



**B.COM**  
**(Accounting & Finance).**  
**SEMESTER – III (CBCS)**

**TAXATION –II**  
**(DIRECT TAX)**

**SUBJECT CODE: UA\_FFSIII.4**

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**Revised Syllabus of Courses of  
B. Com (Accounting and Finance) Programme at Semester III**

## **2. Taxation-II (Direct Taxes)**

### **Modules at a Glance**

SN	Modules	No. of Lectures
1	Definitions and Basis of Charge	15
2	Heads of Income	15
3	Deductions u/s 80 and Exclusions from the Total Income	15
4	Computation of Income and Tax of Individual, Firm and Company (Excluding MAT) and Provisions for Filing Return of Income - Sec 139(1) and Sec 139(5)	15
<b>Total</b>		<b>60</b>

SN	Modules/ Units
1	<b>Definitions and Basis of Charge</b>
	<ul style="list-style-type: none"> <li>• Definitions u/s – 2: Section 2 –Assessee, Assessment Year, Assessment, Annual value, Business, Capital asset, Income, Person, Previous Year, Transfer</li> <li>Basis of Charge: <ul style="list-style-type: none"> <li>Section 3 – 9 – Previous Year, Residential Status, Scope of Total Income, Deemed Income &amp; Exclusions from Total Income: <ul style="list-style-type: none"> <li>• Section 10 – restricted to, Agricultural Income, Sums Received from HUF By Member, Share of Profit from Firm, Casual &amp; Non – Recurring Receipts,</li> <li>• Scholarships, Income of Minor Child, Allowance to Members of Parliament and Legislative Assembly.</li> <li>• Note -Exemptions related to specific Heads of Income to be covered with Relevant Provisions.</li> </ul> </li> </ul> </li> </ul>
2	<b>Heads of Income</b>
	<p><b>Various Heads of Income</b></p> <p><b>Salary Income:</b> Section 15 – 17, Including Section 10 relating to House Rent Allowance, Travel Concession, Special Allowance, Gratuity, Pension – Commutation, Leave Encashment, Compensation, Voluntary Retirement, Payment from Provident Fund</p> <p><b>Income from House Property:</b> Section 22 – 27, Including Section 2 – Annual Value</p> <p><b>Profits &amp; Gains from Business &amp; Profession:</b> Vocation Section 28-32, 36, 37, 40, 40A, 43B, 44AD, 44ADA &amp; 44AE including.: Section 2 – Business</p> <p><b>Capital Gains:</b> Section 45, 48, 49, 50, 54 and 55</p> <p><b>Income from Other Sources:</b> Section 56 – 59</p>
3	<b>Deductions u/s 80 and Exclusions from the Total Income</b>
	<p>80 A- Restriction on claim in Chapter VI- A deductions</p> <p>80 C – Payment of LIC/PF and other eligible investments</p> <p>80CCC – Contribution to certain Pension Fund</p> <p>80D – Medical Insurance Premium</p> <p>80 DD- Maintenance and medical treatment of handicapped dependent</p> <p>80E – Interest on Educational Loan</p> <p>80 TTA- Interest on Saving Bank account</p> <ul style="list-style-type: none"> <li>• 80U – Deduction in the case of totally blind or physically handicapped or mentally retarded resident person</li> </ul>
4	<b>Computation of Income and Tax of Individual, Firm and Company (Excluding MAT) and Provisions for Filing Return of Income - Sec 139(1) and Sec 139(5)</b>
	<p>Computation of Total Income of Individual and HUF with respect to above heads</p> <ul style="list-style-type: none"> <li>• and deductions</li> </ul>

**Note:**

- 1. The Syllabus is restricted to study of particular sections, specifically mentioned rules and notifications only**
- 2. All modules/units include computational problems/ Case study**
- 3. The Law in force on 1<sup>st</sup> April immediately preceding the commencement of Academic year will be applicable for ensuing Examinations**

# INTRODUCTION AND BASIC CONCEPTS

## Unit Structure

- 1.1 Introduction and Objectives
- 1.2 Assessment Year
- 1.3 Previous Year
- 1.4 Person
- 1.5 Assessee
- 1.6 Assessment
- 1.7 Income
- 1.8 Gross Total Income
- 1.9 Total Income
- 1.10 Scheme of charging income tax
- 1.11 Self-Examination Questions

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## 1.1 INTRODUCTION AND OBJECTIVES:

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Income tax is levied by the Central Government under entry 82 of the Union of Schedule VII to Constitution of India. This entry deals with ‘Tax on income other than agricultural income’. This task is achieved by the enactment of the Income Tax Act, 1961[“The Act”].

The Act provides for the scope and machinery for levy and collection of Income Tax in India. It is supported by Income Tax Rules, 1962 and several other subordinate rules and regulations. Besides, circulars and notifications are issued by the Central Board of Direct Taxes (CBDT) and sometimes by the Ministry of Finance, Government of India dealing with various aspects of the levy of Income tax. Unless otherwise stated, references to the sections will be the reference to the sections of the Income Tax Act, 1961.

Section 4, which is the charging section, provides that Income tax is a **tax on the total income of a person** called the assessee of **the previous year** relevant to the **assessment year** at the rates prescribed in the relevant Finance Act

This phrase sets the tone and agenda of any study on Income Tax Law This comprises of the understanding of the following:

- Concept of assessment year and previous year,
- Meaning of person and assessee,
- How to charge tax on income,

- What is regarded as income under the Income-tax Act,
- What is gross total income,
- What is total income or taxable income and
- Income-tax rates

This lesson deals with all these aspects, which lay down the basic framework for levy of income tax in India and also explain the basic concepts and terms used in the income tax law.

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## **1.2 ASSESSMENT YEAR – S. 2(9)**

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Section 2(9) defines an “Assessment year” as *“the period of twelve months starting from the first day of April every year “*

An assessment year begins on 1<sup>st</sup> April every year and ends on 31<sup>st</sup> March of the next year. For example, Assessment year 2022-23 means the period of one year beginning on 1<sup>st</sup> April, 2022 and ending on 31<sup>st</sup> March, 2023

In an assessment year, income of the assessee during the previous year is taxed at the rates prescribed by the relevant Finance Act. It is therefore, also called as the “Tax Year”

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## **1.3 PREVIOUS YEAR- S. 2(34) & S. 3**

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### **3.1. Definition:**

Section 3 defines “Previous year” as *“the financial year immediately preceding the assessment year”*.

Income earned in one financial year is taxed in the next financial year. The year in which income is earned is called the “previous year” and the year in which it is taxed is called the “assessment year”.

This will be explained from the following illustrations:

### **Illustration -1:**

For assessment year 2022-23, immediately preceding financial year 2021-22 i.e. from 1<sup>st</sup> April, 2021 to 31<sup>st</sup> March 2022 will be the previous year” in other words, for the Previous Year 2021-22, Assessment Year will be 2022-23.

In the above case, income is earned during Previous Year 2021-22 will be taxed in the next financial year 2022-23.

### **Illustration -2**

For the Assessment Year 2022-23, Previous Year will be 2021-22 i.e. from 1<sup>st</sup> April, 2021 to 31<sup>st</sup> March 2022.

### 3.2. Common previous year for all source of income:

A person may earn income from more than one sources but previous year will always be common for all the sources of income. This will be so even if a person maintains records or books of accounts separately for different sources of income.

Total income of a person from all the sources of income will be taken together and considered in the previous year or the financial year immediately preceding the assessment year.

#### Illustration-3:

Ashok receives taxable annual salary of Rs 10,00,000 from A Limited and Rs 2,00,000 from B Limited. He also receives taxable income of Rs 1,00,000 as dividend and interest from his investments in shares and fixed deposits. Further, Ashok also runs a personal business, from which he receives Rs 2,00,000 as taxable income.

A's aggregate income of Rs 15,00,000 from all the sources i.e. (Rs 10,00,000+ 2,00,000+ 1,00,000 + 2,00,000 ) will have a common Previous Year 2021-22 and taxed in the Assessment Year 2022-23.

### 3.3. New Business or Profession:

Where, a business is newly set up during the previous year, or where a new source of income has arisen during the previous year, the previous year will be the period (obviously less than one year) commencing from the date of setting up of the new business or the date of new source of income arising.

#### Illustration-4:

Ramesh sets up a business in January, 2022. The period of three months beginning on 1st January, 2022 and ending on 31st March, 2022 will be the Previous Year 2021-22 and taxed in the Assessment Year 2022-23. It is immaterial that previous year is of a period of less than 12 months.

### 3.4. Exception:

There are some exceptions to the rule that income of the previous year is taxable in the next assessment year. In such cases, the income of is taxed in the previous year itself. As a result, in such case, a financial year becomes the previous year as well as the assessment year.

These exceptions are provided to ensure safeguards to smooth collection of income tax from a class of taxpayers who may not be traceable till the commencement of the normal assessment year.

The Exceptions referred to above are:

- a) Income of non-residents from shipping business—S.172;



- b) Income of persons leaving India either permanently or for a long period of time and not likely to return back –S. 173-174;
- c) Income of bodies formed for short duration for a particular event or purpose – S 174A;
- d) Income of a person trying to alienate his assets with a view to avoiding payment of tax – S. 175,
- e) Income of a discontinued business- S.176
- f) Realization of written off bad Debts-S 41(1)
- g) Dividend Income-S 56

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## **1.4 PERSON –S. 2(31)**

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### **4.1 Definition:**

Section 2(31) gives an inclusive definition of “person”

“Person” includes:

- a) an individual;
- b) a Hindu undivided family (HUF);
- c) a company;
- d) a firm;
- e) an Association of Persons (AOP) or a Body of Individuals, (BoI) whether incorporated or not;
- f) a local authority; and
- g) every artificial juridical person not falling within any of the preceding categories

### **4.2 Inclusive definition:**

Since the above definition of “person” is inclusive one and not exhaustive, there may be cases, when an entity not falling in the above seven categories may still be treated as “person” inviting the provisions of the Act.

### **4.3 Profit Motive not necessary:**

As per Explanation to S. 2 (31), an entity need not be formed for profit. Thus, Non-Profit Organizations or charitable trusts are also covered by the definition of “person” although their income is not taxable under the Act on satisfying the certain terms and conditions.

### **4.4 Description of types of persons:**

A brief description of these seven categories is as follows:

**a. Individuals** are all living persons of blood and flesh e.g. Ram, Shyam, Gopal, Albert, Ibrahim etc.

**b. Hindu Undivided Families (HUF)** or Hindu joint families are regarded as separate tax entities in view of the specific law of succession prevalent among the Hindus.

**c. Company** as per section 2(31) includes Indian as well as foreign companies and public as well as private Companies. Besides, the CBDT has the power to declare any institution as a Company. Section 25 companies (charitable companies) are also included under the purview but have separate exemptions under the Act.

**d. Partnership firms** including Limited Liability Partnerships (LLPs) are regarded as distinct taxable units separate from their partners. Therefore, under the Act, firms are taxed as the firms and individual partners are taxed separately in their personal capacity.

**e. BOI and AOP:** BOI and AOP are the group of persons carrying on some activities to earn income such as joint venture.

Normally AOPs are contractual in nature like a joint venture agreement if such venture not formed as a partnership or a company.

On the other hand, BOI may be due to circumstances such as joint owner of an estate. Clubs, Societies, Charitable Trusts etc. are covered under this head.

**f. Local authorities:** Municipal corporations, Panchayats, Cantonment Board, Zila Parishads etc. are the examples of Local authorities.

**g. Residual category:** Final category is residual category and covers all such persons which are not covered in any of the above six categories.

#### Illustration-5:

Determine the status of the following under the income Tax Act, 1961:

Person	Status
Ramesh Agrawal	Individual
Asha Jain	Individual
Reliance Industries limited	Company
Warna Co-Society Ltd	AOP
Indian Red Cross society	AOP
Legal heirs to receive property of late Shri Nusserwanji	BOI
Tata power Ltd	Company
Sachin Tendulkar	Individual
Board for Cricket control in India	AOP
Family of Shri PB Hindu	HUF
Pune Cantonment Board	Local Authority
Mumbai University	Artificial Juridical Person
Ramsay Brothers doing business in partnership	Firm

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## **1.5 ASSESSEE–S. 2(7)**

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### **5.1 Definition:**

U/s 2(7) “Assessee” means a person by whom income tax or any other sum of money is payable under the Act and it includes:

- a. every person in respect of whom any proceeding under the Act has been taken for the assessment of his income or loss or the amount of refund due to him
- b. a person who is assessable in respect of income or loss of another person or who is deemed to be an assessee, or
- c. an assessee in default under any provision of the Act

**5.2** The definition of “assessee” is also inclusive one and may include any other person is not covered in the above categories. In other words, the definition of the assessee is so wide that so as to include a person himself or his representative such as legal heir, trustee etc. Moreover, importance is given not only to the amount of tax payable but also to refund due and the proceedings taken.

**5.3** Definition of the ‘assessee’ covers the following class of persons:

1. A person by whom income tax or any other sum of money is payable under the Act
2. A person in respect of whom any proceeding under the Act has been taken for the assessment of his:
  - a. income or
  - b. loss or
  - c. the amount of refund due to him
3. A person who is assessable in respect of income or loss of another person or
4. A person who is deemed to be an assessee,
5. an assessee in default under any provision of the Act

**5.4** A minor child is treated as a separate assessee in respect of any income generated out of activities performed by him like singing in radio jingles, acting in films, tuition income, delivering newspapers, etc. However, income from investments, capital gains on securities held by minor child, etc. would be taxable in the hands of the parent having the higher income (mostly the father), unless if such assets have been acquired from the minor’s sources of income.

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## **1.6 ASSESSMENT - S 2(8)**

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An assessment is the procedure to determine the taxable income of an assessee and the tax payable by him. S. 2(8) of the Income Tax Act, 1961

gives an inclusive definition of assessment “**an assessment includes reassessment**”

U/s 139 of the Act, every assessee is required to file a self-declaration of his income and tax payable by him called “return of income”.

The Income Tax officer may accept the return summarily without making any enquiry into its contents. This is called as the ‘summary assessment’ -S (143(1).

Alternatively, the assessing officer may call upon the assessee to explain his return of income and thereafter the assessing officer after making necessary enquiry frames a reasoned order determining the total income and the tax payable by the assessee This is called the “regular assessment-  
-S 143(3).”

Completed assessment becomes final except in certain circumstances. These circumstances are;

6.1 U/s 147, an assessment can be reopened to assess income which has escaped assessment,

6.2 U/s 263, the Commissioner of Income Tax may ask an assessment to be redone if the assessment order is erroneous and prejudicial to the interest of the revenue,

6.3 U/s 264, the Commissioner of Income Tax at the application of an assessee or *suo motu*, may ask an assessment to be redone. This is normally done to give relief to the assessee.

6.4 U/s 254, the Income Tax Appellate Tribunal (ITAT) in appeal proceedings may pass an order directing the assessment to be redone.

In all the above cases “reassessment” of the income is required to be done. The definition of assessment includes the regular assessment and reopened or reassessment.

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## **1.7 INCOME- S 2(24)**

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### **7.1 Definition:**

#### **Income includes**

1. Profits and gains;
2. Dividend;
3. Voluntary contributions received by the following:
  - a trust or an institution created or established wholly or partly for charitable or religious purposes;
  - a scientific research association or institution- S.10(21);

- a fund or trust or institution referred for promotion of sports –S 10(23C) iv) / (v);
- any university or other educational institution referred to in sub-clause (iiiad) or sub-clause (vi);
- any hospital or other institution S 10(23C) (iiiie)/via; or
- by an electoral trust

For this purpose, "trust" includes any other legal obligation

4. Receipts by the employees:

- Value of **any perquisite** or profit in lieu of salary taxable U/s 17(2)/ (3)
- Any **special allowance or benefit**, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit;
- Any **allowance granted to the assessee either to meet his personal expenses** at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living ;

- **Value of any benefit or perquisite**, whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;

5. Value of any benefit or perquisite, whether convertible into money or not, obtained by **any representative assessee** U/s 160 or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee and any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary;

6. Value of any benefit or perquisite, whether convertible into money or not, **obtained from a company either by a director or by a person** who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;

7. Incomes from business – s-28

- Managerial compensation – S. 28(ii),
- Income derived by a trade, professional or similar association from specific services performed for its members S. 28(iii)

- Export benefits – Duty drawback, cash assistance and DEPB -S. 28(iia), (iib) and (iic)
  - Value of any benefit or perquisite taxable the value of any benefit or perquisite taxable – S 28 (iv);
  - Sum received from non-compete agreements - S 28 (va)
  - Balancing charge and other receipts earlier allowed as deduction –S 41
  - Profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative Society-S-44 any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule
  - Profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members;
8. Capital gains chargeable under section 45;
  9. Any sum earlier allowed as deduction and chargeable to income-tax under Section 59
  10. Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever. Including any game
  11. Any contribution received from employees towards any provident fund or superannuation fund or Employees State Insurance Act, 1948, or any other fund for the welfare of such employees;
  12. Any sum received under a Key man insurance policy including the sum allocated by way of bonus on such policy.
  13. Any sum of money or value of property received as gift –S 56(2) from 01/06/2010
  14. Excess of any consideration received for issue of shares as exceeds the fair market value of the shares of closely held company except in the case of transfer of such shares for reorganization of business by amalgamation or demerger etc.

**7.2** The above definition indicates that although the Income tax is a tax on income, the term “income” is not exhaustively defined in the Act. Instead, section 2(24) offers an inclusive definition of income and covers in its purview not only the income in its natural and general sense but also several items not otherwise considered as income.

Thus Income means not only the revenue receipts arising or accruing regularly but also capital receipts like gifts and even donations. On the other hand, certain revenue receipts like agricultural income are left out from the scope of the term income.

Some of the principles that have emerged out as a result of customs, practices and judicial pronouncements to ascertain as to what does or does not constitute income are as follows.

1. Revenue receipts are normally regarded as income unless specifically exempted. Income is like the fruit of a tree, where tree is the source and fruits are the income.
2. Income is normally a regular periodical receipt, received or derived from a certain source.
3. The source of income must be external. No one can earn income by or from himself. Therefore, income accruing to clubs, societies etc. from their own members are not taken as taxable income on the ground of mutuality.
4. Income may be in cash or kind.
5. Legality of the source of income is not relevant. Income may be derived from illegal sources like, smuggling, theft, bribery, corruption etc.
6. Receipt is regarded as the income and not the application or use of the income.
7. Receipts, if diverted at the source are not regarded as income.
8. Any dispute regarding the title of the income does not take away its nature as income.
9. Personal gifts have been progressively considered as the income although such gifts are capital in nature. This will be clear from the following:
  - a. Gift to an employee by his employer is included in the definition of salary – Sec 17.
  - b. Gift by the clients or customers are included in the profits and gains from the business or profession. Thus, a car given by a client to his lawyer or a disciple to his guru will be taxable in the hands of income from business or profession – Sec 28.
  - c. All other gifts in excess of Rs. 50,000 in aggregate with certain exceptions like *gift mortis causa* (in contemplation of death) gifts on the occasion of marriage and gifts from defined relatives etc. are taxable as the income from the other sources -Sec 56
  - d. With effect from October 1, 2009, where any immovable property like land, building, property is received without any consideration, the stamp duty value of which exceeds Rs 50,000, the stamp duty value of the property shall be taxable in the hands of the recipient unless received from relatives or on the occasion of marriage or as inheritance.

- e. With effect from October 1, 2009, where any movable property like shares, securities, stamps, etc. and immovable properties with effect from 01-04-2014 whose fair market value exceeds Rs 50,000, the aggregate fair market value shall be taxable in the hands of the recipient unless received from relatives or on the occasion of marriage or as inheritance.
- f. With effect from June. 1, 2010, Shares of closely held companies transferred to another company or firm are covered in the definition of gift except in the case of transfer of such shares for reorganization of business by amalgamation or demerger etc.
10. A distribution of surplus arising from a mutual activity is not considered as income. Thus, a surplus received from a mutual organization like employees' tea club, or a co-operative housing society will not be the income on the ground of mutuality.
11. Income may be recognized either on receipt basis or on accrual basis depending upon the facts and circumstances of each case and method of accounting applied in that case.
12. Income must be certain. Contingent income is not regarded as income unless and until such contingency occurs and the income arises to the assessee.
13. Income is the sum total of all receipts from all the sources and considered accordingly.
14. Pin money received by a woman for personal expenses or even the savings made by her from such receipts is not considered as income. However, the husband will not get any credit from his income for these payments.
15. Income may be received in lump sum or in instalments. Thus, arrears of salary received by a person in lump sum are regarded as his income.
16. Normally only revenue receipts are regarded as income and not the capital receipts unless specifically provided for. For example: Maturity proceeds of Keyman Insurance Policy, sales tax subsidy, Voluntary contribution by a donor to a trust are considered as income though capital in nature.
17. Awards received by a professional sportsperson would be income unless the award is in nature of a gift in personal consideration. Some of the above items are discussed in detail in latter chapters at appropriate places.
18. Income of wife is being taxable in the hands of the husband if the assets out of which the income is arising have not been acquired out of the sources of the wife or from an asset gifted by the husband except as consideration for living apart.



19. Income of minor children is being taxable in the hands of the parents having higher income [ mother or father] except when the income is arising from the efforts of the minor child say modeling charges.

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## **1.8 GROSS TOTAL INCOME- S -14:**

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Section 14 of the Act defines the Gross Total Income as the aggregate of the incomes computed under the five heads after making adjustments for set-off and carry forward of losses. The five heads of income are as follows namely:

1. Income from Salaries
2. Income from House Property
3. Profits and Gains from Business & Profession
4. Capital Gains
5. Income from Other Sources

The aggregate income under these heads is termed as “Gross Total Income” In other words; gross total income means total income computed in accordance with the provisions of the Act before making any deduction under sections 80C to 80U. However, any exemptions as allowed by Section 10 are deducted from the respective heads before arriving at the gross total income like conveyance allowance, capital gains on sale of personal effects, dividend income, etc.

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## **1.9 TOTAL INCOME:**

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The total income of an assessee is computed by deducting from the gross total income all permissible deductions available under the Chapter VI A of the Income Tax Act, 1961. This is also referred to as the “Net Income” or “Taxable Income”.

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## **1.10 CHEME OF CHARGING INCOME TAX**

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Income tax is a tax on the total income of an assessee for a particular assessment year. This implies that;

- Income-tax is an annual tax on income
- Income of previous year is chargeable to tax in the next following assessment year at the tax rates applicable for the assessment. year This rule is, however, subject to some exceptions discussed in Para 4 above.
- Tax rates are fixed by the annual Finance Act and not by the Income-tax Act. For instance, the Finance Act, 2020 fixes tax rates for the financial year 2021-22 i.e. Assessment Year 2022-23

- Tax is charged on every person if the gross total income exceeds the minimum income chargeable to tax.

Tax rates are given in the lesson dealing with computation of income.

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## 1.11 ELF ASSESSMENT QUESTIONS

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1. Income of a previous year is chargeable tax in the immediately following assessment year. Is there any exception to this rule? Discuss
2. Define the term “person”
3. How would you calculate income-tax for the assessment year 2022-23 in the case of different assesses?
4. Explain how education cess will be computed for the Assessment Year 2022-23? [Ans: 4%]
5. What will be the previous year for X, who starts his business on April 6, 2021 [Ans: A.Y. 2022-23]
6. Will the answer to Q 5 be different, if X starts his business on 28th March, 2021? [ Ans: A.Y. 2021-22]
7. Explain that a financial year is a previous year and also an assessment year. Every financial year can also be an assessment year,
8. Previous year is a financial year immediately preceding the Assessment Year Comment
9. What will be the status of University of Mumbai?  
[Ans: Artificial juridical person]
10. Indicate whether the following persons will be taxed as individuals:
  - a) X a partner of a firm
  - b) Y, a managing director of A Ltd;”
  - c) Z is the member of Z HUF
  - d) Municipal Commissioner of Mumbai in respect of the Income of theMunicipal Corporation
  - e) Municipal Commissioner of Mumbai in respect of his salary from theMunicipal Corporation
  - f) A minor acting in TV commercials

[Ans: All except (d) will be taxed, Firm X, A Ltd, Z HUF, Municipal Corp. Separatetax entities]



## **BASIS OF CHARGE AND INCIDENCE OF TAX**

### **Unit Structure**

- 2.1 Introduction and Objectives
- 2.2 Basic Charge of Income Tax
- 2.3 Residential Status
- 2.4 Residential status and incidence of tax
- 2.5 Income deemed to be received in India
- 2.6 Income deemed to be ‘accrue or arise’ in India
- 2.7 Receipt vs. Remittance
- 2.8 Actual receipt Vs Deemed Receipt Total Income
- 2.9 Receipt vs. Accrual
- 2.10 Basis of Charge of Dividend Income
- 2.11 Heads of Income
- 2.12 Self-Examination Questions

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### **2.1 INTRODUCTION AND OBJECTIVES**

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This lesson deals with the scheme of income Tax laid down in section 4 to 9 as to the basis of charging income tax, income on which tax is to be levied, the status of persons and effect of the status of persons on which the income tax is to be levied, periodicity of the tax and other incidental matters.

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### **2.2 BASIS OF CHARGE OF INCOME TAX (S. 4-9)**

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Section 4 lays down the basis of charge and provides that Income tax is the tax on “**total income**” of a “**person**” during the ‘**previous year**’ relevant to the ‘**assessment year**’ at the rates prescribed in the Finance act for the year. Relevant terms have been discussed in detail in the previous chapter.

Section 5 provides that total income of an assessee will be chargeable to tax depending upon the residential status of a person and place and time of accrual of such income. Section 6 lays down the rules for determining residential status of various types of persons

Section 7 specifies the incomes though not received in India but deemed to be received in India.

Section 8 determines the year of taxability of dividend income

Section 9 specifies the incomes though not accrued or arisen in India but deemed to accrue or arise in India.

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## **2.3 RESIDENTIAL STATUS –S 6**

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### **2.3.1 Concept of Residential Status**

Under Section 5 total income of an assessee is chargeable to tax depending upon the residential status of a person and place and time of accrual of such income and the rules for determining residential status of various types of persons are contained in Section 6. These provisions are discussed in detail below:

### **2.3.2 Classification of persons:**

Provisions for determination of the residential status are different for different categories of the assessee viz:

- a) individuals;
- b) Hindu Undivided Families (HUF)
- c) Firms or Associations of Persons(AOP);
- d) Companies; and
- e) Every other person

### **2.3.3 Residential status of individual:**

#### **3.3.1 Resident or Non-resident(NR) -Section 6(1):**

To determine the residential status of an individual, it is to be ascertained whether he is resident or a non –resident during the previous year.

An individual will be a resident in India in any previous year, if he satisfies **at least one** of the following **TWO basic conditions**—

- 1) He is in India in the previous year for a period of **182 days or more**  
OR
- 2) He is in India for a period of **60 days or more** during the previous year **AND 365 days or more** during **4 years** immediately preceding the previous year

#### **Exception:**

The Second condition of **60 days or more** is extended to **182 days or more** in following two circumstances:

- i. **An Indian citizen leaves India** during the previous year
  - for the purpose of taking up employment outside India. OR
  - as a member of the crew of an Indian ship OR.
- ii. **An Indian citizen or a person of Indian origin comes on visit** to India during the previous year.

For this purpose, a person is said to be of Indian origin if either he or any of his parents or any of his grandparents was born in undivided India.

In both the above cases, an individual need to be present in India for a minimum of **182 days or more** to become resident in India **instead of 60 days**.

*If the individual satisfies any of the two conditions, he is a resident in India and if he does not satisfy any of the conditions, he is a non-resident during that particular assessment year.*

### **3.3.2 Resident and Ordinarily Resident [R & O R]-S-6(6)**

Once an individual satisfies any of the above two basic conditions for a particular assessment year, next step would be to determine whether he will be a resident and ordinarily resident of India in that assessment year. S 6(6) provides that a person will be “**resident and ordinarily resident**” in India in any assessment year if he satisfies **BOTH** of the following two conditions Viz he has been: -

- 1) resident in India in at least **2 out of 10 previous years** according to the above basic conditions immediately preceding the relevant previous year. AND
- 2) in India for a period of **730 days or more during 7 years** immediately preceding the relevant previous year.

### **3.3.3 Resident and Not Ordinarily Resident [R & N O R]**

A resident individual, who does not satisfy BOTH of the above conditions given above, will be a Resident but Not Ordinarily Resident in India.

In other words, an individual becomes resident but not ordinarily resident in India

If he satisfies at least one of the basic conditions but satisfies **NONE** of the additional conditions OR Satisfies **ONLY ONE** of the two additional conditions.

### **3.3.4 Non Resident**

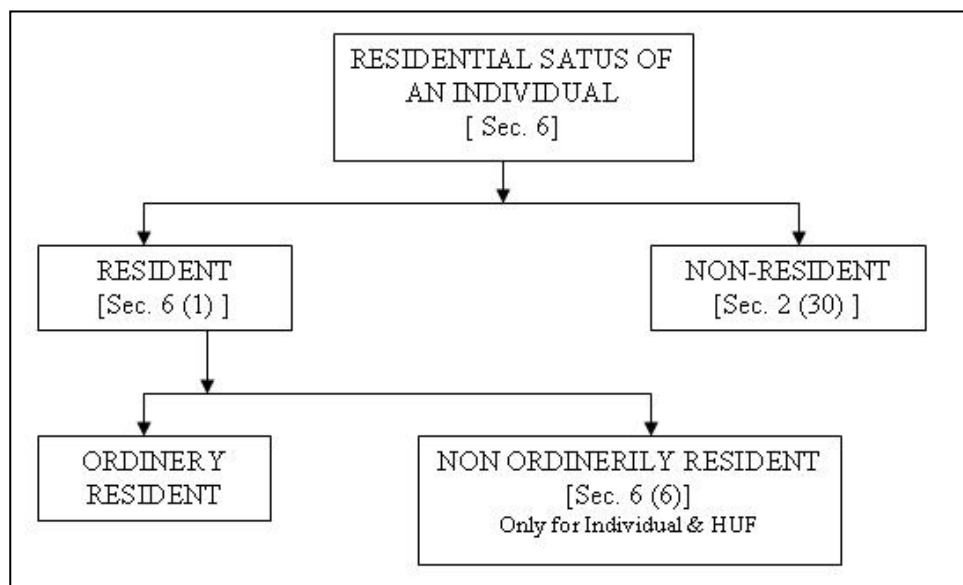
An individual is a non-resident in India if he satisfies none of the basic conditions. It must be noted that if a person satisfies the additional conditions but does not satisfy the basic conditions, he will still be treated as Non-Resident. In such a case, additional conditions are not relevant.

### 3.3.5 SUMMARY

From the above discussion it is brought out that an individual can either be:

- (a) resident and ordinarily resident in India;
- (b) resident but not ordinarily resident in India or
- (c) non-resident

This can be depicted in the following diagram:



Status of the Individual	Basic Condition S.6(1)	Additional Conditions – S 6(6)
Resident and ordinarily Resident	Satisfies at least one condition	Satisfies Both conditions
Resident but not ordinarily Resident	Satisfies at least one condition	Does not satisfy any conditions OR Satisfies only one of the conditions
Non-Resident	Does not satisfy any conditions	Not Required as it is irrelevant whether he does or does not satisfy the additional conditions

### 3.3.6 Some Important points:

Following points are important in determine the residential status of a person

- a) A person need not stay at one place only. Stay may be at different places in India.
- b) A person may stay in India in intervals. Stay need not be continuous.
- c) In computing the stay period, the day on which a person enters India as well as the day on which. he leaves India shall be taken into consideration even if on such days the person is in India only for a part of a day.

*Note: According to decided cases, a total of 24 hours of stay spread over a number of days is to be counted as being equivalent to the stay of one day. But in most questions the hours of arrival and departure are not given. In all such cases day of departure and arrival both shall be computed as two days}.*

- d) A person, who is in India for 182 days or more will always be a resident of India.
- e) Conversely, a person, who is in India for 59 days or less, will always be Non-Resident of India.
- f) An Indian citizen must leave India **for employment or as crew** to get extended limit of 182 days instead of 60 days. A person leaving India as tourist or for medical treatment will not get the limit of 182 days. Further, the condition is relaxed only for Indian citizens and not for persons, who are not Indian citizens.
- g) Persons of Indian origin must come to India on visit for any purpose – pilgrimage, medical treatment or tourism but NOT business or job. Indian citizenship is not the requirement for this purpose.
- h) In computing the days of stay, one must be careful to note the leap years -2012,2016 and 2020.

### 3.3.7 Illustrations:

#### Illustration -1:

Rajesh leaves India for the first time on December 20, 2014. During the financial year 2021-22, he came to India on May 27 for a period of 45 days. Determine his residential status for the Assessment Year 2022-23.

#### Solution:

During the Previous Year 2021-22, Rajesh is in India only for 45 days He does not satisfy any of the basic conditions laid down in section 6(1). Hence, Rajesh is a non-resident in India for the Assessment Year 2022-23.

**Illustration -2:**

Mahesh comes to India, for the first time, on April 16, 2019. He stays in Chennai up to April 10, 2021 and thereafter shifts to Mumbai. He departs from Mumbai for his native country on October 2, 2021. Determine his residential status for the Assessment Year 2022-23.

**. Solution:**

As Mahesh was in India for 185 days\* from April, 1, 2021 to October 2, 2022, which is 182 days. he satisfies the first condition u/s 6(1) of staying in India for 182 days or more during the Previous Year 2021-22, he is a **resident in India**

Month/2020	April	May	June	July	August	Sept	Oct.	Total
Days	30	31	30	31	31	30	2	185

In the previous year 2019-20, Mahesh was in India for 352 days from 16/04/2019 to 31/03/2020 and in the subsequent year 2020-21, he was in India for the whole year. As result Mahesh was resident in India for these two years. Hence he fulfills the first additional condition under Section 6(6) that he must be a resident in India in at least two years out of the ten preceding year i.e. from 2012-13 to 2020-21 (Feb 2020 Leap Month)

But Mahesh was in India for a period of 717 days only [352 days in 2019-20 and 365 days in 2020-21], which is less than 730 days' stay required in the seven preceding year from 2014-15 to 2020-21 as per the second additional condition

Therefore, Mahesh satisfies one of the basic conditions and only one of the two additional conditions, he is, therefore, resident but not ordinarily resident in India for the Assessment Year 2022-23.

**Illustration -3:**

3. Determine residential status for the Assessment Year 2022-23, of Venkat, an Indian Citizen who leaves India for employment in Canada on July 1, 2021.

**Solution:**

Venkat was in India for 92 days in 2021-22 (April: 30 days; May - 31 days; June: 30 days and July 2021: 1 days). Venkat is an Indian citizen, leaving India to take up a job. Hence, he will be get the extend limit of 182 days stay in India during 2021-22. Hence Venkat will be a Non-resident although of was in India for more than 365 days during the four years preceding the previous year

**Illustration - 4:**

What will be the position in the above case, if Venkat leaves India for world tour?



**Solution:**

Venkat will be Resident and Ordinarily Resident of India as he satisfies the second basic condition u/s 6(1) of 365 days stay in the preceding four years and 60 days stay during 2021-22 and also the two additional condition of section 6(6), as being a person born in India, Venkat satisfies both the additional conditions of being resident in India for two years in preceding 10 years and stay of 730 years in seven preceding years.

**Illustration -5:**

Supposing in the above case, Venkat wants to postpone his stay in India, what would be the last date by which he should leave India?

**Solution:**

Since Venkat is covered by the exception, he should depart latest by September 28, 2021 so that his stay in India during the Previous Year 2021-22 is of 181 days (less than 182 days).

**Illustration -6:**

What will be the position in the above case if Venkat is a Nepali citizen settled in India?

**Solution**

Venkat will not be covered by the exception U/s 6(1) as he is not an Indian citizen. Since he satisfies the basic condition and also both the additional conditions of 730 days in 7 preceding years and 2 years' resident in preceding 10 years, he will be a resident and ordinary resident in India

**Illustration -7:**

Chappell, an Australian Citizen comes to India as the Coach of Indian Cricket team. During the Previous Year 2021-22, he stayed in India for 95 days. Before that, he was in India for more than 365 days during the 4 years prior to 2021-22. What will be his residential status for the assessment year 2022-23?

**Solution:**

Chappell satisfies the second basic condition of stay of 365 days or more during the four years preceding the Previous Year 2021-22, and he was in India for more than 60 days during the financial year 2021-22. He will be Resident of India. Since he is not a person of Indian origin nor he comes in India on visit, he will not get the extended time limit of 182 days. Since chapel was never in India, he does not fulfill the additional two conditions, hence he will be Resident but not Ordinarily Resident of India [RNOR].

**Illustration -8:**

Will the position be different in the illustration 7 if Chappell is a resident of Bangladesh?

Although Bangladesh was part of undivided India, Chappell will not get any benefit as he has not come on visit but as a professional coach.

### Illustration -9:

Will the above position change If Chappell is a Pakistani citizen and visits India as a tourist.?

### Solution:

Yes, Chappell will get the extended limit of 182 days and he will be a Non-resident.

## 2.3.4 Residential status of HUF:

### 3.4.1 Resident

As per Section 6(2), a Hindu Undivided Family (HUF) will be **Resident** in India if control and management of its affairs is **wholly or partly** situated in India and conversely, a HUF will be **non- resident** in India if control and management of its affairs is situated **wholly outside** India. This position can be summarized as follows:

Control or Management	Status
Wholly or partly in India	Resident
Wholly outside India	Non resident

Control and management means *de facto* (actual) control or manage but not merely the right to control or manage. Control and management is situated at a place where the head, the seat and the directing power are situated.

### 3.4.2 Resident and Ordinarily resident (ROR)

A HUF can will be Resident and Ordinarily Resident if its Karta satisfies **both** the conditions given in section 6(6) that is the. Karta has been present in India: -

- in at least 2 out of 10 previous years according to the basic condition mentioned immediately preceding the relevant previous year and
- for a period of 730 days or more during 7 years immediately preceding the previous year

### 3.4.3 Resident and Not Ordinarily resident (ROR)

If the Karta does not satisfy both of the two additional conditions, the HUF will be treated as a **resident but not ordinarily resident (RNOR)** in India

### 3.4.4 Non-Resident

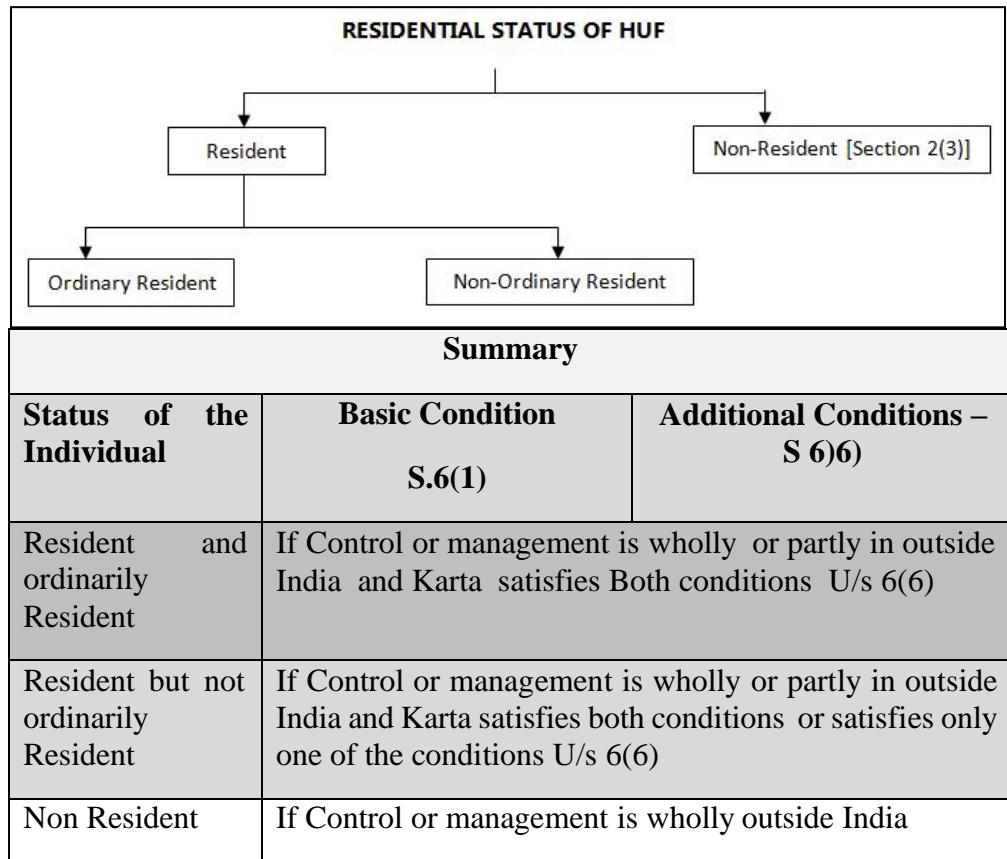
A HUF will be **non- resident** in India if control and management of its affairs is situated **wholly outside** India. It is not the basic conditions but the control and the management of HUF which is relevant to whether the HUF is Resident or Non-Resident. However, to determine ROR status the two additional conditions will be applicable with reference to its Karta.

### 3.4.5 Summary

Thus, like an Individual a HUF may be either: -

- (a) Resident and ordinarily in India, or
- (b) Resident but not ordinarily resident in India or
- (c) Non-resident in India.

This is depicted in the following diagrams:



## 2.3.5 Residential Status of Other Non-Company Persons (-S. 6(2) / S 6(4)

### 3.5.1 Resident -S 6(2)

Like the HUFs, residence of all non-company persons viz a firm an Association of Persons (AOP) or a Body of Individuals (BOI) and every other person will depend upon the place of control and management vide section 6(2).as summarized below:

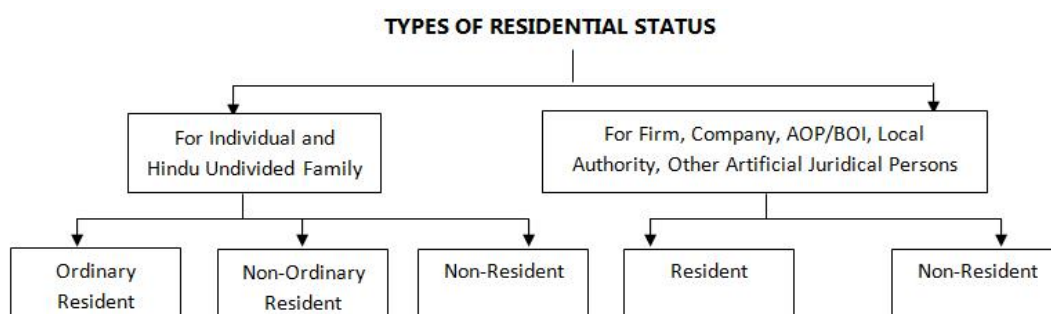
Control or Management	Status
Wholly or partly in India	Resident
Wholly outside India	Non resident

Thus, any such person will be **Resident** in India if control and management of its affairs is **wholly or partly** situated in India and conversely, it will be **non-resident** in India if control and management of its affairs is situated **wholly outside** India.

Control and management means *de facto* (actual) control or manage but not merely the right to control or manage. Control and management is situated at a place where the head, the seat and the directing power are situated.

### 3.5.2 Non Resident

AOP, BOI and firms will be non-resident in India if control and management of its affairs is situated **wholly outside** India. These persons can only be either resident or not resident but not ordinarily residents as depicted in the following diagram:



### Illustration -10:

Whether XYZ operating in India but is partly controlled from outside India will be resident or non –resident if its status is: -;

- a) HUF, c) AOP, d) BOI, e) Artificial juridical person?

### Solution

XYZ will be Resident of India in all the cases.

**Illustration -11:**

What will be the status in the above cases if XYZ is wholly controlled from Mauritius?

**Solution**

XYZ will be Non -Resident of India in all the cases.

**2.3.6 Residential Status of a Company –Section 6(3)**

As per section 6(3), residential status of a company is based on its place of registration and control and management. Indian companies are always treated as resident irrespective of where their control or management is. Other companies' will be resident if their control and management is wholly in India. Even if the part of the management or control is outside India, the foreign company would be treated as non- resident in India

The legal provisions are summarized in the following table.

<b>Company</b>	<b>Status</b>
Indian companies	Resident
Other Companies if control and management is: Wholly or partly in India	Resident
Wholly outside India	Non resident

**Illustration -12:**

What will be the residential status of X LTD an Indian company managed from India?

**Solution**

Indian company will always Resident in India. (f) Foreign Company will be a Nonresident.

**Illustration -13:**

What will be the residential status of Y LTD an Indian company managed from London?

**Solution**

Indian company will always Resident of India even if it is managed from outside India.

**Illustration -14:**

What will be the residential status of T LTD a British company managed from India?

**Solution**

T ltd will resident will be resident in India as its control or management is wholly or partly situated in India.

**Illustration -15:**

What will be the residential status of U Inc.? A US Company managed from London?

**Solution**

U limited will be a Non-resident in India as its control or management is wholly situated outside India.

**2.3.7 Miscellaneous:**

Following points are noteworthy:

**A. Residential status for each previous year:**

Residential status of a person shall be determined for each previous year independently.

**B. Different residential status for different assessment years:**

Residential status of a person may change from previous year to previous year. be different for different assessment years and a person may have different residential status for different assessment years. For instance, if a person leaves India for two years and then comes back, he can be non-resident for those two years and resident for other years.

**C. Resident in India and abroad:**

A person may be “resident” in two or more countries at the same time. Conversely in a particular assessment year, a person may be a non-resident in India as well as other countries.

It is not necessary that a person, who is “resident” in India, will necessarily be non-resident in all the other countries for the same assessment year. This is particularly true of a person, who has changed his country two three times in a year and he does not fall in any category of residents anywhere in the world.

**D. Residence for all sources:**

If a person is a resident for one source of income in a previous year, he shall be deemed to be a resident for all other sources of income also. [Section 6(5)]

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## **2.4 RESIDENTIAL STATUS AND INCIDENCE OF TAX**

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Section 5, states that incidence of tax on a taxpayer depends on his residential status, the place and time of accrual or receipt of income. The section defines the scope of income in the following manner;

### **4.1. Indian Income taxable in all cases:**

Income received in India or deemed to be received in India or income accruing or arising in India or deemed to be accruing or arising in India are included in the income of every assessee regardless of his residential status whether resident or non-resident or R & OR R & NOR

“**Indian income**” is not defined but generally if, any income is received or deemed to be received in India during the relevant year or It accrues or arises or is deemed to accrue or arise in India during the relevant year it is called as “Indian Income”. Some income may be Indian income in following circumstances: —

- If income is received or deemed to be received in India during the previous year AND it also accrues or arises or is deemed to accrue or arise in India during the previous year.
- If income is received or deemed to be received in India during the previous year BUT it accrues or arises outside India during the previous year.
- If income is received outside India during the previous year but it accrues or arises or is deemed to accrue or arise in India during the previous year.

### **4.2. “Foreign income” taxable in some cases**

Unlike Indian Income foreign income is not chargeable to tax in all cases. Logically, foreign income will be the income which is not Indian Income i.e. Any Income is “**foreign income**” if—

- a. Such income is not received or not deemed to be received in India; and
- b. It does not accrue or arise or is not deemed to accrue or arise in India.

In other words, foreign income is income accruing or arising outside India or deemed to be accruing or arising outside India or income received outside India or deemed to be received outside India.,

Taxability of foreign income is as follows;

1. Foreign income is not included in the total income of a non-resident,
2. Foreign Income is included in the total income of a resident and ordinarily resident,
3. Foreign income **will not be** included in the total income of a resident but not ordinarily resident RNOR unless such income is derived from:
  - a business controlled in India or
  - A profession set up in India

Non-business foreign income will not be included in the income of a person who is resident but not ordinarily resident in India.

The Scope of total income chargeable to tax is summarized as follows:

Basis of charge and  
Incidence of tax

<i>Scope of total income –S 5</i>			
Income	Status		
	Resident & Ordinarily Resident	Resident & Not Ordinarily Resident	Non Resident
Indian income	Taxable	Taxable	Taxable
Foreign income	Taxable	Taxable if income is from <ul style="list-style-type: none"> <li>• a business controlled from India or</li> <li>• a profession set up in India</li> </ul>	Not Taxable

**Remarks:**

1. Indian income taxable in all cases
2. foreign income taxable only by a ROR and conditionally by RNOR
3. Nonresidents liable for Indian income only

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**3.5 INCOME DEEMED TO BE RECEIVED IN INDIA - S. 7**

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As per Section 7, the following incomes are included in the scope of total income even if they are not actually received in India:

1. Annual accretion to the credit balance of an employee in the case of recognized provident fund to the extent provided under rules
2. Excess contribution of employer in the case of recognized provident fund to the extent as provided in the rules.
3. Transfer balance to a recognized provident fund from unrecognized provident fund to the extent as provided under the rules.

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**3.6 INCOME DEEMED TO ACCRUE OR ARISE IN INDIA**

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As per Section 9, which is a deeming section, certain incomes are deemed to accrue or arise in India even though they may actually accrue or arise outside India. These incomes are given below:



1. All incomes accruing or arising whether directly or indirectly through or from-
  - a. Any business connection in India or
  - b. Any property in India or
  - c. Any asset or any source of income in India or
  - d. The transfer of a capital asset situated in India.

**Exceptions:** No income is deemed to accrue or arise in following cases:

- I. **Purchase of goods** India by a Nonresident for Export
- II. **Collection of news** by a non- resident running a new agency, or publishing newspapers, magazines or journals
- III. **Shooting of film** in India by a non- resident foreign citizen individual or a company or firm in which no Resident Indian citizen is a partner or shareholder
- IV. Indian Income to be taken **pro rata** if all operations of a business not carried in India

**Explanation:** The term “business connection” includes a person, who –

- I. holds or habitually exercises holds an authority to conclude contract on behalf of the non-resident, except for purchase of goods or merchandises
- II. has no such authority but maintains stock of goods and merchandise in India, from which he regularly delivers stock or merchandise on behalf of the non-resident.
- III. Secures orders in India for the non-resident and other non-resident, controlling, controlled by or subject to the same common control as that of non-resident.

However, there will be no business connection as above if a non-resident carries on a business through a broker, general commission agent or any other agent of independent status, acting in ordinary course of business.

For this purpose, a broker, general commission agent or an agent shall be deemed to be of an independent status if he does not work mainly or wholly on behalf of the non-resident.

2. “Salary” earned in India i.e. salary payable for services rendered **in India**. It also includes salary paid for the rest period or leave period preceded and succeeded by services rendered in India and forms part of service contract of employment.
3. Salary received by **Indian national from the government** in respect of services rendered **out of India**. However, any allowance or any perquisite paid abroad is fully exempt from tax under Section 10(7).
4. Any **dividend paid by an Indian company** outside India.
5. **Interest** payable by the government or a resident person unless such interest is payable in respect of borrowed funds used for a business or

profession carried out of India, or by a non-resident person on funds borrowed for the business or profession carried in India

6. **Royalty** payable by the government or a resident person unless such royalty is in respect of any right of property or services utilized for a business or profession carried out of India for the purpose of earning any income out of India or by a non-resident person in respect of any right of property or services utilized for the purpose of business or profession carried in India or for the purpose of earning any income in India).

**Exception:**

(i) Royalties payable for the transfer of any data, drawings, etc. outside India or imparting of information outside India under an approved agreement by the Central Government made before the 1st day of April, 1976.

(ii) Royalties paid in lump sum, by a resident for transfer of computer software, supplied by a non-resident along with the computer or computer-based equipment under a scheme duly approved by Government of India

7. **Fees for technical services** payable by: by the government or a resident person unless such fees are payable in respect of services utilized in a business or profession for earning any income out of India or by a non-resident person for services utilized in a business or profession carried on by him in India or for earning any income from any source in India.

**Exception:** fees are payable under agreement made before the 1st day of April, 1976 and approved by the Central Government.

The income of a non-resident is deemed to accrue or arise in India under any of the above clauses, shall be included in the total income of the non-resident, whether or not, the non-resident has -

- (i) a residence or place of business or business connection in India; or  
(ii) has rendered services in India.

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### **3.7 RECEIPT VS. REMITTANCE**

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The “receipt” of income refers to the first occasion when the recipient gets the money under his control. Once an amount is received as income, any remittance or transmission of the amount to another place does not result in “receipt” at the other place.

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### **3.8 ACTUAL RECEIPT VS. DEEMED RECEIPT**

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It is not necessary that an income should be actually received in India in order to attract tax liability. An income deemed to be received in India in the previous year is also included in the taxable income of the assessee. The Act enumerates the certain incomes which were dealt with earlier. E.g., If a resident holds an immovable property in Delhi and the rent received thereon is transferred to his bank account in Mauritius, the rent would still be subject to income tax though the income has not been received in India.

### **3.9 RECEIPT VS. ACCRUAL**

Income is said to be received when it reaches the assessee; when the right to receive the income becomes vested in the assessee, it is said to accrue or arise.

### **3.10 BASIS OF CHARGE FOR DIVIDEND INCOME**

Under the companies Act, 1956, a company can declare dividend only at its Annual General Meeting Accordingly, U/s 8, dividend is deemed to be the income of the previous year in which it is declared irrespective of the fact when it was received by the shareholder. Hence the method of accounting for the dividend becomes immaterial for the purposes of this section.

But the position is quite the opposite in case of interim dividend, which is deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to a shareholder irrespective of the date of declaration of interim dividend.

Deemed Dividend under S 2(22) is deemed to accrue or arise in the year in which it was paid or distributed.

This can be summarized as follows:

Final Dividend	Date of declaration
Interim Dividend	Date of distribution
Deemed dividend	Date of Distribution

#### **Illustration-16:**

Determine the scope of total income in respect of the following incomes if the assessee is a (1) resident or (2) a resident and ordinarily resident or (3) a resident but not ordinarily resident:

	Rs
Interest from U.S. Growth Bonds received in India	10,000
Interest from U.S. Growth Bonds received in U.S.	60,000
Interest from U.S. Growth Bonds received in U.S but remitted to India	60,000
Capital gain on house in Mumbai but sold in London	60,000
Capital gain on house in Mumbai but sold in Mumbai	60,000
Rent of a villa in Paris received in Paris	60,000
Rent of a villa in Paris received in Paris	60,000
Agricultural Income from Tea Gardens in Sri Lanka received in Sri Lanka	60,000

Agricultural Income from Tea Gardens in Sri Lanka received in Mumbai	60,000
Profit from a Branch in Sydney	60,000
Profit from a branch in Mumbai	60,000
Salary for working in Jaipur received in Jaipur	60,000
Salary for working in Jaipur received in Lahore	60,000
Salary for working in Lahore received in Jaipur	60,000
Salary for working in Lahore received in Lahore	60,000

Basis of charge and  
Incidence of tax

### Solution

Particulars	R&OR	R&NOR	N R
Interest from Uncle Sam Bonds U.S.A. received in India	60,000	60,000	60,000
Interest from Uncle Sam Bonds U.S.A. received in U.S	60,000	—	—
Interest from Uncle Sam Bonds U.S.A. received in U.S but remitted to India	60,000	—	—
Capital gain on house received in Mumbai but sold in London	60,000	60,000	60,000
Capital gain on house received in Mumbai and t sold in Mumbai	60,000	60,000	60,000
Rent of a villa in Paris received in Paris	60,000	—	—
Rent of a villa in Paris received in Mumbai	60,000	60,000	60,000
Agricultural Income from Tea Gardens in Sri Lanka received in Sri Lanka	60,000	—	—
Agricultural Income from Tea Gardens in Sri Lanka received in Mumbai	60,000	60,000	60,000
Profit from a Branch in Sydney	60,000	60,000*	—
Profit from a branch in Mumbai	60,000	60,000	60,000
Salary for working in Jaipur received in Jaipur	60,000	60,000	60,000
Salary for working in Jaipur received in Lahore	60,000	60,000	60,000
Salary for working in Lahore received in Jaipur	60,000	60,000	60,000
Salary for working in Lahore received in Lahore	60,000	60,000	60,000
Total	9,00,000	6,60,000	6,00,000

\*if controlled from India

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## **2.11 HEADS OF INCOME**

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### **2.11.1 Classification of income**

Income tax is payable by an assessed on his total income from all the source of income. Each source has its own unique features and requires specific treatment for correct computation of income from that particular source. Naturally, rules and method for computation of income from each such source are different according to the nature of the source. These sources of income are classified under various heads of income in section 14. These heads of income are as follows:

- 1) Income under the head salaries (Section 15 – 17)
- 2) Income from house property (Section 22 – 27)
- 3) Profits and gains from business or profession (Section 28 – 44)
- 4) Capital gains (Section 45 – 55)
- 5) Income from other sources (Section 56 – 59)

### **2.11.2 Importance of different heads**

Each head of income provides a different scheme of computation of taxable income under that head depending upon the nature of income and the complexities attached with that head of income. For this reason, each of the head of income has its own deeming provisions and provisions for exclusions and deductions and deductions of expenses etc.

It is therefore, necessary that an income belonging to a specific head must be computed under that head only. If an income cannot be placed under any of the first four heads, it will be taxed under the head “Income from other sources”.

Aggregate of net income under various heads gives total income of the assessee person, from which deductions are made under chapter VIA. The net result is called the total income or sometimes taxable income. Therefore, computation of income under different heads provides the starting point of determining the tax liability.

### **2.11.3 Heads to be mutually exclusive**

All the heads of income are mutually exclusive. If any income is considered under a particular head e.g., Income from house property, it will not be taken into consideration for another head e.g., Profits and Gains from business and profession.

The nature of income is such that at times, it may not be possible to have water-tight compartmentalization.

**Illustration 17**

Under which head would the income of 3 offices are compositely let out on rent by along with services like intercom, security guard, telephone connection, furniture and fixtures, etc. of Swayam will be taxable?

**Solution**

The rent in respect of the commercial property should be taxed under “Income from House Property”. However, income arising out of rentals of the other services should be taxable under the head “Income from Other Sources”. Alternatively, the entire income arising out of the property as well as the services could be taxable as “Income from Business or Profession”

As per departmental clarification, the income in respect of properties should be taxed as “Income from House Property” and the income out of rentals of the other services to be taxed under “Income from Other Sources”.

**2.11.4 Tax on aggregate income under all the heads**

Although the income is computed under five different heads of income, tax will be computed on the aggregate or total income from all the sources taken together at the prescribed rates. However, different tax treatment is given to different items. For instance, Long term Capital gains (LTCG) are generally taxed at 20%. But LTCG on listed securities is exempt from tax. Similarly, short term capital gain on sale of equity shares is taxed at 18%. The amount of such short term capital gains would be deducted from the aggregate total income and accordingly tax rates are applied. Similarly, shipping companies are taxed on the basis of tonnage of the shipping fleet. Lotteries, horse races etc. are taxed at the maximum rate of tax @ 30% All such incomes are excluded and tax is computed on rest of the total income.

**2.11.5 Common residential status for all the heads**

S. 6 provides that where a person is resident for the purpose of any particular head of income, he will also be considered as resident for the purposes of computation of income under all the heads of income.

**2.11.6 Separate sources of income under one head.**

Income is classified for each head of income. That head of income may have different sources of income falling under that head. For instance, a person may be in receipt of his salary from more than one employer or rent from two or more house properties or more than one business. All such sources will be clubbed together to arrive at the income from that head.

**2.11.7 Expenses under each head of income**

It may be noted that expenses may be allowed under each head of income according to the provisions applicable. The recent trend is to restrict and

standardize the allowance of expenditure. For instance, virtually no expenses except professional tax are allowed under the head salaries. Capital gains envisage deduction if only the cost of acquisition and improvement and transfer expenses and so on and so forth.

### **2.11.8 Expenditure incurred in relation to income not includible in total income**

Section 14 A provides that no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to exempted income that is the income which does not form part of the total income under this Act

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## **2.12 SELF ASSESSMENT QUESTIONS:**

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1. Why determination of residential status is important to ascertain the income tax liability?
2. Discuss the legal provisions in respect of residential status of an individual.
3. Briefly state the provisions for determination of the residential status of an (a) AOP (b) Firm (c) Company.
4. What is meant by the control and management of business?
5. When the income is deemed to accrue or arise or be received in India?
6. The incidence of income-tax depends upon the residential status of an assessee". Discuss.
7. Determine whether the following is true or false:
8. The business income received by X Ltd. an Indian company in New York is foreign income of X.
9. The dividend received from a foreign company in India is Indian Income
10. Write short notes on the following:
  - a. Income received in India
  - b. Income deemed to accrue or arise in India
  - c. Control and management of a business
11. Enumerate various heads of income under the Income Tax Act, 1961.
12. State with reason that can an Income be computed under two heads of income.
13. How are the different heads mutually exclusive?

14. Would expenses in respect of collection of dividend be deductible from income from other sources?
15. Ascertain residential status for the assessment years 2022-23 and 2023-24, of Greg, an Australian citizen, came to India as a commentator during the following period:

From	To	Purpose
10.2. 2020	20-04-2021	World Cup
6-10-2020	25-12-2021	England Tour
04-01-2021	12-01-2022	Training Camp
02-03-2021	29-03-2022	Triangular Cup

Besides, Greg was in India for 340 days in four previous years from 2017-18, to 2020-21 and 260 days in three previous years from 2018-19 to 2020-21.

(Ans: 2021-22 Non-residents, 2022-23 R but RNOR)

16. Parthiv made his debut in international cricket on 11/03/2010. In the first match, he was injured and had to be hospitalized. In U.S. He was discharged from the hospital on 29/03/2021. He returned to India took over as coach for Indian cricket team visiting Pakistan. Parthiv submits the following details of his stay outside India:

From	To	Purpose/ Place
10.4. 2021	28-04-2021	World Cup in Dhaka
03-05-2021	09-07-2021	England Tour
27-08-2021	10-09-2021	Canada Tour
11-09-2021	01-10-2021	US holidays
04-01-2022	26-03-2022	Pakistan Tour

(Ans: Non-Resident)

17. Ashok, an Indian citizen, leaves India on May 22, 2021 for vacation to Uganda and returns on April 9, 2022. Determine the residential status of X for the Assessment Year 2022-23? (Ans: Non-Resident)

18. Determine the residential status for the Assessment Year 2022-23, of Sheila, a foreign citizen, who visits India since 1995 every year for a period of 100 days

(Ans: Non-Resident)



19. Fletcher, a foreign citizen comes to India, for the first time on March 20, 2020. On September 1, 2021, he leaves India for Nepal on a business trip. He comes back on February 26, 2022 to permanently stay in India. Determine the residential status of X for the assessment year 2021-22 and 2022-23.

*(Ans Resident and Not Ordinarily Resident for both the years)*

20. Determine residential status for the Assessment Year 2022-23 of Marconi, an Italian citizen, who comes to India for the first time on May 28, 2021.

*(Ans: Resident and Not Ordinarily Resident)*

21. Determine the scope of total income in respect of the following incomes if the assessee is a (1) resident or (2) a resident and ordinarily resident or (3) a resident but not ordinarily resident

New York business income controlled from India	Rs. 100000
Mumbai Business Controlled from Paris	Rs. 40000
Salary in New York as Indian ambassador	Rs. 90000
Profit on sale of shop in Kolkata paid in Karachi	Rs. 50000
Acting in Indian film –fee received in Rome	Rs. 70000
Past untaxed profits remitted to India from London	Rs. 120000

*(Ans. Resident 350000, R & OR 250000, R& NOR 350000/ past profits not taxable)*

22. Blair, a French Citizen had the following incomes during the year ended 31/3/2021. Compute his Total Income for Asst. Year 2022-23 if he is a (1) resident or (2) a resident and ordinarily resident or (3) a resident but not ordinarily resident.

Income from House property in India	Rs. 30000
Income from property in Rome	Rs. 20000
Interest from Bank account in India	Rs. 2400
Income from business in Bangladesh controlled from India	Rs.32000
Interest from Bank account in U.S.	Rs. 22000
Salary earned and received in Tokyo	Rs. 24000
Income earned and received in London	Rs. 26000
Dividend from British Company received in India	Rs.34000

*(Ans. Resident 19400, R&OR Rs. 98600 R but NOR Rs 66400)*

23. Following are the particulars of income of X for the previous year 2021-22:

- i. X is employed in India and receives Rs. 24,000 as salary.
- ii. Dividend received in London on June 3, 2021: Rs. 31,000 from a foreign company;
- iii. Share of profit received in London on December 15, 2021 from a business situated in Sri Lanka but controlled from India:
- iv. Rs. 60,000; remittance from London on January 15, 2022 out of past untaxed profit of 2014-15 earned and received there: Rs. 30,000 and interest earned and received in India on May 11, 2021 Rs. 76,000.

Find out his gross total income, if he is (a) resident and ordinarily resident, (b) resident but not ordinarily resident, and (c) non-resident for the Assessment Year 2022-23

(Ans: R&OR, his gross total income will be Rs. 105000 i.e. Rs. 24,000 + Rs. 31,000 + Rs. 60,000 R& N OR Rs. 84,000 i.e., Rs. 24,000 + Rs. 60,000). Non-resident, Rs. 24,000.

The remittance from London of Rs. 30,000 is not taxable it is not "receipt" of income. The interest of Rs. 76,000 earned and received in India is taxable 2014-15.)



## **SALARIES**

### **(Sections 15, 16 & 17)**

#### **Unit Structure**

3.1 Introduction and Objectives

3.2 Basis of Charge and Meaning and characteristics

3.3 Scope of salary income

3.4 Tax Treatment of some receipts:

[ Basic Salary, Fees, Commission and Bonus, Arrears of Salaries, Advance salary, Gratuity, Commuted Pension, Leave Salary, Retrenchment compensation, House Rent Allowance (S.10-13A), Pension to Gallantry award winners]

3.5 Taxable Value of Cash Allowances-

[Taxable, Wholly exempt and partly tax-free Allowances]

3.6 Taxable Value of Perquisites

3.7 Classification of Perquisites

3.8 Valuation of Perquisites

3.9 Profits in lieu of Salary

3.10 Deductions -Entertainment Allowance, Profession Tax

3.11 Practical illustrations

3.12 Self-Assessment Questions

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### **3.1 INTRODUCTION AND OBJECTIVES:**

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Among the five heads of income listed by S.14, “Salaries” is the first and most important head of income. The concept of “Salaries” is very wide and includes not only the salary in common parlance but also various other receipts, gifts, perquisites and benefits.

The lesson is divided into various sections dealing with the concept of salary income and its characteristics, which define as to what constitutes “salaries” followed by the incomes falling under this head the computation of basic salary, types of allowances and perquisites, valuation of the perquisites, various income tax provisions for computing taxable value of allowances etc. and their detailed descriptions along with the applicable legal provisions of income tax.

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## 3.2 BASIS OF CHARGE AND MEANING

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### 2.1. Basis of charge

Section 15 provides the basis and scope of charging salaries to income tax:

- any salary due from an employer or a former employer to an assessee in the previous year whether actually paid or not,
- any salary paid or allowed to him in the previous year by an employer or former employer to an assessee in the previous year whether actually paid or not, and
- any arrears of salary paid or allowed to him in the previous year by an employer or a former employer if not charged to income tax for any earlier previous year.

Section 16 and Section 17 respectively prescribe the deductions to be made while computing the income from salary and explain the terms

### 2.2. Meaning and Characteristics

To determine, whether any particular income is to be taxed under the head ‘Salaries’ or not, many tests and essential characteristics are observed. These are discussed as under:

- **Employer-Employee Relationship:**

Salary means remuneration received by a person from his employer for rendering personal services to him under an expressed or implied contract of employment or service. It implies the existence of employer-employee relationship between the payer of income and receiver of income. The services must be rendered in the capacity of an employee and not in any other capacity. For example, services rendered by professionals like doctors, architects; lawyers etc. to their clients are not as employees but in the course of their profession. Accordingly, fees received by them will not be covered under the head ‘salaries’ but under the head ‘profits and gains from business or profession’. By contrast, a doctor in employment with a hospital will be an employee and his salary will be covered under this head.

- **Compensation for services rendered:**

The payment must be made to an employee by the employer as compensation for the services rendered by the employee. However, payment made in other forms like gift, perquisites are also included in the definition of the term ‘salary’

- **Name or form not important:**

Salary will be treated as salary regardless of name given to it or the form or mode of payment. Salary may be paid in cash or kind. It may be called as salary or wages. In all cases, it will be treated as salary so long as the relationship between the payer and payee is that of employer and employee and the payment is made as a compensation for the services rendered by the employee.

- **More than One Sources:**

Salary may be from more than one employer.

- **Type of Employment:**

Salary may be in any capacity like part-time employment or full time employment.

- **Past, Present and prospective employer**

Salary may be received from not just the present employer but also a prospective employer and in some cases even from a former employer for example pension received from a former employer.

- **Real intention to pay:**

Salary income must be real and not fictitious. There must exist an intention or an obligation to pay and receive salary.

- **Subsequent Surrender of Salary not tax-free;**

Salary is taxed on due basis. A subsequent surrender of the salary will not be tax-free except where an employee surrenders his salary to the central government, and then the salary so surrendered will not be treated as taxable income of the employee.

- **Tax- Free salary**

Salary paid as tax free is also taxable in the hands of the employee, though contractually income tax on such is borne not by the employee but by the employer.

- **Time of taxability;**

Salary is taxable in the year of *receipt* or in the year of *earning or accrual* of the salary income, *whichever is earlier*. In other words, advance salary will be taxed when received and unpaid salary will be taxed on accrual, i.e. if the salary has been received first, then it will be taxable in the year of receipt. If salary has been earned but not received, then it will be taxable in the year of earning. However, salary once taxed shall not be subjected to tax again; **A c c o r d i n g l y** accounting method employed by the employee is not relevant to determine the taxability of salary.

- **Salary received by individuals only**

Salary is a compensation for personalized services, which can obviously be rendered by a normal human being and not a body corporate. Salary income is taxable in the hands of individuals only. No other type of person such as a firm or HUF, companies can earn salary income.

- **Voluntary payments taxable as salary**

Voluntary payments like gift etc. also form the part of taxable salary.

- **Salary in respect of services rendered in India**

Salary, leave salary and pension even if paid outside India are deemed u/s 9 to accrue and arise in India and are taxable in India. Further, Salary paid to Indian diplomats by the Government of India is deemed to accrue and arise in India although the same is exempted e u/s 10.

- **Gross salary Taxable;**

Compulsory deductions from salary such as employees' contribution to provident fund, deduction for medical scheme or staff welfare scheme etc. are examples of instances of application of income. In these cases, for computing total income, these deductions have to be added back.

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### **3.3 SCOPE OF SALARY INCOME**

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3.1. Section 15 provides the basis of charging salary income and section 17 explains it. Section 17 gives an inclusive definition of salary.

**Salary includes:**

- a. Wages;
- b. Any Pension or Annuity;
- c. Any Gratuity;
- d. Any fees, commission, perquisites or profits in lieu of or in addition to salary or wages;
- e. Any advance of salary;
- f. Any encashment of leave salary;
- g. Annual accreditation to provident fund above the prescribed limits; and
- h. Any amount of credit to provident fund of employee to the extent it is taxable.

3.2. The term "salary" includes not only the basic salary but also Fees, Commission, Bonus, taxable value of cash allowances and perquisites, Retirement Benefits, encashment of leave salary, advance of salary, arrears of salary, various allowances such as dearness allowance, entertainment allowance, house rent allowance, conveyance allowance and also includes perquisites by way of free housing, free car, free schooling for children of employees, etc. Tax treatment of all such receipts is given below.

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### **3.4 TAX TREATMENT OF CERTAIN RECEIPTS**

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#### **4.1. Basic Salary**

Basic salary is fixed as per their respective terms of employment. It may be either a fixed amount or at a graded system of salary. Under the graded system, apart from starting basic, salary annual increments are pre-fixed. The form of salary is for example 12000-300-15000-500-20,000. In this case, the starting basis salary of the employee will be Rs 12,000 and he will be given an annual increment of Rs. 300 till he reaches at the salary level of Rs 15,000. After reaching Rs 15,000, the increment will be Rs. 500 per annum till he reaches the level of Rs 20,000. No further increment is given thereafter till next date of increment or the date when he is promoted and placed in other grade.

#### **4.2. Fees, Commission and Bonus**

Any fees, commission or bonus or incentive paid or payable to an employee by an employer is fully taxable and is included in salary. Such Commission etc. may be payable as a fixed amount or as a percentage of turnover or partly fixed and partly as a percentage of turnover. When commission is based on fixed percentage of turnover achieved by employee, it is included in basic salary for the purpose of grant of retirement benefits and for computing certain exemptions discussed later

#### **4.3. Arrears of salary:**

Arrears of salary are taxed on receipt basis, if the same has not been taxed earlier. However, relief u/s 89 will be allowed in respect of such arrears.

#### **4.4. Advance Salary:**

Advance Salary is taxable on receipt basis in the year of receipt; however, there will be no tax in the year of actual accrual of such salary again. Further assessee shall be entitled to relief u/s 89 in respect of advance salary. **Loan to employee is not treated as advance of salary and** the same is not taxable.

#### **4.5. Gratuity (Section 10(10)):**

Gratuity is a lump-sum payment to reward an employee for his past services, on his retirement or termination. Sec .10 gives tax of treatment of gratuity as under-

1 Amount received as gratuity on termination as per service rules is Fully EXEMPT in case of employees of Central or State governments or local authorities.

2. Other employees in a concern covered under the Payment of Gratuity Act, 1972 EXEMPTED amount would be lowest of the following:

a. Amount of gratuity received, b. Rs 20,00,000

c. 15 days' salary for every completed or part thereof in excess of six months, year of service computed based on last salary drawn taking numerator of 26.

$$\frac{\text{*Completed year of service X 15 days X Last Drawn Salary}}{26}$$

3. Other employees in a concern NOT covered under the Payment of Gratuity Act, 1972 EXEMPTED amount would be lowest of the following:

a. Amount of gratuity received, b. Rs 20,00,000

Half month's salary for every completed year of service in excess of six months (ignoring the fraction) computed based on average salary of last 10 months preceding the retirement.

$$\text{*Completed year of service* } \frac{1}{2} \text{* Avg. Salary for last 10 months}$$

[\*Completed year of service includes a year or part thereof in excess of six months]

### Illustrations -1

Ashik, a government servant, retires 1 June 2021 after 22 years and 9 months' service. He receives gratuity of Rs 25,00,000. Determine the amount of exemption of gratuity if he was drawing a basic Salary for 10 months preceding the month of his retirement at Rs 40,000 p.m.

### Solution

Since A is a government employee, amount received as gratuity on retirement is fully exempt U/s 10(10).

### Illustrations-2

In the above case, what will be the effect if Ashik was working with ABC Limited, covered under the Payment of Gratuity Act, 1972?



**Solution:**

Since Ashik is the employee of a private employer XYZ Limited covered under the Payment of Gratuity Act, 1972, exempt amount will be Rs 5,30,769 being the least of the following:

I. Amount received	Rs 25,00,000
II. Notified amount	Rs. 20,00,000
15-day's salary based on last drawn salary	Rs 5, 30,769
Taxable (Actual Received – Least Exemptions)	Rs. 19,69,231

**Illustrations-3**

In the above case, what will be the effect if ABC Limited is NOT covered under the Payment of Gratuity Act, 1972?

**Solution:**

Since Ashik is the employee of a private employer XYZ Limited not covered under the Payment of Gratuity Act, 1972, exempt amount will be Rs. 4, 60,000 being the least of the following:

I. Actual amount received	Rs 25,00,000
II. Notified amount	Rs. 20,00,000
15 day's salary based on last drawn salary Rs.40, 000* 15/26 *23 years	Rs 4,60,000
Balance Taxable	Rs 20,40,000

**4.6. Commuted Pension (Section 10(10A):**

On retirement of an employer, the employer makes a regular payment to the employee as a reward for his past services. The regular payment so made at monthly or annual intervals is called pension. Some employers allow an employee to forgo a portion of pension in lieu of lump sum amount. This is known as commutation of pension.

Tax treatment of these two kinds of pension is as under:

- a) *Regular payment* of pension (monthly or quarterly or at some other interval Periodical or uncommuted pension is *fully taxable* in the hands of all employees, whether government or non- government.
- b) Tax treatment of *commuted pension* will be as follows:
  - i. Lump sum payment receive on commutation of pension as per service rules is *fully exempt* for employees of the Central or State Government or a Local Authority or a Statutory Corporation

- ii. For other employees receiving such lump sum pension., the exemption is under:
- *One half of the total value* of pension If the employee has not received any gratuity on termination of employment, and
  - *One-third of the total value* of pension, if the employee has received any gratuity on termination of employment.

#### **Illustration-4**

Determine the amount of taxable pension if A receives a monthly pension of Rs 50,000 from the government.

#### **Solution:**

Uncommuted monthly payment of pension received from government will be fully taxable.

#### **Illustration-5**

Determine the amount of taxable pension if A receives a monthly pension of Rs 50,000 a private limited company.

#### **Solution:**

Uncommuted monthly payment of pension from a private company will also be fully taxable. It is immaterial who the employer is.

#### **Illustration-6.**

Determine the taxability in the hands of A, who retires from government service on 1/6/2021 and receives a pension of 5000 p.m. till 31/12/2021. On 01/01/2022, A opts for commutation of 40 per cent of the value of his pension for a lump sum amount of Rs 1,20,000. After the commutation, A gets pension @ Rs 3,000 per month being 60% of the total pension. No gratuity is paid to A.

#### **Solution:**

Lump sum amount of Rs. 1,20,000 received on commutation of pension will be exempt as A is a government employee

Pension Received during 2020-21

NIL 01-06-2021 to 31-12-2021 = 7 months	Rs 5000 p. m	35000
01-01-2022 to 31-03-2022 = 3 months	Rs 3000 p.m.	9,000
Total Regular Pension fully taxable	Rs	44,000

**Illustration-7**

What will be the position in the above illustration if A is a private employee?

**Solution;**

a. Regular pension of Rs 44,000 will be taxable irrespective of the fact that A is government employee or a private employee or whether or not he is in receipt of any gratuity.

b. Commutation of Pension

Amount Received on commutation of 40% of salary	1,20,000	Full
Value of Pension = 1,20,000 /40%		3,00,000
Amount Received during on commutation		1,20,000
½ of Full Value of Pension Rs 3,00,000* ½		1,50,000
Exempted Amount - being the lower of the two		1,20,000
Taxable Amount [1,20,000-1,20,000]		NIL

**Illustration-8**

Ascertain the taxability if A also receives Rs 50,000 as gratuity.

**Solution:**

a. Regular pension of Rs. 44,000 will always be taxable.

b. A is in receipt of gratuity, hence he will be entitled to exemption equivalent to 1/3 of full value of pension of Rs 1,00,000 only. Balance Rs 20,000 will be taxable.

**4.7. Encashment of Leave Salary {Section 10(10AA)}**

When an employee, instead of enjoying leave at his credit, gets the same encashed following tax treatment will be given: -

- a. Amount received on encashment of leave during the *continuity of employment by all the employees*, will be *taxable* in the year of receipt. However, the employee will be entitled to relief u/s 89.
- b. Amount received on encashment of leave at the time of retirement by way of *superannuation* or otherwise, by
  - a. an employee of the *Central or State Government* will be *fully exempt* and
  - b. any other *employees including employees of a local authority or a statutory corporation*, would be exempt at the lowest of the following and only the balance will be taxable: -

- i. Actual amount received
- ii. Notified Amount currently Rs 3,00,000;
- iii. 10 months' average salary or
- iv. Cash equivalent of leave to be encashed
- i.e. (Leave Entitlement - Leave Availed) X Average Salary

### Other Points

- i. Salary for the purpose of calculating the exempt leave encashment means total of basic salary, dearness allowance and commission on sales achieved by salesmen.
- ii. Average salary means average salary of 10 months immediately preceding the retirement.
- iii. Leave entitlement is to be taken at 30 days for each completed year of service. *Part of the year will not be considered as completed year of service.*
- iv. If leave is encashed from more than one employers, the exemption limit will be taken in respect of all the employers.
- v. Superannuation means retirement on attaining a certain age e.g. 60 years. Courts have held that termination and even resignation of the employee will entitle them to exemption under this section.
- vi. Leave to the credit of the employee means total leave available as reduced by total leave availed.

### Illustration- 9

A is government servant working the Government of Maharashtra. A retires on 01/06/2021 after rendering services for

22 years and 9 months. He was drawing a basic Salary for 10 months preceding the month of his retirement at Rs 8000 p.m. Under the service rules, A was entitled to 2 months' leave for every year of service or part thereof against which A availed total earned leave of 10 months.

On Retirement, a received Rs 2,88,000 as leave encashment being Rs 8,000 per month for 36 months i.e. Total Leave earned 2 months per year for 23 years -46 Months Minus leave taken 10 Months)

Compute amount of exemption of encashment of leave salary

**Solution:**

Since A is a government employee amount, received as leave encashment on retirement is **fully exempt U/s 10(10AA)**.

**Illustration-10**

What will be the exempt amount if A was employed with MSFC?

**Solution:**

MSFC is a statutory corporation not regarded as government. Hence, exemption would be at par with a private employee and worked out as the least of the following:

	<b>Rs.</b>
Amount Received on leave encashment	2,88,000
Notified Amount	3,00,000
10 months' average pay@ Rs. 8,000 p.m.	80,000
Encashment of unavailed leave <i>12* Months @ Rs 8,000</i>	96,000
Exempted Amount - being the lower of the two	80,000
<b>Taxable Amount [2,88,000-80,000]</b>	<b>2,08,000</b>

*[\*Leave entitlement – 22 months – Leave availed 10 Months ignoring fractional period of service of 0 9 months as it is not rounded off.]*

**Illustration-11**

What will be the exempt amount if A receives it while in service?

**Solution**

Leave encashment of Rs 2,88,000 during the continuance of employment will be fully taxable regardless of the fact who the employer is.

*IMP - The time and notified amount (wherever applicable in this lesson) should technically be available in question itself as the rules are not in syllabus.*

**4.8. Retrenchment compensation –S.10 (10B)**

Any compensation received by a workman at the time of retrenchment or closure or transfer of undertaking including change of management resulting in interruption of service is exempt fully if it is paid under a scheme of closure approved by the central government and in other cases, least of the following amounts would be exempt:

- Notified amount presently Rs. 5,00,000
- 15 days' average pay for every completed year of service or any part thereof in excess of six months
- Actual amount.

**Other points;**

- Compensation under a Voluntary Retirement Scheme is also exempt u/s 10(10C).
- Where an assessee has to pay higher tax on account of such lump sum receipts, he is entitled to relief u/s 89.
- However, that once an exemption under this section has been claimed relief u/s 89[1] will not be available.

**Illustration-12:**

A workman was retrenched after 20 years and 10 months' service His average salary was Rs 15,000 per month. He was paid Rs 1,80,000 as the retrenchment compensation. Calculate the exempted amount.

**Solution**

The exempt amount will be least of the following: Rs.

Actual Amount Received	1,50,000
Notified Amount	5,00,000
#10-1/2 months' average salary Rs 15,000 per month	1,42,500
Exempted ( Lowest of the above	1,42,500
Taxable 1,50,000-1,42,500	7,500

# (15 days for 20 years and 10 months rounded off to next number.

Relief u/s 89 not available if he claims the above exemption.

**4.9. House Rent Allowance (Section 10-13A)**

House Rent Allowance or HRA paid by the employer to the employee to meet the housing expenses of the employee, is exempt from tax U/s 10(13A) being the least of the following:

- HRA actually received.
- Rent paid by employee in excess of 10 per cent of salary during the previous year.
- 50 per cent of salary, if employee is residing in the 4 metro cities of Mumbai, Delhi, Chennai or Kolkata and 40 per cent of salary, if the employee is residing at any other place.

Salary for the purpose of calculating the amount of deduction from HRA means the aggregate of Basic Salary, Dearness Allowance and Commission received by salesman on sales achieved by him but it does not include other receipts such as overtime pay, conveyance allowance, etc.

*In simple words, so long, the rent paid is up to 10% of the salary, no HRA will be exempt. It is only if the rent paid is more than 10 %, then the actual HRA may be exempt to the extent of 40% or 50% of the salary.*

### **Illustrations-13:**

Calculate the amount of HRA exempt U/s 10(13A) in respect of an employee residing in Mumbai who was in receipt of basis salary of Rs. 65,000 Dearness allowance of Rs. 35,000 and HRA of Rs 25, 000. and he paid the actual rent of Rs 15,000 per annum.

### **Solution:**

Exemption of HRA will be the least of the following: Rs.

Actual HRA Received	25,000
Rent paid in excess of 10 % of salary 15,000- { 10 %( 65,000+35,000) }	5,000
50% of salary	50,000
Exempted ( Lowest of the above)	5,000
Taxable 25,000-5,000	20,000

### **Illustrations-14:**

Compute the exempt HRA If rent paid is Rs. 50,000.

### **Solution:**

	Rs.
Actual HRA Received	25,000
Rent paid in excess of 10 % of salary 50,000- { 10 %( 65,000+35,000) }	40,000
50% of salary	50,000
Exempted ( Lowest of the above)	25,000
Taxable 25,000-25,000	NIL

### **Illustrations-15:**

Calculate the amount of HRA exempt U/s 10(13A) in respect of an employee residing in Agra who was in receipt of basis salary of Rs. 65,000 Dearness allowance of Rs. 35,000 and HRA of Rs 60,000 and he paid the actual rent of Rs 50,000 per annum.

**Solution:**

Salaries

Actual HRA Received	60,000
Rent paid in excess of 10 % of salary	40,000
50,000- { 10 % ( 65,000+35,000)}	
40% of salary	40,000
Exempted ( Lowest of the above	40,000
Taxable 60,000-40,000	20,000

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### 3.5 TAXABLE VALUE OF CASH ALLOWANCES:

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Allowance is a fixed monetary amount paid by the employer to the employee over and above basic salary for meeting certain expenses, whether personal or for the performance of his duties. As a rule, all allowances are taxable and included in gross salary unless specific exemption is provided in respect of such allowance. Accordingly, the allowances are of three types: categories –

1. Fully taxable,
2. Partially exempt and
3. Fully exempt cash allowances.

Moreover, some allowances are unconditionally exempted but in other cases such as HRA, exemption is subject to fulfillment of some conditions. Then in some cases like Transport Allowance, exemption is allowed in respect of a prescribed sum only on *ad hoc* basis.

Some of these allowances are dealt with in the paras to follow.

#### 5.1. Allowances Fully Taxable:

- a. **Dearness Allowance**, a compensatory allowance paid to meet high prices and increased cost of living, - S 15 & 17
- b. **City Compensatory Allowance** also a compensatory allowance paid to employees posted in big cities like Delhi, Mumbai to compensate the high cost of living in such cities
- c. **Non- practicing Allowance** normally paid to compensate professionals in government service like doctors, chartered accountants, engineers, scientists etc., who are prohibited from doing private practice,
- d. **Warden or Proctor Allowance** paid in educational institutions for working as a Warden of the hostel or as a Proctor in the institution,
- e. **Deputation Allowance** paid to an employee sent from his permanent place of service to some place or institute on deputation for a temporary period,



- F. **Overtime Allowance paid** as extra wages paid to an employee putting in extra working hours over and above his normal hours of duty,
- g. **Servant Allowance**, if paid in cash even if servants may have been employed by the employee.
- h. **Other Allowances** by whatever name called such as family allowance, project allowance, Marriage allowance, education allowance, and holiday allowance as these allowances are not specifically exempt.

## 5.2. Wholly and unconditionally exempt Allowances

- a. **Allowances to Judges** of the High Courts and the Supreme Court,
- b. **Allowances by the United Nations organization** to its employees.
- c. **Foreign allowance** paid by the government to its employees being Indian citizen posted out of India for rendering services abroad
- d. **Pension to Gallantry award winners like Paramvir Chakra, Mahavir Chakra, Vir Chakra etc.** - S. 10(18)

## 5.3. Wholly or partly tax-free Allowances:

Following allowance are wholly or partly tax -free. Some of the exemptions are conditional. Most of the *conditions and monetary limits, though prescribed in rules are incorporated in brief to make the subject comprehensive*. Brief description of these allowances is as follows

### a. Entertainment Allowance- S.16 (ii)

Entertainment Allowance to the employee for entertaining the business relations and clientele of the employer is fully taxable by the private sector employees even if the entire amount may have been spent by them.

Government employees are entitled to a deduction/s16 (ii) up to 20 per cent of Basic Salary subject to a maximum of Rs 5,000 per annum, whichever is lower. Full amount is first included in the salary and then the exempted amount is reduced.

### b. Fixed Medical Allowances

Fixed Medical Expenses are taxable but reimbursement of medical expenses is however exempt up to Rs 15,000

### c. Tiffin / Lunch Allowance

Tiffin / Lunch Allowance paid in cash is fully taxable but Cost of Lunch provided to employees on their work place or even lunch coupons redeemable with restaurants is a tax-free perquisite subject to fulfillment of certain *conditions prescribed by the CBDT*.

**d. Transport Allowance- S 10(14)**

Any allowance or benefit given to meet the expense wholly and necessarily in the course of employment is fully exempt u/10(14) subject to the assessee presenting the proof in this regard.

Under Rule 2BB, Transport or conveyance allowance paid to meet conveyance expenses of the employee from place of residence to place of work and back is exempt up to Rs 800 per month (Rs 1,600 in case of a handicapped employee).

For example, if A is in receipt transport allowance @ Rs 1,000 per month, Rs 200 per month (Rs 1000-Rs 800) will be included in total income of A

**e. Other allowances for official Purposes-S 10(14);**

If any allowances (other conveyance between residence and office) are given for official purposes, deduction of amount actually spent from those allowances by the employee in meeting the official expenses will be allowed at a deduction u/s 10(14) from the total amount of allowances received.

For instance, an employee receives Uniform allowance of Rs 5000 but spends only Rs 4000, towards the uniform, then Rs1000 will be taxable in the hands of the employee. Some other examples of these allowances paid for meeting official expenditure incurred exclusively in performance of official duties are travelling allowance, daily allowance, conveyance allowance, helper allowance, research allowance.

**f. Education Allowance:**

Education Allowance given to meet the education expenses of the employee's is taxable in hands of employee. However, under rule 2BB a sum of Rs100 per month per child subject to maximum of two children is allowed as exemption from total education allowance received by the employee in a given year. If the children of the employee are residing in a hostel, an additional exemption of Rs 300 per month per child subject to maximum of two children is made available to the employee. Therefore, if the employee has two children and who are residing in a hostel and the employee is giving total education allowance of Rs 1000 per month, the taxable amount will be (1000-800) i.e. Rs 200 per month only.

**g. Out of station allowance**

An allowance granted to an employee working in a transport system to meet his personal expenses in performance of his duty in the course of running of such transport from one place to another is exempt up to 70% of such allowance or Rs.6000 per month, whichever is less.

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### 3.6 TAXABLE VALUE OF PERQUISITES

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#### 6.1. Definition and Meaning of Perquisites:

Section 17(2), deals with the taxability of perquisites but it does not define the term it. Therefore, turning to normal commercial meaning, perquisites may be called as any casual emolument or benefits attached to an office or position in addition to salary or wages normally given in kind and not in cash but capable of being measurable in money terms.

#### 6.2. Taxability of perquisites:

Perquisites are included in gross taxable salary only if they are:

- allowed by an employer to an employee,
- allowed during the continuation of employment,
- directly dependent on service,
- resulting in the nature of personal advantage to the employee; and
- derived by virtue of employer's authority.

#### 6.3. Taxable perquisites

Sec. 17 (2) provides the following list of taxable perquisites:

- i. Value of *rent-free accommodation* provided to the employee by the employer.
- ii. Value of *concession in the matter of rent* in respect of accommodation provided to the employee by his employer.
- iii. Value of any *benefit or amenity* granted free of cost or at a concessional rate in any of the following cases:
  - a) by a company to an employee who is a director thereof
  - b) by a company to an employee who has substantial interest in the company
  - c) by any employer to an employee who neither is a director, nor has substantial interest in the company, but his monetary emoluments under the head 'Salaries' exceeds Rs. 50,000.
- iv. Any sum paid by the employer towards any obligation of the employee
- v. Any sum payable by employer to effect an assurance on the life of assessee
- vi. The value of any other fringe benefit given to the employee as may be prescribed.

## 6.4. Classification of Perquisites

On an analysis of Section 17(2), the perquisites are of three broad categories:

- Perquisites taxable in all cases
- Perquisites not taxable at all
- Perquisites taxable only in the hands of specified employees only

### A. Perquisites taxable in all cases:

U/s 17(2) the following perquisites are taxable in the hands of all type of employees, whether specified or not:

1. Value of Rent free house provided by employer
2. Value of house provided at concessional rate
3. Any obligation of employee discharged by employer e.g. payment of club or hotel bills of employee, salary to domestic servants engaged by employee, payment of school fees of employees' children etc.
4. Any sum paid by employer in respect of insurance premium on the life of employee

### B. Perquisites, which are tax-free for all the employees

Section 17 specifically states some benefits will not be taxed at all in the hand of the employees and as such, they are exempt from income tax. These perquisites are given below:

#### a. Medical benefits within India:

Medical benefits within India, which are exempt from tax, include the following:

- a) Medical treatment provided to an employee or any member of his family in a hospital maintained by the employer.
- b) Any sum paid by the employer in respect of any expenditure incurred by the employee on medical treatment of himself and members of his family:
  - (i) in a hospital maintained by government or local authority or approved by the government for medical treatment of its employees.
  - (ii) In respect of the prescribed diseases or ailments in any hospital approved by the Chief Commissioner.
- c) If the ordinary medical treatment of the employee or any member of his family is done at any private hospital, nursing home or clinic, the exemption is restricted to Rs.15000.

## **B. Medical benefits outside India**

Medical Treatment outside India, which is exempt from tax, includes the following:

- a) Any expenditure incurred by employer on the medical treatment of the employee or any member of his family outside India.
- b) Any expenditure incurred by employer on travel and stay abroad of the patient (employee or member of his family) and one attendant who accompanies the patient in connection with such treatment, shall be exempt to the following extent:
  - (i) The expenditure on medical treatment and stay abroad shall be exempt to the extent permitted by the Reserve Bank of India.
  - (ii) The expenditure on travel shall be exempt in full provided the gross total income of the employee (including this expenditure) does not exceed Rs.2,00,000.

## **c. Medical Health Insurance within India**

Following are exempted perquisites in respect of medical Health Insurance

- Premium paid by the employer on health insurance of the employee under an approved scheme u/s 36(1) (if)
- Premium on insurance of health of an employee or his family members paid by employer on any scheme approved u/s 80D (Mediclaim).

## **d. ESOP or Sweat Equity**

Any benefit provided by a company free of cost or at a concessional rate to its employees by way of allotment of shares, debentures or warrants directly or indirectly under any Employees Stock Option Plan or Scheme *ESOP/ESOS* of the company offered to such employees in accordance with the guidelines issued in this behalf by the Central Government. However, the difference between the fair Market Value and the issue price will be treated, when such equity is issued at concessional price, as the taxable perquisite value of ESOP

## **e. Transport**

Amenity or benefit granted or provided free of cost or at concessional rate for use of any vehicle provided by a company or an employer for journey by the assessee from his residence to his office or other place of work, or from such office or place to his residence,

## **f. Refreshments**

Refreshment provided by an employer to the employee during working hours in office environment

**g. Others:**

- a. Value of Leave Travel Concession in India.
- b. Amount spent by the employer as its contribution to staff welfare schemes.
- c. Laptops and computers provided for personal use.
- d. Rent free official accommodation provided to a Judge of High Court or Supreme Court or an official of Parliament including Minister and Leader of Opposition in Parliament.
- e. Recreational facilities extended not to a particular employee but to a class of employees.
- f. Amount spent on training of employee or fees paid for refresher course.
- g. Telephone provided to an employee at his residence.
- h. Goods manufactured by the employer sold to employees at concessional rates
- i. Allowances to employees of UNO

Since FBT has been discontinued, value of cars and other perquisites will be taxable in the hands of the employees.

**C. Perquisites taxable in case of Specified Employees only**

U/s 17(2)(iii) the value of any benefit or amenity granted or provided free of cost or at concessional rate *Specified*

*Employees only* will be taxable and *Specified Employees* means an employee who is

- *a director* of or
- who has a *substantial interest* i.e. more than 20 % voting power in the company; where he is employed or
- Any other employee (of any employer including a company) whose income [under the head Salaries *exceeds fifty thousand rupees*
- Salary for this purpose means salary due from, or paid or allowed by, one or more employers, exclusive of the value of all benefits or amenities not provided for by way of monetary payment,

The following perquisites are taxable in case of such employees:

1. Free supply of gas, electricity or water supply for household consumption

2. Free or concessional educational facilities to the members of employee's household
3. Free or concessional transport facilities
4. Sweeper, watchman, gardener and personal attendant
5. Any other benefit or amenity

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### **3.7 VALUATION OF PERQUISITES:**

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Perquisites are taxable in the hands of the employee. However, since they are paid in kind, notional monetary the value of the perquisites must be determined in order to get the taxable amount of perquisites. There are some broad principles for determining the method of calculation of value of taxable perquisites. Briefly, these principles may be stated as follows:

- If the perquisite is entirely for personal benefits, then whatever the employer has spent for providing those perquisites will be added to the salary income of the employee.
- If the perquisite is given by employer to employee for official purposes only, then such perquisites are not being treated as taxable perquisites in the hands of employee.
- Perquisites which are partly used for personal purposes and partly for official purposes - In such cases a reasonable amount of the value of perquisites which is used for personal purposes only will be added to the salary income of the employee.

*Though the actual valuation rule is beyond the scope of the syllabus, general principles for valuation of perquisites may be considered*

#### **a. Accommodation & Furniture**

Valuation of furnished and unfurnished accommodation is made according to Valuation Rules. If the furnishings are owned by the employer, then 10 per cent of the cost will be added to the value of accommodation.

#### **b. Transport**

Broadly no perquisite value is taken in the hands of individual employees in three cases:

- Common transport such as bus provided to all the employees,
- If the employer is in the transport business.

- If a car is provided only for official use or for the purpose of travel from residence to office.

In other cases, a reasonable cost of such transport facilities will be treated as taxable value of perquisites in respect of such facilities

If the car has been provided for personal uses only, then the taxable amount is reasonable expenses on the car maintenance plus depreciation on the car as per income tax rules if the car is owned by the employer.

If the car is used for private as well as for official purposes then a reasonable proportion of, the above is the valuation of the car perquisite in the hands of the employee.

### **c. Domestic servant**

Salary of domestic servants of employer paid by the employer, perquisite value will be taken as per rules.

### **d. Gas, water or electricity:**

- If the employer himself is engaged in the business of providing supply of gas, water, or electricity, then there will *not be any taxable perquisite* in the hands of the employee in respect of such facilities.
- If the employer is not in the business of supply of gas, water or electricity, then the amount spent by the employee in providing the facilities to the employee will be the taxable value of perquisites in the hands of the employee provided the entire facilities are for the personal use of the employees only. Any amount recovered from the employee will be reduced from the perquisite value.
- Where the connection for gas, electricity, water supply is in the name of employee and the bills are paid or reimbursed by the employer, it is an obligation of the employee discharged by the employer. Such payment is taxable in case of all employees under Section 17(2)(iv)

### **e. Educational facilities:**

- If the employer is a school, college or educational institution, then there will not be any perquisites taxable in the hands of any employee.
- If the employer is not a school, college or educational institution, but is engaged in some other business or profession, the value of school fees or colleges fees of the children of the employee paid by the employer will be the taxable value of perquisites in respect if such facility.
- If the children of the employee are allowed free education in an institute run by the employer where the employer is engaged in other



activities, then the value of the perquisites is reasonable cost of education and deemed by the income tax officer in the hands of specified employees.

#### **f. Medical facilities**

- A sum of up to Rs 15000 paid by the employer to the employee by way of reimbursement of medical expenses of the employee and his family will be exempt perquisite in the hand of the employee. Any payment made in excess of Rs15000 will be taxable.
- If the treatment is made in a government approved hospital or recognized hospital, or in government hospital, then no value will be taken as the perquisite value in respect of such medical treatment reimbursement.
- If the medical treatment is done outside India, then up to the amount approved by the RBI for such treatment, no perquisite value will be added to the taxable income of the employee. If payments made by the employer to the employee in this connection exceed the amount approved by the RBI, then such excess will be treated as taxable salary in the hands on of the employee.
- If the employer himself is a medical institution, then provision of medical facilities will not attract any tax in the hands of the employee.

In other words if an employer's own institution provides transport, education or medical facilities, there will be no taxable perquisite value in the hands of the employee.

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### **3.8 PROFITS IN LIEU OF SALARY – S 17(3)**

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U/s 17 (3) profit in lieu of salaries includes:

#### **1. Compensation for Termination of Employment or modification of Terms & Conditions**

The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment or the modification of the terms and conditions relating thereto;

#### **2. Payment from Employer from PF or Other Fund**

Any payment (other than any pension, gratuity, HRA, Retrenchment compensation, etc.) due to or received by an assessee from an employer or a former employer or from a provident or other fund, to the extent to which it does not consist of contributions by the assessee or interest on such contributions.

### **3. Keyman Insurance Policy**

Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

### **4. Sums Received from Future or Former Employer**

Any amount due to or received, whether in lump sum or otherwise, by any assessee from any person (A) before his joining any employment with that person or (B) after cessation of his employment with that person.

### **5. Payment of Employee's Obligation Employer**

Any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee;

### **6. Payments from Certain Funds:**

Any sum payable by the employer, whether directly or through a fund, other than a recognized provident fund or an approved superannuation fund or a Deposit-linked Insurance Fund established u/s 3G of the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 or u/s 6C of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 to effect an assurance on the life of the assessee or to effect a contract for an annuity;

### **7. Treatment of Annual Accretion to Provident Fund;**

Provident Funds are established to provide for the retirement benefits of the employees. The Scheme of funds envisages annual contributions from both the employer and the employee and the accumulation of interest on the balances. The funds are of three types Viz.

- I.** Statutory Provident Fund set up or established and administered by the Government.
- II.** Recognized Provident Fund set up by others but recognized by the Commissioner of Income Tax
- III.** Unrecognized Provident Fund set up by others but not recognized by the Commissioner of Income Tax due to non-compliance with the guidelines laid down for recognition.

The above position is summarized in the following table:

<b>Under Different Provident Fund</b>			
<b>Type of Fund</b>	<b>Employer's</b>	<b>Interest on</b>	<b>Payment on</b>
Statutory	Exempt	Exempt	Exempt
Recognized	Exempt up to 12% of Basic Salary (Excess taxable)	Exempt up to 9.5% p.a. (Excess	Exempt subject to rules
Unrecognized	Exempt	Exempt	Employers' Contribution & interest taxable –S

#### **Other Points:**

1. Employer's Contribution to all the three funds is exempt at the time of contribution.
2. If the P.F. is deducted from the salary of the employee, salary will have to be grossed up in all the three cases.
3. Employees' Contribution when received back on retirement is exempt in all the three above mentioned cases.
4. Interest on Employees' Contribution from Unrecognized Provident Fund will be treated as Income from Other Sources.

#### **8. Transferred Balance: - S. 7**

When an Unrecognized Provident Fund is subsequently recognized, the balances standing in the Unrecognized Provident Fund are transferred to the Recognized Provident Fund. These balances are called transferred balances and are deemed to be the income of that year as per section 7. Such amount consisting of employees' contribution in excess of 12% of Basic Salary and interest credited in excess of 9.5% per annum are taxed as the salary under section 17(1).

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### **3.9 DEDUCTIONS FROM SALARIES: - S. 16**

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Aggregate of taxable amount in respect of salary, various allowances and perquisites is called the Gross Salary. From the Gross Salary so arrived, Deductions are allowed u/s 16. Other than that, no further deductions are allowed under this head. The following are the deduction available to the employee U/s 16: -

Standard deduction means a flat deduction to individuals earning salary or pension income. It was introduced in the Budget 2018 in lieu of exemption

of transport allowance and reimbursement of miscellaneous medical expenses. For AY 2021-22, the limit of the standard deduction is **Rs50,000**.

### **9.1. Entertainment Allowance: -S.16 (2)**

Deduction in respect of entertainment allowance is allowed only **to the Government Servants**. Employees working in private institutions are not entitled to this deduction. Amount of deduction shall not exceed the actual amount or 20% of basic salary or Rs. 5000, whichever is less. Amount actually spent on entertainment is not relevant.

### **9.2 Profession Tax:**

The Profession Tax, paid by an employee in a given previous year, will be deducted from the gross salary in order to get the taxable amount of salary. Profession Tax is levied by state government on employment.

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## **3.10 ILLUSTRATIONS**

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### **Illustration-16:**

R, a Chartered Accountant was appointed as Finance Manager with ABC Bank on 1/4/2019 in the Salary grade of Rs. 12000 – 500 – 20000 – 1000 – 30000.

He was entitled to Leave Travel Concession for proceeding on leave of Rs. 4000. His actual expenditure on this account amounted to Rs. 5000.

As the bank is situated at a place where home food is available, R was offered Tiffin Allowance Rs. 6000, His actual lunch expenses amounted to Rs. 10,000

Reimbursement of medical expenses for treatment of R and his family in private clinic was Rs. 50,000

The Bank has provided free unfurnished flat at Mumbai (rent paid by Bank: Rs. 80,000). However, the perquisite value of that Flat was Rs. 30000.

The employer provided two watchmen (salary Rs .2000 per month each).

Free use of Santro car for official use, car can be used for journey between office and residence.

Free refreshments provided at place of work (Rs. 100 per day for 200 days).

*Compute Salary Income for the assessment 2022-23*

**Solution:****Computation of Salary Income R for AY 2022-23**

<b>Particulars</b>	<b>Rs.</b>
Basic salary (12000+500+500)*12	1,56,000
Leave Travel Concession (Exempt)	NIL
Tiffin Allowance ( Taxable)	6,000
Medical Expenses Reimbursed (50000 – 15000)	35,000
Rent Free Accommodation (Given)	30,000
Watchmen's Salary (2000 * 2 *12)	48,000
Santro Car only for Office use	NIL
Free Refreshments at workplace	NIL
Gross Salary	<b>275000</b>
Less: <b>Deduction U/s 16</b>	
Standard Deduction	<b>(50,000)</b>
Taxable Salary	<b><u>2,25,000</u></b>

**Illustration -17:**

X is in negotiation with two employer A &B, who have made the following offers to X. Help him in making an appropriate choice.

<b>Particulars</b>	<b>Rupees</b>	
	<b>A</b>	<b>B</b>
Basic Salary	500000	50,000
HRA – Actual Rent Rs. 200000	25,0000	0
Free House –fair rental value 50000	0	250000
Transport Allowance	100000	0
Free Use of Car – Amount spent		100000
Education Allowance for one child	5,0000	0
Free Education for 1 child. Amount spent	0	50000
Gardener Allowance	60000	0
Gardener's salary paid by employer		60000
Salary	<b>960000</b>	<b>960000</b>

**Taxable salary from employer A**

Basic Salary		500000
HRA (Actual) Less : Exempt (HRA or 50 per cent of salary paid less 10 per cent of salary 10% of 500000)	250000 <u>150000</u> 200000-	100000
Education Allowance Less : Exempt (100*12)	50000 <u>1200</u>	
Gardener Allowance		60000
Transport Allowance		100000
Gross Salary		<b>799200</b>
Less: <b>Deduction U/s 16</b>		
Standard Deduction		<u><b>(50,000)</b></u>
<b>Taxable Salary</b>		<u><b>749200</b></u>

**Taxable salary from employer B**

Basic Salary	500000
Free House Value	50000
Free Education for 1 child	50000
Gardener's Salary(120 * 12)	1440
Free Car	100000
Gross Salary	<b>851440</b>
Less: <b>Deduction U/s 16</b>	
Standard Deduction	<u><b>(50,000)</b></u>
<b>Taxable Salary</b>	<b>801440</b>

Since Taxable salary will be less with B, He should be preferred to.

**Illustration- 18:**

XY Ltd offers a job with following options to M, who is neither a director nor he has substantial interest in the company:

PARTICULARS	I	II
	Rs.	Rs.
Basic Salary	1,70,000	1,70,000
Bonus	6,000	6,000
Education Allowance for 2 children	10,200	--
Education facility for 2 children in an Institution maintained by the employer	--	10,200
Sweeper Allowance	10,000	--
Free Sweeper	--	10,000
Entertainment Allowance	6,000	--
Club Facility	--	6,000
Conveyance Allowance for personal use	12,000	--
Free Car Facility for Personal Use	--	12,000
Medical Allowance	18,000	--
Medical Facility for M and Family Members in own hospital		
Free gas, electricity and water supply	--	4,500
Fair Rent Rent-free unfurnished house:	24,000	24,000

Which option M must choose on the assumption that he and XY LTD will both contribute 10% of salary towards unrecognized PF?

#### SOLUTION:

PARTICULARS	I	II
	Rs.	Rs.
Income from Salary		
Basic Salary	1,70,000	1,70,000
Bonus	6,000	6,000
Education Allowance (10,200 - 2,400)	7,800	Exempt
Education Facility	--	Exempt
Sweeper Allowance/Facility	10,000	--
Entertainment Allowance/Club Facility	6,000	6,000
Conveyance Allowance/Car Facility	12,000	Exempt
Medical Allowance/facility	18,000	--
Allowance for gas/electricity/water/free Facility		
Rent free unfurnished house	13,430	7,600
Gross Salary	<b>2,47,730</b>	<b>1,89,600</b>
Less: <b>Deduction U/s 16</b>		
Standard Deduction	<b>(50,000)</b>	<b>(50,000)</b>
<b>Taxable Salary</b>	<b>1,97,730</b>	<b>1,39,600</b>

Since taxable income is lower in option II, it should be preferred.

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### 3.11 SELF ASSESSMENT QUESTIONS

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1. What is Salary?
2. Discuss the difference profits in lieu of salary and perquisites.
3. Discuss various deductions available under the head salary.
4. Discuss the tax treatment of the perquisites for different employees.
5. Non- specified employees pay less tax than specified employees".  
Comment.
6. Rajesh is an employee of ABC Ltd. Since 1997, he is receiving entertainment allowance of Rs. 500 p.m. He submits following further information as on 31.03.14 with the request to compute his taxable salary.
  - a) Net Salary of Rs. 4,000 p.m. (including entertainment allowance of Rs. 500 p.m. but after deducting income tax Rs. 500, Provident Fund Rs. 500 and Profession tax Rs. 70)
  - b) He is provided car for his exclusive use during office hours for office work. The petrol and other maintenance expenses come to Rs. 12,000 p.a.
  - c) Received Leave Travel Concession for himself and his family for proceeding on leave to hometown of Rs. 5,000 as prescribed, while actual amount spent by him was Rs. 3,500.
  - d) During the year, he received free services of a cook. (Cost to the employer Rs. 4,400)
  - e) Received Rs. 8,000 on encashment of leave to his credit.
7. Rita was an employee of R India Ltd since 1968 covered by the Payment of Gratuity Act, 1972, retired on 31 January 2014 after 35 years and 7 months' service. At the time of retirement her employer paid gratuity of Rs. 65,000 (exempt u/s 10(10) Rs. 51,000). She received Rs. 50,000 being the accumulated balance of recognized Provident Fund. The due date of salary etc. was 1<sup>st</sup> day of the next month and were paid on due date. He was entitled to a monthly pension of Rs. 400 with effect from 1<sup>st</sup> day of February 2014, which becomes due on the last day of the month.
8. Compute the taxable income of Mr. Hitesh for the AY 2022-23 on the basis of the following further information:
  - (A) Basic Salary Rs. 2,5000 p.m.
  - (B) House Rent Allowance Rs. 4000 p.m. Taxable value is 50% of the amount received.



Project Allowance paid during the year Rs. 12,000.

(C) Bonus paid during the year Rs. 3,6000.

(D) In retirement, on encashment of earned leave at his credit of 15 months he received Rs. 37,500. (Exempt u/s 10(10AA) Rs. 24,600)

9. Suhas submits the following information pertaining to the year 31.3.2022 and asks you to compute his income from salaries for the AY 2022-23.

a) Basic Salary Rs. 5,000 p.m.

b) Dearness Allowance Rs. 3,000 p.m.

c) Bonus @ 20% on salary plus Dearness Allowance

d) Employee contribution 12.5% of basic salary+DA to RPF. Employer also contributes an equal sum.

e) Interest on balance credited to his RPF @ 14% p.a. Rs. 17,500

f) House Rent Allowance Rs. 10,000 p.a.

g) Profession tax paid by employee Rs. 840.

He retired from services on 31.3.2022 opting for 60% commutation of pension and received Rs. 2,40,000 as the only terminal benefit.



## **INCOME FROM HOUSE PROPERTY (SECTIONS 22- 27)**

### **Unit Structure**

4.1 Introduction and objectives

4.2 Basis of Charge

4.3 Deemed owner

4.4 Income Exempt U/s 10

4.5 Computation of income from house property

[GAV, NAV SOP, deemed let out partly let-out and partly self-occupied  
Co-ownership, deductions

4.6 Miscellaneous- Arrears, Losses, TDs and no other deductions

4.7 Illustrations

4.8 Self - Examination Introduction and Objectives

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### **4.1 INTRODUCTION AND OBJECTIVES:**

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Income from house Property” is significantly different from the other heads of income unlike the other heads as it covers not only the actual income but also the notional income.

This lesson explains the taxing provisions related to “Income from house property” contained in Sections 22 to 27 namely -.

- S 22 defines the scope of Income from House Property;
- S .3 gives the mode of computation of income,
- S. 24 specifies the amounts deductible therefrom.
- S. 25 deals with the amounts not deductible.
- S.26 deals with the income of co-owners of a property and
- S. 27 gives the cases where a person not being an owner of the property will be taxed as the deemed owner of such property.

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## 4.2 BASIS OF CHARGE: S. 22:

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**2.2.1** Annual Value of property consisting of **any building or lands appurtenant thereto** of which the **assesse is the owner**, shall be chargeable under the head Income from House Property. This is however not applicable to property occupied for the purpose of assesses own business or Profession-Sec 22.

**2.2.2** In order to charge any income from any property under this head, following conditions are satisfied namely –

a) The property must consist of buildings or land appurtenant or adjacent thereto. other properties are not covered under this head

- **‘Building** ‘means any habitable four-wall structure covered by a roof. It is immaterial whether the building is residential or commercial such as warehouse, office or factory godown, wedding hall, auditorium, business Centre, etc.

- **‘Land appurtenant’** means the land connected or adjacent to the building e.g. open space, approach roads, courtyard, compounds, courtyards, backyards, playgrounds, parking spaces, etc.

Income from any other property e.g. rental Income from a vacant plot of land is not chargeable to tax under this head unless it is appurtenant to a building.

b) The assesse must own the property. It is only the owner or deemed owner of house property who is liable to tax on income under this head. Following points are important in this regard:

(a) Owner may be any person i.e. an individual, HUF, firm, company, cooperative society or association of persons etc.

(b) The person must be the owner in the previous year. Subsequent change in the ownership of the property is immaterial.

(c) Similarly, Sub-letting income of a tenant, who sub-lets the property to another tenant, is also not covered under this head since the tenant is not the owner of the property. Such income will be treated either as business income or as income from Other Sources.

c) The property may be either let-out or used for own residence but it must not be used for the purpose of assesses own business or profession.

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## 4.3 DEEMED OWNER- SEC. 27:

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Section 27, provides exceptions to the principle that ownership as the basis of taxing income from house property, when a person will be deemed to the owner of a property although he may not be the legal owner thereof and income from such property will be treated as income from house property. These exceptions are as follows:

- i. An individual, who transfers any property for inadequate consideration or who gifts that property to **his spouse or to a minor child** other than a married daughter will be treated as deemed owner of that property. In such cases, though legally the owner of the property is the spouse or the minor child, the income from that property will be treated as income of this person who has transferred such property.
- ii. The holder of an **impartible estate** will be treated as the owner of that entire property for example where an HUF jointly holds property on behalf of all its members, then joint HUF will be treated as the owner though legally the property may be in the name of an individual member of family.
- iii. A **member of co-operative society, company or other association of persons** to whom a building has been allotted under a house building scheme of society will also be treated as deemed owner of that property.
- iv. A purchaser who has received possession of a property in part performance of a contract within the meaning of **section 53A of the transfer of property Act** will be treated as deemed owner of that property despite the fact that the agreement for buying of property has not been registered with the appropriate authority.
- v. A person who has acquired right by way of long-term lease of property for period of more than 12 years will be treated as the owner of that property and income from that property. This provision is not applicable on any right by way of a lease renewable from month to month or for a period not exceeding one year.

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#### **4.4 HOUSE PROPERTY INCOME EXEMPT U/S 10**

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Income from house property is exempt from tax u/s 10. If it is earned by certain institutions / organizations/ persons etc. or in certain circumstances such as-

- (a) Income of One Palace of an ex- Ruler - S. 10(19A)
- (b) A local authority S. -10(20)
- (c) A scientific research association -S. 10(20),
- (d) An Institution for development of Khadi & Village Industries -S. 10(23BB)
- (e) Khadi & Village Industries Board -S. 10(23BB)
- (f) A body for administration of charitable & religious trusts & endowments -S. 10(23BBA)
- (g) Approved funds, educational institutions & hospitals- S. 10(23C),
- (h) A trade union or association of trade union- S. 10(24)

- (i) Resident of Ladakh district -S. 10(26A)
- (j) Statutory corporations/ other institution or association finance by the government for promoting the interests of the members of the scheduled caste and scheduled tribes- S. 10(26B)
- (k) Co-operative society for promoting the interests of the members of the scheduled caste and scheduled tribes- S. 10(27)
- (l) A political party -S. 13
- (m) A farmhouse used for agricultural purposes. -S. 10(1)
- (n) property held for charitable purposes -S. 11
- (o) Property used for own business or profession such as letting out property to paying guest, employees' quarters, residence of partners or directors are some of the business uses. –S 22.
- (p) If such property yields any income, such income will be treated as business income and not house property income.
- (q) One Self Occupied Property of an individual or a HUF assessee and not for letting out - S. 23(1). This benefit cannot be availed by non- living entities like firms, companies, etc.

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## **5. COMPUTATION HOUSE PROPERTY INCOME:**

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Income from house property is computed based on its annual value determined u/s 23 and after allowing deductions u/s 24 therefrom. These provisions are explained below:

### **5.1 Annual Value -Sec 23**

Since, there is no definitive meaning of the term annual value defined in Sec 2(22) "as the annual value determined under Sec. 23, meaning of annual value has to be seen in common parlance.

'Annual value' may be defined as the inherent capacity of a property to earn income or the amount for which the property may reasonably be expected to be let out from year to year. It is not the actual rent but the capacity to fetch rent that is important. It implies that a property need not necessarily be let out.

The annual value of a property will, therefore, depend upon the use of the property- self occupied, let out or partly vacant etc. The provisions of section 23 for determination of annual value are given below:

### **5.2 Determination of Gross Annual Value [GAV]**

Annual value of a house property is higher of the Actual Rent or its Reasonable Lettable Value [RLV]-S23 (1) (a)



Direct Tax

**Solution:**

Given Actual Rent -Rs 10,000 per month	1,20,000
(a) Fair rent - Rs. 15,000 per month	1,80,000
(b) Municipal ratable value Rs. 8000 P.M.	96,000
Higher of the (a) and (b) – Fair Rent	<b>1,80,000</b>
Standard Rent Rs 12,000 per month	1,44,000
Fair rent cannot exceed the Standard Rent, Hence Reasonable Lettable Value <b>RLV</b> restricted to	1,44,000
<b>Gross Annual Value Higher</b> of the Two	<b>1,44,000</b>

**Illustration-2:**

What will be the GAV if the Standard rent Rs. 18,000 p.m.?

**Solution:**

Given Actual Rent -Rs 10,000 per month	1,20,000
(a) Fair rent - Rs. 15,000 per month	1,80,000
(b) Municipal ratable value Rs. 8000 P.M.	96,000
Higher of the (a) and (b) – Fair Rent	<b>1,80,000</b>
Standard Rent Rs 18,000 per month	2,16,000
Reasonable Lettable Value <b>RLV</b>	1,80,000
<b>Gross Annual Value Higher</b> of the Two	<b>1,80,000</b>

*Standard rent being only a limiting factor is ignored.*

**Illustration-3:**

What will be the annual value of the property if the Actual rent in the above case is Rs. 20,000 per month; fair rent, ratable value and standard rent remain at the same level of Rs. 15,000, 8000 and 12,000 per month respectively.

**Solution:**

		Income from House Property
Given Actual Rent -Rs 20,000 per month	2,40,000	
(a) Fair rent - Rs. 15,000 per month	1,80,000	
(b) Municipal ratable value Rs. 8000 P.M.	96,000	
Higher of the (a) and (b) – Fair Rent	<b>1,80,000</b>	
Standard Rent Rs 12,000 per month	1,44,000	

Fair rent cannot exceed the Standard Rent, Hence Reasonable Lettable Value **RLV** restricted to 1,44,000

**Gross Annual Value Higher** of the Two **2,40,000**

**Comparison of Reasonable letting value and Rent received/ Receivable- Sec .23(1(b)):**

Gross annual value is the higher of the two values namely the rent received or receivable as compared with the reasonable letting value. Such comparison may throw two possibilities viz: -

- (a) Actual rent received/ receivable is more than the reasonable letting value. In such a case, actual rent will be the Gross Annual Value u/s 23(1)
- (b). OR
- (b) Conversely, the reasonable letting value is more than the actual rent received/ receivable. In this case if the reason for deficiency or shortfall between the actual rent the reasonable letting value is:

- I. Vacancy only and no other reason, such lower rent will be taken as the gross annual value u/s 23(1)(c) or and
- II. Any other reason, reasonable letting value will be the gross annual value.

The above position will be clear from the following diagram:

<u>Situation</u>	<u>Gross Annual Value</u>	
Actual Rent > RLV	Actual Rent	
RLV > Actual Rent	Reason Vacancy	Actual Rent = GAV
	Other reason	RLV =GAV

**5.3 Other Important points: -**

- i. Actual rent is relevant only if the property is let out. A property, which remains vacant or is nor let out at all or a self- occupied property cannot have any actual rent. In such a case, reasonable letting value alone will



be the guiding factor.

- ii. The amount of Rent actually received/ receivable during the previous year will be arrived after deducting rent for the period for which the property was vacant and unrealized rent or bad debts,
- iii. In case of composite rent, expenses on providing amenities to the tenant such as water will be deducted to find out the actual rent.
- iv. For determining the Annual value, the actual rent shall not include the rent, which cannot be realized by the owner. However, the following conditions need to be satisfied for this:
  - (a) The tenancy is bona fide;
  - (b) The defaulting tenant has vacated, or steps have been taken to compel him to vacate the property.
  - (c) The defaulting tenant is not in occupation of any other property of the assessee;
  - (d) The assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfied the Assessing Officer that legal proceedings would be useless.

#### **Illustration-4**

Find out the annual value of a house let out for @ Rs 2,000 per month. Reasonable Lettable Value is Rs 20,000.

#### **Solution:**

Annual value will be the actual rent of Rs 24,000 because it is higher than the reasonable lettable value of Rs 20,000

#### **Illustration-5**

What will be the GAV if the reasonable lettable value is Rs 30,000 but the actual rent is Rs 2,000 per month?

#### **Solution:**

Annual value on this case be the reasonable lettable value i.e. Rs. 30,000 being higher than the actual rent of Rs. 24,000,

#### **Illustration-6**

A house was let out on a monthly rent of Rs. 20,000 for 8 months only. Remaining 4 months it remained vacant. Reasonable lettable value of the house is Rs. 2,40,000. What would be its annual value?

#### **Solution:**

Actual rent is Rs. 1,60,000 for 8 months. However, RLV is Rs. 2,40,000 for the full year. There is a shortfall of Rs. 80,000 compared to the reasonable lettable value.

Actual rent for full year will Rs. 2,40,000, if there is no vacancy. Since the shortfall of Rs. 80,000 is solely on account of vacancy, the gross annual value will be Rs. 1,60,000 being the actual rent.

#### **5.4 Computation of Net Annual Value:**

Sec 23 classifies the house properties into different categories as discussed below:

##### **(A) Self-occupied Business Properties:**

Income from house property used for own business or profession is exempt from tax. If any rent or other income is generated from such property, the same should be treated as business income. Similarly, municipal taxes, repairs, insurance premium, and other expenses incurred on such property etc. will be admissible as business expenses.

##### **(B) Self-occupied Residential Properties (SOP):**

###### **I. SOP – Annual Value to be taken as NIL**

U/s 23(2)(a) value of one residential house part thereof which is occupied by the owner himself for his own residence is taken as nil subject to two conditions namely: -:

- i. The property or part thereof is not let-out actually for any part of the previous year and
- ii. No other benefit has been derived from such property.

Some points are important in respect of SOPs.

1. This exemption is available only to *individuals and HUFs*. Other non-living persons cannot avail this exemption.
2. Exemption is restricted to only *one self-occupied property*,
3. If the assessee *owns more than one self-occupied properties*, the assessee, at his option, may *choose any one* property as self-occupied by him and the remaining properties will be deemed or assumed to have been let-out.
4. Gross Annual Value of such properties deemed to have been let-out, will be determined based on their notional rental value as if the properties were let-out even if no rent has actually been received by the assessee. However, deductions u/s 23 & 24 will be allowed in the normal manner on such property.
5. If an assessee owns only one property, and cannot occupy the same because he is engaged in employment or is carrying on a business or profession elsewhere, these provisions will apply *mutatis mutandis*-Sec. 24(2).

**III. No Deductions allowed from SOP except Interest:**

Once the annual value of a SOP has been taken as nil, no further deduction will be allowed U/s 23 in respect of municipal taxes or U/s 24 except in respect of interest paid or payable on borrowed funds for purchase, construction, repair, renewal or reconstruction of house property as per the following rules

1. Interest paid or payable on loan taken prior to 01/04/1999 will be allowed to the extent of Rs. 30,000.
2. Interest paid or payable on loan taken after 01/04/1999 for acquisition/ construction of house property, will be allowed to the extent of Rs. 2,00,000.
3. But if loan is taken after 01/04/1999 or repairs or renovation of the house property, deduction in respect of interest paid or payable will be restricted to Rs. 30,000.
4. Interest is allowed on accrual basis. Actual payment during the previous is not necessary.
5. Interest paid or payable on money borrowed to acquire or construct the house property, for the period prior to the previous year in which the property had been acquired or constructed, shall be deductible in *five* equal annual instalments starting from the previous year in which the house has been acquired or constructed.
- 6 A fresh loan may be raised exclusively to repay the original loan taken for purchase/ construction etc., of the property. In such a case also, the interest on the fresh loan will be allowable.
7. Interest payable on interest will not be allowed.
8. Brokerage or commission paid to arrange a loan for house construction will not be allowed.
- 9 Any loss arising under the head 'income from house property' may be set-off against the other heads in the same assessment year.

<b>INTERST ALLOWABLE ON LOANS TAKEN</b>		
<b>Before 01/04/1999</b>	<b>AFTER 01/04/1999</b>	
	For Acquisition or Construction	For Repairs or Renovation
Rs 30,000	Rs 2,00,000	Rs 30,000

**Illustrations-7:**

Find out the interest deductible U/s 24 for the assessment year if A borrows Rs. 25,00,000 @ 10% p. a. on 1/4/2009 to construct a Bungalow for own residence.,

**Solution:**

Rs 2,00,000 will be allowed out of interest payable Rs. 2,50,000.

**Illustration-8:**

Determine the amount of interest allowable in the above illustration if the money was borrowed in 1998.

**Solution**

The deduction would be restricted to Rs. 30,000.

**Illustration-9:**

What would be amount of deductible interest if the loan was used for repairs of the bungalow?

**Solution**

The deduction would be restricted to Rs. 30,000.

**Illustration-10:**

If the construction of the Bungalow was completed in February 2012, what would be the amount of deductible interest?

**Solution:**

Loan was taken on 01/04/2009 (F.Y. 2009-10) and building was completed in February 2012 (F.Y. 2011-12).

Interest for the Pre –construction period i.e. F.Y. 2009-10 and 2010-11, works out to Rs 5,00,000. During this period there was no house property, hence, there is neither any income from house property chargeable to tax nor any interest deductible therefrom.

Total interest payable for these two Rs 5,00,000 will be spread over in FIVE equal instalments of Rs 1,00,000 each and will be allowed from assessment year 2012-13 being the year in which the construction was completed for five assessment years up to and including Assessment 2016-17 with in the overall limit of Rs. 1,50,000

**(C) Let-out Properties:**

Following principles will be applicable for determination of annual value of properties let out including SOP deemed to be let out.

## 1. Net Annual Value

Let-out properties are charged to tax at the net annual value (NAV), arrived at by deducting Municipal taxes *paid* by the owner from GAV- (Proviso to S. 23(1)). Municipal taxes paid or borne by the tenant are not deductible. Municipal taxes are taken on cash basis and not accrual basis.

$$\text{NAV} = [\text{GAV}] - [\text{Municipal Taxes paid by the Owner}]$$

## 2. Deductions under section 24:

### (a) Standard deduction

From the net annual value, a standard deduction in respect of Repairs and Collection Charges is allowed to the extent of 30% of the net annual value irrespective of whether the assessee has actually incurred the expenses or not. However, if the repairs are borne by the tenant, this deduction will not be allowed in the hands of the owner of the property.

### (b) Arrears of Rent

A deduction of 30% is allowed for repairs and collection charges from the arrears of rent received in respect of a property let out, which were earlier not charged to tax and the same will be taxable in the year of receipt - Sec 25 B

### (c) Interest on funds borrowed

Interest on loan taken for acquisition, construction, renewal, repairs or reconstruction is allowed on let-out properties without any limit of Rs 30,000/ 1,50,000 as in case of SOP. The interest on loans, is allowable on accrual basis. Similarly, Pre-construction interest from the date of the loan to the end of the previous year before the previous year in which the house was acquired is amortized 1/5th per year for 5 years as in case of SOP from the financial year in which the construction was completed.

### Illustration -11

A took a loan on 01/10/ 2008 of Rs 10,00,000 @ 10% interest p.a for the construction of his house. The house was finally constructed on January 1, 2012. Calculate the pre-construction period interest and also mention the AYs in which the deduction for such interest may be allowed.

### Solution

Loan was taken on 01/10/2008 and the house is constructed in the financial year 2011-12 (Assessment year 2012-13)

Pre-construction period = 01/10/2008 to 31/03/2011 = 2.5 years.

Interest for preconstruction period: Rs 10,00,000 X 10% X 2.5 = Rs 2,50,000, which will be amortized in five equal instalments of Rs 50,000 each from Assessment Year 2012-13, in which the house was constructed, onwards till 2016-17.

**(D) Property let-out and self-occupied for part of the year**

If a property is let-out for whole or any part of the year and self-occupied for the remaining part of the year, it shall be treated as let-out property and computation will be made accordingly by comparing actual rent with the fair rent for the whole property u/s 23(1). It will not be treated as SOP as Sec 23(3) makes it clear the SOP shall not be let-out for any part of the year nor should any benefit be derived from it.

**(E) Property partly let-out and partly self-occupied:**

If a part of the property – say one or two floors or few rooms have been let out and another part of the property is self-occupied, then for each portion the calculation will be made separately. Relevant expenses like property taxes and interest will be allocated suitably for each portion and deductions will be allowed separately for each portion.

NOTE the difference between properties let out /SOP for split period and with split portion used for letting out/SOP.

**(F) Co-ownership – Section 26:**

A property owned by more than one owners having definite and ascertainable share therein, will not be assessed as an association of persons but share of each owner shall be included in his individual income. Supposing the property is occupied by the co-owners themselves, share of each owner will be treated as nil. Each of the co-owners would be entitled to the deduction in respect of interest subject to the limit of Rs 30,000 or Rs 1,50,000, as the case may be.

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**4.6 MISCELLANEOUS:**


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**Recovery of past arrears of AY 2002-03 Onward-S 25B**

Arrears of rent pertaining to period from assessment year 2002-03 or thereafter will be taxable in the year of recovery and 30% deduction is allowable in that year S. 25B

**Recovery of arrears for pre AY 2002-03 –S 25A/25AA**

Recovery of unrealized rent earlier allowed as deduction u/s 24 up to Assessment Year 2002-03 and thereafter from the annual value, are taxable in the year of recovery but 30% deduction will not be allowed (S. 25-A/ 25-AA)

**TDS**

Interest paid to a non-resident outside India without deduction of tax at source will not be allowed as deduction.

**Set off and carry forward of losses:**

Any loss arising under the head “Income from House Property” in respect of interest only can be set off against income arising from other heads and

the remaining loss will be allowed to be set off and carried forward for a period of 8 assessment years

**No other Deductions allowed;**

No deduction would be available in respect of charges like electricity, land revenue, ground rent, insurance, etc. even though they may be actual outgoings since the standard deduction of 30% is supposed to take care of all expenses.

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**4.7 SOLVED ILLUSTRATIONS:**

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**Illustration-12**

Find out the Gross Annual Value in the following cases: -

Particulars	Property				
	I	II	III	IV	V
Municipal Value	5000	5000	5000	5000	5000
Rent Received	5200	5200	5700	5700	6000
Fair Rental Value	5600	5600	5600	5800	6100
Standard Rent under [Rent Control Act]	NA	5500	5500	5500	7300

<b>Solution:</b>					
	I	II	III	IV	V
Municipal Value	5000	5000	5000	5000	5000
Rent Received	5200	5200	<b>5700</b>	<b>5700</b>	6000
Fair Rental Value	<b>5600</b>	5600	5600	5800	<b>6100</b>
Standard Rent under Rent Act	NA	<b>5500</b>	5500	5500	7300
Gross Annual Value	<b>5600</b>	<b>5500</b>	<b>5700</b>	<b>5700*</b>	<b>6100*</b>

- House I- Fair Rent being highest
- House II- fair rent Rs 5,600 limited to Standard Rent Rs 5,500
- House III: Actual Rent being higher Rs 5700
- House IV Actual rent Rs 5,700 being higher than RLV i.e. Fair Rent Rs 5800 limited to Standard rent RS 5,500
- House V – Fair rent being the highest Rs 6100. Standard rent is only a limiting factor, hence ignored.



**Illustration-13**

An owns two houses, I & II. House I is let-out throughout the previous year. House II is self-occupied for nine months and let-out for three months on a monthly rent of Rs 5,000. Determine Taxable income, given the following details: -

	House I	House II
Municipal Value	40,000	50,000
Fair Rent	50,000	48,000
Rent Received	48,000	15,000
Municipal Taxes paid	4,000	5,000
Insurance Premium (not yet paid)	2,000	2,500
Ground Rent	1,000	1,500
Maintenance Charges	3,000	3,500
Electricity Bill	5,000	6,000

**Solution:**

	House I	House II
Gross Rental Value (fair rent for house I and municipal value for house –II)	50,000	50,000
Less : Municipal Taxes paid	4,000	5,000
Net Rental Value	46,000	45,000
Less : Deduction u/s 24		
Repairs & Collection Charges 30%	13,800	13,500
Taxable Income	32,200	31,500

**4.8 SELF EXAMINATION QUESTIONS:**

1. What is annual value? How is it determined?
2. Discuss briefly the various expenses and allowances that are deductible under the head “Income from House Property”
3. Mention the amounts which are not deductible from Income from House Property
4. Write a short note on property owned by co-owners
5. Explain briefly (a) Owner of a house property (b) A member of a co-operative society (c) Annual Value
6. What do you mean by “Self-Occupied house property”? How is the annual value of such property determined?

7. Explain briefly, house property “deemed to be let-out” and how the income from such house property is determined?
8. Is interest paid on a housing loan out of India allowable as a deduction?
9. Explain with reason if the Interest paid by the assessee on borrowed capital in the construction of the property, till the date of letting out an admissible expenditure.
10. Discuss the provisions of Income Tax Act regarding unoccupied residential house?
11. Are there any exceptions to the rule that Ownership is the criterion for assessment of Income from house property under Section 22”? Enumerate and explain.
12. Discuss tax liability of arrears of rent.
13. Explain the provisions of the Income Tax Act with respect to the computation of income from a self-occupied house property.
14. Explain the tax treatment of unrealized rent.
15. Lakdawala completed construction of a residential house on 1.4.1999. Interest paid on loans borrowed for purpose of construction during the 2 year prior to completion was Rs 20,000/- and for the current years was Rs 10,000 The house was let out on a monthly rent of Rs. 4,000/- . Annual Municipal tax was Rs. 6,000/-. Interest paid during the year is Rs. 15,000/-. Amount spent on repairs is Rs. 2,000/-. Fire insurance premium paid is Rs. 1,500/- p.a. The property was vacant for 3 months. Annual letting value is Rs. 30,000/-. Compute the income chargeable to tax under the head “Income from House Property” for AY 4-15 (*Ans. Rs. 8,500*)
16. Ram owned a house property at Chennai which was occupied by him for the purpose of his residence. He was transferred to Mumbai in June 2011 and therefore he let-out the property with effect from July 1, 2011 on a monthly rent of Rs. 3,000/-. The municipal tax payable in respect of the property was Rs. 6,000/- of which only 50% was paid by him before 31.3.2012. Interest on money borrowed for the construction of the property amounted to Rs. 20,000/- Compute the income from house property for the AY 2012-13 (*Ans. Loss Rs 8250*)
17. Arvind commenced his construction of a residential house intended exclusively for his residence on 1.11.2010. He raised a loan of Rs. 5,00,000/- at 10% interest for the purpose of construction on 1.11.2006. Finding that there was an overrun in the cost of construction he raised a further loan of Rs. 8, 00,000/- at the same rate of interest on 1.10.2012. What is the interest allowable under Section 24 assuming that the construction was completed on 31.3.2008? (*Ans. Loss Rs. 1,50,000 pre- construction interest 1/5th*)
18. From the following particulars of his property furnished by Shri S, calculate income from house property who owns a residential house actually let out for 10 months for total rent of Rs. 25,000. Fair rent of

this house is Rs. 27,000 and municipal ratable valuation is Rs. 24,000. Total outgo on account of this house included repairs of Rs. 9,000, Municipal taxes of 18 months Rs. 9,000 and insurance premium of Rs. 1,500. Interest on funds borrowed amounted to Rs. 1,75,000.

He also owns another residential house at Andheri, which is used for own residence. Fair rent of this house is Rs. 80,000 and municipal ratable valuation is Rs. 75,000. Total outgo on account of this house included repairs of Rs. 6,000, Municipal taxes Rs. 18,000 and insurance premium of Rs. 1,500. Construction of this house was complete in 2011 from the funds borrowed from HDFC. During the current year, interest amounting to Rs. 90,000 was paid for the current year and Rs. 60,000 for the last year. A further interest of Rs. 65,000 was paid on loans taken for renovation necessitated due to heavy rains. The interest pertains equally to this year as well as the last year. (*Ans –Let out Property- loss 1,63,000, SOP 1,50,000 – interest paid*)

19. State with reason whether the following incomes will be taxable as income from house property.

- a) R lets out his house to Y, who uses it as his office.
- b) R uses his house as the godown to store his factory goods.
- c) R rents out his property as residential quarters to the workers in his factory at a nominal rent of Rs.500 p.m.
- d) R enters into a written agreement to purchase a property from Y for Rs. 5,00,000. He has paid the consideration and taken the possession of the Property but the property is yet to be registered in the name of R.
- e) R owns a property, which is given on lease to Y for a period of 6 years, lease rent being Rs. 10,000 per month. Y has a right to get the lease renewed for a further period of 6 years.
- f) R owns a property, which is given on lease to Y for a period of one month, Y has a right to get the lease renewed for a period of one month, in each subsequent month, and such renewal is possible with mutual consent till 2020.
- g) R owns a property, which is given on rent to Y. Y annually pays Rs.1,50,000 as rent of the building as well as the charges for different services (like lift, security, etc.) provided by R.
- h) R owns an air-conditioned furnished lecture hall. It is let out, annual rent being Rs 5,00,000, which includes rent of building as well as rent of air conditioner and furniture. (*Ans: a, d, e, f, and g*)



# PROFITS AND GAINS OF BUSINESS OR PROFESSION

(Sections 28 to 44)

## Unit Structure

- 5.1 Introduction and objective
- 5.2 Concept of business
- 5.3 Scheme of computation
- 5.4 Deductions Expressly Allowed Under the Act
- 5.5 Specific Deductions -S.36
- 5.6 General deductions
- 5.7 Specific Disallowances
- 5.8 Typical Illustrations
- 5.9 Self-Assessment Questions

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## 5.1 INTRODUCTION AND OBJECTIVE

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The lesson intends to explain one of the most important and complex heads of income in simple terms beginning from the basic concepts of business, profession, vocation, trade, commerce, manufacture. It also covers the computation of taxable profit and gains of business and profession, various general and specific deductions including depreciation allowable and items not allowed as deduction to the extent contained in Sections 28 to 32, 35, 36, 37, 40, 40A, 43B

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## 5.2 CONCEPT OF BUSINESS AND PROFESSION:

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**2.1** Section 13, includes “profits and gains of business and profession” in the list of heads of income, hence the “Business “and “Profession” become the two significant terms.

**2.2** Business is defined in Sec. 2 (13) in an inclusive definition that “*Business includes any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce or manufacture and profession is defined in section Sec. 2(36), which merely says that “profession” includes vocation;*

**2.3.** A collective reading of the three sections implies that

## □ **Business**

“business” means a business as it is commonly understood and it also includes Trade, Commerce, Manufacture and any adventure in the nature of trade, commerce or manufacture;

Trade, commerce and, business refer to normal commercial activities of dealing or trading in goods or services for profit, producing new goods or articles will constitute manufacture.

## **Profession**

“Profession” means a profession in common parlance and also includes a vocation.

Profession covers the skilled personalized services like doctors, architects, lawyers, chartered accountants.

Vocation includes all the other services even priests, astrologers, plumbers, mechanics, delivering discourse, performing pooja etc.

## **Adventure**

The phrase “Adventure in the nature of trade, commerce or manufacture” indicates that business or profession need not be organized, systematic or regular. A single act may constitute a business or profession. For instance, when a land was purchased developed and subdivided in smaller plots for resale was held as an adventure in the nature of trade or commerce or manufacture.

**2.4** Following other points are noteworthy:

- It makes no difference whether an activity is business or profession, although there are some provisions dealing with such specific activities.
- Business may be legal or illegal, organized or unorganized, regular or occasional, and may or may not require the personal talents or skill. It will nevertheless be business and attract tax liability. For instance, judicially, smuggling was held to be a business.

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## **5.3. SCHEME OF COMPUTATION -SEC. 28-29**

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### **3.1. Basic Scheme of computation –Sec 28- 44D**

Sections 28 to Sec 44D deal with various aspects of business income.

- Sec. 28 is the charging section, which defines what constitutes business income and Sec. 29 provides for mode of computation of business income by deducting expenses from income.

- Sec. 30 to 35 cover expenses allowed to be deducted only by some of the businesses, which are expressly allowed as deduction,
- Sec 36 and 37 deal with general deductions allowed,
- Sec. 40, 40A and 43B cover expenses, which are not deductible in certain circumstances

Lately, business profits are computed on presumptive basis in case of smaller assesses like retailers, construction contractors, transporters etc. these provisions are not covered in the syllabus.

### **3.2. Chargeable income- Sec 28:**

Section 28 defines the scope of business to inter alia include the income from following sources:

- (a) The profits and gains of any business or profession which was carried on by the assessee at any time during the previous year;
- (b) Speculation income treated as separate and distinct source.

Speculative transactions are defined to be the transactions settled by payment of difference in price of goods or securities and not by actual delivery. Loss from this head cannot be set off against any other head of income but carried forward for 8 years;

- (c) Compensation for agency termination etc.;
- (d) Export incentives: cash assistance, duty drawback, DEPB etc.; (e) Profits on sale of import licenses;
- (f) Income derived by a trade, professional or similar association from specific services performed for its members;
- (g) Partners' remuneration from a firm by way of salary fees, commission etc.;
- (h) Value of any benefit or perquisites like gifts in cash or kind; (i) Non-compete agreements;
- (j) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy;
- (k) Amount recovered on account of bad debts allowed in the earlier years;
- (l) Profits on sale of capital assets used for scientific research and allowed as deduction in the earlier years.

### **3.3. Computation of business income -S.29:**

Business income is the aggregate income from all the sources specified in Sec 28 in respect of a business / profession carried on by the assessee in the relevant previous year as reduced by the expenses and deductions laid

down in S. 30 to 44D. On a collective reading of the two sections, following characteristics and conditions are essential: -

1. There must be a business or profession.
2. Such business or profession must be carried on by the assessee.
3. The business or profession must be carried out during the previous year.
4. If a business or profession is closed down, the expenses cannot be deducted.
5. Expenses will be allowed as a deduction from gross receipts only if they have been incurred in the relevant previous year.
6. Expenses incurred before setting of the business will not be allowed except where specifically provided by law.
7. Taxable business or professional income or profit is computed by deducting expenses incurred for earning the income, from the gross income or gross receipts or gross sales subject to modifications given in S. 30 to 44D.

### **3.4. Method of Accounting:**

Business profits are computed in accordance with the method of accounting regularly employed by the assessee. There are two methods of accounting—mercantile system and cash system.

#### **□ Mercantile system**

Under the mercantile system of accounting, all the income and expenses are recorded on accrual basis. Actual receipt of incomes or actual payment of expenses during the year is not necessary. Net profit or loss is computed after considering all income and expenses, whether or not actually received or paid during the accounting period.

If assessee maintains the books of account according to the mercantile system, income of a business or profession, accrued during the previous year is taxable. The income may be received or expenditure may be paid during the previous year or in a year preceding or following the previous year.

#### **□ Cash system**

Under the cash system of accounting, a record is kept of actual receipts and actual payments of a particular year. Net profit under the cash system will be equal to difference of incomes received and expenses paid during the accounting year whether such receipts and payments relate to the previous year or some other year or years.

□ **Hybrid System**

A combination of the two methods, whereby some transactions are recorded on cash basis and some are recorded on mercantile basis is also adopted by some persons. Even under Sec. 43B, tax payments are allowed only on cash basis even though the method of accounting employed may be mercantile.

**Illustration-1:**

An earns commission in the financial year 2020-21 but receives it in the year 2021-22. Under the mercantile system, the commission will be taxed in the year of earning it viz 2020-21 (A.Y.

2021-22) although not actually received during that year.

Under the cash system, it would be taxed in the year of actual receipt 2021-22 (A. Y. 2022-23) although not earned in that year.

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## **5.4. DEDUCTIONS EXPRESSLY ALLOWED**

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The following expenses are expressly allowed as deductions against profits and gains of business or profession:

### **4.1 Rent, Rates, Taxes, Repairs & Insurance for Building- S. 30**

Under Sec. 30, the following revenue expenses incurred in respect of the business premises are allowed to be deducted from the business income:

- a. the rent of premises,
- b. the cost of repairs borne by the assessee in case of a rented business premises;
- c. the cost of current repairs in respect of other premises occupied otherwise than as a tenant;
- d. any sum paid on account of land revenue, local rates or municipal taxes subject to the provisions of section 43B and
- e. Insurance premium paid against risk of damage or destruction of the premises.

Capital expenses are not allowed as deduction under this section.

### **4.2 Repairs & Insurance of Machinery, Plant & Furniture- S. 31:**

Section 31 allows deduction in respect of revenue expenses incurred on current repairs and insurance in respect of plant, machinery and furniture used for business purposes. Capital expenses are not allowed to be deducted under this section. Machinery hire charges are not covered under this section but as residual expenses u/s 37.



### 4.3. Depreciation - S.32:

#### 4.3.1 Conditions for claiming depreciation:

Sec 32 lays down that depreciation will be allowed as deduction in computing the total income of an assessee irrespective of whether or not the assessee has made a claim for deduction, If the following conditions are satisfied: -

##### (i) Depreciation allowed on eligible assets only:

Depreciation will be allowed only on the following assets called depreciable assets:

- buildings, machinery, plant or furniture, being *tangible assets*;
- Know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, being *intangible assets* acquired on or after the 01/04/1998.

**“Building”** means the superstructure only. It does not include the land on which it is constructed.

**“Plant”** includes ships, vehicle, books including technical know-how, scientific apparatus and surgical equipment's used for the purpose of business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.

##### Assets not eligible for depreciation

Following assets are not eligible for depreciation:

- Foreign car acquired between 01/03/ 1975 and 31/03/ 2001 unless it is used in a business of running it on hire for tourists; or outside India in his business or profession in another country; and
- Any machinery or plant if the actual cost thereof is allowed as a deduction in one or more years under an agreement entered into by the Central Government under Section 42.

##### (ii) Ownership – Partial ownership:

Depreciable asset must be wholly or partly owned by the assessee. Fractional or partial ownership is recognized for depreciation purpose. The assessee, therefore, may be owner or the co-owner of the asset. In case of an asset owned by different assesses, each co-owner will be entitled to depreciation on his contribution to the cost of asset.

**Exception:-** Depreciation will be allowed on capital work / renovation or construction of any structure in building though *not owned* by the assessee is held on lease or other right of occupancy and the new structure is owned by the assessee

**(iii) Purpose or User of the Assets**

The asset must be used for the purpose of business or profession of the assessee

**(iv) User of the Assets during the previous year:**

Depreciation will be allowed if an asset is put to use for the purpose of business or profession of the assessee at least for some time during the previous year. Normal depreciation allowance is reduced to 50 per cent of normal depreciation, if an asset is acquired during the previous years and is put to use for the purpose of business or profession for less than 180 days during that year.

It may be noted that this condition is applicable only in respect of *asset acquired during the year* and no other asset. This is because the machinery would undergo wear and tear even if it was not put to actual use.

**Illustration -2**

A Machine purchased on 31/03/2020 is put to use only on 01/01/ 2021. There will be no depreciation in the A.Y. 2021-22 but it would be eligible for full depreciation in A.Y. 2022-23 even though the actual usage of the machine is having been less than 180 days.

**4.3.2 Important Terms:**

□ **Block of Assets**

U/s 2(11) - The term “block of assets” means a group of assets falling within a class of assets comprising of —

- a) Tangible assets, being buildings, machinery, plant or furniture;
- b) intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed.

Thus, block of assets will mean classification of depreciable assets according to the group viz. building, plant, furniture or machinery and each group is further classified according to the applicable rate of depreciation

Two assets of different groups e.g. temporary shed, books of professionals having same rate of depreciation 100% will not form the part of the block.

□ **Written Down Value (WDV)**

- i. Written down value of an asset means:

- a. actual cost to the assessee of the asset acquired in the previous year, and
- b. the actual cost to the assessee less all depreciation actually allowed thereafter

ii. Written down value of any block of assets, means the:

Opening WDV of the block (after 01/04/1988) or in case of slump sale, amalgamation, succession of business and demerger, conversion into company etc. holding /subsidiary company opening value of the block of the previous owner or entity adjusted by:

- a. *the increase* by the actual cost of any asset falling within that block, acquired during the previous year; and
- b. *the reduction* of the moneys payable in respect of any asset falling within that block, which is sold or discarded or demolished or destroyed during that previous year together with the amount of the scrap value, if any, so, however, that the amount of such reduction does not exceed the written down value as so increased.

This may be explained by the following diagram:

BLOCK OF ASSETS						
Depreciated value of the Block  On 01/04/2021	+	Actual cost of assets falling in the block acquired In P.Y. 2021-22	-	Money received or receivable or scrap value of the asset falling within the block of assets sold, discarded, demolished or destroyed during the PY. 2021-22	=	Value of Block on 31/03/2022

### 4.3.3 Other important points:

- (i) Any other things or benefit which can be converted in terms of money cannot be deducted
- (ii) If the resultant block value figure is negative because the sale proceeds exceed the original block value plus increases, it will be treated as short term capital gain.

#### Illustration-3:

On 01/04/2021, A Ltd has four assets depreciable @ 25 per cent having total value as per income tax records at 5,00,000. On

01/06/2021, the company purchases another asset depreciable @ 25 per cent for Rs 2,00,000 and sells an existing asset for Rs 4,00,000. Find out the WDV and depreciation of the block for the A.Y.2022-23

**Solution.**

WDV as on 1/4/2020	5,00,000
Add: Purchases	<u>2,00,000</u>
	7,00,000
Less: Sales	<u>4,00,000</u>
Adjusted Block	<u>3,00,000</u>
Depreciation @ 25 per cent	<u>75,000</u>
WDV of block as on 31 /3/2021	2,25,000

□ **Actual Cost**

Actual cost is determined on the following principles

**i. Subsidy or grant to be reduced**

Actual cost means the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority i.e. subsidy or grant and expenses incurred for acquiring the asset or installation thereof.

**Illustration 4:**

A Purchases a machine for Rs 10 lakhs with non-refundable subsidy of Rs. 4 lakhs from SIDBI. Actual cost of the machine will be Rs. 6 lakhs [Rs. 10 lakhs-Rs 4 lakhs].

**ii.** Actual cost of asset purchased for scientific research and brought into business use will be *Actual Cost – Deduction available u/s 35*.

**Illustration 3:**

A Purchases a machine for scientific research for Rs 10 lakhs with the non-refundable subsidy of Rs. 5 lakhs from SIDBI. The machine is eligible for deduction u/s 35 to the extent of Rs. 3 lakhs Actual cost of the machine will be Rs. 2 lakhs i.e. Rs. 10 lakhs- Rs 5 lakhs - Rs. 3 lakhs

**iii.** Actual cost of asset acquired by way of *gift or inheritance* will be WDV to the previous owner

**Illustration 4:**

If A gifts away to B the machinery in the above illustration, the cost of machine to B will also be Rs. 2 lakhs, which was the cost to A.

**iv.** Where the asset is acquired at an enhanced cost to claim more depreciation and reduce tax liability, actual cost of may be determined by the Assessing Officer. Actual cost of asset used and transferred earlier but now reacquired would be the old WDV or cost of repurchase whichever is less.

### Illustration 5:

A sold a machinery for Rs. 3 lakhs, when its WDV was Rs. 2 lakhs and repurchased the same after two years at the then prevailing market value of Rs. 10 lakhs. If the assessing officer comes to the conclusion that the machine is repurchased for getting more depreciation allowance on enhanced purchase value of Rs. 10 lakhs, he can ignore it and allow depreciation only on Rs. 2 lakhs.

#### 4.3.4 Mode of computation

Following principles are important in computing the depreciation:

- i. Depreciation is calculated on the WDV of the block after adjusting the sales and purchase during the year in that block.
- ii. Rates of depreciation for different assets are taken as prescribed in rules.
- iii. Depreciation will not be allowed on a block if WDV of that block comes to Zero, even if some assets in that block may be existing.
- iv. Similarly, no depreciation will be allowed on a block, in which no assets are left and the block become empty, or ceases to exist, WDV of the block will be treated as short term loss.
- v. Depreciation will be allowed at 50% of the prescribed rates, if the asset is put to use for less than 180 days in the year of acquisition.
- vi. Straight Line Method (SLM) method is applied in case of the assets of the power companies i.e. Undertakings engaged in generation or generation and distribution of power at the prescribed rates of depreciation on the *actual cost* of the assets.
- vii. Additional depreciation of 20% on actual cost in certain cases discussed later on in this lesson.
- viii. No Depreciation will be allowed on foreign cars except in some case dealt with separately.
- ix. Depreciation will not be allowed on scientific research assets, entire cost of which is allowed as deduction u/s 35.

#### 4.3.5 Succession of Business

Succession means takeover of the business by another new entity e.g. conversion of a firm or sole proprietor to company (S. 47 –xiii/xiv), amalgamation, or demerger, or succession of business (S.170), succession of a private company or unlisted public company, by limited liability partnership S. 47 –xiiib, In such cases of succession of business, aggregate depreciation for a year will not exceed the amount of depreciation had such event not taken place and such depreciation shall be apportioned between the old and new entity

**Illustration-6:**

Under a scheme of amalgamation, A Ltd, transfers to B Ltd, machinery having WDV of Rs 3,65,000 on 1/10/2021. Calculate the depreciation in the hands of A Ltd. & B Ltd. If rate of depreciation is 20%.

**Solution:**

If the amalgamation has not taken place, depreciation of Rs. 73000 [20% on Rs. 3,65,000] would be allowed. The aggregate depreciation for the Assessment Year 2022-23 cannot be more than Rs. 73000 and it will be allocated *pro rata* i.e. Rs. 36,600 and Rs. 36,400 in the ratio of 182 days: 183 days respectively being the number of days for which the two companies used the asset.

**4.3.6 Depreciation to be allowed even if no claim made**

The controversy whether depreciation has to be claimed or it can be simply allowed is now settled and explanation 5 makes it clear that the depreciation will be allowed whether or not the assessee has claimed the deduction in respect of depreciation in computing his total income

**4.3.7 Additional Depreciation**

Additional depreciation equal to 20% on the actual cost of any eligible new machinery or plant acquired and installed after 31/03/2008 by an assessee engaged in the business of manufacture or production of any article or thing.

The rate of depreciation will be 10% if the asset is used for a period of less than 180 days during the previous year, Additional Depreciation will not be allowed in respect of the following assets:

- a. Ships and aircrafts;
- b. Second hand machinery used by any other person in or out of India;
- c. Machinery installed in a residential premises or a guesthouse;
- d. Any office appliances or road transport vehicles;
- e. Any plant or machinery, actual cost of which is already allowed as a deduction e.g. asset for scientific research; and
- f. Buildings, furniture & fittings and old plant.

**4.3.8 Loss on Sale of Machinery**

When an asset is sold, discarded, demolished or destroyed in the previous year following rules apply:

a. If block has not become empty and the *assets are still existing* in the block and also *some value is left* in the block, sales proceeds/ scrap value will be deducted from the value of the block and depreciation will be allowed on the resultant value of the block after increase **by the actual cost** of assets acquired, if any

**Illustration 7:**

One of the assets from the block (Depreciation rate 30%) having WDV of Rs. 5 Lakhs is sold for Rs. 1 Lakh; the resultant value of the block will be Rs. 4 Lakhs and the depreciation will be Rs. 1.20 Lakhs

b. When the *value of the block comes to zero, but assets still exist* and the block has not become empty, depreciation will not be allowed.

**Illustration 8:**

In the above example, if the asset is sold for Rs. 5 Lakhs, the resultant value of the block will be zero. Hence, no depreciation will be allowed.

c. If the sale proceeds are more than the adjusted WDV of the block, the resultant surplus will be treated as Short Term Capital Gain regardless of the fact that assets are still left in the block or the block is empty.

**Illustration 9:**

If the above asset is sold for Rs 8 Lakhs, there will be a surplus of Rs 3 lakhs , which will be taxed as short term capital gain.

d. If there are no assets in the block and the block becomes empty but WDV is not fully Witten off:

- there will be no depreciation allowance and
- existing WDV will be treated as terminal loss or short term capital loss due to cessation of the block as result of sales,

**Illustration 10:**

In the above example, if all the assets are sold for Rs 3 Lakhs, the block will be empty as there will be no assets in it. The balance of WDV in the block of Rs 2 lakhs will be treated as short term capital loss there will be no depreciation allowance.

e. When the depreciation is allowed on the **actual cost** / WDV of the assets of the undertakings engaged in generation or destitution of power called power companies, following rules will apply:

- When such an asset viz any building, machinery, plant or furniture in respect of which depreciation is allowed, is sold, discarded, demolished or destroyed in the previous year not being the year in which it is first brought into use, terminal depreciation will be allowed.

- Terminal depreciation is the deficiency or shortfall between the written down value and the sales proceeds / or moneys payable including scrap value, insurance, salvage or compensation moneys payable in respect thereof.
- Terminal depreciation is not allowed in the year in which it was first brought to use.
- Such deficiency must be actually written off in the books of the assessee.
- Any surplus, arising therefrom is called the balancing charge and taxed as income u/s 43.
- Any moneys received over and above the depreciation allowed will be treated as capital gains. (s. 50A)
- In respect of some motor cars, the actual cost was allowed only up to Rs. 25,000, although the actual cost may be higher. In such a case actual cost/deficiency will be taken proportionately in the ratio of actual cost and Rs. 25,000
- Sale includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation.

### **Illustrations -11**

Cost of a machine is Rs 1 lakh. Total depreciation of Rs 80,000 is written off. The Machine is sold for Rs 15,000.

The Written down value of the machine will be Rs.1,00,000-80,000 = Rs 20,000. The deficit of Rs 5,000 or (20,000-15,000) will be the terminal depreciation.

### **Illustration 12**

If the above machine is sold for Rs. 90,000. The surplus of (Rs 90,000-20,000) or Rs 70,000 will be treated as balancing charge (maximum to the extent of depreciation allowed)

### **Illustration 13:**

If the sale price is Rs.1,05,000, then there will be surplus of Rs 85,000 i.e. (1,05,000-20,000). Rs. 80,000 (up to the depreciation allowed) will be the balancing charge and Balance of Rs. 5,000 will be treated as capital gain.

### **4.3.9 Unabsorbed Depreciation**

If amount of depreciation cannot be wholly or partly deducted in any previous year because of the lack of inadequacy of profits or gains, the amount of depreciation not deducted is treated as unabsorbed depreciation and allowed to be carried forward to the for the following



previous year and deemed to be part of that allowance, or if there is no such allowance for that previous year, be deemed to be the allowance for that previous year, and so on for the succeeding previous years for indefinite period – S 32(2).

Moreover, the unabsorbed depreciation is treated as part of the current depreciation; it can be set-off against any other head of income even if the business has been discontinued. Old condition of continuance of business to claim set-off of unabsorbed depreciation is no longer a valid condition.

#### Illustration -14

If the profits before depreciation Rs 50,000 and depreciation allowable is Rs 80,000, depreciation of Rs 50,000 will be deducted and the balance of Rs 30,000 will be unabsorbed depreciation.

#### Illustration-15

Determine taxable income & unabsorbed depreciation:

Particulars	Rs.
Business Income (before depreciation)	10,00,000
Depreciation allowable as per Income Tax Act	16,00,000
Income from other sources	8,00,000

#### Solution:

Particulars		Rs.
Business Income before depreciation	10,00,000	
Less: Depreciation to the extent of profits	<u>10,00,000</u>	NIL
Income from other sources	8,00,000	
Balance of the current depreciation	<u>6,00,000</u>	2,00,000
Taxable Income	Rs.	2,00,000

#### Illustration-16:

In the above case, assume that depreciation is Rs. 20,00,000.

**Solution:**

Particulars		Rs.
Business Income (before depreciation)	10,00,000	NIL
Less: Depreciation to the extent of profits	<u>10,00,000</u>	
Income from other sources	8,00,000	
Unabsorbed Depreciation for the current year to the extent of income	<u>8,00,000</u>	NIL
Taxable Income	Rs.	NIL
Balance to be carried forward to next year as Unabsorbed Depreciation	Rs.	2.00.000

**Illustration-17:**

Compute the Block Value the A.Y. 2022-23 from the following:

**A. Written down value on April 1, 2021**

Particulars & Dep Rate)	Rs.
Plant A,B & C -15%	1,00,000
Plant D & E – 40%	2,60,000
Plant F – 50%	70,000
Building A & B -10%	2,00,000
Building C&D - 5%	7,00,000
Building Temporary Sheds E -100%	8,00,000

**B. Purchase during the Previous Year 2021-22**

Date	Particulars	Rs.
02/04/2021	Plant G -50%	60,000
01/05/2021	Plant H-15%	18,000
01/06/2021	Furniture-10%	60,000
01/08/2021	Building G- 5%	5,00,000
01/09/2021	Computer-60%	1,00,000
01/10/2021	Franchise Rights -25%	10,00,000

C. Sales during the previous year 2021 -22

DATE	PARTICULAR	(RS.)
31/10/2021	Plant C	25,000
31/01/2021	Plant D	15,000
01/06/2021	Furniture	50,000
06/03/2022	Building E	2,00,000

Temporary Sheds were put to use during the previous year.

**Solution: Computation of Depreciation / Cost of Block**

Block	Rate	O/B	Purchase	Sales	C/B	Dep.	C/B
Plant A/B/C	15%	1,00,000	18,000	25,000	93,000	13,950	79,050
Plant D/E	40%	2,60,000	-	15,000	2,45,000	98,000	1,47,000
Plant F/ G	50%	70,000	60,000	-	1,30,000	65,000	65,000
Building A& B,	10%	2,00,000	-	-	2,00,000	20,000	1,80,000
Building C/D /G	5%	7,00,000	5,00,000	-	12,00,000	60,000	11,40,000
Building E	100%	8,00,000	-	2,00,000	6,00,000	0	0
Furniture	10%	-	60,000	50,000	10,000	0	0
Computer	60%	-	1,00,000	-	1,00,000	60,000	40,000
Franchiserights	25%	-	10,00,000	-	10,00,000	2,50,000	7,50,000

*Note: No depreciation will be allowed on block of temporary sheds as the block ceases to exist. WDV Rs 6,00,000 left in the Block will be treated as short term capital loss. Similarly, no depreciation will be allowed on furniture purchased and sold in the same year.*

**Illustration-18**

Opening balance in a certain block of assets consisting of three cars (rate of depreciation: 20%) is Rs. 18,00,000. During the year 2021-22, new car is purchased for Rs. 6,00,000 and an old vintage car was sold for Rs. 24,00,000. Compute the Depreciation for the Assessment Year 2022-23

**Solution****Computation of the value of Net Block**

Particulars	Rs
Opening WDV of Block (Three Cars)	18,00,000
Add: cost of New Car purchased	6,00,000
Total ( Four Cars )	24,00,000
Less: One Car Sold	24,00,000
Closing Balance Three Cars	0

*WDV of the block is zero; no depreciation will be admissible for the A.Y.2022-23 although three cars still exist in the block*

**Illustration-19**

What would be the position, if all of the above four cars were sold for Rs. 2,00,000?

**Solution****Computation of the value of Net Block**

Particulars	Rs
Opening WDV of Block ( Three Cars )	18,00,000
Add: cost of New Car purchased	6,00,000
Total ( Four Cars )	24,00,000
Less: Four Car Sold	20,00,000
Closing Balance -No Cars	4,00,000

*As the block becomes empty on the last day of the previous year, no depreciation is admissible. The residual WDV ion the block Rs. 4,00,000 will be treated as short term capital loss on sale of cars*

**4.4. Expenditure on Scientific Research –S 35**

Section 35 offers tax incentives in respect of expenses incurred on scientific research. Brief description of the incentives is as under:

Sec S 43[4] scientific research” means “any activity for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries”.

**1. Expenditure for own business-100% sec. 35(1)(ii)/35[2]** In case of in-house research 100% deduction will be allowed in respect of following expenditure incurred by the *assessee himself* on scientific research *relating to his own business*: -

- a) any Revenue expenditure; or
- b) any Capital Expenditure other than the cost of land; or

c) expenses both capital and revenue excluding cost of land incurred up to *three years prior to the commencement of business* including salaries of the research staff or research material used in scientific research. Such expenses are allowed as deduction in the previous year in which the business is commenced.

**Following points are important:**

**a.** Expenses must be incurred in relation to assesses own business. Expenses *not related to assesses own business would not be allowed* as deduction

**b.** Deduction is available *even if the relevant asset is not put to use for* research and development during the previous year.

**c.** The expenses may be on plant or equipment for research or construction of building (excluding cost of land) for research or other expenses of capital nature connected with the research.

**d.** The deduction is not available in respect of capital expenditure incurred on the acquisition of any land.

**e.** No deduction by way of depreciation is admissible in respect of an asset used in scientific research covered u/s 35

**f.** If a scientific research asset is sold, its sales price or amount allowed as deduction u/s 35, whichever is less, will be treated as business income of the previous year in which the sale took place [section 41(3)]. *The excess of sale price over cost of acquisition (or indexed cost of acquisition) will be treated as "Capital gains".*

**Illustration -20**

AB Ltd incurs expenses on scientific research related to its business during the financial years 2019-20 onwards @ Rs 1 Lakh per year. It commences the business during the financial year 2021-22. Determine the amount allowable as deduction U/s 35.

**Solution**

Expenses for the financial year 2021-22, year in which the business was commenced and three financial years prior to that 2019-20, 2020-21 and 2021-22 amounting in all to Rs 4 lakhs will be allowed as deduction in A.Y. 2022-23.

**Illustration -21**

A scientific research asset costing Rs. 5,00,000 purchased on 01/01/2009 is sold on 31/03/2022 for Rs. 7,00,000.

**Solution**

Rs. 5,00,000 incurred on scientific research asset will be allowed as deduction in A.Y. 2009-10. When the asset is sold for Rs 7,00,000 the original deduction of Rs 5,00,000 will be charged as business income and excess over the cost Rs,2,00,000 will be chargeable as capital gain in Assessment Year 2022-23.

**2. In-house R & D Expenditure -200% [SEC. 35(2AB)]: U/s**

35 (2AB) (I) Where a company engaged in the business of

- bio-technology or
- manufacture or production of any article or thing,
- not being an article or thing specified in the list of the Eleventh Schedule incurs any expenditure on scientific research (not being expenditure in the nature of cost of any land or building) on in- house research and development facility as approved by the prescribed authority, then, there shall be allowed a deduction of a sum equal to **two times** of the expenditure so incurred.

"Expenditure on scientific research", in relation to drugs and pharmaceuticals, shall include expenditure incurred on clinical drug trial, obtaining approval from any regulatory authority under any Central, State or Provincial Act and filing an application for a patent under the Patents Act, 1970

Following points are important in this regard:

- a. Expenditure may be capital or revenue.
- b. Cost of land and building are not eligible for weighted deduction.
- c. The R & D facility is approved by the prescribed authority.
- d. Deduction available to only company assessee not to the others.
- e. The company has entered into an agreement of cooperation with the prescribed authority.
- f. The Company gets the accounts audited for such a facility.
- g. The items prohibited by schedule XI include:
  - Beer, wine and other alcoholic spirits.
  - Tobacco products like cigars and cheroots, cigarettes, biris, smoking mixtures for pipes and cigarettes, chewing tobacco and snuff.
  - Cosmetics and toilet preparations.
  - Tooth paste, dental cream, tooth powder and soap.

- Aerated waters
- Confectionery and chocolates.
- Gramophones, including record-players and gramophone
- Projectors
- Photographic apparatus and goods.
- Office machines and apparatus such as typewriters, calculating machines, cash registering machines, cheque writing machines, intercom machines and tele printers but NOT Computers.
- Steel furniture, whether made partly or wholly of steel
- Safes, strong boxes, cash and deed boxes and strong room doors.
- Latex foam sponge and polyurethane foam.
- Crown corks, or other fittings of cork

### **3. Contribution made to outsiders [sec. 35(1)(ii)/(iii)/352AA]**

Contribution paid to prominent research institutions is encouraged by allowing a weighted deduction is allowed in respect of contribution paid to such institutions as summarized below:

#### **(A) One and three fourth times (175%) of the sum paid to:**

- a university, college or other institution to be used for research in social science or statistical research- sec. 35(1)(ii]
- Approved and notified research association which has as its object undertaking of scientific research or to a university, college or other institution to be used for scientific research: - sec. 35(1)(iii]

#### **(B) Twice (200%) the sum paid to:**

National Laboratory; or University; or Indian Institute of Technology or Specified person as approved by the prescribed authority for undertaking scientific research programme sec.35(2AA).

#### **(C) One and One fourth times (125%) of the sum paid to:**

- a company for scientific research if the company is registered in India with object of scientific research and development and is approved by the prescribed authority- sec. 35(1) (ia).

#### **(D) Other points;**

- Scientific research carried on by such institute *need not be related to the business of the assessee*

- Contribution, eligible for weighted deduction under this section will not be eligible for any other deduction under the Act.
- A research association can be a university, college or other institution, which has as its object undertaking of scientific research so long as it is approved and notified by the prescribed authority. Subsequently if such approval is withdrawn, it will not be a ground of denial of weighted deduction to the assessee.

#### **4.5. Amortization of Preliminary Expenses-S 35D Eligible assessee;**

Deduction in respect Preliminary expenses is available to of an Indian company or other a resident non-corporate assessee. A foreign company even if it is resident in India, cannot claim any deduction under section 35D.

#### **Time and purpose of preliminary expenses –**

Following expenses are qualified for deduction u/s 35D: —

1. Expenses for setting up any undertaking or business incurred **before** commencement of business or
2. Expenses incurred in connection with extension of an industrial undertaking or in connection with setting up **a new industrial unit after** commencement of business.

Deduction under section 35D is not available in respect of expenditure incurred after commencement of business if such expenditure is incurred in connection with extension of (or setting up) a non-industrial undertaking.

#### **Eligible Expenditure:**

Following expenses are eligible for deduction under this section:

- a. Expenditure in connection with:
  - Preparation of feasibility report,
  - Preparation of project report,
  - Conducting a market survey (or any other survey necessary for the business of the assessee) or
  - Engineering services related to the business of the assessee.

The above work must be carried out either by the assessee or a concern approved by the CBDT.

- b. Legal charges for drafting any agreement for setting up or conduct of the business.



- c. Legal charges for drafting the Memorandum and Articles of Association.
- d. Printing expenses of the Memorandum and Articles of Association.
- e. Registration fees of a company under the provisions of the Companies Act.
- f. Expenses in connection with the public issue of shares or debentures of a company, underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus.
- g. Any other prescribed expenditure.

### **Qualifying Expenditure:**

The aggregate expenditure cannot exceed the following—

**corporate assessee:** 5% of a. cost of project; or

b. capital employed, whichever is more

**non-corporate assessee:** 5 per cent of cost of project Excess expenditure, if any will not be allowed as deduction. **Cost of project:**

Cost of project means the aggregate of actual cost of fixed assets appearing in the in the books of the assessee as on the last day of the previous year in which the business of the assessee commences.

Fixed assets include land, buildings, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on development of land and buildings), or additional cost incurred after commencement of business in connection with extension or setting up an industrial undertaking) of fixed assets,

### **Capital employed in the business of a company –**

Capital employed means the aggregate of the issued share capital, debentures and long-term borrowings, as on the last day of the previous year in which the business of the company commences or additional capital borrowings etc. brought after commencement of business in connection with extension or setting up an industrial undertaking, Long term borrowings for this purpose means moneys borrowed in India by any company from the Government or Financial institutions like ICICI, IFCI etc. or banks or foreign borrowings in connection with acquisition of plant and machinery repayable after a term of seven years or more.

### **Amount of deduction:**

One-fifth of the qualifying expenditure is allowable as deduction in each of the five successive years beginning with the year in which the business commences, or as the case may be, the previous year in which

extension of the industrial undertaking is completed or the new industrial unit commences production or operation.

**Other Points:**

1. Non- corporate assesses are required to get their account audited for claiming deduction under this section.
2. On amalgamation/ demerger of the assessee company with other company, deductions can be claimed by the amalgamating or demerged company.
3. Amount deducted under this section will not be eligible for deduction under any other provision of the Act.

**Illustration -22:**

ABC Ltd, an existing Indian company engaged in developing and providing computer software services which sets up a new unit incurs the following expenditure in connection with the setting up of new unit. The project is complete in March 2021. Determine the amount deduction admissible u/s 35D.

<b>Particulars</b>	<b>Rs</b>
Preparation of project report	2,00,000
Market Survey	6,00,000
Legal charges for additional capital for the new unit	3,00,000
Engineering Services* Blab Ltd not approved by CBDT	5,00,000
Cost of the Project as on 31/03/2021*	60,00,000
Capital employed in the new unit as on 31/03/2021	50,00,000

**Solution:**

**Eligible Expenditure:**

<b>Particulars</b>	<b>Rs</b>
Preparation of project report	2,00,000
Market Survey	6,00,000
Legal issue of additional capital for the new unit	3,00,000
Engineering Services Not Eligible – as not approved	0
<b>Total</b>	<b>11,00,000</b>

**Gross Qualifying Amount:**

5% of the cost of the project-(5% X 60,00,000)	3,00,000
5% of capital employed in the new unit (5% X 50,00,000)	2,50,000
Gross Qualifying Amount the higher of the above two	3,00,000

**Qualifying Amount:**

Net qualifying amount will be Rs 3,00,000 lower of the following: (a)

Gross qualifying amount: Rs 3,00,000 or

(b) Actual amount of preliminary expenses: Rs 11,00,000

**Amount of Deduction:**

$\frac{1}{5}^{\text{th}}$  of the net qualifying amount ( $\frac{1}{5} \times 2,00,000$ ) or Rs 60,000 for each of the 5 assessment from A.Y. 2014-15 onwards

**4.6. Specific deductions: - S. 36**

S. 36(1) allows certain specific deductions from the business income: These deductions are summarized as follows:

**4.6.1 Insurance Premium paid- S. 36(1)(I)/ (1) (Ia)/ S. 36(1) (ib)**

In respect of insurance against risk of damage or destruction of *stocks* or stores used for the purposes of the business or profession; - S. 36(1)(i)

by a federal milk co-operative society to effect or to keep in force an insurance on the *life of the cattle* owned by a member of a co-operative society, being a primary society engaged in supplying milk raised by its members to such federal milk co-operative society --**S. 36(1) (ia)**

by cheque by the assessee as an employer to effect or to keep in force an insurance on the *health of his employees* under a scheme framed in this behalf by the General Insurance Corporation of India-- **S. 36(1)(ib)**

**4.6.2 Bonus or commission- S. 36(1)(ii):**

Any sum paid to an employee as **bonus or commission** for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission. Bonus or commission is, however, allowed u/s 43B as deduction only where payment is made during the previous year or on or before the due date of furnishing return of income u/s139-S.

### 4.6.3 Interest paid on capital borrowed - S. 36(1)(iii):

The amount of interest paid in respect of capital borrowed for the purposes of the business or profession not being interest on amounts borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use. Recurring subscriptions paid periodically by shareholders, or subscribers in Mutual Benefit Societies, which fulfill such conditions as, may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause. This implies that

- Funds must be borrowed.
- Borrowing must be for the purposes of the business or profession
- Interest must be paid or payable on such funds,
- Interest on funds borrowed for expansion etc. is not allowed as deduction. Instead, interest may be treated as the actual cost of the asset and depreciation can be calculated accordingly.
- Contribution paid to benefit society is treated as part of the funds borrowed.

### 4.6.4 Discount on Zero Coupon Bonds- S. 36(1) (iiia):

Discount on notified (by Central Government) Zero Coupon Bonds issued by infrastructure capital company or infrastructure capital fund or a public sector company on or after 01/06/2005 is allowable on *pro rata* basis provided no other benefit or payment is received in respect of such bonds before their maturity.

Since these bonds are normally issued at a price lower than their redemption value, they are called Zero Coupon Bonds, as there is no Coupon Rate of Interest. This difference or discount is allowed on *pro rata* basis having regard to the period of life i.e. date of issue to the date of maturity or redemption of such bonds. Simply speaking, discount on Zero Coupon is amortized over the life time of the Bonds.

#### Illustration-23:

Infrastructure Capital Company issues 1 Crore duly notified Zero Coupon Bonds of Rs. 1000 each at a price of Rs. 640 on 01/01/2020. The bonds are redeemable at par on 31/12/2021. Show how the discount would be deducted from the total income of the company.

**Solution:**

The total discount offered on Zero Bond Coupon is Rs. 360 Crore i.e. 1 Crore X (1000-640). The tenure of the coupon is three years or 36 months.

*Pro rata* deduction to be allowed 30 Crores [ Rs. 360 Crore X 3/36] in AY 2019-20, Rs. 120 Crores each for AY 2020-21 and 2021-22 and Rs. 90 Crores in A.Y. 2021-22.

**4.6.5 Contribution towards a recognized provident fund/ approved superannuation Fund -S. 36(1)(iv):**

Any sum paid by the assessee as an employer by way of contribution towards a recognized provident fund or an approved superannuation fund, subject prescribed limits and conditions and also subject to the provisions of S 43B.

**4.6.6 Contribution to an approved gratuity fund- S. 36(1)(v):** Any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust;

**4.6.7 Employee's Contribution towards PF/ ESIC -S. 36(1) (va)**

Contribution received by an employer from his employees for crediting in any fund (e.g. PF/ESIC etc. covered u/s 2[24] [x] and credited by the assessee to the Employees' account in the relevant fund or funds on or before the due date prescribed under the relevant law.

Net effect of the provisions read with S. 43B is that such contributions are treated as income at first and when paid by the due date are allowed as deductions. If however, the contribution is not paid in time, it will not be allowed as a deduction and effectively considered as the income of the employer even if it is paid later.

**4.6.8 Death of animals-- S. 36(1)(vi)**

In respect of animals which have been used for the purposes of the business or profession otherwise than as stock-in-trade and have died or become permanently useless for such purposes, the difference between the actual cost to the assessee of the animals and the amount, if any, realized in respect of the carcasses or animals;

Where the animals are treated as stock in trade, the loss or profit is the part of normal sales and purchase, therefore this provision is not applicable.

**4.6.9 Bad debts-- S. 36(1)(vii)**

Any amount of bad debt or part thereof, which is written off as irrecoverable in the accounts of the assessee for the previous year. It is subject to certain conditions laid down in this section 36(2) namely: -

- any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall *not include any provision* for bad and doubtful debts made in the accounts of the assessee;
- no such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee;
- if the amount ultimately recovered on any such debt or part of debt is less than the difference between the debt or part and the amount so deducted, the deficiency shall be deductible in the previous year in which the ultimate recovery is made;
- any such debt or part of debt may be deducted if it has already been written off as irrecoverable in the accounts of an earlier previous year but the Assessing Officer had not allowed it to be deducted on the ground that it had not been established to have become a bad debt in that year;
- where any such debt or part of debt is written off as irrecoverable in the accounts of the previous year and the Assessing Officer is satisfied that such debt or part became a bad debt in any earlier previous year not falling beyond a period of four previous years immediately preceding the previous year in which such debt or part is written off, the provisions of sub-section (6) of section 155 shall apply;

**4.6.10 Provision for bad/doubtful debts by banks- S. 36(1) (vii):**

Any provision for bad and doubtful debts up to:

- seven and one-half per cent of the total income by a scheduled Indian bank other non-scheduled bank,
- five per cent of total income a public financial institution or a State financial corporation or a State industrial investment corporation and a foreign bank of the total income (computed before making any deduction under this clause and Chapter VI- A) and
- ten per cent of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner, and subject to certain conditions or
- at the option of such bank what is known as NPA (Non-Performing Assets) in accordance with the RBI guidelines up to 5% of such assets shown in the books of account of the bank on the last day of the previous year a bank,

□ The deduction is subject to two conditions:

-Assessee has debited the amount of such debt or part of debt in that previous year to the provision for bad and doubtful debts account made under that clause and

-Deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause.

#### **4.6.11 Special reserve-- S. 36(1)(viii)**

Any special reserve created and maintained by a financial corporation which is engaged in providing long-term finance for industrial or agricultural development or development of infrastructure facility in India or by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes, *an amount not exceeding forty per cent* of the profits derived from such business of providing long-term finance computed under the head Profits and gains of business or profession before making any deduction under this clause carried to such reserve account subject to a ceiling of twice the amount of the paid-up share capital and of the general reserves.

#### **4.6.12 Promotion of family planning - S. 36(1) (ix)**

Any expenditure *bonafide* incurred by a company for the purpose of promoting family planning amongst its employees and where such expenditure or any part thereof is of a capital nature, one-fifth of such expenditure shall be deducted for the previous year in which it was incurred; and the balance thereof shall be deducted in equal instalments for each of the four immediately succeeding previous years: Further unabsorbed family planning will be allowed to be carried forward and set off in the same manner as depreciation.

#### **4.6.13 Exchange Risk- S. 36(1)(x):**

Any sum paid by a public financial institution by way of contribution towards any Exchange Risk Administration Fund set up by public financial institutions, either jointly or separately.

#### **4.6.14 New Pension Scheme:**

Any contributions by employer to a pension scheme referred to in Section 80CCD (2) on account of employee to the extent of 10%, deductible effective from 1st April 2012

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## 5.5 GENERAL DEDUCTIONS– S. 37:

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All the expenses, which are not covered by any other section will be allowed as a deduction under section 37 subject to conditions mentioned below – section 37(1):

1. The expenses are *not covered* specifically under the provisions of section 30 to 36.
2. The expenses are *not personal* in the nature. Personal income tax, wealth tax, drawings, etc. are held to be personal in nature
3. The expenses are *not in the nature of capital* expenditure. Thus, expenses for acquiring fixed assets, or renovation thereof, conveyance of land, expenses for eviction of a tenant etc. are some examples of capital expenses not allowable.
4. The expenses are incurred *wholly and exclusively for the purpose of such business*.
5. Such expenses should be incurred in the *previous year* only.
6. The expense should be in respect of a business carried on by the assessee and the profits of which are to be computed and assessed and should be incurred after the business set up.
7. Any illegal expenses are not allowed. Thus, penalty, bribery, composition money paid in respect of any offences or breach of law, and even penal interest is held to be not allowable under this section.
8. Political advertisements have been specifically excluded from the purview of the section -. S. 37(2B)
9. All the expenses whether by way of cost of raw materials, tools, spares etc., cost of labour, salary, brokerage, commission, legal fees, litigation expenses, professional tax, trade mark registration, lease rent etc. and various expenses incurred by the assessee will be allowed to be deducted under this section.

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## 5.6. SPECIFIC DISALLOWANCES– S.40-40A-43B

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Disallowance of expenses may be due to much reason Such as Some expenses are expressly disallowed U/s 40, 40A and 43B, while some expenses, are disallowed because the expenses does not satisfy the conditions attached with the allowance. For instance, personal and capital expenses will be disallowed because sec. 37 allows all the expenses which are not personal or which are not of capital in nature. Similarly, S. 37(2B) provides that any expenditure incurred by way of advertisement expenses for giving an advertisement in any publication of a political party will not be allowed as deduction.



Sections 40, 40A and 43B expressly disallow some expenses while computing income chargeable under the head “Profits and gains of business or profession”. Some disallowances are absolute and others are conditional like default in deduction of tax at source notwithstanding anything to the contrary in sections 30 to 38. These disallowances are discussed below

### **A. Disallowance in the case of any assessee – S. 40**

#### **1. Payments to Non-Residents without TDS [S. 40(a)(i)]**

Any Interest, Royalty, Fees for Technical Services payable to a *Non-Resident outside India* chargeable to tax under the Income Tax Act, if *tax has not been deducted* on those amounts or if the tax has been *deducted at source but not paid* during the previous year or in the subsequent year before the prescribed time April 30.

If, however at a later date, tax on such amounts is paid or deducted at source such amounts will be allowed as deduction in the year in which the tax has been paid or deducted

#### **2. Payments made to residents without TDS [S.40 (a) (ia)]**

Any interest, commission or brokerage, rent, royalty fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work), on which tax is deductible at source if *tax-has not been deducted* on those amounts or if tax has been *deducted at source but has not been paid* on or before the due date specified U/s 139(1).

From the above it follows that if TDS has not been collected or paid at all, the relevant expenditure will not be allowed altogether but if the TDS is paid before the due date of filing the return, it will be allowed as a deduction in that year. However, if at a later date, tax on such amounts is paid or deducted at source such amounts will be allowed as deduction in the year in which the tax has been paid or deducted.

#### **3. Any sum paid as securities transaction tax [S. 40(a)(ib)]:**

4. Any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains such as Income Tax, interest and penalty; Fringe Benefit Tax - [S. 40(a) (ii)]

#### **5. Any sum paid on account of wealth-tax. [S. 40(a) (ia)]**

6. *Salary payable outside India* or to a non-resident, and if the tax has not been deducted or deducted and has not been paid therefrom under Chapter XVII-B.

However, such salaries will be allowed as a deduction in the year in which the tax has been paid in respect of the salary. [S. 40(a) (iii)]

7 Any payment to a provident or other fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to secure that tax shall be deducted at source from any payments made from the fund, which are chargeable to tax under the head Salaries. Such payment will not be allowed as a deduction if tax has not been deducted in the year in which such payments have been made. However, these payments will be allowed as a deduction in the year in which tax has been paid. [S.40(a) (iv)]

8 Any tax actually paid by an employer on perquisites u/s10 (10CC)- [S. 40(a) (v)]

### **Illustration- 2.**

Commission of Rs. 1,50,000 has been paid to a Non-Resident for the Previous Year 2021-22. Tax to be deducted is Rs. 35,000 and due date for payment is 30/06/2022.

Discuss the allow ability of commission in each of the following situations.

-

- a) The assessee has not deducted tax at source at all,
- b) The assessee has duly deducted tax at source but not paid the same to the Government in time.
- c) The assessee has duly deducted tax at source and paid the same to the Government.
- d) The assessee has paid the tax to Government after deducting the same in December 2021

### **Solution:**

(a) & (b) Commission will be disallowed u/s 40(a) (i).

(c) Commission will be allowed as a deduction in A.Y. 2022-23 (d), commission will be allowed as a deduction in A.Y. 2022-23

## **B. Disallowances in the case of any firms- S.40**

### **1. Disallowance of Remuneration to Partners– S. 40(b)**

(i) Any payment of remuneration, to any partner who is **not a working partner**; or

(ii) any payment of remuneration to any partner who is a **working partner**, which, in either case, is **not authorized** by, or is not in accordance with, the terms of the partnership deed;

- (iii) Remuneration, to working partner though authorized, relating to any period falling **prior to the date of such partnership deed** or
- (iv) Remuneration, to working partner though authorized and otherwise allowable, if the remuneration to all partners in aggregate exceeds the following limits:

<b>Book Profits</b>	<b>Remuneration allowable</b>
on the first Rs. 3,00,000 of the	Rs.1,50,000 or 90 % of the book-
on the balance of the book-	60 % of the book profits

“*Book-profit*” means the net profit, as shown in the profit and loss account for the relevant previous year, computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit. In other words, Book Profit means net profit before providing for remuneration to partners.

“*Working partner*” means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner.

A *non-working partner* is one who is not a working partner.

“*Remuneration*” means “any payment of salary, bonus, commission or remuneration by whatever name called.

## **2. Disallowance of Interest to Partners-S. 40(b)**

- (i) Any payment of *interest* to any partner which is *not authorized by* or is not in accordance with, the terms of the partnership deed; or
- (ii) Interest, to partner though authorized, relating to any *period falling prior to the date* of such partnership deed or
- (iii) Interest in accordance with the deed of partnership but in excess of the amount calculated at the rate of twelve per cent simple interest per annum;

Following points should be kept in mind:

- A partnership deed may, at any time during the said previous year be amended to provide for payment of interest but such amendment will be applicable only prospectively. Retrospective effect cannot be given to such terms.
- The interest will be taken into account in the same capacity in which it is paid. For instance, A is a partner in his capacity of a trustee of B, interest payable to A in his capacity of trustee alone will be

considered. Interest paid in his individual capacity will be ignored. On the other hand, if A is a partner in individual capacity, interest paid to him in his representative capacity shall be ignored.

**Illustration-25:**

Net Profit of a firm is Rs 50,000 after debiting the following amounts:

- a) Salary to A, who is not a working partner Rs. 50000
- b) Salary to B who is a working partner Rs. 5,00,000 for the whole year from 01/04/2021 to 31/03/2022. The remuneration was provided by the deed dated 01/7/2021
- c) Interest to partners @ 18% Rs. 90,000. Correct interest payable works out to Rs. 72,000

Compute the business profits for the Assessment Year 2022-23.

**Solution:**

Computation of Profits from Business for A.Y. 2022-23

Particulars		Rupees	
Business Profits as per P/L A/c		50,000	
Add: Salaries & Interest paid to partners (50,000+5,00,000+90000)		6,40,000	
Book Profits before interest & remuneration		6,90,000	
Less: Interest authorized by partnership deed restricted to 12% i.e. 72000 X 12/18		48,000	
Book Profit Before Remuneration		6,52,000	
A's Remuneration as he is not a working Partner		NIL	
B's Remuneration (Lowest of the following)		375000	
1. Actual	5,00,000	375000	
2. From the date of deed 01/7/2020 to 31/03/2021 9 months- 500000 X 9/12 ]	3,75,000		
3. Maximum allowable : 90% of first Rs 300000= 270000 Plus 60% of Balance Rs. 3,52,000 – 2,11,200	4,81,200		
Profits from Business		277000	

### 3. Disallowances of Remuneration/Interest in the case of any AOP/BOI-S. 40(ba)

Any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by such association or body to a member of such association or body.

“AOP/BOI do not include a company or a co-operative society or a society registered under the Societies Registration Act, 1860, or other registered charitable trusts). Following points are noteworthy:

1. The capacity of the member will be considered in the same manner as firm.
2. If interest is paid to a member on funds borrowed by him, the disallowances will be only on the net amount receivable by such members.
3. Disallowance in case of AOP/BOI is total unlike the firms, where the disallowance is partial and conditional. As a result, remuneration or interest to members of AOP/BOI are not allowed to be deducted for computing income from business and profession.

#### Illustration-26

X is a member of BOI. X borrows a sum of Rs. 1,00,000 from market with interest rate of 12% and advances it to the BOI. A BOI pays Interest @ 15% p. as to X. Determine the amount to be disallowed.

#### Solution:

BOI has paid Rs 15,000 to X as interest being 15% of Rs. 1,00,000. X in turn has paid interest of Rs 12,000 being 12% on Rs.

1,00,000 on the funds borrowed by him. Disallowance of interest U/s 40 (ba) will be limited to Rs. 3,000 being net interest paid to X [15000- 12,000].

### C. Disallowances in the case of all assesses –S.40A

S. 40A provides for disallowance of certain expenses in certain circumstances like cash payments of Rs. 20,000 or more excessive payments to relatives etc. mainly as anti-avoidance measures. These disallowances are overriding in nature and prevail even if normally such expenses should have been allowed.

#### 1. Excessive payment to relatives -S. 40A (2)

Any expenditure resulting in any payment to any specified person will be disallowed to the extent it is excessive or unreasonable in the opinion of the assessing officer, having regard to the market value of the goods or services and the benefit to the business or profession. The specified persons include the following: -

<b>A. Persons connected with the assessee</b>	
<b>Class of assessee</b>	<b>Specified person</b>
Individual	any relative of the assessee;
Company	any director of the company
Firm	any partner of the firm
Association of Persons	any member of the association
Hindu Undivided Family	any member of the family
Any relative of such director, partner or member	
<b>B. Sister concerns</b>	
<b>Person holding a substantial interest in the business or profession of</b>	<b>Specified person</b>
Individual	Individual
Company	any director of the company
Firm	any partner of the firm
Association of Persons	any member of the association
Hindu Undivided Family	any member of the family
Any relative of such individual director, partner or member	

### **11 Persons connected with the sister concerns**

If partner of a firm, or director of company or member of a HUF, AOP hold substantial interest, then such company, firm, AoP or HUF will be the specified person also other directors, partners, members and their relatives will be the specified persons (The above table will be applicable to the concerns of where such persons are partner's directors or members)

#### **D: Reverse connection:**

Where assessee or his relatives, or if the assessee is a company, firm, HUF, AOP (its directors, members or partners etc. or their relatives), hold substantial interest in the business of other individual, company, firm, AOP or HUF. the latter will be treated as the specified persons.

**“Relative”** in this context means husband, wife, and brother, sister or any lineal ascendant or descendent of the individual.

A person holding **“Substantial interest”** means a person holding 20% voting power in a company at any time during the previous year or twenty per cent of the profits of other concern viz proprietary concern, HUF, AOP, BOI etc.

### Illustrations -27:

Determine the specified person's u/s 40A (2)

- a. A is an individual. His wife is a specified person
- b. A is a firm having B, C and D as partners, B, C, and D and their relatives will be the specified persons
- c. If A is a HUF with B, C, and D as members, B, C, and D and their relatives will be the specified persons
- d. If A is a AOP with B, C, and D as members, B, C, and D and their relatives will be the specified persons
- e. If A is a Company with B, C, and D as directors, B, C, and D and their relatives will be the specified persons.
- f. In the above cases B is a company, then B and all directors of B will be the specified persons.
- g. If C is a firm, then C and all partners of C will be the specified persons  
If D is a HUF or AOP, all the members as well as D will be the specified persons.

### 2. Payments exceeding Rs 20,000 /35,000 other than by way of crossed cheque or demand draft – S. 40A (3)

Where in respect of any expenditure, payment exceeding Rs. 20,000 (Rs. 35,000 in cases of payments made for plying, hiring or leasing goods carriages) during a single day is made otherwise than by way of crossed bank cheque or draft; *whole* of this expenditure will be disallowed.

Following points require attention:

1. The disallowance is on total payment if it crosses the limit of Rs. 20,000 or Rs. 35,000 i.e. on payments of Rs 20,001 (or 35,001) and more.
2. Limit of Rs. 20,000 or Rs. 35,000 will be considered with reference to the aggregate of all the payments made in a single day.
3. If expenditure is allowed in past on the basis of its accrual and subsequently cash payment is made in respect of such liability, in excess of Rs. 20,000 or Rs. 35,000, such excess payment will be deemed to be the business profit in the year of payment.
4. However, Rule 6D provides some case where, no disallowance will be made even if the payment exceeds Rs 20,000 and is made otherwise than by way of crossed cheque or crossed bank draft some of these circumstances are: new buyer, bank holiday, lack of banking facility, etc.

5. S 40A (4) forbids a person to raise an issue in a suit for being offered payment by account payee cheque or draft and not in cash.

**Illustration-28:**

Audit fee provided during the financial year 2021-22 for Rs. 50,000 is paid by cash on 31.03.2022.

**Solution**

Rs. 50,000 will be deemed be the profit of the A.Y. 2021-22.

**Illustration-29**

A makes a payment of Rs. 25,000 by a bearer cheque for purchase of goods and claims that disallowance u/s 40A (3) is not applicable and even if it is applicable, it will be restricted only on Rs. 5,000 being, the amount exceeding Rs. 20,000. Examine his claim.

**Solution**

If payment in excess of Rs 20,000 is not made through account payee cheque or draft etc., entire payment is disallowed without any basic limit. Accordingly, of total payment of Rs. 25,000 will be disallowed. Bearer cheque and cash are not acceptable modes of payment.

**3. Provision for Gratuity-S. 40A (7)**

No deduction shall be allowed in respect of any provision made by the assessee for the payment of gratuity to his employees on their retirement or on termination of their employment for any reason except any provision made by the assessee for the purpose of payment of a sum by way of any contribution towards an approved gratuity fund, or for the purpose of payment of any gratuity, that has become payable during the previous year. Thus, gratuity will be allowed only when it has become due and payable. But once the provision for gratuity has been allowed as deduction in any year, and then subsequent payment of gratuity will not be deductible again.

**4. Provision for non- statutory funds -S.40A (9)**

No deduction shall be allowed in respect of any sum paid by the assessee as an employer towards the setting up or formation of, or as contribution to, any fund, trust, company, association of persons, body of individuals, society or other institution for any purpose, except where such sum is so paid, for the purposes and to the extent provided by or under S. 36(1)(iv)/(v) or as required by or under any other law for the time being in force like approved provident/gratuity funds etc. However, *bonafide* expenditure out of such fund may be allowed if actually spent

S.40 (10). Further U/s S.40 (11) assessee will be entitled to receive back the unutilized part of any such fund/assets



## 5. Disallowances in respect of unpaid Liabilities-Sec. 43B

Section 43B provides an exception to the mercantile system of accounting and says that taxes and other statutory payments will be allowed in the previous year, in which they are actually paid irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him. The section covers any sums payable by the assessee: -

- (a) by way of tax duty, cess or fee, by whatever name called, under any law for the time being in force, or
- (b) as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees, or
- (c) as per S.36 (1)(ii) i.e. Bonus or commission to employees or
- (d) interest on any loan or borrowing from any public financial institutions i.e. ICICI, IFCI, UTI, IDBI LIC or a State financial corporation or a State industrial investment corporation, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or financial arrangement or
- (e) as interest on any loan or advances from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan or advances,
- (f) as an employer in lieu of any leave at the credit of his employee,

The section provides for an exception subject to fulfillment of the following two conditions: —

1. Payment in respect of the expenses is actually made on or before the due date of submission of return of income.
2. The evidence of such payment is submitted along with the return of income.

To sum up, sums paid for statutory liabilities are allowable as they are accrued and paid in the same year. Sum paid after the year is over but before the due date of filing are allowed on accrual basis on submission of proof of payment. Other sums will be allowed only on cash basis and not on mercantile basis. Following table summarizes the position:

Application of Section 43B	
Date of Payment	Year of Deduction
During the year in the year of its accrual	year of payment or accrual as both are same
After the end of the year in which it is accrued but on or before the due date of submission of return of income for that year and the proof of deposit is submitted along with the return of income	year of accrual
Any other time not covered above or proof not attached with return	Year of payment

**Illustration-30**

ABC Limited pays Sales Tax for the financial year 2021-22 before 30/09/2022. Determine the assessment year in which the sales tax may be claimed as deduction.

**Solution**

Due date for filling return of income by a company assessee for the Assessment Year 2022-23 is 30/09/2022. As the tax is paid before the due date, it will be allowed on accrual basis in 2022-23

**Illustration-31:**

ABC Ltd pays the Excise Duty for the Previous Year 2021-22 on 01/10/2022, in which assessment year will it be allowed?

**Solution;**

ABC Ltd. pays tax after the due date for filling return of income, deduction will be allowed only in the year of actual payment year 2021-22 relevant to A.Y. 2022-23.

**Illustration -32**

X Ltd. Has made the following payment of excise duty for the financial year 2020-21

S.No.	Date of payment	Rupees
1	2/5/2021	25,000
2	20/07/2021	65,000
3	16/8/2021	80,000
4	5/12/2021	20,000
5	12/06/2022	40,000
6	2/12/2022	10,000
7	Unpaid	10,000
	<b>Total</b>	<b>2,50,000</b>

Determine the year in which the excise duty will be deducted from the business profits.

**Solution**

- First four payments due and paid in the same year 2021-22 will be allowed as deduction in A.Y. 2022-23
- Rs. 40,000 paid on 12/06/2022 paid before the due date of filing return will be allowed as deduction in A.Y. 2022-23 if that the proof of payment is furnished along with the return of income.
- Rs. 10,000 paid on 02/12/2021 is paid after the due date for filing of return for A.Y. 2022-23 will be allowed in the year of payment i.e. A.Y.2020-21
- Unpaid amount of Rs. 10,000 will not be allowed as deduction until it is actually paid.

**5.7 ILLUSTRATIONS:**

**Illustration -33**

Income & Exp A/c of Law Bros. for the year ending March 31, 2022

To Expenses	150,000	Professional Receipts	380,000
To Depreciation	20,000		
To Remuneration to partners	150,000	By Other fees	90,000
Interest on Capital to partners @ 20 per cent	20,000		
To Net Profit	130000		
<b>Total</b>	<b>360000</b>		<b>470000</b>

**Other Information:**

1. Expenses include Rs. 18,000 and Rs. 12,000 paid in cash as brokerage to a single party on a single day.
2. Depreciation calculated as per section 32 is Rs. 40,000

Compute the total income of the firm.

**Solution****Computation of Total Income of Law Bros. for A. Y. 2022-23**

Net profit as per Income & Exp account	1,30,000
Add: Expenses not allowable	
40A (3)- Cash paid to broker over Rs. 20,000	30,000
40(5) Excess interest to partners -20,000 *8/20	8,000
	1,68,000
Less: Less: Depreciation u/s32 (40,000-20,000)	20,000
	1,48,000
Add: Remuneration to partners debited to P /L A/c	1,50,000
Book Profits	2,98,000
Allowable Remuneration to partners Lower of the two 90 % of 2,98,000 = Rs 2,68,200 or Actual Rs 1,50,000	1,50,000
Total Income	1,48,000

**Illustration -34**

Particulars	Rs.	Particulars	Rs.
To Opening Stock	75,000	By Sales	20,00,00
To Purchases	15,00,00	By Closing	85,000
To Gross Profit	<u>5,10,000</u>		
Total	20,85,00	Total	<u>20,85,00</u>
To Salaries	2,50,000	By Gross Profit	5,10,000
		By Bad Debts	
To Sales Tax	35,000		
To General Expenses	5,000		
Advance Income Tax	54,000		
To Interest on Loan	42,000		
To Interest on Capital	18,000		
To Depreciation on			
To Advertisement	16,000		
To Free Distribution of Samples	3,000		
To Insurance premium on Life of Partners	8,500		
To Printing & Stationery	3,500		
To Net Profit	56,000		
<b>Total</b>	<b>5,35,000</b>	<b>Total</b>	<b>5,35,000</b>

*Trading and P & L A/c of A&B for the year ended 31st March 2022*

**Additional information:**

1. Salaries include Rs. 40,000/- paid to partners, as per partnership deed and well within the limits u/s 40(b).
2. General Expenses are incurred for the purposes of pleasure tour of partners with their family members to Goa.
3. Income Tax includes Rs. 14,000 paid for the partners.
4. Bad Debts recovered were earlier allowed as a deduction.
5. Interest on Capital to partners is in excess of limits specified u/s 40(b) by Rs. 1,500/- but as per partnership deed.
6. Cash expenses over Rs 35,000 for carriage of Rs. 40,000. Compute taxable income of the firm for the Asst year 2022-23

**SOLUTION:**

Computation of Total Income of X & Y Co. for A.Y. 2022-23.		
Particulars	Rs.	Rs.
Profit as per Profit and Loss Account		56000
Add: Exp. disallowed /considered separately		
Salaries to Partners	40000	
General Expenses incurred for personal purpose by the partners		
Cash expenses 40A(3)	40000	
Income Tax (Advance)	54000	
Interest on Capital	18000	
Insurance on Life of Partners	8500	165500
		221500
Less: Interest to partners (18000-1500)		16500
Book Profit		205000
Less: Salaries to partners		40000
Business income		165000

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**5.8. SELF-EXAMINATION QUESTIONS:**

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- 1) Define and explain the term “Business”.
- 2) Explain any six deductions which are specifically allowed as a deduction while computing income from business or profession
- 3) Give a detailed note on depreciation
- 4) Is Depreciation always allowed on WDV?
- 5) What happens when block ceases to exist?

6) Discuss the tax treatment when block comes to zero.

- 7) What are the incomes chargeable under the head “Profits and Gains of Business or Profession”?
- 8) Explain the items of expenses, which are expressly not allowed as deductions while computing income from “Profits and Gains of Business.
- 9) Explain “Section 37(1) is a residuary section while computing Profits and Gains of Business or Profession” to claim deduction under Section 37(1).
- 10) Explain various expenses allowed on payment basis U/s 43B.
- 11) State the disallowance under Section 40A (3) if a purchase bill of Rs 45,000 was immediately paid by cash (*Ans: Rs. 45,000*)
- 12) State whether following expenses are allowed as a deduction or not while computing income from business or profession, if not, give reasons:
  - a. Interest paid outside India wherefrom no tax has been deducted nor there is any representative assessee.
  - b. Income tax paid by the firm.
  - c. Salary paid outside India wherefrom no tax has been deducted nor there is any representative assessee.
  - d. Salary paid to a partner.
  - e. Guest House expenses.
  - f. Advertisement expenses.
  - g. Contribution to Gratuity Fund.
  - h. Interest on borrowed capital.

*(Ans: Item f & h only allowable, d allowed subject to book profits)*
- 13) Discuss the admissibility and/ or inadmissibility of the following expenditure under the Provision of Income Tax Act, 1961
  - a. A technical consultant was paid consultancy fee of Rs. 20,000 in cash by assessee and a deduction was claimed towards the expenditure.
  - b. A senior advocate conducted the Income tax proceeding before the Income Tax authority and was paid Rs 18,000.
  - c. Provision made for gratuity as per actuary valuation of Rs 1,00,000.
  - d. A sum of Rs 1,30,00., was paid towards sales tax liability in the account for the year ending 31.3.2021

e. Stock-in-trade was lost to fire amounting to Rs 10,000/- and was debited to Profit and Loss Account. (Ans: a, b & e allowable)

14) Discuss the implication of the following transactions in the case of a doctor running a nursing home:

(i) Amounts received from the employees of the nursing home as contribution towards Provident Fund for the month of March 2020 paid to the PF - Rs 25,000 in December 2021

(ii) Cash paid for purchase of medicines –Rs 50,000

(Ans.i) 25000 will be Income u/s/S 43 B and

(2) Rs 50,000 disallowed U/s 40A (3)

15) Are the following expenses allowable as deduction under section 37(1): (a) Litigation expenses for official purposes. (b) Expenses relating to purchase of stationary for official purpose and (c) interest on loan taken for the purpose of paying income-tax. (Ans: 1&2 allowable)

16) From the P/L A/c of X for the year ending March 31, 2022, ascertain his total income for the Assessment Year 2022-23:

Expenses	Rs.	Income	Rs.
General expenses	13,400	Gross profits	3,64,500
Bad debts	22,000	Commission	8,600
Advance tax	21,000	Brokerage	37,000
Insurance	600	Sundry receipts	2,500
Salary to staff	26,000		
Salary to X	32,000		
Interest on overdraft	4,000		
Interest on loan to Mrs. X	42,000		
Interest on capital of X	23,000		
Depreciation	48,000		
Advertisement exp.	7,000		
Contribution to RPF	13,000		
Net profit	1,60,600		
<b>Total</b>	<b>4,12,600</b>	<b>Total</b>	<b>4,12,600</b>

**Other information:**

(A) Depreciation allowable is Rs. 37,300 as per the I.T. Rules.

(B) Gen. exp. include Rs. 500 for arranging a party to a friend.

(Ans:  $160600 + 21000 + 32000 + 23000 + 48000 - 37300 + 500 = 247800$ )



- 17) From the following data, calculate the depreciation admissible to an individual carrying on business, for A.Y. 2022-23

Particulars	%	WDV
Factory Building	10	5,00,000
Plant & Machinery	20	8,00,000
Addition to Plant		1,00,000
Sale proceeds of Plant (cost 1,00,000)		5,00,000
Furniture & Fixture	10	1,00,000
Motor Car	20	60,000
New computer	60	60,000

(*build. Rs. 50,000, P&M. 60,000, Comp. Rs.36000, Furni. Rs. 10,000& Car Rs. 12,000*)

- 18) From the following figures, you are required to ascertain the depreciation admissible and other liabilities, if any. In respect of the previous year relevant to the AY 2022-23

Particulars	Plant & Mach	Building
Rate of Depreciation	25%	10%
WDV at the beginning of the year	Rs2,50,000	Rs 5,00,000
Additions during the year	Rs3,00,000	Nil
Sales during the year	Rs10,00,000	Rs 2,00,000

(*Ans. P&M Rs. Nil Rs. 2,00,000 Short term capital gain, Building Rs. 5,000*)

- 19) X Ltd. owns two plants A & B on 1/4/ 2021 (rate of depreciation: 15 per cent) with opening depreciated value of the block at Rs. 2,37,000. It purchases Plant C with depreciation rate of 15% on 31/5/ 2021 for Rs. 20,000 and sells Plant A on 10/04/2021 for Rs 10,000, Plant B on 12/12/2020 for Rs. 15,000 and Plant C on 1/03/2022 for Rs. 24,000, Determine the WDV of the block as on 31/03/2022 and also the depreciation

{*Ans. 237000+20000-49000 = 208000 Short Term Capital Loss, block empty, Dep. -NIL*}

- 20) Compute depreciation for A.Y. 2022-23 from the following: Plant & Machinery A, B& C – W DV on 1/4/2021 Rs. 5,00,000 rate of dep.15%. Plant D purchased on 12/06/2021 rate of dep. 15% for Rs. 40,000. Plant A sold on 8/12/ 2021 for Rs. 1,60,000. (*Ans Value of Block 500000+40000- 160000 = 380000 Dep. 57000*)



## CAPITAL GAINS

### Sections 45 to 55

#### Unit Structure

- 6.1 Introduction and Objectives
- 6.2 Basis of charge S.45/ 46A
- 6.3 Capital asset – S. 2(14)
- 6.4 Types of assets – Short Term & Long Term
- 6.5 Transfer –S.2(47)
- 6.6 Types of Capital Gains - S 2(29A/B)/(42A/B)
- 6.7 Period of holding
- 6.8 Computation of Capital Gains
- 6.9 Value of Consideration
- 6.10 Cost of Transfer
- 6.11 Cost of Acquisition
- 6.12 Fair Market Value
- 6.13 Transactions covered u/s 49(1)
- 6.14 Cost of improvement
- 6.15 Indexed cost of acquisition /improvement
- 6.16 Transactions not regarded as transfer
- 6.17 Typical Illustrations
- 6.18 Self-Assessment Questions

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#### **6.1 INTRODUCTION AND OBJECTIVES**

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Income tax being a tax on income was not perceived to be a levy on transfer of capital assets, for the simple reason that capital assets represented the investments made out of the income saved which was already taxed. The position is substantially changed and now capital gains are being progressively brought to tax-net. The lesson takes note of the development and aims to deal with tax treatment of the capital gains in all respect including the concept of “Capital Asset”, “Transfer”, what

constitutes a capital asset and what is not capital asset, types of capital gains, concept of indexation and computation of the capital gain and other machinery provisions dealing with contained in Sections 45 to 55.

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## **6.2 BASIS OF CHARGE -SEC. 45/46A**

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### **2.1 Capital Gains Defined:**

Section 45 is the charging section. It states that any profits or gains arising from the transfer of a capital asset effected in the previous year shall be the income of the previous year in which the transfer took place. An analysis of the section shows that capital gain tax liability is subject to the following attributes:

- (i) There is a capital asset,
- (ii) The capital asset is transferred by the assessee,
- (iii) The transfer takes place during the previous year and
- (iv) The transfer results in some gain or loss.

Thus, the capital gain will depend upon – existence of a capital asset, transfer of that capital asset during the previous year and the resultant profit or loss from such transfer. Besides, sec. 45 extends the term “capital gain” to cover several other receipts, discussed below:

### **2.2 Insurance money:**

Money or other assets received during the previous year from an insurer on account on account of damage to or destruction of a capital asset, as a result of:

- Flood, typhoon, hurricane, cyclone, earthquake or other convulsions of nature or
- Riot or civil disturbance or
- Accidental fire or explosion or
- Action by an enemy or action taken in combating an enemy

### **2.3 Conversion of capital asset into stock:**

Transfer by way of conversion, by the owner of a capital asset into, or its treatment by him as stock-in-trade of a business carried on by him, but is chargeable to tax in the previous year in which such stock-in-trade is sold or otherwise transferred by him.

### **2.4 Interest in securities**

Transfer made by a depository or a participant of beneficial interest in any securities during the previous year in which such transfer takes place.

## 2.5 Transfer of asset as capital to firm, AOP or BOI:

Transfer of a capital asset made by a person to a firm or other association of persons or body of individual (not being a company or a co-operative society) in which he is or becomes a partner or member by way of capital contribution or otherwise in the previous year, in which the transfer takes place.

## 2.6 Transfer of asset on dissolution of firm, AOP or BOI

Transfer of a capital asset x by way of distribution of capital assets on dissolution of a firm or association of persons or body of individuals (not being a company or co-operative society) or otherwise, in the year previous year in which the transfer takes place

## 2.7 Compulsory Acquisition

Transfer of capital asset by way of compulsory acquisition under any law is chargeable to tax in the previous year in which such compensation or part thereof is received. Any additional compensation shall be taxable in the previous year; in which it is actually received. If the initial/ enhanced compensation is subsequently reduced by any court, tribunal or any authority, the capital gains assessed in the year of receipt of initial compensation or enhanced compensation will be amended to re-compute the capital gains with reference to such reduced compensation.

## 2.8 Repurchase of Units of Mutual Funds

Transfer of capital asset being the units of UTI or other mutual funds issued under the Equity-Linked Savings Scheme on the repurchase thereof by the mutual fund will be taxed in the year of such repurchase.

## 2.9 ESOP /ESOS

Sale value of the shares issued to employees under an equity stock option plan/scheme as reduced by the cost of acquisition / indexed cost of acquisition of the shares will be taxed in the year of such issue.

## 2.10 Buyback

The value of a consideration received by share of a company under a scheme to buy back its own shares u/s 77A of the Companies Act, 1956 as reduced by the cost of acquisition /indexed cost of acquisition will be taxed in the year of buyback. – S 46A

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## 6.3 CAPITAL ASSET – S. 2(14)

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Capital gain arises on transfer of a capital asset. First attribute to attract the capital gains tax, is that there must be a capital asset. As per Sec 2(14) Capital asset means “*property of any kind held by an assessee, whether or not connected with his business or profession,*” But does not include -

- a. **any stock-in-trade, consumable stores or raw materials** held for the purposes of his business or profession;
- b. **personal effects**, i. e. movable property including wearing apparel and furniture held for personal use by the assessee or any member of his family dependent on him, but excludes
  - (a) Jewellery; b) archaeological collections; (c) drawings; (d) paintings; (e) sculptures; or (f) any work of art.

For this purpose, "Jewellery" includes:

- (a) **ornaments made of gold, silver, platinum** or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stone, and whether or not worked or sewn into any wearing apparel;
- (b) **precious or semi-precious stones**, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel;

[Note: Effect of above is that although the jewellery is a movable property held for personal use, it will still be treated as capital asset. Moreover, only **ornaments** are covered in jewellery. Other articles like **silver or gold utensils are neither "jewellery nor ornaments"**.

- c. **Agricultural land** in India, not being land situate  
(applicable from 01-04-2014 onwards i.e. AY. 2014-15)

6.4 areas not in the jurisdiction of a municipality, municipal corporation notified area committee, town area committee, town committee, or by any other name or a cantonment board or cantonment board having population of 10000 or more and

6.5 *in any area within the distance, measured **aerially**, from the local limits from any area of Municipality etc. as above-*

Distance not more than	Population of the area of municipality etc. as per last published census
2 KM	10,001 – 1,00,000
6 KM	1,00,001 – 10,00,000
8 KM	More than 10,00,000

6.6 Special Bearer Bonds, 1991

6.7 6 1/2 per cent Gold Bonds, 1977

6.8 7 per cent Gold Bonds, 1980

6.9 National Defense Gold Bonds 1980

6.10 Gold deposit Bonds under old Deposit Scheme 1999

Note: An explanation is inserted to clarify that “property” includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever;

## 6.4 TYPES OF ASSETS

Based on the period for which the asset is held by the assessee, Capital Assets can be classified into two types as shown in the following diagram:

TYPES OF CAPITAL ASSETS		
Short Term Capital Assets STCA	Long Term Capital Assets LTCA	
Assets not being long Term Assets	Shares, Debentures, Mutual Funds	Other Assets
	12 Months	36 Months

### i. Short Term Capital Asset (STCA)

Short-term capital asset means a capital asset held by an assessee for less than 36 months before it is transferred.

U/s 2(42A), the period of 36 months is taken as 12 months in the following cases:

- a. Equity or Preference shares whether quoted or not,
- b. Securities like debentures, government securities and notified derivatives, which are listed in recognized stock exchange u/s 10-23(D),
- c. Units of UTI
- d. Units of Mutual Funds
- e. Zero Coupon Bonds

In other words, an asset, which is transferred within 36 months of its acquisition by assessee, is called Short Term Capital Asset. Transfer of STCA gives rise to Short Term Capital Gain STCG or Short Term Capital Loss – Section 2(29B).

### ii. Long Term Capital Asset (LTCA).

An asset, which is not a short term capital asset {held for more than 12 or 36 months, as the case may be} before it is transferred is called long term capital asset. Transfer of LTCA gives rise to Long Term Capital Gain LTCG or Long Term Capital Loss – Section 2(42B).

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## 6.5 TRANSFER –S.2(47)

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Since capital gain arises on transfer of a capital asset, there should be a “capital asset” and there should be “transfer” of that asset. Both the conditions are cumulative and must be fulfilled together.

The term “transfer” gains importance because if the transaction involving movement of capital asset from one person to another person is not covered under the definition of transfer, there will be no capital gain chargeable to income tax, even if there is a capital asset and there is again.

For instance, there will be no capital gain on transfer of person motor car because motor car being a personal effect is not a capital asset. Similarly, in case of transmission of shares of A on his death his legal heir B, also there will not be any capital gain. Because, in this case though there is a capital asset, there is no transfer as devolution of asset unto heirs by succession shares of is not regarded as transfer.

Sec 2(47) defines “Transfer” in an inclusive definition:

“Transfer in relation to capital assets includes the following:

- (1) the sale, exchange or relinquishment of the asset

Relinquishment of a right would mean the transfer of a right in favour of another person e.g. sale of right to subscribe shares.

- (2) the extinguishment of rights on the capital asset,

Buyback of shares will be deemed to extinguishment of shares -sec 46A.

Extinguishment of rights results in cessation or destruction or cancellation of rights in a capital asset like surrender of tenancy right

- (3) the compulsory acquisition under any law,
- (4) the conversion of capital asset into stock in trade of a business,
- (5) maturity or redemption of a zero-coupon bond issued by an infrastructure capital company/fund or a public sector company on or after 1.6.2005 and notified by the central government in respect of which no payment or benefit is received before maturity/redemption,
- (6) any transfer involving the allowing the possession of an immovable property u/s 53A of Transfer of Property Act, in part performance of the contract for transfer of that property.
- (7) any transaction involving transfer of membership of a group, association housing society, company, etc., which have the effect of transferring or enabling enjoyment of any immovable property or any rights therein in any manner whatsoever.

- (8) Distribution of assets on the dissolution of a firm, body of individuals or association of persons.
- (9) Transfer of a capital asset by a partner or member to the firm or AOP, whether by way of capital contribution or otherwise
- (10) Transfer under a gift or an irrevocable trust of shares, debentures or warrants allotted by a company directly or indirectly to its employees under the ESOP Scheme of the company as per the guidelines of the Central Government.

S. 47/47A exclude certain transactions from the definition. Some of them are with reorganization of business entities like amalgamation, demerger, gift, will. These transactions are not in syllabus, hence not discussed.

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## **6.6 TYPES OF CAPITAL GAINS**

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Based on the type of asset transferred by the assessee, Capital Gains can be classified into two types

### **i. Short Term Capital Gain (STCG)**

Capital gain arising on transfer of a short-term asset i.e., asset held by an assessee for less than 36/12 months will be short term capital gain and any loss arising on the transfer of short-term asset will be short term capital loss – Section 2(29B)

However, capital gains arising on sale of long-term business assets in a block in case of a slump sale as covered under section 50 would be treated as a short-term capital gain or short-term capital loss.

### **ii. Long Term Capital Gains (LTCG)**

Long-term capital gain is the gain arising on transfer of a long-term asset or an asset held by an assessee for 36/12 months or more. Conversely any loss arising on transfer of long-term asset will be long term capital loss – Section 2(42B)

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## **6.7 PERIOD OF HOLDING- S. 2(42A):**

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Type of capital gain is determined on the basis of the period of holding of the asset. In determining the period for which the capital asset has been held by the assessee the following are the important rules –

- i. In case of shares held in company liquidation the period subsequent to the date of liquidation will not be included. Period of holding will stop running on date of liquidation.

### **Illustration-1**

A company goes into for winding up on 1<sup>st</sup> January, 2004. The liquidator settles the claim on 1<sup>st</sup> January, 2012. The period after 1<sup>st</sup> January, 2004 will not be taken as the period of holding.



- ii. In case capital assets have become the property of the assessee in circumstances mentioned in S. 49(1) in determining the period, the period for which the capital asset was held by the previous owner will also be included.

**Illustration- 2:**

A dies 1<sup>st</sup> January, 2022 leaving a house purchased by him on 15<sup>th</sup> February, 2004 to his son B. B sells this house on 20<sup>th</sup> March, 2021. The gain arising from such sale will be long term capital gain as the holding will be calculated from the date of acquisition by the previous owner on 15<sup>th</sup> February, 2004.

- iii. Shares of an amalgamated company allotted to a shareholder against the shares in an Indian company which was amalgamated, the period for which the shares in the amalgamated company were held by the assessee will also be included.

**Illustration-3:**

R Purchased shares of A Ltd on 12/11/2005. A Ltd amalgamated with S Ltd. on 31/12/2021. Under the scheme of amalgamation, original 1000 shares in R Ltd were converted into 300 shares of S Ltd. If A sells these 300 shares on 1/1/2022, the capital gain will be treated as long term as the period of holding will be reckoned from 12/11/2005 and not 31/12/2021.

- iv. In case of *rights issue* of shares or other securities subscribed to by the assessee on the basis of his rights to subscribe, the counting of the period shall start from the date of allotment by such person or other person in whose favour such right has been renounced.
- v. In case of *renunciation of a rights issue*, for the person who has acquired the rights, the period shall be reckoned from the date of the offer of such rights by the company or institution.
- vi. In case of a *bonus issue*, allotted without payment on the basis of holding of any other financial asset, period shall be reckoned from the date of allotment of such financial asset.
- vii. In case of shares in a resulting company received under a scheme of Demerger Company, the period for which the *shares in the demerged company* were held by the assessee will also be included.
- viii. In case of shares of trading or clearing rights of a recognized stock exchange acquired by a person under its demutualization or corporatization, the period for which, such person was a member will also be included.
- ix. In case of equity shares allotted under demutualization or corporatization of a recognized stock exchange in India, the period for which such person was a member will also be included.

- x. Period of holding of other capital assets will be decided according to the rules framed by the CBDT in that regard.

***Important:** The CBDT has clarified that date of transfer/ acquisition of shares will be considered on the basis of the brokers note / date of contractor date of allotment and FIFO (first in First Out Basis) in the case of Demat Accounts.*

- xi. In case of security or sweat equity shares allotted or transferred by the employer free of cost or at concessional rate to this employees including former employees, popularly called as ESOP, the period shall be reckoned from the *date of their allotment or transfer*.

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## **6.8 COMPUTATION OF CAPITAL GAINS-SECTION- Sec 48**

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### **8.1. General Rule**

Section 48 prescribes that the income under the head “Capital Gains” shall be computed. by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely: -

- (i) Expenditure incurred wholly and exclusively in connection with such transfer;
- (ii) The cost of acquisition of the asset and the cost of any improvement thereto:

### **8.2. Long Term Capital Gains**

Where the capital gain is to be computed in respect of a long-term asset, instead "cost of acquisition" and "cost of improvement", "indexed cost of acquisition" and "indexed cost of improvement" are to be deducted. However, there are two exceptions viz.-

- a.** In case of a non-resident, capital gains on transfer of shares or debentures of Indian company firstly by converting cost of acquisition, full value of consideration and expenses incurred for transfer into originally utilized foreign currency and reconvertng capital gain into Indian rupees and
- b.** Benefit of indexation of cost will not be available on transfer of bonds and debentures even though they may qualify to be called long term capital assets., This is because bonds and debentures are normally issued and redeemed at par and if benefit of indexation is given, it will always give capital loss.

Mode of computation can be depicted as under:

COMPUTATION OF CAPITAL GAINS			
Sales Consideration			
Less			
Expenses on Transfer			
Less			
Indexed cost of acquisition	Indexed Cost of Improvements	Cost of Acquisition	Cost of Improvement
<b>Long Term [LTCA]</b>		<b>Short Term [STCA]</b>	

*Note: The STCG / LTCG computed above are subject to deductions/exemptions under sections 54, 54B, 54D and 54EC, 54ED, 54F 54G etc., which are not in the syllabus.*

### 8.3. Depreciable Capital Assets– Sec. 50

Where a capital asset has been sold or transferred and in respect of such capital asset depreciation had been allowed, the position will be as shown in the diagram below:

Depreciable Capital Assets			
Sales Consideration			
LESS	Expenses on Transfer		
LESS	Opening WDV	PLUS	New Purchase
IF WDV IS ZERO No Depreciation	Surplus Left Taxable as STCG	WDV still Remains	
		If Block Empty	Block Not Empty
		Short Term capital Loss No Depreciation	Claim depreciation

**The detailed rules are as follows:**

- A. Written down value of the block at the beginning of the year as increased by the cost of acquisition of any new asset falling in the same block purchased during the year and the incidental expense on transfer the asset sold. The balance will be the written down value of the block and there will be no capital gain.
- B. If sales consideration exceeds the WDV of the block as increased by the new purchase and the incidental expense on transfer, such excess consideration will be treated as short term capital gain.

- C. If the resulting figure is negative, it will be treated as short term capital loss.
- D. If block ceases to exist, that is all assets in a block are sold, the WDV in the block will be short-term capital loss.

Thus, it will seem that capital gain will arise only if the full value of sale price exceeds the aggregate of the following: -

- Incidental expenses on transfer
- The written down value of the block at the beginning of the previous year.
- Cost of acquisition of the asset falling in that block of assets during the previous year

The resulting figure, if gain would be short term capital gain if loss would be short term capital loss. If block cease to exist, no further deduction will be available and no further deduction will be allowed.

#### Illustration -4:

Compute depreciation / capital gain if Opening WDV of a block with 20% depreciation is Rs. 50,000 and, new asset purchased for Rs 20,000 during the previous year falling in the same black, if: -

1. If no asset was sold during the year.
2. If value of the consideration for asset sold is Rs. 70,000
3. If value of the consideration for asset sold is Rs. 40,000
4. If value of the consideration for asset sold is Rs. 1,00,000
5. If in case 3 both the assets are sold.

#### Solution:

Particulars	I	2	3	4	5
	Rupees				
Opg WDV	50,000	50,000	50,000	50,000	50,000
Add-New Purchase	20,000	20,000	20,000	20,000	20,000
Total	70,000	70,000	70,000	70,000	70,000
Sales	0	70,000	40,000	1,00,000	40,000
WDV /Gain	70,000	0	30,000	(30,000)	30,000
Depreciation	<b>14,000</b>	0	<b>6,000</b>	0	0
STCG	NA	NA	NA	<b>30,000</b>	NA
STCL	NA	NA	NA	NA	<b>30,000</b>
Close WDV	56,000	0	24,000	0	<b>0</b>

Notes: Case (2), Block comes to Zero, hence no Depreciation,

*Case (5)- Block ceases to exist as both the assets are sold, Hence No Depreciation. Residual WDV of Rs. 30,000 will be short term capital loss.*

#### **8.4 Depreciable Assets of energy /power undertaking – S-50A**

Depreciable assets of an undertaking engaged in generation or distribution of power or energy, capital gain in respect of a depreciable asset will be computed with reference to the cost of acquisition as adjusted u/s 43(6) and the gain/loss will be computed accordingly as short term gain/loss.

*Note: Land is not a depreciable asset. Therefore, where by a composite agreement a factory is sold along with the land, depreciable asset will be building and Land will be considered as general capital asset and capital gain will be taken long term if it is for 36 months or more and short term if held for less than 36 months.*

#### **8.5 Assets in Slump Sale – Sec. 50B**

Slump sale means the transfer of one or more undertakings by way of sale for a lump sum consideration without assigning values to individual assets and liabilities of the undertaking. In such cases of slump sale, the undertaking itself will be treated as a capital asset. Section 50B provides that profit arising from the slump sale of an undertaking/s effected in the previous year owned and held by the assessee for not less than 36 months is charged as long term capital gain and if it is held for less than 36 months, it is considered as short term capital gain. For the purposes of slump sale, **‘net worth’ [Sec. 50B (2)] of the undertakings shall be the cost of acquisition and improvement and no indexation u/s 48 is allowed in respect of such cost.**

#### **8.6 Sale of Land or building – Sec. 50C**

Section 50C provides that when a capital asset being land or building or both is transferred by an assessee, the sales consideration will be the actual of consideration received or accruing or value adopted or assessed or assessable by stamp duty authorities or the purpose of payment of stamp duty in respect of such transfer, whichever is higher.

If the assessee does not accept the stamp duty valuation and prefers appeal with the appellate authorities, the value finally determined shall be treated as the value of consideration.

However, if the assessee does not prefer any appeal but claims that agreement value is much lower than the valuation adopted by the stamp duty/registration authorities, the assessing officer may refer it for valuation. However, the consideration will not exceed the value adopted by the state authorities.

#### **Illustration: 5**

A land is sold for Rs 5 Lakhs, but it is valued at Rs 4 lakhs only by the stamp duty authorities, agreement value of Rs 5 lakhs being the higher value will be taken as the consideration for computation of capital gains

**Illustration: 6**

If the above land is valued by stamp duty authorities for Rs 6 lakhs and the assessee does not dispute it, Rs 6 lakhs will be taken as sales consideration

**Illustration: 7**

If in the above case, the assessee, files an appeal with the stamp duty authorities, the consideration will be taken at the amount finally determined by those authorities.

**Illustration: 8**

If in the above case, the assessee, does not file an appeal with the stamp duty authorities, but disputes the stamp duty valuation, the assessing officer will refer the valuation to the Departmental Valuation Officer. However, such valuation cannot be more than Rs 6 lakhs.

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## **6.9 VALUE OF CONSIDERATION- S-48**

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“Full total value of consideration” means the value received or accruing as a result of the transfer. Value may be in terms of money or money’s worth or both, which accrues or arises upon transfer of a capital asset.

Consideration is a result of the act of the parties inter se. It refers to the whole price bargained for between the parties. Sale price of an asset, for instance will be the value of consideration accrued. Actual receipt is irrelevant. *Capital gains are chargeable on accrual basis and not on cash basis.*

The expression “full value of consideration” does not refer to the market value of the asset transferred or the adequacy of the price. However, there are some specific provisions, which require ascertainment of fair market value accruing or arising on transfer of a capital asset

The consideration that cannot be expressed in money’s worth does not form part of full value of consideration for the transfer, giving rise to capital gain. Following are some cases:

- There will be no consideration for a property transferred without consideration or transferred out of natural love and affection or patriotism. Some of such transfers are taxable as gifts u/s 56.
- Full value of consideration in case of a transfer under a gift or irrevocable trust of shares, debentures, or warrants allotted by a company directly or indirectly to its employee’s ESOP/ESOS of the company as per the guidelines issued by the Central Government, will be the fair market value of shares on the date of transfer
- In case of a transfer resulting in exchange of two or more assets, full value of consideration of the assets transferred will be equal to the fair market value of the asset received.

- Amount of any insurance claims received in respect assets destroyed in natural conditions like tsunami, floods, earthquakes, would be deemed the full value of consideration.

### Illustration 9

An exchanges his flat for B's shop. Capital gain will arise on this transaction of exchange. Value of full consideration arising on transfer of A's flat will be the fair market value of the shop transferred by B and vice versa.

S 45 specifies the year of the capital gain liability and the value of consideration arising or accruing in some cases, which are given in the following table:

Sub Section and the nature of the transaction	Previous year when taxed year of -	Value of consideration
(1) Sale or Transfer	Sale or transfer	Sales consideration
(1A) Damage or Destruction	Receipt of claim money	Money received or fair market value
(2) Conversion into stock	Sale of stock	Market value on the date of conversion
(2A) Transfer of securities by depository	Transfer determined on FIFO basis	Consideration for transfer
(3) Transfer as capital contribution in firm / AOP / BOI	Transfer	Value credited in capital account
(4) Transfer on dissolution of firm/AOP/BOI	Transfer	Fair market value on date of transfer
(5) Compulsory acquisition	Receipt of compensation	Initial compensation or enhanced compensation as the case may be
(6) Repurchase of mutual fund units	Receipt or discontinuation of scheme	Repurchase price

### Illustration-10

A purchased gold on 01/04/18 for Rs. 1,00,000. On 01/01/2019 he converted the personal gold into stock in trade. Fair market value on that day was Rs. 7,00,000. This gold was sold on 31/03/2022 for Rs. 12,00,000.

### Solution

Transfer takes place on 01/01/2019 being the date of conversion of personal gold into stock and the amount of Capital gain will be:

Consideration [fair market value on 01/04/2019]	Rs 7,00,000
(-) Indexed Cost of Acquisition $1,00,000 \times 280/100$	Rs 2,80,000
Long Term Capital Gain	Rs 4,20,000

Capital gain of Rs 4,20,000 will arise on 01/04/2019 but will be taxed only when the gold was actually sold in Assessment Year 2022-23. The difference of Rs. 5,00,000 excess of sale price over FMV on 01/04/2019 (12,00,000-7,00,000) will also be taxed in Assessment Year 2022-23 as business profit.

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## **6.10 COST OF TRANSFER – SEC. 48(1)**

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Expenditure incurred wholly and exclusively in connection with the transfer of asset is to be deducted from the total value of consideration while computing the capital gain. Some of the examples of such expenses are lawyers' fee for transfer, brokerage, travelling expenses for transfer, advertisement, stamp duty and registration fee if paid by the seller etc. This is subject to two conditions:

- Such expenditure must not be claimed as deduction as expenditure under any other head.
- The expenditure should be incurred wholly and exclusively in connection with the transfer.
- No expenses will be allowed in respect of share transactions covered under the securities transaction tax.
- Expenses like salary of an employee who helps in maintenance of capital assets will not be allowable since it is an expense not primarily for the transfer of the capital asset but helps in effecting the transfer by maintaining the capital assets.

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## **6.11 COST OF ACQUISITION – [SEC 48 - 46 & 49]**

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Cost of acquisition of an asset is the sum total of amounts spent for acquiring it. The cost of acquisition is the

- price paid by the assessee, where the asset was acquired by way of purchase,
- fair value on the date of exchange, of the asset transferred in exchange, where the asset is acquired in exchange for another asset.
- Expenses incurred on transfer, registration, stamp duty etc. will be included in the cost of acquisition in both the cases.



The relevant provisions are given as under:

Cost of Acquisition	
Date of Acquisition of Assets	
Prior to April,1,1981	April, 1,1981 on wards
Fair market value of asset as on 01/04/1981 –Optional	Actual cost paid for acquisition of asset

**A. (1) Where the asset becomes the property of the assessee by a mode referred to in S 49(1) before 1.4.81:**

- i. Cost of acquisition is the actual cost to the previous owner or the fair market value as on **1.4.81** at the option of the assessee.
- ii. Actual cost to the previous owner cannot be ascertained fair market value on the date on which the asset became the property of the assessee will be taken
- iii. Where there are successive transfers under this mode, the reference to the previous owner will mean last of such previous owners who has acquired the assets by a mode otherwise than any of the modes u/s 49(1).
- iv. In these case the period for which asset was held by the previous owner is also taken into consideration to determine the period for which the asset was held

**A. Where the asset becomes the property of the assessee by a mode referred to in S 49(1) on or after 1.4.81:**

- i. Cost of acquisition is the actual cost to the previous owner.
- ii. Actual cost to the previous owner cannot be ascertained fair market value on the date on which the asset became the property of the assessee will be taken.
- iii. Where there are successive transfers under this mode, the reference to the previous owner will mean last of such previous owners who has acquired the assets by a mode otherwise than any of the modes u/s 49(1).

**B. where the asset becomes the property of the assessee by a mode other than referred to in S 49(1) before 1.4.81:**

Cost of acquisition is the actual cost to the assessee or the fair market value as on 1.4.81 at the option of the assessee.

**C. Where the asset becomes the property of the assessee by a mode other than referred to in S 49(1) on 1.4.81 or thereafter:**

Cost of acquisition is the amount actually spent by the assessee in acquiring the actual asset i.e. the actual cost of acquisition.

#### **D. Where the asset becomes the property of the assessee subject to tax u/s 56:**

If any asset being cash, movable property, or shared of closely held companies with, or without consideration or immovable property without consideration has been subjected to in the manner prescribed in u/s 56, the cost of acquisition would be the cost taken u/s 56 for income tax purposes. The section is discussed in detail in the next chapter. The provision is apparently enacted to avoid double taxation of the same property.

#### **E. Specific Cases:**

##### **i. Earnest money forfeited – S. 51;**

Any earnest money received in advance and forfeited by the assessee, due to failure in negotiation is reduced from the actual cost of acquisition or the fair market value as on 1.4.81 as the case may be and cost of acquisition will be adjusted accordingly.

#### **Illustration-11**

An acquired a building on May 12, 2001 for Rs. 28 lakhs. In 2005, He entered into negotiation with a prospective buyer, who gave him advance money of Rs. 5 lakhs at that time. However, the negotiations failed and A forfeited the advance money. Subsequently, he actually sold the building in August 2021 for Rs 55 Lakhs. Calculate the indexed cost of acquisition and the taxable capital gains on the sale of the building.

#### **Solution:**

Particulars	Rs	Rs
Sales Consideration		55,00,000
Actual Cost	28,00,000	
Less: Earnest money forfeited-sec 51	5,00,000	
	<u>23,00,000</u>	
Indexed Cost of Acquisition $23,00,000 \times 317/100$		72,91,000
Long Term Capital Loss		17,91,000

# 317 and 100 are the Index for financial years 2021-22 & 2001-02

##### **ii. Self-generated assets**

The courts have taken the view that self-generating assets such as goodwill, Patents, copyrights, goodwill, tenancy rights, which have no actual cost of acquisition incurred were not liable to capital gain tax as the cost of acquisition was Nil. As a remedial measure, the law has been amended to provide that in relation to the *Goodwill of a Business, Trade Mark or Brand Name associated with a business, Tenancy Rights, Loom Hours, Route Permits, right to manufacture or produce any process any*

*article, cost of acquisition shall be taken as the purchase price if such price is paid, or NIL, if such price is not paid.* Effectively, the entire sale proceeds less expenses on transfer of self-generated assets will be treated as capital gain. Where such assets have been acquired for a price from some other person, they cannot be called self-generated assets and therefore the other normal provisions of the Income Tax Act apply.

### **iii. Financial assets – shares and other securities**

Where an assessee becomes entitled to subscribe any additional securities, known as ‘Rights’ or where additional shares are issued as bonus i.e. without any payment, the cost of acquisition shall be as follows:

- a. Amount actually paid for acquiring such asset by way of *subscription to the securities* or
- b. Amount actually paid for acquiring such asset by way of exercising his right or entitlement.
- c. NIL where rights are renounced. (In other words consideration for renouncement of rights will be the amount of capital gains as reduced by transfer cost, if any.
- d. Amount paid to the renouncer of rights entitlement and amount paid to the company, which has allotted the rights shares
- e. NIL in case of bonus shares- in other words, sales proceeds of bonus share will be liable to capital gain as reduced by transfer costs, if any. However, if the bonus shares have been acquired prior to 1/4/81, then the share market value of bonus shares as on 1/4/81 will be treated as the cost of acquisition.
- f. Fair Market Value on the date of distribution of capital assets by a Company u/s 46 (2).
- g. Cost of acquisition of the original asset Consolidation, division, conversion, reconversion of share into stock or vice versa and where such cost cannot be reasonably ascertained, the fair market value.
- h. Cost of acquisition of the original shares held by the shareholders in the demerged company as reduced by the amount arrived at u/s 49 (2C).
- i. Cost of acquisition of original membership of a recognized stock exchange when equity share/s allotted to shareholders of recognized stock exchange under a scheme of demutualization or corporatization of the exchange – Sec. 55(2) (ab)
- j. NIL in respect of trading or clearing rights of stock exchange.
- k. *Pro rata* amount i.e. the amount which bears to the Cost of Acquisition of the shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before

such demerger will be the cost of acquisition of Shares in the resulting company— Sec. 49 (2C).

l. Stock option Specified security taxed as perquisites u/s 17 (2) – Sec. 49 (2AA)

m. Actual cost of acquisition in all the other cases.

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## 6.12 FAIR MARKET VALUE

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Fair market value, in relation to a capital asset, means the price that the capital asset would ordinarily fetch on sale in the open market on the relevant date. If the assessee has acquired the asset prior to 1/4/81, he has the option of substituting the fair share market value of the asset as on 1/4/81 instead of actual cost of acquisition. However, this option is available to the assessee only when the asset has been acquired prior to 1/4/81. Fair market value is adopted in many cases like where ascertainment of actual cost is not possible; assets distributed on liquidation have already been dealt with at their appropriate places. Some other cases are considered below:

### a) Conversion of capital asset into stock-in-trade

When the assessee converts a capital asset held by him into stock-in-trade, it will be treated as taxable transfer giving rise to notional capital gains or loss. For this purpose, the fair market value of the capital asset on the date of conversion is treated as notional sale proceeds from which the cost of acquisition / indexed cost of acquisition is deducted in order to get the capital gain. Later, when this converted capital asset is sold there will be business profit or loss i.e. actual sale proceeds less notional fair market value taken, as cost will be the taxable business profit or loss. However, business income as well as capital gains will be chargeable to tax only in the year of actual sale to a third party.

### Illustration-12:

A jeweller converts his ancestral gold ornaments into the stock in-trade of business on 1/1/2008. The ornaments are actually sold on 31/12/2021 for Rs. 15 Lakhs. The market value of the ornaments was Rs. 5 Lakhs on 1/4/82 and Rs. 12 Lakhs on 1/1/2008.

### Solution:

This is a case of conversion of personal asset into stock in trade. The capital gain arises on the date of conversion i.e. 1/1/2008 but date of liability will be 31/12/2021 when the stock was in fact sold.

Being ancestral property, the fair market value of *Rs 5 lakhs* as on 1/4/82 will be the cost of acquisition.

On 01/01/2003 (date of conversion), LTCG will be Rs. 5.15 Lakhs being the difference of market value on the date of conversion and the cost of acquisition. (Rs. 12 Lakhs - Rs. 5 Lakhs X 129/100)

On 31/12/2021, when the ornaments were actually sold for Rs. 15 lakhs, Rs. 3 Lakhs will be treated as business profit and Rs 5.15 lakhs as the LTCG for the A.Y. 2022-23

**b) Introduction of capital asset by a partner:**

When a partner transfers his personal asset by way of his capital contribution in a partnership firm, the amount credited to his capital account on account of this capital asset will be treated as sales proceeds in the hands of the partner from which the cost or indexed cost of acquisition will be reduced to get the amount of capital gains or loss taxable in the hands of the partner.

**c) Takeover of assets by the partner on dissolution of the partnership firm**

When a partner is allocated a capital asset upon the dissolution of a firm the fair market value of the capital asset on the date of dissolution of the firm will be treated as sales proceeds from which the cost of acquisition or indexed cost of acquisition, as the case may be, will be reduced to get the amount of taxable capital gains in the hands of the firm.

**d) Compulsory acquisition of capital asset**

Where there is compulsory acquisition of capital asset by the government or any government authority under law, there will be a taxable capital gain or loss in the year of such compulsory acquisition. However, such capital gain will be chargeable only in the year in which the compensation is received. If the compensation is enhanced later, then the receiver of such additional amount is chargeable to capital gains in the previous year in which such additional compensation is received. If the compensation amount is subsequently reduced, the capital gain already charged will be recalculated as if it were a mistake apparent from the record u/s 155.

**d) Amount received by shareholder on liquidation of the company:**

Out of the money received by the shareholder, a part of the amount will be treated as deemed dividend under section 2(22) and the remaining amount less the indexed cost of acquisition or cost of acquisition, as the case may be, is taxable as capital gains on sale of the shares.

**a. Capital Gains on Sale of Shares under Depository System**

Where an assessee has any depository account and any shares are sold from the depository account, then such cost of acquisition of the shares sold will be determined on FIFO i.e. on first in first out basis. It will be assumed that the assessee's shares deposited in the account first were sold first and accordingly the cost of acquisition, date of acquisition and the period of holding will be calculated.

**b. Stock Lending**

Any share given under the stock-lending scheme approved by SEBI in this behalf will not give rise to any taxable capital gain.

**c. Corporatization of Stock Exchanges**

In case any person transfers equity shares allotted to him as member of a recognized stock exchange in India under a SEBI approved scheme of corporatization of stock exchanges, his original cost of acquisition of membership of the stock exchange will be the cost of acquisition for computation of capital gains on those shares.

**d. Demerger:**

Cost of acquisition of shares in the resulting company in case of a demerger shall be determined as follows: -

Cost of shares of demerged company x Net book value of assets

Net worth of demerged company before demerger

The cost of acquisition of the original shares in the demerged company shall be reduced by the amount calculated as above

**e. Taxation of capital gains of listed shares**

Share are treated separately by the provisions of S 111A/112, whereby an assessee is given the option to either pay a lump-sum tax of 15% and forego the benefit of indexation or alternatively pay regular tax under the normal provisions including indexation.

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**6.13 RANS ACTIONS COVERED U/S 49(1):**


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It has been stated earlier that the cost to the previous owner as well as the period for which the capital asset was held by the previous owner must be considered in cases of transfers covered u/s 49(1). This is because the capital asset *is not actually purchased* by the assessee in all these cases, nevertheless the assets becomes his property in any manner prescribed in S.49(1) say gift or will. These items pertain to acquisition of assets or property as under:

**i. on the total or partial partition of a HUF.**

**ii.** under a gift or will not being gift or transfer through an irrevocable trust of shares, debentures or warrants allotted by a company directly or indirectly to its employees under a Central Government approved employees stock option scheme (ESOP). In such cases, the market value of the shares, debentures or warrants gifted or transferred to the irrevocable trust on the date of transfer will be treated as the sale proceeds for the purpose of capital gains.

- iii. by succession, inheritance or devolution.
- iv. on distribution of assets on liquidation of company.
- v. under a revocable or irrevocable trust.
- vi. on transfer by a wholly owned Indian subsidiary company from its holding company and by a parent company to its 100 per cent Indian subsidiary company.
- vii. on any transfer in scheme of amalgamation by the amalgamated company from the amalgamating company.
- viii. by Hindu undivided family where one of the members has converted its self-acquired property into a joint family property.

### Illustration-13:

ABC HUF allotted a flat purchased by it on 30 June 1998 for Rs 5 Lakhs to A as his share in HUF property on partition. A sells the flat for Rs. 30 lakhs on 1 April 2021. What will A's liability for tax?

### Solution:

a) There will be no liability for capital gain on 30/06/1998 as *partition of HUF is exempted u/s 49.*

b) On 01-04-2021 relevant to Assessment Year 2022-23, *Cost and date of acquisition are same as Previous Owner (HUF) viz Rs 5 lakhs and 30/6/1998.* The capital gain will be as under:

Sales consideration	30,00,000
Indexed cost of Acquisition 5,00,000 X 317/100	<u>15,85,000</u>
LTCG	14,15,000

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## **6.14 COST OF IMPROVEMENT: -S. 55(1)(B)**

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Cost of Improvement in relation to capital asset means any expenditure or cost of capital nature incurred by (a) *the assessee* or (b) *the previous owner* in case of an asset acquired by an assessee in any of the circumstances mentioned in S 49(1): -

- for substantially improving or raising the value of the capital asset or
- in making addition or alteration to capital asset after date of acquisition or
- for any expenditure incurred to protect or complete the title of the capital asset or
- to cure the title of the property or remove any defect from the title.

In other words, cost of improvement includes all those expenditures, which are incurred to increase the value of the capital asset

Following additional points are noteworthy in this regard

In case of a capital asset acquired prior to 1/4/81, where the fair market value of the capital asset as of 1/4/81 is substituted in place of cost of acquisition, all capital expenditure incurred by the assessee or the previous owner *after 1/4/81* in making any additions or alterations to capital asset will be included in cost of improvement but

- a.) **Cost of improvement incurred prior to 1/4/81 will be ignored** in all cases. The reason behind it is that for carrying any improvement in asset before 1st April 1981, asset should have been purchased before 1st April 1981. If asset is purchased before 1st April the fair market value is adopted and the fair market value of asset on 1st April 1981 will certainly include the improvement made in the asset.
- b.) In any other case all the capital expenditure incurred in making in additions or alterations to the capital asset by the assessee after it become his property.
- c.) There will be no cost of improvement to goodwill, right to manufacture or produce or process any articles or right to carry on any business.
- d.) Any expenditure deductible from the income from house property will not be included in cost of improvement.

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## 6.15 DEXED COST

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Sec 48(iii) (vide Explan iii 4 iv) defines Indexed Cost of Acquisition and Indexed cost of Improvement:

**"Indexed cost of acquisition"** means: -

- an amount which bears to the cost of acquisition the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 1st day of April, 1981, whichever is later; and

**"Indexed cost of any improvement"** means: -

- an amount which bears to the cost of improvement the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset took place; and

**"Cost Inflation Index" (CII)** for any year means: -

- Such Index as the Central Government may, having regard to seventy-five per cent of average rise in the Consumer Price Index for



urban non-manual employees for that year, by notification in the Official Gazette, specify in this behalf

Indexed cost of acquisition/ improvement can be shown by the following formulae:

### **Indexed cost of acquisition**

$\text{Cost of Acquisition} \times \text{CII (the year of Transfer)}$
$\text{CII in the year of acquisition or 01-04-1981, whichever is later}$

### **Indexed Cost of Improvement**

$\text{Cost of Improvement} \times \text{CII (the year of Transfer)}$
$\text{CII in the year of Improvement}$

### ***Exceptions:***

Indexation benefit is not available in respect of the following:

1. Short term capital assets
2. Bonds / debentures other than Capital Indexed Bonds Issued by Government;
3. Shares/Debentures of Indian Company Purchased in Convertible Forex by non-residents
4. Depreciable assets
5. Units Purchased in Foreign Currency u/s 115AB by Offshore Fund
6. GDRs purchased in Foreign Currency u/s 115AC Non-Residents
7. Securities u/s 115AD purchased by non-residents
8. Where option of 15% tax rate is claimed/s 112 in respect of shares
9. Slump Sale U/s 50B
10. Foreign exchange assets U/s 115-O by Non- Resident Indians.

Financial Year	Index	Financial Year	Index
2001-02	100	2011-12	184
2002-03	105	2012-13	200
2003-04	109	2013-14	220
2004-05	113	2014-15	240
2005-06	117	2015-16	254
2006-07	122	2016-17	264
2007-08	129	2017-18	272
2008-09	137	2018-19	280
2009-10	148	2019-20	289
2010-11	167	2020-21	301
		2021-22	317

### **6.16 RANS ACTIONS NOT ‘TRANSFER” –SEC 46, 47**

**A.** Section 47 provides that following transactions will not be regarded as transfer for the purpose of section 45:

- 1) any distribution of capital assets on the total or partial partition of a HUF;
- 2) any transfer of a capital asset under a gift or will or an irrevocable trust not being issue of securities allotted under ESOP or ESOS by a company to its employees;
- 3) any transfer of a capital asset not being an asset transferred as stock in trade by a: -
  - (a) by a holding company to its 100% Indian subsidiary company or
  - (b) 100% subsidiary company to its Indian holding company,
- 4) any transfer, in a scheme of amalgamation,
  - (a) of any capital asset by the amalgamating company to an Indian amalgamated company or;
  - (b) of any shares held in an Indian company by the amalgamating foreign company to the amalgamated foreign company if at least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company, and

such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated;

- (c) of any capital asset by a banking company to a banking institution if such scheme is u/s 45(7) of the Banking Regulation Act, 1949;
- (d) of any shares held by a shareholder in the amalgamating company, made in consideration of the allotment to him of any share or shares in an Indian amalgamated company;
- 5) any transfer, in a scheme of demerger,
  - (a) of a capital asset by the demerged company to the resulting Indian company;
  - (b) of shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if the shareholders holding not less than 3/4<sup>th</sup> in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company and such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.
  - (c) any transfer or issue of shares by the resulting company, to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking;
- 6) any transfer in a business reorganization,
  - (a) of a capital asset by the predecessor co-operative bank to the successor co-operative bank;
  - (b) of shares in the predecessor co-operative bank by a shareholder, made in consideration of the allotment to him of any share or shares in the successor co-operative bank.
- 7) any transfer of bonds or Global Depository Receipts U/s 115AC (1), made outside India by a non-resident to another non-resident;
- 8) any transfer of agricultural land in India effected before 01/03/1970;
- 9) any transfer of any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print, to the Government or a notified University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution;
- 10) any transfer by way of conversion of bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company;
- 11) any transfer by way of conversion of bonds referred to section 115AC (1)(a) into shares or debentures of any company;

- 12) any transfer membership of a recognized stock exchange to a company made on or before 31/12/1998 by a person (not being a company) in exchange of shares allotted by that company to the transferor;
- 13) any transfer of land of a sick industrial company managed by its workers' co-operative during the period of loss till the period up to which the company's losses are equal to or more than its capital), under rehabilitation scheme U/s 18 of the Sick Industrial Companies (Special Provisions) Act, 1985;
- 14) any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualization or corporatization of a recognized stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company if:
  - (a) all the assets and liabilities of the firm or of the association of persons or body of individuals relating to the business immediately before the succession become the assets and liabilities of the company;
  - (b) all the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of the succession;
  - (c) the partners of the firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company; and
  - (d) the aggregate of the shareholding in the company of the partners of the firm is not less than fifty per cent of the total voting power in the company and their shareholding continues to be as such for a period of five years from the date of the succession;
  - (e) the demutualization or corporatization of recognized stockexchange in India is carried out under an approved scheme
- 15) any transfer of a membership right held by a member of a recognized stock exchange in India for acquisition of shares and trading or clearing rights acquired by such member in that recognized stock exchange under an approved scheme for demutualization or corporatization;
- 16) any transfer of a capital asset or intangible asset by a private company or unlisted public company to a limited liability partnership or any transfer of a share or shares held in the company

by a shareholder as a result of conversion of the company into a limited liability partnership if –

- (a) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership;
  - (b) all the shareholders of the company immediately before the conversion become the partners of the limited liability partnership and their capital contribution and profit sharing ratio in the limited liability partnership are in the same proportion as their shareholding in the company on the date of conversion;
  - (c) the shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership;
  - (d) the aggregate of the profit sharing ratio of the shareholders of the company in the limited liability partnership shall not be less than fifty per cent at any time during the period of five years from the date of conversion;
  - (e) the total sales, turnover or gross receipts in the business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty Lakh rupees; and
  - (f) no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.
- 17) Any transfer of any capital asset or an intangible asset upon conversion of proprietary concern into a company, if
- (a) all the assets and liabilities of proprietary concern become the assets and liabilities of the company upon such conversion;
  - (b) sole proprietor holds 50% or more of the total voting power for a period of five years from the date of the succession; and
  - (c) the consideration is paid by way of allotment of shares in the company and not in any other form;
- 18) any transfer in a scheme for lending of any securities under an agreement or arrangement, between the lender and the borrower.
- 19) any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government.

- B.** Similarly, U/s46(1), any distribution of assets of a company under liquidation by the liquidator to the shareholder is not regarded as transfer because such distribution is deemed as dividend u/s 2(22);

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## 6.17 ILLUSTRATIONS

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### Illustration 11

State whether the following are the capital Asset or not:

1. Bicycle
2. Horse
3. Car
4. House for self-residence
5. Jewellery
6. House let on hire
7. Silver utensils
8. Air Conditioner used as stock in trade
9. Air Conditioner not used as stock in trade
10. Rural Agricultural Land
11. Urban Agricultural Land

### Solution:

Items 1,2,3,7 & 9 **Bicycle, horse, personal air conditioner and silver utensils** (if used for personal use) are personal effects, hence not capital assets.

Item 8 **Air Conditioner** used as stock in trade and Item 10 **Rural agricultural land** is excluded from the definition of capital asset.

All the remaining items are capital assets including, Item 4 House for self-residence, item 5 Jewellery, item 6 House let out on hire, item 7 Silver utensils and item 11 Urban agricultural land as they are not excluded from the definition of capital asset.

### Illustration-12

State whether the following transactions are transfer:

1. A house transferred by way of will to son.
2. Bonus shares given by a company to its shareholders.
3. Giving away jewellery for a piece of land.
4. Getting money in lieu of shop in a shopping complex.
5. Giving the rights to use the asset.

**Solution**

- 1) Transfer by will is not transfer
- 2) Issue of Bonus share is not transfer
- 3) Exchange of jewellery with land is transfer of both.
- 4) Money being consideration of shop, it is transfer.
- 5) Not transfer as Asset only hired

**Illustration -13:**

An asset was acquired on 31<sup>st</sup> May 2002 for Rs 10,000, it is substantially improved on 30<sup>th</sup> June 2008 for Rs 5,000 and it is sold on 10<sup>th</sup> December 2021 for Rs 75,000. 30,190

**Solution:**

Particulars		Rs
Sales consideration		75,000
Indexed cost of acquisition (10,000* 317/105)	30,190	
Indexed cost of improvement (5,000 X 317/137).	<u>11,569</u>	<u>41,759</u>
Long Term Capital Gain		<u>33,241</u>

**Illustration-14.**

Assume that the asset was acquired before 1/4/81 & and improvement were carried before 1/4/81 there is no change in fair market value on 1/4/81

Particulars		Rs
Sales consideration		75,000
Indexed cost of acquisition (10,000 X 317/100) on 1/4/81*		
Cost of improvement Ignored (Pre-01/04/19810 *Optional (5,000 X 317/100)		<u>47,550</u>
Long Term Capital Gain		27,450

**Illustration-15: 31,700**

A sells a residential house property in Mumbai for Rs. 30,00,000 on May 15, 2021. The house was purchased by him on June 11, 1983 for Rs 2,00,000. Compute the capital gain

**Solution:**

	<b>Rs.</b>
Sales Consideration.	30,00,000
Less- Indexed cost of acquisition $2,00,000 \times 317 / 100$	6,34,000
Long Term Capital Gain	<u>23,66,000</u>

**Illustration-16:**

A sells a flat on 13 March 2022 for Rs 6,00,000. He had acquired the flat on 15 August 2002 for Rs 1,00,000 and had incurred capital cost of major repairs of Rs 50,000 in 2008.

**Solution**

		<b>Rs.</b>
Sales Consideration		6,00,000
Indexed cost of acquisition $1,00,000 \times 317 / 105$	3,01,905	
Indexed cost of improvement $50,000 \times 317 / 137$	1,15,693	4,17,598
Long Term Capital Gain		1,82,402

**Illustration-17:**

X purchased a house property for Rs. 1,00,000 on 31st July 2001 and constructed the first floor in March 2004 for 1,10,000. The house property was sold for Rs 7,10,000 on 1st April 2021. The expenses incurred on transfer of asset were Rs. 10,000. Compute the capital gains from the transaction and show the difference, if any, if the house was constructed in March, 2020

**Solution:**

Sales consideration		7,10,000
Less: Expenses For Transfer		10,000
Net Sales Consideration		7,00,000
Indexed cost of acquisition 1 lakh * $317/105$	3,01,905	
Indexed cost of improvement $1,10,000 \times 317/113$	28,053	3,29,958
Long Term Capital Gain		<b>3,70,042</b>



**Notes:** 1. Date of purchase will be the date of acquisition. Construction of additional floor is improvement to the property.

2. If the house was constructed in March, 2020, it is held for 12 months, which is less than 36 months. It will be short term capital asset not entitled to indexation. Resultant capital gain of Rs 4,90,000 will be Short Term Capital gain [Rs. 700000- (1,00,000+ 1,10,000)- 4,90,000]

### Illustration 18.

On 1/7/2021 X sold gold jewellery for Rs. 80,000. It was purchased on 1/7/1970 for Rs 9000. Market Value of the jewellery was Rs 100,000 as on 1st April 1981 was Rs. 10,000 compute taxable amount of capital gain, if the expense on transfer is .5% . on sales price.

### Solution:

		Rs.
Sales Consideration		80,000
Less: Indexed Cost of Acquisition $10,000 \times 317/100$	31,700	
Expenditure on transfer (0.5% x 80,000)	400	32,100
Long Term Capital Gains		47,900

### Illustration-19:

X invested Rs. 1,00,000 in ornaments and Rs. 50,000 in equity shares on 1<sup>st</sup> March 2019. He sold the jewellery for Rs. 1,20,000 and shares for Rs.1,00,000 on 1<sup>st</sup> August 2021. There was a ½% brokerage on both the investments, both at the time of purchase and sale. Calculate the taxable amount of capital gain.

### Solution:

#### A- Capital Gain on sale of Jewellery

Particulars	Rs.	Rs.
Sales Consideration of Jewellery		1,20,000
Less: Cost of Acquisition	1,00,000	
Brokerages on purchases (0.5% x100,000)	500	
Brokerages on Sales (0.5% x120,000)	600	1,01,100
Short Term Capital Gain		<u>18,900</u>
Jewellery held for 30 months (1/3/2018 to 1/8/2020) less than 36 months, hence STCG, no indexation.		

## B- Capital Gain on sale of Shares

Particulars	Rs.	Rs.
Sales Consideration on Sale of Shares		1,00,000
Less: Indexed Cost of Acquisition	50,000	
Brokerages on purchases (0.5% x 50,000)	250	
	50,250	
50,250 * 317/272	56,890	
Brokerages on Sales (0.5% x 1,00,000)	500	57,390
Long Term Capital Gain		<u>42,610</u>

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**6.18 SELF ASSESSMENT QUESTIONS:**


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1. Write short note on:
  - a. Short Term Capital Gain
  - b. Cost of Acquisition
  - c. Cost of improvement
  - d. Expenditure on transfer
  - e. Transfer
2. Explain the term 'capital asset'.
3. Write short notes on capital gains in the case of compulsory acquisition of a capital asset.
4. What types of transactions are included in the term "transfer" in relation to a capital asset?
5. State the situations under which the written down value of a "block of assets" will be reduced to nil.
6. Give any five items are not considered as 'capital asset'.
7. Discuss the provisions of the Income Tax Act, 1961 regarding:
  - i. Conversion of capital assets to stock-in-trade.
  - ii. Computation of capital gains in case of depreciable assets.
8. State whether the following are the capital Asset or not:
  - a.) Bicycle
  - b.) Horse
  - c.) Car
  - d.) House for self-residence.) Jewellery
  - f.) House let on hire
  - g.) Silver utensils
  - h.) Air Conditioner used as stock in trade

- i.) Air Conditioner not used in own house
- j.) Rural Agricultural Land
- k.) Urban Agricultural Land

{Ans: item g is not capital asset}

9. Whether the following transactions are transfer in relation to capital asset.
- a. A house transferred by way of will to son.
  - b. Bonus shares given by a company to its shareholders.
  - c. Giving away jewellery for a piece of land.
  - d. Getting money in lieu of shop in a shopping complex.
  - e. Giving the rights to use the asset.

[Ans: only c and d are transfers]

10. M sold his house in Mumbai on 15/04/2013 for Rs 6.5 Lakhs. He had purchased it at a cost of Rs. 50,000 on 03 / 07 / 1983. The purchaser paid Rs. 4 lakhs 01/05/2013 and the balance on 30/06/2013 M paid brokerage of Rs. 13,000 for the sale transaction. Compute the total taxable capital gain.

(Ans: LTCG 2,32,258 i.e.  $6,50,000 - 13,000 - 4,04,741 = \{50,000 \times 939/116\}$ )

11. S purchased shares in unlisted Indian companies on 10/06/1982 for Rs. 2,00,000. On 1/06/2008 he started a business as a dealer in shares and transferred the entire holdings to the business. The market value of the shares as on that date was Rs. 8,00,000. He sold the shares Rs. 9,20,000 on 30/10/2020. Compute taxable capital gains from the above transactions.

12. Aditya sold his only house property occupied by him as residential house for Rs 16 lakhs on 31/12/2020. The house property was purchased by him on 28/02/1985 for a consideration of Rs 2 lakhs. Determine the capital gains.

13. Siddhartha converts his plot of land purchased in July 1996 for Rs 60,000 into stock-in-trade on 31<sup>st</sup> March 2004. The fair market value on 31.3.2004 is Rs 1,60,000. The stock-in-trade was sold for Rs 2,00,000 in the month of January 2021. Find out the taxable income, if any, and if so under which “head” of income and for which “assessment year”.

14. X acquired a plot of land on 30.6.1992 for Rs. 2,20,000. Brokerage and other incidental expenses on acquisition of plot were Rs. 30,000. X sold the plot of land on 30.6.2020 for Rs. 12,00,000. What will be the amount of capital gain? Can he claim deduction for ground rent paid by him amounting to Rs? 5,000 during the period when he held the asset?

15. Purchases 250 equity shares of ABC Ltd on 01/04/1988 @ Rs. 270 per share and incurs Rs. 500 on brokerage and transfer. On 01/07/2002, he

gets 200 bonus shares. On 01/09/1994 he gets 300 right shares @ Rs 140 per share. On 28/02/2021 he sells all the 750 shares @ Rs 400 per share and incurs expenditure of Rs. 1,500 on brokerage. Compute his taxable capital gain.

16. Mrs. Padmini owned 2 motor cars mainly for business purposes. The written down value on 1/4/2020 of the block of assets comprising of only these 2 cars, both of which were purchased on 01/05/1999 was Rs. 1,81,000. These 2 cars were sold on 30/06/2021 for Rs. 1,50,000. She had purchased the same during March 1999 for Rs. 2,44,000.

Compute the amount of capital gain chargeable/ Depreciation.

17. P holds 500 shares of ABC Ltd which were allotted to him on 22/4/1996 at Rs. 30 per share. On 24/7/2009. ABC Ltd made right issue to the existing shareholders at the rate of one share for every five shares held at Rs. 20 per share. P renounced the right entitlement in favour of Q at Rs. 13 per right share entitlement on 4/8/2009. Determine the nature and amount of capital gain, if any, taxable in the hands of P. What will be the cost of acquisition of shares purchased by Q?

18. Kishore Industries owned six machines for use in its business. The written down value of these machines at the end of the previous year relevant to the Assessment Year 2022-23 was Rs. 6,50,000. Rate of depreciation is 25% per annum. A new plant was bought for Rs. 6,50,000 on 30<sup>th</sup> November 2020. Three of the old machines were sold on 10/6/2018 for Rs. 9,00,000. Compute:

- a. the claim to depreciation for AY 2021-22.
- b. Capital gains liable to tax for the same assessment year.
- c. If Kishore Industries had sold the three machines in June 2020 for Rs. 14,00,000 will there be any difference in your above working? Explain.

19. Arjun purchased Jewellery on 10/3/1995 for Rs. 1,05,000 and sold it on 2/11/2020 for Rs. 3,98,000 on 2.11.2020. His record shows that He incurred expenses of Rs. 4,000 at the time of the purchase and Rs. 2,000 at the time of sale for brokerage. Compute capital gains chargeable to tax.

20. Sunder sold a residential house for Rs 75 lakhs on 31/03/2021. He had inherited the house from his father in 1990, the fair market value of which as on 1.4.1981 is Rs. 5 lakhs. During the year 2002-2003, he carried out further construction and improvements, at a cost Rs. 6 lakhs. Expenditure in connection with transfer Rs. 50,000 Compute the taxable capital gains.



## **INCOME FROM OTHER SOURCES**

### **(Sections 56 -59)**

#### **Unit Structure**

- 7.1 Introduction & Objectives
- 7.2 Basis of Charge
- 7.3 Incomes specifically chargeable u/s 56
- 7.4 Other incomes chargeable u/s 56
- 7.5 Some specific incomes – gifts, dividend
- 7.6 Deductions
- 7.7 Amounts not deductible
- 7.8 Miscellaneous- Balancing charge, Method of accounting
- 7.9 Self-Assessment Questions

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#### **7.1 INTRODUCTION AND OBJECTIVES**

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Income from other sources” is last and residuary head of income- S 56[1]. It covers all such incomes, which are not chargeable under any other head of income viz salary, Income from house property, capital gains and profits and gains of business and profession. This head also comprises of some well-defined incomes such as interest, dividend, winnings from lotteries and gifts, etc. –S 56(2). The lesson deals with this last but one of the most important head of income with computational aspects and also specific items that can be deducted from the income from other sources.

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#### **7.2 BASIS OF CHARGE- S 56(1)**

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Income of every kind which is not to be excluded from the total income and which is not chargeable under any of the specified heads shall be chargeable to income tax under the head “Income from Other Sources- S 56(1)”.

In other words, if any incomes are taxable, but they cannot be classified under other heads of income viz salary, Income from house property, capital gains and profits and gains of business and profession shall be charged under the head Income from Other Sources

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#### **7.3 INCOMES SPECIFICALLY CHARGEABLE S. 56(2)**

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Section 56(2) lists incomes specifically chargeable to tax under the head “Income from Other Sources”. These incomes are:

- i. Dividends u/s 2(22) (a) to (e)
- ii. Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.
- iii. Any sum received by the assessee from his employee as contribution to any provident fund or superannuation fund or any fund set up under the provisions of the Employee State Insurance Act, 1948 or any other fund for the welfare of such employee is treated as income as referred under Section 2(24) (x), if not chargeable under the head business or profession.
- iv. Income by way of interest on securities, if not chargeable under the head business or profession.
- v. Rental income from machinery, plant or furniture belonging to the assessee and let on hire if not chargeable under the head business or profession.
- vi. Where an assessee lets on hire machinery, plant or furniture belonging to him and also buildings and letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, if not chargeable under the head business or profession.
- vii. Any sum including bonus received under Keyman Insurance Policy shall be treated as income chargeable to tax under this head if not taxable as salary or business income.
- viii. Aggregate of any sum of money exceeding Rs. 50,000 received without consideration by an individual or HUF on or after 1-10-2009
- ix. Aggregate fair market value of movable property if it exceeds Rs 50,000 received without consideration by an individual or HUF after 1-10-2009
- x. The difference between the aggregate fair market value and the consideration received if movable property or immovable property w. e. f. 01-04-2014 exceeding Rs 50,000 is received for inadequate consideration received by any individual or HUF.
- xi. The stamp duty value whether assessed or assessable of any immovable property if the stamp duty value of such property exceeds Rs 50,000 received without consideration by an individual or HUF after 1-10-2009
- xii. Shares of closely held companies having aggregate fair market value exceeding Rs. 50,000 received by a firm or a closely held company without consideration on or after the 1st day of June, 2010 from any person or persons, the public are substantially interested, or for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the

aggregate fair market value of such property as exceeds such consideration:

- xiii. income by way of interest received on compensation or on enhanced compensation referred to in section 145A (b).

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## **7.4 OTHER INCOMES CHARGEABLE**

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Income from other sources is the residual head of income comprising of all the incomes, which are not chargeable elsewhere. Therefore, apart from the incomes specified above, all the other incomes includible under any other heads of income the same will be charged under this head. Some of such items are as follows:

- i. Dividend received from any entity other than domestic company; This is because dividend received from a domestic company is exempt under section 10(34) in the hands of the receiver; Accordingly, dividend received from a cooperative bank or dividend received from a foreign company will be taxable as income from other sources;
- ii. Any pension received by the legal heirs of an employee; Pension received by the employee himself during his lifetime will be charged under section 17(3) as the income from salaries;
- iii. Any winnings from lotteries, crosswords, puzzles, races including horse races, card games or other games of any sort or gambling or betting of any form or nature;
- iv. Income from any plant, machinery or furniture let out on hire where it is not the business of the assessee to do so;
- v. Income from securities by way of interest;
- vi. Any sum received by the assessee from his employees as contribution to any staff welfare scheme; However, when the assessee makes the payment of such contribution within the time limit under the scheme of welfare, then the payment will be allowed as a deduction; only the balance amount will be taxable;
- vii. Income from sub-letting;
- viii. Interest on bank deposits and loans and securities;
- ix. Royalty;
- x. Directors' fees;
- xi. Casual income;
- xii. Agricultural income when taxable e.g. land say situated in a foreign country,
- xiii. Income from undisclosed sources;

- xiv. Rent of plot of land;
- xv. Mining rent and royalty;
- xvi. Casual income under a will, contract, trust deed;
- xvii. Salary payable to a member of parliament;
- xviii. Gratuity received by a director who is not an employee of a company;  
and
- xix. Any other receipt which is income but which does not fall under the other four heads of income viz. salary or business income or income from house property or capital gain.

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## **7.5 SOME SPECIFIC INCOMES:**

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### **5.1. Dividend - Sec 56(2) (i)**

Dividend means distribution of profits by the management to the real owners- the shareholders. Dividend is chargeable to tax whether paid in cash or kind or paid out of taxable profits or tax -free income, out of revenue profits or capital gains. Dividend is taxable when declared at the Annual General Meeting of a company and not when received, but interim dividend is taxable on the basis of payment.

Income from dividend (not being deemed dividend) from an Indian company is tax free in the hands of the shareholders as the distribution of dividends is taxable in the hands of the company.

### **5.2. Deemed dividend: -Loan to shareholders- S. 2(22) (e)**

According to section 2(22) (e), if a closely held company gives a loan or advance to a person for his individual benefit and the person is having substantial interest (10 per cent) in the company or to a concern (HUF/Firm etc.) where the person having substantial interest has at least 20 per cent interest, then the receiver of that loan will be treated as if he has received the dividend amount to the extent of loan and it will be taxable in his hands as dividend income.

This provision has been inserted to prevent persons having substantial control and influence over the affairs of a company to take away all funds of the company as low-interest loans for their personal benefit to the prejudice of the other shareholders.

### **Some other important points should be kept in mind:**

1. The dividend under this clause is taxed in the hands of the shareholder, who is entitled to set off the same if and when company declares any dividend. The dividend will be taxable in the year when the loan was given – S.8. (In practice, since the dividend is tax-free in the hands of the shareholder, the set –off provision does not grant any real benefit of set-off to the shareholder;



2. If the loan is repaid, dividend income will still be taxable in the hands of the recipient. The courts have repeatedly held that there is no inequity in this;
3. The loan will be taxable as dividend only to the extent of free reserves of the company;
4. The section will be applicable only on cash loans or advances and not on advances in kind say by way of sale of goods in the normal course of business;
5. Loans or advance made by the lending company for which lending is the main or substantial part of its business will also not be covered by this section;
6. Any advance or loan made to a shareholder or the concern by a company in the ordinary course of its business, for purchase of its own shares or on demerger etc. will also be not be covered under this section;
7. The dividend will also be subject to TDS;
8. Substantial interest may be existing at any time during the year;
9. Any deemed dividends u/s 2(22) (e) or dividend from any other entity is, however taxable in the hands of the recipient; and.
10. Deduction of expenses on collection and interest on loan, taken for investment in shares, is available against dividend income.

### **Illustration- 1**

A takes a loan of Rs 20 lakhs from A Ltd in which he is a shareholder having substantial interest. A returns the loan next day, when he makes his own arrangement for finance. The Company was having free reserves of Rs 10 lakhs only.

### **Solution**

Out of loan taken from A Ltd., only Rs. 10 lakhs (to the extent of free reserve of the company) will be treated as deemed dividend u/s 2(22) (e). Repayment of loan does not affect the tax liability. If and when A Ltd declares any dividend, A will be entitled to set-off, since, the final dividend is tax free, A will have no real benefit.

### **Illustration- 2**

A takes a loan of Rs 20 lakhs from B, in which he is a shareholder having substantial interest. The Company was having free reserves of Rs 20 lakhs.

**Solution:**

Entire loan amount of Rs 20 lakhs will be deemed to be dividend in the hands of B U/s 2(22) (e).

**Illustration -3**

In the above case, assume B Ltd is a loss making company having no free reserves

**Solution**

Since B Ltd. has no free reserves, the loan taken will not be taxable in the hands of A as dividend.

**Illustration- 4**

A takes a loan of Rs 20 lakhs from D Ltd., in which he holds substantial interest in B Limited for one month only. Thereafter, he transfers the shares. The Company was having free reserves of Rs 20 lakhs.

**Solution**

Entire loan amount of Rs 20 lakhs will be deemed to be dividend in the hands of B U/s 2(22) (e) even if A holds substantial interest only for a part of the year.

**5.3. Deemed dividend – Distribution by Companies: S. 2(22)**

Any distribution by a company to its shareholders which entails the assets of the company, or distribution made on liquidation or reduction of capital is regarded as dividend to the extent of accumulated profits of the company.

Similarly, any distribution by a company to its preference shareholder or debenture holders is also regarded as deemed dividend to the extent of accumulated profits of the company. Dividend in this class is directly taxable in the hands of the company.

**5.4. Interest on securities**

Interest received from debentures of company, mutual funds, and government securities is taxable as income from other sources except when such income is exempt U/s 10 or is taxed as business income. If any tax is deducted at source from interest on such securities, it should be added back and only the gross income should be considered. However, in case of tax-free govt. securities, grossing up is not required as there is no deduction or TDS. However, grossing up is required in case of taxable securities and non-government securities.

From the Interest income from this head, reasonable bank charges and other collection charges, office and other expenses if the same were incurred for earning the income and interest payable on loans taken for acquiring securities can be deducted.

**Illustration -5**

A received Rs 36,900 as interest net of TDS @ 10 on debentures of B Tea Ltd worth Rs 2,50,000 held by him. Calculate the interest income and the amount of TDS @ 10 that can be claimed.

**Solution**

Since interest amount is net of TDS i.e. 90% or [100-10%], it will have to be grossed up and the interest Income will be Rs. 41,000 [ i.e. Rs 36,900/ 90%] and TDS to be claimed Rs 41,000 - Rs 4,100 = Rs 36,900  
Cross verify 10% of Rs. 41,000 = Rs4,100.

**5.5. Winning from Lotteries, Crossword puzzles, etc.**

Winnings from, Lottery, crossword puzzles, card games or other games including any game show like KBC and horse races, betting, gambling etc. are all treated as income from other sources and taxed at the maximum marginal rate u/s 115BB on the gross income without considering -:

- Claiming basic exemption limit
- Deductions under chapter VI-A.
- Expenditure including collection charges, etc. or allowances;
- Benefit of set off and carry forward of losses.

**Illustration 6**

The winnings out of Sawaal Aapka were Rs 1,50,000. Calculate the net receipt.

**Solution**

Since such winning would be subject to maximum marginal rate is 30%, + 3% education cess and the secondary and higher education cess. TDS of 30.9% would be applicable.

TDS deducted = Rs 1, 50,000 X 30.9% = Rs 46,350

Net receipts of winnings = Rs 1, 50,000 – Rs 46,350 = Rs 1,03,650

Or Rs. 1,50,000 X 69.1% = Rs 1,03,650

**5.6. Family Pension**

Family pension means a regular monthly payment made to the legal heirs of the employee after his death. This is treated as income from other source and not salary because there is no employer-employee relationship between the legal heirs and the employer.

Standard deduction equal to 1/3<sup>rd</sup> of the pension or Rs. 15,000 is available as deduction from this income. Significantly, pension amount received



**Following points are important in this regard:**

• **Date of valuation**

Date of agreement will be the date for considering the stamp, if the date of agreement and the date of registration are not the same and part or whole of the amount of consideration thereof, has been paid by any mode other than cash on or before the date of the agreement, in other cases it will be the date of registration.

• **Disputed Value**

If the stamp duty value of immovable property is disputed by the assessee u/s 50C (2), the Assessing Officer may refer the valuation of such property to a Valuation Officer as per the provisions of Sec 50C and 155(15) will apply for valuation of capital asset.

c. Any property, **other than immovable property-**

- i. **without consideration**, the **aggregate fair market value of which exceeds fifty thousand rupees**, the whole of the aggregate fair market value of such property; or
- ii. **for a consideration which is less than the aggregate fair market value** of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration

**5.7.2. Exceptions:**

The provisions will not apply to any sum of money or property received:-

- (a) from any relative; or
- (b) on the occasion of the marriage of the individual; or
- (c) under a will or by way of inheritance; or
- (d) in contemplation of death of the payer or donor; or
- (e) from any local authority defined in S 10[20]-Explanation
- (f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in S. 10 (23C); or
- (g) from any trust or institution registered u/s 12AA

**5.7.3 Meaning of Property:**

Property” means the following capital asset of the assessee: —

- a. immovable property being land or building or both;
- b. shares and securities;

- c. jewellery;
- d. archaeological collections;
- e. drawings;
- f. paintings;
- g. sculptures;
- h. any work of art; or
- i. Bullion w. e. f 01/06/2010

#### 5.7.4 Meaning of Relative

Relative “means:

- I. In relation to an Individual:
  - a. spouse of the individual;
  - b. brother or sister of the individual.
  - c. brother or sister of the spouse of the individual;
  - d. brother or sister of the either of the parents of the individual,
  - e. any lineal ascendant or descendant of the individual
  - f. any lineal ascendant or descendant of the spouse of the individual
  - g. spouse of the persons referred to in (2) to (6) above.

<b>RELATIVE OF A OR MRS. A</b>		
<b>Spouse</b>	<b>Mrs. A</b>	<b>A</b>
Siblings	A's brother	Mrs. A's Brother
	A's sister	Mrs. A's sister
Lineal Ascendants paternal	A's Parents	Mrs. A's Parents
	A's grandparents	Mrs. A's grandparents
Lineal Descendants Paternal	A's sons	Mrs. A's sons
	A's daughters	Mrs. A's daughters
	A's grandsons	Mrs. A's grandsons
Siblings of Parents of Individual (Not of Spouse) Mother's brothers / sister + Father's brother / sister		
<b>Spouses of All the above persons</b>		

Note: This relationship is explained in a diagram, where Lineal ascendants or descendants taken on male side

II. In Relation a Hindu Undivided Family any member thereof.

### **5.8 Cost of Acquisition**

While computing capital gains, cost of acquisition of a property received by a transferor from any exempted mode of transfer e.g. will, is taken at the same cost as that of the previous owner. Further, cost of acquisition of a property received without consideration and is chargeable u/s 56 when it is subsequently sold or transferred shall be the value considered u/s 56.

#### **Illustration -8**

A painting valued at Rs 5,00,000 is transferred for Rs 3,00,000. Difference of between the consideration and the fair market value of Rs 2,00,000 (5,00,000-3,00,000) will be charged u/s 56 being value of inadequate consideration. The painting is resold for Rs 10,00,000; the capital gain will be computed by taking the cost of acquisition of Rs 5,00,000 i.e. Rs 10,00,000-5,00,000 or Rs. 5,00,000

### **5.9 Issue of shares at premium**

Aggregate consideration received by a closely held company (private company), which issues shares at premium or above their face value during a previous year to any person being a resident, to the extent such consideration exceeds the fair market value of the shares by Rs 50,000 except when the shares are issued

- to a venture capital company or
- other company notified by the Central government.

Fair market value of the shares will be determined as per the prescribed rules (Net Asset Value or Break-Up Value Method) any other method as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares, of its assets, including intangible assets, being goodwill, know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature

#### **Illustration -9**

Fair market value of a company's share is Rs 100 per share. It issues 1000 shares for Rs 800 per share, then  $1000 \times (800 - 100) = \text{Rs } 7,00,000$  will be treated as "income from other sources, unless the company is a venture fund or other notified company.

<b>TAXABLE GIFTS AT A GLANCE</b>		
<b>INDIVIDUALS AND HUFs</b>		
<b>RECEIPTS WITHOUT CONSIDERATION</b>		
<i>Cash</i>	50,001	Aggregate
<i>Movable Assets</i>	50,001	Aggregate
<i>Immovable Assets</i>	50,001	Per Property
<b>INADEQUATE CONSIDERATION [ FMV- CONSIDERATION]</b>		
<i>Movable Assets</i>	50,001	Aggregate
<i>Immovable Assets</i>	50,001	Per Property
<i>Shares Of Pvt Co.</i>	50,001	Consideration or difference with FMV
<i>Recd by firm or Co</i>		
<i>Sh. Premium by Pvt Co</i>	50,001	Difference with FMV

**Important Points:**

1. Limit of Rs 50,000 is for each category in case of cash and movable assets and cash but Rs. 50,000 is per immovable property as this section says "such property"
2. Rs 50,000 is not the basic limit. Once the limit of Rs 50,000 exceeds, entire sum will be taxable. For instance, a receives cash gift of Rs 40,000 it will be exempt as it is below Rs 50,000 If he receives another gift of Rs. 10,100 from C. The aggregate gifts of Rs 50,100 will be taxable without any basic exemption
3. The list of relatives **does not include nephews/nieces/ cousins**
4. List of relatives includes Spouses, Siblings - own, spouses' and parents , lineal ascendants and descendants and spouses.
5. List of relatives includes uncles and aunts of the individual but not those of the spouse.
6. Stamp duty valuation will have same meaning as in S 50C.
7. Fair Market Value can be determined by the values.
8. Business assets like stock are not covered by these provisions and normal sale or purchase transactions will not attract the provisions of this section.



9. Any movable property like shares, securities, jewelry, drawings, paintings, sculptures, work of art or archaeological collections or immovable, without consideration the fair market value of which exceeds Rs 50,000 in aggregate during a previous year, or for a consideration falling short of their aggregate fair market value by more than Rs 50,000 will be covered by this provision.

**Illustration 10:**

Compute the total income of XYZ, who receives Rs 60,000 in cash and of 1000 shares of a company valued at Rs. 40 per share as gift from each of the following persons:

1. B, his neighbour.
2. C, employer
3. D, one of his patients
4. E, his sister on the occasion of his daughter's marriage.
5. F, in contemplation of death.
6. Mrs. A
7. Mr. husband of E
8. H, son of E
9. X, a stranger on his marriage.

**Solution**

<b>COMPUTATION OF TOTAL INCOME OF XYZ</b>	<b>Rs.</b>
SALARIES [ gift from C, his employer -Sec 17]	1,00,000
PROFITS AND GAINS OF BUSINESS & PROFESSION- [Gift from D a patient –Sec 28]	1,00,000
OTHER SOURCES –Gifts from the following: - Sec 56	
B - Neighbor.	1,00,000
- sister E 's son [ nephew not exempted]	1,00,000
	2,00,000
Total Income	4,00,000

- Gift of shares of Rs 40,000 and cash Rs 60,000 each treated at par. Therefore, total gift in each case Rs 2,00,000
- Exempt gifts from – (with reason in brief)
- 4. E - sister – Relative
- 5. F in contemplation of death (Gift *mortis Causa*).

6. Mrs. A- spouse –Relative
7. G -E's husband – Sister's spouse –Relative
9. X – on the occasion of marriage (Relationship not relevant)

### 5.10 Gifts Received by firms and companies

When a firm or a closely held company receives, in any previous year, from any person or persons, on or after 01-06-2010 any shares of another closely held company-

- i. Without consideration and the aggregate fair value of such shares exceeds Rs 50,000, the whole of the aggregate fair market value of such shares or property;
- ii. for a consideration which is less than the aggregate fair market value of the shares by an amount exceeding Rs 50,000, the aggregate fair market value of such property as exceeds such consideration:

This section will not however apply to transactions not regarded as transfer u/s 47.

#### Illustration-11:

A Pvt. Ltd. buys shares in B Ltd of Rs 5 lakhs for Rs 1 lakh from C. the difference in the consideration and the fair market value amounting to Rs 4 lakhs will be taxable u/s 56.

#### A. Important points:

- i. The limit of Rs 50,000 is for each category.
- ii. Rs 50,000 is not the basic limit. Once the limit of Rs 50,000 exceeds, entire sum will be taxable. For instance, a receives cash gift of Rs 45,000 it will be exempt as it is below Rs 50,000. Now assume A receives another gift of Rs. 5,100 from C. The aggregate gifts of Rs 50,100 will be taxable without any basic exemption
- iii. In case of immovable property, the limit of Rs. 50,000 is per property
- iv. The list of relatives **does not include nephews/nieces. / cousins**
- v. List of relatives includes Spouses, sibling- own, souses' and parents, lineal ascendants and descendants and spouses.
- vi. Stamp duty valuation will have same meaning as in S 50C.
- vii. Fair Market Value can be determined by the values.
- viii. **Business assets like stock are not covered by these provisions and normal sale or purchase transactions will not attract the provisions of this section.**

- ix. Any movable property like shares, securities, jeweler, drawings, paintings, sculptures, work of art or archaeological collections, without consideration the fair market value of which exceeds Rs 50,000 in aggregate during a previous year, or for a consideration falling short of their aggregate fair market value by more than Rs 50,000 will be covered by this provision.

### **5.11 Additional compensation**

Income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A.]

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## **7.6 DEDUCTIONS -S. 57**

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Following deductions are available u/s 57 in computing the income from other sources:

### **I In case of taxable dividend income and interest from securities:**

Any reasonable sum paid by way of remuneration or commission for the purpose of realizing such income including interest on borrowed capital if such borrowed capital is used for making investment in shares or securities.

### **II In case of income from plant, machinery or furniture given out on hire:**

- a. Current repairs to building.
- b. Current repairs to machinery, plant or furniture.
- c. Insurance premium paid for insuring the plant, machinery, building or furniture.
- d. Depreciation on building, machinery, plant or furniture.
- e. Any expenditure (not being capital expenditure or personal expenditure) which has been incurred wholly, necessarily and exclusively for earning income, such expenditure will also be allowed as a deduction, e.g. sub-letting expenses. Office stationery, rent, salaries, etc. where maintenance of office is necessary for earning the income.

### **III In case of family pension received by legal heirs of an employee,**

A standard deduction of 1/3rd of such amount received as family pension or Rs. 15,000, whichever is less.

For this purpose, family pension means a regular monthly payment made to the legal heirs of the employee after his death. Significantly, pension amount received during the lifetime of employee is taxable as salaries and not entitled to standard deduction.

**IV.** Employees' contribution to Provident or any other fund if deposited before the due date.

**V.** Any allowances paid for breeding or maintaining the racehorses.

**VI.** A deduction of 50% against the enhanced compensation received and no further deduction will be allowed from the income.

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## **7.7 AMOUNTS NOT DEDUCTIBLE- S. 58**

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The following amounts are not deductible while computing income under the head "Income from Other Source":-

- Personal expenses of the assessee;
- Any interest which is payable outside India on which income tax has not been paid or deducted at source;
- Any sum paid on account of wealth tax in India or abroad;
- Any amount not allowable by virtue of it being unreasonable;
- In case of foreign companies, expenditure in respect of royalties and technical services received under an agreement made after 31/3/76; and
- Any expenditure in connection with income from winning from lotteries, crosswords, puzzles, races including racehorses, car races and other games of races, gambling, betting of any form. However, expenses are allowed as a deduction in computing the income of an assessee who earns income from maintaining as well as holding racehorses.

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## **7.8 MISCELLANEOUS**

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### **a) Balancing charge Taxable-S. 59**

Any amount received or benefit derived in respect of any expenditure, incurred or loss or trading liability allowed shall be deemed to be the income of the year in which such benefits is accrued or received as the case may be.

### **b) Method of accounting. - S. 145**

Section 145 relating to method of accounting is also applicable to the computation of income from other sources. Income under this head is computed in accordance with the method of accounting regularly employed by the assessee i.e. if the assessee accounts only on cash receipt and cash payment basis, income will be treated on cash payment and cash receipt basis only; otherwise it will be treated on mercantile basis. An assessee can adopt either the cash method or accrual method of accounting. Hybrid method is not permissible. However, certain items like

lottery, horse races, dividend u/s 2(22) (e) can only be recorded on cashbasis because of their variable nature.

**c) Grossing Up:**

Many times dividends, interest from securities are received after TDS. In such case amount to be included in total income is gross amount and not the amount received. Amount of TDS should be added back.

**Illustration- 3.**

A receives taxable interest of Rs. 18,000 after deduction of 10% TDS. Find out the taxable income.

**Solution**

Since TDS is 10% and 144 amount is Rs. 100

Net amount will be 90%

Amounts to be taxed will be gross amount Rs 20,000 i.e.

$$\frac{\text{Rs } 18,00 \times 100}{90}$$

*Rupees 20,000 will be included in the income and credit for TDS of Rs. 2,000 will be claimed against the tax payable.*

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**7.9 SELF-EXAMINATION QUESTIONS:**

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- 1) Enumerate any five items of income, which are included under the head 'income from other sources'.
- 2) Define Dividend. Discuss the taxability of dividend.
- 3) What are the incomes included under the subhead of winning? What is the rate of tax on such incomes?
- 4) What are the deductions allowable in respect of hire charges of plant and machinery?
- 5) Are there any amounts, which are not allowed as deductions while computing the income from other sources? Give examples.
- 6) A is in receipt of pension as a retired government employee @ Rs. 10000 per month. Besides, he is in receipt of family pension of his late wife @ Rs. 6000 per month. Show how the two amounts will be treated for tax purposes.,

(Hint. Own pension salary / wife's pension other sources with standard deduction Rs15000)

- 7) Show the head of income under which the following items would be charged.

- a. Rent received by an event manager on letting out tents /pandal.
- b. Hiring charges received by a taxi driver.
- c. Car hiring charges received by a company from the cars requisitioned by the Election Commission
- d. Interest on Income Tax Refund
- e. Rent received by letting out own house and
- f. Rent received by sub-leasing premises.
- g. Computer hiring charges.
- h. Salary of director
- i. Salary of M.P/ MLA
- j. Rent of a house.
- k. Rent of a plot of land.
- l. Rent of a machine let on hire along with building and letting is separable.
- m. Dividend from domestic company.
- n. Winning from TV game show like.

(Hints/Answers: item e/j remaining other sources. Director if employee, then salary)



## EXCLUSIONS AND DEDUCTIONS

### Unit Structure

8.1 Introduction and Objectives

8.2 Exemptions and deductions

8.3 Income exempt under section 10

- a. Agricultural income-S10(1)
- b. Receipts by a member from a Hindu Undivided Family-S 1092)
- c. Share of profit of a partner in a firm –S10(2A)
- d. Income of minor Child –S.10(32)
- e. Dividend Income –domestic companies-S10(34)
- f. Dividend Income- Mutual fund units- S10(35)
- g. Other Exemptions

8.4 Deductions –S.80 –Chapter VIA

- a. Investments –S80C
- b. Pension Plan –S 80CCF
- c. Medclaim -80D,
- d. Physical Disability -80DD,
- e. Treatment f major diseases -80DDB,
- f. Interest on educational Loans 80E,
- g. Physical Disability(Own)-80U:

8.5 Solved Examples

8.6 Self-Assessment questions

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### **8.1 INTRODUCTION & OBJECTIVES**

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This lesson deals with the provisions of Income Tax Act 1961 relating to exemption and deduction. Exempted incomes are not considered in the total income. Deductions are allowed U/s 80 –Chapter VIA after the total income is computed. Deductions may be in respect of income or expenditure.

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## 8.2 EXCLUSIONS VS DEDUCTIONS

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### 2.1. Exclusions:

Every income is chargeable to income tax unless it is specifically exempt. It is not relevant that the Income is received in cash or in kind or it is of capital nature or of revenue nature. Income not chargeable to income tax is called **exempt** income. Such income will not be included in computation of income

Every person, who claims an income to be exempt, has to prove that such receipt is so exempt. Exemption may be available to persons e.g. Charitable Trusts or group of income such as agricultural income. Agriculture income of all persons is exempt. On the other hand, all the incomes of a charitable trust are exempt. Further exemptions may be conditional or unconditional.

Sections 10 -13 provide a broad list of income exempt from tax. In addition, Sec. 15 to 56 which provide for computation of income under different heads viz Salaries, Income from house property, Profits and gains of business & profession, capital gains and Income from other sources, also provide for certain exemptions available under a particular head.

Moreover, a receipt of capital nature may be claimed as exempt if it is not specifically chargeable to income tax and also a receipt if does not fall under the definition of income.

To summarize exempt incomes may be of following types:

- Income exempt u/s 10-13
- Income exempted under different heads of income S 15-56
- Income of capital nature not specifically chargeable to income tax and
- Income not falling in the definition of income.

Exempt Income by definition means income not chargeable to tax hence such income is **excluded** from the computation of total income.

### 2.2 Deductions

Deductions are allowed **after** the gross total income is computed. Chapter VIA and various sub-sections of S 80 give a list of deductions allowable on the basis of income or revenue or on the basis of payment and expenditure.

Revenue or income is allowed as deductions U/s 80IA, 80IB etc. to a class of assesses like software, infrastructure companies, companies engaged in construction of, affordable housing etc.



On the other hand, deductions are available in respect of investments in specified securities, payment of mediclaim, expense on handicapped dependent etc. Deductions are allowed after the gross total income is computed.

Some important exemptions and deduction are discussed below.

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### **8.3 INCOME EXEMPT UNDER SECTION 10:**

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Section 10 provides that some classes of incomes will be not chargeable to income tax and will not be considered computation of total income. Burden of proving that a particular item of income falls within this section is on the assessee. Some of such incomes (covered in syllabus) are discussed as under:

#### **3.1 AGRICULTURAL INCOME – S 10(1):**

Under the constitution of India, agriculture is in the state list and the Central Government is not constitutionally competent to levy taxes on agriculture. Accordingly, Section 10(1) of the Income Tax, Act, 1961 exempts agricultural income, except for rate purposes, if agricultural income exceeds Rs 5000)

#### **Meaning of agricultural income**

U/s 2(1A) Agricultural income” means any

#### **A. any rent or revenue derived from land-**

- which is situated in India and
- is used for agricultural purposes

#### **B. any income derived from such land by**

- agriculture; or
- raising the performance by a cultivator or receiver of rent-in-kind of any process to render the produce raised or received by him fit to be taken to market or
- the sale of such produce without performing any other process as stated above.;

#### **C. any income derived from any building is:**

Owned and occupied by owned and occupied by the

- i. receiver of the rent or revenue of any such land, or
- ii. cultivator or
- iii. receiver of rent-in-kind, of any such land as above IF such building is

- a) on or in the immediate vicinity of the land, and
- b) required as a dwelling house, or store-house, or other out-building by reason of his connection with the land, and the land is
- assessed to land revenue in India OR
  - subject to local rates and taxes assessed and collected by the Government And
  - **(w.e. f 01/04/2014)** situated in any area within the distance measured aerially from the local limits of any municipality or cantonment board depending upon its population as per the last published census
  - Eight Kms if population is more than 10 lakh.
  - 6 KMs if it is more than 1 lakh but not exceeding 10 lakhs; or
  - 2 KMs if population is of more than 10,000 but not exceeding one lakh; or

### Other Points

1. Income from land situated in urban area is not exempt
2. Land situated in areas having population of 10,000 or less will qualify for exemption.
3. The exemption is only in respect agricultural income received in India.
4. Agricultural income from a foreign country is treated as non-agricultural income in India.
5. Receipts arising on transfer of agricultural land u/s 2(14) is not considered agricultural income
6. Any income arising from letting out the building for residential or business purpose other than agriculture will not be agricultural income

### Illustration 1

Tukaram has some agricultural land in Nasik. Tukaram employs Sakharam to carry out agriculture at a remuneration based on the value of agricultural produce. Sakharam remits the sale proceeds of the agricultural produce Tukaram after deducting his share of remuneration. Discuss the tax liability of Tukaram and Sakharam.

### Solution

Income on sale of agricultural produce derived from agricultural in India is agricultural income be exempt U/s 10(1) in the hands of Tukaram.

However, Sakharam gets salary for rendering his services. Salary income is not derived from agricultural land; hence, it will be chargeable to income tax under the head “Income from Salaries”.

### 3.2 Receipts by a member from a HUF-S.10(2)

S 10(2) provides that any sum received by an individual as a member of a Hindu undivided family either out of income of the family or out of income of impartible estate belonging to the family will be exempt from tax.

The exemption is provided as a Hindu Undivided family (HUF) is a separate entity independently liable to pay tax on its income. When, the income is distributed among its members, there will be no further tax liability as it will amount to taxing the same income twice.

However, if a member of the family converts his personal property into the family property (called as throwing self-property into family hotchpot), then the income derived from such converted property will not be eligible for exemption U/s 10(2). Instead, it will be clubbed U/S 64(2), in the hands of the member, who has transferred the property to the family

#### Illustration 2

X, an individual, has personal income of Rs. 5,00,000 for the previous year 2013-14. He is also a member of a Hindu undivided family, which has an income of Rs. 2,50,000 for the previous year 2011-12. Out of income of the family, X gets Rs. 1,25,000, as his share in the income of the family. Show the status of the income from taxability point of view.

#### Solution:

X is liable to pay tax only on his personal income of Rs. 5,00,000. His share of Rs. 1,25,000 from HUF is exempt in the hands of X under section 10(2) irrespective of the fact whether the family is chargeable to tax or not. The HUF is liable to tax in respect of its income of Rs. 2, 50,000

### 3.3 Share of Profit of a partner in a firm –S 10(2A)

A firm is a different person for tax purposes just like a HUF. Hence the income or the profits of the firm are taxed independently in its hands and not in the hands of the partners. There are some specific deductions allowable in respect of payments made to partners in respect of interest on their capital and their remuneration separate from its partners for the purposes of income tax. (These provisions are discussed separately in the later chapters)

Therefore, to avoid double taxation of the income, firstly in the hands of the firm and then in the hands of the partners, section 10(2A), provides for exemption of share of profit received by partners from a firm which is assessed as a firm. However, any remuneration paid by the firm or any interest on capital shall not form part of the share of profit received by

partner and will be taxed in the hands of the partners. Any remuneration or interest on capital in excess of the limits laid down in Section 40 shall be chargeable to tax in the assessment of the firm and will form the part of the income allocated to partners exempt U/s 10(2A).

### **3.4 Income of minor child-S10(32):**

Under 64(1A), income of a minor child is clubbed in the hands of his parent, who is having higher income except income earned by minor's personal efforts or skill. As a compensatory measure, section, 10(32) provides an exemption of the amount included in the income of the parent subject to a maximum of Rs. 1,500 per child.

#### **Illustration 3**

What will be the amount exempted U/s 10(32) if income of Rs 1,000 of Suresh, a minor son is included in the income of his father Sudesh?

#### **Solution**

Exemption u/s 10(32) is equal to actual income included in the hands of parent or Rs. 1,500, whichever is less. Hence Exemption available to u/s 10 (32) will be Rs. 1000 only.

#### **Illustration 4**

In the illustration 3, what will be the amount exempted U/s 10(32) if income of Suresh is Rs 15,000.

#### **Solution**

Exemption U/s 10(32) is equal to actual income included in the hands of parent or Rs. 1,500, whichever is less. Hence exemption available to u/s 10 (32) will be Rs. 1,500 only

#### **Illustration 5**

What will be the amount of deduction U/s 10(32) if Incomes of Ashok and Babu amounting Rs 7,500 and Rs 5,500 were clubbed with the income of their father Chandu.

#### **Solution**

Chandu will get exemption of Rs 3,000 being Rs 1,500 per child.

### **3.5 Dividend from domestic companies–S 10(34)**

U/s 115-O, an additional tax @ 18% is payable on distributed profits of domestic companies including SEZ developers. Hence to avoid double taxation of dividend income, any income by way of dividend referred to in section 115-O

It may be noted that deemed dividend covered in S 2(220)(e) is not distribution of profit U/s 115-O. Hence, deemed dividend is not eligible for exemption under this section as well.

### 3.6 Dividend from Units of mutual funds –S 10(34)

Dividend or income received in respect of units of mutual fund or Administrator of the specified undertaking; or specified company is also exempt from Income tax under section 10 (35). However, the income does not include income on transfer of such units.

### 3.7 Other Exemptions:

Sec. 10 provides a comprehensive list of exempt incomes. Important exemptions e.g. gratuity, pension etc., which are for computation of income under the five heads of income, are incorporated at appropriate lessons dealing with such heads of income. Remaining exemptions, though not directly covered by the syllabus, may have a bearing on the computation. A brief summary of such exemptions is given in the following Appendix

## APPENDIX

### A. EXEMPTION TO FOREIGNERS/ NON RESIDENTS.

1. Interest income of non-resident from notified securities, saving certificates/ NRE Account –Sec 10(4). These exemptions are conditional and applicable mainly to persons of Indian origin purchasing the securities in convertible foreign exchange.
2. Remuneration of foreign diplomats -Sec 10(6).
3. Remuneration of a Trainee of a Foreign Government-Sec 10(6)(xi),
4. Remuneration received by Foreign National as an Employee of Foreign Enterprise I – Sec 10(6)(vi)
5. Salary of Non-Resident Employee of a Foreign Ship. –Sec 10(6)(viii)

### B. EXEMPTION TO SALARIED EMPLOYEES

1. Several sections provide for exemption to salaried employees such as leave Travel Allowance, House Rent allowance, Gratuity, Retrenchment allowance, commuted pension, special allowances etc. and dealt with in the chapter relating to salaries.
2. Certain other incomes of Non-Resident deriving income other than salary, royalty or fees for technical services from Government or an Indian concern under an approved agreement and if their tax liability is paid by the employer the tax so paid is exempt from tax. A – Sec 10(6B)
3. Foreign allowances and perquisites to Government employees outside India – Sec. 10(7),

4. Income of an Employee by way of remuneration or social security tax or otherwise of a Foreign Government under Co-operative Technical Assistance Programme/ projects - Sec. 10(8)
5. Income of a Consultant by way of remuneration or, social security tax or otherwise under a Technical Assistance Grant Agreement between the International Organization and the Government of Foreign State- Sec .10(8A):
6. Income of any other person, being a non-resident, engaged by the agency for rendering technical services in India in connection with any technical assistance programme or project, provided in accordance with an approved agreement- Sec .10(8A)
7. Income of an Individual who is assigned to duties in India in connection with any Technical Assistance Programme and Project in accordance with an Agreement entered into by the Central Government and the Agency - Sec .10(8A)
8. Remuneration received directly or indirectly by an individual who is assigned to duties in India in connection with any technical assistance programme and project in accordance with the agreement entered into by the Central Government and the Agency, for such duties from any consultant referred to in clause (8A), income- S. 10(8B)
9. Income accruing or arising outside India by any family member of persons covered u/s 10 (8), (8A) or (8B), in respect of which such member is required to pay any income tax or social security tax to the Government of that foreign state. –Sec 10(9)
10. Value of any travel concession or assistance received or due to the assessee from his employer for himself and his family in connection with his proceeding on leave to any place in India not exceeding the amount of the expenditure actually incurred on fare only through the shortest route- on a maximum of two journeys in a block of four years. S. 10(5),
11. Any allowance paid or allowed outside India by the Government to an Indian citizen for rendering service outside India - Sec 10(7)
12. Amount of tax actually paid by an employer, at his option, on non-monetary perquisites on behalf of an employee in the hands of the employee. Sec – 10(10CC),

**C. EXEMPTIONS TO INSTITUTIONS / FUNDS:**

The income of the following institutions is exempt subject to certain conditions:

1. Local authority i.e. a panchayat, municipality, municipal committee, district board or cantonment board. - S. 10(20)
2. Approved Notified scientific and research association applying which

- has as its object, undertaking research in social science or statistical research, and applying its income wholly and exclusively to its objects, including profits and gains of a business carried on by an institution, which is incidental to its objects. - S. 10(21)
3. News agency set up in India which applies its income or accumulates it for application solely for collection and distribution of news and does not distribute its income in any manner to its members. - S. 10(22B)
  4. Regimental Fund or non-public fund. - S. 10(23AA)
  5. Approved fund for the welfare of employees. - S. 10(23AAA)
  6. Pension fund (Jeevan Suraksha) set up by the Life Insurance Corporation of India or a pension fund of any other insurance company. - S. 10(23AAB)
  7. Khadi and Village Industries Board. - S. 10(23B)
  8. Public charitable Trusts and Religious Institutions. - -S. 11
  9. European Economic Community.
  10. SAARC Fund for Regional Projects.
  11. ASOSAI-Secretariat
  12. Insurance Regulatory and Development Authority
  13. Prime Minister's Relief Fund
  14. National Foundation for Communal Harmony
  15. University/educational institution, hospital or medical institution 10 (22)/(22A)
  16. Professional bodies. S. 10(23A)
  17. Notified fund, charitable/ religious institution or trust. - Sec 10(22B)
  18. Mutual fund -. S. 10(22B)
  19. Notified Investor Protection Fund set up by recognized Stock Exchanges
  20. Credit Guarantee Fund Trust for Small Industries
  21. Approved Venture Capital Fund or Venture Capital Company-10(23FB)
  22. Prasad Bharani (Broadcasting Corporation of India) S.10(23BBH)
  23. Trade Union or Association of trade Unions from house property and other sources.- S. 10(24)

24. Statutory Provident Fund under P. F. Fund Act. - S. 10(25)
25. Employees' State Insurance Fund set up under the ESI Act-. S. 10(25A)
26. Members of scheduled tribes residing in specified areas. - S. 10(26)
27. Statutory Corporation, body, association or institution formed or established for promoting the interests of the members of Scheduled Castes/ Schedules Tribes or backward classes or of any two or all of them. - S. 10(26B)
28. Corporation established by the Central/ State Government for promoting the interests of a notified minority community. -S. 10(26BB)
29. Ex-Servicemen Corporation established under an Act for the welfare and economic upliftment of ex-servicemen being the citizens of India. - 10(26BBB)
30. Co-operative Society formed for promoting the interest of members of either the Scheduled Caste or Scheduled Tribes. - S. 10(27)
31. Coffee Board, Rubber Board, Tea Board, Tobacco Board, Marine Products Export Development Authority, Agricultural and Processed Food Products Export Development Authority and Spice Board. - S. 10(29A)
32. Subsidy received from the Tea Board for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea under any scheme notified by the Central Government-. S. 10(30)
33. Subsidy received from the Rubber Board, Coffee Board, Spices Board or any other Board under any scheme of replanting or replacement, etc.-. S. 10(31)
34. Daily allowance of Members of Parliament while the parliament is in session is and Members of State Legislative Assemblies (up to Rs. 2000) - Sec 10(17)

Exemptions will not be available if the institutions specified [Section 10(23C) (iv) & (have commercial receipts of 25,00,000 or more

#### **D. CAPITAL GAINS**

- i. Any long-term capital gain arising on transfer of eligible equity shares of a company acquired on or after 1.3.2003 but before 1.3.2004 and held for 12 months or more.
- ii. Any capital gain arising to an individual/ HUF on compulsory acquisition of an agricultural land in urban areas (situated within the jurisdiction of a municipality or a cantonment board having population of 10,000 or more or within 8 Kms from the local limits of



such municipality/ board), where the compensation/ consideration is received by the assessee on or after 1.4.2004. Provided, the land was being used for agricultural purposes by the HUF/ individual or his parent(s), during the period of 2 years immediately before acquisition.

- iii. Any long-term capital gains from transfer of equity shares of a company or units of an equity-oriented fund on or after 1.10.2004 and subject to Securities Transaction Tax -Sec 10(38).
- iv. Any income arising from the transfer of a US 64 subject to the condition that any loss arising on transfer of units of US.64 cannot be set off against any income in the same year in which it is incurred and the same cannot be carried forward—Sec 10(33.)

#### **E. MISCELLANEOUS**

- i. Any sum received on life insurance policy (including bonus) not being the amount received on the following policies -
  - a. any sum received under section 80DD (3) or 80DDA (3);
  - b. any sum received under a Keyman insurance policy;
  - c. any sum received under an insurance policy (issued after March 31, 2003) in respect of which the premium payable for any of the years during the term of policy, exceeds 20 per cent of the actual sum assured except in case of the death of the person and the value of any premiums agreed to be returned or of any benefit by way of bonus or otherwise, over and above the sum actually assured, which is received under the policy by any person, which shall not be taken into account for the purpose of calculating the actual capital sum assured under this clause. -Sec 10(10D),
- i. Family pension received by the widow or children or nominated heirs of a member of the armed forces or paramilitary forces of the Union is not chargeable to tax from the assessment year 2005-06, if death is occurred in such circumstances given below—
  - a. acts of violence or kidnapping or attacks by terrorists or anti-social elements;
  - b. action against extremists or anti-social elements;
  - c. enemy action in the international war;
  - d. action during deployment with a peace keeping mission abroad;
  - e. border skirmishes;
  - f. laying or clearance of mines including enemy mines as also mine sweeping operations;

- g. explosions of mines while laying operationally oriented mine-fields or lifting or negotiation mine-fields laid by the enemy or own forces in operational areas near international borders or the line of control;
  - h. in the aid of civil power in dealing with natural calamities and rescue operations; and
  - i. in the aid of civil power in quelling agitation or riots or revolts by demonstrators. - Sec 10(19),
  - iii. Any income by way of dividend referred to in section 115-O [i.e., dividend, not being covered by section 2(22) (e), from a domestic company or any income in respect of units of mutual fund; UTI [, from the administrator units from the specified company is exempt under section 10(34)/ (35),
  - iv. U/s 10AA export incomes of undertakings in SEZ are exempt on pro rata basis i.e.
 
$$\frac{\text{Business Profit X Export Turnover}}{\text{Total Turnover}}$$
  - v. Incomes of charitable trusts and political parties subject to the provisions of Sec 11, 12 and 13.
  - vi. any income of a foreign company received in India in Indian currency on account of sale of crude oil to any person in India subject to approved conditions being satisfied received under a notified agreement or an arrangement with the Central Government or approved by it and the receipt of the money is the only activity carried out by the foreign company in India
- If the premium payable during any previous year for a policy issued on or after 1.4.2012 exceeds 10% of the actual capital sum assured, the entire amount received under such policy shall be taxable except when the sum received on the death of a person

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## 8.4 DEDUCTIONS UNDER CHAPTER VI A

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**4.1** Basic framework of deduction is given in S. 80A, 80B and 80AB of chapter VIA. Salient feature of the framework are as follows:

- Aggregate income computed under various heads of income but before making any deduction under this chapter is called gross total income - S 80B
- From the Gross total income, deductions allowable under chapter VIA (S 80C -80U) are reduced.

- Deductions under this chapter are specific and allowed to only specified tax payers fulfilling the prescribed conditions—S-80A. For instance, deductions s U/s 80-IA, 80-IAB, -IB, 80-IC, 80-ID or 80-IE, are admissible only if the assessee furnishes a return of his income for that year before the due date of filing the return.
- Aggregate deduction under this chapter cannot be more than the gross total income. - Sec. 80AB.
- Most of the deductions are available only to the extent of amount included in the gross total income.
- Deduction can be **claimed only once**. If any deduction is claimed by and allowed to an AOP or BOI, or a firm, it will not be again allowed as deduction to the member.
- Deductions are allowable from the gross total income after excluding long term capital gains, short term capital gain under section 111A, winnings from lottery, crossword puzzles etc. as these items are treated differently for tax purposes.
- Deductions are allowed only if the assessee claims these and gives proof of such investments/ expenditure/ income.
- Deductions under Chapter VIA available of three types: Sect
  - I. Sec. 80C to 80G allow deduction in respect of expenditure or investments made by the assessee
  - II. Sec. 80HH to 80RRB are in respect of certain income on
  - III. Sec 80 U is in the category allowable to a handicapped person irrespective of either income or expenditure.

Following deductions, covered by the syllabus are taken up for detailed discussion in the following paras:

**Deduction in Respect of Certain Saving Schemes-S 80C:** Section 80C provides for deduction in respect of investment or contribution towards specified saving schemes. The basic scheme of the section is as follows:

- a. Only individuals and HUFs are eligible for deduction under this section. Other assesses are not eligible for deduction u/s 80C.
- b. Both residents and the non-resident assessee are eligible for the deduction under the section
- c. The deduction is allowed in respect of the aggregate amount **paid or deposited** during the previous year by the assessee in eligible saving schemes.
- d. The aggregate amount paid or deposited towards these schemes is called **Gross Qualifying Amount**.

- e. The payments/investments eligible under this section are:
- i. **Life Insurance premium** paid on a policy taken (or renewed) by an individual on his own life, life of the spouse or any child (child may be dependent/ independent) or any member of the family in the case of a Hindu undivided family. The premium including the arrears of premium should not exceed 10% of sum assured if policy taken after 0-1-04-2012 (15% for persons with handicap/s 80U or person with suffering from serious disease u/s 80DDB on policy taken after 01-04-2012). Prior to this, the restriction was up to 20% for all assesses.
  - ii. Any sum deducted from salary payable to a Government employee for the purpose of securing him or his wife or children to pay a deferred annuity subject to a maximum of 20% of salary;
  - iii. Contribution towards **Statutory or Recognized Provident Fund;**
  - iv. Contribution towards **15-year public provident fund (PPF)** in the name of himself, wife or child or a family member up to a maximum of Rs 70,000;
  - v. Contribution towards an approved Superannuation Fund;
  - vi. Subscription to **National Savings Certificates, VIII Issue**
  - vii. Contribution for participating in the Unit-Linked Insurance Plan (**ULIP**) of Unit Trust of India;
  - viii. Contribution for participating in the unit-linked insurance plan (**ULIP**) of LIC Mutual Fund (i.e. Dhanraksha plan of LIC Mutual Fund);
  - ix. Payment for notified annuity plan of LIC (i.e. Jeevan Dhara, Jeevan Akshay, New Jeevan Dhara, etc. or any other insurer);
  - x. Subscription towards notified units of Mutual Fund or UTI
  - xi. Contribution to notified pension fund set up by Mutual Fund or UTI;
  - xii. Any sum paid including accrued interest as subscription to Home Loan Account Scheme of the National Housing Bank(**NHB**);
  - xiii. Any sum paid as tuition fees (but not donation) to any university/college/educational Institution in India for full time education for maximum 2 children;
  - xiv. Investment in 10 / 15 years Post Office Cumulative Term Deposits CTDS;
  - xv. Any subscription towards infrastructure bonds or units of Mutual Funds;

- xvi. Any amount paid for the purchase or construction of a residential house property or for purchase of land;
- xvii. Term deposits for a fixed period for at least 5 years with a scheduled bank under a notified scheme;
- xviii. Deposit in an account under Senior Citizens Savings Scheme, 2004;
- xix. 5- years Post Office Time Deposit Account;
- xx. Subscription to notified bonds issued by NABARD;
- xxi. Subscription to eligible issues of equity shares or debentures of an Indian public company or a public financial institution where the entire proceeds of the issue is wholly and exclusively for the purposes of any business specified for developing, maintaining and operating an infrastructure facility for generation or generation and distribution of power or for providing telecommunication services whether basic or cellular or for developing, developing and operating or operating and maintaining an industrial park or a special economic zone- SEZ

**f. Amount of deduction**

Amount of deduction allowable u/s 80C will be: -

- Whole of the amount paid or deposited in the above mentioned schemes called the gross qualifying amount or
- Rs 1,50,000, - whichever is less.
- Maximum deduction u/s 80C, 80CCC and 80CCD cannot exceed Rs 1,50,000.

**g. Some important points:**

- Payment for house may be made to authorized developers or even repayment of loans.
- The amount of investments need not necessarily be made out of the taxable income
- **Life insurance premium paid for parents will not be allowable even if parents are dependent on the assessee.**
- Life insurance premium paid for married daughter will be allowable.
- Dependence of wife or children is not necessary for claiming deduction under this section
- Refundable premium and bonus on premium are not eligible for deduction

- Premature termination (before the period shown below) from any scheme will have the following effects:
- In the year of termination deduction will not be allowed and
- Premium earlier paid and allowed as deduction will be brought back to tax in the current year and added to the total income in the assessment year pertaining to the year of withdrawal.

Premature withdrawal/Transfer/ Termination	
Life insurance Policy	Two years for whole life policy
	One year for other policy
P/O TDS / SCSS	Five Years
Unit Linked Insurance Plan	Five Years
House property-Transfer	Five Years

### Illustration 1:

A whole life policy on which a premium of Rs. 6,000 has been paid up to last year and Rs. 3000 is the current year's premium otherwise eligible for deduction u/s 80C. What will be the effect if the contract is prematurely terminated during the financial year 2021-22?

### Solution

Premium paid in financial year 2021-22 will not be eligible for deduction u/s 80C and the old premium of Rs. 6000 allowed earlier will be added to the income of assessment year 2021-22.

### Illustration 2

Shyam makes the following payments during the financial year 2021-22. His Gross Total Income amounts to Rs 5,00,000. Shyam asks you to calculate the deduction available under section 80C and the taxable income for the assessment year 2021-22.,

School fees of his 4 children	Rs 50,000
University fees of his wife	Rs 20,000
Life insurance for wife and kids	Rs 10,000
Life insurance for parents	Rs 15,000
Life insurance for father-in-law	Rs 10,000
NSC	Rs 20,000
Repayment of principal for house	Rs 35,000
Coaching class fees	Rs 11,030

**Solution**

Gross Total Income		Rs. 5,00,000
School fees up to 2 children	Rs 25,000	
University fees of wife - Not allowed	NIL	
Life insurance for wife and kids	Rs 10,000	
Life insurance for parent Not allowed	NIL	
Life insurance for father-in-law- Not allowed	NIL	
NSC	Rs 20,000	
Repayment of principal for house	Rs 35,000	
Coaching class fee Not allowed	NIL	
Deduction u/s 80C		Rs. 90,000
Total Income		Rs.4,10,000

**Illustration 3**

Ashok has a Gross Total Income of Rs 8,00,000 for the AY 2022-23. He had availed of a deduction in AY 2021-22 of Rs 7,000 in respect of a Life insurance policy, which was prematurely terminated in P.Y. 2021-22 He made the following investments for the P.Y. 2021-22 Insurance for himself (sum assured Rs 1,00,000) Rs 28,000

Insurance for wife (employed with MNC) Rs 25,000

Insurance for son but unpaid Rs 7,500

Compute deduction u/s 80C and the taxable income of Ashok.

**Solution**

Computation of total income		Rs
Gross Total Income		5,00,000
Add: Deduction of last year on termination of policy		7,000
Revised Gross Total Income		5,07,000
Insurance for himself (in excess of 20% of sum assured)	Rs 20,000	
Insurance for wife (dependence not relevant)	Rs. 25,000	
Insurance for son (not paid)	Nil	
Total deduction u/s 80C		45,000
Total Income		4,62,000

**Illustration – 4**

GTI of W for AY 2022-23 is Rs 12,00,000. He invests in he takes a life insurance policy of Rs 1,00,000 and paid premium of Rs 22,000. He paid Premium of Rs 10,000 each for policies of his brother, who and his son, who is independent. of him, W also pays Rs. 20,000 for unrecognized Provident Fund, Rs 10,000 towards P PF Rs 10,000 in ULIP. Besides, he has repaid housing loan to ICICI Bank Rs 80,000 and Rs 20,000 towards outstanding interest.

School fees of three his children amount to Rs 4, 000 Rs. 5,000 and Rs 6,000 respectively.

Compute the deduction/s 80C and the taxable income of W

**Solution**

Computation of total income		Rs
Gross Total Income		12,00,000
Insurance-self ( over10% of sum assured	2,000	
Insurance(son)– dependence not relevant	10,000	
Insurance for brother not allowed	Nil	
Unrecognized Prov. Fund – Not allowed	Nil	
Public provident Fund	10,000	
Unit Linked insurance plan	10,000	
Housing loan –Principal	80,000	
School fee –2 children – Higher figures considered 6,000=+5,000	11,000	
Total deduction u/s 80C-maximum	1,41,000	1,41,000
Total Income		10,59,000

**4.2 Investment in Infrastructure Bonds- S 80CCF**

The Scheme of deduction is summarized below

- **Eligible assesses:** Only Individuals and HUF -Resident or Non – Resident both Other assess not eligible
- **Conditions** – Amounts is **paid or deposited** during the previous year for Subscription to notified infrastructure bonds
- **Maximum Deduction:** Amount paid or deposited for subscription of notified infrastructure bonds or Rs 20,000, whichever is less
- **Other Points** - The deduction is in addition to Rs 1,00,000 available U/s 80C amount so paid will not be eligible U/s 80C.



### 4.3 Medical Insurance Premia- S. 80D:

Section 80D provides for a deduction in respect of the payment made towards medical insurance premia. These provisions are summarized below:

#### i. Eligible Assessee

The deduction is available only to **an individual or HUF, whether resident or non-resident**, if such non-resident was entitled to hold such insurance policy.

#### ii. Mode of Payment

Premium must be paid by mode other than cash such as cheque, credit card or electronic clearance ECS, internet banking except in case of checkup as discussed later, where cash payment is also permissible.

#### iii. Amount of Deduction – individual assesses

a. In case of an individual assessee, the amount of deduction shall be aggregate of the following:

- i. Premium paid under a Medical Insurance Scheme of the General Insurance Corporation approved by the Central Government or any other insurer approved by the Insurance Regulatory and Development Authority popularly known as Mediclaim Policy.
- ii. Contribution paid towards the Central Government Health Scheme; and
- iii. any payment made on account of preventive health check-up of the parent or parents of the assessee

b. premium paid on the insurance **for self, spouse and dependent children**

Covered Individuals	Premium Paid (Rs)		
	For Self, Family, & Children	For Parents	Tax Exemption u/s 80D (Rs)
<b>Individual and parents &lt; 60 years</b>	25,000	25,000	50,000
<b>Individual and family &lt; 60 years but parents &gt; 60 years</b>	25,000	50,000	75,000
<b>Both individual, family and parents &gt; 60 years</b>	50,000	50,000	1,00,000
<b>Members of HUF &amp; Non-resident Individual</b>	25,000	25,000	25,000

**iv. Other points**

- a.** Senior citizen means **an individual resident** of India who is of the age of 60 years or more at any time during the relevant previous year. If the senior citizen is a Non- resident, **deduction will of Rs 25,000**
- b.** The parents and the spouse need not be dependent upon individual assessee but children should be dependent for claiming the deduction
- c.** Deduction is available under this section to an individual in respect of payments made to insure his children but not vice versa and therefore, children cannot claim deduction under this section.

**v. Amount of Deduction to A HUF:**

In case of a HUF deduction will be only in respect of premium paid to effect or to keep in force on the insurance for the health of any member of that HUF and the deduction under this section shall be

- Amount paid or Rs 25,000, whichever is less or
- Amount paid or Rs 25,000, whichever is less, if any insured member of the family is a senior citizen.

**Illustration 6**

Raj and his wife are not senior citizens. Raj pays mediclaim insurance of Rs 8,000 for self, Rs 10,000 for his wife, and Rs 5,000 each for both of his sons, who are independent. He also pays Rs 12,000 for each of his parents who are senior citizens. Calculate the amount of deduction allowable u/s 80D.

**Solution**

<b>Amount of deduction u/s 80D</b>	
Premium in respect of wife	Rs 10,000
Premium for himself	Rs. 8,000
Premium in respect of children (not dependent)	Nil
Total Rs 18,000 restricted to	Rs 25,000
Add : Premium in respect of parents (senior citizens) Rs 24,000 restricted to maximum	Rs 50,000
<b>Deduction available u/s 80D</b>	<b>Rs 75,000</b>

#### **4.4 Deduction U/s 80DD: Expenses on Maintenance of a Handicapped Dependent**

Provisions of S. 80 DD, which provides for deduction in respect of maintenance and treatment of a handicapped dependent are summarized below:

##### **i. Eligible assessee:**

Only an individual or a HUF assessee resident in India is eligible to claim deduction under this section.

##### **i. Eligible Payments:**

Deduction is available in respect of the following:

- a. Expenditure incurred for medical treatment including nursing, training and rehabilitation of a dependent, being a person with disability or
- b. any amount paid or deposited under a scheme framed by LIC or UTI or other insurer approved by the CBDT for maintenance of a dependent being a person with disability

##### **ii. Amount of Deduction:**

Rs. 75,000 [Rs 1,25,000 if the dependent suffers from severe disability IF SOME eligible amount must be spent and such amount spent need not be 50,000 Or 1 lakh rupees.

##### **iii. Conditions: for of Deduction:**

The deduction can be claimed subject to the following conditions:

- a) Deduction is available in respect of a dependent. A dependent in relation to an individual means **self, his/her spouse, children, parents or brothers and sisters** and in relation to a HUF means any of its members, who is wholly or mainly dependent upon the Assessee;
- b) Such dependent person should not claim deduction U/s 80U while computing his total income;
- c) The assessee nominates either the handicapped dependent or any other person or trust to receive the payment under the scheme for the benefit of the handicapped dependent;
- d) In the event of the death of the subscriber assessee, the amount of annuity or lump-sum under the scheme is paid for the benefit of the handicapped dependent.
- e) If the handicapped dependent predeceases the subscriber assessee, then the amount so received shall form part of the total income of the subscriber assessee in the previous year in which the amount is received.

- f) The assessee must furnish a certificate from a neurologist (in case of children, a paediatric neurologist) or a civil surgeon or Chief Medical Officer of a Government hospital in form 10IA (in case of autism, cerebral palsy or multiple disability)
- g) Where the condition of disability requires reassessment, a fresh certificate shall have to be obtained on expiry of the period mentioned in the original certificate.

#### 4.5 . Deduction in respect of Medical Treatment, -S 80DDB

Section 80DDB is introduced to give relief to persons suffering from any major disease and required to spend huge amounts on it. Provisions of the section are explained below:

- **Eligible Assessee:**

An individual or a HUF assessee resident in India, Other assesses not eligible

- **Eligible Payments:**

Amount actually paid for medical treatment of specified disease or ailment of the assessee himself or a person dependent on him or a member of HUF

- **Amount of Deduction** (Lower of the following)

- Amount actually paid in the previous year or **Rs. 40,000**,
- (**Rs 1,00,000** if the person or member is a senior citizen).

- **Other Points**

- i. Dependent relative means an individual himself or, his/her spouse, children, parents or brothers and sisters or a member of the HUF, who is wholly or mainly dependent for support and maintenance on the individual or the HUF
- ii. senior citizen” means an individual resident in India who is of the age of sixty years or more at any time during the relevant previous year.
- iii. The assessee shall furnish with the return of income, a certificate in prescribed form, from a neurologist, an oncologist, a urologist, a hematologist, an immunologist or such other prescribed specialist, working in a Government hospital:
- iv. Amount of deduction shall be reduced by any amount received under an insurance from an insurer, or reimbursed by an employer

#### 4.6 Deduction for Interest on Education Loan - S. 80E

S. 80E allows deduction of Interest on loan taken for higher studies. Provisions of the section are explained below:

- **Eligible assessee**
  - Any individual assessee, whether resident or non-resident,
  - who has taken loan
  - from a financial institution or any approved charitable institution
  - for pursuing higher studies of himself or his relative
- **Amount and term of deduction**
  - Interest on such loan paid by the assessee without any limit.
  - Upto a maximum period of 8 years from the year in which the payment of interest on the loan begins or till the interest is paid in full, whichever is earlier.
- **Other Points**
  - i. Higher education'' means any course or study pursued after passing Senior Secondary Education or its equivalent from any Government recognized school, Board or university
  - ii. Course may be any post-SSC course whether full -time or part time any Government recognized school, Board or university
  - iii. Higher education may be for the assessee himself or any of his relatives. Relative means the spouse and children of the assessee or the student for whom such individual is the guardian.
  - iv. The deduction can be claimed by the student assessee himself if the interest is paid by him or his relative say father if interest on the student's loan is paid by the relative.

**Illustration: 7**

Advise A on the deduction in respect of interest on loan of Rs. 10 lakhs taken from SBI on 01/04/2021 for doing MBA repayable in 10 equal annual instalment carrying interest @ 10%. per annum.

**Solution:**

A being the student himself, is eligible to get deduction/s 80E.

He will get deduction of Rs 1,00,000 in respect of education loan taken for higher studies r the A.Y. 2022-23.

Thereafter, for the next seven years up to and inclusive of A.Y. 2022-23,he will get deduction of Rs. 90,000, 80,000,70,000 60,000,50,000, 40,000and Rs 30,000 respectively.

Thereafter, for remaining two years, no deduction will be available.

**Illustration: 8**

Will B father of A be entitled to deduction U/s 80E in respect of interest paid on A's Loan?

**Solution:**

Yes, if father pays the interest, he will be entitled to claim the deduction.

**4.7 Deduction in case of a Person with Disability – 80U**

S. 80U contains a welfare measure to help a disabled person by reducing his tax burden by providing a deduction. The deduction is available if the following conditions are satisfied:

- **Eligible assessee:**
  - Available to Individual resident of India
  - With at least 40% disability
  - at any time during the previous year.
- **Amount of deduction**
  - Person with minimum disability of 40% - Rs 75,000 and
  - with severe case disability of over 80% - Rs. 1,25,000
- **Other Points**
  - The deduction is of flat amount of Rs 75,000 or Rs 1,25,000.
  - There is no requirement that the amount is spent or not.
  - Mere submission of a disability certificate in the prescribed form will be enough to avail the deduction by the Prescribed medical authority, along the return of income of the assessment year for which the deduction is claimed for the first time.
  - Where the condition of disability requires reassessment of its extent after a period stipulated in the medical certificate, deduction for any year falling after the expiry of such period shall be allowed only if a new certificate is obtained and furnished.
  - "Disability" means blindness, low vision, leprosy-cured, hearing impairment, locomotor disability, mental retardation, mental illness, autism, cerebral palsy and multiple disabilities.
  - "Person with disability" means a person so referred under the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 or the National Trust for Welfare

of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1995.

- “Person with severe disability” means a person with 80% or more of one or more disabilities as referred to in Section 56(4) of the 1995 Act or a person with severe disability referred to in Section 2(o) of the 1999 Act referred to above.

## 8.5 ILLUSTRATION

### Illustration 9

1. S presents his financial data as follows the Previous Year 2021-22.  
Business income Rs.8,10,000
2. Capital Gains Rs. 3,15,000
3. Payment of medical insurance premium on own life Rs. 5,000
4. He pays Rs. 20,000 to GIC for maintenance of his severely disabled son under an approved scheme.
5. He has borrowed Rs 5,00,000 as educational loan for his younger son who pursues MBA from IIM and pays 10% interest on the loan.
6. S himself his severely disabled.

Determine the income of S for the Assessment Year 2022-23

### Solution:

#### Computation of Total Income of X

		Rs
Business Income		8,10,000
Capital gains		3,15,000
Gross Total Income		11,25,000
Deductions under chapter -VIA-		
80D :Mediclaime	5,000	
80DD:Maintenance of dependent with severe disability	*1,25,000	
80E interest on study loan	50,000	
80U :Severe disability	*1,25,000	
Total Deductions under chapter –VIA		3,05,000
<b>Total Income</b>		<b>8,20,000</b>

For 80U full deduction available. Amt spent not relevant

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## 8.6 SELF-EXAMINATION QUESTIONS:

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1. Enumerate and explain various items of income, which are exempt from under Section 10.
2. Explain the difference between deduction and exemption with suitable 3 examples.
3. Define Gross Total Income.
4. Explain the deduction u/s 80C of the Income Tax Act, 1961.
5. What is the amount of maximum deductions u/s 80D?
6. Briefly explain the provisions available under the Income Tax Act relating to deductions from the Gross Total Income in the case of blind or physically handicapped person.
7. What are the exemptions available to foreign nationals in India?
8. Describe any 8 exemptions u/s 10 of the Income Tax Act, 1961.
9. Write short notes on:
  - a) Gratuity
  - b) Leave Salary
  - c) Retrenchment Compensation
  - d) House Rent Allowance
  - e) Dividends
  - f) Income of a minor child
10. Manan gets Rs 8,000 by letting out his agricultural land to a tenant who used the land for vermiculture. Clarify if Manan would be eligible for exemption for agricultural income with appropriate reasons.
11. The net profit as per the P & L A/c was Rs. 2, 85,000 after taking credit of Rs. 45,000 received on maturity of LIC policy and Rs. 30,000 as Interest from government securities and donation of Rs. 40,000 to BMC for promotion of family planning and Rs 5,000 as alms to destitute. He also pays Medclaim for Rs 10,000 in cash and Rs. 10,000 by a credit card and Rs. Rs. 25,000 for his 70-year-old father. Compute total income for the A.Y. 2021-22

(Ans: Bus. Income 2,47,000, Other Sources 30,000 GTI 2,77,000, Total income 2,47,000)

12. A Resident person, who is physically handicapped (75%) earns a net income of Rs 5, 76,000 from a consultancy business run by him. Compute his total income for the AY 2021-22

(Ans: Business income 576,000, deductions, 80U- 75,000 total Income 5,01,000)





## COMPUTATION OF TOTAL INCOME

### Unit Structure

- 9.1 Introduction and Objective
- 9.2 Typical Illustrations on computation of income
- 9.3 Self-Assessment Questions.

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### 9.1 INTRODUCTION AND OBJECTIVES

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The lesson deals with procedural aspect of law in respect of like filing of income tax returns and payment of advance tax and other incidental matters like procedure for computation of total income of individuals, firms and companies, computation of tax liability etc.

*Syllabus mandates computation of total income for the Assessment Year 2022-23; relevant Previous Year 2021-22; covering not cover more than two heads of income and two deductions at a time.*

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### 9.2 COMPUTATION OF TAXABLE INCOME-

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#### 2.1 Taxation of individuals

Following are the salient features of the procedure law relating to preparation of income tax returns.

1. Collection of preliminary details:
  - a. Name of the assessee
  - b. Birth date and age
  - c. Gender
  - d. Residential status
  - e. Assessment year (2022-23)
  - f. Previous year (2021-22)
  - g. Detail of parents and age
  - h. Detail of children and age
  - i. List of Relatives and Associate concerns

These detail may have an impact on the applicable tax rate (e.g. woman, senior citizen, deductions (e. g insurance premium, handicapped assessee, education loan etc.), disallowances based on relation as in 40A (2) or exemption based on relation such as in Sec 56 regarding gifts etc.

2. Ascertainment of income under various heads of income as per the applicable provisions of laws
3. Add income of other assesses which are to be included u/s 60-64 – clubbing provisions
4. Aggregate of income from all such sources, (excluding exempt income) is called the Gross Total Income.
5. From the Gross Total Income reduce the amount of deductions available in Chapter VI A of the Act.
6. The Result will be the total income.
7. Ascertain the tax liability at appropriate rate applicable including special rates applicable to some items of income –horse race, Capital gains on shares.
8. From the tax liability, any tax rebates are to be reduced.
9. The result will be the net tax liability, from which any amounts deducted at source (TDS) or Tax Collected at Source (TCS), and taxes paid in advance are reduced.
10. The final balance, if payable is paid by way of self –assessment tax or if excess paid is shown as the refund due.

### **11. Other Important Points**

- a) Clubbing provisions (S-60- 64), whereby income of other persons is included in the hands of the individual e.g. Income of the minor children
- b) Adjustment of agricultural income if in excess of Rs 5,000 is added in total income and then tax agricultural income is computed separately. Difference will be the tax liability
- c) Interest and remuneration from firm taxable if allowed in the hands of firm. Profit from the firm exempt as it is taxable in the hands of the firm
- d) Income of HUF is to be excluded as tax on such income will be payable by the HUF.
- e) Any loan taken from a company is deemed dividend u/s2 (22)) (e), if the individual has 10% voting power therein.

**PROCEDURE OF COMPUTATION:**

<b>Rate of Tax Applicable On Individual -A.Y. 2022-23</b>			
<b>Individuals</b>	<b>Senior Citizens</b>	<b>Very Senior Citizen#</b>	<b>Tax Rate</b>
0- 2,50,000	0- 3,00,000	0-5,00,000	NIL
2,00,001 - 5,00,000	3,00,001- 5,00,000	-NA	5%
5,00,001 - 7,50,00			10%
7,50,001 – 10,00,000			15%
10,00,001 – 12,50,000			20%
12,50,001 – 15,00,000			25%
15,00,001 and above			30%
Health & Education Cess on tax			4%
<p><i>*Senior Citizen is an individual, who has reached the age of 60 years and #Very Senior Citizen is an individual, who has reached the age of 80 years at any time during the previous year</i></p> <p><i>The Tax rate is subject to rebate of 100% of tax or Rs 2,000 U/s 87A</i></p> <p><i>For assessee having income of Rs 5,00,000 or less</i></p>			

**A. Preliminary Information**

Name and address of the assessee, PAN

Residential

Status

Assessment Year (2021-22)

Previous Year -2020-21

**B. Computation of Total Income**

1. Income from Salary
2. Income from House Property
3. Profit and Gain of business and Profession
4. Capital Gains
5. Income From Other Sources

<b>C. Gross Total Income</b> ( Total of B 1 to 5) Exclude exempt income
<b>D. Deduction under chapter VIA</b>
<b>E. Total Income</b> [D-E]
<b>F. Ascertain Tax Liability</b> Tax at applicable rates + Surcharge Add – Health & Education Cess - 4 % on tax
<b>G. Less :</b> Rebates, Advance Tax , TDS , TCS
<b>H. Add :</b> Interest Payable To Government
<b>I Self-Assessment Tax / Refund Due</b> ( F-G+H)

**Illustration -1.**

Ascertain the tax liability of Rajesh, whose total income is Rs 5,00,000 and also show if there will be any difference in the tax liability if he also has Agricultural income Rs 2,00,000

**Solution**

I If Agricultural income is totally exempt

	Rs
Tax on first Rs 2,50,000	NIL
On Next Rs 2,50,000@ 5%	12,500
Total	12,500
Less Rebate U/s 87A	2,000
	10,500
Add Cess EC+SHEC	315
Total Tax on Rs 5,00,000	10,815

**II If Income includes Agricultural income**

(a) Tax on Total income plus agricultural incomeRs

$$5,00,000 + 2,00,000 = \text{Rs } 7,00,000$$

Tax on first Rs 2,50,000	NIL
On Next Rs 2,50,000@ 5%	12,500
On Balance Rs 2,00,00 @ 10%	20,000
	32,500
Add Cess h & EC Tax	1,300
Total Tax on Rs 7,00,000	33,800

(b) Tax on basic limit plus agriculture income - Rs 18,540

$$\text{Rs } 2,00,000 + 2,00,000 = \underline{\text{Rs } 4,00,000}$$

[First 2,50,00 – NIL + Next 1,50,000@ 5% - Rs 750]

Tax payable (a)- (b) or RS 33,800 – 750= Rs 33,050

Normal tax works out to Rs 10,815, against Rs 33,050. This implies that agricultural income is indirectly taxed.

**2.3. Specific points applicable to Partnership Firms**

U/s 184 the; partnership firm are classified as the (a) partnership firm assessed as such (PFAS) or (b) partnership firm assessed as an association of person. Firms including Limited Liability Partnerships (LLP) are liable to uniform tax rate of 31.2% (30% + 4% Cess) without any basic exemption. However, the firms have to comply with certain procedural requirements given below: -

- The firm shall be evidenced by a partnership deed and the deed must specify the individual shares of the partners. [Sec. 184(1)]
- The firm must file a certified copy of the partnership deed along with the return of income in the first year. [Sec.184 (2)]
- In case of a change in the constitution of the firm or in the sharing ratio of partners, a certified copy of the revised deed t of partnership must be submitted along with the return of income for that year. [Sec. 184(4)]
- There should not be any failure on the part of the firm as is specified in Sec. 144 [Sec. 184(5)]

- After the first year, the firm continues to be assessed as a firm, unless there is a change in either the firm's constitution or the partner's profit sharing ratio and the firm does not satisfy the above conditions. However, there should not be any failure mentioned in sec. 144. [Sec. 184(3)]
- A partnership deed shall be certified in writing by all the major partners. In case of a dissolved firm, and the return is filed after its dissolution, the copy of deed may be certified by all the major partners in the firm immediately before the dissolution. A legal heir can sign for a deceased partner. [Sec. 184(2) Expl.]
- Besides, provisions relating to remuneration and interest paid to partners must be specified in the deed, otherwise the same are not allowed to be deducted in computing the income of the firm.

*(These provisions are dealt with in the lesson dealing in profits and gains of business)*

- If a firm is not assessed as a firm it will be treated as AOP and shall pay tax at the maximum marginal rate. The income will again be added in the income of partners but they will be entitled to rebate u/s 86.

#### **2.4. Specific points applicable to Companies:**

The companies are classified as (a) Domestic and (b) foreign companies. Domestic companies are again of two types (a) Widely held companies and (b) Closely held companies. Different tax rates are applicable on these companies as would appear from the following:

- Domestic Companies: Tax @ 30%, Surcharge 2.5% and Health & Education cess 4% on tax and surcharge (effectively 31.98%)
- Foreign Companies: Tax @ 40%, Surcharge 2% and Health & Education cess 4% on tax and surcharge (effectively 42.432%)
- *Surcharge is payable if the total income exceeds Rs 1 Crore.*
- Some provisions like 40A (2) excessive payment to directors and their relatives, 35 D amortization of expenses are applicable only on companies, merger, demerger, amalgamation, ESOP/ESOS are applicable on company assesses. Companies are also liable to pay Minimum Alternative Tax 18.5%).

*(Discussed under the head capital gains and profits and gains of business and profession to the extent covered in the syllabus.)*

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## **9.3 ILLUSTRATIONS**

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### **Illustration 1**

Compute the taxable income of Mangesh for the AY 2021-22 from the following and also compute the tax liability.:

<b>Profit and Loss Account for the year ended 31st March, 2022</b>			
<b>Particulars</b>	<b>Rs.</b>	<b>Particulars</b>	<b>Rs.</b>
To Salaries	2,10,000	By Gross Profit	5,18,000
To Rent	20,000	By Interest on Bank FD	8,000
To postage	7,000	By Dividend-Indian Co	20,000
To Stationery & Ptg	27,000	By Divid -Co-Op Bank	2,000
To Advertising Exp.	20,000	By Lottery Prize	15,000
To Repairs to Office	22,700	By Int on Debentures	5,000
To Conveyance	17,000		
To Income Tax	30,000		
To IT scrutiny Exp	4,000		
To CA's Fees for Tax	10,000		
To Misc. Expenses	25,000		
To Depreciation	5,000		
To Donation	20,000		
To Net Profit	1,50,300		
	<u>5,68,000</u>		<u>5,68,000</u>

**Additional Information:**

- (1) Salaries include bonus due to employees Rs. 30,000 which was not paid before the due date of filing of Income Tax return.
- (2) Rent is paid for the residential house of Mr. Mangesh.
- (3) Repairs to office include a one-time cash payment of Rs. 20,000 on 18/08/2021
- (4) Miscellaneous expenses include purchase of shares of an Indian company for Rs. 20,000.
- (5) Donations include charity of Rs. 15,000 and Rs 5,000 given to GIC for maintenance of his handicapped brother.
- (6) Depreciation as per Income tax rules is Rs. 4,000.

**Solution:**

<b>Computation of Total Income of Mangesh for A.Y. 2022-23</b>		
<b>Particulars</b>	<b>Rs</b>	<b>Rs</b>
Income from Business		
Net Profit as per P/L Account		1,50,300
<u>Add: Disallowable Expenditure</u>		
Bonus due but not paid u/s 43B	30,000	
Rent (Personal	20,000	
Purchase of share (Misc. Exp)	20,000	
Income Tax	30,000	
Donation (15,000+ 5,000)	20,000	
Depreciation	<u>5,000</u>	<u>1,25,000</u>
		2,75,300
<u>Less: Income Considered Separately</u>		
Interest on Bank FD	8,000	
Dividend from Indian Company	20,000	
Dividend from Co-operative Bank	2,000	
Winning from Lottery	15,000	
Interest on Debentures of Ltd Co	<u>5,000</u>	<u>50,000</u>
		2,25,300
<u>Less: Depreciation as per rules</u>		<u>4,000</u>
<b>INCOME FROM BUSINESS</b>		2,21,300
<b>II <u>Income from Other Sources</u></b>		
Interest on Bank FD	8,000	
Dividend from Indian Company ( Exempt)	0	
Dividend from Co-operative Bank	2,000	
Winning from Lottery	15,000	
Interest on Debentures of Ltd Co	<u>5,000</u>	
<b>INCOME FROM OTHER SOURCES</b>		30,000
<b>GROSS TOTAL INCOME</b>		2,51,300
Less: Deductions- under Ch. VI-A		
80-DD: Maint. of handicapped dependent		<u>50,000</u>
<b>TAXABLE INCOME</b>		<u>2,21,300</u>
Tax Payable		Nil
Surcharge -4%		<u>Nil</u>
<b>Total Tax Payable</b>		Nil

*Note: To claim deduction u/s 80DD, it is not necessary that there must be actual expenses incurred on handicapped dependent.*



**Illustration 2**

Compute the total income and ascertain the tax liability of Sam for the A.Y. 2022-23 from the following Profit and Loss Account:

<b><i>Profit and Loss Account for the year ended 31st March, 2022</i></b>			
<b><i>Particulars</i></b>	<b><i>Rs.</i></b>	<b><i>Particulars</i></b>	<b><i>Rs.</i></b>
To Salaries	1,30,000	By Gross Profit	7,67,000
To Rent	30,000	By UTI Dividend	9,000
To Entertainment Exp	18,000	By LIC Mutual	5,000
To Printing & Stn	25,000	By Gift from Mother	5,000
To Adv. Exp	50,000	By Winning- Puzzle	12,000
To Motor Car Exp	30,000	By Interest on NSC	3,000
To Drawings	60,000		
To Income Tax	16,000		
To Embezzlement -Employee	7,000		
To Staff Welfare Exp	70,000		
To Donation	30,000		
To Depreciation	35,000		
To Net Profit	<u>3,00,000</u>		
Total	<u>8,01,000</u>		<u>8,01,000</u>

**Additional Information:**

- (1) Depreciation as per Income tax rules is Rs. 38,000.
- (2) Staff Welfare expenses include Rs. 20,000 for his own treatment.
- (3) 50% of the rent is paid for his residential house
- (4) Printing includes Rs. 5,000 paid for printing marriage cards for his daughter's marriage

**Solution:**

<b>Computation of Total Income of Sam for AY: 2022-23</b>			
	<b>Rs</b>	<b>Rs</b>	<b>Rs</b>
<b>I Income from Business</b>			
Net Profit as per P/L Account		3,00,000	
<b>Add:</b> Disallowable Expenditure			
Own Medical Expenses	20,000		
Rent (Personal)	15,000		
Printing of Marriage Cards	5,000		
Income Tax	16,000		
Donation	30,000		
Depreciation	35,000		
Drawings	60,000	1,81,000	
<b>Less:</b> Income Considered Separately		4,81,000	
UTI Dividend	9,000		
Income from LIC Mutual Fund	5,000		
Gift from Mother	5,000		
Winning from Crossword Puzzle	12,000		
Interest on NSC	3,000	34,000	
<b>Less:</b> Depreciation as per rules		4,47,000	
<b><i>INCOME FROM BUSINESS</i></b>		<b><u>38,000</u></b>	<b>4,09,000</b>
<b>II Income from Other Sources</b>			
UTI Dividend (exempt)		Nil	
LIC Mutual Fund (exempt)		Nil	
Gift from Mother (exempt)		Nil	
Winning from Crossword Puzzle		12,000	
Interest on NSC		3,000	
<b><i>INCOME FROM OTHER SOURCES</i></b>		<b><u>15,000</u></b>	<b><u>15,000</u></b>
<b>GROSS TOTAL INCOME</b>			<b>4,24,000</b>
<b>Less:</b> Deductions under Chapter VI-A			
80-C NSC Interest Re-invested		3,000	<u>3000</u>
<b>TAXABLE INCOME</b>			<b>4,21,000</b>
Tax Payable on Income			8550
Surcharge @4%			342
Total Tax			8,892

**Illustration 3**

Mr. S. V. Joshi is a Chartered Accountant, following is his Receipt and Payments Account for the year ended 31st March, 2022

<b>Receipts</b>	<b>Rs.</b>	<b>Payments</b>	<b>Rs.</b>
To Cash & Bank B/f	70,000	By Office Rent	6,000
To Fees from Clients (net)	5,60,000	By Ptg & Stn	5,000
To Hon. For Articles	40,000	By Gifts to Staff	11,000
To Dividend-Indian Co	5,000	By General Exp.	14,000
To Interest- Bank SB A/c	2,000	By Motor Car Exp	16,000
To Int.-on PO SB A/c	3,000	By Telephone Exp	12,000
To Interest- Bank FD	8,000	By Income Tax	40,000
To Int. on Govt Securities	6,000	By Drawings	1,20,000
To Sale of Motor Car	1,00,000	By Car Insurance	12,000
		By conveyance	13,000
		By Tally Software	19,000
		By LIC Premium paid	64,000
		By Salaries to Staff	12,000
		By Computer (cost)	50,000
		By Cash & Bank C/f	4,00,000
<b>TOTAL</b>	<b>7,94,000</b>	<b>TOTAL</b>	<b>7,94,000</b>

**Additional Information:**

- (1) Computer was purchased on July 1, 2021 and depreciation is allowed @ 60% on the same.
- (2) Opening WDV of Block of Motor Cars consisting of 2 Motor Cars was Rs. 2,50,000 and depreciation is allowed @ 20% on the same.
- (3) Personal use of the Motor car is estimated to be 25%.
- (4) Fees from clients are after TDS of Rs. 2,000.
- (5) General expenses include a sum of Rs. 4,000 given to his daughter as birthday gift.
- (6) Drawings include a sum of Rs. 30,000 given premium for self and family of Rs. 20,000 and Rs. 10,000 for his father, who is a senior citizen/.

Compute the net taxable income of Joshi for the AY 2022-23

**Solution:**

<b>Computation of Total Income of S. V. Joshi –Asst. Year 2022-23</b>		
<b><u>Particulars</u></b>	<b><u>Rs</u></b>	<b><u>Rs</u></b>
<b><u>Income from Profession</u></b>		
Fees from Clients	5,60,000	
Add: Tax Deducted at Sources	<u>2,000</u>	5,62,000
<b><u>Less: Allowable Expenses</u></b>		
Depreciation on Motor Car	22,500	
Motor Car Expenses @ 75%	12,000	
Office Rent	6,000	
Printing and Stationery	5,000	
General Expenses	10,000	
Motor Car Insurance @ 75%	9,000	
Telephone Expenses	12,000	
Conveyance Expenses	13,000	
Depreciation on Computer @ 60%	30,000	
Salaries to Staff	2,000	
Gifts to Staff	<u>11,000</u>	<u>1,32,500</u>
<b><u>INCOME FROM BUSINESS</u></b>		<b>4,29,500</b>
<b><u>II Income from Other Sources:</u></b>		
Receipts for Writing Articles	40,000	
Interest on Fixed Deposit	8,000	
Interest on Government Securities	6,000	
Interest on SB Account	2,000	
Interest on PO Savings Account (exempt)	Nil	
Dividend from Indian Companies (exempt)	<u>Nil</u>	
<b>INCOME FROM OTHER SOURCES</b>	<b><u>56000</u></b>	<b><u>56000</u></b>
<b>GROSS TOTAL INCOME</b>		<b><u>4,85,500</u></b>
<b><u>Less: Deductions under Chapter VI-A</u></b>		
80-C Life Insurance paid	64,000	
80-D Medical insurance Premia : Rs 10,000 for father + Rs. 15,000 for self- =maximum	<u>25,000</u>	<u>89,000</u>
<b>TAXABLE INCOME</b>		<b>3,96,500</b>
<b>Tax Payable on Income (146500 x 5%)</b>		7,325
<b>Surcharge @ 4%</b>		293
<b>Total Tax</b>		<b>7,618</b>

**Illustration 4**

Compute total income and tax liability on the income of X from the particulars given below:

Basic pay: Rs. 12,000 pm

Education allowance for one child: Rs. 300 pm

Bonus: Rs. 20,000

Salary in lieu of leave: Rs. 15,000

He contributed Rs. 18,400 to the recognized provident fund and an equal amount was contributed by his employer. He received Rs. 14,000 from bank as interest, dividend of Rs. 10,000 from a foreign company and winning from horse race of Rs. 42,500 (gross). He paid Rs. 500 professional tax.

**Solution**

Basic Salary	(12,000 X 12)	1,44,000
Education allowance	(300 X 12) 3,600	
Less: Exempt	(100 X 12) <u>1,200</u>	2,400
Bonus		20,000
Leave Encashment		15,000
		<b>1,81,400</b>
Less Profession Tax		500
Income from Salaries		<b>1,80,900</b>
Dividend from foreign company	10,000	
Winnings from Horse Race	42,500	
Bank Interest	14,000	
Income from Other Sources		66,500
<b>Total Income</b>		<b>2,47,400</b>
Tax Payable		Nil
Education Cess -4% of Tax		Nil
Total Tax		Nil

**Illustration-5**

ABC is a partnership Firm carrying on a business, in which A, B, and C are partners sharing profits and losses equally. In respect of Assessment Year 2021 – 2022, it furnishes the following particulars (*amounts in Rs.*):

- 1 Net loss as per P/L A/c after debiting remuneration/ Interest to partners Rs 2,50,000
- 2 Remuneration paid to partner – A Rs 90,000, B Rs 60,000 & C Rs 30,000
- 3 Interest paid to partners @ 20% per annum on their capital of Rs 1,00,000 each as of 01/04/2021

You are required to work out the income of the firm and the partners A, B and C assuming that partners have no other income.

**Solution:**

<b>COMPUTATION OF TOTAL INCOME OF FIRM</b>		
Net Profit as per Profit and Loss A/c (Loss)		[2,50,000]
Add: Remuneration to Partners	1,80,000	
Interest to partners - 20,000 X3	60,000	2,40,000
		[10,000]
Less:		
Max. Remuneration allowable in case of loss	1,50,000	
Less: Interest allowable only up to 12%	36,000	186,000
<b>LOSS</b>		<b>[196,000]</b>

**TAXABLE INCOME IN THE HANDS OF PARTNERS**

	A	B	C
Salary	75000	50000	25000
Interest	12000	12000	12000
<b>Total Income</b>	<b>87000</b>	<b>62000</b>	<b>37000</b>

- Salary allowed as deduction to firm Rs 1,50,000 taxed in the hands of partners in the ratio of the salary paid to them by firm 90:60:30
- Interest allowed to firm will also be taxed in the hand of the partners
- Total Income of Partners I.e. Salary and Interest taxable as Profits and Gains from Business or Profession:
- Excess of salary and interest, which was disallowed in the hands of the firm is not liable to be taxed in the hands of the partners.

### **9.3. SELF ASSESSMENT QUESTIONS**

1. Discuss the provisions of the advance Tax in the income tax Act.
2. Explain advance tax liability of Ms. ABC if her income will be Rs. 15, 00,000.
3. What are the due dates of payment of advance tax by different assesses?
4. Mr. Ram gives you the Profit and Loss Account for the year ended 31<sup>st</sup> March, 2015. You are required to compute the total income of Ram for AY 2022-23 assuming that Ram has paid LIC premium of Rs. 5, 000. and interest of Rs 25,000 for educational loan of his son.

<b>.Profit and Loss Account for the year ended 31<sup>st</sup> March 2022</b>			
<b>Particulars</b>	<b>Rs.</b>	<b>Particulars</b>	<b>Rs.</b>
To Opening Stock	1,60,000	By Sales	18,50,000
To Purchases	14,05,000	By Closing Stock	1,08,500
To Salaries	1,84,350	By Winnings from Lottery	5,000
To Office Expenses	70,040	By Interest on fixed deposits with bank	15,000
To Office Rent	20,000	By Interest on RBI Bonds (exempt u/s 10)	16,000
To Staff Welfare	13,000	By bad debts recovered	20,000
To Advertisement	65,000	By dividend from Indian companies	9,000
Exp. To Donations	5,000		
To R.D.D.	10,000		
To Mediclaim (Cash)	21,000		
To insurance	10,000		
To Income Tax	8,000		
To Depreciation	20,000		
To Net Profit	32,110		
	<b>20,23,500</b>		<b>20,23,500</b>

**Additional Information:**

- a) Advertisement expenses include Rs. 11,000 for advertisement in a souvenir of a local political party and Rs. 20,000 for introducing a new product in the market.
- b) Donations are given for books to poor students
- c) On August 10, 2011 furniture of Rs. 20,000 was purchased on credit the payment for which was made on April 2, 2013. The same was not recorded in the books of accounts. The rate of depreciation on furniture is 15% per annum. On other fixed assets, depreciation was charged exactly as per I.T. Rules.
- d) Bad debts recovered were allowed during the A.Y 2022-23.
5. Sheela who is suffering from a permanent disability, received the following emoluments from SWY Ltd, her employer for last 10 years during the year ended March 31, 2014: You are required to compute her total income for the AY 2022-23

Basic Salary (NET) April 1, 2013 to September 30, 2021	Rs. 10,000 p.m. (TDS Rs 600 P.M), (Profession Tax Rs 1,250 P.M.)
October 1, 2020 to March 31, 2022	Rs. 12,000 p.m. (TDS Rs. 700 p.m.) (Profession Tax Rs 1,250 P.M.)
Dearness Allowance	40% of basic salary
Entertainment Allowance (Actually spent Rs. 300 p.m.)	Rs. 500 p.m.
Bonus for the year	Rs. 8,000
Conveyance Allowance (Actually spent Rs. 800 p.m.)	Rs. 1,000 p.m.

- 1) Commission from employer is 1% of turnover of Rs. 10 lakhs;
- 2) She needs a personal physical attendant whose salary of Rs. 2,000 p.m. was paid by the employer.
- 3) She paid Mediclaim insurance of Rs. 12,000 for himself and Rs. 5,000 for his brother. Statutory Provident Fund @ 10% of basic salary was deducted from her salary



6. Mrs. Sweety aged 66 years took voluntary retirement on January 1, 2022 from a private bank after completing 26 years and 11 months of service. She furnishes you with the following information: Compute her net taxable income for the AY 2022-23. After retirement, she delivers lectures as guest faculty in Indian Institute of Banking for which She receives honorarium of Rs. 22,000. She paid Mediclaim premium of Rs. 13,200 by crossed cheque. She invests Rs. 50,000 in National Saving Certificates. She received gifts from her colleagues for Rs. 3,00,000 in January 2022

Basic Salary	Rs. 2,800 p.m.
Dearness Allowance	128% of basic salary
Conveyance Allowance (actual expenses. For official purpose Rs. 600 p.m.)	Rs. 900 p .m
Gratuity	Rs. 1,29,200
Commuted pension	Rs. 67,500
Leave Encashment	3 months basic salary
Uncommuted pension	Rs. 2,500 p.m.
Voluntary retirement compensation	Rs. 8,72,000
Profession tax paid	Rs. 1,200

Compute total income of R with 40% disability, from following information regarding his house property for the AY 2021-22

8. Compute total income of R with 40% disability, from following information regarding his house property for the AY 2022-23

<b>Particulars</b>	<b>HOUSE I</b>	<b>HOUSE II</b>
Fair Rent	40,000	60,000
Municipal Valuation	55,000	50,000
Rent received	60,000	--
Municipal tax:		
(a) Paid by the tenant	4,000	--
(b) Paid by Ri	6,000	5,000
Interest on capital borrowed (due but not paid) for the purpose of construction of house property	6,000	13,000
Ground Rent	2,000	--
Insurance premium paid	1,500	--
Other information:		--
(i) Interest from debentures in Y Ltd	12,000	--
(ii) Dividend from UTI	5,000	--
(iii) Bank interest from SBI	3,500	--
(iv) Winning from lottery	28,000	--
(v) Interest from Post Office Savings Account	5,000	--
(vi) Dividend from a co-operative society	5,000	--



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