

Chaturvedi & Pithisaria's

INCOME TAX LAW

Ninth Edition

OMITTED/INOPERATIVE PROVISIONS OF 1961 ACT **RELEVANT TO VOLUME 1**

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Omitted/Phased-out provisions of section 2 of the 1961 Act

APPELLATE ASSISTANT COMMISSIONER [Omitted s. 2(3)]

Introduction under 1961 Act.—The expression “Appellate Assistant Commissioner” was defined under section 2(3).

“Appellate Assistant Commissioner”, defined.—Unless the context otherwise requires, the expression “Appellate Assistant Commissioner” meant—

—a person appointed to be an Appellate Assistant Commissioner of Income-tax under section 117(1) of the 1961 Act.

Omission of section 2(3) of 1961 Act.—Section 2(3) was omitted (w. e. f. 1-4-1988) by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988).

The omission was consequent upon the redesignation of the first appellate authority as “Deputy Commissioner (Appeals)”, with effect from 1-4-1988, by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988). The expression “Deputy Commissioner (Appeals)” has been defined under section 2(19B).

ASSESSMENT YEAR [S. 2(9)]

Introduction under 1961 Act.—The expression “assessment year” has been defined under section 2(9).

“Assessment year”, defined.—Unless the context otherwise requires, the expression “assessment year” has been assigned a special meaning by way of an exhaustive definition so as to mean—

—the period of twelve (12) months commencing on the 1st day of April every year.

It is pertinent to note that according to the charging section 4(1) of the 1961 Act, income-tax shall be charged for any assessment year at any rate or rates prescribed in the Finance Act concerned in respect of the total income of the previous year of every person, unless the case is covered by the proviso to section 4(1) of the 1961 Act.

The concept of ‘assessment year’ must be understood in the manner prescribed under the provisions of the Income-tax Act and not with reference to a particular assessee. Whenever the assessee is permitted to get relief for a specified number of consecutive assessment years, the assessment years should be taken in the natural sequence [*Rockwell Electrodes India Ltd. v. CIT*, (1990) 185 ITR 62, 66, 68 (Mad), a case relating to relief under the then section 80J of the 1961 Act; *Premier Cable Co. Ltd. v. CIT*, (1992) 193 ITR 719, 732-33 (Ker), SLP granted: (1992) 193 ITR (St.) 108 (SC), a case relating also to relief under the then section 80J of the 1961 Act, affirmed in *Premier Cable Co. Ltd. v. CIT*, (1999) 237 ITR 202 (SC)].

DEPUTY COMMISSIONER (APPEALS) [S. 2(19B)]

Introduction under 1961 Act.—*The Direct Tax Laws (Amendment) Act, 1987.*—The expression “Deputy Commissioner (Appeals)” has been inserted (w. e. f. 1-4-1988) by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988) and defined under section 2(19B).

For the scope and effect of the above insertion, reference may be made to paras. 6 to 6.7 of the *Departmental Circular No. 545, dated 21-9-1989*.

Legislative amendments under 1961 Act.—**I. The Finance Act, 1994.**—By the Finance Act, 1994 (32 of 1994), the definition has been amended (w. e. f. 1-6-1994) to include an Additional Commissioner of Income-tax (Appeals).

For the scope and effect of the above amendment, reference may be made to paras. 15 to 15.3 of the *Departmental Circular No. 684, dated 10-6-1994*.

II. The Finance Act, 2023.—By the Finance Act, 2023 (8 of 2023), section 2(19B) has been amended (w. e. f. 1-4-2023) in view of the creation of a new income-tax authority [Joint CIT(A)].

For the scope and effect of the above amendment, reference may be made to paras. 63 to 63.12 of the *Departmental Circular No. 1/2024, dated 23-1-2024*.

MANAGING AGENT [S. 2(20)]

“Managing agent”, defined.—The expression “managing agent” has been defined in relation to a company only. Thus, unless the context otherwise requires, the term “managing agent” shall have the meaning assigned to it in the Companies Act, 1956.

“Managing agent” **meant** any individual, firm or body corporate entitled, subject to the provisions of this Act, to the management of the whole, or substantially the whole, of the affairs of a company by virtue of an agreement with the company, or by virtue of its memorandum or articles of association, and includes any individual, firm or body corporate occupying the position of a managing agent, by whatever name called.

The definition of “managing agent” makes it clear that a managing agent need not necessarily be a servant of the company whose affairs are managed by that managing agent. All that is needed is that the managing agent should have been entitled to the management of the whole, or substantially the whole, of the affairs of the company by virtue of an agreement with the company or by virtue of its memorandum or articles of association. The mere appointment as a managing agent, or working as such, would not necessarily make the person a servant of the company. Though, normally, a managing agent is not a servant of the company, but, if the circumstances so require, he may be held to be a servant of the company [see, *Inderchand Hari Ram v. CIT*, (1952) 22 ITR 108, 116, 117 (All); *CIT v. I.D. Varshani*, (1953) 24 ITR 328, 333 (All)]. Thus, where the Tribunal pointed out that though the assessee was called a managing agent, the powers conferred upon him under the articles were more in the nature of powers given to a servant; and that those powers could be terminated, and the managing agency agreement itself put an end to, and the Tribunal came to the conclusion that in fact the assessee was the chief manager of the company, it was held, that there were materials on which the Tribunal could come to the finding that the remuneration received by the assessee was salary [*CIT v. I.D. Varshani*, (1953) 24 ITR 328 (All)]. But in a case where the appellants were to act as the agents of the company and carry on the general management of the business of the company subject to the control and supervision of the directors, it was held, considering the facts and circumstances of the case together with the powers of sub-delegation, that the appellants were agents of the company and not merely the servants of the company remunerated by wages or salary [*Lakshminarayan Ram Gopal & Son Ltd. v. The Government of Hyderabad*, (1954) 25 ITR 449, 457-58 (SC)]. Also see, *Qamar Shaffi Tyabji v. CEPT*, (1960) 39 ITR 611 (SC); *Inderchand Hari Ram v. CIT*, (1952) 22 ITR 108 (All).

It is pertinent to note that the managing agencies have been **abolished** with effect from 3-4-1970 by virtue of the provisions of new section 324A inserted by the Companies (Amendment) Act, 1969 (17 of 1969). Further, on and from 3-4-1970 so much of the provisions of the Companies Act, 1956 (1 of 1956), as relate to, *inter alia*, managing agents shall **cease** to have effect except as respects things done or omitted to be done under those provisions before such cesser. Ultimately, section 2(25), coining a definition of the expression ‘managing agent’ as also provisions relating to managing agents as contained in the Companies Act, 1956 (1 of 1956), have been **omitted** (w. e. f. 13-12-2000) by the Companies (Amendment) Act, 2000 (53 of 2000).

FRINGE BENEFITS [S. 2(23B)]

Introduction under 1961 Act.—*The Finance Act, 2005.*—The expression “fringe benefits” has been **inserted (w. e. f. 1-4-2006) by the Finance Act, 2005** (18 of 2005) and defined under **section 2(23B)**.

For the scope and effect of the above insertion, reference may be made to *Departmental Circular No. 8/2005, dated 29-8-2005*.

“Fringe benefits”, defined.—Unless the context otherwise requires, the expression “fringe benefits” **means—**

—any fringe benefits referred to in section 115WB of the 1961 Act.

It is pertinent to note that the provisions of Chapter XII-H [containing sections 115W to 115WM] of the 1961 Act were applicable for assessment years 2006-07 to 2009-10.

INCOME [S. 2(24)]

Amount of annuity due [omitted s. 2(24)(viii) of 1961 Act].—Under **section 2(24)(viii)** of the 1961 Act, “any annuity due, or commuted value of any annuity paid, under the provisions of section 280D of the 1961 Act” was included within the definition of income. Where annuity was deposited by a Hindu undivided family which, later, underwent partition as a result whereof the annuity certificate were allotted to a member, it was held that because of the phraseology of the then section 2(24)(viii) of the 1961 Act, the amounts due on such certificates was the income of the member concerned [*Addl CIT v. D.V. Shreerama Murthy*, (1979) 116 ITR 431 (AP); *CIT v. O.N. Talwar*, (1980) 123 ITR 80 (Del)].

This provision was **omitted (w. e. f. 1-4-1988) by the Finance Act, 1988** (26 of 1988).

Concessional issue of shares.—With effect from 1-6-2010, as per **section 2(24)(xv)** read with **section 56(2)(viiia)** of the 1961 Act, where a firm or a closely-held company receives from any person(s), between 1-6-2010 and 31-3-2017, any shares of a closely-held company without consideration as described under section 56(2)(viiia)(i) of the 1961 Act, or for a consideration as described under section 56(2)(viiia)(ii) of the 1961 Act, shall be deemed as ‘income’, subject to certain exceptions.

Section 2(24)(xvi) of the 1961 Act has been **inserted (w. e. f. 1-4-2013)** by the **Finance Act, 2012** (23 of 2012). Thus, with effect from 1-4-2013, as per **section 2(24)(xvi)** read with **section 56(2)(viib)** of the 1961 Act, where a closely-held company receives from any resident person any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be deemed as ‘income’ of such company, subject to certain exceptions.

INSPECTING ASSISTANT COMMISSIONER [Omitted s. 2(27)]

Introduction under 1961 Act.—The expression “Inspecting Assistant Commissioner” was defined under **section 2(27)**.

“Inspecting Assistant Commissioner”, defined.—Unless the context otherwise requires, the expression “Inspecting Assistant Commissioner” **meant** a person appointed to be an Inspecting Assistant Commissioner of Income-tax under section 117(1) of the 1961 Act.

Omission of section 2(27) of 1961 Act.—Section 2(27) of the 1961 Act was **omitted (w. e. f. 1-4-1988)** by the **Direct Tax Laws (Amendment) Act, 1987** (4 of 1988).

The **omission** was consequent upon the redesignation of the “Inspecting Assistant Commissioner” as “Deputy Commissioner”, with effect from 1-4-1988, by the **Direct Tax Laws (Amendment) Act, 1987** (4 of 1988). The expression “Deputy Commissioner” has been defined under section 2(19A) of the 1961 Act.

NATIONAL TAX TRIBUNAL [S. 2(29D)]

Introduction under 1961 Act.—*The National Tax Tribunal Act, 2005.*—The expression “National Tax Tribunal” has been **inserted (w. e. f. 28-12-2005)** by the **National Tax Tribunal Act, 2005** (49 of 2005) and defined under **section 2(29D)**.

“National Tax Tribunal”, defined.—Unless the context otherwise requires, the expression “National Tax Tribunal” **means** the National Tax Tribunal established under section 3 of the National Tax Tribunal Act, 2005 (49 of 2005).

National Tax Tribunal Act, 2005 declared unconstitutional.—The basic structure of Constitution will stand violated in a case where Parliament while enacting legislation pertaining to transfer of judicial powers, does not ensure that newly created Court/Tribunal, conforms with same salient characteristic and standards as that of Court sought to be substituted; and since sections 5, 6, 7, 8 and 13, when examined on touchstone of aforesaid legal position, are found to be unconstitutional and as those provisions constitute edifice of Act, **entire enactment is to be declared unconstitutional** [*Madras Bar Association v. Union of India*, (2014) 368 ITR 42 (SC) = (2014) 49 taxmann.com 515/575 (SC)].

PREVIOUS YEAR [S. 2(34)]

Introduction under 1961 Act.—The term “previous year” has been defined under **section 2(34)**.

“Previous year”, defined.—Unless the context otherwise requires, the expression “previous year” **means** the previous year as defined in section 3 of the 1961 Act.

REGISTERED FIRM [Omitted s. 2(39)]

Introduction under 1961 Act.—The expression “registered firm” was defined under **section 2(39)**.

“Registered firm”, defined (operative up to 31-3-1989).—**Between 1-4-1962 & 31-3-1989**, the expression “registered firm”, unless the context otherwise requires, **meant** a firm registered under the provisions of section 185(1)(a) of the 1961 Act or under that provision read with section 184(7) of the 1961 Act.

Legislative amendment under 1961 Act.—**I. The Direct Tax Laws (Second Amendment) Act, 1989.**—The expression “registered firm” had been **substituted (w. r. e. f. 1-4-1989)** by the **Direct Tax Laws (Second Amendment) Act, 1989** (36 of 1989).

For the scope and effect of the above substitution, reference may be made to paras. 4 to 4.4 of the *Departmental Circular No. 554, dated 13-2-1990*.

“Registered firm”, defined.—Unless the context otherwise requires, the expression “registered firm” **meant** a firm registered under the provisions of section 185(1)(a) or deemed to be registered under the provisions of section 185(6) or under those provisions read with section 184(7) of the 1961 Act.

Omission of section 2(39) of 1961 Act.—Section 2(39) of the 1961 Act was **omitted (w. e. f. 1-4-1993)** by the **Finance Act, 1992** (18 of 1992).

For the scope and effect of the above omission, reference may be made to paras. 48 to 48.10 of the *Departmental Circular No. 636, dated 31-8-1992*.

TAX CREDIT CERTIFICATE [S. 2(43A)]

Introduction under 1961 Act.—*The Finance Act, 1965.*—The expression “tax credit certificate” has been inserted (w. e. f. 1-4-1965) by the Finance Act, 1965 (10 of 1965) and defined under **section 2(43A)**.

“Tax credit certificate”, defined.—Unless the context otherwise requires, the expression “tax credit certificate” means—

- a tax credit certificate granted to any person in accordance with the provisions of Chapter XXII-B of the 1961 Act and any scheme made thereunder.

TAX RECOVERY COMMISSIONER [Omitted s. 2(43B)]

Introduction under 1961 Act.—The expression “Tax Recovery Commissioner” was defined under **section 2(43B)** which was inserted (w. e. f. 1-1-1972) by the Finance (No. 2) Act, 1971 (32 of 1971).

For the scope and effect of the above insertion, reference may be made to *Departmental Circular No. 72, dated 6-1-1972*.

“Tax Recovery Commissioner”, defined.—Unless the context otherwise requires, the expression “Tax Recovery Commissioner” meant—

- a Commissioner or an Assistant Commissioner of Income-tax who may be authorized by the Central Government, by general or special notification in the Official Gazette, to exercise the powers of a Tax Recovery Commissioner.

Omission of section 2(43B) of 1961 Act.—Section 2(43B) of the 1961 Act was omitted (w. e. f. 1-4-1989) by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988).

The scope and effect of the above omission have been elaborated in the following portion of the *Departmental Circular No. 551, dated 23-1-1990*:—

‘12.2 In some bigger charges there were separate wings of Tax Recovery Officers working under the control and supervision of Tax Recovery Commissioner. In order to bring about better co-ordination between the Assessing Officers and the Tax Recovery Officers, it was decided that the latter should work under the administrative control of the respective administrative Commissioners. Consequently, the posts of “Tax Recovery Commissioners”, being no longer necessary, have been abolished. The Amending Act, 1987, has, therefore, omitted clause (43B) of section 2 containing the definition of “Tax Recovery Commissioner”.’.

TOTAL WORLD INCOME [Omitted s. 2(46)]

Introduction under 1961 Act.—The expression “total world income” was defined under **section 2(46)**.

“Total world income”, defined.—Unless the context otherwise requires, the expression “total world income” included—

- all income wherever accruing or arising, except incomes which are not included in the total income under any of the provisions of Chapter III and except any capital gains which are not includible in the total income of an assessee.

Omission of section 2(46) of 1961 Act.—Section 2(46) of the 1961 Act was omitted (w. e. f. 1-4-1965) by the Finance Act, 1965 (10 of 1965).

Erstwhile provisions of section 3 of the 1961 Act

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PREVIOUS YEAR [Law up to assessment year 1988-89]

Legislative amendment under 1961 Act.—I. The Direct Tax Laws (Amendment) Act, 1987.—For the scope and effect of the amendment (w. e. f. 1-4-1988) made in section 3(4) by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988), reference may be made to paras. 6 to 6.7 of the *Departmental Circular No. 545, dated 21-9-1989*.

“Previous year” in general cases [s. 3(1)(a) of 1961 Act].—The expression ‘previous year’ substantially means an accounting year comprised of a full period of twelve months and usually corresponding to a financial year preceding the financial year of assessment. It also means an accounting year comprised of a full period of twelve months adopted by the assessee for maintaining his accounts but different from the financial year and preceding a financial year. For purposes of the charging sections of the Act unless otherwise provided for, it is correlated to a year of assessment immediately following it, but it is not necessarily wedded to an assessment year in all cases and it cannot be said that the expression ‘previous year’ has no meaning unless it is used in relation to a financial year [*CIT v. K. Srinivasan*, (1953) 23 ITR 87, 99 (SC)].

For the purposes of the 1961 Act, as per section 3(1)(a), “previous year” meant the financial year immediately preceding the assessment year.

The general rule, in absence of special provisions and option, is that the ‘previous year’ means the financial year immediately preceding the assessment year. Thus, for assessment year 1982-83, the previous year would be the period from 1-4-1981 to 31-3-1982 [see, *Satya Narain Bagla v. CIT*, (1968) 67 ITR 240, 247 (All)]. For instance, interest income received on unpaid sale price is income from a source different from the one derived by the sale itself. Unless the assessee had exercised option under section 3(1)(b) of the 1961 Act, the previous year for that source is the relevant financial year [*CIT v. Vishnudayal Dwarkadas*, (1980) 123 ITR 140 (Bom)].

Where accounts are not maintained.—Where it is found by the Tribunal that the assessee has not maintained any accounts, his previous year should be the financial year [*CIT v. J.B. Lohada*, (1988) 174 ITR 318 (AP)]. In that case, the assessee received in February, 1970, a certain sum on account of breach of a contract concluded in November, 1969. It was held that the amount was not assessable in the assessment year 1971-72 because both the aforesaid dates fell outside the financial year 1970-71. Similarly, in *CIT v. Amarlal Krishandas*, (1999) 239 ITR 495, 496 (Mad), it has been held that, in respect of income from jackpot winning, the previous year was financial year because the assessee has not maintained any accounts in respect thereof.

Deviation from general rule possible only if accounts are maintained to another date [s. 3(1)(b) of 1961 Act].—The assessee, in section 3(1)(b) of the 1961 Act, has been given an option to have a previous year different from the financial year as prescribed in section 3(1)(a) of the 1961 Act. But that option, in terms of section 3(1)(b) of the 1961 Act, can be exercised only (i) if the assessee has made up his accounts, (ii) up to a date within the financial year immediately preceding the assessment year, and (iii) the period of his ‘accounting year’ is a period of 12 months [*Satya Narain Bagla v. CIT*, (1968) 67 ITR 240 (All); *CIT v. Lakshman Swaroop Gupta & Bros.*, (1975) 100 ITR 222, 226 (Raj); *C. Ag. IT v. M.K. Parameshwaran*, (1980) 126 ITR 143 (Ker); *CIT v. Ramesh Khanna*, (2001) 249 ITR 359, 362 (Del)]. Thus, as per section 3(1)(b) of the 1961 Act, if the accounts of the assessee have been made up to a date within the said financial year, then “previous year” meant 12 months ending on such date, at the option of the assessee.

Section 3(1)(b) of the 1961 Act is quite clear when it provides for the making up of accounts by the assessee. It does not refer to the factum of commencement of accrual of income. What is material is that the crucial date is not the commencement of a new source of income in the financial year preceding the assessment year in the context of section 3(1)(b) of the 1961 Act but the making up of the accounts by the assessee [*Addl. CIT v. K. Ramachandra Rao*, (1981) 127 ITR 414, 420 (AP)].

The option has been given by the statutory provision to the assessee and not to the department and when the assessee exercises the option, the department has no way out except to assess the income in the year for which it has been returned by the assessee [*CIT v. Patiala Sales Corporation Pvt. Ltd.*, (1970) 77 ITR 443, 449 (Punj)].

Exercising an option involves a positive act on the part of the assessee who must be aware of his right. He must then consciously opt for a previous year other than the financial year. Merely mentioning the year as commencing from a particular date on the challan for payment of advance tax cannot be treated as an exercise of such option [*Cf. CST v. Brihan Maharashtra Sugar Syndicate Ltd.*, (1987) 165 ITR 217, 223-24 (Bom); *CST v.*

Brihan Maharashtra Sugar Syndicate Ltd., (1987) 165 ITR 275 (Bom)]. At the same time, there is no particular mode contemplated by law of exercising this option and whether in a given case an option has been exercised or not is essentially a matter of inference [*CIT v. B.C. Kothari*, (1986) 160 ITR 27, 31-32 (Mad), **SLP dismissed**: (1992) 197 ITR (St.) 403-04 (SC)]. However, if the conditions of section 3(1)(b) of the 1961 Act do exist but the assessee did not specifically make the claim for exercise of option in his return or before the taxing or appellate authority, he may, for the first time, lay the claim of such option before the Tribunal [*Addl. CIT v. PKN Obulisami Chettiar*, (1978) 115 ITR 794 (Mad)].

Thus, where an assessee has maintained proper accounts of his income from house property, he is entitled to adopt a previous year different from the financial year [*Addl. CIT v. G.S. Hari Chand Kapoor & Sons*, (1985) 154 ITR 202 (Bom)].

No need to maintain separate books of account for separate sources.—For entitling an assessee to exercise an option under section 3(1)(b) of the 1961 Act in respect of any separate source of income, it is not necessary for him to have either a separate books of account in respect of the income from the separate source or even to have a separate part of the book confined to income from that source. It is enough if the account in respect of the separate source of income has been maintained by the assessee, and that account has been made up to a date within the 12 months ending on the 31st day of March next preceding the year for which assessment is to be made in respect of a year ending on any date other than 31st day of March, to entitle an assessee to exercise the option in question for the first time in respect of the separate source [*CIT v. Patiala Sales Corporation Pvt. Ltd.*, (1970) 77 ITR 433, 448 (Pun)].

“Previous year” for capital gains.—It may be noted that under section 45 of the 1961 Act itself, capital gains are “deemed to be the income of the previous year in which the transfer took place”. Thus, the ascertainment of the previous year for a particular capital gain is to follow the provisions of section 3 of the 1961 Act. In other words, if account of the capital gain has been maintained, may be in the same set of books, and the conditions of section 3(1)(b) of the 1961 Act do exist, the previous year will be as per such accounts. On the other hand, if the capital gains are not at all recorded in the books of account of the assessee, section 3(1)(a) of the 1961 Act shall apply and the financial year wherein the transfer took place shall be the previous year in respect thereof [*CIT v. Kirit Kumar Anubhai*, IT Ref. No. 109 of 1974 decided on 7-4-1976 (Guj)].

In *CIT v. Smt. Renu Khanna*, (1986) 160 ITR 855 (Del), the assessee recorded the transactions of sales resulting in capital gains in a note book. It was held that the assessee has exercised her option under section 3(1)(b) of the 1961 Act to have a previous year of her choice. Thus, where the assessee has opted to have previous year as calendar year ended on 31-12-1964 in respect of the capital gains, no capital gains can be taxed for the assessment year 1965-66 if the relevant capital asset has been transferred after 31-12-1964 [*CIT v. Estate Mineral Development Co. P. Ltd.*, (2002) 253 ITR 757, 759 (Cal)]. In *CIT v. Ramesh Khanna*, (2001) 249 ITR 359, 361, 362 (Del), the assessee had maintained separate accounts for the purchase and sale of the ‘capital asset’ (jewellery) and such accounts were closed on 25-12-1975. It has been held that in view of the provisions of section 3(1)(b) of the 1961 Act, the assessee was within his powers to draw up the profit and loss account for the period ending 25-12-1975 and to have the capital gains computed, for the assessment year 1976-77, till 25-12-1975.

Where the capital asset has been transferred on 4-1-1976 and the assessee has not maintained any books of account in respect of the capital gain arising from such transfer, the Tribunal has been held right in holding that such capital gain accrued to the assessee during the previous year 1975-76 and the same was chargeable to tax for the assessment year 1976-77 [*CIT v. Nirmal Kumar Soorana*, (2003) 263 ITR 322, 324 (Raj)]. Also see, *CIT v. Vimal Kumar Surana*, (2004) 269 ITR 288, 289 (Raj).

In *CIT v. Nellai Murasu Pr. Ltd.*, (1985) 154 ITR 355 (Mad), the gains arising on the sale of land were shown in the books of account maintained for the business. It was held that the capital gains were chargeable in the assessment year relevant to the previous year adopted for the business income. This is so because in a given case, there may be a controversy about the head under which income from a particular source would be assessable. Determination of that controversy will affect the charge of tax and the computation of income. It will in no way affect the “previous year” in which income from such source is assessable [*Fort Properties Pvt. Ltd. v. CIT*, (1994) 208 ITR 232, 254 (Bom)]. In that case, the source of income was the transfer of the property. The previous year for this source of income on the admission of the assessee was the accounting year ending on 31-8-1968, the assessment year for which was the assessment year 1969-70. It was, therefore, not correct to say that the previous year in respect of the very same source of income would change to the financial year once it was assessed not under the head “Income from business” as claimed by the assessee but under the head “Capital gains”. No such change was visualized by section 3 of the 1961 Act. In that view of the matter, the Court was of the clear opinion that the previous year in relation to the income from the transfer of the property in question in the instant case was the accounting year ended on 31-8-1968, the corresponding assessment year being the assessment year 1969-70.

However, in *CIT v. India Sea Foods*, (1987) 168 ITR 721 (Ker), the sale took place on 3-3-1973 and in respect of business income the assessee had adopted calendar year as its previous year. In the return for the assessment year 1973-74, the assessee included the capital gains arising from the said sale. The department contended that the capital gains were to be assessed for the assessment year 1974-75. It was held, negating the department's contention, that the capital gains were to be assessed in assessment year 1973-74, because in respect of such gains the assessee had not exercised any option to adopt a different previous year and, therefore, the financial year was assessee's previous year in respect of such gains.

But, in *Guntur Merchants Cotton Press Co. Ltd. v. CIT*, (1989) 175 ITR 313 (AP), the assessee, following calendar year as its previous year for its business income and maintaining books of account on that basis, received on 28-2-1961 a certain sum [which was chargeable to tax in terms of section 46(2) of the 1961 Act] from the liquidator of a company in which it held shares. It was held that the said sum, even though it was not recorded in the books, was assessable for the assessment year 1962-63 on the basis of the presumption that the assessee has one previous year, namely, calendar year, for all heads of income unless it says that it shall have different previous years for different heads of income. **With great respect to their Lordships, it is submitted that such a presumption is not well founded on the phraseology of section 3 of the 1961 Act.**

"Previous year" for income from other sources.—"Income from other sources" is not the same thing as income from undisclosed source. While income from undisclosed source is taxable as "income from other sources" but the converse is not true. Section 56 of the 1961 Act is the residuary head of income and it also specifically enumerates certain types of income to be taxed under the head "Income from other sources". Income from undisclosed source, if falls within sections 68 to 69C of the 1961 Act, follows the previous year indicated in those respective sections. If such income does not fall in any of the sections 68 to 69C of the 1961 Act, the previous year for its assessment shall be the relevant financial year. The Karnataka High Court, in *CIT v. Lachmandas Veerbhandas*, (1981) 128 ITR 606 (Karn), **affirmed in** *CIT v. Lachhman Das Veerabhandas*, (2001) 247 ITR 810, 811 (SC), has held that so far as the income from other sources is concerned, the previous year in all cases will be the financial year. **With great respect, it is submitted that if income from other sources is recorded into books of account, the option under section 3(1)(b) of the 1961 Act may also be available to the assessee.**

"Previous year", when determined by CBDT [s. 3(1)(c) of 1961 Act].—Section 3(1)(c) of the 1961 Act relates to such assessee or businesses who or which are not governed either by section 3(1)(a) of the 1961 Act [*i.e.*, having the preceding financial year for their previous year] or by section 3(1)(b) of the 1961 Act [*i.e.*, opting for another definite accounting year]. In the case of such assessee or businesses, the CBDT, or any authority authorized by the CBDT in that behalf [*i.e.*, Commissioner of Income-tax (CIT)], may determine any period to be regarded as their previous year.

It seems that these provisions are applicable to save a practical difficulty. Businessmen often follow auspicious accounting years, *e.g.*, *Ram-navami*, *Diwali*, etc. Some of them, *viz.*, *Ram-navami*, Bengali, Fasli, etc., come very close to 31st March. *Ram-navami* falls sometimes a few days before and sometimes a few days after 31st March each year. The provisions of section 3(1)(c) of the 1961 Act may come to their aid.

Date of closing of accounts for assessment year 1964-65, clarification.—*Vide Board's F. No. 30/6/63-IT, dated 4-10-1963*, it has been clarified that as there is no uniformity among assessee in the matter of date of closing of accounts for Samvat Year 2019, it has been decided that for the purpose of section 3 of the Income-tax Act, 1961, the year ending on the 17th or 18th October, 1963, as well as the year ending on the 15th or 16th November, 1963, will be recognized as a previous year for the assessment year 1964-65.

Procedure to be adopted where Hijri year was followed, clarification.—*Vide Board's F. No. 33/8/62-IT (A-II), dated 16-4-1966*, it has been clarified that the following procedure may be adopted in the cases where Hijri year has been followed as previous year:—

- (i) In all pending assessments where the assessee has been following lunar year as the previous year, the Income-tax Officers will switchover to the financial year as the previous year and follow it in subsequent assessments;
- (ii) If, in the first assessment to be made under the new procedure, there is a period prior to the financial year to be taken as the previous year, the income of which has not been assessed in the earlier assessment, the income of such period *plus* the income of the relevant financial year should be taken as total income which should be assessed at the rate applicable to the income of the 12 months of the financial year;
- (iii) Similarly, if in the first assessment to be made under the new procedure, the income of any particular period which has already been assessed for the preceding assessment year has to be considered, it will be taken only for rate purposes;

- (iv) The procedure to be followed proposed at (ii) and (iii) above, will be subject to the assessee concerned agreeing to the same.

“Previous year” in case of business or profession newly set up.—Section 3 of the 1961 Act, *inter alia*, contains two different provisions and an exception in case of a business or profession newly set up in the preceding financial year or in the 12 months immediately preceding the said financial year, which are discussed below.

The option given by section 2(11)(c) of the 1922 Act [corresponding to section 3(1)(d) of the 1961 Act] to an assessee who sets up a new business during a financial year to treat as the first previous year of the business the period from the date of commencement of the business to a date within twelve months of the setting up on which the accounts are made up, can be availed of only if the accounts of the business are made up to that date [*Bhailal Tribhovandas & Co. v. CIT*, (1968) 68 ITR 136 (Guj)].

As per **section 3(1)(d)** of the 1961 Act, in the case of a business or profession newly set up in the said financial year, “previous year” **meant** the period beginning with the date of setting up of the business or profession and—

- (i) ending with the said financial year; or
- (ii) if the accounts of the assessee have been made up to a date within the said financial year, then, at the option of the assessee, ending on that date; or
- (iii) ending with the period, if any, determined under section 3(1)(c) of the 1961 Act.

To take an instance, for the assessment year 2022-23, the relevant financial year is the period between 1-4-2021 and 31-3-2022. If a new business is set up on any date between 1-4-2021 and 31-3-2022, it will fall within section 3(1)(d) of the 1961 Act. Clause (d) is sub-divided into sub-clauses (i), (ii) and (iii). Suppose, a new business is set up on 1-9-2021; it will fall within sub-clause (i) if its previous year ends on 31-3-2022. It will fall within sub-clause (ii), if its accounting year ends on some date within 31-3-2022 and its accounts are made up to that date. It will fall within sub-clause (iii), if the CBDT happens to determine a previous year for his case.

Where an assessee was already having agricultural income in earlier years and was maintaining books of account for that income, the mere fact of inclusion of agricultural income for rate purposes with effect from 1-4-1973 (in relation to assessment year 1974-75) cannot be regarded as setting up of new business or profession by the assessee regarding agriculture so as to fall within the provisions of section 3(1)(d)(ii) of the 1961 Act [*CIT v. Ravinder Kumar*, (1989) 180 ITR 203, 205-06 (Punj); *CIT v. Harbhagwan*, (1989) 180 ITR 206 (Punj)].

In *Kisan Ghar v. CIT*, (1991) 188 ITR 810, 813-14 (All), a firm was dissolved and a new firm was formed on 15-5-1980. It was held that the previous year of the newly formed firm would end with the financial year as provided in section 3(1)(d)(i) of the 1961 Act. In such a situation, section 3(1)(e) of the 1961 Act can have no application.

Where, after dissolution of a firm having three partners, a new firm was constituted with effect from 1-4-1969 adopting accounting year ending on 30-9-1969, it has been held that a new firm came into existence and, by virtue of the provisions of section 3(1)(d) of the 1961 Act, the new firm could adopt a previous year different from the one followed by the dissolved firm [*CIT v. Ghasita Mal Mela Ram*, (1997) 226 ITR 239, 241, 242 (Del)].

As per **section 3(1)(e)** of the 1961 Act, in the case of a business or profession newly set up in the 12 months immediately preceding the said financial year, “previous year” **meant**—

- (i) if the accounts of the assessee have been made up to a date within the said financial year and the period from the date of the setting up of the business or profession to such date does not exceed 12 months, then, at the option of the assessee, such period; or
- (ii) if any period has been determined under section 3(1)(c) of the 1961 Act, then the period beginning with the date of the setting up of the business or profession and ending with that period.

To take an instance, in relation to assessment year 2022-23, the business is newly set up on any date not between 1-4-2021 and 31-3-2022 [in which case it would have fallen under section 3(1)(d) of the 1961 Act] but on any date between 1-4-2020 and 31-3-2021. In such a case, if the accounts are made up from the date of set-up to a date within the period from 1-4-2021 to 31-3-2022 and the period of such accounting does not exceed a period of 12 months, the case will fall within section 3(1)(e)(i) of the 1961 Act and that provision gives an option to such business to have such an accounting year for its previous year. Sub-clause (ii) refers to a previous year if determined by the CBDT under section 3(1)(c) of the 1961 Act.

If a business is newly set up in a financial year preceding the year for which assessment is to be made, it is the option of the assessee to choose as his previous year the period beginning on the date when the business was newly set up and up to the date up to which the accounts are made up, provided that this period does not exceed twelve months [see, *Chandulal Surajmal v. CIT*, (1962) 44 ITR 448, 451 (All)]. For example, where the

assessee set up a business on 16-7-1942, made up its accounts up to 4-7-1943 (although the business was discontinued on 13-3-1943), it was held that the assessee had an option, and had exercised it, to keep his accounting year from 16-7-1942 to 4-7-1943 [*Chandulal Surajmal v. CIT*, (1962) 44 ITR 448, 451 (All)]. But where the assessee took over the assets of a partnership concern, commenced business on 7-4-1947, and made up its first set of accounts up to May 7, 1948, it was held that the assessee having made up his accounts for a period of 13 months (in excess of 12 months), it was not entitled to claim the option [*General Commercial Corpn. Ltd. In re*, (1954) 26 ITR 316 (Mad)]. Also see, *V.D. Rajarathanam v. CIT*, (1968) 68 ITR 19 (AP); *Madras Machine Tools Mfrs. Ltd. v. CIT*, (1975) 98 ITR 119 (Mad).

Case of no previous year for an assessment year.—As per **section 3(2)** of the 1961 Act, where an assessee has newly set up a business or profession in the said financial year and his accounts are made up to a date in the assessment year in respect of a period not exceeding 12 months from the date of such setting up, then, notwithstanding anything contained in sub-clause (iii) of section 3(1)(d) of the 1961 Act, the assessee shall, in respect of that business or profession, at his option, be deemed to have no previous year for the said assessment year under that clause and such option shall, in relation to the immediately succeeding assessment year, have effect as an option exercised under sub-clause (i) of section 3(1)(e) of the 1961 Act.

This category of business/profession concerns one set up, in the context of assessment year 2022-23, on any date between 1-4-2021 and 31-3-2022, and its accounts having been made up to a date, which falls after 31-3-2022, for a period not exceeding 12 months. To this business/profession, the provision of section 3(1)(e) of the 1961 Act has no application because the set-up date does not fall within 1-4-2020 to 31-3-2021. This business also does not fall within sub-clauses (i) and (ii) of section 3(1)(d) of the 1961 Act because the accounting year does not end before 31-3-2022. Thus, in view of the provisions of section 3(2) of the 1961 Act, in answer to a notice under section 139(2) or section 142(1) of the 1961 Act for the assessment year 2022-23, it will be entitled to reply that it has got no previous year relevant to the assessment year 2022-23. The sub-section makes this right absolute even overriding any previous year determined by the CBDT under section 3(1)(c) read with section 3(1)(d)(iii) of the 1961 Act.

Conditions requisite for valid exercise of option.—The requisites essential to option or election are well settled. For the validity of an option, it is essential that the party opting should be cognizant of his rights. The party must have the knowledge of his or her right to opt and of those circumstances which would influence the exercise of an option [*Binodi Ram Balchand v. CIT*, (1962) 44 ITR 249, 254 (MP), **on appeal**, (1970) 77 ITR 128 (SC)]. The exercise of option must be demonstrably plain either by express or implied act involving the utter improbability of the party adopting the other choice open to it. Also see, *Bisheshwar Singh v. CIT*, (1955) 27 ITR 376 (Pat).

Time up to which the option may be exercised.—The option should, ordinarily, be exercised in any case until the filing of the return and the assessee has also the liberty to furnish a revised return, at any time before the assessment is made if he discovers any omission or wrong statement therein [*Binodi Ram Balchand v. CIT*, (1962) 44 ITR 249, 255 (MP)].

Making up of accounts, what it means?—Making up of accounts in this connection means ascertaining the profits and loss accruing during the particular period. Merely closing a ledger at the end of a year and carrying forward balances of the year to the beginning of the next year would not amount to making up of accounts [*Bhailal Tribhovandas & Co. v. CIT*, (1968) 68 ITR 136, 139 (Guj)].

The *Shorter Oxford English Dictionary* ascribes the following meaning to the term “making up of an account”. It is defined as “....to set out the items of (an account); in order to add up and balance (an account)”. In the absence of any definition of the words “making up of an account” in the 1961 Act, it is open to find out the meaning of the words used with reference to the dictionary, keeping in view the purpose of the 1961 Act.

In order to make up an account, it is not necessary that the accounts must be complex requiring the balancing of items of expenditure against the items of income, as the mere listing up of all the relevant data would also be a part of maintaining of an account. Where the figures are merely required to be listed and added up the period for which that exercise is undertaken will be the period for which the account can be said to be made up [*CIT v. John Peter*, (2000) 243 ITR 561, 563 (Mad)]. In the facts of that case, it has been held (p. 564) that the Tribunal was right in holding that the statement filed along with the return was sufficient to show that the assessee had made up his accounts within the financial year in order to have a different previous year within the meaning of section 3(1)(b) of the 1961 Act in relation to the assessment years 1976-77 to 1978-79. In case of an employee-assessee, the only account which he was required to maintain was the record of the amounts received as salary for the relevant previous year.

But, where the profit in question which accrued to the assessee by the dividend income was ascertainable and was in fact ascertained as on a particular date and had been brought into the profit and loss account and the balance-sheet of the assessee, it could not be argued that accounts had not been made up to the date on which the profit accrued [*CIT v. Patiala Sales Corporation Pvt. Ltd.*, (1970) 77 ITR 443, 447 (Pun)].

“Previous year” in case where assessee is a partner in a firm.—As per **section 3(1)(f)** of the 1961 Act, where the assessee is a partner in a firm and the firm has been assessed as such, then, in respect of the assessee's share in the income of the firm, “previous year” **meant** the period determined as the previous year for the assessment of the income of the firm.

The provisions of section 3(1)(f) of the 1961 Act are mandatory. It is clear from the section that in respect of the share of the income of a partner of the firm, if the firm has been assessed as such, the period determined for the assessment of the income of the firm shall be taken to be the period for the assessment of the partner in respect of his share of income from the firm [*CIT v. Sheik Rowther*, (1962) 46 ITR 259, 261 (Ker)]. Also see, *Biswanath Goenka v. CIT*, (1991) 189 ITR 687 (Cal); *CIT v. Bhanumati & Sons Trust*, (2004) 268 ITR 193, 200 (Guj). The effect of clause (f) is that the previous year for the assessment of the income of the firm is statutorily made the previous year of the partner in respect of his share in the income of the firm even if the partner has income from other sources for which he may have a different previous year. The fact that the previous year of the firm ended after the expiry of the previous year in respect of the other income of the assessee does not make any difference so far as the assessment year in respect of the share income was concerned [*CIT v. Mckenzie Ltd.*, (1980) 121 ITR 458 (Bom)]. In other words, the effect of section 3(1)(f) of the 1961 Act is that the previous year for the assessment of the income of the firm is statutorily made the previous year of the partner in respect of his share in the income of the firm even if the partner has income from other sources for which he may have a different previous year [*Nirmal Chandra Choudhury v. CIT*, (1993) 201 ITR 692, 695 (Ori)]. In that view of the matter, the share income of a partner in a firm having accounting year ended on 31-3-1978 has been held taxable in the hands of the partner-assessee for the assessment year 1978-79 even though the partner's previous year ended on 31-12-1977 [*New Ambadi Estates (P.) Ltd. v. CIT*, (1997) 228 ITR 141, 144 (Ker)].

However, in *CIT v. R.Y. Singaram Mudaliar*, (1988) 172 ITR 608, 611 (AP), it has been held that an assessee, who is maintaining books of account for his proprietary business, is entitled to include in such books of account the share income arising to him from a firm following a different previous year and to have the same assessed for the assessment year relevant to the previous year according to which such books of account are maintained. **With great respect, it is submitted that this decision does not properly appreciate the specific provisions of section 3(1)(f) of the 1961 Act.**

Section 3(1)(f) of the 1961 Act is unambiguous and it is provided therein that the share income of the partners in a firm shall be computed for the same period for which the income of the firm is computed for the purposes of assessment to tax. That also stands to reason as the computation of the share of the partner in the income of the firm can be made only when the income of the firm and accounts of the firm for the year are finalised. That section does not deal with all the income of the assessee who happens to be a partner in a firm. It is only concerned with the assessee's share income in his capacity as a partner.

In cases where the previous year followed by an assessee is different from the previous year followed by the firm in respect of the share in the income of the firm, the previous year followed by the firm is necessarily to be regarded as the previous year for the assessment of the share income of the partners of the firm, although for the other income of the assessee, the assessee's previous year is to be followed. The other clauses of section 3(1) of the 1961 Act do not in any manner control section 3(1)(f) of the 1961 Act which deals with one type of income and fixes the previous year in respect of that income alone [*CIT v. Greenham Estates Pvt. Ltd.*, (2002) 254 ITR 402, 403 (Mad), **following** *CIT v. Mckenzie Ltd.*, (1980) 121 ITR 458 (Bom), *Biswanath Goenka v. CIT*, (1991) 189 ITR 687 (Cal) and *New Ambadi Estates (P.) Ltd. v. CIT*, (1997) 228 ITR 141 (Ker), and **dissenting from** *CIT v. R.Y. Singaram Mudaliar*, (1988) 172 ITR 608 (AP)]. Thus, section 3(1)(f) has its own operation and that cannot be curtailed with reference to the provisions of section 3(1)(c). Both provisions are independent of each other to work in their respective spheres [*CWT v. P.R. Shanmugam*, (1985) 153 ITR 330, 337 (Mad)].

The Madras decision [254 ITR 402 (Mad)] has been **followed in** *CIT v. Greenham Estates P. Ltd.*, (2006) 285 ITR 345 (Mad) holding that notwithstanding the previous year with reference to which the firm was assessed being the financial year, the share income of the assessee as a partner in the firm was required to be assessed with reference to the calendar year as the previous year.

Non-applicability in case of AOPs.—In *Pradeep Trust v. CIT*, (2010) 325 ITR 1 (Cal), it has been held that section 3(1)(f) of the 1961 Act was not applicable to a case where the assessee is a member of an AOP. At the relevant period, in the case of income of AOP, it was only such association which was to be assessed, and there was no question of taxation on the share of income of the association in the hands of any member of the association.

“Previous year” in case of life insurance business.—As per **section 3(1)(g)** of the 1961 Act, in respect of profits and gains from life insurance business, “previous year” **meant** the year immediately preceding the assessment year for which annual accounts are required to be prepared under the Insurance Act, 1938 (IV of 1938), or under that Act read with section 43 of the LIC Act, 1956 (XXXI of 1956).

Different previous years in respect of separate sources of income.—As per **section 3(3)** of the 1961 Act, an assessee may have different previous years in respect of separate sources of his income [see, *CIT v. Lachmandas Veerbhandas*, (1981) 128 ITR 606, 609 (Karn), **affirmed in** *CIT v. Lachhman Das Veerabhandas*, (2001) 247 ITR 810, 811 (SC)] but this can be done subject to the other provisions of section 3 [Cf. *CIT v. Lady Kanchanbai*, (1970) 77 ITR 123, 126 (SC); *CIT v. V.E.K.R. Savumiamurthy*, (1946) 14 ITR 185 (Mad)].

No doubt, section 3(3) of the 1961 Act gives the liberty to an assessee to have different previous years in respect of different sources of income. Such an option lies with the assessee and not with the Department [*CIT v. Estate Mineral Development Co. P. Ltd.*, (2002) 253 ITR 757, 759 (Cal)].

Assessee is entitled to claim a separate previous year in respect of the salary income from a foreign employer [*CIT v. B. Murali Mohan Rao*, (1995) 216 ITR 166, 168, 170 (AP)] or for computation of the capital gains [*CIT v. Ramesh Khanna*, (2001) 249 ITR 359, 362 (Del)].

But two previous years in respect of a particular source of income, not possible.—Obviously, there cannot be two previous years in respect of a particular source of income in the same assessment year [*CIT v. Narayanan & Vadivel Thevar*, (1969) 74 ITR 616, 619 (Mad)].

‘Source’, what it is?—‘Source’ means not a legal concept but something which a practical man would regard as a real source of income; the ascertaining of the actual source is a practical hard matter of fact [*Rhodesia Metals Ltd. v. Comr. of Taxes*, (1941) 9 ITR (Supp) 45, 52 (PC). Also see, *CIT v. Lady Kanchanbai*, (1970) 77 ITR 123, 126 (SC); *Performing Right Society Ltd. v. CIT*, (1977) 106 ITR 11, 22 (SC); *Sterling Foods v. CIT*, (1984) 150 ITR 292 (Karn)]. In *Fort Properties Pvt. Ltd. v. CIT*, (1994) 208 ITR 232, 254 (Bom), it has been held that ‘source’ means the real source of the income. Every income must have a source which cannot change.

Illustrations.—For instance, a moneylender would not dream of treating every client of his as being a different source of interest earned by him but that source would be one from the lending of capital to various constituents for the return in the shape of interest. So also, the source of dividend income would be the shareholding in the various companies. A practical man would not ordinarily regard each company as the real and separate source of his dividend income [see, *Satya Narain Bagla v. CIT*, (1968) 67 ITR 240, 246-47 (All)]. Source of dividend income is the shareholding held by the assessee. There may be as many sources of dividend income as there are shareholdings [*Seth Shiv Prasad v. CIT*, (1972) 84 ITR 15, 18 (All). Also see, *Mrs. Kusumben D. Mahadevia v. CIT*, (1963) 47 ITR 214 (Bom); *Mrs. Bacha F. Guzdar v. CIT*, (1955) 27 ITR 1 (SC); *Raja Bahadur Vishweshwara Singh v. CIT*, (1954) 26 ITR 573 (Pat)]. Similarly, the source of the notional income of an assessee by way of deemed distribution of dividend under section 23A of the 1922 Act, as it then stood, was held not different from the source from which the assessee derived dividends declared in the normal way [*Ibid.*; *Ormerods (India) Pr. Ltd. v. CIT*, (1963) 49 ITR 485 (Bom)].

In *Rani Amrit Kunwar v. CIT*, (1946) 14 ITR 561, 582 (All—FB), the learned Judges considered that an agreement or an order of the court requiring the payment of a periodical sum could be regarded as a source of income. In the case of income from business, which is a separate head under section 14 of the 1961 Act, each business has been treated as a distinct source of income. The decision of the Madras High Court, in *CIT v. V.E.K.R. Savumiamurthy*, (1946) 14 ITR 185, proceeds on that basis. Their Lordships of the Judicial Committee, in *Kamakshya Narain Singh v. CIT*, (1943) 11 ITR 513 (PC), held that the agreement to pay the royalty by the lessee of a coal mine was a “source” of the income. A source of income, therefore, may be described as the spring or fount from which a clearly-defined channel of income flows. It is that which by its nature and incidents constitutes a distinct and separate origin of income, capable of consideration as such in isolation from other sources of income, and which by the manner of dealing adopted by the assessee can be treated so [*Seth Shiv Prasad v. CIT*, (1972) 84 ITR 15, 18 (All)]. Thus, shareholdings in different companies constitute different sources of income. The shares of one company may be treated by the assessee as a single shareholding. The assessee may also, for good reason, treat the shares of the same company as constituting a number of separate and distinct shareholdings. The shares may be divided into groups defined by reference to the circumstances in which they were acquired, or to the purpose for which they were purchased, that is, some as investment holding and others as share-dealer’s stock-in-trade, or to the category or class to which they belong, for example, whether they are preference or equity. There may be other criteria reasonably defining them into separate and distinct shareholdings, and, therefore, as distinct and separate sources of income [*Seth Shiv Prasad v. CIT*, (1972) 84 ITR 15, 18-19 (All)]. Salary as a judge is a separate source different and distinct from other sources of income including salary, if any, derived by him from other occupation prior to his appointment as a judge [*Addl. CIT v. K. Ramachandra Rao*, (1981) 127 ITR 414, 419 (AP)].

Income received by way of compensation for requisitioning ships of an assessee carrying on the business of plying river boats would be from the same source that he derives income from ordinarily chartering his ships [see, *CIT v. Bengal River Service Co. Ltd.*, (1968) 70 ITR 100 (Cal)]. Compensation paid for the

termination of, or variation in the terms of, a managing agency agreement, assessable under section 28(ii) of the 1961 Act, is a payment in relation to the managing agency business and, therefore, the previous year relevant to such income would be the same as the previous year for the managing agency business itself [*Chidambaram Mulraj & Co. P. Ltd. v. CIT*, (1976) 102 ITR 7, 12 (SC); *CIT v. Sir Chunilal V. Mehta & Sons P. Ltd.*, (1967) 65 ITR 50 (Bom), **affirmed**, (1971) 82 ITR 54 (SC); *R.V. Lakshmiah Naidu & Co. v. CIT*, (1963) 48 ITR 661 (Mad)].

Under section 2(24)(iv) of the 1961 Act, the value of any benefit or perquisite, etc., obtained from a company by a director, etc., is includible in the income of the director, etc. In *K.S. Malik v. CIT*, (1980) 124 ITR 522 (Del), the assessee-director had taken loans from his company. The board of directors, at the request of the assessee, passed a resolution to write off the debt due by the assessee. It was held that the source of the income represented by this benefit was the passing of the resolution, which was a separate and distinct source altogether. As there was no option exercised by the assessee in respect of such income, the previous year therefor was the financial year.

Previous year of branches.—Each branch of a business is a separate source of income and it is permissible for the assessee to have different previous years for its different offices [*CIT v. Lady Kanchanbai*, (1962) 44 ITR 242 (MP), **affirmed in** (1970) 77 ITR 213 (SC)]. It is also permissible for an assessee to have one previous year for his head office and a different one for each of his branches, but he cannot incorporate two years' results of the branches in one year's account on the ground that the two years' result of the branches happens to come within one previous year of the head office [see, *Mela Mal Shiv Dayal v. CIT*, (1937) 5 ITR 329 (Lah)].

A reconstituted firm may adopt a previous year different from that of the original firm.—After a firm undergoes a change in its constitution, a new firm, though for certain purposes reflecting the personality of the erstwhile firm, comes into existence. The reconstituted firm may, therefore, adopt a previous year different from that of the erstwhile firm [*CIT v. Shiv Shanker Lal Ram Nath*, (1977) 106 ITR 342, 347-48 (All); *CIT v. Bharat Builders & Engineers*, (1982) 29 CTR (All) 267].

However, in the facts of *CIT v. Bharat Nepal Timber Traders*, (1998) 149 CTR (All) 438, 440, 441, the Tribunal was held not justified in holding that the reconstituted firm being a separate and distinct assessable entity different from the firm before its reconstitution was entitled to elect its previous year in the first year of its assessment independently of what was the previous year of the firm. This was so held because in view of the Supreme Court ruling in *CIT v. Empire Estate*, (1996) 218 ITR 355, 359 (SC), it can be said that no new and distinct entity came into being upon retirement of the three partners out of eight partners and the reconstituted firm continued the business of the earlier eight-partners firm.

Change of "previous year", whether possible.—The expression "that where in respect of a particular source of income, profits and gains" in the proviso to section 2(11)(i)(a) of the 1922 Act [corresponding to section 3(4) of the 1961 Act] means the income from a particular source which has been brought to tax under the Act and not which has been taken into consideration for computing the total world income¹ of the assessee. In the context, the word "assessee" in the said proviso refers to the person whose income, profits or gains, in respect of a particular source had been once assessed to tax. The word "assessed" in that proviso means subjected to levy or imposition of tax, not computed. Thus, where income derived by the assessee from the business carried on by it in territories outside the "taxable territories" was taken into consideration in the past for the purpose of determining the rate applicable, it was held that such income was not brought to tax under the Act and it could not be said that the assessee was "assessed to tax" within the meaning of the said proviso [*CIT v. Lady Kanchanbai*, (1970) 77 ITR 123 (SC). Also see, *CIT v. Binodiram Balchand*, (1970) 77 ITR 128 (SC)]. The words "particular source" refer to a known or disclosed source; an undisclosed source can never be said to be a particular source [*Shiv Narain Sarraf v. CIT*, (1966) 62 ITR 711, 717 (All)].

As per **section 3(4)** of the 1961 Act, where an assessee has once exercised the option under 3(1)(b) or 3(1)(d)(ii) or 3(1)(e)(i) of the 1961 Act or has once been assessed in respect of a particular source of income, or of a business or profession newly set up, then he shall not, in respect of that income or, business or profession, be entitled to vary the meaning of the expression "previous year" as then applicable to him, except with the consent of the [(w. e. f. 1-4-1988) Assessing Officer] [up to 31-3-1988) Income-tax Officer] and upon such conditions as the [(w. e. f. 1-4-1988) Assessing Officer] [up to 31-3-1988) Income-tax Officer] may think fit to impose.

Thus, where an assessee has, in respect of a particular source of income, profits and gains, once exercised the option under section 3(1)(b) or section 3(1)(d)(ii) or section 3(1)(e)(i) of the 1961 Act or once been assessed, he cannot vary the previous year except with the consent of the Income-tax Officer [*Addl. CIT v. P.K.N. Obulisami Chettiar*, (1978) 115 ITR 794 (Mad); *Ramji Dass Jain & Co. v. CIT*, (1967) 66 ITR 260, 262 (Punj); *CIT v. Ravinder Kumar*, (1989) 180 ITR 203, 205-06 (Punj)]. The question whether consent had been granted or not is, ordinarily, a question of fact [*CIT v. United Trading Co.*, (1987) 163 ITR 302 (Punj)].

1. The concept of 'total world income' does not, for and from 1965-66 assessment year, form part of the 1961 Act.

If an assessee wants to change the meaning of the previous year as then applicable to him, he must obtain the consent of the Income-tax Officer, and the Income-tax Officer may accord such consent on proper terms. The conditions which the Income-tax Officer can impose when permitting a change of the previous year must be valid, legal and reasonable. He cannot impose conditions which are contrary to the provisions of the Income-tax Act [*J.K. Synthetics Ltd. v. O.S. Bajpai, ITO*, (1976) 105 ITR 864 (All); *CIT v. Premier Mills Ltd.*, (1999) 239 ITR 165, 168 (Mad)]. In the Allahabad High Court case, the Income-tax Officer imposed, *inter alia*, two conditions, viz., (i) that there shall be no loss in a particular part of the changed previous year, and (ii) the change of year should not result in the reduction of tax liability. It was held that these conditions were not valid and/or proper. An appeal by special leave under Article 136 of the Constitution against *J.K. Synthetics Ltd. v. O.S. Bajpai, ITO*, (1976) 105 ITR 864 (All) has been decided by the Supreme Court in *Union of India v. J.K. Synthetics Ltd.*, (1993) 199 ITR 14, 16 (SC), without expressing any opinion on the question whether the change of previous year was rightly revoked or not.

The conditions have to be reasonable and with a view of safeguarding the interest of the revenue. But beyond that there is no further condition or limitation in the section as to the point of time when the consent ought to be sought or granted. It is not necessary that such consent must be obtained prior to the filing of the return or at any particular stage of proceedings or before any specific event [*Addl. CIT v. Mumtaz Silk Centre*, (1975) 101 ITR 355 (All)].

The Income-tax Officer may refuse to give his consent, but if he does give his consent, he has ample power to impose the condition that the full period from the end of the 'previous year' for the preceding year's assessment to the end of the new accounting year—may be 21 months—should be taken as the previous year for the current assessment year [*Esthuri Aswathaiiah v. CIT*, (1966) 60 ITR 411, 415 (SC)]. Also see *Ardeshir H.J. Hormasji v. CIT*, (1966) 59 ITR 57 (AP); *Jamuna Prasad Gur Prasad v. CIT*, (1986) 159 ITR 986 (All); *CIT v. Punjab Gas Cylinder Ltd.*, (2010) 328 ITR 162 (Punj). According to the Karnataka High Court in *CIT v. Swamy & Pathy*, (1992) 195 ITR 707, 712 (Karn), the following propositions flow out of the observations of the Supreme Court in *Esthuri Aswathaiiah v. CIT*, (1966) 60 ITR 411, 415 (SC):—

- “(1) While according consent for the change of the previous year, proper terms may be imposed by the Income-tax Officer; or he may refuse to accord consent.
- (2) The entire period from the end of the earlier “previous year” may be treated as one previous year.
- (3) It is possible to have a “previous year” consisting of more than 12 months.
- (4) There cannot be two previous years in respect of the same assessment year.”

In the facts of Karnataka case, it has been held that the assessee did not act voluntarily while changing the previous year. The assessee had obviously not thought about the legal implications of section 187(2) of the 1961 Act. Throughout its stand had been that there were two units which had to be taxed separately. Hence, the Tribunal did not commit any error in law when it remanded the matter to afford an opportunity to the assessee to exercise the option specifically.

Where the assessee has sought a change in the previous year and permission in that regard is granted by the Officer, such changed previous year is to govern, ordinarily, each and every head of income. Unless the assessee has specifically asked the Officer to give permission as to change of previous year only with regard to one or more head(s) of income, the assessee is not entitled to claim at the time of assessment that the changed previous year should not govern the head 'Capital gains' [*E.I.D. Parry (India) Ltd. v. CIT*, (2000) 243 ITR 116, 120 (Mad)] or any other head of income.

Where the Income-tax Officer imposes arbitrary condition of denying lawful deductions, such order is liable to be quashed as such condition goes against the spirit of the Income-tax Act itself [*VXL India Ltd. v. ITO*, (1987) 168 ITR 805 (Guj)]. Where a condition imposed by the officer is against the provisions of the Act itself, the mere fact that the assessee had accepted it earlier at the time of change of the previous year does not preclude the assessee from questioning the same at the time of assessment [*CIT v. Premier Mills Ltd.*, (1999) 239 ITR 165, 169 (Mad)].

Where, after setting aside ITO's order refusing change of previous year, the CIT has, in his order under section 264 of the 1961 Act, allowed the assessee to file a return as it likes and directed the ITO to pass order under section 3(4) of the 1961 Act while considering the assessment, it cannot be said that the CIT has directed the ITO to grant permission for change of previous year under section 3(4) of the 1961 Act. Further, there is no justification for allowing change of previous year only for the reason that for the subsequent years change in previous year was permitted [*Midas Rubber Pvt. Ltd. v. CIT*, (1998) 146 CTR (Ker) 404, 410, 413 = 232 ITR 824, 831, 834-35 (Ker)].

Exercise of discretion in granting consent.—The question whether the assessee should be allowed to change its previous year or not is a question of discretion of the Assessing Officer. The discretion must be exercised reasonably [*Shreepati Distributors Ltd. v. ITO*, (1987) 168 ITR 530, 532 (Cal)]. In other words, the

discretion must be exercised in conformity with the policy or legislative intent to effectuate which the discretionary power is vested. The legislative intent and policy underlying the provision appear to be clearly to give consent save in exceptional cases with or without conditions. The exercise of discretionary power should not be arbitrary. It should be exercised in a judicial manner. Arbitrary orders unsupported by reasons are logically incomplete and are bound to breed discrimination. Therefore, arbitrary refusal to change the "previous year" is violative of Article 14 of the Constitution. To strike down exercise of arbitrary power is not merely to sustain the rule of law but to exalt it [*Assam Frontier Tea Ltd. v. IAC*, (1987) 164 ITR 253, 266-267 (Gauh)]. At the same time, the Act having conferred the discretion on the Assessing Officer, the discretion as to whether the change in the previous year should be permitted and whether it will prejudice the interest of the revenue has to be decided by the Assessing Officer. The High Court cannot examine the sufficiency or adequacy of the material on the basis of which the decision of the Assessing Officer has been arrived at, as it is not justiciable. The discretion of the Assessing Officer under section 3(4) of the 1961 Act is not, however, so unfettered that his decision cannot be subject to challenge by means of writ proceedings under any circumstances. Though it is for the Assessing Officer to exercise his discretion under section 3(4) of the 1961 Act, the discretion, if exercised arbitrarily or capriciously, is not beyond the scrutiny of the court. Of course, the court will not substitute its own opinion or discretion for that of the Assessing Officer. If the assessee is able to show that his discretion has been exercised in a mala fide or arbitrary manner or on extraneous considerations, the same will be subject to challenge under article 226 of the Constitution. But, simply because the Assessing Officer has not chosen to agree to the terms offered by the assessee, it does not mean that he has acted arbitrarily or capriciously. The fact that the terms put forward by the assessee have not been found sufficient to safeguard the interest of the revenue is a good ground for refusal [*Dalmia Cement (Bharat) Ltd. v. ITO*, (1973) 88 ITR 21 (Delhi)].

No doubt, though the power under section 3(4) of the 1961 Act conferred upon the Officer is a discretionary one but this has to be exercised judicially. Consent cannot be withheld unreasonably. Where the assessee is willing to make good any loss of Revenue, the consent should be given on the basis of such undertaking [*Empire Plantations (India) Ltd. v. Union of India*, (2002) 255 ITR 140, 142, 143 (Cal)].

Where the order refusing the change of previous year was passed after taking into consideration factors not germane for the decision of the issue, the same was held liable to be quashed [*Assam Frontier Tea Ltd. v. IAC*, (1987) 164 ITR 253 (Gauh)]. Similarly, in *Warren Tea Ltd. v. State of Assam*, (1994) 208 ITR 301 (Gauh), a case relating to agricultural income-tax, it has been held, on facts, that the Income-tax Officer had exercised his jurisdiction illegally and refused permission for a change in the previous year. Therefore, his order was liable to be quashed.

However, where there is nothing to suggest that the power of refusal to change previous year was exercised arbitrarily or on irrelevant considerations, no interference is called for [*Shreepati Distributors Ltd. v. ITO*, (1987) 168 ITR 530 (Cal)]. Also see, *CIT v. Nuthern P. Ltd.*, (2006) 284 ITR 396 (Guj).

Implied consent.—Consent accorded by the Assessing Officer may either be express or implied. In each and every case, it is not needed that the assessee must make an application for obtaining consent for change of previous year. Consent may also be implied from the facts and circumstances of a particular case. In *Karnal Kaithal Co-operative Transport Society Ltd. v. CIT*, (1972) 84 ITR 46 (Punj), up to assessment year 1955-56, the assessee filed its returns showing the year ending on 31st March of each year as the previous year. For the assessment years 1956-57 to 1959-60, the assessee voluntarily submitted returns showing the year ended on September 30 of the relevant year as the previous year and the same were accepted by the Income-tax Officer without any objection. It was held that the voluntary submission of the returns on the basis of a changed previous year by the assessee amounted to an application for change of previous year to the Income-tax Officer and the Income-tax Officer's acceptance of those returns without any objection amounted to his implied consent to the change being made.

In *Ratan Lal Ved Prakash v. CIT*, (1983) 144 ITR 135 (All), no formal application was filed by the assessee seeking for change of previous year. But a return was filed on the basis of the changed previous year and assessment was made accordingly. It was held that there was an implied consent.

Revocation of granted permission not possible.—The law does not provide that the permission given for the change of the previous year can be revoked so as to adopt the old previous year [*J.K. Synthetics Ltd. v. O.S. Bajpai, ITO*, (1976) 105 ITR 864 (All)]. In an appeal against the aforesaid Allahabad decision, the Supreme Court in *Union of India v. J.K. Synthetics Ltd.*, (1993) 199 ITR 14, 16 (SC) has expressed no opinion on the question whether the change of previous year was rightly revoked or not.

In *CIT v. Hari Prosad Lohia*, (1983) 143 ITR 276 (Cal), the assessee was given permission to change the previous year by the competent Income-tax Officer. That order was communicated to the assessee and had become final. It was held that the successor-in-office could not summarily reverse that decision while passing the order of assessment.

Request rejected.—Where the request for the change of the previous year has been made long after the end of the assessment year and advance tax for the full year has been paid, the Officer was held justified in rejecting the assessee's request for a change in the previous year for a shorter period [*Vazirbun Trading Co. v. CIT*, (2001) 251 ITR 573, 574 (Mad)].

Refusal of consent to the change of the previous year can have serious consequences for the assessee. In that view of the matter, it is imperative that an order refusing consent or even an order granting consent on conditions should not be passed without first hearing the assessee [*Bennett Coleman & Co. Ltd. v. ITO*, (1983) 141 ITR 239, 246 (Bom)]. **However**, according to the Gauhati High Court, an assessee cannot claim as of right an opportunity of being heard before any order withholding consent for the change in the previous year is passed by the Income-tax Officer [*Assam Frontier Tea Ltd. v. IAC*, (1987) 164 ITR 253 (Gauh)].

The Act does not require the recording of reasons by the Assessing Officer when exercising his discretion under section 3(4) of the 1961 Act nor does the Act require that the reasons for refusal have to be communicated to the assessee [*Dalmia Cement (Bharat) Ltd. v. ITO*, (1973) 88 ITR 21, 24 (Del)]. The above view of a single judge of the Delhi High Court **did not find favour** with the Gauhati High Court in *Assam Frontier Tea Ltd. v. IAC*, (1987) 164 ITR 253, 259, 260 (Gauh), which held that orders unsupported by reasons are logically incomplete.

Deductions to be allowed for the full length of the previous year.—Once the length of the previous year is fixed and the income of the previous year is determined, that income is liable to be charged at the rate specified in the relevant Finance Act. Therefore, it follows that the assessee is also entitled to all statutory deductions which are admissible for the said period and it is impermissible for the officer to curtail the statutory deductions available for the said period [*CIT v. Premier Mills Ltd.*, (1999) 239 ITR 165, 168 (Mad)]. In that case, the assessment year involved was 1980-81. For that assessment year, as per the provisions of the then rule 5(1) of the 1962 Rules, the assessee was entitled to full depreciation even though the depreciable asset has been used for even a single day during the previous year relevant to that assessment year. In that view of the matter, the assessee was held entitled to full depreciation in spite of the fact that the officer has imposed a condition [which was against the provisions of the then Rules] to the effect that depreciation would be allowed for a period of three months, *i.e.*, one-fourth of the full depreciation.

Where the officer has permitted to change the previous year so as to have a period of 15 months, the assessee has been held entitled, for assessment year 1980-81, to the depreciation calculated for the entire period of 15 months as per the proviso to the then rule 5(1) of the 1962 Rules even though the officer has allowed change subject to the condition that the claim for depreciation would be restricted to 12 months [*CIT v. D.P.F. Textiles Ltd.*, (2000) 241 ITR 548, 552-53 (Mad)]. Also see, *CIT v. Electric Control Gear Ltd.*, (2004) 266 ITR 338, 341 (Guj).

No power to vary the rate of tax.—The Assessing Officer has no power to vary the rate of tax at which the income of the previous year is to be assessed. The rate of tax is fixed by the Finance Act every year. By section 4 of the 1961 Act, the tax is levied at that rate for an assessment year in respect of the income of the previous year. Once the length of the previous year is fixed and the income of the previous year is determined, that income must be charged at the rate specified in the relevant Finance Act and at no other rate. Thus, where, for according sanction to the change of previous year, the Income-tax Officer treated a period of 21 months as the previous year for the assessment year 1952-53, it was held that the total income for the entire period of 21 months had to be assessed at the rate specified in the Finance Act, 1952, for that total income and the Income-tax Officer could not apply the rate applicable to the total income of the last period of 12 months [*Esthuri Aswathaiah v. CIT*, (1966) 60 ITR 411 (SC)]. Similarly, where the assessee was allowed to change the previous year and the length of the previous year was determined to be a period of nine months only, it was held that the assessee's income for the nine months could be taxed only at the rates applicable for the income of the said period of nine months and not at the rates applicable for twelve months' income [*K.Y. Pilliah & Sons v. CIT*, (1970) 75 ITR 129 (Mys)]. Also see, *Inland Revenue Commissioners v. Helical Bar Ltd.*, (1971) 79 ITR 418 (Ch D).

Orders amenable to revision.—The grant of consent or the refusal to do so under section 3(4) of the 1961 Act amounts to an order within the ordinary meaning of that word. The grant or refusal is made on the application of the assessee. The exercise of discretion is required. Consent may be granted subject to such conditions as the Income-tax Officer may think fit to impose. This calls for an application of mind. The accord of sanction subject to conditions must be explained in a speaking order as must the refusal of consent. The grant or refusal of consent would, therefore, be an order and would fall within the scope of section 263 [*Bennett Coleman & Co. Ltd. v. ITO*, (1983) 141 ITR 239, 245 (Bom)]. A revision petition under section 264 of the 1961 Act may also lie against such order.

Non-applicability.—If an assessee dies with the consequence that the business carried on by the assessee comes to a close, it is not a case of change of previous year within the meaning of section 3(4) of the 1961 Act.

Change of previous year implies a deliberate or voluntary change at the instance of the assessee. When an assessee dies or where an assessee-firm undergoes a civil death, it no longer has any volition in respect of the change of the previous year. The business comes to an automatic end and the books of account have got to be closed ending with the period when the business closes [*Gauri Sahai Ghisa Ram v. CIT*, (1979) 120 ITR 338, 340-41 (All)].

Grant of change of previous year relevant to assessment year 1988-89.—The following *Departmental Instruction F. No. 165/4/88-IT(AI)*, dated 4-2-1988 is relevant on the point:—

“Change of previous year relevant to the assessment year 1988-89—Request regarding.—The Direct Tax Laws (Amendment) Act, 1987, has, *inter alia*, provided that “previous year”, in relation to the assessment year commencing on the 1st day of April, 1989, means the period which begins with the date immediately following the last day of the previous year relevant to the assessment year commencing on the 1st day of April, 1988, and ends on the 31st day of March, 1989.

2. With a view to avoid various problems which may arise in the transitional year, there may be assesseees who may like to extend their previous year relevant to the assessment year 1988-89 to 31st March, 1988. Such requests for the change of accounting year may be liberally allowed by the assessing authorities under the provisions of section 3(4) of the Income-tax Act, 1961, subject to the condition that the adoption of such a longer previous year does not result in any loss of revenue.

3. These instructions may be brought to the notice of the officers working under you and may also be widely publicized through Chambers of Commerce and other trade associations, etc., in order that the assesseees can take recourse to the provisions of section 3(4) of the Income-tax Act, 1961.”

In view of the aforesaid circular, the respondent was held not required to consider whether previously the petitioner had applied for change in the period of accounting year, and whether such permission had been granted. Further, it was held as there was no loss of revenue because of the change in the accounting year, the petitioner was to be allowed to change the period of accounting year to 18 months from 1-10-1986 to 31-3-1988 in relation to assessment year 1988-89 [*Gujarat Carbon Ltd. v. Deputy CIT*, (1995) 216 ITR 415, 422 (Guj)].

Length of a previous year.—Barring cases of permission for change of previous year or determination by the Board, a previous year shall, ordinarily, consist of a period of twelve months. Even with the consent of the assessee, a longer previous year cannot be adopted for the purpose of assessment [*CIT v. V.V.S. Sarma*, (1977) 110 ITR 778 (Mad)]. A combined reading of several clauses of section 2(11) of the 1922 Act [corresponding to section 3 of the 1961 Act] shows that the length of a ‘previous year’ need not necessarily be 12 calendar months [*Esthuri Aswathaiah v. CIT*, (1966) 60 ITR 411, 414 (SC)].

In the facts of *Addl. CIT v. Syntex Fabrics Ltd.*, (1991) 191 ITR 52, 57 (All), **SLP granted**: (1995) 211 ITR (St.) 13 (SC), it has been held that the Tribunal was right in holding that making one assessment in respect of a period of 18 months was not in accordance with law and that there ought to be two assessments, one for the period from 1-1-1969 to 31-12-1969, and the other for the period from 1-1-1970 to 30-6-1970.

Reference may also be made to *Khalsa Provisions v. CIT*, (1982) 135 ITR 817 (Del) and *Assam Frontier Tea Ltd. v. IAC*, (1987) 164 ITR 253 (Gauh).

“Previous year” for income from undisclosed source.—Under the provisions of the 1922 Act, it was all along held that the option given to an assessee to choose an accounting year other than the one ending on March 31, as a previous year for purposes of income-tax is limited to known sources. So far as undisclosed sources are concerned, there is neither any possibility of the assessee exercising such option nor any possibility of applying anything but the principal definition of the previous year, namely, that it is a period of 12 months ending on March 31, immediately preceding the year for which the assessment has to be made [*CIT v. P. Darolia & Sons*, (1955) 27 ITR 515 (Pat); *Gangadas Sarda v. CIT*, (1956) 29 ITR 799 (Pat); *CIT v. Sheolal Ramlal*, (1958) 33 ITR 47 (MP); *Sushil Chandra Ghose v. CIT*, (1959) 35 ITR 379 (Cal); *Esthuri Aswathaiah v. CIT*, (1960) 39 ITR 24 (Mys); *Bishan Dutt v. CIT*, (1960) 39 ITR 534 (All); *Jethmal Lakhani v. CIT*, (1963) 49 ITR 633 (Cal); *Motilal Bawalal v. CIT*, (1963) 50 ITR 249 (Bom); *K. Narasiah v. CIT*, (1964) 53 ITR 754 (Mys); *Shiv Narain Sarraf v. CIT*, (1966) 62 ITR 711 (All); *Daulatram Rawatmull v. CIT*, (1967) 64 ITR 593 (Cal); *Hukam Chand Ulfatrai v. CIT*, (1967) 64 ITR 619 (Punj); *Gundathur Thimmappa & Sons v. CIT*, (1968) 70 ITR 70 (Mys); *L.B. Belamkar v. CIT*, (1969) 73 ITR 131 (Mys); *Keshtra Mohan Roy v. ITO*, (1971) 81 ITR 15 (Cal); *Raja Sharda Narain Singh v. CIT*, IT Reference No. 471 of 1969, decided by the Allahabad High Court on 4-8-1972; *M.S. Bansal v. CIT*, (1974) Tax LR 1 (All); *Baladin Ram v. CIT*, (1969) 71 ITR 427 (SC); *Sterling Construction & Trading Co. v. ITO*, (1976) 102 ITR 47 (Karn); *Mathuradas Gokuldas v. CIT*, (1976) 102 ITR 425 (Bom); *CIT v. Bhuramal Manikchand*, (1981) 130 ITR 129, 136-37 (Cal); *CIT v. Bihar Cotton Mills Ltd.*, (1986) 160 ITR 275 (Pat); *Addl. CIT v. Hasmat Rai Raj Pal*, (1987) 167 ITR 794 (All); *CIT v. R. Dalmia*, (1986) 157 ITR 221 (Del); *Jainarayan Babulal v. CIT*, (1988) 170 ITR 399 (Bom)]. On the other hand, if, however, the Income-tax Officer holds that the undisclosed or unexplained amount represents secreted profits of the same business, the

previous year for the inclusion of such income would be the accounting year of the business [*CIT v. Meghu Sao Jhandhu Sao*, (1955) 27 ITR 371 (Pat). Also see, *Daulatram Rawatmull v. CIT*, (1967) 64 ITR 593, 616 (Cal)].

In the 1961 Act, there is section 68 according to which 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 Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year. It is, however, obvious that even under the provisions embodied under the new Act it is only when an amount is found credited in the books of an assessee that the section will apply. On the other hand, if the undisclosed income was found to be from some unknown source or the amount represents some concealed income which is not credited in his books the position would probably not be different from what was laid down in the various cases decided earlier [*Baladin Ram v. CIT*, (1969) 71 ITR 427, 432-33 (SC). Also see, *CIT v. Lakshman Swaroop Gupta & Bros.*, (1975) 100 ITR 222 (Raj); *Damodar Hansraj v. CIT*, (1979) 118 ITR 999 (Cal); *Bhogilal Virchand v. CIT*, (1981) 127 ITR 591 (Bom); *CIT v. Dharamchand Anandkumar*, (1981) 128 ITR 219 (MP); *CIT v. N.L. Satyanarayan Setty*, (1981) 129 ITR 226 (Karn)]. The decision in *Baladin Ram v. CIT*, (1969) 71 ITR 427 (SC) has been **applied** by the Calcutta High Court in *CIT v. Orissa Steel Corporation Pr. Ltd.*, (1983) 144 ITR 662 (Cal).

PREVIOUS YEAR [Law between assessment years 1989-90 & 1999-2000]

Legislative amendments under 1961 Act.—I. The Direct Tax Laws (Amendment) Act, 1987.—Section 3 had been **substituted (w. e. f. 1-4-1989)** by the **Direct Tax Laws (Amendment) Act, 1987** (4 of 1988).

The scope and effect of the substitution of section 3, as also insertion of the Tenth Schedule, have been elaborated in the following portion of the *Departmental Circular No. 549, dated 31-10-1989*, as follows:—

‘2. Financial year as uniform previous year for all assessees.—2.1 Change in the definition of previous year (new section 3).—Under the old provisions of section 3, where the assessee did not maintain any books of account, previous year meant the financial year immediately preceding the assessment year. But, where an assessee maintained books of account, he could have a previous year (of not more than 12 months) of his choice. The assessee could even choose different previous years for different sources of income and also for different businesses carried on by him. The assessees were also allowed to change their previous years with the consent of the Income-tax Officer.

2.2 The old system led to a situation where the income earned during the same period by different taxpayers of the same category was subjected to tax in different assessment years and sometimes at different rates. It also opened up a vista for tax avoidance by the taxpayers by adopting different previous years for different sources of income and by changing their previous years at their convenience and to their advantage.

2.3. The Amending Act, 1987, therefore, substituted a new section 3 in the Act to provide for the financial year (year ending 31st March) as uniform previous year for all assessees and for all sources of income. Consequently, the provisions regarding change of the previous year are no longer necessary and do not find a place in the new section. Thus, the adoption of the uniform previous year for all the assessees would remove both the maladies mentioned above. It would also facilitate cross-verification of transactions among different assessees, which has become very necessary now in view of the new procedure of assessment, introduced by the Amending Act, 1987, under which all the returns of income will be accepted as such and passing of assessment orders will not be necessary. (Refer to paras 5.1 & 5.2 of these Explanatory Notes).

2.4. The new section 3 provides that previous year means the financial year immediately preceding the assessment year. It further provides that in the case of a newly set up business or profession or a source of income newly coming into existence during the financial year, the previous year shall begin from the date of setting up or coming into existence of the new business, profession or new source of income and end with the said financial year. It also provides that in the case of an assessee who has been having a previous year different from the financial year, the transitional previous year, *i.e.*, the previous year relevant for the assessment year 1989-90 will be for a period longer than 12 months. Thus, in the case of an assessee, who closes his accounts on 30th June every year, the transitional previous year for the assessment year 1989-90 will be from 1-7-1987 to 31-3-1989, *i.e.*, it will be for a period of 21 months.

2.5. The new section further provides that where the assessee had adopted more than one period as the previous year for the assessment year 1988-89 for different sources of his income, so that more than one period are included in the transitional previous year relevant for the assessment year 1989-90, the longest period shall be regarded as the transitional previous year. This could be explained by the following example:—

Example: An assessee has three separate businesses for each one of which he closed his accounts on different dates, say, 30-6-1987, 31-12-1987 and 31-3-1988, for the assessment year 1988-89. For the assessment year 1989-90, the following periods will be included in the previous year:—

- (1) 1-7-1987 to 31-3-1989 (21 months) for 1st business
- (2) 1-1-1988 to 31-3-1989 (15 months) for 2nd business

- (3) 1-4-1988 to 31-3-1989 (12 months) for 3rd business.

The longest of the three periods is that starting from 1-7-1987 to 31-3-1989 (21 months) and this will be the previous year for all the three businesses for the assessment year 1989-90.

* * *

2.8 Transitory provisions to remove the hardships during the extended transitional previous year for the assessment year 1989-90 (Insertion of Tenth Schedule).—The Amending Act, 1987, also inserted a Tenth Schedule in the Income-tax Act, 1961, which provides transitory provisions to avoid hardships in cases where the transitional previous year relevant for the assessment year 1989-90 exceeds a period of 12 months. The said Tenth Schedule makes the following transitory provisions:—

- (i) The monetary limits mentioned in various sections of the Income-tax Act which are enumerated in the Table given in rule 3, shall be increased during the extended transitional previous year, in proportion to the number of months in the said transitional previous year.
- (ii) Where the transitional previous year includes a part of a month, then if such part is 15 days or more, it shall be increased to one complete month, and if such part is less than 15 days, it shall be ignored.
- (iii) Rule 4 provides that where the transitional previous year consists of a period of 18 months or more, the number of days specified in sub-section (1) of section 6 for determining the residential status of the individual, namely, 182 days and 90 days, shall be increased to 273 days and 135 days respectively.
- (iv) Rule 5 provides that where, in a transitional previous year, the assessee's income under the head "Profits and gains of business or profession" is included in the total income for a period of 13 months or more, the depreciation allowance under section 32(1)(ii) shall be increased proportionately. (Refer to Example 1 in para 2.11).

However, while allowing enhanced depreciation, care should be taken that the total amount of depreciation allowed during the extended transitional previous year, including the depreciation allowed in earlier years, does not exceed the actual cost of the asset. Similar care will also have to be taken where 100% depreciation is allowable on certain block of assets under the rate schedule for depreciation provided in Appendix I to the Income-tax Rules, 1962, or where 100% depreciation is available on machinery or plant costing up to ₹ 5,000 under the provisions of the first proviso to section 32(1)(ii).

Subject to the above, enhanced depreciation shall be admissible in respect of the assets purchased during the extended transitional year, even if the assets are purchased towards the end of such year and used for a small period only. Thus, for example, where the extended transitional previous year consists of 18 months (1-10-1987 to 31-3-1989), enhanced depreciation being 1.5 times the normal depreciation shall be allowed in respect of machinery or plant purchased and installed in the month of March, 1989.

- (v) Rule 6 provides that tax payable on the total income of the transitional previous year shall be calculated at the average rate of tax on the amount obtained by multiplying such total income by a fraction of which the numerator is twelve and the denominator is the number of months in the transitional previous year, as if the resultant amount were the total income. In simple language, the tax shall be calculated in the following manner:—
 - (1) Compute the total income of the whole transitional previous year under the provisions of the Income-tax Act.
 - (2) Divide the income so computed by the number of months in the transitional previous year and multiply it by 12.
 - (3) Agricultural income, if any, derived during the whole transitional previous year should likewise be divided by the number of months in the transitional previous year and multiplied by twelve.
 - (4) Compute the tax payable on such total income (obtained in step No. 2) taking into consideration the net agricultural income, if any, (obtained in step No. 3)
 - (5) The average rate of tax will be

$$= \frac{\text{Tax payable (step No. 4)}}{\text{total income for 12 months (step No. 2)}}$$

- (6) Tax payable on the total income of the transitional previous year shall be derived by multiplying such total income (obtained in step No. 1) by the average rate of tax (obtained in step No. 5) (Refer to Example 1 in para 2.11).

- (vi) Rule 7 empowers the Board, where the transitional previous year is longer than 12 months, to remove genuine hardship, by general or special order, by granting appropriate relief in any case or class of cases.

* * *

2.12 These amendments come into force with effect from the 1-4-1989, and will, accordingly, apply in relation to the assessment year 1989-90 and subsequent years. [Sections 4 and 125 of the Amending Act, 1987].

II. The Direct Tax Laws (Amendment) Act, 1989.—Two new provisos to section 3(2) have been inserted (w. e. f. 1-4-1989) by the Direct Tax Laws (Amendment) Act, 1989 (3 of 1989).

The scope and effect of the above insertion, as also amendments to the Tenth Schedule, have been elaborated in the following portion of the *Departmental Circular No. 549, dated 31-10-1989*, as follows:—

‘2.6. Amendments made by the Amending Act, 1989, to provide for a new business or profession or source of income coming into existence between 1-4-1987 and 31-3-1988.—The new section 3, substituted by the Amending Act, 1987, did not provide for a situation where a new business or profession or a source of income newly comes into existence between the period 1-4-1987 to 31-3-1988 and where the accounts are not closed on 31-3-1988. The Amending Act, 1989, has, therefore, further amended section 3 by inserting the 2nd and 3rd provisos to sub-section (2) of the section to provide that:—

- (i) Where a new business or profession is set up or a source of income newly comes into existence on or after 1-4-1987, but, before 1-4-1988, and where the accounts have not been closed on 31-3-1988, the previous year in relation to the assessment year 1989-90 shall be reckoned from the date of setting up of the new business or profession or the date on which the source of income newly comes into existence to the 31-3-1989.
- (ii) Where the assessee has already been having one or more periods as the previous years for the assessment year 1988-89 in respect of different source or sources of income, in addition to the new business, profession or sources of income referred to above, the previous year in relation to assessment year 1989-90, shall be reckoned separately in the manner specified in the sub-section in respect of each such source of income and the longer or the longest of such periods so reckoned shall be the previous year for the said assessment year.

2.7. The above provisions can be clarified by the following examples:—

Example 1: An assessee started a new business on 1-7-1987. If he closed his accounts on 31-3-1988, his previous year for the assessment year 1989-90 will be the normal period of 12 months (1-4-1988 to 31-3-1989). However, if he does not close his accounts on 31-3-1988, then his previous year for the assessment year shall be the period 1-7-1987 to 31-3-1989 (*i.e.*, a period of 21 months).

Example 2: The assessee in Example 1, who did close the accounts of his new business on 31-3-1988, also had two other businesses already in existence for which the previous years for the assessment year 1988-89 ended as follows:—

- (1) First business—year ended 30-9-1987.
- (2) Second business—year ended 31-12-1987.

For the assessment year 1989-90, the different periods included in the relevant previous year shall be:—

- (1) For new business—1-7-1987 to 31-3-1989 (21 months).
- (2) For second business (old)—1-10-1987 to 31-3-1989 (18 months).
- (3) For second business (old)—1-1-1988 to 31-3-1989 (15 months).

The longest of the three periods, *i.e.*, from 1-7-1987 to 31-3-1989 (21 months), shall be the previous year for all the three sources of income for the assessment year 1989-90.

* * *

2.9 Amendments made by the Amending Act, 1989, to the Tenth Schedule to remove certain hardships and anomalies.—Some hardships and anomalies were pointed out in the provisions of the Tenth Schedule, as inserted by the Amending Act, 1987. Therefore, in order to remove the same, the Amending Act, 1989, has made the following amendments to the provisions of the Tenth Schedule:—

- (i) A new Table has been substituted in rule 3 of the original Table, earlier inserted by the Amending Act, 1987. Some monetary limits mentioned in various sections of the Act, which were not included in the original Table, have now been included. Opportunity has also been taken to correct some references to sections or amounts.

It may be mentioned that the following amounts have also been included in the new Table for being proportionately increased during the extended transitional previous year:

Section 35A 1/14th of the amount of capital expenditure.

Section 35AB 1/6th or 1/3rd of the amount paid as lump sum consideration.

Section 35D 1/10th of the amount of certain preliminary expenses.

Section 80C(3) 1/10th of the actual capital sum assured.

While allowing the enhanced amounts mentioned above during the extended transitional previous year, care should be taken that the total deduction for expenditure or for payment of premia allowed, including deductions allowed in earlier years, does not exceed the total amount of expenditure incurred or the total amount of premia paid. Also having allowed the enhanced deduction during the extended transitional previous year, care should also be taken to correspondingly reduce the last instalment allowable in respect of the same in the subsequent year.

(ii) Two new provisos have been inserted in rule 3 to provide that:—

- (1) the amount of ₹ 10,000 mentioned in column (2) of the Table against section 48(2) shall be increased during the transitional previous year only where the long-term capital gain arises as a result of two or more transfers of long-term capital assets and out of these, at least one transfer is made during the initial period of twelve months and the remaining transfer or transfers is or are made beyond the said period of twelve months comprised within the transitional previous year;
- (2) where more than one period in respect of different sources of income are included in the transitional previous year, the amounts mentioned in column (2) of the aforesaid Table shall be increased to such extent and in such manner as the Board may prescribe having regard to the length of the period or periods included in the transitional previous year in respect of different sources of income, the length of the transitional previous year and other relevant factors.

In this regard, a new rule 125 has been inserted in the Income-tax Rules, 1962, *vide* the Income-tax (Sixth Amendment) Rules, 1989, issued under Notification No. S.O. 361(E), dated 18-5-1989², to indicate as to which monetary limits mentioned in the Table shall be increased according to the length of the transitional previous year and which monetary limit mentioned in the Table shall be increased according to the length of the period in respect of the source of income to which they relate, which is included in the transitional previous year.

- (iii) A new rule 4 provides that the time-limit of 60 days mentioned in sub-section (1) of section 6 of the Act will be increased to 90 days where the extended transitional previous year comprises a period of 18 months or more.
- (iv) A new rule 5 further makes the following provisions in respect of depreciation allowance during the extended transitional previous year:—
 - (1) increased depreciation will also be available in those cases where depreciation is allowable while computing income under the head “Income from other sources”;
 - (2) depreciation will be allowable on “block of assets” instead of on “building, machinery, plant or furniture”; and
 - (3) where more than one period in respect of income under the head “Profits and gains of business or profession” or under the head “Income from other sources” are included in the extended transitional previous year, depreciation allowance shall be calculated separately for each such period included in the said transitional previous year and the said depreciation allowance shall be increased, where necessary, by multiplying it by a fraction of which the numerator is the number of months in such period (after excluding the number of months included in the period in relation to which depreciation has already been allowed or is allowable for the assessment year 1988-89) and the denominator is 12 (refer to Example 3 in Para 2.11).

Before this amendment, it was possible that where the assessee had a period of 15 months for one business and 21 months for another business, then he could avail of depreciation allowance for 21 months in respect of both the businesses, because his transitional previous year shall be of 21 months. But, now the depreciation shall be calculated in respect of the two periods (of 15 months and 21 months) separately. This loophole is, therefore, being plugged.

2. See, (1989) 177 ITR (St.) 236.

- (v) Rule 6 has been amended to provide that where more than one period in respect of different sources of income are included in the extended transitional previous year, then the tax shall be payable at the average rate of tax calculated in accordance with the provisions of this rule on the total income of the extended transitional previous year, after excluding from such total income the income relatable to any such period or periods which has already been included or is includible in the total income of the assessment year 1988-89. (refer to Examples 2 and 3 in para 2.11).

2.10 *Whether there is a compulsion on the assessee to close their accounts on the 31st March.*—It may be clarified that under the provisions of the new section 3, there is no compulsion on any assessee to close his accounts on 31st March only. All that the section requires is that for the purposes of income-tax, income will have to be declared for the year ending 31st March. Therefore, if for any reasons, personal, religious or on any other ground, an assessee wants to continue to close his accounts on a date different from 31st March, he can still do so. However, in such a case the assessee will be required to make up his accounts on 31st March also for the purpose of furnishing the return of income. Therefore, although it would be convenient to both the assessee as well as to the Department, if the assessee closes their accounts on 31st March, but if any assessee does not do so and submits 2 sets of accounts along with his return of income for the year ending 31st March, the same should be entertained by the Assessing Officer.³

2.11 The computation of total income of the extended transitional previous year and the calculation of tax thereon according to the provisions of the Tenth Schedule may be illustrated by means of the examples given below:

Example 1: The previous year of an assessee, assessed as an individual, having income from business ended on 30-6-1987, for the assessment year 1988-89. The particulars of his total income for the transitional previous year of 21 months (1-7-1987 to 31-3-1989) for the assessment year 1989-90 are as follows:—

- (1) Total income before deduction for depreciation allowance ₹ 6,30,000
- (2) Depreciation at the prescribed rates for the period of 12 months ₹ 1,20,000

The computation of depreciation allowable, total income and calculation of income-tax for the assessment year 1989-90 will be as follows:—

- (1) Depreciation allowable: Enhanced depreciation under Rule 5 = ₹ 1,20,000 × (21/12) = ₹ 2,10,000
- (2) Total income for the assessment year 1989-90 = ₹ 6,30,000 – ₹ 2,10,000 = ₹ 4,20,000
- (3) Tax payable for the assessment year 1989-90:
 - (i) Proportionate income for 12 months = ₹ 4,20,000 × (12/21) = ₹ 2,40,000
 - (ii) Tax payable on ₹ 2,40,000 = ₹ 1,04,212
 - (iii) Average rate of tax = ₹ 1,04,212/₹ 2,40,000 = 43.42%
 - (iv) Tax payable on total income = ₹ 4,20,000 × 43.42% = ₹ 1,82,364

Example 2: Suppose an assessee, assessed as an individual, has for each of the assessment years 1988-89 and 1989-90, an annual income of ₹ 2,40,000 from business for which he closes his accounts on 30th June every year, and an annual income of ₹ 1,20,000 from other sources for which he closes his accounts on 31st March every year. For the assessment year 1989-90, his previous years for the two sources of income are as follows:

Business	1-7-1987 to 31-3-1989 (21 months)
Other sources	1-4-1988 to 31-3-1989 (12 months)

The computation of his total income for the assessment years 1988-89 and 1989-90 and tax payable for the assessment year 1989-90 would be as follows:—

- (i) *Income for the assessment year 1988-89:*

From business (1-7-1986 to 30-6-1987)	₹ 2,40,000
From other sources (1-4-1987 to 31-3-1988)	₹ 1,20,000
Total income	₹ 3,60,000
- (ii) *Income for the assessment year 1989-90:*

From business (1-7-1987 to 31-3-1989)	
(21 months)	₹ 4,20,000

3. Reference in this connection may also be made to PIB Press Note, dated 10-6-1988: (1988) 172 ITR (St.) 19-21.

4 From other sources (1-7-1987 to 31-3-1989)	
(21 months)	₹ 2,10,000
Total income	₹ 6,30,000

(iii) *Computation of tax for the assessment year 1989-90:*

- (1) Income for 12 months = ₹ 6,30,000 × (12/21) = ₹ 3,60,000
- (2) Tax on ₹ 3,60,000 = ₹ 1,67,212
- (3) Average rate of tax = ₹ 1,67,212/₹ 3,60,000 = 46.45%
- (4) The above average rate of tax will be applied on the total income of the transitional previous year minus income from other sources for a period of 9 months which has already been taxed in the year 1988-89, i.e., ₹ 6,30,000 – ₹ 90,000 = ₹ 5,40,000
- (5) Tax payable = ₹ 5,40,000 × 46.45% = ₹ 2,50,830

Example 3: The assessee, assessed as an individual, has two businesses for which he closes his accounts on 30th June and 31st December, every year. Particulars of his income for the assessment years 1988-89 and 1989-90 and depreciation claim for the assessment year 1989-90 are as follows:—

For assessment year 1988-89:

Business	Previous year	Income after allowing depreciation claimed under section 32(1)(ii)
First business	1-7-1986 to 30-6-1987	₹ 2,00,000
Second business	1-1-1987 to 31-12-1987	₹ 1,00,000
Total income		₹ 3,00,000

For the assessment year 1989-90:

Business	Previous year	Income before allowing depreciation claimed under section 32(1)(ii)	Depreciation
First business	1-7-1987 to 31-3-1989 (21 months)	₹ 2,35,000	₹ 60,000
Second business	1-1-1988 to 31-3-1989 (15 months)	₹ 75,000	₹ 36,000

The transitional previous year for the assessment year 1989-90 will be for 21 months for both the businesses, i.e., from 1-7-1987 to 31-3-1989.

The assessee's total income for the assessment year 1989-90 and tax thereon will be computed as follows:—

- (1) Income from first business: 1-7-1987 to 31-3-1989 (21 months) = ₹ 2,35,000
 Less: Enhanced depreciation for 21 months = ₹ 60,000 × (21/12) = ₹ 1,05,000
 Income from first business (after depreciation) = ₹ 1,30,000
- (2) Income from second business: 1-7-1987 to 31-3-1989 (21 months):
 For the period 1-1-1988 to 31-3-1989 (15 months) = ₹ 75,000
 For the period 1-7-1987 to 31-12-1987 (6 months) being 50% of income of ₹ 1,00,000 for the entire period of 12 months for the assessment year 1988-89 = ₹ 50,000
 Income from second business before depreciation = ₹ 75,000 + 50,000 = ₹ 1,25,000
 Less: Enhanced depreciation for 15 months = ₹ 36,000 × (21/12) = ₹ 45,000
 Income from second business (after depreciation) = ₹ 80,000
- (3) Total income for the assessment year 1989-90 = ₹ 1,30,000 + ₹ 80,000 = ₹ 2,10,000
- (4) *Computation of tax for assessment year 1989-90:*
 - (i) Income for 12 months = ₹ 2,10,000 × (12/21) = ₹ 3,60,000
 - (ii) Tax on ₹ 3,60,000 = ₹ 41,212

4. This includes income from other sources for the period 1-7-1987 to 31-3-1988 (9 months) amounting to ₹ 90,000 which has already been taxed in the assessment year 1988-89.

- (iii) Average rate of tax = ₹ 41,212/₹ 1,20,000 = 34.34%
- (iv) The above average rate of tax will be applied on the income of the transitional previous year (₹ 2,10,000 *minus* income from other sources for a period of 6 months, *viz.*, ₹ 50,000 which has already been taxed in the year 1988-89, *i.e.*, ₹ 2,10,000 – ₹ 50,000 = ₹ 1,60,000
- (v) Tax payable = ₹ 1,60,000 × 34.34% = ₹ 54,944

2.12 These amendments come into force with effect from the 1-4-1989, and will, accordingly, apply in relation to the assessment year 1989-90 and subsequent years. [Sections 3 and 56 of the Amending Act, 1989].

Constitutional validity of the provisions similar to the substituted section 3 of 1961 Act.—In the context of the provisions of the Karnataka Sales Tax Act, 1957 (25 of 1957), as amended by the Karnataka Sales Tax (Amendment) Act, 1987 (14 of 1987), it has been held that the amended definition of the expression ‘year’ making the financial year uniformly applicable to all the assesseees for the purpose of assessment under that Act is constitutionally valid. However, the provision giving greater retrospective operation than the date of coming into force of the Amending Act was held to be *ultra vires* [*P.Y. Kamat v. State of Karnataka*, (1988) 68 STC 3 (Karn)].

“Previous year” in general cases.—Under section 3(1) of the 1961 Act, ordinarily, a “previous year” means the financial year immediately preceding the assessment year.

According to section 3(21) of the General Clauses Act, 1897 (10 of 1897), a “financial year” means the year commencing on the first day of April.

Thus, for assessment year 1990-91, the financial year 1989-90 is to be taken as the previous year and so on.

“Previous year” for a newly set up business or profession, or a new source.—The proviso to section 3(1) of the 1961 Act makes provisions for the previous year in the case of a business or profession newly set up, or a source newly coming into existence, in a financial year. In such a case, the previous year shall consist of the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ending with the said financial year.

Special provision in relation to assessment year 1989-90.—According to section 3(2) of the 1961 Act, ‘previous year’, in relation to assessment year 1989-90, is to consist of the period beginning with the date immediately following the last day of the previous year relevant to assessment year 1988-89 and ending on 31-3-1989. Thus, in case of an assessee following calendar year as the previous year, the previous year for assessment year 1989-90 will consist of a period of 15 months from 1-1-1988 to 31-3-1989.

In case of an assessee adopting previous year ending on 30th June of each year, the previous year for assessment year 1988-89 would end on 30-6-1987. In such a case, the previous year for assessment year 1989-90, as per section 3(2) of the 1961 Act, will consist of a period of 21 months from 1-7-1987 to 31-3-1989.

Thus, where an assessee has not adopted the financial year as the previous year, in almost all cases, the previous year for the assessment year 1989-90 will exceed a period of 12 months.

The 1st proviso to section 3(2) of the 1961 Act covers the case of an assessee who has adopted more than one period as the ‘previous year’ in relation to assessment year 1988-89 for different sources of his income. In such a situation, the previous year for the assessment year 1989-90 is to be reckoned separately in the manner prescribed in the main section 3(2) of the 1961 Act in respect of each source of income, and the longer or the longest of the periods so reckoned is to be treated as the previous year for the assessment year 1989-90.

Special provision for a newly set up business or profession, or a new source.—2nd and 3rd provisos to section 3(2) of the 1961 Act have been inserted (w. e. f. 1-4-1989) by the Direct Tax Laws (Amendment) Act, 1989 (3 of 1989).

The 2nd proviso to section 3(2) of the 1961 Act takes care of a situation where a business or profession is newly set up, or a source of income newly comes into existence, on or after 1-4-1987 but before 1-4-1988, and the accounts in relation to such business or profession or source of income have not been made up to 31-3-1988. In such a situation, the ‘previous year’ in relation to the assessment year 1989-90 is to consist the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ending on 31-3-1989.

To illustrate, the second proviso is, *inter alia*, attracted in a case where a business is set up on 1-6-1987, and the accounts in relation to such business is made up to 31-5-1988. In such a case, according to the second proviso, the previous year for assessment year 1989-90 is to consist the period from 1-6-1987, to 31-3-1989, *i.e.*, a previous year of 22 months.

In *CIT v. Mahavir Construction Co.*, (1997) 228 ITR 407, 409 (MP), the assessee was given the benefit of adopting a previous year of 23 months in relation to assessment year 1989-90 as per the provisions of the second proviso to section 3(2) of the 1961 Act.

The **3rd proviso to section 3(2)** of the 1961 Act concerns a situation where the assessee has adopted one or more periods as the 'previous year' in relation to assessment year 1988-89 for any source or sources of his income, in addition to the new business, profession or source of income referred to in the second proviso to section 3(2) of the 1961 Act. In such circumstances, the 'previous year' in relation to assessment year 1989-90 is to be reckoned separately in the manner aforesaid in respect of each such source of income, and the longer or the longest of the periods so reckoned is to be taken the 'previous year' in relation to assessment year 1989-90.

Uniform previous year.—Under the existing section 3 of the 1961 Act, each assessee has an option to have a 'previous year' of his choice and also different previous years for separate sources of income. An assessee is also entitled to change the previous year with the consent of the Assessing Officer (up to 31-3-1988, Income-tax Officer).

However, the newly substituted section 3 (w. e. f. 1-4-1989) provides for the financial year (year commencing on 1st April and ending on 31st March) as the uniform previous year for all categories of assessable entities and for all sources of income. There is no provision regarding change of the previous year.

Hardship avoided where the 'transitional previous year' for assessment year 1989-90 exceeds 12 months.—As has been seen above, the 'previous year' reckoned as per the provisions of section 3(2) of the 1961 Act for assessment year 1989-90 may, in certain circumstances, exceed 12 months. In order to avoid hardship in such circumstances, section 3(3) of the 1961 Act enacts transitory provisions as per the rules contained in the newly inserted Tenth Schedule, whereunder the provisions of the 1961 Act are to apply subject to the modifications specified in such rules. Here, it is pertinent to note that the originally inserted Tenth Schedule by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988), with effect from 1-4-1989, has subsequently been amended by the Direct Tax Laws (Amendment) Act, 1989 (3 of 1989), with effect from 1-4-1989. The discussion made hereunder is as per the provisions of the Tenth Schedule as so amended.

In *Kalyanpur Cement Ltd. v. Joint CIT*, (2005) 276 ITR 49 (Cal), it has been held that in view of the provisions contained in section 3 of the 1961 Act as amended by the 1987 Amendment effective from 1-4-1988, the fraction of the period from 1-7-1987 till 31-3-1988 was included in the return for the period ending 31-3-1989. By reason of the substitution of the definition of the expression 'previous year' through the 1987 amendment made effective from 1-4-1988, the period following was to be dealt with as the transitional period as contemplated under section 3(2) read with the Tenth Schedule of the 1961 Act.

'Transitional previous year', defined.—**Rule 1 of the Tenth Schedule** of the 1961 Act coins a definition of the term 'transitional previous year' to mean the period reckoned as the previous year for the assessment year 1989-90 in the manner specified in section 3(2) of the 1961 Act. It is also provided that where the first proviso or the third proviso to section 3(2) of the 1961 Act applies, the 'transitional previous year' is to mean the longer or, as the case may be, the longest of the periods reckoned in the manner laid down in the said first proviso or, as the case may be, the said third proviso.

Transitional previous year exceeding twelve months, special provisions under 1961 Act.—**Rule 2 of the Tenth Schedule** of the 1961 Act lays down that where the 'transitional previous year' is longer than twelve months, the provisions of the 1961 Act and the Finance Act of the relevant year are to apply subject to the modifications specified in the following Rules of the Tenth Schedule:—

- (1) Rule 3 pertaining to monetary limits, etc.,
- (2) Rule 4 with regard to section 6 of the 1961 Act,
- (3) Rule 5 in respect of depreciation allowance, and
- (4) Rule 6 in respect of rate of tax.

Modifications pertaining to monetary limits, etc.—When one goes through the various provisions of the 1961 Act, he finds that certain monetary limits, etc., are mentioned in various sections thereof. For giving a more just and equitable treatment, it is provided in **rule 3 of the Tenth Schedule** of the 1961 Act that the monetary limits, etc., mentioned in various sections of the 1961 Act, which are specifically enumerated in a Table given under that rule, are to be proportionately increased in respect of the extended transitional previous year.

Rounding off of the transitional previous year.—The **1st proviso to rule 3** of the 1961 Act provides that for the purposes of that rule 3 and rules 5 and 6, where the transitional previous year consists of a part of a month, then, if such part is 15 days or more, it is to be increased to one complete month and if such part is less than 15 days, it is to be ignored.

Special provisions for monetary limit of ₹ 10,000 contemplated by the then section 48(2) of 1961 Act.—The **2nd proviso** to the said **rule 3** of the 1961 Act, which has been inserted (w. e. f. 1-4-1989) by the **Direct Tax Laws (Amendment) Act, 1989** (3 of 1989), makes special provisions in relation to the monetary limit of ₹ 10,000 contemplated by the then section 48(2) of the 1961 Act. This proviso provides that the said monetary limit of ₹ 10,000 is to be increased during the transitional previous year only where the long-term capital gain arises as a result of two or more transfers of long-term capital assets and at least one of the said transfers is

made during the initial period of 12 months comprised within the transitional previous year **and** the remaining transfer or transfers is or are made during the period beyond the said period of 12 months comprised within the transitional previous year.

Thus, where the long-term capital gain arises as a result of a single transfer of long-term capital assets, there is no scope for proportionate increase in the monetary limit of ₹ 10,000 contemplated by the then section 48(2) of the 1961 Act. Similarly, where the long-term capital gain arises as a result of two or more transfers of long-term capital assets and all such transfers are made during the initial period of twelve months comprised within the transitional previous year **or** during the period beyond the initial period of twelve months comprised within the transitional previous year, no proportionate increase in the monetary limit of ₹ 10,000 contemplated by the then section 48(2) of the 1961 Act is permissible.

To illustrate, A, an individual, having the transitional previous year from 1-1-1988 to 31-3-1989 for the assessment year 1989-90, transfers two long-term capital assets on different dates, namely, one on 31-10-1988 and the other on 28-2-1989. In such circumstances, A is entitled to avail proportionate increase with regard to the monetary limit of ₹ 10,000 contemplated by the then section 48(2) of the 1961 Act in respect of the amount of long-term capital gains arising as a result of the aforesaid two transfers. This is so because all the conditions envisaged in the second proviso to rule 3 are fulfilled.

However, if these two transfers are made between 1-1-1988 and 31-12-1988 or between 1-1-1989 and 31-3-1989, no proportionate increase is available with regard to the aforesaid monetary limit of ₹ 10,000.

Special provisions where the transitional previous year includes more than one period in respect of different sources of income.—The **3rd proviso** to the said **rule 3**, which has been inserted (**w. e. f. 1-4-1989**) by the **Direct Tax Laws (Amendment) Act, 1989** (3 of 1989), takes care of a situation where more than one period in respect of different sources of income are included in the transitional previous year under the first proviso or the third proviso to section 3(2). In such a situation, the monetary limit or limits specified in the Table below rule 3 is or are to be increased to such extent and in such manner as the CBDT may prescribe in this behalf. Such prescriptions are to be made having regard to—

—length of the period or periods included in the transitional previous year in respect of different sources of income;

—length of the transitional previous year; and

—other relevant factors.

Monetary limits, etc., eligible for proportionate increase.—The **Table below rule 3** specifies the monetary limit or limits, etc., which are eligible for proportionate increase in a case where the transitional previous year is longer than 12 months. These are as follows:—

Section of the 1961 Act	Subject-matter	Monetary limit, etc.
s. 10(3)	Exemption in respect of receipts which are of a casual and non-recurring nature	₹ 5,000
s. 12A(b)	Audit of accounts of a charitable or religious trust or institution	₹ 25,000
s. 13(2)(g)	Forfeiture of exemption to a charitable or religious trust or institution in certain cases	₹ 1,000
s. 16(i)	Straight deduction from salary income	₹ 12,000
s. 16(i), proviso	Restriction as to straight deduction from salary income in certain cases	₹ 1,000
s. 16(ii)	Deduction from salary income in respect of any allowance in the nature of an entertainment allowance specifically granted to the assessee-employee by his employer in certain cases	₹ 5,000 and ₹ 7,500
s. 23(1), second proviso (d)(ii)	Deduction from annual value of newly erected residential units	₹ 3,600
s. 24(2), proviso	Restriction on deduction from income from house property	₹ 5,000
s. 33A(7), proviso	Determination of 'actual cost of planting' for the purposes of development allowance under section 33A	₹ 40,000, ₹ 35,000 and ₹ 30,000
s. 35A	Allowability of expenditure on acquisition of patent rights or copyrights	1/14 th of the amount of

Section of the 1961 Act	Subject-matter	Monetary limit, etc.
		capital expenditure
s. 35AB	Allowability of expenditure on know-how	1/6 th or 1/3 rd of the amount paid as lump sum consideration
s. 35D	Amortization of certain preliminary expenses	1/10th of the amount of certain preliminary expenses
s. 37(2A)	Allowability of expenditure in the nature of entertainment expenditure	₹ 5,000 and ₹ 50,000
s. 40A(2)	Restriction on allowability of legal expenses, etc., in connection with income-tax matters	₹ 10,000
s. 44AA(2)(i) and (ii)	Compulsory maintenance of accounts by certain persons carrying on profession or business	₹ 25,000 and ₹ 2,50,000
s. 44AB	Compulsory audit of accounts of certain persons carrying on business or profession	₹ 40,00,000 and ₹ 10,00,000
s. 48(2)	Deduction in respect of long-term capital gains	₹ 10,000
s. 80C(1)	Deduction in respect of life insurance premia, contributions to provident fund, etc.	₹ 6,000, ₹ 9,000 and ₹ 12,000
s. 80C(3)	Restriction as to allowability of deduction in respect of life insurance premia in certain cases	1/10 th of the actual capital sum assured
s. 80C(4)	Maximum limits of the amount qualifying for deduction under section 80C(1)	₹ 60,000 and ₹ 40,000
s. 80C(7)(c)	Restriction on the qualifying amount in respect of any payment made towards the cost of any new residential property, construction of which is completed after 31-3-1987, eligible for deduction under section 80C(1)	₹ 10,000
s. 80CC(2)	Deduction in respect of investment in certain new shares	₹ 20,000
s. 80CCA(1)	Deduction in respect of deposits under National Savings Scheme or payment to an annuity plan	₹ 30,000
s. 80D(1)	Deduction in respect of medical insurance premia	₹ 3,000
s. 80L(1)	Deduction in respect of interest on certain securities, dividends, etc.	₹ 7,000 (occurring in two places)
s. 80L(1), first proviso	Further deduction in respect of interest on deposits under notified National Deposit Scheme, or income in respect of certain units, or interest on deposits with, or dividend received from, approved public companies	₹ 3,000
s. 80L(1), second proviso	Additional deduction in respect of deposits under notified National Deposit Scheme or dividends from any Indian company	₹ 3,000
s. 80P(2)(c)	Deduction in respect of income of certain co-operative societies	₹ 40,000 and ₹ 20,000
s. 80P(2)(i)	Deduction in respect of income of certain co-operative societies	₹ 20,000
s. 80U	Deduction in the case of totally blind or physically handicapped resident persons	₹ 15,000
s. 139A(2)	Obligation to make application for allotment of permanent account numbers in certain cases	₹ 50,000

Rule 125 of the Income-tax Rules, 1962, made provisions for deductions and allowances for the transitional previous year relating to assessment year 1989-90 which had been **omitted** by the Income-tax (32nd Amendment) Rules, 1999.

Ascertainment of proportionately increased amount.—For ascertainment of the proportionately increased amount eligible for deduction, exclusion, etc., in relation to a transitional previous year exceeding 12 months, the amount concerned is to be multiplied by a fraction of which the numerator is the number of months in the transitional previous year and the denominator is twelve.

Thus, where the transitional previous year runs from 1-10-1987 to 31-3-1989 for the assessment year 1989-90, the proportionately increased amount of deduction under section 16(i) of the 1961 Act would be ₹ 12,000 × (18/12) = ₹ 18,000. Similarly, the proportionately increased amount of deduction under clause (d)(ii) of the second proviso to section 23(1) of the 1961 Act would be ₹ 3,600 × (18/12) = ₹ 5,400 and so on.

Modification in section 6 where the transitional previous year consists of 18 months or more.—**Rule 4** [as substituted by the Direct Tax Laws (Amendment) Act, 1989] of the Tenth Schedule comes into operation where the transitional previous year comprises a period of 18 months or more. In such a case, section 6 is to be modified so that references therein to the periods of 182 days, 90 days and 60 days are to be construed as references, respectively, to the periods of 273 days, 135 days and 90 days.

Modification in respect of depreciation allowance.—**Rule 5** [as substituted by the Direct Tax Laws (Amendment) Act, 1989] of the Tenth Schedule makes special provision for computation of the proportionately increased amount of depreciation allowance in respect of block of assets under section 32(1)(ii) or section 57(ii) read with section 32(1)(ii) of the 1961 Act in a case where the assessee's income under the head "Profits and gains of business or profession" or, as the case may be, under the head "Income from other sources" for a period of 13 months or more is included in his total income for the transitional previous year. In such a case, such depreciation allowance is to be increased by multiplying it by a fraction of which the numerator is the number of months in the transitional previous year and the denominator is 12. Thus, where the depreciation allowance as per section 32(1)(ii) of the 1961 Act works out at ₹ 30,000, the proportionately increased amount of depreciation allowance for a transitional previous year comprising of 15 months would work out at ₹ 30,000 × (15/12) = ₹ 37,500.

The proviso to the said rule 5 takes care of a situation where more than one period in respect of income under the head "Profits and gains of business or profession" or under the head "Income from other sources" are included in the transitional previous year as per the provisions of the first proviso or the third proviso to section 3(2) of the 1961 Act. In such a situation, the depreciation allowance in respect of block of assets is to be—

- calculated separately for each such period included in the transitional previous year in the manner stated in section 32(1)(ii) of the 1961 Act, and
- increased, where necessary, by multiplying it by a fraction of which the numerator is the number of months in such period (after excluding the number of months relatable to the period in relation to which depreciation on block of assets has been allowed or is allowable in the previous year relevant to the assessment year 1988-89) and the denominator is 12.

Tax to be charged at the average rate of tax applicable to the proportionate income of 12 months.—Under **rule 6 of the Tenth Schedule**, the tax chargeable on the total income is to be calculated at the average rate of tax on the amount obtained by multiplying such total income by a fraction of which the numerator is 12 and the denominator is the number of months in the transitional previous year, as if the resultant amount were the total income.

Thus, the steps involved in rule 6 are as follows:—

Step 1—Obtain the proportionate income of 12 months by multiplying the total income (say, ₹ 1,20,000) of the transitional previous year (say, 18 months) by a fraction (12/18). This works out at ₹ 1,20,000 × (12/18) = ₹ 80,000.

Step 2—Calculate tax on such proportionate income of 12 months (₹ 80,000) as if such income were the total income. Such tax works out (in case of an individual) at ₹ 22,312.50 [IT ₹ 21,250 + SC ₹ 1,062.50].

Step 3—Ascertain the average rate of tax on ₹ 80,000. Such average rate works out at (22,312.50/80,000) = 27.89%.

Step 4—Calculate tax on the total income of ₹ 1,20,000 at the average rate of 27.89%. Thus, tax works out at ₹ 1,20,000 × 27.89% = ₹ 33,468.

Thus, the tax chargeable on the total income (₹ 1,20,000) of the transitional previous year (18 months) would be ₹ 33,468. Had there been no provision of rule 6, the tax on total income of ₹ 1,20,000 would have been ₹ 41,212.50 [IT ₹ 39,250 + SC ₹ 1,962.50].

The **proviso [inserted by the Direct Tax Laws (Amendment) Act, 1989]** to **rule 6** takes care of a situation where more than one period in respect of different sources of income are included in the transitional previous year as per the provisions of the first proviso or the third proviso to section 3(2) of the 1961 Act. In such a situation, the tax is chargeable at the average rate of tax, calculated in accordance with the provisions of the main clause of rule 6, on the total income of the transitional previous year after excluding from such total income the income relatable to any such period or periods which has already been included or includible in the total income of the previous year or previous years relevant to the assessment year 1988-89.

Power of the Board to grant relief in case of hardship.—**Rule 7 of the Tenth Schedule** empowers the CBDT, where the transitional previous year is longer than 12 months, to remove genuine hardship, by general or special order, by granting appropriate relief in any case or class of cases.

LexisNexis

Omitted/Phased-out provisions of section 6 of the 1961 Act

Maintaining a dwelling place in India [s. 6(1)(b) of 1961 Act].—The requirements of section 6(1)(b) of the 1961 Act (operative up to 31-3-1983) are completed on fulfilment of two conditions: (1) the assessee maintains or causes to be maintained for him a *dwelling place* (not necessarily a dwelling house) in India for a period of, or periods totalling to, 182 days or more in that year; *and* (2) has been in India for 30 days or more in that year [Cf. *CIT v. K.S. Ratnaswamy*, (1980) 122 ITR 217, 221-22 (SC)]. As a result of the newly inserted *Explanation* (operative between 1-4-1979 and 31-3-1983) in the case of an individual, being a citizen of India, who is rendering service outside India and who is or has been in India on leave or vacation in the previous year, the said period of ‘30 days or more’ is to be raised to ‘90 days or more’. The section uses the expression “dwelling place”, a flexible expression, but the expression must be construed according to the object and intent of the particular legislation in which it has been used. Primarily, the expression means “residence”, “abode” or “home” where an individual is supposed usually to live and sleep and since the expression has been used in a taxing statute in the context of a provision which lays down a technical test of territorial connection amounting to residence, the concept of an abode or home would be implicit in it [*CIT v. K.S. Ratnaswamy*, (1980) 122 ITR 217, 223 (SC)]. The vital fact is not the ownership of the property, but the right of the assessee to reside in a building which is ready and fit for his occupation and which is intended to be used by him as his home. The building or a portion of the building must be available to him and must be at his disposal and he must be in a position to go and occupy it without the permission or leave of any one [*CIT v. Fulabhai Khodabhai Patel*, (1957) 31 ITR 771 (Bom); *Ramjibhai Hansjibhai Patel v. ITO*, (1964) 53 ITR 547 (Guj)]. Also see, *CIT v. Dhanomal Kewalram Aswani*, (1949) 17 ITR 568, 586 (Sind); *S.M. Zackariah Sahib v. CIT*, (1952) 22 ITR 359 (Mad); *CIT v. Janab A.P. Mohamed Noohu*, (1961) 43 ITR 88 (Mad)].

“Maintenance” and “dwelling” are not words of art but have a special signification particularly when they are to raise a statutory presumption under section 6(1)(b) of the 1961 Act (operative up to 31-3-1983) which has a far-reaching fiscal effect on the status of an individual. The inherent concept in the words involves a sense of continuity, periodicity or permanence tending to declare the dwelling place as a house away from home [*CIT v. K.S. Ratnaswamy*, (1970) 78 ITR 303 (Mad), **affirmed**, (1980) 122 ITR 217 (SC)]. In either of the expressions “maintains” and “causes to be maintained”, the volition on the part of the assessee in the maintenance of the dwelling place emerges very clearly; whether he maintains it or he causes it to be maintained, the maintenance of the dwelling place must be at his instance, behest or request and when it is maintained by someone else other than the assessee, it must be for the assessee or for his benefit. The mere ownership of a fractional share or interest in the family house with the consequent right to occupy it without anything more would not be sufficient to satisfy requirement of section 6(1)(b) of the 1961 Act (operative up to 31-3-1983) [*CIT v. K. Ratnaswamy*, (1980) 122 ITR 217, 224, 225 (SC)]. There must be in him a right to live in such a dwelling place maintained for him, because without that right, it could not be said that he has either maintained a dwelling place or a dwelling place has been maintained for him [*Dhirajlal Haridas v. CIT*, (1982) 138 ITR 570, 575 (Bom)].

The connotation of a dwelling place is quite different from a mere residence or a mere house in which one finds oneself for a temporary or short period. A dwelling place connotes a sense of permanency, a sense of attachment, a sense of surroundings which would permit a person to say that the house is his home [*CIT v. Fulabhai Khodabhai Patel*, (1957) 31 ITR 771 (Bom)]. To “maintain” a dwelling place is different from “having” a dwelling place. Neither the *de jure* title nor the *de facto* possession of the dwelling place would by itself constitute a setting apart or keeping ready a dwelling place to be used as a residence or home [*J.M. Abdul Aziz v. CIT*, (1963) 48 ITR 602 (Mad)]. At the same time, where a house in India was owned by the assessee and it was not shown that anybody else was living there as of right, or that it was not fit for occupation and there was also evidence to show that the assessee visited the place now and then for business, it was held that it could be presumed that the assessee maintained the dwelling place [*Motiram Madanlal v. CIT*, (1963) 47 ITR 705 (Punj)].

Illustrations.—(1) The assessee, along with others, inherited a share in a house in India. The house was actually occupied by the other heirs, as the assessee was a resident of Ceylon. The assessee’s wife and children lived with assessee’s father-in-law in the latter’s house. When the assessee came to India, he stayed in either house as a guest. It was held that the assessee did not maintain a dwelling place in India [*CIT v. Janab A.P. Mohamed Noohu*, (1961) 43 ITR 88 (Mad). Also see, *J.M. Abdul Aziz v. CIT*, (1963) 48 ITR 602 (Mad)].

(2) The joint family including the assessee, who was in Ceylon, owned several non-residential buildings and one ancestral house in India, the latter being occupied by the assessee’s step-mother. The joint family properties were being maintained out of its agricultural and rental income in India. The assessee never enjoyed any portion of the family income. During 1953 and 1957, the assessee made occasional visits to India in connection with a theatre hall, constructed there, and stayed sometimes in the family house as a guest and at other times in a hotel

or *chatram*. *Held*, in the circumstances of the case, the assessee cannot be said to have maintained a dwelling house in India [*CIT v. K.S. Ratnaswamy*, (1970) 78 ITR 303 (Mad), **affirmed in** (1980) 122 ITR 217 (SC)].

(3) In *CIT v. Sandeep Kumar Mahansaria*, (1994) 73 Taxman 503, 507-08 (Cal), the assessee purchased a flat for him. He obtained the possession of the flat but the conveyance was not registered. It has been held that it is true that unless a conveyance is registered, the transferee does not get the title of the property but as soon as he gets the possession thereof, there is no further impediment to such flat being used as a dwelling place of the concerned individual. He has all the rights pertaining to ownership excepting that he cannot transfer a better title than he has in possession and he enjoys all his rights. Thus, the assessee was held to maintain a dwelling place within the meaning of section 6(1)(b) of the 1961 Act as it stood up to 31-3-1983.

(4) The assessee was a member of a Hindu undivided family, which owned a house in India. In that house, the family of the assessee also stayed. On the question whether the assessee has maintained a dwelling place within the meaning of the then section 6(1)(b) of the 1961 Act, it has been held that there was nothing on record to indicate that the *karta* of the family maintained the house for the benefit or at the instance of the assessee. The house belonged to the Hindu undivided family. The assessee might have a share in the said house, but the fact was that neither was the house maintained by the assessee nor was that maintained by the *karta* at the behest of the assessee and, therefore, the requirements of the then section 6(1)(b) of the 1961 Act had not been fulfilled. In that view of the matter, the assessee was not a resident in India in the previous year relevant to the assessment year 1980-81 and, therefore, he could not be subjected to an assessment [*CIT v. P. Gangadharan*, (1999) 238 ITR 945, 948 (Ker)].

LexisNexis

Omitted/Phased-out provisions of section 9 of the 1961 Act

INCOME ACCRUING OR ARISING THROUGH OR FROM ANY MONEY LENT AT INTEREST AND BROUGHT INTO INDIA IN CASH OR IN KIND [S. 9(1)(i) of 1961 Act]

Essential requisites.—The essential requisites for the application of these provisions are: In the first place, that the money should have been lent at interest outside India; in the second place, income should accrue or arise directly or indirectly through or from such money so lent at interest; and in the third place, that the money should be brought into India in cash or in kind. If all these conditions are fulfilled, then only the interest shall be deemed to be income accruing or arising in India [see, *CIT v. Sri Meenakshi Mills Ltd.*, (1967) 63 ITR 609, 614 (SC)].

Knowledge must be an integral part of the transaction.—It is proper to read “arising from any money lent at interest and brought into India in cash or in kind” as one head and as indicating one composite transaction. The interest must be the result of the loan of money and the money must be brought into India in cash or in kind. The incident of bringing the money into India in cash or in kind to the knowledge of the lender and the borrower is an integral part of the transaction. After the money is brought into India, how it is used by the borrower is an irrelevant circumstance [Per Kania, C.J., in *A.H. Wadia v. CIT*, (1949) 17 ITR 63, 73 (FC); *CIT v. Sri Meenakshi Mills Ltd.*, (1967) 63 ITR 609, 614 (SC)]. Also see, *Porbandar State Bank v. CIT*, (1950) 18 ITR 134 (Bom).

Relationship of creditor and debtor essential.—The expression “income through or from any money lent at interest and brought into India in cash or in kind” contemplates that there must be a relationship of creditor and debtor between the parties concerned. A loan is something quite different from a debt. For a loan there must be a lender, a borrower, a thing loaned for use, as well as a contract between the parties for the return of the thing loaned. A loan contracted no doubt created a debt [see, *Bombay Steam Navigation Co. (1953) (Pr). Ltd. v. CIT*, (1965) 56 ITR 52, 57 (SC)], but there may be a debt without contracting a loan. Every sale of goods on credit does not amount to a transaction of loan. The essentials of the relationship of a creditor and debtor have been laid down by the Supreme Court in *Chatturbhuj Vithaldas Jasani v. Moreshwar Parashram*, (1954) SCR 817 (SC) and *Radha Kissen v. Keshardeo*, AIR 1957 SC 743. Thus, interest charged for delayed payment of sale price of goods purchased is not covered by this clause [*Lakhmichand Muchhal v. CIT*, (1961) 43 ITR 315 (MP)], nor is the interest on payment of price on deferred terms [*Addl. CIT v. Bharat Fritz Werner P. Ltd.*, (1979) 118 ITR 1018 (Karn)]. This is so even where the unpaid price was represented by the bills of exchange [*CIT v. Saurashtra Cement & Chemical Industries Ltd.*, (1975) 101 ITR 502 (Guj)].

‘In cash or in kind’.—Money in kind means that which retains its character or quality or its kind as money, namely, in commercial forms recognized in the commercial world such as bills of exchange, IOUs or even gold and silver bars or ingots. Plant, goods or machinery is neither money in cash nor money in kind. It does not mean any and every article into which the money has been converted. It has still to be “money in kind” and not money converted into goods, without anything more [*CIT v. National & Grindlays Bank Ltd.*, (1969) 72 ITR 121, 134 (Cal)]. One cannot be very correct in drawing from the above Calcutta decision [72 ITR 121] an absolute proposition that the expression ‘money lent at interest and brought into India in cash or in kind’ can never be money converted into goods [*Salzgitter Industrie Bau GMBH v. CIT*, (1990) 184 ITR 7, 29 (Bom)].

In *Meturit A.G. v. CIT*, (1990) 184 ITR 257, 263-64 (Karn), the Karnataka High Court has **dissented from** the view of the Calcutta High Court [72 ITR 121 (Cal)] that the expression ‘money lent at interest and brought into India in cash or in kind’ would only mean currency in various forms.

Illustrations.—(1) Gwalior Durbar, carrying on money-lending business in British India through an agent, advanced in Gwalior to an Indian company of Bombay a loan on the security of its first mortgage debentures. The company brought the borrowed money to India, paying interest therefor at Gwalior. It was held that interest was assessable as income under these provisions [*A.H. Wadia v. CIT*, (1949) 17 ITR 63 (FC)].

(2) D, as agent of Gwalior Durbar, lent on in West to an Indian company ₹ 1 crore. D was to get a share in the remuneration payable by the company to its managing agents, of which a portion was passed to the Durbar at Gwalior. It was held that the amount received by the Durbar was an asset of money-lending business of the Durbar, and was assessable to tax under these provisions [*A.H. Wadia v. CIT*, (1949) 17 ITR 63 (FC)].

(3) The Durbar derived income from properties in British India which were purchased by the Durbar at execution sales in enforcement of mortgage decrees for money lent. It was held that whether the property, after such purchase, continued to be a part of the assets of the money-lending business of the Durbar was a question of fact to be decided on evidence [*A.H. Wadia v. CIT*, (1949) 17 ITR 63 (FC)].

(4) Porbandar State Bank, resident in India, received deposits in Porbandar State (then outside taxable territories) on which interest was payable at Porbandar. The department disallowed the Bank’s claim that such

interest payment was its business expenditure on the ground that it had not deducted tax at source on such interest payments which were assessable as 'deemed income'. It was held that in order to deprive the Bank of the deduction and to hold that such interest was chargeable to tax as deemed income, it must be found as a fact that the depositors knew it as a part of the integral transaction of the deposit that the Bank would take the money to British India. No such knowledge having been established, these provisions could not come into operation [*Porbandar State Bank v. CIT*, (1950) 18 ITR 134 (Bom)].

(5) Three Madurai cotton yarn mills, M, R and S, had each a branch at Pudukottai, then outside British India. The sale proceeds of the branches were periodically deposited in a Pudukottai branch of a Madurai bank earning interest at Pudukottai. The three mills M, R and S borrowed money from the Madurai branch of the bank on the security of their branches' deposits in the Pudukottai branch of the bank. The Tribunal found that the three mills M, R and S had a preponderant voice in the creation, running and management of the bank, all four having mostly one-family members as shareholders, and that the Pudukottai branch of the bank had transmitted funds deposited by Pudukottai branches of M, R and S to enable its Madurai branch to advance loans to M, R and S at Madurai. It was held that entire transactions formed part of a basic scheme between M, R and S on the one hand and the bank on the other hand that the moneys deposited by M, R and S's Pudukottai branches should be brought into British India and the entire interest earned by Pudukottai branches of M, R and S at Pudukottai was taxable under these provisions [*CIT v. Sri Meenakshi Mills Ltd.*, (1967) 63 ITR 609 (SC)].

(6) Calcutta Electric Supply Corporation Ltd., a company incorporated in England, approached in London the assessee bank with a request for overdraft. The Corporation was, *inter alia*, engaged in the business of supplying electrical energy in Calcutta. The Corporation purchased in England, with the money so allowed on over-draft, generators and other electrical machinery which they brought into India. It was held that the provisions of the section had no application in respect of the interest paid by the Corporation to the assessee bank and also that the electrical generator brought to India was not "money in kind" within the meaning of these provisions [*CIT v. National & Grindlays Bank Ltd.*, (1969) 72 ITR 121 (Cal)].

(7) The assessee, a non-resident company, held 49% of the equity capital of the Indian company. It has supplied the entire technical know-how to the Indian company for the contract work. The plant, machinery and other equipment of a highly specialized nature was required to be purchased in UK, USA and Germany. The Indian company did not have necessary foreign exchange readily available. Delay in purchasing the plant and machinery would have jeopardized the interest of the Indian company. The Indian company approached the assessee-company and the assessee-company agreed to make payments to foreign suppliers of the plant, machinery and other equipment at the request of and on behalf of the Indian company on the condition that the amounts as and when paid will be debited to the account of the Indian company and carry interest. The assessee-company also agreed to receive payment with interest in deferred instalments. That was how it was possible for the Indian company to import plant, machinery and other equipment into India. It was held that the interest of ₹ 25,56,287 received by the assessee-company from the Indian company was income from 'any money lent at interest and brought into India in cash or in kind' and the same was taxable for assessment year 1966-67 under section 9(1)(i), as it then stood [*Salzgitter Industrie Bau GMBH v. CIT*, (1990) 184 ITR 7 (Bom)].

Fourth limb, now omitted.—The fourth limb of section 9(1)(i) of the 1961 Act has now been **omitted** by the **Finance Act, 1976** (66 of 1976), with effect from 1-6-1976. It may be noted that income by way of interest has now been taken to clause (v) of section 9(1) of the 1961 Act.