

CHAPTER-6

COMPLICATIONS RELATING TO INCOME FROM OTHER SOURCES AND SUGGESTIONS TO OVERCOME THEM

6.1 BASIS OF CHARGE :

As per section 56(1), income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under the head "Income from other sources", if it is not chargeable to income-tax under any of the heads specified in section 14, items A to E. Therefore, an income which is not income from "Salaries", "Income from house property", "Profits and gains of business or profession" or "Capital gains", is to be computed and brought to charge under the head Income from other sources."¹

"Income from other sources" is the last and the residuary head of income which comes into operation only when the preceding 4 heads of income are in- applicable. The Supreme Court has held that the residuary head of income can be resorted to only if none of the specific heads is applicable to the income in question and it comes into operation only after the preceding heads are excluded.² Further, the Supreme Court has, in this connection, made two important observation.³ :

- (1) An income can be charged to tax under the residuary head only if none of the specific heads is applicable to the income in question.
- (2) Where an item of income is taxable under one of the specific heads of income and charge under that head of income exhausts the chargeability of income to tax, no part of such income can be charged to tax under the residuary head.

Thus, an income which is neither chargeable under the first 4 heads of income nor which is exempt from tax under sections 10 to 13A, is chargeable to tax under the head "Income from other sources".

6.2 ITEMS OF INCOME SPECIFICALLY CHARGEABLE UNDER

THIS HEAD :

As per section 56 (2), the following 3 incomes are always chargeable to tax under this head of income :

6.2.1 Dividend :

Income by way of dividend when taxable is always taxable under the head "Income from other sources". Therefore, dividend from a foreign company and deemed dividend from an Indian company under section 2 (22) (e) are taxable in the hands of shareholders under this head, regardless of the fact whether shares are held by the assessee as investment or as stock in trade. An Indian company has itself to pay tax on dividend declared by it under section 115-O and its shareholders are exempt from payment of tax in respect of the amount of dividend.

In ordinary parlance, dividend means the amount paid to or received by a shareholder in proportion to his shareholding in a company, out of the total sum so distributed. As per section 2(22) which gives inclusive definition of dividend, dividend includes :

- (a) any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company;
- (b) any distribution to its shareholders by a company of debentures, debenture stock, or deposit certificates in any form, whether with or without interest, and any distribution to its preference shareholders of shares by way of bonus, to the extent to which the company possesses accumulated profits, whether capitalised or not;
- (c) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not;
- (d) any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before April 1, 1933, whether such accumulated

profit have been capitalised or not;

- (e) any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) made after May 31, 1987, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company, in either case, in possesses accumulated profits.

As per explanation 2 to section 2(22), the expression "accumulated profits" in the above subclauses shall include all profits of the company upto the date of distribution or payment referred to in these clauses, and in sub-section (c) shall include all profits of the company upto the date of liquidation, but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Govt. or a Corporation owned or controlled by the Govt. under any law for the time being in force, include any profits of the company prior to three successive previous years immediately preceding the previous year in which such acquisition took place. As per explanation 3, a person shall be deemed to have a substantial interest in a concern, other than a company, if he is, at any time during the previous year, beneficially entitled to not less than 20% of the income of such concern. When dividend is paid by an Indian company under clauses (a) to (d), as stated above, the company will pay dividend tax under section 115-0 and the amount of dividend will be exempt in the hands of the shareholder as per section 10(33)/34 with effect from April 1, 2003. But when dividend is paid as per clause (e), as stated above, it is taxable in the hands of the shareholder and the company will not pay tax on dividend.

With effect from April 1, 2000, the following shall not be treated as

"dividend"—

- (a) any payment made by a company on purchase of its own shares in accordance with the provisions contained in section 77A of the companies Act¹; or
- (b) any distribution of shares made in accordance with the scheme of demerger by the resulting company to the shareholders of the demerged company whether or not there is a reduction of capital in the demerged company.

Treatment of loan/advance to the extent of accumulated profits as dividend

In the case of a closely-held company, payment by way of loan/advance is treated as dividend to the extent of accumulated profits under section 2(22) (e) in the following two cases :

- (1) Such loan/advance is given to a registered shareholder who beneficially holds 10% or more of equity shares in the loan-giving company. Loan or advance may be given to a shareholder directly or it may be given for the benefit of shareholder or on behalf of shareholder. Such loan/advance is treated as dividend to the extent of accumulated profits other than capitalised profits.
- (2) Such loan/advance is given to a "concern" which may be a HUF, sole proprietor, firm, AOP, BOI or a company whereby one of the shareholders beneficially holding 10% equity share capital in the closely-held company has a substantial interest in the "concern". Such loan or advance is treated as dividend in the hands of the "concern". A person is deemed to have a substantial interest in a concern, if he is, at any time during the previous year, beneficially entitled to at least 20% of income of such concern; if such concern is a company, then he should beneficially hold at least 20% equity share capital of the company.

It is noteworthy, in this connection, that shares held by a person in two different capacities—as individual and as HUF, cannot be clubbed for the purpose of deciding whether a person has substantial interest in a concern¹.

If after giving loan or advance to a shareholder, the company declares normal dividend which is set off against outstanding loan or advance, the amount so set off will not be taken as dividend.

Basis of Charges of dividend income :

The charge by way of tax on income from dividend is fixed by section 8 and method of accounting followed by an assessee does not affect this charge in any way. Section 8 prescribes that for the purposes of inclusion in the total income of an assessee –

- (a) any dividend declared by a company or distributed or paid by it within the meaning of sub-clauses(a) to (e) of section 2(22) shall be deemed to be the income of the previous year in which it is so declared, distributed or paid, as the case may be;
- (b) any interim dividend shall be deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the member who is entitled to it.

6.2.1.1 Judicial pronouncements relating to "accumulated profits"–As regards clause (a) under section 2(22), the Supreme Court has held that as no specific mode of distribution is prescribed by the clause, distribution may be in the form of payment in cash or kind. The court held that where a company being entitled to purchase shares in another company in which it was shareholder, distributed such right among its own shareholders in proportion to their shareholding, such distribution of the right amounted to dividend¹. The Court held that dividend need not be distributed in money; it may be distributed by delivery of property or right having monetary value. Further, the Supreme Court held² that when assets are distributed as dividend, amount of dividend is taken to be the market value of the property on the date on which the shareholders become entitled to receive dividend.

As regards clause (c) under section 2(22), the Supreme Court has held that in a scheme of piecemeal distribution, when distribution is made by liquidator, the distribution is deemed to take place in same proportion in which share capital and accumulated profits stood immediately before the distribution in the accounts of the company³.

As regards clause (d) under section 2(22), the Delhi High Court has held that where there is only reorganisation of capital, which results in splitting up of the capital of the company into two companies and there is no reduction of capital in the aggregate, section 2(22) (d) will not apply⁴.

As regards clause (e) under section 2(22), the Supreme Court has held that under this clause, the word "shareholder" refers to the registered shareholder and not merely beneficial owner of a share and hence a loan granted to a beneficial owner of shares, who is not a registered shareholder, cannot be regarded as loan or advance of a "shareholder" so as to fall within the mischief of section 2(22) (e)⁵.

6.2.1.2 Deductions in respect of income from dividend—The income which is taxable by way of dividend is computed after making the following deductions :

- (1) Commission or remuneration for realising dividend—As per section 57(i), an assessee is allowed deduction in respect of any reasonable sum paid by way of commission or remuneration to a banker or any other person hired for the purpose of realising dividend chargeable under this head. Such expenditure is deductible on "due basis" if the assessee follows the mercantile system of accounting and on "payment" basis if the assessee follows the cash system of accounting.
- (2) Any other expenditure incurred for earning such income—As per section 57(iii), any other expenditure is deductible if it is—
 - (i) laid out or expended wholly and exclusively for the purpose of making or earning the income;
 - (ii) not in the nature of capital expenditure;
 - (iii) not in the nature of personal expenses of the assessee; and
 - (iv) laid out or expended in the relevant previous year and not in any prior or subsequent year.

It is not necessary that any income should in fact have been earned as a result of the

expenditure¹. The expenditure or outgoing sought to be deducted should bear a character which has a connection with or relation to the particular activity which produces the income or constitutes its source. The Madras High Court, in this connection, held that where there is no connection or relationship between the litigation expenditure and the dividend income, the expenditure cannot be deducted from the dividend income². It is submitted that the decision of the Madras High Court is quite appropriate in this regard. Also, it is essential that the source of income must exist at the time when the expenditure is incurred. The Allahabad High Court disallowed the expenditure claimed by HUF on account of interest and expenses in respect of a block of shares which, following its partition, ceased to belong to it³. The contention of the High Court, it is submitted, is quite tenable in view of the fact that the impugned shares were not held by the HUF in the relevant previous year.

In this connection, it is important to note that the following expenses are not deductible by virtue of section 58(1) (A) :

- (i) Personal expenses of the assessee.
- (ii) Any interest payable outside India on which tax has not been deducted at source.
- (iii) Any salary payable outside India on the payment of which tax has not been deducted or paid.

6.2.2. Winning from lotteries, etc.

Receipts by way of winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever are chargeable to tax under the head "Income from other sources" even if the person receiving the amount of winnings is a dealer in sale and purchase of lotteries, etc. As per Explanation to section 2(24) (ix), "lottery" includes winnings from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called. Also, according to this Explanation, "card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar

game. As per explanation (b) to section 74A, "horse race" means a horse race upon which wagering or betting may be lawfully made.

Incidence of Tax on Winnings—As per section 115 BB, it is the amount of gross winnings from lotteries, crossword puzzles, races including horse races other than income from the activity of owning and maintaining race horses, card games and other games of any sort or from gambling or betting of any nature whatsoever which is chargeable to tax without claiming any allowance or expenditure. The amount of gross winnings is chargeable to tax at a flat rate of 30%¹. Section 58(4) specifies that no deduction shall be allowed under any provision of the Act in computing the income by way any winnings as stated above. Thus, while computing the income from winnings no deduction is available in respect of the following :

- (a) Section 57.
- (b) Losses under sections 70, 71 and 72.
- (c) Section 80C to 80 μ.

However, as per Circular No. 461, dated July 9, 1986, where a certain percentage has to be foregone by the winning of lotteries, etc. the the Govt. or agency conducting the lotteries, it is deductible as it amounts to diversion by overriding title.

Conversion of "net winning" into "gross winning"—As per section 194 B, the person responsible for paying to any person any income by way of winnings from any lottery or crossword puzzle or card game and other game of any sort in an amount exceeding Rs. 5,000 shall, at the time of payment thereof, deduct income-tax thereon at the rates in force. Thus the person responsible for making payment on account of winnings shall be paying "net amount of winnings" but the amount includible in taxable income of the recipient will be the amount of "gross winnings". Therefore, when information regarding "net winnings" is given in the question, it shall have to be converted into "gross winnings".

Similarly, with respect to winnings from horse race, section 194 BB states that any person, being a bookmaker or a person to whom a license has been granted by the Govt. under any law for the time being in force for horse racing in any race course or for arranging

for wagering or betting in any race course, who is responsible for paying to any person any income by way of winnings from any horse race in an amount exceeding Rs. 2500 shall, at the time of payment thereof, deduct income-tax thereon at the rates in force. In this case also, if "net amount of winning" received is given, then it shall be grossed up to find out the amount of "gross winning" which is includible in taxable income. "Net winnings" can be converted into "Gross winnings" with the help of the following formula :

"Net winnings" is the amount received by the recipient after tax deduction at source. Rate of tax when surcharge is applicable is 33.99% and when surcharge is not applicable rate of tax is 30.9%. Surcharge is leviable at the rate of 10% in the case of an individual/HUF/AOP/BOI when income in a year exceeds Rs. 10 lac and in the case of firm/domestic company when income exceeds Rs. 1 crore. Surcharge is levied at the rate of 10% in the case of artificial juridical person whatever be the amount of income. Surcharge is levied at the rate of 2.5% in the case of a non-domestic company. No surcharge is leviable in the case of co-operative society and local authority. Education cess and secondary and higher education cess are levied at the rates of 2% and 1% respectively on the amount of income tax and surcharge for every assessee.

It is noteworthy that TDS is not required in the case of winnings from races other than horse races, gambling and betting. Therefore, there is no difference between the amounts of "net winning" and "gross winning" in the case of such winnings.

Also, as per provision to section 194 B, where the winnings from lottery or crossword puzzle or card game and other game of any sort are wholly in kind or partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of the winnings, the person responsible for paying shall before releasing the winnings, ensure that tax has been paid in respect of the winnings.

6.2.3 Gifts—As per section 56(2) (vi), in the case of an individual and HUF, if any sum of money is received without consideration on or after April 1, 2006 from any person/persons in excess of Rs. 50,000 in a year, entire amount is chargeable to tax in the

hands of the recipient. If the amount of receipt is upto Rs. 50,000 it would be exempt from tax. Any sum of money received in the following cases shall not be considered for this purpose :

- (1) Money received from a relative—The term 'relative' means (i) spouse of the individual; (ii) brother or sister of the individual; (iii) brother or sister of the spouse of the individual; (iv) brother or sister of either of the parents of the individual; (v) any lineal ascendant or descendant of the individual; (vi) any lineal ascendant or descendant of the spouse of the individual; and spouse of the person referred to in (ii) to (vi) above.
- (2) Money received on the occasion of the marriage of the individual. Marriage gift may be received from relatives, friends or any other person. Gifts on other occasions as, for example, birthday, etc. will, however, be chargeable to tax.
- (3) Money received by way of will or inheritance.
- (4) Money received in contemplation of death of the payer.
- (5) Money received from a local authority.
- (6) Money received from any fund, foundation, university, other educational institution, hospital, medical institution, any trust or institution referred to in section 10(23c) as given in the Appendix 6.2.
- (7) Money received from a charitable institute registered under section 12 AA; the procedure of registration of such institute so is given in Appendix 6.3.

It is important to note that gifts in kind are not covered under section 56 (2) (vi) as discussed above.

Also, the status of trusts has been held to be that of an individual, so receipt without consideration by a trust is taxable alongwith the receipt by an individual and HUF. Thus, a sum of money received by a firm, a company, AOP, BOI without consideration is not taxable under section 56(2) (vi). In the case of an individual and

HUF, gift of money in excess of Rs. 50,000 in a year is taxable whether the recipient is a resident or non-resident; likewise, the donor of gift may be resident or non-resident.

The applicability of the above provisions relating to gifts can be understood with the help of the following example.

Example 6.5

Mr. X gets the following gifts in the previous year 2008-09. What shall be the taxability of gift under each situation for the assessment year 2009-10.

- (i) Gift of Rs. 50,000 on Aug. 12, 2008 from his friend.
- (ii) Gift of jewellery worth Rs. 2 lac on Oct. 27, 2008 from his fiancée.
- (iii) Gift of Rs. 21,000 each from his two friends on Dec. 25, 2008 on his marriage.
- (iv) Gift of Rs. 68,000 on Oct. 5, 2008 from the brother of his father.
- (v) Gift of Rs. 35,000 on Nov. 11, 2008 from friend of his wife on the occasion of his marriage.
- (vi) Gift of Rs. 26,000 on Jan. 15, 2009 from father in law of his brother.
- (vii) Gift of Rs. 41,000 on May 31, 2008 from his friend.

Solution :

**Computation of Taxable Gifts on Mr. X
for the assessment year 2009-10**

Particulars	Amount(Rs.)
(i) Gift from friend [Aggregate of sum of money received in the previous year exceeds Rs. 50,000]	50,000
(ii) Gift of Jewellery (Being in kind)	Exempt
(iii) Gift on occasion of marriage from friends	Exempt
(iv) Gift from brother of father (Being from relative)	Exempt
(v) Gift on occasion of marriage from friend of wife	Exempt

(vi) Gift from father in law of brother (being from non-relative)	26,000
(vii) Gift from friend	41,000
Income from other sources	1,17,000

Note : Since aggregate of sum of money received as gift exceeds Rs. 50,000 entire amount of Rs. 1,17,000 is taxable.

6.3 INCOMES TAXABLE AS 'INCOME FROM OTHER SOURCES' WHEN NOT TAXABLE UNDER THE HEAD 'PROFITS AND GAINS OF BUSINESS OR PROFESSION'.

Following 4 incomes have been specified to be taxable under the head "Income from other sources" when the same are not taxable under the head "Profits and gains of business or profession" :

6.3.1 Employees' contribution towards staff welfare schemes :

As per section 2(24) (x) read with section 56(2) (ic), any sum received by the assessee from his employees as contributions to any provident fund, recognized or unrecognized or superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act,1948, or any other fund for the welfare of such employees is taxable in the hands of the employer under the head "Income from other sources" if it is not chargeable to income tax under the head "Profits and gains of business or profession".

Infact, an employer is allowed deduction under section 57(ia) in respect of any sum received by him as contribution from his employees towards any welfare fund of such employees only if such sum is credited by the employer to the account of the employees in the relevant fund before the due date prescribed in this regard. For this purpose, "due date" is the date by which the employer is required to credit such contribution to the account of the employees in the relevant fund under the provisions of any law or terms of contract of service or otherwise.

This can be easily understood with the help of the following example.

Example 6.1

PQR Ltd. earned a profit of Rs. 12 lac during the previous year 2008-09 after debiting salary to employees Rs. 8 lac. A contribution of Rs. 1 lac is included in the amount of salary of Rs. 8 lac by way of employees' contribution towards provident fund. Out of the amount of Rs. 1 lac, the company transferred Rs. 60,000 before the due date of crediting such payment and Rs. 40,000 after the due date of crediting such payment. Calculate the taxable income of PQR Ltd. for the assessment year 2009-10.

Solution :

Computation of Taxable Income of PQR Ltd. for the assessment year 2009-10

Particulars	Amount(Rs.)
Net profit as per P&L A/c	12,00,000
Add : Employees' contribution towards provident fund treated as income of the company	1,00,000
Total Income	13,00,000
Less : Amount credited by the company before the due date of crediting such sum	60,000
Taxable income of PQR Ltd.	12,40,000

Thus, the company is not allowed the deduction of Rs. 40,000 credited by it after the due date of crediting such sum. The same interpretation holds while computing income from business or profession. If the credit of employees' contribution is not made upto the "due date", deduction under section 36(1) (va) is not available even if–

- (i) salary is actually paid to employees before the, "due date", or
- (ii) employees' contribution to provident fund is paid within the previous year.

6.3.2 Interest on securities

6.3.2.1 Meaning of Security– A "security" is a document held by an investor or creditor guaranteeing his right to receive back payment in respect of debt given to Govt. or other bodies by way of loan, debentures or bonds. When these securities are held as stock-in-trade, income from interest earned thereon is chargeable as income from business. When these securities are held as investment, income from interest is chargeable as income from other sources. Interest on securities, as per section 2 (28B), means–(i) interest on any security of the Central Govt. or a State Govt.; (ii) interest on debentures or other securities for money issued by or on behalf of a local authority or a company or a corporation established by a central, state or provincial Act.

6.3.2.2 Type of securities–Securities may be divided into two categories–Govt. securities and non-Govt. or commercial securities. Govt. securities include securities, bonds including National Development Bonds, loans and National Savings Certificates issued by the Central or State Govts. Debentures, bonds including Development bonds, loans and securities issued by semi-Govt. bodies and companies are included in non-Govt. securities. Non-Govt. securities are also known as commercial securities.

Govt. securities may, further, be divided into two categories–tax free and non-tax free. The Govt. has the power to waive tax on any of the securities issued by it¹. The amount of interest on such securities is fully exempt in the hands of the person who holds such securities. Amount of interest on such securities is not included in taxable income of the person holding such securities.

In the case of non-tax free securities of the Govt., interest accruing is chargeable to tax. But TDS is not applicable in the case of such securities. So, in the case of such securities the amount of interest received is the same as the amount of gross interest which is included in taxable income of the person holding such securities.

Likewise, non-Govt. securities may be classified into two categories–less tax and tax free. 'Less tax' non-Govt. securities are the securities in respect of the amount of interest of which tax is deducted at sources by the body issuing such securities before making payment of interest to the person holding it. The amount of interest received by the assessee together

with the amount of TDS i.e., the amount of gross interest is included in the taxable income of the assessee.

Tax free non-Govt. securities are the securities in respect of the amount of interest of which tax is paid by the body issuing the security on behalf of the purchaser of security; the person holding such security is not required to pay tax on the amount of interest due to him. This is the reason that such, security is known as 'tax-free' security. The amount of tax deposited by the security issuing authority with the Govt. is also included in the taxable income of the assessee along with the amount of interest due or received by him. This is the reason that such, security is known as 'tax-free' security. Of course, the assessee will get relief from tax in respect of the amount of tax paid by the security issuing body on behalf of the assessee at the time of his assessment. It is the amount of gross interest that is included in taxable income of the assessee. If information regarding interest received is given, it can be converted into the amount of gross interest by applying the following formula—

The rate of tax in the case of securities issued by Semi-Govt. bodies and in the case of debentures listed at a recognized stock exchange in India, is 10%. The rate of tax in respect of other securities of the non-Govt. bodies is 20%. So, amount of gross interest in the case of non-listed debentures of a company in the case of which surcharge is not applicable will be—

Amount of gross interest in the case of non-listed debentures of a company in the case of which surcharge is applicable will be—

Likewise, in the case of securities of semi-Govt. bodies and non-listed debentures of companies in the case of which surcharge is not applicable, amount of gross interest will be—

$$\text{or Net interest} \times 100 / 79.4$$

When surcharge is applicable in the case of semi-Govt. bodies and companies issuing non-listed securities, amount of gross interest will be—

$$\text{or Net interest} \times 100 / 77.34$$

6.3.2.3 Accrual of interest on securities—Interest on securities accrues on certain fixed date/dates which is/are specified at the face of the security. In the case of an annual security, only one date is specified on the face of the security; in the case of half-yearly security, two dates are specified on the face of the security with an interval of exactly six months; and so on. In the case of an annual security, entire amount of interest relating to one year falls due on the due date specified on the security even if the holder of the security purchased it only on the previous day. Thus, supposing Mr. X purchased Rs. 20,000, 10% security the interest of which falls due on Jan. 1, every year. On this security interest of Rs. 2,000 will accrue to Mr. X even if he purchased this security on the previous day viz., Dec., 31, 2008, Mr. X is liable to pay tax on entire amount of interest of Rs. 2,000 which will fall due to him on Jan. 1, 2009 even if he held it for just one day.

This rule may give rise to the tendency of indulging in bond-washing transactions with a view to avoid payment of tax. A bondwashing transaction is the transaction where securities are sold to relatives, friends or employees some time before the due date of interest which are again acquired back after the due date of interest is over. The securities are transferred to person/persons whose taxable income even after including income from such securities is either nil or is liable to tax at a low rate. The transaction of sale and then purchase is just a sham and the security, in fact, remains with the original purchaser. As per section 94(1), income from such securities will be deemed to be the income of the transferor and not that of the transferee.

Further, as per section 94(2), when securities are sold cum-interest i.e., including interest, so that either no income is received by him or less income is received by him than the sum to which the income would have amounted if the income from such securities had accrued from day to day and been apportioned accordingly, then the income from such securities for such year shall be deemed to be the income of such person. However, if the assessee proves that there has been no avoidance of tax or the avoidance was not planned by the assessee, the provisions of sections 94(1) and 94(2) are not applicable.

6.3.2.3 Interest on securities exempt from tax—According to section 10(15) interest

on the following securities is exempt from tax and is, thus, not included in taxable income of the assessee who holds them :

- (1) Notified bonds, securities or certificates issued by the Govt. and notified deposits which include :
 - (i) 12-year National Savings Annuity Certificates.
 - (ii) National Defence Gold Bonds, 1980.
 - (iii) Special Bearer Bonds, 1991.
 - (iv) Treasury Savings Deposit Certificates (10 Years)
 - (v) Post Office Cash Certificates (5 Years).
 - (vi) National Plan Certificates (10 Years)
 - (vii) National Plan Saving Certificates (12 years)
 - (viii) P.O. National Savings Certificates (12 Years/7 Years)
 - (ix) P.O. Savings Bank Account.
 - (x) P.O. Cumulative Time Deposit Account (15 years)
 - (xi) Fixed Deposit Scheme governed by the Govt. Savings Certificates (Fixed Deposit) Rules, 1968.
 - (xii) Fixed Deposit Scheme governed by the Post Office (Fixed Deposit) Rules, 1968.
 - (xiii) Special Deposit Scheme, 1981.
 - (xiv) Public Account in Post Office (Upto Rs. 5000).
- (2) Notified Relief Bonds in the case of individuals and HUF.
- (3) Securities held by the Issue Department of the Central Bank of Ceylon.
- (4) Deposits made by a foreign bank performing central banking functions outside India with any scheduled bank in India with the approval of the Reserve Bank of India.
- (5) Loan advanced by Nordic Investment Bank to a project approved by the Central Govt.
- (6) Loan granted by European investment Bank in pursuance of the framework agreement for financial co-operation entered by the Central Govt. with this bank.

- (7) Debt or money borrowed by Govt. or a local authority from foreign sources.
- (8) Money borrowed by an industrial undertaking engaged in the manufacture or processing of goods or in the business of generation or distribution of electricity or any other form of power or in mining or in construction or in the operation of ships or air crafts or construction of rail system or provisions of telecommunication services or the manufacture of computer software, from the notified foreign financial institutions.
- (9) Money borrowed or debt incurred by an industrial undertaking, as stated in (8) above, in a foreign country in respect of purchase outside India of raw-material, capital plant and machinery component.
- (10) Money borrowed from abroad by IFCI, IDBI, ICICI, Export Import Bank of India, NHB, or SIDBI.
- (11) Money borrowed from abroad by any other financial institution (other than the ones stated under (10) above) established in India or a banking company under a loan agreement approved by the Central Govt.
- (12) Money borrowed by an industrial undertaking, stated under (10) above, in a foreign currency from sources outside India under a loan agreement approved by the Central Govt.
- (13) Deposits made by a non-resident or a not-ordinarily resident with a scheduled bank in foreign currency which is approved by the RBI.
- (14) Deposits from abroad with a public company carrying on business of providing long-term finance for construction or purchase of houses in India for residential purposes, in foreign currency from foreign sources under an approved agreement.
- (15) Bonds and debentures issued by public sector companies specified by the Central Govt.
- (16) Deposits under a notified scheme made by a retiring Govt. employee or public sector employee out of his retirement benefits for a lock-in-period of 3 years.

- (17) Securities held by the welfare commissioner, Bhopal Gas Victims, Bhopal in Reserve Bank, SGL Account No. SL/DH 048.
- (18) Deposits held in notified account with the RBI or with a public sector bank for the benefit of victims of the Bhopal gas leak disaster.
- (19) Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999.
- (20) Notified Bonds issued by local authority or by State Pooled Finance Entity.
- (21) Deposits made in an Offshore Banking Unit by a non-resident or not-ordinarily resident assessee.

6.3.2.4 Persons and funds exempt from tax on interest on securities—As per sections 10, 11 and 13A, interest on securities held by the following persons is exempt from tax :

- (1) Local authority.
- (2) Approved scientific research association.
- (3) Any regimental fund or non-public fund.
- (4) An institution existing solely for the development of khadi and village industries.
- (5) Authority established for the development of khadi and village industries.
- (6) Any body or authority constituted for the administration of public religious trusts or endowments.
- (7) The Prime Minister's National Relief Fund, the Prime Minister's Fund for the Promotion of Folk Art, the Prime Minister's Aid to Students Fund, or any other notified institution.
- (8) Registered trade union.
- (9) Statutory provident fund, recognized provident fund, approved superannuation fund and approved gratuity fund.

- (10) Member of a scheduled tribe.
- (11) Corporation or other body or institution established for promoting the interest of the members of scheduled castes/scheduled tribes.
- (12) Public charitable and religious trust or institution.
- (13) Political Party registered with the Election Commission of India.

6.3.2.5 Deduction in respect of Income from interest on securities—The two deductions allowed in this respect as per section 57 are the same as have been discussed under 6.2.1.2 in respect of income from dividend viz., (i) Commission or remuneration for realising interest on securities and (ii) any other expenditure incurred for earning such income.

6.3.2.6 Examples relating to computation of income from interest on securities—The computation of income from interest on securities can easily be understood with the help of the following examples—

Example 6.2

The following securities are held by Mr. X as on April 1, 2008 :

- (a) Rs. 50,000, 8% debentures of ABC Ltd., (dated of payment of interest are June 15 and Dec. 15 every year).
- (b) Rs. 5,00,000, 5% Bihar Govt. Loan (date of payment of interest is January 1).
- (c) Rs. 80,000, 6% non-listed debentures of PQR Ltd. (dates of payment of interest being April 15, and Oct. 15 every year).
- (d) Rs. 10,000, 6.5% Central Govt. loan (date of payment of interest being July 10 every year)
- (e) Rs. 20,000, 9% Relief Bonds.

On Dec., 1, 2008 Mr. X sells 8% debentures of ABC Ltd., Mr. X borrows Rs. 5,20,000 for investing in securities of Bihar Govt. Loan and Relief bonds on April 1,2008 at

the rate of 6% per annum. What shall be the income from interest on securities taxable for the assessment year 2009-10 ?

Solution :

**Computation of interest on securities of Mr. X
for the assessment year 2009-10**

Particulars	Amount(Rs.)
(a) Rs. 50,000, 8% debentures of ABC Ltd., sold on Dec. 1, 2008 [50,000 x 8/100 x 6/12]	2,000
(b) Rs. 5,00,000, 5% Bihar Govt. Loan [5,00,000 x 5/100]	25,000
(c) Rs. 80,000, 6% non-listed debentures of PQR Ltd. [80,000 x 6/100]	4,800
(d) Rs. 10,000, 6.5% Central Govt. Loan [10,000 x 6.5 / 100]	650
(e) Rs. 20,000, 9% Relief Bonds	Exempt
Gross Interest	32,450
Less : Interest on Loan u/s 57 [5,00,000 x 6/100]	30,000
Income from interest on securities	2,450

Notes : (1) Deduction in respect of interest on loan obtained for investment in Relief Bonds is not available since interest income from Relief Bonds is exempt from tax.

(2) Deduction in respect of full amount of interest on loan payable in respect of investment in purchase of Bihar Govt. loan is available even if it is more than income by way interest on such securities. This is due to the fact that the amount of interest payable to the lender by Mr. X is taxable in the hands of the lender and thus the Govt. is not going to loose on this account.

Example 6.3

Mr. X, a resident individual, receives in cash the following income as interest on

securities during the previous year ending March 31, 2009 :

- (a) Rs. 4,000 as interest on Govt. securities.
- (b) Rs. 3,600 as interest on debentures issued by the local authority.
- (c) Rs. 3,600 as interest on debentures of PQR Ltd., (not listed at any stock exchange in India).
- (d) Rs.7,200 as interest on debentures of ABC Ltd. (listed on Delhi Stock Exchange).
- (e) Rs. 7,200 as interest on tax free debentures of GE Ltd., (not listed on any stock exchange).

Assuming that the interest is paid in each case on June 30 and Dec. 31, what is the income from interest on securities for the assessment year 2009-10 ?

Solution :

**Computation of Income from interest on securities of Mr. X
for the assessment year 2009-10**

Particulars	Amount(Rs.)
(a) Govt. securities (TDS does not apply)	4,000
(b) Debentures of a local authority (3,600x100/89.7)	4,013
(c) Debentures of PQR LTd. (not listed) (3,600x100/79.4)	4,534
(d) Debentures of ABC Ltd. (Listed) (7,200x100x89.7)	8,026
(e) Tax free debentures of GE Ltd. (not listed) (7,200x100/79.4)	9,068
Gross Interest	29,641
Less Deduction u/s 57	Nil
Income from interest on securities	29,641

Example 6.4

Mr. X, a resident individual, submits the following particulars of income for the previous year ending March 31, 2009 :

Dividend from REC International Ltd. (Gross) Rs.4,800; Dividend from Sundaram

Finance Ltd. Rs. 2,700; interest paid on capital borrowed for the purpose of investment in shares of Sundaram Finance Ltd. Rs. 4,200; collection charges in respect of dividend Rs. 460. Winnings from lottery net amount Rs.69,100. Tax deducted at source Rs. 30,900. Winnings from card games Rs. 23,500. Interest on securities issued by the Govt. of Singapore Rs. 20,570.

What will be the income of Mr. X under the head 'Income from other sources' for the assessment year 2009-10 ?

Solution :

**Computation of income from other sources of Mr. X
for the assessment year 2009-10**

Particulars	Amount(Rs.)
(a) Dividend from Indian companies	Exempt
(b) Winnings from Lottery (Rs. 69,100 + Rs. 30,900)	1,00,000
(c) Winnings from Card Games	23,500
(d) Interest on securities of Govt. of Singapore	20,570
Income from other sources	1,44,070

Notes : (1) Interest on Capital borrowed for investment in shares of Sundaram Ltd., an Indian company and collection charges in respect of dividend income are not deductible because dividend from Indian companies is exempt from tax.

(2) Interest on securities issued by Govt. of Singapore is not required to be grossed up because TDS by foreign Govt. is not relevant here.

6.3.3 Rental income of machinery, plant or furniture :

According to section 56(2) (ii), income from machinery, plant or furniture belonging to the assessee and let on hire is taxable as income from other sources if the same is not chargeable to tax under the head "Profits and gains of business or profession". The Kerala High Court, in this connection, held that where a company leased out printing machinery and

a distillery plant on rent and the company never carried on at any time neither the business of printing nor that of a distillery, the income received by the company by way of rent from leasing of printing machinery, etc., should be assessed under the head "Income from other sources"¹. It is submitted that the decision of the Kerala High Court is justified.

6.3.3.1 Deductions in respect of income from letting of machinery, plant or furniture—As per section 57(ii), the following deductions are available in respect of income from letting of machinery, plant or furniture :

- (a) Repairs and insurance—As per section 31, if the owner lets out plant, machinery or furniture, the lessee is entitled for deduction in respect of current repairs and insurance. The claim of the assessee in respect of expenditure in excess of "current repairs" would not be sustainable even though it is specially provided in the lease deed. In such case, if lessor makes expenditure on current repairs and such expenditure is necessary for earning of income from letting out, the lessor would be entitled for deduction under section 57(ii).

The expression "current repairs" means repairs which are attended to when the need for them arises from the point of view of the assessee and which are not allowed to be accumulated. Current repairs is meant to preserve and maintain an already existing asset. The Supreme Court has, in this connection, held that the basis object of the expenditure should be to 'preserve and maintain' an already existing asset and it should not be to bring a new asset into existence or to bring a new advantage².

- (b) Depreciation—'Depreciation' is the diminution in value which occurs gradually over useful life of a material thing due to physical wear, tear and decay, and is generally limited to losses or decline in value which cannot be restored by current repairs and maintenance. The words 'machinery', 'plant' and 'furniture' have not been defined in the Act. Therefore, one has to depend upon their natural meaning and interpretations given by the different Courts. The meanings of these terms, conditions for claiming depreciation on them and the system of 'block of assets' used in computing

depreciation have already been discussed in detail in Chapter 4 above.

- (c) Any other expenses for earning income—As per section 57 (iii), any other expenditure is deductible if the following conditions are fulfilled—
- (i) the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning the income.
 - (ii) the expenditure must not be in the nature of capital expenditure;
 - (iii) it must not be in the nature of personal expenses of the assessee; and
 - (iv) it must be laid out or expended in the relevant previous year and not in any prior or subsequent year.

The Supreme Court has, in this connection, held that the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning income whether any income is earned as a result of the expenditure or not¹. Also, it is essential that the source of income must exist in the period when the expenditure is incurred, otherwise it shall not be allowable.

6.3.4 Income from composite letting of building, machinery, plant or furniture :

As per section 56(2) (iii), if an assessee lets on hire machinery, plant or furniture and also building and letting of building is inseparable from letting of machinery, plant or furniture, income from such letting is taxable as "Income from other sources" if the same is not chargeable to tax, under the head "profits and gains of business or profession" what is contemplated under section 56 (2) (iii) is that the letting of machinery, plant or furniture should be inseparable from the letting of the building and that the letting of building need not be incidental to letting of plant, machinery or furniture¹. Here, it is not required that the primary letting must be of the machinery, plant or furniture. The Supreme Court has held, in the case of Sultan Bros.(P.) Ltd. V. CIT that the letting of building would be intended to be inseparable from letting of machinery, plant or furniture when the following 3 conditions are

fulfilled–

- (i) The intention while making the lease should be that the two assets are enjoyed together; whether the lease is one or two;
- (ii) the intention inherent in the lease should be that the letting of the two assets is practically one letting; and
- (iii) the tenant should not accept the lease of the one without the other asset.

These tests are found to be practically applied in the following instances–

- (a) Lease of cinema building with furniture and other articles–Rental income from a Cinema building which is given on lease under a lease deed which indicates that the lease in respect of the theatre as such includes furniture and other articles therein is taxable under the head "Income from other sources" This has been so held by the Andhra Pradesh High Court²; the view of the court, it is submitted, is quite logical and tenable.
- (b) Letting of hotel building and furniture–When building and fixtures/furniture are used for one purpose all together i.e., for running a hotel and not one separately from the other, income from letting out is taxable under section 56 as "Income from other sources", not withstanding that the sum payable for their enjoyment is fixed separately³.
- (c) Letting out of rooms with furniture by a club-when a club lets out rooms alongwith furniture and other facilities solely to its members, the consolidated rent charged by the owner of the club is classifiable as "Income from other sources" and not as income from house property. This has been so held by the Allahabad High Court¹. It is submitted that the contention of the High Court is quite tenable and logical.
- (d) Letting out of building with air-conditioning plant, lifts, etc.,–When an assessee lets on hire building with air-conditioning plant, tubewells, referigerators, etc., on rent collectively as "demised premises", entire rental income is chargeable to tax under the head "Income from other sources" even if rent is fixed separately for buildings and

furniture². This view of the Calcutta High Court, it is submitted, is quite logical. Likewise, the same High Court held that where there is no letting of lift or air-conditioning plant alongwith the letting of the building, the income derived from letting of building would be assessable as "Income from house property" and the lift and airconditioning charges would be taxed as "Income from other sources" and would be shown separately in the assessment order³. This view of the Court; it is submitted, is quite logical and required to be made into law by the Govt.

6.3.4.1 Deductions in respect of income from letting of machinery, plant or furniture alongwith building—As per section 57 (ii), where income is derived from letting out of machinery, plant or furniture on hire and also buildings where the letting of building is inseparable from the letting of such machinery, plant or furniture and the income from such letting is not chargeable to income-tax under the head "Profits and gains of business or profession", the following expenses incurred in respect of these assets are deductible :

- (a) Current repairs of building—The expression "current repairs" connotes repairs which are attended to when the need for them arises from the point of view of the assessee and which are not allowed to be accumulated. As a result of expenditure for current repairs an already existing asset is preserved and maintained. The object of such expenditure is not to bring a new asset into existence⁴. If the amount spent is for the purpose of bringing into existence a new asset or obtaining a new advantage, then such an expenditure would be a capital expenditure which is not allowed to be deducted.
- (b) Insurance premium against risk of damage or destruction of the premises—As per section 30, any premium paid in respect of insurance against risk of damage or destruction of premises is deductible.
- (c) Repairs and insurance of machinery, plant or furniture—Amount spent on account of current repairs and insurance of machinery, plant and furniture are deductible while computing income from other sources in respect of machinery, plant or furniture let on hire alongwith building under section 57(ii) of the Act.

- (d) Depreciation–Deduction for depreciation in respect of machinery, plant, furniture and building is allowed to be deducted in respect of loss or decline in their value which gradually occurs due to physical wear, tear and decay over their useful life; it is generally limited to losses or decline in value which cannot be restored by current repairs and maintenance.

6.4 INCOME TAXABLE AS "INCOME FROM OTHER SOURCES" WHEN NOT TAXABLE UNDER THE HEADS "SALARY" OR "PROFITS AND GAINS OF BUSINESS OR PROFESSION".

As per section 56 (2) (iv) read with section 2 (24) (xi), any sum received under a keyman insurance policy including the sum allocated by way of bonus on such policy is taxable as "Income from other sources" if the same is not taxable as income from "salary" or as "Profits and gains of business or profession". As per Explanation to section 10 (10D) "Keyman insurance policy" means a life insurance policy taken by a person on the life of another person who is or was the employee of the first-mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person. An employee who is placed at a key post or position with an employer is termed as "keyman" and, accordingly, he handles some important responsibility. The employer, in order to give incentive to him and to motivate him, obtains special insurance policy for him.

6.5 EXAMPLE OF OTHER INCOMES CHARGEABLE UNDER THE HEAD "INCOME FROM OTHER SOURCES"

The residuary head of income viz., "Income from other sources" can be invoked only when there is an "income" which is not exempt from tax under sections 10 to 13A and which is not covered under other 4 heads of income. An exhaustive list of incomes chargeable under this head cannot be given because never and never ways of earning income are being devised and explored these days which cannot be predicted beforehand. Human mind is proving to be too fertile to devise legal as well as illegal ways to earn income. This is the reason that ways of earning income, now-a-days, are limitless and, thus, a compact list of incomes chargeable under this head cannot be provided. However, the following are

examples of income chargeable under the head "Income from other sources" other than the incomes discussed above.

- (1) Invigilation and examinership remuneration in respect of different examinations.
- (2) Salary received from the Govt. by Members of Parliament and Members of Legislative Assemblies.
- (3) Remuneration by whatever name called which is received by an employee from a person other than his employer.
- (4) On retirement of an employee, interest included in accumulated amount received by an employee from unrecognized provident fund and from provident fund¹ which is, though, recognized but which does not fulfil the requirement of contribution to the fund for a continuous period of at least 5 years.
- (5) Honorium for delivering lectures.
- (6) Rent of vacant plot of land.
- (7) Income from sub-letting.
- (8) Income from undisclosed and unexplained source :
 - (i) Cash credits which are unexplained—As per section 68, where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the A.O., satisfactory, the sum of credited may be charged to income tax as the income of the assessee of that previous year.
 - (ii) Unexplained investments—As per section 69, where in the financial year immediately preceding the assessment year the assessee has made investments which are not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the

opinion of the A.O., satisfactory, the value of the investments may be deemed to be the income of the assessee of such financial year.

- (iii) Unexplained money—As per section 69A, where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and such money, etc., is not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of acquisition of the money, etc., or the explanation offered by him is not, in the opinion of the A.O., satisfactory, the money and the value of the bullion, jewellery or other valuable article may be deemed to be the income of the assessee for such financial year.
- (iv) Amount of investments, etc., not fully disclosed in the books of account—As per section 69B, where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article, and the A.O. finds that the amount expended on making such investments or in acquiring such bullion, etc., exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of income, and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of the A.O., satisfactory, the excess amount may be deemed to be the income of the assessee for such financial year.
- (v) Unexplained expenditure—As per section 69C, where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof, or the explanation, if any, offered by him is not satisfactory, in the opinion of the A.O., as the case may be, may be deemed to be the income of the assessee for such financial year. Such unexplained expenditure, notwithstanding anything contained in any other provision of the Act, which is deemed to be the income of the assessee shall not be allowed as a deduction under any other head of income.
- (vi) Amount borrowed or repaid on hundi—As per section 69D, where any amount is

borrowed on a hundi from, or any amount due thereon is repaid to, any person otherwise than through an account payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount aforesaid for the previous year in which the amount was borrowed or repaid, as the case may be. Such person shall not be liable to be assessed again in respect of such amount under the provisions of this section on repayment of such amount. The amount repaid, as stated above, shall include the amount of interest paid on the amount borrowed.

- (9) Compensation received for use of business assets.
- (10) Annuity payable to the lender of a trade mark.
- (11) Interest on bank deposits and loans.
- (12) Income from royalty when not chargeable as income from business.
- (13) Ground rent.
- (14) Agricultural income accruing from abroad.
- (15) Director's free including sitting fees.
- (16) Director's commission for under writing shares of a new company or for standing as a guarantor to bankers.
- (17) Insurance commission.
- (18) Family pension received by family members of a deceased employee. As per section 57 (ii a), a deduction equal to Rs. 15,000 or 1/3 of such income, whichever is less, is available by way of standard deduction from such income.
- (19) Interest on securities of a foreign Govt.
- (20) Casual income being, say, money found on the road.
- (21) Mining rent and royalties.
- (22) Interest which is earned before the commencement of business¹.

- (23) Tax on salary of an employee who is working under a contract which is borne by the payer of salary by way of legal obligation.
- (24) Interest on cumulative time deposit.
- (25) Interest on deposit with a firm.
- (26) Income on units of mutual funds.
- (27) Royalty on books.
- (28) Remuneration in respect of participating in a radio-talk.
- (29) Income from articles published in newspapers, magazines, etc.
- (30) Winnings from a wager.
- (31) Income from providing car on hire.
- (32) Income from markets, ferries and fisheries, etc.
- (33) Rent of trade mark.
- (34) Gratuity received by a director from a company when he is not an employee of the company.
- (35) Amount withdrawn from deposit in National Savings Scheme, 1987 on which deduction u/s 80 CCA has been allowed including interest thereon.
- (36) Receipts by cricketers selected to play for India :
 - (i) Test matches in India—Amount actually received by a player from the Cricket Control Board is taxable after allowing a deduction of an amount equal to 75% of such receipt in respect of reasonable expenses incurred to earn such income.
 - (ii) Other matches in India—Generally, the entire receipts by a player from the Cricket Control Board is deemed to have been spent for earning such income and hence is exempt from tax.
 - (iii) Matches outside India—A player is allowed a deduction of 50% of the amount

received for playing in foreign countries and the balance is taxable.

- (37) Tips received by a waiter or taxi-driver which is not given by his employer.
- (38) Winnings from race-course.
- (39) Tax on Salary–Tax on salary of the assessee borne by payer, for whom the assessee was working under a contract, under a legal obligation, is assessable as income of the payee under the head "Income from other sources"¹.
- (40) Money received by an assessee from a business or profession which is discontinued prior to the commencement of the previous year².

6.6 IMPACT OF METHOD OF ACCOUNTING

Method of accounting regularly used by an assessee exercises a great impact on computation of income from other sources. If an assessee used mercantile method of accounting, income and expenditure falling "due" during the previous year are taken into consideration. The difference between the two is treated as income from other sources no matter when income is received and, also, no matter when payment for expenses is made. If an assessee uses cash method of accounting, all payments for expenses made during previous year are taken into consideration no matter to which year they relate. Likewise, all receipts of income during the previous year are taken into consideration no matter to which year they relate. The difference between receipts and payments is income from other sources. However, in case no particular method of accounting is followed regularly, income by way of interest on securities is computed by following the mercantile method.

6.7 EXAMPLES SHOWING THE COMPUTATION OF INCOME FROM OTHER SOURCES :

The following examples help to understand the application of above stated provisions relating to computation of income from other sources :

Example 6.6

Mr. X submits the following particulars of his income for the year ending March, 31,

2009 :

Particulars	Amount(Rs.)
(a) Director's fee from a company	35,000
(b) Dividend received from a foreign company	50,000
(c) Income from agriculture in Pakistant	52,000
(d) Dividend from an Indian Company	28,000
(e) Dividend from a Co-operative Society	32,000
(f) Winnings from Lottery received	48,370
(g) Interest on Post Office CTD	18,000
(h) Ground Rent	14,000
(i) Interest on F.D. in a Bank	12,000
(j) Honorarium for delivering lectures	32,000

Mr. X borrowed Rs. 60,000 @ 10% p.a. on April 1, 2008 for investment in shares of the Indian company. He spent Rs. 5,000 for purchasing the lottery tickets.

Compute income from other sources of Mr.X for the assessment year 2009-10

Solution

**Computation of income from other sources of Mr. X
for the assessment year 2009-10**

Particulars	Amount(Rs.)
Director's free from a company	35,000
Dividend from a foreign company	50,000
Income from agriculture in Pakistan	52,000
Dividend from an Indian Company	Exempt
Dividend from a co-operative society	32,000
Winning from lotteries (48370x100/69.1)	70,000
Interet on Post Office CTD	Exempt
Ground rent	14,000

Interest on F.D. in a Bank	12,000
Honorarium for delivering lectures	32,000
Gross Income	2,97,000
Less : Deductions u/s 57	Nil
Income from other sources	2,97,000

Notes : (1) No deduction is available in respect of interest on money borrowed for investment in shares of Indian company because dividend from such companies is exempt from tax in the hands of shareholders.

(2) No deduction is available in respect of winnings from lotteries u/s 57 read with section 58(4).

(3) Winnings from lotteries is grossed up by using 30.9% to be the rate of tax; had the income of Mr. X been more than Rs. 10 lac, the rate for grossing up the amount of winnings would have been 33.99%.

Example 6.7

Mr. X presents the following particulars of his income and investment for the assessment year 2009-10; what shall be his income from other sources :

- (a) Rs. 5,000 p.m. received by way of salary for serving as a part time teacher in a school
- (b) Received Rs. 10,000 by way of dividend on preference shares of an Indian company and paid Rs. 500 by way of collection charges.
- (c) Rs. 25,000, 11% Tamil Nadu Govt. Securities.
- (d) Rs.28,000, 12% Delhi Development Bonds.
- (e) Rs. 17,470 received as interest on tax free securities of Chits India (P.) Ltd., Company.
- (f) Rs.8,000 received as interest on Haryana Govt. Securities.
- (g) Rs. 20,000, 11% (compound interest) saving certificates purchased on June 1, 2005.
- (h) Interest received on tax free securities of a public limited company Rs. 3,200.
- (i) Rs. 15,000 units of mutual funds on which income received Rs. 1,800/-
- (j) Rs. 2,000 received by account payee cheque as interest on listed debentures of a

company in which the public are substantially interested. He collected interest himself but filed papers claiming Rs. 800 as collection charges.

Solution :

**Computation of Income from other sources of Mr. X
for the assessment year 2009-2010**

Particulars	Amount(Rs.)
Dividend on preference shares	Exempt
Rs. 25,000, 11% Tamil Nadu Govt. Securities	2,750
Rs. 28,000, 12% Delhi Development Bonds	3,360
Rs. 17,470 received as interest on tax free securities of Chits India (P) Ltd., $(17,470 \times 100 / 79.4)$	22,003
Rs. 8,000 received as interest on Haryana Govt. securities	8,000
Rs. 20,000, 11% (Compound interest) savings certificates purchased on June 1, 2005	3,009
Interest received on tax free securities of a public limited company $(3,200 \times 100 / 79.4)$	4,030
Income on units of mutual funds	Exempt
Rs. 2,000 received by way of account payee cheque as interest on listed debentures of a company	2,000
Gross Income	45,152
Less : Deductions u/s 57	Nil
Income from other sources	45,152

Notes : (1) Part time salary is chargeable to tax under the head "Salary".

(2) Collection charges paid in respect of dividend on preference shares are not deductible because preference dividend is exempt from tax.

(3) Interest on savings certificates for the fourth year of their purchase has been calculated as follows :

Interest for first year = $(20,000 \times 11/100) = \text{Rs. } 2,200$

Interest for second year = $(20,000 + 2,200) \times 11/100 = \text{Rs. } 2,442$

Interest for third year = $(22,200 + 2,442) \times 11/100 = \text{Rs. } 2,711$

Interest for fourth year = $(24,642 + 2,711) \times 11/100 = \text{Rs. } 3,009$

(4) Income received by way of account payee cheque on listed debentures is not grossed up, as per section 193, because the amount is less than Rs. 2,500/-

(5) No deduction is available for amount spent by the assessee on collection of interest himself.

Example 6.8

Mr. X, an M.P. from U.P. submits the following particulars of his income for the assessment year 2009-10. Compute his income from other sources.

Particulars	Amount(Rs.)
Salary as M.P.	68,000
Daily allowance as M.P.	28,000
Agricultural income from Pakistan	1,50,000
Royalty from a book on poems	40,000
Cash found in his locker, the sources of which he could not explain	5,00,000
Interest credited to recurring deposit	32,000
Interest credited to CTD A/c in Post Office	42,000
Rent from letting building alongwith plant, machinery & furniture (Per month)	20,000
Dividend from domestic company	35,000
Winnings received from Karnataka State Lotteries	66,010
Winnings from Card games	10,000

He claimed deduction for Rs. 2,800 as expenditure on typing and stationery in respect

of the book written by him. He claimed the following expenses as deduction in respect of the building let out on rent—

Insurance	5,000
Repairs	6,000
Depreciation	10,000

Solution :

**Computation of income from other sources of Mr. X
for the assessment year 2009-10**

Particulars			Amount(Rs.)
Salary as M.P.			1,68,000
Daily allowance as M.P.			Exempt
Agricultural income from Pakistan			1,50,000
Royalty from the book	40,000		
Less : Deductions u/s 57	<u>2,800</u>		37,200
Income from undisclosed sources			5,00,000
Interest on Post Office Recurring A/c			32,000
Interest credited to Post Office CTD A/c			Exempt
Rent of building alongwith plant, machinery & furniture	2,40,000		
Less : Deductions u/s 57 :			
Insurance	5000		
Repairs	6000		
Depreciation	<u>10000</u>	<u>21000</u>	2,19,000
Dividend from a domestic company			Exempt
Winnings from Karnataka Govt. Lotteries (66010x100/66.01)			1,00,000
Winnings from Card Games			10,000
Income from other sources			12,16,200

Note : Since total income exceeds Rs. 10 lac, the rate of TDS on winnings from

lotteries will be $[(30+3) \times 3\% \text{ on } 33]$ or 33.99%.

6.8 COMPLICATION RELATING TO COMPUTATION OF "INCOME FROM OTHER SOURCES" AND SUGGESTIONS TO OVERCOME THEM :

6.8.1 Most of the income stated to be chargeable under this head may actually be charged under other heads :

Eight incomes have been specified, as per section 56(2), to be chargeable under the head "Income from other sources". But, the truth of the matter is that out of the eight specified incomes only three incomes :

(i) dividend, (ii) winnings from lotteries, etc. and (iii) gift, are taxable under the head "Income from other sources" and rest of the five incomes will become chargeable under the head "Income from other sources" when such incomes are not taxable under other head or heads. As regards chargeability of 4 such incomes—(i) employees' contribution towards welfare scheme, (ii) interest on securities, (iii) rental income of machinery, plant or furniture and (iv) rental income of letting out of plant, machinery or furniture alongwith letting out of building when the two lettings are inseparable, it is stated u/s 56(2) that these incomes will become chargeable under the head "Income from other sources" only when they are not chargeable under the head "Profits and gains of business or profession". Likewise, as regards the taxability of income received under keyman insurance policy, it has been stated u/s 56(2) that such income could be charged under the head "Income from other sources" only when such income is not charged to tax under the heads "Profits and gains of business or profession" or under the head "salarly". Thus, the statement u/s 56(2) that 8 incomes are chargeable under the head "Income from other sources" is confusing; it ought to have been avoided. Even otherwise, a list of 100 incomes or so can be given specifying the incomes which are chargeable under the head "Income from other sources" only. However, the specification given u/s 56(1) is quite tenable and logical where it is stated that "income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under the head "Income from other sources", if it is not chargeable

to income-tax under any of the other heads specified u/s 14¹.

6.8.1.1 Suggestion to remove the short coming—Rather than suggesting that 8 income are chargeable under the head "Income from other sources", only this much would be logical to say that an income which is not income from salary, which is not income from house property, which is not income from profits and gains of business or profession and which is not income from capital gains, is the income which is "Income from other sources". All the respondents have opined that section 56(2) should be omitted. The Supreme Court has very rightly stated in this regard that "an income can charged to tax under the residuary head only if none of the specific heads is applicable to the income in question"². It is suggested that if section 56(2) is withdrawn, it would remove the confusion in this regard. The law would become more appropriate specially in view of the fact that "Income from other sources" is undoubtedly the residuary head of income. This leads to suggest that name of the last head of income should be changed from "Income from other sources" to Income from residuary sources". This will take care of the problem of enumerating specific incomes to be chargeable under this head. Infact, this is exactly proposed by the Finance Minister Mr. Pranab Mukherjee in the Direct Taxes Code presented on Aug., 12, 2009.

6.8.2 Definition of 'Dividend' u/s 2 (22) is not exhaustive—

Dividend income whenever taxable, is taxable under the head "Income from other sources" regardless of the fact whether shares are held by the assessee as investment or as stock-in-trade. However, the definition of "dividend" as laid down u/s 2(22) is inclusive as given above. It is stated to include 5 types of incomes under "dividend" from 2(22) (a) to 2(22) (e). Not only this, as per section 2(22), the following 6 incomes are not included in "dividend"—

- (i) a distribution made in accordance with sub clause (c) and (d) in respect of any share issued for full cash consideration, where the holder of the share is not entitled, in the event of liquidation, to participate in the surplus assets;
- (ii) a distribution made in accordance with sub-clauses (c) and (d) is so far as such

distribution is attributable to the capitalised profits of the company representing bonus shares allotted to its equity shareholders during April 1, 1964 and March 31, 1965;

- (iii) any advance or loan made to a shareholder or the said concern by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company.
- (iv) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off;
- (v) any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956¹; and
- (vi) any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company whether or not there is a reduction of capital in the demerged company.

Now, inclusion of five payments or distributions and exclusion of six payments or distributions by a company to its shareholders in the definition of "dividend" makes the meaning of "dividend" all the more blurred. As per the provisions contained in section 2(22), the meaning of "dividend" is not clear.

6.8.2.1 Suggestion to overcome the problem—Simply stated, "dividend" means the amount paid to or received by a shareholder in proportion to his share-holding in a company out of the total sum so distributed.

The complications introduced as a result of five "inclusive" clauses and six "exclusive" clauses to section 2(22) may be easily taken care of by the proposition that dividend received by a shareholder from a domestic company is exempt from tax and the domestic company will pay tax on dividend distributed by it. If a loan or advance is given by a company to a shareholder, it is deemed as dividend, as per provisions contained in section 2(22) (e), and the shareholder is liable to pay tax in respect of such loan or advance. If dividend is received from a non-domestic company, the shareholder is liable to pay tax in

respect of the same. Moreover, the method of accounting regularly employed by the assessee does not affect basis of charge of dividend income. Thus, the complexities introduced by the different clauses relating to "inclusions" and "exclusions" may be done away with without affecting the logical side of incidence of tax relating to dividend. This becomes all the more important in view of the fact that it is easier for the Govt. to collect tax from domestic companies on their distributions of dividend rather than collecting it from shareholders who are spread over every nook and corner of the world.

Eighty-five percent of the respondents have pointed out that section 2(22) is complicated and confusing; it requires to be recasted so that meaning of "dividend" becomes simple. The thrust of the Govt. while framing tax laws should be to frame prudent laws which make the practical side of tax incidence strong and unambiguous. The Supreme Court has very rightly held in this connection that if a particular distribution is not regarded as dividend within the extended meaning of the expression in section 2(22), it may still be dividend provided it is "dividend" under the ordinary meaning of the expression¹. The meaning of "dividend" based on "inclusions" and "exclusions" becomes superfluous. It required to be matched with its meaning as it exists in common parlance.

6.8.3 Determination of "accumulated profits" is very difficult–

Any payment or distribution under different clauses in section 2(22) is treated as dividend. However, such payment or distribution can be treated as dividend only to the extent of "accumulated profits" of the company. As per the different explanations added to substantiate the meaning of the expression "accumulated profits", interpretations of the different courts in this regard and various conditions attached to different clause of section 2(22), the tax law on this point becomes very difficult to comprehend.

As per Explanation 1, accumulated profits do not include capital gains. As per Explanation 2, in case of a company which is not in liquidation, accumulated profits include all profits of a company upto the date of distribution or payment in the case of a company which is not in liquidation, it includes all profits of the company upto the date of liquidation.

When, the liquidation of a company is consequent on the compulsory acquisition of a

company's undertaking by the Govt. or a Govt. Company, accumulated profits do not include any profits of the company prior to the 3 successive years immediately preceding the previous year in which such acquisition took place. Then, accumulated profits include capitalised profits for the purposes of clauses (a) to (d) of section 2 (22); accumulated profits do not include capitalised profits for the purposes of clause (e) of section 2(22). Issue of bonus shares, for example, by capitalising general reserve are capitalised profits.

As per decision of the Supreme Court, accumulated profits include development rebate reserve, development allowance reserve and investment allowance reserve as these reserves are not in the nature of any expenditure or outgoing¹. Based on this decision the Madras High Court held general reserve to be included in accumulated profits². Likewise, the Andhra Pradesh High Court included building reserve fund in accumulated profits stating that it is a fund set apart for constructing new building and being not in the nature of depreciation fund³.

Likewise, the Supreme Court held that balancing charge u/s 41(2) is not part of accumulated profits⁴. The Kerala High Court held that provision for taxation and dividends do not form part of accumulated profits⁵.

Capital gains or capital receipts are included in accumulated profits when these are chargeable to capital gains tax and not otherwise⁶. The Calcutta High Court held that accumulated profits include tax free income and revenue receipts as, for example, agricultural income⁷.

Thus, these and several other decisions of the Courts hold the key towards the determination of "accumulated profits" which help in determination and payment of dividend.

Distribution of accumulated profits under different clauses of section 2(22)–

- (1) Under sub-clause (a)–As per sub-clause (a), distribution by a company of its accumulated profits whether capitalised or not, is dividend in two cases–
 - (i) Distribution should be from accumulated profits and not from capital; and

(ii) Such distribution must result in the release of the assets by the company.

Under this clause distribution may be in the form of payment in cash or kind in view of the fact that no specific mode is prescribed under the clause.

When bonus shares are issued by a company by capitalising its profits, bonus shares are not taken as dividend because there is no release of assets. This is applicable only in the case of equity shares and not in the case of preference shares.

Redemption of bonus shares is possible when bonus shares are in the form of redeemable preference shares. Since there will be release of assets if bonus shares are redeemed, it would constitute dividend¹.

- (2) Under sub-clause (b)–Distributions in the following cases are treated as dividend to the extent of accumulated profits whether capitalised or not in the following cases–
- (i) Distribution by a company to its equity or preference shareholders of debentures, debenture-stock or deposit certificates in any form whether with interest or without interest; and
 - (ii) Distribution of bonus shares by a company to its preference shareholders. Distribution under these two circumstances amounts to dividend even if there is no release of assets at the time of distribution.
- (3) Under sub-clause (c)–Any distribution made by a company on its liquidation to its shareholders is treated as dividend to the extent to which such distribution is attributable to the accumulated profits immediately before its liquidation whether capitalised or not. The distribution is deemed to take place in the same proportion in which share capital and accumulated profits stood immediately before the distribution in the accounts of the company, where a distribution in the winding up of a company is out of accumulated profits, it is dividend even though the amount so distributed does not exceed the capital subscribed by the shareholders.

However, the distribution in respect of preference shares issued for cash consideration in full is not treated as dividend under this sub-clause.

- (4) Under sub-clause (d)–Distribution by a company to its shareholders on the reduction of capital is treated as dividend to the extent of accumulated profits of the company whether capitalised or not. However, distribution in respect of preference shares which are issued for cash consideration in full are not treated as dividend under this clause. It may be noted that the Supreme Court has held that section 2 (22) (d) is constitutionally valid¹.
- (5) Under sub-clause (e)–Distribution of accumulated profits by way of loan or advance in the case of a closely-held company is treated as dividend in two cases stated above in section 6.2.1.

The Supreme Court held in a case that the loans made by the company to an employee who passed it on to the managing director whenever he needed money, even without executing any promote, such loans fell in the category of "benefit" to the managing director and were, therefore, assessable as deemed dividends in the hands of the managing director². Further, the Supreme Court has held that this sub-clause is applicable even if loan is repaid before the end of the previous year; liability is attracted at the moment the loan is given³. However, repayment by a company of deposit made by a shareholder with the company, does not attract the provisions of this sub-clause. An overdraft taken by a shareholder from the company is treated as loan and is taxable as dividend if conditions of this sub-clause are satisfied. This sub-clause are satisfied. This sub-clause is applicable even if loan is given in kind and even" if it is for a short duration. Even loan obtained by an assessee-shareholder from the accumulated profits of the company which are exempt in the hands of the company as agricultural income, is to be treated as deemed dividend in the hands of the assessee⁴. Payment made by a company out of its premium account for dividend distribution cannot be brought to tax in the hands of receiver as deemed dividend in view of the bar imposed by section 78 of the Companies Act in this regard¹.

Actually, the problem as regards determination of "accumulated profits" arises due to the fact that the expression is not defined in the Act. Moreover, the two explanations attached to section 2(22) do not clarify the meaning of the expression; rather they add to the confusion

as to the true meaning of the expression.

For example, Explanation 1 reads—"The expression "accumulated profits", wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April, 1946, or after the 31st day of March, 1948, and before the 1st day of April, 1956."

Now, even a cursory look at the above explanation will reveal the 'oddity' involved in it. The oddity is glaring in view of the fact that the present Income-tax Act came into force in 1961 and the dates given in the Explanation relate to the period before April 1, 1956. Thus, the explanation has no practical utility in the present times.

Likewise, Explanation 2 attached to section 2(22) reads—"The expression" accumulated profits" in sub-clauses (a), (b), (d) and (e), shall include all profits of the company upto the date of distribution or payment referred to in those sub-clause, and in sub-clause (c) shall include all profits of the company upto the date of liquidation, but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Govt. or a corporation owned or controlled by the Govt. under any law for the time being in force, include any profits of the company prior to three successive previous years immediately preceding the previous year in which such acquisition took place".

Now, this explanation states as to what shall be included in "accumulated profits" and what shall not be included in "accumulated profits" in regards to the different sub-clauses of section 2(22). The "inclusions" and "exclusions" stated in this explanation are just as good as a tip of the iceberg; they do not cover the meaning of the expression "accumulated profits".

It is important in this connection that the Govt. has incorporated the meaning of "accumulated profits" in the Direct Taxes Code¹ introduced by the Finance Minister to Parliament on Aug. 12, 2009. It reads : "accumulated profits" in relation to dividend means—

- (a) all profits of the company of three consecutive financial years immediately preceding the financial year in which its undertaking is compulsorily acquired in the case where the company is in liquidation consequent to such compulsory acquisition by, —
 - (i) the Govt.; or

- (ii) a corporation owned or controlled by the Govt. under any law for the time being in force; and
- (b) all profits of the company upto the date of distribution or payment of dividend or upto the date of liquidation, as the case may be, in any other case.

This definition is quite specific as it has been given in regard to the very specific purpose of determination of dividend. To that end, it is quite reasonable and it is hoped that it gets the assent of the Parliament and it will become a part of the Income-Tax Law.

6.8.3.1 Suggestions to overcome the difficulty—Infact, the expression "accumulated profits" is very basic to understand the incidence of tax as regards dividend. As stated above, the two explanations attached to section 2(22) only add the confusion. A plethora of cases as relating to what is included in "accumulated profit" and what is not to be included, have been decided by different courts as is clear from the above cases cited in this regard. This goes to suggest that a concerted effort is required to be made on the part of the Govt. to come up with an appropriate definition of the expression "accumulated profit" which required to be incorporated in section 2 of the Act itself. The definition ought to be so exhaustive that it would take care of the decisions of the various Courts in this regard on the one hand and which should be so appropriate for the fulfillment of the object involved that no scope for any ambiguity is left. This will take care of the ambiguity now associated with the existing law due to, for example, the provision that capitalised profits are part of "accumulated profits" for the purposes of sub-clauses (a), (b), (c) and (d) of section 2(22) but not for the purpose of sub-clause (e) of section 2(22). Issue of bonus shares by capitalising general reserves are, for example, capitalised profits. The prospective definition of "accumulated profits" should be so exhaustive that it could take care of the "inclusions" and "exclusions" associated with the expression as held out by different Courts in this respect. Also, the oddity due to the dates given in sub-clauses (d) and (e) of section 2(22) with respect to what "dividend includes" and in sub-clause (ia) with respect to what "dividend does not include" will, it is hoped, be taken care of. As has already been presented above, the date given in sub-clause (d) is "before the 1st day of April, 1933", in sub-clause (e), the date is "after the

21st day of May, 1987" and in sub-clause (ia), the date is "after the 31st day of March, 1964 and before the 1st day of April, 1965." A concerted effort in devising an appropriate meaning of "accumulated profits", as has also been opined by 70% of the respondents, will, it is hoped, go a long way in removing the anomalies present in the law in its present form.

6.8.4 Subjectivity of an A.O. is involved in treating a transaction relating to sale of securities to be a "bond-washing transaction"

A bond-washing transaction as stated above means a transaction which consists of selling of securities by a person on the eve of due date of interest to some person and acquiring them or similar securities back after the lapse of the due date. The person to whom the security is transferred belongs to low-income group whose income even after inclusion of income from interest on securities so transferred is so low that it is below the minimum exemption limit or is taxable at low rate of tax.

Likewise, tax can be avoided by a person in selling securities on the eve of due date of interest 'cum-interest' i.e., including interest. The income by way of interest will be accruing to the transferee because the transferee will be the owner of securities on the due date. As stated above, the transferee is a person whose income even after inclusion of income by way of interest on such securities is so low that either no tax is payable or, if payable, is payable at a low rate.

So, in these two ways tax liability is avoided. To prevent the avoidance of tax in these ways, sections 94(1) and 94(2) have been devised. As per section 94(1), where a security owner transfers securities on the eve of the due date of interest and reacquires them so that interest is received by the transferee, the income from securities in this case will be deemed to be the income of the transferor. Similarly as per section 94(2), if a person sells securities in which he is having beneficial interest during the previous year in such a way that either no income is received or income received is less than the amount he would have received if interest had accrued from day to day, then income from such securities for the previous year would be deemed as the income of the transferor.

However, as per section 94(3), it has been provided that the deeming provisions of

section 94(1) and 94(2) are not applicable if the owner of securities or the person who has had a beneficial interest in securities, proves to the satisfaction of the A.O. that–

- (i) there has been no avoidance of the income tax; or
- (ii) the avoidance of income-tax was exceptional and not systematic and that there was not in his case in any of the three preceding years any avoidance of income tax under sections 94(1) and (2).

Now, the phrase "proves to the satisfaction of the A.O.", opens up floodgates to corruption. The discretionary power vested in the AO. as a result of this phrase, will, it is humbly submitted, lead to legalise corruption in this manner. The law should be such as could be objectively implemented rather than being subjective; subjectivity will not allow the law to be implemented in its true spirit due to the state of affairs prevalent in the economy at the present times. Instances of corruption on such points are not wanting. The Report of the Comptroller & Auditor General of India speaks of volumes in this regard about almost all the Ministries and Departments of the Govt.

6.8.4.1 Suggestions to remove the 'subjectivity' involved in the provision–The provisions contained in section 94(3) is a utopian law which sounds theoretically logical but is, in all likelihood, impracticable in spirit. This is simply due to the fact that human nature being what it is, people occupying public places have been found, most often, to misuse discretionary powers to their personal advantages. So, to remove this menace, it is suggested that this discretionary power should be done away with and it should be made the law that no exception to the law contained in sections 94(1) and (2) will be entertained and even a single transaction of avoidance of tax would not be allowed. Majority of the respondents viz., 74%, hold this opinion. Income in both the cases will be treated to be the income of the transferor whether the transaction involved was 'systematic' or 'exceptional'. This will make the law practically sound. Moreover, there will not be any unbearable difficulty to assessee involved in such transactions because there is no resentment in public as to objective laws; compliance to subjective laws leads to tax evasion.

6.8.5 Deduction available u/s 57 (iii) is narrow in scope

As discussed above, deductions u/s 57 as provided under sub-sections (i), (ia), (ii) and (iia) are specific in nature. Deduction u/s 57(iii) is general in nature; it reads—"any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income". Besides, as has been held by the Gujarat High Court¹, the expenditure must be laid out or expended in the relevant previous year and not in any prior or subsequent year. Of course, the expenditure should not be in the nature of personal expenses of the assessee.

The Supreme Court has, in this connection, held that it is not necessary that any income should, in fact, have been earned as a result of the expenditure².

The Madras High Court has held that "though sections 37(1) and 57 (iii) have a great deal in common and overlap on an extensive area and the expenditure which qualifies for deduction u/s 57(iii) would necessarily fall within that ambit of section 37(1), the converse cannot be the case. Section 57(iii) is narrower in scope than section 37(1)¹.

The view of the Madras High Court, it is humbly submitted, is quite logical. The test of allowability u/s 57 (iii) is that the expenditure must be incurred for the purpose of "earning or making" the income. While as per section 37(1), the only requirement to be fulfilled is that the expenditure should be incurred for the purposes of the business wholly and exclusively²; it is immaterial whether any income is earned or not.

This point becomes all the more important in view of the fact when shares of an Indian company are purchased with the help of borrowed capital, interest on borrowed capital is not deductible because dividend from an Indian company is exempt from tax in the hands of the shareholder. On the other hand, when shares in a foreign company are purchased with borrowed capital, amount of interest payable in respect of the loan is deductible in full whether no dividend is earned or less amount of dividend is earned and whether no taxable income is accrued or loss from the purchase of shares is incurred. This is illogical.

6.8.5.1 Suggestion to remove the shortcoming—In view of the decisions of the

Madras High Court, it is humbly stated that the interpretation of the Court required to be accommodated into the Act. The provision u/s 57 (iii) should be made at par with section 37(1). The restriction on allowing expenditure when it does not result in earning taxable income should be done away with. Eighty-two percent of the respondents have suggested that the provisions u/s 57 (iii) should be made as broad as the parallel provision contained in u/s 37(1). If no income is earned or no loss is incurred, the deduction on account of expenditure incurred, should be allowed in full and the facility of set off of loss should be made available to the assessee in this regard. This is justified in view of the fact that the Govt will be charging tax from the lender of money on his interest income even if the money is invested by the borrower towards the purchase of tax free securities.

6.8.6 Illogical disallowance of expenditure in respect of income from winnings from lotteries, etc.

No deduction, as per section 58(4), is allowed under any provision of the Act in computing the income by way of any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature. However, this is not the case with respect to income from the activity of owning and maintaining race horses.

Now, this disallowance of expenditure goes against the basic dictum as provided u/s 57(iii) that an expenditure which is neither capital in nature nor personal expenses of the assessee and which is laid out or expended wholly and exclusively for the purpose of earning or making the income is an allowable expenditure; it is deductible at the time of computing taxable income. In the same way, certain expenses have to be incurred in connection with the earning of income from winnings from lotteries, etc. For example, in respect of earning of income by way of winnings from lotteries, an assessee will have to incur cost towards the purchase of lottery tickets, necessary travelling expenses, necessary refreshment expenses, money payable to persons who help the assessee in this activity, etc. No income can be earned without incurring some expenditure. So, the blanket ban on allowing any expenditure whatsoever incurred by an assessee on earning such incomes, is unjustified and illogical.

This does not sound will that the State Govts. themselves conduct lotteries etc. and charge tax at the maximum marginal rate viz., 30% and the Central Govt. still disallows deduction for expenses to assesseees as if they are criminals.

6.8.6.1 Suggestion to remove the injustice—In view of the fact that lotteries etc., are conducted by State Govts., or by Govt. approved bodies, it would be in the fitness of things that assesseees involved in earning such incomes are allowed to avail the deduction as provided u/s 57 (iii). Some percentage, say 6%, subject to a maximum limit be fixed which could be allowed by way of expenses incurred wholly and exclusively for earning such income. In view of the present law one cannot help lament the dictum that the Govt. is a partner only in pleasure of an assessee and not in pains which an assessee has to bear. In order to allay fears of this dictum the Govt. should come out with an amendment in the law so that reasonable expenditure incurred on earning an income is made admissible for deduction while computing taxable income. Afterall, such income is not an income from illegal means for which no deduction for expenses incurred is available to an assessee. Around 80% of the respondents have suggested that in view of the fact that State Govts. themselves are conducting lotteries, etc. and are collecting stupendous amount by way of taxes, it is but necessary that deduction for expenses incurred in earning such incomes is allowed.
