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Taxation in India

International Tax and Business Service

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AUGUST 1979

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New York, N.Y.
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Taxation in India is part of a series that presents information on taxation in various countries of the world. The book is intended to supply information of a general character regarding taxation in India for use as background when considering the conduct of business in that country. Specific questions should be answered by reference to the laws and regulations of the country and by consultation with professional advisors in the light of the particular circumstances.

Taxation in India is published in two forms: in a loose-leaf edition and as a bound book. Only the loose-leaf edition may be supplemented or revised. These supplements will appear on blue-colored sheets inserted at the end of the book. These supplementary pages will be keyed to the original text by chapter and section numbers and should always be read in connection with the original text. In addition, revised information may be presented on pages inserted in the basic text to replace original pages. Revisions of this type are indicated by a date that appears on the bottom of each replacement page.

Rules governing taxation are subject to change and reinterpretation, in many cases with little or no advance notice. The information in this book is based on material available to Deloitte Haskins & Sells as of August 1979.

Deloitte Haskins & Sells.

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Part 1:
The Tax System

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Tax Legislation and Administration

1.01 Enactment of Tax Legislation

Under the Indian Constitution, income taxation is the prerogative of the Union Parliament, consisting of the President of the Indian Republic and the two chambers of the legislature. These legislative chambers are the Rajya Sabha (Council of States—to some extent the equivalent of the United States Senate) and the Lok Sabha (House of the People—similar to the United States House of Representatives). The Union Parliament is also empowered to enact other tax laws that do not come within the exclusive jurisdiction of the legislatures of the individual states.

Theoretically, only the President has the right to initiate tax legislation. In practice, tax bills are recommended by the President, acting on the advice of the Council of Ministers, which is headed by the Prime Minister. Tax legislation is then introduced in the Lok Sabha by the Minister of Finance, a member of the Council of Ministers. The Minister of Finance summarizes and explains the major budget proposals and introduces his annual finance bill, usually in February. The finance bill is discussed by the Lok Sabha and may be amended there. If passed by the Lok Sabha, the bill is sent to the Rajya Sabha for recommendations, which are not binding upon the Lok Sabha. The finance bill passed by the legislature is not enforceable without the President's assent and its publication in the official paper, the Gazette of India, as the finance act of Parliament. At least one finance act is enacted every year. Usually, the effective date is April 1, the beginning of India's financial year.

Generally, the annual finance act determines the income tax rates for the coming financial year. The finance act also provides for changes in the Income Tax Act, 1961, the basic statutory authority on income tax law. Sometimes, amendments to the Income Tax Act, 1961, are made by laws other than the finance acts. Separate laws have also been enacted for taxes on sales, commodities, wealth, gifts and inheritances, and a surtax on corporations.

1.02 Tax Administration

The Ministry of Finance is the supreme authority for all financial and fiscal matters of the Union Parliament. Central government taxes are administered by the Department of Revenue in the Ministry of Finance. This department has two Boards. The Central Board of Direct Taxes administers direct taxes, which consist of income, wealth, gift and estate taxes, and surtax on corporations. The Central Board of Excise and Customs administers the excise and customs laws. Generally, the various tax acts delegate authority to issue regulations to these Boards. Within the Department of Revenue is also the Settlement Commission for settling tax cases in special circumstances.

The Central Board of Direct Taxes. The Central Board of Direct Taxes is composed of a Chairman and four members. The Board issues tax regulations, which become part of the basic statutes when these regulations are approved and published in the Gazette of India. The Board is authorized to set guidelines and principles for the efficient and equitable assessment and collection of taxes. The Board may also accept, in cases of hardship, a late application for tax refund or relief. Directions and instructions issued by the Board are binding upon all officials employed in applying and enforcing the tax laws. The Board determines the jurisdiction of Commissioners of Income Tax, Commissioners of Income Tax (Appeals), and Appellate Assistant Commissioners, on the basis of classes of income or persons, or on a regional basis. The Commissioners of Income Tax are assisted by Inspecting Assistant Commissioners, Income Tax Officers, and Inspectors of Income Tax. Directors of Inspection are also employed to perform such functions as may be assigned to them by the Board.

Basically, Income Tax Officers are responsible for determining income tax liabilities and for making assessments, subject to review by Inspecting Assistant Commissioners and Commissioners of Income Tax. Inspecting Assistant Commissioners, given concurrent jurisdiction by the Commissioners of Income Tax, can also function as assessing officers. Appeals against assessments lie either to the Commissioners of Income Tax (Appeals), or to the Appellate Assistant Commissioners. Broadly, appeals against assessments issued by Inspecting Assistant Commissioners, or by Income Tax Officers on the basis of statutory directions of Inspecting Assistant Commissioners, and appeals against assessments of all companies are decided by the Commissioners of Income Tax (Appeals), and those others issued by Income Tax Officers are generally decided by the Appellate Assistant Commissioners. Their decisions, called appellate orders, may be appealed to the Appellate Tribunal, a quasi-judicial body. The Appellate Tribunal's permission is needed to appeal to the High Courts.

The Central Board of Excise and Customs. The Central Board of Excise and Customs is composed of a Chairman and four members. Its main functions are the administration of excise and customs laws. Taxpayers normally deal with Collectors of Excise and Customs at collection offices in all ports and in the main cities.

The Settlement Commission. For income tax and wealth tax cases that must be settled at times in the interest of the revenue, a Settlement Commission, which is independent of the Central Board of Direct Taxes, is constituted within the Department of Revenue. The Settlement Commission consists of a Chairman and two members appointed by the central government on the basis of integrity and outstanding ability. The Commission deals with voluntary applications

for settlements by errant taxpayers. Applications for settlement will not be accepted where concealment of income or fraud is established. The Settlement Commission can decide on terms of settlement (including the manner of payment of tax penalty or interest) and also can offer immunity from prosecution and penalty in deserving cases. An order of the Settlement Commission is final.

1.03 Judicial Review

Judicial review is allowed upon permission granted by the Appellate Tribunal. The jurisdiction of the High Courts in tax matters is limited to questions of law. Finally, either party may appeal a decision of a High Court to the Supreme Court of India, but only after securing permission of the High Court. Decisions of the Supreme Court of India have the same effect as those of the United States Supreme Court; that is, they become part of India's laws. On the other hand, decisions of the High Courts are comparable to those of the United States Circuit Court of Appeals as they are not binding outside the jurisdiction where rendered. Reports of cases are published.

1.04 Taxes Imposed by State and Local Authorities

Under the Constitution, taxing powers on specific matters are granted to the states. Two or more states may jointly renounce their taxing powers and delegate them to the Union Parliament.

Generally, the states impose taxes on land (13.03), agricultural income (13.05), sales (13.01), motor vehicles, etc. Municipalities impose real property taxes (13.03), use taxes, and other local taxes.

Distinctive Features of the Indian Tax System

2.01 Summary

From the standpoint of revenue for the Indian central government, the most important sources are the income tax (Chapters 3 to 12), and excise taxes and import duties (13.02). Other taxes include wealth, and gift and estate taxes (Chapter 15).

The income tax law classifies income in six categories; one of them a catchall category called "income from other sources" (2.03). There are specific provisions for the computation of income falling within each of the six categories. With some exceptions, the tax payable in an assessment year is based on the previous year's income (2.04). Generally, all income not specifically exempt or excluded is taxable. There is no statutory or judicial definition of income.

For income tax purposes, taxpayers are classified on the basis of residence. In addition to the usual classification of resident and nonresident, another group of individuals are classified as "resident but not ordinarily resident" (2.02). Furthermore, aliens must be distinguished from Indian citizens, and a Hindu undivided family may be taxed as a unit. For corporations it is necessary to distinguish between resident and nonresident, domestic and foreign, and public and private companies (2.02).

Indian tax rates are high compared with some other countries, but there are numerous tax incentives available (2.05 and 2.06) that ease the tax burden of many taxpayers.

2.02 Classification of Taxpayers

For purposes of the income tax and also the taxes on wealth, and estates and gifts (Chapter 15), the taxpayer classifications mentioned in 2.01 are important.

Resident Individuals. Individuals are classified as residents for a taxable year if during the preceding year they satisfied any of the three following tests:

(a) Presence in India for at least 182 days

(b) Presence in India for at least 30 days coupled with maintenance of a dwelling place for at least 182 days

(c) Presence in India for at least 60 days coupled with presence in India for at least 365 days during the four preceding years

However, for an Indian citizen rendering service abroad and who has been in India on vacation during the preceding year, to be classified as a resident under the above test (b) or (c), his presence in India during the preceding year should be for at least 90 days, instead of the 30 days or 60 days specified.

Not Ordinarily Resident Individuals. Individuals who qualify as resident under any of the above tests are treated as not ordinarily resident if they satisfy one or both of the following tests:

(a) Residence in India for less than nine of the ten preceding years

(b) Presence in India for less than 730 days during the seven preceding years

Nonresident Individuals. Nonresidents are those individuals who are not within either of the two categories of residents.

Indian Citizens and Aliens. In general, residence is more important in taxation than citizenship. Certain tax exemptions, however, such as foreign technicians' exemptions (10.05), apply to aliens only.

Hindu Undivided Families. In general, individuals are taxed separately. However, Indian tax law recognizes and treats a Hindu undivided family as a taxable unit. For purposes of determining the residence of a Hindu undivided family, it is treated similarly to a partnership.

Partnerships or Firms. The tax treatment of a partnership depends on whether or not it is registered. Generally, it is advantageous from a tax standpoint to register a partnership. If more taxes would be collected as a result of registration, however, the Indian tax administration will compel a partnership to register. A written partnership agreement indicating the share of each partner must be attached to the application for registration. A partnership is treated as resident in India, unless its management and control are wholly outside the country.

Resident and Nonresident Corporations. All companies incorporated in India are treated as resident corporations. A company incorporated outside India is treated as a nonresident corporation, unless the control and management of its affairs is situated wholly in India.

Any institution or association of persons, whether incorporated or not and whether Indian or alien, may be treated as a "company" for tax purposes, on the basis of an order issued by the Central Board of Direct Taxes.

Domestic and Foreign Corporations. Domestic and foreign corporations must be distinguished to apply the proper tax rates and for certain other provisions. A company, whether or not incorporated in India, may be treated as a domestic corporation if it has made the prescribed arrangements for the declaration and payment of dividends in India. A foreign company that has not made such arrangements is subject to tax at a higher rate (3.03), but is not subject to the tax on accumulated earnings (9.02).

Public and Private Companies. Indian company law distinguishes between public and private companies. A similar but somewhat different distinction is made in the tax law between companies in which the public is or is not substantially interested. The public is considered substantially interested in a company if:

(a) the government holds not less than 40% of its share capital, or

(b) it is not a private company as defined in India's company law, and either its equity shares are listed on a recognized stock exchange on the last day of the previous year, or

(1) its equity shares carrying not less than 50% (40% in the case of an industrial corporation) of the voting power were beneficially held throughout the previous year by the government, a government corporation, a publicly held company, a 100% subsidiary of a publicly held company, or the public, and

(2) such shares were, during the previous year, freely transferable by the holder to other members of the public, and

(3) the affairs of the corporation or shares carrying more than 50% (more than 60% for an industrial corporation) of the voting power were at no time, during the previous year, controlled or held by five or fewer persons.

In determining whether shares were held by five or fewer persons, the shares held by the government, a government corporation, a corporation in which the public is substantially interested, or a 100% subsidiary of such corporation are not taken into account, and certain related persons are counted as single persons. Thus, if a publicly held company owns the required percentage of another corporation, the latter is also treated as a publicly held company.

Industrial, Trading, Investment, and Consulting Corporations. Finally, for tax purposes, companies must be distinguished on the basis of their principal activities. An industrial corporation is one whose business consists wholly or mainly in the manufacture or processing of goods, mining, the generation or distribution of electricity or other form of power, or the construction of ships. A trading corporation is one that deals principally in goods or merchandise manufactured by others. An investment corporation is one whose income consists mainly of dividends, interest, rents, and capital gains. A consulting corporation is one whose business consists wholly of providing technical know-how or rendering such services.

2.03 Schedular Concept of Income Taxation

The tax system provides for six classes or "heads" of income: salaries, interest on securities, rental from real property, income derived in the conduct of a business or profession, capital gains, and

income from other sources (including dividends and rents from personal property). Each category is regulated by specific provisions of the income tax laws. These provisions determine the income items includable and the permissible deductions applicable to each category. The determination of the category of a specific item of income is also important for purposes of the rules concerning the setoff and carryover of losses (7.08). However, the total income derived from all categories must be reported in a single income tax return.

Sources of Income and Place Received. Nonresidents, including corporations, are subject to tax only on income received, derived, or deemed to be received or derived in India (9.01 and 10.04). The rules concerning the place of receipt or source of income are, therefore, important in determining whether an item of income is subject to Indian income tax.

Actual or constructive receipt of income in India is subject to Indian income tax, whether or not the income is derived from Indian sources. After the income has been received by the taxpayer, its subsequent transmittal to another place does not affect the incurrence of tax.

Income derived or deemed to be derived from Indian sources is subject to Indian taxation, regardless of the place of payment. This includes income derived through, or from, any "business connection" in India, any asset located in India, or services performed in India. Dividends received from an Indian company are deemed to be derived from Indian sources (6.04). See 6.03 and 6.06 for the source rules regarding interest income, royalties, and fees for technical services.

The Act does not define the term "business connection." Court decisions indicate that this term is not susceptible of precise definition and each case must be considered on its facts. Generally, the frequency of transactions, their nature, and the relationship between the parties are taken into consideration. Isolated transactions, outright sales from nonresident exporters to Indian importers or customers, or purchases in India by a nonresident individual or corporation for export are not considered to give rise to a business connection and do not result in income subject to Indian taxation. If operations are only partly carried out in India, a portion of the profit may be taxed. The tax administration has held that the sale of an investment in an Indian corporation by a nonresident is subject to Indian capital gains tax (6.05), although the transaction is negotiated and executed outside India.

2.04 Tax Year and Base Period

The assessment year starts April 1 and ends March 31 of the following year. The tax is based on the previous year's income, that is, the period of 12 months ending on or before the March 31 preceding the assessment year. Thus, income of the calendar year 1979, or a fiscal year ending on or before March 31, 1980, is taxed in the assessment year 1980-1981. On the other hand, if a fiscal year ends April 30, 1980, the assessment year will be 1981-1982. A new entity may establish any fiscal year ending not more than 12 months after inception of its business. Once a fiscal year has been established, it may not be changed without consent of the tax authorities.

Generally, the income tax rates in effect during the assessment year apply to the previous year's income. The annual finance act also prescribes separate tax rates for withholding taxes (Chapter 5), and for estimated income tax payments during the current fiscal year (4.02). The tax rates prescribed for withholding taxes on salaries and for estimated income tax payments generally reflect the income tax rates expected to apply in the following assessment year.

2.05 Industrial Tax Incentives

From time to time, incentives appear in the tax laws to encourage the development and expansion of industries and other segments of the economy. These incentives may take the form of special deductions from taxable income, exemptions from tax, tax credit certificates, or reduced tax rates.

Incentives for New Industrial Undertakings and Other Enterprises. A tax incentive, commonly called a "tax holiday," is granted to taxpayers that establish new industrial undertakings or cold storage plants that begin production or operation in India by March 31, 1981. Low priority industrial undertakings (Appendix E) that have begun production after March 31, 1979, however, are not eligible for this incentive. A similar incentive is granted to new hotels operated by a corporation registered in India with a paid-up capital of not less than Rs. 500,000* and to a corporation registered in India owning and operating ships not previously owned and used in Indian territorial waters by a persons resident in India. If certain conditions are met, a specified deduction is allowed from taxable profits derived from such new enterprise for a period of five years beginning with the first year in which manufacture commences, or the hotel, cold storage plant, or ship starts operating. For corporate taxpayers, the deduction allowed is 7.5% of the capital employed in the new enterprise if the production began, or the hotel, cold storage plant, or ship started operating after March 31, 1976, and 6% of the capital employed if the production began, or the operation started, before April 1, 1976. For

* Rs. stands for rupees.

noncorporate taxpayers the deduction is uniformly 6% of the capital employed in the new enterprise. If the full benefit of this deduction is not obtained because of loss or inadequate taxable profits during any of those five years, such unused benefit may be claimed as a deduction during the seven years following the first year of the tax holiday period.

The main condition for this incentive is that the new establishment is not formed by splitting up or reorganizing an existing business (except one entitled to the rehabilitation allowance mentioned at 7.02) or by transferring machinery or equipment previously used for any purpose. Also not permitted is the transfer for use as a new hotel of a building that was previously used as a hotel. It is permitted, however, to transfer used machinery or equipment up to a maximum of 20% of the total value of the machinery and equipment of the new industrial undertaking or cold storage plant, and to transfer used hotel buildings and used machinery or equipment up to a maximum of 20% of the total value of the building, machinery, and equipment of the new hotel. But, the value of such used assets is not includable in computing the capital employed by the enterprise. Reconditioned machinery or equipment imported from abroad is considered as new for this purpose, if certain conditions are met.

This incentive is not limited to newly formed entities. It is available to existing enterprises that set up a new undertaking, except if the new undertaking is merely an expansion of existing facilities.

This tax holiday incentive is in addition to an incentive for new undertakings established in specified backward or rural areas (see next heading), which takes precedence over the tax holiday incentive for purposes of the deduction from taxable income.

Dividends paid by a corporation eligible for the tax holiday deduction of 6% of the capital employed are tax free to the extent of such deduction. This tax exemption is not granted for dividends paid by corporations entitled to deduct 7½% of capital employed.

Incentives for New Undertakings in Backward or Rural Areas. Taxpayers establishing new industrial undertakings or hotels in specified backward areas, or new small-scale industries in any rural areas of the country, are allowed a deduction of 20% of taxable income derived from such new enterprise, if certain conditions are met. The deduction is for ten years beginning with the first year in which manufacture commences or the hotel starts operating. A mining operation is not eligible for this incentive.

Other Industrial Tax Incentives. Book publishers can deduct 20% of taxable income attributable to the printing and publication of books. This deduction ends in the income year preceding assessment year 1980-1981.

Income derived from a business of livestock breeding, or poultry or dairy farming, is exempt from tax to the extent of the higher of Rs.10,000 or one-third of such income, and that from a business of growing mushrooms is exempt to the extent of the lower of Rs.10,000 or one-third of such income.

Corporations and cooperative societies engaged in industries that use as raw materials the products of agriculture, animal husbandry, or dairy and poultry farming, are allowed to deduct 120% of certain expenditures. The deductible expenditures are those incurred in providing agricultural supplies (such as seeds, fertilizers, pesticides, and tools) or in rendering technical and other services to a cultivator, grower, or producer of agricultural products.

Tax relief is given to corporations that realize a capital gain upon removal of their industrial operations from an overcrowded urban area with the approval of the Central Board of Direct Taxes. Tax credit certificates are issued in the amount of the capital gains tax (6.05).

Reduced tax rates may apply to technical assistance fees and royalties received by a foreign corporation from an Indian concern (Rate Tables).

An Indian corporation is allowed a deduction of 40% of royalties and fees for technical know-how and related services received from any concern in India under an agreement approved by the government (6.06).

Earnings of foreign technicians, teachers, and professors are exempt from tax, subject to certain conditions and limitations (10.05).

Other investment incentives include a development rebate granted to a specified date and an investment allowance or initial depreciation allowed to certain industries and hotels for new investments in certain capital assets (7.02), writeoffs permitted for capital outlays on industrial research facilities (7.01), exemption from income tax for interest on foreign loans for industrial purposes (6.03) and for dividends received by domestic companies from new Indian companies engaged in certain high priority industries (6.04), lower effective tax rates for domestic intercorporate dividends (6.04), and a deduction from taxable income allowed to certain taxpayers for investing in shares of new public companies engaged in non-low-priority indus-

tries (10.02). A wealth tax exemption for five years is allowed for investment in shares of new industrial corporations engaged in certain priority industries (13.04).

Outside the tax system, various industrial incentives are offered by state governments to industries that locate in notified backward areas. These include cash grants of a percentage of fixed capital investment, loans from financial institutions at a reduced interest rate, subsidies for feasibility studies, and a refund of sales tax payments over the first five to ten years of production in the form of long-term, interest-free loans.

2.06 Exporting and Other Tax Incentives

Domestic corporations and resident noncorporate taxpayers are allowed a weighted deduction from taxable income for specified expenditures incurred for the promotion of exports. The deduction allowed is 133% of such expenditures. The specified expenditures include maintenance costs of a branch outside India, and expenses on advertising and traveling outside India.

Sales tax does not apply to export sales. Excise taxes paid by a manufacturer on manufactured goods are generally refunded if the goods are exported.

A number of other tax incentives are designed to encourage savings and the inflow of foreign exchange or to promote rural development. Certain dividends, technical service fees, and royalties received by an Indian company from a foreign corporation, and brought into India in convertible foreign exchange, are exempt from income tax (6.04 and 6.06). Also tax exempt are interest earned by a nonresident on funds remitted from abroad and deposited in a bank in a nonresident (external) account under the foreign exchange regulations (6.03) and income earned by a nonresident of Indian nationality or origin on units of Unit Trust of India purchased by remittances from abroad or out of funds held in the nonresident (external) account (6.01). For persons of Indian origin residing abroad who intend to reside in India permanently, assets brought into India or acquired from money brought into India are exempt from wealth tax for seven assessment years following the year of return to India (13.04).

Individuals and Hindu undivided families are exempt from income tax on dividends from Indian companies, income from Unit Trust of India, interest on government securities, bank and specified other deposits, and debentures. The maximum exemption is income up to Rs. 3,000. An additional exemption up to Rs. 2,000 is given for income from Unit Trust of India in excess of the Rs. 3,000 exemption (6.03). Tax relief is also allowed to these taxpayers in the form of

limited deductions from taxable income for payments for life insurance policies, provident and pension funds, and certain deposits with the post office and in unit-linked insurance plans (10.02).

Corporations and cooperative societies may deduct from their taxable business income any expenditure on programs of rural development that have been approved by prescribed authorities. The deduction is allowed for expenditures whether or not related to the business.

Taxpayers are allowed deduction for payments made by them to an institution set up for executing programs of rural development, or for training of persons for implementation of any program of rural development. The institution and also the program of rural development undertaken must be approved by prescribed authorities. The deduction is allowed as a business expense to taxpayers who are engaged in business and as an itemized deduction from taxable income for others (7.01 and 10.02).

Part 2: Income Taxes

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Tax Rates

3.01 Summary

The annual finance acts passed by Parliament, usually during April, provide the tax rates applicable to the current assessment year. These acts also prescribe two additional rate schedules. One schedule is for the withholding taxes on dividends, interest, and other payments (5.02), and the other is for withholding taxes on salaries (5.01) and for estimated income tax payments (4.02). The latter schedule usually forms the basis for tax rates in the following year. For example, the Finance Act of 1979 prescribes the rates for the assessment year 1979-1980 and also the rates for withholding and advance tax payments to be made during that year, which will be applied against the taxes for the assessment year 1980-1981 (2.04).

Individuals, corporations, and other taxpayers are taxed at varying rates, as set forth in detail in the Rate Tables.

Aggregation of Agricultural Income and Taxable Income. Agricultural income is exempt from national income tax (6.01 and 13.05). However, any such income is aggregated with taxable income for determining income tax payable on taxable income by individuals, Hindu undivided families, unregistered firms, and associations of persons. Aggregation is not required when taxable income does not exceed Rs. 10,000. If there is a net loss for the year from various agricultural sources, the loss is taken as zero in the aggregation. However, carryover of an agricultural net loss for a year to offset net agricultural income of succeeding years is allowed. Only the resultant net agricultural income, if any, in the succeeding years is aggregated with taxable income to determine income tax payable. The income tax on taxable income is computed in the following manner:

(1) Taxable income and agricultural net income are aggregated, and basic income tax is calculated on the aggregated amount, as per Rate Tables, without applying the marginal relief indicated in the Rate Tables.

(2) Basic income tax is calculated as per Rate Tables, without applying the marginal relief indicated in the Rate Tables, on agricultural net income increased by Rs. 8,000/-.

(3) The excess of (1) over (2), limited to 60% of the excess of taxable income over Rs. 10,000, constitutes basic income tax payable on taxable income for the year. A surcharge on the basic income tax payable, at the rate indicated in the Rate Table, is added.

3.02 Individuals

The basic income tax rates and the surcharge that applies to the taxable income of individuals, unregistered partnerships, and Hindu undivided families are set out in the Rate Tables.

Only a specified proportion of long-term capital gains earned by a taxpayer other than a corporation is included in taxable income (6.05). In effect, therefore, long-term capital gains bear a lower burden of income tax.

Hindu Undivided Families. The tax rates applicable to individuals, including the surcharge, also apply to Hindu undivided families, except where a member has independent taxable income in excess of Rs. 10,000 and for whom a separate table of tax rates appears in the Rate Tables.

Unregistered Firms or Partnerships and Associations of Persons. The tax rates applicable to individuals also apply to unregistered firms and associations of persons. The income taxed in the return of the unregistered partnership or association of persons is not taxed again in the hands of the partners or members of the association of persons. However, each partner or member of the association must include his share of such income in determining the tax rate applicable to his other income. The share of loss, however, is not allowed to be offset against other income of any year.

Registered Firms or Partnerships. The basic income tax rates on registered professional partnerships is slightly lower than for other registered partnerships (Rate Tables).

Cooperative Societies. The basic tax rates for cooperative societies are shown in the Rate Tables. Here, too, a surcharge applies (Rate Tables).

3.03 Corporations

Corporations are subject to tax at different rates depending on the status of the company and the nature of its income.

Domestic Companies. Domestic companies are subject to the basic tax rates shown in the Rate Tables on taxable income other than long-term capital gains (6.05), which are subject to special rates also shown in the Rate Tables. Domestic private companies are taxed at somewhat higher rates than domestic public companies. Different tax rates apply to domestic private industrial companies than to other than industrial companies (Rate Tables). A surcharge is added to the basic tax payable by domestic companies (Rate Tables).

Intercorporate dividends received by a domestic company are generally included in taxable income to the extent of 40% of such dividends (6.04). This has the effect of reducing the basic tax rate on intercorporate dividends.

Foreign Companies. Foreign companies that have not qualified as domestic companies (2.02) are taxed at the rates shown in the Rate Tables, which vary depending on the nature of their income. Long-term capital gains (6.05) are subject to the same special tax rates as are applicable to domestic companies (Rate Tables).

Surtax on Corporations. In addition to the basic income tax (including the surcharge), corporations, including foreign corporations, are subject to a surtax on chargeable profits in excess of the greater of 15% of their capital or Rs. 200,000. The surtax rate is 25% of the excess chargeable profits not in excess of 5% of the corporation's capital, and at the rate of 40% on the balance. However, the combined basic income tax, surcharge, and surtax may not exceed 70% of the taxable income for income tax purposes, in the case of a domestic corporation in which the public is substantially interested and whose share capital paid in cash exceeds 25% of the capital computed for surtax purposes. If this limitation applies, the surtax is correspondingly reduced. For details of the computation of chargeable profits and capital, see 9.02.

Accumulated Earnings Tax. Domestic companies in which the public is not substantially interested (2.02) are subject to an accumulated earnings tax if they fail to distribute to their shareholders a statutory percentage of their profits. If the tax applies, undistributed profits are taxed at varying rates from 25% to 50%. See Rate Tables and 9.02 for details.

Returns, Assessments, and Payment of Tax

4.01 Returns and Assessments

All taxpayers, including those subject to withholding tax (Chapter 5), must file an income tax return during each assessment year (2.04) showing the total amounts derived from the various classes of income (2.03) for the previous year. However, an employee whose salary income excluding fringe benefits does not exceed Rs. 18,000, and whose other income consists only of specified tax-exempt interest and dividends not exceeding Rs. 3,000 (2.06), need not file a tax return if the employer has withheld tax from the salary (5.01). This exception does not apply to a director or an employee who controls 20% or more of the voting power of the company.

Generally, taxpayers with commercial, industrial, or professional income must file their tax returns within four months of the close of their fiscal year or by June 30 of the assessment year, whichever is later. Other taxpayers must file their returns by June 30 of the assessment year. Upon application, the Income Tax Officer may grant an extension of time for filing the return. A taxpayer who has not filed within the normal time period, or within any extension granted, may still file a valid return at any time within two years from the last day of the assessment year. This time limit also applies to filing for refunds.

The tax return must contain details of the computation of income, and the taxpayer must compute the tax due. Payments of advance income tax (4.02) and withholding tax are creditable against the final tax liability. Total taxable income is rounded off to the nearest multiple of Rs. 10, and tax payments and refunds are rounded off to the nearest rupee.

All taxpayers must obtain a permanent account number from the Income Tax Officer, and this number must appear on all tax returns and other tax documents.

4.02 Payment of Tax

Taxpayers whose tax is not fully covered by withholding must make three advance income tax payments during the fiscal year ending on March 31 whenever taxable income (exclusive of capital gains and winnings from a variety of games of chance) exceeds the following:

Corporations	Rs. 2,500
Registered partnerships	20,000
Others	10,000

If the taxpayer's accounting year ends on or before December 31 of the year preceding the assessment year, advance tax is payable by June 15, September 15, and December 15. The Central Board may allow payment of the last instalment on March 15 instead of Decem-

ber 15 by classes of taxpayers likely to be harmed by the earlier payment because of the nature of their business. If the taxpayer's accounting year ends after December 31, tax payments are due on September 15, December 15, and March 15 of the year preceding the assessment year. Thus, the tax on the income of an accounting year is paid on an estimated basis during that year, although it is assessed in the following year (2.04).

By the due date of the first instalment, the taxpayer is required to send to the Income Tax Officer a statement of advance income tax payable by him during the fiscal year. The advance income tax payments are computed by him at the rates prescribed for this purpose by the annual finance act (Chapter 3). These rates are applied to the taxable income (excluding capital gains and gambling winnings, etc.) of the taxpayer in the latest previous year for which he has been regularly assessed, or in the subsequent year for which he has paid tax on the basis of the return filed (see next paragraph), but assessment has not been completed, whichever is higher. The taxpayer has also an option to make his own estimate of taxable income for the current year and pay the advance tax instalments calculated on such estimate, if he expects his current income to be less than the estimated income determined on the first said basis. Allowance is made for withholding taxes. If at any time before the final instalment is due, the taxpayer on a review finds that the advance income tax is likely to exceed the tax computed by him earlier on the aforesaid basis by more than 33⅓%, he must file a revised estimate with the Income Tax Officer, and any remaining instalments must be increased accordingly. In hardship cases, the Commissioner may extend the time for the taxpayer to furnish the revised estimate up to 30 days after the end of the taxpayer's accounting period. When an extension is granted, the taxpayer must pay the advance tax previously computed on the regular due dates and the remaining tax, based on his revised estimate, by the extended date. A taxpayer who has not been previously assessed must estimate his taxable income for the current year by December 15 if his accounting year ends on or before December 31 and by March 15 if it ends thereafter and must prepay his tax liability for the following assessment year based on such estimate.

Before filing the income tax return for any assessment year (4.01), the taxpayer must pay the tax due on the basis of the return, as reduced by payments of advance income tax and withholding tax.

Upon receipt of the return, the Income Tax Officer will proceed to make a regular assessment (4.03). He must notify the taxpayer by an assessment form and notice of demand showing the computation of income tax liability. Any balance payable is generally due within 35 days following receipt of this notice. When taxes have been over-

paid, the excess is refunded on making a regular assessment. If a taxpayer's return claims an overpayment of taxes and asks for a refund, the Income Tax Officer will, if a regular assessment is not likely to be made within six months following filing of the return, make a provisional assessment within that period and allow a refund.

A nonresident who is leaving the country must first obtain a tax clearance certificate that shows he has paid his taxes or made satisfactory arrangements for payment.

4.03 Examination of Returns

Returns are reviewed by the Income Tax Officer, who may issue a regular assessment after correcting any arithmetical errors and making other changes that do not require the presence of the taxpayer or additional information. However, such assessment does not bar the Income Tax Officer from later reviewing the original assessment on his own or at the request of the taxpayer; nor does it preclude the Income Tax Officer from making a further assessment after examining books of account and other supporting documents.

Alternatively, the Income Tax Officer may ask for information and examine the books of account and other supporting documents prior to making a regular assessment. If he proposes any variation in the income or loss reported by the taxpayer, and the proposed addition to the reported income or disallowance of loss exceeds Rs. 100,000, he is required to send a draft assessment to the taxpayer. The taxpayer may send his objections to such variation. If he does, the Income Tax Officer will forward the papers to the Inspecting Assistant Commissioner for his directions. After providing the taxpayer with an opportunity to be heard, the Inspecting Assistant Commissioner gives directions that enable the Income Tax Officer to make a regular assessment. In the event the taxpayer does not object to the proposed variation within a specified period, the Income Tax Officer may make a regular assessment without referring to the Inspecting Assistant Commissioner.

If a return has not been filed or information has not been supplied, the Officer may make an assessment based on his best judgment. The statute of limitations for making a regular assessment or a best judgment assessment is, generally, the later of two years from the last day of the assessment year, or one year from the date of the deferred filing of a valid return (4.01).

A completed assessment may be reopened by the Income Tax Officer if income has escaped assessment. The Officer may also commence assessment proceedings when income has escaped assessment because the taxpayer has not filed a return or for other reasons. The time limit for commencing proceedings to tax escaped income is

four years after the end of the assessment year. In case of fraud, the period is eight years generally, and 16 years if the untaxed income is Rs. 50,000 or more for any year. The statute of limitations for completing the assessment is four years from the end of the assessment year or one year from the commencement of assessment proceedings, whichever is later. In case of fraud, the period is four years from the last day of the assessment year in which the proceedings were commenced.

A completed assessment may also be amended by the Income Tax Officer on his own motion or at the instance of the taxpayer to rectify any mistake apparent from the record. The statute of limitations for rectification is four years from the date of the assessment sought to be rectified. At the direction of the Commissioner of Income Tax, the Inspecting Assistant Commissioner may exercise all or any of the functions of the Income Tax Officer.

4.04 Interest and Penalties for Late Filing and Late Payment

When the time for filing a return is extended beyond the due date (4.01), or when there is default in filing a return, interest on the unpaid balance of tax is charged at the rate of 12% per year from the due date of the return. Penalties are levied for almost any unjustified failure to comply with the obligations imposed by the tax laws. Failure to file a timely return is subject to a penalty of 2% of the tax payable for each month of delay. This penalty is waived if the total income does not exceed by Rs. 1,500 the maximum tax-exempt amount. Failure to obtain a permanent account number may result in a penalty of up to Rs. 500.

Concealment in reporting income or the deliberate filing of an inaccurate return is subject to a penalty of not less than 100% and not more than 200% of the amount of the unreported income if the offense occurred before April 1, 1976. The penalty is not less than 100% and not more than 200% of the amount of the tax sought to be evaded, if the offense occurred after March 31, 1976. A taxpayer reporting less than 80% of his income in a return filed before April 1, 1976 is deemed to have concealed income. When a return is filed after March 31, 1976, a taxpayer is deemed to have concealed income if the Income Tax Officer adds to the reported income as a consequence of the taxpayer's not offering a bona fide explanation or offering a false explanation of any facts material to the determination of the taxable income. The presumption of concealment of income also arises if a person who has not been taxed previously has taxable income, but fails to file a return before the expiration of two years from the last day of the relevant assessment year.

If a person fails to file an advance income tax estimate when required, or to pay the advance tax when due, or if the advance tax paid is less than 75% of the assessed tax, interest of 12% per year is charged from April 1 following the financial year to the date of such assessment on the entire shortfall in estimated tax payment. In addition, a taxpayer who knowingly files a false estimate, or fails to file a required estimate without reasonable cause, is subject to a penalty of not less than 10% or more than 150% of the amount by which the tax paid, if any, falls short of 75% of the "assessed tax." "Assessed tax" means the tax determined by regular assessment, less any tax withheld at the source, and excluding any tax caused by an increase in tax rates over the preceding year.

Failure to pay tax due when filing the income tax return may result in a penalty of 2% of the tax payable for each month of delay. Failure to pay income tax assessed by the Income Tax Officer within the prescribed time results in the payment of interest at 12% per year from the due date, and is subject to a penalty that may amount to 100% of the unpaid tax. In addition to these penalties, persons who willfully attempt to evade tax or avoid payment of tax, or willfully fail to file income tax returns in due time, or make statements they know to be false, may be liable to imprisonment for three months to seven years as well as a fine.

For failure to withhold tax, or to pay tax withheld to the government see 5.03.

Withholding Taxes

5.01 Withholding of Income Tax on Salaries

Employers must withhold income tax on salaries and other compensations paid to their employees. The rate of withholding tax is based on the employee's estimated salary income, whether paid in cash or in certain forms of taxable fringe benefits, such as free accommodations or accommodations rented at less than normal value, and car allowances (10.05). Retirement annuities paid to partners of registered firms engaged in professional activities are also subject to withholding tax (12.04).

5.02 Withholding on Interest, Dividends, and Other Payments

Generally, interest and dividends are subject to withholding tax. However, no withholding is required on interest stemming from tax-free securities paid to residents, nor on interest paid by an individual or a Hindu undivided family, nor on interest paid by a partnership to its partners, nor on interest paid to a resident not exceeding Rs. 1,000 in total during a financial year. Banks are not required to withhold on interest paid or credited to resident depositors' accounts. Withholding is also not required on interest paid to residents on certain deposits specified by the government. No withholding is required on dividends not exceeding Rs. 250 paid to a resident noncorporate shareholder if the shareholder states in a written declaration in the prescribed form that his estimated taxable income for the year will be less than the minimum liable to income tax (Rate Tables). Withholding is also not required on dividends paid to residents stemming from investments in the Unit Trust of India; nonresidents are also free from withholding on the first Rs. 5,000 of such dividends.

Withholding of tax is required on all payments of insurance commissions, on winnings from lotteries and crossword puzzles in excess of Rs. 1,000, and on winnings from horseraces in excess of Rs. 2,500. Payments made by the government, a local authority, a statutory corporation, or any company, to a contractor for the execution of work under a contract are subject to withholding tax, as are payments by a contractor to a subcontractor. No withholding is required, however, on a payment to a subcontractor by a contractor who is an individual or a Hindu undivided family. Also, no withholding is required on payments to a contractor or a subcontractor if the contract amount does not exceed Rs. 5,000.

On royalties and similar payments, withholding is required only if the recipient is a nonresident. For the rates of withholding taxes, see Rate Tables.

5.03 Payment of Tax Withheld

Taxes withheld must be paid to the government within seven days following the date of withholding, except that taxes withheld on interest, insurance commissions, and payments to contractors and subcontractors may be paid within seven days from the last day of the month in which the withholding took place. Failure to withhold tax, or to pay the taxes withheld to the government when due, results in interest charges of 12% per year and is subject to a penalty that may amount to 100% of the unpaid withholding tax.

Employers must file an information return by April 30 of each year. This return states the total taxable salary paid to each employee and the tax withheld during the previous year ending on March 31. Information returns must also be filed periodically in respect of all taxes withheld and paid over to the government.

Income Subject to Tax

6.01 The Nature of Income—Nontaxables

The Indian Income Tax Act does not define "income." There are different classes of income with specific provisions for determining the income and allowable deductions within each class. There are also detailed provisions concerning the place of receipt and the source of income (2.03).

The Act, however, states that a resident is taxable on income from all sources inside and outside India, while a nonresident is taxable only on income received or derived, or deemed to be received or derived, in India. A not ordinarily resident individual is taxable as a nonresident, but he is also subject to tax on income from a business or profession controlled from India even though carried on outside India. The Act also enumerates items of income that are not includable in "total income" and are nontaxable. In addition, certain exemptions in the nature of tax incentives or concessions are available for specific periods (2.05 and 2.06).

Agricultural income is exempt from income tax under the Income Tax Act, but is taxed under the Agricultural Income Tax Act, enacted by many of the states (13.05). Gifts or bequests do not constitute income. These are, however, subject to gift tax or estate tax (Chapter 15). See 3.01 for the aggregation of agricultural income in determining income tax rates. Some other items not included in income and not taxable are:

(a) Termination pay and gratuity within limits received by an employee upon discharge, retirement, or death (10.05).

(b) Payment in commutation of pension benefits within limits received by an employee.

(c) The accumulated balance received from an approved provident fund by an employee on his retirement (12.01).

(d) Interest on certain investments and deposits under saving schemes (6.03).

(e) Life insurance proceeds (6.07).

(f) Gain from sales of personal and household effects, certain agricultural lands, and certain government bonds (6.05).

(g) Income earned by a nonresident of Indian nationality or Indian origin on units of Unit Trust of India purchased out of funds remitted from abroad or held in the nonresident (external) account under the foreign exchange regulations (2.06).

The following types of income are specifically regarded as taxable income:

(a) Winnings from lotteries, crossword puzzles, races, card games, other games, and other types of betting and gambling.

(b) Income receipts of a casual and nonrecurring nature.

(c) Voluntary contributions received by a charitable or religious trust, not being contributions to the corpus of the trust.

(d) Compensation received by a taxpayer in respect of the vesting in the government of the management of any property or business.

For corporate taxpayers, all lottery winnings are taxable. For noncorporate taxpayers, a specified portion of lottery winnings is deductible in computing taxable income. The deduction allowed is 100% of the winnings when the total income does not exceed Rs. 10,000. In other cases, the first Rs. 5,000 of the winnings and 50% of any excess over Rs. 5,000 is deductible from total income.

The first Rs. 1,000 of the aggregate income of a casual and nonrecurring nature that are not capital gains, do not arise from business, are not additional compensation to any employee, and are other than lottery winnings, are exempt from tax.

6.02 Business Income

Generally, the income or loss from a business is determined from the accounting records, with such modifications as are necessary to reflect tax principles. The Act contains specific provisions for deductible and nondeductible business expenses, depreciation allowances, and other allowable deductions (Chapter 7). Income must be determined separately for separate businesses, even though they may be owned by the same individual.

Shipping Income of Nonresidents. The taxable business income of a nonresident engaged in the operation of ships is deemed to be 7.5% of the aggregate of:

(a) Amounts received in India or elsewhere for carrying passengers or goods shipped from an Indian port; and

(b) Amounts received or deemed to be received in India for carrying passengers or goods shipped at any port outside India.

The nonresident does not have the option to be assessed on actual income.

6.03 Interest Income

Interest income, in general, is taxable. All interest paid by the government is deemed to be derived from an Indian source and is taxable. Interest paid on moneys borrowed and used for a business or profes-

sion carried on in India, or for earning income from any source in India, is also deemed to be derived by the recipient from Indian sources, regardless of the source of loan or the place of payment. However, there are a number of exceptions to these rules. Some exceptions apply to all taxpayers, while others are limited to loans from foreign sources.

Interest on National Plan Certificates, Post Office National Certificates, Post Office Cumulative Time Deposits, and similar government obligations is exempt from tax. Interest paid by the government or a local authority on money borrowed from sources outside India is also exempt.

Interest paid by an industrial undertaking in India is exempt if it is paid on loans from foreign financial institutions that have been approved by the government, or on foreign loans for the purchase abroad of plant and machinery or raw material, or on other foreign currency loans approved by the government, to the extent that the rate of interest does not exceed the rate approved by the government. Also exempt is interest on bank deposits maintained in India by a nonresident in a nonresident (external) account under foreign exchange regulations. For an individual or a Hindu undivided family, interest from the following sources is tax exempt to the extent of Rs. 3,000 per year: interest on government securities, on deposits with banks and on specified other deposits, on debentures; and the exemption of Rs. 3,000 also includes dividends from domestic companies and Unit Trust of India. An additional amount up to Rs. 2,000 is exempt in respect of dividends from Unit Trust of India not covered by the Rs. 3,000 exemption.

6.04 Dividends

Dividends received from domestic and foreign corporations fall within the category of "income from other sources." Dividends from domestic corporations are subject to income tax even though paid outside India. Collection charges paid to obtain the dividends, and interest on loans used to purchase the shares, are deductible from the gross dividend in computing taxable dividend income. However, this deduction is not allowed to a foreign company.

Domestic corporate shareholders receiving dividends from another domestic corporation are entitled to a percentage deduction in computing taxable income. The deduction allowed and the remaining taxable portion of such intercorporate dividends are as follows:

	Deduction Allowed	**Taxable Percentage**
Dividends from a company formed after February 28, 1975 and engaged in the manufacture of specified articles (Appendix C; Items 2 to 4, 7 to 15, 17, 18, 23, 24, 26, 27 and 29, excluding alloy, malleable and S.G. iron castings, and refractories)	100%	None
Other dividends	60%	40%

Dividend income received by a foreign company is taxed at the flat rate of 25% (Rate Tables).

An Indian company is exempt from tax on dividends received in or brought into India in convertible foreign exchange from a foreign corporation on shares allotted to the Indian company in connection with patents, know-how, processes, or technical services furnished to the foreign corporation and approved by the government (2.06).

For dividends and certain interest exempted from tax up to Rs. 3,000 for individuals and Hindu undivided families, see 6.03. The following dividends are entirely tax exempt:

(a) Dividends paid out of tax-exempt income by corporations engaged in new industrial undertakings, or operating new cold storage plants, hotels, or ships, provided the manufacture commenced or the operations started before April 1, 1976 (2.05).

(b) Stock dividends.

When bonus shares are sold, a taxable capital gain may result. See 9.07 for the taxability of distributions on liquidation of a corporation.

6.05 Capital Gains and Losses

Gains from the transfer of capital assets are generally taxable. Transfer includes the sale, exchange, or relinquishment of an asset, the extinguishment of any rights therein, or the compulsory acquisition thereof under any law.

Capital asset means any property, except the following: inventory, personal belongings (including an automobile and furniture for personal use, but excluding jewelry), agricultural land, and gold bonds

of the central government maturing in 1977 and 1980. However, agricultural land situated in urban areas having a population of 10,000 or more and in specified adjoining areas is considered a capital asset.

Capital gains or losses represent the difference beween the cost of the capital asset, increased by the cost of improvements and expenditures connected with the transfer, and the consideration received. For assets acquired prior to January 1, 1964, the taxpayer may use as cost of the asset its fair market value on January 1, 1964. Moreover, the Income Tax Officer may substitute the fair market value of the asset at the date of transfer for the consideration reported by the taxpayer, if the former exceeds the latter by 15% or more. The only exceptions are when the asset is transferred to the government, and when the consideration received is determined or approved by the government or the Reserve Bank of India.

Capital gains and losses are divided into short-term and long-term. The long-term holding period is three years.

Special tax rates apply to long-term capital gains realized by corporations (Rate Tables). For taxpayers other than corporations, only a portion of long-term capital gains is liable to tax. This is provided by a deduction in computing taxable income of a specified proportion of the long-term gains included in total income. The deduction is 100% of the long-term gains when the total income does not exceed Rs. 10,000. In other cases, the first Rs. 5,000 of long-term gains is deducted in full from total income, and any excess over Rs. 5,000 is deducted to the extent of 25% of the gains on land and buildings and 40% of other long-term gains. For this computation, the first Rs. 5,000 is considered as gains on land and buildings to the extent of such gains, and any excess as other long-term gains.

Short-term capital gains are treated as ordinary income for tax purposes.

Long-term capital losses offset long-term capital gains. Any net long-term capital losses (except losses of an individual not exceeding Rs. 5,000) may be carried over four years and used only to offset long- term capital gains realized during that period. The taxpayer has a limited option to offset losses under other classes of income against long-term capital gains (7.08).

Short-term capital losses offset first short-term capital gains, then other classes of income, and finally long-term capital gains. Any remaining short-term capital loss may be carried over eight years and used only to offset short-term capital gains realized during that period.

Tax relief is given to corporations that realize a capital gain upon removal of their industrial operations from an overcrowded urban area with the approval of the Central Board of Direct Taxes. Tax credit certificates (2.05) are issued in the amount of the capital gains tax; a proportionately lesser credit is allowed if the cost of moving and acquiring land and buildings in a new area within three years is less than the realized capital gain.

No taxable capital gain results from the transfer of property between a parent and a 100% owned subsidiary company, or from the transfer of property between two companies in a merger or reorganization if the transferee is an Indian company. However, a liquidation of a corporation may result in a capital gain as well as in dividend income (9.07).

Capital gains on the transfer of residential buildings are tax exempt if the consideration does not exceed Rs. 25,000 and if the total value of land and buildings owned by the transferor does not exceed Rs. 50,000.

The tax on certain capital gains may be postponed if the assets are replaced by similar assets within specified time limits. The time limit for property used as a residence is one to two years, and for agricultural land in municipal or urban areas it is two years. When industrial land and buildings are subject to a compulsory acquisition, the time limit is three years. The tax is avoided completely if the replacement assets are held more than three years.

The tax on any long-term capital gains can also be avoided completely, if the taxpayer invests the net value of consideration realized on the transfer of the long-term capital asset in any specified assets within six months from the date of the transfer and holds the new investment more than three years. The specified assets are—in a case where the long-term capital asset is transferred before March 1, 1979, government securities, units of Unit Trust of India, deposits with State Bank, nationalized banks or cooperative banks, and certain specified debentures and equity shares of companies; in a case where the long-term capital asset is transferred after February 28, 1979, National Rural Development Bonds issued by the government.

6.06 Income from Rentals, Royalties, Patents, Copyrights, Etc.

Rental Income from Real Property. The rental value of buildings not used in the taxpayer's trade or business is taxable under the category "rental from real property," whether the building is occupied by the owner or rented to others. Deductions are allowed for repairs (a lump sum of one-sixth of the rental value), insurance, interest on capital

borrowed for costs related to the property, ground rents, taxes, rent collection charges, and unrealizable rent. An allowance is granted for a vacancy period of rental property. No deduction is allowed for depreciation on buildings that are not used in the taxpayer's trade or business.

When real property is occupied by its owner, the rental value is reduced by the lesser of 50% of such value or Rs. 1,800. The rental value is further limited to 10% of the taxpayer's total income, without including the income from the self-occupied property.

Royalties and Technical Service Fees. Royalties and fees for technical services are treated either as business income or, for a taxpayer not engaged in business activities, as income from other sources. The term "royalties" includes lump-sum or periodical payments for the transfer or grant of rights in or for the use of any patent, invention, model, design, secret formula or process, trademark, copyright, or similar property. It also includes payments for the imparting of technical, industrial, commercial, or scientific know-how. Payments, whether lump sum or periodical, for managerial, technical, or consultancy services are termed fees for technical services.

Royalties and Technical Service Fees Received by Residents. Royalties and fees for technical services received by residents are generally taxable and the related expenses are deductible in the computation of net taxable income. Royalties and fees received in, or brought into, India in convertible foreign exchange by an Indian company from any foreign enterprise or from the government of a foreign state, under an agreement approved by the Central Board of Direct Taxes, are exempt from income tax (2.06). On royalties and fees received by an Indian company from a concern doing business in India, under an agreement approved by the Central Board of Direct Taxes, 40% of such income is deductible so that only 60% is subject to tax.

Royalties and Technical Service Fees Received by Nonresidents. Royalties and fees for technical services payable by the government are deemed to be derived from Indian sources and the nonresident recipient is taxed. Royalties and fees payable by a resident or a nonresident are also deemed to be derived from Indian sources and are taxed if the rights, property, or information for which the royalties are paid, or the services for which the fees are paid, are used or utilized by the person making the payment for the purpose of a business or profession carried on by him in India or in earning income from any source in India. The place of transfer, grant, performance, or receipt is irrelevant. This rule also applies to lump-sum payments for the

transfer of know-how or the rendering of technical services outside India. The exceptions to this rule are:

(1) a lump-sum royalty received outside India for the transfer of know-how outside India under an agreement made before April 1, 1976, and approved by the government; in such case, the nonresident recipient may not be taxed on the lump-sum royalty;

(2) fees for technical services, received outside India by a nonresident under an agreement made before April 1, 1976, and approved by the government; in such case, only fees to the extent related to services rendered in India are deemed to be derived from Indian source.

For a foreign company, no deduction is allowed for expenses if the royalty or fees for technical services are received under an agreement made with the Indian concern after March 31, 1976. If received under an agreement made before April 1, 1976, actual expenses incurred may be deducted, subject to a maximum deduction of 20% of the gross receipts. Reduced tax rates, however, apply to royalties and fees for technical services earned by foreign corporations (3.03).

6.07 Insurance Proceeds and Annuities

Insurance received under a policy relating to trading assets is taxable, as are the proceeds under a policy insuring against loss of profits. However, life insurance proceeds and lump-sum receipts under a personal accident or disability policy are not taxable. All annuities, including an annuity purchased under a contract with a life insurance company, are taxable as income.

Deduction Items

7.01 Business Expenses

The income tax laws provide generally for the deduction of expenses wholly or exclusively incurred for the purposes of a business or profession. In addition, the law permits the deduction of certain items, some of which may not be deductible under the general provision. These include preoperation expenses and scientific research expenditures. Certain other expenditures are not deductible even though incurred for business purposes. Any payment for goods, services, or facilities to a relative or associate concern must not be excessive or unreasonable. Payments in excess of Rs. 2,500 must generally be made by check or bank draft to be deductible. Capital expenditures and expenditures not related to business are not deductible unless expressly permitted.

Preoperation Expenses. Two types of expenses incurred by Indian companies and resident individuals before business starts are amortizable at the rate of 10% a year for ten years. The types of amortizable expenses are:

(1) Those for new facilities and the expansion of existing facilities. This includes feasibility and project reports, market surveys, and engineering services, whether performed by the taxpayer or by approved professional concerns.

(2) Those for the costs of issuing shares and debentures, and other costs of incorporating a company.

The amortization period for both types of expenses begins when the unit starts operating, or the expansion is complete, or business commences. The amortization is subject to a limiting factor: the annual charge cannot exceed 2½% of the cost of the project or, at the option of the company, 2½% of the capital employed in the company, which includes share capital, debentures, and long-term capital raised for purposes of the new or enlarged facility.

If the business of the company is transferred by merger during the ten-year period, the successor company is entitled to deduct the remaining amortization (9.07).

Scientific Research Expenditures. Research and development expenses of the taxpayer's business and contributions for research purposes to specifically recognized institutions or accredited universities are fully deductible in the year incurred. In the three years preceding the commencement of business, salaries of personnel engaged in scientific research related to the taxpayer's business and the costs of materials used in such scientific research are allowed as deductions in the year of commencement of business.

Capital assets acquired for scientific (including agricultural) research may be written off in full in the year acquired. A weighted deduction is allowed of one and one-third times the contributions by a taxpayer to recognized and accredited universities for specially approved scientific research programs that may, but need not, be related to the taxpayer's business.

Other Weighted Deductions. Export market promotion expenses and certain expenses incurred by agri-based industries for agricultural development are also entitled to weighted deductions (2.06).

Deductions for Expenditure Not Related to Business. For corporations and cooperative societies, expenditures incurred on approved programs of rural development are allowed as deductions. Payments made to approved institutions set up for executing programs of rural development or for training of persons for implementation of such programs are also allowed as deductions from business income for all taxpayers (2.06).

7.02 Depreciation

Depreciation is allowed for buildings, machinery, and equipment owned by the taxpayer and utilized in the trade or business. Capital expenditures for improving or expanding rented buildings are also depreciable. No depreciation is allowed, however, on foreign manufactured motor cars acquired after February 28, 1975, except when used for rentals to tourists.

Authority has been delegated to the Central Board of Direct Taxes (1.02) to determine the depreciation rates for the various types of assets. Appendix B lists the rates for the most important categories of assets. These rates are allowed in full if the asset is in use on the last day of the accounting year.

Items of machinery and equipment that cost Rs. 750 or less may be written off in the year they are first used. See 7.01 for the writeoff of capital assets acquired for scientific research. Corporate expenditures of a capital nature for the purpose of promoting family planning among employees are deductible over a period of five years.

Actual cost is the basis for depreciation. When the rupee equivalent of foreign liabilities incurred to acquire depreciable assets increases or decreases as a result of foreign exchange fluctuations, the cost for depreciation purposes must be correspondingly increased or decreased. However, no adjustment is made of the investment allowance. (See later in this section.)

Depreciation Methods. The declining-balance method is the only permissible method of depreciation, except for ocean-going ships, where the straight-line method of depreciation is allowed.

Initial Depreciation. An initial depreciation of 40% is allowed on the cost of new buildings constructed for homes or for the welfare of employees whose annual earnings are not more than Rs. 10,000. A similar initial depreciation allowance of 25% is allowed on the cost of new hotels constructed by an Indian company for its own use, if approved by the government.

Initial depreciation allowances are deductible only in the first year. They are in addition to normal depreciation and do not reduce the remaining cost basis for purposes of computing normal depreciation. Total depreciation allowances over the years cannot exceed actual cost. Thus, the initial depreciation allowances only accelerate the rate of depreciation.

Extra-Shift Depreciation. For certain kinds of machinery utilized for more than one shift, the depreciation allowance may be increased. For double shifts, the normal allowance for depreciation is increased by 50%. The increase is 100% for three shifts. The computation of this additional allowance is based on the actual number of extra-shift days compared with the normal number of working days during the year. The normal number of working days is deemed to be the greater of actual working days and 240 days (180 for companies whose work is seasonal).

Investment Allowances. A one-time allowance called "investment allowance" is granted for new ships or aircraft acquired after March 31, 1976, by a taxpayer operating ships or aircraft, and for new machinery or equipment installed after that date by all industrial undertakings except those engaged in low-priority industries (Appendix E). A small-scale industrial undertaking is, however, eligible for investment allowance even if engaged in manufacturing low-priority items (Appendix E). A used ship or aircraft acquired from a non-resident and imports of used machinery or equipment not previously subject to depreciation for Indian tax purposes are treated as new for this allowance. A taxpayer is entitled to this allowance at the time the eligible property is placed in service. The allowance is 25% of the eligible property's cost and is deductible from taxable income.
For industries [other than low-priority industries (Appendix E)] using any technology or know-how developed in government laboratories, by public-sector companies, by universities, or by an institution recognized by prescribed authority, the allowance is 35% of the cost of the eligible property installed between July 1, 1977 and March 31, 1982, if certain conditions are met. The basis of the property for normal and extra-shift depreciation is not reduced by this investment allowance. Thus, depreciation in excess of cost is permissible for eligible property.

The investment allowance is granted on condition that the assets are exclusively used in the taxpayer's business and are not disposed of for eight years, except that the assets may be sold to the government or to a government corporation, or transferred in a merger or reorganization (9.07). In addition, 75% (50% for ships) of the allowance must be transferred to a restricted reserve account that must be utilized to acquire new ships or aircraft or machinery or equipment within ten years. Pending such an acquisition, the reserve must be utilized for the conduct of the taxpayer's business. No part of this reserve may be used during the ten-year period for dividend distributions or for investment outside India. If these conditions are not satisfied, the tax for the year the allowance was granted is recomputed.

A similar allowance called "development allowance" is granted for the cost of planting tea bushes in new areas. The allowance is 50% of the cost of planting, including land preparation, but subject to a ceiling based on the area covered, and the upkeep for a four-year period. The allowance is granted in two stages: (1) for the costs incurred in the first year and (2) for the next three years' costs. The allowance, then, is obtained in the year following each of these stages.

One condition for grant of development allowance is that the taxpayer not dispose of the land during an eight-year period, except if the land is sold to the government or to a government corporation, or is transferred in a merger or reorganization (9.07). Another condition is that 75% of the allowance must be transferred to a restricted reserve account, which must be utilized for the conduct of the taxpayer's business and must not be used for dividend distributions or for investment outside India during a period of eight years.

An allowance called "development rebate," somewhat similar to the investment allowance, was granted on ships acquired or machinery or equipment installed prior to June 1, 1974. In a few cases, this development rebate continued to be granted on assets acquired or installed after June 1, 1974, but before certain specified dates.

Deferral of Depreciation. In India, depreciation is not mandatory. It may be deferred to later years if profits are not sufficient to absorb the allowable depreciation charge. This privilege is granted for normal, initial, and extra-shift depreciation and for investment allowances. The deferral of depreciation is unlimited in duration and may be used in whole or in part in any future year, as long as the ownership of the business does not change. However, the investment allowance is lost if not taken within eight years from the date the asset was placed in service (7.08).

If an industrial company or a company owning ships that is not viable financially merges with another company, the successor may be entitled to the deferred depreciation of the predecessor, if certain conditions are met (9.07).

Intangible Assets. Intangibles, other than patents and copyrights and wasting assets such as mines, are not depreciable or amortizable. Patents and copyrights may be written off over a period of 14 years or their remaining life, whichever is less.

Depreciation is permissible on acquired know-how that is part of a depreciable asset. In this situation, depreciation is based on the cost of the asset including the acquired know-how. Acquired process know-how embodied in documents, drawings, etc., in the form of a book is also eligible for depreciation as per the ruling of the High Courts. Supreme Court has held that payments made to a party for right to have access to his technical knowledge and research results are deductible business expenses.

Sale or Other Disposition of Depreciable Assets. A loss on a sale or other disposition of depreciable assets is deductible as final or terminal depreciation in the year of sale or other disposal. Gain (the excess of the amount received over the adjusted basis of the asset) is taxed as ordinary income to the extent of prior depreciation—similarly to recapture of depreciation in the United States. Gain in excess of the portion treated as ordinary income is taxed as a capital gain (6.05).

Rehabilitation Allowance. An industrial undertaking that ceases operations because of destruction or extensive damage to its buildings or other depreciable assets from natural calamities, riot, explosion, or enemy action is entitled to a rehabilitation allowance if it is reestablished within three years of the year of discontinuance. The allowance is 60% of the terminal depreciation allowable for the damage or destroyed depreciable assets. This 60% allowance is deductible in the year operations are reestablished.

7.03 Depletion and Other Items Attributable to Mineral Extraction

Indian companies and resident individuals are allowed to amortize expenditures incurred in prospecting for specified minerals, other than oil. Only prospecting expenditures incurred during the first year of commercial production and the four preceding years qualify for amortization. The annual deduction is 10% of the qualifying expenditure and is allowed for a period of ten years beginning with the first year of commercial production. If the full deduction is not used in any year because of a loss or inadequate income, the unused amortization may be claimed as an additional deduction in the following

years, but no carryover of unused amortization is allowed after the tenth year of commercial production. The costs of acquiring land, depreciable assets, mineral deposits, or the right to extract minerals are not considered as prospecting expenditure under this provision, and depletion allowances are not granted on these assets. If a merger occurs during the ten-year amortization period, the successor corporation is entitled to the remaining amortization (9.07).

A taxpayer in a joint venture with the central government for the exploration and extraction of oil may be entitled to depletion allowances. The agreement may specifically provide for a depletion allowance and for the deduction of surveying, prospecting, exploration, and drilling expenses.

7.04 Bad Debts

Business bad debts that become totally or partially worthless during the year may be deducted, but only on the specific charge-off method. The deduction is allowable only if the uncollectable accounts are also written off for book purposes. Additions to a reserve for bad or doubtful debts, based on estimate of probable losses, percentage of sales, or any general measurements are not deductible for tax purposes. The only exception is a reserve made by a scheduled bank in relation to advances made by its rural branches. In this case, deduction is allowed for additions to a reserve for bad or doubtful advances limited to 1½% of the aggregate average advances made by its rural branches.

7.05 Payment of Rents, Royalties and Technical Assistance Fees

Rent for the lease of real property for carrying on business activities is deductible. Rent paid by a partnership to a partner on premises owned by him is a deductible expense to the partnership and income to the partner.

Royalties for the use of patents, technical processes, know-how, copyrights, and similar annual payments are deductible, except when made by an Indian branch of a foreign company to its head office. Payments for the acquisition of intangible assets, such as know-how, are not deductible but may be subject to depreciation (7.02).

Technical assistance fees paid in connection with the fabrication or installation of machinery or plant are part of the cost of the asset on which depreciation is allowed. Fees related to the operation of the plant or manufactured products, and for other technical assistance, are deductible expenses.

7.06 Taxes

Any tax levied on the profits of a business is not deductible. Thus, income tax, surtax, and foreign income taxes are not deductible. Miscellaneous taxes such as sales, use, excise, and local property taxes are deductible as business expenses. Wealth tax is not deductible.

7.07 Interest

Interest payments on debentures or other borrowings for business purposes are generally deductible. However, for a company (other than a banking, investment, or finance company) 15% of the interest paid on deposits received or borrowings is not deductible, except for the following: interest paid on borrowings from governments, banks, specified and notified financial institutions, any other company, or any foreign source, is deductible in full. Also fully deductible are interest paid on a loan secured as prescribed from any person; on security deposits from employees, purchasing agents, and selling agents; on advances received against orders; and on moneys received as subscriptions or advance calls toward shares, stocks, secured bonds, or debentures of the company. No interest paid outside India, however, is deductible unless tax has been withheld in accordance with the requirements outlined at 5.02.

Interest on late payment of taxes is not deductible, but interest paid on loans used to pay income taxes is deductible from taxable income.

The cost of money borrowed during the construction of a plant is added to the cost of the depreciable property.

7.08 Operating Losses

Deduction from Nonbusiness Income. The provisions for absorption and carryover of losses are complicated because of the schedular concept of income taxation and the deferral of depreciation and the investment allowances.

Although a taxpayer files one annual income tax return, the income or loss of each class of income is computed separately. In the same assessment year, gains and losses of all classes of income are combined, with the exception of losses from lotteries, etc., discussed in the next paragraph, long-term capital gains and losses, and speculation business losses. In other words, all income other than long-term capital gains offsets all losses except losses from lotteries, etc., long-term capital losses, and speculation business losses. In addi-

tion, the taxpayer has the option to offset losses under any class of income (except losses from lotteries, etc., and speculation losses) against long-term capital gains realized in the same year. Speculation business losses may be offset only against speculation business income.

Losses from lotteries, crossword puzzles, races, card games, other games, and other gambling methods offset only the same type of winnings in the same assessment year. No other income can be set off against these losses.

In offsetting losses against income of the same year, deferred depreciation of past years is deemed to be current depreciation. Therefore, unlike carryover business losses, discussed next, such deferred depreciation can be used to offset other classes of income unless it is part of a speculation loss.

A loss incurred in maintaining race horses may be carried over against racing income of the four succeeding taxable years, provided the racing activity is continued.

Carryover and Carryback of Business Losses. A business loss, to the extent not offset by nonbusiness income or capital gains realized during the same assessment year, may be carried over against business income of the eight succeeding taxable years, provided the business in which the loss was incurred is still carried on. A speculation business loss may be carried over for the same period, but it can be used only to offset speculation business income.

Losses may not be carried back. Net business income, before investment allowances but after deducting losses sustained the same assessment year, is first offset by business losses carried over from prior assessment years, then by deferred depreciation, any development rebate carried over from prior years, any development allowance carried over from prior years, any development allowance for the same assessment year, any investment allowance carried over from prior years, and finally by any investment allowance for the same assessment year. This order of priority must be followed.

For a rehabilitated industrial undertaking (7.02), the eight-year period for carrying over any unabsorbed losses of the year of discontinuance starts with the year operations begin again. See 9.07 for the effect on loss carryovers of changes in ownership of certain corporations, and of mergers.

If the distributive share of a partner in a registered partnership (2.02) is a loss, it may be offset against other income in the same year or carried forward for setoff against the distributive share of income of the succeeding eight years of the same partnership. In an unregistered partnership (2.02), the partners are not allowed to offset the loss against their other income of any year. Only the partnership may carry the loss forward and offset it against income of the succeeding eight years.

For carryover of long-term and short-term capital losses, see 6.05.

7.09 Worthless Stocks, Securities, and Other Assets

Losses on worthless stocks and other securities are capital losses and can be offset only against capital gains (6.05), except that investment companies may treat them as business losses. If a depreciable asset becomes worthless, a deduction is allowed for the remaining undepreciated cost (7.02).

7.10 Casualty Losses

There is no specific provision concerning casualty losses. Inventory lost by fire, storm, shipwreck, or other casualty is deductible. A casualty loss involving depreciable assets is treated as a loss on the sale or disposition of depreciable assets (7.02). If a casualty loss involves a nondepreciable asset, no loss is allowed, but a sale of such asset is subject to capital-loss treatment (6.05).

7.11 Charitable Contributions

Charitable contributions are generally not deductible. A full or partial deduction is allowed, however, for contributions in cash aggregating at least Rs. 250 to certain institutions and funds that fulfill certain conditions. The deduction allowed is 100% of qualifying contributions for promotion of family planning, and 50% of other qualifying contributions. Qualifying contributions are limited to the lesser of 10% of the taxpayer's total income or Rs. 500,000, except for contributions to the National Defense Fund, the Nehru Memorial Fund, the Prime Minister's Drought Relief Fund and the Prime Minister's National Relief Fund.

7.12 Advertising, Entertainment, and Travel Expenses

Expenditure on advertising in a souvenir, brochure, or the like, published by a political party, is not deductible. Advertising expenses on presentation articles, in excess of a ceiling of Rs. 50 per article, are also not deductible. The aggregate expenditure incurred on other

advertising, publicity, and sales promotion in India, adjusted by excluding certain specified expenses, is disallowed to the extent as follows:

	Extent of Disallowance of the Adjusted Expenditure
If such adjusted expenditure does not exceed ¼% of the turnover or gross receipts of the business	10%
If such adjusted expenditure exceeds ¼%, but does not exceed ½% of the turnover or gross receipts of the business	12½%
If such adjusted expenditure exceeds ½% of the turnover or gross receipts of the business	15%

No disallowance, however, is made if the adjusted expenditure does not exceed Rs. 40,000/-. Specified expenses excluded for determining the adjusted expenditure include advertising in small newspapers; salaries and other compensation of employees engaged in and maintenance of office for advertising, publicity, or sales promotion; sales conference, trade fair and exhibition expenses; and publication of journals, catalogues or price lists. A new industrial undertaking is not subject to this disallowance for a period of three years beginning with the first year in which manufacture commences.

Entertainment expenses are deductible from income year 1976-1977 on a decreasing basis as taxable income from business before such expenses, and before investment allowances (7.02), goes up. The maximum deduction is limited to the smaller of actual expenses or the following: ½% of the first Rs. 1,000,000 of taxable income with a minimum allowance of Rs. 5,000; ¼% of the next Rs. 4,000,000, and ⅛% of such income in excess of Rs. 5,000,000. The maximum deduction is Rs. 30,000.

Expenditures on maintenance of a guesthouse are not deductible. However, the expenses of a guesthouse maintained as a vacation home for the exclusive use of employees are deductible, provided the taxpayer has at least 100 employees.

7.13 Legal Expenses

Legal expenses wholly and exclusively incurred for business purposes are deductible. Legal expenses incurred in connection with the acquisition of a capital asset are a capital expenditure, and must be added to the cost of the asset. Depreciation may be claimed if the

asset is depreciable. The deduction for expenses related to the preparation of tax returns, the determination of tax liability, and income tax appeals is limited to Rs. 5,000.

7.14 Insurance

A deduction is allowed for the cost of insuring against risk of damage or destruction by fire, theft, etc., of business assets and properties, and for other types of business risks. An employer may also deduct premiums for accident and disability insurance on his employees.

7.15 Reserves

No deduction is granted for additions to any type of reserve, except in cases indicated in the next paragraph.

For insurance companies, reserves for the depreciation of investments and for unexpired risks are deductible. Approved financial corporations engaged in providing long-term finance for industrial or agricultural development in India, and approved public companies formed and registered in India with the main object of providing long-term finance for residential housing in the country, are entitled to a deduction limited to 40% of the taxable income, for amounts transferred by them to a special reserve account. However, if the aggregate of transfers made from year to year exceeds paid-up share capital of the corporation, no deduction is allowed. For scheduled banks, addition to reserve for bad or doubtful debts in relation to their rural advances is deductible within certain limits (7.04).

7.16 Nondeductibles

Monthly salaries in excess of Rs. 5,000 of an employee in India or a director are not deductible. Moreover, for an employee whose annual salary exceeds Rs. 7,500, or a director, the cost of fringe benefits in excess of the lesser of 20% of the salary and Rs. 1,000 a month is nondeductible. Thus, the deduction for monthly salary and fringe benefits is subject to an overall ceiling of Rs. 6,000 for any one employee or director. However, these limitations do not apply to certain foreign technicians (10.05). Fees paid for services rendered by a person who at any time during the previous two years was the taxpayer's employee are deductible only to the extent of Rs. 60,000. Other items not deductible for Indian tax purposes are:

- Fines and penalties
- Employee bonuses in excess of the amount payable under the Payment of Bonus Act, 1965

- Provisions for accrued gratuity or superannuation benefits payable to employees on their retirement. [Provisions for a gratuity that has become payable and contributions to an approved gratuity or superannuation fund are deductible (Chapter 12)] .

Beginning with assessment year 1977-1978 (income year 1976-1977) for a nonresident, including a foreign company, deductible head office expenditure is restricted to the lowest of the following three amounts:

(1) 5% of the total income of the year, before the deduction of deferred depreciation and investment allowances. If there is a loss, 5% of the average income of the immediately preceding three years;

(2) Average of head office expenditure allowed in the three assessment years 1974-1975 to 1976-1977 (income years 1973-1974 to 1975-1976);

(3) Actual head office expenditure incurred during the year attributable to the business in India.

Thus, a nonresident to whom no deduction for head office expenditure has been allowed for any of the three income years 1973-1974 to 1975-1976, or who has started his business in India for the first time in or after the income year 1976-1977, will not be allowed deduction for any head office expenditure.

For the above purposes, head office expenditure means executive and general administrative expenditure incurred by the nonresident taxpayer outside India.

Accounting for Income and Expenses

8.01 Tax Accounting Generally

Income from a trade or business is generally determined on the accrual basis, although the cash-basis method is permissible and is ordinarily adopted by professional firms. The main requirements are that the method of accounting be consistently followed and clearly reflect income.

Other methods, such as a system partly on the cash basis and partly on the accrual basis, are permissible, but the taxpayer must obtain the consent of the tax administration.

8.02 Accrual of Business Income and Expenses

Business income must be accrued in the year in which all the facts establishing the taxpayer's right thereto have occurred. This is true even though the amount might be uncertain. Similarly, expenses must be accrued in the year incurred or in which the liability has arisen. The accrual method excludes any deduction for a contested liability or disputed right. In these situations, the date of settlement is controlling.

8.03 Long-Term Contracts and Instalment Sales

The percentage-of-completion method of accounting is commonly employed by contractors and builders. The completed-contract method is permissible upon approval by the tax administration. The same method must be followed consistently for all contracts of this nature.

For instalment sales contracts, recognition of income as instalments are collected is permissible for tax purposes if such treatment is consistently followed by the taxpayer for book purposes.

8.04 Inventories

Inventory is commonly valued at the lower of cost or market. The Indian Income Tax Act does not stipulate a specific method for determining the cost of inventory, but any method adopted by a taxpayer must be consistently followed. LIFO or the base-stock method are not permitted.

"Cost" is not defined. Here again, any reasonable concept of cost sanctioned by accounting practice may be adopted by the taxpayer and, once adopted, must be consistently followed.

Provisions Peculiar to Corporations

9.01 Resident and Nonresident Corporations Compared

The differences between resident and nonresident corporations, as well as between domestic and foreign corporations, are explained at 2.02. A resident corporation is taxed on its worldwide income, while a nonresident corporation is assessed only on its income received or derived, or deemed to be received or derived, in India. The income tax rate on foreign corporations is higher than on domestic companies because distributions by the latter are subject to Indian taxation (6.02), while there is usually no Indian tax liability on distributions by foreign corporations. Either no deduction or a limited deduction is allowed to a foreign corporation for expenditures incurred in earning royalties, technical service fees, and dividends. However, reduced rates of tax apply to such income (6.06 and 6.04). The accumulated earnings tax imposed on certain domestic companies does not apply to a foreign corporation that has not made arrangements for the payment of dividends in India. Certain tax incentives granted to corporations are not available to nonresident corporations (2.05 and 2.06).

9.02 Accumulated Earnings Tax and Surtax

Accumulated Earnings Tax. An accumulated earnings tax is levied on domestic companies. The tax rate applied to the undistributed income is 50% for investment corporations, 37% for trading corporations, and 25% for other corporations. Undistributed income means distributable income reduced by the distributions to shareholders within 12 months of the end of the previous year. Distributable income means taxable income reduced by the income tax, the surtax (next heading) and certain business expenditures not deductible for income tax purposes. The tax is imposed only if the taxpayer, within 12 months of the end of the previous year, has not made statutory dividend distributions of 90% of the distributable income if the taxpayer is an investment corporation, 45% if a consulting service corporation, and 60% generally in other situations. For corporations, other than investment or consulting service corporations, the statutory distribution requirement is increased to 90% if the accumulated earnings and reserves exceed the higher of a certain percentage of the aggregate of paid-up capital and loans from shareholders, or the same percentage of the book value of the fixed assets. The percentage is 100% for a trading corporation and 200% for a nontrading corporation. When a corporation is active in more than one category, the required statutory dividend distribution percentages apply to the income from each category.

The following corporations are exempt from the accumulated earnings tax:

- A corporation in which the public is substantially interested (2.02), and a 100% subsidiary of such a corporation.
- An Indian industrial corporation (2.02).
- An Indian corporation engaged mainly in the export business, or in construction or service activities outside India.
- A foreign corporation that has not made arrangements for the payment of dividends in India.

Also exempted are corporations with accumulated losses or whose realized income is too small to warrant the statutory distribution. In hardship cases upon application, the Central Board of Direct Taxes may reduce by not more than 20% the percentage of income required to be distributed.

Surtax. A speciat surtax is imposed on excess profits of all corporations. The tax is assessed on chargeable profits in excess of the greater of 15% of capital or Rs. 200,000. The surtax is imposed at the rate of 25% on excess profits equal to 5% of the corporation's capital, and at the rate of 40% on the balance. However, for a domestic corporation in which the public is substantially interested and whose paid-up in cash share capital exceeds 25% of the capital computed for surtax purposes, the aggregate of basic income tax, surcharge, and surtax may not exceed 70% of taxable income.

This tax is in addition to the income tax, and the corporation must file a separate return for surtax purposes before September 30 of the assessment year. The tax is payable separately and, like the income tax, it is based on the previous year's taxable income.

In determining chargeable profits subject to the surtax, the starting point is taxable income for income tax purposes. The exemption of certain income of new industrial undertakings (2.05) is allowable for surtax as well as income tax purposes.

Certain types of income are not subject to surtax. These include: capital gains, profits on depreciable assets, interest on tax-free securities, dividends from domestic corporations, and royalties from the government, local authorities, or an Indian concern. In addition, nonresident corporations are entitled to exclude all interest income and technical service fees received from the government, local authorities, or an Indian concern.

From the income so determined, income tax itself is deductible, except for any portion allocable to capital gains and dividends exempt from the surtax. The surtax itself and the accumulated earnings tax are not deductible.

The taxable income so adjusted is subject to surtax to the extent that such income exceeds the higher of Rs. 200,000 or 15% of the corporation's capital. For this purpose, capital consists of the paid-up share capital, paid-in surplus, the investment allowance reserves, and other reserves not created for deductible expenses. Capital is reduced by the cost of any shares or other investments whose income is exempt from surtax. The capital is computed at the beginning of the previous year, and is increased or decreased for changes occurring in that year. In the case of a nonresident corporation, its capital is the same percentage of worldwide capital as its income from Indian sources is of its worldwide income.

9.03 Affiliated Corporations

Each corporation is a separate entity for tax purposes. There are no provisions for filing a consolidated tax return by a parent corporation and its subsidiaries, or for aggregating profits and losses of related corporations.

If a corporation has a "substantial interest" in the taxpayer corporation, any payments by the taxpayer corporation to the former corporation considered excessive or unreasonable may not be deductible by the taxpayer corporation. Twenty percent or more of the voting power is deemed to constitute a substantial interest.

9.04 Investment Holding Corporations

Investment holding corporations are taxable in the same manner as corporations generally. An investment company may hold securities for the purpose of earning dividends and interest, or the securities may constitute stock-in-trade. In the former case, the profit or loss on sale of investments is treated as capital gain or loss and in the latter as business income or loss.

9.05 Unit Trusts and Investment Trusts

The Unit Trust of India, formed under the Unit Trust of India Act, makes diversified security investments to obtain investment income and realize capital gains on behalf of its unitholders. Annual distributions are made to unitholders. The Unit Trust of India is exempt from tax on its income. For tax withholding and taxation of distributions by the Unit Trust of India, see 5.02 and 6.02.

Other investment trusts are taxable in the same manner as taxpayers generally.

9.06 Special Type Entities

The income tax laws contain provisions that apply to special types of organizations. These provisions are discussed in the paragraphs which follow on page 51.

Insurance Corporations. Special rules apply to determine the income of insurance businesses, and particularly complex rules apply to life insurance companies. However, these provisions are not important for purposes of this booklet, as insurance in India is entirely controlled by nationalized institutions.

Cooperative Societies. The profits of cooperative societies are taxable at much lower rates than apply to corporations (Rate Tables). Moreover, the profits of a cooperative society attributable to the following activities are not taxable: banking or providing credit facilities to its members, cottage industry, supplying agricultural inputs and the processing or marketing of agricultural produce of its members, and fishing activities of its members. Also exempt from tax are income of a society from supplying milk to a federal milk cooperative society, to the government, or to a government corporation supplying milk to the public, or from letting out warehouses for storage and marketing of commodities, or from investments in other cooperative societies. In addition, the income of a cooperative society engaged in activities other than the above is exempt up to Rs. 20,000. From assessment year 1980-1981 for a consumer's cooperative society the exemption is up to Rs. 40,000.

Charitable or Religious Trusts. Income of a public charitable or religious trust from property held for charitable and religious purposes is generally taxable to the extent not applied to the object of the trust in India during the previous year. For this purpose, voluntary contributions received by a trust, not made by a donor with a specific direction that they form part of the corpus of the trust, are treated as income from property held by the trust. A trust may accumulate up to 25% of the income of the previous year for future application. Therefore, a trust is taxable only on 75% of its income to the extent not applied to charitable or religious purposes in India.

Additional accumulation of income for charitable or religious purposes at a future date is allowed, and tax exemption given on such accumulations, if conditions with regard to investments of accumulations are met. The trust must notify the Income Tax Officer in the prescribed manner specifying the purpose for which the income is to be accumulated. The period of accumulation cannot exceed 10 years.

Private charitable or religious trusts are taxable on total income in the same manner as taxpayers generally.

Clubs, Trade Associations, and Certain Funds. Clubs and trade associations that are nonprofit organizations and exist for the benefit of all members are not taxable. Income of recognized or approved provident, pension, and gratuity funds (12.01) is also not taxable.

9.07 Liquidations and Other Corporate Changes

Changes in Ownership. A corporation in which the public is not substantially interested (2.02) is entitled to carry over its prior net operating losses (7.08) only if, at the end of the previous year, not less than 51% of the stock was owned by shareholders who also owned at least 51% of the stock at the end of the loss year, unless the Income Tax Officer is satisfied that the change in ownership was not for tax avoidance purposes.

Transfers Between Parent and Subsidiary. No capital gain or loss is realized on the transfer of capital assets from a corporation to its wholly owned Indian subsidiary, or from a wholly owned subsidiary to its Indian parent corporation. The basis of the assets in the hands of the transferee remains the same as for the transferor company.

Mergers and Reorganizations. A surviving corporation, or a new corporation formed in a merger or reorganization, is entitled to the investment allowances (7.02) granted to one or more predecessors transferring assets eligible for such allowance. Such a carryover is conditioned upon the successor corporation satisfying the conditions required for the granting of this allowance.

Following a merger or reorganization, the unamortized balance of preoperation and mineral prospecting expenses (7.01 and 7.03) of a predecessor corporation may be amortized by the successor corporation over the remaining period of amortization.

If an industrial company that is not viable financially, or a company that owns ships, merges with another company, the successor corporation may be entitled to carry over any accumulated business losses not arising from speculation and any deferred depreciation of the predecessor, provided certain conditions are met and the government declares the merger to be in the public interest. For the successor corporation, the same eligibility conditions will apply in utilizing these benefits as applied to the merging company.

No capital gain or loss is realized on the transfer of capital assets in a merger or reorganization, providing the successor is an Indian corporation. The basis of the assets in the hands of the successor corporation is the same as it was for the merging company or companies.

Liquidations. Distributions upon liquidation of a corporation constitute dividend income (6.02) to the extent of accumulated earnings at the date of liquidation. However, in the case of a forced liquidation resulting from a compulsory acquisition by the government, distributions of income realized before the immediately preceding three years are not treated as dividend income.

Distributions of assets in kind by a liquidating corporation do not result in taxable capital gain to the distributing corporation. However, if the market value of the assets at the time of distribution, reduced by the amount treated as dividend income, exceeds the basis of the stock, the difference represents a capital gain for the recipient.

Provisions Peculiar to Individuals

10.01 General

Individuals are subject to personal income tax at the graduated tax rates listed in the Rate Table. Agricultural income, if any, is aggregated with taxable income for determining the appropriate income tax rate (3.01).

Generally, each spouse and minor child must report his own income in a separate individual income tax return. If, however, members of a family are partners in a partnership (other than a professional partnership), the spouse with the larger income must report in his individual income tax return the distributive shares of the other spouse and of any minor children. This rule also applies where a spouse indirectly through the medium of a trust is a partner in a partnership where the other spouse is a partner. Similarly, a spouse must include in his taxable income any income of the other spouse or minor children derived from assets he has transferred to any one of them for less than adequate consideration.

The spouse with the larger income must also include salary or other remuneration of the other spouse from a concern in which the former has a substantial interest, as well as the distributive share of a minor child who is a partner in any partnership either directly or through the medium of a trust. An exception to the inclusion of remuneration occurs if the other spouse possesses technical or professional qualifications and the remuneration derived is solely attributable to the application of the technical or professional knowledge. A substantial interest refers to a 20% or more voting power in a corporation, or a 20% or more interest in the profits of a concern held singly or jointly with relatives.

An individual must include in his taxable income any income derived by his son's wife or minor child from assets transferred after May 31, 1973, to either for less than adequate consideration.

An individual who converts his personal assets after December 31, 1969, into Hindu undivided family property, or transfers his personal assets after such date to the Hindu undivided family for less than adequate consideration, must include in his taxable income the entire income derived by the joint family from such assets.

A partner of a registered partnership must include in his individual income tax return any interest, salary, and rent paid to him by the partnership, plus his share of the remaining partnership income, and less his share of the income tax payable by the partnership. A partner of an unregistered partnership (2.02) is not taxed on his share of the partnership income, but he must aggregate his share of such income to determine the tax rate applicable to his other income.

Tax-Exempt Income. A professor, teacher, or research worker who is an Indian citizen is entitled to a deduction of 50% of his professional income earned abroad from a foreign university or other educational institution. Similarly, a resident author, playwright, artist, musician, or actor is entitled to a deduction of 25% of his professional income earned abroad and brought into India under foreign exchange regulations. See 10.05 for the exemption of salary income of certain employees. For individuals, certain dividends and interest are tax exempt (6.03 and 6.04).

10.02 Itemized Deductions

In addition to the deductible business expenses discussed in Chapter 7, some other deductions are allowed to individual taxpayers. The following items are deductible within limits that will be explained: premiums on life insurance or endowment policies, or the purchase of deferred annuities, for the taxpayer or his spouse or children, and paid out of taxable income; an employee's contributions to an approved provident or pension fund; cumulative time deposits made in a post office; subscriptions to a public provident fund scheme; and contributions for participation in a Unit-linked Insurance Plan. The limitations are, firstly, the contributions to the provident and pension funds are limited to the lesser of 20% of salary or Rs. 10,000 (12.03). Secondly, monthly cumulative time deposits are limited to Rs. 1,000 in a ten-year account. Thirdly, annual subscriptions to a public provident fund scheme are limited to Rs. 30,000. The resulting amount is combined with the insurance premiums and contributions to the Unit-linked Insurance Plan, and the total is subject to a fourth limitation of the lesser of Rs. 30,000 or 30% of the taxable income before these deductions. For an author, playwright, artist, musician, or actor, the limitation is the lesser of Rs. 50,000 or 40% of professional income. The amount so limited is deductible, for the assessment year 1979-1980, to the extent of 100% of the first Rs. 5,000, 50% of the next Rs. 5,000 and 40% of the balance. From assessment year 1980-1981, the deduction is limited to 100% of the first Rs. 5,000, 35% of the next Rs. 5,000, and 20% of the balance. Other itemized deductions that are available to all individual taxpayers are in the list which follows on page 56.

Item	Deduction
1. Charitable contributions to institutions that fulfill certain conditions—qualifying contributions generally limited to 10% of the taxpayer's income	50% of contributions; 100% if for promotion of family planning
2. Rent for personal residence in specified cities in excess of 10% of the taxpayer's income, if no rent allowance is paid by employer	Limited to lesser of Rs. 3,600 or 15% of taxable income
3. Interest paid on loans to pay income tax	Full amount
4. Expenditures for preparing tax return, determining tax liability, or tax appeal	Limited to Rs. 5,000
5. Payments made to approved scientific research institutions, or approved institutions set up for executing programs of rural development or for training of persons for that purpose (2.06)	Full amount
6. Investment made during the year from taxable income, in shares of new public companies engaged in non-low-priority industries if certain conditions are met (2.05)	Limited to lesser of Rs. 5,000 or 50% of the amount invested
Deductions Allowed to Resident Individuals	
7. Medical expenses on behalf of a dependent, under certain conditions	Up to Rs. 2,400
8. For total blindness or a permanent physical disability	Rs. 5,000

Deduction Allowed to Resident Indian Citizens

9. When income does not exceed Rs. 12,000, a deduction from taxable income for higher education expenses of a dependent child, brother, or sister, of an amount of Rs. 1,000 or, in certain cases, Rs. 500 for each such dependent. This deduction is allowed only for any two dependents.

Deduction Allowed to Resident Aliens

10. Aliens are entitled to a deduction from taxable income for education expenses of their children outside India, amounting to Rs. 1,500 for one child and Rs. 3,000 for more than one child.

For deductions allowed to a self-employed person, and for premiums paid toward retirement annuities, see 12.03, and for a special deduction allowed to employees, see 10.05.

10.03 Personal Allowances

There are no personal allowances as such in the Indian tax laws. A general exemption in the lower income brackets is built into the Rate Tables.

10.04 Resident and Nonresident Individuals Compared

The categories of individual taxpayers are residents, not ordinarily residents, and nonresidents. In addition, aliens must be distinguished from Indian citizens. These terms are defined in 2.02.

Residents are subject to Indian taxation on worldwide income, after itemized deductions. Nonresidents are subject to Indian taxation on income received or derived, or deemed to be received or derived, in India (2.03 and 6.01). Nonresidents are taxed at the same graduated rates as residents. Not ordinarily residents are generally taxable as nonresidents, but they are subject to tax on income from a business or profession controlled or carried on in India even though received or derived outside India.

See 6.03 for exempt interest received by a nonresident on bank deposits. Certain itemized deductions are not available to a nonresident (10.03).

10.05 Taxation of Employees

Salary, like other income, is taxed on the previous year's basis (2.04). Bonuses and special compensation are taxable in the year paid, regardless of when the services were actually rendered. The Commissioner of Income Tax, however, may grant such relief as is considered appropriate under the circumstances; for instance, when wages in arrears for a full year are paid, or when lump-sum payments in excess of exemptions are received from a gratuity fund (12.03). The employer must withhold the tax at the time of payment, and the employee must file an individual income tax return after the end of the year (4.01). Under certain conditions, an employee whose salary income, excluding fringe benefits, does not exceed Rs. 18,000, need not file a tax return (4.01).

Fringe Benefits. Generally, free medical services supplied to employees and their families, reimbursement of medical expenses, free refreshments supplied on the premises, recreation facilities, and the value of home leave passages do not constitute taxable income to the employees. On the other hand, rent-free accommodations, auto-

mobile allowances, and free gas, electricity, or water supplied by the employer for the employee's household generally constitute taxable income to the employee.

For rent-free accommodations that are unfurnished, the taxable value of the benefit is deemed to amount to 10% of the salary. If the fair rental value of the accommodation exceeds 20% of the salary, the amount in excess of 20% is deemed additional taxable compensation. For accommodations in Bombay, Calcutta, New Delhi, and Madras, this percentage is increased to 30%. For furnished rent-free accommodations, 10% per annum of the original cost of the furniture or, if the furniture is hired, the amount of the rental, constitutes taxable compensation to the employee. Furniture includes television sets, radios, refrigerators, air conditioners, and other household appliances. If a car is provided to an employee, the amount of additional income varies with the horsepower. The basic monthly amounts for a car are Rs. 300 or Rs. 400 if the employer pays all expenses, and Rs. 100 or Rs. 150 if personal-use expenses are paid by the employee. If a chauffeur is provided with the car, an additional Rs. 150 per month constitutes taxable compensation to the employee. Other benefits in kind are generally valued at the employer's cost.

Passage moneys paid to an employee for himself and his family for travel to his hometown or home country, during vacation or upon retirement, are tax exempt. For an employee who is an Indian citizen, the passage-money exemption is extended to travel by the employee and his family to any place in India, but the exemption is generally limited to the cost that would have been incurred for travel to his hometown.

Employers' contributions not exceeding 10% of an employee's salary to a recognized provident fund (12.01) do not constitute taxable income to the employee. Interest at a rate not exceeding 8.25% credited to an employee by a provident fund is not taxable, if it does not exceed one-third of the employee's salary.

Termination Pay and Gratuity. Gratuity received by an employee on retirement, incapacity to work, death, or discharge by the employer, not exceeding one-half month's salary for each year of completed service, and based on the average salary for the last three years, is not taxable. The maximum amount exempt is the lesser of 20 months' average salary or Rs. 30,000. A gratuity received by an employee under the Payment of Gratuity Act, 1972, is fully exempt. Termination pay or compensation for loss of employment, not exceeding the lesser of Rs. 20,000 or the amount calculated under the provisions of the Industrial Dispute Act, 1947, is also tax exempt.

The accumulated balance received from a recognized provident fund by an employee on retirement is not taxable if the accumulations were made during continuous employment for a minimum of five years.

Technician's Exemption. A technician who is an Indian citizen, rendering service outside India, for either a foreign employer or an Indian concern, under a contract of service approved by the government or the prescribed authority, can deduct 50% of his remuneration earned abroad as tax exempt, but such exemption is limited to a 36-month period.

Compensation paid to an alien who is a technician is exempt up to Rs. 4,000 a month for two years following his arrival in India, provided he has not been a resident of India in any of the four preceding years, his employment contract is approved by the central government, and he has applied for such approval not later than six months after the commencement of service. The first condition may be relaxed by the government in an exceptional case. Only technicians with specialized knowledge and experience in construction, manufacturing, mining, the generation of electricity or other forms of power, agriculture, animal husbandry, dairy farming, deep-sea fishing, shipbuilding or such other field as the government may specify, qualify for this exemption. During the two-year exemption period, the employer may pay the income tax on the technician's compensation in excess of Rs. 4,000 a month. When, with government approval, the technician stays on after the two-year period, the employer may pay the income tax on the technician's compensation for the next two years. Such discharge of the employee's income tax liability by the employer does not constitute taxable income to the employee.

Foreign professors and teachers, whose employment contracts with universities or other educational institutions in India have been approved by the central government within one year from commencement of their services, are exempt from tax for the first three years (without the Rs. 4,000 a month limitation) and, if their services extend beyond three years, the employer may absorb the income tax on their compensation for the next two years without such tax payment constituting taxable income of the employee. Remuneration received by an alien for research work in India during the first two years is also exempt from income tax, subject to certain conditions.

Deductions of Employees. A standard deduction is allowed to an employee from his salary income to meet expenses incurred in the performance of his duties. The deduction is 20% of the first Rs. 10,000 of the salary and 10% of the balance. The total deduction is limited to Rs. 1,000 when the employee receives a conveyance allowance or is furnished with a car by the employer for his personal use and Rs. 3,500 in other cases.

Relief from Double Taxation of Foreign Income

11.01 Tax Treaties

India has entered into tax treaties with several countries (Appendix A). The provisions of these treaties are not identical in every case. The treaties determine the source rules of income and the country empowered to tax specific types of income in order to avoid double taxation. Rules are also included to ensure that the tax incentives granted on certain types of income in the Indian tax law are not lost by having the same income taxed in full in another country.

India has also entered into arrangements with Sierra Leone for granting relief to income taxed in both countries. No agreement has been reached on a tax treaty between India and the United States.

11.02 Credit for Foreign Income Taxes

In the absence of a tax treaty or other arrangements, Indian tax laws provide for unilateral relief from double taxation for resident taxpayers. The mechanics of allowing a credit for foreign taxes paid on income subject to Indian taxation are somewhat similar to the foreign tax credit in the United States. The credit is limited to the lesser of the taxes assessed in the two countries on the same foreign income. Unlike the United States system, excess foreign tax credits cannot be carried over or back.

Indian income tax laws provide for deferring the taxation of foreign blocked income.

Pensions, Pension Funds, and Other Retirement Benefits

12.01 Taxation of Retirement Benefits and Contributions

Three categories of retirement benefit funds are recognized by Indian tax laws: provident funds, pension funds (superannuation funds), and gratuity funds. Although the purposes of the funds are similar, there are some differences in their operations. A provident fund is based on joint contributions by both employer and employee. Pension and gratuity funds have their source in employer's contributions only, but an employee may contribute to a pension fund.

In a provident fund, the employee is entitled to receive the amounts credited to his account upon termination of his employment. In a gratuity fund, the employee receives a lump-sum payment upon retirement. In a pension fund, the employee receives an annuity upon retirement. An employer may set up a separate provident fund, or make the contributions to the State Provident Fund, which is an approved fund for tax purposes.

Certain tax exemptions are provided for contributions to, and benefits from, funds that are recognized or approved by the Commissioner of Income Tax (12.02). Employers' contributions to approved funds are not taxed currently to the employees.

The accumulated balance received from a provident fund by an employee on his retirement is not taxable if such balance has been accumulated during continuous employment of at least five years. Lump-sum payments from a gratuity fund on retirement are also exempt from tax to the extent of one-half month's "salary" for each year of service, but subject to a maximum exemption of 20 months' salary or Rs. 30,000. For this purpose, "salary" means the average salary for the three years immediately preceding the year of payment.

Payments received by an employee during his lifetime from a pension fund in the form of an annuity or pension, or as a lump sum in lieu thereof, are generally taxable, but there are certain limitations. Payments by reason of the death of the employee are tax exempt.

12.02 Recognition or Approval of Funds

Recognition or approval of retirement funds by the Commissioner of Income Tax is conditioned upon the transfer of funds to two or more trustees under an irrevocable trust indenture executed in India. In addition, an employer's contribution to a provident fund for any employee must not exceed the employee's own contributions and must normally not be in excess of 10% of the employee's salary. The employer's contributions to both provident and pension funds must not exceed 25% of the employee's salary. Total contributions to a provident fund for and by an employee who controls more than 10% of the

voting power of his employer corporation may not exceed Rs. 250 a month. A director who controls more than 5% of the voting power of the stock of a corporation cannot participate in a pension fund.

Pension Plans for the Self-Employed. Contributions by self-employed individuals for retirement benefits plans are generally not deductible. However, resident Indian citizens who are partners of registered firms (2.02) engaged in professional activities are entitled to deduct the cost of purchasing approved life annuities, to the extent of the lesser of Rs. 5,000 or 10% of the contributor's professional income. Such annuities are taxable income when received by the beneficiary and are subject to withholding tax (5.01). Contributions to a public provident fund set up by the government are deductible within the limitations outlined at 10.02 and benefits received from such a fund are not taxable.

12.03 Deduction of Pensions and Contributions to Approved Funds

Contributions by an employer to approved provident, pension, and gratuity funds are deductible. A lump-sum initial contribution for past services to a pension or gratuity fund is also deductible if the amount is reasonable with regard to the services of the employees. Employees' contributions to an approved provident fund qualify for a deduction from taxable income to the extent of the lesser of 20% of salary or Rs. 10,000. The total deduction for contributions to provident and pension funds and certain other items is subject to further limitations (10.02).

Unrecognized Funds. Contributions to unrecognized or unapproved funds are not deductible by either the employer or the employee. When an employee retires, payments made by the employer from such provident fund or as a gratuity are allowable deductions. Pension payments made after retirement are also deductible. The retiring employee, however, is subject to tax on monies received by him from such provident fund and also on pensions from the employer. A lump-sum gratuity received from the employer is exempt in the same manner as the amount received from an approved gratuity fund.

Part 3:
Other Taxes

Deloitte Haskins & Sells

Taxes on Sales, Transactions, Commodities, and Property

13.01 Taxes on Sales and Other Transactions

Each state has its own laws imposing sales or purchase taxes. Generally, exemptions are granted to food articles, fresh fruits, vegetables, fertilizers, and similar items. Tax rates vary according to the items and the states. They range from ¼% to 45% and are generally between 4% and 10%. There is also no uniform basis of levy. In some states, the sales tax is imposed on the sale to the consumer, and in other states the tax is levied on each sale of the same goods. In a third group, sales tax is levied only on the first and last sales.

The power of the states to levy sales tax is limited to transactions within the state. Sales involving transfers of goods from one state to another are taxed under the Central Sales Tax Act. The rate of tax generally is 4% on sales to a dealer in another state and 10% on sales to a consumer. Export sales are not subject to sales tax. Certain municipalities charge a use tax (*octroi*) on goods sent into their local jurisdictions for consumption.

13.02 Excise Taxes

Excise taxes are imposed by the central government on the production or manufacture in India of numerous articles. Parliament may change the rates, or it may authorize the government to levy the taxes within prescribed limits. The tax is payable upon removal of goods from the factory or warehouse. Rates on selected items are shown in the Rate Tables. With a few exclusions and exemptions, all goods manufactured in a factory, other than those goods for which higher rates of excise tax are prescribed, are subject to an excise levy of 8% ad valorem. The government has the right to impose an additional duty on imported articles to counterbalance the excise tax on articles produced within the country. Excise tax repayments are generally granted on goods exported. Customs duties are levied on most types of imported goods.

13.03 Local Taxes on Real Property

Taxes on real property are imposed by the local authorities. Such taxes are generally based on the annual rental value of the property. Taxes on land are also imposed by the states.

13.04 Wealth Tax

Individuals and Hindu undivided families pay a wealth tax each tax year based on their net wealth at the valuation date, that is, the last day of the taxpayer's previous tax year (2.04). Corporations are not subject to wealth tax.

Taxable net wealth is the total value of assets owned by the taxpayer, less debts. Certain assets are excluded from net wealth, such as unmatured insurance policies (except as discussed hereafter); the right

to receive certain pensions, annuities, and balances in provident funds; certain savings accounts and certificates; animals; growing crops; equipment used in agriculture; and household goods. One taxpayer residence is excluded up to a value of Rs. 100,000. Agricultural land and certain "other items" are also excluded from taxable net wealth up to an aggregate value of Rs. 150,000. An additional amount up to Rs. 25,000 is excluded in respect of units in Unit Trust of India. These excluded "other items" include most government securities (a few are deductible outside the limit), shares in Indian companies, units in the Unit Trust of India, bank deposits, specified other deposits, specified debentures, and the assets of an industrial business. A six-month holding period, ending on the valuation date, generally applies to most assets for exclusion from wealth tax. Investments in shares issued after February 28, 1975, by new industrial corporations engaged in the priority industries listed in Appendix C are separately excluded from taxable net wealth for a five-year period.

The value of a right to receive an annuity purchased by a taxpayer is included in taxable wealth. A proportion of the value of an unmatured insurance policy is also included if the premiums are payable over a period of less than ten years. Assets transferred by a taxpayer to his spouse, minor children, son's wife, or the son's minor child for less than adequate consideration are, with certain exceptions regarding the transfer period, included in the taxable net wealth of the taxpayer.

A person of Indian origin who resides abroad can claim exemption from wealth tax for seven years on the wealth brought into India if he returns to India with the intention of permanently residing there. This exemption also applies to assets acquired in India from monies brought into India. For a nonresident Indian citizen, investments in shares issued after March 31, 1976, by companies engaged in certain priority industries or in exports are exempt from wealth tax.

The wealth tax rates are progressive, as shown in the Rate Tables, and net assets located in India are generally subject to tax at these rates. For an alien who is a nonresident in India, however, the tax is reduced by 50%. A similar reduction of 50% applies to net assets located outside India, and owned by a resident citizen of India. Any nonresident, not ordinarily resident, or alien is exempt from tax on net wealth located outside India.

Penalties similar to those for income taxes (4.04) may be assessed for failure to file returns, for filing inadequate information, or for concealing assets. The penalties range up to twice the value of the assets involved if the default or offense is committed before April 1, 1976, and ranges up to five times the tax involved for a default or offense taking place after March 31, 1976.

13.05 Miscellaneous Taxes

Documentary Stamp Taxes. Numerous documents are subject to stamp taxes. The tax depends on the nature of the document. Documents not duly stamped cannot be admitted as evidence in courts.

Entertainment Tax and Taxes on Occupations. The states may levy tax on admissions to exhibitions, motion pictures, amusements, games, and sports. Generally, the rate is based upon the admission charge.

Taxes on employment, professions, and business establishments are imposed by some states.

Agricultural Income Tax. Agricultural income is exempt from income tax under the Union Income Tax Act (6.01). Such income is taxable, however, under the Agricultural Income Tax Act enacted by many states. Tax rates vary widely. They range up to 78%, and provide liberal exemptions.

Foreign Travel Tax. Through June 14, 1979, a 12.50% tax was levied on international journeys by ship or aircraft. The tax was imposed on passengers leaving for, or arriving from, a foreign place, when the fare for such journey was paid in Indian currency.

Effective June 15, 1979, the basis of levy of foreign travel tax is revised. The tax is now levied in respect of every person going by air or ship to a place outside India at the rate of Rs. 100. A person proceeding to specified neighboring countries, however, is required to pay only Rs. 50.

Employment Taxes

Employers engaged in manufacturing operations, and their employees whose salary do not exceed Rs. 1,000 a month, must contribute to the Employees State Insurance Fund. This Fund provides benefits for sickness, maternity, and employment-related injuries.

The employer's weekly contribution ranges from Rs. 0.75 for an employee whose average daily wages are below Rs. 2, to a maximum of Rs. 7.50 for an employee whose average daily wages are Rs. 24 or higher. Employees contribute at half these rates, but an employee whose average daily wage is below Rs. 1.50 is not required to contribute.

The contribution is made through the weekly purchase by the employer of contribution stamps that are affixed to a card for each employee. The employees' portion of this contribution is withheld from their wages.

Most employers must also contribute 0.50% of gross payroll of employees whose salaries do not exceed Rs. 1,600 per month to a government-administered Insurance Fund, which provides life insurance benefits for employees. The government contributes to this benefit at one-half the rate of employers. In addition, employers and the government contribute 0.10% and 0.05%, respectively, for administration costs. Employees are not required to contribute.

When an employee dies, his dependent will receive a payment from the Fund equal to the employee's average balance in the Provident Fund (Chapter 12) during the preceding three years, but subject to a maximum benefit of Rs. 10,000.

Estate and Gift Duties

15.01 Estate Tax

Estate tax is levied on an estate valued in excess of Rs. 50,000. Graduated rates of tax range from 4% on estates between Rs. 50,000 and Rs. 100,000 to 85% on the excess over Rs. 2,000,000, as shown in the Rate Tables.

The tax is imposed on transfers of property passing on the death, or taking effect at the time of death, of a person. Also included in the taxable estate are gifts made in contemplation of death, gifts to public charities within six months and other gifts within two years prior to death, and gifts of property in which the donor retained an interest.

Within certain limitations, gifts and life insurance proceeds are exempt from estate tax, but must be included in the estate to determine the average rate of tax applicable to the taxable estate. Other limited exemptions include the decedent's residence and personal effects.

A percentage of the value of property owned by a decedent may be excluded from the taxable estate if the property had been included in another estate within a period of five years. The percentage is 50% in the first year and 10% less in each of the next four years. Property is valued for estate tax purposes at an estimated price that could be obtained if it were sold in the open market. From such value, deductions are allowed for debts of the decedent and funeral expenses. Debts payable abroad are generally deducted from property located abroad.

Effect of Domicile. The domicile of the decedent is irrelevant for property that has a situs in India. Such property is subject to estate tax unless it is exempt for other reasons. Domicile is also immaterial for real property located outside India, since it is exempt from Indian estate tax in all cases. Personal property with a situs outside India is taxable if the decedent was domiciled in India, and is generally exempt if he was domiciled abroad. However, property held in trust in which the decedent had a life interest is taxable, regardless of the decedent's domicile, if the settlor was domiciled in India when the trust was created.

Situs of Property. The situs of property may be important in determining the estate tax liability. Any interest in real property has a situs where the property is located. The situs of personal property is determined under rules issued by the Central Board of Direct Taxes or under the provisions of a tax treaty. The only country with which India has entered into an estate tax treaty is the United Kingdom.

15.02 Gift Tax

A gift tax is imposed for each assessment year on individuals, partnerships, associations, and corporations in which the public is not substantially interested. A gift is defined as a transfer from one person to another of any property, voluntarily and without adequate consideration. A release, discharge, or surrender of any debt, claim, or interest in property may give rise to a gift tax if no adequate consideration is received.

Taxable gifts made during the previous year (2.04) in excess of Rs. 5,000 are subject to tax at the graduated progressive rates shown in the Rate Tables. If a taxpayer has made taxable gifts during one or more of the preceding four years (not being before June 1, 1973), the gift tax payable by the taxpayer on the value of gifts made during the gift year is determined in the following manner:

(a) The taxable gifts made during the gift year and the four preceding years are aggregated, and the gift tax is calculated on the aggregate amount as per Rate Tables;

(b) The taxable gifts made during the four preceding years only are aggregated, and the gift tax is calculated on the total amount as per Rate Tables;

(c) The amount by which the tax under (a) exceeds the tax under (b) is the tax payable on the gifts made during the gift year.

Certain gifts are exempt from tax. Among the more important exemptions are testamentary legacies or gifts made in contemplation of death (15.01), gifts up to Rs. 10,000 to a dependent relative on the occasion of his or her marriage, gifts to a spouse up to an aggregate maximum of Rs. 50,000 in one or more previous years, and donations to the government, charitable institutions, or funds that are not wholly or substantially religious in nature.

Gifts of real property located outside India are not subject to tax. Gifts of personal property located outside India are also exempt if they are made by an alien or by a citizen of India who is a nonresident or not ordinarily resident. Such gifts are also exempt if made by a nonresident partnership, association, or corporation. For the purpose of determining the location of property, the same situs rules apply as for the estate tax.

The gift tax is payable by the donor, but if not paid by him, it may be recovered from the donee or, if real property is the subject of a gift, the tax may become a lien against such property.

Part 4: Rate Tables, Bibliography and Appendices

Income Taxes—Individuals, Hindu Undivided Families, and Unregistered Partnerships

(Rates in effect for withholding taxes and estimated tax payments during the year 1979-1980, and expected to be in effect for assessment in the year 1980-1981)

Basic Income Tax:

Income Bracket (Rs.)	Tax on Lower Amount (Rs.)	Rate on Excess over Lower Amount (%)
0- 8,000	None	None
8,000- 15,000	None	15
15,000- 20,000	1,050	18
20,000- 25,000	1,950	25
25,000- 30,000	3,200	30
30,000- 50,000	4,700	40
50,000- 70,000	12,700	50
70,000-100,000	22,700	55
100,000-upward	39,200	60

Surcharge:

Surcharge on basic income tax		20

Notes:

1. No tax is payable if the taxable income does not exceed Rs. 10,000.
2. If the taxable income is between Rs. 10,001 and Rs. 12,000, the basic income tax is limited to 30% of the excess of taxable income over Rs. 10,000.
3. Taxpayers with agricultural income must compute their tax as outlined in 3.01.
4. Hindu undivided families with one or more members whose independent taxable income exceeds Rs. 10,000 are subject to the following basic income tax schedule, and to the 20% surcharge.

Income Bracket (Rs.)	Tax on Lower Amount (Rs.)	Rate on Excess over Lower Amount (%)
0- 8,000	None	None
8,000-15,000*	None	18
15,000-20,000	1,260	25
20,000-25,000	2,510	30
25,000-30,000	4,010	40
30,000-50,000	6,010	50
50,000-70,000	16,010	55
70,000-upward	27,010	60

*No tax is payable if taxable income does not exceed Rs. 10,000. For taxable income between Rs. 10,001 and Rs. 13,000, the basic income tax is limited to 30% of the excess of taxable income over Rs. 10,000.

Income Taxes—Registered Partnerships

Basic Income Tax:

Income Bracket (Rs.)	If professional income amounts to at least 51% — Tax on Lower Amount (Rs.)	If professional income amounts to at least 51% — Rate on Excess (%)	Other registered partnerships — Tax on Lower Amount (Rs.)	Other registered partnerships — Rate on Excess (%)
0- 10,000	None	None	None	None
10,000- 25,000	None	4	None	5
25,000- 50,000	600	7	750	7
50,000-100,000	2,350	13	2,500	15
100,000-upward	8,850	22	10,000	24

Surcharge:

Surcharge on basic income tax	20

Income Taxes—Cooperative Societies

Basic Income Tax:

Income Bracket (Rs.)	Tax on Lower Amount (Rs.)	Rate on Excess over Lower Amount (%)
0-10,000	None	15
10,000-20,000	1,500	25
20,000-upward	4,000	40

Surcharge:

Surcharge on basic income tax	20

Note:

The above rates are prescribed for estimated tax payments during the year 1979-1980 and are expected to be brought into force for assessment in the year 1980-1981.

Income Taxes—Corporations

Basic Income Tax:

Income Bracket (Rs.)	Tax on Lower Amount (Rs.)	Rate on Excess over Lower Amount (%)
Domestic companies in which the public is substantially interested:		
0-100,000	None	45
100,000-140,000	45,000	80
140,000-upward	77,000	55
Domestic companies in which the public is not substantially interested:		
Industrial companies:		
0-200,000	None	55
200,000-250,000	110,000	80
250,000-upward	150,000	60
Other than industrial companies		65
Foreign companies:		
Royalties or technical service fees received from an Indian concern under an agreement made before April 1, 1976, and approved by the government		50
Royalties or technical service fees received from an Indian concern under an agreement made after March 31, 1976, and approved by the government:		
1) On lump-sum consideration for the transfer outside India of know-how		20*
2) On other royalties or technical service fees		40*
Dividends		25*
Other income		70
Life insurance companies:		
All income from life insurance business		12½*
Other income is taxed at the same rates as domestic companies in which the public is substantially interested		

(continued)

Income Taxes—Corporations (continued)

Surcharge:	**Rate (%)**
Surcharge on basic income tax	7.5

Note:
Surcharge does not apply to rates marked with an asterisk.

Surtax on excess profits:	
On taxable income (less certain exemptions and deductions) in excess of 15% of capital or Rs. 200,000, whichever is greater:	
On such excess up to 5% of capital	25
On the balance of the excess	40
Long-term capital gains:	
Land and buildings	50
Other	40

(For a company in which the public is substantially interested, if taxable income excluding long-term capital gains does not exceed Rs. 100,000, the tax rate on land and buildings is 40%.)

Accumulated Earnings Tax on accumulated taxable income of non-industrial domestic companies in which the public is not substantially interested and which fail to distribute the statutory percentage of profits:

	Statutory Percentage for Distribution (%)	**Rate of Tax (%)**
Investment companies	90	50
Consulting service companies	45	25
Trading companies with accumulated earnings that exceed the shareholders' paid-up and loan capital or the value of fixed assets, whichever is greater	90	37
Other trading companies	60	37
Any other companies with accumulated earnings in excess of twice the shareholders' paid-up and loan capital or twice the value of fixed assets, whichever is greater	90	25
Any other companies in other situations	60	25

(See 2.02 for classification of companies, and 9.02 for exemptions.)

Withholding Tax Rates on Dividends, Interest, and Other Payments

	Rate of Tax (%)
Resident individuals:	
Winnings from lotteries, crossword puzzles, and horseraces	36
Interest, other than interest on securities	10
Dividends and interest on securities, other than tax-free securities	24
Insurance commissions	10
Nonresident individuals:	
Interest on tax-free securities	18
Other income (Note 1)	36
Domestic companies:	
Interest, other than interest on securities	21.5
Dividends, insurance commissions, and interest on securities other than tax-free securities	24
Foreign companies:	
Dividends from a domestic company	25
Royalties and technical service fees received from an Indian concern under an agreement approved by the government:	
If the agreement was made before April 1, 1976	53.75
If the agreement is made after March 31, 1976:	
(1) On lump-sum consideration for the transfer of know-how outside India	20
(2) On other royalties and technical service fees	40
Interest on tax-free securities	47.3
Other income	75.25
General:	
On payments to a contractor for work performed	2
On payments by a contractor to a subcontractor	1

Notes:

(1) Tax is withheld at the rate of 36% of the payment or, if greater, at the rate of basic income tax and surcharge that would apply if the payment were the entire income of the taxpayer for the year.

(2) See 5.02 for exemptions from withholding.

Estate Tax

Estate Bracket (Rs.)	Tax on Lower Amount (Rs.)	Rate on Excess over Lower Amount (%)
0- 50,000	None	None
50,000- 100,000	None	4
100,000- 200,000	2,000	10
200,000- 350,000	12,000	15
350,000- 500,000	34,500	25
500,000-1,000,000	72,000	30
1,000,000-1,500,000	222,000	40
1,500,000-2,000,000	422,000	50
2,000,000-upward	672,000	85

Gift Tax

Gift Bracket (Rs.)	Tax on Lower Amount (Rs.)	Rate on Excess over Lower Amount (%)
0- 5,000	None	None
5,000- 25,000	None	5
25,000- 55,000	1,000	10
55,000- 105,000	4,000	15
105,000- 205,000	11,500	20
205,000- 505,000	31,500	25
505,000-1,005,000	106,500	30
1,005,000-1,505,000	256,500	40
1,505,000-2,005,000	456,500	50
2,005,000-upward	706,500	75

Wealth Tax—Individuals and Hindu Undivided Families

(for assessment in the year 1980-1981)

The following tax table is for individual and for Hindu undivided families none of whose members have taxable wealth exceeding Rs. 100,000. No wealth tax is payable if the taxable wealth does not exceed Rs. 100,000. If the taxable wealth is between Rs. 100,001 and Rs. 111,100 the tax payable is limited to 5% of the excess of taxable wealth over Rs. 100,000.

Wealth Bracket (Rs.)	Tax on Lower Amount (Rs.)	Rate on Excess over Lower Amount (%)
0- 250,000	None	½
250,000- 500,000	1,250	1
500,000-1,000,000	3,750	2
1,000,000-1,500,000	13,750	3
1,500,000-upward	28,750	5

The following tax table is for Hindu undivided families where one or more members of the family have taxable wealth exceeding Rs. 100,000. No wealth tax is payable if the taxable wealth does not exceed Rs. 100,000. If the taxable wealth is between Rs. 100,001 and Rs. 142,800, the tax payable is limited to 5% of the excess of taxable wealth over Rs. 100,000.

Wealth Bracket (Rs.)	Tax on Lower Amount (Rs.)	Rate on Excess over Lower Amount (%)
0- 250,000	None	1½
250,000- 500,000	3,750	2
500,000-1,000,000	8,750	3
1,000,000-upward	23,750	5

Excise Taxes

(Selected items only)

Commodity	Rate of Excise Tax (% ad valorem)
Cosmetics and toilet preparations	100
Tires for motor vehicles	57.75
Cement	40
Refrigerators:	
Capacity not exceeding 165 liters	40
Other refrigerators	80
Water coolers	25
Other refrigerating appliances and machinery	80
Air conditioners:	
Package-type or window air conditioners	25
Other air conditioners	110
Air conditioning appliances and machinery	110
Electric dry batteries	25
Electric storage batteries	20
Tractors used for agricultural purpose	10
Tractors used for other purposes	15
Trailers	10

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Kanga and Palkhivala, *The Law and Practice of Income Tax,* Bombay, N. M. Tripathi Private Ltd.

S. A. L. Narayana Row, *Estate Duty Simplified,* 4th edition, Madras, The Madras Law Journal Office.

A. N. Aiyar's *Indian Tax Laws,* Madras, Company Law Institute of India Private Ltd. (published annually).

Countries with Which India Has Entered into Tax Treaties

Agreements of a general nature with:

- Austria
- Belgium
- Denmark
- Federal Republic of Germany
- Finland
- France
- Greece
- Japan
- Malaysia
- Norway
- Sri Lanka
- Sweden
- United Arab Republic (Egypt)

Agreements confined to operations of aircraft and/or shipping:

- Afghanistan (Aircraft)
- Bulgaria (Shipping)
- Ethiopia (Aircraft)
- Iran (Aircraft)
- Italy (Aircraft)
- Lebanon (Aircraft)
- Romania (Aircraft and shipping)
- Switzerland (Aircraft)
- U.S.A. (Aircraft)
- U.S.S.R. (Shipping)

Agreement with United Kingdom for estate taxes.

Depreciation Rates (7.02)

	Rate of Annual Depreciation (%)
Buildings:	
First class of selected materials:	
Ordinary	2½
Factory	5
Second class of less substantial construction:	
Ordinary	5
Factory	10
Third class of inferior but not temporary construction:	
Ordinary	7½
Factory	15
Furniture and Office Equipment:	
General	10
Air conditioners	15
Hotels and moving picture theatres	15
*Typewriters, accounting machines, and similar office equipment	15
*Data processing machines	20
*Transportation Equipment:	
Automobiles	20
Tractors and trucks	30
Vessels:	
Ocean steamers and motor vessels	5
Inland steamers and motor vessels:	
Speed boats	20
Others	10
Machinery and Equipment:	
General	10
*Building contractors' machinery	15
Machinery coming into contact with corrosive chemicals	15
Machine tools—automatic and semiautomatic machines and precision machine tools	15
*Mineral oil concerns—refineries and field operations:	
Boilers, prime movers, process equipment, surface storage tanks and pipelines, jetties, and dry docks	10
Portable boilers, drilling tools, wellhead tanks, and rigs	30
Curbside pumps, including underground tanks and fittings	15

(continued)

	Rate of Annual Depreciation (%)
*Mines and quarries:	
Boilers and head gears, shafts, inclines, and tramways on the surface	10
Portable underground machinery	30
Surface and underground machinery, head gear, moving parts, and rails	15
*Moving picture film production and exhibition	20
*Radio apparatus	15
Rubber and plastic goods factories:	
General	15
*Molds	40
Tea factories	15
*Weighing machines	10

Items of machinery and equipment marked with an asterisk do not qualify for the extra shift allowance (7.02).

An extra allowance equal to one-half of the normal allowance may be claimed by an Indian company for machinery and equipment installed in a hotel approved by the government.

Priority Industries to Which Certain Incentives Apply

I. Businesses involved in the generation or distribution of electricity or any other form of power.

II. Businesses involved in the construction, manufacture, or production of any of the following articles:

(1) Iron and steel (metal)
(2) Nonferrous metals
(3) Ferro alloys and special steels
(4) Steel castings and forgings and alloy malleable and S.G. iron castings
(5) Thermal and hydro power generation equipment
(6) Transformers and switch gears
(7) Electric motors
(8) Industrial and agricultural machinery
(9) Earth moving machinery
(10) Machine tools
(11) Fertilizers
(12) Soda ash
(13) Caustic soda
(14) Commercial vehicles
(15) Ships
(16) Aircraft
(17) Tires and tubes
(18) Paper, pulp, and newsprint
(19) Sugar
(20) Vegetable oils
(21) Textiles made wholly or mainly of cotton, including cotton yarn, hosiery, and rope
(22) Textiles made wholly or mainly of jute, including jute twine and jute rope
(23) Cement and refractories
(24) Pesticides
(25) Carbon and graphite products
(26) Inorganic heavy chemicals
(27) Organic heavy chemicals
(28) Synthetic rubber and rubber chemicals (including carbon black)
(29) Industrial explosives
(30) Basic drugs
(31) Industrial sewing machines
(32) Finished leather and leather goods

Specimen Tax Computation of a Domestic Corporation

In Which the Public Is Substantially Interested and Which Is Engaged in a Priority Industry (Assessment Year 1979-1980)

Income Tax	**Note No.**	**(Rs.)**	**(Rs.)**
Computation of Taxable Income:			
Net profit for the year ended December 31, 1978 per books	1		2,297,550
Add:			
Provision for income tax and surtax	2		4,100,000
Depreciation charged in the books	3		346,000
Accrual for retirement gratuity	4		150,000
Charitable contributions not deductible	5		28,000
Legal fees in connection with capital expenditures	6		10,000
Provision for bad debts	7		25,000
Entertainment expenses	8		63,000
Investment allowance reserve (75% of Rs. 75,000)	9		56,250
Excess compensation to employees	10		44,000
Total			7,119,800
Deduct:			
Depreciation alowable for tax purposes	3	340,000	
Gratuity paid to retired employees	4	23,000	
Bad debts charged to reserve	7	10,500	
Dividends from domestic companies	11	22,500	
Long-term capital gains on sales of:	12		
Land and buildings		4,000	
Securities		3,000	
Royalties and fees from a foreign enterprise for technical services	13	34,000	437,000
			6,682,800
Deduct:			
Entertainment expenses:	8		
Rs. 1,000,000 at ½%		5,000	
4,000,000 at ¼%		10,000	
1,682,800 at ⅛%		2,103	
6,682,800		17,103	
Investment allowance on new machinery (25% of cost—Rs.300,000)	9	75,000	92,103
Total income carried forward			6,590,697

(continued)

Income Tax	Note No.	(Rs.)	(Rs.)
(brought forward)			6,590,697
Dividend income:			
Dividends received from domestic companies	11	22,500	
Less dividends from new industrial undertaking engaged in priority industry	14	4,000	
Total taxable dividends		18,500	
Less 60% of taxable dividends	15	11,100	7,400
Taxable income, excluding long-term capital gains			6,598,097
Long-term capital gains:	12		
On land and buildings		4,000	
On securities		3,000	7,000
Total taxable income			6,605,097
Computation of Income Tax			
Tax on taxable income, excluding long-term capital gains—Rs. 6,598,100 at 55%		3,628,955	
Surcharge at 5% on basic tax (see note)		181,447	3,810,402
Tax on long-term capital gains:			
Land and buildings—Rs. 4,000 at 50%		2,000	
Other—Rs. 3,000 at 40%		1,200	3,200
			3,813,602
Surtax—Computation on next page			283,577
Total income tax and surtax			4,097,179

Note:

For assessment year 1980-1981, the surcharge rate is 7.5% on basic income tax.

(continued)

Computation of Surtax	Note No.	(Rs.)	(Rs.)
Taxable income for income tax purposes	16		6,605,097
Deduct:			
Long-term capital gains	17	7,000	
Dividends from domestic companies	17	7,400	14,400
			6,590,697
Deduct:			
Total income tax payable	18	3,813,602	
Less:			
Income tax on capital gains		3,200	
Income tax on dividends—Rs. 7,400 at 55% plus 5% surtax on basic tax		4,274	
Total		7,474	3,806,128
Income subject to surtax			2,784,569
Less:			
Statutory deduction (15% of capital or Rs. 200,000 whichever is higher):	19		
Paid-up share capital		10,000,000	
Paid-in surplus		2,000,000	
Investment allowance reserves		500,000	
		12,500,000	
Deduct investment in domestic corporations	17	200,000	
Capital at January 1, 1976		12,300,000	
15% of capital			1,845,000
Income subject to surtax			939,569
Tax Computation:			
Rs. 615,000 (equal to 5% of capital) at 25%			153,750
Rs. 324,569 (balance) at 40%			129,827
Total Surtax			283,577

(continued)

Notes:

1. The profit for the year ended December 31, 1978, from all sources forms the basis of income tax liability for the assessment year 1979-1980 (2.04).

2. The liability for income tax and surtax is not a deductible expense (7.06).

3. Book depreciation is added back in determining taxable profits. A depreciation schedule is submitted with the tax return showing the depreciation allowable at the prescribed rates (7.02).

4. Provisions for employee retirement benefits are not deductible, unless the amount is funded and the fund is recognized by the Commissioner of Income Tax. If such conditions are not met, payments made directly to employees are deductible only when paid (7.16 and 12.03).

5. Charitable contributions to institutions not approved are not deductible. A deduction of 50% of contributions to approved institutions is allowed (7.11).

6. Legal expenses relating to capital expenditures are not deductible (7.13).

7. Provisions made for doubtful debts are not allowable and are therefore added back to profits. Bad debts actually written off during the year are allowed even though charged to the reserve (7.04).

8. Allowable entertainment expenses are limited to a certain percentage of the profits (7.12).

9. Investment allowance at the rate of 25% of cost is allowed on new machinery installed by non-low-priority industries. An amount equal to 75% of the allowance must be transferred to a specific reserve by a charge to profits of the year. Such charge to profits is added back and the full allowance is deducted in the computation (7.02).

10. Salary and cost of fringe benefits to an employee in excess of Rs. 6,000 per month are not deductible (7.16).

11. Dividend income included in the profits per books is deducted in arriving at income from business and is separately considered under "income from other sources" (2.03 and 6.04).

12. Long-term capital gains are also considered separately (2.03).

13. Royalties and fees received from a foreign enterprise in connection with the use of patents, know-how, etc., are exempt from tax if the agreement is approved by the government (2.06 and 6.06).

(continued)

14. Dividends received by a domestic company from a new company engaged in priority industry are exempt from tax (6.04).

15. Only 40% of taxable dividends is included in taxable income (6.04).

16. Taxable income as determined for income tax purposes is the basis of the surtax liability (9.02).

17. Long-term capital gains and dividends received from domestic companies are excluded for the surtax computation. The cost of investments, from which dividend income is received, is deducted in the capital computation (9.02).

18. Income tax payable is deductible, except the portion applicable to long-term capital gains and dividends (9.02).

19. From income subject to surtax, a statutory deduction of the higher of Rs. 200,000 or 15% of the capital at the beginning of the year is given (9.02).

Low-Priority Industries

Investment allowances do not apply to businesses involved in the construction, manufacture, or production of any of the following:

(1) Beer, wine, and other alcoholic spirits
(2) Tobacco and tobacco preparations
(3) Cosmetics and toilet preparations
(4) Toothpaste, dental cream, tooth powder, and soap
(5) Aerated waters in whose manufacture blended flavoring concentrates in any form are used
(6) Confectionary and chocolates
(7) Record players and records
(8) Broadcast television receiver sets, radios, radiograms and tape recorders (including cassette recorders and tape decks)
(9) Motion picture films and projectors
(10) Photographic apparatus and goods
(11) Electric fans
(12) Domestic electric appliances
(13) Household furniture, utensils, crockery, and cutlery
(14) Pressure cookers
(15) Vacuum flasks and other vacuum vessels
(16) Tableware and sanitaryware
(17) Glass and glassware
(18) Chinaware and porcelainware
(19) Mosaic tiles and glazed tiles
(20) Organic surface active agents, surface active preparations, and washing preparations
(21) Synthetic detergents
(22) Office machines and apparatus
(23) Steel furniture, whether partly or wholly of steel
(24) Safes, strong boxes, cash and deed boxes, and strong room doors
(25) Latex foam sponge and polyurethane foam
(26) Pigments, colors, paints, enamels, varnishes, blacks and cellulose lacquers
(27) Crown corks and other fittings of cork, rubber, polyethylene, or any other material
(28) Pilfer-proof caps for packaging or other fittings of cork, rubber, polyethylene or any other material
(29) Amplifiers or any other apparatus used to address the public