

# Lesser-known deductions under Income-tax Act, 1961

**CA Saurabh Shah**

*For discussion purposes only and should not be construed  
as any professional advice*

# Anecdote 😊



1	NIL
2	NIL
3	NIL
4	NIL
5	\$1
6	\$3
7	\$7
8	\$12
9	\$18
10	\$59
<b>Total</b>	<b>\$100</b>

1	NIL
2	NIL
3	NIL
4	NIL
5	NIL
6	\$2 (33%)
7	\$5 (28%)
8	\$9 (25%)
9	\$14 (22%)
10	\$49 (16%)
<b>Total</b>	<b>\$80</b>

# Amendments in section 54 / 54F

## Section 54 / section 54F – Amendment in brief



### Amendment

- Section 54/54F provides for exemption from capital gains if the capital gains (section 54) / net consideration (section 54 F) is invested in purchase of residential property in India (new asset)
- Huge exemptions claimed by HNIs while purchasing expensive residential house. Memorandum states that this defeats the purpose of the provision
- Cost of new house now capped to INR 10 crores for the purpose of exemption. Gain / net consideration in excess of INR 10 crores is chargeable to capital gains
- This amendment is effective from 1 April 2024 i.e. from AY 2024 25 and onwards

**Amendment not applicable for gains booked in FY 2022-23. Thus, no upper cap on amount eligible for exemption u/s 54 and 54F in such cases**

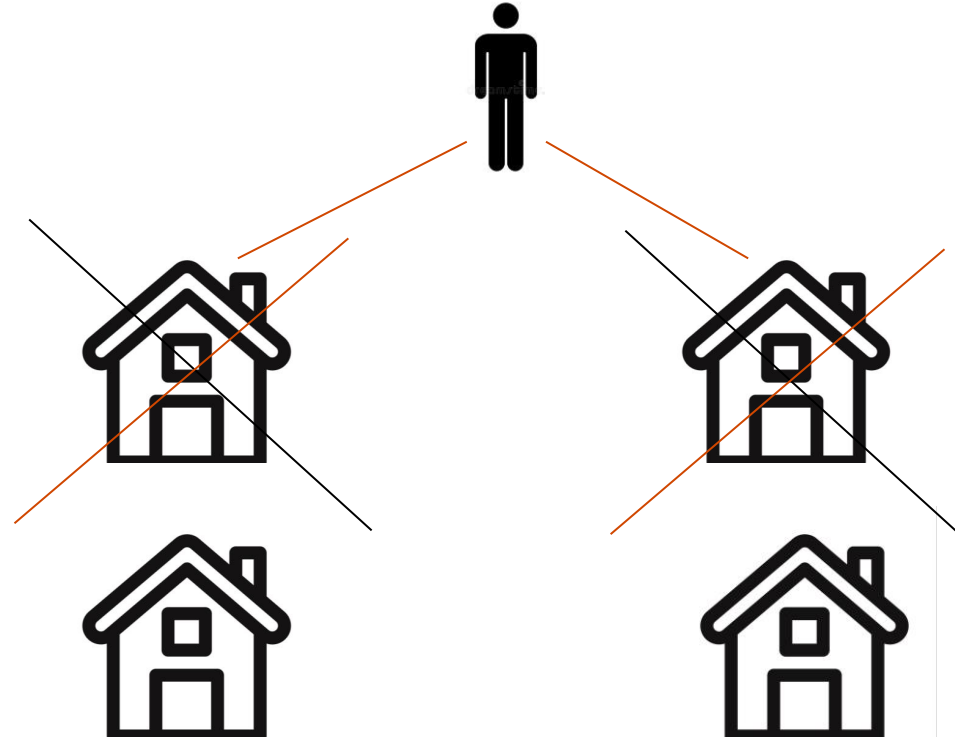
## Section 54 – Illustrative impact



Particulars	Section 54	
	Pre	Post
Consideration	100	100
Indexed cost	(10)	(10)
Gross capital gains	90	90
Cost of new house	100	100
Tax cost of new house	100	10
Net taxable capital gains	NIL	80

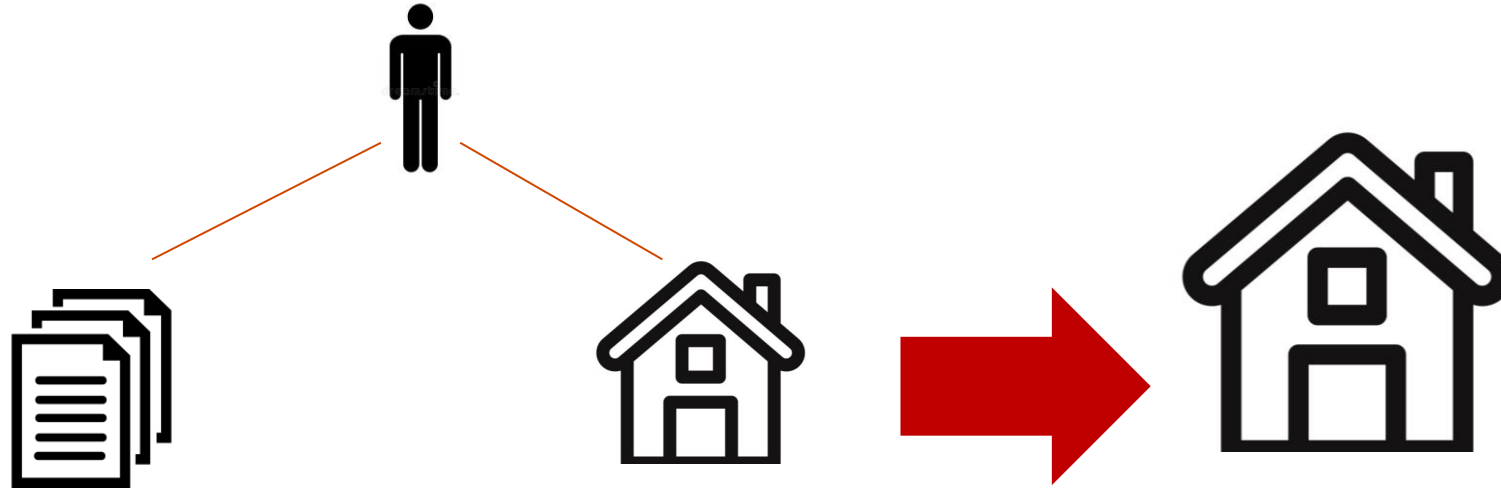
**Technical snag – Cost of new house regarded as NIL if sold within 3 years**

## Section 54 – Illustrations



**Individual selling 2 house properties (SOP/DLOP) and purchasing 2 new properties worth INR 10 cr each – whether roll over possible?**

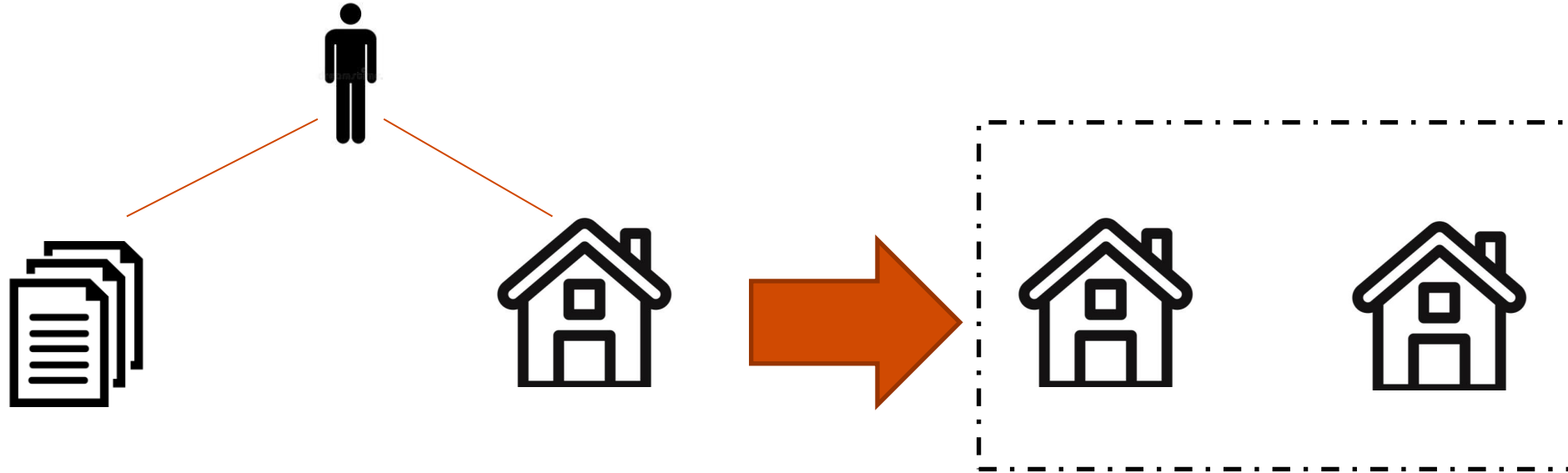
## Section 54 – Illustrations



One flat of INR 20 cr purchased against share sale and sale of existing house property Whether deduction u/s 54 and 54F can be claimed for INR 10 cr each?

Assuming shares having different costs are sold, selection of particular class for section 54F purposes imperative in order to maximize the benefit. Each share is a different source as held by Mumbai Special Bench in *JCIT v. Montgomery Emerging Markets Fund*

## Section 54 – Illustrations



**Two flats of INR 10 cr each purchased against share sale and sale of existing house property. Whether deduction u/s 54 and 54F can be claimed for INR 10 cr each?**



# Interest limitation under section 57

## Interest limitation under section 57



### Proviso to section 57

*Provided that no deduction shall be allowed **from** the dividend income ....., other than deduction on account of interest expense, and in any previous year such deduction shall not exceed twenty per cent of the dividend income,.. included in the total income for that year, without deduction under this section.*

**Will the interest limitation apply if no dividend income is earned during the year?**



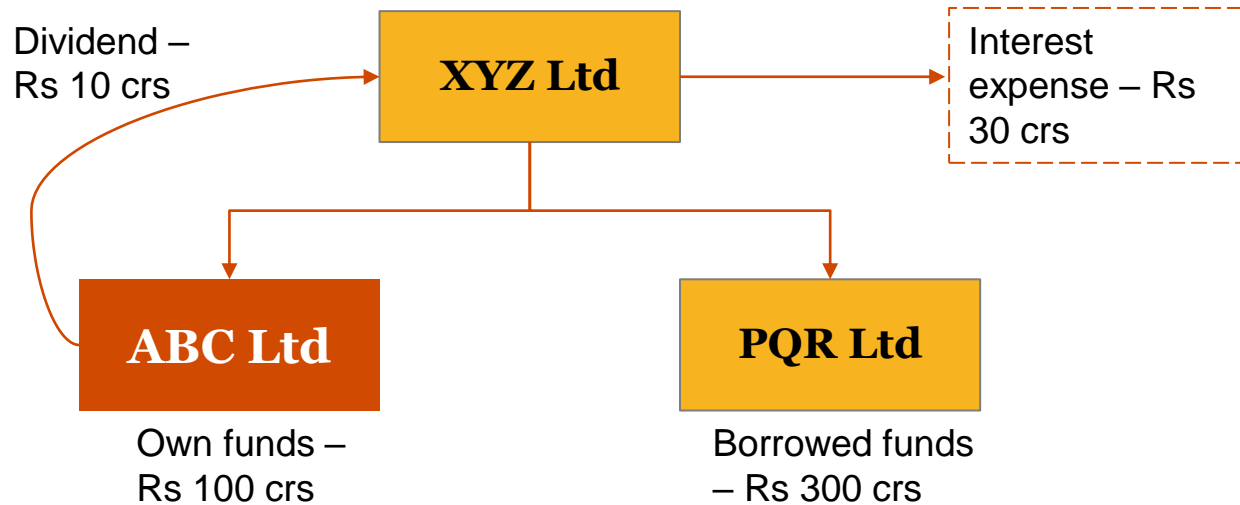
### Interest limitation of 20% will not apply in absence of dividend income

- Meaning of word “from”
  - ❑ ‘From’ means ‘out of’ [*Universal Radiators v. CIT [1993] 68 Taxman 45 (SC)*]
- Analogy from section 48 – Deduction ‘from’ full value of consideration
  - ❑ Machinery provisions of section 48 fails if there is no consideration *CIT v. Mohanbhai Pamabhai [1973] 91 ITR 393 (Guj)*
- Prerequisite of dividend income to be “included in total income” in order for limitation to trigger
  - ❑ Analogy from judicial precedents in context of section 14A – no disallowance in absence of exempt income
- Incongruous result if dividend income of Rs 1 is received is of no relevance [*CIT v. Elphinstone Spinning and Weaving Mills [1960] 40 ITR 142 (SC)*]
- Even in absence of any income, deduction u/s 57(iii) can be claimed [*CIT v. Rajendra Prasad Moody [1978] 115 ITR 519 (SC)*]

# Interest limitation under section 57



## Investments made out of own funds as well as borrowed funds



Particulars	Computation of income	
	View 1	View 2
Dividend from ABC Ltd	10 crs	10crs
Less: interest expense w.r.t. investments in ABC Ltd	NIL	NIL
Less: interest expense w.r.t. investments in PQR Ltd	(30 crs)	(30 crs)
Taxable income	(20 crs)	8 crs

# Deductibility of foreign taxes

# Deductibility of foreign taxes



## Section 2(43) of the Act

*"tax" in relation to the assessment year commencing on the 1st day of April, 1965, and any subsequent assessment year means income-tax chargeable under the provisions of this Act*



## Section 40(a)(ii) of the Act

*Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",—*

*(a) in the case of any assessee—*

*(ii) any sum paid on account of any rate or **tax** levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains.*

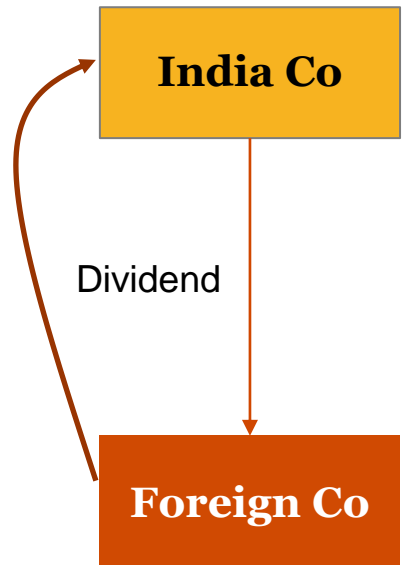
*Explanation 1.—For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate or tax levied includes and shall be deemed always to have included any sum eligible for relief of tax under section 90 or, as the case may be, deduction from the Indian income-tax payable under section 91.*

# Deductibility of foreign taxes



## Whether foreign taxes are eligible for deduction?

- Explanatory Memorandum to Finance Bill, 2006 stated that Explanation was specifically inserted to prevent cases where taxpayers were claiming relief under section 90 and Section 91 of the Act as well as a tax deduction of the same.
- Thus, where no relief has been taken under Section 90 of the Act, there should not be a bar to claim the deduction to the extent of tax paid abroad
- Bombay High Court in Reliance Infrastructure Ltd v. CIT [2016] 390 ITR 271 (Bom)
  - ❑ Appears that there is no negative judicial precedents thus far
- However, section 40 disallows expenses which are otherwise allowable
- Is tax an expenditure for purpose of business?



Taxes withheld by Foreign Co – 30%

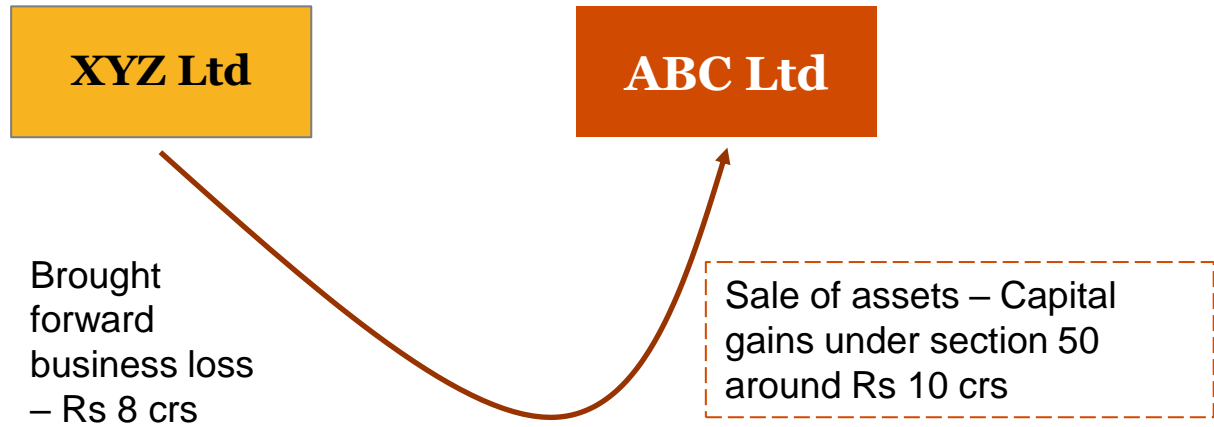


Capital gains u/s 50 – Whether set-off permissible against business losses?

# Capital gains u/s 50 – Whether set-off permissible against business losses?



## Sale of depreciable assets



- Language employed in relevant provisions
- Supreme Court in case of Cocanada Radhaswami Bank [1965] 57 ITR 306
- Karnataka High Court in case of Nandi Steels [2021] 436 ITR 238 (Kar)
- Whether exemption under [section 54/54F](#) is available against such short term capital gains?

# Capital gains u/s 50 – Whether set-off permissible against business losses?



## Section 72 of the Act

Where for any assessment year, the net result of the computation **under the head "Profits and gains of business or profession"** is a loss to the assessee, not being a loss sustained in a speculation business, and such loss cannot be or is not wholly set off against income under any head of income in accordance with the provisions of section 71, so much of the loss as has not been so set off or, where he has no income under any other head, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and—

(i) it shall be **set off against the profits and gains, if any, of any business** or profession carried on by him and assessable for that assessment year

# Capital gains u/s 50 – Whether set-off permissible against business losses?



## Section 70(1) of the Act

*where the net result for any assessment year in respect of any source falling under any head of income, other than "Capital gains", is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head*

## Section 74(1) of the Act

*Where in respect of any assessment year, the net result of the computation under the head "Capital gains" is a loss to the assessee, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and—*

*(a) in so far as such loss relates to a short-term capital asset, it shall be set off against income, if any, under the head "Capital gains" assessable for that assessment year in respect of any other capital asset;*

*(b) in so far as such loss relates to a long-term capital asset, it shall be set off against income, if any, under the head "Capital gains".....*

# Capital gains u/s 50 – Whether set-off permissible against business losses?



## Section 54 of the Act

*....where, in the case of an assessee being an individual or a Hindu undivided family, the capital gain arises from the transfer of any **long-term capital asset**, not being a residential house.....*

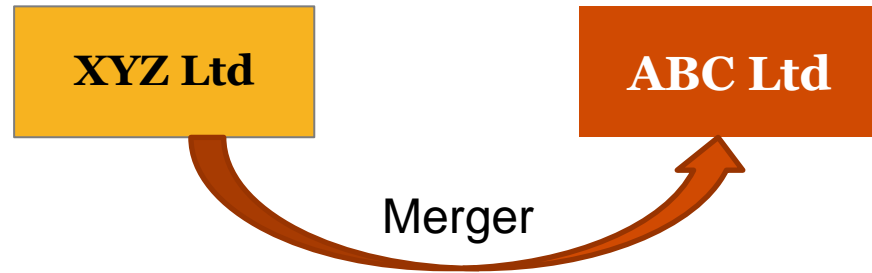


Claim of capital loss of  
amalgamating company by  
amalgamated company

# Claim of capital loss of amalgamating company by amalgamated company



## Merger of XYZ Ltd with ABC Ltd



Unabsorbed capital loss of XYZ Ltd is Rs 100 crores

- Language employed in relevant provisions ([Section 72A](#))
- Pune ITAT in case of Capgemini [TS-918-ITAT-2022(PUN)]
  - ❑ All benefits and privileges available to amalgamating co must travel to amalgamated company basis the Scheme
  - ❑ Law of succession puts the successor in shoes of predecessor
  - ❑ Section 72A only puts certain conditions on availability of business loss
  - ❑ It is not as if section 72A is the only provision taking care of all benefits and advantages which flow to the successor

# Claim of capital loss of amalgamating company by amalgamated company



## Section 72A of the Act

*Where there has been an amalgamation of—*

*(a) a company owning an industrial undertaking or a ship or a hotel with another company;*

*then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected*

*(a) "accumulated loss" means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, under the head "Profits and gains of business or profession"*





# Section 79 – Carry forward and set-off of losses

## Section 79 – carry forward and set-off of losses



Shareholders	Shareholding	
	Year 1	Year 4
Mr. A	10%	51%
Mr. B	20%	
Mr. C	30%	
Mr. D	40%	
Mr. E	-	49%
<b>Total</b>	<b>100%</b>	<b>100%</b>

## Section 79 – carry forward and set-off of losses



Shareholders	Shareholding		
	31 March 2023	1 July 2023	31 March 2024
Mr. A	10%	1%	51%
Mr. B	20%		
Mr. C	30%		
Mr. D	40%		
Mr. E	-	99%	49%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

## Section 79 – carry forward and set-off of losses



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Loss

Loss

Profit

## Section 79 – carry forward and set-off of losses

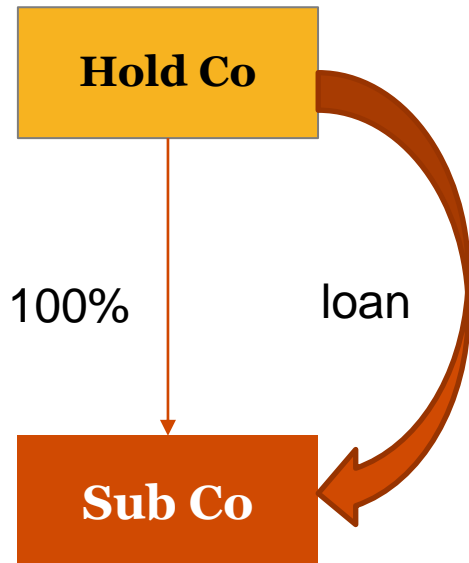


### Section 79 of the Act

*Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place during the previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year, **unless** on the last day of the previous year, **the shares of the company carrying not less than fifty-one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred***

# Write-off of investment in a subsidiary

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## Whether deduction allowable on such write-off?

- Extremely fact-based exercise
- Nature of relationship between Hold Co and Sub Co
- Whether investment was on account of commercial objectives to further the business of Hold Co?
- Extent of nexus with business operations

**Similar rationale could apply in cases where loan given to Sub Co is written off on account of inability of Sub Co to repay the money**

# Write-off of investment in a subsidiary



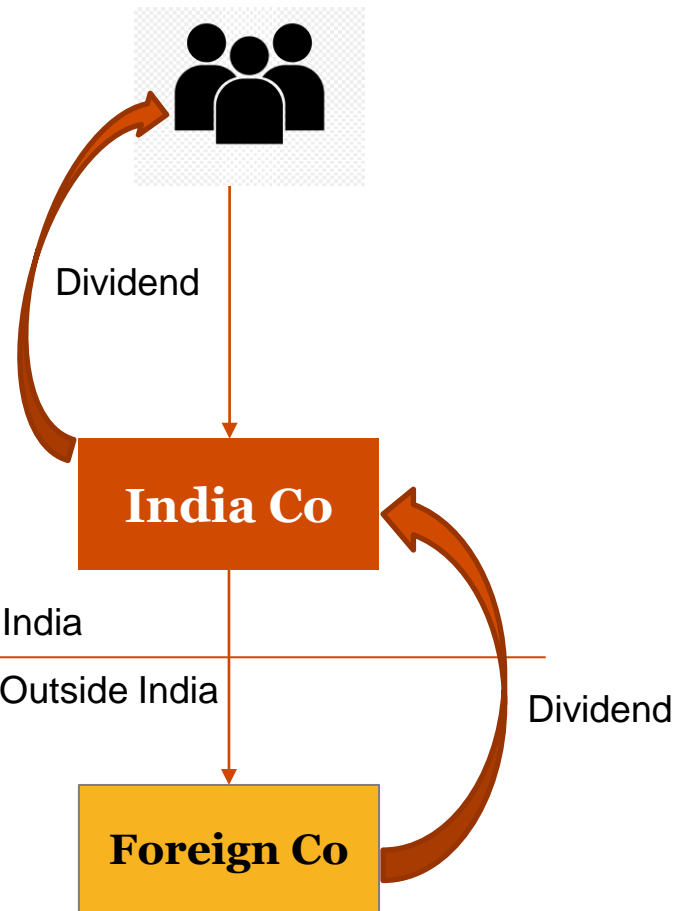
- Investment in Sub Co was an integral part of business of Hold Co
- Memorandum permits to invest in Sub Co
- Hold Co has invested in Sub Co to support its own business and not with an aim to earn any return on investment
- Hold Co is taking keen interest in business of Sub Co (could be substantiated by board minutes, emails, etc)





# Interplay between section 80M and foreign dividends

# Interplay between section 80M and foreign dividends



## Computation of total income of India Co

Particulars	Amount (in crores)
Business income	100
Dividend from Foreign Co	75
<b>Gross Total income</b>	<b>175</b>
Less: Deduction under section 80M	(75)
<b>Net total income</b>	<b>100</b>
<b>Tax liability</b>	<b>??</b>

## Section 80M



*Where the gross total income of a domestic company in any previous year includes any income by way of dividends from any other domestic company or a foreign company or a business trust, there shall, in accordance with and subject to the provisions of this section, **be allowed in computing the total income of such domestic company, a deduction of an amount equal to so much of the amount of income by way of dividends** received from such other domestic company or foreign company or business trust as does not exceed the amount of dividend distributed by it on or before the due date.*

*Where any deduction, in respect of the amount of dividend distributed by the domestic company, has been allowed under sub-section (1) in any previous year, no deduction shall be allowed in respect of such amount in any other previous year.*

# Leasehold premium

# Tax treatment of leasehold premium



- Land acquired on lease from state owned industrial corporations (say, GIDC) to set-up a factory
- Typically, premium amount is very high and annual rent is disproportionately low
- Lease period is reasonably long (60 – 99 years)

## Nature of lease premium – Revenue or Capital?

- Lease premium is nothing but advance rent discounted at present value
- However, benefit given till perpetuity
- Automatic renewal without payment of premium
- Favorable cases in Gujarat, Karnataka and Kolkata

## If capital, whether it qualifies as intangible asset eligible for depreciation?

- Any other business or commercial right of similar nature – quite broad
- Colorable device – freehold land v. leasehold land
- Favorable ITAT decisions

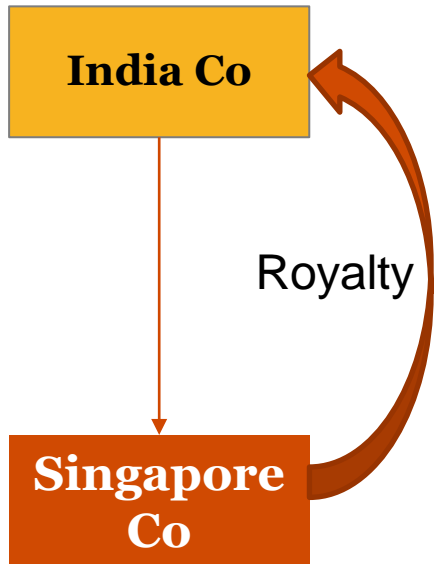
## If revenue, whether allowable in entirety in Year 1 or over a period of lease?

- Better view is to capitalize to capital WIP from which it can get capitalized into different Fixed Assets on which depreciation can be claimed

# Tax sparing credit



## Concept of tax sparing credit



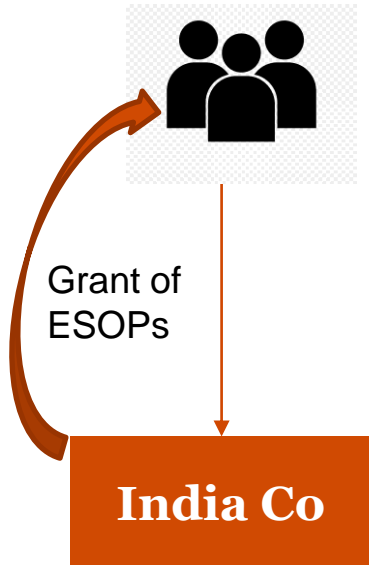
- India Co earns income of INR 100 from Singapore Co
- Singapore has a tax rate of 30%; however, on account of an exemption, no taxes are paid in Singapore
- India also taxes its residents on their world-wide income at a 30% tax rate
- India-Singapore Tax Treaty has a concept of tax sparing

**Against Indian tax liability, credit will be given for taxes which are spared in Singapore subject to certain conditions**

# Deductibility for ESOP expenses



# Deductibility of ESOP expenses



Particulars	Amount
Grant price	INR 20
Market value as on date of grant	INR 100
Vesting period	4 years
ESOP expense which can be claimed	INR 80 (over a 4 year period)
Market value as on date of exercise	INR 150
ESOP expenses which can be claimed in year of exercise	INR 50

# Amendment in section 37



### Section 37 of the Act

*Explanation 1.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.*

*[Explanation 3.—For the removal of doubts, it is hereby clarified that the expression "expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law" under Explanation 1, **shall include and shall be deemed to have always included the expenditure incurred by an assessee,—***

*(i) for any purpose which is an offence under, or which is prohibited by, any law for the time being in force, in India or outside India; or*

*(ii) to provide any benefit or perquisite, in whatever form, to a person, whether or not carrying on a business or exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guideline, as the case may be, for the time being in force, governing the conduct of such person; or*

*(iii) to compound an offence under any law for the time being in force, in India or outside India]*



### Questions

- Does the Tax Department have the jurisdiction to to decide whether receipt of ‘benefit or perquisite’ would violate any law or rule or regulation or guideline, as the case may be, for the time being in force, governing the conduct of recipient person?
  - ❑ Arguable that that no disallowance shall be attracted under section 37, unless the competent authority under prescribed rules or regulations, have determined a case on merits, whether it involves violation of law or not.
  - ❑ Maria Social Service Society v. CIT [2018] 408 ITR 462 (Kar) – Commissioner cannot decide whether FCRA was violated and thereby cancel the registration



### Questions

- Whether settlement fees paid under FEMA or SEBI or any other regulations, without admission of offence, would be subject matter of disallowance under clause (iii) of Explanation 3 to section 37?
  - ❑ Restriction proposed under Explanation 3 to Section 37 should not apply, if such amount is paid as settlement of any irregularity without admission of offence.
  - ❑ amount paid as settlement fees should not be regarded as any amount paid for compounding of an offence
  - ❑ It is compensatory and not penal in nature
  - ❑ Mumbai ITAT in ITO v. Reliance Share & Stock Brokers (P.) Ltd - Consent fees paid to settle dispute cannot be equated with 'penalty' for infraction of law and hence, consent fee should be allowable as business expenditure, since it was paid for the purpose of business.

Thank you!



"That concludes my presentation. I'll now open this up for some answers."