# Advanced Diploma in Corporate Taxation, NALSAR

# Paper-2: Business Income of the corporates

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# Section 28(i)

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

Paraphrasing –

- Profits and gains
- Of any business or profession
- Business or profession to be carried on
- At any time during the PY

# Section 28(i)

Carried on – Is it mandatory that business needs to be continuously be carried upon?

Clause (*i*) of section 28 lays down that "the profits and gains of any business or profession which was carried on by the assessee *at any time during the previous year"* shall be chargeable to income-tax as "Profits and gains of business or profession"

Thus, it is not necessary for profits of the business to be taxable that the business must be actively carried on for the whole of the previous year, or till the end of the previous year.

Whenever an assessee receives in the course of his business money or money's worth, income embedded therein accrues or arises to him, and becomes subject to an ambulatory charge. If at the end of the previous year, on making up accounts, there is no overall income, the charge does not crystallize because there is no income on which the charge of tax may settle [*CIT v. Bangalore Transport Co. Ltd.*, (1967) 66 ITR 373 , 375 (SC)].

# Section 28(i)

Where the business or profession is discontinued before the commencement of the previous year but profits of that business or profession are received in a previous year after the discontinuance of that business or profession, if the assessee had a mercantile system of account, such profits would already have been taken as the income of the year of accrual and, in that case, those profits cannot again be brought to tax in the year of receipt. For an assessee who kept his accounts on the cash basis, in case the assessee had discontinued his business or profession before the commencement of the previous year and did not carry it on *at any time during the previous year*, any receipt of profit in such previous year could not, under the provisions in the 1922 Act, be brought to tax under this head [see, *Nalinikant Ambalal Mody v. S.A.L. Narayan Row*, (1966) 61 ITR 428 (SC); *CIT v. Express Newspapers Ltd.*, (1964) 53 ITR 250 (SC)] nor under the residuary head [*Nalinikant Ambalal Mody v. S.A.L. Narayan Row*, (1966) 61 ITR 428 (SC)].

It may be noted that in the 1961 Act, this lacuna has been, in the case of income from business as well as profession, removed by introducing relevant provisions in section 176 which deems such receipt to be the income of the recipient chargeable to tax in the year of receipt.

# Section 28(i)

**Carrying on business is primary condition** - The primary condition for the application of section 10 of the 1922 Act [corresponding to section 28 of the 1961 Act] is that the tax is payable by an assessee under the head 'Profits and gains of business' in respect of business carried on by him. When an assessee does not carry on business at all, section 10 cannot be applicable and the income that he receives cannot bear the character of profits of business - *New Savan Sugar & Gur Refining Co. Ltd.* v. *CIT* [1969] 74 ITR 7 (SC)/*Senairam Doongarmall* v. *CIT* [1961] 42 ITR 392 (SC).

**Tax liability arises only if business is carried on** - Tax is payable under section 10(1) of the 1922 Act [corresponding to section 28 of the 1961 Act] by an assessee on its profits or gains earned in the business, profession or vocation carried on by him in the year of account. If no business at all is carried on in that year, liability to tax does not arise under section 10(1) - *Bombay Steam Navigation Co. (1953) (P.) Ltd.* v. *CIT* [1965] 56 ITR 52 (SC).

**Payment/collection of outstandings does not amount to carrying on of business** - It cannot be said, that because liabilities of a closed business were outstanding, it has to be held that either the business was continuing or that an intention to resume business must be inferred. A business which is closed down cannot be deemed to be carried on only because its outstandings are being collected - *CIT* v. *Lahore Electric Supply Co. Ltd.* [1966] 60 ITR 1 (SC)/*Indraprastha Steel Industries Ltd.* v. *ITAT* [1973] 88 ITR 138 (Delhi).

[*See* also *P.V. Gajapathi Raju* v. *CIT* [1989] 176 ITR 238 (Mad.)/*S.P.V. Bank Ltd.* v. *CIT* [1980] 126 ITR 773 (Ker.)].

# Section 28(i)

The fundamental idea underlying each of the words used in the definition of ‘business’ in section 2(13) is the continuous exercise of an activity referred to in the definition, and the same central idea is implicit in the words ‘carried on by him’, occurring in section 28(i). These critical words are an essential constituent of that which is to produce income taxable under section 28(i)

The profits or gains which were not earned when the business was being carried on by the assessee during the accounting year fall outside the provisions of section 28(i) [*CIT v. Express Newspapers Ltd.*, (1964) 53 ITR 250 (SC)]

Similar reasoning will apply where loss is incurred after the business was already closed or transferred or compul-sorily acquired [*Indo-Burma Petroleum Co. Ltd. v. CIT*, (1980) 124 ITR 719 (Cal); *S.P.V. Bank Ltd. v. CIT*, (1980) 126 ITR 773 (Ker)].

**Tax is on profits, and not on gross receipts** - 'Gains' is really the equivalent of 'profits'. The profit of a trade or business is the surplus by which the receipts from the trade or business exceeded the expenditure necessary for the purpose of earning those receipts. The tax is upon income, profits or gains; it is not a tax on gross receipts - *CIT* v. *Bokaro Steel Ltd. (No. 1)* [1988] 170 ITR 522 (Pat.).

# Section 28(i)

**Receipts prior to carrying on of business are not business receipts** - A business must be carried on before there can be any profit or gain, and if any receipt is received before the business is carried on, it is not a business receipt and if any expenditure is incurred before the business has started, it is also not a business expenses. Where the assessee received grant-in-aid before it started business, it could not be treated as business receipt - *CIT* v. *State Trading Corpn. of India Ltd.* [1973] 92 ITR 294 (Delhi).

**Gifts are business receipts only if received in the course of, or incidental to, business** - In a case where the recipient of a gift is carrying on business, there is no third course open : either it is a gift pure and simple and hence outside the purview of income-tax, or it is a business receipt properly regarded as a part of the recipient's trading profits. In order that a payment, with a gift element or an element of bounty, may be treated as part of the taxable income of a businessman, it must be shown that gift had been received in the course of, or as a necessary incident of, the recipient's business. It is not enough, therefore, that the hand that receives the gift is the hand of a person who bears the character of a businessman - *CIT* v. *Parmanand Uttamchand* [1984] 146 ITR 430 (Mad.). Where the assessee, a dealer in cloth, received a gift from his supplier under a gift scheme formulated by the supplier for having achieved a specified target of purchases, the value of the gift so received was clearly a trading receipt - *Boeing* v. *CIT* [2001] 250 ITR 667 (Mad.).

# Section 28(i)

**No profit can arise out of withdrawal of stock-in-trade for personal use** - Withdrawing stock-in-trade by a businessman is not a business transaction and by act of withdrawal no profit can be said to accrue to him and, accordingly, it is sufficient if said businessman has credited its business with cost price of stock so withdrawn. It is wholly unreal and artificial to separate the business from its owner and treat them as if they were separate entities trading with each other and, then by means of a fictional sale, introduce a fictional profit which in truth and in fact is non-existent - *Sir Kikabhai Premchand* v. *CIT* [1953] 24 ITR 506 (SC).

# Section 28(i)

Amounts received by a company, during its pre-business period, as interest on advances to contractors for construction work, rent from quarters let out to employees of contractors, higher charges on plant and machinery let out to contractors, royalty on stones removed from the assessee's lands and other miscellaneous receipts were held not assessable as income of the assessee because all such receipts were incidental and subservient to overall construction work during pre-business period [*CIT v. Bokaro Steel Ltd.*, (1988) 170 ITR 522 (Pat); *Bokaro Steel Ltd. v. CIT*, approved in CIT v. Bokaro Steel Ltd, (1999) 236 ITR 315 (SC)].

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In *CIT v. Hindustan Electro Graphites Ltd.* [(1989) 177 ITR 465 (MP)], interest on fixed deposit and on late payment of call money received prior to setting up of business has been held taxable as income.

# Section 28(i)

Income from illegal sources-
Crime, such as house-breaking, is not trade, and therefore the proceeds are not caught in the taxing net. Similarly, the gains of theft, decoity, misappropriation or cheating cannot be treated as taxable income from any business or commerce [see, 7.5. *Parkar v. V.B. Palekar*, (1974) 94 ITR 616 , 639 (Bom)]. It does not follow, however, that there cannot be a business answering to the description of trade, *albeit* it is tainted with illegality. Trafficking in drugs, for example, is of the nature of trade, *albeit* such trafficking may, in certain circumstances, be illegal [*Lindsay v. Commrs. of Inland Revenue*, (1932) 18 Tax Cas. 43, 56]. Profits from carrying on the business of smuggling are, thus taxable [see, *CIT v. Piara Singh*, (1972) 83 ITR 678 (Punj), affirmed, (1980) 124 ITR 40 (SC)]

In *Dr T A Quereshi* v. *CIT* (2006) 157 Taxman 514 = 287ITR547 (SC), it has been held that business loss from illegal activities can be set off against income of such illegal activities (in this case, loss arising out of seizure of heroin was allowed as business loss.

***Difference between loss and expenses!!***

# Section 28(i)

Section 37(1) is a specific provision where deduction is provided for any expenditure laid out or expended wholly and exclusively for the purpose of the business or profession. On the other hand, a general provision has been made in section 28(i) read with section 29 for determination of "profits and gains of any business or profession" carried on by the assessee "in accordance with the provisions contained in sections 30 to 43C". In arriving at the figure of profits and gains in the commercial sense business expenditure of all types, whether specifically provided for or not, may be deducted under section 28(*i*) itself [see, *Addl. CIT v. Rustam Jehangir Vakil Mills Ltd.*, (1976) 103 ITR 298 , 310 (Guj)].

# Section 28(ii)

any compensation or other payment due to or received by,—

(a) any person, by whatever name called, managing the whole or substantially the whole of the affairs of an Indian company, at or in connection with the termination of his management or the modification of the terms and conditions relating thereto;

(b) any person, by whatever name called, managing the whole or substantially the whole of the affairs in India of any other company, at or in connection with the termination of his office or the modification of the terms and conditions relating thereto ;

(c) any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of the terms and conditions relating thereto ;

(d)any person, for or in connection with the vesting in the Government, or in any corporation owned or controlled by the Government, under any law for the time being in force, of the management of any property or business ;]

(e)any person, by whatever name called, at or in connection with the termination or the modification of the terms and conditions, of any contract relating to his business;

***Accordingly, for this inclusion, these compensation might have been a capital receipt not chargeable to income-tax . Also note,*** **The sums chargeable under this clause are included in the definition of 'income' in s 2(24)(v) .**

# Section 28(ii)

The word ‘termination’ as used here contemplates termination of the agreement in the several manners contemplated under the Contract Act and by other statutes. It includes cessation of the mutual rights and obligations of either party under the agreement even as a result of an act of the State, *e.g.*, acquisition, etc. [*Development of Industries (India) Pr. Ltd. v. CIT*, (1968) 68 ITR 310 , 318 (Cal).

It is not necessary that in order to fall within these provisions the agency, etc., should be terminated by external authority. Even where the assessee himself terminates the agency, the case would fall within these provisions [*Sharma & Co. v. CIT*, (1965) 56 ITR 176 , 181 (All)].

# Section 28(ii)

Compensation for termination, etc., of managing. agency agreement, etc., is taxable under these provisions even though the same is paid not by the managed company, etc., but by a third person [*J.R. Kimtee & Sons v. CIT*, (1978) 115 ITR 190 (AP)]. It is immaterial whether the payment proceeds from the principal or employer or from some other person. All that is necessary is that it must be a payment due to or received by a person holding an agency, etc., and the payment is made at or in connection with the termination of, or variation in the terms relating to, the agreement, etc. Further, these provisions are attracted even where the relevant amount of compensation was adjusted against debts owed by the assessee.

# Section 28(ii)

For invoking the provisions of section 28(ii)(c) it is essential that the person concerned must be holding an agency in India, the agency must have been determined or its terms varied to his prejudice and for that he must have received, or be entitled to receive, a certain amount by way of compensation. If the relationship be any other than an agency, the provisions are not attracted [see, *Daruvala Bros. P. Ltd. v. CIT*, (1971) 80 ITR 213 (Bom)].

# Section 28(ii)

But for this inclusion, the compensation might have been a capital receipt not chargeable to income-tax

The provisions similar to section 28(ii)(c) cover compensation for termination of managing agency even though such termination was found not *bonafide* [*CIT v. Seksaria Sons Pr. Ltd.*, (1982) 138 ITR 419 (Bom)].

In the facts of *CIT v. J. B. Lohada* [(1988) 174 ITR 318 , 324–25 (AP)], it has been held that the sum of Rs. 2 lakhs received by the assessee could not be treated as payment on account of termination of the managing directorship of the assessee because the said sum was arrived between the parties by way of compromise when the asses-see threatened to sue the late Nizam for specific performance of the agreement and other reliefs.

# Section 28(ii)

Section 28(*ii*) provides for taxation of any compensation or other payment received by any person in certain specified situations. Section 28(*ii*)(*e*) has been inserted with effect from assessment year 2019-20 to provide that any compensation received or receivable in connection with the termination or the modification of the terms and conditions of any contract relating to its business shall be taxable as business income

The Memorandum states that the section will include revenue receipts as well as capital receipts. Hence, it will include compensation for loss of source of income.
In view of the aforesaid amendment, the following payments which were hitherto regarded as exempt shall now be taxable:

(i) CIT v. Seshasayee Bros. (P.) Ltd. [1999] 104 Taxman 48 (Mad.) [Compensation received by assessee on termination of consultancy agreement on a principal and principal basis]
(ii)Daruwala Bros. (P.) Ltd. v. CIT [1971] 80 ITR 213 (Bom.) [Distribution agreement]
(iii) IAC v. Ghaziabad Engineering Co. (P.) Ltd. [1984] 7 ITD 289 (Delhi - Trib.) [Premature termination of distributorship]
(iv) Delhi Tambaku & Udyog Ltd. v. IAC [1987] 20 ITD 718 (Delhi - Trib.) [Agreement to manufacture on a principal to principal basis]
(v) Oberoi Hotel (P.) Ltd. v. CIT [1999] 103 Taxman 236 (SC) [compensation to give up right to purchase and/or operate a hotel under an agreement]

# Section 28(ii)

The amendment covers compensation upon termination of a contract or modification of its terms. It appears that damages upon breach of contract without involving its termination or modification may not be covered by the amendment. Its taxability would depend upon factors such as, the nature of contract, whether it is in the ordinary course of business or otherwise and so on. To illustrate, suppose the assessee has entered into a contract with another party for supply of machinery who delays the supply. On account of late delivery of machinery, the assessee is given compensation. In this case, it could be argued that the damages for late delivery of machinery are not covered under the amendment if such damages are paid without involving the termination or modification of the agreement

section is very widely worded it would cover contracts relating to acquisition of capital assets and hence on a literal reading, the compensation or other payment at or in connection with termination of such contract would be taxable as business income under section 28(*ii*)(*e*). On the other hand, Courts have held that giving up the right to obtain conveyance of immovable property or to claim specific performance is a transfer, assessable as capital gains.

It could be argued that the provision may be so construed as being applicable to cases other than those relating to transfer of a capital asset.

# Section 28(ii)

Section 28(ii)(e) provides for taxation in respect of any contract relating to "business". Now,

♦section 28 provides that profits and gains of business or "profession" shall be chargeable to tax.

♦section 28(i) provides for taxation of profits and gains of any business or profession.

♦section 28(iv) refers to taxation of benefit or perquisite arising from the exercise of a profession.

♦section 28(va)(a) refers to any activity in relation to business or profession.

However, the new section 28(ii)(e) is consciously restricted to business.

There is a controversy as to whether the term 'business' includes 'profession'. It has been held that :

(a)business does not include profession for the purposes of section 28(va) [Satya Sheel Khosla v. ITO [2015] 63 taxmann.com 293 (Delhi - Trib.); Dr. K. Premraj v. Dy. CIT [2014] 41 taxmann.com 81/149 ITD 339 (Chennai - Trib.)];

(b)business includes profession for the purposes of section 9(1)(i) [Barendra Prosad Ray v. ITO [1981] 6 Taxman 19 (SC)];

(c)business does not include profession for the purposes of section 32(1)(iv) [G.K. Choksi & Co. v. CIT [2007] 165 Taxman 299 (SC)].

Hence it is a moot point as to whether the amendment covers compensation upon termination or modification of any term relating to a profession.

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Hence it is a moot point as to whether the amendment covers compensation upon termination or modification of any term relating to a profession.

# Section 28(iii)

This clause makes an exception to the general rule that income of mutual associations is not subject to charge of income-tax .In other words, the concept behind section 28(iii) is to cut at the mutuality principle being relied on in support of a claim for exemption, when the assessee was actually deriving income or making profits as a result of rendering specific services for its members in a commercial way. This clause creates a statutory fiction [*CIT v. South Indian Film Chamber of Commerce*, (1981) 129 ITR 22.
The idea behind section 28(iii) clearly is to tax the surplus arising from services rendered by such associations to its members which would otherwise have been outside the tax net

A trade association is an association of the tradesmen, businessmen or manufacturers for the protection and advancement of their common interest. On the other hand, a trading association is an association which indulges in some sort of business activities and which, apart from preserving the interest of its members, also works for profit [*CIT v. Shree Jari Merchants Association*, (1977) 106 ITR 542 , 550 (Guj)].

The word 'specific' only means definite, distinctly formulated or stated with precision. The words "performing specific services" in this clause means "conferring particular benefits", that is, conferring on the members some tangible benefit which would not be available to them unless they paid the specific fees charged for such benefits [*CIT v. Calcutta Stock Exchange Association Ltd.*, (1959) 36 ITR 222 (SC)

# Section 28(iv)

Inserted by the Finance Act , 1964, this clause includes, with effect from April 1, 1964, the value of any benefit or perquisite arising from business or the exercise of a profession in a taxpayer's business income, irrespective of whether the value of such benefit or perquisite is convertible into money or not so convertible. The clause does not apply to receipts in cash. The expression "benefit or perquisite, whether convertible into money or not" indicates that pure money receipts are not covered under this clause. The writing off or waiver of a loan by a creditor would not attract s 28(iv) .The provisions are similar to those in section 17(2)(iii) which include the value of benefit or amenity to certain employees in the assessable salary income . The chargeablility under section 28(iv) also depends on the method of accounting employed by the assessee [see, *CIT v. American Consulting Corporation*, (1980) 123 ITR 513 (Ori); *Dhrangadhra Chemical Works Ltd. v. CIT*, (1977) 106 ITR 473 (Bom)]. Clause (*iv*) deals with the value of any benefit or perquisite, whether convertible into money or not. The only condition for inclusion of the same in the chargeable income of the assessee is that it should arise from business or exercise of a profession [*Protos Engineer Co. P. Ltd. v. CIT*, (1995) 211 ITR 919 , 923 (Bom)].
In order to attract the provisions of section 28(iv), there must be a nexus between the business of the assessee and the benefit which the assessee has derived [*CIT v. Bhavnagar Bone & Fertiliser Co. Ltd.*, (1987) 166 ITR 316 (Guj)].

# Section 28(v)

**Clause (v): Remuneration and Interest from Firm.**—From the assessment year 1993-94 there is a complete change in the scheme of taxation of firms and partners. The share of income that a partner derives from the firm in which he is a partner is exempt under s 10(2A) . But the remuneration that he gets as working partner of the firm and the interest that he earns on the funds invested in the firm is taxed in his hands under this clause. These items are also included in the definition of income in s 2(24)(ve) . Such remuneration and interest constitute deductible expense for the firm under s 40(b) . If, for any reason, such allowance of interest or remuneration to the firm is denied or reduced, the inclusion thereof in the partner's hands is correspondingly adjusted in terms of the proviso to this clause, and the machinery for the consequent rectification of the partner's assessment is embodied in s 155(1A) .

# Section 28(va)

**Clause (va): Non-compete Payments, Fees and Exclusivity Rights.**—This clause, added from the assessment year 2003-04, brings to tax any sum received or receivable, in cash or in kind, in consideration of a restrictive covenant not to carry out any activity in relation to any business. Receipt of non-compete fee prior to April 1, 2003 have been held to be capital receipts and not income. With a view to subject such compensation to capital gains tax, s 55(2)(a) is amended from April 1, 1998. This clause is inserted to tax such compensation as business income if it is not taxable as capital gain. This clause taxes a sum received for a restrictive covenant in relation to a business, but not a profession. (For the distinction between business and profession, see ante under 'Business, profession or vocation'.)

This clause also brings to tax as business income the consideration for the secrecy of know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision of services.

# Section 28(vi)

**Clause (vi): Amount received under Keyman Insurance Policy.**—Any amount received by an assessee as the beneficiary under a Keyman insurance policy, whereunder the life of the assessee's employees is insured, is brought to tax under this clause as business income. Such amount is also included within the definition of 'income' under s 2(24)(xi) . The term 'Keyman insurance policy' is defined in the explanation to s 10(10D) . Where the employee himself is the beneficiary in such a policy, the amount received by him is taxed in the employee's hands under s 17(3)(ii) .

Whether deduction available u/s 37 for premium paid?

- **CIRCULAR NO.38/2016 [F.NO.279/MISC./140/2015-ITJ], dated 22/11/2016**

# Section 28(via)

Section 45(2) provides that capital gains arising from a conversion of capital asset into stock-in-trade shall be chargeable to tax. However, in cases where the stock in trade is converted into, or treated as, capital asset, hitherto, there was no express provision in the Act to provide for its taxability. Further, it was held that conversion of a trading asset into capital asset did not result in any taxable income or loss, covered by "profits and gains of business". [*CIT* v. *Dhanuka & Sons* [1979] 1 Taxman 417 (Cal.)[1]; *Deeplok Financial Services Ltd.* v. *CIT* [2017] 80 taxmann.com 51/247 Taxman 139 (Cal.); *Asstt. CIT* v. *Bright Star Investment (P.) Ltd.* [2008] 24 SOT 288 (Mum. - Trib.)]. Section 28(*via*) has now been inserted with effect from assessment year 2019-20 to provide that if any inventory is converted into capital asset or treated as a capital asset, the fair market value (FMV) of the inventory on the date of conversion or treatment determined in the *prescribed manner*, shall be deemed to be income chargeable as business income.

Further, *Explanation 1A* has been inserted in section 43(*1*) with effect from assessment year 2019-20 to provide that where the capital asset referred to in section 28(*via*) is used for the purposes of business or profession, the actual cost of such asset to the assessee shall be the fair market value which has been taken into account for the purposes of section 28(*via*).

The provision applies to all assessees whether individual or AOP or firm or company, etc., and whether residents or non-residents.

# Section 28(via)

Section 45(2) provides that profits and gains arising on conversion of a capital asset into stock-in-trade will be taxable in the year in which the stock-in-trade is transferred. Unlike section 45(2), no such provision is introduced in section 28 regarding year of taxation of income upon conversion of stock-in-trade into capital asset. Further, while the definition of term "income" has been amended to include the conversion, there is no amendment to section 5 or section 9. Hence, in which year is the income upon conversion taxable?
It is pertinent that the section is silent as to the year of taxation.

Section 28(*via*) does not override section 5 and income can be taxed only if it accrues or arises or is received : the year of taxation under section 28(*via*)would depend on the method of accounting followed that is, mercantile or cash [section 145(1)]
Also, in the absence of any specific year being mentioned in section 28(via), the words “taxable in the year of conversion” cannot be read and it cannot be assumed that the fair market value of inventory is taxable in the year of conversion.

# Section 41

This section enumerates receipts which are deemed to be income under the head 'Business or profession'. The main difference between this section and the corresponding provisions of the 1922 Act is that whereas under that Act, none of these items was chargeable as income in a year in which the business to which they related was not in existence at all, this section imposes a charge even if the business has ceased to exist prior to the year in which the liability under this section arises.

Sub-section (1) provides that where an allowance is granted to an assessee in any year in respect of any loss, expenditure or trading liability and subsequently, during any previous year the assessee receives, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure, or the assessee is benefited by the remission or cessation of the trading liability, the amount received or the amount of the liability which is extinguished is chargeable as business profits of that previous year.

Section 41(1) applies to waiver of loan - Commissioner v. Mahindra and Mahindra Ltd., (2018) 93 taxmann.com 32 (SC)

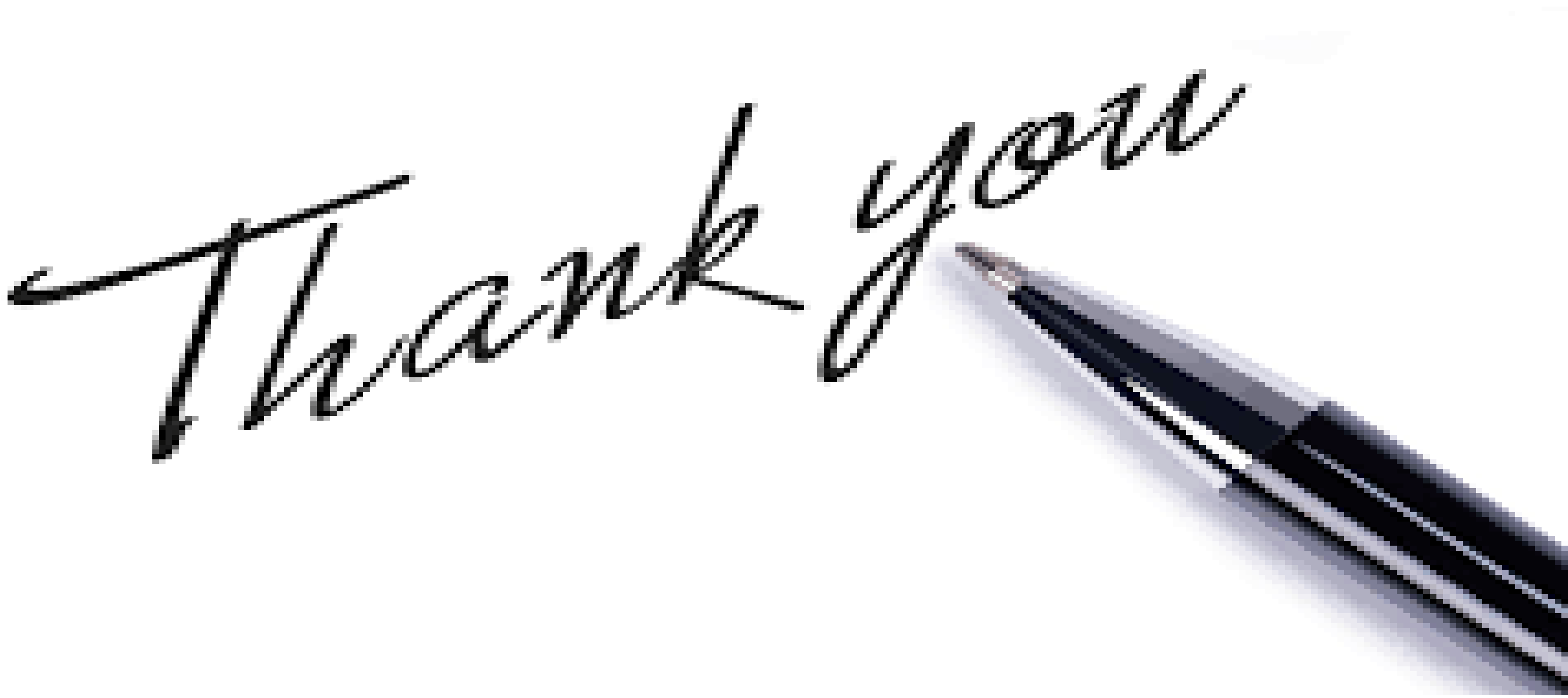
# Section 41

Earlier, the Supreme Court in *Saraswati Industrial Syndicate Ltd v CIT,* (186 ITR 278) while holding that the benefit derived by the amalgamated company in respect of a trading liability allowed to the amalgamating company cannot be taxed in the hands of the amalgamated company under s 41(1), observed that in order to attract s 41(1) the identity of the assessee in the earlier year in which deduction was granted in relation to a trading liability and in the subsequent year, in which the benefit is derived must be the same; and if there is a change in the identity of the assessee, there should be no tax liability under s 41(1) ; and further, if the assessee, to whom the trading liability may have been allowed as a business expenditure in the earlier year, ceases to be in existence or if the assessee has changed on account of the death of the earlier assessee, the benefit received in the subsequent year cannot be treated as income received by the assessee. Now, s 41(1) has been amended by the Finance Act 1992 from April 1, 1993 so as to provide that the benefit derived by the successor in business in respect of the cessation of the liability of the predecessor is taxable in the hands of the successor under s 41(1) .

# Section 41

As regards trading liabilities, it is only upon 'remission or cessation' that this sub-section comes into operation.When a liability becomes barred by the law of limitation, there is neither remission nor cessation of the liability: the liability is not extinguished, only the creditor's remedy becomes barred. Therefore, if the amount of a trading debt was allowed as an expense to an assessee, the amount cannot be taxed under this sub-section as the income of the year in which the debt due by the assessee becomes time-barred,even if the amount is credited to the profit and loss account.With a view to supersede all these judicial decisions/arguments, to the effect that unilateral act of writing back a liability does not necessarily result in cessation of liability within the meaning of s 41(1), Explanation 1 to s 41(1) has been inserted by the Finance (No 2) Act 1996 from April 1, 1997 to provide that cessation of liability would include the remission or cessation of liability by a unilateral act by the assessee or the successor, as the case may be.


Questions?

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