

## 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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Under Entry 82 of the Schedule VII to the Constitution of India, the Central Government is empowered to levy “Tax on income other than agricultural income in India”.

Accordingly, the parliament enacted Income Tax Act, 1961 [“The Act”] to provide for the scope and machinery for levy and collection of income tax in India.

The Act is supported by Income Tax Rules, 1962 and several other subordinate rules and regulations.

Further, the Central Board of Direct Taxes (CBDT) and the Ministry of Finance, Government of India are empowered to issue from time to time circulars and notifications dealing with various aspects of the levy of Income tax.

Unless otherwise stated, references to the sections throughout this book will be the reference to the sections of the Income Tax Act, 1961.

Section 4 is the charging section. It says 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 including the basic framework for levy of income tax in India.

This lesson will explain various aspects, basic concepts and terms used in the income tax law, which include:-

- (a) Assessment Year
- (b) Previous Year,
- (c) Person,
- (d) Assessee,
- (e) Meaning of income i.e. What is regarded as income?
- (f) What is not regarded as income
- (g) Income chargeable to tax
- (h) Income not chargeable to income tax i.e. exempt income
- (i) How to charge tax on income,
- (j) Gross Total Income,
- (k) Total Income or Taxable Income and
- (l) Income-tax rates

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## **1.2 ASSESSMENT YEAR – Section 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.

### **Illustrations**

1. Assessment year 2018-19 means the period of one year beginning on 1<sup>st</sup> April, 2018 and ending on 31<sup>st</sup> March, 2019.
2. Assessment year 2022-23 will mean the period of one year beginning on 1<sup>st</sup> April, 2022 and ending on 31<sup>st</sup> March, 2023.

Income of an assessee during the previous year is taxed in the relevant assessment year. Assessment year is sometimes also called as the **“tax year”**

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

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### 3.1. Definition:

As per section 3 “previous year” means **“the financial year immediately preceding the assessment year”**.

The year in which income is earned is called the **“previous year”**.

The income earned by an assessee in one financial year (**previous year**) is taxed in the next financial year called the “assessment year”.

### Illustrations

3. Income earned during financial year 2021-22 will be taxed in the financial year 2022-23.

Hence, 2022-23 will be the assessment year.

The financial year 2021-22 being the financial year immediately preceding the assessment year will be the previous year.

4. For the assessment year 2017-18, previous year will be 2016-17 i.e. from 1<sup>st</sup> April, 2016 to 31<sup>st</sup> March 2017.

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

A person is liable to pay taxes on total income earned by him during the previous year from all sources of income.

The previous year will be common for all sources of income, even if he maintains records or books of account separately for different sources of income.

### Illustration

5. Particulars of income earned by Ashok during the financial year 2021-22 are :-

	Rs (lakh)
Salaries from X Limited	2.40
Salaries from Y Limited	4.80
Professional income	2.50
Dividend	1.20
Interest	<u>1.75</u>
Aggregate Income	<u>12.65</u>

Ashok has earned the aggregate income of Rs 12.65 lakh from different sources during the financial year 2021-22. Hence, the previous year for all these sources of income will be the financial year 2021-22 and the relevant assessment year will be 2022-23.

Ashok will be liable to pay tax on aggregate income of Rs. 12.65 lakh from all the sources of income for the previous year 2021-22 relevant to assessment year 2022-23.

### **3.3. New Business or Profession:**

Where during a financial year where a

- (a) business is newly set up or
- (b) new source of income has arisen

during that financial 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 arising of the new source of income and ending on the 31<sup>st</sup> March next.

### **Illustration**

6. R sets up a business on 01 March 2022. The period of one month beginning on 1st March 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. Exceptions**

The general rule that income of the previous year is taxable in the next assessment year is subject to some exceptions and the assessee is liable to pay tax on the income in the same previous in which he earns it. In such cases, previous year and assessment year will be the same.

These exceptional cases ensure safeguards to smooth collection of income tax from a class of taxpayers who may not be traceable until the commencement of the normal assessment year.

Some of such exceptions are as under:-

- a) Income of non-residents from shipping business-Section 172
- b) Income of persons leaving India permanently or for a long period of time and not likely to return back –Section 173 and 174;
- c) Income of bodies formed for short duration for a particular event or purpose – Section 174A;
- d) Income of a person trying to alienate his assets with a view to avoiding payment of tax – Section 175 ,
- e) Income of a discontinued business- Section 176
- f) bad debts written off allowed as deduction in earlier years is taxable in the year of realization vide Section 41(1)
- g) Deemed dividend – Section- 56

### 4.1 Definition:

As per section 2(31) “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:

The definition of “person” is inclusive, not exhaustive. Accordingly 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:

Explanation to section 2(31) makes it clear that an entity need not be formed for profit. Absence of profit motive will not be the criteria to exclude any entity from being a “person”. Accordingly a non-profit Organisations or charitable trusts will also be 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. **Individual** means any living persons of blood and flesh.

Examples Aruna, Arvind, Fatima, Albert, Ibrahim, Rose etc.

- b. **Hindu Undivided Family (HUF)** or a Hindu joint family is regarded as separate tax entity in view of the specific law of succession prevalent among the Hindus.

- c. **Company** as per section 2(31), includes any

- Indian or foreign company,
- Public or private Company,

- Charitable or non-profit company incorporated under section 8 of the Companies Act, 2013 ( corresponding to old section 25 of the Companies Act, 1956). However, such company is eligible to claim exemption from tax, on compliance of the legal conditions given in other provisions of the Act, or
  - Any institution declared by CBDT as a company.
- d. **Partnership firm** including a limited liability partnership (LLP) is regarded as distinct taxable unit separate from its partners. Accordingly, a firm is taxed separately as a firm and its partners are taxed separately in their personal capacity.
- e. **Body of individuals (BOI)** and **Association of Persons (AOP)** are the group of persons carrying on some activities to earn income such as joint venture.
- f. On the other hand, BOI may be due to circumstances such as joint owners of an estate. Clubs, societies, charitable trusts etc. are covered under this head.

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

- g. **Local authorities** include Municipal Corporations, Panchayats, Cantonment Boards, Zila Parishads etc.
- h. The seventh and final category is residual category , which covers all such persons which are not covered in any of the above six categories.

### Illustration

7. Determine the category of the following entities as person as per section 2(31) of the Income Tax Act, 1961:

Person	Status
Rajul	Individual
Smita	Individual
Reliance Infra Limited	Company
Gokul Co- Op Society Ltd	AOP
Indian Red Cross Society	AOP
Legal heirs to receive property of late Shri Nusserwanji	BOI
Tata Power Ltd	Company
Virat Kohli	Individual
Board for Cricket Control in India	AOP
Family of Shri PB Hindu	HUF
Pune Cantonment Board	Local Authority
Pune University	Artificial Juridical Person
Ramu Brothers doing business in partnership	Firm

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## 1.5 ASSESSEE–SECTION 2(7)

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### 5.1 Definition

As per section 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 assessment of fringe benefits or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or by such other person, or of the amount of refund due to him or to such other person ;
- b. every person who is deemed to be an assessee under any provision of this Act ;
- c. every person who is deemed to be an assessee in default under any provision of this Act.

**5.2** The definition of “assessee” is also an inclusive definition. The definition is so wide in scope as to include any other person not covered in the above categories.

Further ,the definition covers not only a person but also his representative such as legal heir, trustee, liquidator of a company assessee etc.

Moreover, importance is given not only to the amount of tax payable but also to refund due and the proceedings taken.

**5.3** Thus, an assessee may be :-

- (i) A person by whom income tax or any other sum of money is payable under the Act
- (ii) 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
- (iii) A person who is assessable in respect of income or loss of another person or
- (iv) A person who is deemed to be an assessee,
- (v) an assessee in default under any provision of the Act

**5.4** A minor child is a separate assessee only in respect of the income generated :-

- a. out of activities performed by him like singing in radio jingles, acting in films, tuition income, delivering newspapers, etc. or
- b. from an asset assets acquired from the minor's sources of income

Other income of a minor child will be clubbed with or included in the income of the parent having the higher income subject to a maximum deduction of Rs 1500 per child under section 10 in respect of income so clubbed .

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## 1.6 ASSESSMENT - Section 2(8)

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The Act does not define “assessment”. Instead, section 2(8) states “**an assessment includes reassessment**”.

In common parlance, assessment is the procedure to determine the taxable income of an assessee and the tax payable by him.

Section 139, requires an assessee to file in prescribed form 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’ under section 143(1).

Alternatively, the officer may call upon the assessee to explain his return of income and after making necessary enquiry, frame a reasoned order determining the total income and the tax payable by the assessee this is called the “regular assessment” under section 143(3).

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

**1.7** Under section 147, an assessment can be reopened to assess income which has escaped assessment,

**1.8** Under section 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 ,

**1.9** Under section 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.

**1.10** Under section 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.

**7.1 Definition:**

Section 2(24) gives an inclusive definition of income. It states that "Income" includes—

(i) profits and gains ;

(ii) dividend;

(iia) voluntary contributions received by

- A trust or any other legal obligation created wholly or partly for charitable or religious purposes or
- an institution established wholly or partly for such purposes or
- an association or institution referred to in section 10(21) or (23), or
- a fund or trust or institution referred to in sub-clause (iv) or (v) or
- any university or other educational institution referred to in sub-clause (iiiad) or (vi) or
- any hospital or other institution referred to in sub-clause 10(23C)(iii) or (vii) or
- an electoral trust.

(iii) the value of any perquisite or profit in lieu of salary taxable under section 17 (2) and (3) ;

(iiia) any special allowance or benefit, other than perquisite included under sub-clause (iii), 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 ;

(iiib) 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 ;

(iv) the 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;

(iva) the value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee mentioned in section 160 (1) (iii) (iv) or by any person on whose behalf or for whose benefit ("beneficiary") 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 ;

(v) any sum chargeable to income-tax under section 28 (ii) and (iii) or section 41 or section 59;

(va) any sum chargeable to income-tax under section 28 (iia);

(vb) any sum chargeable to income-tax under section 28 (iib) ;

(vc) any sum chargeable to income-tax under section 28 (iic);

(vd) the value of any benefit or perquisite taxable under section 28 (iv);

(ve) any sum chargeable to income-tax under section 28(v);

(vi) any capital gains chargeable under section 45;

(vii) the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule ;

(viiia) the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members;

(viii) [Omitted by the Finance Act, 1988, w.e.f. 1-4-1988.

(ix) 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.

For this purpose—

(i) "lottery" includes winnings from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;

(ii) "card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game ;

(x) any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act, 1948 , or any other fund for the welfare of such employees ;

(xi) any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

(xii) any sum referred to in section 28(va);

(xiiia) the fair market value of inventory referred to in section 28(via)

- (xiii) any sum referred to inspection (2) (v);
- (xiv) any sum referred to in section 56 (2) (vi) ;
- (xv) any sum of money or value of property referred to in section 56 (2) (vii) or (viia);
- (xvi) any consideration received for issue of shares as exceeds the fair market value of the shares referred to in 56 (2)(viib);
- (xvii) any sum of money referred to in 56 (2) (ix);
- (xviiia) any sum of money or value of property referred to in 56 (2) (x);
- (xviiib) any compensation or other payment referred to in section 56 (xi);
- (xviii) assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee other than,—
  - (a) the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions section 43(1) explanation 10,
  - (b) the subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by the Central Government or a State Government, as the case may be;

**7.2.** Section 2(24) gives an inclusive definition of “income”., which covers income in its natural and general sense and also several items not otherwise considered as income.

Income means not only the revenue receipts arising or accruing regularly but also capital receipts like gifts and even donations and gifts. 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 follow :

1. Ordinarily Income is a regular periodical receipt, received or derived from a certain source.
2. The source of income must be external. No one can earn income by or from himself.
3. On this principle, income accruing to clubs, societies etc. from their own members are not taken as taxable income on the ground of mutuality.
4. Normally, only revenue receipts are regarded as income unless specifically exempted.

5. On Capital receipts are not treated as income unless the law specifically provides e.g. capital gains, gifts, maturity proceeds of keyman insurance policy, sales tax subsidy, voluntary contribution by a donor to a trust, which are included in income in spite of being capital receipts.

Income is like the fruit of a tree, where tree is the source, or the capital asset.

6. Income may be in cash or kind.
7. Income need not be legal. It may even be derived from illegal sources like, smuggling, theft, bribery, corruption etc.
8. It is the receipt, which is income not its application or use.
9. Any receipt diverted at the origin or the source by overriding title will not be regarded as income.
10. Any dispute in the title of the income does not take away its nature as income.
11. A gift is a capital receipt given for personal considerations. However, the is no longer valid proposition as the law specifically provides for taxation of gifts, e.g.:-
- Gift by an employer to an employee is deemed to be taxable salary u/s 17.
  - Gift by a client or customer is deemed as the income under the head profits and gains from business or profession u/s 28. Hence, a gift given by a client to his lawyer or chartered accountant or a patient to his doctor, or a disciple or pupil to his guru, will be taxable as the income of the recipient (donee) from business or profession u/s 28 .
  - Personal gifts in excess of Rs. 50,000, from all sources are taxable as income from other sources u/s 56 subject to certain exceptions. Further. Inadequate consideration on transfer of immovable or movable assets is also considered as taxable gift u/s 56. This aspect is dealt with in great detail in the lesson relating to income from other sources
12. Income may be recognised either on receipt basis or on accrual basis depending upon the facts and circumstances of and the method of accounting applied in each case.
13. Income must be certain. Contingent income is not regarded as income unless and until such contingency occurs and the income arises to the assessee.
14. Income is the sum total of all receipts from all the sources and considered accordingly.

15. 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.
16. 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.
17. Awards received by a professional sportsperson would be income, unless the award is in nature of a gift for personal consideration.
18. Income of wife is be 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 be 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- Section 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 adjusting 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

From the above it appears that:-

- The Gross Total Income is the aggregate of income computed under the five heads in accordance with the provisions of the Act
- Any income exempted from tax u/s 10 or other provisions E.G., conveyance allowance, capital gains on sale of personal effects, dividend income, etc. is not considered or excluded from the income computed under the respective heads.
- The aggregate income is before making any deduction under chapter VIA i.e. sections 80C to 80U.

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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 SCHEME 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 above.
- ◆ Tax rates are fixed by the annual Finance Act and not by the Income-tax Act. For instance, the Finance Act, 2022 fixes tax rates for the financial year 2021-22 relevant to assessment year 2022-23. Tax rates are given in the lesson dealing with computation of income.
- ◆ Tax is charged on every person if the total income exceeds the minimum income chargeable to tax.

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## 1.11 SELF 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 2018-19 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?

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[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 the Municipal Corporation
- e) Municipal Commissioner of Mumbai in respect of his salary from the Municipal Corporation
- f) A minor acting in TV commercials

[Ans: All except (d) will be taxed, Firm X , A Ltd , Z HUF , Mun Corpn. Separate tax 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 Heads of Income
- 2.6 Self-Examination Questions

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### 2.1 INTRODUCTION AND OBJECTIVES

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Sections 4 to 9 contain provisions with regard to the basis of charging income tax, scope of total income, on which tax is to be levied along with the residential status and its effect on tax liability of the assessee, periodicity of the tax and other incidental matters. Thus lesson will deal with the provisions which define the mechanism of levy of income tax in India.

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### 2.2 BASIS OF CHARGE OF INCOME TAX (Sections 4.9)

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#### I. Charge of income tax- Section 4

Section 4(1) is the charging section, which provides that *income tax shall be charged for any assessment year at any rate or rates prescribed in the Finance Act in respect of the total income of the previous year of every person.*

Accordingly, Income tax is charged:-

- on the total income of
- from a person called assessee
- earned for himself or in representative capacity such as legal heir of estate, parent of a minor child etc.
- during the previous year or a period other than the previous year (vide proviso to section 4).

- relevant to the assessment year.
- at the rate or rates prescribed in the Finance Act for that year.
- payable by way deduction at the source (TDS) , tax collection at source (TCS), Advance Tax or Self- assessment Tax or other manner prescribed by the Act.

Basis of Charge and Incidence  
of Tax

## **II. Scope of Total Income- Section 5**

As per section 5, total income of an assessee is chargeable to tax depending upon-

- a) the residential status of a person; and
- b) place and time of accrual of such income.

## **III. Residential status and place – Section 6**

Section 6 lays down rules for determining residential status of different types of persons

## **IV. Income accrued or received in India – Sections 7-8-9**

Section 7 specifies the incomes, which are not received in India but are deemed to be received in India.

Section 8 deals with the year of taxability of dividend income.

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

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## **2.3 RESIDENTIAL STATUS –SECTION 6**

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### **3.1 Classification of persons:**

Section 6 dividesd assessee (persons) into different categories,

- a) Individual
- b) Hindu Undivided Family (HUF)
- c) Firm, Body of Individual, (BOI), Association of Persons(AOP);
- d) Company and
- e) Every other person

The section then proceeds on to prescribe different criteria for each category for determination of the residential status of a person falling in that category as discussed below:.

## 3.2 Residential status of individual

### 3.2.1 Basic conditions: - Section 6(1):

As per section 6(1), an individual is said to be a resident in India in any previous year, if he satisfies **at least one** of the following **two** basic conditions: —

- a) He is in India in that previous year for a period or periods amounting in all to 182 days or more ; or
- b) He has been in India for a period or periods amounting in all to
  - I. 365 days or more during the 4 years immediately preceding that previous year; and
  - II. 60 days or more during that previous year.

#### Exception:

The period of stay of 60 or more in India as per condition (b-II) will be extended to 120/182 days or more in following two circumstances:

A. 182 days or more in case of :-

- i. An Indian citizen **leaving** India during the previous year
  - a. for the purpose of taking up employment outside India ; or
  - b. as a member of the crew of an Indian ship.
- ii. An Indian citizen or a Person of Indian Origin (PIO) **coming to India on visit** during the previous year.

B. 120 days or more in case of :-

- i. An Indian citizen or
- ii. A Person of Indian Origin (PIO)

having total income, other than the income from foreign sources exceeding 15 lakh rupees during the previous year.

A person is said to be of Indian origin (PIO) if either he or any of his parents or grandparents was born in undivided India.

Net effect of the above exception is that time limit for stay in India gets extended from 60 day to 120 or 182 days as the case may be to become resident in India.

These may result in following two propositions that in a particular previous year and individual -

- (a) does not satisfy any of the two basic conditions; or
- (b) satisfies any one or both *of the two basic conditions.*,

Then the residential status of the *individual will be:-*

Basis of Charge and Incidence  
of Tax

- i. a non- resident in case(a), and
- ii. a resident of India in case (b).

### 3.2.2 Residence under section 6(1A)

As per newly inserted section 6(1A) with effect from A.Y. 2021-22 an Indian citizen, who is not resident in India in a particular previous year as per section 6(1) shall still be deemed to be resident in India for that year if such individual-

- i. has total income, other than the income from foreign sources, exceeding 15 lakh rupees during the previous year, and
- ii. is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.

#### **Liable to tax**

As per section 2(29A) “**liable to tax**”, in relation to a person, means that there is a liability of tax on such person under any law for the time being in force in any country, and shall include a case where subsequent to imposition of tax liability, an exemption has been provided.

#### **Income from foreign sources**

"Income from foreign sources" means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India) and which is not deemed to accrue or arise in India.

To sum up, under section 6(1A) an individual will be treated as resident of India for a particular previous year who does not satisfy any of the two conditions given in section 6(1) but

- i. has Indian income of more than Rs 15 lakh and
- ii. is not liable to pay tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.

### 3.2.3 Resident & Ordinarily Resident [R &OR ]-Section-6(6)

Once a person becomes a resident of India in a particular previous year as per section 6(1), next step would be to determine whether he will be a resident and ordinarily resident of India in that previous year as per section 6(6).

Section 6(6) provides that a person will be “resident and ordinarily resident” in India in any assessment year if he is -

A. an individual, who satisfies BOTH of the following conditions:

- (a) he has been a resident of India in two out of ten previous years immediately preceding that previous year as per section 6(1) AND
  - (b) he was in India for a period or periods amounting in all to 730 days or more during the seven previous years preceding that previous year.
- B. a citizen of India, or a Person of Indian Origin (PIO), having total income, other than the income from foreign sources, exceeding 15 lakh rupees during the previous year, who has been in India for a period or periods amounting in all to 180 days or more.

### **3.2.4 Resident & Not Ordinarily Resident [R &NOR] –Section 6(6)**

As per section 6(6), Resident and Not Ordinarily Resident [R &N O R] will include the following:-

- A. an individual who
- (a) has been a non-resident in India in nine out of the ten previous years preceding that year, or
  - (b) has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to 729 days or less;
- B. a citizen of India, or a Person of Indian Origin (PIO), having total income, other than the income from foreign sources, exceeding 15 lakh rupees during the previous year, who has been in India for a period or periods amounting in all to 120 days or more but less than 180 days; or
- C. a citizen of India who is deemed to be resident in India under section 6(1A).

### **3.2.5 Non- Resident**

Any person, who is not a resident in India for any previous year, will be a non-resident for that year that is to say -

1. An individual who does not satisfy any of the two basic conditions under section 6(1) although such person may satisfy the two additional conditions under section 6(6).
2. An Indian citizen or PIO who has total income from domestic sources of Rs 15 lakh or less, irrespective the number of days of his stay in India unless such person is covered under section 6(1).
3. An Indian citizen or PIO who has income from domestic sources of more than Rs 15 lakh but who is in India for 119 days or less.

### 3.3.1 SUMMARY

An individual can either be:

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

Following table gives the summary of the provisions

Status	Conditions
Resident of India	Any individual, who satisfies any one of the conditions of stay in India under section 6(1): <ul style="list-style-type: none"> <li>i. 182 days or more during the relevant previous year or</li> <li>ii. 365 days or more in 4 previous years prior to that year AND additional stay of 60 or 182 days in the relevant previous year</li> </ul>
	An Indian citizen or PIO, who <ul style="list-style-type: none"> <li>i. has total income from domestic sources of more than Rs 15 lakh and</li> <li>ii. is in India for 120 days or more.</li> </ul>
	An Indian citizen or PIO who <ul style="list-style-type: none"> <li>i. has total income from domestic sources of more than Rs 15 lakh and</li> <li>ii. is not liable to pay tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.</li> </ul>
Resident and Ordinarily Resident	Any individual who satisfies <ul style="list-style-type: none"> <li>i. either of the two conditions under section 6(1) and</li> <li>ii. both of the additional Conditions under section 6(1).</li> </ul>
	An Indian citizen or PIO, who <ul style="list-style-type: none"> <li>i. has income from domestic sources of more than Rs 15 lakh and</li> <li>ii. is in India for 180 days or more.</li> </ul>
Resident but Not Ordinarily Resident	Any individual, who <ul style="list-style-type: none"> <li>i. satisfies either of the two conditions under section under section 6(1) but</li> <li>ii. does not satisfy one or both of the additional conditions under section 6(6)</li> </ul>
	An Indian citizen or PIO, who <ul style="list-style-type: none"> <li>i. has income from domestic sources of more than Rs 15 lakh and</li> <li>ii. is in India for a period of 120 days to 179</li> </ul>

	days;
	An Indian citizen who is <ol style="list-style-type: none"> <li>having Indian income of more than Rs 15 lakh and</li> <li>not liable to pay tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.</li> </ol>
Non- Resident	Any person, who does not satisfy any of the two basic conditions under section 6(1). IT IS NOT RELEVANT if he Satisfies the two additional conditions .
	An Indian citizen or PIO who has income from domestic sources of Rs 15 lakh or less, irrespective the number of days of his stay in India unless he is covered under section 6(1)
	An Indian citizen or PI, who <ol style="list-style-type: none"> <li>has income from domestic sources of more than Rs 15 lakh but</li> <li>is in India for 119 days or less.</li> </ol>

### 3.3.2 Some Important points:

- In computing the days on which a person is in India
  - Stay may be at one place or more than one place. Stay at difference places in India will be aggregated.
  - Stay in India may be continuous or in intervals. Stay in intervals will be aggregated.
  - Both the day of arrival in India and departure from India shall be considered even if on such days the person is in India only for a part of a day. However, the courts have held that *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. Students are advised to consider the day of departure and arrival both as two days, if the hours of arrival and departure are not given.*
- A person, who is in India for 182 days or more, will always be a resident of India.*
- Conversely, a person, who is in India for 59 days or less, will always be Non-Resident of India except when covered under section 6(1A).*
- An Indian citizen must leave India for employment or as crew to avail extended limit of 182 days instead of 60 days.
- An Indian citizen leaving India Resident and ordinarily in India will not get the extended time limit of 182 days .

- f) The condition is relaxed only for Indian citizens and not for persons, who are not Indian citizens.
- g) Indian citizens or persons of Indian origin( PIO) must come to India on visit for any purpose; pilgrimage, medical treatment or tourism; but not business or job to avail extended limit of 182 days Indian citizenship is not the requirement for this purpose.
- h) While computing the period of stay, note that 2008, 2012 and 2016 and 2020 were leap years with one extra day.

### 3.3.3 Illustrations :

1. Ankit leaves India for the first time on May 20, 2015. During the financial year 2021-22, he came to India on June 10 for a period of 55 days.

Ankit is in India only for 55 days during the previous year 2021-22. He will be a non-resident in India for the assessment year 2022-23 as he does not satisfy any of the basic conditions laid down in section 6(1).

2. Aman, an U.S. citizen arrives in India for the first time in Pune on April 16, 2019. Thereafter, on April 29, 2017, he moves to Mumbai. He leaves Mumbai for his native country on October 8, 2021. Determine his residential status for the assessment year 2022-23.

During the previous year 2021-22, Aman is in India for 191 days.

April	May	June	July	August	September	October	Total
30	31	30	31	31	30	8	191

He is a Resident in India as he satisfies the first condition under section 6(1).

During the previous year 2019-20, Aman was in India for 351 days (leap year) and full 365 days during the previous year 2020-21. Thus, he satisfies the first additional condition under section 6(6) that he must be a resident in India in at least two year out of the ten preceding years.

However, Aman does not satisfy the second condition under section 6(6) as he was in India for a period of 716 days only (351+ 365 days in the previous year's 2019-20 & 2020-210 being less than 730 days specified in the section.

Aman is a resident but not ordinarily resident in India for the assessment year 2022-23 because he satisfies one of the basic conditions and only one of the two additional conditions,

3. Ravi, an Indian citizen leaves India on June 30, 2021 to join a job in Canada.

During previous year 2021-22 Ravi was in India for 91 days (April- 30 days + May 31 days+ June 30 days) being less than 182 days. He is an

Indian citizen leaving India to take up a job. Hence he is covered by the exception under section 6(1). Hence, Ravi is Non -resident for the assessment year 2022-23 although he was in India for more than 365 days during the four years preceding the previous years

4. Assuming that Ravi leaves India for world tour, he will not be covered by the exception under section 6(1).

Accordingly he will be a resident of India as he satisfies the second basic condition under section 6(1) of 365 days' stay in the preceding four years and 60 days stay during the previous year 2021-22.

Since Ravi also satisfies both the additional conditions of being resident in India for two years in preceding 10 years and stay of 730 days in seven preceding years, he will be Resident and Ordinarily Resident of India.

5. Ravi wants to postpone his departure for Canada, then 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).

6. Assuming that Ravi is Nepali citizen settled in India, he will not get the benefit of 182 days under section 6(1) as he is not an Indian citizen. He satisfies the basic condition (b) and 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.

7. Bret Lee an Australian citizen comes to India to coach Indian cricket team for a period of 95 days each year from the previous year 2013-14 onwards.

Bret Lee, was in India during the previous year 2021-22 for 95 days and 380 days during the preceding four years.

He satisfies the second basic condition under section 6(1) but not covered by the exception of 182 days instead of 60 days in India because he is not a person of Indian origin nor he comes in India on visit is a resident of India.

He will be Resident in India.

However he does not satisfy the two additional conditions as he was in India for only  $95 \times 7 = 665$  days being less than 730 days in the preceding 7 years

8. The position will not be different if Bret Lee is a resident of Bangladesh as he has not come on visit but as a professional coach, although he is Person of Indian origin (PIO), Bangladesh being a part of undivided India.

9. If Bret Lee is a Bangladeshi citizen visiting India as a tourist, he will get the extended limit of 182 days and will be a Non- resident.

### **3.4. Residential status of HUF**

Basis of Charge and Incidence  
of Tax

#### **3.4.1 Resident**

As per section 6(2), a Hindu Undivided Family (HUF) will be:

- (a) Resident in India if control and management of its affairs is wholly or partly situated in India.
- (b) Non- resident in India only if control and management of its affairs is situated wholly outside India.

#### **3.4.2 Resident and Ordinarily resident (ROR)**

As per section 6(6), a HUF can be Resident and Ordinarily Resident if its Karta or manager satisfies both of the following two conditions viz. the Karta or the manager :-

- (a) has been a non-resident in India in 9 out of the 10 previous years preceding that year, and
- (b) has during the 7 previous years preceding that year been in India for a period of, or periods amounting in all to 729 days or less

It may be noted that additional conditions are same as those applicable to the individual but applicable on the Karta or the manager of a HUF.

#### **3.4.3 Resident and Not Ordinarily resident (RNOR)**

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 only if control and management of its affairs is situated wholly outside India.

The place of control and management of HUF is relevant to determine its status under section 6(1) whether it is Resident or Non-Resident. However, the two additional conditions Under section 6(6) are applicable with reference to its Karta or Manager to determine to R & OR status

#### **Summary**

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

- (a) Resident and ordinarily Resident (R&OR) in India if is controlled or management wholly or partly in India or
- (b) Non-resident in India if its control or management is wholly outside India .
- (c) Resident and not ordinarily Resident (R&NOR) in India if two additional conditions as per section 6(6) are satisfied by the Karta / Manager .

### 3.5. Residential Status of Other Non-Company Persons

#### (Section 6(2) & 6(4))

#### 3.5.1 Resident –Section 6(2)

Under section 6(2) Residential status of all non-company persons viz a firm an Association of Persons (AOP) or a Body of Individuals (BOI) and every other person also depends upon the place of control and management like HUFs.

Any such person will be:

- (a) Resident in India if control and management of its affairs is wholly or partly situated in India, ;
- (b) Non-resident in India if control and management of its affairs is situated wholly outside India.

#### 3.5.2 Non Resident

An AOP, BOI or a firm 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 resident .

#### Illustration

1. An entity operating in India takes instructions from Dubai either wholly or partly. It will be Resident of India in all the cases a HUF, AOP, d) BOI or other artificial juridical person.
2. If the above entity is wholly controlled from Mauritius , it will be Non -Resident of India in all the cases .

Control and management means *de facto* (actual) control or management , not merely the right to control or manage. Place of control and management is situated where the decision making of the entity as a whole is situated.

### 3.6. Residential Status of a Company –Section 6(3)

A company will be resident of India in any previous year, if—

- (i) it is an Indian company; or
- (ii) its place of effective management (POEM), in that year, is in India.

"Place of effective management" means a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made.

From the above , it follows that :-

Basis of Charge and Incidence  
of Tax

- 1 Residential status of a company is based on its place of registration and control and management.
- 2 An Indian company will be resident in India irrespective of where their control or management is.
- 3 Any other company( i.e.. a foreign company ) will be a Resident in India if place of effective management (POEM) ) of such company is situated in India .
- 4 A foreign company will be non-resident will be resident if their control and management is wholly in India if place of effective management (POEM) ) of such company is situated outside India.

The legal provisions are summarised in the following table.

Company	Status
Indian company	Resident
Foreign company - POEM situated in India	Resident
Foreign company- POEM situated outside India	Non resident

### Illustrations

1. Residential status of A Ltd., which is an Indian company managed from India is resident in India. Place of management is immaterial.
2. Residential status of, B Ltd., an Indian company managed from London, will also be Resident in India. Place of management is immaterial,
3. Residential status of C Ltd. , which is a British company managed from India , will be resident in India as its POEM is situated in India.
4. Residential status of D incorporated , which is an American company managed from Paris , will be a Non-resident in India as its POEM is wholly situated outside India.

### 3.7. Miscellaneous:

#### (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 may change from previous year to previous year 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 in a particular year. Similarly, in a particular assessment year, a person may be a non-resident in India as well as other countries.

In other words, 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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Provisions of section 5, which defines the scope of total income taxable in India, are given below.

**4.1. Scope of total income for a Resident**

As per section 5(1), the total income of any previous year of a person, who is a resident includes all income from whatever source derived which—

- (a) is received or is deemed to be received in India in such year by or on behalf of such person ; or
- (b) accrues or arises or is deemed to accrue or arise to him in India during such year ; or
- (c) accrues or arises to him outside India during such year .

**4.2. Person not ordinarily resident in India**

Total income of a person, who is not ordinarily resident in India within the meaning of section 6(6) shall not include the income which accrues or arises to him outside India unless it is derived from a business controlled in or a profession set up in India. Thus the Income of such person shall include the following income from whatever source derived which—

- (a) is received or is deemed to be received in India in such year by or on behalf of such person ; or
- (b) accrues or arises or is deemed to accrue or arise to him in India during such year ; or

- (c) accrues or arises to him outside India during such year if such income is derived from a business controlled in or a profession set up in India

#### 4.3. Person who is a non-resident

As per Section 5(2), the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

- (a) is received or is deemed to be received in India in such year by or on behalf of such person ; or
- (b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Thus the total income of a non-resident shall not include accrues or arises to him outside India during such year.

#### 4.4. Important points

- (a) Incidence of tax on a taxpayer depends on :-

- the residential status, and
- the place and time of accrual or receipt of income.;

(b) Income accruing or arising outside India shall not be deemed to be received in India by reason only of the fact that it is considered in a balance sheet prepared in India.

(c) Income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India.

(d) Indian income will be taxable in all cases. Indian income or Income received, accruing or arisen in India or deemed to be received, accruing or arising in India will be included in the income of every person regardless of his residential status whether resident , non-resident, or R & OR or R & NOR.

- (e) Income may be “ Indian income” in a previous year if :-

- Income is received or deemed to be received in India and such income is also accrued or arisen or deemed to be accrued or arisen in India;
- If income is received or deemed to be received in India but it accrues or arises outside India; or
- If income is received outside India but it accrues, arises, or is deemed to accrue or arise in India.

(f) “Foreign income” or income, which is not Indian Income or Income not received, accrued or arisen in India nor deemed to be received, accrued or arisen in India is taxable as under:-

- I. Foreign income is not included in the total income of a non-resident.,
- II. Foreign Income is included in the total income of a resident and ordinarily resident. ,
- III. Foreign income will not be included in the total income of a resident but not ordinarily resident R&NOR unless such income is derived from:
  - a business controlled in India or
  - 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. Thus foreign income taxable only by a R&OR and conditionally by R&NOR

(g) Under section 7 some incomes are deemed to be received in India e.g. Transfer balance of PF. Similarly, As per Section 9, certain incomes are deemed to accrue or arise in India even though they may actually accrue or arise outside India e.g. income attributable to any business connection in India or any property in India or any asset or any source of income in India or the transfer of a capital asset situated in India. Hence, rent from an Indian building or dividend of shares of an Indian company will be deemed to accrue in India.

(h) Residents are liable in respect of all income Indian or foreign but Non-residents liable for Indian income only

(i) 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.

(j) 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.

(k) 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.

(l) Section 8 deals with tax treatment of dividend. As per the section final dividend is taxable on the date of AGM when it was declared. Interim and deemed dividend are taxable on the date of distribution .

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of Tax

### Summary :

<b>Scope of total income –Section 5</b>			
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

### Illustrations

1. 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:

Income	Rs
Interest from U.S. Bonds received in India	80,000
Interest from U.S. Bonds received in U.S.	80,000
Interest from U.S. Bonds received in U.S but remitted to India	80,000
Capital gain on house in Mumbai sold in London	80,000
Capital gain on house in Mumbai sold in Mumbai	80,000
Rent of a villa in Paris received in Paris	80,000
Rent of a villa in Paris received in Mumbai	80,000
Agricultural Income from Tea Gardens in Nepal received in Nepal	80,000
Agricultural Income from Tea Gardens in Sri Lanka received in Mumbai	80,000
Profit from a Branch in Sydney	80,000
Profit from a branch in Mumbai	80,000
Salary for working in Pune received in Pune	80,000
Salary for working in Pune received in London	80,000
Salary for working in London received in Mumbai	80,000
Salary for working in London received in London	80,000

**Solution**

Particulars	R&OR	R&NOR	N R
Interest from U.S. Bonds received in India	80,000	80,000	80,000
Interest from U.S. Bonds received in U.S.	80,000	-	-
Interest from U.S. Bonds received in U.S but remitted to India	80,000	-	-
Capital gain on house in Mumbai sold in London			80,000
Capital gain on house in Mumbai sold in Mumbai	80,000	80,000	80,000
Rent of a villa in Paris received in Paris	80,000	-	-
Rent of a villa in Paris received in Mumbai	80,000	80,000	80,000
Agricultural Income from Tea Gardens in Sri Lanka received in Sri Lanka	80,000	-	-
Agricultural Income from Tea Gardens in Sri Lanka received in Mumbai	80,000	80,000	80,000
Profit from a Branch in Sydney	80,000	80,000	-
Profit from a branch in Mumbai	80,000	80,000	80,000
Salary for working in Pune received in Pune	80,000	80,000	80,000
Salary for working in Pune received in London	80,000	80,000	80,000
Salary for working in London received in Mumbai	80,000	80,000	80,000
Salary for working in London received in London	80,000	-	-
<b>Total</b>	<b>12,00,000</b>	<b>8,00,000</b>	<b>7,20,000</b>

\*if controlled from India

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## **2.5 HEADS OF INCOME- SECTIONS 14 -14A**

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### **5.1. Classification of income**

Aggregate income from all sources is liable to Income tax. Such income has to be classified under different heads of income according to its nature as the income tax law provides for specific treatment, rules and method for computation of income for each head of income. Section 14 gives 5 heads of income for classification of income, viz.:

- 1) Income under the head salaries -Section 15 – 17

- 2) Income from house property-Section 22 – 27
- 3) Profits & gains from business or profession -Section 28 – 44
- 4) Capital gains-Section 45 – 55
- 5) Income from other sources-Section 56 – 59

## **5.2. Importance of different heads**

The law provides different scheme for computation of taxable income under that head . This comprises of deeming provisions, exclusions and deductions and deductions of expenses etc. under the head.

## **5.3. Heads to be mutually exclusive**

It is imperative that income is computed under the specified head only. 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.

However, an income, not falling under any of the first four heads, will be taxed under the head “Income from other sources”.

### **Illustration**

Three offices are compositely let out on rent by alongwith services like intercom, security guard, telephone connection, furniture and fixtures, etc. of Swayam will be taxable.

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”.

Alternatively, the entire income arising out of the property as well as the services could be taxable as “Income from Business or Profession”

## **5.4. Tax on aggregate income under all the heads**

Aggregate of income under all the five heads will be the gross total income of the assessee, from which deductions are made under chapter VIA. The net result is called the total income or sometimes taxable income, which is subject to tax at the prescribed rates , except in case of income for which different rates are given. E.G. Long term capital gains on securities taxable now at 10% and on other assets at 20%, short-term capital gain on sale of equity shares at 15%, income from lotteries, horse races etc. at the maximum rate of tax @ 30%. Such income will be deducted from the aggregate total income and the balance of the total income will be taxable at prescribed rates.

### **5.5. Common residential status for all the heads**

As per section 6 a person is resident for the purpose of any particular head of income, will also be considered as resident for the purposes of computation of income under all the heads of income.

### **5.6. Separate sources of income under one head.**

A particular 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.

### **5.7. 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 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.

### **5.8. Expenditure incurred in relation to income not includible in total income**

Section 14A 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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## **2.6 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

Basis of Charge and Incidence  
of Tax

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.

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 2021-22 and 2022-23 of Turner an Australian citizen, came to India as a commentator during the following period:

From	To	Purpose
10.2. 20-21	20-04-20-21	World Cup
6-10-20-21	25-12-20-21	England Tour
04-01-2022	12-01-2022	Training Camp
02-03-2022	29-03-2022	Triangular Cup

Besides, Turner was in India for 340 days in four previous years from and 260 days in three previous years prior to that

(Ans: 2022-23 Non-resident, 2022-23 R but RNOR)

16. Determine the residential status of Parthiv, who made his debut in international cricket on 11-03-2021. In the first match, he was injured and had to be hospitalized in U.S. He was discharged from the hospital on 29-03-2022. 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
10-04-2020	28-04-20-20	World Cup in Dhaka
03-05-20-20	09-07-20-20	England Tour
27-08-20-20	10-09-20-20	Canada Tour
11-09-20-20	01-10-20-20	US holidays
04-01-2021	26-03-2021	Pakistan Tour

(Ans: Non-Resident)

17. Ashok, an Indian citizen, leaves India on May 22, 2012 for vacation to Uganda and returns on April 9, 2018. 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 1985 every year for a period of 90 days (Ans: Non-Resident)

19. Fletcher, a foreign citizen comes to India, for the first time on March 20, 2018. On September 1, 2018, he leaves India for Nepal on a business trip. He comes back on February 26, 2021 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, 2020.

(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 31/3/2022. 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 2022-23

Basis of Charge and Incidence  
of Tax

- 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 2003-04 earned and received there. Rs. 30,000 and interest earned and received in India on May 11, 2022 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. 1,05,000 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 2023-24.)*



## **SALARIES SECTIONS 15, 16 & 17**

### **Unit Structure**

- 3.1 Introduction and Objectives
- 3.2 Basis of Charge
- 3.3 Meaning and characteristics
- 3.4 Scope of salary income
- 3.5 Tax Treatment of some receipts:
- 3.6 Taxable Value of cash allowances-
- 3.7 Taxable Value of Perquisites
- 3.8 Classification of Perquisites
- 3.9 Valuation of Perquisites
- 3.10 Profits in lieu of Salary
- 3.11 Deductions-Standard Deduction Entertainment Allowance, Profession Tax
- 3.12 Practical illustrations
- 3.13 Self- Assessment Questions

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

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“Salaries” is the first and most important of the five heads of income given in section 14. The Act assigns “Salaries” a very wide meaning and includes not only the salary in common parlance but also various other receipts, gifts, perquisites and benefits.

The lesson deals with various provisions as to what constitutes salaries, other relevant terms such as allowances, perquisites and benefits, their types and valuation and other applicable provisions contained in sections 15, 16 and 17 as well as computation of income under the head salaries.

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### **3.2 BASIS OF CHARGE AND MEANING- Section 15**

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#### **2.1. Basis of charge**

Section 15 provides the basis of charging salary income. Section 17 explains it. Section 16 prescribes the deductions to be made from salary income.

Under section 15, the term salary embodies past (arrears), present and future salary (Advance). The section states that the following income shall be chargeable to income tax under the head "Salaries"—

- (a) any salary due from an employer or a former employer to an assessee in the previous year, whether paid or not;
- (b) any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him;
- (c) any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.

It may, however be noted that where any salary paid in advance is included in the total income of any person for any previous year, it shall not be included again in the total income of the person when the salary becomes due.

The section excludes any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner from the firm from the “salary” under this section. This is because these items are considered as business income under section 28.

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### 3.3 MEANING AND CHARACTERISTICS

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Section 15 states that salaries –past, present and future will be taxable under the head “salaries”. It does not define salaries. Hence, it becomes necessary to determine, whether any particular income is to be taxed under the head ‘Salaries’ or not with the help of common practices, tests, norms, judicial decision developed over the years. These are discussed in detail as under: -

#### 1. Employer-employee relationship:

Salary may be defined generally as the remuneration paid by an employer to an employee for rendering personal services by the employee to the employer under an expressed or implied contract for rendering such services.

The definition salary implies the existence of an express or implied contract for employment between the employer and the employee whereby the employee provides personal services to the employer for remuneration.

#### 2. Compensation for services rendered :

Salary is paid as a compensation for the services rendered as an employee and not in any other capacity.

Therefore, remuneration paid by a hospital to a doctor employee for taking care of the patients in that hospital will be salary, but the services rendered

by that doctor to patients in his private clinic will not be salary as the he is not an employee of the patients. Payment received from patients will not be salary but his professional income.

It will be true of services rendered by other professionals like doctors, architects; lawyers, Chartered Accountants etc. to their clients and the fee paid by their clients will be professional fees not salary.

### **3. Name or form not important:**

Any remuneration paid as compensation for services rendered by an employee to his employer will be treated as salary regardless of the name by which such remuneration is called such as salary, wages gift, perquisites or otherwise so long as -

- (a) the relationship between the payer and payee is that of employer and employee; and
- (b) the payment is made as a compensation for the services rendered by the employee.

### **4. Mode of Payment**

Salary may be paid in cash or kind.

### **5. More than One Source :**

Salary may be from more than one employer.

### **6. Type of Employment:**

Salary may be for any type of employment whether part-time or full time employment.

### **7. 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 such as pension received from a former employer.

### **8. 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.

### **9. Subsequent Surrender of Salary not tax-free;**

Salary is taxable when it becomes due. 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.

## 10. Tax- Free salary

Salaries Sections 15, 16 & 17

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.

## 11. Time of taxability;

Salary is taxable at the time of its accrual or receipt, whichever is earlier. Method of accounting employed by the employee is not relevant to determine the taxability of salary. Hence-

- (i) Current salary is taxable when it is accrued although it may be payable later.
- (ii) Past salary or arrears are taxable, when they are actually received, if they were not taxed earlier.
- (iii) Advance salary is taxable at the time of receipt and it will not be taxed again when it is accrued.

## 12. Salary received by individuals only

Salary is a compensation for personalised services; which can be rendered only by normal human beings. No other type of person such as a firm, HUF, company or a body corporate can earn salary.

## 13. Voluntary payments taxable as salary

Voluntary payments like gift by an employer to an employee also form the part of taxable salary.

## 14. Salary in respect of services rendered in India

Under section 9, salary, leave salary and pension paid outside India are deemed to accrue and arise in India and are taxable in India. Similarly, salary paid to Indian diplomats by the Government of India is deemed to accrue and arise in India although the same is exempted under section 10.

## 15. 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 in the net salary received and gross salary will be taxable. .

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## 3.4 SCOPE OF SALARY INCOME- Section 17

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**4.1.**Section 15 defines the scope and basis of salaries and section 17 explains it in an inclusive definition.

**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.

**4.2.** "Salary" includes the basic salary and 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, value of perquisites by way of free housing, free car, free schooling for children of employees, etc.

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## **3.5 TAX TREATMENT OF SOME RECEIPTS**

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### **5.1. Basic Salary**

Basic salary is the amount of salary fixed as per the terms of employment. It may be a pre-determined fixed sum, or a graded amount enhanced by pre-fixed annual increment.

Under the graded system, the terms of employment fix the salary at say Rs. 10,000-20,000-50,000-1,00,000-2,00,000. The starting salary of the employee will be Rs 10,000, which will be raised by Rs 200 to Rs. 10,200 in the next year and so on till he reaches the level of Rs 15,000 p.m.

Thereafter, the annual increment will be Rs 500 per annum till he reaches level of Rs 20,000 p.m. After reaching the level of Rs 20,000 p.m. increment will not be given, unless he is promoted and placed in other grade.

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

Any fees, commission, bonus, or incentive paid or payable to an employee by an employer is 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

Salaries Sections 15, 16 & 17

### 5.3. Arrears of salary:

Arrears of salary are taxed on receipt basis, if the same has not been taxed earlier. However, the employee will be entitled to claim relief under section 89 in respect of such arrears.

### 5.4. Advance Salary:

Salary **received in advance** is taxable on receipt basis. There will be no tax again in the year in which the salary actually accrues. The employee can claim relief under section 89 in respect of advance salary. However, **advance or loan against salary will not be taxable.**

### 5.5. Gratuity - Section 10(10):

Gratuity is a lump-sum payment to reward an employee for his past services, on his retirement or termination.

Amount received as gratuity on termination is exempt under section 10(10) as under:-

- 1 Employees of Central or State governments or local authorities fully exempt
- 2 Employees in a concern covered under the Payment of Gratuity Act, 1972 exempt amount lowest of the following:
  - a. Amount of gratuity received,
  - b. Rs 10,00,000
  - 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.

*\*Completed year of service X 15 days X Last Drawn Salary*

26

- 3 Employees in a concern not covered under the Payment of Gratuity Act, 1972 exempt amount lowest of the following:
  - a. Amount of gratuity received,
  - b. Rs 10,00,000
  - c. 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.

*\*Completed year of service X ½ X Average Salary for last 10 months*

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

### Illustrations

A retires on 1 June 2021 after 22 years and 9 months' service. He receives gratuity of Rs 15,00,000 . 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. The exemption will be as follows:-

- (a) If A is a government employee, gratuity of Rs 15,00,000 is fully exempt under section 10(10).
- (b) If A was working with an employer covered under the Payment of Gratuity Act, 1972,
- |  |   |
|--|---|
| (i) Actual amount received                       | Rs. 15,00,000                               |
| (ii) Notified amount                             | Rs. 10,00,000                               |
| (iii) 15-day's salary based on last drawn salary | Rs. 40,000 * 15/26 * 23 years = Rs 5,30,769 |
| Exempt amount lowest of the above                | Rs 5,30,769                                 |
| (iv) Taxable amount                              | Rs 15,00,000 - 5,30,769 = 9,69,231          |
- (c) If A was working with an employer not covered under the Payment of Gratuity Act, 1972 :
- |  |                                      |
|--|--------------------------------------|
| (i) Actual amount received                       | Rs. 15,00,000                        |
| (ii) Notified amount                             | Rs. 10,00,000                        |
| (iii) 15-day's salary based on last drawn salary | Rs. 40,000 X 11 months = Rs 4,40,000 |
| 23*0.5 -fraction ignored                         |                                      |
| Exempt amount Lowest of the above                | Rs 4,40,000                          |
| (iv) Taxable amount                              | Rs 15,00,000 - 4,40,000 = 10,60,000  |

### 5.6. Commuted Pension (Section 10(10A) :

Pension is a regular payment made at monthly or annual intervals by an employer to his employee on retirement his retirement of an employer as a reward for his past services. When an employee is allowed to forgo a portion of pension in lieu of a lump sum amount called 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) Lump sum payment received by an employee on commutation of pension as per service rules will be-
- i. fully exempt for employees of the Central or State Government or a Local Authority or a Statutory Corporation
  - ii. partially exempt for other employees to the extent of -
    - a. *One half of the total value* of pension If the employee has not received any gratuity on termination of employment, and
    - b. *One-third of the total value* of pension, if the employee has received any gratuity on termination of employment.

### Illustrations

1. B receives monthly pension of Rs 50,000 from the Government, - Pension fully taxable.
2. B receives monthly pension of Rs 50,000 from a private employer, then also it will be fully taxable. It is immaterial who the employer is.
3. B retires from government service on 01-06-2021. B receives pension @ Rs 6000 p.m. till 31-12-2021. On 01-01-2022, B opts for commutation of 40 per cent of the value of his pension for a lump sum amount of Rs 1,60,000. After commutation, B gets Rs 3,000 per month being 60% of the total pension. Determine the taxability of pension if no gratuity is paid to B.
  - a) Lump sum amount of Rs. 1,60,000 received on commutation of pension will be exempt as B is a government employee
  - b) Regular pension Received during financial year 2021-22 Rs 52,800 will be fully taxable

01-06-2021 to 31-12-2021 @ Rs 6,000 P.M = Rs 42,000

01-01-2022 to 31-03-2022 @ Rs 3600 p. m = Rs 10,800

**Total** Rs 52,800

4. What will be the position in the above cases if B is a private employee?

Commutation of Pension	Rs.
Amount Received on commutation of 40% of salary	1,60,000
Full Value of Pension = 1,60,000 / 40%	4,00,000
Amount Received on commutation	1,60,000
½ of full value of pension Rs 4,00,000 * ½	2,00,000
Exempted Amount - being the lower of the two	1,60,000
Taxable Amount	NIL

Regular pension of Rs 52,800 will be taxable irrespective of the fact that B is government employee or a private employee or whether or not he is in receipt of any gratuity.

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

**Solution:**

- a. Regular pension of Rs. 52,800 fully be taxable in all cases.
- b. If B is a government employee, the amount received on commutation of pension will be fully exempt regardless of the fact that he also receives gratuity.
- c. If B is a non- governmental employee and is in receipt of gratuity, from Rs 1,60,000 received on commutation, B will be entitled to exemption of Rs 1,33,333 being 1/3 of full value of pension (1/3 of Rs 4,00,000). Balance Rs 27,667 will be taxable.

**5.7. 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 under section 89.
  - b. Amount received on encashment of leave at the time of retirement by way of *superannuation* or otherwise, will be-
    - i. *fully exempt in case of an employee of the Central or State Government* ; and
    - ii. Partially exempt in case of any other *employee including employees of any local authority or statutory corporation* to the extent of 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

### Following points are important in this regard:

Salaries Sections 15, 16 & 17

- (a) Salary for the purpose of calculating the exempt leave encashment means total of basic salary, dearness allowance and commission on sales achieved by salesmen.
- (b) Average salary means average salary of 10 months immediately preceding the retirement.
- (c) Leave entitlement is to be taken at 30 days for each completed year of service. *Part of the year will be ignored and not considered as completed year of service.*
- (d) If leave is encashed from more than one employer, the exemption limit will be taken in respect of all the employers.
- (e) 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.
- (f) Leave to the credit of the employee means total leave available as reduced by total leave availed.

### Illustrations

1. On 01-06-2021, A retires from his job with the Government of Goa service of 22 years and 9 months. For 10 months prior to retirement, his basic salary was Rs 10,000 p.m. A was entitled to 2 months' leave for every year of service or part thereof.

A availed total earned leave of 10 months and encashed unavailed leave for 36 month for Rs 3,60,000 @ Rs 10,000 p.m.

A is government employee. Leave encashment pf Rs 3,60,000 on retirement is fully exempt under section 10(10AA).

2. If A was employed with MTNL, a statutory corporation. Exemption will be as under :-

	Rs.
Amount Received on leave encashment	3,60,000
Notified Amount	3,00,000
10 months' average pay@ Rs. 10,000 p.	1,00,000
Encashment of unavailed leave 12 months	1,20,000
Exempted Amount - being the lower of the two	1,00,000
Taxable Amount [3,00,000- 1,00,000]	2,00,000

*\*Leave entitlement – 22 months – Leave availed 10 Months ignoring fractional period of service of 9 months as it is not rounded off. MTNL at par with a private employee as statutory corporation is not considered Government.*

3. What will be the exempt amount if A receives the leave encashment while in service?

**Solution**

Leave encashment during continuance of employment is fully taxable regardless of who the employer is.

**5.8. Retrenchment compensation –Section.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;**

- (i) Compensation under a Voluntary Retirement Scheme is also exempt under section 10 (10C).
- (ii) Where an assessee has to pay higher tax on account of such lump sum receipts, he is entitled to relief under section 89.
- (iii) If an assessee claims exemption under this section, then he can not claim relief under section 89[1].

**Illustration**

A workman was retrenched after 20 year and 10 months' service. His average salary was Rs 10,000 per month. He was paid Rs 1,40,000 as the retrenchment compensation. Calculate the exempt amount.

**Solution**

The exempt amount will be least of the following:

	Rs.
Actual Amount Received	1,40,000
Notified Amount	5,00,000
#10-1/2 months' average salary Rs 10,000 per month	1,05,000
Exempted ( Lowest of the above	10,500
Taxable 1,40,000-1,05,000	35,000

*#(15 days for 20 years and 10 months rounded off to next number. Relief under section 89 not available if he claims the above exemption.*

## 5.9. House Rent Allowance (Section 10-13A)

Salaries Sections 15, 16 & 17

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

- (i) HRA actually received.
- (ii) Rent paid by employee in excess of 10 per cent of salary during the previous year.
- (iii) 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 upto 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

1. For an employee residing in Delhi ,who is in receipt of basic salary- Rs. 60,000, Dearness allowance-Rs. 30,000 and HRA- Rs 35,000, exemption of HRA will be the least of the following assuming he paid rent - Rs 15,000 per annum.

	Rs.
Actual HRA Received	35,000
Rent paid in excess of 10 % of salary $15,000 - \{10\% (60,000 + 30,000)\}$	6,000
50% of salary	45,000
Exempted ( Lowest of the above)	6,000
Taxable $35,000 - 6,000$	29,000

2. Exempt amount If rent paid is -Rs. 50,000 :

	Rs.
Actual HRA Received	35,000
Rent paid in excess of 10 % of salary $50,000 - \{10\% (60,000 + 30,000)\}$	41,000
50% of salary	45,000
Exempted ( Lowest of the above)	35,000
Taxable	NIL

## 3. Exempted HRA for an employee based in Pune :

	Rs.
Actual HRA Received	35,000
Rent paid in excess of 10 % of salary	41,000
50,000- {10 % ( 60,000+30,000)}	
40% of salary	36,000
Exempted ( Lowest of the above)	35,000
Taxable	NIL

*Note - The time and notified amounts, wherever applicable in this lesson, are technically not in syllabus but given to keep the text logically complete. These should be available in question.*

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### 3.6 TAXABLE VALUE OF CASH ALLOWANCES:

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Most employers offer allowances or fixed monetary amounts to the employees over and above basic salary normally paid to meet some personal expenses like house rent, conveyance etc. or for performance of their duties such as entertainment or telephone allowance or partly for personal and partly for official purpose.

All such allowances are taxable and included in gross salary unless specific exemption is provided in respect of such allowance. Accordingly, the allowances are of four categories –

- Fully taxable allowances;
- Allowances fully and unconditionally exempt
- Allowance, which are tax-free or taxable subject to certain conditions or limits.
- Allowances, in respect of which exemption is allowed only for a sum prescribed on *ad hoc* basis.

Some of these allowances are dealt with as under:-

#### 6.1 Allowances Fully Taxable :

- Dearness allowance, a compensatory allowance paid to meet high prices and increased cost of living.
- 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
- 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,
- 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 the employee may have employed servants.
- h. Other allowances by whatever name called such as family allowance, project allowance, marriage allowance, education allowance, holiday allowance etc. as these allowances are not specifically exempt.

## **6.2 Wholly and unconditionally exempt Allowances**

- a. Allowances paid to Judges of the High Courts and the Supreme Court,
- b. Allowances paid 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. under section 10(18)

## **6.3 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- Section 16 (ii)**

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

For the Government employees, the allowance is partially exempt by way of deduction under section 16(ii) upto 20 per cent of basic salary, or 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 allowance is taxable but reimbursement of medical expenses is exempt upto 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- Section 10(14)**

Any allowance or benefit given to meet the expense wholly and necessarily in the course of employment is fully exempt under section 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 upto Rs 1600 per month ( Rs 3,200 in case of a handicapped employee) .

For example, if A is in receipt transport allowance @ Rs 2,000 per month, Rs 400 per month (Rs 2000-Rs 1,600) will be included in total income of A.

**e. Other allowances for official purposes- Section 10(14)**

Under section 10(14) allowances (other than conveyance between residence and office) are exempt to the extent of amount actually spent from those allowances by the employee in meeting the official expenses.

For example, where an employee receives uniform allowance of Rs 10,000 and spends Rs 4000 on uniforms, then Rs 4,000 actually spent will be exempt and unspent sum of Rs 6,000 will be taxable in the hands of the employee.

Some other examples of the allowances paid for meeting expenses 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 Rs 100 per month per child or Rs 300 per month if the child stays in a hostel subject to maximum of two children is allowed as exemption from such allowance received by the employee.

**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 upto 70% of such allowance or Rs.6000 per month, whichever is less.

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### 3.7 TAXABLE VALUE OF PERQUISITES

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Salaries Sections 15, 16 & 17

#### 7.1 Definition and meaning of perquisites:

Although value of perquisites allowed to an employee is chargeable to tax under section 17(2), but the section does not define what constitutes perquisites. In normal commercial parlance, perquisites denote any casual emoluments or benefits attached to an office or position in addition to salary or wages. Perquisites are normally allowed in kind, not in cash and are measurable in monetary terms.

#### 7.2 Taxability of perquisites:

Perquisites are included in 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 personal advantage to the employee; and
- derived by virtue of employer's authority.

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### 3.8 CLASSIFICATION OF PERQUISITES

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Section 17(2) gives the following list of taxable perquisites:

- i. Value of *rent-free accommodation* provided to the employee by the employer.
- ii. Value of *concession in 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 is neither 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.

The perquisites may be broadly classified in 3 categories:

- (i) Perquisites taxable in all cases,
- (ii) Perquisites not taxable at all and
- (iii) Perquisites taxable only in the hands of specified employees.

### **8.1 Perquisites taxable in all cases:**

The following perquisites are taxable under section 17(2) in the hands of all type of employees, whether specified or not:

- (i) Value of Rent free house provided by employer
- (ii) Value of house provided at concessional rate
- (iii) 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.
- (iv) Any sum paid by employer in respect of insurance premia on the life of employee.

### **8.2 Perquisites tax-free for all the employees**

As per section 17, following perquisites are not taxable in the hand of the employees:-

#### **i. Medical benefits within India:**

Exempted medical benefits within India, include:-

- i. Medical treatment provided to an employee or any member of his family in a hospital maintained by the employer.
- ii. 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:
- iii. In a hospital maintained by government or local authority or approved by the government for medical treatment of its employees.
- iv. In respect of the prescribed diseases or ailments in any hospital approved by the Chief Commissioner.
- v. 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.

**ii. Medical benefits outside India**

Exempted medical Treatment outside India includes:

- i. Any expenditure incurred by employer on the medical treatment of the employee or any member of his family outside India.
- ii. Any expenditure incurred by employer on travel and stay abroad of the patient being the 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.

**iii. Medical Health Insurance within India**

Exempted perquisites in respect of medical Health Insurance include:-

- i. Premium paid by the employer on health insurance of the employee under an approved scheme under section 36(1)(ib)
- ii. Premium on insurance of health of an employee or his family members paid by employer on any scheme approved under section 80D (Mediclaime).

**iv. 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.

**v. 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.

**vi. Refreshments**

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

**vii. 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.

**8.3 Perquisites taxable by specified employees only**

Under section 17(2)(iii) the value of any benefit or amenity granted or provided free of cost or at concessional rate to specified employees only will be taxable. Specified employee means an employee who is-

- (a) *a director* of the employer ;or
- (b) who has a *substantial interest* (more than 20% voting power) in the company where he is employed or
- (c) 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 taxable perquisites are:-

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, personal attendant and
5. Any other benefit or amenity.

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### 3.9 VALUATION OF PERQUISITES:

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Perquisites are benefits granted in kind. Monetary value of the perquisites taxable is taxable in the hands of the employees. Broad principles for determining the value of taxable perquisites are stated as under:-

- a) The amount actually spent by the employer will be the full taxable value of perquisite allowed entirely for personal benefits of the employee.
- b) Taxable value of the perquisite allowed to an employee for official purposes only shall be nil and perquisites will not be taxable in the hands of employee.
- c) Taxable value of the perquisites allowed partly for personal and partly for official purpose, will be the amount of perquisites reasonably used for personal purposes.

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

#### a. Accommodation & Furniture

Value of furnished and unfurnished accommodation is determined according to the Valuation Rules. 10 per cent of the cost will be added to the value of accommodation, if the employer owns the furnishings.

#### b. Transport

No perquisite value is taken in the hands of individual employees in case where:-

- (a) common transport such as bus provided to all the employees; or
- (b) the employer is in the transport business; or
- (c) the 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

Where a car owned by the employer is provided to an employee for exclusive personal use by the employee, the taxable value of the perquisite will be determined by taking reasonable expenses incurred by the employer on the maintenance of car and depreciation on the car as per income tax rules.

If such car is used both for private and official purposes, then a reasonable proportion of the perquisite value relating to the personal use will be taken as the taxable value 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:**

- i. *Taxable perquisite of providing supply of gas, water, or electricity will be nil, if the employer himself is engaged in the business providing these facilities.*
- ii. If the employer is not in the business of supply of gas, water or electricity, then the amount spent by the employer 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.
- iii. 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 employer discharged by the employer. Such payment is taxable in case of all employees under Section 17(2)(iv).

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

- i. Taxable perquisite value of education provided by an employer being a school, college or an educational institution, will be taken as nil.
- ii. If the employer is not a school, college or an 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 of such facility.
- iii. 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**

- (i) 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 Rs.15000 will be taxable.
- (ii) If the treatment is taken in a government approved hospital or recognized hospital, or in government hospital, no value will be taken

as the perquisite value in respect of such medical treatment reimbursement.

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- (iii) 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 of the employee.
- (iv) If the employer himself is a medical institution, provision of medical facilities will not attract any tax in the hands of the employee.

From the above, it follows that there will be no taxable perquisite value in the hands of the employee in respect of transport, education or medical facilities provided by an employer's own institution.

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### **3.10 PROFITS IN LIEU OF SALARY – Section 17(3)**

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Under section 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 by the 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 recognised provident fund or an approved superannuation fund or a Deposit-linked Insurance Fund established under section 3G of the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 or under section 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. Under the scheme of funds both the employer and the employee make contribution to the funds and interest is accumulated therein till an employee is retired. The funds are of three types, Viz.:-

- i. Statutory Provident Fund(SPF) set up, established and administered by the Government.
- ii. Recognised Provident Fund (RPF) set up by other employers but recognised by the Commissioner of Income Tax
- iii. Unrecognised Provident Fund (UPF) set up by other employers but not recognised by the Commissioner of Income Tax due to non-compliance with the guidelines laid down for recognition.

Following is the summary of tax treatment of different funds :

- (a) Employer's Contribution to statutory PF, interest thereon and the amount paid on retirement of the employee, all three are exempt.
- (b) Employer's Contribution to statutory RPF is exempt upto 12% of basic salary and interest on PF is exempt upto 8.5% p.a. Excess contribution or interest will be taxable. The amount paid on retirement of the employee will be exempt subject to rules.
- (c) Employer's Contribution to UPF and interest thereon is exempt from tax but it will be taxable, when paid on retirement of the employee under section 17(3).
- (d) Employer's Contribution to all the three funds is exempt at the time of contribution.
- (e) If the P.F. is deducted from the salary of the employee, salary will have to be grossed up in all the three cases.
- (f) Employees' Contribution when received back on retirement is exempt in all the three above mentioned cases.

- (g) Interest on Employees' Contribution from UPF will be treated as Income from Other Sources.

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## **8. Transferred Balance: - Section 17**

When an unrecognised provident fund is subsequently recognised and the balance standing in the unrecognised provident fund is transferred to the Recognised Provident Fund, it is called transferred balance. As per section 17(1), Transferred Balance shall be deemed to be the salary income of that year to the extent such balance comprises of employees' contribution in excess of 12% of basic salary and interest credited in excess of 8.5% p.a.

## **9. Salaries exempt under section 10**

Section 10 provides for exemption of salaries to certain classes of employee and in respect of certain types of allowance and perquisites. A broad list of such exemptions is given below.

### **a. Exemption of salaries to foreigners and non-resident employees**

1. Interest income of non-resident persons of Indian origin from notified securities, saving certificates/ NRE Account purchased in convertible foreign exchange—Section 10(4).
2. Remuneration / salary of
  - (i) Foreign diplomats - Section 10(6),
  - (ii) trainees of foreign governments- Section 10(6)(xi),
  - (iii) foreign national as an employee of foreign enterprises – Section 10(6)(vi),
  - (iv) Non-Resident employees of foreign ships-Section 10(6)(viii),
  - (v) Persons from foreign governments under Co-operative Technical Assistance Programme/ projects- section 10(8),
  - (vi) a consultant under Grant Agreement between the International Organisation and the Government of Foreign State-Section 10(8A)
  - (vii) non-residents 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.- section 10(8A)
  - (viii) 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. –section 10(8A)

- (ix) an individual who is assigned to duties in India in connection with any technical assistance programme and project from a consultant referred to section 10(8A), income- section 10(8B).
- 3. 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. section 10(6B)
- 4. Income accruing or arising outside India by any family member of persons covered under section 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. – section 10(9)
- 5. 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. section – 10(10CC).

**b. Other Exemptions to salaried employees**

A broad list of all the important exemptions in respect of allowances granted to employees discussed above in this lesson is given below:-

- (i) Value of travel concession/ assistance- section 10(5),
- (ii) allowance paid by the government to a Indian citizen rendering service outside India - section 10 (7)
- (iii) Death cum Retirement gratuity - section 10(10)
- (iv) Commuted pension section 10 (10A),
- (v) Leave encashment section 10 (10AA)
- (vi) Retrenchment compensation -Section 10(10B)
- (vii) Voluntary Retirement Compensation - section 10(10C)
- (viii) Value of tax-paid perquisite - section 10(10CC)
- (ix) Payment from statutory PF - section 10(11)
- (x) Any payment from National Pension Trust or upto 40% on closure of such account - section 10(12A /12B)
- (xi) house rent allowance section 10(13A),
- (xii) Special allowances etc. section 10(14).

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### **3.11 DEDUCTIONS FROM SALARIES - SECTION 16**

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From the aggregate of taxable amounts chargeable as taxable salary viz. salary, bonus , allowances and perquisites (called gross salary), income

under the head "Salaries" shall be computed after making the following deductions under section 16, namely:-

Salaries Sections 15, 16 & 17

**a) Standard Deduction**

A deduction of Rs 50,000 or the amount of the salary, whichever is less.

**b) Entertainment Allowance**

A deduction in respect of any allowance in the nature of an entertainment allowance specifically granted by an employer to the assessee who is in receipt of a salary from the Government, a sum equal to one-fifth of basic salary (exclusive of any allowance, benefit or other perquisite) or Rs 5,000, whichever is less.

No deduction is allowable to employees in private sector.

**c) Profession Tax:**

A deduction of any sum paid by the assessee on account of a tax on employment (profession tax) leviable by or under any law by the state government.

Other than that, no further deductions are allowed under this head.

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### **3.12 ILLUSTRATIONS**

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1. R was appointed as Finance Manager with ABC Bank on 1-4-2013 in the Salary grade of Rs. 12000 – 500 – 20000 – 1000 – 30000. Other details are as under:-

1. Leave travel Concession for proceeding on leave of Rs. 4000. Actual expenditure amounted to Rs. 5000.
2. Tiffin Allowance Rs. 6000. Actual lunch expenses amounted to Rs.10,000.
3. Rs. 50,000 as reimbursement of his of medical expenses from the employer for treatment of himself and his family in private clinic.
4. 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.
5. The employer provided two watchmen drawing salary Rs. 5000 per month each.
6. R is entitled to free use of Santro car for official use and for journey between office and residence.
7. Free refreshments provided at place of work @ Rs. 100 per day for 200 days.

*Compute Salary Income for the Assessment Year 2022-23.*

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

Particulars	Rs.
Basic salary (Rs 12,000 + 8 increments of Rs 500 R. 16000 X 12)	1,92,000
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 (5000 * 2 * 12)	1,20,000
Santro Car only for Office use	NIL
Free Refreshments at workplace	NIL
	3,83,000
Less Standard Deduction under section 16(1)	50,000
Taxable Salary	<u>3,33,000</u>

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

Particulars	Rupees	
	A	B
Basic Salary	5,00,000	5,00,000
HRA – Actual Rent Rs. 200000	2,50,000	0
Free House – fair rental value 50000	0	2,50,000
Transport Allowance	1,00,000	0
Free Use of Car – Amount spent		1,00,000
Education Allowance for one child	50,000	0
Free Education for 1 child. Amount spent	0	50,000
Gardener Allowance	60,000	0
Gardener's salary paid by employer		60,000
Salary	<b>9,60,000</b>	<b>9,60,000</b>

**Solution**

Salaries Sections 15, 16 &amp; 17

**Taxable salary from employer A**

Basic Salary		5,00,000
HRA (Actual)	2,50,000	
Less : Exempt (HRA or 50 per cent of salary or Rent paid less 10 per cent of salary 2,00,000- 10% of 5,00,000)	<u>1,50,000</u>	1,00,000
Education Allowance	50,000	
Less : Exempt (100*12)	<u>1,200</u>	48,800
Gardener Allowance		60,000
Transport Allowance	1,00,000	
Less : Exempt (800*12)	<u>9,600</u>	90,400
		7,99,200
Less: Standard Deduction under section 16(1)		50,000
Taxable Salary		<u>7,49,200</u>

**Taxable salary from employer B**

Basic Salary	5,00,000
Free House Value	50,000
Free Education for 1 child	50,000
Gardener's Salary(120 * 12)	1,440
Free Car	1,00,000
	<b>8,51,440</b>
Less: Standard Deduction under section 16(1)	50,000
<b>Taxable Salary</b>	<u><u>8,01,440</u></u>

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

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

PARTICULARS	I	II
	Rs.	Rs.
Basic Salary	2,70,000	2,70,000
Bonus	10,000	10,000
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	--	18,000
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 unrecognised PF?

**SOLUTION:**

PARTICULARS	I	II
	Rs.	Rs.
Income from Salary		
Basic Salary	2,70,000	2,70,000
Bonus	10,000	10,000
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	4,500	--
Rent free unfurnished house	13,430	7,600
Gross Salary	<b>3,51,730</b>	<b>2,93,600</b>
Less: Standard Deduction u/s 16(1)	<b>50,000</b>	<b>50,000</b>
<b>Taxable Salary</b>	<b>3,01,730</b>	<b>2,43,600</b>

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

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### 3.13 SELF ASSESSMENT QUESTIONS

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Salaries Sections 15, 16 & 17

1. What is meant by Salary?
2. Distinguish profits in lieu of salary from perquisites.
3. How are the perquisites for different employees treated?
4. Explain various deductions available under the head salary.
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 31.03.2022 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) Receives 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. R was an employee of R India Ltd since 1968 covered by the Payment of Gratuity Act, 1972, retired on 31 January 2021 after 35 years and 7 months' service. On retirement, her employer paid gratuity of Rs. 85,000; exempt under section 10(10) Rs. 50,000. R also received Rs. 50,000 as the accumulated balance of Recognised Provident Fund. The due date of salary etc was 1<sup>st</sup> day of the next month and were paid on due date. She was entitled to a monthly pension of Rs. 400 with effect from 1<sup>st</sup> day of February 2021, which becomes due on the last day of the month. Compute her taxable income for Assessment Year 2022-23
8. From the following information furnished by H , Compute his taxable income of H for the Assessment Year 2022-23 :
  - (A) Basic Salary Rs. 2,50,000 p.m.
  - (B) House Rent Allowance Rs. 40,000 p.m. Taxable value is 50% of the amount received.

- (C) Project Allowance paid during the year Rs. 12,000.
- (D) Bonus paid during the year Rs. 3,6000.
- (E) In retirement, on encashment of earned leave at his credit of 15 months he received Rs. 40,000 (Exempt under section 10(10AA) Rs. 24,000)
9. S submits the following information pertaining to the year 31.3. 2022 and asks you to compute his income from salaries for the Assessment Year 2022-23.
- a) Basic Salary Rs. 25,000 p.m.
  - b) Dearness Allowance Rs. 30,000 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. 1,50,000 p.a. Rent paid Rs . 12,500 p.m.
  - g) Profession tax paid by employee Rs. 840.
  - h) S received Rs 2,40,000 as the commuted value of 40% of pension on his retirement from service on 31.3.2021 as the only terminal benefit beside the balance in his PF account at Rs 20,00,000.



## **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
- 4.5 Computation of income
- 4.6 Miscellaneous provisions
- 4.7 Illustrations
- 4.8 Self - Examination Questions

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### **4.1 INTRODUCTION AND OBJECTIVES**

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Sections 22 to 27 deal with computation of income from house property. This lesson deals with the provisions in detail as unlike other heads of income, computation under this head covers actual as well as notional income

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### **4.2 SCOPE AND BASIS OF CHARGE: SECTION- 22**

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#### **2.1 Sections dealing with income from house property**

Section	Subject matter
22	Scope of income under the head income from house property
23	Mode of computation of income
24	Deduction available under this head
25	Amounts not deductible
26	Property owned by co-owners
27	Deeming provisions, where a person not being an owner of the property will be taxed as the deemed owner of such property

**2.2** Section 22 is the charging Section which provides that annual value of property consisting of any building or lands appurtenant thereto of

which the assessee is the owner, shall be chargeable under the head income from house property. However, the Section expressly excludes property occupied for the purpose of assessee's own business or profession.

**2.3** As per Section 22, income from building or land appurtenant or adjacent thereto only be covered under this head.

**2.4** For this purpose:-

'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.

**2.5** 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.

**2.6** The assessee must be the owner or deemed owner of house property during the previous year. Any subsequent change in the ownership of the property is immaterial.

**2.7** Any person may be the owner whether an individual, HUF, firm, company, cooperative society or an association of persons.

**2.8** A tenant is not the owner of a property. Hence, income of a tenant from sub-letting a rented property to another tenant is also not covered under this head. It will be taxable as business income or income from Other Sources.

**2.9** The property is either let-out or used for own residence. The Section specifically excludes a property used for assessee's own business or profession.

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## **4.3 DEEMED OWNER- SECTION 27**

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Under Section 27, following classes of persons shall be deemed to be the owner of a property although they may not be the legal owner thereof.

a) An individual, who transfers any property to his spouse or a minor child, other than a married daughter, for inadequate consideration, shall be treated as deemed owner of that property although in such cases, legal owner of the property is the spouse or the minor child.

b) The holder of an impartible estate is deemed to be the owner of the entire property. E.g., an HUF jointly holding a property on behalf of all its members shall be deemed to be the owner of such property although the property may be in the name of an individual member of family.

c) 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 such society or company or AOP shall be deemed to be the owner of that property.

d) 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, shall be deemed to be the owner of that property despite the fact that the agreement for buying of property has not been registered with the appropriate authority.

e) A lessee, who has acquired right by way of long-term lease of property for period of more than 12 years, shall be deemed to be the owner of such property. However, 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 EXEMPT INCOME

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4.1 Under the Sections 10 to 13 income from house property, of certain persons, institutions and organisations is exempt from tax. Some of such exemptions are as under:-

- (a) A farmhouse used for agricultural purpose Section- 10(1)
- (b) Income of one Palace of an ex- Ruler - Section 10(19A)
- (c) A local authority Section -10(20)
- (d) A scientific research association -Section 10(20),
- (e) An Institution for development of Khadi & Village Industries -  
Section 10(23BB)
- (f) Khadi & Village Industries Board -Section 10(23BB)
- (g) A body for administration of charitable & religious trusts & endowments -Section 10(23BBA)
- (h) Approved funds, educational institutions or hospitals -  
Section 10(23C),
- (i) A trade union or association of trade union- Section 10(24)
- (j) Resident of Ladakh district -Section 10(26A)
- (k) Statutory corporations/ other institution or association finance by the government for promoting the interests of the members of the scheduled caste and scheduled tribes- Section 10(26B)
- (l) Co-operative society for promoting the interests of the members of the scheduled caste and scheduled tribes- Section 10(27)
- (m) A property held for charitable purposes -Section 11

(n) A property held by a political party -Section 13

4.2 As per Section 22, a property used for own business or profession, e.g. letting out property, or using it as a shop, office, factory, guest house for business clients or for providing accommodation to, partners, directors or employees, will be excluded from the income from house property.

Any income arising from such property will be chargeable income of the business or profession, not as income from house property.

4.3 As per Section 23(1), one self-occupied property of an individual or a HUF assessee is exempt. This benefit is not available to a property which is let out or to non-living entities like firms, companies, etc.

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## 4.5 COMPUTATION OF HOUSE PROPERTY INCOME

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**5.1** Income from house property is computed in two steps:

I Determining annual value of the house property as per Section 23

II Reducing from the annual value the deductions available under Section 24.

### 5.2 Annual Value - Section 23

Section 2(22), which defines the term annual does not give any definitive meaning to it. Instead it only says annual value means “the annual value determined under Section 23.

In normal commercial terms ‘annual value’ means 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 important to note that annual value does not refer to the rent of a property actually received but the capacity or worth of the property to fetch rent.

This implies that a property need not necessarily be let out. Moreover, the annual value of a property depends on the use of the property- self occupied, let out or partly vacant and several other factors like its location, age etc.

### 5.3 Gross Annual Value [GAV]

As per Section 23(1)(a), annual value of a property is its-

(i) actual rent (**AR**), or

(ii) reasonable lettable value (**RLV**);

whichever is higher.

Actual rent [**AR**] means the rent received or receivable, where the property has been actually let out by the owner.

Reasonable lettable value [RLV] means the expected rent, which the property might reasonably be expected to yield from year to year. It is not necessary that a property must be let out.

Where a property is not let out, RLV may be estimated on the basis of the following factors:

- (a) Fair rent or the rent of similar properties in the same locality. The fair rent may be different in different circumstances or different contractual obligations.
- (b) Municipal value (MV) i.e. the ratable value of a property fixed by the local authorities for the purposes of assessment of local taxes payable. Municipal Value is fixed according to prevalent market rent receivable in respect of a property, hence it is considered as a reliable criterion to determine the reasonable letting value of the property.
- (c) Standard rent or the rent fixed under the rent control laws to control or limit the rents prevailing in a locality. These laws prohibit the landlords from charging rent in excess of the standard rent. However, the landlord is at liberty to charge rent at a rate lower rent than the standard rent. Hence, actual rent can be more or less than the fair rent but can never exceed the standard rent.

#### **5.4 Comparison of RLV and AR - Section 23(1(b))**

As per Section 23(1)(a), annual value of a property is higher of its actual rent (AR) vis-à-vis its reasonable lettable value (RLV). This may result in following situations:-

- (a) AR is more than RLV. In that case AR will be GAV.
- (b) AR is less than RLV ( i.e. RLV is more than AR) and the reason for actual rent being less is because of -
  - I. Vacancy only and no other reason, then the AR , even if it is lower, will be the GAV under Section 23(1)(c)
  - II. any other reason, RLV shall be the GAV.

#### **5.5 Other Important points:-**

- (i) Actual rent will be relevant only if property is let-out. Obviously no rent will be received if the property remains vacant or nor let out at all or the property is self- occupied. In such cases, reasonable letting value will be sole 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 unrealised 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) Actual rent shall not include the rent, which cannot be realised 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.

### Illustrations

1. A property is let out at a monthly rent of Rs. 11,000. Its Municipal ratable value is Rs. 10,000 per month, the fair rent is Rs. 14,000 per month and standard Rent is Rs. 12,000 p. m. The GAV will be computed as under

	Rs	Rs
I. Actual rent :Rs 11,000 p.m.		1,32,000
II. (a) Fair rent: Rs. 14,000 p.m.	1,68,000	
(b)Municipal value @ Rs.10,000 p.m.	1,20,000	
Higher of the (a) and (b) – fair rent	1,68,000	
Standard Rent Rs 12,000 p.m.	1,44,000	
Fair rent cannot exceed the Standard Rent. Reasonable lettable value RLV restricted to:		<b>1,44,000</b>
Gross Annual Value (GAV) higher of	AR/RLV	1,44,000

2. If the standard rent Rs. 18,000 p.m. , GAV will be as under :

	Rs	Rs
I. Actual rent: Rs 11,000 p.m.		1,32,000
II (a) Fair rent – Rs. 14,000 p.m.	1,68,000	
(b)Municipal value: Rs. 10,000 p.m.	1,20,000	
Higher of the (a) and (b) – Fair Rent	<b>1,68,000</b>	
Standard Rent Rs 18,000 p.m.	2,16,000	
Reasonable Lettable Value <b>RLV</b>		1,68,000
Gross Annual Value Higher of the Two		<b>1,68,000</b>

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

3. If the actual rent Rs. 17,000 per month, the GAV will be : -

	Rs	Rs.
I. Actual Rent -Rs 17,000 per month		<b>2,04,000</b>
ii. (a) Fair rent - Rs. 14,000 per month	1,68,000	
(b)Municipal value@ Rs .10,000 p.m.	1,20,000	
Higher of the (a) and (b) – Fair Rent	1,68,000	
Standard Rent Rs 12,000 per month	1,44,000	
RLV cannot exceed Standard Rent		1,44,000
Gross Annual Value higher of AR/ RLV)		<b>2,04,000</b>
Note:- For tax purposes legality not relevant although it is an offence to charge excess rent than the standard rent.		

4. A house is let out for Rs 15,000 per month for six months. Its RLV is Rs 3,60,000.

In this case AR is Rs 1,80,000. There is shortfall of Rs 1,80,000 between the AR and RLV, which is only because there was a vacancy of six months.

Hence, GAV will be Rs. 1,80,000

5. A house is let out for @ Rs 50,000 per month. Its fair rent is Rs 4,50,000.

AR Rs 6,00,000 and RLV Rs 4,50,000. Shortfall not due to vacancy s house let out for full year.

Hence, GAV will be Rs 6,00,000(AR) being higher than RLV.

6. RLV of a house is Rs 3,00,000 but the actual rent is Rs 20,000 per month. GAV will be Rs 3,00,000 (RLV) being higher than (AR).

7. A house is let out for 8 months for monthly rent of Rs. 50,000 per month. For the remaining 4 months, the house remained vacant. Reasonable lettable value of the house is Rs. 2,40,000.

The RLV Rs. 6,00,000 for the full year.

AR Rs 4,00,000 i.e. Rs. 50,000 p.m. for 8 months.

Shortfall of Rs 2,00,000 solely on account of vacancy as the AR for full year would be Rs. 6,00,000, if there is no vacancy. The GAV will be Rs. 4,00,000 being the actual rent.

## 5.6 Computation of Net Annual Value (NAV)

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

**(i) Self-occupied business properties:**

Incomes from house property used for own business or profession is exempt from tax. Any rent or other income generated from such property will be treated as business income.

On the other hand, expenses incurred on such property such as municipal taxes, repairs, insurance premium etc. will be admissible as business expenses.

**(ii) Self-occupied Residential Properties (SOP):**

Following are the provisions in respect of the annual value of a self-occupied residential property.

**A. Annual value to be taken as NIL**

Under Section 23(2)(a), annual value of a house or part of a house which is in the occupation of the owner (self-occupied property) for the purposes of his own residence shall be taken to be nil.

The exemption will be available even if the property can not be actually occupied because the owner resides at a different place in a building not belonging to him only because of his employment, business or profession carried on at any other place.

**B. Exceptions- Section 23(3)**

Exemption to a SOP will be denied in two cases, viz.:-

- a) If the house or part of the house is actually let during the whole or any part of the previous year; or
- b) any other benefit therefrom is derived by the owner.

**C. More than one properties – Section 23(4)**

Where the self-occupied property consists of more than one house, then the exemption shall be available only in respect of any two such houses, which the assessee may, at his option, specify in this behalf. Earlier the exemption was available in respect of any one house only. Now, the second house will also be treated as self-occupied and thereby necessity of paying tax on notional rent has been removed.

The annual value of the other house or houses shall be determined as if such house or houses had been let out (Deemed to be let out property (DLP)).

In other words, where the assessee *owns more than one* self-occupied *properties*, the assessee, at his option, may *choose any one* property as self-occupied by him.

The remaining properties will be deemed or assumed to have been let-out (DLP) even if they are occupied by him and not actually let out.

Annual Value of DLP will be determined on the basis of the notional RLV even if no rent has actually been received by the assessee. However, other deductions under Sections 23 or 24 will be allowed in the normal manner.

**D. Exemption only to individuals and HUFs:**

Exemption for SOP is available only to *individuals and HUFs*. Other non-living persons cannot avail this exemption.

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

Where the annual value of a SOP is taken as nil, no deduction will be allowed from such annual value under Section 23 or 24 except in respect of interest paid or payable on borrowed funds.

In other words, municipal taxes will not be allowed as deduction nor repair allowance of 30% of annual value will be allowed under Section 24 while computing the NAV of SOP.

**F. Deduction of interest : -**

**(i) Amount deductible**

Interest payable on funds borrowed for acquisition, construction, repair, renovation or reconstruction of two self-occupied houses will be allowed subject to following limits in aggregate for both the houses:-

- a) Funds borrowed prior to 01-04-1999 to acquire, construct, renew or restructure the property – Rs 30,000.
- b) Funds borrowed on and after 01-04-1999-
  - I) Rs 30,000 if the funds are borrowed for repairs of the property, and
  - II) Rs 2,00,000 if the funds are borrowed to acquire or construct the property and such acquisition or construction of the property is completed within 3 years from the end of the financial year in which capital was borrowed.

**(ii) Pre-construction interest**

Interest payable on capital borrowed to acquire or construct the house property, for the period prior to the previous year in which the property has been acquired or constructed, will be allowed as deduction in five equal installments beginning from that previous year and for each of the four immediately succeeding previous years:

**(iii) Interest allowed under other provisions**

Amount of interest will be reduced to the extent it is allowed under any other provision of the Act.

**(iv) Interest on new loan to pay old loan :**

Interest payable on new loan taken by an assessee subsequently to make repayment of the capital borrowed for construction or acquisition etc. will also be allowed. However, any interest payable on interest will not be allowed as deduction.

**(v) Accrual basis**

Interest on capital borrowed is allowed as deduction when it is accrued. Actual payment during the previous year is not necessary.

**(vi) Other provisions**

- I. Brokerage or commission paid to arrange a loan for house construction is not allowed as deduction.
- II. Interest payable on loan taken for construction etc. of a property is allowed and not on any loan taken for payment of interest.
- III. Any loss arising under the head 'income from house property' may be set-off against the other heads in the same assessment year for a period of 8 years from the year of loss.
- IV. The assessee is required to furnish a certificate, from the person to whom any interest is payable on the capital borrowed, specifying the amount of interest payable by the assessee for the purpose of such acquisition or construction of the property, or, conversion of the whole or any part of the capital borrowed which remains to be repaid as a new loan.

**Illustrations**

1. On 01-06-2018, A borrows Rs 15 lakh @ 8% p.a. to construct a house for own residence. The construction is completed in May 2021.

The construction is completed within three years of taking the loan, Interest of Rs 1,20,000 for the financial year 2021-22 will be allowed.

Interest for the previous financial year 2018-19, 2019-20 and 2020-21 Rs 3,40,000 will be allowable in five equal installments of Rs 68,000 for five years beginning from the financial year 2021-22 (Assessment Year 2022-23) subject to a limit of Rs 2,00,000.

2. Assuming the capital was borrowed, the deduction would be restricted to Rs. 30,000.

3. If capital borrowed is used for renovation or repairs of the bungalow, the deduction would be restricted to Rs. 30,000.

4. If the construction of the house could not be completed till December 2021 i.e. within three years of taking loan, the deduction will be restricted to Rs 30,000.

### **(iii) Let-out Properties (LOP)**

Following principles will be applicable for determination of annual value of properties let out including deemed to be let out self-occupied properties (DLOP)

#### **1. Net Annual Value (NAV)**

Vide Proviso to Section 23(1), net annual value of a let-out property value (NAV) is arrived at by deducting Municipal taxes actually *paid* by the owner from GAV.

**NAV = GAV - Municipal Taxes paid by the owner.**

Two important points to be noted are:-

- I) Municipal taxes will be deducted on payment basis, not accrual basis.
- II) Municipal taxes paid or borne by the tenant are not deductible

#### **2. Deductions under Section 24:**

##### **a) Standard deduction**

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

##### **(b) Interest on funds borrowed**

Deduction in respect of interest on funds borrowed for acquisition, construction, renewal, repairs or reconstruction of let-out properties is allowable on accrual basis without limit of Rs 30,000/ 2,00,000 as in the case of SOP.

As in the case of SOP,  $\frac{1}{5}^{\text{th}}$  of the pre-construction interest is allowed as deduction for each of the 5 years from the date of the loan to the end of the previous year in which the construction was completed.

#### **Illustration**

On 01-10-2014 A borrowed Rs 10,00,000 @ 12% p.a. for the construction of his house. The house was finally constructed on 31-03- 2017 and let out.

The construction of house is completed within the three years of borrowing funds. Hence interest for pre-construction period 01-10-2014 to 31-03- 2017 amounting to Rs 3,00,000 will be amortized in five equal installments of Rs 60,000 each from 2018-19 to 2022-23.

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

A property let-out for whole or any part of the year and self-occupied for the remaining part of the year, 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 under Section 23(1).

It will not be treated as SOP as Section 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.

**(v) 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.

**(vi) 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. If co-owners themselves occupy the property, 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 2,00,000 as the case may be.

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## **4.6 MISCELLANEOUS**

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**A. Recovery or realization of past arrears/ unrealised rent**

Under Section 25A, any arrears of rent or any unrealised rent will be taxable in the year when it is realised or recovered irrespective of whether the assessee does or does not own the property in the that year. Such rent shall be eligible for deduction @ 30% in that year.

**B. TDS**

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

**C. 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

#### D. 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.

### 4.7 ILLUSTRATIONS:

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

Particulars	Property				
	I	II	III	IV	V
Municipal value	8000	8000	8000	8000	8000
Rent received	8200	8200	8700	8700	9000
Fair rental value	8600	8600	8600	8800	9100
Standard rent under [Rent Control Act]	NA	8500	8500	8500	10300

#### Solution:

vi.	I	II	III	IV	V
Municipal value	8000	8000	8000	8000	8000
Rent received	8200	8200	<b>8700</b>	8700	9000
Fair rental value	<b>8600</b>	<b>8600</b>	8600	<b>8800</b>	<b>9100</b>
Standard rent	NA	<b>8500</b>	8500	<b>8500</b>	10300
Gross Annual Value	<u>8600</u>	<u>8500#</u>	<u>8700@</u>	<u>8500#</u>	<u>9100\$</u>

# Fair rent limited to standard rent Rs 8,500

@ Actual rent even if it's more than standard rent.

\$ Standard rent is only a limiting factor, hence ignored.

2. Ashok owns two houses. He lets out House A throughout the previous year and occupies House B for nine months for own residence and let-out for three months on a monthly rent of Rs 5,000. Determine Taxable income, given the following details:-

	House A	House B
Municipal value	30,000	60,000
Fair rent	40,000	50,000
Rent received	48,000	15,000
Municipal taxes paid	6,000	4,000
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 A	House B
Gross annual value AR-House A ( municipal value for B	48,000	60,000
Less : Municipal taxes paid	6,000	4,000
Net annual value	44,000	56,000
Less : Deduction under Section 24		xvi.
Repairs & Collection charges @ 30%	13,200	22,400
Taxable Income	30,800	33,600

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**4.8 SELF EXAMINATION QUESTIONS:**


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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 regarding unoccupied residential house?
11. Enumerate and explain if any , the exceptions to the rule that Ownership is the criterion for assessment of Income from house property under Section 22”
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 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 from House Property” for AY 2022-23 (*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 2021 and therefore he let-out the property with effect from July 1, 2021 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 31.3.2022. Interest on money borrowed for the construction of the property amounted to Rs. 20,000/- Compute the income from house property for the AY 2022-23( *Ans. Loss Rs 8250* )
17. Arvind commenced construction of his residential house intended exclusively for his residence on 1.11.2020. He raised a loan of Rs. 5,00,000/- at 10% interest for the purpose of construction on 1.11.2017. Finding that there was an overrun in the cost of construction he raised a further loan of Rs.8 lakh at the same rate of interest on 1.10.2018. What is the interest allowable under Section 24 assuming that the construction was completed on 31.3.2021?

(*Ans. Loss Rs. 1,50,000 pre- construction interest 1/5th*)

18. S 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 2019 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. Compute income from House Property

(Ans: L.O.P - 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.
- R lets out his house to Y for using it as his office.
  - R uses his house as the godown to store his factory goods.
  - R rents out his property as residential quarters to the workers in his factory at a nominal rent of Rs.500 p.m.
  - 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.
  - 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.
  - 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 2022.
  - 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 ;lift, security, etc. provided by R.
  - 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 & Profession
- 5.3 Scheme of computation
- 5.4 Deductions expressly allowed under the Act
- 5.5 General deductions
- 5.6 Illustrations
- 5.7 Self-Assessment Questions

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### **5.1 INTRODUCTION AND OBJECTIVE**

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The third and one of the most important head of income is “Profits and gains of business and profession” in as much as this head covers the entire commercial activity of the nation in their different forms, types and variants such as trade, commerce, manufacture, business profession, vocation and any adventure in the nature of trade or manufacture.

This lesson will cover the detailed structure for computation of income under this head, general and specific deductions allowable under this head and also 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 Definitions**

##### **2.1.1. Business :**

Section 2(3) defines “business” in any inclusive manner:

*“Business includes any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce or manufacture.”*

The definition includes “business” not only in its general commercial sense but also several other activities, namely- trade, commerce, manufacture and any adventure in the nature of trade, commerce or manufacture.

Business, trade and commerce refer to buying and selling of goods or services for profit and other incidental activities, manufacturing means producing new goods or articles.

### **2.1.2. Profession**

Section 2(36) defines “profession” also in an inclusive manner viz. **“Profession” includes vocation**”.

“Profession” in common parlance means rendering of skilled services like as those of doctors, architects, lawyers, chartered accountants or other professionals.

Vocation means a specified occupation, profession, trade, calling or career especially a religious one such as services of management gurus, yoga gurus, astrologers, tarot readers, palmists priests, plumbers, mechanics priests or preachers delivering sermons or discourses or performing havan or pooja etc.

### **2.1.3. Adventure**

The phrase “Adventure in the nature of trade, commerce or manufacture” indicates that business or profession need not be organised, 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, it was held an adventure in the nature of trade or commerce or manufacture.

### **2.1.4. Provisions to apply uniformly**

Income under the head “Profits and gains of business and profession” will be uniformly chargeable to tax regardless of the following considerations:-

- a) Type or description whether any activity is business, profession, vocation or an adventure in the nature of trade, commerce or manufacture although there are some provisions such as presumptive tax applicable to different activities.
- b) Legality or illegality whether the income is from a legal and legitimate business or profession or from any illegal, immoral, illegitimate or criminal activity such as theft, bribery, gambling, smuggling, extortion or other criminal or illegal activities.
- c) Regularity or irregularity whether the business or profession is regular, irregular or occasional. Even a single activity or adventure will be chargeable under this head if it is in the nature of trade, commerce or manufacture.
- d) Organised or unorganised ; and
- e) Whether or not requires personal talents or skill.

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## 5.3 SCHEME OF COMPUTATION -Sections 28-29

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Profits and Gains of Business  
or Profession (Sections  
28 to 44)

### 3.1. Chargeable income- Section 28

Section 28 is the charging section. It defines the scope of income under the head profits and gains of business or profession as the aggregate of all income from different sources specified below in this section in respect of a business or profession carried on by the assessee any time during the previous year:-

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

*Compensation for termination or modification of contracts*

- (ii) any compensation or other payment due to or received by any person at or in connection with the termination of contract modification of the terms and conditions relating thereto for ;
  - a. managing the whole or substantially the whole of the affairs of an Indian company,
  - b. managing the whole or substantially the whole of the affairs in India of any other company,
  - c. holding an agency in India for any part of the activities relating to the business of any other person by any person,
  - d. vesting in the Government, or in any corporation owned or controlled by the Government, under any law ,of the management of any property or business ;
- (iii) income derived by a trade, professional or similar association from specific services performed for its members;

#### **Export incentives**

- (iiia) profits on sale of an import licence ;
- (iiib) cash assistance received or receivable by any person against exports under any scheme of the Government of India ;
- (iiic) duty drawback in respect of customs or excise duty person against exports ;
- (iiid) any profit on the transfer of the Duty Entitlement Pass Book Scheme (DEPB);
- (iiie) any profit on the transfer of the Duty Free Replenishment Certificate;
- (iv) value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;

- (v) any interest, salary, bonus, commission or remuneration due to or received by a partner of a firm as adjusted by any amount not allowed to be deducted under section 40(b);

### **Non- compete agreement**

(va) any sum, whether received or receivable, in cash or kind, under an agreement for not carrying out any activity in relation to any business or profession or not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services if such amount is -

- chargeable under the head "Capital gains" or
- received as compensation, from the multi-lateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme(UNEP), in accordance with the terms of agreement entered into with the Government of India.

(vi) any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

(vii) any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD (Scientific Research) in earlier years

(viii) Amount recovered on account of bad debts allowed in the earlier years;

### **(ix) Speculation Business**

Speculation business carried on by an assessee is deemed to be distinct and separate from any other business if speculative transactions, which are settled by payment of difference in price of goods or securities and not by actual delivery are of such a nature as to constitute a business.

### **(x) Income on receipt of capital asset or stock in trade by specified person from specified entity- Section 9B**

As per the newly inserted section 9B, if there is any -

1. transfer of any capital asset or stock in trade or both
2. by a specified entity being a firm, AOP, BOI but not a company or a co-operative society
3. to a specified person being any partner or member thereof
4. in connection with any **dissolution or reconstitution** of such entity, then any profits or gains arising from such transfer of capital asset or stock-in-trade shall be taxable under the head "Capital Gain" or

“Business or Profession” respectively of such specified entity of the previous year in which such capital asset or stock in trade or both were received by the specified person.

Profits and Gains of Business  
or Profession (Sections  
28 to 44)

### Other points

1. Fair market value of the capital asset or stock in trade or both on the date of its receipt by the specified person shall be deemed to be the full value of the consideration received or accruing as a result of such deemed transfer of the capital asset or stock in trade or both by the specified entity.
2. Reconstitution of the specified entity means,
  - (a) Retirement of one or more partners or members, of such entity; or
  - (b) Admission of one or more new partners or members, in such specified entity along with one or more partners or members, continuing as partner or partners or member or members after the change;
  - (c) Change in share of some or all of the old partners or members continuing.

### 3.2. Computation of business income –Section-29

Section 29 spells out the mode of computation of taxable income under this head by deducting from the aggregate income, expenses incurred by the assessee during the previous year for earning such income subject to the following principles or conditions:-

- a) Expenses will not be deducted, if the business or profession is closed down during the previous year.
- b) Expenses incurred before setting of the business will not be allowed except where specifically provided by law.
- c) Some expenses are fully deductible, while others are deductible only partially ;
- d) Similarly, some deductions are assessee -specific i.e. allowable to some classes of assessees e.g. a company or a firm but not to others ;
- e) Some deductions are without conditions, while others are subject to fulfillment of conditions attached with the deduction.
- f) The expenses may be deducted in accordance with the conditions attached in section 28- 43D, viz.
- (i) Sections 30 to 35 provide expressly for deduction of expenses in some cases
- (ii) Sections 36 and 37 provide for general deductions.
- (iii) Sections 40, 40A and 43B provide for disallowance of expenses in certain circumstances which are otherwise deductible.

- (iv) Sections 44A to 44D deal with the computation of income on presumptive basis in case of smaller assessee like professionals, retailers, insurance agents, transporters etc.

### **3.3. Method of Accounting: (Sec 145 / 145A)**

As per section 145(1), income chargeable under the head “Profits gains of business or profession” or “income from other sources may be computed according to either cash or mercantile system of accounting regularly employed by the assessee.

#### **a) Mercantile system or accrual system of accounting**

Under the mercantile or accrual system of accounting, income and expenditure accrued during the previous year will be recorded in the books and the taxable income from profits or gains from such a business or profession will be the difference between the expenses or income accrued during that previous year.

Actual receipt of the income or payment of expenses during the year is not mandatory. Instead, such income may be received, or expenses may be paid in the previous year or in a year preceding or following the previous year.

#### **b) Cash system of accounting**

Under the cash system of accounting, incomes actually received, and expenses actually paid during a particular previous year will be recorded and considered for computing taxable profits or gains from a business or a profession. Net profit under the cash system will be equal to the difference of incomes received and expenses paid during the accounting year whether such receipts and payments relate to that particular year or some other year or years.

#### **c) Hybrid system of accounting**

Hybrid system of accounting combines the features of both the methods. Accounts may be maintained as per the accrual or mercantile system, but some items of income or expenses on cash or receipt basis or vice versa. Even statutorily, section 43B provides for deduction of specified statutory dues only when they are actually paid although the method of accounting employed may be mercantile.

### **Illustration**

A 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 2020-21 assessment year 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 or assessment year 2022-23 although not earned in that year.

#### **d) Income Computation & Disclosure Standards**

As per Section 145(2), the Central Government may notify in the official gazette from time to time Accounting Standards to be followed by any class of assessee or in respect of any class of income. Such accounting standards are called Income Computation and Disclosure Standards (ICDS). So far, the CBDT has notified 10 Income Computation and Disclosure Standards (ICDS), effective from assessment year 2017-18 onwards.

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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- Section 30**

Vide section 30, rent, rates, taxes, repairs and insurance for premises, used for the purposes of the business or profession are deductible as under:-

- a) The amount paid as rent or on account of repairs of in respect of the premises occupied by the assessee as tenant.
- b) The amount paid on account of current repairs to the premises occupied by the assessee otherwise than as a tenant,
- c) Any sums paid on account of land revenue, local rates or municipal taxes subject to the provisions of section 43B ; and
- d) The amount of insurance premium paid against risk of damage or destruction of the premises.

The deduction is subject to the following modifications:-

- (i) Capital expenses are not allowed as deduction under this section.
- (ii) Where a part of any premises is partly used as dwelling house by the assessee, the deduction will be restricted to proportionate amount of rent or repairs determined by the assessing office applicable the part of the premises used for business/ profession- section 38.

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

Vide section 31, following deductions are allowed in respect of repairs and insurance of machinery, plant or furniture used for the purposes of the business or profession:—

- (i) The amount paid on account of current repairs thereto if such expenses are revenue expense, not capital expenses;
- (ii) The amount of any insurance premium paid against risk of damage or destruction thereof.

In a case, where the building, machinery, plant or furniture is not exclusively used for the purposes of the business or profession, the deduction shall be restricted to a fair proportionate part thereof which the assessing officer may determine, having regard to the user of such building, machinery, plant or furniture for the purposes of the business or profession.

Machinery hire charges are allowed under section 37 as residual expenses not under this section.

### 4.3. Depreciation - Section-32:

#### 4.3.1 Conditions for claiming depreciation:

Under section 32 an assessee is entitled to claim deduction in respect of depreciation in computing the total income if he fulfills the following conditions:-

##### (i) *Claim not necessary*

Depreciation will be allowed as deduction irrespective of whether or not the assessee has made a claim for deduction so long as the conditions for the allowance of depreciation are satisfied.

##### (ii) *Depreciation allowed on eligible assets only:*

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

*Tangible assets*; being

Buildings, machinery, plant or furniture,

*Intangible assets* being

Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature.

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

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

##### (iii) *Assets not eligible for depreciation*

Following assets are not eligible for depreciation:

- a) Foreign car acquired between 01-03-1975 and 31-03- 2001. However *foreign cars purchased on or after 01-04-2001 will be eligible for depreciation* ; and

b) 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.

(iv) *Ownership – Partial ownership:*

Assessee must own the depreciable asset wholly or partly as the sole owner or the co-owner thereof. In case of an asset owned by different assesseees, each co-owner will be entitled to depreciation on his contribution to the cost of asset.

**Exception:**

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

(v) *Purpose or user of the assets*

The assessee must use the asset for the purpose of his business or profession.

(vi) *User of the assets during the previous year:*

If an asset acquired by the assessee during the previous year, is put to use for the purposes of his business or profession for a period of -

- 180 days or more, the depreciation will be allowed at full rate prescribed.
- 180 days; i.e. 179 days or less; depreciation will be allowed @ 50% of the rate prescribed.

The condition is applicable on an *asset acquired during the year* not on other asset. This is because the machinery would undergo wear and tear even if it was not put to actual use

**Illustration**

A Machine is purchased on 31-03-2021 is put to use on 01-04- 2021.

No depreciation will be allowed depreciation in assessment year 2021-22 because the machine though acquired, is not put to use during the previous year 2020-21. Full depreciation will be allowable assessment year 2022-23

**4.3.2 Additional Depreciation- Section 32(1)(ia)**

Section 32(1)(ia) read with Sec 32AD provides for allowing additional depreciation over and above the *normal depreciation as per the following scheme:-*

**(i) Eligibility assessee**

Any assessee being an *industrial undertaking* engaged in the business of *manufacture or production of any article or thing or transmission of power*.

**(ii) Rate of additional depreciation allowable**

- a) 20% of the actual cost of new plant or machinery (not being ships or aircrafts) acquired and installed after 31st March, 2005.
- b) 35% of the actual cost *in case of the assessee being a manufacturing undertaking or enterprise set up in the notified backward areas of the States of Andhra Pradesh, Bihar, Telangana and West Bengal on or after 1st April, 2015 and the Assessee acquires and installs new plant & machinery between 01-04 2015 & 31-03-2020.*
- c) 50% of the above rates i.e. 10% or 17.5%, where the plant or machinery is acquired and installed for less than 180 days of the relevant previous year and the balance 50% will be allowed in the immediately succeeding previous year

**(iii) Assets not be eligible for additional depreciation: -**

- 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

**4.3.3 Important Terms :****(i) Block of Assets**

*As per section 2(11) "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, not being goodwill of a business or profession in respect of which the same percentage of depreciation is prescribed.

Thus by definition, block of assets is a classification of assets based on the twin criteria of:

- (a) Class of asset viz. building, plant, furniture or machinery to which the asset belongs to ; and
- (b) Rate applicable on the asset within that class.
  - The assets within a class eligible for same rate will form a block of assets but
  - not assets from different groups having same rate nor
  - the assets from different classes having same rate.
  - A block may have a single asset in it.

**(ii) Written Down Value (WDV) of an asset**

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.

**(iii) Written Down Value (WDV) of block of assets**

Written down value of any block of assets, means

- a. the opening WDV of the block of
  - the assessee or
  - the previous owner or entity, in case of slump sale, amalgamation, succession of business , demerger, conversion into company etc. or holding/subsidiary company

**b. adjusted by: -**

- (i) *the increase* by the actual cost of any asset falling within that block, acquired during the previous year; and
- (ii) *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.
- (iii) at opening WDV for A.Y. 2021-22 of block of asset under which “goodwill of a business or profession” is included shall be reduced by the WDV of goodwill of a business or profession.

**Other important points:**

- (i) Any other things or benefit which can be converted in terms of money can not 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.
- (iii) If depreciation was claimed on goodwill forming part of the block of the assets in the A.Y. 2020-21; then while computing opening WDV for A.Y. 2021-22, the amount of reduction calculated in above shall not exceed the WDV of such block of assets. A.Y. 2022-23 onwards there will be no depreciation on goodwill.

### Illustration

- Opening value of block having four machines (depreciation @ 15%) Rs 7,00,000 as at 01-04-2021.
- On 01-06-2021, another machine Purchased with depreciation @ 25% for Rs 3,00,000.
- Sold an existing machine for Rs 6,00,000. Ascertain depreciation for the A.Y.2022-23 and the closing value of block as on 31-03-2022.

Solution	Rupees
WDV as on 1-4-2021	7,00,000
Add: Purchase during the year	3,00,000
	10,00,000
Less: Sales during the year	<u>6,00,000</u>
Adjusted Block	<u>4,00,000</u>
Depreciation @ 15 per cent	<u>60,000</u>
WDV of block as on 31 -3-2022	<u>3,40,000</u>

### (iv) Actual Cost

Actual cost is determined on the following principles

#### i. Subsidy or grant to be reduced to determine actual cost

As per section 43(1), 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 such as subsidy or grant and expenses incurred for acquiring the asset or installation

Grant or subsidy whether of revenue or capital nature are taxable as income, unless it has been reduced from the actual cost of a depreciable asset.

### Illustration

ABC purchases a machine for Rs 12 lakh with non-refundable subsidy of Rs. 3 lakh from the Government. Actual cost of the machine will be Rs. 9 lakh [Rs. 12 lakh - Rs 3 lakh].

#### ii. **Scientific Research Asset**

Actual cost of asset purchased for scientific research and brought into business use will be *Actual Cost minus deduction available* under section 35.

### Illustration

Purchases a machine for scientific research for Rs 12 lakh with the non-refundable subsidy of Rs. 5 lakh from SIDBI. The machine is eligible for deduction under section 35 to the extent of Rs. 3 lakh. Actual cost of the machine will be Rs. 4 lakh i.e. Rs. 12 lakh - Rs 5 lakh - Rs. 3 lakh.

#### iii. **Gift, inheritance etc.**

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

### Illustration

If A gifts away to B the machinery in the above illustration, the cost of machine to B will also be Rs. 4 lakh, which was the cost to A.

#### iv. **Enhanced cost**

Where in the opinion of the assessing officer, an asset is acquired at an enhanced cost to claim more depreciation and reduce tax liability, actual cost will be equal to the actual cost of asset used and transferred earlier but now reacquired or cost of repurchase, whichever is less.

### Illustration

A sold a machinery with WDV of Rs 9 lakh for Rs. 10 lakh and repurchased it after two years at the prevailing market value of Rs. 20 lakh. If the assessing officer is of the opinion that the machine is repurchased for claiming more depreciation, he can ignore the enhanced purchase value of Rs. 20 lakh and treat Rs. 9 lakh as the actual cost.

### 4.3.4 Mode of computation

Following principles are important in computing the depreciation:

- Depreciation is calculated on the WDV of the block after adjusting the sales and purchase during the year in that block.
- Rates of depreciation for different assets are taken as prescribed in rules.
- 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.
- No assets are left in the block and the become empty, or ceases to exist. WDV of the block will be treated as short term loss.
- Depreciation will be allowed at 50% of the prescribed rate, if the asset is put to use for less than 180 days in the year of acquisition.
- Straight Line Method (SLM) method is applied in case of the assets of the power companies or the undertakings engaged in generation or generation and distribution of power at the prescribed rates of depreciation on the *actual cost* of the assets.
- Additional depreciation of 20% or 35% on actual cost is allowable as discussed above.
- Depreciation will not be allowed on scientific research assets, entire cost of which is allowed as deduction under section 35.

#### 4.3.5 Succession of Business

Succession means takeover of a business by another new entity e.g.

- Conversion of a firm or sole proprietor to company -Section 47(xiii)/(xiv),
- Succession of a private or unlisted public company, by limited liability partnership- Section 47(xiiib), or
- Amalgamation - demerger- succession of business - Section 170.

In such cases, aggregate depreciation for the 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

Under a scheme of amalgamation, A Ltd, transfers to B Ltd, machinery having WDV of Rs 7,30,000 on 1-08-2021. Calculate the depreciation in the hands of A Ltd. & B Ltd. If rate of depreciation is 10%.

#### Solution:

- Depreciation for the full year if the amalgamation has not taken place Rs. 73,000 [10% on Rs. 7,30,000 ]
- Aggregate depreciation for assessment year 2021-22 cannot exceed Rs. 73000

- *Pro rata allocation* of depreciation for the two periods :

$$\text{Pre amalgamation} - 122/365 \times 73000 = \underline{\text{Rs } 24,400}$$

$$[01-04-2021 \text{ to } 31-07-2021 = 122 \text{ days}] \text{ Post amalgamation} - 243/365 \times 73000 = \underline{\text{Rs } 4,8600}$$

$$[01-09-2021 \text{ to } 31-03-2022 = 243 \text{ days}]$$

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

As per explanation 5 to section 32, 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 Loss on Sale of Machinery

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

- The block has some assets and some value left in it, that is the block does not become empty because any assets are sold from it and other *assets are still existing* in it and the value of the block also does not become zero also *some value is still left* in the block, sales proceeds - scrap value will be deducted from the value of the block. Depreciation will be allowed on the resultant value of the block after increase by the actual cost of assets acquired, if any.

##### Illustration

A car in a block of 4 cars with opening WDV of Rs15 lakhs is sold for Rs. 5 Lakh. Rate of depreciation is 10%. The block has not become empty as 3 cars are still left in it, depreciation Rs 1 lakh will be allowed at 10% on the resultant WDV of Rs 10 lakh in that block.

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

##### Illustration

A car in a block of 4 cars with opening WDV of Rs15 lakhs is sold for Rs. 15 Lakh. The value of the adjusted block will be zero. No depreciation will be allowed although 3 cars still exist in it.

- 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

In the above example, the car is sold for Rs 18 lakh; the resultant surplus of Rs 3 lakh will be taxable as short-term capital gain.

- If there are no assets left and the block becomes empty but the WDV is not fully written off, then

- 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:

All assets in a block with opening WDV of Rs 4 lakh sold for Rs 1.50 lakh. The block becomes empty as there are no assets in it. No depreciation will be allowed and the balance of Rs 2.50 lakh will be treated as terminal depreciation or short term capital loss

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 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 under section 43.
- Any moneys received over and above the depreciation allowed will be treated as capital gains under section 50A.
- Sale includes a transfer by way of exchange or compulsory acquisition under any law in force for the time being but does not include a transfer in a scheme of amalgamation.

### Illustrations

1. Depreciation of Rs 70,000 was written off in respect of a machine actual cost of which is Rs 1 lakh, is sold for Rs 18,000. Its WDV is Rs 30,000 (Rs.1,00,000-70,000). Deficit Rs 12,000 (Rs.30,000-18,000) will be terminal depreciation.
2. If this machine is sold for Rs. 50,000, the surplus of Rs 20,000 (Rs 50,000-30,000) will be the balancing charge- maximum to the extent of depreciation allowed.

3. If the sale price of this machine is Rs.1,25,000, leaving surplus of Rs 95,000 (1,25,000-30,000), then there will be balancing charge of Rs. 70,000 being the amount of the depreciation allowed and the balance of Rs.25,000 will be treated as capital gain.

#### 4.3.8 Unabsorbed Depreciation- Section 32(2)

Where the depreciation can not be wholly or partly deducted in any previous year due to inadequate profits or gains the amount of depreciation not deducted is treated as unabsorbed depreciation and allowed to be carried forward as per section 32(2) to the following previous year and deemed to be part of allowance for that year.

If there is no such allowance for that previous year, amount so brought forward shall be deemed to be the allowance for that previous year, succeeding previous years and so on.

Unabsorbed depreciation is treated as part of the current depreciation and can accordingly be set-off against any other head of income even where the business has been discontinued.

#### Illustrations

1. Assuming depreciation allowable Rs 60,000 and profit before depreciation is Rs 20,000, claim for depreciation will be allowed to the extent of available profits i.e. Rs 20,000. The balance of Rs 40,000 will be unabsorbed depreciation to be carried forward to the subsequent years.
2. Determine taxable income & unabsorbed depreciation :

Particulars	Rs.
Business Income before depreciation)	13,00,000
Depreciation allowable as per Income Tax Act	18,00,000
Income from other sources	8,00,000

**Solution:**

Particulars		Rs.
Business Income before depn.	13,00,000	
Less: Depn. to the extent of profits	<u>13,00,000</u>	NIL
Income from other sources	8,00,000	
Balance of the current depreciation (18,00,000 -13,00,000 )	<u>5,00,000</u>	3,00,000
Taxable Income	Rs.	3,00,000

3. Assuming claim for depreciation is of Rs. 25,00,000. **Solution:**

Particulars		Rs.
Business Income before Depn. Depreciation to the extent of profits	13,00,000 <u>13,00,000</u>	NIL
Income from other sources Unabsorbed Depreciation for the current year to the extent of income	8,00,000 <u>8,00,000</u>	NIL
Taxable Income		NIL
Unabsorbed Depreciation to be carried forward to next year (25 lakh-13 lakh- 8lakh)		4,00,000

4. Ascertain value of block on 31-03-2022 :

A. Written down value on April 1, 2021

Particulars & Depn Rate)	Rs.
Plant A,B & C -20%	1,50,000
Plant D & E – 30%	2,40,000
Plant F – 40%	90,000
Building A & B -5%	2,00,000
Building C&D - 10%	7,00,000
Building E -Temporary Sheds E -100%	9,00,000

B. Purchase during the previous year 2021-22

Date	Particulars	Rs.
02-04-2021	Plant G -40%	60,000
01-05-2021	Plant H- 20%	20,000
01-06-2021	Furniture-10%	60,000
01-08-2021	Building G- 10%	5,00,000
01-09-2021	Computer-60%	2,00,000
01-10-2021	Franchise Rights -25%	8,00,000

C. Sales during the previous year 2021- 22

DATE	PARTICULARS	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 in the previous year.

## Solution

Profits and Gains of Business  
or Profession (Sections  
28 to 44)

### Computation of Depreciation - Cost of Block

Block	Rate	Block 01-04-2021	Purchase	Sales	Block	Dep.	Block 31-03-2022
Plant A-B-C-H	20%	1,50,000	20,000	25,000	1,45,000	29,000	1,16,000
Plant D-E	30%	2,40,000	-	15,000	2,25,000	67,500	1,57,500
Plant F- G	40%	90,000	60,000	-	1,50,000	60,000	90,000
Building A& B,	5%	2,00,000	-	-	2,00,000	10,000	1,90,000
Building C-D -G	10%	7,00,000	5,00,000	-	12,00,000	1,20,000	10,80,000
Building E	100%	9,00,000	-	2,00,000	7,00,000	0	0
Furniture	10%	-	60,000	50,000	10,000	0	0
Computer	60%	-	2,00,000	--	2,00,000	1,20,000	80,000
Franchise rights	25%	-	8,00,000	-	8,00,000	2,00,000	6,00,000

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

5. Opening WDV of a block of assets consisting of three cars (rate of depreciation @ 20%) is Rs. 5,00,000. During the year 2021-22, new car is purchased for Rs. 10,00,000 and an old vintage car was sold for Rs. 15,00,000. Compute depreciation for Assessment Year 2022-23.

## Solution

### Computation of the value of Net Block

Particulars	Rs.
Opening WDV of block-3 Cars	5,00,000
Add: cost of new car purchased	10,00,000
Total-4 cars	15,00,000
Less: sales price -1 car Sold	15,00,000
Closing Balance of block -3 cars	0
Depreciation allowable- WDV is nil <i>although 3 cars still exist in the block</i>	0

6. 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-3 Cars	5,00,000
Add: cost of new car purchased	10,00,000
Total-4 cars	15,00,000
Less: sales price -4 cars sold	2,00,000
Closing Balance -No Cars	13,00,000
Depreciation allowable ( empty block)	0
Short term capital loss on sale of cars	13,00,000

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

Section 43(4) defines “scientific research”, which means “*any activity for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries*”.

Following amounts are exempt under section 35.

**A. Expenditure on in-house Research relating to own business – Sections 35(1)(i) ,(iv) and 35[2]**

Following are the salient features of the provisions;

- (i) Deduction is allowed in respect of both revenue and capital expenses.
- (ii) Revenue expenses include salaries of the research staff or research material used in scientific research
- (iii) Capital expenses include expense on plant, equipment, construction of building other than cost of land.
- (iv) Expense may be incurred during the previous year.
- (v) Expenses incurred three years prior to commencement of business will be allowed in the previous year in which the business is commenced.
- (vi) Expenses should be incurred in relation to assessee’s own business. Expenses not *related to assessee’s own business would not be allowed.*
- (vii) Deduction is available, *even if the relevant asset is not put to use for research and development during the previous year.*
- (viii) An asset used in scientific research covered under section 35, is not eligible for depreciation. However, such asset will be eligible for

depreciation when such asset is put to use for business after cessation of scientific research,

- (ix) On sale of a scientific research asset the sales price of the asset or amount allowed as deduction under section 35, whichever is less, will be treated under section 41(3) as business income of the previous year in which the sale took place. The excess of sale price over cost (or indexed cost) of acquisition will be treated as “Capital gains”.

### Illustrations

1. AB Ltd incurs expenses on scientific research related to its business @ Rs 1.50 Lakh per year from the financial years 2016-17 onwards. It commences the business during the financial year 2021-22.

Deduction under section 35 will be allowed at Rs 6 lakh in aggregate of expenses incurred in assessment year 2021-22, the year in which the business was commenced and 3 years prior to that i.e. from 2018-19 to 2020-21. Expenditure incurred in the years 2016-17 & 2017-18 will be ignored.

2. If a scientific research asset purchased on 01-01-2019 at a cost of Rs. 3 lakh, on which full deduction was allowed under section 35 in Assessment Year 2015-16 is sold on 31-03-2022 for Rs. 7 lakh, then Rs 3 lakh being the amount of original deduction allowed, will be charged as the business income and excess over the cost Rs. 4 lakh will be chargeable as capital gain in assessment year 2018-19.

### B. Sum paid for research to others -Section 35(1)(ii)

An amount equal to **one and one half** times of any sum paid to a research association which has as its object the undertaking of scientific research or to any university, college or other institution approved to be used for scientific research

### C. Sum paid to a R & D company – Section 35(1)(iia)

Any sum paid to a scientific R&D company registered in India and approved by the prescribed authority to be used by it for scientific research

### D. Sum paid for social sciences etc.- Section 35(1)(iii)

Any sum paid to any approved research association which has as its object the undertaking of research in social science or statistical research or to a university, college or other institution to be used for research in social science or statistical research.

### E. Sum paid for approved research - Section 35(1)(iii)

A sum equal to **One and one-half** times of the sum paid by an assessee to a National Laboratory or a University or an Indian Institute of Technology or a specified person with a specific direction that the said sum shall be used for scientific research undertaken under a programme approved in this behalf by the prescribed authority.

## **F. Approved in-house Research in drugs, bio- technology etc. - Section 35(2AB)(a)**

A sum equal to one **and one-half** times of the capital or revenue expenditure (except **on land & Building**) incurred on scientific research (clinical drug trial, obtaining approval from any regulatory authority under law and filing an application for a patent) ;

- by a **company** ( not allowed to other assessees)
- 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 XI Schedule),
- In-house **research & development facility** approved by the prescribed authority subject to the condition that the company enters into an agreement with it for co-operation in such research and development facility and fulfils such other prescribed conditions with regard to maintenance of accounts and audit thereof and furnishing of reports.

### **Some relevant points**

1. Goods specified schedule XI include beer, wine & other alcoholic spirits, tobacco products like cigars, cheroots, cigarettes, biris, smoking mixtures for pipes and cigarettes, chewing tobacco, snuff , cosmetics and toilet preparations, tooth paste, dental cream, tooth powder, soap, aerated waters, confectionery, chocolates, gramophones, record-players, projectors, photographic apparatus and goods , office machines and apparatus such as typewriters, calculating machines, cash registering machines, cheque writing machines, intercom machines and teleprinters but NOT Computers, furniture, made partly or wholly of steel , safes, strong boxes, cash and deed boxes, strong room doors, latex foam sponge, polyurethane foam, crown corks, and other fittings of cork.
2. Cost of building will be eligible for deduction under section 35(2).
3. The expenditure, on which weighted deduction is allowed under this section, will not be eligible for deduction under any other provisions of the Act.
4. "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.
5. Scientific research by at the approved institutes *need not be related to the business of the assessee*

6. Contribution eligible for weighted deduction under this section will not be eligible for deduction under other provisions of the Act.
7. In case of any subsequent cancellation or withdrawal of approval to a notified university, college, research association or other institution or any approved programme is withdrawn, weighted deduction will not be denied to the assessee.
8. Any violation of condition for approval will result into withdrawal of the deduction as a mistake apparent from record.
9. On amalgamation the provisions will continue to apply to the amalgamated company as if the amalgamating company had not sold or otherwise transferred the asset.

#### **4.5. Amortisation of Preliminary Exp. -Section 35D**

The provisions of section 35 D for Amortisation of Preliminary Expenses are summarised as under:-

##### **A. Eligible assessee :**

- a) an Indian company, or
- b) a resident non-corporate assessee.

A foreign company irrespective of its residential status and a non-resident or N.O.R non company entity are not eligible under this section

##### **B. Time and purpose of preliminary expenses –**

1. For Setting up an undertaking or business BEFORE commencement of business; or
2. In connection with:
  - a) extension of an industrial undertaking; or
  - b) setting up a **new industrial** unit

AFTER commencement of business.

Expenses incurred after commencement of business, in connection with extension of or setting up a non-industrial undertaking will not be eligible.

##### **C. Eligible Expenditure:**

- (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, carried out by the assessee himself or by 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. (M-A)
- (d) Printing expenses of the Memorandum and Articles .
- (e) Registration fees of a company under 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.

#### **D. Qualifying Expenditure:**

The aggregate expenditure exceeding the following limits will not be eligible for deduction under this section:-

- a) corporate assessee - Higher of the following :
  - 5% of cost of project; or
  - capital employed, whichever is more
- b) non-corporate assessee: 5 per cent of cost of project

#### **E. Definitions of the terms**

##### **(i) Cost of project:**

Cost of project means the aggregate of actual cost of fixed assets appearing 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.

##### **(ii) Capital employed –**

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.

**F. Amount of deduction:**

One-fifth of the qualifying expenditure is allowable as deduction in each of the five successive years beginning from the year of –

- commencement of the business, or
- completion of extension of industrial undertaking , or
- commencement of production or operations by the new industrial unit.

**G. Other Points:**

1. Non- corporate assesseees 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**

ABC Ltd is an existing Indian company engaged in developing and providing computer software services. It incurs the following expenditure in connection with the setting up of a new unit. The project is complete in March 2018. Determine the amount deduction admissible under section 35D.

Particulars	Rs
Preparation of project report	2,50,000
Market Survey	4,00,000
Legal charges for additional capital for new unit	3,50,000
Engineering services not approved by CBDT	5,00,000
Cost of the Project as on 31-03-2022*	50,00,000
Capital employed as on 31 -03-2022	60,00,000

**Solution:****Eligible Expenditure:**

Particulars	Rs
Preparation of project report	2,50,000
Market Survey	4,00,000
Legal charges - additional capital for new unit	3,50,000
Engineering services not approved- ineligible	0
Total	10,00,000

**Gross Qualifying Amount:**

5% of cost of the project- (5% X 50,00,000)	2,50,000
5% of the capital employed (5% X 60,00,000)	3,00,000
Gross Qualifying Amount ( higher of the two )	3,00,000

**Qualifying Amount:**

Net qualifying amount Rs 3,00,000 being the lower of the following:

- I. Gross qualifying amount :Rs 3,00,000 or
- II. Actual amount of preliminary expenses: Rs 10,00,000

**Amount of Deduction:**

1-5<sup>th</sup> of the net qualifying amount (1/5 x 3,00,000) Rs. 60,000 each for 5 assessment from assessment year 2022-23 onwards.

**4.6. Specific deductions: - Section 36**

Section 36(1) expressly allows the following specific deductions in computing taxable income under the head profits and gains of business or profession:

**4.6.1. Insurance premium – Section 36(1)(i)-(ia)-(ib)**

Any amount of any insurance premium paid

- To cover risk of damage or destruction of business *stocks used in* business or profession; - Section 36(1)(i)
- on the *life of the cattle* owned by the milkmen being member of a primary co-operative society, by a federal milk co-operative society- Section 36(1)(ia)
- on the *health of his employees* by an employer , paid by any mode of payment other than cash (e. g. cheque) an approved scheme framed by the GIC or other insurer approved by the IRDA)- Section 36(1)(ib)

#### 4.6.2. Bonus or commission- Section 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. Under section 43B, bonus or commission will be deducted only on payment thereof on or before the due date of furnishing return under section 139.

#### 4.6.3. Interest on capital borrowed - Section 36(1)(iii):

Interest paid or payable on borrowed funds used for the purpose of business or profession.

Borrowed fund include recurring subscriptions paid periodically by shareholders - subscribers in Mutual Benefit Societies, which fulfill the prescribed conditions is deemed to be capital borrowed.

Interest paid/payable in respect of capital borrowed for acquisition of an asset for extension of existing business or profession whether capitalized in the books of account or not will be allowed only when an asset is put to use.

Interest for the period from the date of borrowing till the date when the asset is put to use will not be allowed but be added to the cost of the asset. This is in harmony with ICDS- IX, which mandates commencement of capitalization of interest from the date of borrowing of funds till the asset is first put to use, irrespective of whether acquisition of the asset is for extension of existing business or not.

#### 4.6.4. Zero Coupon Bonds- Section 36(1)(iiia):

Discount on notified (by Central Government) Zero Coupon Bonds issued by an infrastructure capital company or infrastructure capital fund or a public sector company is allowable on *pro rata* basis provided no other benefit or payment is received in respect of such bonds before their maturity.

Zero Coupon Bonds are the bonds, which do not carry coupon rate of interest. Instead, these bonds are issued at a price lower than their redemption value. The difference between issue price and redemption value or the discount is allowed as deduction 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. Briefly, discount on Zero Coupon is amortised over the life time of the Bonds.

#### Illustration-25:

ICC Ltd . issues 50 lakh duly notified Zero Coupon Bonds of Rs. 500 each at a price of Rs. 404 on 01-01-2019. 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:**

Face value of Bond- Rs 500

Issue price - Rs 404

Discount offered Rs 500-404 = Rs 96

Total discount offered on 50 lakh bonds- Rs. 48 Crore

The tenure of the coupon is three years or 36 months.

*Pro rata* deduction to be allowed

Assessment year 2019-20- 3 months from 01-01-2019 to 31-03-2019	$3/36 \times 48 \text{ Cr}$	Rs.4 Cr.
Assessment year 2020-21 full year	$12/36 \times 48 \text{ Cr}$	Rs16 Cr.
Assessment year 2021-22 full year	$12/36 \times 48 \text{ Cr}$	Rs16 Cr.
Assessment year 2022-23 9 months 01-04 -2021 to 31-12-2021	$9/36 \times 48 \text{ Cr}$	Rs 12 Cr.

#### **4.6.5. Contribution towards RPF - Approved Superannuation Fund –Section- 36(1)(iv):**

Any contribution paid by the assessee as an employer towards a recognised provident fund- approved superannuation fund, subject prescribed limits and conditions subject to the provisions of Section 43B.

#### **4.6.6. New Pension Scheme- Section- 36(1)(iva)**

Any contributions by employer to a pension scheme referred to in section 80CCD(2) on account of employee to the extent of 10% of his salary plus dearness allowance but excluding all other all other allowances and perquisites.

#### **4.6.7. Approved gratuity fund- Section 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;

#### **4.6.8. PF - ESIC - Section 36(1)(va)**

Contribution received by an employer from his employees for crediting in any fund e.g. Provident Fund (PF) or Employees State Insurance Contribution (ESIC) 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.

Such contributions from employees are treated as income of the employer under section 2(24)(X) when received and allowed as deduction when paid by the due date in terms of section 43B.

#### **4.6.9. Death of animals—Section 36(1)(vi)**

The difference between the actual cost to the assessee of the animals and the amount, if any, realised in respect of the carcasses or animals used for the purposes of the business- profession otherwise than as stock-in-trade but died or become permanently useless for such purposes,

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.

#### **4.6.10. Bad debts- Section 36(1)(vii)**

Under Sec section 36(1)(vii) and 36(2), any amount of bad debt or part thereof, which is written off as irrecoverable in the accounts of the assessee for the previous year is allowable subject to following conditions-

- (a) There is relationship of debtor and creditor.
- (b) The debt is incidental to the business or profession.
- (c) The debt has been considered in the computation of income, or it represents money lent in ordinary course of the business of banking or money-lending.
- (d) Bad debt is written off as irrecoverable in assessee's accounts in the previous year
- (e) Any debt written off but not allowed earlier may be deducted as bad debts
- (f) Bad debts will not include any provision for bad and doubtful debts made in the accounts of the assessee;
- (g) Any deficiency will be deductible in the previous year in which the ultimate recovery is made;
- (h) any such debt or part of debt written off as irrecoverable in an earlier previous year may be deducted if the deduction was not allowed on the ground that it had not been established to have become a bad debt in that year;
- (i) The assessing officer may deduct bad debts written off in the current year in an earlier previous year under section 155(6) within a period of 4 years if he is satisfied that the debt became irrecoverable in earlier years .
- (j) A bad debts can be claimed without recording in books of account as irrecoverable or bad as per second proviso to section 36(1)(vii) if the debt was considered in the computation of income as per the notified ICDSs.

**4.6.11. Provision by banks-Section 36(1)(viia):**

Under section 36(1)(viia) deduction is allowed to schedule and non-scheduled Indian banks, financial institutions and non-banking financial companies in respect of provision for bad and doubtful debts upto the following limits namely - :

- 8.5% of total income by a scheduled Indian bank other non-scheduled bank,
- 5% 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
- 10% of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner, and subject to certain conditions or
- 5% of total income of a non- banking financial company;
- 5% of Non-Performing Assets or NPAS in accordance with the RBI guidelines shown in the books of account of the bank on the last day of the previous year a bank at the option of the bank.

The deduction is subject to two conditions:

- (a) 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.
- (b) 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.

**4.6.12. Special reserve - Section 36(1)(viii)**

Under Section 36(1)(viii) financial institutions will be allowed a deduction upto 40% of their profits in respect of amounts transferred to a special reserve created and maintained by them subject to a ceiling of twice the amount of the paid-up share capital and of the general reserves.

Financial corporation mean

- a corporation which is engaged in providing long-term finance for industrial, agricultural development or development of infrastructure facility in India ,or
- 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,

Profit means 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

#### **4.6.13. Promotion of family planning - Section 36(1)(ix)**

Vide section 36(1)(ix) *bonafide* expenditure incurred by a company for promotion of family planning amongst employees is allowable:

- in full if the expenditure is of revenue nature; and
- One fifth of capital expenditure for each of the five years beginning from the year in which it was incurred.

Unabsorbed family planning expenditure will be allowed to be carried forward and set off in the same manner as depreciation.

#### **4.6.14. Expenses by statutory bodies: section 36(1)(xii)**

Under section 36(1)(x), revenue expenditure incurred, by any statutory corporation or a body corporate for the objects and purposes authorised by the Act under which it is constituted or established will be deductible.

#### **4.6.15. Cash Transaction Tax- Section 36(1)(xiii)**

Any amount of banking cash transaction tax paid by the assessee is deductible under section 36(1)(xii):

#### **4.6.16. Credit Guarantee Fund- Section- 36(1)(xiv)**

Any sum paid by a public financial institution by way of contribution to a specified credit guarantee fund trust for specified small industries will be deductible under section 36(1)(xiv).

#### **4.6.17. Security Transaction Tax - Section 36(1)(xv):**

The security transaction tax (STT) paid by the assessee will be deducted under section 36(1)(xv), if the income arising from taxable securities transactions is included in the income computed under the head "Profits and gains of business or profession.

#### **4.6.18. Commodity Transaction Tax Sec 36(1)(xvi)**

The commodity transaction tax paid by the assessee will be deducted under section 36(1)(xvi), if the income arising from such taxable commodity transactions is included in the income computed under the head "Profits and gains of business or profession.

#### **4.6.19. Expenditure by Co-operative Society for purchase of Sugarcane [Section 36(1)(xvii)]**

The expenditure incurred by a co-operative society engaged in the business of manufacture of sugar for purchase of sugarcane at a price, which is equal to, or less than the price fixed or approved by the Government, will be allowed as a deduction under section 36(1)(xvii).

**4.6.20. Losses as per IDCDS-Section 36(1)(xviii)**

Marked to market loss or other expected loss as computed in accordance with notified income computation and disclosure standards.

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**5.5 GENERAL DEDUCTIONS– Section 37**


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Section 37 is the residual section. It provides for deduction of all the expenditure as under:-

- (a) The expenditure should be incurred *wholly and exclusively for the purposes of the business- profession* carried on by the assessee, in respect of which income is computed under this head.
- (b) The expenditure, subject to the provisions of Section 43B, should be incurred during the previous year.
- (c) *expenses should be incurred after the business or profession is set up*
- (d) *Expenses must be revenue expenses in nature e.g.* expenses by way of cost of raw materials, tools, spares, cost of labour, salary, brokerage, commission, legal fees, litigation expenses, professional tax, trade mark registration, lease rent or other business expenses incurred by the assessee;
- (e) Under section 37, following expenses are not allowed as deduction:
  - i. Capital expenditure e.g. expenditure on acquisition or renovation of assets, conveyance or registration of land, eviction of a tenant etc.;
  - ii. Personal expenses e.g. income tax or wealth tax, drawings or household expenses of the assessee;
  - iii. Expenses expressly allowed in Section 30 to 36;
  - iv. Expenses incurred for any purpose which is an offence, or which is prohibited by law, e.g. penalty, bribery, composition money paid in respect of any offences or breach of law or penal interest under any law etc.
  - v. Expenses on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party specifically excluded from the purview of the section - Section 37(2B)
  - vi. any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013

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**5.6 SPECIFIC DISALLOWANCES– Sections 40-40A-43B**


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**6.1.** Some expenses are not allowed to be deducted from while computing the business income for a number of reasons such as :-

- (a) Not satisfying the inherent conditions attached with the allowance. For instance section 37 allows only revenue expenses incurred wholly and exclusively in the course of business or profession. Hence, personal and capital expenses will be disallowed.
- (b) Absolute disallowances for policy reasons such as political advertisement and CSR expense, which are expressly disallowed under section 37.
- (c) Defaults such as non-deduction of tax at source.
- (d) Deferment or time factor. E.g., Unpaid taxes, bonus etc. covered under section 43B are disallowed in the year of accrual.
- (e) Personal element, e.g., drawings by an individual, interest and remuneration in case of a firm.
- (f) Reasonableness e.g. unreasonable payments to relative under section 40A(2),
- (g) Cash payments under section 40A (3)
- (h) Partial disallowance due to ceilings, e.g. interest and remuneration payable to partners.
- (i) Express disallowance , e.g. CST expenses

These disallowances are discussed below,

## **6.2. Disallowance for any assessee – Section 40(a)**

### **1. *Payments to Non-Residents without TDS* -Section 40(a)(i)**

Any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable,—

(A) outside India; or

(B) in India to a non-resident, not being a company or to a foreign company,

on which tax is deductible at source and such tax has not been deducted or, after deduction, has not been paid on or before the due date for filing return of income under section 139 (1).

The amount so disallowed will be allowed as a deduction in computing the income of a subsequent previous year in which such tax has been paid.

### **Illustration**

A pays commission of Rs. 1,00,000 to a Non-Resident for the previous year 2021-22, on which tax of Rs 20,000 is required to be deducted. Show whether the commission will be allowable in the following situations.-

- a) A does not deduct tax at source at all.
- b) A deducts tax at source but not does not pay the tax to the Government in time.
- c) A deducts tax at source but not and pays it to the Government in time.
- d) A pays the tax to Government after deducting the same in December 2022

**Solution:**

In cases (a) and (b) commission will be disallowed under section 40(a)(i) because the assessee fails to deduct the TDS or pay the amount of TDS to the Government.

In case(c) deduction will be available in assessment year 2022-23.

In case(d), deduction will be allowed in assessment year 2023-24.

2. Payments to residents without TDS- section 40(a)(ia)

30% of any sum paid or payable to a resident, on which tax is deductible at source and such tax has not been deducted or, after deduction, has not been paid on or before the due date for filing return of income under section 139 (1) shall be disallowed under section 40(a)(ia).

Such disallowance will not be made if the recipient of the income has paid the due tax thereon and as a result thereof the assessee is not deemed to be an assessee in default under section 201(1).

The sum of 30% so disallowed will be allowed as deduction in computing the income of a later previous year in which such tax has been paid:

3. Payment of fringe benefit tax Section 40(a)(ib):

4. Any sum paid on account of any rate or tax levied on the profits or gains of any business- profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains.- Section 40(a) (ii);

5. Payment on account of *wealth-tax*-Section 40(a) (iia)

6. Any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called, which is levied exclusively on; or which is appropriated, directly or indirectly, from, a State Government undertaking by the State Government. - Section 40(a) (iib)

7. *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.-Section 40(a) (iii)

8. 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.-Section 40(a) (iv)

8 Any tax actually paid by an employer on perquisites under section 10 (10CC)-Section 40 (a) (v)

### 6.3. Disallowances in the case of any firms- Section 40(b)

#### a. *Remuneration to partners*— Section 40(b)

Following are the provision about remuneration payable to partners of a firm assessable as such namely:-

(i) Any payment of remuneration to any partner ,

a. who is **not a working partner**; or

b. who is a **working partner**, but such payment of remuneration is **not authorised** by, or is not in accordance with, the terms of the partnership deed;

c. a working partner but payment of remuneration though authorised, relates to any period falling **prior to the date of such partnership deed** or

For this purpose, “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;

(ii) any payment of remuneration, to a working partner though authorised and otherwise allowable, if the remuneration to all partners in aggregate exceeds the following limits:

Book Profits	Remuneration allowable
on the first Rs. 3,00,000 of the book profit or in case of a loss	Rs.1,50,000 or 90 % of the book-profit, whichever is more;
on the balance of the book-profit	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.

*“Remuneration”* means “any payment of salary, bonus, commission or remuneration by whatever name called.

**b. Interest to Partners-Section 40(b)**

- (i) Any payment of *interest* to any partner which is *not authorised by* or is not in accordance with, the terms of the partnership deed; or
- (ii) *Interest*, to partner thought authorised, relating to any *period falling prior to the date* of such partnership deed
- (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 are also relevant in this regard:-

- (i) 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.
- (ii) The interest will be considered in the same capacity in which it is paid.

**Illustrations**

1. A is a partner in a firm as a trustee of B. A advances his personal money and also B's money to the firm. The firm pays interest to A in his personal capacity and as the representative or trustee of B.

Interest payable to A in his capacity of trustee will be considered under section 40(b). Interest paid in his individual capacity will be ignored. On the other hand, if A is a partner in his individual capacity, then interest paid to him in his representative capacity shall be ignored.

2. For the financial year 2021-22 a firm shows net profit of Rs 50,000 after debiting the following amounts:

- (i) Remuneration to A ( not a working partner) Rs 50,000.
- (ii) b) Remuneration to B- Rs 5,00,000 for the full year. The firm has made provision for his remuneration by a partnership deed dated 01-7-2017
- (iii)c) Interest to partners @ 18% p.a. Rs. 90,000.

Compute the business profits for assessment year 2020-21

**Solution:**

Profits and Gains of Business  
or Profession (Sections  
28 to 44)

<b>Computation of Business Profits</b> <b>Assessment Year 2020-2021</b>		
<b>Particulars</b>	<b>Rupees</b>	
<i>Business Profits as per P/L A/c</i>	<i>50,000</i>	
<i>Add back- Salaries &amp; Interest paid to partners</i> <i>(50,000+5,00,000+90000)</i>	<i>6,40,000</i>	
<i>Book Profits before interest &amp; remuneration</i>	<i>6,90,000</i>	
<i>Less: Interest authorised by partnership deed</i> <i>restricted to 12% i.e. 90,000 X 12-18</i>	<i>60,000</i>	
<i>Book Profit Before Remuneration</i>	<i>6,30,000</i>	
<i>Remuneration to Partners</i> <i>( Lowest of the following )</i>	<i>3,75,000</i>	
<i>A –( Nor working partner</i>	<i>NIL</i>	
<i>B- Actual Remuneration</i>	<i>5,00,000</i>	
<i>Remuneration allowed from the date</i> <i>of deed - 9 months from 01-07-</i> <i>2017 to 31-03-2018</i> <i>5,00,000 X9-12</i>	<i>3,75,000</i>	
<i>Maximum allowable</i>	<i>4,75,200</i>	
<i>90% of Rs 300000 of book profit</i> <i>Rs 2,70,000</i>		
<i>60% of the balance book profit of Rs</i> <i>(6,42,000-3,00,000)- 2,05,200</i>		
<i>Profits from Business</i>	<i>2.55,000</i>	

**c. Payment of Remuneration and Interest by an association of persons(AOP) -body of individuals (BOI)-Section 40(ba):**

In respect of any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by an association of persons (AOP) body of individuals (BOI) to a member of such association or body following points are relevant:-

- a.** Association or “Body” does not include a company or a co-operative society or a society registered under the Societies Registration Act, 1860, or other registered charitable trusts).
- b.** Unlike a partnership firm, no part of interest paid to a member is allowable in case of an association or a body. Hence, capacity or status of the member in such AOP or BOI is relevant. Accordingly –
  - i.** Interest paid by a member in his representative capacity to the association or body or *vice versa* shall be ignored if he is a member in his individual capacity.
  - ii.** Conversely, Interest paid by a member in his individual capacity to the association or body or *vice versa* shall also be ignored if he is a member in his representative capacity

- iii. Interest paid by a member in his representative capacity to the association or body or *vice versa* shall be considered if he is a member in his representative capacity.
- iv. Interest paid by a member in his individual capacity to the association or body or *vice versa* shall be considered if he is a member in his individual capacity
- c. Where, interest is paid to a member on funds borrowed by him, the disallowances will be only on the net amount receivable by such members.
- d. Remuneration or interest to members of AOP/BOI are not allowed to be deducted for computing income from business and profession

### Illustration

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. BOI pays Interest @ 15% p. a. to X. Determine the amount to be disallowed.

### Solution:

Particular	Rs
Interest payable by BOI to X 15% on Rs 1,00,000	15,000
Interest payable by X on his borrowing 12% on Rs 1,00,000	12,000
Disallowable under section 40(b) ( Net)	3,000

## 6.4. Disallowances In the case of all assesses –S.40A

Section 40A provides for disallowance of certain expenses in certain circumstances. Most of these disallowances are anti-avoidance measures in nature and as such are overriding and prevailing. Section 40A(1) expressly states that:-

*“ The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other provision of this Act relating to the computation of income under the head "Profits and gains of business or profession".*

The disallowances are discussed as under:-

### 1. Excessive payment to relatives - Section 40A (2)

Under section 40A(2)(a), any expenditure resulting in any payment to any specified person may 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 section specifically excludes domestic transaction referred to in section 92BA, if such transaction is at arm's length price as defined in 92F(ii).

Section 40A(2)(b) gives a long list of specified persons, which is summarised as under :-

<b>A. Persons connected with the assessee</b>	
<b>Status of assessee</b>	<b>Specified person</b>
Individual	any relative of the assessee;
Company	any director or his relative
Firm	any partner or his relative
Association of Persons	any member or his relative
Hindu Undivided Family	any member or his relative
<b>B. Sister concerns</b>	
Entity holding substantial interest of the assessee	
<i>Person holding a substantial interest in the business or profession of the assessee</i>	<i>Specified person</i>
Individual	Individual or his relative
Company	any director or his relative
Firm	any partner or his relative
Association of Persons	any member or his relative
Hindu Undivided Family	any member or his relative
<b>C. Persons connected with the sister concerns</b>	
If partner of a firm, or director of company or member of a HUF or AOP hold substantial interest in another company, firm, AOP or HUF, then such entity along with 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 partners directors or members)	
<b>D : Reverse connection :</b>	
Where assessee or his relatives, or if the assessee is a company, firm, HUF or, 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 of specifies persons under section 40A(2)**

- A is an individual. His wife Mrs A and his relatives will be specified persons.

- b. A is a firm having B, C & D as partners, B, C & D and their relatives will be the specified persons
- c. If A is a HUF with B, C & D as members, B, C & D and their relatives will be the specified persons
- d. If A is a AOP with B, C & D as members, B, C & D and their relatives will be the specified persons
- e. If A is a Company with B, C & D as directors B, C & D and their relatives will be the specified persons.
- f. In the above cases B is a company, B and all directors of B will be the specified persons.
- g. If C is a firm, C and all partners of C will be the specified persons
- h. If D is A HUF or AOP, all the members as well as D will be the specified persons.

## **2. Payments exceeding Rs 10,000 -35,000 other than by way of crossed cheque or demand draft – Section 40A(3)/(3A)**

Under section 40A(3)/(3A), in respect of any expenditure, payment exceeding Rs. 10,000 (Rs. 35,000 in cases of payments made for plying, hiring or leasing goods carriages) during a single day is made otherwise than by an account payee cheque drawn on a bank or account payee bank draft, or use of electronic clearing system(ECS) through a bank account, no deduction shall be allowed in respect of such expenditure.

### **Following points require attention:**

1. Limit of Rs. 10,000/ 35,000 will be considered with reference to the aggregate of all payments made in a single day.
2. Total payment will be disallowed if it crosses the limit of Rs. 10,000 or 35,000 in cash. There is no threshold limit of 10,000/35,000.
3. If an 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. 10,000 or 35,000, such excess payment will be deemed to be the business profit in the year of payment.
4. Rule 6D gives some exceptions, when disallowance will not be made if the payment exceeding Rs 10,000 or 35000 is made otherwise than by way of crossed cheque- bank draft etc. some of these circumstances are payment to new buyer, bank holiday, lack of banking facility, etc.
5. Section 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.

## Illustrations

1. Legal fee provided during the financial year 2015-16 for Rs. 80,000 is paid by cash on 31.03.2022.

### Solution

Legal fee of Rs 80,000 allowed as deduction in assessment year 2015 -16 will be deemed be the profit of the assessment year 2022-23 when it was paid cash.

2. A makes a payment of Rs. 12,000 by a bearer cheque for purchase of goods and claims that disallowance under section 40A(3) is not applicable and even if it is applicable, it will be restricted only on Rs. 2,000 being, the amount exceeding Rs. 10,000. Examine his claim.

### Solution

If payment in excess of Rs 10,000 is made otherwise than by an account payee cheque or draft etc., total payment of Rs 12,000 will be disallowed without any basic limit. Bearer cheque and cash are not acceptable modes of payment.

### 3. Provision for Gratuity-Section 40A (7)

Any provision for payment of gratuity to employee on their retirement or termination of their services for any reason will not be allowed under section 40A (7). But if such provision is made by contributing to an approved gratuity fund or for payment of gratuity that has become payable during the previous year, will be allowed as deduction.

Hence, gratuity is allowed as a deduction only when it has become due and payable. However, once the provision for gratuity has been allowed as deduction in any year, then any subsequent payment thereof will not be deductible again.

### 4. Provision for non- statutory funds –Section 40A (9)

Under section 40A(9), deduction will not 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 paid for the purposes and to the extent provided by or under section 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, any *bona fide* sum actually spent out of such fund will be allowed as deduction under section 40(10). Further, under section 40 (11) assessee will be entitled to receive back the unutilised part of any such fund-assets.

### 5. Unpaid Liabilities-Section 43B

Section 43B provides an exception to the mercantile system of accounting in respect of taxes and other specified expenses, which 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 bonus or commission to employees under section 36(1)(ii) ; or
- (d) as 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, a co-operative bank other than a primary agricultural credit society, a primary co-operative agricultural or rural development bank accordance with the terms and conditions of the agreement governing such loan or advances, or
- (f) as an employer in lieu of, any leave at the credit of his employee, or
- (g) as user , to Indian Railways for use of railway assets.

Sec 43B provides will not be applicable if :—

1. The payment is actually made on or before the due date of submission of return of income; and
2. the evidence of such payment is submitted along with the return of income.

In brief section 43B provides that

1. Sums accrued and paid within the same previous year would be allowed in that year ;
2. Sums accrued in one year and paid in the following year but before the due date of filing will also be allowed on accrual basis on submission of proof of payment .
3. Other sums will be allowed only on cash basis and not on mercantile basis.

Following table summarises the position:

Profits and Gains of Business  
or Profession (Sections  
28 to 44)

<b>Application of Section 43B</b>	
Case	Year of deduction
Accrued and paid in same year	Year of payment- accrual as both are in same year
Paid 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

### Illustrations

1. ABC Limited pays Sales Tax for the financial year 2022-23 before 30-09-2022. Determine the assessment year in which the sales tax may be claimed as deduction.

#### Solution

Tax is paid before due date for filling return of income viz. 30-09-2018. Hence, it will be allowed on accrual basis in Assessment Year 2022-23.

2. ABC Ltd pays GST for the previous year 2021-22 on 01-03-2022. In which Assessment Year will it be allowed?

#### Solution

Deduction will be allowed only in the year of actual payment year 2022-23 relevant to assessment year 2023-24 as the payment has been made tax after the due date for filling return of income.

3. From the following record of GST payments made during financial year 2021-22. Show the year in which the GST will be deducted from the business profits of the assessee.

S. No.	Date of payment	Rupees
1	02-05-2021	40,000
2	20-07-2021	75,000
3	16-08-2021	60,000
4	05-12-2021	30,000
5	12-06-2022	35,000
6	02-12-2022	20,000
7	Outstanding	90,000
	Total	3,50,000

**Solution**

Date of payment	Rupees	Assessment year in which deducted	Reason
02-05-2021	40,000	2022-23	Due & paid in same Financial year
20-07-2021	75,000	2022-23	
16-08-2021	60,000	2022-23	
05-12-2021	30,000	2022-23	
12-06-2022	35,000	2022-23	Paid before by due date of return if proof of payment is furnished along with return of income
02-12-2022	20,000	2023-24	Delayed , paid after due date of return
Outstanding	90,000	NA	Allowable in the year when paid

**5.6 ILLUSTRATIONS:**

1. From the following Income & Expenditure account of Advocate Mohan for the year ending March 31, 2022, compute the total income. of the firm.

To Administrative. Expenses	18,50,000	Professional Receipts	65,00,000
To Depreciation	80,000		
To Remuneration to Proprietor	2,50,000	By Other fees	90,000
To Interest on proprietor's capital	1,60,000		
To Net Profit	42,50,000		
Total	65,90,000		65,90,000

**Other Information:**

- Expenses include salary paid in cash Rs 2,00,000 and transport Rs 25,000 to a single party on a single day .
- Depreciation allowable under section 32 Rs. 3,50 000

## Solution

Profits and Gains of Business  
or Profession (Sections  
28 to 44)

Computation of Total Income of Mohan for A. Y. 2022-23

Net profit as per Income & Exp account	42,50,000
Add: Expenses not allowable	
40A(3)- Cash salary paid over Rs. 10,000	2,00,000
Remuneration to proprietor	2,50,000
Interest to proprietor	1,60,000
	48,60,000
Less: Depreciation under section 32 (3,50,000-80,000)	2,70,000
Total Income	45,90,000

2. From the given Trading and P & L A/c of A for the year ended 31st March 2022, compute taxable income for the A. Y. 2022-23.

Particulars	Rs.	Particulars	Rs.
To Opening Stock	75,000	By Sales	20,00,000
To Purchases	15,00,000	By Closing Stock	85,000
To Gross Profit	5,10,000		
Total	20,85,000	Total	20,85,000
To Salaries	2,50,000	By Gross Profit	5,10,000
To Sales Commission	40,000	By Bad Debts Recovery	25,000
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 Furniture & Fittings	4,000		
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		
Total	5,35,000	Total	5,35,000

**Additional information:**

1. Salaries include Rs. 40,000 paid to proprietor .
2. General Expenses are incurred for the purposes of pleasure tour of proprietor and his family members to Goa.
3. Income Tax includes Rs. 14,000 paid for the proprietor .
4. Bad Debts recovered were earlier allowed as a deduction.
5. Cash expenses over Rs 35,000 for carriage of Rs. 40,000 and over Rs 10,000 in respect of other expenses Rs 60,000.

**SOLUTION**

<b>Computation of Total Income of X &amp; Y Co. Assessment Year 2022-23</b>		
<b>Particulars</b>	<b>Rs.</b>	<b>Rs.</b>
Profit as per Profit and Loss Account		56000
Add: Exp. disallowed -considered separately		
Salaries to the proprietor	40000	
General Expenses incurred for personal purpose by the partners	5000	
Cash expenses 40A(3)	100000	
Income Tax (Advance)	54000	
Interest on Capital	18000	
Insurance on Life of Proprietor	8500	225500
Business income		281500

**5.7 SELF-EXAMINATION QUESTIONS:**

- 1) Define and explain “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 Written down Value?
- 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 “while computing Profits and Gains of Business or Profession”, “Section 37(1) is the residuary section to claim deduction.

10) Explain expenses allowed on payment basis under section 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 1,30,000, was paid towards sales tax liability in the account for the year ending 31.3.2016
- 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)*
- f. Discuss the implication of the following transactions in the case of a doctor running a nursing home:
- g. Amounts received from the employees of the nursing home as contribution towards Provident Fund for the month of March 2022 paid to the PF - Rs 25,000 in December 2022

**h.** Cash paid for purchase of medicines –Rs 50,000

*(Ans. 25000 Income under section- 43 B (2) Rs 50,000 disallowed under section 40A(3))*

**i.** 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)*

14) From the P-L A-c of X for the year ending 31-03-2018, ascertain total income for the Assessment Year 2018-19 :

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		
Total	4,12,600	Total	4,12,600

**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)*

15) From the following data, calculate the depreciation admissible to an individual carrying on business, for Assessment Year 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 lakh)		5,00,000
Furniture & Fixtures	10	1,00,000
Motor Car	20	60,000
New computer	60	60,000

*(buildg. Rs. 50,000, P&M . 60,000, Comp. Rs.36000, Furni. Rs.10,000 & Car Rs.12,000)*

16) From the following, ascertain depreciation admissible and other liabilities, if any. In respect of the previous year relevant to the AY 2022-23

Profits and Gains of Business  
or Profession (Sections  
28 to 44)

Particulars	Plant & Mach	Building
Rate of Depreciation	25%	10%
WDV at the beginning of the year	Rs 2,50,000	Rs 5,00,000
Additions during the year	Rs 3,00,000	Nil
Sales during the year	Rs 10,00,000	Rs 2,00,000

(Ans. P&M Rs. Nil Rs. 2,00,000 Short term capital gain, Building Rs. 5,000)

17) X Ltd. owns two plants A & B on 1-4-2017 (depreciation-15% per cent) with opening depreciated value of the block Rs. 2,37,000. It purchases Plant C with depreciation -15% on 31-5-2017 for Rs. 20,000 and sells Plant A on 10-04-2017 for Rs. 10,000, Plant B on 12-12-2017 for Rs. 15,000 and Plant C on 1-03-2018 for Rs. 24,000. Determine the WDV of the block as on 31-03-2018 and also the depreciation

{Ans.  $237000 + 20000 - 49000 = 208000$  Short Term Capital Loss, block empty, Depn -NIL}

18) Compute depreciation for ASSESSMENT YEAR 2018-19 from the following:

Plant & Machinery A, B & C – WDV on 1-4-2017 Rs. 5,00,000 rate of dep. 15%. Plant D purchased on 12-06-2017 Rate of dep. 15% for Rs. 40,000. Plant A sold on 8-12-2017 for Rs. 1,60,000.

(Ans Value of Block  $500000 + 40000 - 160000 = 380000$  Dep. 57000)



## CAPITAL GAINS

### Sections 45, 48, 49, 50, 54

#### Unit Structure

- 6.1 Introduction and Objectives
- 6.2 Basis of charge
- 6.3 Types of capital assets
- 6.4 Types of capital gains
- 6.5 Period of holding
- 6.6 Computation of Capital Gains
- 6.7 Value of Consideration
- 6.8 Cost of Transfer
- 6.9 Cost of Acquisition
- 6.10 Fair Market Value
- 6.11 Transactions covered under section 49(1)
- 6.12 Cost of improvement
- 6.13 Indexed cost of acquisition /improvement
- 6.14 Transactions not regarded as transfer
- 6.15 Illustrations
- 6.16 Self-assessment questions

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#### **6.1 INTRODUCTION AND OBJECTIVES**

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Tax on capital gains is an exception to the rule that Income tax is tax on income. There are many who consider capital gains is being a tax on inflation in the value of capital asset due to erosion in the value of money is not correct. More so as investment in capital assets is made from the money saved from the earnings on which tax had already been paid.

This has given birth to a complex set of legal provisions addressing concerns of taxpayers dealing with novel concepts and terms such as capital asset, transfer, indexation, computation, short term capital asset, long term capital asset, cost of acquisition etc.

This lesson takes a detailed look into different aspects of tax treatment of capital gains contained in section 45-55 to the extent mandated by the syllabus.

Capital Gains Sections 45, 48,  
49, 50, 54

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## 6.2 BASIS OF CHARGE - SECTION 45

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### 2.1 Capital Gains defined

Section 45 is the charging section. It reads:

*“Any profits or gains arising from the transfer of a capital asset affected in the previous year shall be the income of the previous year in which the transfer took place”.*

Accordingly, section 45 mandates that following ingredients must coexist to attract capital gain tax.

- (i) Capital Asset
- (ii) Transfer
- (iii) Transfer effected during the previous year
- (iv) Gain or loss as result of transfer.

This legal position indicates:

- (i) Every asset may not be a capital asset as defined in section 2(14). Hence, transfer of any asset which is not a capital asset within the meaning of section 2(14), e.g. personal effects, will not attract capital tax.
- (ii) Every movement of a capital asset from one person to may not be transfer as defined in section 2(47). Hence, any change in ownership of any capital asset, which is not transfer within the meaning of section 2(47), e.g. devolution or transmission of an asset unto heirs by succession will also not attract capital tax.

### 2.2 Capital asset

As per section 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
  - (i) Jewellery;
  - (ii) archaeological collections;

- (iii) drawings;
- (iv) paintings;
- (v) sculptures; or
- (vi) 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;

In this connection two points are noteworthy:-

- (i) Jewellery is not personal effect even if it may be held for personal use but "capital asset", transfer of which will attract capital gain tax.
- (ii) Jewellery covers only ornaments. Silver or gold utensils and other such articles will be treated as personal effects.

c. **Agricultural land** in India, not being land situate in :

- a. areas not in the jurisdiction of any municipality, municipal corporation, notified area committee, town area committee, or any other committee called by whatever name, or cantonment board having population of 10000 or more and
- b. 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

- d. Special Bearer Bonds, 1991
- e. 6 -1/2 per cent Gold Bonds, 1977
- f. 7 per cent Gold Bonds, 1980
- g. National Defence Gold Bonds 1980
- h. Gold deposit Bonds under Gold Deposit Scheme 1999

Further, “property” includes any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.

Capital Gains Sections 45, 48,  
49, 50, 54

### **2.3 Transfer – Section 2(47)**

In an inclusive definition, section 2(47) states “Transfer in relation to capital assets includes the following:-

(1) sale, exchange or relinquishment of the asset;

Relinquishment of a right means transfer of a right in favour of another person e.g. sale of right to subscribe shares.

(2) extinguishment of rights on the capital asset;

Extinguishment of rights results in cessation or destruction or cancellation of rights in a capital asset like surrender of tenancy right for e.g. buyback of shares results in extinguishment of shares.

(3) compulsory acquisition under any law;

(4) 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, a fund or a public sector company notified by the central government in respect of which, no payment or benefit is received before maturity or redemption;

(6) any transfer involving the allowing the possession of an immovable property under section 53A of the Transfer of Property Act, 1872 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 directly or indirectly to its employees under the ESOP scheme of the company as per the guidelines issued by the Central Government.

Sections 47 and 47A state what transactions are not regarded as “transfer” e.g. transfer upon reorganisation of business entitles like amalgamation, demerger, gift, will etc.

## 2.4 Other receipts chargeable to capital tax

Section 45 includes following other receipts as capital gains:

### a) *Insurance money*

Money or other assets received during the previous year from an insurer on account of damage to or destruction of a capital asset, as a result of:

- i. Flood, typhoon, hurricane, cyclone, earthquake or other convulsions of nature or
- ii. Riot or civil disturbance or
- iii. Accidental fire or explosion or
- iv. Action by an enemy or action taken in combating an enemy.

### b) *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.

### c) *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.

### d) *Transfer of asset as capital to firm , AOP or BOI*

Transfer of a capital asset 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.

### e) *Transfer of asset on dissolution of firm , AOP or BOI*

Transfer of a capital asset 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 previous year in which the transfer takes place.

### f) *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 any court, tribunal or any authority subsequently reduces the initial compensation, 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.

**g) 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.

**h) 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.

**i) Buyback- Section 46A-115QA**

Section 46A has been deleted and section 115QA has been made applicable to all the companies. The section provides that consideration received by the shareholder from a company under a scheme to buyback its own shares under section 68 of the Companies Act, 2013 as reduced by the cost of acquisition/ indexed cost of acquisition will be taxed in the year of buyback.

**j) Joint Development Agreement(JDA)- Section 45(5A)**

The value of the capital asset being land or building or both transferred by an individual or a HUF under a registered specified agreement called Joint Development Agreement(JDA) to develop real estate for a consideration of a share being land and building or both, whether with or without or part payment of consideration in cash; shall be the stamp duty valuation on the date on which the competent authority issues a completion certificate for the entire property and capital gain will be chargeable accordingly on that date.

**k) Income on receipt of capital asset or stock in trade by specified person from specified entity- Section 9B.**

As per the newly inserted section 9B if there is any

1. transfer of any capital asset or stock in trade or both
2. by a specified entity being a firm, TOP, BOI but not a company or a co-operative society
3. to a specified person being any partner or member thereof
4. in connection with any **dissolution or reconstitution** of such entity then any profits or gains arising from such transfer of capital asset or stock-in-trade shall be taxable under the head “Capital Gain” or “Business or Profession” respectively of such specified entity of the

previous year in which such capital asset or stock in trade or both were received by the specified person.

### Other points

1. Fair market value of the capital asset or stock in trade or both on the date of its receipt by the specified person shall be deemed to be the full value of the consideration received or accruing as a result of such deemed transfer of the capital asset or stock in trade or both by the specified entity.
2. Reconstitution of the specified entity means,
  - (a) Retirement of one or more partners or members, of such entity; or
  - (b) Admission of one or more new partners or members, in such specified entity along with one or more partners or members, continuing as partner or partners or member or members after the change;
  - (c) Change in share of some or all of the old partners or members continuing.
3. Although, capital gain arises to a partner or member on extinguishment or relinquishment of his right in the specified entity in connection with reconstitution or dissolution of the specified entity, it is deemed as income of the specified entity under section 45(4). The specified entity would be assessed under section 9B r.w.s. 48 for its own income and under section 45(4) for income arising to partner thereof.
4. Capital Gain under section 45(4) shall be calculated with the following formula:
 

Value of any money received by the partner or member from the specified entity on the date of such receipt

Add FMV of the capital asset received by the partner or member from the specified entity on the date of such receipt

Less the amount of balance in the capital account of the partner or member in the books of account of the specified entity at the time of its reconstitution without considering increase in the capital account of the partner or member due to revaluation of any asset or due to self-generated goodwill or any other self-generated asset

  - If the Value comes to negative, then capital gain will be deemed to be zero.
  - “self-generated goodwill” and “self-generated asset” mean goodwill or asset, as the case may be, which has been acquired without incurring any cost for purchase or which has been generated during the course of the business or profession

5. In computing Capital Gain under section 48, capital gain in the hands of the special entity, the gain above shall be deductible from the full value of consideration along with cost of acquisition, cost of improvement and expenditure incurred exclusively in connection with transfer, to avoid double taxation of the same.
6. Section 9B deals with incidence of tax arising at the time of dissolution or reconstitution. Section 45(4) deals with the taxability at the time of reconstitution only. Thus, section 45(4) does not apply at the time of dissolution.

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## 6.3 TYPES OF CAPITAL ASSETS

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Depending upon the period for which the asset is held by the assessee before its transfer, capital assets may be of two types:

I Short Term Capital Asset(STCA) or

II Long Term Capital Asset (LTCA)

**a) Short Term Capital Asset (STCA)- Section 2(29A)**

(i) Generally, short-term capital asset means a capital asset held by an assessee for less than 36 months before it is transferred.

(ii) The period of 36 months is reduced to 12 months for the following assets:-

- (a) Equity or preference shares quoted,
- (b) Securities like debentures, government securities and notified derivatives, which are listed in recognised stock exchange under section 10-23(D),
- (c) Units of UTI
- (d) Units of equity oriented mutual funds
- (e) Zero coupon bonds.

(iii) the period of holding is reduced to 24 months for the following assets

- (a) unlisted Shares,
- (b) immovable property ( land, building or both)

**b) Long Term Capital Assets (LTCA)- Section 2(29A)**

A long term capital means a capital asset, which is not a short-term capital asset. In other words, a capital asset will be a long term asset if it is held for more than 12, 24 or 36 months before it is transferred.

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## 6.4 TYPES OF CAPITAL GAINS

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Capital gains arising on the transfer of a capital asset will be short term capital gain or long term capital gain depending upon the type of the asset which is transferred that is:-

### (i) **Short Term Capital Gain (STCG)**- Section 2(29B)

Any gain arising on transfer of short term capital asset (asset held by an assessee for less than 36/ 24/12 months) will be short term capital gain and any loss arising on the transfer of short term asset will be short term capital loss.

In case of slump sale under section 50, gain arising on sale of long term business, assets in a block and surplus left in a block on transfer of all depreciable assets in the block would be treated as a short term capital gain (loss).

### **Long Term Capital Asset (LTCG)** – Section 2(42B)

Long-term capital gain is the gain arising on transfer of a long-term asset or an asset held by an assessee for 36/12/24 months or more. Conversely, any loss arising on transfer of long-term asset will be long-term capital loss.

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## 6.5 PERIOD OF HOLDING- SECTION 2(42A)

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The principal criterion to determine whether any asset is long-term asset or short term asset is the period of holding of an asset by the assessee before its transfer.

Type of the asset in turn determines whether capital gain arising on transfer of such asset is long-term capital gain/loss or short term capital gain/loss.

The period of holding is determined on the basis of the following principles:-

1. In case of shares held in company in liquidation, the period subsequent to the date of liquidation will not be included. Period of holding will stop running on date of liquidation.

### **Illustration**

A buys some shares in a company on 01-01-2019. The Company goes into liquidation on 01-06-2019. The liquidator settles the claim on 01-03-2022.

The period of holding of the shares will be five months from 01-01-2019 to 01-06-2019. The period after 01-06-2019 will not be included in the holding.

2. In case of a capital asset, which becomes the property of the assessee in circumstances mentioned in section 49(1) such as death, gift etc., the period for which the previous owner held such capital asset will also be included in the period of holding.

### Illustration

A dies on 01-01-2022 leaving to his wife Mrs A, his flat bought on 01-01-2016.

Mrs. A sells the flat on 20-03-2022. The period of holding will include the holding by A from 01-01-2016 to 01-01-2022.

Since the flat is held for more than two years it will be a long term asset giving rise to LTCG/ (LTCL).

3. In case of shares of an amalgamated company allotted to a shareholder against the shares in an Indian company, which was amalgamated, the period for which the assessee held the shares in the amalgamated company will also be included.

### Illustration

R buys 1000 shares of S Ltd on 12-11-2016. On 31-12-2021 S Ltd amalgamates with H Ltd and original 1000 shares in S Ltd were converted into 300 shares of H Ltd. R sells these 300 shares of H Ltd. on 01-01-2022.

The period of holding of 300 shares of H Ltd will include the holding during the period 12-11-2016 to 31-12-2021. The shares will LTCA and the capital gain arising on sale of these shares will be LTCG.

4. In case of right issue of securities, the period of holding shall start from the date of allotment on rights issue of shares or other securities subscribed by the assessee or other person in whose favour such right has been renounced.

5. In case of *renunciation of rights*, 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.

6. 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.

7. In case of shares in a resulting company received under a scheme of demerger of a company, the period for which the *shares in the demerged company* were held by the assessee will also be included.

8. In case of shares of trading or clearing rights of a recognised stock exchange acquired by a person under its demutualisation or corporatisation, the period for which, such person was a member will also be included.

9. In case of equity shares allotted under demutualisation or corporatisation of a recognised stock exchange in India, the period for which such person was a member will also be included.

10. Period of holding of other capital assets will be decided according to the rules framed by the CBDT in that regard. As per the CBDT clarification, date of transfer/ acquisition of shares will be considered on the basis of the brokers' note / date of contract or date of allotment and FIFO (First in First Out Basis) in the case of Demat Accounts.

11. In case of security or sweat equity, allotted or transferred by the employer free of cost or at concessional rate to the employees including former employees, popularly called as ESOP, the period shall be reckoned from the *date of their allotment or transfer*.

12. The period of holding of units acquired in the consolidated scheme of mutual fund shall include the period for which the units in consolidating schemes were held by the assessee.

13. The period of holding of a capital asset, being share or shares of a company, acquired by a non-resident assessee on redemption of GDRs would be reckoned from the date on which a request for such redemption was made.

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## **6.6 COMPUTATION OF CAPITAL GAINS- SECTION 48**

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### **6.1. General Rule**

As per section 48, 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:

### **6.2. Long Term Capital Gains**

Where the capital gain is to be computed in respect of a long term asset, instead of "cost of acquisition" and "cost of improvement", "indexed cost of acquisition" and "indexed cost of improvement" will be deducted subject to following exceptions, when benefit of indexation of cost will not be available, viz.-

**a.** Capital gain on transfer of shares or debentures of Indian company by a non-resident will be computed by converting the cost of acquisition, full value of consideration and expenses incurred for transfer into originally utilised foreign currency and reconvertng capital gain into Indian currency.

**b.** Capital gain on transfer of bonds and debentures although they may qualify as 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, and

**c.** Capital gain in case of slump sale under section 50B

As per Section 2(42C) “Slump Sale” means the transfer of one or more undertakings by any means as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.

This implies that:

STCG =(Sales Consideration-Expenses on Transfer) - (cost of acquisition+ Cost of Improvement)

LTCG = Sales Consideration - Expenses on Transfer) -(Indexed cost of acquisition + Indexed Cost of Improvement)

The Finance Act, 2021 has amended Section 50B(2) to provide that the fair market value (FMV) of the capital assets (being an undertaking or division transferred by way of slump sale) as on the date of transfer shall be calculated in the prescribed manner. Such FMV shall be deemed to be full value of the consideration received or accruing as a result of transfer of such capital asset. Further, the value of capital asset being goodwill, which has not been acquired by the assessee by purchase from previous owner, shall be taken as Nil while computing net worth.

### 6.3. Depreciable Capital Assets– Section 50

Tax treatment on sale or transfer of capital asset in respect of which depreciation had been allowed, will be as under:-

- (a) Written down value(WDV) of the block at the beginning of the year increased by the cost of acquisition of any new asset falling in the same block purchased during the year and incidental expenses on transfer the asset purchased, will be the WDV of the block.
  - i. There will be no capital gain if sales proceeds of asset sold are equal to the WDV of the block as increased by the new purchase and the incidental expense on transfer.
  - ii. 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.
  - iii. If sales consideration is less than 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 loss.
- (b) If block ceases to exist, i.e., all assets in a block are sold, the WDV in the block will be short-term capital loss.

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 will be short term capital gain or short term capital loss. If block cease to exist, no further deduction will be available, nor will any further deduction be allowed.

if goodwill of a business or profession is forming part of the block of the asset as on A.Y. 2020-21 and depreciation has been claimed on it, capital gain will be determined as prescribed by the CBDT

### **Illustration:**

From the following particulars in respect of a block of assets ascertain the capital gains or loss:

- a. Opening WDV Rs 80,000
- b. Cost of new asset purchased Rs 20,000
- c. Rate of depreciation 15%

Compute the depreciation or capital gain if-

1. No asset was sold during the year , or
2. Value of the consideration for asset sold was
  - (a) No asset sold
  - (b) Rs 70,000
  - (c) Rs. 1,00,000
  - (d) Rs. 1,20,000
  - (e) All assets in the block sold for Rs 40,000

**Solution:**Capital Gains Sections 45, 48,  
49, 50, 54

Particulars	a	b	c	d	d
	Rupees				
Opg. WDV	80,000	80,000	80,000	80,000	80,000
Add-New Purchase	20,000	20,000	20,000	20,000	20,000
Total	1,00,000	1,00,000	1,00,000	1,00,000	1,00,000
Sales	0	70,000	1,00,000	1,20,000	40,000
WDV /Gain	1,00,000	30,000	0	(20,000)	60,000
Depreciation	15,000	4,500	0	0	0
STCG	-	-	-	20,000	-
STCL	-	NA	-	NA-	60,000
Clos. WDV	85,000	25,500	0	0	0

*Notes: No depreciation in case b as WDV in block comes to zero and in case e, all the assets are sold, hence the block ceases to exist. Residual WDV of Rs. 60,000 will be short term capital loss.*

**6.4 Depreciable assets of power undertaking- Section 50A**

In respect of a depreciable assets of an undertaking engaged in generation or distribution of power or energy, short-term gain/loss will be computed with reference to the cost of acquisition as adjusted under section 43(6).

In case of a composite agreement for sale of a factory building along with the land, depreciable asset will be building not the land because land is not a depreciable asset.

*Land will be considered as general capital asset giving rise to long term or short term capital gain depending upon the period for which it is held.*

**6.7 VALUE OF CONSIDERATION- SECTION 48**

“Full total value of consideration” means the value received or accruing because of the transfer.

It indicates the whole of the price in terms of money or money’s worth or both bargained for between the parties *inter se*, which accrues or arises upon transfer of a capital asset.

*The capital gains will be chargeable on accrual basis and not on cash basis* actual receipt of the value is irrelevant.

Further, “full value of consideration” does not refer to the market value of the asset transferred or the adequacy of the price except in some specific cases, where fair market value accruing or arising on transfer of a capital asset is required to be ascertained for instance under sections 50C, 50CA etc. Some specific cases are considered below.

(i) There will no capital gain in case of transfer of a property without consideration or out of natural love and affection. However, the transaction will be subject to the provisions of section 56.

(ii) Full value of the consideration will be the fair market value of any shares, debentures, or warrants on the date of transfer in case of transfer by a company of the same as a gift or under an irrevocable trust allotted directly or indirectly to its employees under employees' stock option/scheme (ESOP/ESOS ) as per the guidelines issued by the Central Government,

(iii) 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.

### Illustration

A exchanges his flat for B's car. In this case "Full total value of consideration of A's flat will be the fair market value of the car transferred by B and vice versa.

(iv) 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.

Section 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

Capital Gains Sections 45, 48,  
49, 50, 54

On 01-04-2001 Ashok bought personal gold ornaments for Rs 2 lakh. On 01-01-2010, he converted ornaments into stock of his new jewellery showroom. Fair market value of the ornaments was Rs. 5 lakh on that day. On 31-03-2022, he sold the ornaments for Rs. 12 lakh. Determine the tax incidence.

### Solution

On conversion of personal ornaments in to business stock on 01-01-2010 transfer takes place. The Capital gain will be:

Full values of consideration [FMV 01-01-2010] Date of conversion into stock	5,00,000
Less-Indexed Cost of Acquisition( revised) [2,00,000 X 148/100]	2,96,000
Long Term Capital Gain arising on 01-01-2010 Taxable in A.Y. 2022-23 when ornaments actually sold along with business profit Rs 7 lakh (12-5 lakh)	2,04,000

## 6.8 COST OF TRANSFER – SECTION 48 (1)

While computing the capital gain, expenditure incurred wholly and exclusively in connection with the transfer of asset will be deducted from the total value of consideration subject to the following conditions:

(i) The expenses should be incurred wholly and exclusively in connection with the transfer.

Lawyers' fee for transfer, brokerage, travelling expenses for transfer, advertisement, stamp duty and registration fee, if paid by the seller etc. will be allowable but normal administrative expenses like salary of staff for upkeep or maintenance of property will not be allowable .

(ii) The expenses must not be claimed as deduction as expenditure under any other head.

(iii) No expenses will be allowed in respect of share transactions covered under the securities transaction tax.

## 6.9 COST OF ACQUISITION – [SECTIONS 48 - 46 & 49]

Cost of acquisition is the sum total of amounts spent for acquiring a capital asset including the following-

(i) price paid by the assessee for purchase of property ; or

(ii) fair value on the date of exchange , of the asset transferred in exchange, where the asset is acquired in exchange for another asset ; and

(iii) expenses incurred on transfer, registration, stamp duty etc.

The relevant provisions are given as under:-

**A. (1)** Where asset becomes the property of the assessee by a mode referred to in section 49(1) before 1-4-2001

- i. Cost of acquisition is the actual cost to the previous owner or the fair market value as on 1-4-2001 at the option of the assessee.
- ii. Where 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 under section 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. (2)** Where asset becomes the property of the assessee by a mode referred to in section 49(1) on or after 1-4-2001

- i. Cost of acquisition is the actual cost to the previous owner.
- ii. Where the 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 under section 49(1).

**B. (1)** Where asset becomes the property of assessee by a mode other than referred to in section 49(1) before 1-4-2001:

Cost of acquisition is the actual cost to the assessee or the fair market value as on 1-04-2001 at the option of the assessee.

**B. (2)** Where asset becomes property of assessee by a mode other than referred to in section 49(1) on and after 1-4- 2001, cost of acquisition is the amount actually spent by the assessee in acquiring the actual asset i.e. the actual cost of acquisition.

**C.** Where any asset being cash, movable property, or shares of closely held company's immovable property becomes the property of the assessee

subject to tax under section 56 as such asset is received without consideration or for consideration less than the fair market value, the cost of acquisition of such asset will be same as the cost adopted under 56. The section is discussed in detail in the next chapter. The provision is apparently enacted to avoid double taxation of the same property.

#### **D. Specific Cases:**

##### **i. Earnest money forfeited – Section 51;**

Any earnest money received in advance and forfeited by the assessee, due to failure in negotiation will be taxable as “income from other sources”.

##### **Illustration-11**

On 01-07-2020 A receives advance of Rs 5 lakh from a prospective buyer for sale of his flat purchased on 01-06-2010 for Rs. 28 lakhs. Later, negotiations failed and A forfeited the advance money. *Earnest money of Rs 5 lakh will be taxable, in A.Y. 2021-22 as income from other sources.*

##### **ii. Self-generated assets**

Self-generating assets such as goodwill, patents, copyrights, tenancy rights, which have no actual cost of acquisition incurred, were judicially held to be not liable to capital gain tax as the cost of acquisition was nil. The position has been partially changed and the amended section *provides 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.” As a result, effectively, entire sale proceeds less expenses on transfer of self-generated assets will be treated as capital gain.

##### **iii. Financial assets – shares and other securities**

Where an assessee becomes entitled to subscribe to any additional securities, known as “Rights” or where additional shares are issued as bonus 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 for a price, then 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. 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 01-04-2001, then the share market value of bonus shares as on 01-04-2001 will be treated as the cost of acquisition.

- f. Fair Market Value on the date of distribution of capital assets by a Company under section 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 under section 49 (2C).
- i. Cost of acquisition of original membership of a recognised stock exchange when equity share/s allotted to such shareholders under any scheme of demutualization or corporatisation of the exchange - section. 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– Section 49 (2C).
- l. Stock option Specified security is taxable as a perquisite under section 17(2) – Section 49 (2AA)
- m. Actual cost of acquisition in all the other cases.
- n. Vide Section 55 , cost of acquisition of purchased goodwill of a business or profession is to be calculated after reducing depreciation amount which was allowed for Assessment Years prior to A.Y. 2021-22. Cost of acquisition of goodwill of a business or profession other than purchased shall be taken to be Nil.

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## 6.10 FAIR MARKET VALUE (FMV)

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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 01-04-2001, he has the option of substituting the fair share market value of the asset as on 01-04-2001 instead of actual cost of acquisition.

Fair market value is adopted, 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

Capital Gains Sections 45, 48,  
49, 50, 54

When an assessee converts a personal capital asset into stock-in-trade of his business, such conversion will give rise to notional capital gains or loss on the date of such conversion, but it will be chargeable to tax, when such capital asset (stock after the conversion) is actually sold.

For this purpose, the fair market value of the capital asset on the date of conversion will be treated as notional sale consideration from which the cost of acquisition / indexed cost of acquisition will be deducted to get the capital gain.

When the converted capital asset is sold as stock, then the difference between the actual sale proceeds and notional fair market value taken on the date of conversion will be taxable as business profit or loss.

### Illustration

Ramesh converts his ancestral jewellery into the stock in-trade of his business on 31-10-2011. The jewellery was sold on 28-02-2022 for Rs. 50 Lakh. FMV of the jewellery was Rs. 10 lakh on 01-04-2001 and Rs. 30 Lakh on 31-10-2011.

### Solution:

Deemed consideration on conversion into stock FMV on 31-10-2011	Rs 30.00 lakh
Less - indexed cost of acquisition Cost on 01-04-2011: Rs.10 lakh X 184-100	Rs.18.40 lakh
Capital gain on 31-10- 2011 taxable on 28-02-2022 (when sold)	Rs 11.60 lakh
Business profit on 28-02-2022(Rs 50-30) lakh	Rs 20.00 lakh

### 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 in respect 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 upon the dissolution of a firm, a partner is allocated a capital asset, 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**

In case of compulsory acquisition of any capital asset by the government or any authority under any law, taxable capital gain or loss will arise in the year in which such asset is compulsorily acquired but will be chargeable only in the year, in which the compensation is received.

If the compensation is subsequently enhanced, the additional amount will be chargeable as 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 under section 155.

#### **d) Amount received on liquidation of the company:**

Any amount received by the shareholder on liquidation of a company, is taxable as deemed dividend under section 2(22) to the extent of reserves. The Balance amount as reduced by the indexed cost of acquisition or cost of acquisition will be taxable as capital gains arising on sale of the shares.

#### **e) Sale of Shares under depository system**

Cost of acquisition shares sold from a depository account, will be determined on first in first out (FIFO) basis on the assumption that the shares deposited in the account first were sold first. Accordingly the cost of acquisition, date of acquisition and the period of holding will be calculated.

#### **f) Stock Lending**

Any share given under any stock-lending scheme approved by SEBI will not give rise to any taxable capital gain.

#### **g) Corporatisation of Stock Exchanges**

In case any person transfers equity shares allotted to him as member of a recognised stock exchange in India under any 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.

#### **h) Demerger:**

While computing capital gains arising on cost of acquisition of the original shares in the demerged company shall be reduced by the amount calculated in respect of the shares in the resulting company determined as under :-

Cost of shares of demerged company x Net book value of assets

Capital Gains Sections 45, 48,  
49, 50, 54

Net worth of demerged company before demerger

### **i) Taxation of capital gains of listed shares**

Under sections 111A/112, short term capital gain in respect of shares subject to securities transactions tax (STT), is at the option of the assessee subject to 15%+4% cess without benefit of indexation or alternatively pay regular tax under the normal provisions including indexation. Long term capital gain on sale of shares over Rs 1 lakh is taxable @ 10% plus 4% cess. There is a cap of 15% on surcharge.

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## **6.12 SPECIFIC TRANSACTIONS-SECTION 49(1)**

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As per section 49(1), where a capital asset became the property of the assessee in certain circumstances the cost of acquisition of such asset shall be deemed to be

- the cost for which the previous owner of the property acquired it as be increased by
- the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be.

The circumstance/modes referred to in section 49, where a capital asset became property of the assessee are as under:-

- (i) any distribution of assets on total or partial partition of a Hindu undivided family;
- (ii) under a gift or will;
- (iii) by succession, inheritance or devolution;
- (iv) distribution of assets on the dissolution of a firm, body of individuals, or other association of persons, where such dissolution had taken place at any time before 01-04-1987;
- (v) distribution of assets on the liquidation of a company;
- (vi) under a transfer to a revocable or an irrevocable trust;
- (vii) under any such transfer as is referred to in clause (iv)/ (v)/ (vi)/ (via) / (viiab)/(viiab)/ (vii) /(viiab)/ (viiab)/ (viiab)/ (viiab)/ (viiab) or clause (xiv) of section 47;
- (viii) Conversion of personal asset of the assessee as the joint property of the HUF referred to in section 64(2);
- (ix) 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 / ESOS);

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.

- (x) by succession, inheritance or devolution;
- (xi) distribution of assets on liquidation of company;
- (xii) under a revocable or irrevocable trust;
- (xiii) 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;
- (xiv) any transfer in scheme of amalgamation by the amalgamated company from the amalgamating company;
- (xv) by Hindu undivided family where one of the members has converted its self acquired property into a joint family property;
- (xvi) Transfer of units by unit holders on consolidation of plans within a mutual fund scheme; or
- (xvii) Redemption by an individual of sovereign gold bonds issued by RBI.

### Illustration

Ram receives a flat as his share on partition of his HUF. The HUF had purchased the flat on 01-04-2001 for Rs 10 lakh. On 1 November 2021 Ram sells the flat for Rs. 35 lakh.

- (i) There will be no liability for capital gain on 01-04-2001 as partition of HUF is exempted under section 49.
- (ii) When the flat is sold on 1-11-2021 (A.Y. 2022-23), its cost and date of acquisition will same as that of the previous owner (HUF) i.e. Rs. 10 lakh and 01-04-2001 respectively. The capital gain will be as under:

Sales consideration	35,00,000
Indexed cost of Acquisition $10,00,000 \times 317/100$	<u>31,70,000</u>
LTCG	<u>3,30,000</u>

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## 6.13 COST OF IMPROVEMENT-SECTION 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 *the assessee* or the previous *owner* in case of an asset acquired by an assessee in any of the circumstances under section 49(1):-

- (a) for substantially improving or raising the value of the capital asset or
- (b) in making addition or alteration to capital asset after date of acquisition or
- (c) for any expenditure incurred to protect or complete the title of the capital asset or
- (d) to cure the title of the property or remove any defect from the title.

Following additional points may be noted:

- (1) Where a capital asset is acquired prior to 1-4-2001 and its fair market value (FMV) as of 1-4-2001 is substituted in place of the original cost of acquisition, cost of improvement incurred by the assessee or the previous owner *prior to 01-04-2001 will be ignored*. The cost of improvement made upto 1-4-2021 is impliedly included in the FMV on 1-4-2021.

However, capital expenditure incurred by the assessee or the previous owner *after 01-04-2001* in making any additions or alterations to capital asset will be included in cost of improvement.

- (2) 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.
- (3) 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.
- (4) Expenditure deductible from the income from house property will not be included in cost of improvement.

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## 6.14 INDEXED COST OF ACQUISITION / IMPROVEMENT

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Explanation iii to section 48(iii) defines indexed cost of acquisition, indexed cost of improvement and cost inflation index as under:-

- (a) **"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, 2001, whichever is later. In other words –

**Indexed cost of acquisition =**

Cost of Acquisition X CII in the year of Transfer

CII in the year of acquisition\* (or 01-04-2001)

(b) **"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; i.e.

**Indexed Cost of Improvement**

Cost of Improvement X CII ( the year of Transfer)

CII in the year of Improvement

(c) **"Cost Inflation Index" (CII) 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.

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
<b>2021-22</b>			<b>317</b>

**Exceptions:**

Indexation benefit is not available in respect of the following:

1. Short term capital assets;
2. Bonds/ debentures(except 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 by an Offshore Fund under section 115AB;
6. GDRs purchased in foreign currency by Non-Residents under section 115AC;
7. Securities purchased by non-residents under section 115AD,

8. Where option of 15% tax rate is claimed in respect of capital gain on shares under section 112;
9. Slump Sale under section 50B; and
10. Foreign exchange assets purchased by Non- Resident Indians under section 115-O.

Capital Gains Sections 45, 48,  
49, 50, 54

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## 6.14 EXEMPTION – SECTION 54

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Under sections 54, 54B, 54D, 54EC, 54F, 54G and 54H to capital gains arising from the transfer of certain capital assets are exempt in certain circumstances. Only section 54 is covered in the syllabus. Salient feature of the section are given below:

### Profit on sale of property used for residence -Section 54

#### A. Eligible assessee -

Exemption is available only to Individuals and HUFs. Other assesseees are not eligible to claim exemption under this section.

#### B. Eligible capital gain :

Exemption is available only respect of capital gain arising on transfer of a **long term residential house used for self-occupation or let out**, the income of which is chargeable under the head 'Income from house property'.

Short term capital gains are not eligible for exemption under this section

#### C. Extent of exemption

I. The exemption will be to the extent amount invested by the assessee or in case of his death, his legal heir who has

- a. purchased in India one residential house
  - i. within one year before such transfer or
  - ii. two years after such transfer or
- b. constructed in India one **residential house** within *three years after such transfer*

II. Where the amount of the capital gain does not exceed two crore rupees, the assessee may, at his option, purchase or construct **two residential houses** in India, and where such option has been exercised, for the words "one residential house in India", the words "two residential houses in India" shall be substituted and any reference to to "new asset" shall be construed as a reference to the two residential houses in India:

III. However, once during any assessment year, the assessee has exercised the option ( to buy / construct two houses instead of one house),

he shall not be subsequently entitled to exercise the option for the same or any other assessment year.

#### D. Other points

- (i) Old house (which is sold) must be a residential house In India or outside India, chargeable under the head income from house property for self-residence or for letting out.
- (ii) New house, purchased or constructed also must be a residential house situated India.
- (iii) New house, purchased or constructed outside India will not be eligible for exemption.
- (iv) Purchase of new house may be before or after but construction can be only after the sale of old house.

#### Illustration

On 01-01-2010 Ashok purchased a residential house for self-occupation for Rs 5 lakh and spent Rs 1 lakh on its registration and improvement.

He sold the house on 01-01-2022 for Rs 19 lakhs and purchased a new residential house on 01-03-2022 for Rs 6 lakh. The exemption under section 54 will be as under:-

Particulars	Rs
Sales consideration	19,00,000
Indexed cost of acquisition + improvement Rs. ( 5,00,000+1,00,000) *317/148 Index for F.Y. 2009-10 & 2022-23	12,85,135
LTCG	6,14,865
Exemption under section 54	6,00,000
Taxable capital gain	14,865

#### (v) Restriction of transfer of new house

If the new house is transferred within a period of three years from the date of its purchase or construction, the amount exempt under section 54 will be reduced from cost of the new house and the capital gain will be accordingly computed.

#### (vi) Deposit Account

Unutilized amount of the capital gain for purchase or construction of a new house is required to be deposited in a specified deposit account with a bank before the date for furnishing the return of income and the proof of such deposit is required to be filed with the return of income. Amount so deposited will be treated as amount utilized towards acquisition of new house.

The amount in deposit account can be utilized for purchase or construction of house within the specified period.

Capital Gains Sections 45, 48,  
49, 50, 54

The unutilised amount is treated as capital gain of the relevant previous year in which the period of three years from the date of transfer of the old house expires

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## 6.15 ILLUSTRATIONS

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1. State whether the following are the capital Asset or not:

- (a) Bicycle
- (b) Horse
- (c) Car
- (d) House for self residence
- (e) Jewellery
- (f) House let out
- (g) Silver ornaments
- (h) Air Conditioner used as stock in trade
- (i) Air Conditioner not used as stock in trade
- (j) Rural Agricultural Land
- (k) Urban Agricultural Land

### **Solution:**

Items (d) House for self-residence, (e) Jewellery, (f) House let out, (g) Silver ornaments and (k) urban agricultural land are capital assets.

Items (a) Bicycle, (b) horse, (c), personal car, (i) personal air conditioner are personal effects, hence not capital assets.

Items (h) Air-conditioner used as stock in trade and (j)-Rural agricultural land are excluded from the definition of capital asset.

2. 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 assets.
- 4) Money being consideration of shop, it is transfer.
- 5) Not transfer as asset only hired

3. An asset was acquired on 31 May 2001 for Rs 20,000, it was substantially improved on 30 June 2004 for Rs 5,000 and sold on 10 December, 2021 for Rs 85,000. Compute the capital gains.

**Solution:**

Particulars		Rs
Sales consideration		85,000
Indexed cost of acquisition (20,000* 317/100)	63,400	
Indexed cost of improvement 5,000 X 317/113).	<u>14,027</u>	<u>77,427</u>
Long Term Capital Gain		7,573

4. Assume that the asset was acquired before 01-04-2001 & and improvement were carried before 01-04-2001 and there is no change in fair market value on 01-04-2001.

**Solution:**

Sales consideration		85,000
Indexed cost of acquisition (20,000 X 317/100) on 01-04-2001*	63,400	
Cost of improvement Ignored (Pre- 01/04/2001 - *Optional	<u>0</u>	63,400
Long Term Capital Profit		21,600

5. 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, 2002 for Rs 9,00,000. Compute the capital gain

**Solution:**Capital Gains Sections 45, 48,  
49, 50, 54**Rs.**

Sales Consideration.	30,00,000
Less- Indexed cost of acquisition 9,00,000X 317 /105	27,17,143
Long Term Capital Gain	<u>2,82,857</u>

6. A sells a flat on 13 April,2021 for Rs 8,00,000. He had acquired the flat on 15 August 2004 for Rs 1,50,000 and had incurred capital cost of major repairs of Rs 50,000 in 2007-08.

**Solution**

Sales Consideration		<b>Rs.</b> 8,00,000
Indexed cost of acquisition 1,50,000*317 /113)	4,20,796	
Indexed cost of improvement 50,000* 317/ 129)	1,22,868	5,43,664
Long Term Capital Gain		2,56,336

7. X purchased a house property for Rs. 6,00,000 31-02-2016 and constructed an additional floor in March 2016 for 1,10,000. The house property was sold for Rs 9,10,000 31-03-2022. 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 purchased in March, 2021

**Solution:**

Sales consideration		9,10,000
Less: Expenses For Transfer		10,0000
Net Sales Consideration		9,00,000
Indexed cost of acquisition 6 lakh * 317/254	7,48,819	
Indexed cost of improvement 1,10,000 x 272/254	1,37,283	8,86,102
Long Term Capital Gain		<b>13,888</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 purchased in March, 2021, it is held for 12 months, which is less than 24 months. It will be short term capital asset not entitled

to indexation. Resultant capital gain of Rs 1,90,000 will be Short Term Capital gain [Rs. 900000- (6,00,000+ 1,10,000 )

8. On 1-7-2022 sold gold jewellery for Rs. 2,50,000. It was purchased on 1-7-1970 for Rs 9000. Market Value of the jewellery as on 1st April 2001 was Rs. 70,000. Compute taxable amount of capital gain, if the expense on transfer is 5% on sales price.

**Solution:**

Sales Consideration		<b>Rs. 2,50,000</b>
Less: Indexed Cost of Acquisition cost as on 01-04-2001 = $70,000 \times \frac{317}{100}$	2,21,900	
Expenditure on transfer (0.5% x 2,00,000)	1,000	2,22,900
Long Term Capital Gains		27,400

9. On 01-03-2020, X invested Rs. 4,00,000 in ornaments and Rs. 80,000 in unquoted equity shares. On 01-08-2021 X sold the jewellery for Rs. 5,00,000 and shares for Rs. 1,60,000. He paid @1/2% brokerage of consideration on all the transactions. Calculate the taxable amount of capital gain.

**Solution**

**A- Capital Gain on sale of Ornaments**

Particulars	Rs.	Rs.
Sales Consideration		5,00,000
Less: Cost of Acquisition	4,00,000	
Brokerages on purchases (0.5% x 100,000)	2,000	
Brokerages on sales (0.5% x 5,00,000)	2,500	4,04,500
Short Term Capital Gain as ornaments held for 30 months (01-03-2020 to 01-08-2021) less than 36 months, hence STCG, no indexation.		<u>95,500</u>

**B- Capital Gain on sale of Shares**

Particulars	Rs.	Rs.
Sales Consideration on Sale of Shares		1,60,000
Less: Indexed Cost of Acquisition	80,000	
Brokerages on purchases (0.5% x 50,000)	400	
	80,400	
$80,400 \times \frac{317}{240}$	1,06,195	
Brokerages on Sales (0.5% x 1,60,000)	800	1,06,995
Long Term Capital Gain (No STT paid, hence exemption not available)		<u>53,005</u>

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## 6.16 SELF ASSESSMENT QUESTIONS:

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Capital Gains Sections 45, 48,  
49, 50, 54

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. Explain capital gains on compulsory acquisition of a capital asset.
4. What is "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. Explain the provisions regarding:
  - i. Conversion of capital assets to stock-in-trade.
  - ii. 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
  - e. 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 house transferred by way of will to son.
  - Bonus shares given by a company to its shareholders.
  - Giving away jewellery for a piece of land.
  - Getting money in lieu of shop in a shopping complex.
  - Giving the rights to use the asset.

[Ans: only c and d are transfers]

10. Ajay converted personal investment in unquoted shares into stock in June, 2015. He had purchased the shares in F.Y. 2011-12 for Rs. 2,00,000. The market value of the shares, in June 2017 Rs. 8,00,000. He sold the shares Rs. 9,20,000 on 30-10-2021. Compute taxable capital gains.

(Ans: Rs 1.20 lakh business profit and LTCG ( 8 lakh -2 lakh \*254- 182 = Rs 5,20,879 in 2015-16, taxable in A.Y. 2022-23)

11. Aditya sold his only residential house for Rs 18 lakh on 31-12-2021. He had purchased it on 28-02-2005 for Rs 2 lakh. Determine the capital gains.

(Ans: LTCG Rs15,02,347 = [18,00,000- 2,97,653 Rs. 2,00,000X 317/113])

12. Siddharth converts his plot of land purchased in July 2006 for Rs 60,000 into stock-in-trade on 31<sup>st</sup> March 2014. The fair market value on 31.3.2014 is Rs 1,60,000. The stock-in-trade was sold for Rs 2,00,000 in the month of January 2022. Find out the taxable income, if any, and if so under which “head” of income and for which “assessment year”.

(Ans: LTCG 1,60,000-60,000 X 220-122 = Rs. 91,803 in AY 2014-15 Business Income Rs. 40,000 taxable in AY 2018-19)

13. X acquired a plot of land on 30.6.2006 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 30.6.2021 for Rs. 12,50,000. 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?

(Ans: LTCG 12,50,000- 6,49,590 - 2,50,000X 317-122= Rs.6,00,410, No)

14. Raju buys 250 equity shares of A Ltd on 01-04-2011 @ Rs. 270 per share and incurs Rs. 500 on brokerage and transfer. On 01-07-2012, he gets 200 bonus shares. On 01-09-2014 he gets 300 right shares @ Rs 140 per share. On 28-02- 2017 he sells all the 750 shares@ Rs 1000 per share and incurs expenditure of Rs. 1,500 on brokerage. Compute his taxable capital gain.(STT not paid)

(Ans: Sales [750X 1000]- 1500 = Rs 7,48,500- Purchase [[250X270+500] X 317/184]= Rs 1,17,152 +0 Bonus+ Right [300X140]X 317/240 = 55,475 LTCLG Rs.5,75,873 i.e. { 7,48,500 -1,72,627 = [1,17,152 +0+ 55,475]

15. WDV of the block on 01-04- 2017 of the block (depreciation 25%) comprising of two copiers is Rs 6 lakh. Both the copier were discarded on 31-03-2021 and sold for Rs.80,000. Each. New copier was bought on 01-04-2021. For Rs 13 lakh. Compute the amount of capital gain chargeable-Depreciation. (Ans: STCL: 4.4 lakh No depreciation on empty block in AY.2021-22 . New copier will qualify for dep. In A.Y.2022-23).

16. Ramesh sold jewellery on 15-11-2017 for Rs. 4,50,000. He purchased it on 01-04-2014 for Rs. 3,05,000. He paid brokerage of Rs. 4,000 for purchase and Rs. 2,000 for sale. Compute capital gains chargeable to tax.

(Ans: LTCG RS 39,863=  $\{4,50,000-2000 -4,08,137 [3,05,000+4000 \times 317/240]$

17. Mahesh sold his flat 15-04-2017 for Rs 16.5 Lakh. He had purchased it for Rs 50,000 on 03-07-1983. Its market value as on 01-04-2001 was Rs 5 lakh. He paid brokerage of Rs. 13,000 for the sale transaction. Compute the total taxable capital gain. (Ans: LTCG  $16,50,000-13,000-15,85,000 \{5,00,000 \times 317/100\} = \text{Rs } 52,000$ )

18. A purchased 1000 share of Reliance @ Rs 1000 each. Reliance goes for right issue in the ratio of 1:1 for Rs 600. A sells (renounces) his rights for 500 shares @ Rs 50 per share to X. Ascertain the liability for taxable capital gains, if any.

(Ans: for A-STCG  $500 \times 25 = 12500$ , Cost of New shares  $500 \times 600 = 3,00,000$  For X- Cost of Acquisition of right  $500 \times 600 + 50 = 3,12,500$ )

19. A sold a residential house for Rs 55 lakhs on 31-03-2015. He had inherited the house from his father in 1990, the fair market value of which as on 1.4.2001 was Rs.10 lakhs. During the year 1992-1993, he carried out further construction and improvements, at a cost of Rs. 6 lakhs. Expenditure in connection with transfer Rs. 50,000 Compute capital gains.

(Ans: LTCG Rs 55 Lakh  $-50,000 -31,70,000 [Rs. 10 lakhs \times 317/100] = 22,30,000$  Improvement in 1992-93 will be ignored).

20. WDV of Block of 2 machines- (depreciation 15%) owned by K Ltd. was Rs 9 lakh as on 01-04-2021. AK purchased a new machine for Rs 8 lakh on 30-12-2021 and sold the old machines for Rs. 10 lakh. Compute depreciation and taxable capital gains if any, for AY 2022-23 . Show the difference if AK sold the machines for Rs. 8 lakh.

(Ans: a) block Rs 9 lakh+ 8 lakh – 10 lakh = 7 lakh. Deprecation @ 15% - Rs 1,05,000 b)STCG- 1 lakh , Depreciation- Nil.



## 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 Some specific incomes – gifts, dividend
- 7.5 Deductions
- 7.6 Amounts not deductible
- 7.7 Miscellaneous- Balancing charge, Method of accounting
- 7.8 Self- Assessment Questions

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### 7.1 INTRODUCTION AND OBJECTIVES

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This lesson deals with the provisions of section 56 to 59 relating to “Income from other sources”, its scope, computation and the deductions allowable therefrom.

This is the last and residuary head of income. Any income not covered under any other head of income specified in section 13 is chargeable to tax under this head.

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### 7.2 BASIS OF CHARGE- SECTION 56

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**2.1.** As per section 56 (1), any income, which is not chargeable to tax under any other heads of income and which is not to be excluded from the total income shall be chargeable to tax as residuary income under the head “Income from Other Sources”.

**2.2.** As per section 56(2), the following incomes are specifically chargeable to tax under the head “Income from Other Sources”:-

- i. Dividends
- 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 towards provident fund , superannuation fund or Employee State

Insurance fund or any other employees' welfare fund, if not chargeable under the head 'profits and gains of business or profession'.

Income From Other Sources  
(Sections 56 -59)

- iv. Interest on securities, if not chargeable under the head 'profits and gains of 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 'profits and gains of business or profession.'
- vi. Composite rental income from letting machinery, plant or furniture with buildings and letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, if not chargeable under the head 'profits and gains of business or profession'.
- vii. Any sum including bonus received under keyman insurance policy, if not taxable as salary or 'profits and gains of business or profession'.
- viii. Any sums of money exceeding Rs. 50,000 in aggregate received without consideration by an individual or HUF.
- ix. Fair market value of movable property received without consideration by an individual or HUF if it exceeds Rs 50,000 in aggregate.
- x. The difference between the aggregate fair market value and the consideration received by an individual or HUF in respect of a movable property or immovable property, if such difference exceeds Rs 50,000.
- xi. The stamp duty value of any immovable property ( whether assessed or assessable) if it exceeds by Rs 50,000 than the consideration for such immovable property received by an individual or HUF.
- 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 or for a consideration which is less than the aggregate fair market value of the property by an amount exceeding Rs 50,000.
- xiii. Interest received on compensation or on enhanced compensation referred to in section 145A (b).
- xiv. Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if such sum is forfeited and the negotiations do not result in transfer of such capital asset.

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### 7.3 INCOMES SPECIFICALLY CHARGEABLE - SECTION 56(2)

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In addition to the residuary income chargeable to tax but not covered under other heads of income, the head “income from other sources” also covers some well-defined income given as under:-

- i. Dividend received from any entity other than a domestic company; Section 10(34) is deleted, hence dividend received from a domestic company is not exempt w. e. f. AY. 2021-22. Dividend received from a cooperative bank or a foreign company will also be chargeable under this head.
- ii. Pension received by the legal heirs of an employee; Pension received by the employee himself during his lifetime is 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 letting out any plant, machinery or furniture on hire where it is not the business of the assessee to do so;
- v. Interest on securities if it is not chargeable as the profit and gains of business or profession;
- vi. Employees’ contribution to any staff welfare scheme received by the employer, which is not paid within the prescribed time. However deduction will be allowed in respect of the amount of contribution paid, 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 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. Gratuities received by a director who is not an employee of a company;  
and
- xix. Any other receipt, which is income but does not fall under the other four heads of income viz. salary or business income or income from house property or capital gain.

Income From Other Sources  
(Sections 56 -59)

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## 7.4 SPECIFIC INCOMES COVERED

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### 4.1. Dividend – Section 56(2) (i)

Dividend is the amount of profits distributed by a company among its shareholders or members. Some important principles concerning the dividend are given as under: -

1. Taxable amount of dividend shall be chargeable as income from other sources.
2. It is not relevant whether dividend is , in cash or kind or out of taxable profits or tax -free income, out of revenue profits or capital gains.
3. Dividend may be final , Interim or deemed dividend
4. Dividend declared at the annual general meeting of a company (AGM) , where the final accounts for the financial year are laid before the members, is called as the final dividend. Such dividend is chargeable to tax on the date of AGM, in which it is declared. Date of actual payment is not relevant. Final dividend , once declared becomes a debt due and cannot be withdrawn. In case of non-payment it is earmarked in a separate account as per the Companies Act, 2013.
5. The dividend declared by the board of directors between two AGMs is called Interim dividend. Interim dividend is taxable when it is made available or paid to the shareholders.
6. Deemed dividend is not dividend in real terms. Certain payments made to shareholders by the company or its liquidator are deemed to be dividend in the hands of the shareholder in different circumstances prescribed in Section 2(22) and are chargeable under the head income from other sources when such sums are actually paid .

### 4.2. Deemed dividend: -Loan to shareholders- S. 2(22) (e)

Under Section 2(22)(e) any sum paid as loan or advance by a closely held company

- to a shareholder for his individual benefit, and if such shareholders and his relatives holds substantial interest (10 per cent stake in share capital or voting power )in the company or

- to a concern(HUF/Firm etc) where the person having substantial interest has at least 20 per cent interest, shall be deemed to be the dividend in the hands of the shareholder.

This provision intends 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 are relevant: -

1. Dividend income will be taxable in the hands of the recipient in the year in which such loan or advance was given- Section 8 .
2. The section will apply only on cash loans or advances.
3. Advances made in kind e.g. of sale of goods on credit in the normal course of business will not be deemed to dividend.
4. Dividend will be chargeable even if the loan or advance has been repaid. The courts have repeatedly held that there is no inequity in this;
5. A shareholder is entitled to set off the deemed dividend if and when company declares any dividend.
6. The loan will be taxable as dividend only to the extent of free reserves of the company;
7. 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;
8. 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;
9. Substantial interest may be existing at any time during the year;
10. Any deemed dividends under section 2(22)(e) or dividend from any other entity is, however taxable in the hands of the recipient; and.
11. Deduction of expenses on collection and interest on loan, taken for investment in shares, is available against dividend income.

### Illustrations

Ascertain the amount of deemed dividend under section 2(22) (e) in the following situations. The companies are closely held, and the shareholder has substantial interest therein .

1. A borrows Rs one Cr from ABC Private Ltd. and returns the loan next day, when he makes his own arrangement for finance. The Company was had free reserves of Rs 10 lakh.

### **Solution**

Income From Other Sources  
(Sections 56 -59)

Out of the loan amount of Rs one Cr. , only Rs. 10 lakhs , to the extent of free reserve of A Ltd. will be treated as deemed dividend under section 2(22)(e). Repayment of loan does not affect the tax liability. A is entitled to setoff deemed against dividend If and when declared. .

2. A takes a loan of Rs 50 lakhs from B Ltd., having free reserves of Rs 50 lakhs.

### **Solution:**

Entire loan amount of Rs 50 lakhs will be deemed dividend in the hands of B under section 2(22) (e)

3. In the above case, assume the company is a loss making company having no free reserves

### **Solution**

Since the company has no free reserves, the loan taken will not be taxable in the hands of A as dividend.

4. A takes a temporary loan of Rs 10 lakhs from Dee Private 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 10 lakhs will be deemed dividend in the hands of B under section 2(22) (e), even if A holds substantial interest only for a part of the year.

### **4.3. Distribution by Companies: Section 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 debentureholders 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.

### **4.4. 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 under section 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

A received Rs 45,000 as interest net of TDS @ 10% on debentures of B Ltd worth Rs 2,50,000 held by him. Calculate the interest income and the amount of TDS @ 10% that can be claimed.

### Solution:

Dividend received net of 10% TDs:	Rs 45,000
Gross Dividend – $45000/90\%$ :	Rs 50,000
TDS claim 10 % of Gross dividend	Rs 5,000

## 4.5. 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 under section 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

If A wins Rs 10 lakh in a TV show, it will be subject to maximum marginal rate 30%, + 4% education cess and the Health and Education Cess HEC (total 31.2%) payable at source. Hence, A will receive only Rs 6,88,000 and tax will be deducted at source Rs 3,12,000

## 4.6. 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  $\frac{1}{3}^{\text{rd}}$  of the pension or Rs. 15,000 is available as deduction from this income. Significantly, pension amount received during the lifetime of employee is taxable as salaries under section 17(3).

Income From Other Sources  
(Sections 56 -59)

### Illustration

Mrs. S receives Rs 60,000 as yearly pension after the death of her husband. She spends Rs 1000 as expenses for collection of pension .

### Solution

Pension amount	Rs 60,000
Less: Lower of the following :	Rs 15,000

- $\frac{1}{3}^{\text{rd}}$  of the pension i.e. =

$$\text{Rs } 60,000 \times \frac{1}{3} = \text{Rs } 20,000 \text{ or}$$

- Rs 15,000

Taxable Pension	Rs 45,000
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*No further deduction will be allowed in respect of collection expenses.*

## 4. 7. Gifts in the hands of individuals and HUFs:

Traditionally the gifts were not taxable being capital receipts. Later, section 56 has been amended to bring gifts under the tax net. Provisions regarding the taxability of gifts are summarised below.

### 4.7.1 Taxable Gifts

As per section 56(2) ((vii), following receipts by an individual or a Hindu undivided family, in any previous year from any person or persons will be taxable as “Income from Other Sources:

- a. The whole of the aggregate value of any sum of money, received without consideration, the aggregate value of which Rs 50,000.
- b. Any immovable property,
  - i. without consideration, the stamp duty value of which Rs 50,000 , the stamp duty value of such property;
  - ii. for a consideration which is less than the stamp duty value of the property by an amount exceeding Rs 50,000,

Following points are important in this regard :

### 4.7.2 Date of valuation

When the date of agreement and the date of registration are not the same stamp duty value will be considered on :-

- the date of agreement if any 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;
- the date of registration in all other cases .

### 4.7.3 Disputed Value

If the stamp duty value of immovable property is disputed by the assessee under section 50C(2) , the Assessing Officer may refer the valuation of such property to a Valuation Officer as per the provisions of sections 50C and 155(15) will apply for valuation of capital asset.

### 4.7.4 Any property, other than immovable property-

- without consideration, the aggregate fair market value of which exceeds Rs. 50,000, the whole of the aggregate fair market value of such property; or
- for a consideration which is less than the aggregate fair market value of the property by an amount exceeding Rs 50,000, the aggregate fair market value of such property as exceeds such consideration.

### 4.7.5 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 section 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 section 10 (23C) ; or
- (g) a trust or institution, etc., registered under section 10(23C), 12A or section 12AA or section 12AB. if the property or money has been received by the persons other than those referred to under section 13(3).

### 4.7.6 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

Income From Other Sources  
(Sections 56 -59)

#### 4.7.7 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.
- II. In relation a Hindu Undivided Family any member thereof.

#### 4.7.8 . 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

A painting valued at Rs 10 lakh is transferred for Rs 8 lakh. Difference of between the consideration and the fair market value of Rs 2 lakh, will be charged u/s 56 being value of inadequate consideration. The painting is resold for Rs 15 lakh, the capital gain will be computed by taking the cost of acquisition of Rs 10 lakh i.e.  $\text{Rs } 15 \text{ lakh} - 10 \text{ lakh} = \text{Rs. } 5 \text{ lakh}$ .

#### 4.8. 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, i.e. net asset value or break-up value method or 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, licences, franchises or any other business or commercial rights of similar nature.

### Illustration

A company issues 10,000 shares @ Rs 200 as against the fair market value of Rs 100 per share. then  $10000 \times (200-100) = \text{Rs } 10 \text{ lakh}$  will be treated as “ income from other sources , unless the company is a venture fund or other notified company. .

Following table summarizes the position of gifts u/s56

<b>TAXABLE GIFTS AT A GLANCE</b>		
<b>INDIVIDUALS AND HUFs</b>		
<b>RECEIPTS WITHOUT CONSIDERATION</b>		
<b>Cash</b>	50,001	Aggregate
<b>Movable Assets</b>	50,001	Aggregate
<b>Immovable Assets</b>	50,001	Per Property
<b>INADEQUATE CONSIDERATION [ FMV- CONSIDERATION]</b>		
<b>Movable Assets</b>	50,001	Aggregate
<b>Immovable Assets</b>	50,001	Per Property
<b>Shares of Pvt Co.</b>	50,001	Consideration or difference with FMV
<b>Recd by firm or Co</b>		
<b>Sh. Premium by Pvt Co</b>	50,001	Difference with FMV

### Important Points:

Income From Other Sources  
(Sections 56 -59)

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 the 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 valuer.
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, jewellery, drawings, paintings, sculptures, work of art or archaeological collections or immovable, without consideration, having aggregate fair market value exceeding Rs 50,000 during a previous year, for a consideration falling short of their aggregate fair market value by more than Rs 50,000 will be covered by this provision.

### Illustration

Compute the total income of XYZ, who receives Rs 60,000 in cash and of 500 shares of a company valued at Rs. 120 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****COMPUTATION OF TOTAL INCOME OF XYZ**

Particulars	Rupees
Salaries -gift from employer C section 17	1,20,000
Profits and gains of business & profession- Gift from patient -D Section 28	1,20,000
Income from Other sources- Section 56 sister E 's son [ nephew not exempted] B- his neighbour 1,20,00X2	2,40,000
Total income	3,00,000

- Gift of shares of Rs. 6,000 and cash Rs 60,000 each treated at par. Therefore, total gift in each case Rs 1,20,000

- Exempt gifts from – ( with reason in brief )

E - sister – Relative

F in contemplation of death ( *Gift mortis Causa* ).

Mrs. A- spouse –Relative

G -E's husband – Sister's spouse –Relative

On Occasion of marriage (Relationship not relevant )

**4.9 Gifts Received by firms and companies**

When a firm or a closely held company receives, in any previous year, from any person or persons, any shares of another closely held company-

- 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;
- 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 how ever apply to transactions not regarded as transfer under section 47.

**4.10.** Under the new sub-section 56(2)(vii), firms, widely held companies and AOP are liable to pay tax on the difference between fair market value and the actual consideration of movable or immovable asset.

Income From Other Sources  
(Sections 56 -59)

**Illustration-11:**

A Pvt. Ltd. buys shares in B Ltd of Rs 15 lakh for Rs 8 lakh from C. the difference in the consideration and the fair market value amounting to Rs 7 lakh will be taxable under section 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, cash gift of Rs 45,000 received by A, is not taxable being below Rs 50,000. A receives another gift of Rs. 5,100 from C, then the aggregate gifts of Rs 50,100 will be taxable without any basic exemption.
- iii. The limit of Rs. 50,000 is per immovable property.
- iv. The list of relatives excludes nephews/nieces/ cousins.
- v. List of relatives includes spouses, own siblings, spouses' siblings and parents' siblings, lineal ascendants, descendants and their spouses .
- vi. Stamp duty valuation has the same meaning as in S 50C.
- vii. Fair Market Value can be determined by the valuers.
- viii. Business assets like stock are outside the scope of this section. Hence, normal transaction of sale and purchase of goods or stocks will not attract the provisions of this section.
- ix. Any movable property like shares, securities, jewellery, 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.
- x. Partition in HUF, transaction between relatives and trusts are still excluded from the scope of the section.
- xi. Shares received by an individual or HUF as a consequence of demerger or amalgamation of a company or a business reorganisation of a co-operative bank shall not to be subject to tax by virtue of section 56(2)(vii).
- xii. The section has been enlarged to include firms and companies in its purview.

#### 4.11. 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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### 4.5 DEDUCTIONS -SECTION 57

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Section 57 allows the following deductions 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 realising 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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## 4.6 AMOUNTS NOT DEDUCTIBLE- SECTION. 58

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Income From Other Sources  
(Sections 56 -59)

The following amounts are not deductible while computing income under the head “income from other source”:-

- Personal expenses of the assessee;
- Any interest which 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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## 4.7 MISCELLANEOUS

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### a) Balancing charge taxable-Section. 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- Section 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 under section 2(22)(e) can only be recorded on cash basis 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**

A receives taxable interest of Rs. 81,000 after deduction of 10% TDS . Find out the taxable income.

**Solution**

Amounts to be taxed will be gross amount Rs 90,000 i.e.

$$\frac{\text{Rs.}81,000 \times 100}{(100 - 10)}$$

*Rupees 90,000 will be included in the income and credit for TDS of Rs. 9,000 will be claimed against the tax payable.*

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**4.8 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.,  
( Own pension salary / wife's pension other sources with std deduction Rs 15000 )
- 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)

Income From Other Sources  
(Sections 56 -59)



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## 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-Section 10(1)
  - b. Receipts by a member from HUF-Section 10(2)
  - c. Share of profit of a partner in firm –Section 10(2A)
  - d. Income of minor Child –Section 10(32)
  - e. Other Exemptions
- 8.4 Deductions –Section 80 –Chapter VIA
  - f. Investments –Section 80C
  - g. Pension Plan –Section 80CCF
  - h. Medici claim -Section 80D,
  - i. Physical Disability –Section 80DD,
  - j. Treatment of major diseases –Section 80DDB,
  - k. Interest on educational Loans Section 80E,
  - l. Physical Disability(Own)- Section 80U:
- 8.5 Solved Examples
- 8.6 Self-Assessment questions

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### 8.1 INTRODUCTION & OBJECTIVES

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Exemption refers to an income not at all considered or excluded while computing total income. Deduction on the other hand may be in respect of income or expense or both. Income will be considered while computing total income but once again deducted along with deductions in respect of expenses.

This lesson deals with the provisions of Income Tax Act 1961 relating to exemptions contained in Section 10 to 13 and deductions accordance with Section 80 of chapter VIA of the Act.

**8.2.1 Exclusions or Exemptions**

Exempt income means the Income, which is neither chargeable to income tax nor considered or included in the computation of total income. Exempt income is altogether excluded and does not form part of total income. Every receipt is presumed to be chargeable to tax unless such receipt is proved to be specifically exempt from tax.

Exemptions may of different nature.

- (a) Exemptions granted to a person or class of persons such as charitable trusts in respect all or some of their incomes.
- (b) Exemptions in respect of specified incomes exempt in the hands of all types of assesseees such as interest on certain notified securities, dividend till 2 years ago (now taxable) agricultural income etc.
- (c) Exemptions available unconditionally,
- (d) Exemptions that can be claimed only on fulfillment of certain condition such as in case of startups, SEZ etc.
- (e) Exemptions to certain incomes exclusively granted under Sections 10 to 13.
- (f) Exemption granted under particular head of income while computing income under Sections 15 to 56 under different heads viz Salaries, Income from house property, Profits and gains of business & profession, Capital gains and Income from other sources.
- (g) A receipt not falling under the definition of income under Sections 2(14) or a receipt, which is of capital nature, will be excluded unless it is specifically chargeable to income tax.

**8.2.2 Deductions**

Income (after excluding exempt income) is computed under different heads of income as provided in Sections 15-56. Aggregate of such income is called Gross Total Income.

From the Gross Total income so computed, deductions are allowed under the provisions of Sections 80 of chapter VIA of the Act either in respect of any income or revenue or in respect of any payment or expenditure.

Sections 80IA, 80IB etc. provide for deduction in respect of revenue or income of a class of assesseees like software, infrastructure companies, companies engaged in construction of affordable housing etc. while Sections 80 C , 80D etc. provide for deductions in respect of investments in specified securities, payment of mediclaim, expense on handicapped dependent etc.

## 8.3 INCOME EXEMPT - SECTION 10:

Section 10 provides that any income falling within any of the clauses of that Section shall not be included in computing the total income of a previous year of any person. However, burden is on the assessee to prove that a particular item of income falls within this Section. Syllabus includes only exemption available under a particular head. All such exemptions are taken up with the respective heads of income. Some other exempt incomes are as under:-

### 8.3.1 Agricultural Income

Under the constitution of India, agriculture is in the state list. Central Government is not constitutionally competent to levy taxes on agriculture. Accordingly, agricultural income is exempt under Section 10(1) of the Act. However, agricultural income is taken for rate purposes, if it exceeds Rs 5000.

#### Meaning of agricultural income

As per Section 2 (1A) “Agricultural income” means any:-

- A. any **rent or revenue** derived from land-
  - (i) which is situated in India and
  - (ii) is used for agricultural purposes
- B. any **income derived from such land** by
  - (i) agriculture; or
  - (ii) 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
  - (iii) the sale of such produce without performing any other process as stated above. ;
- C. **any income derived from any building** owned and occupied by
  - (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
 if such building is
  - a) on or in the immediate vicinity of the land, and
  - b) required as a dwelling house, or storehouse, or other outbuilding by reason of its connection with the land, and the land is

- (i) assessed to land revenue in India or
- (ii) subject to local rates and taxes assessed and collected by the government and
- (iii) situated in any area within the distance measured aerielly from the local limits of any municipality or cantonment board depending upon its population as per the last published census namely -
  - 2 kms if population is more than 10,000 but not exceeding 1 lakh;
  - 6 kms. if population is more than 1 lakh but not exceeding 10 lakh; or
  - 8 kms. if population is more than 10 lakh.

### 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. Agricultural income must be 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 under Section 2(14) is not considered agricultural income but may give rise to capital gain.
6. Any income arising from letting out the building for residential or business purpose other than agriculture will not be agricultural income

### Illustration

T employs S to carry out agriculture on his agricultural land at remuneration based on the value of agricultural produce. S remits the sale proceeds of the agricultural produce to T after deducting his share. .

Income on sale of agricultural produce derived from agricultural in India being the agricultural income is exempt under Section 10(1) in the hands of T.

S earns salary for rendering his services. It is not derived from agricultural land. Hence, it will be chargeable to income tax under the head “Salaries”.

## 9 Share of Profit of a partner in a firm –Section 10(2A)

Share of a person being a partner of a firm, which is separately assessed as such, in the total income of the firm will be exempt from tax under Section 10(2A).

A firm like a HUF is assessed as a separate entity. Hence the exemption is provided to avoid double taxation of same income first in the hands of the firm and then again in the hands of the partners.

The exemption is restricted to share in the total income of the firm not to payment of any interest on capital or remuneration paid by the firm, which is taxable in the hands of the partners to the extent it was allowed as a deduction to the firm.

But 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 under Section 10(2A).

## 10 Income of minor child

Under Section 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. Section 10(32) provides for an exemption of the amount included in the income of such parent subject to a maximum of Rs. 1,500 per child.

### Illustrations

1. Income of Rs 1,000 of S, a minor son is included in the income of his father F. Amount exempt under Section 10 (32) will be Rs. 1000 being actual income included in the hands of parent or Rs. 1,500, whichever is less.
2. Assuming income of S is Rs 15,000, exemption under Section 10 (32) will be restricted to Rs. 1,500 only.
3. Assuming income of two minor children S and T amounting Rs 7,500 and Rs 5,500 is clubbed with F's income, exemption under Section 10(32) will be of Rs 3,000 being Rs 1,500 per child.

## 11 Dividend from domestic companies–Section 10(34)

With effect from 1 April 2020, the erstwhile dividend distribution tax (DDT) @ 15% u/s 115-O has been abolished and the dividend income is now taxable in the hands of shareholders

## 12 Dividend from Units of mutual funds –Section 10(35)

With effect from 1 April 2020 Dividend or income received in respect of units of mutual fund or administrator of the specified undertaking; or specified company is taxable in the hands of the assessee

## 13 Other Exemptions:

A brief summary of exemptions under Section 10 is given for reference as it may have a bearing on the computation.

**1. Exemption to Foreigners/ Non Residents**

(i) Interest income of non-resident persons of Indian origin (PIO) from notified securities, saving certificates/ NRE Account. Purchased in convertible foreign exchange– Section 10(4).

**Remuneration / salary of**

- (ii) foreign diplomats - Section 10(6).
- (iii) a trainee of a foreign government- Section 10(6)(xi),
- (iv) a foreign national as an employee of foreign Enterprise -Section 10(6)
- (v) Non-Resident employee in Foreign Ship– Section 10(6)(viii)
- (vi) Person from a foreign government under Co-operative Technical Assistance Programme/projects- Section 10(8)
- (vii) a consultant under Grant Agreement between the International Organisation and the Government of Foreign State- Section 10(8A):
- (viii) 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- Section 10(8A)
- (ix) 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 - Section 10(8A)
- (x) an individual who is assigned to duties in India in connection with any technical assistance programme and project from a consultant referred to S 10(8A), income- Section 10(8B)
- (xi) Income other than salary, royalty or fees for technical services from Government or an Indian concern under an approved agreement and if tax is paid by the employer the tax so paid is exempt from tax. - Section 10(6B)
- (xii) Income accruing or arising outside India by any family member of persons covered Section 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 – Section 10(9)
- (xiii) 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- Section 10(10CC).

**2. Exemption to Salaried Employees**

- (i) Exemption granted to salaried employee have been dealt in detail in the lesson relating to salaries such as
- (ii) Value of any travel concession/ assistance- Section 10(5),
- (iii) allowance paid by the government to a Indian citizen rendering service outside India - Section 10 (7)
- (iv) Death cum Retirement gratuity - Section 10(10)
- (v) Commuted pension Section 10 (10A),
- (vi) Leave encashment Section 10 (10AA)
- (vii) Retrenchment compensation - Section 10(10B)
- (viii) Voluntary Retirement Compensation Section - 10(10C)
- (ix) Value of tax-paid perquisite - Section 10(10CC)
- (x) Leave travel allowance,
- (xi) Payment from statutory PF - Section 10(11)
- (xii) Any payment from National Pension Trust or upto 40% on closure of such account - Section 10(12A /12B)
- (xiii) house rent allowance Section -10(13A),
- (xiv) special allowances etc. Section 10(14)

**3. Exemptions to Institutions / Funds**

The income of the following institutions is exempt subject to certain conditions:

- (i) Local authority Panchayats, municipality, municipal committee, district board, cantonment board-Section 10(20)
- (ii) 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 -Section 10(21)
- (iii) 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.- Section 10(22B)
- (iv) Regimental Fund or non-public fund.- Section 10(23AA)
- (v) Approved fund for the welfare of employees.- Section 10(23AAA)

(vi)	Pension fund (Jeevan Suraksha) set up by the Life Insurance Corporation of India or a pension fund of any other insurance company Section 10(23AAB)
(vii)	Khadi and Village industries Board Section. 10(23B)
(viii)	Public charitable trusts , religious institutions and political trusts - Section 11 ,12, 13
(ix)	European Economic Community.
(x)	SAARC Fund for Regional Projects.
(xi)	ASOSAI-Secretariat
(xii)	Insurance Regulatory and Development Authority
(xiii)	Prime Minister's Relief Fund
(xiv)	National Foundation for Communal Harmony
(xv)	University/educational institution, hospital or medical institution Section 10 (22)/(22A)
(xvi)	Professional bodies . Section 10(23A)
(xvii)	Notified fund, charitable/ religious institution or trust.- Section 10(22B)
(xviii)	Mutual fund - Section 10(22B)
(xix)	Notified Investor Protection Fund set up by recognised Stock Exchanges
(xx)	Credit Guarantee Fund Trust for Small Industries
(xxi)	Approved Venture Capital Fund or Venture Capital Company- Section 10(23FB)
(xxii)	Prasad Bharati (Broadcasting Corporation of India) Section 10(23BBH)
(xxiii)	Swachh Bharat Kosh – Section 10(23C(iiiaa))
(xxiv)	Clean Ganga Fund - Section 10(23C(iiiaaa))
(xxv)	Core Settlement Guarantee Fund set up by a recognized clearing corporation in accordance with notified regulations- Section 10(23EE) to the extent of contributions from members fines and income from investments.
(xxvi)	Trade Union or Association of trade Unions from house property and other sources.- Section 10(24)
(xxvii)	Statutory Provident Fund under P. F. Fund Act.- Section 10(25)

(xxviii)	Employees' State Insurance Fund set up under the ESI Act-Section 10(25A)
(xxix)	Members of scheduled tribes residing in specified areas. – Section 10(26)
(xxx)	Statutory Corporation, body, association or institution formed or established for promoting the interests of the members of Scheduled Castes/ Scheduled Tribes or backward classes or of any two or all of them. Section 10(26B)
(xxxi)	Corporation established by the Central/ State Government for promoting the interests of a notified minority community. - Section 10(26BB)
(xxxii)	Ex-Servicemen Corporation established under an Act for the welfare and economic upliftment of ex-servicemen being the citizens of India.- Section 10(26BBB)
(xxxiii)	Co-operative Society formed for promoting the interest of members of either the Scheduled Caste or Scheduled Tribes.- Section 10(27)
(xxxiv)	Coffee Board, Rubber Board, Tea Board, Tobacco Board, Marine Products Export Development Authority, Agricultural and Processed Food Products Export Development Authority and Spice Board.- Section 10(29A)
(xxxv)	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- Section 10(30)
(xxxvi)	Subsidy received from the Rubber Board, Coffee Board, Spices Board or any other Board under any scheme of replanting or replacement, etc.- Section 10(31)
Exemptions not be available to the institutions under Section 10(23C) having commercial receipts of Rs. 25,00,000 or more	
<b>CAPITAL GAINS</b>	
(xxxvii)	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 if STT is paid except in case of a transaction undertaken in foreign currency on a recognised stock exchange located in an International Financial Services Centre even
(xxxviii)	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 -Section 10(38).

(xxxix) 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.

(xl) Any income arising from the transfer of units of 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—Section 10(33)

### MISCELLANEOUS

(xli) Daily allowance of Members of Parliament while the parliament is in session is and Members of State Legislative Assemblies upto Rs. 2000 - Section 10(17)

(xlii) 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. - Section 10(10D),

(xliii) 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 A.Y. 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. - Section 10(19),
- (xliv) Any income by way of dividend referred to in Section 115-O 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),
- (xlv) Interest income arising to certain persons-Section 10(15):
- (xlvi) Income by way of interest, premium on redemption or other payment on notified securities, bonds, annuity certificates or other savings certificates subject to prescribed conditions and limits.
- (xlvii) Interest from Post Office Savings Bank Account:
  - (1) Rs. 3,500 in case of an individual account.
  - (2) Rs. 7,000 in case of a joint account.
- (xlviii) -Interest on deposit certificates issued under the Gold Monetization Scheme, 2015.
- (xlix) 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-Section 10(48)
- (l) Exemption of income accruing or arising to a foreign company on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India. if(1) such storage and sale by the foreign company is pursuant to an agreement or an arrangement entered into by the Central Government or approved by the Central Government; and (2) having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Government in this behalf.- Section 10(48A):
- (li) 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

**Other Exempt Income**

- (lii) Under Section 10AA export incomes of undertakings in SEZ are exempt on pro rata basis i.e.

$$\frac{\text{Business Profit} \times \text{Export Turnover}}{\text{Total Turnover}}$$

- (liii) Incomes of charitable trusts and political parties subject to the provisions of Section 11, 12 and 13.

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## 8.4 DEDUCTIONS UNDER CHAPTER VI A

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**4.1** Sections 80A and 80AB of chapter VIA provide for a basic framework for deduction to be made from gross total income. Salient points of such framework are as under:-

- (a) Aggregate of total income of an assessee will be computed under different heads of income as provided in Sections 15-58 before making any deduction under this chapter called the gross total income.
- (b) From the gross total income long term capital gains, short term capital gain under winnings from lottery, crossword puzzles etc. are excluded as these items are treated differently for tax purposes.
- (c) From the gross total income, deductions are allowable under Sections 80C to 80U of chapter VIA.
- (d) The aggregate of all deductions under this chapter cannot exceed the amount of gross total income of the assessee
- (e) Deduction is admissible to the members of an AOP or BOI in relation to their share therein under Sections 80G, 80GGA, 80GGC, 80HHA, 80HHB, 80HHC, 80HHD, 80I 80IB , 80IC, 80ID, 80IE, 80J or 80JJA.
- (f) No deduction will be allowed if any exemption is claimed and allowed to eligible assessee, enterprises, units, or undertakings under Sections 10A, 10Aa, 10B, 10BA, or 35AD for that year. Further, such deduction shall not exceed the profits and gains of such undertaking or unit or enterprise or eligible business.
- (g) As per Section 80A, the above deduction will be available only if the assessee makes a claim in his return of income.

- (h) Section 80B clarifies that deduction in respect of any income shall be allowed if such income is included in gross total income.
- (i) For deduction in respect of any payment, the assessee has to claim the deduction and submit the proof of such payment for any investments/ expenditure etc.
- (j) Deductions under Chapter VIA are of three types:
  - I. In respect of expenditure or investments made by the assessee - Sections 80C to 80G
  - II. In respect certain income -Sections 80HH to 80RRB
  - III. Irrespective of whether income or expenditure- Sections 80 U allowable to a handicapped person.

Some of the deductions covered by the syllabus are discussed in the following paragraphs.

#### **4.2 Deduction in respect of investments in specified saving schemes- Section 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:

- (i) Only individuals and HUFs are eligible for deduction under this Section. Other assesseees are not eligible for deduction u/s 80C.
- (ii) Both residents and the non-resident assessee are eligible for the deduction under the Section
- (iii) The deduction is allowed in respect of the aggregate amount **paid or deposited** during the previous year by the assessee in eligible saving schemes.
- (iv) The aggregate amount paid or deposited towards these schemes is called **Gross Qualifying Amount**.
- (v) The payments/investments eligible under this Section are:
  - (a) 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 or independent
    - A Hindu undivided family on the life of any member of the family

The premium including the arrears of premium should not exceed 10% of sum assured if policy is taken after 0-1-04-2013 (15% for persons with handicap under Section 80U or person suffering from serious disease under Section 80DDB on policy taken after 01-04-2014). Prior to this, the restriction was up to 20% for all assessees.

- (b) Any sum paid under the contract of non –commutable deferred annuity plan for the purpose of securing the individual or his spouse or children to pay a deferred annuity ;
- (c) Any sum deducted from salary payable to a Government employee for the purpose of securing the individual or his spouse or children to pay a deferred annuity subject to a maximum of 20% of salary;
- (d) Contribution towards statutory provident fund;
- (e) Contribution towards 15 year Public provident fund(PPF) in the name of himself, wife or child or a family member upto a maximum of Rs 1,00,000;
- (f) Contribution towards Recognized provident fund;
- (g) Contribution towards an approved *Superannuation Fund*;
- (h) Investment in 10 / 15 years Post Office Cumulative Term Deposits( CTDS);
- (i) Subscription to notified deposit scheme e.g. NSS
- (j) Subscription to National Savings Certificates, VIII Issue
- (k) Contribution for participating in the Unit-linked Insurance Plan (**ULIP**) of Unit Trust of India;
- (l) Contribution for participating in the Unit-linked insurance plan (**ULIP**) of LIC Mutual Fund (i.e. Dhanraksha plan of LIC Mutual Fund);
- (m) Payment for notified annuity plan of LIC (i.e. Jeevan dhara, Jeevan akshay, New Jeevan Dhara, etc. or any other insurer;
- (n) Subscription towards notified units of mutual fund/ UTI
- (o) Contribution to notified pension fund set up by mutual fund or UTI;
- (p) Any sum paid including accrued interest as subscription to home loan account scheme of the National Housing Bank(**NHB**);
- (q) 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;
- (r) Any subscription towards infrastructure bonds or units of Mutual Funds;

- (s) Any amount paid for the purchase or construction of a residential house property or for purchase of land;
- (t) Term deposits for a fixed period for at least 5 years with a scheduled bank under a notified scheme;
- (u) Deposit in an account under Senior citizens savings scheme, 2004;
- (v) 5- years post office time deposit account;
- (w) Subscription to notified bonds issued by NABARD;
- (x) 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

**Amount of deduction allowable u/s 80C :-**

- Whole of the aggregate amount paid or deposited in the above mentioned schemes the gross qualifying amount or
- Rs 1,50,000, whichever is less.
- Under section 80CCE, maximum deduction u/s 80C, 80CCC and 80CCD cannot exceed Rs 1,50,000.

**(vi) Some important points:**

- 1) Payment for house includes the amount paid to authorised developers or repayment of loans.
- 2) The amount of investments need not necessarily be made out of the taxable income
- 3) Life insurance premium paid for parents will not be allowable even if parents are dependent on the assessee.
- 4) Life insurance premium paid for married daughter will be allowable.
- 5) Dependence of wife or children is not necessary for claiming deduction under this Section.
- 6) Refundable premium and bonus on premium are not eligible for deduction
- 7) Premature termination( before the period shown below) from any scheme will have the following effects:
- 8) In the year of termination, deduction will not be allowed ;

- 9) 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

### Illustrations

1. On a whole life policy, a premium of Rs. 6,000 was paid upto last year. Current year's premium otherwise eligible for deduction u/s 80C is Rs 3,000. The policy is prematurely terminated during the financial year 2021-22.

Premium paid in financial year 2021-22 will not be eligible for deduction under Section 80C. Premium of Rs. 6000 allowed earlier will be added to the income of assessment year 2022-23

2. Kanti makes the following payments during the financial year 2021-22. His Gross Total Income amounts to Rs 8,00,000, Compute the deduction available under Section 80C and the taxable income for the A.Y. 2022-23.

School fees of his 4 children	Rs 60,000
University fees of his wife	Rs 10,000
Life insurance for wife and kids	Rs 40,000
Life insurance for parents	Rs 15,000
Life insurance for father-in-law	Rs 40,000
NSC	Rs 60,000
Repayment of principal for house	Rs 50,000
Coaching class fees	Rs 11.030

**Solution**

Gross Total Income		Rs. 8,00,000
School fees up to 2 children	Rs 35,000	
University fees of wife - Not allowed	NIL	
Life insurance for wife and kids	Rs 40,000	
Life insurance for parent Not allowed	NIL	
Life insurance for father-in-law- Not allowed	NIL	
NSC	Rs 60,000	
Repayment of principal for house	Rs 50,000	
Coaching class fee Not allowed	NIL	
Deduction under Section 80C maximum allowable	1,85,000 –	Rs.1,50,000
Total Income		Rs.6,50,000

3. Anshu has a Gross Total Income of Rs 8,00,000 for the AY 2022-23. He availed of deduction in AY 2018-19 of Rs 10,000 in respect of a life insurance policy, which was prematurely terminated in P.Y. 2021-22. During the year, he paid premium of Rs 28,000 on a policy himself for Rs 1,00,000, and Rs 25,000 Insurance for wife (employed with MNC), Insurance premium due for son but unpaid Rs 7,500

Compute deduction u/s 80C and the taxable income of Anshu.

**Solution**

Computation of total income		Rs
Gross Total Income		8,00,000
Add: Deduction of last year on termination of policy		10,000
Revised Gross Total Income		8,10,000
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		7,65,000

4. Gross Total income of Manu for AY 2022-23 is Rs 10,00,000. He pays premium of Rs 22,000 on a policy of Rs 1,00,000 on his own life, Rs 15,000 each for policies of his son and brother, both being dependent on him. Manu contributes Rs. 20,000 for unrecognized provident fund, Rs 30,000 towards PPF, and Rs 20,000 in ULIP. He repaid housing loan to ICICI Bank Rs 80,000 with Rs 20,000 towards outstanding interest.

School fees of three his children amounts to Rs 4,000 Rs. 5,000 and Rs 6,000 respectively.

Compute the deduction/s 80C and the taxable income of Manu.

### Solution

Computation of total income		Rs
Gross Total Income		10,00,000
Insurance-self- over 20% of sum assured	20,000	
Insurance(son)–dependence not relevant	15,000	
Insurance for brother not allowed	Nil	
Unrecognized PF -Not allowed	Nil	
Public provident Fund	30,000	
Unit Linked insurance plan	20,000	
Housing loan –Principal	80,000	
School fee –2 children – Higher figures considered 6,000=+5,000	11,000	
Total deduction u/s 80C-maximum	1,76,000	1,50,000
Total Income		8,50,000

### 4.3 Deduction in respect of Contribution to certain pension funds – Section 80CCC.

Section 80CCC is directly not covered in syllabus but is indirectly relevant as aggregate deduction under Sections 80C, 80CCC and 80CCD shall not exceed Rs 1,50,000.

Under Section 80CCC, deduction is allowed to Individuals in respect of amounts paid/ deposited(excluding any interest /bonus accrued/ credited to the assessee) during the previous year to effect or keep in force a contract for any annuity plan of Life Insurance Corporation of India or any other insurer for receiving pension from the fund under Section 10(23AAB).

The amount received by the assessee or his nominee a) on account of the surrender of the annuity plan whether in whole or in part, in any previous year, or (b) as pension received from the annuity plan shall be deemed to be the income of the assessee/ nominee, in the year of withdrawal or when pension is received.

#### 4.4 Health insurance premia- Section 80D:

Provisions of Section 80D, which provides for a deduction in respect of the health premia paid are summarized as under:--

- (a) **Eligible Assessee** : individual or a Hindu undivided family
- (b) **Nature of Deduction** : payment made towards medical insurance premia paid during the previous year
- (c) **Mode of Payment**: The premium shall be paid by any mode other than cash, e.g. cheque, ECS or other electronic mode. However, payment for preventive health check-up may be made by any mode including cash.

#### (d) Amount of Deduction In case of an individual assessee

##### Premium and checkup for self and family

(i) Deduction shall be aggregate of the following payments made for **self and family**, or Rs 25,000, whichever is less

- a) the whole of the amount paid (premium) to effect or to keep in force an insurance on the health of the assessee or his family ; or
- b) any contribution made to the Central Government Health Scheme or other notified scheme (popularly called Mediclaim policy), or
- c) any payment made on account of preventive health check-up of the assessee or his family upto Rs 5,000

##### (ii) Medical expenditure for self or family member

The whole of the amount paid on account of medical expenditure incurred on the health of the assessee or any member of his family being a **very senior citizen** if no amount has been paid to effect or to keep in force an insurance on the health of such person or Rs 50,000, whichever is less.

Thus, an assessee may either pay the insurance premium (Rs 25,000 including 5,000 for medical checkup) or incur medical expenditure subject to a maximum limit of Rs 30,000.

##### (iii) Premia paid for parents

The amount of deduction shall be aggregate of the following or Rs 25,000 whichever is less

- (a) the whole of the amount paid to effect or to keep in force an insurance on the health of the parent or parents of the assessee or

(b) any payment made on account of preventive health check-up of the parent or parents of the assessee as does not exceed Rs 5,000

(iv) ***Medial Expenditure for parents***

The whole of the amount paid on account of medical expenditure incurred on the health of *any parent of* the assessee being *very senior citizen not exceeding* in the aggregate Rs. 30,000 if no amount has been paid to effect or to keep in force an insurance on the health of such person

Maximum deduction under both the above cases will be restricted to Rs 50,000

(v) **Other points**

- 'Family' means the spouse and the dependent children of the assessee
- "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;
- "Very senior citizen" means an individual resident in India who is of the age of *eighty years or more* at any time during the relevant previous year.
- The parents and the spouse may not be dependent upon the assessee, but his children must be dependent for claiming the deduction
- Expenses paid for preventive health check-up have a sub limit of Rs 5,000 within the overall limit of Rs 25,000 /30,000 and such expenses may be paid in cash.
- Any medical insurance premia paid to effect or keep in force an insurance on the health of any person being a senior citizen, or a very senior citizen, the limit of Rs 25,000 ( for individual and HUF) will be enhanced to Rs 30,000
- Insurer should be notified by the IRDA or Central Government

(e) **Amount of Deduction to A Hindu undivided family :**

Where the assessee is a Hindu undivided family, amount of deduction shall be the aggregate of the following, namely:—

- (i) whole of the amount paid to effect or to keep in force an insurance on the health of any member of that Hindu undivided family as does not exceed in the aggregate Rs 25,000 ; and
- (ii) the whole of the amount paid on account of medical expenditure incurred on the health of any member of the Hindu undivided family being a very senior citizen as does not exceed in the aggregate Rs 50,000 , if no amount has been paid to effect or to keep in force an insurance on the health of such person:

The aggregate deduction shall not exceed Rs 50,000 .

<b>Sec 80D – Amount of deduction available to an individual ( inclusive of preventive health check-up)</b>			
Situation	Self, Spouse & Dependent Children Rs	Parent(s) whether or not dependent Rs	Total deduction u/s 80D  Rs
All below the age of 60 years	25,000	25,000	50,000
Assessee and his family less than 60 years and parents above 60 years	25,000	50,000	75,000
Assessee and his family have attained the age of 60 years and above	50,000	50,000	1,00,000
<b>Sec 80-D Amount of deduction available to a HUF ( inclusive of preventive health check-up)</b>			
One or more member of HUF is a senior citizen			50,000
None of the members is a senior citizen			25,000

### Illustration

Raj and his wife are not senior citizens. Raj pays mediclaim insurance of Rs 18,000 for self , Rs 20,000 for his wife ,and Rs 5,000 his two independent sons. He also pays Rs 18,000 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 20,000
Premium for himself	Rs. 18,000
Premium in respect of children (not dependent)	Nil
Total Rs 38,000 restricted to	Rs 25,000
Add : Premium in respect of parents (senior citizens) Rs 36,000 restricted to maximum	Rs 50,000
<b>Deduction available U/S 80D</b>	<b>Rs 75,000</b>

### 4.5 Deduction in respect of expenses on maintenance and medical treatment of a dependent who is a person with disability- Section 80DD:

(i) **Eligible assessee:** Individual and Hindu undivided family, who is a resident of India. Other assesseees not eligible.

(ii) **Eligible Payments:**

Expenditure incurred for medical treatment including nursing, training and rehabilitation of a dependent, being a person with disability or

a. any amount paid or deposited under a scheme framed by the or any other insurer or the administrator or the specified company (UTI) approved by the Board in this behalf for the maintenance of a dependent, being a person with disability.

(iii) **Amount of Deduction :** Rs 75,000 in all cases , Rs.1,50,000, if dependent person suffers from severe disability

So long the assessee incurs some amount of eligible expenditure, the deduction will be allowed irrespective of the amount actually spent . It is not necessary to spend full amount of Rs 75,000 or 1.50 lakh rupees .

(iv) **Conditions for of Deduction :**

The following conditions should be satisfied to claim deduction:

(a) Deduction is available in respect of a "dependent" person.

(b) A dependent person means:-

- Spouse, children, parents, brothers or sisters of an individual or any of them.
- a member of a Hindu undivided family.

(c) Such person must be dependent wholly or mainly on such individual or Hindu undivided family for support and maintenance.

(d) Such dependent person must not claim deduction u/s 80U while computing his total income for that assessment year;

(e) 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;

(f) 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.

(g) 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.

(h) The assessee must furnish a certificate from a neurologist, a pediatric neurologist, in case of children,) or a civil surgeon or Chief Medical Officer of a Government hospital in form 10IA (in case of autism, cerebral palsy or multiple disability)

- (i) 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.

#### 4.6 Payment for Medical Treatment-Section. 80DDB

**Eligible assessee:** Individual and Hindu undivided family, who is a resident of India. Other assessees 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 :**

- Amount actually paid in the previous year or
- Rs. 40,000 or
- Rs 1,00, 000, if such person or member is a senior citizen, whichever is lower

##### **Other Points**

- (a) *"Dependent relative" means*
- a. *an individual himself,*
  - b. *spouse, children, parents or brothers and sisters of an individual , or*
  - c. *a member of the HUF, who is wholly or mainly dependent for support and maintenance on the individual or the HUF*
- (b) *"senior citizen" means an individual resident in India who is of the age of 60 years or more at any time during the relevant previous year;*
- (c) *"very senior citizen" means an individual resident in India who is of the age of 80 years or more at any time during the relevant previous year,*
- (d) 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 :
- (e) Amount of deduction shall be reduced by any amount received under an insurance from an insurer, or reimbursed by an employer

#### 4.7 Deduction in respect of interest on loan taken for higher education Sec 80E

**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**

- 1) “Higher education” means any course or study pursued after passing Senior Secondary Education or its equivalent from any Government recognized school, Board or university.
- 2) “Course” may be any post-SSC course whether full -time or part time any Government recognised school, Board or university.
- 3) 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.
- 4) 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.

**Illustrations**

1. A borrows Rs 15 lakh from SBI on 01-04-2014 for pursuing MBA. The loan is repayable in 10 equal annual instalment carrying interest @ 10% per annum.

A being the student himself, is eligible to get deduction/s 80E upto A.Y. 2021-22. Thereafter, for the remaining two years, no deduction will be available. Amount of deduction in respect of interest will be as under:-

Assessment Year	Interest allowable Under Section 80E
2014-15	1,50,000
2015-16	1,35,000
2016-17	1,20,000
2017-18	1,05,000
2018-19	90,000
2019-20	75,000
2020-21	60,000
2021-22	45,000

2. if father of pays the interest, he will be entitled to claim the deduction.

## 4.8 Person with Disability – Section 80U

### Eligible assessee

- 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 ;
- Persons with severe disability of over 80% - Rs. 1,50,000

### Other Points

- 1) The deduction u/s 80U of Rs 75,000 / 1,50,000 is of a flat amount without any requirement for spending that amount.
- 2) Mere submission of a disability certificate in the prescribed form will be enough to avail the deduction along with the return of income of the assessment year for which the deduction is claimed for the first time.
- 3) 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.
- 4) “Disability” means blindness, low vision, leprosy-cured, hearing impairment, locomotor disability, mental retardation, mental illness, autism, cerebral palsy and multiple disabilities.
- 5) “Person with disability” & “Person with severe disability” have been defined in the Persons with Disabilities (Equal Opportunities, Protection of Rights & Full Participation) Act, or the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation & Multiple Disabilities Act, 1995.

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## 8.5 ILLUSTRATIONS

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1. S presents the following data for the previous year 2021-22.
  - (a) Business income Rs. 6,50,000
  - (b) Capital Gains Rs. 2,50,000
  - (c) Payment of medical insurance premium on own life Rs.10,000
  - (d) He pays Rs. 20,000 to GIC for maintenance of his severely disabled son under an approved scheme.
  - (e) 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.

(f) S himself his severely disabled.

Exclusions and Deductions

(g) Determine the income of S for the assessment year 2022-23

**Solution:**

**Computation of Total Income of X**

		Rs
Business Income		6,50,000
Capital gains		2,50,000
Gross Total Income		9,00,000
Deductions under chapter -VIA-		
80D :Mediclaime	10,000	
80DD:Maintenance of dependent with severe disability	*1,50,000	
80E interest on study loan	50,000	
80U :Severe disability	*1,50,000	
Total Deductions under chapter -VIA		3.60,000
Total Income		5,40,000

For 80U, full deduction available. Amt spent not relevant

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**8.6 SELF-EXAMINATION QUESTIONS:**

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1. Enumerate various income, exempt from under Section 10.
2. Explain the difference between deduction and exemption with 3 suitable 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 relating to deductions from the gross total income in the case of blind or physically handicapped person.
7. Enumerate exemptions available to foreign nationals in India.
8. Write short notes on:
  - a) Gratuity
  - b) Leave Salary
  - c) Retrenchment Compensation
  - d) House Rent Allowance
  - e) Dividends
  - f) Income of a minor child
9. 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.

- 10.** 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 Mediclaim for Rs 10,000 in cash and Rs. 10,000 by a credit card and Rs. 25,000 for his 70 year old father . Compute total income for the A.Y.2022-23.

*(Ans: Bus. Income 2,47,000, Other Sources 30,000 GTI 2,77,000, Tot. inc. 2,47,000)*

- 11.** 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 2022-23

*(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 Computation of Total Income
- 9.3 Typical Illustrations on computation of income
- 9.4 Payment of Advance Tax
- 9.5 Filing of Returns
- 9.6 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.

*As per the syllabus, law applicable as on 1-4-2022 will be considered for computation of total income for the assessment year 2022-23 (previous year 2021-22). Further, the computation will be restricted to not 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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#### 9.2.1 Computation Procedure for individual assessee

The procedure for preparing and filing of the income tax returns for the financial year 2021-22 relevant to assessment year 2022-23 may be summarized as under:-

1. Collection of preliminary details:
  - (a) Name of the assessee
  - (b) Birth date and age
  - (c) Gender
  - (d) Email address
  - (e) Mobile number
  - (f) PAN
  - (g) Aadhar No and linkage with PAN

- (h) GST No , if any
- (i) Residential status
- (j) Assessment year-2022-23
- (k) Pervious year-2021-22
- (l) Detail of parents and age
- (m) Detail of children and age
- (n) List of Relatives and Associate concerns
- (o) List of investments in saving schemes like LIC, PF etc.
- (p) Insurance premium paid
- (q) Details of handicapped dependents
- (r) Certificate of interest paid on housing loan

These details are relevant to ascertain:-

- i. Applicable tax rate e.g. woman, senior citizen, super senior citizen etc.
  - ii. Deductions such as insurance premium, handicapped assessee, education loan, housing loan interest etc.
  - iii. Disallowances based on relation as in section 40A(2); and
  - iv. Exemption based on relation e.g. gifts from relatives under section 56, 80U, 80D etc.
2. Computation of income under the five heads of income as per the applicable provisions of law.
  3. Income of other assessee; e.g. minor children, spouse etc., which are to be included as per the clubbing provisions given in sections 60-64.
  4. Aggregate of income from all such sources excluding the 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. Computation of 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 reduced.

9. The result will be the net tax liability, from which any amounts deducted at source (TDS), Tax Collected at Source (TCS) and taxes paid in advance are reduced.
10. The final balance, if any, is payable as self –assessment tax under section 140A before filing the return of income.
11. If the advance tax and TDS are more than the tax payable, the excess is shown as the refund due.

## 12. Other Important Points

- a) Agricultural income in excess of Rs 5,000 is added to the total income and tax is computed on such total income. From the tax so computed, tax on agricultural income is separately computed by adding Rs 2,50,000 to the agricultural income. Difference of the two , will be the tax liability
- b) Interest and remuneration payable to partners will be taxable if they are allowed in the hands of firm. Profit from the firm exempt in the hands of the partners as it is taxable in the hands of the firm.
- c) Income of HUF will be excluded as HUF is liable to pay tax on its income.
- d) Any loan taken from a closely held company is deemed dividend under section 2(22)(e) in the hands of the individual where such individual and his relatives hold 10% voting power therein.
- e) Income tax return can be filed only through e fling portal with OTP or digital signature through the link <https://www.incometax.gov.in/iec/foportal/>.

## 2.1 PROCEDURE OF COMPUTATION:

A. Preliminary Information
Name and address of the assessee ,
PAN
GST No
E mail
AAdhaar No
Bank Account No BSR NO
Residential Status : Resident & Ordinary Resident / Resident & Not Ordinary Resident / Non Resident
Assessment Year 2022-23

Previous Year	2021-22
<b>B. Computation of Total Income</b>	
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) ( excluding 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 ( after marginal relief) Add Heath & Education Cess @ 4% of 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)	

## 2.2 Existing Tax Regime

Assessee has been given an option to choose between the old scheme and new scheme of assessment.

Under the old scheme an assessee is entitled to all rebates and deductions and pay tax at normal rates which are as under:-

<b>Income Tax Rates for Assessment Year 2022-23</b>	
Applicable to Individual (resident or non-resident) , HUF, Association of Person, Body of Individual or any other artificial juridical person	
Slab	Rate
<b>Individuals</b>	
First Rs 2,50,000	Nil
2,50,001-5,00,000	5%
5,00,001-10,00,000	20%
10,00,001 and above	30%
<b>Senior Citizens-</b> (Age 60 years Anytime during the P.Y.)	
First Rs 3,00,000	Nil
3,00,001-5,00,000	5%
5,00,001-10,00,000	20%
10,00,001 and above	30%
<b>Very Senior Citizens</b> (Age 80 years anytime during P.Y.)	
First Rs 5,00,000	Nil
5,00,001-10,00,000	20%
10,00,001 and above	30%
<b>Surcharge on Income Tax ( For all)</b>	
Where total income is Rs 50 lakh or less	NIL
Where total income exceeds Rs. Rs 50 lakh	10%
Where total income exceeds Rs. 1 Crore	15%
Where total income exceeds Rs. 2 Crore	25%
Where total income exceeds Rs. 5 Crore	37%
Maximum Cap on surcharge on income chargeable under sections 115AD(1)(b) 111A 112A and dividend income except when the income is taxable under sections 115A, 115AB, 115AC, 115ACA and 115E	15%
<b>Rebate under section 87A</b>	
A resident individual, whose net income does not exceed Rs. 5 lakh can avail rebate under section 87A equal to 100% of income-tax or Rs. 12,500, whichever is less.	
<b>Health &amp; Education Cess (HEC) @ 4% on Tax +Surcharge</b>	
No basic exemption, allowance or expenditure shall be allowed to in computing the deemed income, unexplained income, investments, money etc. chargeable under sections 68/69/69A/69B/69C/69D [Section 115BBE] Set-off of losses not permissible against such income.	

### 2.3 New Tax Regime

From the A.Y.2020-21 a new tax regime with lower rates of income tax has been introduced. The scheme is optional. An assessee may either continue with the old tax regime or may opt for the new regime. However, where an the assessee opts for the new tax regime, as many as

70 exemptions and deductions that are available in the old tax regime will not be allowable to such assessee.

## **2.4 Exemptions deductions not allowed under new tax rate regime**

Following is the broad list of some of the common exemptions and deductions, which will not be allowed' under the new tax rate regime:-

- (a) House Rent Allowance (HRA)
- (b) Leave Travel Allowance (LTA)
- (c) Relocation Allowance
- (d) Conveyance Allowance
- (e) Daily Expenses in course of employment
- (f) Other Special Allowance [Section 10(14)]
- (g) Children education allowance
- (h) Standard Deduction on Salary
- (i) Interest on Housing Loan (Section 24)
- (j) Deduction under chapter VI-A e.g. section 80C, 80D, 80 E etc. except section 80CCD (2).

## **2.5 Exemptions and deductions allowed under new tax rate regime**

Following exemptions and deductions will be allowed' even under the new tax rate regime

- (a) Conveyance allowance for expenditure incurred for traveling to work
- (b) Transport allowance for specially-abled people
- (c) Deduction for employment for new employees under section 80JJAA
- (d) Investment in Notified Pension Scheme (NPS) under section 80CCD(2)
- (e) Any allowance for traveling for employment or on transfer
- (f) Depreciation under section 32 except additional depreciation

## 2.6 Tax Rates under the new tax rate régime

Computation of Total Income

<b>Income Tax Rates for A.Y 2022-23-New Regime</b>	
Applicable to Individual (resident or non-resident) , HUF, Association of Person, Body of Individual or any other artificial juridical person <b>Including senior citizens and very senior citizens</b>	
Slab	Rate
<b>Individuals</b>	
First Rs 2,50,000	Nil
2,50,001-5,00,000	5%
5,00,001-7,50,000	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%
<b>Surcharge on Income Tax ( For all)</b>	
Where total income including chargeable under sections 111A (Short Term capital gain on Listed securities) 112 (Long Term capital Gains) 112A (Long Term Capital Gains on Listed securities) and dividend	
Rs 50 lakh or less	NIL
Exceeds 50 lakh upto Rs 1 Crore	10%
Exceeds Rs. 1 Crore upto Rs. 2 Crore	15%
Where total income <b>excluding</b> chargeable under sections 111A , 112 and 112A and dividend	
Exceeds Rs. 2 Crore upto Rs. 5 Crore	25%
Exceeds Rs. 5 Crore	37%
Thus maximum cap on surcharge on income chargeable under sections 111A Short Term STT paid Listed Capital Gains 112 Long Term capital Gains 112A Long Term Listed Capital Gains and dividend is 15%	

<b>Rebate under section 87A</b>
A resident individual, whose net income does not exceed Rs. 5 lakh can avail rebate under section 87A equal to 100% of income-tax or Rs. 12,500, whichever is less. Available under new regime also
Health & Education Cess (HEC) @ 4% on Tax +Surcharge
No basic exemption, allowance or expenditure shall be allowed to in computing the deemed income, unexplained income, investments, money etc. chargeable under sections 68/69/69A/69B/69C/69D [Section 115BBE]  Set-off of losses not permissible against such income.  No special rates for senior (60years) and very senior citizens(80 years )

## 2.7 Old Tax Regime Vs. New Tax Regime,

The new tax regime includes seven lower income tax slabs. An individual who make low investments in tax-saving schemes like PPF LIC etc. can benefit from new tax regime.

Because of the rebate under section 87 A available under both the regimes, an individual having income upto Rs. 5 lakh will not be affected by either of the two.

The new tax regime can be beneficial for individuals who have a taxable income of up to Rs. 15 lakh. The old regime is a better option those having income more than Rs 15 lakh as the slab rate becomes 30% in both

## 2.8 Illustrations On Old and New Tax Regime

1. Computation of tax liability for A whose Total income of A is Rs 12 lakh for the P.Y.2021-22(A.Y.2022-23)

	Old Regime	New Regime
Total Income	12,00,000	12,00,000
Tax Payable		
First 250,000	0	0
Next 2,50,000 @ 5% both	12,500	12,500
Next 2,50,000 @ 20% old 10% New	50,000	25,000
Next 2,50,000 @ 20% old New 15%	50,000	37,500
Next 2,00,000 @ 30% old New 20%	60,000	40,000
Total Tax	1,72,500	1,15,000
Add Health & Education Cess @4%	6,900	4,600
Total Tax	1,79,400	1,19,600

2. Computation of tax liability for A whose Total income of A is Rs 12 lakh for the P.Y.2021-22(A.Y.2022-23) and Rs 1,91,670 under section 80C/D

Computation of Total Income

	Old Regime	New Regime
Total Income Less 1,91,670	10,08,330	12,00,000
Tax Payable		
First 250,000	0	0
Next 2,50,000 @ 5% both	12,500	12,500
Next 2,50,000 @ 20% old 10% New	50,000	25,000
Next 2,50,000 @ 20% old New 15%	50,000	37,500
Next 8,330 @ 30% old New 20%	2,499	40,000
Total Tax	1,14,999	1,15,000
Add Health & Education Cess @4%	4,600	4,600
Total Tax	1,19,599	1,19,600

3. Computation of tax liability for A whose Total income of A is Rs 15 lakh from salaries for the P.Y.2021-22(A.Y.2022-23) and he makes investment of Rs 1,50,000 qualified under section 80C, Rs 25,000 under section 80D and also pays housing loan interest of Rs 2,00,000.

	Old Regime	New Regime
Salaries	15,00,00	15,00,00
Standard Deduction	50,000	0
Taxable Salaries	14,50,000	15,00,00
House property Income (SOP) NIL		NIL
Less Interest under section 24(1)	(2,00,000)	0
Gross Total Income	12,50,000	15,00,00
Tax Payable		
First 250,000	0	0
Next 2,50,000 @ 5% both	12,500	12,500
Next 2,50,000 @ 20% old 10% New	50,000	25,000
Next 2,50,000 @ 20% old New 15%	50,000	37,500
Next 2,50,000 @ 30% old New 20%	75,000	40,000
Next 2,50,000 @ 30% old New 30%	0	75,000
Total Tax	1,87,500	1,90,000
Add Health & Education Cess @4%	7,500	7,600
Total Tax Liability	1,95,000	1,97,600

From the above following conclusions be drawn:

1. On total income of Rs. 12 lakh without deduction it will be advisable to go for the new regime because tax liability under the new regime Rs 1,19,600 is substantially lower than liability under the old regime is Rs 1,79,400.
2. On investment of Rs.1,91,670 in mediclaim, life insurance, ULIP, payment of children tuition fees, payment of EMI on education loan, purchasing a house with a home loan tax free securities, liability under both the scheme is at par.
3. Individual who have more investments in various tax saving instruments, should opt for the old tax regime as it helps with higher tax deduction and lower tax liability.

### 9.3 TYPICAL ILLUSTRATIONS

1. Ascertain the tax liability of R, whose total income is Rs 5 lakh. A also show if there will be any difference in the tax liability if he also has agricultural income Rs 1 lakh.

#### Solution

##### I Tax on Income of Rs 6 lakh

	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	0
	12,500
Add HEC @4%	500
Total Tax on Rs 5,00,000	13,000

##### II If Income includes Agricultural income

- (a) Tax on Total income plus agricultural income  
Rs 5 lakh + 1 lakh = Rs 6 lakh

	Rs
Tax on first Rs 2,50,000	NIL
On Next Rs 2,50,000 @ 5%	12,500
On Balance Rs 1,00,000 @ 20%	20,000
	32,500
Add Cess HEC @ 4%	1,300
Total Tax on Rs 6,00,000	33,800

- (b) Tax on basic limit plus agriculture income

$$-\text{Rs } 1,00,000 + 2,50,000 = \text{Rs } 3,50,000$$

Rs

Computation of Total Income

Tax on first Rs 2,50,000 NIL

On Next Rs 1,00,000 @ 5% 5,000

Rebate u/s 87A 5,000

Balance Tax payable NIL

(c) Tax payable (a)- (b) or Rs 33,800 – NIL= Rs 33,800

2. Compute total income of Mangesh for the AY 2022-23 from the following and also compute the tax liability.

Profit and Loss Account for the year ended 31st March, 2022			
Particulars	Rs.	Particulars	Rs.
To Salaries	2,00,000	By Gross Profit	9,25,000
To Rent	30,000	By Interest on FD	10,000
To postage	10,000	By Dividend-Indian	25,000
To Stationery & Ptg	37,000	By dividend- Co-bnk	10,000
To Advertising Exp.	25,000	By Lottery Prize	15,000
To Repairs to Office	25,000	By Debenture Int.	5,000
To Conveyance	20,000		
To Income Tax	15,000		
To IT scrutiny Exp	8,000		
To CA Fee for Tax	10,000		
To Misc. Expenses	20,000		
To Depreciation	10,000		
To Donation	10,000		
To Net Profit	5,70,000		
	9,90,000		9,90,000

**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 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. 10,000.

**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		5,70,000
<u>Add: Disallowable Expenditure</u>		
Bonus due but not paid –section 43B	30,000	
Rent (Personal	30,000	
Purchase of shares (Misc Exp)	20,000	
Income Tax	30,000	
Donation (10,000+ 5,000)	15,000	
Depreciation	<u>10,000</u>	<u>1,35,000</u>
		7,05,000
<u>Less: Income Considered Separately</u>		
Interest on Bank FD	10,000	
Dividend from Indian Company	25,000	
Dividend from Co-operative Bank	10,000	
Winning from Lottery	15,000	

Interest on Debentures of Ltd Co	<u>5,000</u>	<u>65,000</u>
		6,40,000
<b>Less:</b> Depreciation as per rules		<u>10,000</u>
Business Profits		6,30,000
<b>II <u>Income from Other Sources</u></b>		
Interest on Bank FD	10,000	
Dividend from Indian Company	25,000	
Dividend from Co-operative Bank	10,000	
Winning from Lottery	15,000	
Interest on Debentures of Ltd Co	<u>5,000</u>	
Income from Other Sources		65,000
Gross Total Income		6,95,000
Less: Deductions- under Ch. VI-A		
80-DD: Maint. of handicapped dependant		<u>1,00,000</u>
Total Income		<u>5,95,000</u>
Tax Payable 12,500 on 5 L+20% 95000		31,500
HEC 4%		<u>1,260</u>
Total Tax Payable		32,760

Computation of Total Income

*Note: it is not necessary there must be actual expenses incurred on handicapped dependent to claim deduction u/s 80DD.*

3. Compute the total income and ascertain the tax liability of Sam for the A.Y. 2022-23 from the following Profit and Loss Account:

Profit and Loss Account for the year ended 31st March, 2022.			
Particulars	Rs.	Particulars	Rs.
To Salaries	1,30,000	By Gross Profit	10,67,000
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	50,000
To Advt 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	6,45,000		
Total	11,46,000		11,46,000

**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:**

Computation of Total Income

<b>Computation of Total Income of Sam for AY: 2022-23</b>			
	Rs	Rs	Rs
<b>I Income from Business</b>			
Net Profit as per P/L Account		6,45,000	
Add: 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	
Less: Income Considered Separately		8,26,000	
UTI Dividend	9,000		
Income from LIC Mutual Fund	5,000		
Gift from Mother	45,000		
Winning from Crossword Puzzle	12,000		
Interest on NSC	3,000	74,000	
		7,52,000	
Less: Depreciation as per rules		38,000	
Income from Business			7,14,000
<b>II Income from Other Sources</b>			
UTI Dividend		9000	
LIC Mutual Fund		5000	
Gift from Mother (exempt)		Nil	
Winning from Crossword Puzzle		12,000	
Interest on NSC		3,000	
Income from Other Sources		15000	44,000
Gross Total Income			7,58,000
Less: Deductions under Chapter VI-A			
80-C NSC Interest Re-invested		3,000	3000
Total Income			7,55,000
Tax Payable on Income			63500
HEC@ 4%			2140
Total Tax			14040

4. Jain a Chartered Accountant gives the following Receipt and Payments Account for the year ended 31st March, 2022.

Receipts	Rs.	Payments	Rs.
To Cash & Bank B/f	70,000	By Office Rent	6,000
To Fees from Clients (net)	6,60,000	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 Interest.-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	5,00,000
TOTAL	8,94,000	TOTAL	8,94,000

**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. 20,000.
- (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.

Computation of Total Income

**Solution:**

Computation of Total Income of S. V. Joshi A.Y . 2022-23		
Particulars	Rs	Rs
Income from Profession		
Fees from Clients	6,60,000	
Add: Tax Deducted at Sources	20,000	6,80,000
Less: Allowable Expenses		
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	11,000	1,32,500
Income from business		8,12,500
II Income from Other Sources:		
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	Nil	
(exempt)		
Dividend from Indian Companies	5,000	
Income from Other Sources	61,000	61,000
Gross Total Income		8,73,500
Less: Deductions under Chapter VI-A		
80-C Life Insurance paid	64,000	
80-D Medical insurance Premia :		
Rs 30,000 for father + Rs. 25,000 for self- =maximum	55,000	1,19,000
TAXABLE INCOME		7,54,500
Tax Payable on Income		64,400
HEC@ 4%		2,672
Total Tax		67,072

**5. Compute total income and tax liability on the income of X from the particulars given below:**

Basic pay: Rs. 36,000 pm

Education allowance for one child: Rs. 300 pm

Bonus: Rs. 26,000

Salary in lieu of leave: Rs. 25,000

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. 2,500 professional tax.

**Solution**

<b>Computation of Total Income – A.Y. 2022-23</b>		
Basic Salary	36,000 X 12)	4,32,000
Education allowance	(300 X 12) 3,600	
Less: Exempt	(100 X 12) <u>1,200</u>	2,400
Bonus		26,000
Leave Encashment		25,000
		<b>4,85,400</b>
Less Profession Tax		2,500
Income from Salaries		<b>4,82,900</b>
Dividend from foreign company	10,000	
Winnings from Horse Race	42,500	
Bank Interest	14,000	
Income from Other Sources		66,500
Total Income		<b>5,49,400</b>
Tax Payable		23,330
HEC @4%		933
Total Tax		<b>24,263</b>

## 9.4 PAYMENT OF ADVANCE TAX -SECTIONS 208-209

Computation of Total Income

**4.1** As per section 208, all assesseees are required to pay advance tax on their current income from all sources, if tax liability for payment of tax is Rs.10,000 or more. .

### 4.2. Amount and due Dates for payment of Advance Tax;

Advance tax is payable four instalments by the companies and in three instalments by other assesseees as per the following table:

INSTALLMENT FOR PAYMENT OF ADVANCE TAX	
Due date	Tax Payable as % of total tax
15 June	Not Less than 15%
15 September	Not Less than 45% Less tax paid (30%)
15 December	Not Less than 75% Less tax paid (30%)
15 March	Not Less than 100% Less tax paid (25%)
Tax payable by assessee covered under section 44AD /44ADA for presumed taxation 100% of tax payable before 15 March	
Payment made by 31 <sup>st</sup> March considered Advance Tax	

### 4.3. Miscellaneous

- The Assessing officer may, serve a notice upon the assessee to pay advance tax on the basis of the last regular assessment and if the assessee does not pay the advance tax he/it shall be deemed to be an assessee in default.
- For shortfall / non- payment assessee will be liable to pay interest under sections 234 B and 234 C.

### Illustration

**1.** Assuming income of an for F. Y. 2021-22 estimated to be Rs 10,00,000 , current tax liability works out at Rs.1,17,000 ( first 2.5 lakh nil +12,500 on next 2.5 lakh @ 5% + 1,00,000 on next 5 lakh @ 20% Rs 1,12,500 + 4,500 HEC @4%):-

Installment	Due Date	Amount	Cumulative
I - 15%	15 June ,2017	17,550	17,381
II- 45%	15 September,2017	35,100	52,650
III-75%	15 December,2017	35,100	87,750
IV- 100%	15 March,2018	29,250	1,17,000

## **9.5 FILING OF RETURNS- SECTION 139(1) 139(4) ,139(5) & 139(8)**

### **5.1 Liability for filing returns –Original Return**

Under section Sec 139(1) it is mandatory for the following classes of assessee to file return of income or loss:

**1.** Every Person (other than a company or a firm) if his total income or the total income of any other person in respect of which he is assessable under the Act during the previous year

- a. exceeds the basic exemption limit ( Rs 2,50,000 )or
- b. exceeds the basic exemption limit before claiming the deduction under sections 10(38), 10A, 10B, 10BA, 54, 54B, 54D, 54EC, 54F, 54G, 54GA and 54GB even if Total income is less than the 2,50,000/- after claiming the benefit of the above provisions

**2.** Every person who , during the previous year

- a. has deposited aggregate amount exceeding 1 Crore in one or more current accounts maintaining with banking company and co-operative bank.
- b. has incurred as aggregate amount exceeding 2,00,000/- for foreign traveling for himself or for any other person.
- c. has incurred expenditure on consumption of electricity for an aggregate amount of Rs. 1,00,000.
- d. is in occupation of an immovable property exceeding a specified floor area, whether by way of ownership, tenancy or otherwise, as may be specified by the Board in this behalf;
- e. is the owner or the lessee of a motor vehicle other than a two-wheeled motor vehicle, whether having any detachable side car having extra wheel attached to such two-wheeled motor vehicle or not; or
- f. is the holder of a credit card, not being an "add-on" card, issued by any bank or institution; or

- g. is a member of a club where entrance fee charged is twenty-five thousand rupees or more,
- 3. Companies, Firms including Limited Liability Partnerships (LLPs) irrespective of the income.

5.2 Such return of income or loss shall be filed :

- a. on or before the due date
- b. in prescribed form,
- c. verified in prescribed manner and
- d. setting forth such other particulars as may be prescribed and
- e. digitally signed in electronic form i(Section 139D) by
  - (i) a company or
  - (ii) Other assessee having tax audit or having income of Rs 10 lakhs or more.

### 5.3 Due date for filing return of income

Due date for filing return means –

- (a) The 31st day of October of the assessment year in the case of the assessee being -
  - (i) a company; or
  - (ii) a person (other than a company) whose accounts are required to be audited under this Act or any other law in force; or
  - (iii) a partner of a firm whose accounts are required to be audited under the Income-tax Act, 1961 or any other law for the time being in force or the spouse of such partner if the provisions of section 5A applies to such spouse (Goan couple covered under Portuguese Civil Code) .
- (b) the 31st day of July of the assessment year in the case of any other assessee,
- (c) the 30th day of November of the assessment year in the case of an assessee including the partners of the firm or the spouse of such partner if the provisions of section 5A applies to such spouse), being such assessee, who is required to furnish a report referred to in section 92E. (Transfer Price Audit Cases).
- (d) the 31st day of October of the assessment year in the case of a person other than a company not covered above.

**Illustrations: -****Due dated for the following assessees**

Assessee	Income	Status	Due Date
XYZ Limited	Loss	Company	31-10-2022
XYZ Limited	Profit	Company	31-10-2022
X	Gross Income Rs 50,000	Individual	Not liable
T	Gross Income Exempt under section 10A, 10 Cr	Individual	31-07-2022
Z	Loss audited	Individual	31-07-2022
A	NIL not audited	Firm	31-07-2022
B	Nil Audited	Firm	31-10-2022

**5.4 Belated Return – Section 139(4)**

Any person who has not furnished a return within the time allowed to him under section 139 (1), may furnish the return for any previous year at any time before three months prior to the end of the relevant assessment year or before the completion of the assessment, whichever is earlier. This is called belated return.

A person who is required to furnish a return of his income, or loss under this section and who has not filed original return of income or loss before the due date may file the belated return latest by 31 December 2022, if the assessment is not completed by that date. However such person will be liable to pay penalty of Rs 5,000 under section 271F. :

**5.5 Revised return – Section 139(5)**

Any person, who has furnished the original return under section 139(1) or belated return under section 139(4) and discovers any omission or any wrong statement therein, he may furnish a revised return at any time before three months prior to the end of the relevant assessment year i.e. 31 December 2022 for the A.Y. 2022-23 or before the completion of the assessment, whichever is earlier. A return furnished in response to notice under section 142(1) or 148 can not be revised under this section.

**5.6 Updated return –section 139(8A)**

An assessee may file an updated return can be filed with effect from 01-4-2022 in respect of his income or in representative of other person whether or not he has furnished a return under sections 139(1), 139(4) or 139(5) for

an assessment year at any time within twenty-four months from the end of the relevant assessment year.

Updated return is not allowed in following cases-

1. if for the relevant assessment year such return -
  - (a) is a return of a loss;
  - (b) has the effect of decreasing the total tax liability determined on the basis of return furnished under sections 139(1), (4) or (5),
  - (c) results in refund or increases the refund due on the basis of return furnished under sections 139(1) (4) or 5).
2. Where any search, seizure requisition of book under section 132 or survey under section 133A has been initiated in the preceding assessment year,
3. where an updated return has been furnished by him under this sub-section for the relevant assessment year;
4. any proceeding for assessment or reassessment or recomputation or revision of income under this Act is pending or has been completed for the relevant assessment year in his case;
5. Where the Assessing Officer has information in respect of such person for the relevant assessment year in his possession under the Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976, the Prohibition of Benami Property Transactions Act, 1988, the Prevention of Money-laundering Act, 2002, the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 and the same has been communicated to him, prior to the date of furnishing of updated return,
6. Where information for the relevant assessment year has been received under an agreement referred to in section 90 or section 90A in respect of such person and the same has been communicated to him, prior to the date of furnishing of updated return,
7. where any prosecution proceedings have been initiated for the relevant assessment year in respect of such person, prior to the date of furnishing of updated return, or
8. he is such person or belongs to such class of persons, as may be notified by the Board in this regard:

#### Other Points

1. Where any person has sustained a loss in any previous year and has furnished a return of loss in the prescribed form within the time allowed under section 139(1) may furnish an updated return of income:

2. an updated return shall be furnished for each such subsequent previous year in cases where amount of carried forward losses, unabsorbed depreciation, MAT tax credit under section 115JAA / 115JD is be reduced for any subsequent previous year as a result of furnishing of return of updated income for a previous year,
3. Additional Tax under section 140B is required to be paid for opting to file Updated return equal to
  - (a) 25 per cent of aggregate of tax and interest payable if such return is furnished after the expiry of the time available under sections 139(4)/(5) and before completion of period of 12 months from the end of the relevant assessment year
  - (b) 50 per cent of aggregate of tax and interest payable in if updated return is filed after 12 months but before 24 months from the end of the relevant assessment year

#### 5.4 Other Points:

- A. CBDT is vested with the powers to prescribe forms of return
- B. A return must be properly verified and signed by an individual or partner of a firm or a director of company etc.
- C. Consequences of late filing of return ;
  - Liability for Interest @ 1% per month under section 234A
  - Penalty of Rs 5,000 if return filed before 31st December and 1,0000 if filed thereafter. Return cannot be filed after March 31,2022
  - **Certain exemptions cannot be claimed** including section 11 available to charitable trusts.
  - A belated return cannot be revised
  - Loss is not allowed to be carried forward.
- D. Return will not be treated defective if self –assessment tax not paid
- E. A return cannot be revised if filed in response to notice under section 142.
- F. Belated return cannot be filed beyond the end of the assessment year

## 5.5 Prescribed returns for the Asst Year 2022-23:

Computation of Total Income

ITR- 1	Resident Individuals (other than not ordinarily resident) having total income up to Rs. 50 Lakhs from salaries, one house property, other sources & agricultural income up to Rs. 5,000.
ITR- 2	Individuals or HUFs not having income from business or profession and who cannot file returns in Form ITR-1.
ITR- 3	Individuals or HUFs having income from business or profession
ITR- 4	Individuals, HUFs, and Firms (other than LLPs) being a resident having total income up to Rs. 50 Lakhs and having income from business or profession computed u/s 44AD, 44ADA or 44AE.
ITR- 5	LLPs
ITR- 6	The companies including One-Person Companies
ITR- 7	Companies claiming exemption under section 11

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## 5.7 SELF ASSESSMENT QUESTIONS

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1. Discuss the provisions for payment of advance tax. .
2. Explain advance tax liability of Ms. ABC if her income will be Rs 15,00,000 for the financial year 2021-22.
3. What are the due dates of payment of advance tax by different assesseees?
4. Ram gives you the Profit and Loss Account for the year ended 31<sup>st</sup> March, 2022. 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.

Profit and Loss Account for the year ended 31 <sup>st</sup> March 2022			
Particulars	Rs.	Particulars	Rs.
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 Exp. To Donations	65,000	By dividend from Indian companies	9,000
To R.D.D.	5,000		
To Mediclaim (Cash)	10,000		
To insurance	21,000		
To Income Tax	10,000		
To Depreciation	8,000		
To Net Profit	20,000		
	32,110		
	<hr/>		<hr/>
	<b>20,23,500</b>		<b>20,23,500</b>

**Additional Information:**

- 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.
- Donations are given for books to poor students
- On August 10, 2021 furniture of Rs. 20,000 was purchased on credit the payment for which was made on April 2, 2016. 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.
- Bad debts recovered were allowed during the A.Y 2009-10.

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, 2022: You are required to compute her total income for the AY 2022-23.

Computation of Total Income

Basic Salary (Net) 1-4-2021 to 30-9-2021	Rs. 10,000 p.m. (TDS Rs 600 P.M) , (Profession Tax Rs 1,250 )
1-10-2021 to 31-3-2022	Rs. 12,000 p.m. ( TDS Rs. 700 p.m. ) (Profession Tax Rs 1,250 .)
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, 2018 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

7. Compute total income of Krishna for the AY 2022-23 from the Profit and Loss Account of his proprietary concern for the year ended March 31, 2022

Particulars	Rs.	Particulars	Rs.
To Opening Stock	2,34,000	By Sales	12,40,000
To Purchase	10,00,000	By Closing Stock	2,05,000
To Office Salaries	57,000	By Income Tax Refund	15,000
To Proprietor's Salaries	30,000	(including interest Rs. 2,000)	
To Bad Debts	25,000	By Dividend from UTI	20,000
To Advertisement	10,500	By Dividend from Y Ltd (an Indian Company)	25,000
To Fire Insurance Premium	4,500	By Interest on PPF	5,000
To Conveyance Exp	6,000	By Lottery prize received	10,000
To Interest on Proprietor's Funds	25,000		
To Medical Expenses	20,000		
To General Expenses	35,000		
To Wealth Tax paid	5,000		
To Residential Telephone expenses	14,000		
To Depreciation	30,000		
To Net Profit	20,000		
	<u>15,20,000</u>		<u>1520,000</u>

**Additional Information**

Computation of Total Income

- a) The residential telephone is used half the time for office work.
  - b) Purchases include Rs. 1,00,000 paid for cash purchases, exceeding the limits prescribed under Section 40A(3).
  - c) General expenses include advance income tax of Rs. 10,000 paid during the year and Rs. 500 for purchase of lottery tickets.
  - d) Depreciation allowable as per Income Tax Rules Rs. 25,000
  - e) Agricultural income Rs.70,000.
8. Compute total income of R with 40% disability, from following information regarding his house property for the AY 2022-23.

Particulars	HOUSE I	HOUSE II
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		--
Insurance premium paid	2,000	--
Other information:	1,500	
(i) Interest from debentures in Y Ltd		--
(ii) Dividend from UTI	12,000	--
(iii) Bank interest from SBI	5,000	--
(iv) Winning from lottery	3,500	--
(v) Interest from Post Office Savings Account	28,000	--
(vi) Dividend from a co-operative society		--
	5,000	
	5,000	

