable under electricity Supply Act being not penalty is allowable–*(C.I.T. v. Travancore Electrical Chemical Industries Ltd. (Reported in BTD 1996 xxiv P.I.)*; Expenditure, incurred for shifting business from one place to another–*C.I.T.* v. *Bhagwater Rerolling Mills (Reported in 1996 BTD xxiv)* have been held deductible as moneys laid out for the purpose of business.

Where an assessee company acquires the business of an individual under a contract which provides *inter alia* that the company should pay an annuity to his widow, such an annuity or any sum paid in commutation of it would not be expenditure incurred wholly or exclusively for the purpose of the company's business *(Andrew Yule & Co. Ltd.* v. *C.I.T. [1963] 49 I.T.R. 57)*. In this case the chairman of a company was killed by a mob in the course of a journey not connected with the company's business compensation paid was not laid out wholly and exclusively for the purpose of business. Costs of obtaining probate or letters of administration incurred by the legal representatives of a deceased trader, or interest paid on account of deficiency in advance payment of tax *(Balmer Laurie & Co. Ltd.* v. *C.I.T. [1960] 39 I.T.R. 751)*, or interest on moneys borrowed for making payment of income-tax *(Sir Kameshwar Sinh* v. *C.I.T. [1961] 42 I.T.R. 774)*, cannot, needless to say, be allowed as a deduction under this clause. A barrister's expenses of travelling between his home and his chambers cannot be allowed as business expenditure even if he does a part of his professional work at home *(Newson* v. *Robertson 33 T.C. 452 (C.A.))*. Hotel charges of the partners of an assessee firm in respect of a tour undertaken for the purpose of procuring business for the firm have been entirely disallowed by the Allahabad High Court *(Ramkisham Sunderlal* v. *C.I.T. [1951] 19 I.T.R. 324)*. Where a money-lender incurs a loss upon the purchase of land from his debtor or at a Court sale *(Badri Shah Sohan Lal* v. *C.I.T. 1936 I.T.R. 303)*, or upon the purchase of a property with a defective title for a consideration which was to be utilised in financing a litigation regarding that property *(Anand Beharilal* v. *C.I.T. [1952] 22 I.T.R. 205)*, the loss cannot be the subject of a deduction under this clause, if the transaction is not in the course of or incidental to the business of money-lending.

The Privy Council held in *Tata Hydro-Electric Agencies Ltd.* v. *C.I.T. (1937 I.T.R. 202)* that if the purchaser of a business undertakes to the vendor as one of the terms of the purchase that he will pay a sum annually to a third party, irrespective of whether the business yields any profit or not, the annual payments are inadmissible as business expenditure, and it would make no difference if the annual sum is made payable out of a particular receipt of the business, irrespective of the earning of any profit from the business as a whole. Lord Macmillan said, "That they had to make those payments no doubt affected the ultimate yield in money to them from their business but that is not the statutory criterion. They must have taken this liability into account when they agreed to take over the business. In short, the obligation to make these payments was undertaken by the appellants in consideration of their acquisition

of the right and opportunity to earn profits, that is, of the right to conduct the business and not for the purpose of producing profits in the conduct of the business".

In the case of a rubber estate expenditure was incurred on maintenance of immature rubber plants. During the year there were no yields. Such expenditure was held as an allowable expenditure–*M.S.M.M. Meyyappa Chetair* v. *C.I.T., Madras (1963 PTD 489)*.

When once a rubber plantation has been laid, that is to say, that the land has been acquired and made fit for planting and the trees are actually planted, the stage of the capital expenditure ceases, and whatever is spent thereafter upon the maintenance of the trees, such as weeding, superintendence etc. is in the nature of revenue notwithstanding that the trees have not started to yield and will not yield for so long as six years thereafter.

Rent paid by the assessee firm for residential facilities of its partners under the terms of the instruments is an allowable expenditure as held by the Tribunal–1973 BTD (Trib) 15.

Expenditure for partition, wall panelling, construction of show window is also held as a revenue expenditure by the Tribunal.

Fees paid to Registrar of Companies for increasing capital was held as revenue expenditure – *C.I.T.* v. *Kushanchand Chellaram (Reported in 1984 BTD XII 28)*.

Assessee took loan in foreign currency for import of machinery, loss due to difference in exchange of rate as claimed was held an allowable expenditure–1987 BTD XV 225 (Trib). (Contrary decision in Tribunal, vide 1992 BTD XX 83 (Trib).

Exchange loss arising out of loan for working capital is held as a revenue expenditure–1992 BTD xx 97 (Trib).

Motor vehicles were taken on lease for four years with option to purchase at a nominal price. Amount paid for lease is held to be revenue expenditure and not a capital expenditure–1998 BTD 42 (Trib).

Reference to Court.–Whether a particular item of expenditure has been incurred wholly and exclusively for the purpose of the business is a mixed question of fact and law *(Imperial Chemical Industries (India) Ltd. In re, 1935 I.T.R. 21, 46)*. The Privy Council laid down in *Tata Hydro-Electric Agencies Ltd.* v. *C.I.T. (1937 I.T.R. 202, 210)* that the question whether a particular payment is an admissible deduction under this section is open to argument in the Court on the facts as found. The Supreme Court of India observed in *Eastern Investments Ltd.* v. *C.I.T. (1951 20 I.T.R. 1, 4)* that "though the question must be decided on the facts of each case, the final conclusion is one of law" *(Andrew Yule & Co. Ltd.* v. *C.I.T. [1963] 49 I.T.R. 57)*.

In any case, the Court can interfere if the Tribunal has misdirected itself on a point of law or if there is no evidence to support the Tribunal's finding *(Imperial Chemical Industries (India) Ltd., In re, 1935 I.T.R. 21, 39-40)*. "If the Commissioners state the evidence which was before them, and add that upon such evidence they hold

that certain results follow, it is open ... to the Court to say whether the evidence justified what the Commissioners held" *(Stanley* v. *Gramophone & Type-writer Ltd. 5 T.C. 358).*

If excessive remuneration is paid to an employee out of "family feeling", or to a director of a private limited company, the question what part of the remuneration is allowable as representing a fair wage is obviously a question of fact for the Department *(Lakshmi Ammal* v. *C.I.T. [1955] 27 I.T.R. 584).* The question whether the remuneration was actually paid by the assessee is a question of fact but the Tribunal's finding on the point would be set aside by the Court if there is no evidence to support it *(Badridas Bansidhar* v. *C.I.T. [1954] 25 I.T.R. 353).*

VI. CAPITAL EXPENDITURE AND INCOME EXPENDITURE

An item of expenditure though wholly and exclusively laid out for the purpose of the business or profession would nevertheless be inadmissible as an allowance if it is of a capital nature. "The statute refuses to take an ordinary balance-sheet, or the net profits thereby ascertained, as the measure of the assessment, and requires the full balance of profits, without allowing any deduction except for working expenses and without regard to the state of the capital account or to the amount of capital employed in the concern, or sunk and exhausted, or withdrawn" *(Tata Iron & Steel Co. Ltd. 1 I.T.C. 125, 132).* (Money paid to the underwriters on an issue of certain preference shares by a company for increasing the capital is not an item of deductible expenditure–*Tata Iron & Steel Co. Ltd).*

The expression "capital expenditure" is not defined, and the words *"in the nature of capital expenditure"* which occur in this section make the meaning of the expression more elastic in its application to the facts of each case. The expression must be construed in a business sense. The problem of discriminating between capital receipts and income receipts has already been dealt with under s. 16. Generally speaking, the criteria which are invoked in distinguishing between capital receipts and income receipts will also serve to distinguish between capital disbursements and income disbursements. (See under s. 16, "Tests to distinguish between capital and income receipts).

In the case of *C.I.T.* v. *National Rayon Corporation Ltd. (reported in BTD 1991 XIX 160)* the tests to distinguish between capital or revenue expenditure have been described as follows–"unless expenditure is directly related to a capital asset, acquired or to be acquired in future, it cannot bring in enduring benefit of capital nature" ... Expenditure incurred on foreign tour of managing director and works manager to reduce foreign exchange component in the expenditure to be incurred in setting up plant is revenue expenditure.

IMMATERIAL CONSIDERATIONS.–The following considerations are immaterial in determining the question whether a payment is a capital disbursement or an income disbursement:

(i) Lump sum and periodic payments.–That the expense is a periodic expense or a lump sum payment is immaterial for the purpose of determining its

nature. A lump sum payment may be revenue expenditure, e.g., when it represents the commutation of a series of annual revenue payments; and a recurring periodic payment may be capital expenditure, e.g., when it represents the payment by instalments of a capital sum *(Assam Bengal Cement Co. Ltd.* v. *C.I.T. [1955] 27 I.T.R. 34 46 (S.C. of India))*. In this case the assessee company formed with the object of carrying on business as miners of limestone and manufacturers of cement, obtained for that purpose a lease of certain limestone quarries. As per the lease deed the assessee agreed to pay the lessor annually a sum of Rs. 5000/- during the whole period of lease in addition to rents and royalties as a "protection fee" and in consideration of that payment the lessor undertook not to grant any lease to any other party in respect of other neighboring lime stone quarries. The assessee also agreed to pay rs.35,000 annually for five years as a further "protection fee" and in consideration of that payment the lessor gave a similar undertaking in respect of another group of quarries. The question was whether in computing its profits the assessee was entitled to deduct the sum of Rs.5000 and Rs.35,000 paid to the lessor under Sec. 10(2)(xv). Held, in the circumstances of the case the two sums of Rs.5000 and Rs.35000 are being expenditure of a capital nature.

ILLUSTRATION

The assessee agreed to purchase a dental practice for a primary price of £15,000, subject to increase or diminution as therein provided. The primary price was to be satisfied by a payment of £5,000 on the exchange of the agreement, and as to the balance by the payment each year for ten years of a sum equal to 25% of the net profits of the practice for each year. If the amounts so paid over during the ten years were, in the aggregate, more or less than the balance of the primary purchase price, that price was to be treated as correspondingly increased or diminished. Held, the annual sums paid under the agreement were instalments of capital and were not admissible as deductions *(I.R.* v. *Ramsay 20 T.C. 79)*.

(ii) Magnitude of payment.–The magnitude of a disbursement is immaterial for the purpose of determining its nature, for magnitude is a relative term. But at the same time the magnitude of a transaction is not an entirely irrelevant consideration.

(iii) Capital receipt does not spell capital disbursement.–The fact that a certain payment constitutes an income or capital receipt in the hands of the recipient is not material in determining whether the payment is a revenue or capital disbursement in the hands of the payer. As Macnaghten, J., said in *Racecourse Betting Control Voard* v. *Wild*, "The payment may be a revenue payment from the point of view of the payer and a capital payment from the point of view of the receiver, and *vice versa.*"

(iv) Payment out of capital or profits.–For the purpose of determining whether an expenditure is of a capital or revenue nature it is immaterial whether the expenditure is made out of moneys withdrawn from the capital of the concern or out of its profits.

(v) Entries in account books.–That an item of expenditure is debited in the trader's books to revenue account is by no means conclusive as to its nature. "Traders

frequently prefer to debit to revenue account payments which are in their nature proper to be carried to capital account. If they do so, it means nothing more than that they have a conservative taste in the matter of accountancy"–*Monghyr Electric Supply Co. Ltd.* v. *C.I.T. [1954] 26 I.T.R. 15.*

Form v. Substance.–In considering whether an item of expenditure is of a capital or revenue nature, one must consider the nature of the concern, the ordinary course of business usually adopted in that concern and the object with which an expense is incurred *(Assam Bengal Cement Co. Ltd.* v. *C.I.T. [1955]27 I.T.R.34, 45 (S.C. of India)*. The Court cannot ignore the legal position represented by the form of the transaction and regard "the substance of the matter". If the form of the transaction points to a revenue disbursement, the assessee's right to allowance cannot be defeated by invoking the doctrine of "the substance of the matter".

Where the transaction takes the "form" of a contract or other deed, it depends upon a proper construction of the terms of the deed whether a payment made thereunder is a capital disbursement or a revenue disbursement. The true nature of the transaction must be collected from the entire document. In all taxation matters, emphasis must be placed upon the business aspect of a transaction rather than the purely legal and technical aspect–*Per Chagla, C.J., C.I.T.* v. *Kolhia Hirdagarh Co. Ltd. 1949 I.T.R. 545, 555.*

TESTS TO DISTINGUISH BETWEEN CAPITAL AND INCOME DISBURSEMENTS

The following tests are generally applied in determining whether a particular item of expenditure constitutes revenue disbursement or capital disbursement: –

1. Bringing into existence an asset or advantage of enduring benefit.–In *Atherton* v. *British Insulated & Helsby Cables Ltd. (1926 A.C. 205, 10 T.C. 155)*, which is the leading modern authority on the subject, the assessee company claimed to deduct a sum which it had settled upon trust to form the nucleus of a pension fund for its employees. The House of Lords rejected the claim on the ground that the expenditure was of a capital sum which would for ever after relieve the company from making any further payment whatsoever. Viscount Cave, L.C., in the course of his speech said, "When an expenditure is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade ... there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital" *(C.I.T.* v. *Finlay Mills [1951] 20 I.T. 475, 477 (S.C. of India)), and Indian Molasses Co. (P.) Ltd.* v. *C.I.T. [1959] 37 I.T.R. 66, 75 (S.C. of India)*. Viscount Cave further pointed out in this case that the dictum that "capital expenditure is a thing that is going to be spent once and for all and income expenditure is a thing which is going to recur every year" is not, and was not intended to be, a decisive test in every case. There are many cases where a payment though made "once and for all" would be properly chargeable against the revenue receipts for the year *(See ante under "Lump sum and periodic payments")*. Lord Atkinson in a concurring speech indicated that the word "asset" ought not to be confined to

"something material"; the asset or advantage may be of an impalpable or incalculable nature–*Assam Bengal Cement Co. Ltd.* v. *C.I.T. [1955] 27 I.T.R. 34 (S.C.)*. Thus expenditure on a scheme which increases the value of a capital asset is capital expenditure.

In further elucidation of the principle, Romer, L.J., laid down in *Anglo-Persian Oil Co. Ltd.* v. *Dale (16 T.C. 253, 274 [1932] K.B. 124, 146)* as follows:

(a) The advantage paid for need not be of a positive character and may consist in the getting rid of an item of fixed capital that is of an onerous character.

(b) The expenditure is to be attributed to capital if it be made "with a view" to bringing an asset or advantage into existence and it is not necessary that it should have that result–*Collins* v. *Joseph Adamson & Co. 1939 I.T.R. 92, 99*. Thus a sum spent in trying to procure an agency agreement–*Henderson* v. *Meade-King Robinson & co. Ltd. 22 T.C. 97*, or a licence, *Southwell* v. *Savill Bros. Ltd. 4 T.C. 430; Pyrah* v. *Annis & Co. Ltd. [1957] 31 I.T.R. 517, affirmed, 37 T.C. 163 (C.A.), [1958] 33 I.T.R. 604*, would be capital expenditure though the intended agency licence may not be ultimately secured.

(c) By "enduring" is meant "enduring in the way that fixed capital endures" and it does not connote a benefit that endures in the sense that for a good number of years it relieves the assessee of a revenue payment. Where an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade there is good reason for treating such an expenditure as properly attribution not to revenue but to capital–*Imperial Chemical Industries (India) Ltd. [1985] I.T.R. 21, 40*. A payment made by the assessee to free himself from a capital liability, e.g., an onerous lease, is capital expenditure, while a payment which frees an assessee from the liability to make an annual revenue payment is revenue expenditure *(Green* v. *Cravens Rly. Carriage & Wagon Co. Ltd. 32 T.C. 359)*. Thus a sum paid by an assessee to free himself from a disadvantageous agency agreement *(Anglo-Persian Oil Co.* v. *Dale 16 T.C. 253; Anglo-Persian Oil Co. (India) Ltd.* v. *C.I.T. 1933 I.T.R. 129)*, or a sum paid to an employee in commutation of an annual pension, or a sum paid in commutation of annual premiums payable under a staff assurance policy, is revenue expenditure because it frees the assessee from the liability to make annual revenue payments. But the cost of labour-saving machinery cannot be claimed as revenue expenditure on the ground that it reduces the annual labour bill; it is capital expenditure for it brings into existence an enduring asset *(Approved by S.C. in Assam Bengal Cement Co. Ltd.* v. *C.I.T. [1955] 27 I.T.R. 34 44)*.

Bhagwati, J., delivering the judgment of the Supreme Court of India, laid down in *Assam Bengal Cement Co. Ltd.* v. *C.I.T. (1955 27 I.T.R. 34, 46)* that the expression "once and for all" in Viscount Cave's test does not mean that the payment should be made in a single sum and at one time: "the expression 'once and for all' is used to denote an expenditure which is made once and for all for procuring an enduring benefit to the business as distinguished from a recurring expenditure in the nature of operational expenses".

The same test was formulated by Lord Clyde, in *Robert Addie & Sons' Collieries Ltd.* v. *I.R.*, in these words: "Is it part of the company's working expenses, is it expenditure laid out as part of the process of profit-earning? –or, on the other hand, is it a capital outlay, is it expenditure necessary for the acquisition of property or of rights of a permanent character, the possession of which is a condition of carrying on its trade at all?" This test was approved by the Privy Council in *Tata Hydro-Electric Agencies Ltd.* v. *C.I.T. (1937 I.T.R. 202, 209).*

"Enduring".–The words "permanent" and "enduring" are only relative terms and not synonymous with everlasting. They merely indicate that the asset or right acquired must have enough durability to justify its being treated as a capital asset. What that degree of durability or permanence should be, depends upon the facts of each case. Knives and lasts of which the average life was three years, were held by the House of Lords to be capital assets of a cobbler's business. Where the duration of a licence was three years, and in another case eight years, the licence was regarded as a capital asset, and the expense of procuring it was disallowed as being capital expenditure. Similarly, where a steel company entered into an agreement with a railway company, under which the railway company in consideration of the sum of £1,80,000 to be paid by the steel company in equal monthly instalments over a period of ten years, agreed for that period to close down its steel works and to purchase its requirements of specified steel products from the steel company the Court of Appeal held that the extinction of the railway company's own manufacturing works for a period of ten years and the right to the whole custom of the railway company for that period constituted a capital advantage to the steel company and the price paid for it was a capital disbursement. Likewise, payments made by the lessee of limestone quarries to the Government who were the lessors, in consideration of the Government's entering into certain covenants which ensured elimination of competition in the lessee's field of operations for the period of the lease, viz. twenty years, were held by the Supreme Court of India to be capital expenditure resulting in an "enduring" advantage to the lessee. On the other hand, the Supreme Court held in *C.I.T.* v. *Finlay Mills ([1951] 20 I.T.R. 475, approving C.I.T.* v. *Century Spg., etc., Co. Ltd. 1947 I.T.R. 105)* that the registration of trade marks under the Trade Marks Act, 1940, which is valid for a period of seven years only, after which it has to be periodically renewed by paying fresh fees, does not bring any advantage of enduring benefit to the trade and the registration fees are deductible as revenue disbursement. Similarly, where a bus service company made an annual payment to a State for the monopoly right for five years to ply buses on a certain route and was, as a result of such payment, absolved from the liability to pay tax per trip per vehicle, the annual

payment was held to be a revenue disbursement *(Jagat Bus Service* v. *C.I.T. 1950 I.T.R. 13).*

2. Fixed capital and circulating capital.–An item of disbursement may be regarded as capital expenditure when it is referable to fixed capital or capital assets; it is revenue expenditure when it is referable to circulating capital or stock-in-trade *(C.I.T.* v. *Sri Rama Sugar Mills [1952] 21 I.T.R. 191, 230).* (In this case old boiler was replaced by a new one but exactly similar boiler). In the leading case of *John Smith & Son* v. *Moor (12 T.C. 266, 282 (H.L.))*, Lord Haldane drew this distinction between fixed capital and circulating capital: "Fixed capital [is] what the owner turns to profit by keeping it in his own possession; circulating capital [is] what he makes profit of by parting with it and letting it change master." In that case unexecuted contracts under which a coal merchant was entitled to obtain supplies of coal were held to be part of the fixed capital of the business and the sum paid by the purchaser of the business to acquire the right to these contracts was held to be on capital account.

What is a capital asset in the hands of one person may be a trading asset in the hands of another, and the nature of expenditure may consequently vary according to the nature of trade in which it is incurred. (See further under s. 16, "Fixed capital and Circulating capital").

But the principle that expenditure referable to or in connection with fixed capital is capital expenditure, is not of universal application. Interest on the unpaid price of capital assets is deductible as revenue expenditure. (See *ante* "Interest on unpaid purchase price) Where expenditure is incurred in merely *preserving or maintaining* capital assets, such expenditure is nonetheless allowable as on revenue account. (See *post* under "Legal or other expenses incurred in preserving or maintaining assets".

3. Expenditure relating to the framework of the business.–Expenditure which relates to the very framework of the taxpayer's business is capital expenditure. Money laid out to secure or money received for the cancellation of such an agreement which affected the whole structure of the trader's profit making apparatus was held to be on capital account.

4. Initial expenditure.–Initial expenditure is regarded as on capital account, for it is incurred not in earning profits but in setting the profit-earning machinery in motion. Lord Sands observed in *I.R.* v. *Granite City Steamship Co. Ltd.*: "Broadly speaking, outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for a substantial replacement of equipment" *(Bhor Industries Ltd.* v. *C.I.T. [1963] 48 I.T.R. 376).* Where a company purchases a dilapidated ship or a railway line in an imperfect condition and reconditions it before using it for the purposes of the trade, the expense of reconditioning is capital outlay *(Highland Rly. Co. Ltd.* v. *Balder-Ston 2 T.C. 485).* (See *infra* under "Current and accumulated repairs). Commission paid to brokers and other expenses incurred in raising share capital or debentures are capital disbursement *(Tata Iron & Steel Co. Ltd. 1 I.T.C. 125).*

In *Assam Bengal Cement Co. Ltd.* v. *C.I.T.*, where expenditure was incurred by a newly formed company with a view to eliminating competition, the above test laid down by Lord Sands was cited with approval by the Supreme Court of India though the judgment rested on another ground viz. that the expenditure was incurred to acquire an asset or advantage of enduring benefit to the trade and was therefore of a capital nature *(See, however, the judgment of Chakravartti, J., [1952] 21 I.T.R. 38, 54, which was affirmed by S.C. of India)*.

The price paid for acquiring leases or licences in respect of shell-fields with a view to starting that particular venture is capital expenditure.

The cost of acquiring, draining, laying out and building upon land, with the object of starting a plantation, would be capital expense: but weeding and superintending expenses incurred year after year, even on immature plants, during the working of the plantation would be revenue disbursement.

5. Terminating disadvantageous relationships.–It was laid down in *G. Scammell & Nephew Ltd.* v. *Rowles (1940 T.R. Suppl. 41, 54 (C.A.) and Dalmia Jain & Co. Ltd.* v. *C.I.T. [1958] 33 I.T.R. 294)* that expenditure incurred for the termination of a trading relationship in order to avoid losses occurring in the future through that relationship, whether pecuniary losses or commercial inconveniences, is revenue expenditure. (See also the case of *(Western India Oil Distributing Co. Ltd. (1970) 77 I.T.R. 140 ante)*. Thus a payment made by a company to an undesirable life director in order to get rid of him *(Noble* v. *Mitchell 11 T.C. 372)* or to any director whose appointment is terminated in the interest of the company *(Indian Copper Corpn. Ltd.* v. *C.I.T. [1960] 38 I.T.R. 544)*, or a payment made to disembarrass the company of an onerous agency agreement *(Anglo-Persion Oil Co. Ltd.* v. *Dale 16 T.C. 253)*, is a revenue disbursement. Such payments are allowable as revenue expenses for they are made not to secure any asset but "to enable the business to continue its same course as before and only to remove a difficulty in carrying the business on the same lines as before".

6. Expenditure incurred to acquire a concern, goodwill, or the right to earn profits. –In *City of London Contract Corpn. Ltd.* v. *Styles (2 T.C. 239, 243 (C.A.))*, It was held that money expended not for the purpose of carrying on a concern but to *acquire* the concern is capital expense. In that case money was paid by a limited company to buy up the business of a firm and it was held to be on capital account. So also where a son bought his deceased father's business at a valuation, in accordance with the provisions of the will, the sum paid by him to acquire the right to certain contracts which were part of the fixed capital of the business was held to be capital expenditure. But commission paid or other expenditure incurred to secure a contract or an order in the ordinary course of the business carried on by a trader is revenue expense: it cannot be regarded as capital expenditure incurred to procure a new business or concern *(Munshi Gulab Singh & Sons* v. *C.I.T. 1946 I.T.R. 66 (Lah.); See also Narandas Mathuradas & Co.* v. *C.I.T. [1959] 35 I.T.R. 461)*.

Where one partner acquires the right to conduct the firm's business for a period of years as the sole owner thereof, in consideration of making annual payments

to the other former partners, such annual payments constitute capital disbursements, for they are made to "acquire the concern" or to acquire "the right to conduct the business". So also where the assessee deposited a certain amount with an oil company as a condition of being given the agency of the company, and a part of the deposit was lost on the company's going into liquidation, the loss was held to be on capital account. But if the deposit was made as a condition of securing a contract in the ordinary course of business, the loss of such a deposit would be allowable as a revenue loss *(Narandas Mathuradas & Co.* v. *C.I.T. [1959] 35 I.T.R. 461).*

The Principle is that a price paid, whether in a lump sum or by instalments, for the *acquisition or purchase of the goodwill* of a business is capital expenditure; but a fee or rent paid for the *use of the goodwill* is a revenue payment, even though no term is fixed for the duration of the use of the goodwill *(Vithaldas Thakordas & Co.* v. *C.I.T. 1946 I.T.R. 822).* Thus the price paid for the purchase of a dental practice is capital expenditure. But annual sums paid in consideration of the right to use a firm's goodwill, name, staff and premises for a period of years *(C.I.T.* v. *Ethiraj [1962 46 I.T.R. 484),* or annual sums paid by the underlessee of business premises for enjoyment of the goodwill rights of the grantor's business under an agreement which is to cease if the underlease is terminated *(Ogden* v. *Medway Cinemas Ltd. 18 T.C. 961),* are revenue expenditure.

Payments to partners.–The purchase price paid by an incoming partner for a share in the firm would be capital expenditure and cannot be allowed to him as a deduction from his share of profits, even if the partnership is formed only for a single venture of a short duration. A sum paid to buy out a partner is a capital disbursement and is not deductible in computing the income of the partner who purchases the interest of another. Similarly, an unpaid debt due to a firm from a retired partner would be a capital loss. The share of profits paid under a decree to one of the co-sharers of a partnership venture would be inadmissible, for it would be a mere distribution of profits. (Cf. under s. 16, "Payments in respect of a partner's interest".

Expenditure incurred to buy off competition or promote trade.–While a sum paid to get rid of a director, agent or other employee is a revenue payment *(See ante under "Terminating disadvantageous relationships"),* a sum paid by a company to a retiring director in consideration of the director's covenant not to compete with the company is capital expenditure *(Associated Portland Cement Manufacturers Ltd.* v. *Kerr 27 T.C. 103).* By buying off potential competitors the company improves the value of its goodwill and thus brings into existence an advantage for the enduring benefit of the trade. In *Behari Lal Beni Parshad* v. *C.I.T. (1959 35 I.T.R. 576),* payment made by the assessee with a view to keeping his competitor out of the assessee's field of business was held to be capital expenditure. Similarly, where a member of a trade association makes a contribution towards the expenditure incurred by the association in removing or preventing trade competition by non-members, it is capital expense, for it creates for the members of the association advantages of an enduring nature. In *Assam Bengal Cement Co.* v. *C.I.T.*, the Supreme Court of India held that annual payments made by the lessee of limestone quarries to the Government of Assam who were the lessors, in consideration of the Government's

entering into certain covenants which ensured to the assessee elimination of competition during the period of the lease, were on capital account.

However, if a lump sum is paid on the termination of an agency, and one of the terms of the agreement terminating the agency is that the agents shall not compete with their principals after the agency ceases, the payment would be a revenue expenditure and the Department cannot split it up and disallow a part of it as capital expenditure incurred to buy off competition *(Imperial Chemical Industries (India) Ltd. in re, 1935 I.T.R. 21)*.

But the expenditure may be of a revenue nature where the object is not to avoid competition altogether by elimination of the competitor himself but the object is to earn more profits by keeping up remunerative prices by the elimination of underbidding *(Guest, Keen & Nettlefolds v. Fowler 5 T.C. 511)*. If a trader makes payments to his rival upon the latter's undertaking not to underquote him in submitting certain tenders, the payments would be allowable as revenue expenditure incurred exclusively for business purposes: money spent to obtain a contract in the trader's ordinary line of business by shutting off competition cannot be regarded as capital expenditure incurred to procure a new business or concern *(Munshi Gulab Singh & Sons v. C.I.T. 1946 I.T.R. 66)*. Similarly, annual payments made by company A to company B carrying on a similar business, under an agreement which gave company A a commanding interest in the management of company B, the object of company A being to eliminate competition in prices and otherwise promote its trade, were held deductible upon the Commissioner's finding that the expenditure was incurred for the purpose of the trade *(Moore v. Stewarts & Lloyds Ltd. 6 T.C. 501)*. Cf. under s. 16 "Compensation for restraint on trading ...".

Legal or other expenses incurred in preserving or maintaining assets.–It was said in *Southern v. Borax Consolidaed Ltd.* that "Where a sum of money is laid out for the acquisition or the improvement of a fixed capital asset it is attributable to capital *(Bradbury v. United Glass Bottle Firs. Ltd. 38 T.C. 369, 383 (C.A.))*, but if no alteration is made in the fixed capital asset by the payment, then it is properly attributable to revenue, being in substance a matter of maintenance, the maintenance of the capital structure or the capital assets of the company". In the case of *Borax Consolidated*, the legal expenses incurred by the assessee company in defending its title to its assets were held to be revenue disbursement, for the legal expenses did not create any new asset at all but were expenses incurred in the ordinary course of maintaining the assets of the company. This decision has been approved by the House of Lords *(Morgan v. Tate & Lyle Ltd. [1954] 26 I.T.R. 195, 201, 205 (H.L.), 35 T.C. 367)* and has been followed by the Indian High Courts which have held that such legal expenses are deductible–the questions whether they are incurred to defend capital assets or to defend stock-in-trade *(C.I.T. v. Raman & Raman Ltd. [1951] 19 I.T.R. 558)* and whether the assessee figures as plaintiff or as defendant and what the ultimate result of the litigation is *(Transport Co. (Pr.) Ltd. v. C.I.T. [1962] 46 I.T.R. 1009)*, being immaterial. Where, however, an assessee purchases a capital asset with knowledge of defect in title and perfects or improves it by further payment, the

expenditure incurred is attributable to capital *(Mahabir Parshad & Sons* v. *C.I.T. 1945 I.T.R. 340, 353)*.

In *C.I.T.* v. *Finlay Mills (1951 20 I.T.R. 475, 479)* the Supreme Court of India cited the case of *Borax Consolidated* with approval and, applying the principle of it, held the fees payable in respect of periodic registration of trade marks under the Trade Marks Act, 1940, to be on revenue account.

Legal expense in connection with a suit brought by or against the assessee to restrain the user of a trade-mark *(Central India Spg., etc., Co.* v. *C.I.T. 1943 I.T.r. 266)*, or legal expenditure incurred by a director of a company in defending a suit brought to challenge the validity of his election to the directorship, is allowable as a revenue deduction.

For case-law on the question whether legal expenses are incurred for "the purpose of the business", see above under "legal and accountancy expenses ...".

Apportionment.–If a litigation is partly for the purpose of preserving or maintaining the assessee's assets, and partly for another purpose *e.g.* to acquire new assets, that portion of the expenditure which is incurred for the former purpose should be allowed as a revenue deduction *(Transport Co. Ltd.* v. *C.I.T. [1957] 31 I.T.R. 259)*.

Expenditure incurred to oppose nationalization or to prevent extinction of business. –Just as expenditure incurred to preserve one asset is deductible as revenue business expense, so is expenditure incurred to preserve *all the assets* of the business *(All India Reporter Ltd.* v. *C.I.T. [1963] 49 I.T.R. 196 (legal expenses of opposing winding-up petition held deductible))*. The House of Lords held in *Morgan* v. *Tate & Lyle Ltd. (1954 26 I.T.R. 195, 35 T.C. 367)* that expenditure incurred in a propaganda campaign to prevent the seizure by the State of all the assets and undertaking of the company upon threatened nationalization was allowable. Likewise, expenditure incurred by a firm of brewers in anti-prohibition propaganda at a time when the Government contemplates the introduction of legislation for prohibition would be deductible. See *ante* under "Expenditure incurred to oppose nationalization or to prevent extinction of business".

Capital and revenue disbursements for the benefit of employees.–A gratuity *(Gordon Woodroffe Leather Mfg. Co. Ltd.* v. *C.I.T. [1962] 44 I.T.R. 551 (S.C. of India))*, bonus *(Associated Printers (Madras) Pr. Ltd.* v. *C.I.T. [1961] 43 I.T.R. 281)*, or an annual pension paid to a servant, is revenue expenditure. Similarly, a lump sum paid for the purchase, for the benefit of a former employee, of an annuity equal in amount to the pension, or paid in commutation of annual premiums payable under a staff assurance policy *(Green* v. *Cravens Rly. Carriage & Wagon Co. Ltd. 32 T.C. 359)*, or in commutation or reduction of periodic remuneration *(Wilson* v. *Nicholson sons & Daniels Ltd. 25 T.C. 473)*, is a revenue disbursement. But a lump sum paid by an employer to an insurance company as premium for a policy which gives the employer sums equivalent to the pensions of former servants is a capital expense where the pensioners are not parties to the arrangement. For, in such a case, the employer does not get rid of his liability to pay the annual pensions but gets a capital asset, *viz.*, the policy *(Morgan Crucible Co.* v. *I.R. 1933 I.T.R. 26)*. A lump

sum set aside or settled upon trust by a company to serve as nucleus of a pension fund or invalidity fund for its employees is a capital disbursement, for it results in the acquisition of a capital asset, *viz.* the fund *(Atherton* v. *British Insulated & Helsby Cables Ltd. 10 T.C. 155 (H.L.))*. (See further under Paragraph 5 of Part B of Sixth Schedule ..., "Employer's contributions to provident and other funds".

The question as to how far payments made to employees are allowable as expenditure incurred wholly for the purpose of the business, is discussed *ante* under "Remuneration, pensions, gratuities etc. paid to directors and employees" and "Excessive remuneration ...".

Compensation paid to directors, agents and other employees on termination of their services.–Compensation paid to an agent for termination of the agency agreement *(Anglo Persian Oil Co. Ltd.* v. *Dale 16 T.C. 253)* or to a director upon termination of his appointment *(Indian Copper Corpon. Ltd.* v. *C.I.T. [1960] 38 I.T.R. 544)* (it was held in that case that even in the absence of any contract between the company and its directors for a payment of compensation for the outgoing director and the payment made for commercial expediency. It is not necessary for expenditure to be allowable under section 19(2)(xv) of the Income-tax Act, 1922 that there should be any direct correlation in point of time between the expenditure and the earning of any profits) is deductible as revenue expenditure, provided the termination is in the interest of the company making the payment. Retrenchment compensation paid to the employees of one of the two cinema theatres on its closing down was held to be allowable revenue expenditure as the two cinema theatres of the assessee constituted one business–*Pradeep Pictures* v. *C.I.T. (M.P.) 1983, 143 I.T.R. 300*. In *Anglo Prsian Oil Co. (India) Ltd.* v. *C.I.T. (1933 I.T.R. 129)*, compensation paid to the agents, Shaw Wallace & Co., upon termination of their agency, was held to be a *revenue disbursement* allowable to the principal company, though that payment was held to be a *capital receipt* in the hands of the agents in the leading case of *C.I.T.* v. *Shaw Wallace & Co. (6 I.T.C. 178 (P.C.) See ante under "Capital receipt does not spell capital disbursement"* (this principle does no longer exist with the change in law). Where a company paid a sum as the price of getting rid of a life director whose presence on the Board was regarded as detrimental to the profitable conduct of the company's business the payment was allowed as a revenue expense *(Noble* v. *Mitchell 11 T.C., 372)*. Damages paid to a dismissed servant, or a sum paid by way of agreement in satisfaction of the claim for damages, would be deductible, provided the servant is dismissed in the interest of the trade and not merely on personal grounds. (Cf. under s. 16, "Compensation for loss of office or employment, or for cessation of business).

In a case, upon the transfer of a business the transferees agreed to take into their service the transferors' manager at a fixed salary with liberty to commute the same by payment to him of a gross sum and the transferees paid the manager the stipulated gross sum in commutation. Held, they could not claim it as a deduction, for the commutation money was a capital disbursement, being in fact part of the purchase money for the transfer of the business. Likewise, in a case where under an agreement for sale of the shares of a company the company was to pay compensation for loss of

office to the directors and auditor of the company who, under the agreement, were to resign, the compensation was disallowed as not having been incurred wholly and exclusively for the purposes of the company's business *(James Snook & Co. Ltd.* v. *Blasdale 33 T.C. 244 (C.A.))*, apart from the question whether it was on capital account. Donovan, J., said, "The mere circumstance that compensation to retiring directors is paid on a change of shareholding control does not of itself involve the consequence that such compensation can never be a deductible trading expense ..... But it is essential in such cases that the company should prove to the Commissioners' satisfaction that those who were to buy their shares came to a decision to pay solely in the interests of its trade".

Licences.–Payment for an annual licence is revenue expenditure *(Sheikh Rahmat Ali* v. *C.I.T. [1960] 39 I.T.R. 506)*. But payment by the lessee of licensed hotel premises to the local authorities as the "monopoly value" on the grant of a three-year licence has been held to be capital expenditure *(See also Assam Bengal Cement Co.* v. *C.I.T. [1955] 27 I.T.R. 34 (S.C. of India)*. Likewise moneys expended by a brewery firm in an attempt (successful or unsuccessful) to acquire new licensed premises or by a public carrier to obtain a licence for a large fleet of vehicles would be a capital disbursement. The price of a licence granted to a carting contractor for a period of eight years to deposit earth, slag, etc. on the land of the licensor is a capital expense. Annual payments made to the Government, in lieu of tax on motor vehicles per trip, for the exclusive right to ply buses on a certain route, would be revenue disbursement *(Jagat Bus Service* v. *C.I.T. 1950 I.T.R. 13)*.

(See also *ante* under "Expenditure incurred to buy off competition or promote trade").

Payments under lease.–A premium paid by the lessee for the grant or renewal of a lease is normally capital expenditure, whether it is payable in a lump sum or in instalments over the whole period of the lease along with rent. (See under s. 16, "Premium (salami) paid for lease"). But the mere fact that half the total rent for the term of the lease is taken in advance in one year would not justify a finding that the payment is by way of a premium *(Hakim Ram Prasad, In re, 1936 I.T.R. 104)*. If the sum paid represents not premium or salami for the lease but advance payment of rent, it would be allowable as revenue expenditure *(C.I.T.* v. *Globe Theatres Ltd. 1950 I.T.R. 403)*.

Expenditure to obtain raw material or stock-in-trade.–The cost of material worked up in a manufactory is revenue expenditure and it "does not become a capital expenditure merely because the material is provided by something like a forward contract under which a person for the payment of a lump sum down secures a supply of the raw material for a period extending over several years". In *Mohanlal Hargovind* v. *C.I.T. (1949 I.T.R. 473, followed in Shankerlal Dayaram* v. *C.I.T. [1956] 30 I.T.R. 272)* the assessees carried on business as manufacturers and vendors of *bidis* which are composed of tobacco contained and rolled in *tendu* leaves. The assessees entered into a number of short-term contracts under which, in consideration of a sum payable by instalments, the assessees were granted the exclusive right to collect and remove *tendu* leaves from specified areas. The Privy Council, overruling

I.T. Appellate Tribunal v. *Haji Sabumiyan Haji Sirajuddin (1946 I.T.R. 447)*, held that the expenditure was to secure raw material and was allowable as being on revenue account. Lord Greene, delivering the judgment of the Board, said, "If the *tendu* leaves had been stored in a merchant's godown and the appellants had bought the right to go and fetch them and so reduce them into their possession and ownership, it could scarcely have been suggested that the purchase price was capital expenditure. Their Lordships see no ground in principle or reason for differentiating the present case from that supposed" *(1949 I.T.R. 437, 478)*.

A case on the other side of the line is *Hood Barrs* v. *I.R. (37 T.C. 188 [1958] 34 T.R. 238 See also Koru* v. *C.I.T. [1960] 40 I.T.R. 701)* where the assessee entered into a contract with a company under which he acquired a right to select and thereafter cut and carry away such trees, standing on the company's land, as fell within the size and description mentioned in the agreement. There was no time limit fixed within which the right of cutting the trees had to be exercised. The House of Lords held that the money paid under the agreement represented capital expenditure and not revenue expenditure for the purchase of stock-in-trade. Lord Keith said, "The nature of the right, the indefiniteness of the period for its exercise, and the lack of identification of the trees on which the right was to be exercised, to which may be added the size of the transaction and the absence of any evidence of intention or means to complete it within any foreseeable time, all, in my opinion, negative the idea that the appellant had anything that could be called stock-in-trade".

The expression "capital expenditure" must normally be construed in a business sense *(Mohanlal Hargovind* v. *C.I.T. 1949 I.T.R. 473, 477 (P.C.))*, (in this case sums were paid by a manufacturer of bidis to owners of forests for collecting and removing tendu leaves without securring any interest in the land or trees, are, in fact, payments for collecting raw material and, hence, a revenue expenditure), and emphasis should be placed upon the business aspect of a transaction rather than on the purely legal and technical aspect *(C.I.T.* v. *Kolhia Hirdagarh Co. Ltd. 1949 I.T.R. 545, 555)*. The intention must be gathered from the entire document *(See also ante under "Form* v. *Substance")*. The principle is that where the true nature of the transaction which may be misdescribed as a "lease" of land, is that of a sale of raw materials, coupled with a licence to the purchaser to come on the land and remove the materials sold, the consideration for the so-called "lease" is really the purchase price of the raw materials and must therefore be allowed as revenue expenditure as is in the case of *Mohanlal Hargovind* v. *C.I.T. 1949 I.T.R. 454, 555 (P.C.))*. But if the transaction is actually intended to create a lease-hold interest in land and brings into existence an asset or advantage for the enduring benefit of the trade, the premium paid for such an interest would be capital expenditure. "Wherever at the time of the contract it is contemplated that the purchaser should derive a benefit from the future growth of the thing sold, from further vegetation and from the nutriment afforded by the land, the contract is to be considered as for the interest in land; but where the process of vegetation is over, or the parties agree that the thing sold shall be immediately with-drawn from the land, the land is to be considered as a mere warehouse of the thing sold and the contract is for goods" *(Maharajadhiraja of Darbhanga* v. *C. Ag. I.T. [1952] 21 I.T.R. 258)*.

Thus where a manufacturer of crude saltpetre took salt-bearing lands on short-term or long-term "leases", the sums paid in respect of the "leases" were held to be revenue expenditure as being merely the purchase-price of raw material *(C.I.T.* v. *Bhojraj Harichand 1946 I.T.R. 277 (long-term leases))*. Likewise it has been held by a Full Bench of the Lahore High Court in *Benarsidas Jagannath,* In re *(1947 I.T.R. 185, cited by S.C., Asam Bengal Cement Co. Ltd.* v. *C.I.T. [1955] 27 I.T.R. 34)*, that where a manufacturer of bricks obtains certain lands on so-called short-term "leases" for the purpose of digging out earth for the manufacture of bricks, and the whole intention and purpose of the agreement is to procure earth for the purposes of manufacture and not to acquire any interest in land, the consideration paid by the manufacturer to the owners of the lands is revenue expenditure; for in such a case the payment is the price of the raw material, *viz.*, brick-earth, and the expense does not bring any asset or advantage of enduring benefit into existence. On the other hand, where the lease of the brick-field is for a long period, say 10 or 20 years, and also confers cultivating rights or other substantial interest in the land *(Benarsidas Jagannath, In re 1947 I.T.R. 185, 204)*, or where a brick manufacturer takes on lease lands bearing brick-earth as premises for his kiln and the outlay is made for the initiation of the business *(C.I.T.* v. *Tika Ram & Sons Ltd. 1937 I.T.R. 544 (F.B.))*, the premium paid for such a lease would be capital expense. In this case it was held that where the assessee, a brick manufacturer owned as proprietor a part of the land from which earth was taken out for the manufacture of bricks, the cost of the earth dug up and used in bricks was a capital expense, because the assessee was not a mere purchaser of raw material, i.e. earth, but was a person who had acquired certain rights in the land itself.

In *Pingle Industries Ltd.* v. *C.I.T. (1960 40 I.T.R. 67)* periodic payments for the right to extract stones from quarries under a contract for a term of years, and in *Abdul Kayoom* v. *C.I.T. (1962 44 I.T.R. 689, approving Abdul Kayum Sahib Hussain* v. *C.I.T. 1939 I.T.R. 652)* the rent paid under a "lease' conferring an exclusive right "to fish for, take and carry away all chunk shells in the sea off the coast line" of a certain district, were held by the Supreme Court of India, by a majority, to be capital expenditure. S.K. Das, J., in his dissenting judgments, held them to be revenue expenditure on the ground that in both the cases the payments constituted the cost not of any capital asset but merely of raw materials or stock-in-trade. It is submitted by the learned authors, Kanga and Palkhivala with respect, that the majority view requires reconsideration and that the dissenting judgments of S.K. Das, J., in the two cases are correct both in the enunciation of the legal principles and their application to the facts of each case.

Purchase of land with standing crop.–In *I.R.* v. *Pilcher (E.D. Sassoon & Co. Ltd.* v. *C.I.T. [1954] 26 I.T.R. 27, 58-60 (S.C. of India)* the assessee, a fruit grower and fruit salesman, purchased for £5,500 the freehold of a cherry orchard inclusive of the year's fruit crop which was nearly ripe for picking,. The assessee claimed to deduct £2,500 as the purchase price of the crop of cherries. The Court of Appeal negatived the claim, holding that there was no separate purchase of the cherries as such, that the purchase was a single transaction resulting in the acquisition of a single capital asset and that no part of the price paid for the asset could be

allowed as revenue expenditure. Different considerations would have applied if the assessee had first purchased the standing crop of cherries for a separate consideration and then purchased the freehold interest in the land.

Cost of fittings and of shifting a concern to new premises.–Shop fittings are capital assets and their cost is capital expenditure *(Hyam* v. *I.R. 14 T.C. 479, 486)*. In the case of a *travelling* business, *e.g.*, a travelling butcher's shop or a circus, the expenses of fittings and fixtures would be deductible as revenue disbursement *(Eastmans Ltd.* v. *Shaw 14 T.C. 218 (H.L.))*. But in the case of a *flitting* business, where the owner of the business transfers it to new premises or opens and closes shops or branches in different parts of the country, the loss represented by the difference between the sale-proceeds of the fixtures and fittings in shops closed and the cost of fixtures and fittings in shops opened is a capital loss *(Eastmans Ltd.* v. *Shaw 14 T.C. 218 (H.L.))*. Where a factory is shifted from one site to another, the expenses of dismantling, transporting and re-erecting the same plant and machinery would be on capital account. But in another case factory was shifted from one place to another and the expenditure incurred was held to have been incurred wholly and exclusively for purpose of business being expenditure incurred for keeping business alive – *C.I.T.* v. *Bhagwati Rerolling Mills (Rajsthan) reported in D.T.D. 1996 xxiv 162*. Again, where on the rebuilding of business premises, the old fittings are sold and new fittings installed in the newly constructed premises, the difference between the price realised for the old fittings and the cost of the new fittings is taken as a capital loss.

Current and accumulated repairs, and replacement.–Current repairs are provided for by cl. (vi) of Sec. 29(1) and the case-law on repairs has been noted under cl. (vi) of Sec. 29(1). but an item of expenditure which may not be deductible under cl. (xxvii) may still be allowed under this clause *(C.I.T.* v. *Sri Rama Sugar Mills Ltd. [1952] 21 I.T.R. 191, 196)*. Where an assessee whose business was to ply motor-cars for hire bought a car not to use it as a car but to resolve it into its component parts and use the parts for casual repairs to his existing fleet of ears, the cost of the car was held to be an income disbursement allowable under this clause though it could not be deducted under cl. (vi) as the cost of "current repairs" *(Ratan Singh* v. *C.I.T. A.I.R. 1926 Mad. 462, 2 I.T.c. 294)*.

Since cl. (vi) grants an allowance only in respect of *current* repairs, the cost of arrears of repairs would not be allowable under those sections but may nevertheless be an admissible deduction under this clause. The cost of repairs is allowable, not in the year in which the repairs become necessary but in the year in which the expenditure on repairs is actually incurred or paid *(See Naval Colliery Co. Ltd.* v. *I.R. 12 T.C. 1017 (H.L.))*. The cost of repairs would be a revenue disbursement even though repairs may not be undertaken every year but may be effected when matters become serious, say, once in three years *(Ounsworth* v. *Vickers Ltd. 6 T.C. 671, 675)*. "Accumulated arrears of repairs are nonetheless repairs necessary to earn profits, although they have been allowed to accumulate"–*Law Shipping Co. Ltd.* v. *I.R. 12 T.C. 621, 625*.

But repairs *necessary at the time of purchase* to render the subject of purchase serviceable, fall to be added to the initial cost as a capital charge–*Jackson* v. *Laskers Home Furnishers Ltd. 37 T.C. 69, [1958] 33 I.T.R. 663.* In *Highland Railway Co. Ltd.* v. *Balderston (2 T.C. 485)* a company purchased a railway line in an imperfect condition. The expense of renewal or improvement to bring it up to the proper standard was held to be capital expenditure, on the ground that it was part of the cost of acquiring that line, the price paid being less in view of the necessity of improvement. In *law Shipping Co. Ltd.* v. *I.R. (12 T.C. 62)* the assessee purchased a second-hand ship which was in need of heavy repairs and effected the repairs after using it for some time Held, that except for such part of the cost of the repairs as was attributable to the period during which the ship was employed in the assessee's trade, the expenditure was on capital account. It was as much a capital expenditure from the point of view of the purchaser's business as it would have been if the work had been executed by the seller before the sale and the cost had been added by him to the price of the ship. Similarly, where a company owned a single ship which was seized by the enemy during war and handed back at the end of the war in a condition which necessitated extensive repairs, it was held that the necessity for the repairs had not arisen out of the use of the ship by the company and that the cost of the repairs was capital expenditure– *I.R.* v. *Granite city Steamship Co. 13 T.C. 1.*

In the case of *C.I.T.* v. *Sri Rama sugar Mills Ltd. (Madras), ([1952] 21 I.T.R. 191)* the assessee company, carrying on the business of manufacturing sugar, replaced one of the three boilers in its factory by a new but exactly similar boiler. It was found by the Tribunal that "the boilers were a part of the unit of the machinery required for the manufacture of sugar." Satyanarayana Rao, J., held that the cost of purchase, erection and fitting of the new boiler was allowable as revenue expenditure. "The boiler which was substituted was exactly similar to the old one, and by this expenditure the assessee company did not bring any additional advantage to the trade or business which they were carrying on and there is no improvement ..... It cannot be suggested that by using a new boiler for an old one, the productive capacity of the sugar manufacturing unit was in any manner increased." Raghava Rao, J., held that the expenditure could not be allowed as it was on capital account. "The new boiler has come in substitution for the old boiler which was part of the fixed capital of the company and therefore partakes of the character of such capital. It may or may not be of superior quality or calibre to that of the old boiler, but it certainly has resulted in a substantial extension of the period of the serviceableness of the machinery and in the creation of an asset of lasting advantage or enduring benefit to the company in the nature of a fresh fixed capital asset." As the judgment of Satyanarayana Rao, J., agreed with the decision of the Tribunal, it prevailed under s. 98 of the Civil Procedure Code, read with s. 66A of the 1922 Act as it them stood. In *Corera & Bros* v. *C.I.T. (1963 49 I.T.R. 188)* the same High Court approved the principle laid down by Satyanarayana Rao, J.

Allowance of purchase price of patents and copyright.–The price paid for the purchase of copyright *(Hira Lal Phoolchand* v. *C.I.T. 1947 I.T.R. 205)* or patent rights *(Minsararasam Co. Ltd.* v. *C.I.T. 6 I.T.c. 65)* is capital expenditure. There is no

provision in this Ordinance for allowing such expenditure either by way of depreciation or otherwise as a revenue deduction.

Miscellaneous instances of revenue expenditure.–Payment made for use of quota rights is allowable *(Kandappa Mudaliar* v. *C.I.T. [1957] 32 I.T.R. 313)*. The cost of raw material used for manufacturing purposes is revenue expenditure. Where the purchaser of raw material agrees to pay for the raw material at a certain rate plus an additional royalty out of the profits of the manufacturing business, the royalties are a part of the price of the raw material and must be regarded as revenue expenditure *(Indian Turpentine & Resin Co. Ltd.* v. *C.I.T. 3 I.T.C. 219)*. In the case of a hotel or restaurant business, the cost of table-furniture, linen, crockery, pots and pans may be on revenue account. The cost of dredging carried on by a harbour authority for the purpose of keeping their channels clear for navigation is revenue expenditure, and so also is expenditure incurred in the removal of obstructions in the harbour or in raising ships deliberately sunk at the entrance to the harbour during war with a view to preventing enemy submarines from entering the harbour. The expense of dredging would be revenue disbursement even though dredging may not be undertaken every year but may be done when matters become serious, say, once in three years. Costs of advertisement would also be on revenue account even if there is "a special campaign of advertisement" on the occasion of the opening of several new branches *(Hindustan Commercial Bank Ltd. [1952] 21 I.T.R. 353)*. Yearly payments made as compensation for the use and occupation of a building for business purposes are revenue payments, and nonetheless so because they are intended to recoup the owner of the building by yearly instalments the capital value of the cost of construction *(Racecourse Betting Control Board* v. *Wild 22 T.C. 182, 1938 4 All E.R. 487)*. Expenditure incurred by a surgeon or a businessman on a study tour abroad to acquire knowledge of the latest techniques *(Dr. Vadamalayan* v. *C.I.T. [1960] 40 I.T.R. 501)*, or expenditure on the maintenance and weeding even of immature plants, during the working of a plantation *(Travancore Rubber & Tea Co. Ltd.* v. *C. Ag. I.T. [1961] 41 I.T.R. 751)*, or monthly payments made by a licensed motor transport company for procuring the right to make more trips *(C.I.T.* v. *Tangail General Trading & Transport Corpn. Ltd. [1963] 47 I.T.R. 148)*, would be on revenue account. In the case of *American Bureau of Shipping* v. *C.T. (South Zone)* Chittagong a non-resident assessee, who is liable to pay tax only for Bangladeshi income, expenditure incurred outside the country for the necessity of Head Office abroad such type of expenditure like, plan approval, meeting expenses will be allowed under s. 10(2)(xvi) of I.T. Act, 1922 (S.C. of Bangladesh) reported in করাদালত, April, 1998.

The Taxes Appellate Tribunal, Dhaka Bench gave a decision to the effect that Jamuna Surcharge and Development levy were properly deductible from the dividend income of the assessee as the income was diverted to the Government before its receipt in the hand of the assessee–1995 BTD xxiii 84 (Trib.).

(Note–"Business expense may be increased with the increase in sales"–as observed by the Tribunal–1997 BTD xxv 150 (Trib.)).

Miscellaneous instances of capital expenditure. –instances of capital expenditure are–the cost of constructing a factory or fitting machinery, the cost of

equipment and apparatus or furniture, the cost of erecting buildings and plants or constructing a new reservoir, the cost of erection of a wooden sea-wall by the proprietors of a beach cafe as a protection against erosion *(Avon Beach & Cafe Ltd.* v. *Stewart 31 T.C. 487)*, the cost of replacing an embankment *(Phillips* v. *Whieldon Sanitary Poteicries Ltd. 33 T.C. 213)* or filling up a pit where the accumulation of waste water was causing a nuisance, expenditure on improvements to property as distinguished from mere repairs *(Henriksen* v. *Grafton Hotel 1943 I.T.R. Suppl. 10)*, the cost of reconstructing or refurnishing business premises or converting business premises when switching over from one type of manufacture to another *(Lothian Chemical Co. Ltd.* v. *Rogers 11 T.C. 508)*, the expense incurred by an electric light power supply company in replacing consumers' fans and motors and renewing service lines on adoption of alternating instead of direct current *(Nagpur Electric Light & Power Co. Ltd.* v. *C.I.T. 6 I.T.C. 303)*, the purchase price of the right to use a secret manufacturing process, costs, expenditure incurred by a company in raising loans or issuing debentures for capital outlay *(C.I.T.* v. *India Cements Ltd. [1963] 47 I.T.R. 438)*, or in the financial readjustment of a company's borrowed capital, e.g., bonus or premium paid on redemption of debentures before maturity with a view to issuing a fresh set of debentures at a lesser rate of interest *(Associated Hotels of India Ltd.* v. *C.I.T. [1953] 23 I.T.R. 134)*, financial help rendered by a manufacturer to concerns supplying him with raw materials by way of investment of capital and *not* as advance payment of price of goods *(C.I.T.* v. *Mysore Sugar Co. Ltd. [1962] 46 I.T.R. 649 (S.C. of India))*, sums allocated to a sinking fund to extinguish a debt incurred for business purposes, whether the sinking fund is constituted voluntarily *(Merscy Docks & Harbour Board* v. *Lucas 2 T.C. 25 (H.L.))* or under statutory obligation *(City of Dublin Steam Packet Co.* v. *O'Brien 6 T.C. 101))*, the loss suffered through the destruction of a ship in collision *(Legg & Son Ltd.* v. *I.R. 12 T.C. 391)*, legal expenses in connection with mortgage of the premises belonging to the assessee in which the assessee carries on his business *(Small* v. *Easson 12 T.C. 351)*, deposit made in Court by the purchaser at a sale in execution of a mortgage decree *(Raja Roghunandan Prasad* v. *C.I.T. 1933 I.T.R. 113, 121 (P.C.))*, expenses incurred in completing title and entering into possession after the court-sale has become absolute *(Raja Roghunandan Prasad* v. *C.I.T. 1933 I.T.R. 113, 125 (P.C.))*, stamp duty and registration fee in respect of transfer of shares to a bank by way of security for money borrowed for the purchase of managing agency rights *(Bhadani Bros Ltd.* v. *C.I.T. [1955) 27 I.T.R. 423)*.

ILLUSTRATION

A company made annual payments for wagons under a hire-purchase agreement extending over a period of years. Held, the annual payment should be disintegrated and that part of it which represented rent for the hire was deductible as a revenue disbursement, while the balance of the sum which represented the payment of the price towards the eventual purchase was capital expenditure. *(Darngavil Coal Co. Ltd.* v. *Francis 7 T.C. 1)*.

Allowance cannot be spread over a number of years.–Revenue expenditure incurred wholly and exclusively for the purpose of business must be allowed in its entirety in the year in which it is incurred. The Department cannot

claim to spread it over a number of years and allow only an aliquot part of it in each year. In *Hindustan Commercial Bank*, In re *(1952 21 I.T.R. 353)*, the assessee Bank opened several new branches in the relevant accounting year and incurred an expenditure of Rs. 89870 by way of salaries etc. in respect of the new branches. The Tribunal held it to be revenue expenditure incurred wholly and exclusively for the purpose of the business but treated it as "deferred expenditure", spread it over a period of twenty years and allowed a deduction of 1/20th of the amount during the relevant year. The Allahabad High Court held that the whole amount of the expenditure was deductible in the year in which it was incurred.

Reference to Court.–Whether a certain expenditure is of a capital or revenue nature is a mixed question of fact and law. In any event the Court can interfere if there is no evidence to support the Tribunal's finding, or if the Tribunal has misdirected itself on a point of law *(Central India Spg., etc., Co.* v. *C.I.T. 1943 I.T.R. 266, 284; Orr & Sons* v. *C.I.T. [1959] 35 I.T.R. 556).*

The inference to be drawn from proved facts is a question of law and therefore the question whether a certain payment is an admissible deduction under this section is open to argument in the Court on the facts as found *(Tata Hydro-Electric Agencies Ltd.* v. *C.I.T. 1937 I.T.R. 202, 210 (P.C.)).*

The court may remit a case back to the Tribunal for disintegrating an item of expenditure into separate amounts of capital and revenue *(C.I.T.* v. *Gurupada Dutta 1946 I.T.R. 100, 105 (P.C.)).*

Entertainment expenses. –Expenses on entertainment incurred by a businessman out of a business motive and not out of any motive of social or private hospitality, are allowable as revenue expenditure *(Rentleys, Stokes & Lowless* v. *Beeson 33 T.C. 491 (C.A.)).* Rule 65 puts a ceiling on the deduction on account of entertainment expenses. For the purpose of disallowance of the amount or rate of entertainment allowance section 30 (f)(i) of the Ordinance prescribes that the amounts or rates in excess of the expenditure as specified in the rule, as given below shall not be admissible:

(a) on the first taka *ten lakh* of income, profits and gains of the business or profession (computed before making any allowance in respect of expenditure on entertainment) deduction shall be at the rate of *four* percent,

(b) on the balance of income, profits and gains, computed in the above manner the allowance shall be at the rate of *two* percent.

It was observed by the High Court Division of the Supreme Court of Bangladesh in the case of *N.Mohd. Engineering Industries Ltd.* v. *C.T., Zone-2 Chittagong* (reported in 2000 BTD XXVIII 29, 33) that even in the event of loss an assessee is entitled to entertainment allowance at the prescribed rate since income, as defined in Sec. 2(34) of the Ordinance includes any loss of income, profit or gains.

Sec. 30: Deduction not admissible in certain circumstances.– Notwithstanding anything contained in section 29, no deduction on account of allowance from income from business or profession shall be admissible in respect of the following, namely:

(a) any payment which is an income of the payee classifiable under the head "Salaries" if tax thereon has not been paid in accordance with provisions of Chapter VII;

(aa) any payment made by an assessee to any person if tax thereon has not been deducted and credited in accordance with the provisions of Chapter VII and (value-added tax) thereon has not been collected or deducted and credited in accordance with the provisions of)

(b) any payment by way of interest, salary, commission or remuneration made by a firm or an association of persons to any partner of the firm or any member of the association, as the case may be:

(c) any payment by way of brokerage or commission made to a person who is not a resident in Bangladesh unless tax has been deducted therefrom under section 56:

(d) any payment to a provident fund or other fund established for the benefit of the employees unless the employer has made effective arrangements to secure that tax shall be deducted at source from any payments made from the fund which are taxable being income falling under the head "Salaries";

(e) So much of the expenditure by an assessee on the provision of perquisites or other benefits to any employee as exceeds fifty per cent of the salary excluding perquisites and other benefits of such employee or [seventy-two thousand] taka, whichever is less; or

(f) any expenditure in respect of the following as is in excess of the amount or rate prescribed in this behalf and as is not, in the cases of sales and services liable to excise duty, supported by excise stamp or seal, namely:

(i) entertainment;

(ii) foreign travels of employees and their dependents for holidaying and recreation;

(iii) publicity and advertisement; and

(iv) distribution of free samples.

Deductions not admissible-Sec. 30: The following deductions shall not be admissible from income from business or profession:

Cl.(a): Salaries.–This clause prohibits allowance of any payment chargeable under the head, "salaries" if it is payable to an employee before deduction of tax or if tax has not been paid under Sec. 50 on the salary. In a case the Tribunal, Dhaka bench (I.T.A. No. 395 of 1996-97) observed that if voluntary payment of tax is made by the employee himself the restrictive provision of Sec. 30(a) shall not apply since the purpose of law shall not be frustrated in that case. But the Calcutta High Court held that "the employer's liability to deduct tax is absolute and is not affected by any private arrangement whereby the employee has undertaken to discharge his own liability–*John Patterson & Co. (India Ltd.* v. *I.T.O. (Cal.)(1959) 36 I.T.R.* (See further under deduction of tax at source (See 50)

Cl. (aa): Any payment made by the assessee before deduction of tax under ss. 50-56 and credited in accordance with the provisions of Chpater VII and before deduction of value-added tax and credited in accordance with the provisions of value Added tax 1991 shall not be permissible deduction under this clause.

Cl. (b): Interest, salary, commission or remuneration paid to partners.– This clause prohibits absolutely any allowance in respect of any payment by way of interest, salary, commission or remuneration made by a firm to any of its partners. "Commission" does not include a rebate. But interest paid by a partner to the firm would be included in the firm's total income *(Ram Mahadeo Prasad* v. *C.I.T. [1953] 24 I.T.R. 176).* The prohibition contained in this clause is absolute and makes no distinction between payments by way of interest, commission, salary, remuneration made to a partner as a partner and such payments made to him in a different character, e.g., as the proprietor of an independent concern *(Goodsir & Co.* v. *C.E.P.T. 1948 I.T.R. 367).* But payments other than interest, salary, commission or remuneration are outside the purview of this clause. Thus rent paid by a firm to a partner who owns the premises in which the firm carries on business and in respect of which the firm is a tenant of the partner is admissible as a deduction *(Goodsr & Co.* v. *C.E.P.T. 1948 I.T.R. 367, 372).* Similarly, if the partnership runs a hotel and one of the partners carries on an independent business as a wine merchant, the price of wine supplied by the partner to the firm would be allowed in computing the firm's profits *(C.I.T.* v. *Dahanukar [1959] 36 I.T.R. 459).*

Private limited companies and Hindu trading joint families are not partnerships in law and therefore to them this clause can have no application. Reasonable remuneration paid to the directors of a private limited company, or paid to a member of a Hindu joint family for services rendered to the family business, is allowable. See under cl. (xxvii), "Remuneration, pensions, gratuities etc. paid to directors and employees", and "Excessive remuneration ...".

Cl. (c): Payment of Brokerage or commission to a non-resident person.– This clause prohibits payment of Brokerage or Commission to a non-resident on which tax has not been paid or deducted under section 56. If any agent of the non-

resident is liable to pay tax on behalf of the non-resident assessee this restrictive clause shall not apply in that case. All the provisions as specified in Sec. 56 for deduction of tax from income of non-resident shall have to be looked into.

Cl. (d): Employer's contribution to a provident fund or other fund.–See notes to cl. (xxvii) under the head, "Employer's contribution to provident or other fund (Page 284).

Cl. (e): Expenditure on the provision of perquisites or other benefits to the employee.–Salary including perquisites is paid by the employer to the employees is an allowable deduction under the residuary clause of Sec. 29(1). This clause (30(c)) restricts the allowance of perquisites paid to the employees by putting a ceiling on the payment of perquisite as a deductible expense. Many companies are providing their directors and other privileged employees lavish perquisites and a considerable amount is thus allowed to these companies to be deducted from the profits. In order to curb this tendency the definition of the expression "employee" has been changed by making an amendment in cl.(b) of sub-rule (2) of rule 33 by the Finance Act 2000, wherein has been stated that the expression, "employee" does not include a shareholder director of a company". The amendment as made in the rule without making any corresponding amendment in sec. 2(28) giving definition of "employee", so far as it provides for exclusion of a shareholder director from the definition of "employee" appears to be *ultra vires* the Ordinance as the section [Sec. 2(28)] giving definition of "employee", in relation to company, that includes the managing director or any other director who performs any duties or functions in connection with the management of the affairs of the company (See the case of *C.I.T.* v. *Cheniappa Mudaliar [1964] Mad. 53 I.T.R. 323* under "order of Appellate Tribunal" in sec. 159).

To remove the complications in the computation of the actual amount of deductible perquisites on the basis of a certain fixed percentage of salary Cl. (e) of sec. 30 has been amended by the Finance Act, 2000. With this amendment so much of the expenditure on the provision of perquisities or other benefits to any employee, (excluding shareholder director of a company), as exceed one lakh thirty two thousand taka shall not be allowed as a deduction, i.e. the maximum amount allowable under this clause is limited to one lakh thirty two thousand taka, whatever be the amount of salary.

Before the amendment of the rule by the Finance Act, 2000 the law as it was, in the computation of allowable deduction under this clause perquisites and other benefits are to be deducted from Salary. The definition of 'salary' under Sec. 2(58) and perquisites under Sec. 2(45) is different from the definition of 'salary as was given in the explanation I of Sec. 10(4)(d) of the Income tax Act 1922 for the purpose of computation of allowance under this clause and the interpretation of 'perquisites and other benefits' as has been given by the Court in India in many cases as well as by the High Court Division of the Supreme Court of Bangladesh in the case of *C.T.* v. *M/s. Titas Gas Transmission & Distribution Co. Ltd.* which are based mainly on the provisions of Income-tax Act 1922 cannot be fully applied to our law. Considering the judgement of the High Court Division in *C.T.* v. *Titas Gas Transmission and distribution Co. Ltd. (reported in 1993 BTD XXI 64-78)* and the Tribunal's decision in

the light of section 2 (58), 2(45) and 30(e) of the Income-tax Ordinance, 1984 the Taxes Appellate Tribunal, Division Bench, Dhaka (reported in 1997 BTD XXV 152-166) in I.T.A. no. 134 of 1994–95 the details of allowable expenditures under the heads of "Salary" and Allowances as given in this case may be a reliable guide to approach the problem. In this case the question whether 'bonus' will be included into salary or perquisites has been discussed and it has been said that bonus is neither categories as perquisites nor benefits under Sec. 2(45) for the purpose of Sec. 30(e). It is more alike to salary than to perquisites. It is in addition to salary", hence it is to be added to salary for the purpose of computation of allowance under Sec. 30(e). The Tribunal directed to consider Bonus, Provident Fund and Gratuity as part of salary, excluding perquisites and other benefits as envisaged under Sec. 30(e) computing 50% salary under that section and then add perquisites and other benefits paid in excess of 50% of salary including Bonus, Provident Fund and Gratuity–I.T.A. No. 1870 of 1995-96 and 147 of 1996-97 reported in 1997 BTD XXV 118. "Salary" as mentioned here will be inclusive of wages paid to labourers since labourers are included in the definition of "Employee" as they are paid wages, and salary includes wages–1994 BTD xxii P.I. (Trib.). Recently the High Court Division of the Supreme Court of Bangladesh citing the cases of *(Commissioner of Taxes* v. *Mysore Commercial Chemical Co. Ltd.)* reported in 126 I.T.R. 340 and the case of *C.I.T.* v. *Johnson Pumps (India) Ltd.* reported in 172 I.T.R. 333 held the view, as was laid down in those cases, that any benefit given to an employee in kinds amounts to perquisites but any benefit given in cash becomes a part of his salary. (Note–the amendment as has been brought in has, however, settled the issue).

In the case of *C.T. Dhaka (South zone)* v. *M/s. Telephone Shilpi Sangstha Ltd.* the High Court Division of the Supreme Court in Bangladesh (reported in 1994 BTD XXII 284) observed that under this clause a limit has been placed on the quantum of perquisites or other benefits and held that this is to be computed employee-wise separately.

Cl. (f): Any expenditure in respect of the following.–(i) expenditure on entertainment; (ii) foreign travels of employees and their dependents for holidaying and recreation; (iii) Publicity and advertisement; and (iv) distribution of free samples. Expenditure on the above-mentioned heads are allowed as deductible expense but subject to the limits as prescribed in the Rules framed by the Board for these purposes. Further, if the expenditure is connected with sales and services liable to excise duty such expenditure must be supported by stamp duty or seal of the Excise Department (presently Customs Department).

Entertainment Expense.–For the purpose of putting a ceiling for allowance Rule 65 prescribes the limitation for allowances under Sec. 30(f)(i), excess of which shall not be allowed as admissible expense. (see further under 'Entertainment Expense').

Foreign travel for employees and their dependents.–Maximum amount allowable for the purpose Sec. 30(f)(i) in respect of expenditure on foreign travels for holidaying and recreation of an employee and his dependents has been prescribed in Rule 65A.

Publicity and advertisement. –Expense on advertisement (dealt in ante page-308). Rule 65B limiting the expenditure on advertisement has been with-drawn. Expenditure on advertisement if not of capital nature is an allowable expenditure.

In the case of *Hindustan Commercial Bank Ltd.–((1952) 21 I.T.R. 353)* the assessee, a bank incurred during the relevant accounting year certain expense in opening some bank branches and other offices and a sum of tk.24,645 representing charges for advertisement, entertainment, invitation cards and further sum of Tk.89,870 for postage, telephone, conveyance salary etc. was expended. The question arose whether the expenditure was of capital nature and whether the allowance for such expenditure was to be spread for a number of years and Tk.24,670/- was of capital nature. Held, i) that there was no legal justification for spreading out a sum over a period of some years and the amount was deductible in the year in which it was incurred if it was not in the nature of capital expenditure and (ii) assuming that, the sums of Tk.89,870/- and Tk.24,675/- were expense incurred wholly and exclusively for the purpose of business and they were of the nature of revenue expenditure and was admissible deduction under Sec. 10(2)(xv) (corresponding to sec. 29(1)(xxvii)).

Expense on the distribution of free samples.–Expense at different rates on the basis of turnover of the business in which distribution of free samples are made has been prescribed under Rule 65C for the purpose of 30(a)(iv).

Sec. 31: Capital gains - The tax shall be payable by an assessee under the head "Capital gains" in respect of any profits and gains arising from the transfer of a capital asset and such profits and gains shall be deemed to be the income of the income year in which the transfer took place:

Provided that no tax shall be payable by an assessee, being a non-resident, in respect of any profits and gains rising from the transfer of stocks or shares of a public company as defined in the Companies Act, 1994 (xviii of 1994) subject to the condition that such assessee is entitled to similar exemption in the country in which he is a resident.

Sec.32: Computation of capital gains – (1) The income under the head " Capital gains" shall be computed after making the following deduction from the full value of the consideration received or accruing from the transfer of the capital asset or the fair market value thereof, whichever is higher, namely:-

(a) any expenditure incurred solely in connection with the transfer of the capital asset; or

(b) the cost of acquisition of the capital asset and any capital expenditure incurred for any improvements thereto but excluding any expenditure in respect of which any

allowance is admissible under any provisions of sections 23, 29 and 34.

(2) For the purpose of this section, "cost of acquisition of the capital asset" means -

(i) where it was acquired by the assessee by purchase, the actual cost of acquisition: and

(ii) where it became the property of the assessee-

(cc) under a deed of gift, bequest or will: or

(ccc) under a transfer on a revocable or irrevocable trust:

(d) on any distribution of capital assets on the liquidation of a company: or

(e) on any distribution of capital assets on the dissolution of a firm or other association of persons or the partition of a Hindu undivided family:

the actual cost of acquisition to the previous owner of the capital asset as reduced by the amount of depreciation, if any, allowed to the previous owner: and where the actual cost of acquisition to the previous owner cannot be ascertained, the fair market value at the date on which the capital asset became the property of the previous owner:

Provided that where the capital asset is an asset in respect of which the assessee has obtained depreciation allowance in any year, the cost of acquisition of the capital asset to the assessee shall be its written down value increased or diminished, as the case may be, by any adjustment made under section 19(16) or (17) or section 27(1)

Provided further that where the capital asset became the property of the assessee by succession, inheritance or devolution, the actual cost of acquisition of the capital asset to the assessee shall be the fair market value of the property prevailing at the time the assessee became the owner of such property.

(3) Where in the opinion of the Deputy Commissioner of Taxes the fair market value of a capital asset (transferred by an assessee as on the date of transfer exceeds the full value of the consideration declared by the assessee by an amount of not less than fifteen per cent of the value so declared, the fair market value of the capital asset shall be determined with the previous approval of the Inspecting Joint Commissioner.

(4) Where in the opinion of the Deputy commissioner of Taxes the fair market value of a capital asset transferred by an assessee as on the date of the transfer exceeds the declared value thereof by more than twenty five per cent of such declared value, the Government may offer to buy the said asset in such manner as may be prescribed.

(5) Notwithstanding anything contained in this section or section 31, where a capital gain arises from the transfer of a capital asset which immediately before the date on which the transfer took place was being used by the assessee for the purposes of his business or profession and the assessee has, within a period of one year before or after that date, purchased a new capital asset for the purposes of his business or profession, then, instead of the capital gain being charged to tax as income of the income year in which the transfer took place, it shall, if the assessee so elects in writing before the assessment is made, be dealt with in accordance with the following provisions of this sub-section, that is to say-

(a) if the amount of the capital gains is greater than the cost of acquisition of the new asset,--

(i) the difference between the amount of the capital gain and the cost of acquisition of the new asset shall be charged under section 31 as income of the income year, and

(ii) for the purposes of computing in respect of the new asset any allowance under the Third Schedule or the amount of any capital gain arising from its transfer, the cost of acquisition or the written down value, as the case may be, shall be nil, or

(b) if the amount of the capital gain is equal to or less than the cost of acquisition of the new asset,--

(i) the capital gain shall not be charged under section 31, and

(ii) for the purposes of computing in respect of the new asset any allowance under the Third Schedule or any income under section 19(16) or the amount of any capital gain arising from its transfer, the cost of acquisition or the written down value, as the case may be, shall be reduced by the amount of the capital gain:

Provided that where in respect of the purchase of a new capital asset consisting of plant or machinery, the assessee satisfies the Deputy Commissioner of Taxes that despite the exercise of due diligence it has not been possible to make the purchase within the period specified in this sub-section, the

Deputy Commissioner of Taxes may, with the prior approval of the Inspecting Joint Commissioner, extend the said period to such date as he considers reasonable.

(6) Notwithstanding anything contained in this section or section 31, where a capital gain arises from the transfer of a capital asset being buildings or lands appurtenant thereto the income of which is chargeable under the head "Income from house property", which in the two years immediately preceding the date on which the transfer took place was being used for the purposes of residence, and the assessee has within a period of one year before or after that date purchased, or has within a period of two years after that date constructed, a house property for the purposes of residence, then, instead of the capital gain being charged to tax as income of the income year in which the transfer took place, it shall, if the assessee so elects in writing before the assessment is made, be dealt with in accordance with the following provisions of this sub-section, that is to say-

(a) if the amount of the capital gain is greater than the cost of acquisition of the new asset,--

(i) the difference between the amount of the capital gain and the cost of acquisition of the new asset shall be charged under section 31 as income of the income year, and

(ii) for the purpose of computing in respect of the new asset any capital gain arising from its transfer, the cost of acquisition shall be nil, or

(b) if the amount of the capital gain is equal to or less than the cost of acquisition of the new asset,--

(i) the capital gain shall not be charged under section 31, and

(ii) for the purpose of computing in respect of the new asset any capital gain arising from its transfer, the cost of acquisition shall be reduced by the amount of the capital gain:

Provided that where in respect of the purchase or construction of a new capital asset consisting of building for the purpose of residence, the assessee satisfies the Deputy Commissioner of Taxes that despite the exercise of due diligence it has not been possible to

make the purchase or construction within the period specified in this sub-section, the Deputy Commissioner of Taxes may with the prior approval of the Inspecting Joint Commissioner, extend the said period to such date as he considers reasonable.

(7) Notwithstanding anything contained in this section or section 31, where a capital gain arises from the transfer of a capital asset being government securities and stocks and shares of public companies listed with a stock exchange in Bangladesh, other than bonus share of a company, then no tax shall be charged under section 31.

(8) Notwithstanding anything contained in this section or section 31, where a capital gain arises from the transfer of a capital asset being buildings or lands which, within a period of two years immediately following the date on which the transfer took place, is invested in the acquisition of capital asset of an industrial undertaking, or in the acquisition of a new apartment to be used for resident under an agreement made between the assessee and a company or a cooperative society formed for the purpose of developing housing and real state [or in the constructing of a new building or purchase of a new apartment to be used for residence], [or purchase of new shares of a company listed with a Stock Exchange in Bangladesh or purchase of National Investment Bonds issued by the Governme[illegible] the capital gain being charged to tax as income of the inc[illegible]ch the transfer took place, it shall, if the assessee so elects [illegible]ore the assessment is made, be dealt with in accordance with the following provisions of this sub-section, that is to say-

(a) if the amount of the capital gains is greater than the cost of acquisition of the new asset-

(i) the difference between the amount of the capital gain and the cost of acquisition of the new asset shall be charged under section 31 as income of the income year; and

(ii) for the purposes of computing depreciation in respect of the new asset, any allowance under the Third Schedule or the amount of any capital gains arising from its transfer, the cost of the acquisition or the gains arising from its transfer, the cost of acquisition or the written down value, as the case may be, shall be nil, or

(b) if the amount of the capital gain is equal to or less than the cost of acquisition of the new asset,--

(i) the capital gain shall not be charged under section 31, and

(ii) for the purposes of computing in respect of the new asset any allowance under the Third Schedule or any income under section 19(16) or the amount of any capital gain arising from its transfer, the cost of acquisition or the written down value, as the case may be, shall be reduced by the amount of the capital gain.

(9) Notwithstanding anything contained in this section or section 31, where a capital gain arises from the transfer of a capital asset being building or lands which, within a period of one year immediately following the date on which the transfer took place, is invested [in the acquisition, otherwise than by purchase, or transfer from previous holders, of stocks or shares of public limited companies listed with a stock exchange in Bangladesh] and the stocks or shares are held by the assessee for at least two years from the date of acquisition, the capital gain shall not be charged to tax as income of the year in which the transfer took place.

(10) Notwithstanding anything contained in this section or section 31, where a capital gain arises from the transfer by the assessee being buildings or lands to a new company registered under the Companies Act, 1913 (VII of 1913) or কোম্পানী আইন, ১৯৯৪ (১৯৯৪ সনের ১৮ নং আইন)], for setting up of an industry, and if the whole amount of capital gain is invested in the equity of the said company, then the capital gain shall not be charged to tax as income of the year in which the transfer took place.

(11) Notwithstanding anything contained in this section or section 31, where a capital gain arises from the transfer of capital asset of a firm to a new company registered under {the Companies Act, 1913 (VII of 1913) or কোম্পানী আইন, ১৯৯৪ (১৯৯৪ সনের ১৮ নং আইন)}, and if the whole amount of the capital gain is invested in the equity of the said company by the partners of the said firm, then the capital gain shall not be charged to tax as income of the year in which the transfer took place.

(12) Notwithstanding anything contained in sub-sections (5), (6), (7), (8), (9), (10), and (11), no exemption shall be allowed to any person on so much of profits and gains arising out of the transfer of a capital asset as is attributable to the cost of acquisition of such asset in respect of which

any investment allowance referred to in paragraph 1, 2, 3, 4, 5, 6, 8, 9, 10 and 11 of **PART B** of the **SIXTH SCHEDULE** to this Ordinance was at any time allowed.]

Sec.31. Capital gains.–Under this section tax shall be payable by an assessee under the head "Capital gains" in respect of any profits and gains arising from the transfer of capital asset and such profits and gains shall be deemed to be the income of the income year in which such transfer takes place.

"Transfer of a capital asset" - Capital asset has been defined in Sec. 2(15). It does not include stock-in-trade, personal effects (movable property including wearing apparel, jewellery, furniture, fixture, equipment and vehicles which are held exclusively for personal use or for any member of the family of the assessee dependent on him) and agricultural land situated outside the jurisdiction of municipality, municipal corporation or a Cantonment Board. (See further under "Capital asset" under sec. 2(15) *ante*).

"Transfer" in relation to a capital asset includes the sale, exchange, or relinquishment of the asset or the extinguishment of any rights therein under sec. 2(66). (See, "Transfer" *ante*. Although the definition of "transfer" does not include compulsory acquisition of the asset but provision has been made under sec. 52C for deduction at source from compensation against acquisition of property by the Government of any immovable property situated within the jurisdiction of any city corporation, pourashava or Cantonment Board. The section applies even to cases where the whole business undertaking is sold –*Kallick Nexion And Co* v. *C.I.T. (1963) 49 I.T.R. 244, 258-9.*

A sale by the receiver appointed by the Court would be covered by this section - *Gowri Tile Works* v. *C.I.T. [1957] 31 i.t.r. 250.* A lease of mines or land would be a transfer and the salami or premium paid for the lease may be assessable as capital gains - *Traders & Miners Ltd.* v. *C.I.T. [1955] 27 I.T.R 341.* But the mere grant of the right of management of a capital asset would not be covered by this section – *Lajwanti Sial* v. *C.I.T. [1957] 32 I.T.R. 526.* The section applies even to capital gains arising from the relinquishment of a capital asset. But where an assessee voluntarily relinquishes his right to some capital asset in favour of another he does not thereby suffer a capital loss for the purposes of this section and cannot set it off against capital gains arising from other transactions - *David Mitchell* v. *C.I.T. [1956] 30 I.T.R. 701, 720-1.* For determining the year of chargeability, the relevant date is not the date of the agreement to sell but the date of the sale, i.e., effective transfer of title as contemplated by the parties – *C.I.T.* v. *Elder [1954] 25 I.T.R. 150.* So fair market value of the capital asset is to be determined on the date of transfer and not on the date of any prior written agreement for transfer (Circular no. 1 of 1983 - C. no. 18 (164) I.T. - IV 77-78 dated 12. 4. 83). Capital gains are assessable as the income of the year in which the transfer takes place, even though they may be realised later or there may be no realisation at all as a result of a variation agreed upon in a subsequent year – *T.V. Sundaram Iyengar & sons Ltd.* v. *C.I.T. [1959] 37 I.T.R. 26.*

Capital gains may arise in exchange of property – Land was given to a construction company in exchange of two flats and the land was valued at a higher price than the cost resulting in increase of wealth. The excess price may be capital gains but sec. 19(4) cannot be invoked for unexplained investment. The assessee may also claim exemption for investment of the capital gains into residential flats – I.T.A. 1632 of 1994–95 (করাদালত, জুলাই ১৯৯৮).

The assessee contributed his land to a firm as its partner. In was held that the handing over of the capital asset to the firm did amount to a transfer, but no capital gains chargeable to tax accrued to the assessee –*Ram Chandra Agarmal* v. *C.I.T. (Delhi) Reported in 1996 B.T.D. XXIV 193.*

Transactions not regarded as transfer – Sec. 2(66) enacts that the following transactions shall not be regarded as transfer for this purpose – (i) any transfer of the capital asset under a gift, bequest, will or an irrecoverable trust; (ii) any distribution of capital assets of a company to its shareholders on its liquidation; and (iii) any distribution of capital assets on the dissolution of the firm or association of persons or on the partition of a Hindu undivided family, and as such shall not be assessable to capital gains tax. This sub-section applies to a *distribution of capital assets in specie only*; and therefore capital gains made by an administrator on sale of the testators' assets effected with a view to distributing the sale proceeds among the legatees as directed by the will *(James Anderson* v. *C.I.T. [1960] 39 I.T.R. 123 (S.C. of India)* or capital gains made by the Receiver appointed by the court on sale of the assets of a dissolved firm *(C.I.T. v. Walji Damji [1955] 28 I.T.R. 914)* would not be exempted from tax. Under Cl.(b) of sec 2(66) a company cannot be regarded as having made any capital gains if it merely distributes its assets among its shareholders on liquidation; but in such a case the shareholder may be chargeable to capital gains tax in respect of the money received or the market value of other assets distributed in *specie* on liquidation, as reduced by the amount assessed as dividend under sec. 2(26).

Capital gains tax on shareholders when two companies amalgamate. – In a case where company A amalgamates with and merges into company B, and the shareholders of company A are allotted shares in company B, a question arises whether those shareholders would be liable to capital gains tax. No capital gains tax would be payable unless the amalgamation involves (a) a transfer, or (b) a sale, or (c) an exchange, or (d) a relinquishment of the asset or (e) the extinguishment of any rights therein (s.2(66)). It is clear that amalgamation would not involve any transfer or sale. It would not involve any "exchange" either, within the legal meaning of that term, because the allotment of new shares by company B is not a transfer nor is there transfer of any asset by the shareholders of company A to company B– See the definition of "exchange" in s. 118 of the Transfer of Property Act, 1882). The transaction would not involve "relinquishment of the asset", because relinquishment postulates the continued existence of the asset over which the rights of its holder are relinquished or surrendered, whereas upon amalgamation the shares in company A would cease to exist. The amalgamation would involve extinguishment of the asset, viz. shares in company A: but the better view is that it would not involve "extinguishment of any right therein" which expression seems to indicate the

continued existence of the capital asset over which the rights of its holder are extinguished. Sec. 2(66) refers to the extinguishment of any rights in the capital asset; it does not use the expression "the extinguishment of the capital asset" nor the expression "the extinguishment of the capital asset or of any rights therein". It seems, therefore, that such amalgamation would not be a "transfer" within s.2(66) and no capital gains tax would be payable by the shareholders of company A on such an amalgamation. However, the question whether such amalgamation would be covered by the words "the extinguishment of any rights therein" cannot be regarded as altogether free from doubt.

Set-off and carry-forward of capital loss – (See. Sec. 37 *Post*)

Computation of tax on capital gains–(See. Paragraph 2 of the Second Schedule)

Proviso to sec. 31 - Tax exemption for non-resident–The proviso allowed exemption of tax on capital gains for non-resident person in respect of any profits and gains arising from the transfer of stocks or shares of a public company as defined in the Companies Act, 1913 and 1984 – The exemption is allowed on condition, that such non-resident person is entitled to similar exemption in the country in which he is resident.

Computation of capital gains – sec. 32: This section lays down the mode of computing capital gains. The amount of capital gain is arrived at by deducting two items from the full value of the consideration for which the transfer is made, namely, (a) expenditure incurred solely in connection with the transfer –Cl.(a) and (b) the cost of acquisition to the assessee (as is mentioned in sub-section 2), of the capital asset and the cost of improvement, i.e. such expenditure of a capital nature incurred in making additions or alternations as is not allowable in computing the taxable profits. Any expenditure in respect of which any allowance is admissible under any provisions of sections, 23, 29 and 34 shall be excluded.

Sec. 32(2): Cost of acquisition – The general principle for computing capital gains is to deduct from the sale price the cost of acquisition to the assessee. To this general principle excepting in the case in which the assessee acquires the capital asset by purchase when the actual cost will be the cost of acquisition certain exceptions are engrafted by sub-section (2) of sec. 32 under which the cost to the previous owner is deemed to be the cost of acquisition to the assessee.

Where the asset became the property of the assessee under a gift, bequest or will or trust, or on the liquidation of a company, or on the dissolution of a firm or other association of persons or on a partition of a Hindu undivided family the cost to the previous owner as reduced by the amount of duplication if any, allowed to the previous owner as reduced by the amount of depreciation, if any allowed to the previous owner should be taken into account for the purpose of determining the capital gain and if the cost to the previous owner cannot be ascertained the fair market value at the date on which the capital asset became the property of the previous owner should be deemed to be the cost to the assessee. The other provisions regarding computation of cost would apply to such notional figure of cost to the assessee. For instance, the cost to the previous owner must be reduced by the depreciation

allowance granted to the previous owner or to the assessee, subject to adjustment on account of balancing allowance or balancing charge, and must be increased by the cost of any improvement borne by the previous owner or the assesee.

Proviso to sec. 32(2) specifically provides that if the asset is one in respect of which the assessee has obtained depreciation allowance in any year, the cost of acquisition is taken to be the written-down value, as adjusted, i.e. diminished or increased, as the case may be, by any balancing allowance or balancing charge under sec. 19(16) or (17) or sec. 27(1) or 29(1) (xi). The adjustment is with reference to balancing allowance actually deducted or balancing charge actually levied. If for any reason no such balancing allowance is actually deducted or balancing charge actually levied, the written-down-value must be taken without any increase or diminution–*Gouri Tile works* v. *C.I.T. (1957) 31 I.T.R. 250.*

It has been further provided in the second proviso that where the asset became the property of the assessee by succession, inheritance or devolution the cost of acquisition to the assessee shall be taken the fair market value of the property at the time when the asset became the property of the assessee.

Sub-secs. (3) and (4): Transfer for less than the fair market value under this sub-section.–The Deputy Commissioner of Taxes is entitled, in computing capital gains, to ignore the actual consideration received for the transfer and to substitute a notional or fictional consideration based on the fair market value of the asset on the date of the transfer. In case of alleged under-statement of sale-value of property the onus to prove the actual money consideration from the sale of property is on the revenue. If the fair market value exceeds by an amount of not less than fifteen percent of the declared value by the assessee the fair market value shall be taken into consideration with the previous approval of the Inspecting Joint/Additional Commissioner of Taxes. In a case where the market value exceeds by more than twenty five percent of the declared value the Government may offer to buy the said asset in the manner as prescribed under rule 42.

In determining the fair market value the mere fact that another property with similar location had been sold for a higher price is not sufficient. There must be material to show that consideration had not been truly stated – *Forbes Forbes Campbell And Co. Ltd. And Another – (Bombay) (Reported in 1997 BTD XXV 110-111).*

Exemption from capital gains tax - sub-sections 5 to 11 of sec. 32 – Exemptions for capital gains tax have been provided for in these sub-sections in respect of capital gain arising from the transfer of different types of capital assets if such capital gain is invested in the acquisition of specified assets fulfilling the conditions as required in the respective sections. The exemptions for capital gains have, however, been set-off in the form of reduction in depreciation or balancing allowance or increase in balancing charge or by higher capital gains tax as and when the new capital asset is sold as per the provisions laid down in sub-sections 5, 6 and 8.

Sub-section 12 has further put limitations to the exemptions for capital gains arising out of the transfer of capital assets in which the assessee made investments

and thereby enjoyed rebate for investment allowance under some paragraphs of part B of the Sixth Schedule; but it is doubtful whether 1, 2, 3, 4, 5, 6 and 11 as mentioned in this sub-section have any application in determining the cost of acquisition of any capital asset.

Sub-section 5: Capital gain arising from the transfer of capital asset used for the purpose of business – Where a capital gain arises from the transfer of a capital asset used for the purpose of business or profession immediately before the date of transfer and the assessee has purchased a new capital asset within a period of one year before or after the date of transfer for the purpose of his business or profession, such capital gain instead of being charged to tax in the year of transfer shall be dealt in the following manner, if the assessee so elects in writing:

(a) if the amount of capital gains is greater than the cost of acquisition of the new asset-

(i) the excess of the capital gain over the cost of acquisition of the new asset shall be charged to tax under sec. 31 as income of the year, and

(ii) for the purpose of computation of depreciation allowance or the amount of capital gain in case of its subsequent transfer the written-down-value or the cost of acquisition, as the case may be, of the new asset shall be nil, or

(b) if the amount of the capital gain is equal or less than the cost of acquisition of the new asset, –

(i) the capital gain shall not be charged to tax under sec. 31 and

(ii) for the purpose of computing depreciation allowance under the Third Schedule or balancing charge under sec. 19(16) in respect of the new asset or for the purpose of computing capital gain arising from the transfer of the new asset, the written-down-value or the cost of acquisition, as the case may be, shall be reduced by the amount of exempted capital gain so invested in the acquisition of the said new asset.

The Deputy Commissioner of Taxes has been given the discretion to extend the period of one year, either before or after the transfer, for the purchase of the new capital asset who can, with the previous approval of the Joint/Additional Commissioner of Taxes extend the period if satisfied that the assessee inspite of his exercise of diligence could not purchase the new capital asset within the period fixed for purchase of new capital asset. But this provision shall apply only in respect of the case of purchase of capital asset consisting of plant or machinery.

Sub-sec.6: Exemption of capital gains arising from the transfer of residential house property – If the assessee transfers his house property , income of which is chargeable under the head "Income from House Property", which in the two years immediately preceding the date of the transfer, was being used for the purpose

of residence, and the assessee has purchased within a period of one year before or after the date of purchase or has within a period of two years after the date of transfer constructed a house property for the purpose of residence, no capital gain tax would be attracted if the amount of the capital gain is not greater than the cost of the new asset. If the amount of the capital gain is greater than the cost of the new asset, only the excess of the capital gain over the cost of the new asset would be chargeable to tax under section 31. However, this sub-section goes on to provide that the exemption would be offset by a liability to higher capital gains tax if and when the new asset is sold.

The provision for exemption under this sub-section would also apply in case the amount of capital gains is invested in a property jointly owned by the spouse, that is husband can invest the amount in the construction of a building with his wife (see note of sec. 43(4) (iii) and 'Appellate Tribunal' case no I.T.A. no. 2343 of 1995-96 reported in 1999 BTD XXVII 47).

The Deputy Commissioner of Taxes may, at his discretion, but subject to the approval of Joint/Additional Commissioner of Taxes, extend the period fixed for the purpose of purchase or construction of the new asset consisting of building for the purpose of residence.

(**Note:** This sub-section has however, been omitted by the Finance Act, 2000.)

Sub-sec. 7: Exemption of capital gains arising from the transfer of Government Securities and stocks and shares of public companies – This sub-section grants total exemption of tax for capital gains arising from the transfer of Government securities and stocks and shares listed with a Stock Exchange in Bangladesh.

Sub-sec. 8: Exemption of capital gains arising from the transfer of buildings or lands – Where a capital gain arises from the transfer of a capital asset being buildings or lands which, in the two years immediately following the date of the transfer is invested for the following purposes–

(i) in the acquisition of capital asset of an industrial undertaking, or

(ii) in the acquisition of a new apartment to be used for residence under an agreement made between the assessee and a company or a cooperative society formed for the purpose of developing housing and real estate; or

(iii) in the construction of a new building or purchase of a new apartment or apartments to be used for residence; or

(iv) for purchase of new shares of a company listed with a stock exchange in Bangladesh; or

(v) for purchase of National Investment Bonds issued by the Government, in which cases no capital gains tax can be attracted if the amount of the capital gain is not greater than the amount invested for the above purposes. If the amount of the capital gain is greater than the cost of

the new asset as mentioned above, only the excess of the capital gain over the cost of the new asset would be chargeable to tax under sec. 31 as income of the year.

Provisions have, however, been made in this sub-section to offset the amount of exemption for capital gain tax. The cost of acquisition of the new asset shall be reduced by the amount of exemption of capital gain resulting in reduction of depreciation and balancing allowance or increase in balancing charge under sec. 19(16) and higher capital gains tax if and when the new asset is sold.

(**Note:** This sub-section has however, been omitted by the Finance Act, 2000.)

Sub-sec. 9: Exemption in respect of capital gains arising from transfer of buildings or lands – Where capital gain arises from the transfer of a capital asset comprising building or lands will be exempted if such capital gain is invested in a year following the date of such transfer in the acquisition of stocks or shares of public limited companies listed with a Stock Exchange in Bangladesh. To get such exemption two conditions are to be fulfilled – (i) the investment shall be in the primary stocks or shares of the company and not by purchase or transfer from previous holders; (ii) such stocks or shares are held by the assessee for at least two years from the date of purchase and cannot be transferred within this period.

(**Note:** This sub-section has also been omitted by the Finance Act, 2000.)

Sub-sec. 10: Exemption of capital gain arising from transfer of capital being buildings or lands to a new company – No capital gains tax shall be attracted for capital gains arising from transfer of capital being buildings or lands to a new company registered under the Companies Act, 1913 or 1994 for setting up an industry if the whole amount of the capital gain is invested in the equity share capital of the said company.

Sub-sec. 11: Exemption of capital gain of a firm arising from transfer of its capital asset to a new company – Capital gains tax shall not be charged for capital gains arising from transfer of capital assets of a firm to a new company registered under the Companies Act, 1913 or 1994 if the whole amount of capital gain is invested in the equity share capital of the company by the partners of the said firm.

Income from other sources – secs. 33 and 34

Sec. 33: Income from other sources – The following income of an assessee shall be classified and computed under the head "Income from other sources", namely:-

(a) dividend and interest;

(b) royalties and fees for technical services;

(c) income from letting of machinery, plants or furniture belonging to the assessee, and also of buildings belonging to

him if the letting of buildings is inseparable from the letting of the machinery, plant or furniture;

(d) any income to which section 19(1), (2), (3), (4), (5), (8), (9), (10), (11), (12), (13) or (21) applies;

(e) any other income of any kind or from any source which is not classifiable under any of the other heads specified in section 20.

Sec. 34: Deductions from income from other sources – (1) The amount of interest paid in respect of money borrowed for the purpose of acquisition of share of a company.

(2) Any expenditure, not being in the nature of capital expenditure or personal expenses of the assessee, incurred solely for the purpose of making or earning the relevant income.

(3) Where the income is derived from letting on hire of machinery, plant or furniture belonging to the assessee and also of building belonging to him if the letting of the building is inseparable from the letting of such machinery, plant or furniture, the same allowances as are admissible under section 29(1), (vi), (vii) and (xi) to an assessee in respect of income under the head "Income from business or profession" subject to the same conditions and limitations as if the income from such letting on hire were income from business or profession:

Provided that the provisions of section 19(16) shall also be applicable for the determination of any profits where the sale proceeds of such machinery, plant, furniture or building exceeds the written down value thereof.

(4) Notwithstanding anything contained in this section, no allowance shall be made on account of-

(a) any interest chargeable under this Ordinance which is payable outside Bangladesh on which tax has not been paid and from which tax has not been deducted at source under section 56; or

(b) any payment which is chargeable under the head "Salaries" if tax has not been paid thereon or deducted therefrom under section 50.

Sec. 33: Scope – This section deals with the residuary head of income and sweeps in all such taxable income, profits and gains as fall outside the preceding

specific heads; but the section does not apply to income which is not includible in the total income of the assessee at all, e.g. the classes of income which under s. 44(1) read with part A of Sixth Schedule are exempted from tax –*Probhat Chandra Barua v. C.I.T. 5 I.T.C. 1 (P.C.)*.

Where there is a specific head for the income in question and a specific section providing for the head, this residuary section cannot be called in aid –*Bhar State Co-op. Bank Ltd. v. C.I.T. [1960] 39 I.T.R. 114 (S.C. of India)*. In this case it was held that "the various heads under sec. 6 of the Income tax Act are mutually exclusive. Sec. 12 of the Income Tax Act (corresponding to sec. 33 of Income tax Ordinance, 1984) is a residuary section and does not come into operation until the preceding heads are excluded. The Privy Council also laid down in –*C.I.T.* v. Basant Rai Takhat Singh *1933 I.T.R. 197, 201*, the residuary head "does not come into operation until the preceding heads are excluded."

Two propositions were laid down by the House of Lords in –*Salisbury House Estate Ltd.* v. *Fry 15 T.C. 266*, which are equally applicable under this Act. (a) The residuary head of income can be resorted to only if none of the specific heads is applicable to the income in question; (b) if a certain item of income is taxable under one of the specific heads, the charge under that head exhausts the taxability of the income, and no part of such income can be brought to charge again under the residuary head. See under s. 20. ("Charge under specific head is obligatory and exhaustive").

Income under this head is to be computed in accordance with the method of accounting regularly employed by the assessee, provided the method is such that the income can be properly deduced therefrom (s. 35). Where no method of accounting has been regularly employed, a non-trader cannot be assessed, generally speaking, under this section in respect of money which he has not received.

Income falling under the residuary head. – Income from an office not amounting to employment would fall within this section, while profits of employment are taxable as "salaries" under s. 21. Generally a director of a company is not as such an employee of the company. The fees he receives by virtue of his office as a director should be taxable, not as salary under s. 21, but as income from other sources under this section –*C.I.T.* v. *Lady Navajbai Tata 1947 I.T.R. 8*. But there may be special cases, where the director becomes an employee under sec. 2 (28). Commission earned by a director or any other individual for negotiating the sale of a company's branch *(Mudd v. Collins 9 T.c. 297)*, a company's shares *(Grey* v. *Tiley 16 T.C. 414)*, or for procuring insurance *(Hugh v. Rogers 38 T.C. 270)*, underwriting shares *(Lyons v. Cowcher 10 T.c. 438)*, or guaranteeing another's overdraft or otherwise pledging one's credit *(Ryall* v. *Hoare 8 T.C. 521; Sherwin* v. *Barnes 16 T.C. 278)*, would be chargeable under this section. Tips received by a waiter or taxi-driver, not being given by his employer, would be taxable, not under s. 21, but under this section.

Interest on securities other than those specified in s. 22 may fall within this section. So also may interest on loans, deposits or current account, and interest payable under a decree *(Lal Jagmohandas Rastogi v. C.I.T. 3 I.T.C. 274)*.

Sec. 24 deals only with house-property. Therefore, mining rents and royalties, non-agricultural rents and profits from a zamindari –*(Probhat Chandra Barua* v. *C.I.T. 5 I.T.C. 1 (P.C.)* or bustee lands *(In re Amulyadhan Addy 1936 I.T.R. 164)*, income from market rights, fisheries, rights of ferry or moorings *(Rajendra Narayan Bhanja Deo* v. *C.I.T. 1937 I.T.R. 111)*, grazing rights agricultural income arising outside Bangladesh and rents and royalties paid for a licence to take away earth *(Mahadeo Ashram Prasad* v. *C.I.T. 2 I.T.C. 281)*, are taxable under this section. Even in respect of house-property, it is only the owner who can be assessed under s. 24; where the assessee is a short-term lessee of a building and makes a profit by subletting or relctting it, the charge may be under this section *(Gooptu Estates Ltd. v. C.I.T. 4 I.T.C. 146, 149)*.

Payment received by a non-professional writer from a newspaper for the serial rights in a story *(Housden v. Marshall 38 T.C. 233, [1960] 38 I.T.R. 233)*, fees received by a professional man as a university examiner *(Dr. Sir H.S. Gour* v. *C.I.T. 3 I.T.C. 350)*, examination and enrolment fees received by a Bar Council *(C.I.T.* v. *Bar Council, Madras 1943 I.T.R. 1)*, a periodic allowance received under some custom, usage, contract, order of the court or other binding agreement *(Rani Amrita Kunwar* v. *C.I.T. 1946 I.T.R. 561, 569, 582)*, income derived by an Ayurvedic physician from a dramatic troupe maintained by him *(Varier* v. *C.I.T. 1940 I.T.R. 628)*, fees received by the executors of a deceased partner for the use of the firm's goodwill *(Mackintosh* v. *I.R. 14 T.C. 15)*, interest received by the heirs of a deceased moneylender on outstanding loans, where the heirs do not continue the money-lending business *(Raghunath Prasad* v. *C.I.T. [1955] 28 I.T.R. 45)*, compensation received for use of machinery by a third party *(C.I.T.* v. *Sathappa Chettiar [1951] 20 I.T.R. 393, 398)* compensation received for use of machinery by a third party *(C.I.T.*v. *Sathappa Chettiar* [1951] 20 I.T.R. 393, 398), may be taxed under this section. For cases of patent and copyright royalties, see under s. 16, and note to Cl. (b).

Annuities and periodic allowances:– A periodic allowance, payable under some legal custom, usage, contract, order of the Court or other binding obligation, would be taxable under this section *(Rani Amrit Kunwar* v. *C.I.T. 1946 I.T.R. 561, 569, 582 (F.B.)*, but not a voluntary allowance paid by a father to his child or by one relative to another, for such a voluntary allowance is not "income" at all.

Annuities paid by an employer fall under s. 21. All other kinds of annuities, e.g. those payable under an insurance policy or any other contract, under a will, trust, settlement or any other legal obligation, fall under this section *(Gopal Saran Narain Singh* v. *C.I.T. 1935 I.T.R. 237 (P.C.)*.

Where the assessee gets the annuity tax-free and the trustees pay the tax thereon, the amount of the tax should be added and brought in, and the gross annuity would be the income of the assessee under this section. Similarly, in the case of tax-free dividends or tax-free interest on debentures, it is the gross amount that should be included in the total income. Where an assessee, entitled to an annuity of £500 from an insurance company, received only £225, the company having deducted £275 as tax under the United Kingdom income-tax law, it was held that the whole amount of 500

Pounds was includible in the assessee's total income. (Cf. under s. 22, "Tax-free salary").

Dividends and interest - Cl.(a) of sec. 33 – Dividend income is taxable as income in the year in which it is declared (s. 19(7) as income from other sources in the case of an investor in shares *(Eastern Investments Ltd.* v. *C.I.T. [1951 20 I.T.R. 1 (S.C. of India)*, but was taxable as profits of business where the shares were held as stock-in-trade - (The assessee company was a dealer in shares which constituted its stock-in-trade. In the year 1950-51 the assessee suffered a business loss which was allowed to be carried forward. In 1951-52 the assessee again suffered a business loss. After setting-off the loss against dividend income, there remained a balance of dividend income. Held, (i) that the dividend income received by the assessee in respect of the shares was income from business chargeable under sec. 10 and not income under sec. 12; (ii) that therefore, the assessee was entitled to set-off the loss brought forward from the year 1950-51 against the dividend income of the year 1951-52 – (*C.I.T. Bombay* v. *Ahmuty & Co.Ltd. [1955] 27 I.T.R. 63)*. The case was further discussed in the Taxes Appellate Tribunal, Dhaka (I.T.A. 1787 to 1789 of 1981-82) 1986 B.T.D. xiv 185-192 relying on the principle laid down by the Supreme Court of India in the case of *(C.I.T.* v. *P.M. Muthuraman Chettiar)*, wherein it was observed that dividend yielded by a company at a particular time is an income from business.

A deduction is allowed from the dividend-income in respect of any interest paid on borrowed capital for acquisition of shares of a company and in respect of a reasonable sum paid by way of commission or remuneration to a banker or any other person realising the dividends on behalf of the assessee. (See s. 34(1). It has however, been held in the case of *(East India Agencies (Pvt.) Ltd.* v. *C.I.T. (Kerala H.C.))* reported in 1993 BTD XX 239 that where the only income of the assessee was from dividend no effort was necessary for collecting dividend and no expense need be incurred. Expenses incurred by the assessee including the salary paid could not be allowed as a deduction.

Interest on short-term deposits of surplus money before the commencement of business is an income from Other Sources, but interest paid on borrowings for business cannot be deducted from interest received under sec.57 (corresponding to sec. 34 of I.T. Ordinance, 1984) – *C.I.T.* v. *Manglam Cement Ltd. (reported in 1997 BTD XXV 83)*

Monies realised on liquidation of a company were invested in fixed deposits by the liquidator and interest earned on such deposits cannot be business income since the activities of the liquidator cannot be called business activities. Such interest earned is income from other sources but the expenditure incurred by the liquidator towards salaries, legal fees, liquidation expenses etc. cannot be deducted from such interest since such expenditure is not related to earning of interest – *(Vijaya Laxmi Sugar Mills Ltd. v. C.I.T. (S.C. of India) reported in 1994 B.T.D. xxii 288-289).*

Dividends can only be received by the registered shareholder and not by the beneficial owner of shares. If a person buys shares and does not get the shares transferred to his name in the share register of the company, he would not be a

shareholder and the amount equivalent to the dividend received by him from the registered shareholder would not be dividend *(Howrah Trading Co. Ltd. v. C.I.T. [1959] 36 I.T.R. 215 (S.C. of India)*. Such amount equivalent to the dividend would be assessable as profits of business if the shares are beneficially owned as stock-in-trade and in other cases as income from other sources under this section.

Application of dividend. – It has been noted above that this section would not apply unless the dividend is received as such by a shareholder. Conversely, if it is so received, the fact that the shareholder has to apply it in a particular manner under a binding obligation would not prevent it from being taxable as dividend and attracting the provisions of this section. In *Calico Printers' Assn. Ltd.* v. *C.I.T. (1949 I.T.R. 149)* the assessee association, which was the purchaser of practically all the shares in a company, was bound under the terms of the agreement of purchase to procure, after its becoming the shareholder, the declaration by the company of a dividend which was to be paid over to the vendor as part of the price of the shares. Held, the dividend was the income of the association and assessable in its hands. Likewise, a special dividend received by a shareholder in pursuance of an agreement to apply the dividend in purchasing more shares in the company would all the same be includible as dividend in the shareholders' total income *(Roe v. I.R. 8 T.C. 613)*. See further under s. 16, "Application of income and its diversion by overriding title").

Shares sold cum-dividend. –Dividend accrues not from day to day but only when it is declared. When shares are sold cum-dividend or a short time before the declaration of the dividend the whole dividend is to be included in the total income of the person–whether he is the seller or the buyer–who acquires the right to receive it after the sale, without any deduction in respect of the diminution or increase in the purchase price which the parties might have agreed to make on account of the impending dividend. For instance, where a person purchased shares shortly before the declaration of the annual dividend, and paid what was expressed in the contract to be an extra sum in addition to the purchase price on account of the impending dividend, it was held that the whole dividend when received was assessable in the purchaser's hands as his income without any deduction in respect of the extra sum agreed to be paid by him on account of the dividend *(I.R. v. Forrest 8 T.C. 704)*. Such additional sum would be regarded as merely part of the capital cost of the shares to the purchaser *(Ibid.)* and similarly, the seller would not be assessable in respect of such sum which would be looked at as part of the capital value realised by him for the shares *(Calco Printers' Assn. Ltd. v. C.I.T. 1949 I.T.R. 149, 157)*.

The principle is that there is no apportionment by time in the case of dividends. The whole dividend is taxable in the hands of the person who is entitled to it as being on the register of shareholders at the time when the dividend is declared, irrespective of whether he was the owner of the shares throughout the period for which the dividend is declared. This principle also applies when the dividend becomes payable after a shareholder's death. A part of such dividend, apportioned to the period up to the date of the death, cannot be treated as the income of the deceased, but the whole dividend must be treated as income of the estate received by the legal representative *(I.R. v. Henderson's Executors 16 T.C. 282)*.

The above principles also apply in the case of sale of securities cum-interest. For cases of securities sold cum-interest, see ante under s. 22 "Securities sold cum-interest: No apportionment of interest".

The foregoing principles must, however, be read subject to the provisions of s 106 which hits those who seek to avoid tax by systematic sales of shares cum-dividend or securities cum-interest. Under that section the Deputy Commissioner of Taxes may, in certain circumstances, deem the income from shares and securities to accrue from day to day and tax the seller on that basis. See, further, notes to that section post.

It may be mentioned here that the dividend income will be deemed to be the income of the year in which it is declared (s. 19 (7)).

Exemption.–Dividend income received by an assessee other than a company out of the profits of a publicly traded company shall be exempt from tax payable under the Ordinance if the dividend is paid out of the profits of the period for which the company enjoys tax exemption– *S.R.O.* 265-2/86 dated 1st July, 1986. In order that the shareholder may get exemption the company must have assessable income which is entitled to exemption but it is not further necessary to grant a certificate to the shareholder that it has obtained such exemption–*Indo Commercial Bank Ltd.* v. *C.I.T. (1962) 44 I.T.R. 22, 24.*

The term "Publicly traded company" has the same meaning as defined in part B of the Third Schedule.

Further, any income from dividend received by an assessee, other than a company, out of investments made on or after 1st July, 1984, in the purchase of shares of public limited companies listed with the stock exchange is exempt upto thirty thousand taka. When the amount exceeds thirty thousand taka, the excess of thirty thousand taka shall be chargeable to tax–Paragraph 22 of Part A of Sixth Schedule. The Finance Act 2000 has increased the exemption limit from taka thirty thousand to taka forty thousand.

Cl.(b): Royalties and fees for technical services– Royalties have been defined in Sec. 2(56) and the definition of royalties includes technical services, that is, the act of imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill or any information concerning the working of or the use of a patent, invention, model, design, secret process or formula or trade mark or similar property.

Royalty, as has been defined, means a consideration, may be a lump sum but excluding capital gains, for transfer of the right to use any patent, license, formula, trade mark, copy right, literary, artistic, scientific work, secret process or similar property. It also includes the payment of a sum for the use of mining rights. Royalties payable under mining leases which stand on a different footing from premium or salami which is in substance a rent. It is the compensation which the occupier pays the owner for that *species* of occupation which the contract between them allows. Mining royalties are income within the meaning of this Ordinance and fall to be taxed

under sec. 33, as income from Other Sources. Although they may be regarded in one sense as instalments of the purchase price of the minerals forming part of the land, they are income and none the less so merely because they are paid for rights the exercise of which involves a waste of the capital – *Kamakshya Narain Singh* v. *C.I.T. 1943 I.T.R. 513, 524 (P.C.).* "Once it is established that the royalties are income within the meaning of the Act, it is not material that the mines are in course of being exhausted, unless it is provided in the Act that there should be a deduction from the income on that particular ground. But there is under the Act no provision for allowance for amortisation in respect of the minerals being exhausted."

Royalties paid by a licensee for the right to take away earth to be used for brick-making or extracting saltpeter are income – the fact that removal of the soil itself is involved does not make the case any different from cases of royalties on underground coal and quarries – *Maharani Janki Kuer* v. *C.I.T. 5. I.T.C. 281.*

Mining royalties or rent, taxable as income, may be (i) a lump sum (*Manyam Meenakshamma v. C.I.T. [1956] 30 I.T.R. 286),* or (ii) a fixed annual sum, or (iii) a royalty on the amount of minerals extracted, called tonnage royalty or (iv) such a royalty but not less in the aggregate than a fixed amount each year, called minimum royalty. The minimum royalty is a species of annual guarantee; it does not correspond to any coal in fact extracted and taken away: it is simply income flowing from the covenants in the lease, contigently on the lessee's failure to take the minimum quantity of coal. It would be payable if in any year the lessee took no coal at all, or if the coal in the mine was completely exhausted before the termination of the lease *(Kamakshya Narain Singh* v. *C.I.T. 1943 I.T.R. 513, 519-20 (P.C.).* A lump sum received on assignment of a contractual right to realise rents or royalties from coalfields for a certain number of years was held to be mere advance payment of royalty and assessable as income *(Nilkantha Narayan Singh* v. *C.I.T. [1951] 20 I.T.R. 8).* Likewise, if under a business arrangement for exploitation of mines, periodic payments fixed with reference to sales and profits are made to the assessee, in consideration of transfer of leasehold rights and concessions, they would be taxable as income *(National Cement Mines Industries Ltd.* v. *C.I.T. [1961] 42 I.T.R. 69 (S.C. of India).*

But where payments by way of royalties are made not under a lease but on an outright sale of mining lands or oil fields, the royalties may be held to be capital payments on the ground that they represent not the profits derived from property but the price of it *(British South Africa Co. v. C.I.T. 1946 I.T.R. Suppl. 17, 29 (P.C.).* In *Minister of National Revenue* v. *Spooner (1933 A.C. 684 1933 I.T.R. 299),* the assessee sold to a company all her right, title and interest in and to twenty acres of land. In consideration of the sale the company agreed to pay to the assessee the sum of 5,000 dollars in cash on the execution of the agreement, to issue to her 25,000 fully paid shares of 1 dollar each in the company, and further to deliver to her order "the royalty hereby reserved .... namely 10 per cent of all the .... oil produced ..... from the said lands." In the year of assessment the company sold the whole of the oil produced and paid over 9,570 dollars to the assessee, being 10 per cent of the gross proceeds, which she accepted in satisfaction of the "royalties" reserved to her under the

agreement. Held, the sum of 9,570 dollars was a capital receipt. The use of the word "royalty" in the agreement did not affect the capital nature of the receipt. Lord Macmillan, delivering the judgment of the Privy Council, said that the share which the assessee became entitled to receive of the oil from the land which she had sold to the company was not a royalty "in the ordinary sense familiar in the case of mining leases where the lessor stipulates for payment by his lessee of a fixed rate per ton of the mineral oil. Here there is no relation of lessor and lessee. The transaction was one of sale and purchase. It may have taken the form which it did because of the uncertainty whether oil would be found by the purchaser or not; as the value of the land depended on this contingency, the price, not unnaturally, was made to depend in part on the event." They royalty was held to be capital *though it was to go on in perpetuity (The Court of Appeal held in I.R. v. 36/49 Holdings Ltd. 25 T.C. 173 that annual cash payments which were to go on in perpetuity could not be classed as capital)*. This was a very exceptional case and cannot be regarded as laying down any general principle *(National Cement Mines Industries Ltd. v. C.I.T. [1956] 29 I.T.R. 629, 652-5, affirmed. [1961] 42 I.T.R. 69, 78 (S.C. of India)*.

Patent and copyright royalties: Remuneration of writers.– A patent is a capital asset. Patent royalties are payments, periodic or in a lump sum, made for the user or assignment of a patent. Royalties for the *user*, past, present or future, of a patent are taxable as income where there is a working licence and the transaction does not amount to an exclusive licence affecting the capital rights of the patentee *(Rustproof Metal Window Co. v. I.R. 1948 I.T.R.)*: such royalties are income even though they may be paid in a lump sum for user extending over several years *(Mills v. Jones 14 T.C. 769 (H.L.)* and even though the payment may be irrespective of *actual* user *(Rustproof Metal Window Co. v. I.R. 1948 I.T.R.)*. But where the owner of a patent sells or surrenders it or grants an exclusive licence to another which *pro tanto* disentitles the owner from exercising his capital patent rights, the transaction amounts to a *total or partial assignment* of the capital rights and the royalty is a capital receipt *(Collins v. Firth-Brearley Stainless Steel Syndicate Ltd. 9 T.C.520)*. For in such a case the owner parts with a capital asset, viz. the corpus of the patent, even if he parts with it only for a certain limited period, for a certain limited area, or for a certain limited type of customer *(Margerison* v. *Tyresoles Ltd. 25 T.C. 59)*. But an annual royalty, particularly if it is based upon the assignee's turnover or profits, may be regarded in some cases as an income receipt even if it is in consideration of a total *assignment* of a patent; and in such cases the assignor may be regarded as having exchanged his capital asset for a recurring income payment *(Jones* v. *I.R. 7 T.C. 310 Cf. ant under "Annuities and annual instalments of capital")*. The question whether it is a case of user or assignment must be determined with regard to the substance of the matter, and the mere use of the words "capital sum" or "royalty" by the parties is not conclusive. Nor is it material whether the consideration is given in a lump sum or in instalments *(Rustproof Metal Window Co.* v. *I.R. 1948 I.T.R.)*, or how the item has been dealt with in the balance sheet or in the profit and loss account.

Ordinarily, the assignment of a patent is a transaction on capital account; but where a person carries on a trade in the buying and selling of patents or habitually

sells his own patents, or carries on the vocation of an inventor, the sale-proceeds would be business income *(Anant Ram Khem Chand* v. *C.I.T. 1937 I.T.R. 511, 516).*

The owner of a secret process or design stands in a very analogous position: he has no monopoly at law but he has a monopoly in fact. The price he receives for its sale or surrender may be a capital receipt *(Handley Page* v. *Butterworth 19 T.C. 328, 360 (H.L.).* The judgments of the House of Lords in – *Moriarty* v. *Evans Medical Supplies Ltd. (37 T.C. 540, [1959] 3 I.T.R. 707)* and *Jeffrey* v. *rolls-Royce Ltd. (40 T.C. 443)* establish that "know-how" may be a capital asset and the price received on its sale a capital receipt, but moneys received for systematic and repeated exploitation of know-how would be on revenue account.

A patentee sold his entire patent rights for a lump sum and annual royalties. The royalties were to be based upon the volume of business done. Held, the lump sum was a capital receipt, but the royalties which rose or fell with the chances of the business were income *(Jones* v. *I.R.* 7 T.C. 310).

Copyright.–The foregoing principles apply to payments in respect of copyright as well. In cases *other than those of professional authors*, royalties payable for a licence to translate and publish a copyright book are income; but if there is a total or partial assignment of the copyright which is a capital asset, the payments therefor would be capital. Between a licence and a partial assignment of copyright the line runs very fine, and each agreement must be construed in the light of its own facts *(Withers* v. *Nethersole 28 T.C. 501, 510 (H.L.).* The use of the word "royalty" is not decisive, nor is it material whether the payment is periodic or in lump sum *(I.R.* v. *Longmans Green & Co. Ltd. 17 T.C. 272, 283-4).* In *I.R.* v. *Longmans Green & Co. (17 T.C. 272)* royalties (per number of copies sold) for the exclusive right of translation and publication of a French book in the English language in certain specified editions were held to be income on the ground that the agreement did not amount to an assignment of the copyright. If the whole and unlimited rights of translation and publication in English had been transferred, the transaction would have constituted an assignment. The sole and exclusive right of printing and publishing compositions in a particular form was held not to amount to an assignment of the copyright, while an absolute transfer of the performing rights of an opera within a prescribed area was held to be an assignment and not a mere licence *(Messager* v. *British broadcasting Co. 1929 A.C. 151 (H.L.).*

Payments received from a newspaper for articles containing advice by a tipster as to what horses are likely to win, or advice by a meteorological expert as to what the weather is likely to be, are income, for they are remuneration for services rendered *(Graham* v. *Arnott 24 T.C. 157).* Similarly, where a solicitor's clerk who had never carried on the profession of an author received a sum of money from a newspaper for the *serial rights* in his life-story, it was held to be an income receipt, since the transaction amounted to performance of services to the newspaper, the sale of the serial rights being subsidiary thereto. The services "are the fruit of the individual's capacity which may be regarded in a sense as his capital, but are not the capital itself" *(Housden* v. *Marshall 38 T.C. 233, [1960] 38 I.T.R. 233).* But in *Trustees of Earl Haig* v. *I.R. (22 T.C. 725),* where the trustees put the testator's war

diaries, the copyright in which belonged to them, at the disposal of a biographer who made full use of them in writing the biography and the profits derived from the sale of the biography were equally divided between the biographer and the trustees, the sums received by the trustees were held to be capital payments. The ground of the decision was that the payments were not merely for the use of a capital asset, but in return for the realisation of a considerable part of its capital value. The copyright in the diaries remained in the trustees subject only to the licence granted to the biographer to make use of them for the purposes of his book, but the result of the transaction was that to a large extent the publication value of the diaries was exhausted, and the asset itself–the publication rights–was alienated to the biographer.

Where the publishers paid the author a sum of £150 for licence to publish one edition of his book, and the Commissioners found that it was a capital payment, it was held that there was evidence to support the Commissioners' finding, for there was an implied obligation on the part of the author "to give no licence to anybody else to publish the book for a period of time" *(Beare v. Carter 1940 I.T.R. Suppl. 127, 23 T.C. 353)*. The correctness of this decision is, it is submitted, not free from doubt.

In *Withers* v. *Nethersole (1948 I.T.R. Suppl. 92 28 T.C.)* a lump sum was paid to the assessee who had ceased to carry on the vocation of a dramatist, for the film rights and broadcasting rights in her play and for the right to adapt or add to the play for the purposes of a film. It was held by the House of Lords to be a capital receipt, because the transaction amounted to partial assignment of the copyright and constituted the sale of a capital asset *(Shiner v. Lindblom 39 T.C. 367 (resale of film right)*. But sums received for the grant of exhibition and distribution rights in films would be on revenue account *(Mitchell* v. *Rosay 35 T.C. 496 (C.A.)*.

Where a man exercises the *profession of an author*, the price realised by the sale of the whole or part of the copyrights of his books is as much taxable under s. 28 (professional income) as royalties received from his books, for the sale of copyright is only one way of making a profit from the exercise of a writer's profession *(Withers* v. *Nethersole 1948 I.T.R. Suppl. 92, 96, 100 (H.L), 28 T.C. 501)*. It was so laid down by the *Court of Appeal in Mackenzie v. Arnold (33 T.C. 363)*.

The only section in the Ordinance dealing specifically with the topic of copyright is s. 36. The provisions of that section have no bearing whatever on the question whether the amounts received by an author by way of royalty or as the price of assignment of his copyright are income or capital. The only object of that section is to give the author of a literary or artistic work the option of having his taxable income from his work spread over two or three years.

Relief for income from royalties. – Section 36 grants some relief to authors of literary or artistic works by providing that what is taxable as income in their hands should be allocated, at their option, over a period of years depending on the time taken for such works by the authors, and should bear tax at a lower rate than the normal rate of tax which might be attracted if the entire amount is charged as the income of a single year.

The amount which is received in lump sum shall be the income of the income year in which it is received and the immediately preceding year if the time taken in making such work exceeds twelve months but does not exceed twenty four months. If the time taken in making such work exceeds twenty four months, the amount so received shall be the income of the income year in which it is received and the two immediately preceding income years and such allocations shall be in equal proportions to each such income year.

The lump sum amount as referred to above includes advance payment of royalties and the "author" includes a joint author–Expln. to sec. 36.

C.(c): Machinery, plant or furniture let on hire with buildings. –Where an assessee lets on hire his machinery, plant or furniture, with or without buildings, and the letting amounts to a business, the case would fall under s. 28 (that being the specific head). (See under s. 28, "Income from letting out a business asset") In that case, the assessee would be entitled to all the allowances provided under that head and this section would have no application. Where, however, the letting does not amount to a business, in which case there is a composite and inseparable letting of machinery, plant or furniture belonging to the assessee and also buildings the whole rental income would be assessable under this section and no part of the rent would be assessable under sec. 24 and in such a case s. 34 permits deductions on account of current repairs, insurance premium, depreciation and balancing allowance in respect of the leased assets, as provided for the head "business" *(C.I.T.* v. *Ranjit Singh [1955] 28 I.T.R. 14)*. These allowances are in addition to the general allowance granted by s. 34(2) in respect of any revenue expenditure laid out or expended wholly and exclusively for the purpose of making or earning the income *(C.I.T.* v. *Jagannatha Govindas [1962] 45 I.T.R. 61)*. Likewise, a balancing charge is leviable under s. 19(16) in respect of depreciable assets. When an asset is let on hire by the assessee under a hire-purchase agreement, this section would apply and the assessee would be entitled to allowances under s. 34 *(Sardar Tara Singh* v. *C.I.T. [1963] 47 I.T.R. 756)*.

But in order that cl.(c) may apply, the letting of the machinery, plant or furniture should be inseparable from the letting of the building. The view of the Bombay High Court in *Sultan Bros. (Pr.) Ltd.* v. *C.I.T. ([1960] 38 I.T.R. 85)* that in order to attract the application of this clause it is further necessary that the letting of the plant, machinery or furniture should be primary and the letting of the building should be subsidiary or secondary, is, it is submitted by the learned authors, Kanga and Palkhivala, incorrect. This section makes it clear that where there is a composite and inseparable letting of machinery, plant or furniture belonging to the assessee and also buildings, the whole rent would be assessable under this section as income from other sources even if the buildings also belong to the lessor, and no part of the rent would be assessble under s. 24 as income from house property.

Cl.(d): See under "unexplained investments, etc. deemed to be income" in sec. 19 *ante* .... Profits chargeable to tax as income from other sources–sec. 19(1), (2), (3), (4), (5), (8), (9), (10), (11), (12), (13), or (21).

Cl.(e): See under "scope" in sec. 33 *ante*.

Deduction from dividends – sec. 34:

Sub-sec.(1): The provisions of this sub-section have been considered under sec. 33 "Dividends and Interest", *ante.*

Sub-sec.(2): Allowance for revenue expenditure. –In computing the income under this head, deduction is to be made in respect of expenditure incurred solely for the purpose of earning such income, provided the expenditure is not in the nature of capital expenditure or personal expenses of the assessee.

No allowance can be granted under this section unless four conditions are satisfied: (i) The expenditure should be incurred solely for the purpose of making or earning the income. (ii) It should not be in the nature of capital expenditure. (iii) It should not be in the nature of personal expenses of the assessee. It should be incurred in the accounting year and not in any prior or subsequent year. Whereas this section allows expenditure "laid out or expended wholly and exclusively for the purpose of making or earning such income", the allowance under s. 29(xxvii) is in somewhat wider terms–"laid out or expended wholly and exclusively for the purposes of the business or profession" *(Sir Kameshwar Singh v. C.I.T. [1957] 32 I.T.R. 377).* Bearing this in mind, the case-law under s. 29(xxvii) may be applied to the present section. Reference may be made to the notes to that clause for the principles governing the first three conditions stated above. (See *ante*). The fourth condition–*viz.* that the expenditure should be incurred in the year of account, and not in any prior or subsequent year–is established by the Privy Council case, *C.I.T.* v. *Basant Rai Takhat Singh (1933 I.T.R. 197)*, and is dealt with under s. 29, "Expenses and losses claimed should have been incurred in the accounting year".

In *Eastern Investments Ltd.* v. *C.I.T. ([1951] 21 I.T.R. 1)* the assessee, an investment company, under an agreement with its principal shareholder, reduced its share capital and issued debentures carrying interest to that shareholder. The transaction was effected by the company voluntarily on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the company's activities. The transaction was not challenged on the ground of fraud. The Supreme Court of India held that the interest paid by the company on its debentures was allowable as expenditure incurred solely for the purpose of earning the company's income, the fact that the transaction resulted in considerable benefit to the principal shareholder being irrelevant. It was further held that in the absence of fraud the questions whether a transaction had the effect of diminishing the assessee's taxable income, whether it was a prudent or wise transaction and whether it was necessary for the assessee to enter into that transaction, were irrelevant in determining whether expenditure relating to that transaction should be allowed under this head. Bose, J., delivering the judgment of the Court, said, "This being an investment company, if it borrowed money and utilised the same for its investments on which it earned income, the interest paid by it on the loans will clearly be a permissible deduction under section 12(2) of the Income-tax Act [1922]. Whether the loan is taken on an overdraft, or is a fixed deposit or on a debenture makes no difference in law.... It cannot be disputed that if the debentures were held by a third party, the interest payable on the same would be an allowable deduction in calculating the total income of the assessee

company. What difference does it make if the holder of the debentures is a shareholder?" (See further the case of *Maharani Janki Khar [1956] 29 I.T.R. 10*)

The expenditure must be incurred *for the purpose of earning the income (Sir Kameshwar Singh v. C.I.T. [1957] 32 I.T.R. 377)*. It is *not* further necessary that "the purpose" should have been fruitful and income should in fact have been earned in the accounting year as a result of that expenditure *(See under s Cl. (xxvii) of sec. 29, "Unremunerative expenditure")*. Interest on moneys borrowed to purchase shares should be allowed as a deduction even if the shares have yielded no dividend in the relevant accounting year *(Ormerods (India) Pr. Ltd. v. C.I.T. [1959] 36 I.T.R. 329)*. Municipal taxes in respect of property from which the income is derived are deductible. Where an assessee is charged on the profits made by letting his house furnished, no deduction can be made in respect of the rent paid by the assessee for accommodation elsewhere during the period of the letting, for such expense has nothing to do with the rent received for the furnished house and besides it would be in the nature of personal expenses of the assessee *(Wylie* v. *Eccott 6 T.C. 128; Smith* v. *Irvine 27 T.C. 381)*. Likewise, no deduction can be allowed from interest earned on deposit, in respect of interest paid on moneys borrowed to pay household expenses or income-tax, even though without such borrowing the assessee would have to withdraw the deposit to pay the expenses or tax. In some cases it has been held that in an assessment in respect of mining rents and royalties, the assessee is not entitled to deduct cesses paid by him on the basis of profits earned *(In re Jyoti Prasad Singh Deo 1 I.T.C. 103)*; but, these cases require reconsideration. But a rate imposed on the annual output of a coal mine, irrespective of any profit being earned, is deductible under this sub-section *(K.M. Selected Coal Co. of Manbhum, In re, 1 I.T.C. 281)*.

The various specific allowances provided in s. 29(i) to (xxvii) cannot be imported wholesale into this section *(C.I.T.* v. *Dharmaraja Nadar [1948] I.T.R. 281 293)*. However, the tax under this head is not upon gross receipts but upon "income" properly so called, and therefore such deductions may be made as are necessary to ascertain the true income *(Probhat Chandra Barua* v. *C.I.T. 5 I.T.C. 1(P.C.)*. Thus in assessing the income from a zamindari under this section, the annual jama or Government revenue should be deducted *(Probhat Chandra Barua* v. *C.I.T. 5 I.T.C. 1(P.C.)*. Where the assessment is in respect of non-agricultural income derived from coal-fields situate in a zamindari, a proportionate part of the jama payable for lands under which the coal-fields are situate should be allowed. Similarly, where a receiver is appointed by the Court of an estate yielding both agricultural and non-agricultural income, a proportionate portion of the receiver's salary should be deducted in computing the non-agricultural income under this section *(Sachindra Mohan Ghosh* v. *C.I.T. 5 I.T.C. 396)*.

Expenditure incurred by a director of a company in defending a suit brought for a declaration that his election to the directorship was invalid was held allowable *(C.I.T.* v. *Sir Purshottamdas Thakurdas 1946 I.T.R. 305)*. A company at the development stage and before it starts carrying on any business cannot claim an allowance under this section in respect of office and establishment expenses against its income assessable as income from other sources *(C.I.T.* v. *Bihar Spg. & Wvg. Mills Ltd. [1953] 24 I.T.R. 108)*. For expenditure ascertained with reference to profits, see

ante under s. 29(xxvii), "Payments out of profits and payments ascertained by reference to profits")

Plant or furniture with buildings – (See note under Cl.(c) of sec. 33 *anti*)

Sub-sec(4)(a): Interest payable abroad–This provision, intended to counteract evasion of tax, is similar to that enacted in section 23(2) wherein it has also been said that no deduction shall be allowed in respect of interest payable outside Bangladesh on which tax has not been paid or deducted in accordance with the provisions of Ch.VII.

(b) Salaries paid without deduction of tax at source–A similar provision is to be found in sec. 30(a) wherein it has also been said that any payment which is classifiable under the head, "salaries" no deduction shall be allowed if tax thereon has not been paid or deducted in accordance with the provisions of Ch. VII.

Sec. 35: Method of accounting.–(1) All income classifiable under the head ["Agricultural income"], "Income from business or profession" or " Income from other sources" shall be computed in accordance with the method of accounting regularly employed by the assessee.

(2) Notwithstanding anything contained in sub-section (1), the Board may, in the case of any business or profession or class of business or profession, or any other source of income, or any class of persons, by a general or special order, direct that the accounts and other documents shall be maintained in such manner and form, and that payments of commercial transactions recorded in such manner, as may be prescribed or as may be specified in such direction; and thereupon the income of the assessee shall be computed on the basis of the accounts maintained, payments made and transactions recorded accordingly.

(3) Without prejudice to the preceding sub-sections, every public or private company as defined in the Companies Act, shall, with the return of income required to be filed under this Ordinance for any income year, furnish a copy of the trading account, profit and loss account and the balance sheet in respect of that income year certified by a chartered accountant.

(4) Where--

(a) no method of accounting has been regularly employed, or if the method employed is such that, in the opinion of the Deputy Commissioner of Taxes, the income of the assessee cannot be properly deduced therefrom; or

(b) in any case to which sub-section (2) applies, the assessee fails to maintain accounts, make payments or

record transactions in the manner directed under that sub-section; or

(c) a company has not complied with the requirements of sub-section(3);

the income of the assessee shall be computed on such basis and in such manner as the Deputy commissioner of Taxes may think fit.

Method of accounting sec. 35. – Section 13 of 1922 Act which corresponds to this section supersedes the decision of the Madras High Court in – *Board of revenue* v. *Arunachalam Chettiar (17 I.T.C. 75)* where interest which had accrued in the year of account to a money-lending firm whose accounts were maintained on the mercantile basis, but which was not realised in cash or by adjustment in the accounts, was held not liable to tax under the old Income-tax Act of 1918. It was said in the judgement that "if the present Act is found to admit of extensive evasion in India, the remedy is to be found in an alternation of the law". In pursuance of the suggestion for "an alteration of the law" sec. 13 was introduced in 1922 Act. As a result of the operation of the section, profit must be computed and taxed under the Act on the accrual basis, irrespective of receipt or realisation, where the method of Accounting warrants such computation.

Assessee free to choose a proper method of accounting–sub-sec.(1). –This section enacts that for the purposes of s. 28 (profits of business, profession or vocation) s. 26 (agricultural income) and s. 33 (income from other sources), income, profits and gains must be computed in accordance with the method of accounting *regularly* employed by the assessee. Excepting sub-sec.(2) where the Board has been given the power to direct that the accounts and other documents shall be maintained in such manner and form and the transactions shall be recorded in such manner as may be prescribed by the Board in the case of any business or profession or class of business or profession or any other source of income or any class of persons and thereupon the income of such assessee shall be computed on the basis of accounts maintained accordingly, the choice of the method of accounting, like the choice of the "income year", lies with the assessee *(B.C.G.A. (Punjab) Ltd.* v. *C.I.T. 1937 I.T.R. 279, 299 (F.B.); Subra manyam Chettiar* v. *C.I.T. 2 I.T.C. 365, 371 (S.B.)*, but the assessee must show that he has followed his chosen method *regularly, (B.C.G.A. [Punjab] Ltd.* v. *C.I.T. 1937 I.T.R. 279 (F.B)*. It was observed in the case of – *Rathna Tea Estate* v. *C.I.T. (H.C. of Dhaka)* reported in 1965 PTD 203, that "the word regularly" has nowhere been explained. So certainly it is no synonymous with the word "perpetual" or "permanent". In our view it seems the intention underlying this expression is that if it appears that the assessee concerned means to adopt the changed method of accounting for the year under assessment as also for subsequent years at the relevant time then it cannot be contended that it would be a departure from the rule underlying the principal clause of sec. 13 (corresponding to sec. 35). The section does not indicate by an express language or by implication that the assessee is not permitted to adopt a changed method of accounting provided he does not mean to adopt such a changed course only for a casual period and he does not mean to evade

collection of taxes ..... If by reason of such changed mode or method of accounting it becomes unintelligible to the Income-tax Officer and if in his opinion the income, profits and gains cannot properly be deduced therefrom then it will be in his discretion to make the computation upon such basis and in such manner as the Income-tax officer may determine. The decision of the Privy Council in the case of *C.I.T. Bombay Presidency* v. *Ahmedabad Cotton Mills Company Ltd. (57 I.A. 21)* does not in our view, lay down that it is not permissible to adopt a changed method of accounting even though it might be bonafide and there might not be any prejudice to the interest of the Department concerned in the matter of collection of taxes ..... Upon a reading of the language of the section, it seems to us that there is no bar against a possible change in the method of accounting provided it does not prejudice the interest of the Department concerned". In another case (*Sarupchand* v. *C.I.T.*) reported in 1991 BTD it has been held that "an assessee is at liberty to alter the regular method of accounting which he employed in the past by abandoning the same and starting a new regular method ..... and not merely a new method for a casual period." Even for the very first accounting period, the method of accounting would be deemed to have been *regularly employed* if the same method is shown to have been employed for the subsequent accounting periods *(Sundaram & Co. Ltd.* v. *C.I.T.* [1959] 36 I.T.R. 162). In the case of *House Building Finance Corporation* v. *C.I.T. (Dhaka)* reported in 1985 BTD xiii 23 it was held that the assessee can switch over from mercantile system to cash system of accounting, but it must be regularly employed by him so as to reflect his correct income. The Department is bound by the assessee's choice of a method regularly employed unless by that method the true income, profits and gains cannot be arrived at. In the leading case of – *C.I.T.* v. *Sarangpur Cotton Mfg. Co. (1938 I.T.R. 36-401)*, Lord Thankerton, delivering the judgment of the Board, said with reference to this section, "Their Lordships are clearly of opinion that the section relates to a method of accounting regularly employed by the assessee for his own purposes–in this case for the purposes of the company's business–and does not relate to a method of making up the statutory return for assessment to income-tax *(Cf. "[The assessee] cannot for the purpose of more conveniently carrying on his own business adpot the mercantile basis and then for the purpose of income-tax assessment adopt the cash basis")*. Secondly, the section clearly makes such a method of accounting a compulsory basis of computation unless in the opinion of the Deputy Commissioner of Taxes, the income, profits and gains cannot properly be deduced therefrom". If the true income, profits and gains cannot be ascertained on the basis of the assessee's method, it would be the duty of the Deputy Commissioner of Taxes to discard the method, wholly or in part, and to adopt a method of his own *(C.I.T.* v. *Maharajadhiraja of Darbhanga* 1933 I.T.R. 94, 100 (P.C.). Where no method of accounting has been regularly employed, the income must be computed upon such basis as the Deputy Commissioner of Taxes may determine(8), but the section does not vest in the assessing officer any arbitrary power to make an assessment in the air. In cases where books of accounts and evidences are not available, past record may be the basis of assessment. These principles have been re-affirmed by the Supreme Court of India in *(C.I.T.* v. *McMillan & Co. ([1958] 33 I.T.R. 182, 188))*. In this section the word "method" must be given a broad and reasonable interpretation.

The method of accounting can affect the computation of income only under the heads of business or profession (s. 28), agriculture income (s. 26), and income from other sources (s. 33). The provisions of this section do not apply to salaries (s. 21), interest on securities (s. 22), income from house property (s. 24) and capital gains (s. 32). Although dividend income is taxable as income from other sources (s. 19(7)), by reason of the provisions of s. 19(7) it is taxable as the income of the year in which it is declared, irrespective of the method of accounting employed by the shareholder *(See Purshotamdas Thakurdas* v. *C.I.T.* [1985] 34 I.T.R. 204).

Different methods of accounting: Charge on accrual, receipt or other basis.–The two main methods of accounting are the cash system and the mercantile system. The distinction between these two systems has been drawn in the Full Bench case, *Dhakeshwar Prasad* v. *C.I.T. (1936* I.T.R. 71, 74*)*, [see also the case of *Morri Industries Ltd.* v. *C.I.T. (1971) 82 I.T.R. 835, 840 (S.C. of India)*] by Sir Courtney Terrell, C.J., in these words: "There are two methods of accounting for the income, profits and gains of a business which are generally referred to as the cash basis and the mercantile basis. According to the former a record is kept of actual receipts and actual payments, entries being made only when money is actually collected or disbursed, and if the profits of the business are accounted for in this way the tax is payable on the difference between the receipts and the disbursements for the period in question. There is, secondly, the mercantile system under which a profit and loss account is maintained. Wherein profits or gains are credited though they are not actually realised and the entries thus made really show nothing more than an accrual or arising of the said profits at the material time. The same is the position with regard to debit entries. In *Keshav Mills Ltd.* v. C.I.T. (1953) 23 I.T.R. 230, 239 the Supreme Court (India) had also noticed and emphasised the fundamental distinction between the two systems of accounting. Again in *C.I.T.* v. *Krishnaswami Mudaliar (1964) 53 I.T.R. 122, 129, 130)* the Supreme Court (India) stated, "whereas under the cash system no account of what are called the outstandings of the business either at the commencement or at the close of the year is taken; according to the mercantile method actual cash receipts during the year and the actual cash outlays during the year are treated during the year in the same way as under the cash system, but to the balance thus arising there is added the amount of the outstandings not collected at the end of the year and from this is deducted the liabilities incurred or accrued but not discharged at the end of the year. At the end of the financial year the assets and liabilities are valued and entered in the account and the difference between the two is the profit upon which the tax is paid. In most cases the debts would be valued as of their face value, that is to say, at the moment at which it is (*sic*) shown as having accrued. Nevertheless the accounting is on a valuation basis and the debts in so far as they are entered in the accounts are considered in the light only of an asset" *(Feroz Shah* v. *C.I.T.* 1933 I.T.R. 219, 225 (P.C.). In another Full Bench case, *C.I.T.* v. *Singari Bai* (1945 I.T.R. 224, 227), Sir Iqbal Ahmad, C.J., examined the scope of this section and described the mercantile system as follows: "The assessee, a professional money-lender, regularly kept her accounts according to what is known as the 'mercantile accountancy system' or the 'book profits system of accountancy' or the 'complete double entry book-keeping'. Under this system the net profit or loss is

calculated after taking into account all the income and all the expenditure relating to the period, whether such income has been actually received or not and whether such expenditure has been actually paid or not. That is to say, the profit computed under this system is the profit actually earned, though not necessarily realised in cash, or the loss computed under this system is the loss actually sustained, though not necessarily paid in cash. The distinguishing feature of this method of accountancy is that it brings into credit what is due immediately it becomes legally due and before it is actually received; and it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed" *(Keshav Mills Ltd.* v. *C.I.T.* [*1953] 23 I.T.R. 230, 239 (S.C. of India)* and *C.I.T.* v. *Krishnaswami Mudaliar [1964] 53 I.T.R. 122, 129, 130)* discussed in the case of *(C.I.T.* v. *Kerala Financial Corporation (reported in 1991 BTD xiv 72).*

But even under the mercantile system, a mere claim by the assessee is not sufficient to make income accrue–the profit must become actually due *(C.I.T.* v. *Jai Parkash Om Parkash Co. Ltd.* [1961] 41 I.T.R. 718); and likewise a mere claim against the assessee is not sufficient to justify a deduction–a liability must definitely arise *(Kanpur Tannery Ltd.* v. *C.I.T. [1958] 34 I.T.R. 863).* If a business liability has definitely arisen in the accounting year, a deduction should be allowed although the liability may have to be discharged at a future date and the cost of discharging it may be indefinite and may have to be estimated *(Calcutta Co. Ltd.* v. *C.I.T. [1959] 37 I.T.R. 1 (S.C. of India)).* Again, if an ascertained enforceable liability has arisen, the fact that the assessee does not intend to discharge it would not affect his right to a deduction under the mercantile system *(Rajarathina Nadar & Sons* v. *C.I.T. [1956] 29 I.T.R. 834).* On the other hand, where the accounts are kept on receipt basis, allowances must be granted in the year of disbursement, irrespective of the question when the liability to pay the same arose. The assessee may even follow a system of accounting under which certain expenses are deductible years after they are incurred and paid *(Gappumal Kanhiyalal* v. *C.I.T. [1961] 42 I.T.R. 446).* In this case the assessee a money lender, incurred certain litigation expenses in connection with the realisation of his business debts during the year 1932 to 1939. He claimed deduction of the entire expenses in the year 1938–39 and the claim was allowed as a bad debt. The assessee again incurred legal expenses during 1939 and 1943 and when the case was finally decided he claimed a deduction of the total expenses in the year 1944-45 though only a sum of Rs. 20 had been spent in that year.

Held, that in keeping with the assessee's regular method of accounting which the department had accepted in the past, the assessee was entitled to a deduction of the entire litigation expenses in the year 1944-45 even though they were not incurred in that year – *Gappumal Kanhailal* v. *C.I.T. [1961] 42 I.T.R. 446.* See further under s. 29, "Expenses and losses claimed should have been incurred in the accounting year".

Under s. 32 of the Sale of Goods Act, 1930, unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions. Therefore, in the absence of a contract to the contrary, under the mercantile system of accounting expenditure on goods should be allowed under s. 29 in the year in which the goods

are delivered to the assessee, though the invoices may be sent by the supplier later *(New Victoria Mills Co.* v. *C.I.T. [1952] 21 I.T.R. 567).*

The computation of income may be made on the basis of the method of accounting regularly adopted by the assessee, even though the method is neither purely cash nor purely mercantile but is hybrid or a mixture of the two methods *(Dhakeshuar Prasad* v. *C.I.T. 1936 I.T.R. 71. (F.B.)).* That the regular method is unscientific or anomalous is immaterial for the purpose of this section which only requires the method to be such that the real income, profits and gains can be properly deduced therefrom. The name by which a method is called is an immaterial consideration, and it is equally immaterial whether the system adopted by the assessee conforms to the requirements of [illegible]wn method of accounting *(Feroz Shah* v. *C.I.T. 1933 I.T.R. 219, 225 (P.C.))*. Conversely, even if the method regularly adopted by the assessee is a well-recognised method of accounting, –it should still be rejected by the Deputy Commissioner of Taxes if it does not afford a true picture of the profits in any one year of charge *(Minister of National Revenue* v. *Anaconda American Brass Ltd. [1956] 30 I.T.R. 84 (P.C.))*.

What Deputy Commissioner of Taxes has to consider is not the system of accounting followed by the assesseee as regards a particular business transaction in respect of which proper entries may not have been made in the regular accounts but the system of accounting generally adopted by the assessee in respect of all his business transactions *(C.I.T.* v. *Jag Sah Muni Lal Sah* 1939 I.T.R. 522, 534). If the Department has accepted the system of assessing interest on the accrued or mercantile basis, it is not entitled to switch over to cash basis in order to tax any interest received subsequently and thereby circumvent the time limit laid down under sec. 34..... The Department can assess or reassess only those items of escaped income in a particular accounting year which relate to that very year – *C.I.T.* v. *Jug Shah Munilal Shah (1939) I.T.R. 522, 534.* Assessee can switch over from mercantile system to cash system of accounting, but it must be regularly employed by him so as to reflect his correct income–*House Building Finance Corporation* v. *C.I.T. (North),* Dhaka–reported in 1985 BTD XIII 23. However, an assessee may employ one method of accounting for one part of his business or one class of customers, and a different method for another part of his business or another class of customers; and if he employs such different methods regularly and consistently, the profits would have to be computed in accordance with the respective methods, provided the result is a proper determination of the true profits. In this connection it may be noted that s. 10(2)(xi) of the 1992 Act (which granted an allowance in respect of bad debts and corresponded to the present s. 29(xvi) clearly contemplated accounts in respect of different parts of the same business being kept on different bases.

A firm cannot claim to be assessed on the aggregate of the amounts drawn by the partners in a year out of the firm's profits, as representing the firm's professional or business income in that year. "Withdrawals" by partners is not a method of keeping accounts within the meaning of this section, and the fact that a firm had been assessed in past years on the footing of such withdrawals in each year

cannot make it "a method of accounting regularly employed by the assessee" *(Motichand & Devidas 1946 I.T.R. 534, 542).*

Under s. 17 profits are chargeable when they *accrue* or *arise* or are *received.* The effect of this section is that the assessee's choice of the system of accounting determines whether profits are to be actually charged when they accrue or when they are received or at some other point of time *(Fatehchand Chhakodilal* v. *C.I.T. 1945 I.T.R. 198. Cf.).* If the assessee's accounts are kept on the *mercantile* basis, the income would be taxable when it *accrues* or is earned, irrespective of receipt *(C.I.T.* v. *Thiagaraja Chetty & Co. [1953] 24 I.T.R. 525 (S.C. of India)),* the charge being on the net "book profits" *(Shiva Prasad Gupta* v. *C.I.T.* 3 *I.T.C. 406, 415).* Even if a certain amount of income earned is not likely to be realised, it should nevertheless be included in accounts maintained on the mercantile basis, though it may be open to the assessee in such a case to claim, under s. 29(xvi & xvii), an allowance in respect of the same amount as a bad debt *(Ramkumar Kedarnath* v. *C.I.T.* ibid.). On the other hand, if the accounts are maintained on the *cash* basis, income would be chargeable only if it is *received* in the accounting year *(C.I.T.* v. *Maharajadhiraja of Darbhanga* 1933 I.T.R. 94 100-1 (P.C.)). Under the cash system, income when received may attract tax even if the source of the income has ceased to exist at the time of the receipt, and all admissible expenditure must be allowed in the year in which it is actually disbursed, irrespective of the question when the liability to pay the same arose.

If an assessee has been taxed in respect of "book profits" which have accrued but have not been received, he cannot be taxed on the same sums of money when they are actually received in a later year of assessment. A man cannot be taxed twice over in respect of the same income *(C.I.T.* v. *Mutha Sarvarayudu* 2 I.T.C. 208).

Disputed claims by or against assessee.–Even under a mercantile system, a mere claim by the assessee is not sufficient to make income accrue–the profit must become actually due (sec. 17 – "Date of accrual of business profits"); and likewise a mere claim against the assessee is not sufficient to justify a deduction – a liability must definitely arise – *C.I.T.* v. *Swadeshed Cotton and Fiom Mills Ltd.* 53 I.T.R. 134 (S.C. of India).

Receipts and expenses carried to suspense account. –Under some *hybrid* systems of book-keeping, income is chargeable when it *arises*, i.e., when the method of accounting shows it in the shape of profits and gains (which may be some years after the income has accrued and has been received). An assessee may hold all or some of his realisations in suspense and show them in the accounts as income or profit in a later year; in which event the amounts would be chargeable in such subsequent year in which the final impress of profit is so to speak, stamped upon them(14). Likewise, an assessee may keep legal expenses in a suspense account and follow the regular method of claiming them as deductions in the year in which the litigation ends *(Gappumal Kanhiyalal* v. *C.I.T.* [1961] 42 I.T.R. 446). In *C.I.T.* v. *Maharajadhiraja of Darbhanga (*1933 I.T.R. 94*)*, and in *C.I.T.* v. *Kmeshwar Singh* 1 I.T.R. 92, the assessee entered into money-lending transactions, and kept a deposit register in which payments made by debtors were recorded but without any allocation

between principal and interest. Subsequently, if and when allocation was made, an entry in respect of the interest portion of such payments was made in the interest ledger as well as in the interest account of the general ledger. This allocation was made, not necessarily in the year in which the money was actually received by the assessee, but sometimes in the following year and sometimes several years later. In the relevant assessment year the Income-tax Officer took first the amount which was allocated to interest and credited in the interest register in the previous year and which had not borne tax: he next examined the deposit register and in the case of sums there shown as received in the previous year but from which no allocation had been made to interest account, he himself calculated the proportion of each receipt which represented interest and added the result to the figure obtained from the interest register. The Privy Council upheld the assessment. "What the Officer is directed to compute is not the assessee's receipts but the assessee's income *(Probhat Chandra Barua* v. *C.I.T.* 5 I.T.C. 1, 5 (P.C.)) and in *dubio* what the assessee himself chooses to treat as income may well be taken to be income and to arise when he so chooses to treat it....Their Lordships see nothing contrary to principle in the computation of an assessee's total income for a particular year as consisting in part of actual receipts in that year and in part of sums carried by the assessee to income account in that year out of the receipts of previous years which have been held in suspense and no part of which has previously been returned as income".

But it is only where, according to the system of accounting adopted by the assessee, allocations are made not in the year when the amount is received but in a later year that the income so allocated may be taxed as the income of such later year *(Ratanchand Lallumal,* In re, 1936 I.T.R. 189, 200). Under the pure mercantile system, income can be taxed only as the income of the year of accrual, and under the pure cash system only as the income of the year of receipt. The mere fact that certain income has escaped tax in the relevant assessment year, because of a device adopted by the assessee or otherwise, does not entitle the Revenue to assess the same *as the income of any subsequent year* when the mistake becomes apparent *(C.I.T.* v. *Jug Sah Muni Lal Sah* 1939 I.T.R. 522). In this case it was also held that under sec. 34 the Department can assess or reassess only those items of escaped income in a particular accounting year which relate to that very year. (See further under s. 16, "Each year is a separate, self-contained period") Similarly, income would be held to accrue despite the fact that the debtor by whom the amount of income is payable carries the amount to a suspense account or withholds payment on account of a pending dispute. Likewise, an assessee who maintains his accounts on the mercantile or cash basis cannot, generally speaking, escape tax by carrying profits which have accrued or been received to a suspense account *(Kamakhya Narain Singh* v. *C.I.T.* 1942 I.T.R. 177); though in the special circumstances of a case an assessee may be permitted to carry a part of his receipts to reserve and exclude it from the computation of profits.

In another case, *C.I.T., Kerala* v. *Kerala Financial Corporation (reported)* in 1991 BTD xiv 53-86) the Kerala High Court after discussing a number of case decisions came to the conclusion that, "real income did arise on the dates on which the interest became due, and according to the system of accounting regularly maintained by the assessee during the relevant years, such income became assessable

to tax. Neither the Circular of the Reserve Bank of India nor the letter of the Board to the Government of Hariana saved such income from being taxed". The facts of the case were that the Financial Corporation that followed mercantile system of accounting did not receive interest for more than three years, the interest that accrued but not received was transferred to suspense account under advice from Reserve Bank of India, the object of advice was to prevent profits being shown at unduly inflated rate. The system of accounting was not changed during the year. Interest accrued was thus chargeable to tax.

In the course of the discussion the decision of the Supreme Court (India) in the case of *C.I.T.* v. *Shoorji Vallabhdas & Co.* (1962) 46 I.T.R. 144, 148 wherein the observation if Hidayatullah, J. was quoted which runs as, "No doubt, the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be tax, even though in book-keeping, an entry is made about a 'hypothetical income' which does not materialise ..... where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might in certain circumstances has been made in the books of account. A mere book-keeping entry cannot be income unless income has actually resulted". (See below "method of accounting cannot affect ambit of taxation".

Method of accounting cannot affect ambit of taxation.–Under this section the assessee's regular method of accounting determines the mode of *computing* the taxable income but it does not determine or even affect the range of taxable income or the *ambit of taxation* – *C.I.T.* v. *Krishna Swami Mudaliar* 53, I.T.R. 122, 128 (S.C. of India). The provision for computation of income contained in this section cannot derogate from the provisions of the charging section. In other words, the charge on income accruing or received in Bangladesh, imposed by s. 17, cannot be avoided by any method of accounting. This proposition is of particular significance in the case of non-residents who might be assessable in respect of stray items of income accruing or received in Bangladesh. The chargeability of income received in Bangladesh cannot be escaped by a non-resident on the ground that his regular method of accounting is mercantile *(Keshav Mills Ltd.* v. *C.I.T.* [1953] 23 I.T.R. 230 (S.C. of India)), nor can the chargeability of income accruing in Bangladesh be escaped on the ground that he maintains his accounts on the cash system.

Casual departure from regular method of accounting not permitted.– The Deputy Commissioner of Taxes, even where he accepts the assessee's method of accounting, is not bound by the figure of profits shown in the accounts *(C.I.T.* v. *McMillan & Co.* [1958] 33 I.T.R. 182, 187 (S.C.)). The assessee cannot escape liability to tax by omitting to make an entry or making a wrong entry in the accounts. The date of taxability of income is the date when the appropriate entries are made or should be made in the accounts in accordance with the method of accounting regularly employed by the assessee – *C.I.T.* v. *Kmeshawar Singh* 1 I.T.R. 94, 101 (P.C.). The substantive part of the section makes it clear that the income is to be computed "*in accordance with* the method of accounting regularly employed". The

Deputy Commissioner of Taxes may include in the computation of income an amount which does not figure in the accounts but the inclusion of which is required by the assessee's method of accounting; that is to say, the Deputy Commissioner of Taxes may, without deviating from the assessee's method, make such adjustments in the profit and loss account as are necessary for giving full and true effect to that method itself *(C.I.T.* v. *Singari Bai* 1945 I.T.R. 224, 239 (F.B)). Having adopted a regular method of accounting, the assessee cannot be allowed to change it or depart from it for a particular year or for part of the year or in respect of particular transactions *(Feroz Shah* v. *C.I.T.* 1933 I.T.R. 219 (P.C.)). The burden of proving that there has been a change in the method of accounting is on the Department *(Ramswarup Bengalimal* v. *C.I.T.* [1954] 25 I.T.R. 17). The assessee's departure from his own regular method cannot be justified on the ground that a similar departure in a prior year had been made by the assessee without any protest on behalf of the Department *(B.C.G.A. (Punjab) Ltd.* v. *C.I.T.* 1937 I.T.R. 279, 298-9 (F.B.)). Likewise, if the Income-tax authorities have accepted the assessee's system of accounting and taxed him on that basis for a number of years, they cannot suddenly seek to tax him on a different basis in a particular year *(Bansilal Abirchand* v. *C.I.T.* 3 I.T.C. 57). For instance, where an assessee who had adopted the mercantile system of accounting had been taxed for several years on the accrual basis, it was held that it was not open to the Department to turn round and tax him on the cash basis in the year in which he received some income which had escaped tax in the year of accrual, so as to get over the period of limitation prescribed for assessment of income which had escaped tax *(C.I.T.* v. *Jug Sun Muni Lal Sah* 1939 I.T.R. 522). (See also the note under "Different Methods of Accounting").

Bona fide change of method.–*Sarupchand* v. *C.I.T. (1936 I.T.R. 420)* and *Indo-Commercial Bank Ltd.* v. *C.I.T.* ([1962] 44 I.T.R. 22) are authorities for the proposition that it is open to an assessee to make a clean change of the regular method adopted by him up to that time, provided he satisfies the Department on proper evidence that he has in fact changed the regular basis of accounting and has not merely abandoned or changed it for a casual period to suit his own purposes (In re *Chouthmal Golapchand* 1938 I.T.R. 733). A *bona fide* change of the regular basis of accounting must be accepted by the Department and may be given effect to on such terms as may be necessary for preventing escape from taxation. (See also the case of H.B.F.C. under *note* in "Assessee free to choose a proper method of accounting). But even *bona fide* changes, if too frequent, would disentitle the assessee to have his yearly income computed in accordance with his own changing methods, and would justify an assessment under sub.s. 4(b); for the assessee's method of accounting prevails only if it has been regularly employed. "The intention of the legislature in enacting section 13 [of the 1922 Act] was that for income-tax purposes the assessee should be entitled to make use of any method of accounting that he chooses to adopt, but he must follow the selected method 'regularly', and is not to be allowed to change his system of book-keeping from year to year or so frequently as to prevent a fair estimate of his income, profits and gains *de anno in annum* from being ascertained" *(C.I.T.* v. *P.L.S.M. Concern* 1934 I.T.R. 417, 420 (F.B.). The Income-tax Officer's

refusal to accept the new method adopted by the assessee may be questioned on an appeal to the superior authorities *(Sarupchand* v. *C.I.T.* 1936 I.T.R. 420, 423*)*.

Computation of business profits.–Lord Justice Moulton said in Re *Spanish Prospecting Co. Ltd.(15)*, "'Profits' implies a comparison between the state of a business at two specific dates usually separated by an interval of a year. The fundamental meaning is the amount of gain made by the business during the year. This can only be ascertained by a comparison of the assets of the business at the two dates." These observations have been frequently cited and relied upon *(See E.D. Sasson & Co. Ltd.* v. *C.I.T.* [1954] 26 I.T.R. 27, 46-7 (S.C. of India). But as the House of Lords pointed out in *Naval Colliery co. Ltd.* v. *I.R.*(12 T.C. 1017, 1047), the principle stated by Lord Moulton, which may have application in certain cases, cannot be universally applied and, indeed, it needs material modification (See also *Board of Revenue* v. *Arunachalam Chettiar* 1 I.T.C. 75 (F.B.)). Lord Moulton himself pointed out that the rule ceases to apply where the rights of the revenue are involved. For the purposes of the Income-tax Act, it would be more accurate to say that the businessman pays on what he gets less the current expenses for getting it and the proper statutory allowances (*Alianza Co. Ltd* v. *Bell* [1904] 2 K.B. 666, 671).

In *British South Africa Co.* v. *C.I.T.* (1946 I.T.R. Suppl. 17 (P.C.)), the assessee company, which traded in mining rights and concessions, acquired numerous mining rights and concessions over various territories together for a lump sum, and realised some of them in the accounting year. The profits on the realisation, arrived at by deducting an appropriate amount for the cost of acquisition from the sale-proceeds, was held to be taxable as business income. Viscount Simon, delivering the judgment of the Board, said that the fact that it was impossible to allocate any part of the cost to any one or any block of the individual trading assets which had been acquired by the company together, did not in law entitle the company to have the assessment of its profits postponed until the whole of the unrecouped balance of expenditure had been made good and thereafter to have all receipts assessed in full. From the point of view of accountancy there might be no other way of finding the company's ultimate profit and equally it might be a convenient arrangement if the taxing authority chose to adopt it, but it was impossible to find support for it in terms of the statute under the income of a particular year should be ascertained by applying the relevant statutory provisions as best they could be applied. Likewise, the Patna High Court held in *Sukhdeodas Jalan* v. *C.I.T.* (1954 26 I.T.R. 617) that in the case of a contractor, the profits may be determined each year though the contract may take several years to be completed and payments there-under may also be received by the assessee in several years.

Profits of an isolated venture.–In the case of a single venture in the nature of trade, the question of assessing profits would, as a general rule, arise only when the venture comes to an end or the entire cost is recouped. See *ante* under "Single transaction".

Profits of trade in land and building. –In *Calcutta Co. Ltd.* v. *C.I.T* ([1959] 37 I.T.R. 1) the Supreme Court held that a dealer in land who sells plots in pursuance of a development scheme is, under the mercantile system of accounting,

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entitled to deduct from the sale proceeds an estimated amount of expenditure to be incurred in future in discharge of a definite liability incurred under the contract of sale.

Opening value of stock-in-trade: Cost of acquisition. –No gain or profit can be said to arise unless and until a balance is struck between the cost of acquisition and the proceeds of sale *(British South Africa Co.* v. *C.I.T.* 1946 I.T.R. Suppl. 17 (P.C.)). When stock-in-trade is purchased and brought in, the proper figure to be debited in the accounts is the actual cost of the stock to the assessee even though the ordinary market price at the time of the purchase might have been lower or higher. In *Craddock* v. *Zevo Finance Co. Ltd. (27 T.C. 267, 287 (H.L.))*, Viscount Simon said, "The profit or loss to a trader in dealing with his stock-in-trade is arrived at for income-tax purposes by comparing what his stock in fact cost him with what he in fact realised on resale. It is unsound to substitute alleged market values for what it in fact cost him." In that case, the assessee, an investment dealing company, was formed to take over the speculative investments of another company which went into voluntary liquidation with a view to a reconstruction. The investments were purchased by the assessee company at their cost price to the old company, which was much above the market value prevailing at the time of the purchase by the assessee company. The consideration was satisfied by the assessee company undertaking to discharge certain liabilities of the old company and by the allotment of its share capital as fully paid to the shareholders of the old company. The House of Lords held that the transaction being a *bona fide* and genuine bargain, the assessee company was entitled to debit the agreed purchase price as the cost of the investments, and the Department was not entitled to substitute a different figure alleged to represent the market value of the investments at the time of purchase. Lord Greene, M.R., whose judgment was confirmed by the House of Lords, said, "It is, I think, true as a general proposition that where a company acquires property for fully paid shares of its own, the price paid by the company is, *prima facie*, the nominal value of the shares". But different considerations apply where assets which a company proposes to acquire for shares are deliberately overvalued for the purpose of issuing an inflated amount of share capital or issuing shares at a discount. In *Murphy* v. *Australian Machinery & Investment Co. Ltd.*(7) the assessee company sold mining interests to a number of other companies which were formed for the purpose, in consideration of those companies allotting their fully paid shares to the assessee company. The aggregate face value of such shares was a deliberately inflated figure far in excess of the true value of the mining interests. The assessee company afterwards sold those shares. The Court of Appeal held that, in computing the assessable profits of the company from the sale of shares, the amount to be deducted as the cost of the shares to the assessee company was not their par value but the true value of the mining interests at the time of their sale to the other companies.

Difficulty may arise in determining the cost of particular items of stock where numerous varieties of assets are bought for a lump sum or the consideration for the purchase does not consist of only a definite amount. In *British South Africa Co.'s* case (1946 I.T.R. Suppl. 17 (P.C.)) which has been noted above, numerous items of stock-in-trade were purchased for a lump sum and the Privy Council held that the

Department should disintegrate the cost of acquisition and apportion it properly and reasonably among the various items. As Viscount Simon said in *Gold Coast Selection Trust Ltd.* v. *Humphrey (1949 I.T.R. Suppl. 19, 26-27 (H.L.))*, "if the asset is difficult to value but is none the less of a money value, the best valuation possible must be made. Valuation is an art, not an exact science. Mathematical certainty is not demanded, nor indeed is it possible." In *Osborne* v. *Steel Barrel Co. Ltd.* the assessee company acquired stock-in-trade along with capital assets for a lump sum paid partly in cash and partly by the allotment of its shares as fully paid to the vendor. The Court of Appeal held that it was for the Department to apportion the consideration and allocate a part of it to the stock-in-trade, taking the par value of the shares as part of the price paid by the company. It was further held that in the absence of any evidence as to the value of the capital assets or that the aggregate value of the assets exceeded the total price paid, the Department was justified in proceeding on the footing that the value of the assets acquired by the company was no more than what it paid for them and accordingly taking the market value of the stock as *prima facie* its cost to the company. In *J. & M. Craig (Kilmarnock) Ltd.* v. *Cowperthwaite (13 T.C. 627)* the consideration paid by the assessee for the purchase of stock-in-trade and fixed assets of a going concern included, in addition to a sum of cash, a convenant for indemnity in respect of unascertained liabilities of the vendors. To make provision for the liabilities which were indefinite as to amount and which were part of the cost of acquisition to the assessee, the assessee was permitted, having regard to the special facts of the case, to write up the original arbitrary valuation of the stock to the estimated market value. In *Bennett, Oswald & Worskett* v. *Bennet (21 T.C. 209)* the assessees, who carried on the trade of builders and land developers, bought a plot of land for the expressed purchase price of £15,000. Under the agreement of purchase they further undertook to pay the son of the vendor a *minimum* sum of £25,000 as and when they resold the whole of the land. It was held that the cost of acquisition to the assessees was £40,000.

Cost where "right" shares or bonus shares are issued.—In *Dhun Dababhoy Kapadia* v. *C.I.T.* ([1963] 48 I.T.R. 882) the Bombay High Court held that where a company resolves to issue new shares and offers them to the existing shareholders, and a shareholder sells his right to apply for the new shares, in computing the taxable profits the cost should be taken as nil: the value of such right according to accountancy principles or the depreciation in the value of the existing shares should not be deducted from the sale proceeds. The Allahabad High Court has likewise held that when bonus shares held as stock-in-trade are sold, their cost must be taken as nil and hence the entire sale proceeds should be treated as business profits *(Motilal* v. *C.I.T.* [1961] 41 I.T.R. 382). On the other hand, the Patna High Court has held that in such a case the face value of the bonus shares should be taken as their cost *(Dalmia Investment Co. Ltd.* v. *C.I.T.* [1961] 41 I.T.R. 705). This point was left open by the Supreme Court in *Emerald & Co. Ltd.* v. *C.I.T.*([1959] 36 I.T.R. 257) where it was held that if an assessee sells the original shares which had been purchased by him and retains the bonus shares, the profit or loss should be computed by deducting the purchase price of those shares from their sale price, ignoring the bonus shares altogether, and not by averaging the cost of all the shares.

Capital investments converted into stock-in-trade.–Where an investor converts his capital assets into stock-in-trade and starts dealing in them, the taxable profit on the sales must be determined by deducting from the sale proceeds the *market value* of the assets at the *date of their conversion* into stock-in-trade (since that is the cost to the business) and not the original cost to the investor *(C.I.T.* v. *Shirinbai Kooka* [1962] 46 I.T.R. 86 (S.C. of India)). Thus the heirs of a deceased businessman inheriting his stock-in-trade and commencing their own new business with it, would be entitled to value their opening stock at its market value at the commencement of their business *(C.I.T.* v. *Appu chettiar* [1962] 45 I.T.R. 152*)*. (Cf. "Valuation of stock withdrawn from business").

Valuation of trading stock in hand at cost or market value. –Whatever may be the method of accounting, whether cash or mercantile, it would be impossible to assess the true profits without taking into account the value of the stock-in-trade at the beginning and at the end of the year –*C.I.T.* v. *Krishnaswami Mudaliar* 53 I.T.R. 122, 132 (S.C. of India).

The value of the unsold stock-in-trade in hand is an essential item in the computation of the profits or losses for a period *(Chainrup Sampatram* v. *C.I.T.* [1953] 24 I.T.R. 481, 487 (S.C. of India)). The reason is that profits may exist in kind as well as in cash and realisation may be only the conversion of profits in kind into profits in cash(23*)*. But, as the Supreme Court pointed out in *Chainrup Sampatram* v. *C.I.T.*(24), it is a misconception to think that any profit arises out of the valuation of the closing stockas the "source" of the profit or that the situs of its arising or accrual is where the valuation is made. Stock which the assessee has contracted to purchase and which might have been appropriated to the contract but the property in which has not passed to the assessee, cannot be regarded as the assessee's trading stock "in hand" and should not, as a general rule, be valued in the accounts as such *(Benjamin Smith & Son* v. *I.R.* 139 L.T. 97 (H.L.).

It is well established, that, on general principles of commercial accounting, in the profit and loss account of a merchant's or manufacturer's business, the values of the trading stock in hand at the beginning and at the end of the accounting year should be entered at cost or market value, whichever is lower *(Chainrup Sampatram* v. *C.I.T.* [1953] 24 I.T.R. 481 (S.C. of India), –the market value being ascertained as at the close of the accounting year and not as at any intermediate date between the commencement and the close of the year *(Asher Textiles Ltd.* v. *C.I.T.* [1952] 22 I.T.R. 125), and the cost being either the actual cost of the closing stock or the average cost of the stocks purchased *(Minister of National Revenue* v. *Anaconda American Brass Ltd.* [1956] 30 I.T.R. 84 (P.C.). This rule is obviously intended to be in favour of the trader and enables him to distribute his loss more evenly *(Ramswarup Bengalimal* v. *C.I.T. [1954] 25 I.T.R. 17, 24)*. It is to be observed that allowing the assessee to write down the stock when market value is lower than cost is in effect the allowance of a reserve for future unrealised loss and as such is an exception to the general rule that a precautionary reserve for anticipated loss is not allowable and no unrealised loss can be set off against the profits of the accounting period *(Chainrup Sampatram* v. *C.I.T.* [1953] 24 I.T.R. 481, 485 (S.C. of India)). But whereas the

assessee can thus get an allowance in respect of future unrealised loss, the Department is not entitled, by putting on the stock the market value where it exceeds cost, to bring in and charge the unrealised notional profit *(Chainrup Sampatram* v. *C.I.T. [1953] 24 I.T.R. 481, 485 (S.C. of India))*, unless the assessee's regular basis of valuation is market rate throughout.

The assessee is not bound to adopt either the average cost for all the items or the market rate for all the items of the stock-in-trade: he is entitled to adopt regularly the lower figure for *each item taken separately*. In *C.I.T.* v. *Chari & Ram* (1949 I.T.R. 1.) the assessees were dealers in dyestuffs and chemicals comprising numerous items. In valuing their opening and closing stock, *the method regularly employed* by them was to take the average cost or market value, whichever was lower, in respect of each separate item of the stock. For the relevant period the average cost of the opening stock was in respect of all the items lower than the market rate and so the assessees valued the entire opening stock on the average cost basis. At the time of valuing the closing stock, with regard to some of the items the market rate was lower, and with regard to the other items it was higher, than the average cost. Therefore in valuing the closing stock the assessees took the average cost for those items of which the cost was lower than the market rate and adopted the market rate for the other items of which the market rate was lower than the average cost. Held, the assessee's basis of valuation, which was in accordance with their regular method of accounting, should be accepted by the Department.

Under this section the assessee is free to adopt his own method of accounting, and instead of valuing the stock at cost or market price, whichever is lower, the assessee may regularly employ the method of valuing it only at cost both at the beginning and at the end on every year, irrespective of fluctuations in the market value–*Investment Ltd.* v. C.I.T., I.T.R. 533, 538 (S.C. of India), or always at the market rate irrespective of the question whether it is higher than cost.

To value the closing stock of a year at the same figure as the opening stock of that year, irrespective of the cost or market value at the close of that year, is not a proper method of accounting *(Asher Textiles Ltd.* v. *C.I.T. [1952] 22 I.T.R. 125)*. On the other hand, it is obvious that the closing stock of a year is the opening stock of the next year; and the valuation placed by the assessee upon his closing stock of a year should be adopted by him as the valuation of the opening stock of the next year *(Chouthmal Golapchand* 1938 I.T.R. 733, 743). In *C.I.T.* v. *Chengalvaraya chetty*, an assessee, who had valued his closing stock in hand in a certain year at the market price as being lower than the cost, was held not entitled to take the cost price of the same stock as the value of the opening stock of the next year but bound to adopt the market price on the basis of which he had been assessed in the preceding year. To hold otherwise would be to permit the assessee to debit himself over again with the same anticipated loss on the same goods for perhaps a number of years *(C.I.T.* v. *Chengalvaraya Chetty* 2 I.T.C. 14, 19). But if the closing stock of the year next preceding the relevant accounting year has been undervalued, the Deputy Commissioner of Taxes may rectify the mistake by placing a proper valuation upon

the stock at the beginning of the relevant accounting year – *(Ahmedabad New Cotton Mills* v. *C.I.T.* 3 I.T.C. 91, 101, 105, affirmed 4 I.T.C. 245 (P.C.).

Even if the method of valuation adopted by the assessee is a well recognised method of accounting for the corporate purposes of a trading company.–e.g. the last-in-first-out method or the "base stock system",–it should still be rejected by the Deputy Commissioner of Taxes if it does not afford a true picture of the profits in any one year of charge *(Minister of National Revenue* v. *Anaconda American Brass Ltd.* [1956] 30 I.T.R. 84 (P.C.)).

Valuation of work in progress. –Direct cost and on-cost methods. –The value of work in progress may be arrived at by the direct cost method under which the cost of direct materials and labour are alone taken into account, or by the on-cost method under which a proportion of indirect expenditure, i.e. factory and office expenses, is added to the direct cost. In *Duple Motor Bodies Ltd.* v. *Ostime* the House of Lords held that, generally speaking, a company which employs the direct cost method cannot be compelled to change to the on-cost method, but that there is no universal rule and in the special circumstances of a case work-in-progress may be valued at a figure higher or even lower than that arrived at by the direct cost method.

Regular basis of valuation must be adhered to.–Under this section the assessee is free to adopt his own method of accounting, and instead of valuing the stock at cost or market price, whichever is lower, the assessee may regularly employ the method of valuing it only at cost both at the beginning and at the end of every year, irrespective of fluctuations in the market value, or always at the market rate irrespective of the question whether it is higher than cost. Whichever basis of valuation is adopted, it must be adhered to consistently: casual departure from the regular basis of valuation cannot be permitted (*C.I.T.* v. *Visweswardas Gokuldas* 1946 I.T.R. 110). "The one thing that is essential is that there should be a definite method of valuation adopted which should be carried through from year to year, so that in case of any deviation from strict market values in the entry of the stock at the close of one year it will be rectified by the accounts in the next year". The onus of proving that the regular basis of valuation has been departed from is on the Department (*Ramswarup Bengalimal* v. *C.I.T.* [1954] 25 I.T.R. 17, 22, 26). But it is open to an assessee to make a clean change of the regular method of valuation (*Indo-Commercial Bank Ltd.* v. *C.I.T.* [1962] 44 I.T.R. 22). Likewise, it is open to the revenue to reject a basis of valuation which had been accepted by it consistently in the past, provided there are overriding reasons for effecting a change–*BSC Footwear Ltd.* v. *Ridgway* 47 TC 495 (H.L.) 83 I.T.R. 269.

Valuation of stock withdrawn from business.–In *Sir Kikabhai Premchand* v. *C.I.T.* ([1953 24 I.T.R. 506) the Supreme Court of India held that if the stock-in-trade was entered in the accounts at cost and carried forward from year to year at cost, it must be taken out of the accounts also at cost when it is withdrawn from the business *(Chouthmal Golapchand* 1938 I.T.R. 733*)*. The contrary view of the House of Lords in the case of *Sherkey* v. *Wernher* is not applicable here. In that case it was held that where an assessee withdrew some horses from his business of running a stud farm and used them for his non-taxable activity of racing as a recreation, the amount

to be brought into the accounts of the business was not the cost of breeding the horses but their market value. (See below "sale at price below market value and capital investments converted into stock-in-trade")

Sale at price below market rate.–Where goods are sold at less than their market value, in the absence of evidence to show either that the sales were sham transactions or that the market prices were in fact paid by the purchases, the mere fact that the goods were sold at a concessional rate to benefit the purchasers at the expense of the vendor does not entitle the Department to assess the difference between the market price and the price paid by the purchasers, as the income of the vendor–*C.I.T.* v. *Raman & Co.* 67 I.T.R. 11, 17 (S.C. of India). "The law does not oblige a trader to make the maximum profit that he can out of his trading transactions". However, when there is a sale at a gross undervalue by a company to an associated company, the revenue is entitled to find that it is not a transaction made in the course of trade and therefore disallow the resulting loss as not being a business loss; but the vendor company cannot be assessed on the notional profit which it did not make but could have made by effecting the sale at the market value (Sec. *ante* "Valuation of stock withdrawn from business") –The decisions to the contrary in *Petrolin Securities Ltd.* v. *Ayres* 41 I.T.C. 389 (C.A.) which follow *Sharkey* v. *Wernher* 36 T.C. are not applicable here.

Undervaluation or arbitrary valuation.–Arbitrary valuation of stock, regardless of the cost or market value, must be rejected as an improper method of accounting even if it is adopted by the assessee uniformly year after year *(Chhaoni Lal Pragdas* v. *C.I.T.* [1957] 31 I.T.R. 597*)*.The assessee may value his stock-in-trade either at cost or at market rate; but he is not entitled to value it below both. In cases of under-valuation, the Deputy Commissioner of Taxes should reject that part of the assessee's method and proceed to compute the income on the basis of a proper valuation in exercise of his powers under sec. 4(a) – *(C.I.T.* v. *Achrulal* 1938 I.T.R. 255*)*. In *C.I.T.* v. *Sarangpur cotton Mfg. Co.*(1938 I.T.R. 36) the assessees had for years past adopted regularly the method of valuation of stocks by taking some price well below both cost and market price and they followed this method in the relevant accounting year. The object of the strident undervaluation was the creation of a "secret reserve" which involved the retention of profits so as not to be included in the profits shown to the shareholders by the profit and loss account and the balance sheet, but which constituted part of the taxable profits. The Income-tax Officer, without applying his mind to the question whether the true profits could be deduced from the method of accounting regularly employed by the assessees, accepted the accounts and held the assessees bound by the figure of profit shown in the accounts. The Privy Council held that the profit shown in the profit and loss account and the balance sheet was not the true figure for income-tax purposes. "The Income-tax Officer could not reasonably conclude that the true profits could be properly deduced from a gross undervaluation".

Where the opening as well as the closing stock for the year is undervalued, the Deputy Commissioner of Taxes should not revalue the closing stock only at its true value, while declining to revalue the opening stock also on the same basis, for,

obviously, proper valuation at one end and undervaluation at the other would not disclose the true profits of the year *(C.I.T. v. Ahmedabad New Cotton Mills Co. Ltd.* 4 I.T.C. 245 (P.C.)).

Sub-sec.(2): Board's power to determine the manner in maintaining accounts–Although the assessee is free to choose his own method of accounting for the purpose of profits and gains from busines or profession or from agriculture or income from Other Sources but his right to make choice of the method of accounting has to some extent been curtailed by the provisions of sub-section(2) of this section. Under this sub-section the Board has been given the power to direct the manner in which the accounts and documents shall be maintained and in which way and form the commercial transactions of receipts and payments shall be recorded. In accordance with the provisions of this sub-section the Board has prescribed in Rule 8 the manner in which the professional persons, like doctors, legal practitioners (including income-tax practitioners), accountants, auditors, architects and engineers shall record receipts and payments in the form prescribed by the Board. Likewise, the Board has under Rule 30, 31 and 32 has prescribed the mode of disintegration of income when such income is the combined income from agricultural produce and manufacturing process. Where the assessee fails to maintain accounts or to record transactions in the manner as directed by the Board the DCT shall in such cases compute income in such manner as he thinks fit- sub-section. 4(b). The Board's power to direct the method of accounting to be followed by the assessee will, however, be applicable only in the computation of income from particular business or any other source or of specified persons and this power of the Board shall not in any way injure the right of the assessee in general to make choice of the method of accounting freely to be followed in computing his income following such method regularly.

Sub-sec.(3): Maintenance of accounts by companies.–An assessee may maintain accounts which may be incorrect or incomplete or he may not maintain any accounts but companies, public or private as defined in the Companies Act, 1913 or 1994 shall have to maintain accounts which will be audited by the Chartered Accountants and a copy of the trading account, profit and loss account and balance sheet as audited and certified by the Chartered Accountants shall accompany the return to be filed under sec. 75 or 78. In the case of partnership firm also the maintenance of accounts is not prerequisite to determine the genuineness of the firm. Where the assessee excepting companies does not maintain any books of accounts the Deputy Commissioner of Taxes may compute the income on such basis as he thinks proper or at a flat rate but in that case the DCT shall exercise his judgement reasonably and judicially, and the assessee cannot be compelled to maintain regular books of accounts. The assessees, as referred to in Rule 8, e.g. doctors, lawyers etc. are to follow the instructions of the Board as to how the receipts and payments and other commercial transactions are to be recorded in a manner as prescribed in the rule.

Sub-sec.(4): Power of Deputy Commissioner of Taxes to compute profits on his own basis. –This sub-section provides that (a) where no method of accounting has been regularly employed by the assessee or (b) no accounts, as required by sub-section (2) have been maintained, the Deputy Commissioner of Taxes shall make his

own estimate of profits. But nothing has been mentioned about a case where the accounts, as maintained, are correct and complete but the method employed is such that income profits and gains cannot properly be deduced therefrom, but even in that case also the Deputy Commissioner of Taxes is bound to compute the income upon a basis and in a manner determined by himself–*C.I.T.* v. *Mudaliar* 53 I.T.R. 122 (S.C. of India).

The assessee's method of accounting prevails and precludes the Deputy Commissioner of Taxes from computing the profits only if it has been regularly employed and as such that the true profits can be correctly determined by it –*Namesivayam Chettiar* v. *C.I.T. 38 I.T.R., 579 (S.C. of India).*

The mode of accounting adopted by the assessee in the accounting year might be perfectly regular in the sense that it follows one of the standard methods, yet if the assessee has not *employed it regularly*, the Deputy Commissioner of Taxes may discard it and compute the income upon a different basis *(B.C.G.A. (Punjab) Ltd.* v. *C.I.T.* 1937 I.T.R. 279, 299 (F.B.)). Secondly, as the Privy Council laid down in *C.I.T.* v. *Sarangpur Cotton Mfg. Co.* (1938 I.T.R. 36), even if there is a method of accounting regularly employed by the assessee, the Deputy Commissioner of Taxes is not *prima facie* entitled to accept the method or to hold the assessee bound by the figure of profits shown by the accounts. "It is the duty of the Deputy Commissioner of Taxes, where there is such a method of accounting, to consider whether income, profits and gains can properly be deduced therefrom, and to proceed according to his judgment on this question". Even if the assessee has regularly employed a well-recognised method of accounting, the Deputy Commissioner of Taxes must still discard it and act under this sub-section if the method does not show correctly the profits of the year. In the case of a contractor, if accounts are maintained separately for each contract and closed on its completion, the profits of each year may not be deducible from such accounts, for a contract may take several years to be completed and payments thereunder may also be received in several years. In such a case the Deputy Commissioner of Taxes may act under the sub-section and assess the profits of each year by employing a proper method of computing profits arising under incomplete contracts *(Sukhdeodas Jalan* v. *C.I.T. [1954] 26 I.T.R. 617).* In this case it was held that since sec. 3 (corresponding to sec. 16) imposes a charge of income-tax upon the profits and gains of the assessee for the accounting year it is the duty of the Income-tax authorities to ascertain the profits and gains accruing to the assessee in respect of the payment received during the accounting year. It cannot be said that merely because a contract was completed after the accounting year no profits arose or accrued to the assessee in the accounting year.... in such cases this sub-section shall apply and the assessee's profit had to be determined on estimate.

Under this sub-section the Deputy Commissioner of Taxes may reject the assessee's regular method of accounting *either wholly or in part (C.I.T.* v. *Maharajadhiraja of Darbhanga* 1933 I.T.R. 94, 100-1 (P.C.)). For example, if undervaluation of stock is an ingredient of the assessee's method of accounting, the Deputy Commissioner of Taxes may reject that part of the method and enter proper

valuations of stock in the accounts, while accepting the rest of the assessee's method (See ante "undervaluation or arbitrary valuation").

In *Sarangpur Cotton Mfg. Co.'s* case (1938 I.T.R. 36, 40) the Privy Council further held that the Income-tax Officer cannot refuse to accept the assessee's method of accounting as a basis of computation merely because the figure of profits shown by the assessee in the accounts is not the true figure for income-tax purposes. "It may well be that, though the profit brought out in the accounts is not the true figure for income-tax purposes, the true figure can be accurately deduced therefrom. Again, the Deputy Commissioner of Taxes cannot reject the accounts or the assessee's method of accounting merely because the accounts are not balanced, i.e., the aggregate of the expenditure has not been deducted from the aggregate of the gross receipts *(Raghunath Mahadeo* v. *C.I.T.* 2 I.T.C. 94 and 302*)*, or because the relevant accounting year of the assessee covers two dates of the 31st March (where accounting year ends on 31st March). If there is no material before the Deputy Commissioner of Taxes to justify the finding that income cannot properly be deduced from the assessee's regular method of accounting, an assessment made in pursuance of this sub-section would be vitiated *(Arumugaswami Nadar* v. *C.I.T.* [[1961] 42 I.T.R. 237*)*. In the case of an assessee who maintains regular account books which are not found to be incorrect, the mere facts that a stock register is not maintained and that the rate of profits shown by the assessee's books is considered by the Deputy Commissioner of Taxes to be unreasonably low may provoke an inquiry but they would not be sufficient to justify action under this sub-section *(Veeriah Reddiar* v. *C.I.T.* [1960] 38 I.T.R. 152*)*. However, the absence of a stock register coupled with other facts may justify the application of this sub-s. (2).

Where the computation of profits for a particular year has been made under the sub-section upon a basis determined by the Income-tax Officer, profits included in such computation cannot be included again in the assessment for any subsequent year *(C.I.T.* v. *Mutha Sarvarayudu* 2 I.T.C. 208*)*. The burden is on the assessee to prove that the profits sought to be assessed were so included in the computation of profits under the sub-section in any prior year *(C.T.V.S. Chettyar Firm* v. *C.I.T.* 4 I.T.C. 160*)*.

Judgment of the Deputy Commissioner of Taxes must be reasonably and judicially exercised.—The power under this sub-section to choose the basis and manner of computation of income is not an arbitrary power to assess the income; he must exercise his discretion and judgment judicially and reasonably *(C.I.T.* v. *Sarangpur Cotton Mfg. Co.* 1938 I.T.R. 36 (P.C.)*)*. He cannot base the computation solely on extra-judicial considerations like his experience of other cases or the assessee's local business reputation *(Ram Khelawan and Saha Thakur Das, In re 1939 I.T.R. 607)*. After rightly discarding the assessee's method of accounting, the Deputy Commissioner of Taxes should not himself adopt a wrong or improper method of computation *(C.I.T.* v. *Maharajadhiraja of Darbhanga* 1933 I.T.R. 94 100 (P.C.)*)*, *e.g.* merely adding a lump sum to the income returned, without adopting any method or disclosing any basis for such addition *(Nathuram Munnalal* v. *C.I.T. [1954] 25 I.T.R. 216, 220)*. If the Deputy Commissioner of Taxes adopts one particular method, he must pursue it to its logical conclusion *(Shiva Prasad Gupta* v. *C.I.T.* 3 I.T.C. 406,

415). For instance, if the Deputy of Commissioner of Taxes takes the accumulated interest of several past years as the income of the accounting year, losses suffered in those years may also have to be allowed *(Ibid)*. Again, he is not at liberty to tax what is not chargeable under the Ordinance even though the assessee has permitted himself to be taxed in respect of similar sums in past years *(Dhakeshwar Prasad* v. *C.I.T.* 1936 I.T.R. 71, 75, 79 (F.B.)).

Where two methods of computation are available to the Deputy Commissioner of Taxes acting under the sub-section, the one which is more just to the assessee and which involves a lesser margin of the chance of error should be taken as the basis *(Gemini Pictures Circuit Ltd.* v. *C.I.T.* [1958] 33 I.T.R. 547). Lord Loreburn said in *Sun Ins. Office* v. *Clark* (6 T.C. 59, 77 (H.L.)), "A rule of thumb may be very desirable, but cannot be substituted for the only rule of law that I know of, *viz.* that the true gains are to be ascertained as nearly as it can be done".

Impropriety of method of accounting distinguished from falsity of account books. –Accounts must be distinguished from the method of accounting. Sub-sec. (1) deals merely with the *method of accounting*. If the assessee's method of accounting is improper, i.e., such that the real profits cannot properly be deduced therefrom, the Deputy Commissioner of Taxes must reject the *method* under the sub-section, but he cannot merely on that ground reject *the account books (Nathuram Munnalal* v. *C.I.T.* [1954] 25 I.T.R. 216, 220). He must compute the income, having regard to the entries in the books, by applying a method of his own, *e.g.* by revaluing undervalued stocks. Even where the accounts are complicated, the Deputy Commissioner of Taxes must exercise his judgment, and if by a reasonable amount of labour he can deduce the true profit from the accounts he should do so and not reject the account books *(Gurmukh Singh* v. *C.I.T.* 1944 I.T.R. 393 (F.B.)).

If, however, the account books are unreliable, false or incorrect, or are incomplete, *e.g.* where entries in respect of certain transactions are altogether omitted with a view to suppressing profits, the Deputy Commissioner of Taxes has of course the power to reject such account books. Under the 1922 Act it was held that the Income-tax Officer could reject such incorrect or incomplete account books and make an assessment under the old s. 23(3) on the income as estimated by himself *(Gunda Subbayya* v. *C.I.T.* 1939 I.T.R. 21 (F.B.)). If the accounts are found to be incorrect or incomplete, the case would fall, under sub-s. (4). For instance, the method of accounting regularly employed may be the cash system which is a proper method, but the entries in the books of account may be false or fabricated. To such a case sub-s. (4) applies, and the Deputy Commissioner of Taxes should reject such account books and estimate the real income in such manner as he thinks fit. Conversely, accounts may be rejected as to their method but accepted as to their facts, in which event this sub-section would operate *(C.I.T.* v. *Khemchand Ramdas* 1940 I.T.R. 159, 177). The cases relating to the rejection of account books as being unworthy of credence and assessment of income according to the estimate of the Deputy Commissioner of Taxes are discussed below under "Rejection of incorrect or incomplete accounts".

Incorrect or incomplete accounts or no method of accounting regularly employed. –This sub-section covers three types of cases–

(a) acceptable method of accounting but unacceptable accounts;
(b) unacceptable method of accounting and unacceptable accounts and
(c) no method of accounting regularly employed.

(a) Where a proper method of accounting has been regularly employed by the assessee but the case falls under this sub-section because of the incorrectness or incompleteness of the accounts as required to be kept under sub-section (2), the Deputy Commissioner of Taxes should make the assessment, on the basis of the method of accounting regularly employed, as far as possible. In such a case this sub-section empowers the Deputy Commissioner of Taxes to reject the books and determine the income on such basis and in such manner as he thinks fit, but not to reject the method of accounting which has been regularly employed and from which the income can be properly deduced.

(b) In a case where the method of accounting is improper and the accounts are also incorrect or incomplete *(Navadwipchandra Nagendra Das* 1939 I.T.R. 488*)*, the Deputy Commissioner should reject both the method and the accounts and would be free to choose his own basis and manner of assessment).

(c) If no method of accounting has been regularly employed by the assessee, the Deputy Commissioner of Taxes is again free to choose his own basis and manner of assessment. But if the accounts are correct and complete, he should compute the income, *on the basis of the accounts*, by applying a method of his own *(See the cases of correct and complete books but improper method of accounting)*.

Where no method of accounting has been regularly employed, a non-trader cannot be assessed, generally speaking, under s. 33 ("Income from other sources") in respect of money which he has not received(24), but he may be assessed on receipt basis *(Mewar Industries Ltd.* v. *C.I.T.* [1963] 47 I.T.R. 72*)*.

Rejection of incorrect or incomplete accounts. –The only effect of this sub-section is that in the specified cases as mentioned in sub-section 4(a) and (b) it empowers the Deputy Commissioner of Taxes to compute income on his own basis. While the method of accounting may be rejected under basis Cl.(a) of sub-sec. (4), the account books themselves may be rejected under sub-section (4)(b). If the account books are unreliable, incorrect or incomplete–e.g., where entries in respect of certain transactions are altogether omitted or incorrect or fictitious entries are made with a view to suppressing profits, –the Deputy Commissioner of Taxes may reject such account books under this sub-section. "The power to reject the books produced by the assessee in support of his return is implied in the power of the Deputy Commissioner of Taxes to inquire into the total income of the assessee and does not need to be specifically conferred" *(Gurmukh Singh* v. *C.I.T.* 1944 I.T.R. 393, 421*)*.

The accounts would be rejected as unreliable if important transactions are omitted therefrom *(Paras Dass Munna Lal* v. *C.I.T.* 1937 I.T.R. 523*)* or if proper particulars and vouchers are not forthcoming and the accounts show an abnormally low rate of profit *(C.I.T.* v. *Abdul Aziz Sahib* 1939 I.T.R. 647*)*. But the Deputy

Commissioner of Taxes cannot reject account books merely because the accounts are not balanced, i.e., the expenditure has not been deducted from the gross receipts *(Raghunath Mahadeo* v. *C.I.T. 2* I.T.C. 94 and 302*)*, or because they do not include entries relating to the assessee's foreign business *(Muthukaruppan Chettiar* v. *C.I.T.* 1939 I.T.R. 76, 89 (F.B.)*)*.

If the assessee has made a return and has produced his accounts in obedience to a notice under s. 77, the Deputy Commissioner of Taxes would not be justified in rejecting the accounts and disbelieving the return unless he has given notice to the assessee under s. 83(1) to appear before him and adduce evidence in support of his return *(Dhuni Chand Dhani Ram* v. *C.I.T.* 2 I.T.C. 188*)*. See further under s. 83(1), "Notice to attend or produce evidence".

Computation of profits at a flat rate.–In cases where no method of accounting has been regularly employed by the assessee or where the assessee's method of accounting or account books are rejected, the Deputy Commissioner of Taxes may, exercising his judgment reasonably and judicially, compute the profits by applying a flat rate of a certain percentage to the admitted or estimated turnover or gross receipts *(Feroz Shah* v. *C.I.T.* 1933 I.T.R. 219 (P.C.)*)*, or to the outlay *(In re Krishna & Co.* 1939 I.T.R. 513*)*, or to the capital employed in a money-lending business *(Narayan Atmaram Patkar* v. *C.I.T.* 1934 I.T.R. 486*)*, or compute the profits on any other reasonable basis of estimate *(Ganeshi Lal Ram Chand* v. *C.I.T.* 1941 I.T.R. 241*)*. In determining the flat rate of profits, the Deputy Commissioner of Taxes may have regard to the rate of profits made by the assessee in past years, the average rate of profits made by other traders in the line and other circumstances *(Feroz Shah* v. *C.I.T.* 1933 I.T.R. 219 (P.C.)*)*. The flat rate adopted by the Deputy Commissioner of Taxes may be altered in appeal by the higher authorities *(Pearey Lal Shukla* 1942 I.T.R. 239*)*.

In the case of an assessee who deals in different commodities, the Deputy Commissioner of Taxes may accept the assessee's figure of profit as regards transactions in one commodity and apply a flat rate of profit in respect of transactions in other commodities *(C.I.T.* v. *Achrulal* 1938 I.T.R. 255, 263*)*, without giving special notice to the assessee in that behalf *(Ganeshilal Chhappanlal* v. *C.I.T.* 1941 I.T.R. 81*)*.

Where the true profits can be ascertained without much trouble by reference to the account books, assessment of profits at a flat rate should not generally be made *(C.I.T.* v. *Achrulal* 1938 I.T.R. 255*)*. Where the amount of items of income omitted from the accounts cannot be accurately determined, a reasonable lump sum may be added to the figure of profits shown by the accounts to represent the amount of omissions *(Tarachand Pohumal* v. *C.I.T.* 1936 I.T.R. 312, 316*)*.

Sec. 36: Allocation of income from royalties, literary works, etc. –Where the time taken by the author of a literary or artistic work in the making thereof exceeds twelve months, the amount received or receivable by him during any income year in lump sum on account or

royalties or copyright fees in respect of that work shall, if he so claims, be deemed to be the income of–

(a) the income year in which it is received and the immediately preceding income year if the time taken in making such work exceeds twelve months but does not exceed twenty-four months; and

(b) the income year in which it is received and the two immediately preceding income years if the time taken in making such work exceeds twenty-four months,

and shall be allocated in equal proportions to each such income year and the income of the assessee in respect of an income year shall be computed accordingly.

Explanation.–For the purposes of this section, the expression "author" includes a joint author and the expression "lump sum" in regard to royalties or copyright fees includes an advance payment on account of such royalties or copyright fees which is not returnable.

Dealt under "relief for income from royalties under sec. 33" (Income from Other Sources)

Set-off and carry forward of losses–Secs. 37 to 42.

Sec. 37: Set off of losses. – Where, in respect of any assessment year, the net result of computation of income under any head is a loss, the assessee shall, subject to the other provisions of this Ordinance, be entitled to have the amount of such loss set off against his income, if any, assessable for that assessment year under any other head:

Provided that any loss in respect of any speculation business or any loss under the head "Capital gains" shall not be so set off but shall, in accordance with the provisions of this Ordinance, be set off, or be carried forward to succeeding assessment year or years for set off, against any income in respect of speculation business or any income under the head "Capital gains":

Provided further that for the purposes of this section the Deputy Commissioner of Taxes shall, in computing any loss, deduct any amount received in cash as subsidy from the Government.

Single tax on total income. –It has been noted *ante* under s. 20 which classifies income under seven heads that income-tax is only one tax, levied on the sum total of the income classified under various heads, and that it is not a collection

of distinct taxes levied separately on each head of income. (See under s. 20 "Seven heads of income", and "Income-tax is only one tax"). One of the important consequences which follow from the principle that income-tax is only one tax and there are not as many taxes as there are heads of income, is that a loss sustained in any year under one head should be set off against income under another head in that year, in order to arrive at the true total income of the assessee.

Set-off of loss against income under same head. –Except in the two cases noted below, if the net result in respect of any source under any head is a loss, that loss may be set off against income from another source under the same head although there is no specific provision in the Ordinance. Income under each head is computed by lumping together the incomes from various sources which fall under the same head. For instance, where a man carries on several businesses, or both business and profession, he is entitled to set off losses in one business against profits in another, or losses in business against professional earnings, and the tax is leviable only on the balance of profits after deducting such losses. There is no such express provision in the Ordinance for setting off losses against income under the same head, but the principle was held to be implicit in the Ordinance. For instance, losses in a business were set off against profits in another business or against professional earnings under the old s. 10 of 1922 Act itself which corresponded to s. 28 of this Ordinance *(Anglo-French Textile Co. Ltd.* v. *C.I.T.* [1953] 23 I.T.R. 82 (S.C. of India)*)*. The assessee company was running the business through another company which incurred loss in the assessment year 1962-63. The assessee claimed that the loss for 1962-63 be set-off against the income from the subsequent years of that business. It was held that the composition of the assessee company owning the business is not changed by mere agreement to run the business and the Tribunal found that the same business to have continued, the claim of set-off of loss be allowed as the same business to have continued – *C.T. Chittagong Zone* v. *M/s Sterling Plywood Product Ltd.* –(H.C. Div. of S.C. of Bangladesh) reported in 1982-BTD X 17.

The loss in one business may be set off against the profits *of the same year* in another business *(Vengoo Iyer* v. *C.I.T.* [1961] 42 I.T.R. 494*)*, even though the business in which the loss was incurred may have been carried on only for a brief period in the accounting year and discontinued within such year *(Hulasilal Ramdayal* 1941 I.T.R. 635*)*. When the dividend income is the income from business or profession, the assessee is entitled to set-off loss under sec. 10 and not under sec. 24(1) – I.T.A No. 1787 to 1789 (reported in BTD 1986).

There are two exceptions to the rule that a loss can be set off against any other income under the same head. A loss in a speculation business (s. 39) can be set off only against the profits of another speculation business, and a loss in respect of a capital gains can be set off only against the income in respect of any other capital gains (s. 40). Speculation losses and losses under the head "Capital gains" are dealt with respectively by ss. 39 and 40. Loss of Gambling activities should not also be set-off against income under other heads.

Sec.37: Set-off of loss against income under another head.–If after setting off losses against income under the same head the net result is still a loss, such loss

may be set off under s. 37 against income of the same year under any other head *(Ambika Silk Mills Co. Ltd.* v. *C.I.T.* [1952] 22 I.T.R. 58*)*. For instance, loss in business may be set off against income from property, and loss under the head "Income from other sources" may be set off against profits of business *(Varier* v. *C.I.T.* 1940 I.T.R. 628*)*. The only exceptions to this rule are loss in speculation business and loss falling under the head "Capital gains", which cannot be set off against income falling under any other head (First proviso to sec. 37). Except in these two cases, a loss under any head may be set off under any other head. Second proviso to this section provides that in computing any loss to be set-off any subsidy received in cash shall be deducted from the loss and the resulting loss only shall be set off.

Sec.38: Carry forward of business losses.–Where, for any assessment year, the net result of the computation of income under the head "Income from business or profession" is a loss to the assessee, not being a loss sustained in a speculation business, and such loss has not been wholly set off under section 37, so much of the loss as has not been so set off, the whole of the loss, where the assessee has no income under any other head or has income only under the head "Capital gains", shall be carried forward to the next following assessment year, and –

(a) it shall be set off against the income, if any, from the business or profession for which the loss was originally computed if such business or profession continued to be carried on by him in the income year; and

(b) if the loss cannot be wholly so set off, the amount of the loss not so set off shall be carried forward to the next assessment year and so on for not more than six successive assessment years.

Carry forward of business loss. sec. 38–If the loss cannot be set-off under sec. 37 because of the absence or inadequacy of income of the same year under any other head, it may, under this section, be carried forward and set-off against the profits of a subsequent year.

The right of carry forward of loss under this section is subject to the following restrictions:

(a) the loss should be in a business or professions;

(b) the loss may be carried forward and set-off against the profits and gains of the same business or profession as that in which the loss was incurred (Cl.a). In no case can a loss carried under this section be set-off against the profits from a source other than the same business or profession;

(c) the business or profession in which the loss was originally sustained should continue to be carried on by the assessee in the year in which the carried forward loss sought to be set-off (Cl.a). Income from business or profession which has been discontinued at any time before the commencement or during the courses of the said income year shall be chargeable to tax under sec. 19(6) and the business shall be deemed to have been carried on during the year. But no provision has been made for set-off of unabsorbed loss carried forward in that year.

(d) the loss can be carried forward and set-off only against the profits of the assessee who incurred the loss. In other words, the person who incurred the loss alone has the right to carry forward the same and the successor in business, cannot claim to carry forward the loss incurred by his predecessor in business. The only exceptional case is that of succession by inheritance (42(4)).

(e) no loss can be carried forward for more than six successive years (s. 38(b)).

(f) It should not be sustained in a speculation business. Losses in speculation business are separately dealt with by sec. 39.

Continuance of business in which loss was incurred.– The question whether the assessee's activities in different years or in the same year constitute the same business or separate and distinct businesses, is material, because the section allowed a carried forward loss to be set off only against the profits of the same business, i.e. the business in which the loss had been incurred, and not against the profits of any other business *(C.I.T.* v. *International Industries Ltd. [1952] 22 I.T.R. 44)*. Under this Ordinance the right of carry-forward is still conditional upon the continuance of the business in which the loss was incurred, and this condition necessarily involves the question whether a business carried on by the assessee in a subsequent year is the same as the business in which the loss was incurred.

The right of carry-forward and set-off of losses continues only so long as the business continues: the right would be lost if the business ceases to be carried on. Therefore, if the business is discontinued by the assessee, the loss which has been carried forward and yet remains to be set off would become a capital loss and cannot be set off against the profits of any other business *(C.I.T.* v. *International Industries Ltd.* [1952] 22 I.T.R. 44*)* even if such other business was also carried on by the assessee at the time when the loss was incurred.

Where the assessee company was carrying on business in various agencies. The assessee was also appointed as the managing agents of Blue Mountain Estate and Industries Ltd. The assessee company continued to receive income from managing agency over the years. In the assessment year 1969-70 there was a net loss under the head "Business". This loss related to the managing agency receipts. In the year 1970-71 there was only income from managing agency and in the year 1971-72 there was income from managing agency as well as from other commission. The Tribunal held that the entire agency business is a single business of which managing agency is one

facet and commission agency is another facet. The business was not separate and distinct business since there was a common administration, common fund, common place of business and common management and therefore there was interlacing between the managing agency and commission agency. It was also found that from the assessment year 1972-73 onwards, the assessee ceased to be managing agents due to abolition of the managing agency system.

Held, on reference by the Madras High Court that there was a composite business of agency and hence merely because the assessee ceased to carry on the managing agency business, it could not be held that the assessee had ceased to carry on the business of agency which consisted of managing agency and commission agency. Therefore, the assessee was entitled to carry forward and set-off the loss incurred in the managing agency business against the income derived during the assessment years 1972-73 to 1976-77 – *C.I.T.* v. *Kothari & Sons (Agencies) P. Ltd.* (reported in 1996 BTD XXIV pp 130-132).

In a case where a company carried on business as brewers of beer, and thereafter ceased brewing but continued to bottle and sell beer supplied to its specifications by another brewery company, it was held that the company ceased trading as brewers and commenced a fresh trade of selling beer *(Gordon & Blair Ltd.* v. *I.R.* 40 T.C. 358*)*. It is submitted that this case cannot be regarded as an authority for the general proposition which would be incorrect, that an assessee, who used to sell products of his own manufacture and who continues to sell but ceases to manufacture, should be regarded in all cases as having discontinued his old business and set up a fresh business.

If an assessee uses a commercial asset himself and then lets it out temporarily, he would be treated as continuing the same business. Where a company which was carrying on the business of manufacturing groundnut oil and cake let out its entire oil mill during the relevant accounting year, the company was held to have carried on the same business during that year (letting out being a mode of exploiting the commercial assets) and to be entitled to set off the carried forward loss of the manufacturing business against the rental receipts (*Lakshmi Industries (Pr.) Ltd.* v. *C.I.T. [1961] 41 I.T.R. 645)*. See further under s. 28, "Income from letting out a business asset", "Business may be passive or dormant. –Periods of lull and inactivity", and "Business carried on in the course of administration, or winding up or liquidating a concern").

It is impossible to formulate any infallible general rule or test applicable to all cases for determining whether two businesses are separate or whether they constitute one and the same business: the determination of that question depends upon the facts and circumstances of each case *(Hiralal Kalyanmal* 1943 I.T.R. 128, 138*)*. Ship-owning and ship-brokering *(Birt, Potter & Hughes Ltd.* v. *I.R.* 12 T.C. 97((C.A.)*)*, ship-owning and under-writing *(Scales* v. *George Thompson & Co. Ltd.* 13 T.C. 83*)*, speculation in cotton and commission agency business in cotton *(Hiralal Kalyanmal* 1943 I.T.R. 128, 141*)*, business of "manufacturing chemists" and herb-growing *(I.R.* v. *William Ransom & Son Ltd.* 12 T.C. 21, 30*)*, tobacco business and money-lending *(Mothay Ganga Razu* v. *C.I.T. 1939 I.T.R. 149)*, speculation business

and money-lending, manufacture of glass and manufacture of sugar *(Ganga Glass Works* v. *C.I.T. [1951] 19 I.T.R. 126)*, have been held to be separate businesses on the facts of the case. On the other hand, boiler-making and shell-making, money-lending and cloth business *(Arunachalam Chetty* v. *C.I.T.* I.L.R. 52 Mad. 296 (S.B.)), and dealing in sewing machines and dealing in stocks and shares *(C.I.T.* v. *Pfaff Sewing Machine Co. (India) Ltd.* [1956] 30 I.T.R. 518*)* (it was held in that case that when a company which is dealing in a number of commodities discontinues its dealing in one commodity and concentrates its attention on dealing in another commodity, it cannot be said to carry on a different business), have been held to constitute one and the same business on the facts of the case. The fact that the concerns are carried on in different names *(Arunachalam Chetty (A.L.A.R. Bros.)* v. *C.I.T.* 3 I.T.C. 209*)*, or in different premises or localities, or even in different countries *(Chidambaram Chettiar* v. *C.I.T.* 1945 I.T.R. 177), or that each place of business has its separate capital *(C.I.T.* v. *A.L.V.R.P. Firm 1940 I.T.R. 531), or that the accounts are maintained separately*, or that there are separate agents or staff to run each business *(Chidambaram Chettiar* v. *C.I.T. 1945 I.T.R. 177)*, or that the nature of the business operations or the character of the commodities dealt in is widely different, e.g. in case of multiple stores *(Hiralal Kalyanmal* 1943 I.T.R. 128, 138*)* and speculation in various commodities *(Govindram Bros. Ltd.* v. *C.I.T. 1946 I.T.R. 764)*, does not necessarily make them separate and distinct businesses.

If a company carries on several concerns, all those concerns do not necessarily constitute one business: a company, no less than an individual, may be engaged in separate businesses at the same time *(South Indian Industrials Ltd.* v. *C.I.T.* 1935 I.T.R. 11 (S.B.); *Egyptian Hotels Ltd.* v. *Mitchell* 6 T.C. 542, 550 (H.L.)) or at different times *(C.I.T.* v. *International Industries Ltd.* [1952] 22 I.T.R. 44*)*. In the case of *Hiralal Kalyanmal*, Beaumont, C.J., said, "It is obvious that mere common ownership of the businesses does not mean that they are merely branches of the same business. It is also I think obvious that the mere fact that the two businesses are of a distinct nature does not necessarily mean that they are distinct businesses. You can have two branches of a multiple store, one selling drugs and the other selling cloth. Nobody would suggest that these two departments constitute two different businesses" *(See also Soundrapandia Nadar* v. *C.I.T.* 1950 I.T.R. 163, 170*)*.

Test of inter-connection and unity.–One test which has been frequently invoked in order to determine whether two or more businesses are separate businesses or constitute the same business, is that laid down by Rowlatt, J., in *Scales* v. *George Thompson & Co. Ltd.* (13 T.C. 83, 89), *viz.* is there an interconnection, an inter-lacing, an inter-dependence between, and a unity embracing, the businesses? The inter-dependence may be financial; the unity may be unity of management and control *(Soundrapandia Nadar* v. *C.I.T. 1950 I.T.R. 163, 172-3)*. In *Chidambaram Chettiar* v. *C.I.T.* (1945 I.T.R. 177) the assessee carried on money-lending business in India and also in Penang. The profits arising in India and in Penang were derived from different sources, the accounts were maintained separately, the staff for each business was separate and a long distance separated India from Penang. But the foreign office was a branch office and was controlled by and closely connected with the headquarters in India. The picture being that of a trading organisation inter-connected as head office

and branch, with financial inter-dependence and unity of control, it was held, applying the above test laid down by Rowlatt, J., that the business operations in India and in Penang constituted one and the same business and not distinct or separate businesses.

The same test was applied by the Bombay High Court in–*Govindram Bros. Ltd.* v. *C.I.T. [1946] I.T.R. 764*, where the assessee carried on speculation in various commodities in various markets. The speculation business was carried on in the same premises, by the same staff and with the aid of the same accounts. It was held on the facts of the case that speculation in the various commodities constituted one and the same business. Chagla, J., held that speculation or the speculative character of the businesses was not by itself such a nexus or inter-connection as made the businesses one and the same business but the inter-connection was to be found in the other circumstances of the case. In another case where a manufacturer of bidis engaged in speculation in cotton, it was held to be a separate business in the absence of any inter-connection between the two businesses *(C.I.T.* v. *Ramakrishna Ramnath 1944 I.T.R. 21)*. But where a merchant carried on speculation in various commodities and the capital employed in the business of speculation was the same as in his ordinary business as a merchant, the accounts of the businesses were mixed up, the items of expenditure were inter-woven and the overhead expenses were common *(Rekhabchand Sarogi* v. *C.I.T. 1947 I.T.R. 465, 476)*, and similarly where a grain merchant entered into forward contracts in grains *(Soundrapandia Nadar* v. *C.I.T. 1950 I.T.R. 163)*, it was held on the facts of the case that the merchant did not engage in a separate or different business by engaging in speculation or forward contracts. But these decisions must now be read subject to the provisions of Expln. to s. 28 which enacts that a business in speculative transactions should be deemed to be distinct and separate from any other business.

The fact that in a particular year the assessee discontinues doing any business in a particular commodity or in a particular market does not necessarily make it a separate or new business when he recommences doing business in that commodity or in that market *(Govindram Bros. Ltd.* v. *C.I.T.* 1946 I.T.R. 764, 773*)*. Development of an existing business would not amount to a new business *(Spiers & Son Ltd.* v. *Ogden 17 T.C. 117)*, but a new venture even in the assessee's ordinary line of business may amount to a new business *(See H. & G. Kinemas Ltd.* v. *Cook 18 T.C. 116)*.

Sec. 39: Carry forward of loss in speculation business.–(1) where, for any assessment year, the result of computation of income in respect of any speculation business carried on by the assessee is a loss, it shall be set off only against the income, if any, from any other speculation business carried on by him and assessable for that assessment year.

(2) Where, for any assessment year, any loss computed in respect of speculation business has not been wholly set off under sub-section (1), so much of the loss as has not been so set off, or the whole loss where the assessee has no income from any other speculation business, shall, subject

to the provisions of this Ordinance, be carried forward to the next following assessment year, and–

(a) it shall be set off against the income, if any, from any speculation business carried on by him and assessable for that assessment year; and

(b) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the next assessment year and so on for not more than six successive assessment years.

Loss in speculation business–Sec.39–"Speculative transaction" is defined by s. 2(61). Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business is regarded as speculation business (See further note under "Speculative transactin" with note).

Unlike other losses, a loss in speculation business cannot be set-off under first proviso to sec. 37 under the same head against profits in a non-speculation business but it can be set-off only against profits, if any of another speculation business. The loss in a speculation business cannot be set off even against the profits of the same business of which speculation forms a part in reality, because speculation is deemed, by a fiction of law, to be distinct and separate from any other business. However, an assessee who incurs a loss in a speculation business carried on by him individually is entitled to set it off against his share of the profits in another speculation business carried on by a firm in which he is a partner *(Ramanlal Prabhudas Shah* v. *C.I.T.* [1957] 31 I.T.R. 924). In the case of *C.I.T. Andhra Paradesh* v. *Puttaiah Seshaiah & Co.* it was held by the Andhra Pradesh H.C. that the assessee was not entitled to the set-off of loss arising from payment of price difference in respect of unfulfilled contracts of sale otherwise than by actual delivery or transfer of the commodity against the profits from its regular business –(Reported in 1986 BTD XIV 15-16) See further "Income from speculative transaction under sec. 28.

Under sub-s. (2) a loss in a speculation business can be carried forward to a subsequent year and set off only against the profits of any speculation business carried on in that year, even if the profits are of a speculation business distinct and separate from the speculation business in which the loss had been incurred. This provision constitutes a departure from the principle applicable to other business losses, *viz.* that a loss can be carried forward and set off against the profit of the business or profession in which the loss is incurred. Like other business losses under s. 38(b), losses in speculation business under this section can be carried forward only for a period of six years. Like other business losses the right of carry forward of losses in speculation continues only so long as the speculation business continues: the right would be lost if the speculation business ceases to be carried on.

Sec. 40: Carry forward of loss under the head "Capital gains".– (1) Where, in respect of any assessment year, the net result of computation of income from any source under the head "Capital gains" is

a loss, it shall be set off only against income from any other source falling under that head and assessable for that year.

(2) Where, for any assessment year, any loss computed under the head "Capital gains" has not been wholly set off under sub-section (1), so much of the loss as has not been so set off, or the whole loss where the assessee has no income from any other source falling under that head, shall, subject to the provisions of this Ordinance, be carried forward to the next following assessment year, and–

(a) it shall be set off against income, if any, of the assessee under that head and assessable for that year; and

(b) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the next assessment year and so on for not more than six successive assessment years.

(3) Where, in respect of any assessment year, the loss computed under the head "Capital gains" does not exceeds five thousand taka it shall not be carried forward and where it exceeds five thousand taka only so much of such loss shall be carried forward as exceeds five thousand taka.

Set-off and carry forward of loss under the head Capital gains-sec. 40–Losses in speculation business (s. 39) and losses under the head "Capital gains" (sec. 40) are the only exceptions to the general rule of set-off of loss from one source against any income from another source under the same head (proviso to sec. 37), and set-off of loss under one head against income under another head (s. 38), in the same year. Losses under the head "Capital gains" can in no case be set off against income under any other head.

The combined effect of ss. 37 and 40 is as follows: –

(1) Losses under the head capital gains may be
   (a) set off in the same year against capital gains relating to any other capital asset (s. 40(1));
   (b) carried forward and set off against the capital gains of a subsequent year assessable for that year (s. 40(a));
   (c) carried forward for six years, the (s.40(a)).

The right of carry-forward is subject to one exception. In the case of any assessee, the net loss relating to capital assets, cannot be carried forward in any case if the loss does not exceed tk. 5,000 (s. 40(3)).

• Where an assessee contracts to buy a capital asset and, being unwilling to complete the transaction, procures another buyer who pays a lesser price, the balance of the contractual amount paid by the assessee would not be a loss arising from a transfer of a capital asset *(Ratanchand Hirachand* v. *C.I.T. [1960] 38 I.T.R. 76)*.

Generally speaking, capital gains are let off with a lighter burden under this Ordinance than other income. But one of the inequitable anomalies of the Ordinance is that it bears more hardly on an assessee who *bona fide* invests in a capital asset but sells it within a year to another who deals in the same asset. If the investor makes a profit on the sale of the capital asset, he is taxed at the full rates applicable to business profits (Paragraph 2 of Second Schedule) but if he makes a loss, he has neither the right to set off such loss against income under any other head in the same year nor has he the right to set off such loss, carried forward, against any business income of a subsequent year, while the dealer has both the rights.

Sec. 41: Carry forward of loss under the head "Agricultural income.–Where, for any assessment year, the net result of the computation of income under the head "Agricultural income" is a loss to the assessee, and such loss has not been wholly set off under section 37, so much of the loss as has not been so set off, or the whole of the loss where the assessee has no income under any other head or has income only under the head "Capital gains", shall be carried forward to the next following assessment year, and–

(a) it shall be set off against agricultural income, if any, of the assessee assessable for that assessment year; and

(b) if the loss cannot be wholly so set off the amount not so set off shall be carried forward to the next assessment year and so on for not more than six successive assessment years.

Carry forward of loss under the head "Agricultural Income-sec. 41–If in any assessment year there is any loss under the head, "Agricultural Income" because of the absence or inadequacy of income in the same year under any other head or the assessee has only income under the head, "capital gains" such loss may under this section be carried forward and set-off against the profits of a subsequent year. The loss as carried forward shall be set-off against the income under the head. "Agricultural income" of that assessment year and in no case a loss carried forward under this section be set-off against the profits from a source other than agricultural income. No loss under this head can be carried forward for more than six successive assessment years.

Sec. 42: Conditions and limitations of carrying forward of loss, etc. –(1) The provisions of sections 37, 38, 39, 40 and 41 shall have effect subject to the conditions and limitations set out in this section.

(3) In the case of a firm–

(a) where the assessee is the firm, and loss sustained by it under any head of income shall be set off under section 37 only against the income of the firm under any other

head and not against the income of any of the partners of the firm; and

(b) where the assessee is a partner of the firm, he shall not be entitled to have any loss sustained by the firm carried forward and set off against his own income.

(4) Where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance, no person, other than the person incurring the loss, shall be entitled to have the loss in such business or profession set off against his income under any other head.

(5) In the case of a firm in the constitution of which a change has occurred, –

(a) the firm shall not be entitled to set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, of the income year in the firm; and

(b) a partner of the firm shall not be entitled to the benefit of any portion of the said loss as is not apportionable to him.

(6) Where, in making an assessment for any year, full effect cannot be given to the allowances referred to in section 29(1) (viii) owing to there being no profits or gains chargeable for that year or such profits or gains being less than the allowance then, subject to the provisions of sub-section (7), the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following year and be deemed to be part of that allowance or if there is no such allowance for that year, be deemed to be the allowance for that year and so on for succeeding years.

(7) Where, under sub-section (6), depreciation allowance is also to be carried forward, effect shall first be given to the provisions of sections 38 and 39(2).

Conditions governing carry forward of loss where the assessee is a firm-sec. 42.–In the case where the assessee is a firm tax is levied on the firm directly as a distinct unit of assessment. Any loss incurred by a firm may be set off by the firm against its income of the same year under the same head or any other head, and further, any unabsorbed loss may be carried forward by the firm and set off against its profits in a subsequent year, subject to the provisions of ss. 37 to 40. But no

individual partner has the right to set off his share of the firm's loss (sec. 42(3)(a)) against his own income of the same year under the same head or any other head nor has he the right to carry forward his share of the firm's loss. Under the 1922 Act the position was that if a firm was not assessed at all as a firm, any partner could set off his share of the firm's loss against his other business income or against his income under any other head *(C.I.T.* v. *Muthuraman Chettiar* [1962] 44 I.T.R. 710 (S.C. of India)*)*, and he could also carry forward his share of the firm's loss. In this case it was observed that "it is worthy of note that though the profit of each distinct business may have to be computed separately, the tax is chargeable under section 10 not on the separate income of every distinct business but on the aggregate profits of all businesses carried on by the assessee. It follows from this that where assessee carries on several businesses he is entitled under sec. 10 and not under sec. 24(1) to set off losses in one business against profits in another. If as we hold that sec. 24(1) has no application to the facts of the present case the second proviso thereto can also have no application". The Taxes appellate Tribunal, Bangladesh, Dhaka bench discussed the issue in a case no. I.T.A. 1787 to 1789 of 1981-82 (reported in 1986 BTD xiv 183-207) and observed further, although there was diversity of opinion among the members of the Tribunal, that "if the amount of profits has to be added to the individual income of a partner, it follows that the loss has to be deducted. It is only if the loss is under a different head from other income that the question of set off under sec. 24(1) arises. In such a case the loss can only be carried forward by the partnership itself". .... "Moreover, the second proviso to sec. 24(1) applies only where the assessee is an unregistered firm" and not in the case where the assessee is an individual". Section 24(1) (corresponding to sec. 42(3)(a)) deals with different heads and hence cannot be applicable which deals with the loss computed under sec. 10. But the law however, which expressly enacts that in the case of a firm no partner has a right to carry forward and set off against his own income. The law has of course, remained silent about the set off of the firm's share of loss in the same year in which the loss was computed.

In short, in computing the income of a firm, any loss incurred by the firm may be set off against the firm's income of the same year under any head, subject to ss. 37 to 42. Any unabsorbed loss may, in the case of a firm, be carried forward by the firm, but a partner cannot set off his share of the firm's loss against his personal income or carry forward the same. (The case discussed above requires consideration).

A firm cannot claim to set off against its own profits the loss suffered by another firm, even if the partners in the former firm are also partners in the latter *(C.I.T.* v. *Muthu Ramanathan Chetty* 2 I.T.C. 194*)*.

Sec.42(4): See sec. 38 under "Carry forward of business loss *ante*"

Sec. 42(5): Change in the constitution of a firm–carry forward and set off of losses on change in the constitution of firm (or on succession) –The broad principle underlying ss. 37 to 42 is that the right of carry forward and set off of losses is available only to the person who has suffered the loss and to no one else. This section is the necessary corollary to this principle.

Sec. 86 provides that where a change has occurred in the constitution of a firm, the assessment should be made on the firm as constituted at the time of making the assessment, but for the purpose of inclusion in the total incomes of the partners the firm's profits should be apportioned between the partners who in the previous year were entitled to receive the same. The effect of this sub section as far as can be gathered from its clumsy language, is that a firm is not entitled to carry forward and set off against its own profits of a subsequent year so much of its loss as is proportionate to the share of a retired or deceased partner, nor is any partner entitled to carry forward and set off against his own profits any other partner's share of the loss.

Similarly where a person carrying on any business or profession is succeeded in such capacity by any other person, the successor has no right to carry forward and set off any loss incurred by his predecessor, the general principle being that the successor in business must be treated as if he had commenced or set up a new business *(United Steel Cos. Ltd.* v. *Cullington* 23 T.C. 91 (H.L.)*)*. thus where the business of a joint family was carried on after partition by the erstwhile coparceners in partnership, the firm could not claim to carry forward and set off against its profits the loss incurred by the family, since the firm and the family were different entities though their members were the same individuals *(Keshrichand Bhanabhai* v. *C.I.T. [1951] 20 I.T.R. 201)*. Likewise, where a company was formed to amalgamate the undertaikings of two existing companies and the businesses carried on by those two companies were continued by the new company, it was held that the new company was not entitled to carry forward and set off against its profits the losses which had been incurred by the two companies *(United Steel Cos. Ltd.* v. *Cullington 23 T.C. 91 (H.L.))*. Where a business is transferred, the unabsorbed depreciation allowance and other losses of the previous owner cannot be assigned to the successor so as to enable him to carry them forward and set them off against his own profits *(Indian Iron and Steel Co. Ltd.* v. *C.I.T. 1943 I.T.R. 328 (P.C.))*. Nor can the previous owner claim to carry forward and set off the loss after he has assigned the business to another, for the right of carry forward is conditional upon the assessee continuing to carry on the business in which the loss was incurred *(See under s. 38, "Continuance of business in which loss was incurred".)*. Thus the unabsorbed loss becomes a capital loss when the business changes hands, just as it becomes a capital loss when the business is discontinued.

To the general rule that the successor in business cannot claim to carry forward and set off the loss of his predecessor, the exception is the case where the succession is by inheritance *(C.I.T.* v. *Maniben [1960] 38 I.T.R. 80)*. The heir would be entitled to carry forward the loss incurred by the previous owner.

For cases of succession and change in the constitution of a firm, see notes under ss. 86, 87 and 88.

Sec. 42(6) and (7): Carry forward of unabsorbed depreciation allowance of past years and business loss–Distinction between business loss and unabsorbed depreciation–

(i) the unabsorbed depreciation is deemed to be part of the depreciation allowance for a subsequent year and will enter into the computation of the income of such subsequent year. Carried forward loss does not enter into such computation, but after the subsequent year's income is determined the carried forward loss is deducted therefrom.

(ii) the unabsorbed depreciation, as stated above, can be set off against *any* income of a subsequent year under any head, whereas the carried forward loss can be set off only against the profits of any business or profession.

(iii) the sub-section (sub-sec.(6)) allows the carried forward of depreciation allowance to any subsequent year without any time-limit, while a loss can be carried forward under Cl.(b) of section 38 only for a period of six years.

Sec. 42(7) requires that losses which have been carried forward from past years should first be set off against business profits under this section and it is only if any balance of profits still remains that the unabsorbed depreciation allowance of past years carried forward under s. 42(6) should be set-off against such balance of profits *(Jaipuria China clay Mines Pr. Ltd.* v. *C.I.T.* [1962] 46 I.T.R. 707*)*. This provision enures for the benefit of the assesse because, unlike Cl.(b) of sec. 38 which prescribes a limit of six years for the carry-forward of business losses, s. 42(6) lays down no time limit for the carry-forward of unabsorbed depreciation allowance, and the right of carry-forward in respect of depreciation allowance may be availed of in later years when losses can no longer be carried forward having regard to section 42(7). Where full effect of depreciation allowance cannot be given in the assessment year for inadequacy of profit or absence of profit the amount of depreciation to which effect could not be given shall be carried forward to the following year and added to the depreciation of that year and be deemed to be a part of the depreciation of that year. In absence of any depreciation allowance of that year the carried forward depreciation allowance shall be deemed to be the allowance of that year and be set off against the income of the assessee of the succeeding years.

Unabsorbed depreciation of earlier years can be set off against the income of the assessee of the current year under other heads (*C.I.T.* v. *Ahmedabad Electricity Co. Ltd. (Bom.)* 1973, 89 I.T.R. 77) and even it can be set off against the capital gains of that year (*Ambika Silk Mills Co. Ltd. (Bom)* 1952, 22 I.T.R. 58*)*. See *ante* under ".... "Carry-forward of Depreciation Allowance".

Sec. 43: Computation of total income.–(1) For the purpose of charge of tax, the total income of an assessee shall be computed in the manner provided in this ordinance.

(2) In computing the total income of an assessee, there shall be included any exemption or allowance specified in part B of the Sixth Schedule and any income deemed to be the income of the assessee under

section 19, subject to the limits, conditions and qualifications laid down therein.

(3) Where the assessee is a partner of a firm, then, whether the firm has made a profit or a loss, his share (whether a net profit or a net loss) shall be taken to be any salary, interest, commission or other remuneration payable to him by the firm in respect of the income year increased or decreased respectively by his share in the balance the profit or loss of the firm after the deduction of any interest, salary, commission or other remuneration payable to any partner in respect of the income year and such share shall be included in his total income:

Provided that if his share so computed is a loss, such loss may be set off or carried forward and set off in accordance with the provisions of section 42.

(4) In computing the total income of any individual for the purpose of assessment, there shall be included–

(a) so much of the income of the spouse or minor child of such individual as arises, directly or indirectly, –

(i) from the membership of the spouse in a firm of which such individual is a partner;

(ii) from the admission of the minor child to the benefits of partnership in a firm of which such individual is a partner;

(iii) from assets transferred directly or indirectly to the spouse [otherwise than by way of gift or for adequate consideration] or in connection with an agreement to live apart; or

(iv) from assets transferred directly or indirectly to the minor child, not being a married daughter, by such individual [otherwise than by way of gift or for adequate consideration]; and

(b) so much of the income of any person or association of persons as arises from assets transferred, [otherwise than by way of gift or for adequate consideration], to such person or association of persons by such individual for the benefit of the spouse or minor child or both.

(5) All income arising to any person by virtue of a settlement or disposition whether revocable or not from assets remaining the property of the [settlor] or disponer, shall be deemed to be income of the [settlor] or disponer, and all income arising to any person by virtue of a revocable transfer of assets shall be deemed to be income of the transferor and shall be included in the total income of such person.

(6) For the purposes of sub-section(5), –

(a) a settlement, disposition or transfer shall be deemed to be revocable if it contains any provisions for the retransfer directly or indirectly of the income or assets to the [settlor], disponer or transferor, or in any way gives the [settlor], disponer or transferor a right to resume power directly or indirectly over the income or assets;

(b) the expression "settlement or disposition" shall include any disposition, trust, covenant, agreement or arrangement, and the expression ["settlor] or disponer", in relation to a settlement or disposition, shall include any person by whom the settlement or disposition was made.

Total income.–Sec. 43: The meaning and import of "total income", which is defined by Cl.(65) of s. 2, has already been considered above in the notes to that clause. This section deals with the computation of total income and provides what sums are to be included in determining the total income. Tax deducted at source is regarded as income received and has to be included in the total income under s. 48(2), while credit for the tax deducted is given to the assessee under s. 62. Rule 24 prescribes the form of return of total income which must be filled in by the assessee.

Exempted income included into total income. sub-sec.(2). –It has already been noted under sec. 2(65) *ante* (see under "total income") that exemption granted under this Ordinance is of two kinds. Certain classes of income are exempted from tax and also excluded from the computation of total income, e.g. income exempted in specified Paragraphs of part A of Sixth Schedule and some items in the Government Notifications issued under sec. 44(4); while certain other classes of income are exempted from tax but they are to be included in the assessee's total income, e.g. the sums exempted under paragraph 15 (income from association of persons on which tax has already been paid by the Association) and paragraph 16 (share income from a firm, if tax is paid on such income by the firm) of part B of Sixth Schedule. Total income also includes certain other income under sec. 19 (unexplained investments deemed as income – see *ante* under "unexplained investments as income"). The effect of including exempted income in the assessee's total income is mainly two fold:

Firstly, it would affect the rate of tax applicable to the chargeable portion of the total income of the assessee, since the rate of tax payable by the assessee is determined with reference to the total income. Secondly, rebate of tax is given for several investment allowances under specified Paragraphs of part B of Sixth Schedule, calculations of which are made with reference to the total income. For example, rebate of tax on account of such investments is restricted under sec. 44(3) to a ceiling calculated by reference to the assessee's total income; and income which is exempted from tax but included in the assessee's total income would have to be taken into consideration in determining the ceiling upon which the amount of rebate will be calculated. For example, rebate of tax on account of life insurance premium and other investment allowances shall be at fifteen percent of tax deduction on such investments which are permissible upto twenty percent of total income or one lakh fifty thousand taka, (which has been raised to two lakh taka by the finance Act of two thousand), whichever is less (s. 44(3)). Thus rebate of tax on account of investments is restricted to a ceiling calculated by reference to the assessee's total income.

Computation of partner's share in the firm's profit or loss.–sub-sec.(3)–This sub-section lays down the mode of computing a partner's share in the profit or loss of the firm. The formula is to take any interest, salary, commission or other remuneration payable to the partner by the firm, and to add to or subtract from it respectively the partner's share in the balance of the profit or loss of the firm after the deduction of any interest, salary, commission or other remuneration payable to any partner. Though the interest, salary, commission or other remuneration payable to any partner is to be deducted from the firm's profits before computing a partner's share therein under this section, such deduction is not permissible in computing the taxable business income of the firm (See sec. 30(b)).

The allocation of firm's profit or loss amongst the partners is, therefore, made in three stages–

(i) The profit or loss of the firm is to be computed in accordance with the provisions of sec. 28. It may be noted that nothing paid to any partner by way of interest, salary, commission or other remuneration by the firm is allowable.

(ii) Out of the firm's income so computed will be deducted the payments made by the firm to its partners on account of interest, salary, commission or other remuneration.

(iii) Finally, the balance of the firm's profit or loss is distributed amongst the partners according to their profit/loss sharing ratio.

So the share of a partner in a firm (whether a net profit or net loss) will be taken to be any salary, interest, commission or other remuneration payable to him by the firm in the income year increased or decreased respectively by his share in the balance of the profit or loss of the firm after deduction of any interest, salary, commission or other remuneration payable to any partner in respect of the income year.

Cl. (a) or sub-sec.(2) exemption for partner's share in profits of a firm.– This clause grants exemption from income-tax to a partner of a firm in respect of his share in the profits and gains of the firm. However, though the partner's share of profits is thus exempt from tax, it has to be included in his total income by reference to which the rate of tax applicable to his taxable income is determined – Paragraph 16 on part B of Sixth Schedule.

Three points may be noted about the contents of this clause.

First, the exemption applies only in the case of the partners of a firm. The levy is made directly on a firm, in other words, a firm is taxed as a distinct assessable entity and to tax the partners individually again would result in double taxation.

Secondly, the partner's share of profits which is exempt under this section is to be computed in the manner laid down in sec. 43(3), –i.e., it includes any interest, salary, commission or other remuneration payable to him by the firm in addition to his share in the balance of the firm's profits. The result is that any interest, salary, commission or other remuneration received by partner from his firm would be exempt from tax in his hands. Under s.30(Cl.b) any sums paid by way of interest, salary, commission or remuneration by a firm to any of the partners are not deductible from the profits of the firm. Since such sums are taxed as part of the income of the firm, they are not taxed again as the income of the partner to whom they are paid.

Thirdly, the exemption applies only to that portion of a partner's share of profits *on which the tax has already been paid by the firm*. If the firm's income is below the taxable limit or if the firm has committed default in payment of the tax due, the partner's full share of the firm's profits would have to be added to his other income and the benefit of this clause would not be available to him. Where a firm was not assessed to tax because of certain losses which absorbed the entire income and left the firm with a net loss instead of profit, a partner who received interest from the firm on his capital investment in the firm was held not entitled to claim exemption in respect of such interest, for no tax had been paid thereon by the firm *(Kanhaiyalal* v. *C.I.T.* 1937 I.T.R. 730*)*.

While this clause exempts a partner in respect of his share in a firm's profits, in cases where a firm incurs a loss a partner is not allowed to set off, or carry forward and set off, his share of the loss (s. Cl.(b) of sec. 42(3)).

Exemption for member's share in profit of an association of persons –paragraph 15 of part B of Sixth Schedule.–The provisions of this paragraph apply to a member of an association of persons which are identical to the provisions as are contained in paragraph 15 which deal with exemption for a partner's share in profits of a firm. See notes to Paragraph 16 of part B of Sixth Schedule.

Sub-sec.(4): Income of other persons included in assessee's total income: Individual assessable in respect of income of spouse or minor child.–This sub-section aims at foiling an individual's attempt to avoid or reduce the incidence of tax by transferring assets to the spouse or minor child, or admitting the spouse as a partner or admitting a minor child to the benefits of partnership in a firm in which

such individual is a partner *(C.I.T. v. Manilal Dhanji [1962] 44 I.T.R. 876, 881)*. Since this sub-section creates artificial liability to tax, it must be strictly construed *(Ibid)*.

For the purpose of the application of this sub-section, it is immaterial whether the partnership was formed before or after the commencement of the Act *(C.I.T. v. Lakshmanier 1941 I.T.R. 668)* and whether the transfer was effected before or after that date. Since the section deals only with income arising after the introduction of the sub-section, it cannot be held to be retrospective in its operation, even though it covers income arising from transactions effected prior to its insertion *(Pandit Gaya Prasad Tewari v. C.I.T. 1942 I.T.R. 308, 320 (S.B.)*. See, further, under s. 16, "Law to be applied is that in force in the assessment year".).

Cls. (i) and (ii). –Share of spouse or minor child in a firm. –Cls. (i) and (ii) of this section provide that in computing the total income of an individual there should be included the income arising directly or indirectly to the spouse as a partner, or to a minor child from admission to the benefits or partnership, in a firm of which such individual is a partner. If the individual is not a partner in the firm in which the spouse or minor child has a share, the spouse's or minor child's share of profits in such a firm cannot be included under this section in the individual's total income *(C.I.T. v. Gokaldas Hukumchand* 1943 I.T.R. 462, 469*)*, though apart from the provisions of this section it may be so included under the general law if the spouse or minor child is proved to be only a nominee or benamidar of the individual. If it is found that the husband and wife are not partners, cl. (i) of this section would not come into operation *(C.I.T. v. Waliur Rahman* 1946 I.T.R. 287*)*.

If a minor child is purported to be admitted as a full-fledged partner in a firm instead of being admitted to the benefits of partnership, cl. (ii) would have no application and the minor's share of the firm's profits cannot be included in the parent's total income *(Cursetji Dubash v. C.I.T. [1963] 49 I.T.R. 671)*. The Kerala High Court has held that where a minor married female is admitted to the benefits of partnership in a firm in which both her husband and her father are partners, her share of the firm's profits should be included in the total income of her father and not her husband *(Kumaraswamy Reddiar v. C.I.T. [1963] 49 I.T.R. 687)*.

This section would apply irrespective of whether the assessee's spouse or minor children are allowed a share in the firm without any contribution on their part to the capital or assets of the firm, or whether they bring their own capital into the firm. *(C.I.T. v. Lakshmanier 1941 I.T.R. 668)*. Thus this section would apply to a case where the members of a Hindu family, upon severance of the joint family status, continue to run the family business in partnership and a minor son's share in the family property remains in the firm as his contribution to the assets of the partnership *(Ibid)*.

Where the husband and wife are partners in a firm which exercises a *profession*, the husband and the wife ought to be assessable separately is respect of his or her share of the firm's profits but there is no such provision in the law.

Where both husband and wife are partners in a firm, the question arises as to which spouse should be assessed in respect of the other's share of the firm's profits or in respect of the share of profits of a minor child admitted to the benefits of partnership but the 1922 Act was specific on this issue wherein the husband would be assessable for wife's share of income. Indian law however gives the predictable answer–that spouse or parent is to be fastened with vicarious liability whose total income (excluding the income referred to in cl. (i) or (ii), as the case may be) is greater than that of the other. Where any such income is once included in the total income of either spouse or parent, such income arising in any subsequent year should not be included in the total income of the other spouse or parent unless circumstances necessitate such change.

In the absence of a specific provision in law what would be the position of the income of the spouse if the wife owns and manages a business, and she takes her husband into partnership with her in the business as a dormant partner.

Income from membership in the firm. –What is to be included in the total income of an individual under this section is the income of a spouse or minor child arising directly or indirectly "from the membership of the spouse" in the firm, or "from the admission of the minor to the benefits of partnership" in the firm, of which the individual is a partner. This section covers the share of the profits of the firm received by the spouse in his or her *capacity as a partner* or by the minor child in his or her *capacity as one admitted to the benefits* of partnership. But the income received from the firm by the spouse or minor child under any other contract with the firm or in any other capacity, *e.g.*, as a lender or landlord does not fall within these clauses and is not includible in the other spouse's or parent's total income. Thus interest paid by the firm to its members on their contributions to the capital of the firm would arise directly or indirectly from their membership in the firm and would fall within these clauses; but not interest on loans or on voluntary deposits *(Bhogilal Laherchand* v. *C.I.T.* [1954] 25 I.T.R. 523*)*. In other words, the artificial mode of computing a partner's share in the firm's profits laid down in s. 43(3) for other purposes is not decisive under these clauses. When a partner can have a contract of loan, lease, sale or purchase with his firm, there is no reason why he cannot have a separate contract of employment with the firm. Any remuneration paid to a partner by the firm under a separate and distinct contract of employment or for other services is not income arising from membership of the firm and is not covered by these clauses–*C.I.T.* v. *Gurunath Dhakapph 72 I.T.R. 192 (S.C. of India)).*

Income includes loss–In *Dayabhai Vadera* v. *C.I.T. (60 I.T.R. 551)* the Guzrat High Court held that in this sub-section "income" does not include a loss and therefore the share of loss apportioned to a spouse or minor child in a partnership cannot be included in the individual's total income. But in *Kapadia* v. *C.I.T. (87 I.T.R. 511)* the Karnataka High Court, dissenting from the Guzrat decision, held that "income" in this section includes a loss. On general principles, income from membership in the firm would include a loss, and the context of clauses (i) and (ii) does not warrant the contrary construction. The liability to assessment cannot alternate from year to year between the individual and the spouse, depending on

whether there is profit or loss. Besides, in the absence of other income, the right to carry forward the loss in a running business would be completely lost if the individual is to be vicariously liable when there is a profit and the loss is to remain a dead loss in the assessment of the spouse or minor child.

Partnership presupposes at least two majors. –Cl.(ii) of this section would not apply where an individual gives a minor child a share in the profits of the business, and there is no other sharer in the business. The reason is that admitting a minor to the benefits of partnership presupposes partnership, and a partnership presupposes at least two majors; therefore, a minor child cannot be said to have been admitted to the benefits of partnership when the parent and the child are the only sharers in the business *(Jakka Devayya & Sons* v. *C.I.T.* [1952] 22 I.T.R. 264*)*. However, in such a case, Cl. (iv) should be attracted if the minor child is made a sharer otherwise than for adequate consideration, since the grant of a share in the business constitutes a transfer of an asset.

Sub-cls. (iii) and (iv) of cls. (a) and (b). Transfer of assets to or for the benefit or spouse or minor child. –Under cls. (iii) and (iv)(b) the income arising from assets transferred by an individual to the spouse or minor child, or to a person or association of persons for the benefit of the spouse or minor child, would have to be included in the transferor's total income. There are two exceptions to this rule in the case of a transfer of assets to the spouse, –*viz.*, (i) where the transfer is by way of gift or for adequate consideration, or (ii) where it is in connection with an agreement to live apart. Likewise, there are two exceptional cases where income arising from assets transferred to a minor child is not included in the parent's total income, –*viz.*, (i) where the transfer is by way of gift or for adequate consideration, or (ii) where the minor is a married daughter. These two are also the exceptional cases in which the section does not apply to a transfer to a person or association for the benefit of the spouse or minor child of the transferor.

"Before the income can be held to come within the ambit of section 16(3)(a)(iii) and (iv) of I.T. Act, 1922 (Corresponding to sec. 43(4) cls. (iii) & (iv)) it must be proved to have arisen directly or indirectly from a transfer of assets made by the assessee in favour of his wife or minor children and the connection between the transfer of assets and the income must be proximate and the income must arise as a result of the transfer and not in some manner connected with it – *C.I.T.* v. *S. Sivasubramaniam* (reported in 1993 BTD xxi 261)

Transfer for adequate consideration or by way of gift. –A transfer should not only be for good consideration but should be for *adequate* consideration (*i.e.*, consideration equal or nearly equal to the value of the assets transferred) in order that this section may not apply *(H.P. Banerjee* v. *C.I.T.* 1941 I.T.R. *137)*. Natural love and affection cannot constitute "adequate consideration", as the Supreme Court of India held in *Tulsidas Kilachand* v. *C.I.T.* ([1961] 42 I.T.R. 1). Where a person transfers some property to a women in consideration of the forthcoming marriage between them and the marriage takes place, the income accruing to the wife from the property after the marriage can be included in the husband's income under the provisions of section 16(3)(a)(iii) of the Income-tax Act, 1992 but not under the provisions of

section 16(1)(c) inasmuch as the transfer becomes irrecoverable as soon as the marriage takes place –*P.J.P. Thomas* v. *C.I.T. Calcutta*(reported in 1963 PTD v 602).

A settlement of properties made by a father in favour of his minor children to fulfil his legal duty to maintain and educate the children according to their status in life is not a transfer made "otherwise than for adequate consideration" within the meanning of section 16(3)(a)(iv) of the Indian Income-tax Act, 1922 – *S.Viswason* v. *C.I.T., Kerala (reported in* 1964 P.T.D. vi 86).

The assessee transferred a house property to his wife in lieu of dower and claimed that the income from the property belonged to his wife and cannot be included in his total income under section 16(3) of I.T. Act, 1922 (corresponding to sec. 43(4) (a)(iii). It cannot be said that the transaction was without consideration. The assessee had to meet the liability of the dower debt, and since the house was transferred in lieu of that debt, it must be taken to have been transferred for adequate consideration. Income from the said property cannot legally be included in the total income of the assessee. The Central Board of Revenue in its Circular no. 14 of 1959, C. No. 4(38) –I.T.P/59 date 10th August, 1959, which is still in force by law of adoption, giving clarification about application of the provisions of section 9 and sec. 16(3) (corresponding to sec. 24 and section 43(4)), has mentioned that the Board has already issued instructions that *Huq Meher* or dower is adequate consideration and where a property is transferred in lieu of dower by the husband to his wife sec. 16(3) does not apply and the income from the property will not be included in the total income of the husband. It was, however, pointed out that in the Board's Circular No. 6 of 1957 dated the 13th March, 1957 that where "the consideration is not adequate and the property is transferred in favour of the wife the income derived from such property cannot be split-up in proportion of the actual consideration paid, but the same in its entirety will have to be included in the total income of the husband". Putting in the form of a concrete example, these instructions mean that if the dower is Rs.25,000 and the husband gives the property of the value of Rs.50,000 to the wife in lieu of the dower the entire income from the property will be liable to tax in the hands of the husband, because Rs.25,000 cannot be adequate consideration for a property of the value of Rs.50,000. Subsequently the Board reconsidered the issue and has decided thereafter that where the value of the property is more than the amount of dower, for tax purposes it may be recognised that the property to the extent of the quantum of the dower has been transferred to the wife. It is for example, the amount of dower is Rs.50,000 and the value of the property is Rs.75,000 transfer of two-thirds of the property will be considered to be valid for tax purposes and two-third of the income from the property will be liable to tax in the hands of the wife and one-third of the income from the property in question will be liable to tax in the hands of the husband. Circular No. 14 of 1959 C No. 4(38) ITP/519 dated 10-8-59 issued by the Central Broad of Revenue has analysed what would happen to the investment made by wife or husband in a property. If the amount was not given as a gift and not for the purpose of living separately then in that case by fiction of law the husband becomes joint owner of the property. The Madras High Court in the case of *R. Ganesan* v. *C.I.T.* (1963) I.T.R xviii 411 held, where an amount was transferred by an assessee to his wife towards construction of a house otherwise than for adequate consideration or

in connection with an agreement to live apart, the income from the house property was includible in the total income of the assessee but the measure of income to be so included will be subject to the first proviso to section 9(2) of the Act."

"Section 9 does not create an artificial income. In the case of a person occupying the property the income arising therefrom is notional but none the less it is real income and is liable to tax".

The use of expression "indirectly" in section 16(3) (corresponding to section 43(4)) is broad enough to include an income which is not received in *specie* but represent such advantages as the enjoyment of the property might secure, which enjoyment be translated in terms of money. The Calcutta High Court in the case of *G.B. Banerjee* v. *C.I.T., West Bengal* 1979 I.TR. vol. 117 page 446 applied this principle.

Following this principle if the husband invests any money in his wife's property he becomes the joint owner of the property and in consequence he will get exemption under section 32(6) if capital gain is invested in that property. (See exemption has been withdrawn by the Finance Act, 2000)

By way of gift: It was noted in that Circular that one cannot gift away what does not belong to one. Dower cannot therefore be paid from the house-building advance or other loan taken by husband and invested in the property sought to be transferred to the wife wholly or partly, in satisfaction of her dower. But this clarification has been overruled by the Supreme Court of Bangladesh in the case of *Secretary, Ministry of works, Government of Bangladesh v. Sultana Suraya Akhtar and others, reported in 1996 BTD xxiv 252.* It was held in that case that if a transfer is made of the property mortgaged to H.B.F.C. without their prior permission, then the transferee shall be bound to pay the loan due to the Corporation since there is no penal clause in Presidents Order 7 of 1973 (Bangladesh House Building Corporation Order) to the effect that a transfer of property mortgaged to H.B.F.C. shall be deemed to be invalid in the absence of the prior permission of the Corporation. Under Muslim law an oral heba is a valid mode of transfer. This is not an instrument but is a mere piece of evidence which does not require registration within the meaning of sec. 17 of Registration Act.

In a case the assessee took land on lease from D.I.T. and he constructed a building on the lease-hold land. He gifted orally the building to his son and daughter on 30.6.86 and gave possession of the property to them on that date. The oral gift was confirmed by an affidavit on 20.7.93. The lessor D.I.T. recognised the donee on 30.6.90–whether it was effective from 30.6.86 or 30.6.90. Held, in Muslim law gift is complete by mere oral declaration of the gift by the donor, acceptance thereof by the donee and delivery of possession. It was further held that the gift is complete on 30.6.86 and not on 30.6.90 – I.T.A nos. 3053 to 3058 of 1994-95 reported in 1998 B.T.D xxvi 36-37.

It may be noted that the expression "directly or indirectly" which occurs in connection with a transfer to a spouse or a minor child in cls. (iii) and (iv) does not find a place in cl. (b) which deals with transfer of assets to a person or an association

for the benefit of the transferor's spouse or minor child. A simple instance of the type of cases covered by cl. (b) would be a transfer of assets to trustees under a deed of trust for the benefit of the settlor's spouse or minor children *(I.R.* v. *Dewar* 16 T.C. 84 (H.L.)*)*; in such cases the settlor would be taxed under cl. (b) in respect of the income arising to the trustees *(C.I.T.* v. *Sir Mahomed Yusuf Ismail* 1944 I.T.R. 8*)*. Even if the settlor makes a declaration of trust for the benefit of his wife or minor child, under which he himself is the sole trustee, cl.(b) would still apply, for in such a case there would be a constructive transfer from the individual in his personal capacity to himself in his capacity as the trustee *(Tulsidas Kilachand* v. *C.I.T.* [1961] 42 I.T.R. 1 (S.C. of India)*)*. If only a portion of the income of the trust is reserved for the wife or minor child, Cl. (b) would nevertheless apply and that portion of the income which is set apart for the benefit of the wife or minor child would be taxable in the hands of the settlor *(Baidya Nath De* v. *C.I.T.* [1960] 40 I.T.R. 175*)*.

The Allahabad High Court held in *Mohd. Ishaq* v. *C.I.T. ([1951] 19 I.T.R. 70)* that the Almighty in the capacity of a transferee receiving property under a deed of wakf is a juristic entity and therefore a "person" within the meaning of cl. (b), and consequently that part of the income of a wakf created by the assessee, which is received for the benefit of the assessee's wife and minor children, can be included in the total income of the assessee under cl. (b)

The Supreme Court (India) held in *C.I.T.* v. *Kesharlal Patel (55 I.T.R. 637, 640)* that the word "transfer" in this section is used in the strict sense and not in the sense of including every means by which property may be passed from one to another. The expression "from assets transferred" in this section would include a settlement or other transfer subject to restrictions and conditions, as well as an absolute and unconditional gift of the assets *(Hood Barrs* v. *I.R.* 27 T.C. 385 (C.A.)*)*. The grant of a lease of land would amount to a transfer of an asset *(Kali Prasad Singh* v. *C.I.T. [1955] 27 I.T.R. 506)*. A mere loan or advance would not be a transfer of assets *(Murthi* v. *C.I.T. [1961] 42 I.T.R. 379)*. Where a business is transferred as a going concern by a father to his sons, the income from the business coming to the share of the minor sons would be taxable in the hands of the father under cl. (iv) *(Chaturbhujdas Karnani* v. *C.I.T. [1958] 34 I.T.R. 553)* and it is taxable as business income.

A unilateral Act of remuneration or surrender of an interest under a trust is not a transfer" *Tulsidas Kalachand* v. *C.I.T. 42 ITR 1 (S.C. of India))*. But where a company issues right shares and the assessee renounces his right to the shares in favour of his wife or minor child, such renunciation is a transfer covered by cl. (iii) or (iv) –*Harendar Sengh* v. *C.I.T. 83 I.T.R. 416 (S.C. of India))*.

Where a coparcener throws his separate property into the hotch-pot and converts it into joint family property, or when such property is subsequently partitioned among the family members including the coparcener's wife and minor children, there is no direct or indirect transfer by the coparcener to the wife or minor children, and the provisions of cls. (iii) and (iv) are not attracted *(Keshavlal Lallubhai Patel* v. *C.I.T. [1962] 44 I.T.R. 266)*. The position would be the same even if the two processes of conversion and partition are dealt with under a single deed.

If an individual purchases property in the name of his wife with his own money, it would be a transfer of assets within the meaning of cl. (iii) of this section *(Pandit Gaya Prasad Tewari* v. *C.I.T.* 1942 I.T.R. 308 (S.B.)*)*. If thereafter the wife should settle the property upon trust, reserving to herself a portion of the income under the guise of remuneration for services to be rendered by her in connection with the trust properties, the income so reserved to the wife would "arise directly or indirectly from assets transferred" within the meaning of this section and would have to be included in the husband's total income *(Pandit Gaya Prasad Tewari* v. *C.I.T.* 1942 I.T.R. 308 (S.B.)*)*.

In the case of *R. Ganesan* v. *C.I.T., Madras, (1965)* I.T.R. xviii 411 it was held that where an amount was transferred by an assessee to his wife towards construction of a house otherwise than (by way of gift) or for adequate construction or in connection with an agreement to live apart the income from the house property was includiable in the total income of the assessee but the measure of income to be so included will be subject to the first proviso to sec. 9(2) of the I.T. Act, 1922. As a result the assessee may become the joint owner of the property.

The effect of the principle as discussed putting in the form of concrete examples of the C.B.R's circular (Circular No. 14 of 1959, C. No. 4(38) –ITP/59 dated the 10 the August, 1959) will be that in case of joint contribution by husband and wife in the construction of a building, both of them will be joint owner and share the income of the building according to the extent of investment made by them in the construction of the building (see also under "Income from House Property" – sec. 24).

Where amounts stand to the credit of the wife in the husband's business accounts, and the husband admits that some of the amounts were gifted by him and fails to prove the source from which the other moneys came, the Department would be entitled to presume that they represent assets transferred otherwise than for adequate consideration by the husband to the wife and to include the interest earned on such amounts in the husband's total income *(Sinnaswami Pillai* v. *C.I.T. 1942 I.T.R. 71)*.

This section applies to income arising from assets transferred to or for the benefit of an individual's spouse or minor child, to capital gains arising from the transfer of such assets–*Sevantilal Setha* v. *C.I.T. 68 ITR 503 (SC of India)* and to income arising from new assets into which the assets originally transferred might have been converted but it does not apply to income arising from accumulated income or from *accretions* to such assets. If an individual transfers shares to his minor son, bonus shares received by the son in respect of his shareholding would not be "assets transferred" to the son but would be *accretions* to the asset transferred; and the dividend on the bonus shares cannot be included in the father's income under cl. (iii) *(Popatlal Bhikamchand* v. *C.I.T.* [1959] 36 I.T.R. 577*)*.

Income *actually arising* from assets transferred is covered by this section, but not income *deemed to arise* by fiction of law from such assets. Thus, in the case of shares purchased by the wife out of funds provided by her husband, the *notional* dividend which was *deemed* to have been distributed in respect of those

shares could not be included in the husband's income(*C.I.T.* v. *Phirozshaw Mistry [1959] 36 I.T.R. 582).*

Where the assessee borrows money to make a gift of it to his minor son, he is entitled to deduct the interest paid on the loan from the income arising from the money gifted which is included in his total income under the section –*Kevalchand Mehta* v. *C.I.T.* 67 I.T.R. 804.

"Individual"–In *C.I.T.* v. *Sodra Devi* and *Damayanti Sahni* v. *C.I.T. ([1957] 32 I.T.R. 615)* the Supreme Court of India held that in s. 16(3) of the 1922 Act the word "individual" did not include females. That decision would not apply under the present section in which the word "individual" obviously includes females. Therefore, cases of a gratuitous transfer of assets by a mother to her minor child or the admission of a minor child to the benefits of partnership in a firm of which the mother is a partner fall within this section and the minor's income in such cases is includible in the mother's total income.

Step child or illegitimate child. –In this section the word "child" includes a step child and an adopted child (s. 2(18)) and it means a ligitimate child and does not include an illegitimate child. Consequently, where an illegitimate minor son of an assessee is admitted to the benefits of partnership in a firm of which the assessee is a partner, or a trust is created by the assessee in favour of his illegitimate minor child, the minor's share of the firm's profits *(C.I.T.* v. *Rajasundaram Chetty 1950 I.T.R. 145)* or the income of the trust *(Executors of Krishna Iyer* v. *C.I.T. [1960] 38 I.T.R. 144)* cannot be included in the income of the assessee.

"Spouse".–Pre-nuptial transfer. –The word "wife" or "spouse" does not include a female with whom the assessee has an illicit connection, for however long a period *(Executors of Krishna Iyer* v. *C.I.T. [1960] 38 I.T.R. 144).* In order to attract the application of cl. (iii) the relationship of husband and wife should subsist not only at the time of the accrual of income but also when the transfer of assets is made. The principle that emerges from the Indian Supreme Court's decision in *Philip Thomas* v. *C.I.T. (*[1963] 49 I.T.R. (S.C. of India) 97*)* is that a transfer which takes effect before marriage is not made to the "spouse" and is not covered by cl. (iii), even though it may be made in consideration of a promise to marry or may be a gift subject to the subsequent condition of marriage; and that English decisions based on the general principle of aggregation of the wife's income with the husband's are not in point.

"Immediate or deferred benefit".–Cl. (b) would apply even if the trust is for the "deferred benefit" of the minor child and the minor child derives no benefit under the trust in the accounting year. "Deferred benefits here means benefit deferred to a year subsequent to the accounting year in which the income is taxable, so long as it is not deferred beyond the minority of the child. The reason is that the section requires that the income to be for the *"benefit of the minor child"*, even when the benefit is deferred. Thus cl. (b) would apply even if the income during minority is to be accumulated and added to the corpus and the income from the increased corpus or the income therefrom is to be given to the child after attaining majority.

After child attains majority.–After the child attains majority, this section would cease to apply and the income from assets transferred to or for the benefit of the child would no longer be taxable in the parent's hands. Cls. (iv) and (b) of this section would cease to apply also in the case of a minor daughter getting married. For the purposes of this section and for determining whether the child is a minor, the material period is the income year. Therefore if a son, who was admitted to the benefits of partnership in a firm in which the father was a partner, was a minor throughout the accounting year, his share of profits for that year would have to be included in the father's income notwithstanding that the assessments on the firm and the father might be made after the son attains majority *(Chimanlal Lalbhai 1944 I.T.R. 199)*. If the son admitted to the benefits of partnership attains majority in the course of the accounting year and elects to become a partner before the end of that year, and under the terms of the partnership the profits are to be ascertained only at the end of the year, no part of the son's share of profits of that year would be includible in the father's total income under this section, not even a proportionate part computed up to the date when the son attained majority *(Bhogilal Laherchand* v. *C.I.T. [1955] 28 I.T.R. 919)*.

Benami or incomplete transactions.–This section does not avoid or invalidate transfers made in favour of the transferor's spouse or minor child *(H.P. Banerjee* v. *C.I.T. 1941 I.T.R. 137)*. On the contrary, it assumes that the transfer is valid and genuine and that the income from the assets transferred is in fact the income of the spouse or minor child *(Ibid)*. If the transfer is not genuine and the spouse or minor child is only a nominee or benamidar of the transferor, apart from the provisions of this section, the income may be included in the transferor's total income under the general law. Similarly, if the transfer to the spouse or minor child is not valid, effective and complete, the income will continue to remain that of the intending transferor under the general law and the provisions of this section would not apply.

Cross Transfers. –In *C.I.T.* v. *Kothari ([1963] 49 I.T.R. 107)* the Supreme Court of India held that cross transfers–*e.g.* a transfer of assets by A for the benefit of B's wife and a transfer of assets of equal or nearly equal value by B for the benefit of A's wife–which are so intimately connected as to form parts of a single transaction, are covered by this section, though the two transfers may not be mutual *i.e.* each transfer may not constitute consideration for the other in the technical sense. The decision rested on the ground that such cross transfers were comprehended by the word "indirectly" in cl. (iii) and sub-cl. (b) which expressly refer to "assets transferred directly or indirectly". But from the mere facts that a transfer is made by A to B and after sometimes by B to A's wife or minor child and the subject matter of the transfers is the same, an inference cannot be drawn that they are parts of the same transaction so as to amount to an indirect transfer by A to his wife a minor child–*C.I.T.* v. *Wadilal Chunilal 47 I.T.R. 305*. Since the words 'directly or indirectly" do not occur in cl.(b) which deals with trusts created for the benefit of the settlor's spouse or minor child, the decision in *Kothari's* case may not apply to a case of "cross" trusts.

Retirement of father and admission of minor son to benefits or partnership. –The Madras High Court held in *Sayani* v. *C.I.T. ([1963] 49 I.T.R. 903)*

that where the father retired from a partnership and his minor son was admitted, with the same share, to the benefits of the partnership after it was reconstituted, and the amount standing to the credit of the father in the firm was transferred to the credit of the son, there was in substance an indirect transfer of the father's interest in the firm to the minor son whose share of profits was therefore assessable in the father's hands.

Sub-sections 5 and 6: Transfers and settlements.–Commenting on the corresponding legislation in England Lord Macmillan said in *Chamberlain* v. *I.R. (25 TC. 317, 329-30 (H.L.))* "This legislation ..... designed to overtake and circumvent a growing tendency on the part of tax payers to endeavour to avoid or reduce tax-liability by means of settlements ..... the method consisted in the disposal by the tax-payer of part of his property in such a way that the income should no longer be received by him, while at the same time he retained certain power over, or interest in, the property or its income. The legislator's counter was to declare that the income of which the tax-payer had thus sought to disembarrass himself should notwithstanding, be treated as still his income and taxed in his hands accordingly"–Quoted from *Tulsidas Kilachand* v. *C.I.T. (1961) 42 I.T.R. 1, 4 (S.C. of India)*. Under these sub-sections income which arises to any parson (a) by virtue of a settlement or disposition, whether revocable or not, from assets remaining the property of the settlor or disponer or (b) by virtue of a revocable transfer of assets, (assets not remaining the property of the transferor) shall be deemed to be the income of the settlor or transferor, as the case may be, and taxed as *his* income.

Scope and effect of these sub-section. –The effect or scope of these sub-sections are as follows–

I. Transfer of income without transfer of assets.–All income arising to any person by virtue of any transfer, settlement, trust, covenant, agreement or arrangement, *from assets remaining the property of the person* who made the transfer, settlement, etc., is deemed to be the income of that person and is taxable in his hands. It is immaterial whether the transfer, settlement, etc., is revocable or not. There is no exception to this rule.

II. Revocable transfer of assets.–All income arising to any person by virtue of a *transfer of assets* (it may be a settlement, trust, covenant, agreement or arrangement or any other kind of transfer) is deemed to be the income of the transferor and taxed in his hands–

(a) if the transfer is revocable, or

(b) if it contains any provision for the direct or indirect retransfer of the whole or any part of the income or assets to the settlor, disponer or transferor, or

(c) if in any way it gives the transferor a right to reassume power directly or indirectly over the whole or any part of the income or assets.

Transfer of income without transfer of assets. –In cases where by virtue of a transfer (which includes under s. 43(6)(b) disposition, a settlement, trust, covenant, agreement or arrangement) income arises to any person and there is no

transfer of the assets from which the income arises, the income may, on general principles, be regarded as the income of the transferor and be assessed in his hands, though it would be applied in a particular manner under the legal obligation *(Provat Kumar Mitter* v. *C.I.T.* [1961] 41 I.T.R. 624 (S.C. of India)*)*. (See under s. 16 "Application of income and its diversion by overriding title") This section provides that in all such cases the income should be assessed as the income of the transferor, thus rendering it unnecessary to decide the question whether in a given case under the general law the income is the income of the transferor or of the other person to whom it arises by virtue of the transfer.

Revocable transfer of assets. –All income arising to any person by virtue of a revocable transfer of assets is chargeable under this section as the income of the transferor. The words "revocable" and settlement, disposition or "transfer" in this sub-section must be given the artificially extended meanings ascribed to them by cl. (b) of s. 43(6)(a). (see further under "Scope and effect of these sub-section" *ante*)

"Revocable".–Retransfer of income or assets to settlor, or right to reassume power. –For the purposes of this clause a transfer, settlement, etc. is revocable, notwithstanding that the power of revocation is not absolute or unqualified. For example, even if a transfer can be revoked only with the consent of any named person or persons, e.g. the beneficiaries, it would nevertheless be revocable *(Behramji Lalkaka* v. *C.I.T.* 1948 I.T.R. 301*)*. Though the revocation may be contingent or conditional still the deed remains a revocable deed of trust (See further under "When trust comes to an end" *ante*). Likewise an out and out sale which provides for retransfer to the vendor in certain contingencies would still be revocable within the meaning of this clause *(Tarunendra Nath Tagore* v. *C.I.T.* [1958] 33 I.T.R. 492*)*. Again, it is not necessary that the power of revocation should be exercisable by the settlor himself. A trust which is irrevocable at the settlor's instance but can be revoked by the trustees is a revocable trust. A limited power of revocation enabling the settlor to appoint new beneficiaries would also make the settlement revocable within this clause *(Keshavlal Punjaram* v. *C.I.T.* 1944 I.T.R. 185*)*. But where a trust-deed contained a provision to the effect that in certain circumstances a beneficiary would forfeit all interest in the trust properties and in such a case the interest forfeited would vest in the other beneficiaries, and, further, the deed empowered the settlor to cancel the forfeiture and declare that such a beneficiary would continue to be entitled to his share, it was held that the right to cancel the forfeiture was not a "right to reassume power over the income or assets" and did not make the trust revocable within this clause *(Tayabali Mandiwalla* v. *C.I.T.* 1949 I.T.R. 187*)*. Likewise where the settlor is himself a trustee, provisions in the trust-deed to prevent frivolous litigation or limiting the rights of the beneficiary to question the *bona fides* or certain acts of the trustees, cannot be construed as giving the settlor-trustee the right to reassume power over the income or assets *(C.I.T.* v. *Sir S.M. Bose* [1952] 21 I.T.R. 135*)*.

A trust will not be revocable within this clause merely because the income of the trust is to be applied in payment of the debts of the settlor: such a provision cannot be treated as one for indirect retransfer of income to the settlor and the fact that he

derives a direct or indirect benefit is irrelevant in the case of irrevocable trusts *(Raghbir Singh* v. *C.I.T. [1961] 42 I.T.R. 410)*.

In *Ratilal Nathalal* v. *C.I.T. [1951] 20 I.T.R. 307*, which was affirmed by the Indian Supreme Court on appeal *(C.I.T.* v. *Ratilal* Nathalal *[1954] 25 I.T.R. 426)*, the Bombay High Court laid down three propositions: –

(a) Where a settlement is made by two or more persons, this clause would be satisfied if there is a provision for retransfer, directly or indirectly, of the income or assets to *any one* of the settlors, it being not necessary that such a provision should be in favour of all the settlors.

(b) Where a settlement is made of property belonging to a Hindu undivided family and the settlement is executed by all the coparceners in their capacity as members of the *joint family, the joint family may be regarded as the "settlor"*.

(c) In the case of such a settlement of joint family property, if a member who has executed the settlement as representing the joint family, is given a beneficial interest in the income *in his individual capacity* and for his personal benefit, that would not be a case of retransfer of income *to the joint family*, the trust would not be a "revocable trust" within this clause, and the income received by the coparcener in his individual capacity would not be includible in the total income of the joint family.

When trust comes to an end. –In *Behramji Lalkaka* v. *C.I.T. (1948 I.T.R. 301)* the assessee settled certain properties upon trust for the benefit of his three children. In accordance with the terms of the trust-deed, upon the death of one of the children the property set apart for him was held by the trustees absolutely in equal shares for the other two children. Held, in respect of the property so held absolutely for the two surviving children the trust had come to an end, the trustees who were in possession were merely bare trustees, and the income from the property arose to the children no longer by virtue of the trust but by reason of the fact that they had become the absolute owners of the property. Therefore, s. 16(1)(c) of the 1922 Act corresponding to the present sub-section had no application, and though the trust-deed reserved to the settlor the power of revocation, the income in question could not be deemed to be his income and taxed in his hands.