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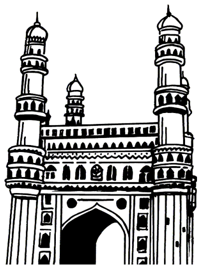

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Direct and Indirect Taxes – Canons of Taxation - Features and History of Income Tax in India – Definitions and Basic Concepts of Income Tax: Assessee – Deemed Assessee – Assessee-in-default – Assessment Year – Previous Year - Person – Agricultural Income – Heads of Income – Gross Total Income – Total Income — Incomes Exempt from Tax. Residential Status and Scope of Total Income: Meaning of Residential Status – Conditions applicable to an Individual Assessee – Incidence of Tax – Types of Incomes. (Theory only)

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INCOME FROM SALARIES:

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UNIT - III

INCOME FROM HOUSE PROPERTY:

Definition of ‘House Property’ – Exempted House Property incomes– Annual Value – Determination of Annual Value for Let-out House and Self-occupied House – Deductions u/s.24 – Problems on computation of Income from House Property.

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PROFITS AND GAINS OF BUSINESS OR PROFESSION :

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CAPITAL GAINS AND INCOME FROM OTHER SOURCES :

Introduction - Meaning – Scope of charge – Basis of charge – Short term and Long term Capital Assets – Transfer of Capital Asset – Deemed Transfer –Determination of Cost of Acquisition – Procedure for computation of Long-term and Short-term Capital Gains/ Losses – Exemptions in respect of certain Capital Gains u/s. 54 – Problems on computation of capital gains - General Incomes u/s. 56(1) – Specific Incomes u/s. 56(2) – Dividends u/ s. 2(22) – Winnings from lotteries Puzzles, crown world puzzles, Races – Interest on Securities – Gifts received by an Individual – Casual Income – Family Pension – Rent received on let out of Furniture- Plant and Machinery with/without Building – Deductions u/s. 57. (Theory only)

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Frequently Asked & Important Questions

UNIT - I

1. What do you mean by Canons of Taxation? Discuss the principles to be consider at the time of framing an ideal taxation policy.

Ans : **(Imp.)**

Refer Unit-I, Q.No. 9

2. Explain the history and features of income tax in India.

Ans : **(Imp.)**

Refer Unit-I, Q.No. 10

3. State the various income slab and tax rates for the assessment year 2021-22.

Ans : **(Imp.)**

Refer Unit-I, Q.No. 17

4. "Income tax is a tax on income, but all incomes are taxable". Explain.

Ans : **(Imp.)**

Refer Unit-I, Q.No. 19

5. How do you determine residential status of an individual?

Ans : **(Aug.-21, Imp.)**

Refer Unit-I, Q.No. 21

6. Define Incidence of Tax. Discuss in detail about types of incomes.

Ans : **(Imp.)**

Refer Unit-I, Q.No. 23

7. Discuss in detail Scope of Total Income.

Ans : **(Imp.)**

Refer Unit-I, Q.No. 24

8. What is Agricultural Income? Explain different types of Agricultural Incomes.

Ans : **(Imp.)**

Refer Unit-I, Q.No. 25

UNIT - II

1. What is meant by Annual Accretion? Explain with an example.

Ans : **(Imp.)**

Refer Unit-II, Q.No. 6

2. What is provident fund? Explain different types of provident fund and its treatment.

Ans : **(Imp.)**

Refer Unit-II, Q.No. 7

3. Define Allowances. What type of allowances received by an employee.

Ans : **(Imp.)**

Refer Unit-II, Q.No. 8

4. Explain the term perquisites. List out any ten perquisites which are fully taxable.

Ans : **(Oct.-21, Aug.-21, Imp.)**

Refer Unit-II, Q.No. 10

5. Explain in detail about the Profits in Lieu of Salary and their treatment.

Ans : **(Imp.)**

Refer Unit-II, Q.No. 11

6. Smt. Roja rani is an employee in a private company. Her basic salary is 15,000p.m, D.A. `. 3,000p.m., Transport allowance `.3,000p.m. (Actual amount spent `. 2,000) She receives the following medical benefits from the company during the previous year. Calculate income from salary current assessment year. Reimbursement of the following medical expenses incurred by Smt. Roja.

i) On treatment of herself by family Doctor `. 5,000.

ii) On treatment of herself employed daughter `. 4,000.

iii) On treatment of her Father-in-law dependent on her in a Nursing home `. 10,000.

iv) Medical allowance `. 1,000p.m.

vi) On treatment of her minor son abroad `. 1,02,000.

vii) On treatment of her son in a Government hospital `. 3,500

Sol : **(Imp.)**

Refer Unit-II, P.No. 21

7. Mr. Pratap an employee of Public sector company, rurnestones me following mtoimanon

(a) Basic Pay ` 11,60,000

(b) Arrears of Salary ` 54.000

(c) Advance Salary ` 10,000

(d) Small Car was provides by the Employer, which he has used both for official and business purposes

(e) Professional Tax paid ` 3,200 per annum

(f) **House Rent Allowance received ` 25,720, Exempted Allowance is ` 12,500**

(g) **Employee spent ` 15,000 as Medical expenses towards treatment in recognized hospital and the same amount has been reimbursed**

(h) **Entertainment Allowance is ` 42,620 and Deduction is ` 5,000**

(i) **Employer paid Club Bill ` 5,000, Electricity ` 7,200**

Compute his Taxable Salary.

Sol : **(Oct.-21)**

Refer Unit-II, P.No. 22

UNIT - III

1. What is meant by Annual Value? Explain different factors that are to be considered in determining the annual value of the house property.

Ans : **(Oct.-21, Imp.)**

Refer Unit-III, Q.No. 3

2. Explain in detail determination of Annual Value for Let-out House.

Ans : **(Oct.-21, Imp.)**

Refer Unit-III, Q.No. 4

3. Explain the computation of annual value for Self-occupied House.

Ans : **(Imp.)**

Refer Unit-III, Q.No. 5

4. What deductions are allowed from the annual value in computing taxable income from house property?

Ans : **(Oct.-21)**

Refer Unit-III, Q.No. 6

5.

Particulars	House-I	House-II
Municipal Value	8,00,000	12,00,000
Fair Rental Value	9,00,000	12,00,000
Standard Rent	10,00,000	10,00,000
Actual Rent	12,00,000	Self occupied
Date of Construction	1 / 5 /2001	1/10/2015
Interest on Loan taken to construct the house		
Pre Construction Interest	60,000	80,000
Vacancy period	1 month	–
Municipal Taxes	10%	15%

Above are the particulars given by Bala krishna compute income from House Property

Sol : **(Imp.)**

Refer Unit-III, P.No. 6

UNIT - IV

1. Explain the various incomes chargeable under head profit and gains.

Ans : **(Imp.)**

Refer Unit-IV, Q.No. 2

2. Briefly explain the points to be considered while computing business income.

Ans : **(Imp.)**

Refer Unit-IV, Q.No. 3

3. Explain in brief the deductions allowed while computing business (or) professional income of assessee.

Ans : **(Imp.)**

Refer Unit-IV, Q.No. 5

4. Explain the Miscellaneous Provisions under section 44.

Ans : **(Imp.)**

Refer Unit-IV, Q.No. 8

5. Mr. Gopal submits the following particulars for the year ended 31 st March, 2021. Compute his Income from Business.

Profit and Loss Account

Particulars	Amount (`)	Particulars	Amount (`)
To Salary	1,05,000	By Gross Profit	8,00,000
To Telephone Expenses	11,000	By Income from House Property	6,000
To Repairs	18,000	By Profit on Sale of Land	70,000
To Legal Expenses	39,000	By Interest on Securities	1,000
To Motor Car Expenses	44,000	By Bad Debts recovered	5,000
To Income Tax	10,000		
To Security Transaction Tax	6,000		
To Provision for Taxation	3,000		
To interest on Loan	12,000		
To Bad Debts	6,000		
To Provisions for Bad Debts	8,600		
To Depreciation	45,000		
To General Expenditure	42,000		
To Net Profit	5,32,400		
	8,82,000		8,82,000

Additional Information:

1. Interest paid on Loan for purchase of Machinery
2. As per the Income Tax Act allowable Depreciation is ` 30,000
3. Repairs included in Capital Expenditure ` 12,500, current year repairs ` 5,500
4. Proprietor Salary included in Salary ` 25,000
5. General expenditure included ` 15,000 paid as penalty for violation of Income Tax rules.

Sol : **(Oct.-21, Imp.)**

Refer Unit-IV, P.No. 2

---

6. What are the differences between Capital and Revenue Expenses.

Ans : **(Imp.)**

Refer Unit-IV, Q.No. 17

---

7. What is depreciation? Explain the conditions for charging depreciation ?

Ans : **(Oct.-21, Imp.)**

Refer Unit-IV, Q.No. 18

---

8. Dr. Krishna submitted the following income and expenditure account for the year ending 31st March 2021. Compute the income from profession.

Expenditure	Amount (`)	Income	Amount (`)
To Purchase of medicines	50,000	By Consulting fees	3,05,000
To Purchase of life saving medical equipment on 01/05/2013	1,20,000	By Visiting fees	66,000
To Dispensary rent	24,000	By Sale of medicines	60,000
		By Interest on debenture	18,000
To Salary to staff of Ltd. Co.	32,000		
To Telephone charges	8,000	By Pension	40,000
To Income tax	14,000	By Misc. income	290
To Subscription to journals	1,250		
To Gifts given to friends	2,000		
To Ambulance van expenses	18,500		
To House hold expenses	86,000		
To Public deposits in X ltd.	40,000		
To Net income	93,540		
	4,89,290		4,89,290

Depreciation on Ambulance Van is ` 20,000.

Sol : **(Aug.-21, Imp.)**

Refer Unit-IV, P.No. 11

UNIT - V

1. Define Capital Gain. Explain different types of Capital Gains.

Ans : **(Imp.)**

Refer Unit-V, Q.No. 1

2. Discuss in detail about Deemed Transfer.

Ans : **(Imp.)**

Refer Unit-V, Q.No. 6

3. How do you determined the cost of Acquisition for various situations? Explain.

Ans : **(Imp.)**

Refer Unit-V, Q.No. 9

4. Write in detail about Procedure for computation of Long-term and Short-term Capital Gains?

Ans : **(Imp.)**

Refer Unit-V, Q.No. 10

5. Explain about the exemptions in respect of capital gains u/s 54.

Ans : **(Imp.)**

Refer Unit-V, Q.No. 13

6. Mr. Vigneshwar sold his residential house for ` 32,50,000 on 15th August 2019-2020 (CII = 289) which he purchased on 10.08.1988 for ` 1,02,000. Fair market value on 01-04-2001 is ` 8,50,000 and selling expenses 2%. Compute the Income from Capital Gain and Tax Liability if Income from Other Heads is nil.

Sol : **(Oct.-21, Imp.)**

Refer Unit-V, P.No. 4

7. Explain briefly about General Incomes u/s. 56(1).

Ans : **(Imp.)**

Refer Unit-V, Q.No. 15

8. "Mention the different kinds of incomes specially mentioned as chargeable to tax under the head income from other sources.

Ans : **(Imp.)**

Refer Unit-V, Q.No. 16

9. Mr. Ramraj received following incomes during the previous year relevant to current assessment year

(i) ` 20,000; 10% Preference Shares of Wipro Limited Company

(ii) ` 30,000; 12.5% Gold Deposit Bonds

(iii) ` 25,000; 5% Government of India Loan

(iv) ` 1,50,000; 6% Tax Free Debentures of Birla Company Limited

(v) ` 75,000; 4% (Less Tax) Telangana Government Bonds

(vi) ` 1,00,000; 2% Tax Free Kerala Government Securities

(vii) ` 15,000; 7.5% Nagpur Municipal Bonds

(viii) ` 40,000; 13% Tax free Debentures of Vandana ltd.

Collection charges are ` 450 and Interest on Loan taken to purchase Birla Company Debentures is ` 500. Compute Income from Securities for the assessment year 2021-2022

Sol : **(Oct.-21, Imp.)**

Refer Unit-V, P.No. 10

UNIT I

INTRODUCTION:

Direct and Indirect Taxes – Canons of Taxation - Features and History of Income Tax in India – Definitions and Basic Concepts of Income Tax: Assessee – Deemed Assessee – Assessee-in-default – Assessment Year – Previous Year - Person – Agricultural Income – Heads of Income – Gross Total Income – Total Income — Incomes Exempt from Tax. Residential Status and Scope of Total Income: Meaning of Residential Status – Conditions applicable to an Individual Assessee – Incidence of Tax – Types of Incomes. (Theory only)

1.1 Introduction to Tax

1.1.1 Direct and Indirect Taxes

Q1. Define Tax. What are the characteristics of Tax?

Ans : **(Imp.)**

Meaning

The term 'Tax' means statutory payment to be made by the public and imposed by the Government. The word 'tax' is derived from a Latin word "Tax are" it means to estimate or value.

Definition

Prof. Adams defined 'Tax' as, from the stand point of the state, a tax is source of derivative revenue; from the angle of the citizen, a tax is a coerced payment; from the administrative point of view; it is a demand for money by state in conformity to established rules; from the point of view of a theory, a tax is a contribution from individuals for common expenditure.

Characteristics

The following are the important characteristics of tax.

1. Taxes can be/shall be imposed by the Government only.
2. Taxes are paid in the form of cash. (In the ancient days taxes were collected in the form of kind also).
3. The aim of levying tax is to promote the welfare of the people living in the country.
4. The object of tax is to raise revenue to the Government.
5. Tax is a legal collection.
6. Payment of tax involves an element of sacrifice.
7. It is levied by the Government by virtue of its power conferred under the constitution.
8. Tax is not a payment for specific service rendered by the Government to tax payer.
9. Tax may be imposed on income or wealth or on a commodity i.e., either directly or indirectly etc.

Q2. What are the objectives of Tax?

Ans : **(Imp.)**

Every Government has to discharge its statutory, administrative and social functions. To discharge the said duties money is required by the Governments. So every Government's major source of revenue comes by levy and collection of taxes from the public. The objects of taxes can be studied from two angles

I. Traditional Approach

II. Modem Approach

I. Traditional approach

Under this approach the objectives of taxation can be studied as

(a) Main objectives

(b) Subsidiary objectives.

(a) Main objectives

1. To generate income, to meet day-to-day expenditure of the Government.
2. To make provisions to fulfill the basic needs of the people.

3. Taxation policy is a key instrument to bring socio and economic changes of the people.
4. Tax is levied to protect the home trade and domestic industry from the global businessmen.
5. Prevention and control of concentration of economic power i.e., income and wealth in the hands of few persons in other words remove disparities..
6. A good taxation system provides redistribution of income and wealth i.e. making the lower income people to become rich and the rich not to grow at a faster rate.

(b) Subsidiary objectives:

The following are the subsidiary objectives.

1. One of the economic objective of imposing taxes is for formation of public capital for the rapid development of the economy.
2. In times of scarcity of a commodity, heavy taxation or high tax rate reduces the domestic consumption example taxes on gold, petrol.
3. To encourage savings and channelize such savings into investments in the form of shares of limited companies / units of mutual funds etc.

II. Modern Approach

The basic objective of taxation in the olden days is to raise the revenue by the Government to meet its cost viz administration cost, maintenance of law and order and to provide defence against external threats. But in the modern days the taxation policy is an important tool to reduce inequalities of income and wealth and to promote accelerated economic development. The objects of modem approach are listed below.

1. Ensuring accelerated economic development.
2. Increasing employment opportunities.
3. Reducing regional imbalances.
4. Regulation of consumption of undesirable commodities.
5. Protection of domestic industries from the competition of foreign industries.
6. Control and audience of trade cycles through anti inflationary and anti deflationary measures.
7. Promoting capital formation.
8. Promoting exports and restricting imports.
9. Regulating production from the National point of view.

Q3. Explain in detail various forms of tax.

Ans :

1. Duty

Imposition of tax to regulate industrial production and to control export and import of the goods is known as Duty. For example, on goods manufactured in the factory within the country excise duty is levied. On the goods imported into or exported from a country customs duty is levied.

2. Cess

If the tax is levied for a specific purpose then it is known as "Cess". For example health and education cess, it is levied for promoting health and education in the country."

3. Surcharge

Tax on tax is known as surcharge. If the object of levying higher tax is for short period of time, then govt, resorts to have surcharge.

4. Octroi

If tax is levied by Municipal Corporation or Grama Panchayat on the goods brought from other parts of the country by traders for sale into their Jurisdiction limits, then it is known as Octroi. This tax is also known as entry tax.

5. Terminal Tax

It is the tax levied by local bodies or municipalities on the goods leaving for sale from their boundaries into other parts of the country.

6. Toll Tax

This tax is paid by vehicular travellers. The persons who are travelling in car, bus, jeep etc. for using the road or bridge to reach their destination have to pay the tax. Toll tax is collected not only from passengers travel vehicles but it is also collected from trucks, lorries carrying the goods for transportation.

Q4. What are direct taxes? Explain its merits and demerits.

Ans : **(Imp.)**

Meaning

Direct taxes are those which are paid after the income reaches the hands of the taxpayer; while indirect taxes are paid before the goods or services reaches the taxpayer. In other words, we can say that the Direct Taxes are those taxes the burden of which cannot be shifted and these are paid by the taxpayer directly from his income, wealth or estate.

Merits

1. Economy

The cost of collecting direct taxes is low as compared to indirect taxes. The payment of these taxes is made directly to the Government.

2. Certainty

Every tax payer knows how much and when (due date) he/she has to pay tax. The Government also knows about the tax revenue likely to be received.

3. Elasticity

Direct taxes are elastic in nature. Government can increase its revenue just by increasing the tax rate and by withdrawing the deductions and exemptions.

4. Equity

Direct taxes are equitable because rich has to pay more tax and the poor man has to pay either low tax or no tax.

5. Convenience

Most of the direct taxes are collected at the source of income itself as such it is convenient to the tax payers.

6. Civic consciousness

It is believed that direct taxes create consciousness among the tax payer about their contribution to the revenues of the Government.

7. Less possibility of shortage

The possibility of shortage in the amount collected as direct taxes is a rarity. The persons who have deducted tax has to remit the amount with in the time stipulated. Time if there is any delay or default then the person has to pay interest, penalty etc., and is also subject to other punishments under the law.

8. Reducing the inequalities

Direct taxes ultimately affects the rich persons and if the Government spends the amount on increasing the incomes of the poor people it can improve the standard of living.

9. Controls the effects of business cycle

Direct taxes can be used as a tool to mitigate the effects of inflationary and deflationary trends by increasing or decreasing the tax rates.

Demerits

1. Unpopular

Direct taxes are not popular when compared to indirect taxes. No person is willing to forego his part of income or wealth towards payment of taxes, i.e., people will oppose imposition of direct taxes.

2. Inconvenience

Indirect taxes are convenient because they are paid without being conscious of payment of tax and that too in small amounts.

Under the direct tax laws, tax payers are required to maintain the accounts of their income, savings and capital expenditure etc. and the same is to be submitted to the tax department at the time of filing the return. If he fails to file the return-in-time it becomes an offence which causes inconvenience and irritation to the tax payer.

3. Complexity of laws

Generally the provisions of direct taxes contain deductions, exemptions and chargeability of income etc. To a common man it becomes a problem to understand the provisions of the Act and is compelled to take the help of "tax consultants".

4. Arbitrary tax rates

Tax rates are fixed by the Minister in charge with the help of tax department officials who may not possess the knowledge to assess the tax payment capacity of the people.

5. Possibility of evasion

It is observed throughout the world that tax evasion is there in high degree in the payment of direct taxes when compared with indirect taxes.

Q5. Explain various forms of Direct taxes.

Ans :

Following are the direct taxes levied by the central government,

(a) Income Tax

At present Income Tax Act, 1961 is in force in India. Income tax is mainly computed on the total annual income of a person. It is charged every year on both legal and illegal income earned by a person. The scope of total income relies upon the residential status of a person.

(b) Dividend Tax

Dividend tax is paid by the companies on the dividend paid to the shareholders. This is an additional tax to the company's income tax.

(c) Inheritance Tax

If any person receives a property from his/her ancestor then he/she is liable to pay tax on such property or wealth which is imposed by the government. However, this type of tax is not functioning today.

(d) Estate Duty

This type of tax is charged on the whole property which is left by a deceased person. At present, estate duty has been dissolved in India.

The following are the popular forms of indirect taxes which are imposed by the government,

(a) Excise Duty

The excise duty is imposed by the government on the production of goods for home consumption. Generally, the central government collects it at a specified rates.

(b) Value Added Tax (VAT)

VAT is a common tax levied by the government at each point of exchange of goods from basic production to final consumption. The evaluation of VAT is based on the difference between the sales price of goods or services (outputs) and the cost of goods and services (inputs) bought for production. Except VAT, the cost of inputs consists of charges including all taxes. The whole tax is borne by the final consumer as the tax passes from the producer of raw materials to consumer which covers both producers and traders at each point of exchange.

(c) Custom Duty

These taxes are popularly known as tariffs. They are generally imposed on exchange of goods and services between countries. Therefore, a country imposes custom duty on both imports and exports and then collects revenue tariffs on imports.

(d) Sales Tax

Sales tax is the tax on total sale of goods. The government imposes sales tax as a proportion or share of the retail price of a product at the time of sale.

Q6. What are indirect taxes ? Explain its merits and demerits.

Ans :

Meaning

Indirect Taxes are those taxes the burden of which by nature is shifted and which are paid by the taxpayer indirectly i.e. while purchasing goods or services we pay excise duty or service tax.

Merits

1. Convenience

Indirect taxes are included in the price of the goods and services and as such tax payer is not aware of tax payment while purchasing the goods and services. Since the tax is paid, tax payer is aware of the payment of tax but he does not feel it as a burden. At the time of business transaction it will not cause any inconvenience to the tax payer.

2. Productivity

Indirect taxes are highly productive. By imposing few taxes Government can get huge revenues. Government can impose tax on selected goods and services whose demand is inelastic.

3. Minimum evasion

Generally indirect taxes are levied and collected at the time of production or purchase of the goods by the business man and the scope for tax evasion is minimum.

4. Wide coverage

Indirect taxes covers most of the people irrespective of rich or poor will make to contribute to the Government i.e. indirectly it is helping one and all to participate for the development of the nation.

Demerits

1. Uncertainty

Revenue to be collected through indirect taxes contains uncertainty because it is not easy to estimate the demand for goods, which is influenced by a number of factors.

2. Violation of ability to pay principle

Both rich and poor have to pay the same price for the goods i.e., both have to pay same amount of tax and this is against to the canon of taxation.

3. Inflationary in nature

Indirect taxes lead to a rise in prices. The increase in the prices of raw materials, finished goods etc. creates inflationary trends in the economy.

4. High cost of collection

Administrative cost of collecting indirect taxes may be high because they have to be collected from large number of persons that too in small amounts.

5. Absence of consciousness

Indirect taxes are collected through middle men like traders. The tax payer does not feel the payment of tax while purchasing the goods i.e., indirect taxes may not create the civic consciousness in the minds of the people.

Q7. Explain various forms of Indirect taxes.

Ans :

The following are the popular forms of indirect taxes which are imposed by the government,

(a) Excise Duty

The excise duty is imposed by the government on the production of goods for home consumption. Generally, the central government collects it at a specified rates.

(b) Value Added Tax (VAT)

VAT is a common tax levied by the government at each point of exchange of goods from basic production to final consumption. The evaluation of VAT is based on the difference between the sales price of goods or services (outputs) and the cost of goods and services (inputs) bought for production. Except VAT, the cost of inputs consists of charges including all taxes. The whole tax is borne by the final consumer as the tax passes from the producer of raw materials to consumer which covers both producers and traders at each point of exchange.

(c) Custom Duty

These taxes are popularly known as tariffs. They are generally imposed on exchange of goods and services between countries. Therefore, a country imposes custom duty on both imports and exports and then collects revenue tariffs on imports.

(d) Sales Tax

Sales tax is the tax on total sale of goods. The government imposes sales tax as a proportion or share of the retail price of a product at the time of sale.

Q8. Differentiate between direct and indirect taxes.

Ans : **(Aug.-21, Imp.)**

S.No.	Direct Taxes	S.No.	Indirect Taxes
1.	Direct taxes are levied on income or wealth of a person, as such it affects rich person i.e., low income people need not pay any tax or they are required to pay at lower rate tax at the most	1.	Indirect taxes are levied on manufacturer or seller of the goods or both. They shift the tax burden to the next purchaser and finally to the consumer by charging a higher price. In other words it effects substantially on the poorer section of the people.
2.	The tax bearer knows the tax liability, time and amount of tax to be paid.	2.	Business men may charge much higher price than the tax amount and the same is included in the price as such the consumer is not aware about the tax effect.
3.	Increase in tax rate may reduce savings and investment by the public. Increase in the rate will help to control the inflation.	3.	Increase in the tax rate is bound to reduce consumption and it helps in intensifying the inflationary position in the economy.
4.	There is a scope for tax evasion, either by not paying the taxes or tax payer may understate the income or actual wealth by suppressing the facts.	4.	The scope for tax evasion by the ultimate consumer is not there, but right from the manufacturer to the retailer, the scope for tax evasion is possible by showing less production or sales.
5.	The Government has to establish link with every tax payer as such the cost of collecting to the Government will be higher.	5.	The cost of collecting taxes to the Government is minimum when compared to direct taxes, Government collects tax directly from the producers of the goods and the business men. And there is no need to maintain a link with the consumer who ultimately is the bearer of this tax.
6.	Ability of the tax payer is taken into account and thus it satisfies the principle of equity.	6.	Ability of the tax payer is ignored, Both rich and poor have to pay the same amount of tax.
7.	Tax payer is having civic consciousness.	7.	Tax payer may not possess civic conscious-ness.

1.2 Canons of Taxation

Q9. What do you mean by Canons of Taxation? Discuss the principles to be consider at the time of framing an ideal taxation policy.

Ans : **(Imp.)**

Meaning

Canons of taxation means the directive principles to be followed by the Government while framing the taxation policy and imposing the taxes on the people. With a change in economic, political and social scenario, the taxation policies have undergone a drastic change with regard to its objectives, coverage and administration etc. For judging the merits of a 'Tax' Adam Smith gave a set of basic principles known as cannons of taxation.

Principles

According to Adam Smith the following principles are to be kept in mind while framing an ideal taxation policy.

1. Canon of equality
2. Canon of certainty
3. Canon of economy
4. Canon of convenience.

1. Canon of equality

Under this principle rich shall bear a higher tax burden. This canon of equality advocates that the burden must be directly proportionate to income and wealth of a person. Income of a person determines the ability to pay. Tax burden should be more on rich than on the poor. Tax rates should be reasonable and it must encourage to earn more and more. If tax rates are high it will result in low savings and low investment. Lack of equality may result into social disorder, economic crisis in the country.

2. Canon of certainty

According to Adam Smith, tax policies must be specific and there should not be any confusion about the tax amount, time of payment etc. This cannon also emphasizes that the Government should not follow an arbitrary method and show discrimination in imposing taxes. Tax laws should not be subject to frequent amendments. If frequent amendments are there it hinders the economic activity in the country.

3. Canon of economy

This principle states that the minimum possible expenditure is to be incurred to collect the tax. Taxation should be economical. If the cost of collection is too high on account of high administrative expenses of tax department, then the very purpose of levying the tax i.e., to generate more revenues to the common well being gets defeated.

4. Canon of convenience

This principle states that the tax must be collected in a convenient manner from the tax payers. For example, farmers feel convenient to pay tax on the sale of crop. Salaried persons and land lord of a property feel convenient when they receive their income as salary and rent respectively. To the extent possible tax amount should be collected in installments through bank.

Other canons of taxation

Canons of taxation advocated by other economists are as follows:

1. Canon of productivity
2. Canon of simplicity
3. Canon of elasticity
4. Canon of diversity
5. Canon of expediency
6. Canon of co-ordination.

1. Canon of productivity

The term productivity means collecting sufficient revenues/income to the Government. It is considered as productive if tax policy with regard to rate [as productive if it] generates sufficient income to the Government to meet its expenditure and to provide the required facilities to the public. It is preferable to have few productive taxes rather than having a number of unproductive taxes.

2. Canon of simplicity

This principle states the need to have a simple taxation system in the country. The provisions in the tax laws, tax rates and the provisions of the Act must be with in the reach of a common man in understanding the provisions. The rules and regulations must promote honesty among the tax payers and officials working in the tax department. A complicated procedure not only irritates a common man but also encourages more cases of tax evasion and corrupt practices.

3. Canon of elasticity

The tax policies of the Government should contain flexibility. It should be capable of increasing the revenues in times of emergency situation like war, floods etc. by increasing the tax rates. In order to build up tempo for rapid economic development the tax rates should be kept at low level, with this it encourages more savings and invites more capital investment in the trade, business and industrial activities. In other words, the tax system should be capable of adopting changes according to the needs of economic environment in the country.

4. Canon of diversity

According to this principle there should be many taxes instead of a single tax. The taxation system of the country should make most of the potential tax payers to contribute to the revenues of the Government in one tax or the other. To achieve this, Government should impose both direct and indirect taxes.

5. Canon of expediency

According to this principle taxes should be levied after considering economical, social and political factors. Imposition of new taxes/new methods of tax payment should not invite social and political resistance.

6. Canon of co-ordination

In a federal set up like our country, there should be proper co-ordination between taxes imposed by central, state Governments and local authorities. The sales tax policy followed by different state Governments lead to unhealthy practices and tax evasion in the country. So, care is to be taken for proper coordination between different political ideologies of the Government.

In our country political factors are influencing the tax policy of the Government. While deciding the suitable taxation policy in addition to above mentioned canons of taxation the following points are to be given due care.

1. Promoting national interest.
2. Minimum sacrifice by the tax payer or Promoting honesty by having few taxes and low rate of taxes.
3. No scope for discrimination among the income earners customers.
4. Efficient administrative system.

1.3 Features and History of Income Tax in India

Q10. Explain the history and features of income tax in India.

Ans : **(Imp.)**

History

The income-tax was introduced in India for the first time in 1860 by British rulers following the mutiny-of 1857. The period between 1860 to 1886 was a period of experiments in the context of income-tax. This period ended in 1886 when first Income-tax Act came into existence. The pattern laid down in it for levying of tax continues to operate even today though in some changed form. In 1918 another Act—Income-tax Act, 1918 was passed but it was short lived and was replaced by Income-tax Act, 1922 and it remained in existence and operation till 31st March, 1961.

Features

1. Levied as per the Constitution

Income tax is levied in India by virtue of entry 82 of list I (Union List) of Seventh Schedule to the Article 246 of the Constitution of India which authorizes the Central Government to 'impose tax on income other than agricultural income'.

2. Levied by Central Government

Income tax is charged by the Central Government on all income other than agricultural income. However, the power to charge income tax on agricultural income has been vested with the State Government as per Entry 46 of List II, i.e., State List.

3. Direct Tax.

Income tax is a direct tax. It is so because the liability to deposit and ultimate burden are on same person. The person earning income is liable to pay income tax out of his own pocket and cannot pass on the burden of tax so paid on the persons from whom the income has been earned.

4. Annual Tax

Income tax is an annual tax because it is the income of a particular year which is chargeable to tax.

5. Tax on Person

It is a tax on income earned by a person. The term 'person' has been defined under the Income tax Act. It includes individual, HUF, Firm, Company, local authority, Association of person or body of Individual or any other artificial juridical persons. The persons who are covered under Income tax Act are called 'assessees'.

6. Tax on Income

It is a tax on income. The Income tax Act has defined the term income and it includes salary income, house property income, business/profession income, capital gains and other sources income. However, there are certain incomes which are specifically exempt from income tax.

7. Income of 'Previous Year' is assessable in 'Assessment Year'

Income earned during a particular financial year is assessed to tax in the immediately following financial year. The year of earning income is called 'Previous Year' and the year in which assessment of income is done is called 'Assessment Year'. The return of previous year's income is filed in the relevant assessment year.

8. Charged at prescribed rate(s).

Income tax is charged at prescribed rate(s). The rates of income tax differ for different incomes and for different persons. While tax rates for normal incomes are prescribed by the annual Finance Act, tax rates for certain special incomes have been prescribed under Income Tax Act itself. For instance, the following tax rates have been prescribed under Income Tax Act :

(i) Tax on long term capital gain @ 20% (Section 112).

(ii) Tax on short term capital gain on shares covered under STT @ 15% (Section 111A)

(iii) Tax on lottery income @ 30% (Section 115BB)

Q11. Explain the tax structure in India

Ans :

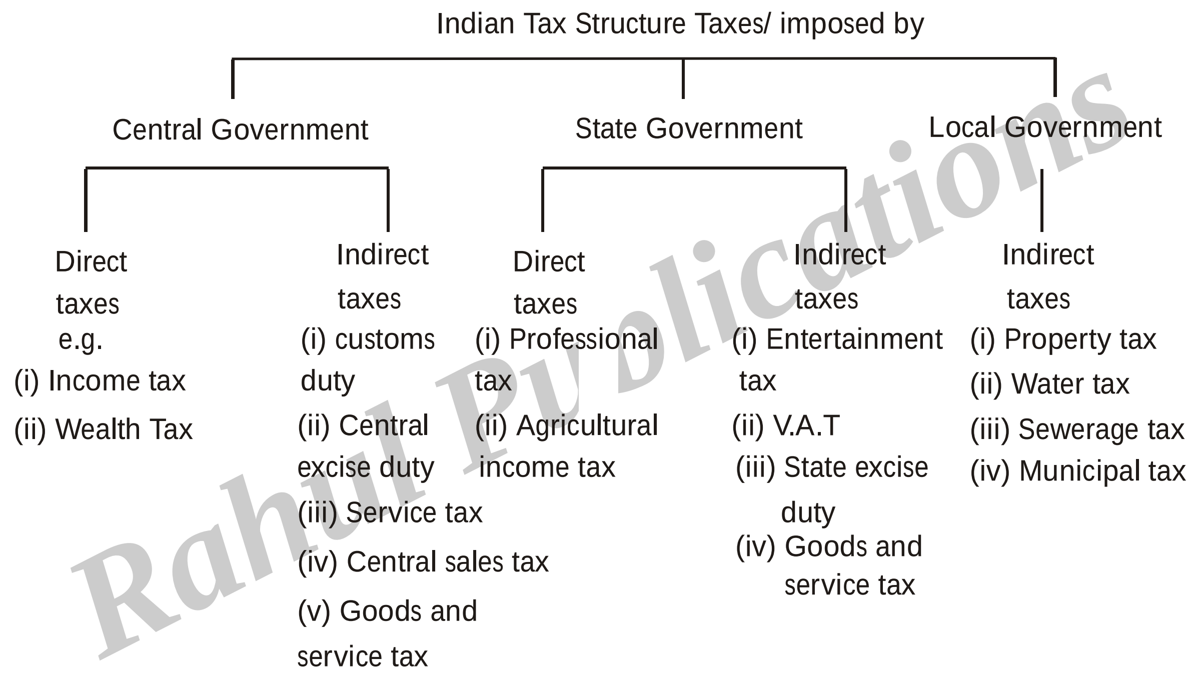
According to the Indian constitution the subjects of administration or governance in the country is vested with (a) Union Government (b) State Governments (c) Local Authorities. Based upon this structure the tax structure is based on three fold.

(i) Taxes imposed by Central Government

(ii) Taxes levied by the State Government

(iii) Taxes levied by Local Authority

From the above chart it can be seen that two taxes viz. sales tax and excise



From the above chart it can be seen that two taxes viz., sale tax and excise duty are in the list of both Central and State Governments (concurrent list). In case of sale of goods within a state sales tax (presently it is known as VAT) is imposed and if the sale of goods is of inter state, Central sales tax is applicable. Similarly in the case of manufacturing of liquors and drugs, excise duty is levied by State Governments whereas in the case of manufacture of excisable goods the tax is imposed by the Central Government.

Direct taxes in India

In our country direct taxes are levied by Central Government, State Governments and Local Authorities. Direct taxes levied by the Central Government are as under.

1. Income tax
2 Dividend tax
3. Estate duty
4. Inheritance tax
5. Gift tax

1. Income tax

Income tax is tax on annual income of a person, presently Income Tax Act, 1961 is in force in our country. The important features of income tax are

(i) Income tax is levied every year on the annual income of a person.

(ii) Income tax is computed on the total income of a person covered under 5 heads of income and after deducting chapter VIA deductions.

(iii) The scope of total income of a person depends upon his residential status.

(iv) There are two types of taxation (a) Flat rate (b) Slab rate.

(v) Income tax is levied upon both legal and illegal income earned by a person.

2. Dividend tax

Companies are required to pay dividend tax on the dividend paid by them to the share holders. This tax is in addition to that company pays income tax on its income. This is also called corporate Dividend Tax.

3. Estate Duty

The tax is levied upon the entire estate left by a deceased person. Presently the estate duty is abolished in the country.

4. Inheritance tax

This tax is levied on transferring the property or estate to the beneficiaries. At present this type of tax is inoperative.

5. Gift tax

If a person gifts property or any other asset, he has to pay gift tax. Some of the estate owners used to prefer gifting the property during their life time to avoid estate duty. To plug this loop hole Government introduced gift tax in the year 1953 but it was abolished in the year 1985 due to low revenue and higher cost in collecting the tax.

Direct Taxes at State Level

The following direct taxes can be levied by State Governments.

1. Agricultural Income Tax
2. Land Revenue
3. Professional Tax

1. Agricultural Income Tax

According to the provisions of constitution tax on agricultural income is a State Government subject. As on today no State Government has passed any legislation to tax agricultural income i.e., on agricultural income there is no tax.. But according to Income Tax Act, 1961 agricultural income is considered to tax non-agricultural income.

2. Land Revenue

Land revenue is taxed on the output from the agricultural land. This is one of the oldest tax levied by the Government. Presently in our country almost all the states abolished this tax.

3. Professional tax

State Government fixes a specified amount to be paid on each type of occupation viz salaried persons, business and professionals' like Doctors, Advocates, Chartered Accountants etc. The tax amount is fixed per head per annum and is to be paid in lumpsum. However in the case of employees it is permitted to paid in monthly instalments and tax is to be deducted at source by the employer.

Direct taxes at Local Government Level:

Property tax

Local Governments like Municipal Corporations, Municipalities and Grama Panchayats etc. levy property' tax on house property', based upon rental capacity of the house. If the house is not letout even then the owner has to pay property tax based upon its fair rental value.

Indirect taxes in India:

Indirect taxes can be levied by the Central Government, State Governments and Local Authorities.

Indirect Taxes levied by the Central Government: The following are the selected important indirect taxes levied by the Central Government.

1. Excise duty
2. Customs duty
3. Goods and Services Tax
4. Sales Tax

1. Excise duty

It is one of the indirect taxes levied by the Central Government. Excise duty is levied on the goods manufactured/produced in the country. Firstly the manufacturer has to pay the tax to the Government. Manufacturer transfers the tax burden by charging a higher price to the distributor of goods. There after the distributor transfers the tax burden to wholesaler and from wholesaler to retailer and finally retailer shifts the tax burden to consumer through price mechanism. In summary form firstly the tax or duty is paid by the manufacturer but finally it is borne by the consumer. Excise duty is a tax on commodity but not on business transaction.

Excise duty is charged on the excisable goods at the prescribed rates mentioned in the provisions of the Central Excise Act, 1944. The duty is shared by the Central Government with the states from which it is collected.

2. Customs duty

Customs duty is taxed on the imported and exported goods. The main object of imposing customs duty is to prevent illegal import and export of goods to and from India. The duty is charged based upon the value of the goods imported/exported. This duty of collections is not shared with any State Government i.e., The entire tax collections will be taken by the Central Government.

3. Goods and Services Tax

Goods and Services Tax is tax that customers have to bear when they buy any goods or services, such as food, clothes, items of daily needs transportation, electronics, travels etc. The concept of GST is that it is an Indirect Tax, i.e., this tax is not directly paid by customers to the Government, but is rather levied on the manufacturer or seller goods and the providers of services. The sellers usually add the tax expense into their costs and the price the customers pay is inclusive of GST.

4. Sales Tax

Sales tax is tax on the sale of goods. Sales tax is payable by the seller, which he recovers from the purchaser. The tax may be included in the price charged or it may be an item of money payable by the customer in addition to price. Sales tax is of two types: (i) Central Sales Tax and (ii) State Sales Tax

(i) Central sales tax

When the seller of goods and purchaser are situated in different states i.e., when the goods physically moves from one state to another, central sales tax is applicable. The tax is levied by the Central Government, but the tax is collected and utilized by the State Government where the goods were sold.

(ii) State sales tax

When seller of the goods and purchaser are situated in the same state i.e., the movement of goods takes place within a state, state sales tax is applicable.

Indirect taxes levied by the State Government

1. State Sales Tax
2. Value Added Tax (VAT)
3. Entertainment Tax
4. State Excise Duty
5. Motor Vehicle Tax

1. State Sales Tax

When seller of the goods and purchaser are situated in the same state i.e., the movement of goods takes place within a state, state sales tax is applicable. Sales tax is one of the top revenue earnings of State Governments. Unfortunately there is no uniformity in all State Sales Tax Act with regard to the basic exemption, rate of tax and list of the commodities covered. Due to this unhealthy competition is taking place between the State

Governments and also among the business people. To overcome this problem VAT is introduced in all the states to have uniformity in the provisions of the Act.

2. **Value Added Tax (VAT)**

VAT is a tax on final consumption of goods and services. VAT works on the principle that when raw material passes through various manufacturing stages and manufactured product passes through various distribution stages, tax will be levied on the value added at each stage but not on the gross sale price. The basic difference between VAT and sales tax is that sales tax is payable on total value of goods, while VAT is payable on value addition at each stage.

3. **Entertainment Tax**

State Governments levy entertainment tax on cinemas, trade fairs, exhibitions etc. Of all, entertainment tax on cinema is more popular. Levy of tax is of two types. Firstly, it is on the use/sale price of the ticket. Second type is slab system. Under this method the exhibitor of cinema has to pay tax on the seating capacity of the hall instead of collections made by them by sale of tickets.

4. **State Excise Duty**

According to the constitution State Government can levy excise duty on

(a) Alcoholic liquors for human consumption

(b) Opium and Indian hemp. For the remaining goods Central Government is empowered to levy excise duty. For most of the states revenue from alcoholic drinks has become major source of revenue and year after year the revenue are showing increasing trend.

5. **Motor Vehicle Tax**

State Governments collect tax on the use of two/three wheelers, cars, heavy and light vehicles. Earlier it was collected annually. To minimize the cost of collection of the tax and to eliminate tax evasion, presently tax is collected for life time of the vehicle, known as life tax. It is collected at the time of purchase of vehicle.

Q12. Explain in detail about GST.

Ans :

Goods and Service tax was first introduced in France in the year 1954, Several other world countries followed the tax law in their respective economies and at present around 160 countries are following the tax law.

GST in India

Goods and Service tax has been passed in Parliament on 29th March 2017 and came in to force from 1st July 2017 whole of India. The new GST law has replaced many indirect tax laws previously enforced by Government. The new GST law shall make it easy, convenient and also remove the cascading effect of taxes on the taxpayers. The GST Law will govern the transactions of Supply of Goods and Service. The GST is a Multi stage taxation system throughout the supply chain. This is a destination based tax unlike the previous tax laws which were taxed based on Manufacture or start point of sale.

The GST Council which shall have representation from both State Government and Central Government which shall meet regularly to decide on the GST rules and regulations rates and also to govern the compliance issues. The GST council has 33 members and the chairman shall be the union finance minister.

In India, GST has been divided into 5 tax slabs namely 0%, 5%, 12%, 18% and 28%.

The rates are levied based on classification of the products FISN Code (Harmonized System of Nomenclature) and services based on the SAC (Service Accounting Code)

Certain Products such as alcohol, petrol, petroleum products, natural gas and aviation turbine fuel are not covered under GST but are kept as state subject. Components of GST:

1. CGST – Central Goods and Services Tax.
2. SGST – State Goods and Services Tax.
3. IGST – Integrated Goods and Services Tax.
4. UTGST – Union Territory Goods and Services Tax.

1.4 Definitions and Basic Concepts of Income Tax

1.4.1 Assessee – Deemed Assessee – Assessee-in-default – Assessment Year – Previous Year - Person

Q13. Explain the various basic concepts of income tax.

(OR)

Define the following terms :

(i) Assessee

(ii) Deemed Assessee

(iii) Assessee-in-default

(iv) Assessment Year

(v) Previous Year

(vi) Person

Ans :

(i) Assessee

Assessee means a person by whom any tax or any other sum of money such as interest or penalty etc., is due under the Income Tax Act or in respect of whom any proceedings under the Act has been taken for the assessment of his income or the income of other person for which he is assessable or any refund is due to him or to such other person. On studying the above definition It can be seen that a person shall be treated as an "Assessee" under the following situations.

(ii) Deemed Assessee

Generally, the person whose income exceeds the exempted limit is liable to pay tax but if such a person is a minor his parents i.e. Father/Mother and in the case of lunatic the legal representatives or trustee of such persons or guardian for him will be liable for tax payment. The parent or guardian or trustee will be treated as deemed to be an assessee, and is known as representative assessee. i.e. For the assessment of others one who is liable to pay tax is known as "Deemed Assessee". In the following situations the person is treated as an assessee for the tax payable on behalf of others.

(i) Trustee of Trust.

(ii) Legal Representative of a deceased person A person whose taxable income is more than the exempted limit if he dies before the ending date of previous year or date of filing return then his legal representatives Viz wife or son etc. is treated as deemed assessee.

(iii) Legal guardian of a minor or lunatic person.

(iv) Official receiver appointed by court.

(iii) Assessee-in-Default

When a person violates the provision of the Act in discharging his duties then he is known as assessee in default, e.g when salary is paid it is the duty of the pay disbursing officer or employer to deduct tax at source on the income of employee and the same shall be remitted to Income Tax Department within the stipulated time. Similarly, tenant has to deduct tax before paying rent to the land lord.

In the following situations a person is treated as "Assessee in default".

(i) Fails to deduct tax and remit the tax deducted fully.

(ii) If a person failed to pay advance tax.

On studying the above provisions about an assessee it can be concluded that every assessee is a person but every person need not be an assessee. For example, Mr. Gopinath, whose status is an 'individual' having an income of ` 1,20,000 during the relevant previous year to the current assessment year is a "person" but not an "assessee" because his income is less than the exempted limit of income. Similarly, a person may not have his own taxable income but still he is treated as an assessee.

For example, if minor's income is more than the exempted limit of the parents then one of the parent is treated as an assessee.

(iv) Assessment Year

Assessment year means the period of 12 months commencing from 1st April of every year and ending on 31st March succeeding the financial year or previous year of the assessee. The current assessment year is 2021-22.

During this period the total income of an assessee earned during the previous year is assessed to tax, i.e. Assessment year is the year in which income of the relevant previous year and income of earlier period if not taxed is assessed to tax. It is also known as tax year. Assessment year ending does not mean that the assessment of an assessee must be completed. It only signifies the provision of Income Tax Act existing of that period are to be applied in computing taxable income and tax liability.

Determine the period of first previous year in relation to the assessment year 2021-22 in the following cases.

(i) Mr. Srikanth started a computer business on 15-8-2020.

(ii) Mr. G.S.Reddy was appointed as Internal Auditor in a limited company on 1-11-2020.

(iii) Sri R.D. Burman purchased a house on 1-4-2020 and letout on a monthly rent of `. 5,000.

(iv) Sri Vishnu Vardhan purchased a house on 1-2-2021 and let out on a monthly rent of `. 6,000.

(v) Smt Y.J. Rani presently working as a lecturer and residing in her own house She purchased another house on 15-5-2020 for letting out.

Sol :

Assessment year 2021- 22

S.No.	Name of the Assessee	Date of new source of income	Period of previous year
1.	Mr. Srikanth	15-08-2020	15-8-2020 to 31-3-2021
2.	Sri G.S. Reddy	1-11-2020	1-11-2020 to 31-3-2021
3.	Sri R.D. Burman	1-04-2020	1-4-2020 to 31-3-2021
4.	Sri Vishnu Vardhan	1-02-2021	1-2-2021 to 31-3-2021
5.	Smt Y.J. Rani	15-5-2020	15-5-2020 to 31-3-2021

(v) Previous Year

Previous year is the preceding 12 months period to the relevant assessment year. It starts on 1st April and ends on 31st March. Total income earned during the above period is considered for tax purposes, therefore it is also known as Income year or Accounting year. Previous year is the financial year immediately preceding the assessment year. **Eg :** For the assessment year 2021-22 relevant previous year is 2020-21.

(vi) Person

According to Income Tax Act, 1961 the term person includes the following types of assessees who are as follows :

(i) A natural person he/she who is liable to pay tax on his personal income is designated as an "Individual" i.e., an individual who is assessed in respect of his personal income.

(ii) A Hindu Undivided Family

A Hindu undivided family means a group of persons lineally descended from a common ancestor. The Head of the Hindu Undivided Family is known as Karta. Karta is assessed for the income derived by the Joint Hindu Family. If other member of the family is managing and controlling then he will be designated as Manager and is liable to pay tax.

(iii) Company : A Company which is incorporated under the Companies Act of 2013.

(iv) Firm

A partnership of two or more persons carrying on a business or profession under the Indian Partnership Act, 1932.

(v) An Association of persons or a body of individuals

For eg., A group of persons formed for promoting a Joint venture business or trustees of a trust etc.

(vi) A Local authority: Eg. Municipalities, Local Bodies etc.

(vii) Every artificial juridical person: Not falling in any of the preceding categories. **Eg:** a Statutory corporation or a Hindu deity.

Q14. Define income. What items comes under the category of income?

Ans :

Sec.2 (24) deals with the term "INCOME". As the income of a person is taxable it is necessary to know the meaning of the term income. Unfortunately, under the Act, no where the term income is defined but what receipts will be treated as income is mentioned. If the assessee proves that a receipt during the previous year is not an income then he is not liable to pay tax on such a receipt. If Mr. X takes a loan of ` 10,000 then it is treated as a receipt but not an income. It can be concluded that every income is a receipt but all receipts are not incomes. Sec.2(24) defines income to include the following items.

1. Profits and gains
2. Dividends
3. Voluntary contributions received by a charitable or religious trust or other institutions established wholly or partly for such purpose (but these do not include contributions, which are made with specific direction that they shall form part of the corpus of the trust or institution).

4. The value of any perquisite or profit in lieu of salary taxable under the head "Salaries". The value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee i.e., agent of a non resident guardian of a minor or lunatic as mentioned in Sec. 160(i) (iii) and (iv), or by any person i.e., the beneficiary on whose behalf or for whose benefit any income is receivable by the representative assessee in respect of any obligation which but for such payment, would have been payable by the beneficiary himself.
5. Any sum chargeable to income tax under clauses (ii) and (iii) of Sec.28 (i.e., profits and gains of business or profession) or Sec.41 (i.e., recovery of losses, expenses or trading, liability in respect of which the assessee had been granted a deduction in a preceding previous year) or Sec.59 (i.e., deemed profits) (a) The value of any benefit or perquisite taxable under clauses (iv) Sec.28 (i.e., arising from any business or profession).
6. Any capital gains chargeable under Sec.45.
7. 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 Sec.44 or any surplus taken to be such profits and gains by virtue of provisions contained in the first schedule.
8. Any annuity due, or commuted value of any annuity paid under the provisions of Sec.280D.

Q15. Discuss briefly about PAN.

Ans :

Permanent Account Number means the number which is allotted by the tax assessing officer to the assessee for easy identification. In case of need, this number is useful to trace out the previous returns submitted by the assessee and assessment orders passed on by the Department.

Under section 139A & Rule 114, the number is allotted by the Assessing Officer when the assessee applies for the same.

Income exceeds the exempted incomes limit, then has to apply to the concerned I.T.O. for allotment of the number. Once the number is allotted the assessee or PAN card holder need not apply every year. If there is a change in the residential address or if any corrections are required then he can apply for such changes. The assessee shall intimate the Assessing Officer any change in his address or in the name and nature of his business on the basis of which the permanent account number was allotted to him. If the PAN card holder losses his card then a new card will be issued for a nominal fee. In the case of business or profession if the sales or gross receipts exceeds ` 5,00,000 one has to apply for the same though the person may not have the taxable income.

Q16. Define tax liability. What are the elements of tax liability?

Ans :

Tax liability refers to the amount paid by an assessee on taxable income of previous year to Income Tax Department.

Elements

The tax liability of an individual includes the following elements,

1. Income Tax for Individuals

Individual assessee is liable to pay tax on income earned in previous year. Individuals are classified three categories (1) Non-Senior Citizens, (2) Senior Citizens and (3) Super Senior Citizens in order to ascei the tax rate and to calculate tax liability. An individual whose age is below 60 years is considered as non-se citizen, if the age lies between 60 years to 80 years then he/she will be treated as "Senior Citizen". If an individual age is more than 80 years then he/she will be treated as "Super Senior Citizens". The determination of tax liability considers residential status of a person whether resident or non-resident.

If an individual is "Resident" then he is liable to pay tax on incomes earned in India and in foreign count If he is non-resident then he is liable to pay tax only on income earned in India.

The basic exemption limit of income for different citizens is given below,

S.No.	Particulars	Residential Status	
		Resident	Non-resident
1.	Non-Senior Citizen	2,50,000	2,50,000
2.	Senior Citizen	3,00,000	2,50,000
3.	Super Senior Citizen	5,00,000	2,50,000

2. Surcharge

Surcharge is the additional tax on tax and usually charged on basic income tax. Central government imposed surcharge only when it requires huge revenues. During an year, if total income of an individual is between 50 lakhs to 1 crore then the surcharge is levied @ 10%, if any individual's total income is more than rupees crore then surcharge can be levied @ 15% on basic income tax. If the income is more than 2 crores but less than 5 crores then surcharge is levied @ 25%, If the income is more than 5 crores then surcharge is levied @ 37%.

3. Health and Education Cess

A rate of 4% is calculated on income tax as education cess.

4. Marginal Relief

The assessee whose residential status is 'Resident' can claim marginal relief when surcharge is more than the actual income i.e., exceeding 50,00,000 rupees. In short, marginal relief is the reduction in tax liability or concession given to tax payer.

Marginal relief can be calculated as,

Marginal relief = Difference in income tax – Difference in income

5. Tax Rebate u/s 87 A

Tax rebate is defined as concession in tax payment. Tax rebate can be claimed only by 'individuals' i.e., non- senior citizens and senior citizens whose residential status is 'Resident' relevant to the previous year and having total taxable income below 5,00,000. It is taxed on normal and special incomes except casual incomes. Firms, H.U.F and companies cannot claim tax rebate including super senior citizens who already have exemption limit upto 5,00,000. Hence, it is for only low income persons.

Calculating Rebate Amount

Consider least of the following two,

(i) Actual income tax

(ii) ` 12,500.

Q17. State the various income slab and tax rates for the assessment year 2021-22.

Ans : **(Imp.)**

1. Individual (Resident or Resident but not ordinarily Resident or non-resident), who is of the age of less than 60 years on the last day of the revent previous year and for HUF

Total Income	Tax (Existing Scheme)	Tax (New Scheme)
Up to ` 2,50,000	Nil	Nil
` 2,50,001 to ` 5,00,000	5%	5%
`5,00,001 to ` 7,50,000	20%	10%
` 7,50,001 to ` 10,00,000	20%	15%
` 10,00,001 to ` 12,50,000	30%	20%
` 12,50,001 to ` 15,00,000	30%	25%
Above ` 15,00,000	30%	30%

2. Resident or Resident but not Ordinarily Resident senior citizen, i.e., every individual, being a resident or Resident but not Ordinarily resident in India, who is of the age of 60 years or more but less than 80 years at any time during the previous year,

Total Income	Tax (Existing Scheme)	Tax (New Scheme)
Up to ` 2,50,000	Nil	Nil
` 2,50,001 to ` 3,00,000	Nil	5%
` 3,00,001 to ` 5,00,000	5%	5%
` 5,00,001 to ` 7,50,000	20%	10%
` 7,50,001 to ` 10,00,000	20%	15%
` 10,00,001 to ` 12,50,000	30%	20%
` 12,50,001 to ` 15,00,000	30%	25%
Above ` 15,00,000	30%	30%

3. Resident or Resident but not Ordinarily Resident senior citizen, i.e., every individual, being a resident or Resident but not Ordinarily Resident in India, who is of the age of 80 years or more at any time during the previous year

Total Income	Tax (Existing Scheme)	Tax (New Scheme)
Up to ` 2,50,000	Nil	Nil
` 2,50,001 to ` 5,00,000	Nil	5%
` 5,00,001 to ` 7,50,000	20%	10%
` 7,50,001 to ` 10,00,000	20%	15%
` 10,00,001 to ` 12,50,000	30%	20%
` 12,50,001 to ` 15,00,000	30%	25%
Above ` 15,00,000	30%	30%

Sample Calculation for Different Tax Rates as Per Citizens

Resident - “Non-senior citizen”

Less than 60 years of age.

Total Income	Income Tax Amount
Up to ` 2,50,000	Nil
` 2,50,001 to ` 5,00,000	Total income × 0.05 – 12,500
` 5,00,001 to ` 10,00,000	Total income × 0.2 – 87,500
` 10,00,001 and above	Total income × 0.3 – 1,87,500

Resident - “Senior citizen”

Age 60 years or more but below 80 years

Total Income	Income Tax Amount
Up to ` 3,00,000	Nil
` 3,00,001 to ` 5,00,000	Total income × 0.5 – 15,000
` 5,00,001 to ` 10,00,000	Total income × 0.2 – 90,000
` 10,00,001 and above	Total income × 0.3 – 1,90,000

Resident - “Super Senior citizen”

Age 80 years or above

Total Income	Income Tax Amount
Up to ` 5,00,000	Nil
` 5,00,001 to ` 10,00,000	Total income × 0.2 - 1,00,000
` 10,00,001 and above	Total income × 0.3 – 2,00,000

Procedure

1. First deduct taxable incomes @ flat rates from total income such as long term capital gains, short term capital gain on shares and also casual incomes. Then apply the above mentioned formula for calculating income tax.
2. Calculate surcharge @ 10% if income exceeds 50 lakhs, then calculate health and education cess @ 4%.

   ∴ Tax Liability = Income tax + Surcharge + Health and Education cess

   ∴ Tax Due or Refund of tax = Tax liability — Tax deducted at source – Advance Tax paid.

PROBLEMS

1. Calculate tax liability of Mr. Chary aged 35 years. If total income is ` 5,07,000.

Sol :

The assessee is non senior citizen and the basic exemption is `. 2,50,000.

Income Slab	Income	Tax Rate Tax	Amount in `
First 2,50,000	→ 2,50,000	Nil	= Nil
2,50,001 to 5,00,000	→ 2,50,000	→ 5% of 2,50,000	= 2,500
5,00,001 to 10,00,000 → Balance	→ 7000 →	20% of 7,000	= 1,400
	5,07,000		13,900

Income tax = 13,900

Less: Tax Rebate Nil

13,900

Add: Health and Education Cess @ 4% = 556

Tax liability 14,456 or 14,460

∴ Tax liability is ` 14,460.

2. Calculate tax liability of Sri Shyam Sunder if total income is ` 9,52,000.

Sol :

The assessee is non senior citizen and the basic exemption is ` 2,50,000.

Income Slab	Income	Tax Rate	Tax Amount in `
First 2,50,000	→ 2,50,000	→ Nil	= Nil
2,50,001 to 5,00,000	→ 2,50,000	→ 5% of 2,50,000	= 12,500
5,00, 001 to 10,00,000	→ Balance 4,52,000	→ 20% of 4,52,000	= 90,400
	9,52,000		1,02,900

Income tax = 1,02,900

Less: Tax rebate Nil

1,02,900

Add: Health and Education Cess @ 4% = 4,116

Tax liability 1,07,016 or 1,07,020

∴ Tax liability is ` 1,07,020.

3. Calculate tax liability of Mr. B aged 30 years. If total income is `. 4,40,000.

Sol :

The assessee is non senior citizen and the basic exemption is `. 2,50,000.

Income Slab	Income	Tax Rate Tax	Amount in `
First 2,50,000	→ 2,50,000	→ Nil	= Nil
2,50,001 to 5,00,000	→ 1,90,000	→ 5% of 1,90,000	= 9,500
	4,40,000		9,500

Income tax	= 9,500
Less : Tax rebate is least of the following two amounts.	
(a) Actual Income tax ` 9,500 (b) `. 12,500	9,500
	Nil
Add : Health and Education Cess @ 4%	Nil
Tax liability	Nil

Note : Total income is less than `. 5,00,000, hence tax rebate is allowed

4. Calculate tax liability and determine how much tax is deducted at source in the following three situations if income from other heads is nil. The lottery prize amount is: Situation 1: `. 200, Situation 2: `. 2,00,000, Situation 3: `. 2,00,00,000.

Sol :

(i) For any type of assessee basic exemption from casual income is not allowed.

(ii) Tax rebate is not allowed for casual incomes.

(iii) For all types of income viz casual, normal and special if total income is more than 50 lakhs surcharge is payable.

Particulars	Situation 1	Situation 2	Situation 3
Income in `.	200	2,00,000	2,00,00,000
Basic Income tax @ 30%	60	60,000	60,00,000
Add : Surcharge @ 15%	NIL	NIL	9,00,000
Total Income Tax	60	60,000	69,00,000
Add: Health and Education cess @ 4% on total income tax	2.40	2,400	2,76,000
Tax liability	62.40 or 62	62,400	71,76,000
Tax deducted at source (T.D.S)	NIL	60,000	60,00,000

Special Note

(i) Tax is deducted at source only when the payment is more than 10,000.

(ii) (According to latest Income Tax Rules 1962) the organizer of Lucky Dip has deduct tax @ 30% only and

(iii) Assessee has to pay balance of tax liability amount before filing the Annual Return of income to the Income Tax Department.

5. For the assessment year 2021-22 Smt. soujanya's income details are Total Income `. 9,00,000 and income from long term capital gain on listed equity shares (securities transaction tax is paid) `. 3,10,000. Calculate tax liability.

Sol :

The assessee is non senior citizen and the basic exemption is `. 2,50,000.

Income Slab	Income	Tax Rate	Tax Amount in `
First 2,50,000	→ 2,50,000	→ Nil	= Nil
2,50,001 to 5,00,000	→ 2,50,000	→ 5% of 2,50,000	= 12,500
5,00,001 to 10,00,000 → Balance	→ 4,00,000	→ 20% of 4,00,000	= 80,000
	9,00,000		92,500

Income tax	= 9,500
Tax on long term capital gain @ 10% (`. 2,10,000)	21,000
	1,13,500
Less : Tax rebate	Nil
	1,13,500
Add : Health & Education Cess @ 4%	4,540
Tax liability	1,18,040

∴ Tax liability is 1,18,040.

Note: Long term capital gain on shares, exemption is given upto 1,00,000. Excess of 1,00,000 is taxed @ 10%.

Note: Total income is more than `. 5,00,000, hence tax rebate is not allowed.

Q18. What are the exceptions to the General rule of income tax?

Ans :

The general rule is that the income earned in an year (previous year) is taxed in the subsequent year (Assessment year) but in the following cases the income is taxed in the year of its earning i.e., during the previous year which are as follows:

(i) Persons leaving India with an intention not to return to India during the relevant assessment year.

(ii) Income of non-resident shipping companies.

(iii) Income of discontinued business.

(iv) Persons transferring their assets to avoid tax.

(i) Persons Leaving India

When it is brought to the knowledge of the I.T.O. by the assessee or by others that he is leaving India during the current assessment year and his return to the country in the same assessment year is uncertain then the total income of such person from the commencement of relevant previous year to the date of his departure shall be assessed in the same previous year.

Eg: Dr. Manmohan Singh who has been assessed regularly to the Income Tax is leaving India on some foreign assignment. He will be asked by the I.T.O. to pay tax for the income earned from the commencement of the current previous year till his departure.

According to Prof. Swami Nayak who has been assessed regularly to the Income Tax is leaving India as a tourist or as a delegate then he will not be asked to pay the tax immediately, he will be assessed to tax after his return to India.

(ii) Income of Non Resident Shipping Companies

If a non resident shipping company does not have its representation in India, the owner or master of the ship has to the a return to the I.T.O. concerned showing the income earned by the company on account of carrying passengers or cargo etc., before leaving the port in India. The I.T.O. on receiving such return has to assess the income and determines the tax liability. After paying the tax liability by the shipping company, a clearance certificate will be issued by the department of Income Tax.

(iii) Income of Discontinued Business

Under Sec. 176, any person discontinuing the business or profession shall inform the I.T.O. of such discontinuance within 15 days thereof, in such a case the I.T.O. will assess the income for the period from the commencement of the current previous year till the date of discontinuance and determines the tax liability and the proprietor or the partner will be asked to pay the tax due immediately.

(iv) Persons Trying to Transfer the Assets to Avoid Tax (sec61)

During the current assessment year if any person transfers or sells any of his assets with a view to avoid tax under this Act, then I.T.O. who assesses his income, determines the tax liability and collects the tax immediately.

1.5 Incomes Exempt from Tax

Q19. Write any ten exempted incomes u/s 10.

(OR)

Explain any 10 exempted incomes u/s 10.

(OR)

Explain exempted incomes from tax u/s 10 of IT Act 1961.

(OR)

"Income tax is a tax on income, but all incomes are taxable". Explain.

Ans : **(Imp.)**

Sec-10 of Income Tax Act deals with exempted incomes. These incomes are totally exempted from tax and therefore not included in the gross total income of an assessee. The following table list out the exempted income u/s 10,

S.No.	Sections	Exempted Incomes	Sector
1.	U/s 10(1)	Fully exempted	Agricultural income.
2.	U/s 10(2)	Fully exempted	Share of income from HUF.
3.	U/s 10(2A)	Fully exempted	Share of income from firms.
4.	U/s 10 (4)(i)	Fully exempted	Interest received by an NRI towards bonds and securities.
5.	U/s 10(4)(ii)	Fully exempted	Any income received by non-resident by way of interest on Non-resident (external) account
6.	U/s10(4B)	Fully exempted	Interest paid to a non-resident person belonging to an Indian origin.
7.	U/s10(10AA)	Fully exempted	Amount received as leave encashment on retirement.
8.	U/s10(10B)	Fully exempted	Retrenchment Compensation given to workers.
9.	U/s10(10BB)	Fully exempted	Payment received under Bhopal Gas leak Disaster.
10.	U/s 10 (30)	Fully exempted	Amount received as subsidy from or through Tea Board.
11.	U/s 10(11)	Fully exempted	Payment received out of statutory provident fund.
12.	U/s10(23EA)	Fully exempted	Income of notified investor protection fund.
13.	U/s10(23BBE)	Fully exempted	Any income of the Insurance Regulatory and Development Authority of India.
14.	U/s10(23D)	Fully exempted	Income of mutual fund.
15.	U/s10(10A)	Fully exempted	Commuted value of pension received.
16.	U/s 10 (7)	Fully exempted	Perquisites and allowances given by government to its employees posted abroad.
17.	U/s 10(5)	Fully exempted	Leave travel concessions given to Indian citizen employee.
18.	U/s 10 (21)	Fully exempted	Income of approved scientific and research association.
19.	U/s10(29A)	Fully exempted	Income of coffee board, coir board etc.
20.	U/s 10 (23 AA)	Fully exempted	Income received by any Regimental Fund or non-public fund by Indian armed forces.

1.6 Residential Status

1.6.1 Meaning

Q20. Explain briefly about Residential Status.

Ans :

Introduction

Income Tax is chargeable in respect of total income of a person earned during the previous year. The scope of total income depends upon the residential status of a person. What incomes are to be included and excluded in computing total taxable income i.e., the income earned and received in India only is to be taxed or the income earned and received outside India is also to be taxed depends upon the residential status of the assessee with reference to the relevant Previous Year. Relevant previous year means the previous year for which the residential status is to be determined. For our present study, Relevant Previous Year is (R.P. Y) 2017-18 and any preceding years are termed as earlier previous years.

If the residential status of a person is "Resident" then he has to pay tax on global income i.e., the income received in India and also on the income received outside India. On the other hand if the residential status of a person is "Non - Resident" then he has to pay tax on the income earned in India only.

Citizenship of a person does not determine the residential status i.e., the citizenship of a person is determined according to the provisions of the Constitution, while the residential status of a person is determined according to the provisions of the Income Tax Act 1961.

The term "Residential Status is a technical term and it is determined for deciding tax liability of a person". Citizenship is a general term and it grants the fundamental rights to an individual. Citizenship of a person does not change every year, but residential status of a person may change every year, the change depends upon the movement of a person from India to other countries and visiting India from other countries.

Meaning

Tax is charged on the income of the assessee. Under the Income Tax Act, 1961, the total income of every person is computed based upon his/her Residential Status. For the purpose of determining the residential status, assessee's are classified into the following categories:

The term 'Person' has been defined under section 2(31) includes :

i) An individual

ii) Hindu Undivided Family

iii) Firm

iv) Company

v) AOP/BOI

vi) Local authority

vii) Every other artificial juridical person not falling in proceeding six sub-classes.

1.6.2 Conditions applicable to an Individual Assessee

Q21. How would you determine the status of an individual?

(OR)

How does income tax department determine the residential status of an individual?

(OR)

How will you determine residential status of an individual?

(OR)

How do you determine residential status of an individual?

Ans : **(Aug.-21, Imp.)**

Section 6 of the Income Tax Act 1961, has given the following conditions which are divided in two i.e.,

1. Basic conditions and
2. Additional conditions

1. Basic Conditions

The Basic Conditions are as follows

(i) Individual should stay in India for a period of 182 days in relevant previous year (2019-20).

(ii) Individual should stay in India for a period of 60 days in relevant previous year (+) 365 day in preceding relevant previous four years.

If the individuals satisfy the above said conditions, then they are said to be "Resident" for that particular relevant previous year.

If the status of individual is determined as "Resident", then apply the test of additional condition to know whether the individual is."Ordinary Resident or Not an Ordinary Resident".

2. Additional Conditions

The additional condition are as follows,

(i) Individual should slay in India for a period of 2 year out preceding 10 previous year relevant to the present previous year.

(ii) Individual should stay in India for 730 days out of 7 years preceding to the relevant previous years.

If the Individuals satisfy all the four conditions i.e, basic condition as well as additional conditions; then such an individual is determined as "Resident and Ordinary Resident".

In ease the individuals don't satisfy the additional conditions but fulfill 'only the basic conditions, then their status will be determined as "Resident but not Ordinary Resident".

Non - Resident

If an individual doesn't satisfy any of the basic conditions, then for such individual, the status will be determined "Non-Resident"

Taxability

According to the status of individuals, their income will become liable to be charged for tax. If the status is determined Resident and Ordinary Resident, then such an individual is charged to tax on both the income earned in India as well as foreign income.

In case were the individual status is Non-Resident or Not Ordinary Resident, then such an individual will become liable to pay tax only on Indian income.

For understanding the residential status in detail, it's important to study the categories of individual also i.e., special category and general category.

(i) Special Category

The following individuals are considered as special category individuals,

(a) An Indian citizen going to foreign country for employment.

(b) A person of Indian origin visiting India in that relevant previous year.

(c) Crew member of ship of Indian ship.

(ii) General category

An individual residing in India without any travel history since last 11 year preceding relevant previous year comes under this category.

Exceptions to the General Rules for Deter mination of Residential Status

These exceptions are applied only for the special category individuals and not for the general category.

(a) For Indian citizen going to foreign on employment purpose, will be considered as "Resident" only if he satisfies the 1st basic condition i.e., stay in India for 182 days , if this condition is not satisfied then they are determined as" Non-Resident".

(b) An Indian citizen or an Individual of Indian origin, who comes to visit India in the relevant previous year and stays for minimum period of 182 days, will be considered as "Resident" for that previous year.

[Person of Indian origin means either the individual or their parents or grand-parents were bom in undivided India].

(c) A crew member or staff of Indian ship, goes out of India but stay in India for atleast 182 days in relevant previous year will also be considered as "Resident" for that relevant previous year.

For all these special category individuals, only the basic condition will applied to determine the "Residential Status". If they doesn't satisfy this condition, then they are considered as "Non-Resident".

Note

Form the financial year 2020-21, an individual going out of India for employment basis and whose income exceeds ` 15 lakhs, for such an individual, only the basic condition of stay in India will be more than 60 days but less than 182 days has been reduced to 120 days or more in this financial year.

Q22. How do you determine the residential status of HUF, Firm, Company, AOP and every other person.

Ans : **(Imp.)**

The determination of residential status of HUF, firm, company, AOP and every other person are as follows,

1. HUF

HUF means Hindu Undivided Family and usually it is a business concern. The head of this HUF is known as "Karta" and other members are known as "Co-Parceners".

Sec-6 (2) of the Income-Tax Act 1961, given condition for determining residential status of HUF. The conditions are classified as Basic and Additional conditions.

(a) Basic Conditions

(i) An HUF is said to be resident in India if their control and management i.e, business decisions are controlled partly or fully from India during the relevant previous year.

(ii) If the affairs of the' business are controlled form outside the India, then they are determined as "Non- Resident".

(b) Additional Conditions

If a HUF satisfies the 1st condition i.e, the business is controlled and managed completely form India, or partly from India, then their status is resident. Then in such a case, apply the additional conditions to the status of Karta i.e.,

(a) karta should be resident in India for at least 2 years out of 10 preceding relevant previous year.

(b) Karta should be in India for a period of 730 days or 7 years preceding relevant previous year.

If these conditions are satisfied, then the status of HUF will be determined as "Resident and Ordinary Resident".

If the HUF satisfies only the basic condition, then its status is determined as "Resident but not an ordinary Resident".

Note: In absence of Karta, manager will be considered as head and his status is determined for residential status.

2. Firm

It means any sole proprietorship or partnership firm registered under Partnership Act 1932. The status of the firm is determined according to Sec. 2 (23)(i) of the Act ; according to this, the firm can be Resident or Non- Resident.

If the business is controlled and managed partly or fully from India, then the status of firm is "resident". If the business in completely controlled and managed from outside India, then the status will be "Non-Resident".

3. Company

It means any company which is registered under Indian Companies Act 2013. Sec. 6 (3) defines status of company as resident only if it is registered under India Companies Act 2013. The status of every Indian company will be always 'Resident".

4. Association of Persons (AOP)

Sec. 6 (4) says that if the affairs of the AOP is controlled and managed fully or partly from India, then the status of AOP is " Resident". If the affairs are managed and controlled completely out of India, then their status is "Non-Resident".

5. For Every Other Persons

Sec. 6 (4) for every other person, the status is determined according to the place of control and management. If it is in India, then resident, if controlled outside India, then Non-resident. Other persons are like Local Authority and Artificial Judicial Person.

PROBLEMS

6. On 10th Oct, 2020 Mr. Pradeep Kumar a practicing Chartered Accountant left India for the first time to join Atlas Financial Service in New York city, America and returned to India on 18th March, 2021 on 15 days leave. Determine his residential status for the year 2020-2021 in terms of Resident or Non-Resident.

Sol :

To determine the residential status as resident or non resident basic condition is to be applied. During the previous year 2020-21 his stay in India is as under.

2020										2021		
Month	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
No. of days Stay in India	30	31	30	31	31	30	10	-	-	-	-	14	207

Assessee is an Indian citizen and left to the foreign country for "Employment purpose", so his case can be considered as 'Special". During the previous year 2020-21 he stayed in India for more than 182 days hence his residential status is "Resident".

7. Mr. Rajmohan an Indian citizen went to London for business purpose on 8th July, 2020 and came back to India on 25 th March, 2021. He was never out of India in the past. Determine his residential status for the assessment year 2021-22 as resident or non resident.

Sol :

To determine the residential status as resident or non resident basic condition are to be applied Residential status is to be determined for the previous year but not for the assessment year. For the assessment year 2021-22, relevant previous year is 2020-21. During the previous year 2020-21 his stay in India is as under.

2020										2021			
Month	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
No. of days Stay in India	30	31	30	8	-	-	-	-	-	-	-	7	106

Assessee is an Indian citizen and left to the foreign country for business purpose. So his case can be treated under special category.During the previous year 2020-21 he stayed in India for less than 182 days, hence his residential status is "Non-resident".

8. Mr. Manoharan is the Karta of H.U.F. whose property is situated in Delhi. During the previous year 2020-21 he was in America. What is the residential status of H.U.F.

Sol :

Basic condition

Place of control and management. During the previous year 2020-21 the control and management of affairs is out of India i.e., The basic condition is not satisfied, hence the residential status of H.U.F. is “Non Resident”.

9. Mrs. I.P. Nathan 53 years age an Indian citizen left to America on 1st July, 2015 and returned to India on 1st May, 2018 and again left to America on 1st Jan, 2021. Determine her residential status for the previous year 2020-21 relevant to the assessment year 2021-22.

Sol :

To determine the residentail status, first basic conditions are to be verified.

Basic conditions (1) Stay in India for a minimum period of 182 days.

During the previous year 2020-21 (1-4-2020 to 31-3-2021) she stayed in India for a period of 276 days. (Apr.30 + May.31 + June.30 + July.31 + Aug.31 + Sept.30 + Oct.31 + Nov.30 + Dec,31 + Jan.l)She is satisfying this condition.

Mrs. I.P. Nathan is satisfying one of the basic conditions (First test), so she is “Resident”.

Analyticaltable

S.No.	Previous year	Status
1.	2019-20	Resident
2	2018-19	Resident
3.	2017-18	Non-Resident
4.	2016-17	Non-Resident
5.	2015-16	Non-Resident
6.	2014-15	Resident
7.	2013-14	Resident
8.	2012-13	Resident
9.	2011-12	Resident

Additional Conditions:

(1) Resident in 2 out of 10 previous years, immediately preceding to the relevant previous year.

On observing the analytical table and second basic condition it can be seen that she was resident for 2 years out of 10 preceding previous years. It means she is satisfying this condition.

(ii) Stay in India for 730 days in 7 previous years.

During the last 7 years she stayed for more than 730 days.

Conclusion: Mrs. I.P. Nathan is satisfying one of the basic conditions so she is resident and satisfying both the additional conditions, hence her residential status is “Resident, and ordinarily Resident”.

1.7 Incidence of Tax

1.7.1 Types of Incomes

Q23. Define Incidence of Tax. Discuss in detail about types of incomes.

Ans : **(Imp.)**

Incidence of tax means the burden of payment of tax. In simple it denotes tax liability of a person. According to Sec. 5 of the Indian Income Tax Act, the concept of "Income" and the place of earning income is in India or in a foreign country are deciding factors for determining the tax liability. Section 5 deals with scope of total income i.e. what incomes are to be included and excluded in computing the total income of an assessee. The tax liability of a person depends upon his/her residential status during the relevant previous year.

Types of Incomes

The classification of incomes based upon its origin is of two fold:

(i) Indian Income

(ii) Foreign Income

(i) Indian Income

Income earned received and deemed to be received in India are treated as Indian income. An individual either Indian citizen or a foreign national received income from

(i) Salary for the services rendered in India

(ii) Rent received from a property situated in India

(iii) Income from the business or profession which is established in India

(iv) Income from any asset held in India

(v) Capital gain on transfer of assets held in India

(vi) Any other income for which the source of income is in India are treated as Indian income.

(ii) Foreign Income

If the source of income and receipt of income are in a foreign country then income received by a person shall be treated as foreign income.

1.7.2 Scope of Total Income

Q24. Discuss in detail Scope of Total Income.

Ans : **(Imp.)**

(i) Scope of total income of 'a Resident' [Section 5(1)]

(a) Income received or deemed to be received in India during the relevant accounting year. The place and date of accrual is immaterial.

(b) Income which accrues or arises or is deemed to accrue or arise in India during the relevant accounting year irrespective of the date and place of its receipt.

(c) Income accruing during the relevant accounting year outside India whether it is brought or not in India during the year.

Scope of Total Income = Indian Income + Foreign Income

(ii) Scope of total income of 'Not Ordinarily Resident' [Section 5(1)]

(a) Income received or deemed to be received in India during the relevant accounting year. The date and place of accrual is immaterial.

(b) Income which accrues or arises or is deemed to accrue or arise in India during the relevant accounting year irrespective of the date and place of its receipt.

(c) Income accruing or deemed to accrue or deemed to be received outside India during the relevant accounting year from a business set up in and controlled from India.

Scope of Total Income = Indian Income + One particular type of foreign income

(iii) Scope of total income of 'Non-Resident' [Section 5(2)]

(a) Income received or deemed to be received in India during the relevant accounting year. The date and place of accrual is immaterial.

(b) Income which accrues or arises or is deemed to accrue or arise in India during the relevant accounting year irrespective of the date and place of its receipt.

Scope of Total Income = Indian Income

1.8 Agricultural Income

Q25. What is Agricultural Income? Explain different types of Agricultural Incomes.

Ans : **(Imp.)**

Meaning

According to the Section 10(1) of Income Tax Act 1961, the agricultural income is fully exempted from tax. This IT Because, the agricultural income comes under the subject of State Government. Hence, Central Government cannot levy tax on it. Sec 2(1 A) discuss about agricultural income.

The income derived from the land which is used for agriculture activities and the land is situated in India, then it is treated as agriculture income.

For any income to be considered as an agricultural income, the following three conditions have to satisfied i.e.,

➢ Rent/revenue should be derived from the land.

➢ The land should be situated in India.

➢ The land must have been used for agricultural purpose only.

Types

1. Rent or revenue derived from the land

If the owner of the land gives agricultural land on lease i.e., granting the right of using the land for agricultural purpose then the rent received by the landlord from the tenant either in cash or in kind or a share in the output of the produce of a grower, will be treated as Agricultural Income. If the tenant has given the lands on sublease rent received by him will also be considered as the Agricultural Income.

The term revenue means the sale proceeds of agricultural produce or income directly related to the land, for eg., if the output of a crop is 10 bags which is sold in the market @ `. 4,500 per bag, then the sale proceeds `. 45,000 is known as revenue. If some amount of money is received for renewal of agricultural lands which are given on lease is also treated as agricultural income.

Where income is derived indirectly from land the same cannot be considered as agricultural income. Eg. Dividends received by a share holder out of agricultural income of a company engaged in agriculture.

2. The Land Is Used For Agricultural Purpose

To consider an income as agricultural income it is necessary that the land is used for agricultural purpose. The test to be applied for determining whether an income is agricultural or not, is performance of basic operations by the assessee.

In agriculture the activities are classified into two:

(i) Basic Operations (ii) Subsequent Operations

(i) Basic Operations

If an agricultural operation involves involvement of human skill and labour on the land prior to germination of plants, then these operations are known as Basic Operations. The examples for basic operations are cultivation, seeding, plantation, watering and sowing etc.

(ii) Subsequent Operations

Operations performed after the produce sprouts then these operations are known as subsequent operations. Weeding, cutting, harvesting, etc are examples for subsequent operations. If an assessee has performed basic operations and subsequent operations or only basic operations then the income received is treated as agricultural income. If an assessee performs only subsequent operations then the income received by him is not considered as agricultural income. For Eg. Income derived from the forest trees, profit made by a trader on purchasing the standing crop.

3. Land Situated

The agricultural land must be situated in India i.e.. income from agricultural lands which are situated in a foreign country is not considered as agricultural income, for taxation purpose in the case of "Resident" it is treated as income from other sources.

Kinds Of Agricultural Income

1) Rent from the agricultural land

2) Revenue received from an agricultural land

3) Income received by performance of some process to render the produce saleable e.g.:-Tobacco leaves cannot be in its natural form. First they have to be dried up for marketing, similarly other agricultural commodities like Turmeric, Jowar etc.

   Note: The process under taken should be of normal one i.e., making the agricultural product to fit for sale in the market and should not loose the basic characteristic of agricultural product.

4) From the assessment year 2009-10 onwards any income derived from saplings or seedlings grown in nursery are considered as agricultural income.

Special Note:

(i) For nursery income whether the assessee has performed basic operations or not, is not to be considered.

(ii) If a person acquires (purchases) nursery plants and sells, then it becomes business income.

(iii) Income derived from the sale of seeds by an agriculturist is agricultural income. Income derived by growing special quality of grass like carpet grass or sports ground like golf etc. is an agricultural income.

5. Income from House used for Agricultural purpose

Income from house property used for agricultural purpose is an exempted income, if the following conditions are satisfied.

(i) The house is situated near to agricultural lands.

(ii) The house is under the control of agriculturist.

(iii) The building is used for conducting agricultural activities i.e., the house is used as store room or for personal residence.

(iv) The house is subject to land revenue tax.

(v) The house is situated in a rural area.

The following two parameters are to be considered to determine whether the land is Rural Agricultural land or Urban Agricultural land.

(i) Population as listed below

(ii) Distance between the municipal boundaries to the present land situation.

	Population of the municipality	Distance from the land to the municipal limit (in K.M)	Rural Position
1.	More than 10,000 but less than 1,00,000	More than 2 K.M.	Rural Agricultural land
2.	More than 10,000 but less than 1,00,000	Less than 2 K.M.	Urban Agricultural land
3.	More than 1,00,000 but less than 10,00,000	More than 6 K.M.	Rural Agricultural land
4.	More than 1,00,000 but less than 10,00,000	Less than 6 K.M.	Urban Agricultural land
5.	More than 10,00,000	More than 8 K.M.	Rural Agricultural land
6.	More than 10,00,000	Less than 8 K.M.	Urban Agricultural land

Q26. Explain partly agriculture income and non-partly agriculture income.

Ans : **(Imp.)**

(ii) Partly agriculture income

In some cases we find that the income derived is composite, i.e., partly agricultural and partly non-agricultural. There are a few situations in which the income received as rent-in-kind on the land used for such purposes is partly of agricultural in nature. The details of these situations and the amounts to be treated as agricultural and non-agricultural incomes are as follows:

(ii) Partly Non-agricultural income

As per Rule 7, while calculating non-agricultural income, the market value of the agricultural produce raised by the assessee or received as rent-in-kind and utilized as raw material, will be deducted act of the total profits (composite income) of such assessee and not the actual cost of cultivation. However, difference between the market value of such produce (used as raw material) and the cost of cultivation shall be treated as agricultural income. Then

(a) Non-agricultural Income = Sale proceeds of industrial product (e.g., Sugar) - M.V. of Agricultural used as raw material - Industrial expenses

Note : Cost of calcuvation is not to be charged as expenses.

(b) Agricultural Income = M.V. of Agricultural produce used as raw material - Cost of cultivation

M.V = Market Value

Meaning of 'Market Value' [Rule 7(2)]. Market value means :

i) Average selling price in the relevant previous year, if the produce is ordinarily sold in the market.

ii) If the agricultural produce is not ordinarily sold in the market, the total of followings shall be treated as 'market value' :

  a) the expenses of cultivation;

  b) the land revenue or rent of the land on which the produce is grown;

  c) a reasonable amount of profit which in the opinion of Assessing Officer is considered proper.

Rule 7 A—Growing and manufacturing of Rubber in India

Income derived from the sale of centrifuged latex or cenex or latex based crops.

In other words, first of all, Total Income/Composite income shall be calculated as follows :

Composite Income or Total Income = Sale proceeds of Rubber *(i.e.,* Industrial product)

Cost of cultivation *(i.e.,* Agricultural expenses)

Industrial expenses

Now, Agricultural income = 65% of composite income

and Non-agricultural income = 35% of composite income

Then, 35% of total income of such rubber industries will be chargeable to tax under the head 'Profit and Gains of Business or Profession.'

Rule 7B—Growing and manufacturing of coffee in India

Any income derived by a person from selling coffee (in India) manufactured from self-grown coffee (in India) shall also be composite income comprising of agricultural income and non- agricultural income.

In such a case also, first of all total income/composite income shall be calculated as follows Composite income or Total income = Sale proceed of coffee *(i.e.,* Industrial product)

- Cost of cultivation *(i.e..* Agricultural expenses)
- Industrial expenses

Now,

***Case* I. If coffee is grown and cured by seller [Rule 7B(I)]**

Agricultural Income = 75% of composite income

and Non-agricultural income = 25% of composite income

Thus, 25% of total income of such coffee industries will be chargeable to tax under the head 'Profits and Gains of Business or Profession'.

***Case* II. If coffee is grown, cured, roasted and grinded by the seller with or without mixing chicory or other flavouring ingredients,** [Rule 7B(IA)]

Agricultural income = 60% of composite income

and Non-Agricultural income = 40% of composite income

Thus, 25% or 40% (as the case may be) of total income of such coffee industries will be chargeable to tax under the head 'Profits and Gains of Business or Profession.'

Rule 8—Growing and manufacturing of Tea in India

While determining the taxable income in such cases, the average market value of the agricultural produce, i.e., sugarcane, which has been utilized as a raw material during the relevant previous year, shall be deducted from the income of the factory. No further deduction is permissible in respect of any expenditure incurred by the assessee as cultivator or receiver of rent-in-kind."

Any income derived by a person from selling tea (in India) manufactured from self grown tea leaves (in India) shall also be composite income comprising of agricultural income and non-agricultural income. Rule 8 provides method for separate calculation of the two incomes.

As per rule 8, in such a case, first of all, composite income shall be calculated as follows :

Composite Income/ Total Income	= Sale proceeds of Tea (i.e., Inductrial Product)	- Cost of cultivation (i.e., Agricultural expenses)	- Industrial Expenses

Note: M.V. of tea leaves is not to be deducted as cost

Now, Agricultural Income = 60% of Composite Income

Non-Agricultural Income = 40% of Composite Income

Then, 40% of total income of such sugar industries will be chargeable to tax under the head 'Profits and Gains of Business or Profession'.

Partly Agricultural and Partly Business Income in Nutshell

Crop	Rule	Agricultural Income	Business Income
Rubber manufacturing business	7A	65%	35%
Coffee grown and cured by seller	7B(1)	75%	25%
Coffee grown, cured, roasted and grounded by the seller in India with or without mixing chicory or other flavouring ingredients	7B(1A)	60%	40%
Growing and Manufacture of Tea	8	60%	40%
Other Commercial Crops	7	Market value of the product	Balance Amount

Q27. What are the conditions to be satisfied to treat any income as an agricultural incomes

Ans : **(Oct.- 21)**

1. Rent(Or)revenue Derived From The Land

If the owner of the land gives agricultural land on lease i.e., granting the right of using the land for agricultural purpose then the rent received by the land lord from the tenant either in cash or in kind or a share in the output of the produce of a grower, will be treated as Agricultural Income. If the tenant has given the lands on sublease rent received by him will also be considered as the Agricultural Income.

The term revenue means the sale proceeds of agricultural produce or income directly related to the land, for eg., if the output of a crop is 10 bags which is sold in the market @ `. 4,500 per bag, then the sale proceeds `. 45,000 is known as revenue. If some amount of money is received for renewal of agricultural lands which are given on lease is also treated as agricultural income. Where income is derived indirectly from land the same cannot be considered as agricultural income. Eg. Dividends received by a share holder out of agricultural income of a company engaged in agriculture.

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To consider an income as agricultural income it is necessary that the land is used for agricultural purpose. The test to be applied for determining whether an income is agricultural or not, is performance of basic operations by the assessee.

In agriculture the activities are classified into two:

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(ii) Subsequent Operations

(i) Basic Operations

If an agricultural operation involves involvement of human skill and labour on the land prior to germination of plants, then these operations are known as Basic Operations. The examples for basic operations are cultivation, seeding, plantation, watering and sowing etc.

(ii) Subsequent Operations

Operations performed after the produce sprouts then these operations are known as subsequent operations. Weeding, cutting, harvesting, etc are examples for subsequent operations. If an assessee has performed basic operations and subsequent operations or only basic operations then the income received is treated as agricultural income. If an assessee performs only subsequent operations then the income received by him is not considered as agricultural income. For Eg. Income derived from the forest trees, profit made by a trader on purchasing the standing crop.

3. Land Situated In India

The agricultural land must be situated in India i.e., income from agricultural lands which are situated in a foreign country is not considered as agricultural income, for taxation purpose in the case of "Resident" it is treated as income from other sources.

Kinds Of Agricultural Income

1) Rent from the agricultural land

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Note : The process under taken should be of normal one i.e., making the agricultural product to fit for sale in the market and should not loose the basic characteristic of agricultural product.

4) From the assessment year 2009 - 10 onwards any income derived from saplings or seedlings grown in nursery are considered as agricultural income.

1.9 Heads of Income

1.9.1 Gross Total Income – Total Income

Q28. What are the various sources of income?

(OR)

What is gross total income?

Ans :

Section 14 of Income-tax Act 1961 provides for the computation of total income of an assessee which is divided under five heads of income. Each head of income has its own method of computation. These five heads are :

(i) Income from 'Salaries' [Sections 15-17];

(ii) Income from 'House Property' [Sections 22-27];

(iii) Income from 'Profits and Gains of Business or Profession' [Sections 28-44];

(iv) Income from 'Capital Gains' [Sections 45-55] ; and

(v) Income from 'Other Sources' [Sections 56-59].

Taxable Income

These incomes form part of total income and are fully taxable. These are treated u/s 14 to 69 of the Act. These are salaries, rent, business profits, professional gain, capital gain, interest, dividend, winnings from lotteries, races etc.

Q29. Explain how net agricultural income can be compuse.

Ans :

The net agricultural income is the gross of the agricultural income calculated as per the rules specified under section 2 (1A) of the Income Tax Act, 1961. In order to compute tax of individuals, HUF etc., who is having integration of income, the following rules are followed as per the assessment year 2018-19 to compute net agricultural income,

1. Rent or revenue acquired from agricultural land should be calculated in a similar method as income under the head "Income From Other Sources" under sections 57 to 59 of the Income Tax Act is calculated.

2. Income gained from agricultural activities should be calculated in a similar manner as income under the head "Profits and Gains of Business or Profession". Ail the provisions regarding depreciation and loss in case of death of animals involved in agricultural activities and provisions of sections 30, 31, 32, 34, 36, 37, 38,40, 40A, 41, 43 and 43 A should be applicable.

3. Income derived from agricultural house property should be calculated in a similar method as income under the head "Income From House Property" under sections 23 to 27 of the Income Tax Act.

4. The provisions of rule 8 should be applicable for determining the share of income from tea business.

5. For calculating the share of income or loss of a partner from the agricultural income or loss of a firm assessed as firm, the rules specified in the Income Tax Act are applicable.

6. Loss generated from agriculture should be set off against the profits from agriculture. The share of loss of a partner from a firm assessed as association of persons or a body of individuals would not be set off against his own agricultural income.

7. If the state government imposes any tax on agricultural income, it is allowed as deduction.

8. When the net agricultural income from different mediums mentioned above in the previous year is a loss then those losses would be ignored and the net agricultural income would be taken as nil.

Short Question & Answers

1. Canon of equality

Ans :

Under this principle rich shall bear a higher tax burden. This canon of equality advocates that the burden must be directly proportionate to income and wealth of a person. Income of a person determines the ability to pay. Tax burden should be more on rich than on the poor. Tax rates should be reasonable and it must encourage to earn more and more. If tax rates are high it will result in low savings and low investment. Lack of equality may result into social disorder, economic crisis in the country.

2. Canon of certainty

Ans :

According to Adam Smith, tax policies must be specific and there should not be any confusion about the tax amount, time of payment etc. This cannon also emphasizes that the Government should not follow an arbitrary method and show discrimination in imposing taxes. Tax laws should not be subject to frequent amendments. If frequent amendments are there it hinders the economic activity in the country.

3. Canon of economy

Ans :

This principle states that the minimum possible expenditure is to be incurred to collect the tax. Taxation should be economical. If the cost of collection is too high on account of high administrative expenses of tax department, then the very purpose of levying the tax i.e., to generate more revenues to the common well being gets defeated.

4. Define Tax.

Ans :

Meaning

The term 'Tax' means statutory payment to be made by the public and imposed by the Government. The word 'tax' is derived from a Latin word "Tax are" it means to estimate or value.

Definition

Prof. Adams defined 'Tax' as, from the stand point of the state, a tax is source of derivative revenue; from the angle of the citizen, a tax is a coerced payment; from the administrative point of view; it is a demand for money by state in conformity to established rules; from the point of view of a theory, a tax is a contribution from individuals for common expenditure.

Characteristics

The following are the important characteristics of tax.

1. Taxes can be/shall be imposed by the Government only.
2. Taxes are paid in the form of cash. (In the ancient days taxes were collected in the form of kind also).
3. The aim of levying tax is to promote the welfare of the people living in the country.
4. The object of tax is to raise revenue to the Government.
5. Tax is a legal collection.
6. Payment of tax involves an element of sacrifice.

5. What are direct taxes

Ans :

Meaning

Direct taxes are those which are paid after the income reaches the hands of the taxpayer; while indirect taxes are paid before the goods or services reaches the taxpayer. In other words, we can say that the Direct Taxes are those taxes the burden of which cannot be shifted and these are paid by the taxpayer directly from his income, wealth or estate.

6. What are indirect taxes

Ans :

Meaning

Indirect Taxes are those taxes the burden of which by nature is shifted and which are paid by the taxpayer indirectly i.e. while purchasing goods or services we pay excise duty or service tax.

7. What do you mean by Canons of Taxation.

Ans :

Meaning

Canons of taxation means the directive principles to be followed by the Government while framing the taxation policy and imposing the taxes on the people. With a change in economic, political and social scenario, the taxation policies have undergone a drastic change with regard to its objectives, coverage and administration etc. For judging the merits of a 'Tax' Adam Smith gave a set of basic principles known as cannons of taxation.

Principles

According to Adam Smith the following principles are to be kept in mind while framing an ideal taxation policy.

1. Canon of equality
2. Canon of certainty
3. Canon of economy
4. Canon of convenience.

8. Value Added Tax (VAT)

Ans :

VAT is a tax on final consumption of goods and services. VAT works on the principle that when raw material passes through various manufacturing stages and manufactured product passes through various distribution stages, tax will be levied on the value added at each stage but not on the gross sale price. The basic difference between VAT and sales tax is that sales tax is payable on total value of goods, while VAT is payable on value addition at each stage.

9. GST.

Ans :

Goods and Service tax was first introduced in France in the year 1954, Several other world countries followed the tax law in their respective economies and at present around 160 countries are following the tax law.

GST in India

Goods and Service tax has been passed in Parliament on 29th March 2017 and came in to force from 1st July 2017 whole of India. The new GST law has replaced many indirect tax laws previously enforced by Government. The new GST law shall make it easy, convenient and also remove the cascading effect of taxes on the taxpayers. The GST Law will govern the transactions of Supply of Goods and Service. The GST is a Multi stage taxation system throughout the supply chain. This is a destination based tax unlike the previous tax laws which were taxed based on Manufacture or start point of sale.

The GST Council which shall have representation from both State Government and Central Government which shall meet regularly to decide on the GST rules and regulations rates and also to govern the compliance issues. The GST council has 33 members and the chairman shall be the union finance minister.

10. Assessee

Ans :

Assessee means a person by whom any tax or any other sum of money such as interest or penalty etc., is due under the Income Tax Act or in respect of whom any proceedings under the Act has been taken for the assessment of his income or the income of other person for which he is assessable or any refund is due to him or to such other person. On studying the above definition It can be seen that a person shall be treated as an "Assessee" under the following situations.

11. Deemed Assessee

Ans :

Generally, the person whose income exceeds the exempted limit is liable to pay tax but if such a person is a minor his parents i.e. Father/Mother and in the case of lunatic the legal representatives or trustee of such persons or guardian for him will be liable for tax payment. The parent or guardian or trustee will be treated as deemed to be an assessee, and is known as representative assessee. i.e. For the assessment of others one who is liable to pay tax is known as "Deemed Assessee". In the following situations the person is treated as an assessee for the tax payable on behalf of others.

(i) Trustee of Trust.

(ii) Legal Representative of a deceased person A person whose taxable income is more than the exempted limit if he dies before the ending date of previous year or date of filing return then his legal representatives Viz wife or son etc. is treated as deemed assessee.

(iii) Legal guardian of a minor or lunatic person.

(iv) Official receiver appointed by court.

12. Assessee-in-Default

Ans :

When a person violates the provision of the Act in discharging his duties then he is known as assessee in default, e.g when salary is paid it is the duty of the pay disbursing officer or employer to deduct tax at source on the income of employee and the same shall be remitted to Income Tax Department within the stipulated time. Similarly, tenant has to deduct tax before paying rent to the land lord.

In the following situations a person is treated as "Assessee in default".

(i) Fails to deduct tax and remit the tax deducted fully.

(ii) If a person failed to pay advance tax.

On studying the above provisions about an assessee it can be concluded that every assessee is a person but every person need not be an assessee. For example, Mr. Gopinath, whose status is an 'individual' having an income of ` 1,20,000 during the relevant previous year to the current assessment year is a "person" but not an "assessee" because his income is less than the exempted limit of income. Similarly, a person may not have his own taxable income but still he is treated as an assessee.

For example, if minor's income is more than the exempted limit of the parents then one of the parent is treated as an assessee.

13. Assessment Year

Ans :

Assessment year means the period of 12 months commencing from 1st April of every year and ending on 31st March succeeding the financial year or previous year of the assessee. The current assessment year is 2021-22.

During this period the total income of an assessee earned during the previous year is assessed to tax, i.e. Assessment year is the year in which income of the relevant previous year and income of earlier period if not taxed is assessed to tax. It is also known as tax year. Assessment year ending does not mean that the assessment of an assessee must be completed. It only signifies the provision of Income Tax Act existing of that period are to be applied in computing taxable income and tax liability.

14. Previous Year

Ans :

Previous year is the preceding 12 months period to the relevant assessment year. It starts on 1st April and ends on 31st March. Total income earned during the above period is considered for tax purposes, therefore it is also known as Income year or Accounting year. Previous year is the financial year immediately preceding the assessment year. **Eg :** For the assessment year 2021-22 relevant previous year is 2020-21.

15. Person

Ans :

According to Income Tax Act, 1961 the term person includes the following types of assessees who are as follows :

(i) A natural person he/she who is liable to pay tax on his personal income is designated as an "Individual" i.e., an individual who is assessed in respect of his personal income.

(ii) A Hindu Undivided Family

A Hindu undivided family means a group of persons lineally descended from a common ancestor. The Head of the Hindu Undivided Family is known as Karta. Karta is assessed for the income derived by the Joint Hindu Family. If other member of the family is managing and controlling then he will be designated as Manager and is liable to pay tax.

(iii) Company : A Company which is incorporated under the Companies Act of 2013.

(iv) Firm

A partnership of two or more persons carrying on a business or profession under the Indian Partnership Act, 1932.

(v) An Association of persons or a body of individuals

For eg., A group of persons formed for promoting a Joint venture business or trustees of a trust etc.

(vi) A Local authority: Eg. Municipalities, Local Bodies etc.

(vii) Every artificial juridical person: Not falling in any of the preceding categories. **Eg:** a Statutory corporation or a Hindu deity.

16. PAN.

Ans :

Permanent Account Number means the number which is allotted by the tax assessing officer to the assessee for easy identification. In case of need, this number is useful to trace out the previous returns submitted by the assessee and assessment orders passed on by the Department.

Under section 139A & Rule 114, the number is allotted by the Assessing Officer when the assessee applies for the same.

Income exceeds the exempted incomes limit, then has to apply to the concerned I.T.O. for allotment of the number. Once the number is allotted the assessee or PAN card holder need not apply every year. If there is a change in the residential address or if any corrections are required then he can apply for such changes. The assessee shall intimate the Assessing Officer any change in his address or in the name and nature of his business on the basis of which the permanent account number was allotted to him. If the PAN card holder losses his card then a new card will be issued for a nominal fee. In the case of business or profession if the sales or gross receipts exceeds ` 5,00,000 one has to apply for the same though the person may not have the taxable income.

17. Residential Status.

Ans :

Introduction

Income Tax is chargeable in respect of total income of a person earned during the previous year. The scope of total income depends upon the residential status of a person. What incomes are to be included and excluded in computing total taxable income i.e., the income earned and received in India only is to be taxed or the income earned and received outside India is also to be taxed depends upon the residential status of the assessee with reference to the relevant Previous Year. Relevant previous year means the previous year for which the residential status is to be determined. For our present study, Relevant Previous Year is (R.P. Y) 2017-18 and any preceding years are termed as earlier previous years.

If the residential status of a person is “Resident” then he has to pay tax on global income i.e., the income received in India and also on the income received outside India. On the other hand if the residential status of a person is “Non - Resident” then he has to pay tax on the income earned in India only.

Citizenship of a person does not determine the residential status i.e., the citizenship of a person is determined according to the provisions of the Constitution, while the residential status of a person is determined according to the provisions of the Income Tax Act 1961.

The term "Residential Status is a technical term and it is determined for deciding tax liability of a person". Citizenship is a general term and it grants the fundamental rights to an individual. Citizenship of a person does not change every year, but residential status of a person may change every year, the change depends upon the movement of a person from India to other countries and visiting India from other countries.

Meaning

Tax is charged on the income of the assessee. Under the Income Tax Act, 1961, the total income of every person is computed based upon his/her Residential Status. For the purpose of determining the residential status, assessee's are classified into the following categories:

The term 'Person' has been defined under section 2(31) includes :

i) An individual

ii) Hindu Undivided Family

iii) Firm

iv) Company

v) AOP/BOI

vi) Local authority

vii) Every other artificial juridical person not falling in proceeding six sub-classes.

18. Define Incidence of Tax.

Ans :

Incidence of tax means the burden of payment of tax. In simple it denotes tax liability of a person. According to Sec. 5 of the Indian Income Tax Act, the concept of "Income" and the place of earning income is in India or in a foreign country are deciding factors for determining the tax liability. Section 5 deals with scope of total income i.e. what incomes are to be included and excluded in computing the total income of an assessee. The tax liability of a person depends upon his/her residential status during the relevant previous year.

Types of Incomes

The classification of incomes based upon its origin is of two fold:

(i) Indian Income

(ii) Foreign Income

19. What is Agricultural Income

Ans :

According to the Section 10(1) of Income Tax Act 1961, the agricultural income is fully exempted from tax. This IT Because, the agricultural income comes under the subject of State Government. Hence, Central Government cannot levy tax on it. Sec 2(1 A) discuss about agricultural income.

The income derived from the land which is used for agriculture activities and the land is situated in India, then it is treated as agriculture income.

For any income to be considered as an agricultural income, the following three conditions have to satisfied i.e.,

- Rent/revenue should be derived from the land.
- The land should be situated in India.
- The land must have been used for agricultural purpose only.

20. What is gross total income?

Ans :

Section 14 of Income-tax Act 1961 provides for the computation of total income of an assessee which is divided under five heads of income. Each head of income has its own method of computation. These five heads are :

(i) Income from 'Salaries' [Sections 15-17];

(ii) Income from 'House Property' [Sections 22-27];

(iii) Income from 'Profits and Gains of Business or Profession' [Sections 28-44];

(iv) Income from 'Capital Gains' [Sections 45-55] ; and

(v) Income from 'Other Sources' [Sections 56-59].

Choose the Correct Answer

1. Education cess is leviable in case of: [c]
   (a) An individual and HUF (b) A company assessee only
   (c) All assesses (d) Only for Senior citizens
2. Incomes which accrue or arise outside India but are received directly into India are taxable in case of [d]
   (a) Resident only (b) Both ordinarily resident and NOR
   (c) Non-resident (d) All the assesses
3. Income deemed to accrue or arise in India is taxable in case of : [d]
   (a) Resident only (b) Both ordinarily resident and NOR
   (c) Non-resident (d) All the assesses
4. PAN Stands for ________ [b]
   (a) Personal account number b) Permanent Account number
   (c) Previous account number (d) None of the above
5. The rate of tax that is leivable on STCG arising from transfer of Equity shares of a Company or units of an Equity oriented fund is [c]
   (a) 10% (b) 15%
   (c) 20% (d) 25%
6. Surcharges means [a]
   (a) Tax on tax (b) Tax on income
   (c) Tax on special income (d) None
7. BOI means [b]
   (a) Body of intelligence (b) Body of individuals
   (c) Body of income (d) None
8. Residential status of a company is defined u/s [c]
   (a) 3 (3) (b) 4 (3)
   (c) 6 (3) (d) None
9. The total income is based upon ______ status [a]
   (a) Residential (b) Citizen
   (c) Income (d) None
10. Resident is liable to pay tax on [c]
    (a) Indian income (b) Foreign income
    (c) Both a & b (d) None

Fill in the blanks

1. Tax is levied for specific purpose is known as ________.
2. Income tax act came in to force on ________.
3. Income received from outside India is called ________.
4. The normal rates of income tax are mentioned in ________.
5. GST tax rates are classified in to ________.
6. The term Assessee has been defined in the section ________.
7. The term person has been defined in ________.
8. LTCG stands for ________.
9. The term income has been defined in ________.
10. The number of heads of Income under Income Tax Act, 1961 are ________.

ANSWERS

1. Cess
2. April 1 1962
3. Foreign Income
4. Finance Act
5. 5 slab rates
6. Section 2(7) of Income Tax Act, 1961
7. Section 2(31) of Income tax Act, 1961
8. Long term capital gain
9. Section 2(24) of Income Tax Act, 1961
10. Five

UNIT II

INCOME FROM SALARIES:

Definition of 'Salary' – Characteristics of Salary – Computation of Salary Income: Salary u/s 17(1) – Annual Accretion – Allowances – Perquisites – Profits in lieu of Salary – Deductions u/s. 16 – Problems on computation of Income from Salary.

2.1 Definition of Salary

Q1. Define Salary.

(OR)

What is meant by Salary?

Ans :

Section 17(1) defines "salary" which includes the following receipts:

1. Wages
2. Any annuity of pension
3. Any gratuity
4. Any fees, commissions, perquisite or Profits in lieu of or any addition to salary or wages.
5. Leave encashment or salary in lieu of leave
6. The annual accretion to the credit balance of employees recognised provident fund to the extent it is taxable
7. Transferred balance of unrecognised provident fund to the balance of recognised provident fund to the extent it is taxable.
8. The contribution made by the central government to the account of an employee under a pension scheme referred to in section 80 CCD.

The above definition of salary can be explained in the following manner:

1. **Wages**

   Any amount received by the employee from his employer for work or service rendered is called wages or salary. Generally the amount payable for non-manual work is treated as salary and amount payable for manual work is called wages.

2. **Any Annuity of Pension**

   Pension is a periodic payment from the past employer for the service rendered in past. It is fully taxable during the previous year. The employee gets pension after his retirement. It may be received direct as pension or out of a superannuation fund created by employer.

3. **Any Gratuity**

   The employer pays an amount to the employee at the time of his retirement as a token of gratitude for the service rendered. It is treated as Salary but in case of death gratuity is paid to his family member which is treated as income from other source for his legal heirs.

4. **(a) Fees:** Any amount received by the employee for doing any extra work other than the job assigned to him. Fees is paid by employer for extra work done by employee. It is fully taxable.

   (b) Commission: If the employee received any commission which, is a fixed percentage on turnover achieved by him, such commission shall be treated as salary. Commission is paid as a percentage on profit/sales. It is fully taxable.

(c) **Perquisite:** Any benefit or amenity received by the employee from his employer in addition to wages or salary. It may be given in cash of kind. The monetary value of the benefit is taxable.

(d) **Profit in Lieu or in addition to Salary:** Any cash payment received by the employee u/s 17(3) is treated as Profit in lieu of salary.

5. Leave Encashment or Salary in lieu of Leave

If the employee receives any salary in lieu of leave during the service period is fully taxable but if he receives it after retirement exemption is allowed.

6. Annual Accretion

The annual accretion of the accumulated balance of recognised provident fund of the employee shall be taxable as:

(i) Contribution made by the employer in excess of 12% of the salary of the employee

(ii) Interest credited to R. P. F in excess of 9.5% of the accumulated balance of that previous year.

7. Transferred Balance of Unrecognised Provident Fund

When an unrecognised provident fund is recognised for the first time the balance standing to the credit of the employee provident fund account at the time of recognition is called transferred balance. In this case the fund will be treated as recognised provident fund from the begining. The excess amount transferred to RPF over exempted amount shall be taxable portion of transferred balance.

8. Contribution made under Pension Scheme u/s 80CCD

The Central Government introduced a new pension scheme for all categories of employee in which the employee who joined in a job after 1.4.2014 comes under the preview of this section. It is mandates now the employee and employer shall contribute 10% of the salary to notified pension account.

2.1.1 Characteristics of Salary

Q2. What are the Characteristics of a Salary?

Ans : **(Imp.)**

1. Employer and Employee Relationship

"Employment" means holding of any post or office on regular basis under an agreement of service whether full time or part time and involving manual or non-manual work. Any Payment will be Salaries only if there is relationship of employer and employee between payer and payee.

2. Salary from more than one Employer

If an individual received salary from more than one employer (due to part time job or change of job) during the same previous year it will be taxed under salaries.

3. Salary from Present, Past and Prospective Employer

Salary received during the previous year from past, present or prospective employer is taxable under this head. Hence the salary of past employer received during the previous year is taxable along with the salary received from the Present employer.

4. Tax Free Salary

Some times the employer pay tax free salary to employee. It means the employer pays tax due on such salary on behalf of employee to the tax department. Here the salary for employee is the aggregate of net salary received plus amount of tax Paid by the employer.

5. Previous Year for Salaries

The Previous year for the purpose of income from salaries shall the financial year of the government. It means 1st April to 31st March of the relevant previous year.

6. Pension

Pension received by an employee after retirement is taxable under salaries. Pension earned and received abroad is taxable only in case of ordinary resident. Whether remitted to India or not. Pension received from the former employer is also taxable under this head.

7. Salary & Professional Income

If any professional person, such as, lawyer or Chattered accountant or doctor works under a contract of service and received the remuneration for his professional work will be taxable under salaries. But if the employment is incidental to the exercise of a profession any payment for it will be taxable under "Profit & Gains of Business & Profession".

8. Accrual or Receipt Basis

Salary is taxable on accrual or receipt basis, which ever comes earlier. In case where employer has not paid salary, it is chargeable on accrual basis.

9. Place of Accrual

Salary is supposed to accrue at a place where service is rendered. Under section 9(1)(2) salary earned in India shall be deemed to accrue or arise in India whether it is paid in India or outside India. In case of an Indian citizen who is a government employee and is serving out side India, the salary received by him will be treated as Indian income through the services are rendered outside India.

10. Personal Gifts and Voluntary Payment

An employee will be taxed under "Salaries" in respect of all payments received from employer, whether in cash or kind, under a contract or other wise and in addition to salary.

11. Advance Salary

If the employee receives some salary in advance in a previous year which was not due for that financial year shall be taxable in the year of receipt.

12. Arrear Salary

Any amount of salary received during the relevant previous year related to earlier previous year either from present or past employer is treated as arrears salary. It is taxable in the year in which received. But the assessee can claim for relief u/s 89(1) for the amount so received.

13. Deduction by Employer

Due to the obligatory condition the employer makes certain deduction out the salary of employee. Then the tax is not chargable on the net amount received by the employee but it will be the gross salary due to him.

Some of the important deductions made by the employee are as follows:

- Employee contribution to Provident fund.
- Processional tax deducted.
- Income tax deducted.
- Any deductions authorized by employee.
- Any deductions for amenities Provided by the employee.

14. Due Date of Salary

Generally the employee gets his salary after completion of a month in our financial system from his organization or office whether government or non-govt. During a financial year he has to get salary from 1st April to 31st March for 12 months or a continuous service but if the employee joins during the financial year, his salary will be for a period from date of joining to 31st March of the relevant previous year.

In case of government and semi-government employees the salary for particular month is due on first day of next month and in case of banks and non-government bodies the salary is due on the last date of the same month. Hence, the Salary become due: (a) 1st day of the month, (b) Last day of the month

(a) 1st day of the Month: During the Previous year 2018-19, the 1st Salary shall be due on 1st April 2018 for the month of March 2018 and last salary shall be due on 1st March 2019 for the month February 2019. (salary for the period -March 2018 to February 2019)

(b) Last day of the Month: During the previous year 2018-19, the 1st salary shall be due on 30th April 2018 for the month of April 2018 and last salary shall be due 31st March 2019 for the month of March 2019. (Salary for the period - April 2018 to 31st March 2019)

15. Salary Grade Scale of Pay

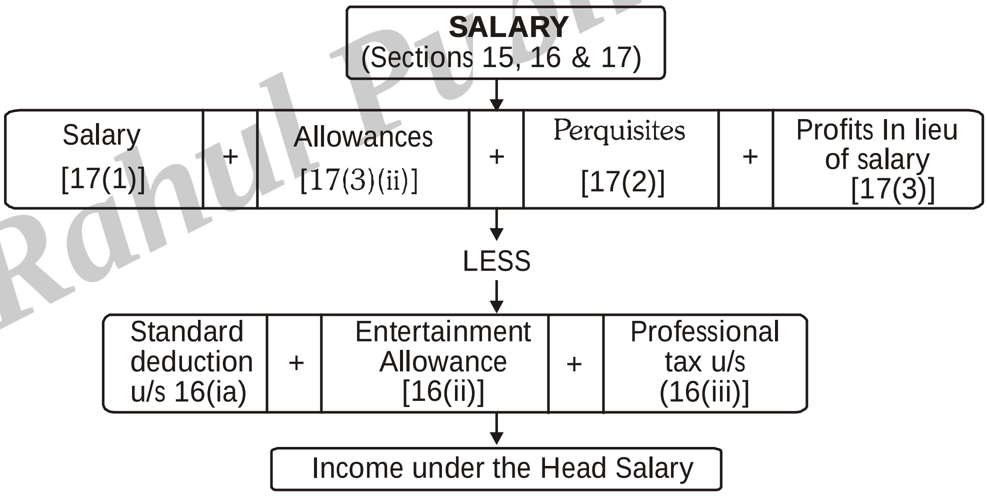
Generally the salary is Paid to employees on the basis of their scale of pay or salary grades. The pay scale decides the starting salary of the employee at the time of appointment and during the entire service period. He gets an annual increment after completion of one full year of service and continue till reaches the maximum Limit.

2.2 Computation of Salary Income u/s 17(1)

Q3. State the components of salary income.

Ans : **(Imp.)**

Salary income of an employee is to be computed in accordance with the provisions laid down in sections 15, 16 and 17. Section 16 gives deductions to be allowed out of incomes taxable under this head. Section 17(1) defines the word 'salary' as mentioned in section 15. Section 17(2) and 17(3) further define the terms 'Perquisites' and "profits in lieu of salary". These can be depicted in the form of chart given below :



The components of salary income are available in the form of cash/benefits/facilities.

Salary Income = Salary + Allowances + Perquisites + Profits in lieu of salary.

1. Salary

Salary means the payment which is made to some categories of persons like salary of partners, employees or workers, members of parliament and so on.

Like person receiving the remuneration and a person paying the remuneration should have a relationship of master (i.e., employer) and servant (i.e., employee) then only such remuneration is considered as income from salary.

2. Allowances

Allowance refers to any fixed monetary benefits provided by the employer to his/her employee for the purpose of meeting specific expenditures in the form of House Rent Allowance, Entertainment Allowance, children education allowance and so on. The payment of an allowance may be an agreement or at the choice of the employer. Hence, employer has the right to withdraw the allowances or he may increase or decrease the allowances.

3. Perquisites

According to Income Tax Act, the term perquisites refers to any form of benefit (paid either in cash or in kind) by the employer to the employee or his/her family members.

4. Profits in Lieu of Salary

The amount paid by the employer to the employee in place of salary is known as "Profits in lieu of salary". This amount is paid only where the salary discontinues to be a regular payment.

Q4. Show the format of computation of salary income u/s 17(1) of income tax act 1961.

Ans :

Following is the format for computation of salary income u/s 17(1) of Income Tax Act 1961,

Computation of Mr. ....Income from salary (for the Assessment Year..........)

Particulars	Amount (`)
Salary:	
Basic pay	xx
Bonus	xx
Fees	xx
Commission	xx
Employer's contribution to R.P.F in excess of 12% of salary	xx
Excess of interest on R.P.F [Over the exempted rate 9.5 %]	xx
Contribution made by employer to employee under	
New Pension Scheme [N.P.S]	xx
Allowances:	
Dearness Allowance (D.A)	xx
Dearness Pay (D.P)	xx
C.C.A	xx
House Rent Allowance [un-exempted]	xx
Entertainment allowance	xx
Perquisites:	
Rent free accommodation	xx
Insurance premium paid by the employer	xx
Provision of domestic servant	xx

Profits in lieu of Salary:		
Compensation received on termination		xx
Transferred balance (U.R.P.F. to R.P.F)		xx
Gross Income from salary		xx
Deduction u/s 16:		
Standard deduction u/s 16(ia)	xx	
Entertainment allowance u/s 16 (ii)	xx	
Professional Tax u/s 16 (iii)	xx	xx
Income from salary		xx

Q5. Define the following terms.

1. Basic pay

2. Bonus

Ans :

1. Basic Pay

Basic pay is the prime salary. This salary may change every year on account of increments, e.g. If the basic salary of an employee is `. 6,000 and increment is `. 300 it means after completing one year of service the basic pay will be `. 6,300 for the second year and `. 6,600 for the third year and so on.

In some of the organizations the basic pay may be in the graded form. e.g. Scale of pay `. 11,500-500-13,000-750-16,000-1,000-20,000.1n the first year of service the basic pay starts with `.11,500 and for every one year of completed service it increases by `. 750 till it reaches `. 13,000 and thereafter it increases every year by `. 1,000 till it reaches Rs. 16,000 and then the increase will be `. 1,000 for one year of service. When the basic pay becomes `. 20,000 i.e. maximum limit thereafter it will not increase year after year, until the scale is revised.

Note: Increment need not be same amount. Presently for the government employees it increases by a fixed percentage in an year and in the private sector increments may be given two or three times in a year.

2. Bonus

In principle bonus received by an employee is taxable as salary income. It is taxable on receipt basis. The treatment of different types of bonus is explained as under.

(i) Legal Bonus

Bonus payable to an employee under the provisions of an Act viz. Payment of Bonus Act is known as ‘ legal bonus’ and it is taxed as an item of salary.

(ii) Contractual Bonus

Bonus payable as per the terms of service conditions is known as ‘Contractual Bonus’ and it is taxed as an item of salary.

(iii) Incentive Bonus

If bonus is paid for the efficiency of the employee then it is known as 'Incentive bonus', and it is taxed as an item of salary.

(iv) Gratuitious Bonus

Any bonus paid in excess of Statutory limit i.e. maximum limit mentioned in the Bonus Act or in excess of the agreed amount then it is known as 'Gratuitious bonus'. This is taxable as perquisite under the head Income from salary.

2.3 Annual Accretion

Q6. What is meant by Annual Accretion? Explain with an example.

Ans : **(Imp.)**

Annual accretion in any previous year to the balance at the credit of an employee participating in a recognised provident fund as consists of:

(a) Contribution made by the employer in excess of 12% of the salary of the employee; and

(b) Interest credited on the balance to the credit of the employee in so far as it exceeds the amount allowed at a rate exceeding such rate as may be fixed by the Central Government in this behalf by notification in Official Gazette, shall be deemed to have been received by the employee in that previous year and shall be included in the total income for that previous year and shall be liable to income-tax.

The above-mentioned rule makes it clear that any contribution by employer to R.P.F. in excess of 12% of employee's salary is to be added in salary.

About interest the taxable portion will be excess of Interest credited to the balance of R.P.F. over a rate of interest to be announced by the Government from time to time.

To simplify the above discussion it can be put in the following manner :

Taxable annual accretion will consist of :

(a) Excess of employer's contribution to Recognised Provident Fund over 12% of employee's salary', and

(b) Excess of interest credited to R.P.F. over interest calculated at prescribed rate (i.e., 9.5%) of the balance standing to the credit of employee.

Example :

Calculate the taxable amount of annual accretion to R.P.F. if following information is provided by assessee :

(i) Pay @ ` 40,000 p.m.

(ii) Commission received by him on the basis of turnover achieved by him : ` 1,36,000;

(iii) Employer's contribution to R.P.F. @ 13% of salary;

(iv) Interest credited during the year to R.P.F. Balance @ 12% is ` 64,000.

Sol :

Calculation of taxable portion of annual accretion

	Particulars	`	`
(i)	Employer's contribution to R.P.F. @ 13% of		
	salary [13% of (4,80,000 + 1,36,000)]	80,080	
	Less 12% of salary being exempted	73,920	6,160
	Taxable Portion		
(ii)	Interest credited to R.P.F. Balance @ 12%	64,000	
	Less exempted upto @ 9.5% (64,000 x 9.5%/12)	50,667	
	Taxable portion		13,333
	Taxable portion of annual accretion		19,493

Q7. What is provident fund? Explain different types of provident fund and its treatment.

Ans : **(Imp.)**

To encourage savings for the social security of employees, the Government has set up various kinds of provident funds. The employee contributes a fixed percentage of his salary towards these funds and in many cases employer also contributes. The whole contribution along with interest is credited to employee's account. He will get payment out of this fund at the time of retirement and at some other important occasions. If the employee dies, his heirs will get the full payment.

Provident Funds are of four kinds :

(a) Statutory Provident Fund or the Fund to which the Act of 1925 applies (S.P.F.).

(b) Recognized Provident Fund (R.P.F.).

(c) Unrecognized Provident Fund (U.R.P.F.).

(d) Public Provident Fund (P.P.F.).

(a) Statutory Provident Fund

Statutory provident fund is the oldest type of fund. It was started in the year 1925 through a Provident Fund Act of 1925. This fund was started with a view of promoting savings amongst government employees. Generally, this fund is maintained by Government or Semi-Government Departments like Railways, Reserve Bank of India, Colleges, Universities, local bodies, insurance companies, etc.

The employer's contribution towards the employee's statutory provident fund and the amount of interest earned on the accumulated balance to the employee's credit balance are not to be included in the income of employee and so it is ignored.

When the employee retires or leaves the service and receives any amount from the accumulated balance to his credit in the statutory provident fund, the amount so received will not be included in employee's total income [Section 10(11)] being exempted income.

The employee's own contribution will qualify for deduction u/s 80C.

(b) Recognised Provident Fund.

As the name suggests, it is a fund to which the Commissioner of Income-tax has given the recognition as required under the Income-tax Act. Generally this fund is maintained by industrial undertakings, business houses, banks, etc.

- The employer's contribution over and above 12% of employee's salary, will be included in employee's salary income for tax purposes.
- The employee's contribution towards this fund will fully qualify for deduction u/s 80C
- Interest on Provident Fund credit balance upto prescribed rate (9.5%) is exempted, but interest credited over and above such rate is deemed to be employee's salary income and is included in salary income of that previous year.

(c) Unrecognised Provident Fund.

It is the provident fund which is not recognised by the Commissioner of Income-tax. The employee and the employer both contribute towards this fund.

The employee's contribution is added in this salary (if 'net salary' or 'salary after deduction of is given) and he will not be allowed any deduction u/s 80C regarding this contribution while computing the total income of the employee.

The employer's contribution and interest on the accumulated credit balance of the fund are not to be included in employee's salary income from year to year.

A payment received out of this fund is taxable so far it represents the employer's contribution and interest thereon. The employee is entitled to relief under section 89(1). [The employee's contribution is ignored because it was taxed when it was contributed]. Interest on the employee's own contribution will be taxable as 'Income from Other Sources' and not as salary income.

Transferred balance. When the unrecognised provident fund is recognised for the first time, the credit balance in the employee's unrecognised provident fund is transferred to the recognised provident fund account. This balance is known as transferred balance. In such case fund will be treated as RPF from the day of its inception and exemption will be allowed in same manner. Only excess of amount transferred to RPF over exempted amount shall form taxable portion of transferred balance.

(d) Public Provident Fund

So far all these funds were for the salaried people. On July 1, 1968 a new fund known as public provident fund was started so that self-employed people may also enjoy the benefit of deduction u/s 80C. Self-employed people are doctors, lawyers, accountants, actors, traders, pensioners. This fund can suit all types of pockets and its working is also very simple. The interested people can open their account in State Bank of India and its subsidiaries. The subscription can be between ` 500 and ` 1,50,000 in one year. At one time one can deposit in multiples of 50 and in one month only one deposit is possible and in the year minimum subscription should be ` 500 and the maximum ` 1,50,000.

2.4 Allowances

Q8. Define Allowances. What type of allowances received by an employee.

Ans : **(Imp.)**

Allowance is a fixed monetary benefit given by the employer to an employee for a specific purpose e.g. House Rent Allowance, Children Education Allowance etc. The employer can withdraw the allowance or he can increase or decrease. The allowance amount i.e., the payment of an allowance can be either on account of an agreement or at the discretion of the employer. From taxability point of view the employees can be classified into two categories.

(I) Special category employees.

(II) General category employees.

(I) Special category employees

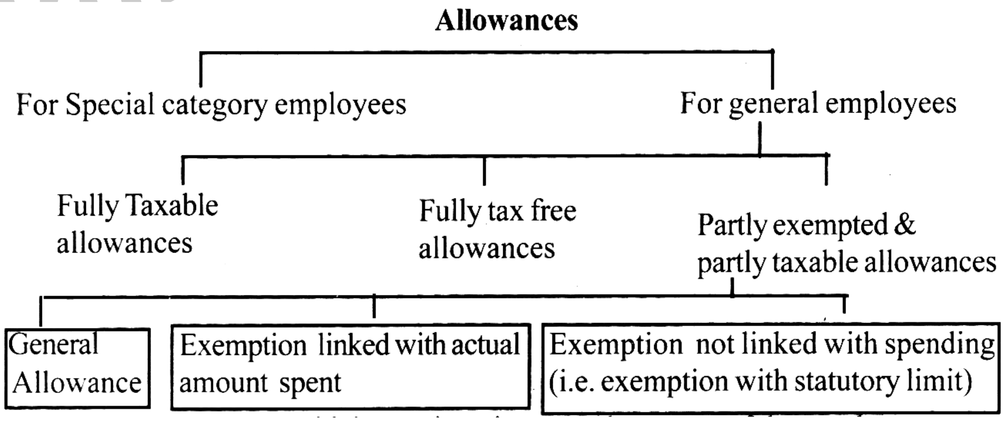
Any/All allowances received by the following persons is fully exempted from tax.

1. Allowances received by Judges of High Court and Supreme Court.
2. Allowances received by employees of U.N.O
3. Allowances received by a teacher/professor/ research scholar from a foreign country which is SAARC member nation. The exemption is allowed for a period of two years.
4. Allowance received by chairman/member of U.RS.C

(II) General category employees

From the Income tax point of view the allowances are classified into three types.

1. Fully Taxable Allowance.
2. Fully Tax Free Allowance or Exempted Allowance.
3. Partly Taxable Allowance i.e., un-exempted amount is taxable.



Note:

The allowances, which are given in general to many of the employees, are discussed as under.

I. Fully Taxable Allowances:

Following allowances are fully taxable:

(a) Dearness allowance (D. A.) or High cost of living allowance

(b) Additional D.A.

(c) City Compensatory Allowance (C.C.A.)

(d) Marriage Allowance

(e) Family Allowance

(f) Meals Allowance

(g) Servant Allowance

(h) Project Allowance

(i) Interim relief

(j) Medical Allowance

(k) Lunch Allowance

(l) Over time Allowance

(m) Warden Allowance

(n) Non-practicing Allowance

(o) Tiffin allowance

(p) Dress Allowance

(q) Daily Allowance.

Note-1: Foreign allowance: For government employees it is fully tax free and for others fully taxable.

Note-2: If D.A. enters for retirement benefit then it is known as D.P. (Dearness Pay i.e., that part of the D.A. which enters for retirement benefit is known as D.P). In the case of retired employees D.A. is termed as "Dearness Relief or D.R. which is fully taxable.

II. Fullytax Free (or) Exempted Allowances:

1) Foreign allowance to government employees.

   Note: Any allowance paid by government to an employee working in a foreign country who is a citizen of India is fully tax free.

2) Any allowance paid to High Court and Supreme Court Judges, Chief Election Commissioner, Election Commissioner, Present and former Chairman and members of Union Public Service Commission.

3) Allowances received by an employee of U.N.O / Diplomatic and Consulate staff of Foreign Government working in India from his employer.

4) Allowances received by a teacher/professor research scholar from a foreign country which is SAARC member nation for a period of two years.

5) Allowance received by chairman/member of U.P.S.C

III. Partly Taxable Allowances:

The following allowances are partly exempted from tax i.e., un-exempted amount of allowance is taxable.

The allowances in this category can be sub-classified as

(i) General Allowances

(ii) Exemption linked with actual expenditure

(iii) Exemption which does not linked with actual expenditure.

Q9. Define the following terms :

(i) General Allowances

(ii) Exemption of Allowance linked with actual expenditured incurred

(iii) Exemption of Allowance not linked with actual expenditured

Ans :

I. General Allowances

In this, our study is confined to two important allowances

(i) Entertainment Allowance

(ii) House Rent Allowance.

(i) Entertainment Allowance

Rule: Unexempted amount is taxable

Entertainment allowance is one of the items of deductions allowed u/s 16 (ii) from-the salary income, i.e., it is not an item of exempted allowance. This allowance may be given for official purpose or for personal purpose. For Entertainment allowance given by the employer for official purpose, it is not to be treated as income. However, if the actual amount spent is less than the received amount then the difference amount is treated as taxable income under the head "Allowances". Entertainment allowance given by the employer for personal purpose may be allowed as deduction.

Note: If nothing is mentioned in the problem then the entertainment allowance received is to be treated for personal purpose only.

Steps :

1. Add the Actual amount of allowance received to the salary i.e., writing in the statement under the head "Allowances".
2. Calculate the exempted amount of allowance in the working notes.
3. Deduct the exempted amount of allowance under the head "Deductions" u/s 16(ii).

Deduction

Entertainment allowance is allowed as deduction only for Government employees. The term Government employee includes Central government or State Government employees but does not include the employees of statutory corporations and local authorities, for Non-Government employees, it is not allowed

Employees

- Central & State Government Employees
- Employees of statutory Corportions Local Authorities and Non-Government employees → No deduction is allowed

The deduction is least of the following three amounts.

(a) 20% of salary

(b) Actual amount of allowance received plus receivable

(c) ` 5,000.

Note:

(i) Actual amount spent is not to be considered.

(ii) ` 5,000 is the ceiling amount and not per annum.

2. House Rent Allowance [Sec.l0 (13A) and Rule 2A]

This is one of the major allowances given by the employer to employee. The allowance is given towards rent of the house. The employer is not concerned whether the employee is paying rent of the house or not, if so, how much? According to Sec.10 (13A) and Rule 2A, House Rent Allowance is allowed as exemption. The conditions for availing the exemption and other provisions are as under:

Rule:

This allowance is allowed as exemption only when the assessee is paying rent of the house where he is presently residing.

Steps:

1. First calculate the exempted amount of allowance in the working notes.
2. Add the un-exempted allowance to the salary under the head "Allowances".

Note : For giving the exemption, employees are divided into two categories

a. Employees living in Mumbai, Delhi, Kolkata and Chennai.

b. Employees living in Other places.

Employees

Employees residing in metro cities Mumbai, Delhi, Kolkata, Chennai The least of the following three amounts is allowed as exemption.	Employees residing in non-metro other cities/towns The least of the following three amounts is allowed as exemption.
A. Actual House rent Allowance received B. Rent Paid (–) 10% of salary C. 50% of salary	A. Actual House Rent Allowance received. B. Rent Paid(–) 10% of salary C. 40% of salary

Special Points

1. In the H.R.A. exemption calculation, if one of the amounts is zero (0) or in negative value no deduction is allowed i.e., Actual Allowance received is fully taxable.

2. If the rent is paid to near relatives (like father or mother) and If the payment is a genuine one exemption can be given.

3. Rent paid to Wife

   (i) If the husband has constructed or purchased a house out of his money, but registration of the house is made in the name of wife and when they are living together Rent paid to wife cannot be given as exemption.

   (ii) If the house is purchased out of "Stridhan" of wife or from her personal funds (earnings and debt) then exemption may be given. However the wife is liable to pay tax on the rent received under the head "Income from House Property".

   (iii) If husband and wife are living separately out of a court order (not by mutual agreement) rent paid will be given as exemption.

4. If the employee received H.R.A but rent is not paid to the land lord then exemption cannot be given for the unpaid period of rent.

5. House is taken on rental basis, if rent is paid to the landlord but the house is not yet occupied then exemption cannot be given.

6. For giving exemption place of residence and payment of rent are important and the place of job or employment is not to be considered.

7. If two or more persons (including husband & wife) took a property on rental basis and rent is paid jointly then each person can avail the exemption of H.R.A.

II. Exemption of Allowance linked with actual expenditured incurred [sec10(14)(i)]

(i) Actual allowance received (–) Exempted amount = taxable amount,

(ii) If details of actual amount spent is not given, then make an assumption that employee has spent the entire amount of allowance received and as such actual amount received becomes fully exempted.

The details of allowances are as under.

1. Uniform allowance
2. Helper allowance
3. Daily allowance
4. Conveyance allowance
5. Transfer allowance
6. Academic allowance

} → Actual amount spents is allowed as exemption

S.No.	Allowance	Purpose	Special related points
1.	**Uniform Allowance**	The allowance is given to purchase and maintain the uniform dress for discharging official duties or specific dress to wear on official & ceremonial functions.	1. Dress allowance is folly taxable and employee cannot claim any exemption.
2.	**Helper or Assistant Allowance**	The allowance is given to seek the help/assistance from a person to discharge	(i) Servant for personal/domestic purpose is not treated as
3.	**Daily Allowance**	An allowance given to employee when he is not in the head quarter to meet incidental expenses viz. Boarding & lodging etc.	1. Lunch or dinner allowance is fully taxable.
4.	**Conveyance Allowance**	Conveyance means a mode of transport. An allowance given to meet expenditure on conveyance for discharging official duties.	1. This allowance is given if conveyance is not provided by the employer. 2. If employee uses his own Motor Cycle/Car for official purpose then expenditure incurred for the same shall be allowed as exemption. 3.Expenditure to travel between residence and office is not treated as conveyance expenses, (please refer transport allowance)
5.	**Travel or Transfer Allowance**	To meet cost of travel on tour which includes packing, transporting of personal effects or the transfer of employment from one city/town to other.	1.Travel kit allowance is tax free. **e.g.,** Tooth powder, Brush, Toilet soap box, Shaving set etc.
6.	**Academic / Professional Development / Research Allowance**	Allowance given to enrich academic, research and professional knowledge.	1. This allowance is meant for employee only and not for his family members like wife, children etc.

(iii) Exemption of Allowance not linked with actual expenditure (Sec 10(14)(ii))

The rule of this allowance is exemption given without any pre-conditions and for each allowance maximum exemption limit is disclosed in the Income Tax Act.

Exemption:

Least of the following two amounts,

(i) Actual amount of allowance received.

(ii) Statutory limit (i.e., Maximum exemption limit).

1. Children Education Allowance

Least of the following two amounts,

(i) Actual allowance received

(ii) ` 100 p.m per child (i.e., for two children).

Note: Children include adopted children but not grand children.

2. Children Hostel Allowance

Exemption is least of the following two amounts,

(i) Actual allowance received

(ii) ` 300 p.m per child (i.e., for two children).

Note: Children includes adopted child but not grand children.

3. Truck Driver or Air Hostess Allowance

Least of the following two amounts,

(i) 70% of allowance received

(ii) ` 10,000 p.m.

4. Transport Allowance (i.e., Travelling between the residence and Work Place)

(i) If the assessee is normal person, fully taxable.

(ii) If the employee is physically challenged/Physically handicapped/bind person `. 3,200 p.m.

S.No.	Allowance	Exemption : Least of the two (a) Actual Allowance received (b) Stationary limit (Maximum exemption limit)
1.	**Children Education Allowance**	(a) Actual Allowance received. (b) 100 p.m. per child (for two children) **Note:** The term children includes adopted child but does not include grand children.
2.	**Children Hostel Allowance**	(a) Actual Allowance received (b) ` 300 p.m. per child (for two children) **Note:** The term children includes adopted child but does not include grand children.
3.	**Truck driver/AirHosters / Allowance**	(a) 70% of the allowance received (b) 10,000 p.m.
4.	**Transport Allowance** (for travelling between the residence and the place of work.)	If the assessee is normal person, fully taxable. If the employee is Physically challenged/ Physically handicapped/blind person ` 3,200 p.m.

PROBLEMS

1. Smt. Sravanthi is working as an officer in Telangana Government. Her Salary Particulars are Basic pay 11,000 p.m.; C.C.A. **` 900 p.m.; Entertainment allowance ` 700 p.m.. Compute the amount of entertainment allowance to be allowed as deduction.**

Sol :

Assessee is working in state government. Hence, she is eligible for deduction U/S 16 (ii)

Calculation of entertainment allowance as to be allowed as deduction through the following.

Deduction is allowed "Least" of the following :

a) Actual received = 700 × 12 = Rs. 9,600

b) 20% of salary = $(11,000 \times 12) \times \frac{20}{100}$ = Rs. 26,400

c) Ceiling / Standard Amount = Rs. 5,000

From the above Rs. 5,000 is least amount. Hence, the deduction is Rs.5,000.

Note : Salary means basic pay only.

2. Sri Srujan Kapoor is an employee of a limited company at Jamshedpur, is in receipt of `.44,000 as basic pay, `. 18,000 as Dearness Allowance forming part of salary for all retirement benefits, `.6,000as City Compensatory allowance, `. 8,800 as Accommodation allowance, `.12,000 as Entertainment allowance. He is paying a monthly rent of `.1,000 and electricity bill of the house at a flat rate of `.300 p.m. Determine the amount of House Rent allowance exemption u/s 10(13A).

Sol :

Assessee is residing in jamshedpur and paying rent of the house. So, exemption can be given exemption is "Least" of the following.

(a)	Actual HRA Received	= Rs. 8,800
(b)	Rent paid -10% of salary [12,000 – 6,200]	= Rs. 5,800
(c)	40% of salary (62,000 × 40/100)	= Rs. 24,800

Exemption = Least from the above = Rs. 5,800.

Note : Salary means Basic Pay + D.A only

Salary = 44,000 + 18,000 = Rs. 62,000.

3. Mr. Ravi is employed in Public Works Department of Government of Telangana. His salary particulars are as under: Calculate the deduction allowed u/s 16(ii).

Basic pay `. 6,000 p.m.; D.A. `. 800 p.m. (enters for retirement benefit) Education allowance `. 350 p.m.; Entertainment allowance `. 1,300 p.m

Sol :

The assessee is a Government employee so the deduction is least of the following three amounts.

(a) 20% of salary

20% of (6,000 × 12) = 14,400

(b) Actual allowance received

1,300 × 12 = 15,600

(c) `. 5,000

5,000 = 5,000

∴ `. 5,000 will be allowed as deduction u/s 16(ii).

Note:

Salary means basic pay only i.e., even if D.A. enters for retirement benefit it shall not be considered.

4. Smt. Layakarini is working in TATA Ltd. as an Accounts Executive. Her salary particulars are: Basic pay `. 70,000; D.A. `. 14,000; Commission part of the salary 5% on sales (During the relevant previous year sales are `. 2,45,000); Entertainment allowance `. 25,000. Calculate taxable amount of Entertainment allowance.

Sol :

The assessee is a Non-Government employee so deduction is not allowed.

Actual amount of Allowance received	=	25,000
Less: Deduction allowed	=	Nil
Taxable Amount	=	25.000

$\therefore$ `. 25,000 is the taxable amount of entertainment allowance.

5. Mr. Ragava is working as a lecturer in a Government college, New Delhi. His salary particular are as under.

Basic pay 5,000 p.m., DA 2,000 p.m., CCA 1,000 p.m. and HRA received 3,000 p.m and rent paid 1,500 p.m.. Compute exempted HRA u/s 10 (13 A).

Sol :

Computation of Exempted HRA

The assessee is paying the rent and residing in Delhi. So, the exemption will be least of the following three amounts,

(i) Actual house rent allowance received = ` 36,000 (3,000 × 12)

(ii) Rent paid-(10% of salary) = $\left[1,500 \times 12 - \left(5,000 \times 12 \times \frac{10}{100}\right)\right]$ = ` 12,000

(iii) 50% of salary = $\left[5,000 \times 12 \times \frac{50}{100}\right]$ = ` 30,000

$\therefore$ Exemnted HRA = ` 12.000.

6. Compute exempted HRA from the following information,

(i) Basic pay ` 60,000 p.m

(ii) DA ` 40,000 p.m

(iii) HRA ` 18,000 p.m

(iv) Rent paid in Delhi ` 25,000 p.m

Sol :

The assessee is paying rent for Delhi, which is a metro city. So the exemption will be least of the following three amounts,

(i) Actual allowance received, 18,000 × 12 = (`) 2,16,000

(ii) Rent paid (–) 10% of salary = (`) 2,28,000

$$\left[25,000 \times 12 - 60,000 \times 12 \times \frac{10}{100}\right]$$

(iii) 50% of salary

$$\left(60,000 \times 12 \times \frac{50}{100}\right) = (`)\ 3,60,000$$

Least of the above 3 amounts is 2,16,000

$\therefore$ Exempted HRA = $\boxed{2,16,000}$

7. Mr. Ahmed Ali is a State Government employee, working in Hyderabad. His salary particulars are as under: Basic Pay `. 8,500 p.m.; D. A. l,400p.m.; C.C.A. `.630p.m.; H.R.A. `. 1,200 p.m.; Rent is `.2,000p.m.;due to financial difficulties rent is not paid for the last two months. Calculate exempted amount of H.R.A.

Sol :

The assessee is paying rent of the house but rent is due for 2 months i.e., rent is paid for 10 months, even then exemption can be given proportionately for the period of rent paid.

Salary = 8,500 × 10 = 85,000; 10% of Salary = 8,500; Rent paid (2,000 × 10 = 20,000).

As the assessee is living in Hyderabad (Other towns) the exemption is least of the following three amounts.

a) Actual Allowance received 1,200 × 12	=	14,400
b) Rent Paid (–) 10% of Salary = 20,000 (–) 8,500	=	11,500
c) 40% of Salary = 40% of 85,000	=	34,000

Actual Allowance received	=	14,400
Less: Exempted	=	11,500
Un-exempted	=	2,900

∴ `. 11,500 is allowed as exemption.

8. Satya Krishna Prabhave is working as a lecturer in Govt. College, Delhi. His salary particulars per annum are as under - Basic Pay ` 82,000; DA ` 38,000; CCA ` 16,000 and HRA ` 24,000 (Rent paid by him is ` 19,000). Calculate the exempted amount of HRA.

Sol :

Computing exempted HRA of Assessee Satya Krishna Prabhave

The Exempted HRA will be least of the following amounts, i.e.,

(i) Actual house rent allowance = 24,000

(ii) Rent paid – 10% of salary

= 19,000 – 8,200 [10% of 82,000]

= 10,800

(iii) 50% of salary = 41,000

∴ The Exempted Amount of House Rent Allowance is ` 10,800.

9. Compute Taxable House Rent Allowance exempted, from the following information:

(a) Basi Pay ` 60,000 p.m.

(b) Dearness Allowance 80% of Basic Pay

(c) House Rent Allowance 30% of Basic Pay and rent paid to accommodation in Delhi ` 30,000 p.m.

Sol :

Computing Taxable House Rent Allowance

$\Rightarrow$ Basic Pay = 60,000 × 12 = 7,20,000

D.A = 80% of basic pay 80

$$= 7,20,000 \times \frac{80}{100} = 5,76,000$$

House Rent Allowance = 30% of Basic pay

= 7,20,000 = 2,16,000

Calculating Exempted HRA

Exempted HRA is least of the following,

(a) Actual Rent received = 2,16,000

(b) Rent paid – 10% of salary

$$(30,000 \times 12 = 3,60,000) - 7,20,000 \times \frac{10}{100} = \text{` } 2,88,000$$

(c) 50% of salary (Metro city)

$$50\% \text{ of salary} = 7,20,000 \times \frac{50}{100}$$

= 3,60,000

Taxable HRA

= Actual Amount Received – Exempted Amount

= 2,16,000 – 2,16,000 = '0'

$\therefore$ Taxable HRA = Nil

2.5 Perquisites

Q10. Define the term Perquisites. Explain the various types of Perquisites.

(OR)

Explain different types of perquisites that are the part of Income from salary.

(OR)

Explain the term perquisites. List out any ten perquisites which are fully taxable.

Ans : **(Oct.-21, Aug.-21, Imp.)**

According to Income Tax Act, the term perquisites refers to any form of benefit (paid either in cash or in kind) by the employer to the employee or his/her family members.

Perquisite is an outcome of an agreement between employee and employer or as part of the service conditions. Any facility provided or payment made to an employee when a contingency arises cannot be considered as a perquisite.

For example, Due to floods employee's house was damaged, on humanitarian grounds the employer has provided rent-free accommodation till the employee got his house repaired. This cannot be treated as a perquisite as the employee does not enjoy a right to use the house under the service agreement. On the other hand if the perquisite is provided to an employee and he has not availed it, then the value of the perquisite becomes taxable income.

Types

Following figure shows the various types of perquisites and fringe benefits,

Types of Perquisites and Fringe Benefits

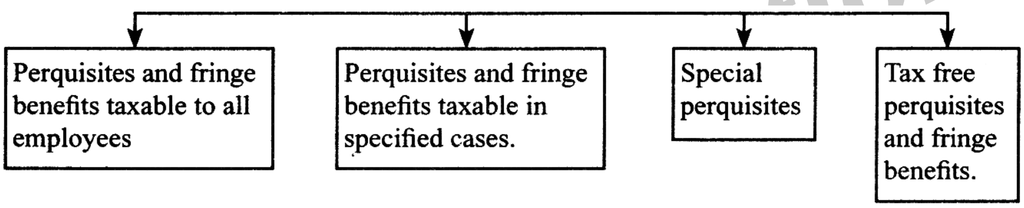


Fig.: Types of Perquisites and Fringe Benefits

1. Perquisites and Fringe benefits taxable to all employees

The following are the perquisites, which are taxable to all employees.

1. Rent free accommodation.
2. Concession in rent of the accommodation.
3. Insurance premium paid by the employer on the life of the employee.
4. Personal monetary obligations of the employee met by the employer.
5. Interest free loan or concession in interest on loan.
6. Holiday Facilities.
7. Free Meals/Food
8. Medical Facilities
9. Gifts
10. Credit Card
11. Club membership
12. Use of movable assets
13. Transfer of movable assets

2. Rent Free Accommodation (3(1)

If the employer provides a house or a flat to an employee for his residential house, without charging or collecting nominal or part of the rent then it is a perquisite taxable to all employees. The term accommodation includes a house, flat, farmhouse or accommodation in a hotel, motel, service apartment, guesthouse, caravan, mobile home, ship or other floating structure.

For valuation of perquisites the accommodation is of two types.

i) Unfurnished accommodation (i.e. without providing any furniture)

ii) Furnished accommodation (Providing furniture)

The term "furnished" includes furniture, television'sets, refrigerator, air conditioner plant and equipment and any other household appliances.

For valuation of rent-free accommodation perquisite the employees are divided into two categories.

(i) Government employees.

(ii) Non-Government employees or other employees

(i) For Government employees: Employees of Central and State Government and employees on deputation in Government controlled undertakings are considered as Government employees. The value of perquisites is determined as under.

Accommodation

- **Unfurnished accommodation**
  - Rent fixed by the Government
- **Furnished accomodation**
  - Rent fixed by the Government + 10% p.a. on cost of the furniture provided or hire charges of the furniture.

(ii) For other employees: Semi-Government employees, employees working in local authorities, Foreign Government, private sector and public sector are considered as other employees.

Note: Employees working in R.B.I., S.B.I. Statutory Corporations, Government Companies or undertaking where the Government or R.B.I. holds not less than 40% of shares are known as Semi Government Employees.

The value of the perquisite is as under :

Value of the unfurnished accommodation

The accommodation provided by the employer may be (A) Own accommodation or (B) Rented/ hired accommodation.

A) When the accommodation is owned by the employer.

Population as per 2001 census of a city where Perquisite value the accommodation is provided

(i)	Not exceeding 10 lakhs	7.5% of salary
(ii)	Exceeding 10 lakhs but not exceeding 25 lakhs	10% of salary
(iii)	Exceeding 25 lakhs	15% of salary

Note: If name of the city/town is not mentioned then make an appropriate assumption for population of the city and write a note to that extent.

(B) When the accommodation is hired by the employer.

In all cities the perquisite value is least of the following two amounts

a) Rent paid by the employer b) 15% of salary.

Calculating Salary:

Salary = Basic pay + Bonus (except gratuitous bonus) + Fees + Commission + D.P. + All taxable allowances (Dearness Allowance will be included only when it enters for retirement benefits) + Any monetary payment made by the employer (other than perquisites e.g. Leave encashment gratuity received in service etc.) + Income tax or Profession tax paid or reimbursed by the employer.

Special Note :

The following items are **"not to be included".**

a) D. A, if it does not enter for retirement benefits.

b) In the problem if D. A. is given as part of salary or D.P then we have to make assumption that D.A. enters for retirement benefits.

c) Employer's contribution to provident fund.

d) Tax free allowances (allowances which are exempt from tax)

e) The value of the perquisites.

f) Medical benefits provided or reimbursement of medical expenses.

Furnished accommodation

Any accommodation, first it has to be valued as unfurnished and then add 10% p.a of the original cost of furniture or actual hire charges paid in the case of furnished house. Furniture includes Television sets, refrigerators and other household appliances.

When the employer provides accommodation in a hotel (both for Government and other employees)

The value of the perquisite is least of the following two amounts:

a) 24% of salary.

b) Actual charges paid or payable to hotel.

This perquisite becomes tax-free to all employees on satisfying the following three conditions.

1. If the accommodation is provided in a hotel on the transfer of the employee from one place to another.
2. Such accommodation is provided for less than 15 days.
3. Such a hotel is hired but not owned by the employer.

Note:

i) The term hotel includes motel, service apartment and guest house.

ii) If the employer owns the hotel then the perquisite value becomes nil.

iii) If the hotel is owned by the employer and the accommodation is provided for more than 15 days in a normal situation then it is valued as rent free accommodation in the employer owned house.

Accommodation provided in a remote area: If the employer provides rent-free accommodation in a remote area then it becomes a tax-free perquisite if the following two conditions are satisfied.

1. If the employee is working in a mining site or an offshore oil exploration site or project execution site or power generation site or dam site.

2 The accommodation is provided in a remote area.

3. The accommodation provided is a temporary in nature and plinth area is less than 800 s.q. yards.

Note:

" Remote area" means an area that is located at least 40 km away from town and having a population less than 20,000 as per 2001 census.

3 Insurance premium paid by the employer

The value of the perquisite is the actual premium paid (+) Premium due but not yet paid. The employer may pay premium by treating like payment of any revenue expenditure or from a specific fund created for payment of life insurance premium. However the employer should not pay the premium out of the following funds :

i) Recognized provident fund.

ii) Approved superannuation fund.

iii) Deposit linked Insurance fund created out of special Acts.

If the employer pays premium on life policies of the employees to meet his own liability in the event of any accidents or death is not a perquisite. Similarly if the employer pays premium/contribution to Employee State Insurance Scheme (E.S.I.) it is not taxable income.

Note:

(i) The premium paid on life policy is the perquisite taxable to all employees, and the employees can claim a deduction under section 80C.

(ii) In this case perquisite becomes taxable on the due date of premium and actual date of payment is not to be considered.

4. Any Personal monetary obligations of the employee met by the employer.

Any monetary obligation of the employee is discharged by the employer.

Which otherwise would have been payable by the employee is perquisite taxable to all employees. The value of the perquisite is the actual amount paid by the employer. The following are few examples of personal monetary obligation met / paid by the employer.

(i) If the employer pays club fees, personal expenses or personal obligations of the employee.

(ii) If the employer pays or reimburses the school or college fees of the children then it is a perquisite taxable in all cases.

(iii) If the employee employs the sweeper or gardener or any other servant but the employer pays the salary, then it is a Perquisite taxable in all cases.

(iv) Income tax or professional tax paid by the employer.

(v) Electricity, water, gas bill of the domestic connections are in the name of the employee but the bill is paid by the employer.

Note:

In all the above mentioned examples actual amount paid by the employer is the value of perquisite.

5. Interest-free loans or concession in Interest on Loans Rule 3(7)(i)

If the employer grants loans to employees for personal purpose as interest free loan or gives it on a concessional rate of interest then it is taxable in all cases. The employer may grant loan from his own funds or provides from other institutions or employer helps in obtaining loan from others by standing as surety or guarantor is considered as taxable perquisite. The loan may be given to the employee or his family members viz., spouse, children and their spouses, parents and dependents are considered as members of the family.

The value of the perquisite is equal to interest charged by State Bank of India to its customers on its lending .The rate of interest to be taken , is the prevailing rate on the first day of the relevant previous year to the current assessment year. For the assessment year 2021-22 the interest rate on 1-4-2020 shall be taken for the academic purpose.

6. Holiday facilities Rule 3 (7) (ii)

When any holiday is availed by the employee or any other member of his family, and the expenses on tour / travelling, for accommodation and other expenses are paid / payable or borne or reimbursed by the employer then it is taxable perquisite to all the employees. The value to the perquisite is equal to the aggregate of travelling expenses, accommodation expenses and other expenses paid by the employer.

Travelling expenses includes expenses for reaching the place of holiday from the place of normal work (for both onward and downward journey) and expenses on local trips/ site seeing at the place of visit.

The accommodation may be provided by the employer in a guest house or holiday home or rooms in the hotel. If the employer owns the accommodation and this facility is offered to all employees then the value of the accommodation is to be taken as nil, but if the facility is offered for few employees then the value of the accommodation is taxable. The value of the accommodation is hire charges in similar accommodation in the same city or similar cities. The holiday facility does not include leave travel concession.

Types of Tours:

Tours undertaken by an employee can be classified into three categories

i) Official tours

ii) Private tours

iii) Official tours extended as vacation.

(i) Official tours

The expenses incurred on official tour of the employee will not be treated as perquisite.

If the family members accompanied with the employee, then the expenses paid by the employer on travel, boarding, lodging and local tours will be treated as value of perquisite. If the family members accompanying is a must then it becomes tax free perquisite, i.e., in a normal situation it is taxable and in an extra ordinary situation it is tax free perquisite.

(ii) Private tours

The expenses paid by the employer on private tour of the employee or his family members will be treated as the perquisite value i.e. aggregate of expenses paid by the employer on travel, boarding, lodging local tours is the value of the perquisite.

(iii) Official tour extended as vacation

If an employee goes for an official tour and extends into a vacation the treatment is explained as under

- Travel expenses (excluding for local trips / site seeing) of the employee both the ways are not to be considered for valuation of perquisite.
- Boarding and lodging expenses of the employee for official period is not to be considered for valuation of the perquisite.
- Boarding and lodging expenses of the employee for the vacation period are to be considered for valuation of the perquisite.
- Travel expenses (including local trips), boarding, lodging and other expenses paid by the employer for the members of the family for the entire period (including official tour period) are to be considered for valuation of the perquisite.

Note: The above said rules are not applicable to "Leave travel concession" availed by the employee?

7. Medical Facilities

(i) Reimbursement of medical and health insurance premium paid by the employer for employee or spouse or dependent parent / children, or any scheme approved by Insurance Regulatory and Development Authority (IRDA) which qualifies for deduction u/s 80D is tax-free perquisite.

Note: The term family means (a) Spouse (b) Children of the assessee (c) Parents (d) Brothers and sisters of the assessee.

(ii) Treatment in hospital maintained by the employer to the employee or any other family member is tax-free perquisite.

(iii) The employer pays for the treatment of the employee or his family members in hospitals maintained by the Government or hospitals approved by the Government is tax-free perquisite.

(iv) Any sum paid by the employer in respect of expenditure incurred by employee or his family members' medical treatment in respect of prescribed diseases or ailments in any hospital approved by the Chief Commissioner of Income Tax is tax-free perquisite.

(v) Reimbursement of medical expenses incurred by the employee in a "recognized hospital" in India is tax free perk.

(vi) Reimbursement of medical expenses incurred by the employee in an "Unrecognized Hospital" in India is fully taxable perquisite.

(vii) If the employer pays medical expenses directly to the hospital for the treatment of employee or his family members in a private nursing home in respect of specified diseases or ailments as prescribed in the Income tax Rules is fully.

(viii) For reimbursement of medical expenses incurred by the employee in a foreign country, The provisions are as under.

a)	For treatment of employee or his family member	→	It is tax free perquisite to the extent of amount permitted by Reserve Bank of India.
b)	For Stay abroad of the Patient and one attendant	→	It is tax free perquisite to the extent of amount permitted by Reserve Bank of India.
c)	For expenses incurred on travel of the patient and one attendant if the gross total income of the assessee is less than ` 2,00,000	→	Tax free perquisite
d)	For expenses incurred on travel of the patient and one attendant if the gross total income of the assessee is more than ` 2,00,000.	→	Taxable perquisite (Actual amount reimbursed is the value of perquisite)

Note: Fixed Medical Allowance:

If the assets receives a fixed amount as medical allowance then it is fully taxable.

8. Gifts given by the employer Rule 3(7)(iv)

During the previous year if any gift in kind is received by the employee or his family members from the employer is tax free perquisite upto the value of 5.000 and the excess amount is taxable perquisite . The exempted amount is the aggregate of all the gifts received by the employee and his family members The gift may be presented in a normal course or on ceremonial occasions. Birthday of the employer or employee, marriage functions in the employer's or employee's family, farewell parties, annual day celebrations are some of the examples of ceremonial occasions. The employer need not give gifts to all the employees. Even if it is given to few employees it becomes taxable perquisite to those who have received. The gifts given to the employee on his / her retirement is also a taxable perquisite. The employer may present the gift either in cash or in kind.

(i) If the employer gives gift in cash or which are convertible into cash. (Ex: Gift Cheques/Cash certificates/Gift vouchers which can be encashed into cash etc,) then it is fully taxable.

Note: The basic exemption of ` 5,000 is not allowed.

(ii) If the gift given is in kind then upto ` 5,000 is tax free and the excess amount becomes taxable perquisite.

(iii) Personal gifts given by the employer for the personal qualities out of natural love and affection of the employee is not a perquisite.

Gift in kind for achieving targets:

If the employer gives gifts to the employees for achieving the targets (sales target, production target, recovery of dues target etc) either in cash or in kind is taxable perquisite. The value of the perquisite is the value of gift.

Note: The basic exemption of ` 5,000 is not allowed

9. Club Membership Rule 3(7)(vi)

The value of any benefit derived by the employee or his family members on account of becoming a member in a club and employer paying directly the expenditure or reimburses such expenses in a club is the perquisite taxable to all employees. The perquisite value is aggregate expenditure paid by the employer during the previous year for admission fee, membership fee (periodical or annual) and monthly bills etc.

Note: (i) If the employer is having a corporate membership of a club, which enables the employee or his family members for availing benefits, the membership fee paid by the employer is not to be included in the value of the perquisite (ii) If the employer provides the facility to become the member of a health club or sports club to all the employees then it becomes a tax-free perquisite i.e. if this facility is offered to selected or few employees then it becomes taxable perquisite. Actual amount paid by the employer is the value of the perquisite.

Note: Initial deposit or fees for corporate membership paid by the employer are not to be considered.

The employee may become a member of a club for

i) Personal purpose

ii) business / official purpose

iii) Partly for personal and partly for business / official purpose.

(i) Club membership for personal use : If the employee or his family members have become a member of a club for personal purpose then expenses paid by the employer is value of perquisite.

(ii) Club membership for business / official purpose: If the employee has become a member of a club for promoting the business of the employer then perquisite value is Nil.

(iii) Club Membership partly for (business) Ethcial purpose and partly for personal purpose: The employee has become member of a club for personal recreation and also for promoting the business of the employer. If the employer pays all the expenses, then the expenses paid for personal benefit is taken as value of the perquisite.

According to some experts admission fee and membership fees paid by the employer is not to be considered.

10. Use of movable assets

If the employee or his members of the family uses any ‘movable’ assets belonging to the employer it becomes taxable perquisite to all the employees. The term movable assets does not include the following

(i) Computers

(ii) Laptops

(iii) any other asset, which is valued as perquisite according to Income.

Tax Act eg. Washing machine or furniture etc.

The value of the perquisite is valued as under:

S.No.	Particulars	Perquisite value
1.	If the movable assets are owned by the employer	10% per annum of the actual cost (original cost)
2.	If the movable asset is hired by the employer	Actual hire charges paid by the employer

2. Perquisites and Fringe Benefits Taxable in Specified Cases

Some of the perquisites and fringe benefits taxable in specified cases are listed below,

1. Provision of car and other conveyances, Rule 3 (2).
2. Provision of services of servants, Rule 3 (3).
3. Supply of gas, water and electricity, Rule 3 (4).
4. Transport facilities allowed by transport organizations, Rule 3 (6).
5. Educational facilities, Rule 3 (5).

wever, the provision of motor car and other conveyances, mentioned under Rule 3 (2), is considered as common rule which are as follows,

S.No.	Situation	Expenses paid by	Use of Car	Perquisites Value
1.	If car is owned or hired by employer	Employer	Official	Nil
2.	If car is owned or hired by the employer	Employer	Partly official & partly personal	(i) Small car engine capacity is less than 1.6 lt or 1,600 cc. ` 1,800 p.m + Driver's salary ` 900 p.m. (ii) Big car engine capacity is more than 1.6 lt or 1600 cc. ` 2,400 p.m + Driver's salary ` 900 p.m. **Note:** Actual Salary paid to the driver is not considered. Driver's Salary ` 900 is to be added to car value.
3.	If car is owned or hired by the employer	Employee	Partly official and partly personal	(i) Small car : ` 600 p.m + driver's salary ` 900 p.m (ii) Big car : ` 900 p.m + driver's salary ` 900. p.m.
4.	If car is owned by the	Employer	Partly official and partly	(i) Small car : Actual amount paid by employer - ` 1,800 p m (ii) Big car: Actual amount paid by employer- ` 2,400 p.m **Note:** If driver's salary is paid by employer then deduct extra ` 900 p.m in each case.
5.	If car is owned by the employee	Employer	Official	Nil
6.	If car is owned by the employee	Employee	Personal	Nil
7.	If car is owned by the employer expenses	Employer	Personal	Total amount of the following, (a) Fuel and maintenance xxx (b) Driver s salary xxx (c) 10% Depreciation on cost of car xxx Total (a + b + c) xxx Less: Amount charged by the employee xxx

3. Special Perquisites

The following perquisites are taxable to all employees from 2010-11 assessment year onwards,

1. Allotment or transfer of sweat equity shares.
2. Employer's contribution to Recognised or approved Superannuation Funds.

4. Tax-free perquisites and Fringe Benefits to all employees

The following is the list of important perquisites, which are tax-free to all employees:

I) Expenditure on food

1. Free refreshments/snacks /tea/soft drinks (Non-Alcholic drinks) supplied to the employee by the employer during office hours in the office /business premises.
2. Free meals (including lunch and dinner) provided by the employer during the office hours in the office / business premises and if the value / cost of each meal is less than `. 50.

   Note: If the cost of each meal is more than 50 then the excess amount becomes taxable perquisite.
3. Free meals (including lunch and dinner) provided by the employer during the office hours through paid vouchers which are non-transferable and are useable in the eating-places or joints and if the cost of each meal is less than 50.

   Note:

   (i) If cost of each meal is more than ?. 50 then the excess amount becomes taxable perquisite.

   (ii) If the paid vouchers are transferable in nature then it becomes taxable perquisite.
4. Free meals provided by the employer during working hours in a remote area or an offshore installation.
5. Free meals provided by the employer when the employee is on official tour.
6. Subsidised lunch or dinner provided by the employer to the employee.

   Note: Lunch allowance is fully taxable.

II) Educational

1. If the employer pays or reimburses fee for the studies of employee then it becomes tax-free perquisite.
2. Cost of refresher course attended by the employee and the employer makes the payment.
3. When employer provides free education to the children of employee in an educational institution run by the employer is tax-free perquisite if the cost of per student in this institution is less than `.1,000 p.m.
4. When employer provides free education to the children of employee in an educational institution patronised by the employer is tax-free perquisite if the cost per student in this institution is less than 1,000 p.m.

   Note: If the cost per student is more than 1,000 p.m. in both the cases it becomes taxable perquisite.
5. Scholarships given to the children / members of the employees on merit basis / economic criteria is tax-free perquisite.

   Note: Scholarships given by the employer to an employee out of an agreement between them is taxable perquisite.

III) Rent-free accommodation

1. Rent-free accommodation provided to an employee in a remote area.
2. Rent-free accommodation provided for less than 15 days in a hotel if the employee has been transferred from one place to another.
3. Rent-free official residence provided to the judges of High Court and Supreme Court.

IV) Medical Facilities

1. Reimbursement of medical and health insurance premium paid by the employer for employee spouse or dependent parent / children, or any scheme approved by Insurance Regulatory and Development Authority (IRDA) which qualifies for deduction u/s 80D is tax-free perquisite.
2. Treatment in hospital maintained by the employer to the employee or any other family member is tax-free perquisite.

PROBLEMS

10. Mr. Jayaraman is working in Accountant's General office in Chennai. His salary particulars are as follows : Basic pay : `. 17,500 p.m; D.A. `. 2,800 p.m.; Servant allowance : `. 300 p.m.; he is provided with rent-free accomodation in Chennai. The rent of the accommodation as per Government rules is `. 8,000 p.m. He is also provided with a television set and a refrigerator that is hired for `. 1,500 p.m. Compute the value of rent free accommodation.

Sol :

Assessee is a Government Employee. So, the value of Rent free accomadation fixed by the Government only.

As per the given details,

(i) Value of unfurnished accomadation	= 8.000 × 12 =	Rs 96,000
Add : Hire changes of furniture	= 1,500 × 12 =	Rs. 18,000
Value of Rent free Accomadation		Rs. 1,14,000

➢ Hire charge of furniture means, Rent value of Television and refrigerator.

11. Mr. Jagadeesh is working in Income Tax department and his salary particulars are follows: Basic pay `. 10,000 p.m.; D.A. `. 2,500 p.m.; C.C.A. `. 3,500 p.m. Children education allowance for his two children : `. 3,000 p.a.; he is provided rent free accommodation in an apartment which is hired by the department for `. 3,000 p.m. while the licence fee fixed by the Government is `. 2,500 p.m.; the furniture was provided to him which is valued `. 50,000 and an air-conditioner was provided for three months which is valued at `. 60,000 during the previous year. Compute the value of rent-free accommodation.

Sol :

Assessee is a Government employee. So, value of Rent free accomodation fixed by the Government only.

As per the given details

(i) Value of unfurnished accomodation	= 2,500 × 12 =	Rs. 30,000
Add value of furniture (Note)	=	Rs. 6,500
Value of Rent fee Accomodation		Rs. 36,500

Note: Calculation furniture value

(a) Value of furniture = Rs. 50,000.

Provide Depreciation @10% cost = $5,000 \times \frac{10}{100}$ = 5,000

(b) Value of Air condition = Rs. 60,000.

Provide Depreciation @ 10% of cost for 3 months

$60,000 \times \frac{10}{100} \times \frac{3}{12}$ = 1500

Total value of furniture (a + b) Rs. 6,500

2.6 Profits in Lieu of Salary

Q11. Explain in detail about the Profits in Lieu of Salary and their treatment.

Ans : **(Imp.)**

Any amount received in place of salary is known as profits in lieu of salary. These include the following :

i) Compensation for loss of employment.

ii) Any payment from un-recognized provident fund.

iii) Any amount received under a keyman insurance policy including bonus,

iv) Any amount received or due (in lump-sum or otherwise) from any person before going to any employment with that person or after the cessation of employment with that person.

v) Any payment received from the former employer or present employer in appreciation for services rendered.

The following are not to be included under the head "Profits in lieu of Salary."

The excess amount over the exempted limit is taxable as salary income.

1. Death cum Retirement Gratuity.
2. Commutation of Pension.
3. Leave encashment on the eve of retirement.
4. Refund from Statutory Provident Fund and Recognised Provident Fund.
5. Retrenchment compensation up to ` 5,00,000/-

1. Death-cum-retirement gratuity[Section 10(10)]

Gratuity means gracious payment made by the employer to his employee services rendered. In other words it is paid in recognition of the services of an employee. Gratuity is paid on the eve of retirement/ becoming incapacitated prior to retirement/on termination of employment/death or resignation. All Government employees are entitled to receive gratuity on their retirement. In the case of other employees the provisions of Payment of Gratuity Act are applicable. According this Act, where the number of employees working is 10 or more will receive gratuity from their employer on the eve of retirement. In simple, most of employees are receiving gratuity on the date of retirement. The other details are as under:

i) If the gratuity is received by the legal heirs on the death of a government or non-government employee is an exempted income.

ii) Gratuity paid while in service from the present employer is not allowed as exemption and it will be treated as salary income under the head “salary”.

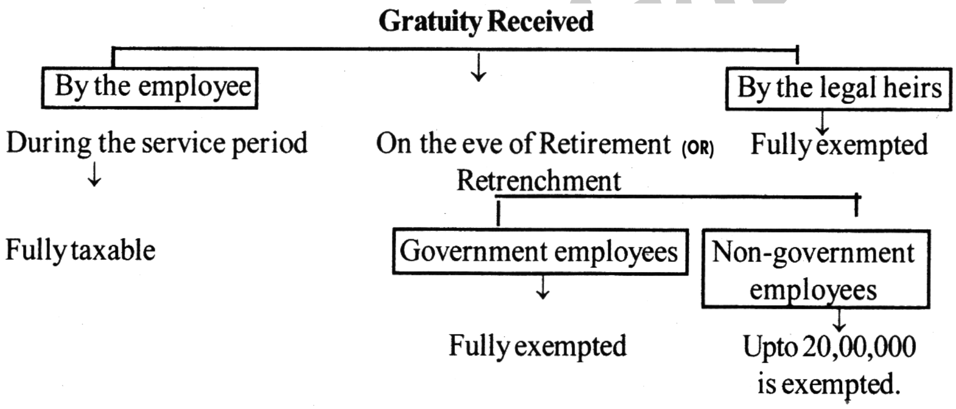
iii) Gratuity received from the former employer may be given as exemption according to the provisions explained in the Act.

iv) If the assessee received the gratuity earlier and claimed exemption then also he is entitled for exemption in the subsequent period of receipt, but the limit of `. 20,00,000 will be reduced by the amount of exemption allowed earlier

v) Employer’s contribution to Gratuity Fund of the employee → It is not taxable at the time of contribution but when it is actually received by the employee the above said rules/provisions are to be observed.

vi) Gratuity is received from two or more employers is exempted upto the limited mentioned.

Special note : Gratuity received during the service period is fully taxable as salary income for all categories of employees.

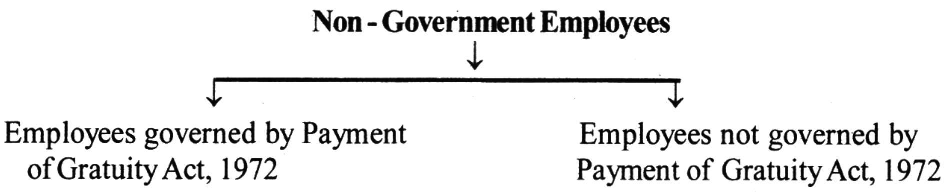


Exemption

In the case of Government Employees (Central, State & Semi) : Gratuity received is fully exempted

In the Case of Non Government Employees:

The classification of non-government employees is as under.



Non-Government Employees - Governed by Gratuity Act

The least of the following three amounts is exempted.

a) Actual amount received

b) 15 days salary × No. of years of service completed or part there of in excess of six months.

c) `.20,00,000

Note:

i) Salary means Basic + D. A. only (of the retiring month)

ii) 15 days salary is calculated as under

15 days salary = Salary last drawn × 15/26

iii) While calculating completed years, if the fraction is six or more than 6 months then it is rounded off to the next year. If the fraction period is less than six months, then the fraction period will be ignored.

Non-Government Employees - who are not governed by the Payment of Gratuity Act.

The exemption is least of the following three amounts:

a) Actual amount received.

b) 1/2 month average salary × No. of years of service completed.

c) `. 20,00,000

Note:

(i) Average monthly salary is calculated on the basis of average salary of 10 months immediately preceding the month in which an employee retired.

(ii) Salary means Basic Pay only and D.A. will be included only when it enters for retirement benefits. If Commission is payable with fixed rate on turnover, such commission is also to be included in the salary.

2. Commutation of Pension Sec. 10 (10A)

Pension refers to a periodical payment made by the employer to his employee for the services rendered by him in the past and if a employee is wishing to take a lumpsum amount instead of such periodical payment then it is known as "Commutation of pension". It is an option provided to employee for deciding the mode of receiving pension from employer. It is not compulsory for a employee to choose this option.

Treatment for Commutation of Pension

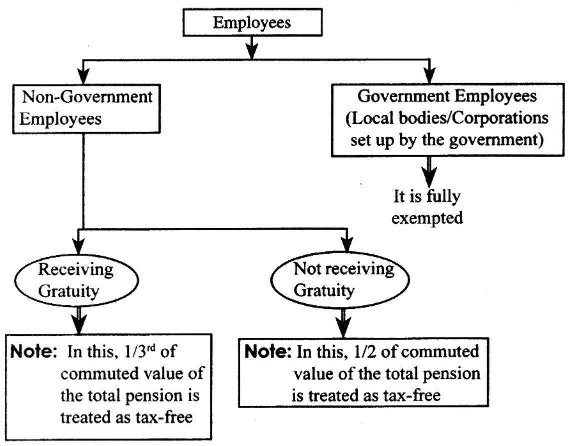


Fig.: Treatment for Commutation of Pension Procedure

Step-1: Calculating commuted value for total pension (i.e., 100%).

Step-2: Calculating the exempted amount.

Step-3: Calculating the taxable amount (if required).

3. Leave encashment on the eve of retirement.

Employees are entitled to various types of leaves. Casual leave, Earned leave, Privilege leave, Medical leave etc., Generally leave is of two types

(i) The leave may be availed, otherwise it gets lapsed E.g.: Casual leave.

(ii) The leave gets accumulated year after year. The accumulated leave can be availed or it may be encashed. E.g.: Earned leave or privileged leave.

Encashment of leave

During the service period if the leave is encashed by the employee while in service then it becomes taxable to all types of employees i.e., both for government and non-government employees it becomes taxable income in the year of receipt. However assessee can claim relief u/s 89 (1).

Encashment of leave at the time of retirement

For the purpose of exemption of leave encashment at the time of retirement, the employees are classified into two categories.

(1) Government employees.

(2) Non-government employees.

The treatment of encashment of leave salary is as under.

EMPLOYEES

Government Employees	**Non-Government Employees**
(Central/State Govt.) ↓ Fully Exempted.	Least of the following four amounts is exempted. a) Cash equivalent to balance of the leave period i.e. unavailed leave at the time of retirement subject to ceiling on the basis of maximum 30 days leave for every year of service. b) 10 months average salary. c) Actual amount received. d) ₹. 3,00,000.

Special note: First calculate the qualifying leave period which is least of the following two.

(a) leave period.

(b) One month for every one year of service completed i.e. ceiling leave period.

Note:

(i) Average salary means, average of 10 months salary preceding to the date of retirement and Salary means Basic Pay only. D.A. is included if it enters for retirement benefits plus Commission (If the commission is based on a fixed percentage of turnover achieved by the employee as per the service contract).

(ii) At the time of encashment employee will receive cash equivalent to basic pay plus all allowances, but for calculating exemption average salary is calculated, which is equal to basic pay + (D.A + Commission if enters for retirement benefits).

4. Refund from Statutory Provident Fund and Recognised Provident Fund.

(i) Actual amount received is fully exempted.

5. Retrenchment compensation up to ` 5,00,000/-

Compensation received by a worker at the time of his retrenchment.

The exemption is least of the following three amounts.

(a) Actual amount received.

(b) Amount calculated as per the Industrial Disputes Act (15 days average pay for every completed year of service or part thereof in excess of 6 months)

(c) ` 5,00,000.

Compensation received on voluntary retirement or voluntary separation Sec.10 (IOC) read with rule 2BA

The Compensation received by an employee of the following organizations under Voluntary Retirement Scheme or Voluntary Separation or under Golden Hand Shakes Scheme is exempt from tax on satisfying the necessary conditions. The exemption is available to the employees of the following:

1. Any public sector company
2. Any other company
3. Any authority established under a Central, State or Provincial Act
4. A local authority.
5. A co-operative society.
6. Any university established under any law.
7. An Indian Institute of Technology; and
8. Any notified Institute of Management.
9. State Government.
10. Central Government.

Guidelines

1. The Scheme of Voluntary retirement applies to an employee who has completed 10 years of service or completed 40 years of age.
2 It applies to all categories of employees viz., namely workers, executives etc. but not to directors of a company.
3. The scheme should result into overall reduction in the existing strength of the employees of the organization.
4. Vacancy caused by voluntary retirement is not to be filled up.
5. The retiring employee is not to be employed in another company or concern belonging to the same management.

Amount of Exemption

The exemption amount is least of the following two amounts:

(a) Actual amount received

(b) `. 5,00,000

Note:

1. Salary means basic pay only D.A. and commission are included if they enter for retirement benefit.
2. This exemption is allowed only one time in the life of an assessee.

PROBLEMS

12. Sri Raghavendra, Senior Accounts Officer in Indian Railways retired from the service after serving for 28 years. He received `. 9,00,000 as gratuity, on the date of his retirement his monthly salary was basic `. 35,000; D.A. `. 4,000 and H.R.A. `. 750. Calculate the taxable amount of gratuity.

Sol :

Assessee is worked in central Government Hence, His Taxable gratuity is Nil.

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13. Sri Gopi Chand retired from the service of Save More Company Limited during the previous year relevant to the current assessment year. He served the company for 25 years 8 months. The company paid him `. 14,00,000 as gratuity his last salary drawn was basic `. 38,000; D.A. `. 18,500 C.C.A. `. 2,500 and H.R.A. `. 3,200 per month. Calculate the taxable amount of gratuity.

(i) If he is governed by the Gratuity Act.

(ii) If he is not governed by the Gratuity Act.

Sol :

Situation (i) If he is Governed by the Gratuity Act.

Exemption of Gratuity Amount = Least from the following

(i) Actual Amount received = Rs. 14,00,000.

(ii) 15 days salary × No. of . years service completed.

$$56{,}500 \times \frac{15}{26} \times 26 = \text{Rs. } 8{,}47{,}500$$

(iii) Ceiling /standard Amount = Rs. 20,00,000

Exemption = Least from the above = Rs. 8,47,000

Taxable Gratuity = Actual Amount Received - Exemption Gratuity

Taxable Gratuity = 14,00,000 – 8,47,500

Taxable Gratuity = Rs. 5,52,500

Note : Salary means Basic Pay + DA (retiring month only)

= Salary = 38,000 + 18,500

Salary = Rs. 56,500.

Situation (ii) If Assessee is not not Governed by Payment of Gratuity Act.

Exemption of Gratuity = Least from the following

(i) Actual amount Received = Rs. 14,00,000

(ii) $\frac{1}{2}$ Average of Salary × No. years of Service completed

$\frac{1}{2} \times 38{,}000 \times 26$ = Rs. 4,94,000

(iii) Ceiling Standard Amount = Rs. 20,00,000

Exemption = Least from the above = Rs. 4,94,000

Taxable Gratuity = Actual Amount received - Exemption

Taxable Gratuity = 14,00,000 – 4,94,000

Taxable Gratuity = Rs. 9,06,000

Note : Salary means Basic pay only for last 10 months.

Average Salary = $\frac{38,000 \times 10}{10}$ = Rs. 38,000

14. Sri Vikram Sinha, an employee of a limited company received `. 9,00,000 as gratuity. He retired after serving 33 years. On 15-4-2020. At the time of retirement his monthly salary was `. 25,000. If he is covered under the Gratuity Act calculate the un-exempted amount of Gratuity.

Sol :

The assessee is Non Government employee and covered by Gratuity Act.

Step 1: Calculating salary = 25,000.

Step 2 : Calculating 15 days salary = 15/26 × 25,000 = 14,423

Step 3 : Calculating the exemption amount which is least of the following three amounts.

(a)	Actual amount received	9,00,000
(b)	15 days of salary x No. of years of service 14,423 × 33 =	4,75,959
(c)	`. 20,00,000	20,00,000

Actual amount received = 9,00,000

Less: Exempted = 4.75.959

Un-exempted = 4,24,041

∴ **Unexempted amount of gratuity is 4,24,041.**

15. Sri Chinnaji after working for 26 years 7 months in a Ltd. Company (Covered under Payment of Gratuity Act) retired from the service on 30th November 2020 and he has drawn 55,000 basic, D. A `. 22,000, H.R. A 6,000 and C.C.A `. 3,000 pay in the month of retirement. The company paid him `. 15,00,000 as gratuity. Calculate the taxable amount of gratuity.

Sol :

Step 1: Calculating salary = Salary = Basic + D.A. = 55,000 + 22,000 = 77,000.

Step 2: Calculating 15 days salary = 15/26 × 77,000 = 44,423.07

Step 3: No. of years of service completed = 26.7 years, but for calculation it will be taken as 27 years.

Assessee is non-Government employee and is governed by Payment of Gratuity Act. Exemption is least of the following three amounts.

(a)	Actual amount received		15,00,000
(b)	15 days of salary x No. of years of service	(44,423.07 × 27) =	11,99,423
(c)	`. 20,00,000		20,00,000

Actual amount received = 15,00,000

Less: Exempted = 11,99.423

Taxable = 3,00,577

∴ **Taxable amount of gratuity is 3,00,577**

16. Mr. Saleem retired during the previous year relevant to the current Assessment year after serving for 22 years 6 months in Spectrum Co. Ltd. As per service conditions he is entitled for 1.5 months leave for one year of service completed. Fraction of a year service is not counted. During the service he has already encashed leave for 18 months. Calculate the taxable amount of leave encashment. Leave encashment is permitted for one year period only on the last gross pay. Average salary p.m. is `. 7,500 and gross pay 37,500 p.m.

Sol :

Step 1: Calculating leave time for the service period, (calculated leave period) For 1 year of completed service leave period is 1.5 months.

For 22 years ?

22/1 x 1.5 = 33 months

Step 2: Calculating ceiling on leave period: 1 month for I year of service completed = 1× 22 = 22 months

Step 3: Calculating qualifying leave period which is least of the two

A) Actual leave period A) 33 months

B) Ceiling period B) 22 months

Step 4: Calculating Balance of unavailed leave period at the time of retirement.

Total leave period = 22 months

Less: Leave period availed during service = 18 months

leave balance due at the time of retirement = 4 months

Step 5: Calculating the average salary (if necessary) = 7,500.

Step 6: Calculating the exempted amount. For Non-Govt Employees the exemption is least of the following four amounts.

a)	Cash equivalent to the balance of leave period (i.e) unavailed leave		
	Period at the time of retirement.	4 × 7,500	= 30,000
b)	10 months average salary	10 × 7,500	= 75,000
c)	Actual amount received	12 × 37,500	= 4,50,000
d)	`. 3,00,000	3,00,000	= 3,00,000

Step 7: Calculating the taxable amount.

Actual amount received	=	4,50,000
Less: Exempted amount	=	30,000
Taxable amount	=	4,20,000

∴ Taxable amount is ` 4,20,000.

2.7 Deductions u/s. 16

Q12. State the various deductions that are allowed from salary income u/s 16.

Ans :

While computing the income from salary the following three deductions are allowed:

1. Standard deduction under Sec. 16 (ia)
2. Entertainment Allowance under Sec. 16 (ii)
3. Professional tax or employment Tax under Sec. 16 (iii)

1. Standard Deduction: Sec. 16(ia)

This deduction is a compulsory one, for the persons having income from salary, including retired employees drawing pension income. Standard deduction is allowed to meet various expenses that employee has to meet while in the employment like expenses on travelling to office and back to home, expenses of stationary, medical expenses etc. It is allowed as deduction, even if he has not actually incurred any expenditure incidental to employment.

Since the standard deduction is a compulsory one to be allowed as deduction, the same is also known as "Statutory deduction" under the head income from salary. The deduction is least of the following two amounts.

(a) Gross Income from salary

(b) ` 50,000

2. Entertainment Allowance Sec.16(ii)

Entertainment allowance is allowed as deduction only to Government employees. The term Government employee includes employees of Central Government or State Government but does not include the employees of statutory corporation and local authorities and for the non-government employees it is not allowed as deduction. The deduction is least of the following three amounts.

(a) 20% of salary,

(b) Actual amount of allowance received and receivable,

(c) ` 5,000.

Note: Actual amount spent is not to be considered.

Note: Salary means Basic Pay only

3. Profession Tax or Employment Tax Sec.16(iii)

This tax is levied by state government on all earning individuals. The earning can be through any medium. It has to be paid by each and every individual who earns an income for living.

As it is levied by the state government the amount is different for each state but the maximum limit is set at ` 2,500 p.a. Each state declares a slab and it is deducted on basis of slab. It is paid every month. It is collected by the employer from the monthly salary of employee then the employer pay to the government.

The professional tax slabs for Telangana State are as follows,

- For monthly salary of ` 15,000, tax is nil.
- For salary from ` 15,000 - 20,000 the tax payable is ` 150/- pm.
- For salary above ` 20,000 it is ` 200 pm.

PROBLEMS

17. Mr. Vallabhai Patel, is working as Govt, employee in Telangana State and he is getting Basic Pay ` 24,000 p.m. Dearness Allowance ` 15,000 p.m. Children Hostel Allowance ` 2,000 p.m. towards 2 children. He is provided rent free accommodation in Hyderabad and its rental value fixed by Govt, as ` 5,000 p.m. But its Fair Market Value ` 72,000 p.a. He is getting Entertainment Allowance ` 5,000 p.m. He is also provided a Small Motor Car for office and personal use and its expenses are paid by employer. He is given medical reimbursement of ` 50,000 spent in unrecognized hospital by employer. He paid Professional Tax ` 200 p.m. Compute Income from Salary.

Sol:

Computation of Income from Salary of Mr. Vallabhai Patel for the Assessment Year 2021-22

Particulars	Amount (`)
Basic pay	2,88,000
Allowances:	
Dearness allowance	1,80,000
Entertainment allowance	60,000
Children hostel	16,800
Perquisites	
Rent free accommodation	60,000
Motor car	21,600
	6,26,400
Less: Deduction U/S 16 @	
Standard deducts u/s 16(ia)	50,000
Entertainment Allowance u/s 16(ii)	5,000
Professional tax (200 × 12) u/s 16(iii)	2,400
Taxable salary income	5,69,000

Working Notes

1. Basic pay 24,000 × 12 = 2,88,000

2. D. A 15,000 x 12 = 1,80,000

3. Hostel allowance

   2,000 × 12 = 24,000

   Less: Exempted Amount = 7,200

   300 pm × 12 × 2

   16,800

4. Rent free accommodation

   Govt fixed – 5,000 × 12 = 60,000

5. Entertainment allowance

   Least of the following is exempted and remaining amount is taxable

   (i) 20% of salary (2,88,000 × 20%) = 57,600

   (ii) (–) Actual amount received (5,000 × 12) = 60,000

   (iii) 5,000

6. Motor car for office and personal use

   Expenses paid by employer

   1,800 × 12 = 21,600

18. Veer Savarkar, a Govt, employee furnishes the following information:

(i) Basic Pay ` 15,000 p.m.

(ii) Dearness Allowance ` 4,000 p.m. (Enters into retirement benefits)

(iii) Arrears of Salary ` 15,000

(iv) Rent free accommodations owned by employer having a fair rental value. ` 70,000 per annum, cost of Furniture ` 90,000 rent fixed by Govt. ` 25,000 per annum.

(v) Deputation Allowance ` 6000 p.a.

(vi) Own contribution to SPF ` 20,000.

(vii) Employer's contribution to provident Fund ` 20,000.

(viii) Interest on Provident Fund @14% t 7,200.

(ix) Reimbursement of medical expenses ` 25,000 (Recognized hospitals) Compute his Taxable Salary.

Sol :

Computation of Income from Salary of Veer Sarvarkar for the Assessment Year 2021-22

Particulars	Amount (`)
Salary	
Basic Pay	1,80,000
Arears of Salary	15,000
Allowances	
Dearness Allowance	48,000
Deputation Allowance	6,000
Perquisites	
Rent free furnished accommodation	34,000
Gross Salary	2,83,000
Less: Deduction	
Standard deduction U/S 16(ia)	50,000
Professional Tax 16(iii)	Nil
Net Taxable Salary	2,33,000

Working Notes

1. Basic Pay 15,000 × 12 = 1,80,000
2. D.A. 4,000 × 12 = 48,000
3. Rent free accommodation

FRV	= 70,000
Govt.	= 25,000
Rent Fixed by Govt	= 25,000
(+) 10% cost of Furniture	= 9,000
$\left(90,000 \times \frac{10}{100}\right)$	34,000

4. Deputation allowance is taxable
5. Own contribution SPF for govt, employee qualify for deduction U/S 80C under GTI.
7. Employees contribution to P.F is fully exempted from tax.
8. Interest on P.F is a tax-free perquisite for govt, employees.
9. Reimbursement of medical expenses in govt, recognized hospital is tax-free.

19. From the following particulars, compute the income from salary and tax on total income of Smt. Lakshmi (working in pvt company) for the assessment year 2021-22.

(i) Basic pay ` 2,10,000

(ii) Dearness Allowance ` 1,05,000

(iii) CCA ` 36,000

(iv) Conveyance allowance ` 10,000 p.a. (85% spent)

(v) A big car is provided for official and personal use and employer paid all the expenses.

(vi) Gas, water and electricity bill paid by the employer ` 10,000/-

(vii) Laptop given for personal use by the company 40,000

(viii) Employment tax paid 300 p.m.

(ix) Income from house property (taxable) 2,05,000/-

(x) Income from other sources (taxable) 1,05,000/-

(xi) Contribution to new pension scheme 10% equally by the company.

(xii) Qualified savings u/s 80C 75,000/-

Sol :

Computation of Income from Salary and Tax on Total Income of Smt. Lakshmi for the Assessment Year 2021-22

Particulars	Amount (`)
Salary:	
Basic Pay	2,10,000
Contribution made by employer to employee under	21,000
New Pension Scheme [N.P.S] 2,10,000 × $\left[2{,}10{,}000\frac{10}{100}\right]$	
Allowances:	
Dearness Allowance	1,05,000
C.C.A	36,000
Conveyance Allowance	1,500
Perquisites:	
Motor Car	28,800
Gas, Water and Electricity Bill	10,000
Gross Income from Salary	4,12,300
Deductions u/s 16:	
Employment tax (300 × 12)	3,600
Income from Salary	4,08,700
Income from house property (taxable)	2,05,000
Income from other sources (taxable)	1,05,000
Gross Total Income	7,18,700
Deductions u/s 80 C to 80 U	
Qualified Saving u/s 80C	75,000
Employee Contribution to N.P.S u/s 80 CCD (1)	21,000
Employer Contribution to N.P.S u/s 80 CCD (2)	21,000
Total Income	6,01,700

Working Notes

1. Conveyance Allowance

The unspent amount of conveyance allowance is taxable.

Actual allowance received = ` 10,000

Less: Amount Spent (85%) $\left[10,000 \times \frac{85}{100}\right]$ = ` 8,500

Unspent Amount = ` 1,500

2. Motor Car

The assessee is using a big car for official and personal use and all the expenses are paid by the employer, therefore the motor car value is 2,400 × 12 = ` 28,800.

3. Gas, Water and Electricity Bill

Employee income from salary is more than ` 50,000 p.a. So, these perks are fully taxable.

4. Laptop

If employer is giving a laptop to employee for any purpose, then the value of perk is fully exempted.

5. Employment Tax

In is allowed as deduction u/s 16 (iii).

6. Contribution to New Pension Scheme

Contribution made by employer is fully included in salary income of employee, however, it is allowed as deduction u/s 80 CCD (2) out of gross total income upto 10% of employee's salary. Contribution made by employee is eligible for deduction out of gross total income u/s 80 CCD (1) upto 10% of his salary.

Note: Salary = Basic Salary + D.A [If under terms of employment]

20. Sri. Bhanu Prasad is working in T.V.S Company Limited of Chennai in Guntur Town of Andhra Pradesh as branch manager. From the following particulars calculate the tax liability of Sri. Bhanu Prasad Salary: Basic pay `. 13,500 p.m., Bonus 30,000, D.A. `. 2,800 p.m., C.C.A. 3,200 p.m., Entertainment Allowance 1,600 p.m. House Rent Allowance `. 3,500 p.m. (Actual rent paid in Guntur 2,400 p.m). The employer provided the following:

1. **Credit card of Andhra Bank for personal use and the employer paid membership fee `. 500, payment of bills 9,500.**
2. **The employer paid the following bills for personal use:**

   Cell phone: 17,000; electricity: `. 10,500, Water `. 1,600; and club bill `. 7,400.
3. **The employer on the occasion of Sri. Bhanu Prasad's birthday presents a wristwatch worth `. 2,500 and cash prize `.4,500 for achieving the sales target**
4. **A small car for his office and personal use is provided and all the expenses are paid by the employer.**
5. **The following are deductions from the salary Professional tax `. 4,200; Income tax: `. 2,500**

Sol :

Computation of Sri. Bhanu Prasad's Income from Salary

For the Assessment Year 2021-22

Particulars		Amount in `
Salary		
Basic Pay @ `. 13,500 p.m.		1,62,000
Bonus		30,000
Allowances		
D.A @ `. 2,800 p.m.		33,600
House Rent Allowance		29,400
C.C.A.@ `. 3,200		38,400
Entertainment allowance @ ?. 1,600 p.m.		19,200
Perquisites		
Credit card		10,000
Gifts		4,500
Electricity and water bill of the residence		12,100
Club bill		7,400
Motor car		21,600
Profits in lieu of salary		Nil
Gross Income from salary		3,68,200
Deductions		
Standard Deduction u/s 16(ia)	50,000	
Entertainment allowance u/s 16(ii)	Nil	
Professional Tax u/s 16 (iii)	4,200	54,200
Income from Salary		3,14,000

Working Notes:

1. House Rent Allowance : Salary = 1,62,000; 10% of salary = 16,200;

Rent paid = 2,400 × 12 = 28,800.

The assessee is paying rent of the house, so exemption can be given. He is living in Guntur (other towns) so the exemption is least of the following three amounts.

(a)	Actual Allowance received	3,500 × 12	= `. 42,000
(b)	Rent paid (–) 10% of salary	(28,800)(–) (16,200)	= 12,600
(c)	40% of salary	40% of 1,62,000	= `. 64,800

Actual allowance received = 42,000

Less: Exempted amount = 12.600

Un-exempted amount = 29.400

2. **Entertainment Allowance:** The assessee is a Non-Government employee, so deduction is not allowed.

3. **Credit card:** If employer provides a credit card to an employee or his family members then it becomes taxable perquisite to all employees. Perquisite value actual amount paid by the employer `.10,000.

4. **Payment of cell phone bill:** If the employer pays cell phone bill then it is a tax- free perquisite.

5. **Payment of electricity and water bill:** If the employer pays electricity and water bill of the residence then it is taxable perquisite to all employees. The value of the perquisite is the actual amount paid by the employer

   Electricity bill = 10,500

   Water Bill = 1,600

   = 12,100

6. **Club Bill:** If the employer pays club bill then it becomes taxable perquisite. Perquisite value is actual amount paid by the employer `. 7,400.

7. **Gift from the employer:**

   (A) Gift received in kind from the employer is exempt upto `. 5,000.

   (B) Gift or prize received in cash is frilly taxable without giving any basic exemption.

8. **Motor Car :** The salary income after deductions is more than `. 50,000 hence motor car becomes taxable perquisite.

   The employer owns the car and it is used both for official & personal purpose. Car provided is a small one and all the expenses are paid by the employer, so the perquisite value is `. 1,800 p.m. i.e., 1,800 × 12 = 21,600.

9. **Standard deduction :** The deduction is least of the following two amounts.

   (a) Gross Income from salary `. 3,68,200

   (b) `. 50,000

10. **Profession Tax:** Actual amount paid will be allowed as deduction = 4,140

11. **Calculating Tax Liability:**

   Income tax = 3,14,000 × 0.05 (–) 12,500 = 3,200

   Income Tax = 3,200.00

   Add: Health and Education cess @ 4% = 128.00

   3.328.00 or 3,328

   Less: Tax Deducted at Source (T.D.S) = 2.500

   Tax payable = 828

   ∴ Tax payable is `. 830.

21. Smt. Roja rani is an employee in a private company. Her basic salary is 15,000p.m, D.A. `. 3,000p.m., Transport allowance `.3,000p.m. (Actual amount spent `. 2,000) She receives the following medical benefits from the company during the previous year. Calculate income from salary current assessment year. Reimbursement of the following medical expenses incurred by Smt. Roja.

i) On treatment of herself by family Doctor `. 5,000.

ii) On treatment of herself employed daughter `. 4,000.

iii) On treatment of her Father-in-law dependent on her in a Nursing home `. 10,000.

iv) Medical allowance `. 1,000p.m.

vi) On treatment of her minor son abroad `. 1,02,000.

vii) On treatment of her son in a Government hospital `. 3,500

Sol : **(Imp.)**

Computation of Smt Roja rani's Income from Salary For the Assessment Year 2021-22

Particulars		**Amount in `.**
Salary:		
Basic pay @`. 15,000		1,80,000
Allowances:		
D.A.@ `. 3,000		36,000
Transport Allowance @ `. 3,000		36,000
Medical allowance @ `. 1,000		12,000
Perquisites:		
Reimbursement of her self	5,000	
Reimbursement of her Daughter	4,000	
Reimbursement of her Father-in-law	10,000	19,000
Profits in lieu of salary		Nil
Gross Income from Salary		2,83,000
Deductions:		
Standard deduction u/s 16(ia)		50,000
Income from salary		2,33,000

Working Notes :

1. **Transport Allowance:** Assessee is a normal person. Actual amount spent is not to be considered. Amount received is fully taxable.
2. Medical allowance actually received is fully taxable.
3. Reimbursement of medical expenses on the treatment of either assessee or family member in a private hospital is taxable perquisite.

4. **Minor son abroad treatment:** For reimbursement of medical expenses incurred by the employee or his family member in a foreign country, It is tax free perquisite to the extent of amount permitted by Reserve Bank of India.
5. **Treatment in Government Hospital:** Reimbursement of medical expenses incurred by the employee in a “recognised hospital” in India is tax free perk.
6. **Standard deduction :** The deduction is least of the following two amounts.
   (a) Gross Income from salary `. 2,83,000
   (b) `. 50,000.

22. Mr. Pratap an employee of Public sector company, rurnestones me following mtoimanon

(a) Basic Pay ` 11,60,000

(b) Arrears of Salary ` 54.000

(c) Advance Salary ` 10,000

(d) Small Car was provides by the Employer, which he has used both for official and business purposes

(e) Professional Tax paid ` 3,200 per annum

(f) House Rent Allowance received ` 25,720, Exempted Allowance is ` 12,500

(g) Employee spent ` 15,000 as Medical expenses towards treatment in recognized hospital and the same amount has been reimbursed

(h) Entertainment Allowance is ` 42,620 and Deduction is ` 5,000

(i) Employer paid Club Bill ` 5,000, Electricity ` 7,200

Compute his Taxable Salary.

Sol : **(Oct.-21)**

Computation of Taxable Salary of Mr. Pratap for Assessment Year 2021 -22

Particulars	Amount (`)
Salary	
Basic Pay	11,60,000
Arrears of Salary	54,000
Advance Salary	10,000
Allowances	
House Rent Allowance	13,220
Entertainment Allowance	42,620
Perquisites	
MotorCar	21,600
Club bill	5,000
Electricity	7,200
Gross Salary	13,13,640
Less: Deduction U/S 16	
Standard deduction u/s (ia)	(50,000)
Entertainment allowance u/s 16 (ii)	(5,000)
Professional Tax u/s 16 (iii)	(3,200)
Taxable Salary	12,55,440

Working Notes:

1. Arrears of Salary

It is taxable in the year of receipt.

2. Advance Salary

It is taxable in the year of receipt, however an assessee can claim relief u/s 89 (i).

3. Motor Car

Assessee using small car for official and personal use which is provided by the employer. Therefore, the motor car value is,

1800 × 12 = ` 21,600

4. Professional Tax

Actual amount paid is allowed as deduction.

5. House Rent Allowance

Actual amount spent	25,720
Less: Exempted	12,500
Un-exempted	13,220

6. Medical Expenses

Reimbursement of medical expenses in recognized hospital is tax-free perquisite.

7. Club Bill and Electricity Bill.

Club Bill and Electricity bill paid by the employer are taxable Derauisites.

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23. Compute Income from salary of Mr. Gopi a private employee for the assessment year 2021-22

	`` ` ``
(i) Basic Pay	**2,80,000**
(ii) D.A. 54,000	
(iii) Entertainment allowance	**10,000**
(iv) Commission	**10,000**
(v) Medical allowances (fixed)	**8,000**
(vi) Free supply water, gas & electricity	**9,900**
(vii) Employers contribution to PFF	**18,000**
(viii) House rent allowance (Rent paid at Chennai ` 18,000)	**14,000**
(ix) Profession tax paid	**2,400**

Sol :

Computation of Income from Salary of Mr.Gopi for the Assessment Year 2021-22

Particulars	Amount (`)
Salary	
Basic Pay	2,80,000
Commission	10,000
Employers contribution to PPF	18,000
Allowances	
D.A	54,000
Entertainment Allowance	10,000
Medical allowance (Fixed)	8,000
Flouse rent allowance	14,000
Perquisites	
Free supply of water, gas & electricity	9,900
Gross Income from Salary	**4,03,900**
Less: Deduction U/S 16	
Standard deduction u/s (ia)	(50,000)
Professional Tax u/s 16 (iii)	(2,400)
Income from Salary	**3,51,500**

Working Notes:

1. **Entertainment Allowance**

   Entertainment allowance is not allowed as deduction as the assessee is a private employee

2. **Medical Allowance**

   It is fully taxable as the assessee receives a fixed amount.

3. **Free supply of Water, Gas & Electricity**

   It is a fully taxable perquisite

4. **House Rent Allowance**

   Least of the following is allowed as exemption,

   (a) Actual allowance received 14,000

   (b) Rent paid (–) 10% of salary

   = 18,000 – (10% of 2,80,000)

   = 18,000 – 28,000

   = – 10,000

   (c) 50% of salary $= 2,80,000 \times \frac{50}{100} = 1,40,000$

   Since, one of the amount in above calculation is (-)ve, no exemption is given Actual allowance received = 14,000

   Less: Exempted Nil

   Un-exempted = 14,000

5. **Profession Tax**

   Actual amount naid is allowed as deduction u/s 16 (iii).

Short Question and Answers

1. Define Salary.

Ans :

Section 17(1) defines "salary" which includes the following receipts:

1. Wages
2. Any annuity of pension
3. Any gratuity
4. Any fees, commissions, perquisite or Profits in lieu of or any addition to salary or wages.
5. Leave encashment or salary in lieu of leave
6. The annual accretion to the credit balance of employees recognised provident fund to the extent it is taxable
7. Transferred balance of unrecognised provident fund to the balance of recognised provident fund to the extent it is taxable.
8. The contribution made by the central government to the account of an employee under a pension scheme referred to in section 80 CCD.

2. Components of salary income.

Ans :

1. Salary

Salary means the payment which is made to some categories of persons like salary of partners, employees or workers, members of parliament and so on.

Like person receiving the remuneration and a person paying the remuneration should have a relationship of master (i.e., employer) and servant (i.e., employee) then only such remuneration is considered as income from salary.

2. Allowances

Allowance refers to any fixed monetary benefits provided by the employer to his/her employee for the purpose of meeting specific expenditures in the form of House Rent Allowance, Entertainment Allowance, children education allowance and so on. The payment of an allowance may be an agreement or at the choice of the employer. Hence, employer has the right to withdraw the allowances or he may increase or decrease the allowances.

3. Perquisites

According to Income Tax Act, the term perquisites refers to any form of benefit (paid either in cash or in kind) by the employer to the employee or his/her family members.

4. Profits in Lieu of Salary

The amount paid by the employer to the employee in place of salary is known as "Profits in lieu of salary". This amount is paid only where the salary discontinues to be a regular payment.

3. What is meant by annula accretion?

Ans :

Annual accretion in any previous year to the balance at the credit of an employee participating in a recognised provident fund as consists of:

(a) Contribution made by the employer in excess of 12% of the salary of the employee; and

(b) Interest credited on the balance to the credit of the employee in so far as it exceeds the amount allowed at a rate exceeding such rate as may be fixed by the Central Government in this behalf by notification in Official Gazette, shall be deemed to have been received by the employee in that previous year and shall be included in the total income for that previous year and shall be liable to income-tax.

The above-mentioned rule makes it clear that any contribution by employer to R.P.F. in excess of 12% of employee's salary is to be added in salary.

About interest the taxable portion will be excess of Interest credited to the balance of R.P.F. over a rate of interest to be announced by the Government from time to time.

To simplify the above discussion it can be put in the following manner :

Taxable annual accretion will consist of :

(a) Excess of employer's contribution to Recognised Provident Fund over 12% of employee's salary', and

(b) Excess of interest credited to R.P.F. over interest calculated at prescribed rate (i.e., 9.5%) of the balance standing to the credit of employee.

4. What is provident fund?

Ans :

To encourage savings for the social security of employees, the Government has set up various kinds of provident funds. The employee contributes a fixed percentage of his salary towards these funds and in many cases employer also contributes. The whole contribution along with interest is credited to employee's account. He will get payment out of this fund at the time of retirement and at some other important occasions. If the employee dies, his heirs will get the full payment.

Provident Funds are of four kinds :

(a) Statutory Provident Fund or the Fund to which the Act of 1925 applies (S.P.F.).

(b) Recognized Provident Fund (R.P.F.).

(c) Unrecognized Provident Fund (U.R.P.F.).

(d) Public Provident Fund (P.P.F.).

5. Define Allowances.

Ans :

Allowance is a fixed monetary benefit given by the employer to an employee for a specific purpose e.g. House Rent Allowance, Children Education Allowance etc. The employer can withdraw the allowance or he can increase or decrease. The allowance amount i.e., the payment of an allowance can be either on account of an agreement or at the discretion of the employer. From taxability point of view the employees can be classified into two categories.

(i) Special category employees.

(ii) General category employees.

6. House Rent Allowance.

Ans :

This is one of the major allowances given by the employer to employee. The allowance is given towards rent of the house. The employer is not concerned whether the employee is paying rent of the house or not, if so, how much? According to Sec.10 (13A) and Rule 2A, House Rent Allowance is allowed as exemption. The conditions for availing the exemption and other provisions are as under:

Rule:

This allowance is allowed as exemption only when the assessee is paying rent of the house where he is presently residing.

Steps:

1. First calculate the exempted amount of allowance in the working notes.

2. Add the un-exempted allowance to the salary under the head "Allowances".

Note : For giving the exemption, employees are divided into two categories

a) Employees living in Mumbai, Delhi, Kolkata and Chennai.

b) Employees living in Other places.

Employees

Employees residing in metro cities Mumbai, Delhi, Kolkata, Chennai The least of the following three amounts is allowed as exemption.	Employees residing in non-metro other cities/towns The least of the following three amounts is allowed as exemption.
A. Actual House rent Allowance received B. Rent Paid (–) 10% of salary C. 50% of salary	A. Actual House Rent Allowance received. B. Rent Paid(–) 10% of salary C. 40% of salary

7. Define the term Perquisites.

Ans :

According to Income Tax Act, the term perquisites refers to any form of benefit (paid either in cash or in kind) by the employer to the employee or his/her family members.

Perquisite is an outcome of an agreement between employee and employer or as part of the service conditions. Any facility provided or payment made to an employee when a contingency arises cannot be considered as a perquisite.

For example, Due to floods employee's house was damaged, on humanitarian grounds the employer has provided rent-free accommodation till the employee got his house repaired. This cannot be treated as a perquisite as the employee does not enjoy a right to use the house under the service agreement. On the other hand if the perquisite is provided to an employee and he has not availed it, then the value of the perquisite becomes taxable income.

8. Rent Free Accommodation (3(1).

Ans ;

If the employer provides a house or a flat to an employee for his residential house, without charging or collecting nominal or part of the rent then it is a perquisite taxable to all employees. The term accommodation includes a house, flat, farmhouse or accommodation in a hotel, motel, service apartment, guesthouse, caravan, mobile home, ship or other floating structure.

For valuation of perquisites the accommodation is of two types.

i) Unfurnished accommodation (i.e. without providing any furniture)

ii) Furnished accommodation (Providing furniture)

The term "furnished" includes furniture, television'sets, refrigerator, air conditioner plant and equipment and any other household appliances.

For valuation of rent-free accommodation perquisite the employees are divided into two categories.

(i) Government employees.

(ii) Non-Government employees or other employees

9. Deductions that are allowed from salary income u/s 16.

Ans :

While computing the income from salary the following three deductions are allowed:

1. Standard deduction under Sec. 16 (ia)
2. Entertainment Allowance under Sec. 16 (ii)
3. Professional tax or employment Tax under Sec. 16 (iii)

1. Standard Deduction: Sec.16(ia)

This deduction is a compulsory one, for the persons having income from salary, including retired employees drawing pension income. Standard deduction is allowed to meet various expenses that employee has to meet while in the employment like expenses on travelling to office and back to home, expenses of stationary, medical expenses etc. It is allowed as deduction, even if he has not actually incurred any expenditure incidental to employment.

Since the standard deduction is a compulsory one to be allowed as deduction, the same is also known as "Statutory deduction" under the head income from salary. The deduction is least of the following two amounts.

(a) Gross Income from salary

(b) ` 50,000

2. Entertainment Allowance Sec.16(ii)

Entertainment allowance is allowed as deduction only to Government employees. The term Government employee includes employees of Central Government or State Government but does not include the employees of statutory corporation and local authorities and for the non-government employees it is not allowed as deduction. The deduction is least of the following three amounts.

(a) 20% of salary,

(b) Actual amount of allowance received and receivable,

(c) ` 5,000.

Note: Actual amount spent is not to be considered.

Note: Salary means Basic Pay only

3. Profession Tax or Employment Tax Sec.16(iii)

This tax is levied by state government on all earning individuals. The earning can be through any medium. It has to be paid by each and every individual who earns an income for living.

As it is levied by the state government the amount is different for each state but the maximum limit is set at ` 2,500 p.a. Each state declares a slab and it is deducted on basis of slab. It is paid every month. It is collected by the employer from the monthly salary of employee then the employer pay to the government.

The professional tax slabs for Telangana State are as follows,

- For monthly salary of ` 15,000, tax is nil.
- For salary from ` 15,000 - 20,000 the tax payable is ` 150/- pm.
- For salary above ` 20,000 it is ` 200 pm.

10. What are the Characteristics of a Salary?

Ans :

1. Employer and Employee Relationship

"Employment" means holding of any post or office on regular basis under an agreement of service whether full time or part time and involving manual or non-manual work. Any Payment will be Salaries only if there is relationship of employer and employee between payer and payee.

2. Salary from more than one Employer

If an individual received salary from more than one employer (due to part time job or change of job) during the same previous year it will be taxed under salaries.

3. Salary from Present, Past and Prospective Employer

Salary received during the previous year from past, present or prospective employer is taxable under this head. Hence the salary of past employer received during the previous year is taxable along with the salary received from the Present employer.

4. Tax Free Salary

Some times the employer pay tax free salary to employee. It means the employer pays tax due on such salary on behalf of employee to the tax department. Here the salary for employee is the aggregate of net salary received plus amount of tax Paid by the employer.

5. Previous Year for Salaries

The Previous year for the purpose of income from salaries shall the financial year of the government. It means 1st April to 31st March of the relevant previous year.

Exercise Problems

1. Sri. K.S. Sunder is working in Ministry ofRailways, Government ofIndia at Kanchipuram (Tamil Nadu State). He submitted the following particulars of his income for the previous year 2020-21. Compute income from Salary for the assessment year 2020-21. Basic pay `. 32,600 p.m.; Entertainment allowance `. 4,000 p.m.; House Rent Allowance `. 5,000 p.m. (Rent paid by him `. 6,000 p.m.) C.C.A. 1,000 p.m. he paid `. 200 p.m. as professional tax. Employer's contribution to S.RF 13% of salary; Interest credited in S.RF. @ 10% `. 38,400 During the previous year he availed free travel passes for himself and wife and two children valued `. 33,400.

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2. Smt. Manjushree is working in a Ltd Co., since 1-10-96 her income particulars for the year ending 31 st March 2021 are as under.

   1. Basic pay @ `. 25,000 p.m.
   2. Education allowance `. 3,000 p.m.
   3. Entertainment Allowance @ `. 6,000 p.m.
   4. D.A. `. 9,500 p.m.
   5. Conveyance Allowance `. 10,000 p.a. (85% is spent for official purpose).
   6. Bonus `. 30,000.
   7. Free refreshments provided during the office hours in the office premises valued at `. 6,000.
   8. Employer's contribution to approved Superannuation Fund `. 1,70,000.
   9. The company gave interest-free loan of `. 15,000 as festival loan to be deducted in 12 monthly instalments. (S.B.I. rate 12.05%)
   10. The Company sold Office table costing `. 15,000 for `. 5,000 which is purchased 2 years ago.

   During the year the company paid Telephone bill of the residence `. 78,000 and reimbursed `. 65,000 medical expenses spent in a recognised hospital in India. During the year she paid `. 250 p.m. as professional tax. Compute the income from salary for the current assessment year.

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3. Sri D.V. Ramana Murthy is working in Seven hills Software, Tirupati Town of A.P. as marketing executive. His salary particulars for the previous year relevant to the current assessment year are as under. Compute income from salary. Basic pay `. 21,400 p.m.; D.A. `. 10,500 p.m.; (enters for Superannuation Benefits); Bonus `. 22,000; Commission `. 91,000.

   Employer provided the following perquisites.

   (i) Rent free furnished house, lease rent of unfurnished house `. 72,000; cost of the furniture provided `. 60,000 and book value at the beginning of the year for furniture was `. 12,000.

   (ii) School fee of two children paid by the employer `. 20,000.

   (iii) Credit card expenses reimbursed `. 15,000.

   (iv) Employer's contribution to approved Superannuation Fund 5% of basic plus D.A.

   (v) Free meals at a cost of `. 75 per day and snacks @ `. 60 per day for 280 days is provided

   (vi) Twoyears back he took a car loan from the company @5.80% interest `. 7,20,000 and repaid `. 1,20,000 in principal amount. S.B.I rate of interest is 9.80%.

   (vii) His payments: Professional tax `. 4,500 (Due `. 900).

Choose the Correct Answer

1. R, who is entitled to a salary of Rs.10,000 p.m. took an advance of Rs.20,000 against the salary in the month of March 2021. The gross salary of R for assessment year 2021-22 shall be: [a]

   (a) Rs.1,40,000 (b) Rs.1,20,000

   (c) Rs 1.50.000 (d) None of these two

2. A is entitled to children education allowance @ Rs. 80 p.m. per child for 3 children amounting Rs. 240 p.m. It will be exempt to the extent of : [a]

   (a) Rs.200 p.m. (b) Rs.160 p.m.

   (c) Rs. 240 p.m. (d) None

3. Remuneration received by a teacher of a college from the University for checking answer scripts is taxable as: [b]

   (a) Salaries

   (b) Income from other sources

   (c) Profits or Gains of Business of Profession

   (d) Income from speculative business

4. Interest credited in RPF is taxable, if at exceeds [a]

   (a) 9.5% (b) 12%

   (c) 8.5% (d) None

5. Leave encashment is fully taxable, when the employee is received during the________. [c]

   (a) Retirement (b) Retrenchment

   (c) Service period (d) None

6. Profession tax is exempted on the basis of ________. [b]

   (a) Paid (b) Due or paid

   (c) Due basis (d) None Actually

7. Motor car with more than 1.6 litters cubic capacity is given to the employee both for official and personal use with expenditure on running and maintenance met by the employer. The car was self driven by the employee. The perquisite value shall be [b]

   (a) 1,200 p.m. (b) 1,800 p.m.

   (c) 2,400 p.m (d) Nil

8. X received 100,000 from the prospective employer before joining duty in order to resign from the present employer. Subsequently, he joined the new employer. The amount received is: [b]

(a) Taxable as income from business b) Taxable as salary income

(c) Exempt from tax u/s 10 d) Exempt being capital receipt

9. For non-Government employee governed by Payment to Gratuity Act, 1972, the monetary limit for exemption is: [c]

(a) Rs. 5,00,000 (b) Rs. 3,50,000

(c) Rs. 10,00,000 (d) Limitless

10. Entertainment allowance is allowable to : [a]

(a) Govt. Employees (b) Non-Govt. Employees

(c) Both a and b (d) None of the above

Fill in the blanks

1. For employees Covered under payment gratuity Act 1972 Rs _______ is the statutory limit
2. Salary may be paid in _______.
3. Other allowances to meet personal expense are exempt u/s _______.
4. Over time remuneration is _______ under the head Salaries
5. Other employees who receive gratuity _______ of the pension exempt.
6. Salary is taxable either or _______ basis
7. Rs. _______ is the statutory limit for other employees receiving leave encashments.
8. No exemption is allowed for HRA when rent paid does not exceed _______ of Salary
9. _______ of cost of furniture added to the value of Rent free accommodation.
10. Director employee is a _______ for the valuation of perks.

ANSWERS

1. Rs. 3,00,000
2. Cash or kind
3. u/s 10(14)
4. taxable
5. 1/3rd
6. due or receipt
7. Rs. 300,000;
8. 10%;
9. 10%;
10. Specified Employee

UNIT III

INCOME FROM HOUSE PROPERTY:

Definition of 'House Property' – Exempted House Property incomes– Annual Value – Determination of Annual Value for Let-out House and Self-occupied House – Deductions u/s.24 – Problems on computation of Income from House Property.

3.1 Definition of 'House Property'

Q1. Define Income from House Property. Under what conditions it is treated as income from House Property. (Imp.)

Ans :

If a person receives rent from his own building then such income is treated as income from house property. A person can receive income from a house in two forms (i) Profit on sale of house (ii) Rent received on let out. Profit on sale of house is treated as capital gain under separate head of income. Rent received by the owner of a house is treated as Income from House Property. The use of the house is shown in the following chart.

Use of House by owners of the Building

Letout for any purpose	For running own business or for carrying profession	For owner's residentical purpose
Taxable income and expenses incurred on house are considered.	Income of this house is taken as Nil, and expenses incurred on house are treated as business/profession expenses.	Income of this house is taken as Nil, but some expenses are allowed as deduction.

Conditions

The following three conditions are satisfied then only the income derived from the building/house is treated as "Income from House Property".

First condition : The property should consist of any building or lands connected to the building.

A permanent structure on the land is known as building, which is capable for the use for which it is constructed, i.e. a house in collapsing stage or a house without roof and doors or a house which is under construction cannot be treated as building.

From Income Tax Act point of view buildings are of two types

(i) buildings which require roof for using e.g. using for residential purpose, running a hotel business or for having an office room to carry professional services by an Advocate or Chartered Accountant etc.

(ii) A permanent structure on the land designed for a useful purpose i.e. a building which does not require a roof e.g. stadium or swimming pool etc.

Second condition : The assessee should be owner of the property

The term ownership is to be taken in the spirit of the language, i.e. if a person is not the owner of a building either in letter or spirit of the term "owner" then income received by him from the building is treated as "Income from other sources" but not as an income from house property, e.g. Rent received from sublet is considered as income from other sources. Ownership of the building is of three types,

(i) Freehold Rights

(ii) Leasehold Rights

(iii) Deemed ownership Rights

(i) Freehold Rights

It means a person who acquired a house/ building by means of purchase or inheritance or gift or under a will having absolute rights to enjoy the property with regard to using the building either for living or for using self or for let out and to sell the property or transferring the property to any one.

(ii) Leasehold Rights

If the agreement between the owner and tenant of a property is for a longer period of time and under the terms of agreement if the lessee (Tenant) constructed a permanent structure on leased property and any rent received from the construction made shall be treated as "Income from House Property".

For example Sri Ravi kanth took a property on lease for 35 years from Sri Govind on an annual rent of `. 6,00,000 to run a business and he constructed one more floor or added new rooms to the existing structure and let out the constructed portion on a monthly rent of `.15,000 to Sri Veera swamy. Comment upon the same.

(iii) Deemed ownership

If a person is legally not the owner of a building but enjoys all the rights on the property viz. Letting out or transferring the property for no consideration or transferring the house or property to members of the family etc. then he is considered as deemed owner. The following persons, though not owners of property in the legal sense are liable to pay tax as deemed owners.

(i) Person transferring property to spouse (without adequate consideration and when living together)

(ii) Person transferring property to minor child except married minor daughter.

(iii) Karta in the Hindu Undivided Family.

(iv) Member of a housing co-operative society.

3.1.1 Exempted House Property Incomes

Q2. State the Exempted House Property Incomes.

Ans :

Under section 10 of the Income-tax Act 1961 following incomes from house property are exempted from tax. These incomes are not to be included in the total income of assessee. Hence no tax is payable on such incomes. These incomes are :

1. Agricultural House Property [Section 2(I)(c)]

Income from such house property which situated on or in the immediate vicinity of agricultural land which is used for agricultural purposes - cultivator is exempted from tax.

2. House property held for charitable purposes [Section 11]

Any income from a house property held for charitable or religious purposes *e.g.,* rent from shops owned by a temple is exempted.

3. Self-occupied but vacant house [Section 23(3)].

In case an assessee keeps one of his own houses reserved for self-occupation but is living in a rented house else where due to his employment or profession the income from such house is taken to be nil.

4. **House used for own business or profession**

There is no income chargeable to tax under this head from such house property.

5. **Property held by registered trade union [Section 10(24)].**

Income from a house property owned by a registered trade union is not to be included in its G.T.I.

6. **Income from house property held by following shall be exempted**

(i) House property held by a local authority.

(ii) House property held by a scientific research institution.

(iii) House property held at a political party.

(iv) House property held by a university and any other educational institution work for spreading education and not to earn profit.

(v) House property held by a hospital or medical institution working for the spreading of medical services to people and are not meant for earning profit.

7. **One house property (a palace) owned by a former ruler of Indian states.**

Ex-rulers of Indian states may be owning many palaces but only one palace of their choice shall be treated as self occupied house and shall be exempted.

8. **Two self occupied houses**

In case assessee owns more than one residential houses, the net annual value of any two houses shall be taken as nil but in case he owns more than two houses, then only two of his choice but normally of higher value shall be treated as self occupied ones and others are treated as (deemed to be) let out houses.

9. **House Property held as Stock-in-Trade and not let out during the previous year [Section 23(5)]**

Where any house property (building and land appurtenant thereto) is held as stock-in-trade the property is not let during the whole or part of the year, the annual value of such property be taken as nil for the period upto two (one year upto A.Y. 2019-20) years from the end of the financial year in which the certificate of completion is obtained.

In other words notional income of such house property shall be considered as income only after two years from the end of the financial year in which certificate of completion is obtained from the component authority.

3.2 Annual Value

Q3. Define Annual Value.

(OR)

What is meant by Annual Value? Explain different factors that are to be considered in determining the annual value of the house property.

Ans : **(Oct.-21, Imp.)**

According to section 23 (1), the word ‘annual value’ is defined as “the sum for which the property might reasonably be expected to fetch if the property is let out from year to year subject to deduction on account of municipal taxes.” From this definition, it should be clearly understood that the annual value does not mean the rent received or rental value of the house but the ‘notional’ rent which the house can reasonably fetch, if the property is let out to the tenant having regard to local conditions, the type of building, cost of construction, valuation by the municipality, pugree or premium paid by the tenant and so on.

If Rent Control Act is in operation, then the standard rent should be taken as the basis for determining the annual value.

To summarize, annual value is generally determined taking into account the following factors:

1. Rent received or receivable from the tenant or Actual Rent
2. Municipal value of the property
3. Fair rental value
4. Standard rent determined under the respective Rent Control Acts of the state.

1. Rent received or receivable or Actual Rent(ARV)

It is the rent actually received by the owner of the house from the tenant. Actual rent received or receivable is an important factor in determining the annual value. However, it alone cannot be a major factor, because actual rent depends on many issues like, relationship between the tenant and the landlord, existence of standard rent, payment of municipal taxes etc.

Sometimes the owner provides certain facilities to the tenant and charges extra cost for these which is included in the rent, then such cost shall be reduced out of the rent received and balance should treated as "Actual Rental Value".

Such common facilities are:

(a) Swimming pool maintenance charges.

(b) Lift and pump maintenance charges.

(c) Lighting of common stairs and corridors.

(d) Salary of gardener and watchman.

(e) Water and electricity charges.

The cost of these facilities is charged separately by the owner excluding the rent of house property. It is treated as separate source of income. After deducting the expenses of these facilities from its income, the balance is taxable under the income from other sources.

2. Municipal Rental Value (MRV)

For the purposes of levying local taxes the local authority. i.e., Municipal Corporation/ Committee etc. conducts a periodical survey of the house properties in their local limits- On the basis of such survey the rental values are fixed which serves as the basis for levying tax. The rental value so fixed is called Municipal Rental Value (M.R.V.).

3. Fair Rental Value [FRV]

It is the rental value a house property can fetch. It is based on the rent prevailing for similar type of accommodation in same or similar type of locality. It is based on the principle that rent prevailing in same locality for similar sized property is almost the same. Such rental value is called Fair Rental Value (F.R.V.).

4. Standard Rent [S. RENT].

The rent fixed under Rent Control Act, where so ever applicable, is called Standard Rent.

5. Expected Rental Value (ERV). The expected rental value shall be determined as under:

A. In case standard rent has not been fixed

(i) Municipal Rental Value

(ii) Fair Rental Value

(iii) Actual Rent Received.

Whichever higher shall be treated as expected rental value.

B. In case standard rent has been fixed

(i) Municipal Rental Value

(ii) Fair Rental Value

(iii) Standard Rent.

In case standard rent has been fixed, the expected rent cannot exceed standard rent. So firstly compare Municipal rental value and fair rent and find out the higher one and the amount so calculated cannot exceed amount of standard rent but if actual rent received is more than standard rent, then actual rental value shall be treated as expected rental value.

6. Unrealized Rent (UR)

It refers to the rent that could not be realized by the owner from his/her tenant. Unrealized rent can be deducted from annual rental value, if the following conditions are satisfied:

(i) The tenancy is bona fide.

(ii) The defaulting tenant has vacated the property.

(iii) The defaulting tenant is not in occupation of any other property belonging to the owner.

(iv) The assessee has undertaken all necessary steps to institute legal proceedings.

7. Vacancy Period Rent

It refers to the rent for the period during which let out property has remained vacant in the previous year.

3.2.1 Determination of Annual Value for Let-out House and Self-occupied House

Q4. Explain in detail determination of Annual Value for Let-out House.

(OR)

Explain the computation of annual value for let-out house.

(OR)

Explain the determination of Gross Annual Value.

Ans : **(Oct.-21, Imp.)**

Situation 1: When the house is let out throughout the previous year and there is no unrealized rent & vacancy of the house.

(i) While solving the problems students are advised first to complete the calculations of Expected Rental Value and Actual Rental Value and then proceed to compute "Income from House Property",

(ii) The working of problem can be divided into three parts.

First part: Calculation part to findout Expected Rental Value (E.R. V) & Actual Rental Value (A.R.V) (in the working notes)

Second Part: Preparing the income statement.

Third Part: Working notes for computation of income.

First part: Calculation part to findout Expected Rental Value (E.R.V) & Actual Rental Value (A.R.V)

Step 1: Calculating Expected Rental Value, which is higher of the following two amounts.

(A) Municipal Rental Value

(B) Fair Rental Value

Step 2: Limiting E.R.V or Calculating adjusted E.R.V: This step is required only when standard rent is given in the problem : Selecting least of the following two amounts

(A) Expected Rental Value

(B) Standard Rent

Rule: Expected Rental Value shall not be more than Standard Rent.

Step 3: Calculating Actual Rental Value (A.R. V)

$$\boxed{\text{A.R.V} = \text{Rent received } (+) \text{ Rent Receivable } \pm \text{ Special Adjustments}}$$

Calculating Actual Rental Value (A.R.V)

In a normal situation rental value for 12 months period is known as Actual Rental Value. However to calculate A.R.V the following points are to be considered.

(i) Outstanding rent of the relevant previous year shall be added to the rent received

$$\boxed{\text{A.R. V = Rent received + Rent receivable or outstanding rent}}$$

(ii) If the owner (assessee) has provided any amenities/facilities to the tenant then the cost of such facilities shall be deducted from the 12 months period rental value e.g., lift maintenance of premises, watchmen and gardener's salary, etc.

Note: If the owner collects any amount towards services/facilities provided then service charges collected becomes "Income from other sources", while computing this income expenses incurred shall be deducted from services charges collected.

Under this situation while calculating Actual Rental Value (A.R.V) if service charges are collected by the owner then do not deduct cost of facilities provided to the tenant from rental value i.e. if service charges are not collected separately then cost of facilities shall be deducted from actual rental value.

$$\boxed{\text{A.R. V - Rental value for 12 months period (-) cost offacilities provided}}$$

(iii) If the owner has paid personal obligation expenses of the tenant related to let out house, then deduct such expenses from Actual Rental Value e.g., watchmen's salary/electricity/gas bill of the let out house

$$\boxed{\begin{array}{c}\text{A.R. V=Rent received + Rent receivable or outstanding rent - Expenses}\\ \text{related to the house paid by the owner}\end{array}}$$

(iv) If the tenant pays the personal obligations of the owner like interest paid on the loan taken by the owner, life insurance premium etc., then the same is to be added to the actual rent received.

Special note: If the tenant pays municipal taxes and expenses for repairs then the same shall not be added to the actual rent received.

(v) In the case of newly purchased or constructed house calculate A.R.V for the time period for which property is available for let out (This situation will arise for the first previous year for this source of income.)

(vi) If the house is sold or transferred to others during the previous year then calculate income from house property from 1st April to the date of sale or transfer.

(vii) Advance rent or refundable deposit received from the tenant are not to be added to rent received amount.

(viii) If non-refundable deposit is received for the rental agreement period viz., for a period of 5 or 10 years etc. then proportionate deposit amount per annum is added to the actual rent received.

Second Part: Preparing Income Statement

Third Part: Working notes for computation of income.

Step 1: Calculating Gross Annual Value, which is higher of the following two amounts.

(A) Expected Rental Value. (When standard rent is not given) or Adjusted Expected Rental Value (If standard rent is given)

(B) Actual Rental Value.

Step 2: Deducting municipal taxes/local taxes from Gross Annual Value.

Gross Annual Value (GA. V) (-) Municipal taxes paid = Net Annual Value (N.A.V)

Municipal taxes: Municipal taxes that are paid to local authorities like municipality. Development authority Cantonment Board etc. Actual amount paid by the assessee is to be deducted from gross annual value. These include Municipal tax, Service charges such as Sanitation Cess, Sewerage tax, Conservancy tax, Library cess, Water tax, Fire tax and Education cess etc.

(i) If Municipal taxes are due but not paid then due amount is not to be deducted from gross annual value.

(ii) Arrears of Municipal taxes paid in the relevant previous year to the current assessment year is to be deducted from gross annual value.

(iii) Municipal taxes paid by the tenant is not to be deducted from gross annual value.

(iv) Municipal taxes paid in advance is not allowed as deduction in the year of payment, but it is allowed as deduction in the year for which the payment is made.

(v) Interest on loan taken to pay municipal taxes is not allowed as deduction.

(vi) If the house/building is situated in a foreign country and local taxes paid by the assessee then these taxes are deducted from gross annual value, i.e., to compute net annual value, municipal taxes paid on the house property situated in foreign country is allowed as deduction.

(vii) Taxes levied by State or Central Government but collected by municipal authorities shall not be treated as municipal taxes, hence they cannot be deducted from the gross annual value.

Step 3 : Allowing the deduction u/s 24.

Situation 2 : Let out house - Unrealized rent of the current previous year and the house is not vacant during previous year.

First part

Calculation part to find out Expected Rental Value (E.R.V) & Actual Rental Value (A.R. V)

Step 1 : Calculating Expected Rental Value, which is higher of the following two amounts.

(A) Municipal Rental Value

(B) Fair Rental Value

Step 2 : Limiting E.R.V or Calculating adjusted E.R.V : This step is required only when standard rent is given in the problem :

Selecting least of the following two amounts.

(A) Expected Rental Value

(B) Standard Rent

Rule

Expected Rental Value shall not be more than Standard Rent

Step 3 : Calculating Actual Rental Value (A.R.V)

Actual Rental Value = Rent received + Rent receivable (outstanding rent) (-) Unrealized rent of the current year only.

Second Part: Preparing Income Statement

Third Part

Working notes for computation of income.

Step 1: Calculating Gross Annual Value, which is higher of the following two amounts.

(A) Expected Rental Value. (When standard rent is not given) or Adjusted Expected Rental Value (If standard rent is given)

(B) Actual Rental Value.

Step 2 : Deducting municipal taxes/local taxes from Gross Annual Value.

Gross Annual Value (GA.V) (-) Municipal taxes paid - Net Annual Value (N.A.V) Step 3 : Allowing deductions u/s 24.

Situation 3:

Let out house-house is vacant for some period during the previous year. (There is no unrealized rent)

Before studying the procedure to compute income from house property under this situation i.e., when the house is vacant for some period during the previous year let us study the following points very carefully.

Actual Rental Value is governed by the following important factors.

(1) Loss due to vacant of the house.

(2) Unrealized rent or bad rent.

(3) Cost of amenities or facilities provided to the tenant.

(4) Tenant's personal obligation towards let out house like water bill, gas bill, electricity bill is paid by the owner.

First part

Calculation part to find out Expected Rental Value (E.R.V) & Actual Rental Value (A.R.V)

Step 1: Calculating Expected Rental Value (E.R.V.), which is higher of the following two amounts.

(A) Municipal Rental Value (M.R.V.)

(B) Fair Rental Value (F.R.V.)

Step 2 Limiting E.R.V or Calculating adjusted E.R.V : This step is required only when standard rent is given in the problem : Selecting least of the following two amounts.

(A) Expected Rental Value

(B) Standard Rent

Rule: Expected Rental Value shall not be more than Standard Rent.

Step 3 : Calculating Actual Rental Value (A.R.V.)

A.R.V = Rental value for 12 months period (–) Rent for vacant period (Vacancy loss)

Second Part: Preparing Income Statement

Third Part

Working notes for computation of income.

Calculating Gross Annual Value (G.A.V)

→ Gross Annual value is higher of the following two amounts,

(a) Expected Rental Value

(b) Actual Rental Value

Special Note:

If Actual Rent Value is less than Expected Rental Value due to vacancy only, then Gross Annual Value = Actual Rental Value.

Step 4 : Deduct Municipal Taxes or Local Taxes paid by the owner.

Step 5: Allowing deductions u/s 24.

Situation 4:

For Let out property House is vacant for some period → and unrealized rent is also there.

First Part

Step 1: Calculating Expected Rental Value (E.R.V.), which is higher of the following two amounts.

(A) Municipal Rental Value (M.R.V.)

(B) Fair Rental Value (F.R.V.)

Step 2: Limiting E.R.V or Calculating adjusted E.R.V: This step is required only when standard rent is given in the problem : Selecting least of the following two amounts

(A) Expected Rental Value

(B) Standard Rent

Rule: Expected Rental Value shall not be more than Standard Rent

Step 3: Calculating Actual Rental Value (A.R.V.)

A.R. V. = Rent for 12 months period (-) Unrealized rent

Step 4: Deduct rent for vacancy period from Actual Rental Value.

Special Note

Do not deduct unrealized rent and vacancy loss in one step, because in many a cases we have to find out whether Actual Rental Value is less than Expected Rental Value due to vacancy or any other factor.

Second Part: Preparing Income Statement

Third Part:

Step 1: Calculating Gross Annual Value: The guide lines for determining Gross Annual Value is as under.

Guiding principles, rules for deter mining GA.V

1. Actual Rental Value (Adj) is less than Expected Rental Value due to "vacancy"

   $\Rightarrow$ Gross Annual Value = Actual Rental Value (Adj)

2. Actual Rental Value (Adj) is less than Expected Rental Value not due to "vacancy" Viz., but due to other factors like unrealized rent etc. $\Rightarrow$ Gross Annual Value = Expected Rental Value

3. Actual Rental Value (Adjusted) is more than Expected Rental Value inspite of "vacancy". $\Rightarrow$ Gross Annual Value = Actual Rental Value (Adj)

Step 2 : Deduct Municipal Taxes or Local Taxes paid by the owner.

Step 3 : Allowing deductions u/s 24.

Situation 5: The house was vacant for 12 months during the previous year.

1. **Gross Annual Value (GAV):** The Gross Annual Value will be nil when actual rental value is nil. Whereas, other calculations will be same as followed in above situations.

2. **Local or Municipal Taxes:** Actual amount paid is to be deducted from the Gross Annual Value (GAV).

3. **Standard Deduction:** Standard deduction is not allowed, if Net Annual Value (NAV) is nil or negative.

4. **Interest on Loan taken to Construct the House:** Interest on loan taken to construct the house is allowed as deduction.

Situation 6 : If the house is situated in Metro cities.

Situation 7: House Property situated in a Foreign Country

If an assessee is having house property in foreign country then income from such house becomes taxable income on satisfying the following conditions.

Conditions:

During the relevant previous year the residential status of the assessee is "RESIDENT'.

OR

If the residential status of the assessee is "Resident but not ordinary Resident"

OR

Residential status of the assessee is Non-resident and rent of the property first received in India.

Method of computation :

It is same as studied for computing the income from house property for a let out house or self occupied house situated in India.

Computation of ....'s Income From House Property for the Assessment Year ....

Particulars	Amount in `.	Amount in `.
Gross Annual Value (G.A.V)		xxx
Less : Municipal /local taxes		xxx
Net Annual Value (N.A.V)		xxx
Deductions u/s 24		
Standard deduction or Statutory deduction u/s 24 (a)	xx	
Interest on loan u/s 24 (b)	xx	xxx
Income / loss from House Property		xxx

Q5. Explain in detail determination of Annual Value for Self-occupied House.

(OR)

Explain the computation of annual value for Self-occupied House.

Ans : **(Imp.)**

Situation 1: Occupying one/two house as self occupied for residential purpose throughout the previour year.

When the assessee has occupied one/two houses for his own residential purpose. Both GAV and NAV will be nil. The exemption is applicable for two houses to an individual/ HUF.

Deduction u/s 24(b) in respect of loan taken for purchase or construction or for repairs or reconstruction will be restricted to ` 30,000/2,00,000 in aggregate for upto to two houses.

Situation 2: Occupying more than two houses as self occupied for residential purpose throughout the previous year.

When the assessee has occupied more than two houses for his own residential purpose, two houses according to the choice of the assessee will be treated as self occupied houses, other house will be deemed to be let out. Income from such house will be computed as it is deemed to be let out.

Other properties shall be deemeed to be let out and its GAV shall be computed as if the property was let out during the year.

Step 1: Create three options with two houses as self occupied and other houses as deemed to be let out (vice-versa).

Step 2: Compute income from house property in all options and

Step 3 : Choose the option having lower income from house property.

Under this situation income from house property is calculated as under:

Step 1: Calculating Gross Annual Value which is higher of the following two amounts

(a) Municipal Rental Value

(b) Fair Rental Value

Step 2 : Deducting municipal taxes paid.

Step 3: Allowing the following two deductions

(i) Standard deduction

(ii) Interest on loan (Actual interest paid + interest payable)

Note: Interest on loan is allowed as deduction on due basis also i.e., even if interest is not paid during the previous year interest for the previous year period can be claimed as deduction.

Deemed to be let out house - where the house comes under the jurisdiction of Rent Control Act.

Gross Annual Value is calculated as under

Step 1: Selecting higher of the following two amounts.

(a) Municipal Rental Value

(b) Fair Rental Value

Step 2: Calculating Gross Annual Value which is least of the following two amounts.

(a) Selected amount in the step no. 1

(b) Standard rent

Situation 3:

Self occupied house - During the previous year part of the period is let out and part of the period is self occupied.

During the previous year relevant to the current assessment year if the house is self occupied for the part of the year and let out for part of the year, then the treatment to compute income is explained as under.

Special note:

(i) Under this situation the period of self-occupancy is to be ignored completely i.e., income from house property is to be calculated as the house is let out for the whole year.

(ii) For the self occupied period income is not to be computed.

(iii) Municipal taxes paid and interest on loan are to be deducted fully.

Step 1: Calculating Expected Rental Value, (for 12 months period) which is higher of the following two amounts.

(A) Municipal Rental Value (for 12 months)

(B) Fair Rental Value (for 12 months)

Step 2: Limiting E.R.V or Calculating adjusted E.R.V: This step is required only when standard rent is given in the problem : Selecting least of the following two amounts

(A) Expected Rental Value

(B) Standard Rent

Rule: Expected Rental Value shall not be more than Standard Rent

Step 3: Calculating Actual Rental Value (A.R.V)

A.R.V = Rent received (+) Rent Receivable ± Special Adjustments.

Step 4: Calculating Gross Annual Value, which is higher of the following two amounts.

(A) Expected Rental Value. (When standard rent is not given) or Adjusted Expected Rental Value (If standard rent is given)

(B) Actual Rental Value.

Step 5 : Deducting municipal taxes/local taxes from Gross Annual Valu.

Step 6 : Allowing the deduction u/s 24.

Situation 4

Building consists of Independent living units/floors/flats during the previous year. If part of the house is self occupied and remaining part is let out

If a Building consists of more than one independent units/floors/flats during the previous year, if part of the house is self occupied for residence and remaining part is let out then the benefit of self occupancy can be given.

In such a situation two income statements are to be prepared.

(1) For self occupied part.

(2) For let out part.

Joint expenses are to be apportioned as per instructing given in the problem. If there are no instructions, then these expenses are to be apportioned in the ratio of space occupied for self occupied part and let out part.

Situation 5: If part of the house is self occupied and remaining part is let out where independent units/floors are not there in a building.

In a building independent units/floors are not there but during the previous year part of the building is self occupied and remaining part is let out then assessee can not claim the benefit of "Self Occupancy". Under this situation only one income statement is to be prepared. For computing the income the provisions of let out house are to be followed. Municipal taxes paid and interest on loan taken to purchase/construct/repairs/renovation are to be given for the whole amount.

Situation 6: Self Occupied House - Vacant due to Employment or business etc.

If the house is not occupied by the assessee due to employment or business or profession carried on in other place and is residing in a rented house and is not deriving any income from that house then the annual value of such property is taken as nil. And no deductions are allowed u/s 24 except interest paid on loan taken for construction or purchase or renovation or repairs etc. which is least of the following two amounts.

(a) Actual interest paid or due

(b) `. 30,000/2,00,000

Situation 7: Self occupied House - Vacant due to occupying official Residence.

Government officials and non government officials who have to reside in official residence due to office held by them the annual value of their own house is taken as nil. For example District Collector, Vice Chancellor of a University, Chief Executive of a Company have to reside in official residence. If they are owning a house and they are not in a position to occupy due to official protocol, the annual value of own house will be taken as nil. And no deductions are allowed u/s 24 except interest paid on loan taken for construction or purchase or renovation or repairs etc., which is least of the following two amounts.

a) Actual interest paid or due

b) `. 30,000/2,00,000

Special Note: The official residence provided by the employer will be treated as perquisite, i.e., Rent free accommodation.

Situation 8: Self occupied House- Using for running own business or carrying a profession.

If the assessee is using the house for running his own business or to carry his profession, then the income from such house property shall be taken as Nil. Expenses incurred on the house like Municipal taxes, Repairs, insurance etc will be treated as business or professional expenditure.

Special note to the students : There is no need to prepare a statement to find out the income. They are advised to write a note to that extent.

Situation 9 : The assessee owns a house and it is let out to the employer and the same house is provided to the assessee as rent free accommodation.

Situation 10 : Letting out the house property without receiving any rent.

Under this situation gross annual value is higher of the following two amounts.

(a) Municipal Rental Value

(b) Fair Rental Value

Computation of Income from House Property (Self Occupied) for the Assessment Year ....

Computation of Mr.......'s Income from House Property for the Assessment Year ....

Particulars	Amount (`)	Amount (`)
Gross Annual Value [G.A.V]		Nil
Less : Munipal taxes		Nil
Net Annual Value (N.A.V)		**Nil**
Deduction u/s 24		
1. Standard deduction u/s 24(a)	Nil	
2. Interest on loan u/s 24 (b)	xxx	xxx
Income/Loss from House Property		**xxx**

3.3 Deductions u/s 24

Q6. Discuss the various Deductions from annual value for let-out house and self-occupied house.

(OR)

What deductions are allowed from the annual value in computing taxable income from house property?

(OR)

Write about the deductions from annual value of house property.

Ans : **(Oct.-21)**

Deductions u/s 24 for Let out house

1. Standard deduction or Statutory deduction u/s 24 (a)

This is a compulsory deduction to every assessee who is having income from let out house. Actual expenditure incurred will not be considered. The deduction is given at a flat rate of 30% on Net Annual Value.

Note: When the Net annual Value is nil or in negative standard deduction is not allowed as deduction.

2. Interest on Home loan u/s 24(b)

(i) Interest on loan taken to purchase or construction, repairs or renovation or reconstruction of the house is allowed as deduction.

(ii) If the interest is paid in India actual interest amount is allowed as deduction. And if the interest is paid outside India, tax is to be deducted at source, then only it can be allowed as deduction.

(iii) Interest on loan is allowed as deduction on due basis also i.e., even if interest is not paid during the previous year interest for the previous year period can be claimed as deduction.

(iv) If interest paid for earlier period is not claimed as deduction, then the same cannot be claimed as deduction in the current year.

(v) Interest on loan taken to purchase or to acquire the property or to construct the house, interest paid for period prior to purchase/completion of construction will be allowed as deduction in five equal annual installments commencing from previous year in which the house construction is completed.

"Prior to construction period" means the period commencing on the date of borrowing and ending on earlier of the following two dates :

(a) March 31st immediately prior to the date of completion of construction/ date of acquisition.

(b) Date of repayment of loan.

(vi) Interest relating to the year of completion of construction can be fully claimed. as deduction in that year irrespective of the date of completion.

(vii) Interest on interest i.e. penal interest is not allowed as deduction.

(viii) If a new loan is taken to repay the original loan, interest paid on the new loan will be allowed as deduction (Assessee has to satisfy in this regard to assessing officer with the facts.

(ix) Brokerage or commission paid or expenses incurred to raise the loan are not allovedas deduction.

Deductions for Self Occupied House

In case of self-occupied house only one deduction is allowed i.e., interest paid on money borrowed to purchase or construct or reconstruct or to carry out repairs of the house.

1. If house is purchased/constructed and money is borrowed before 1-4-99 then least of the following two amounts will be allowed as deduction,

   (i) Actual interest paid or payable

   (ii) ` 30,000.

2. If House is Purchased/constructed and money is borrowed on or after 1-4-99 then deduction will be allowed upto ` 2,00,000 on fulfilling the following three conditions,

(i) The loan must be taken either for constructions/purchase of the house, the loan must be taken after 1-4-99.

(ii) The purchase/construction process should be completed within 3 years of the financial year starting from the date on which loan has been taken.

(iii) A person/institution lending money must issue a certificate to the borrower. This certificate must contain the following information,

   (a) Actual amount of loan sanctioned for the purpose of purchase/construction of the house.

   (b) Amount of Interest payable for the previous year to current assessment year.

   (c) Actual principal amount repaid in the preceding previous year to the present assessment year.

   (d) Outstanding principal amount.

   In case, if assessee fails in meeting satisfy the above three conditions then he/she is eligible for a deduction of ` 30,000 (Maximum).

   In case if new loan is taken by the assessee to repay the old loan then interest payable on new loan is allowed as deduction. The deduction will be least of the following two amounts,

   (a) Actual amount of Interest payable

   (b) ` 2,00,000

Deduction for Interest on Housing Loan - 80 EE

Interest payable on loan taken to purchase the property will be allowed up to ` 50,000 when following conditions are fulfilled,

1. Loan is sanctioned by financial institution in the financial year 2016-17.
2. The sanctioned loan amount does not exceed ` 35,00,000.
3. The value of property is not more than ` 50,00,000.
4. The assessee doesn't have any property on the date loan is sanctioned.

In addition to deduction u/s 24, this deduction is available from assessment year 2020-21.

If loan is taken for making repairs/renovation/ reconstruction of the house either before 1-4-99 or after 1 -4-99 then deduction will be least of the following two amounts,

(i) Actual amount of Interest payable

(ii) ` 30,000

Section 80EEA

In computing the total income of an assessee bring an individual not eligible to claim deduction under section 80EE, there shall be deducted. Deduction for interest payable on loan taken by individual from any financial institution for purchase of residential house property shall be allowed upto 1,50,000. If the assessee is satisfying all the following conditions.

1. Loan sanction between 1-4-2020 to 31-3-2021.
2. Stamp duty value for residential house property does not exceeds `. 45,00,000.
3. Assessee does not own any residential house property on the date of loan sanction.

3.4 Problems on Computation of Income from House Property

1. Sri. Durga Prasad is the owner of a house, let out the house for 10 years on 15th May 2013 on a monthly rent of ` 7,500 and received 2,00,000 non-refundable deposit interest earned on deposit is 12%. The municipal valuation is ` 80,000 p.a. Fair Rental Value is ` 75,000. Sri. Durga Prasad incurs the following expenses. Municipal taxes ` 10,000, Repairs ` 5,000, interest paid on the loan taken to purchase the house. ` 15,000. During the previous year rent is received for 10 months and balance is due. Compute Income from House Property.

Sol :

Computation of Sri. Durga Prasad's Income from House Property for the assessment year 2021-22

Particulars	Amount in `	Amount in `
Gross Annual Value (G. A.V)		1,10,000
Less: Municipal taxes		10,000
Net Annual Value (N.A.V)		1,00,000
Deduction u/s 24		
Standard deduction u/s 24 (a)	30,000	
Interest on loan u/s 24 (b)	15,000	45,000
Income from House Property		55,000

Working Notes :

First part: Calculation part to findout Expected Rental Value (E.R.V) & Actual Rental Value (A.R.V)

1. Calculating Expected Rental Value, which is higher of the following two amounts.

(a)	Municipal Rental Value	(a)	80,000
(b)	Fair Rental Value	(b)	75,000

2. Calculating A.R. V: A.R.V = Rent Received + Outstanding Rent + Proporationate Non-refundable Deposit.

   (7,500 × 10) (+) (7,500 × 2) (+) (2,00,000 ÷ 10)

   ⇒ 75,000 (+) 15,000 (+) 20,000 = 1,10,000.

   Note : Interest received on deposit is to be shown under the head “Income from other sources”.

Third Part: Working notes for computation of income.

1. **Calculating Gross Annual Value, which is higher of the following two amounts.**

(a)	Expected Rental Value	(a)	80,000
(b)	Actual Rental Value	(b)	1,10,000

2. **Municipal taxes:** Actual amount paid by the assessee to be deducted from the Gross Annual Value.
3. **Standard deduction:** 30% of N. A.V = 30% of 1,00,000 = 30,000.
4. **Interest on loan:** The loan is taken for purchasing the house so it is allowed as deduction, Actual interest for the previous year paid /payable will be allowed as deduction ` 15,000.

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2. **On 2-4-2020 Smt. Maheshwari purchased a residential house in Madurai city for ` 33,50,000 for this she took a housing loan from South Indian Bank @ 6% for ` 12 lakhs and the balance amount is adjusted through her past savings. The house is letout immediately and other particulars are as under.**

Municipal rental value	**1,75,000**	**Rent of similar building**	**2,75,000**
Standard rent	**2,00,000**	**Rent received**	**2,10,000**
Municipal taxes	**20,000**		

Interest due for the year on loan taken to construct the house is paid fully. Hire charges for the furniture provided to the tenant ` 30,000.

Compute Income from House Property for the assessment year 2021-22.

Sol :

Computation of Smt. Maheshwari's Income from House Property for the assessment year 2021-22

Particulars	Amount in `	Amount in `
Gross Annual Value		2,00,000
Less: Municipal taxes		20,000
Net Annual Value (N.A.V)		1,80,000
Deductions u/s 24		
1. Standard deduction	54,000	
2. Interest on loan	72,000	1,26,000
Income from House property		54,000

First Part: Calculation part to findout Expected Rental Value (E.R. V) & Actual Rental Value (A.R.V)

Note: When Standard rent is given, it means the house is governed by the jurisdiction of Rent Control Act.

Step 1: Calculating Expected Rental Value:

Which is higher of the following two amounts.

(a) Municipal Rental Value 1,75,000

(b) Fair Rental Value 2,75,000

Step 2: Limiting E.R.V or Calculating adjusted E.R.V:

This step is required only when standard rent is given in the problem :

Selecting least of the following two amounts.

(a) Expected Rental Value 2,75,000

(b) Standard rent 2,00,000

2. Calculating Actual rental value : Actual Rental value = Rent received (–) Hire charges paid for the furniture provided.

= 2,10,000 (–) 30,000 = 1,80,000.

Third Part: Working notes for computation of income.

1. **Calculating Gross Annual Value which is higher of following two amounts.**

   (a) Adjusted Expected Rental Value 2,00,000

   (b) Actual rental value 1,80,000

2. **Municipal taxes:** Actual amount paid will be deducted from Gross Annual Value = 20,000.

3. **Standard deduction:** 30% of N.A.V. $\rightarrow$ 30% of 1,80,000 = 54,000.

4. **Interest on loan u/s 24(b):** The house is purchased during the previous year with loan money from the bank, hence deduction is allowed. The details are as under.

2-4-2020 to 31-3-2021 = 1 year (App); Total Interest = 12,00,000 × 6% = 72,000

3. Mr. Subhash chandra Bose owns a house property in Calcutta. Compute the Gross Annual Value MRV - ` 70,000; FRV- ` 72,000; SRV - ` 72,000; Actual Rent ` 85,000.

Sol : **(Imp.)**

Computing the Gross Annual Value of Mr. Subash Chandra Bose for the Assessment Year 2021-22

Step - 1 : Compare MRV & FRV whichever is higher will be notional rent

$$\left.\begin{array}{l}\text{(a) MRV} - 70{,}000\\ \text{(b) FRV} - 72{,}000\end{array}\right\}\text{N.R.} = 72{,}000$$

Step - 2 : Compare notional rent with standard rent whichever is less will be expected rent.

$$\left.\begin{array}{l}\text{(a) Notional Rent} - 72{,}000\\ \text{(b) Standard Rent} - 72{,}000\end{array}\right\}\text{Both are equal, so expected rent is 72,000}$$

Step - 3 : Compare Expected Rent with Actual Rental Value, Which ever is higher is G.A.V

(a) ERV – 72,000

(b) ARV – 85,000

∴ GAV is = 85,000

4. Sri Ragava Rao purchase a house in Kakinada in the year 1990 and using for residential purpose. During the previous year and relevant year the following particulars are furnished.

MRV 25,000, FRV 30,000, the expenses paid are Municipal taxes 10%, Non-Agricultural land tax ` 1,000, Repairs 2,800, Insurance 500, and interest paid on loan taken to purchase the house 38,000. Compute income from house property.

Sol : **(Imp.)**

Computation of Income from House Property of Sri Ragava Rao for the Assessment Year 2021-22

Particulars	Amount (`)	Amount (`)
Gross Annual Value (GAV)		30,000
Less: Municipal taxes		2,500
Net Annual Value (NAV)		27,500
Deductions u/s 24:		
Statutory Deduction	8,250	
Interest on Loan	38,000	46,250
Loss from House Property		**(18,750)**

Working Notes

1. Calculation of Gross Annual Value (GAV)

Which is highest of the following two amounts,

(a) Municipal Rental Value = ` 25,000

(b) Fail Rental Value = ` 30,000

∴ GAV = ` 30,000

2. Municipal Taxes

10% of Municipal Rental Value

$$= 25{,}000 \times \frac{10}{100}$$

∴ MRV = 2,500

3. Statutory Deduction

30% of NAV

NAV = ` 27,500

$$\text{Statutory Deduction} = \text{` } 27{,}500 \times \frac{30}{100}$$

Statutory Deduction = 8,250

4. Interest on Loan

Interest on loan is allowed as deduction (i.e., ` 38,000).

5. Mrs. Rajani is having a property in Simla, which she has let-out to Mrs. Radha for a monthly rent of ` 6,000. The municipal value of the property is ` 20,000 p.a and fair rental value is ` 60,000. p.a. During the previous year, the house is vacant for 3 months. According to the agreement, the tenant has paid municipal taxes of ` 3,000. Mrs. Rajani paid an interest of ` 2,500 for a loan taken to construct the house. Compute her income from house property.

Sol :

Computation of Mrs. Rajani Income from house property for the Assessment year 2021- 22

Particulars	Amount (`)
GAV	54,000
Less: Municipal taxes	Nil
NAV	54,000
Less: Deductions u/s 24	
Standard deduction u/s 24 (a) 30% on NAV	16,200
Interest on loan u/s 24 (b)	2,500
Income from House Property	**35,300**

The ARV is less than ERV, but still ARV is taken as GAV because ARV is less than ERV due to vacancy loss.

Working Notes:

Calculate GAV

(a) Compare MRV with FRV to get ERV, the highest amount will be ERV.

(i) MRV = ` 20,000

(ii) FRV = $\boxed{\text{` 60,000}}$

∴ ERV = ` 60,000

(b) Calculate ARV

= Monthly rent – Vacancy loss = (6,000 × 12) – (` 6,000 × 3)

= ` 72,000 – ` 18,000 = ` 54,000

(c) GAV = ARV = ` 54,000.

6.

Particulars	**House-I**	**House-II**
Municipal Value	**8,00,000**	**12,00,000**
Fair Rental Value	**9,00,000**	**12,00,000**
Standard Rent	**10,00,000**	**10,00,000**
Actual Rent	**12,00,000**	**Self occupied**
Date of Construction	**1 / 5 /2001**	**1/10/2015**
Interest on Loan taken to construct the house		
Pre Construction Interest	**60,000**	**80,000**
Vacancy period	**1 month**	**–**
Municipal Taxes	**10%**	**15%**

Above are the particulars given by Bala krishna compute income from House Property (Imp.)

Sol :

Computation of Income from Home Property of Bala krishna for

Assessment year 2021-22

Particulars	**House-I Let out (`)**	**House-II Self Occupied (`)**
Gross Annual Value	11,00,000	Nil
Less : Municipal tax (10%)	80,000	Nil
Net Annual Value	10,20,000	Nil
Less : Deduction U/S 24		
(a) Standard deduction U/S 24 (a) 30%	(3,06,000)	Nil
(b) Interest on loan 24 (b)	(52,000)	(64,000)
	6,62,000	**(64,000)**

Taxable income of Mr. Bala krishna from House property is as follows,

Assessee is having income from let-out home and loan from self-occupied house. Intra head adjustment is done to get the taxable income i.e., from income of first-house deduct the loss of second house.

	House I (let out)	6,62,000
Less :	House II (self-occupied)	(64,000)
	Taxable income	**5,98,000**

Working Notes

1. Compute GAV for Home I (Let Out)

Compare $\left.\begin{array}{l} \text{MRV} - 8,00,000 \\ \text{FRV} - \boxed{9,00,000} \end{array}\right\}$ the highest amount is ERV

Compare $\left.\begin{array}{l} \text{ERV} - \quad \boxed{9,00,000} \\ \text{Standard Rent} - 10,00,000 \end{array}\right\}$ the least amount is AERV

Compare $\left.\begin{array}{l} \text{AERV} \ - \ 9,00,000 \\ \text{ARV} \quad -11,00,000 \end{array}\right\}$ which ever is highest is GAV

[12,00,000 – 1,00,000 vacancy period = 11,00,000]

2. Calculate 10% MT on MRV

$= 8,00,000 \times \frac{10}{100} = 80,000$

3. Pre-Construction Interest on Loan

$= 60,000 \times \frac{1}{5} = 12,000$

= Current Year Interest = 40,000

= Total Interest = 40,000 + 12,000 = 52,000

4. Pre-Construction Interest on Loan for Self - Occupied House

$80,000 \times \frac{1}{5} = 16,000$

Current Year Interest = 48,000

Total Interest = 48,000 + 16,000 = 64,000

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7. Mr. Rana Pratap owns a property in Hyderabad.

MRV – ` 1,60,000 ; FRV – ` 2,10,000; SRV – ` 1,80,000

The house is let out upto January 31st, 2018 (` 14,000 p.m.) From February 1st 2018 the house is self occupied by him. Municipal tax paid ` 16,000. Interest on loan for constructing the property ` 1,20,000. Compute his Income from House Property for AY 2021- 22.

Sol : **(Imp.)**

Computation of Income from House Property of Mr. Rana Pratap for Assessment year 2021-22

	Particulars		Amount (`)
GAV			1,80,000
Less : Municipal taxes			16,000
NAV			1,64,000
Less : Deduction			
(a)	Standarded U/S 24 (a) 30% on NAV	49,200	
(b)	Interest on loan	1,20,000	1,69,200
	Income from House Property		**5,200**

The ARV is less than ERV, but still ARV is taken as GAV because ARV is less than ERV due to vacancy loss.

Working Notes

1. $\left.\begin{array}{l}\text{MRV} - 1,60,000 \\ \text{FRV} - 2,10,000\end{array}\right\}$ Which ever is higher

   E.R.V = 2,10,000

2. ERV with SRV

   $\left.\begin{array}{l}\text{ERV} - 2,10,000 \\ \text{SRV} - 1,80,000\end{array}\right\}$ Which ever is least

   $\therefore$ AERV = 1,80,000

3. AERV with ARV

   $\left.\begin{array}{l}\text{AERV } 1,80,000 \\ \text{ARV } 1,40,000\end{array}\right\}$ Which ever is higher

   $\therefore$ G.A.V = 1,80,000

   Note : Assessee occupied the house from 1-2-2018

   $\therefore$ ARV is calculated only for 10 months.

   GAV = 1,80,000

8. Ms. Sundari is the owner of a property constructed at Mahaboobnagar on 31-08-2012. Particulars are furnished here under.

Particulars	`
Municipal Rental Value	**3,60,000**
Fair Rental Value	**3,90,000**
Standard Rental Value	**3,75,000**
Actual Rental Value	**4,80,000**
Unrealized Rent	**80,000**
Municipal Taxes	**12%**
Interest on Loan	**68,000**
Preconstruction Interest	**90,000**
Actual Repairs	**16,000**
Sewerage Tax (due)	**9,000**
Education Cess	**2,500**
Fire Insurance Premium	**4,000**

Compute income from house property for the assessment year 2021-22.

Sol : **(Imp.)**

Computation of Ms. Sundari's Income from House Property for the Assessment year 2021-22

Particulars		**Amount (`)**	**Amount (`)**
Gross Annual Value (G.A.V)			4,00,000
Less : Municipal taxes (50% paid by tenant)			21,600
Net Annual Value (N.A.V)			3,78,400
Deductions U/S 24 :			
Standard deduction 30% of NAV		(1,13,520)	
Interest on loan U/S 24(b)	68,000		
Pre-Construction interest	18,000	(86,000)	1,99,520
Income from House Property			**1,78,880**

Working Notes

Step-1: Calculating Expected Rental Value (E.R.V)

Which is higher of the following two amounts,

(a) Municipal Rental Value ` 3,60,000

(b) Fair Rental Value $\boxed{\text{` 3,90,000}}$

Step-2: Calculating Adjusted E.R.V

Which is least of the following two amounts,

(a) Expected Rental Value ` 3,90,000

(b) Standard Rental Value $\boxed{\text{\` 3,75,000}}$

Step-3: Calculating Actual Rental Value

ARV = Rent for 12 months period - Unrealized rent

= 4,80,000 – 80,000

= $\boxed{\text{\` 4,00,000}}$

Step-4: Calculating Gross Annual Value

Which is higher of the following two amounts,

(a) Adjusted E.R.V ` 3,75,000

(b) Actual Rental Value $\boxed{\text{\` 4,00,000}}$

Municipal Taxes

It is charged over Municipal Rental Value

i.e., $3,60,000 \times \frac{12}{100} = 43,200$

50% of Municipal Taxes paid by tenant i.e., $43,200 \times \frac{50}{100} = 21,600$

$\therefore$ 21,600 is deducted from GAV.

Interest on Loan

The loan is taken for construction of house. So deduction will be allowed ` 68,000

Pre-Construction Interest

Interest paid for period prior to construction will be allowed as deduction in five equal annual installments.

$90,000 \times \frac{1}{5} =$ ` 18,000

Sewerage Tax (Due)

It is not allowed as deduction

Note : Repairs are not allowed as deduction.

9. Mr. 'X' owns the following house properties for the assessment year 2021-22.

Particulars	House I	House II
Municipal value	60,000	40,000
Fair Rental value	75,000	60,000
Rent received	80,000	NA
How used	Let out	Own residence
Standard rent	50,000	40,000
Municipal taxes	10%	12%
Sewerage tax	2,000	3,000
Interest on loan	8,000	10,000
Ground rent	8,000	6,000
Land Revenue	4,000	3,000
Collection Charges	3,000	6,000

Compute income from house property for the A.Y. 2021-22

Sol : **(Imp.)**

House-I (Let-out)

Computation of Mr. X Income from House Property for the Assessment Year 2021-22

Particulars	Amount (`)	Amount (`)
Gross Annual Value (GAV)		80,000
Less : Municipal taxes	6,000	
Sewerage tax	2,000	8,000
Net Annual Value (NAV)		72,000
Deductions u/s 24 :		
Standard deduction	21,600	
Interest on Loan	8,000	29,600
Income/Loss from House Property		**42,400**

Working Notes

1. **Gross Annual Value (GAV)**

Step-1: Calculation of Expected Rental Value

Which is higher of the following two amounts,

(a) Municipal Value = ` 60,000

(b) Fair Rental Value = $\boxed{\text{` } 75{,}000}$

Step-2: Computation of Adjusted expected Rental Value

Which is least of the following two amounts,

(a) Expected Rental Value = 75,000

(b) Standard Rent = ` 50,000

Step-3: Computation of Gross Annual Value (GAV)

Which is higher of the two amounts,

(a) Adjusted Expected Rental Value = ` 50,000

(b) Actual Rent/Rent Received = ` 80,000

∴ Gross Annual Value = ` 80,000

2. Local/Municipal Taxes

Municipal taxes are charged on municipal i.e., ` 60,000 × 10% = ` 6,000 and it is deducted from G.A.V.

3. Interest on Loan

Interest paid for loan taken for construction of house-I is allowed as deduction = ` 8,000

4. Standard Deduction

30% of NAV

= ` 72,000 × $\frac{30}{100}$ = $\frac{30}{100}$ = ` 21,600

House-II (Self Occupied)

Computation of Mr. X Income from House Property for the Assessment Year 2021-22

Particulars	Amount (`)	Amount (`)
Gross Annual Value (GAV)		Nil
Less : Municipal taxes	Nil	
Sewerage tax	Nil	Nil
		Nil
Interest on Loan		10,000
Income/Loss from House Property		**– 10,000**

Working Notes

1. Gross Annual Value (GAV)

For self occupied house, Gross annual will be taken as nil.

2 Deductions

For self occupied house, no deductions are allowed except interest paid on loan taken to purchase or construct the house. Hence, actual interest will be allowed as deduction (i.e., ` 10,000)

Particulars	Amount (`)
Income from House-I	42,400
Less : Loss from House-II	10,000
Total Income	**32,400**

10. Mr. Kumar holds a house property which he lets out to Sri Shoban for ` 10,000 per month. Municipal Rental Value of the property is ` 7,500, Fair Rental Value is ` 8,500. During the previous year the tenant has not paid one month rent which is not recoverable. Expenses that are incurred by him Municipal Taxes ` 4,000, Insurance Premium paid is ` 10,200. Kumar took a loan of ` 11,00,000 for construction of the house and paid interest of ` 30,240. Calculate Income from House Property for the current assessment year.

Sol : **(Oct.-21)**

Computation of Income from House property of Mr. Kumar for A.Y 2021-22

Particulars	Amount (`)
GAV	1,10,000
Less: Municipal taxes	(4,000)
NAV	1,06,000
Less: Deduction U/S 24	
(a) Standard deduction u/s 24 (a) (30 % on NAV)	(31,800)
(b) Interest on loan u/s 24 (b)	(30,240)
Income from House Property	43,960

Working Notes:

1. Calculation of GAV

(a) Calculate ERV by comparing MRV and FRV. The highest will be ERV,

(i) MRV = ` 7,500 × 12 = 90,000

(ii) FRV = ` 8.500 × 12 = $\boxed{1,02,000}$

∴ ERV = ` 1,02,000

(b) Calculate ARV

ARV = Monthly Rent – Unrealized Rent

= (10,000 × 12) = 1,20,000 – Unrealized rent

= ` 1,20,000 – ` 10,000 = ` 1,10,000

(c) Calculate GAV by comparing ERV and ARV, highest amount will be GAV

(i) ERV = $\boxed{1,02,000}$

(ii) ARV = 1,10,000

GAV = ARV = ` 1,10,000

2. Insurance Premium

It is not allowed as deduction.

Short Question and Answers

1. Define Income from House Property

Ans :

If a person receives rent from his own building then such income is treated as income from house property. A person can receive income from a house in two forms (i) Profit on sale of house (ii) Rent received on let out. Profit on sale of house is treated as capital gain under separate head of income. Rent received by the owner of a house is treated as Income from House Property.

2. State the Exempted House Property Incomes.

Ans :

Under section 10 of the Income-tax Act 1961 following incomes from house property are exempted from tax. These incomes are not to be included in the total income of assessee. Hence no tax is payable on such incomes. These incomes are :

(i) Agricultural House Property [Section 2(I)(c)]

Income from such house property which situated on or in the immediate vicinity of agricultural land which is used for agricultural purposes - cultivator is exempted from tax.

(ii) House property held for charitable purposes [Section 11]

Any income from a house property held for charitable or religious purposes *e.g.,* rent from shops owned by a temple is exempted.

(iii) Self-occupied but vacant house [Section 23(3)].

In case an assessee keeps one of his own houses reserved for self-occupation but is living in a rented house else where due to his employment or profession the income from such house is taken to be nil.

(iv) House used for own business or profession

There is no income chargeable to tax under this head from such house property.

(v) Property held by registered trade union [Section 10(24)].

Income from a house property owned by a registered trade union is not to be included in its G.T.I.

3. Define Annual Value.

Ans :

According to section 23 (1), the word 'annual value' is defined as "the sum for which the property might reasonably be expected to fetch if the property is let out from year to year subject to deduction on account of municipal taxes." From this definition, it should be clearly understood that the annual value does not mean the rent received or rental value of the house but the 'notional' rent which the house can reasonably fetch, if the property is let out to the tenant having regard to local conditions, the type of building, cost of construction, valuation by the municipality, pugree or premium paid by the tenant and so on.

If Rent Control Act is in operation, then the standard rent should be taken as the basis for determining the annual value.

To summarize, annual value is generally determined taking into account the following factors:

(i) Rent received or receivable from the tenant or Actual Rent

(ii) Municipal value of the property

(iii) Fair rental value

(iv) Standard rent determined under the respective Rent Control Acts of the state.

4. Standard deduction or Statutory deduction u/s 24 (a)

Ans :

This is a compulsory deduction to every assessee who is having income from let out house. Actual expenditure incurred will not be considered. The deduction is given at a flat rate of 30% on Net Annual Value.

Note: When the Net annual Value is nil or in negative standard deduction is not allowed as deduction.

5. Interest on Home loan u/s 24(b)

Ans :

(i) Interest on loan taken to purchase or construction, repairs or renovation or reconstruction of the house is allowed as deduction.

(ii) If the interest is paid in India actual interest amount is allowed as deduction. And if the interest is paid outside India, tax is to be deducted at source, then only it can be allowed as deduction.

(iii) Interest on loan is allowed as deduction on due basis also i.e., even if interest is not paid during the previous year interest for the previous year period can be claimed as deduction.

(iv) If interest paid for earlier period is not claimed as deduction, then the same cannot be claimed as deduction in the current year.

(v) Interest on loan taken to purchase or to acquire the property or to construct the house, interest paid for period prior to purchase/completion of construction will be allowed as deduction in five equal annual installments commencing from previous year in which the house construction is completed.

"Prior to construction period" means the period commencing on the date of borrowing and ending on earlier of the following two dates :

(a) March 31st immediately prior to the date of completion of construction/ date of acquisition.

(b) Date of repayment of loan.

(vi) Interest relating to the year of completion of construction can be fully claimed. as deduction in that year irrespective of the date of completion.

(vii) Interest on interest i.e. penal interest is not allowed as deduction.

(viii) If a new loan is taken to repay the original loan, interest paid on the new loan will be allowed as deduction (Assessee has to satisfy in this regard to assessing officer with the facts.

(ix) Brokerage or commission paid or expenses incurred to raise the loan are not allovedas deduction.

6. Deductions for Self Occupied House

Ans :

In case of self-occupied house only one deduction is allowed i.e., interest paid on money borrowed to purchase or construct or reconstruct or to carry out repairs of the house.

1. If house is purchased/constructed and money is borrowed before 1-4-99 then least of the following two amounts will be allowed as deduction,

   (i) Actual interest paid or payable

   (ii) ` 30,000.

2. If House is Purchased/constructed and money is borrowed on or after 1-4-99 then deduction will be allowed upto ` 2,00,000 on fulfilling the following three conditions,

(i) The loan must be taken either for constructions/purchase of the house, the loan must be taken after 1-4-99.

(ii) The purchase/construction process should be completed within 3 years of the financial year starting from the date on which loan has been taken.

7. Net Annual Value

Ans :

Net annual value refers to the amount of rent that could be charged for a house property and the same can be used as a basis for calculating taxable income from house property. In simple words, It is the value that is determined by deducting municipal taxes such as property tax, sewerage tax etc, from Gross Annual Value of the house property.

It is calculated as,

Net Annual Value (N.A.V) = Gross Annual Value (G.A.V) – Municipal taxes paid The following deductions from Net Annual Value (N.A.V) are allowed in order to determine taxable income from house property,

(i) Deduction at 30% on NAV under section 24(a)

(ii) Interest on loan under section 24(b). [If the loan is taken by the assessee for purchase, construction, repair or reconstruction of house property].

Exercise Problems

1. On 1 st April, 2020 Sri. Jagadeesh is the owner of a house which is let out to Sri. Mohanlal on a monthly rent of `. 7,000 and received 3 months advance rent and `. 12,000 as deposit. The Municipal Rental Value is `. 60,000 p.a. and rent of similar building is `. 8,000 p.m. Sri. Jagadeesh incurs the following expenses Municipal taxes `. 6,000; Insurance (Fire) `. 300; Interest on loan taken to construct the house `. 13,000; Ground rent `. 250; Repairs `. 4,000; and collection charges `. 500. Compute the income from house property for the current assessment year.

   [Ans : `. 50,000.]

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2. Mr. Mohan Reddy is the owner of a house property whose municipal valuation is `. 2,50,000 p.a. (Standard Rent 3,60,000 p.a.) is let out on a monthly rent of `. 25,000 and Fair Rental Value is `. 2,10,000 p.a. Municipal taxes due `. 30,000 out of which `. 15,000 is paid so far. Other expenses: Repairs `. 4,000; Insurance `. 1,025 and interest on loan to purchase the house `. 45,000. The tenant has not yet paid last 1 month rent. Find out the income from house property for the current assessment year.

   [Ans : `. 1,54,500.]

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3. Mrs. Sandhya of 45 years age owns a house, which was let out to Mrs. Devi on a rent of `. 10,000 p.m. Municipal value of it is `. 1,00,000 and Fair Rental Value is `. 1,10,000. Standard rent `. 75,000. Mrs. Devi did not pay the rent for July and so ,was made to vacate on 31 -7-20. On 1st August she let out to Mrs. Shanti on a rent of `. 9,000 p.m. Expenses incurred during the previous year are: repairs `. 8,000; municipal taxes `. 15,000; interest on loan taken to construct the house `. 72,000. Calculate income from house property.

   [Ans : `. 11,100]

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4. Sri P.S.Reddy is the owner of a house property, consisting of building, open land for car parking and kitchen garden the building is let out for residential purpose on a monthly rent of `. 18,000; Municipal valuation is `. 1,80,000; rent for the similar building is `. 20,000 p.m.; The open land is letout on a monthly rent of `. 5,000 to run car parking business. During the previous year the house was vacant for one month. The rate of municipal tax is 15%. He constructed the house by raising a loan from H.D.F.C. and the interest paid during the previous year is 12% on the outstanding amount of `. 2,00,000. The other expenses are: Fire insurance `. 800; Collection charges `. 1,000; Repairs `. 3,000; Ground rent `. 2,500 and brokerage paid to raise loan `. 750. Compute income from house property.

   [Ans : `. 42,000]

Choose the Correct Answer

1. Income from House Property will discussed u/s [a]

   (a) 22 to 27 (b) 20 to 27

   (c) 24 to 27 (d) None

2. Annual value of the house property located outside India is [d]

   (a) Taxable in hands of all assessee

   (b) Taxable in hands of non-resident assessee

   (c) Exempted from tax in India

   (d) Taxable in hands of resident and ordinarily resident assessee

3. Income received from house in classified in to - types [b]

   (a) 3 (b) 2

   (c) 4 (d) None

4. Interest relating to pre-construction period is allowable - [d]

   (a) In 5 equal installments from the year in which it was incurred

   (b) In the year in which it was incurred

   (c) In the year in which house property was constructed

   (d) In 5 equal installments from the year in which property is constructed

5. For the purpose of claiming higher deduction u/s 24(b) while computing income of a self-occupied property assessee is required to take — [d]

   (a) Loan on or before 01- 04-1999 (b) Loan on or after 01-04-1999

   (b) Loan after 01- 04 -2009 (d) Both a or b

6. House is situated in Agriculture Land and rent is realized from that is treated as [b]

   (a) Income from House property (b) Income from Agriculture

   (c) Income from other sources (d) None

7. Unrealized rent of Rs 50,000 was received in June, 2011. The property was sold before April,2011. How much of unrealized rent is taxable? [b]

   (a) Rs. 50,000 (b) Rs. 35,000

   (c) Rs. 30,000 (d) Not taxable

8. Quantum of deduction by way of interest on moneys borrowed for construction of self-occupied house property is [c]

   (a) Rs. 1,50,000 (b) Rs. 30,000

   (c) Rs. 2,00,000 (d) Rs. 1,00,000

9. A gifted his house property to his married daughter in 5,000. A has let out the house property @ Rs. 10,000 p.m. The income from such house property will be taxable in the hands of : [a]

(a) A's daughter

(b) A. However , income will be computed first as Mrs. A's income and thereafter clubbed in the income of A

(c) A as he will be treated as deemed owner & liable to tax

(d) None

10. R transferred his house property to his wife under an agreement to live apart. Income from such house property shall be taxable in the hands of : [c]

(a) R as deemed owner

(b) R. However, it will be first computed as Mrs. R income & Thereafter clubbed in the hands of R

(c) Mrs. R

(d) None

Fill in the blanks

1. The sum the property might reasonably be expected to fetch if it is let out is known as ________
2. Standard Rent is fixed under the ________
3. Standard deduction u/s 24 is ________ of Net Annual Value
4. Expenses on Self occupied house and used for own business shall be treated as ________ expenditure
5. Income from a farm house is ________ u/s 10.
6. A has two house properties. Both are self-occupied. The annual value is ________
7. An assessee has borrowed money for purchase of a house & Interest is payable outside India. Such interest shall: ________
8. Interest on capital or loan received by a partner from a firm is ________
9. Annual value is defined under section ________
10. Types of housing properties are classified in to ________

ANSWERS

1. Annual Value
2. Rent Control Act
3. 30%
4. Business Expenses
5. NIL
6. One house shall be nil, other house to be taxed
7. Be allowed as deduction if the tax is deducted at source
8. Taxable under the head of business and profession
9. 23(1)
10. 4 types

UNIT IV	**PROFITS AND GAINS OF BUSINESS OR PROFESSION :** Definition of 'Business and Profession' – Procedure for computation of Income from Business – Revenue and Capital nature of Incomes and Expenses – Allowable Expenses u/s. 30 to 37 – Expenses expressly disallowed – Deemed Profits – Miscellaneous provisions u/s 44. Depreciation: Meaning – Conditions for charge of depreciation – Problems on computation of Income from Business.Income from Profession: Rules– procedure – problems on computation of Income from Profession.

4.1 Definition of Business and Profession

Q1. Define the following terms :

(i) Business

(ii) Profession

Ans :

(i) Business [Section 2(13)

Business simply means any economic activity carried on for earning profits. Section 2(13) has defined the term as "any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce and manufacture". In the words of Justice S.R. Dass, "The word 'business' connotes some real, substantive and systematic or organized course, activity or conduct with a set purpose".

In this connection it is not necessary that there should be a series of transactions in a business and also it should be carried on permanently. Neither repetition nor continuity of similar transactions is necessary. As already defined under section 2(13), the income derived from any adventure in the nature of trade is also treated as business income.

(ii) Profession [Section 2(36)]

A profession is an occupation requiring purely intellectual skill or manual skill controlled by the intellectual skill of the operator, e.g., lawyer, accountant, engineer, surgeon, author etc. So profession refers to those activities where the livelihood is earned by the persons through their intellectual or manual skill. Under section 2(36) profession includes vocation.

Vocation simply means a way of living for which one has special fitness. A vocation does not involve any organized or systematic activity like business. So vocation simply means any type of activity in which a person is engaged and he earns his livelihood from such activity. The practice of a religion may also amount to vocation. Any gain or receipt arising out of vocation is certainly taxable under this head of income. Writing of articles in the magazines is also a vocation.

Q2. Explain the various incomes chargeable under head profit and gains.

Ans : **(Imp.)**

The following are the incomes which are chargeable to income-tax under the head 'Profits and Gains ' Business or Profession'.

1. Business or Professional Income [Section 28(i)]

The profits and gains of any business or profession which was carried on by the assessee at any time during the previous year are assessed under this head. The business or profession should be carried on in the previous year and it is not necessary that it should continue throughout the year. The owner of the business is to be charged under this section, whether he may carry business personally through a manager, agent or servant.

Business outside India and Business in India stand on the same footing for the purposes of this action.

All revenue profits arising from business or profession are chargeable even if they are of a casual md non-recurring nature.

Illegality of the business or profession does not exempt its income from tax.

2. Compensation [Section 28(h)]

Any compensation or other payment due to or received by the following persons is assessable as business income :

(a) any person, by whatever name called, managing the whole or substantially the whole of the affairs of an Indian company, at or in connection with the termination of this management or the modification of the terms and conditions relating thereto.

(b) any person, by whatever name called, managing the whole or substantially the whole of the affairs of a company in India or any other company, at or in connection with the termination of the office or the modification of the terms and conditions relating thereto.

(c) any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of the terms and conditions relating thereto.

(d) any person for or in connection with vesting in the Government or in any corporation owned or controlled by the Government under any law for the time being in force, of the management of any property or business.

(e) Any compensation due or received by any person, may be called by any name at or in the connection with the termination or the modification of the terms and conditions, as the case may be, of any contract relating to his business.

3. Income of a Trade or Professional Association [Section 28(tti)]

A trade association is a non-profit voluntary organization of business competitors operating in the same line of business for the promotion of their common economic interest.

Income derived by a trade, professional or similar association from specific service performed for its members only is considered to be business income and taxed accordingly. Section 28(iii) further says that income arising from specific services rendered by the association to its members is taxed only and income not arising from specific purpose is outside the purview of this clause, e.g., entrance fees or member's periodical subscription etc. are not taxable.

This provision does not apply to social clubs. Under section 44A, in case of trade association if the total amount of expenditure exceeds the receipts from the members, the deficit will be allowed as deduction in computing the income of the association assessable under the head 'Profits and Gains of Business or Profession' or in computing the income assessable under any other head. The deduction of this type is subject to the following two conditions :

(a) The association does not distribute its income to its members except as grants to any association or institution affiliated to it.

(b) The amount of deduction to be allowed should not exceed 50% of the total income of the association before this deduction.

If there is no income under that head or the deficiency exceeds such income, then the whole or balance of the deficiency can be set off against the income under any other head. However, the deficiency deductible should not exceed half of the total income of the association.

4. Export Incentives

(a) Profit on sale of Licence [Section 28(iii)(a)]: Granted under the Imports (Control) Order 1955 made under the Imports and Exports (Control) Act 1947.

It has been inserted retrospectively from 1-4-62.

(b) Cash Assistance [Section 28(iii)(b)]: (By whatever name called) received or receivable by any person against exports under any scheme of the Government of India.

It has been inserted retrospectively from 1-4-67.

(c) Any Duty of Customs or Excise: [Section 28(iii)(c)]. Repaid or repayable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules 1971. It has been inserted retrospectively from 1-4-72.

(d) Profit on transfer of Duty Entitlement Pass Book: It has inserted that any profit on transfer of he Duty Entitlement Pass Book Scheme being Duty Remission Scheme under the export import policy formulated and announced under section 5 of the Foreign Trade Development and Regulation Act

(e) Profit from Duty-free replenishment scheme: It has inserted with retrospective effect from 1.4.2001 that any profit from Duty Free Replenishment Scheme being Duty Remission Scheme under the export import policy formulated and announced under section 5 of the Foreign Trade Development and Regulation Act

5. Value of benefit or perquisite [Section 28(iv)]

The value of any benefit or perquisite, whether convertible into money or not arising from business or the exercise of a profession, is chargeable under the head 'Profits and Gains of Business or Profession'. As the benefit and perquisites received by an employee fall and are taxed under the head 'salaries', similarly benefits and perquisites arising from business or exercise of profession are taxed under the head 'Profits and Gains of Business or Profession'.

6. Salary, Interest, Bonus, Commission or Remuneration received by a partner from a Firm [Section 28(v)]

With effect from assessment year 1993-94 any salary, interest, bonus, commission or remuneration received by a partner of a firm from firm assessed as firm u/s 184 under Income-tax Act 1961, is to be treated as business income in the hands of partner.

In case such payments are subjected to restrictions u/s 40(b) the income under this section shall be upto the amount allowed as deduction to firm while calculating business income.

7. Any Amount Received Under certain Agreement for not to Carry on Business/ Profession [Section 28(va)]

Any sum whether received or receivable in cash or in kind under an agreement for :

(a) not carrying out any activity in relation to any business ; or

(b) not sharing any know-how, patent, copyright, trade-mark, license, 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 of services.

(c) not carrying out any activity in relation to any profession shall also be income chargeable to income-tax under the head "Profits and gains of business or profession", [w.e.f. Assessment Year 2017-18]

Exceptions: The following receipts shall not be chargeable to tax as business income under section 28(Va) :

(i) any sum whether received or receivable in cash or in kind on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business which is chargeable under the head 'Income from capital gains' or

(ii) any sum received as compensation from the multilateral fund of the Montreal Protocol on substances that deplete the Ozone Layer under the United Nations Environment programme in accordance with the terms of agreement entered into with the Government of India.

8. Speculation Business [Explanation to Section 28]

Explanation No.2 of section 28 says that where speculative transactions carried on by an assessee are of such nature as to constitute a business, such business shall be deemed to be distinct and separate from any other business.

Section 43(5) has explained a speculative transaction as "a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips.

9. Income Derived from Illegal Business

The law doesn't make difference between legal and illegal business while computing income under the head profit/ gains of business.

10. Keyman Insurance Policy (Sec. 28 (vi))

Any amount received under this scheme including bonus on policy is chargeable to tax. It is an insurance policy taken by one person on the life of another person.

If any capital Asset is converted into inventory then the fair market value of inventory, determined as per prescribed manner is taxable under this head.

11. Transfer of Certain Assets Specified U/S 35 AD in Certain Circumstances (Sec. 28(vii))

Any amount received receivable on account of any capital Asset, being demolished, discarded or transferred is chargeable to tax under the head profit/ gain of business.

Incomes which are Related to Business But Not Computed as Business Income

1. Income from House Property Held in Form of Stock-in-trade

If the assessee is to purchase the houses and give "it on rent, then such rent received will be computed under the head income from house property but not treated as business Income. Thus, if any income received from house property which is held as stock- in-trade is not treated as income from business.

2. Dividends on Shares

If an assessee deals in shares and holds the shares as stock-in trade, then dividend received on such shares in not charged to tax under the head profit/gains of business.

The dividends received from Indian company is an exempted income, where an dividends received from foreign company in charged to tax under the head income from other sources.

3. Profit or Loss on Sale of Business Assets

Any profit earned or loss incurred on sale of business asset is also not charged to tax under this head, but charged under the head capital gains, but if the assets are held as stock-in-trade, or assets held by power sector, or used for scientific research, then it will be charged under the head profit/gains of business.

4. Income Earned Through owning and Maintaining of Horses

Any income earned through owning and maintaining of horses used for race is chargeable under the head income from other sources.

5. Casual Income

Any income earned through winning lotteries, puzzles, game shows or any other casual income is not to be charged under the head business income.

4.1.1 Procedure for Computation of Income from Business

Q3. Briefly explain the points to be considered while computing business income.

Ans : **(Imp.)**

1. Business is carried on by assessee

The owner of the business is liable to pay tax if his income exceeds the exempted limit and whether the assessee is doing the business for himself or through employees is not to be considered. This right to carry on business may be exercised by the assessee personally or through his agent or employees.

Note: If the owner of the business is a minor then guardian is liable to pay tax.

2. Business or Profession should be carried on during the previous year.

3. Legality of the business is not to be considered.

Income Tax Act does not make any distinction between legal and illegal business. The income from illegal business is to be computed in the same manner, as income from legal business is computed i.e., all expenses incurred to earn illegal income will be allowed as deduction. However, if loss is there from an illegal business the same cannot be set off against the profit of legal business.

4. Aggregation of business Incomes

If an assessee is carrying on many types of business, first profit or loss from each business is to be computed and then profits are aggregated. If loss is there from one business then it can be set off against the profit of another business.

5. Recovery of sum already allowed as deductions

If an expenditure or loss is allowed as deduction in the earlier assessment years and if these amounts are recovered subsequently then it is taxable as business income of the year in which it is recovered, e.g. Bad debts allowed as deduction . and recovered subsequently.

6. Notional profits are not to be considered

If an assessee sends goods costing ` 10,000 to the branch with an invoice price of ` 12,000, if these goods were not yet sold, the excess amount of ` 2,000 is termed as notional profit, which is not taxable.

7. Speculation business

The profits of speculation business are clubbed with other business incomes and accordingly tax is levied. But if there is speculation loss, it can be set off against profits of speculation business only.

8. Profit on sale of assets on winding up of the business

If the business is wound up and the assessee derives profit by the sale of assets (except stock in trade) then these profits are not included under this head, i.e., profit on sale of stock in trade alone is taxable as business profits.

9. Beneficial Ownership

It is not only the legal ownership but also the beneficial ownership which is to be considered. For e.g: Mr. Munnalal is the owner of the business and by agreement or arrangement profits are enjoyed by Mr. Harigopal. Mr. Munnalal is known as Benamidar, who is not liable to pay tax but Sri Harigopal is liable to pay tax.

10. Anticipated profits i.e., expected profits in the future is not to be considered.

11. Method of recording the transactions by the assessee is not important. For e.g. A revenue income is not credited in the profit and loss account by the assessee, but assessing authority determines the income according to the provisions of Income Tax Act only.

Q4. Explain the procedure for computation of income from business.

Ans :

Computation of Income from Business for the Assessment year 2020-21

Particulars	Amount (`)	Amount (`)
Net Profit as per Profit and Loss A/c	xxx	
Add: Inadmissible expenses:	xxx	
Income tax paid	xxx	
Charity and donation	xxx	
Household expenses	xxx	
Loss on sale of motor car	xxx	
Life insurance premium of proprietor	xxx	
Interest on capital	xxx	
Provision for bad debts	xxx	
Salary to proprietor	xxx	
Fines and penalties	xxx	
Staff welfare fund	xxx	
Gifts and presents	xxx	
Over valuation of opening stock	xxx	
Under valuation of closing stock	xxx	
Contribution to un-recognized provident fund	xxx	xxx
		xxx
Less: Incomes to be shown under other heads:		
Rent received	xxx	
Interest from Bank	xxx	
Dividend received	xxx	
Refund of income-tax	xxx	
	xxx	
Less: Expenses not charged to Profit and Loss A/c (Deductions):		
Depreciation	xxx	
Sales tax paid	xxx	
Excise duty paid	xxx	xxx
Income for Business		xxx

4.1.2 Allowable Expenses u/s. 30 to 37

Q5. Explain in brief the deductions allowed while computing business (or) professional income of assessee.

Ans : **(Imp.)**

According to income tax Act 1961, Sec 30-37, there are many types of expenses which incur in business and the nature of expenses depends upon the type of business assessee is carrying on; so the following limit of deduction is not final but prepared on general guiding principle any expenditure is incurred for earning on income, but it is not included in the list, still it will be allowed on deduction from business income, if assessee can prove that expenditure was related to business only.

Allowable Deduction are as Follows

1. Expenditure incurred in ordinary commercial trading and was useful in earning business income.
2. Expenditure which is incidental to business or profession.
3. Prohibited expenses are not allowed as deduction whether express or implied.
4. If expenditure is incurred before selling up the business then it is not to be allowed on deduction, deduction are allowed only for those expenses which occurs during relevant accounting year.
5. The expenses which are related to that particular business only should be allowed. Expenses of one business cannot be allowed from the income of other business.
6. The expenses of discontinued business cannot be charged from the income of existing business. The expenses of shutdown business are capital loss.
7. For single transactions all expenses are allowed irrespective of the year in which it is incurred.
8. A partner can claim a deduction for expenses from their share of firm profit, if it has incurred in earning partnership profit.
9. Loss of any type is not allowed, only expenses are allowed to be deducted.
10. Expenditure of capital nature is not allowed.
11. Only the expenditure which incurred will be allowed but not the provisions or reserves, created out of profits for future expense/loss.
12. An amount recovered, which was allowed earlier as expenses will become taxable in the year of recovered.
13. The assessee is responsible to proof that a particular expense was in relation to earn business income only, so that has to be allowed as deduction.

Other Deductions

Following is the list of deduction which are expressively allowed as expense from business income,

1. **Rent:** Allowed only if the building is taken on rent and rent is paid, if business is carried on from own building then rent is not allowed as deduction.
2. **Repairs:** Repairs means expenses incurred to maintain the building in working condition, So any expenses towards repairs the building is allowed as deduction, it will be allowed for both rented and own building.
3. **Rates & Taxes:** Any amount paid towards, land revenue, local taxes, etc., are also allowed.
4. **Insurance Premium:** Any amount towards the insurance premium of the building, insurance taken for risk of damage because of fire/earthquake is an allowable expense
5. **Depreciation:** Sec (32) provides for deduction of depreciation of an assets used in business, for their purpose the assets are classified into various blocks. According to rate of depreciation only the depreciation calculated according to income tax rules will be allowed as deduction, and not the depreciation calculated by assessee as per accounting rules and depreciation is allowed on block of assets and not single assets.
6. **Expenditure for Scientific Research:** It is an expenditure incurred for extending knowledge in natural or applied sciences, expenditure incurred on any scientific research which helps in expanding the business of assessee is allowed or deduction.

7. Research Came on by Outside Agency

If the assessee provides financial assistance to an outside agency to carry on the research work, the outside agency can be college, university or any other body.

The amount of deduction allowed in @150% of actual expenditure incurred on research done by approved association.

- It amount is given for research in social, science or statistical research, and research is done by approved association whose objective is to do research work only and that research may or may not be related to the assessees business then rate of deduction allowed is @100% of actual expenditure incurred.

8. Contribution given to any national laboratory is allowed @150% of actual amount given.

9. Expenditure on scientific research is carried forward or set-off is allowed and debited to Profit and Loss A/C for full amount and in case profit is not enough to set-off then it can be set-off from income of other heads.

10. Any expenditure incurred towards know-how (before 1.4.98)

- The lump-sum consideration paid is allowed to be deduction in 6 equal installments. Starting from the year consideration paid.
- If the know-how was developed by Indian university or laboratory then the consideration paid will be allowed as deduction in 3 equal instalments.

11. Any amount spent to obtain licence for telecommunication services and actual payment has been made, then a deduction in equal instalments of appropriate fraction shall be allowed on deduction, starting from year in which payment has been made and ends in the year in which life of spectrum ends

12. Preliminary Expenses: Expenditure incurred before the commencement of business or after the commencement, or in connection with the extension of business or new undertaking any under company or a person resident in Indian can claim this deduction.

Expenditure eligible for deduction U/S 35 D(2) are of following types,

- Feasibility report preparation
- Project report preparation
- Conducting survey for business
- Any services related to engineering
- Any legal charger for drafting agreement
- In case of company, legal charges incurred for drafting the memorandum & Articles of Association
- Fees paid for registering the company
- Amount incurred for issue of subscription of shares, and debentures, underwriting, brokerage and printing and advertisement of prospects.

Eligible Amount for Deduction

The amount to be allowed on deduction should not exceed 5% of the cost of project and for company at the option of 5% of capital employed the expenditure shall be divided into 5 instalments in equal amounts for each of five succeeding years.

- From the Assessment year 2009-10 this deduction is allowed for service industry also.

13. Expenditure for Demerger or Amalgamation: The amount spend on amalgamation or demerger can be written off in 5 successive previous year and every year $\frac{1}{2}$th amount is allowed to be deducted.

14. Audit: The amount spent by non-corporate assessee for utilising the services of chartered accountant for auditing the company's book will be allowed as deduction U/'s 350 & E.

15. Other Deduction

(i) Insurance premium paid for stocks on an insurance against risk.

(ii) Health insurance premiums paid for employees under the scheme of general insurance corporation of India & run by central government.

(iii) Any amount paid to employees by assessee a part from Salary like Bonus or commission is also allowed on deduction.

4.1.3 Expenses Expressly Disallowed

Q6. What are the Expenses Expressly Disallowed as deduction in computing the profit of business.

Ans :

The expenses expressly disallowed as deduction in computing the profits of business are as follows,

1. Provision for doubtful/bad debts is not allowed as deduction but in case of rural branches of commercial banks, it is allowed as deduction.
2. Provision for gratuity.
3. Expenditure on advertisement in any souvenir, pamphlet, brochure, magazine etc., published by political party is disallowed.
4. Personal taxes such as Income tax. Gift tax, advance payment of tax.
5. Provision for tax and arrears of income tax.
6. Interest paid 0" borrowings from outside India.
7. Interest royalty, technical service fees etc., paid without TDS outside India.
8. Wealth tax.
9. Payment of salary without TDS outside India.
10. Tax paid on prerequisites by the employers.
11. Provision for non-compliance of TDS.

Other Expenses

1. All provisions, funds, reserves.
2. Payment of salary rent to proprietor.
3. Proprietor's drawings.
4. Proprietor's personal expenses.
5. Charity and donations.
6. Expenditure to remove competitor.
7. Fines and penalties.
8. Capital expenditure.
9. Expenditure on registration of business assets.
10. Expenditure incurred for raising capital.
11. Legal expenses of capital assets.
12. Compensation paid relating to breach of contract, in order to purchase business assets.
13. Expenditure incurred on recreating temple or club for employees.
14. Expenditure on installing electrical work in new production office.
15. Amount paid for life insurance premium of the proprietor.

Q7. Explain the following item treatment, for calculating profit from business.

(i) Repairs on Building

(ii) Scientific Research

(iii) Loss arising from misappropriation by an employment

(iv) Revenue payments in cash.

Ans :

(i) Repairs on Buildings

Any repairs or maintenance done to maintain the building used for business purpose in a good condition is allowed as on deduction for income tax purpose but the expenditure should be of nature, any capital expenditure is not allowed on deduction for tax purpose.

This deduction can be claimed while calculating the net taxable income from business and profession.

It can be claimed for rented or own business whether building is taken on rented or owned by them both this is on own building capital expense is not allowed but will be added to block of interest and claim depreciated.

(ii) Scientific Research (Sec 35)

Any activity taken up for the extension of knowledge in fields of natural or applied science including agricultural is known as scientific research any such activity carried on by business concern in claim deduction for the expenses incurred for allowing deduction of this expenditure is classified as follows.

1. Revenue expenditure — if the assessee carry on scientific research on their own and incurs revenue expenditure during the RY then such expenditure is allowed in deduction only if it is related to business.

2. If the business concern contribution an amount to some specified institution who carry on this research activity, then a percentage of amount is allowed on deduction from assessee's business income.

   For approved scientific association its 175%

   For approved university or college its 175%

For approved university, college or other institution for use of research it is 125%

Social science or statistical research

(iii) Loss Arising from Misappropriation by an Employment

The loss arising because of misappropriation or negligence of employee is allowed as admissible expenses while computing business income.

(iv) Revenue Payments in Cash Sec 40(A)(5)

Any payment made towards the purchase of goods and the amount is more than ` 10,000 then it should be done through payee cheque. If such payments of amount ` more than 10,000 will be disallowed while computing business income.

- If any payment is made towards or them the amount is 35,000.
- This element of cash payment of ` 10,000 is not applicable towards payment or purchasing of an amount or payments made to financial.
- If payment is made for 2 or more bills to same individual and amount is not more than ` 10,000 then it is allowed on deduction.
- Payment made an part of fill on different deals to different person which is not more than ` 10,000 it is allowed on deduction.

4.1.4 Miscellaneous Provisions u/s 44

Q8. Explain the Miscellaneous Provisions under section 44.

Ans : **(Imp.)**

1. Section 44 AD

With effect from assessment year 2011-12, certain assessees engaged in a business are allowed to compute their business income on presumptive or estimated basis and thus, exempted from maintaining books of account as required u/s 44AA.

In case assessee fulfills certain conditions as given below, then it is presumed that assessee's business income is estimated at only 6% of his total turnover or gross receipts which is received by an account payee cheque or a account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed. In case assessee wants to declare higher income, he can do so.

In case the assessee is not receiving payments through account payee cheques or drafts or through the use of electronic clearing system then the existing rate of deemed profit of 8% of turnover or gross receipts shall continue to apply.

Conditions

Computation of business income on estimated basis u/s 44AD shall be allowed in case assessee fulfills following conditions :

1. This provision is applicable only if assessee is a resident individual, resident H.U.F. or a resident partnership firm (but not a Limited Liability Partnership).
2. Assessee has not, claimed any deduction u/s 10A, 10AA, 10B, 10BA, and 80RRB.
3. Assessee may be engaged in any business except the business of playing, hiring or leasing of trucks where section 44AE applies.
4. Assessee's total turnover or gross receipts in the relevant previous year does not exceed ` 2 crore.

2. Section 44A DA

(i) Notwithstanding anything contained in sections 28 to 43C, in the case of an assessee, being a resident in .India, who is engaged in a profession referred to in section 44AA(1) and whose total gross receipts do not exceed ` 50,00,000 in a previous year, a sum equal to 50% of the total gross receipts of the assessee in the previous year on account of such profession, or as the case may be, a sum higher than the aforesaid sum claimed to have been earned by the assessee, shall be deemed to be the profits and gains of such profession chargeable to tax under the head "Profits and gains of business or profession".

(ii) Any deduction allowable under the provisions of sections 30 to 38 shall, for the purposes of sub-section (1) of section 44 ADA, be deemed to have been already given full effect to and no further deduction under those sections shall be allowed.

(iii) The written down value of any asset of profession shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.

(iv) An assessee who claims that his profits and gains from the profession are lower than the profits and gains specified in sub-section (1) of the proposed section and whose total income exceeds the maximum amount which is not chargeable to income-tax shall be required to keep and maintain such books of account and other documents under sub-section (1) of section 44AA and get them audited under section 44AB.

3. Section 44 AE

(a) This section is applicable only on those persons who are engaged in the business of plying, hiring or leasing goods carriages and who owns not more than 10 such goods carriages.

(b) This section has fixed monthly income chargeable to tax as business profit in respect of each type of vehicle which is as under :

   (i) For a heavy goods vehicle: The profits and gains shall be an amount of ` 1,000 per ton of gross vehicle weight or unladen weight, as the case may be, for every month or part of a month during which the heavy goods vehicle is owned by the assessee in the previous year or an amount claimed to have been actually earned from such vehicle, whichever is higher.

   (ii) For a goods carriage other than heavy vehicle: The profits and gains shall be an amount equal to seven thousand five hundred rupees for every month or part of a month during which the goods carriage is owned by the assessee in the previous year or an amount claimed to have been actually earned from such goods carriage, whichever is higher.

(c) In case presumptive income per vehicle per month is adopted, it will be presumed that all the expenses u/s 30 to 38 have been charged.

(d) In case assessee is a firm. The remuneration allowable u/s 40(b) shall be deducted out of income computed u/s 44AD(1).

(e) It will also be presumed that full depreciation has been calculated and deducted for calculating written down value of the assets.

(f) Assessee can claim deductions under section 80.

(g) The provisions of section 44 AA and 44 AB shall not be applicable on such business and for calculating monetary limits the gross receipts or the income shall not be considered.

(h) The assessee may or may not apt for this scheme. In case he does not opt for this scheme he shall be required to maintain accounts and get them audited.

4. Section 44 AF

This section deals with the computation of profit and gains of retail traders. However the section 44AF is eliminated from the Act since assessment year 2011-12. All the things covered in this section now shifted to section 44AD.

5. Section 44 B

This section deals with the taxation on shipping business profits. The provision of this section are as follows,

(a) The assessee shall be non-resident of India.

(b) The assessee shall be engaged in operations of ships.

6. Section 44 BB

This section deals with the computations of taxable income from activities connected with exploration of mineral oils. The conditions of this section are as follows,

(a) The assessee may be resident or non-resident of India.

(b) The assessee shall be engaged in the business of providing services and facilities in connection with plant or machinery, exploitations of mineral oils etc.

7. Section 44 BBB

This section deals with the computation of profits and gains of foreign companies engaged in business of civil construction. The conditions of this section are as follows,

(a) The tax payer shall be a foreign company.

(b) The tax payer shall be involved in civil construction business or in.

4.1.5 Problems on Computation of Income from Business

Q9. State, with reasons, whether the following expenses are admissible while computing business income.

(i) Donation to an approved trust 5,000/-.

(ii) Legal expenses to defend a trade contract 6,000/-.

(iii) Contribution to staff welfare fund

(iv) Sales tax paid.

Ans :

(i) Donation to an Approved Trust ` 5,000

Donation given to an approved trust is not allowed as deduction. If given under debit-side of profit and loss a/c add to Net Profit, while computing business income.

(ii) Legal Expenses to Defend a Trade Contract ` 6,000

Legal expenses relating to trading contracts are allowed as deduction as, it is directly related to business.

(iii) Contribution to Staff Welfare Fund

Any amount contributed to staff welfare fund is not allowed as deduction. Not related to business

(iv) Sales Tax Paid

Sales tax is a business tax and allowed as deduction. It is directly related to business and expenditure to business.

Q10. How will you deal the following while computing business income?

(a) Advance income tax paid ` 25,000

(b) Brokerage paid for raising loan for the purpose of business ` 50,000

(c) Amount paid as commission to purchase machinery ` 15,000

(d) Expenditure incurred on income tax proceedings ` 10,000.

Ans :

(a) Advance Income Tax

It is a personal tax of the assessee, hence, it is not allowed as deduction. It shown on expenses in profit and loss a/c, add back to net profit, while computing business income.

(b) Brokerage Paid for Raising Loan

If loan is raised for the purpose of business then expenditure incurred on raising such loan is allowed as deduction (except some expenses which are prohibited under law). Hence, brokerage paid shall be allowed as deduction.

(c) Amount Paid as Commission

Commission paid towards the purchase of machinery is treated as business expenditure and it is allowed as deduction.

(d) Expenditure Incurred on Income tax

Expenditure incurred on income tax proceedings is also allowed as deduction, provided they should be legal.

Q11. How will you deal with the following while computing the business income:

(a) Bad debts ` 8,000

(b) Staff welfare fund ` 22,000

(c) Loss of stock by Ant ` 8,000

(d) Provision for bad debts ` 15,000.

Ans :

(a) Bad Debts ` 8,000

Any amount which becomes irrecoverable in nature is termed as bad debts and is allowed as deduction.

Note: Any debts which are arising due to insolvency of debtors are not allowed as deduction.

(b) Staff Welfare Fund ` 22,000

It is an amount paid by the staff as their contribution towards welfare fund is allowed a deduction.

(c) Loss of Stock by Ant ` 8,000

It is a loss sufferred by the assessee and is allow as deduction.

(d) Provision for Bad Debts ` 15,000

Provision for bad debts are not allowed a: deduction (except rural branches of commercial banks as it is reserve created for future loss out of profits am not loss in actual.

Q12. How will you deal with the following while computing the business income:

(a) Donations ` 15,000

(b) Registration Expenses of Business Asset ` 48,000

(c) Sales Tax ` 12,000

(d) Interest on Wife's Loan ` 38,000.

Ans :

(a) Donations ` 15,000

Donations are not allowed as deduction, as it is nowhere related to business add to the net profit.

(b) Registration Expenses of Business Asset ` 48,000

Expenses relating to registration of a business asset is a capital expenditure, hence it is not allowed as deduction.

(c) Sales Tax ` 12,000

Sales tax is a business tax and allowed as deduction.

(d) Interest on Wife's Loan ` 38,000

It is a personal expense, hence it is not allowed as deduction. Personal expansion if debited on expenses then add back to net profit.

PROBLEMS

1. Profit and loss account of Sri Prashanto Chatterjee for the year ended 31 st March is as under.

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Salaries	70,000	By Gross profit	3,67,500
To Rent	21,000	By Commission	15,000
To Entertainment expenditure	13,000	By Sale of Scrap	8,000
To Trade expenses	16,500	By Refund received (GST)	3,800
To GST	35,000	By Penalty waived (excise duty	12,500
To Telephone charges	18,000	By Surplus on sale of shares	60,000
To Gifts to customers	28,000	By Winning from lottery	
To Stock destroyed by fire	5,000	(part of the business	
To Betterment charges for landed property	10,000	activity)	50,000
To Breakfast expenses to employees	7,500		
To Advertisement expenses	80,000		
To Compensation paid to employees	11,500		
To Cost of maintaining pet animals	24,000		
To Travelling expenses	15,000		
To Depreciation on assets	19,500		
To Net profit	1,42,800		
	5,16,800		5,16,800

Additional information:

(1) Salaries includes ` 6,000 of the last year.

(2) 15,000 salary outstanding at the end of the year not yet recorded.

(3) Depreciation allowed as per the provisions of I.T. Act ` 32,000.

(4) Advertisement expenses includes.

(a) ` 30,000 capital expenditure 1/4 of this is permitted to be allowed as deduction.

(b) ` 10,000 paid to souvenir of a political party during the elections.

(5) During the year a machinery costing ` 30,000 is purchased and the payment is made in cash.

(6) Salaries includes a payment of ` 6,000 to an expert for taking his advice for the business.

(7) Entertainment expenses includes ` 1,000 for Pooja expenses.

(8) During the previous year ` 30,000 subsidy is received from the government for an export order and the same is not recorded in the books.

(9) Refund of deposit from OYT Scheme ` 40,000.

(10) Goods costing ` 5,000 sold to a customer on cost basis normal selling price is ` 6,000.

(11) Goods costing ` 20,000 taken for personal use is credited in sales account as ` 25,000.

(12) On 2-4-2020 a dog is purchased for 7,500 for security of the business premises and a cat for ` 1,000 to prevent the loss of stock from damages by rats and unfortunately both the animals died in an accident. Compute income from business for the assessment year 2021-22.

Sol.:

Computation of Mr. Prashanto Chatterjee's Income from the Business
For the Assessment Year 2021-22

Particulars	Amount `	Amount in `
Net profit as per Profit & Loss Account.		1,42,800
Add: Expenses debited in the Profit and Loss Account		
but not allowed as deduction		
Last year salary paid during the current year	6,000	
Betterment charges paid for landed property	10,000	
Advertisement expenditure-capital	22,500	
Advertisement to souvenir of a political party	10,000	
Depreciation on assets debited in the P&L account	20,500	69,000
		2,11,800
Less: Incomes to be shown under other heads		
Surplus on sale of shares	60,000	
Penalty waived	12,500	
Winning from lotteries	50,000	1,22,500
		89,300
Less/Deduction: Expenses allowed as deduction but		
not debited in P&L account		
Outstanding salaries for the current year	15,000	
Depreciation as per Income Tax Act	32,000	
Book profit/notional profit on the goods taken for personal use	5,000	
Loss on death of animals	8,500	60,500
		28,800
Add: Incomes/Receipts not credited in the profit and loss a/c		
Subsidy received.	30,000	
Refund of deposit from OYT Scheme	40,000	70,000
Income from business		98,800

2. Mr. Gopal submits the following particulars for the year ended 31 st March, 2021. Compute his Income from Business.

Profit and Loss Account

Particulars	Amount (`)	Particulars	Amount (`)
To Salary	1,05,000	By Gross Profit	8,00,000
To Telephone Expenses	11,000	By Income from House Property	6,000
To Repairs	18,000	By Profit on Sale of Land	70,000
To Legal Expenses	39,000	By Interest on Securities	1,000
To Motor Car Expenses	44,000	By Bad Debts recovered	5,000
To Income Tax	10,000		
To Security Transaction Tax	6,000		
To Provision for Taxation	3,000		
To interest on Loan	12,000		
To Bad Debts	6,000		
To Provisions for Bad Debts	8,600		
To Depreciation	45,000		
To General Expenditure	42,000		
To Net Profit	5,32,400		
	8,82,000		8,82,000

Additional Information:

1. Interest paid on Loan for purchase of Machinery
2. As per the Income Tax Act allowable Depreciation is ` 30,000
3. Repairs included in Capital Expenditure ` 12,500, current year repairs ` 5,500
4. Proprietor Salary included in Salary ` 25,000
5. General expenditure included ` 15,000 paid as penalty for violation of Income Tax rules.

Sol : **(Oct.-21, Imp.)**

Computation of Mr. Gopal's Income from Business for A.Y 2021-22

Particulars	Amount (`)	Amount (`)
Net Profit as per profit and Loss Account		5,32,400
Add: Inadmissible Expenses		
Repairs (Capital Expenditure)	12,500	
Income Tax	10,000	
Security Transaction Tax paid	6,000	
Provision for Taxation	3,000	
Interest paid on purchase of machinery	12,000	
Provision for Bad Debts	8,600	
Depreciation (Debited to Profit and Loss Account)	45,000	
Proprietor's Salary	25,000	
Penalty	15,000	1,37,100
Less: Incomes to be Shown Under Other Heads		3,95,300
Income from House Property	6,000	
Profit on Sale of Land	70,000	
Interest on Securities	1,000	77,000
Less: Deductions		3,18,300
Depreciation		30,000
Income from Business		**2,88,300**

Working Notes

1. **Salary, Telephone, Legal and Motor Car Expenses**

   These expenses are business expenses. Hence, allowed as deduction.

2. **Income Tax**

   It is a Personal tax, hence, it is not allowed as deduction.

3. **Repairs**

   Capital expenditure is not allowed as deduction. However, current repairs are allowed as deduction.

4. **Interest on Loan**

   Interest paid on loan taken for purchase of machinery is a capital expenditure. Hence, it is not allowed as deduction.

5. **Security Transaction Tax**

   Since interest on securities is not part of the business, deduction is not allowed.

3. Compute Business Income for Previous Year 2020-21 of Tantia Topu.

Trading and Profit Loss A/c

Particulars	Amount (`)	Particulars	Amount (`)
To Opening stock	25,000	By Sales	3,35,300
To Purchases	1,85,300	By Closing Stock	96,000
To Trade expenses	30,000	By Bad debts	240
To Salaries	10,400	By Discount	8,000
To Bonus to staff	3,000	By Dividends	12,000
To Rent	12,000	By Refund of Income Tax	15,000
To Printing / Stationary	1,600	By Interest on Fixed Deposit	45,000
To Gifts to customers	2,100		
To Donations	1,500		
To Advertisements	5,100		
To Drawings	7,200		
To Life Insurance Premium	3,600		
To Car expenses	2,000		
To Discount	30		
To Depreciation	10,000		
To General Expenses	30,000		
To Net Profit	1,81,910		
	3,10,742		5,11,540

Additional Information

(i) Reimbursement of advertisement expenses receive from the supplier is ` 3,500.

(ii) 1 /4 of the premises is used for own residences.

(iii) Contribution of ` 1,000 is payable to the trade association, for filing a case against Govt.

(iv) Car expenses related to business.

(v) General expenses include ` 32,000 for maintaining the plants on traffic islands and payment of salary to the domestic servant ` 1,000.

(vi) Depreciation allowed other than on car as per IT is ` 8,500.

(vii) The car was sold during the previous year for ` 4,00,000, which was purchased on the same year for ` 4,80,000.

Sol.:

Computing Business Income for Mr. Tontia Topu for AY 2021-22

Particulars	**Amount (`)**	**Amount (`)**
Net Profit as per Profit and Loss Account		1,81,910
Add: Inadmissible Expenses		
Donation	1,500	
Drawings	7,200	
Life insurance premium	3,600	
Rent 1/4 used for own	3,000	
Re-imbursement of advertisement expenses	3,500	
Salary to domestic servant	1,000	
General expenses	32,000	51,800
		2,33,710
Less: Admissible Expenses		
Contribution to trade association	1,000	1,000
		2,32,710
Less: Income to be Shown Under Other Heads		
Dividends	12,000	
Refund of income tax	15,000	
Interest on fixed deposit	45,000	72,000
		1,60,710
Less: Deductions		
Depreciation according to IT rules	8,500	8,500
Net Income from Business		1,52,210

Working Notes

1. Rent $\frac{1}{4}$ of premises used for own residence $= 12{,}000 \times \frac{1}{4} = 3{,}000$
2. Re-imbursement of advertisement expenses is taxable.
3. Car expenses are related to business, so allowed on expenses.
4. Payment of domestic servant is not allowed on business expenses.
5. Depreciation claim is according to IT rules. Therefore, allowed as deduction from business income.
6. The car sold during previous year doesn't come under the head business income.

4. Sri Govind Charan Singh is the owner of a business in Chandigarh. He earned a net profit of ` 6,00,000 after providing ` 30,000 for doubtful debts and ` 1,25,000 for depreciation. Scrutiny at the assessment stage revealed the following facts. Compute tax liability if income from other heads is ` 5,00,000.

i) Interest debited include ` 20,000 paid for the loan taken from a friend and ` 10,500 on loan taken from wife.

ii) Donation include ` 40,000 paid to an approved Scientific Research Institute.

iii) Interest received from debtors ` 5,000 and ` 15,000 on Tax Free Government securities is credited in the profit and loss Account.

iv) Assessee admitted that a cash sale of ` 50,000 and a cash purchase of ` 28,000 are not yet recorded.

v) Expenditure on advertisement includes ` 18,000 paid for advertisement in souvenir published by a Political party.

vi) The actual amount of depreciation allowable is ` 27,000.

vii) On 11th Nov' 2020 goods purchased for ` 43,000 for cash and a crossed cheque is issued immediately.

viii) Salaries include ` 90,000% contribution to Provident Fund of the employees and equal contribution is received from the employees and of which ` 72,000 is deposited.

Sol :

Computation of Sri Govind Charan Singh's income from Business for the assessment year 2021-22

Particulars	Amount	Amount
Net profit as per profit and loss account		6,00,000
Add: In admissible expenses		
Provision for doubtful debts	30,000	
Depreciation debited in the P & L a/c	1,25,000	
Advertisement in a political party souvenir	18,000	
Cash purchases	43,000	2,16,000
		8,16,000
Less: Incomes to be shown under other heads		
Interest on Tax free Govt, securities	15,000	15,000
		8,01,000
Less: Deductions		
Cash purchases - unrecorded	28,000	
Depreciation allowed as per I .T Rules	27,000	55,000
		7,46,000
Add: Unrecorded Revenues/Incomes		
Cash sale - unrecorded	50,000	
Provident Fund contribution of the employees not yet deposited	18,000	68,000
Income from business		8,14,000

5. Mr. Srinivas submits the following particulars for the year ended 31-3-2021. Compute his income from business.

(i)	Profit as per profit and loss A/c	2,80,000
(ii)	Donation to an approved institution	20,000
(iii)	Interest on capital	10,000
(iv)	Patents acquired	25,000
(v)	Provision for income tax	10,000
(vi)	Provision for sales tax	18,000
(vii)	Bad debts written off	12,000
(viii)	Provision for bad and doubtful debts	14,000
(ix)	Interest on late payment of sales tax	8,000
(x)	Advertisement expenses (gift worth ` 2000 were given to each of the important customers)	20,000
(xi)	Depreciation (Allowed upto ` 40000 including on patents)	60,000

Sol :

Computation of Mr. Srinivas's Income from Business for the Assessment year 2021-22

	Particulars	Amount (`)	Amount (`)
	Net Profit as per Profit and Loss account		2,80,000
Add:	**Inadmissible Expenses:**		
	Donation to an approved institution	20,000	
	Interest on capital	10,000	
	Patents acquired	25,000	
	Provision for income tax	10,000	
	Provision for sales tax	18,000	
	Provision for bad and doubtful debts	14,000	
	Depreciation	20,000	1,17,000
			3,97,000
Less:	**Incomes to be shown under other heads:**		Nil
			3,97,000
Less:	**Deductions:**		Nil
	Income from Business		3,97,000

Working Notes

1. **Donation to an Approved Institution**

   Donation given to an approved institution is not allowed as deduction.

2. Interest on capital, provision for income tax, provision for sales tax and provision for bad and doubtful debts are not allowed as deduction.

3. **Patents Acquired**

   It is a capital expenditure, hence it is not allowed as deduction.

4. Interest on Late Payment of Sales Tax This is allowed as deduction.

5. **Advertisement Expenses**

   Advertisement through gifts are allowed as deduction, irrespective of their cost.

6. **Depreciation**

   Excess of allowable amount is taken under inadmissible expenses i.e., 60,000 – 40,000 = 20,000.

6. Given below is the profit and loss account of Mr 'X' for the year ending 31-3-2021.

Dr. **Cr.**

Particulars	Amount (`)	Particulars	Amount (`)
To Salaries	40,000	By Gross Profit	4,00,000
To Bad debts	10,000	By Discount	10,000
To Provision for bad debts	15,000	By Commission	10,000
To Insurance	4,000	By Bad debts recovered	20,000
To Advertising	10,000	By Rent Received	30,000
To Interest on Capital	5,000		
To Interest on loan	5,000		
To Depreciation	25,000		
To Net Profit	3,56,000		
	4,70,000		4,70,000

Additional information:

(i) Allowable depreciation as per Income Tax rules ` 30,000/-

(ii) Insurance includes Life Insurance premium of the proprietor ` 2000.

Sol :

Computation of Mr. X's Income from Business for the Assessment year 2021-22

Particulars		Amount (`)	Amount (`)
	Net Profit as per profit and loss account		3,56,000
Add:	**Inadmissible Expenses**		
	Provision for bad debts	15,000	
	Interest on capital	5,000	
	Depreciation	25,000	
	Life insurance of the proprietor	2,000	47,000
			4,03,000
Less:	**Incomes to be shown under other heads**		
	Rent received		30,000
			3,73,000
Less:	**Deductions**		
	Depreciation as per Income Tax rules		30,000
	Income from Business		3,43,000

Working Notes

1. Salaries

Salaries paid to staff is a business expenditure. Hence, it is allowed as deduction.

2. Provision for Bad Debts

It is anticipatory loss. Hence, it is not allowed as deduction.

3. Insurance, Advertising, Discount, Commission and Interest on Loan These are allowed as deduction.

4. Interest on Capital

It is a notional expenditure. Hence, it is not allowed as deduction.

5. Rent Received

It is shown under the head "Income from other sources".

6. Depreciation

If depreciation is given on debit side of P&L a/c without giving any other details, then it is taken under the sub-heading "inadmissible expenses". But, if depreciation is given as per IT Act, then it is to be taken under the sub-heading "deductions".

7. Life Insurance Premium

It is a personal expenditure, hence it is not allowed as deduction.

4.2 Deemed Profits

Q13. What do you mean by Deemed Profits?

Ans : **(Imp.)**

(i) Deductions allowed earlier but recovered later on [Section 41(1)].

The Finance Act 1992 has substituted the sub-section 41(0 by the following with effect from assessment year 1993-94 :

Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee (here-in-after referred to as first- mentioned persons) and subsequently during any previous year.

(a) the first mentioned person has obtained, whether in cash or in any other manner whatsoever any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by such person or value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to tax as the income of that previous year whether the business or profession in respect of which the allowance or deduction has been made, is in existence in that year or not.

(b) in case such benefit or cash is obtained by successor in business in manner whatsoever respect of which loss or expenditure was incurred by first-mentioned person the provisions mentioned in (a) above shall be applicable against such successor in business and he shall be liable to pay tax-on such deemed profit.

The words successor in business means :

(a) in case of amalgamation - the amalgamated company;

(b) in case of succession - the successor;

(c) in case a firm is succeeded by another firm, such other firm.

For the purposes of this section the expression "loss or expenditure or some benefit in respect of any such trading liability by way of remission or cessation thereof' shall include the remission or cessation of any liability by a unilateral act by the first mentioned person under clause (a) or the successor in business under clause (b) of that sub-section by way of writing off such liability in his accounts.

(ii) Balancing Charge [Section 41(2)].

In case any building, plant and machinery or furniture owned by assessee is sold, demolished, destroyed or discarded during the year and on which depreciation has been claimed by the assessee on straight line method, the excess of amount realised over W.D.V. shall be deemed as business profit but it shall not exceed depreciation allowed on such asset.

(iii) Profit on sale of assets used for scientific research [Section 41(3)].

Where capital asset was purchased for scientific research and is sold without having been used for any other purpose, excess amount of Sale price added with the deduction allowed earlier over the capital cost of the asset is taxable as deemed income of the year in which sale was affected.

(iv) Bad debts allowed earlier but recovered [Section 41(4)].

Bad debts allowed earlier but recovered later on shall be deemed profits of the year in which they are recovered.

(v) Amount withdrawn from special reserve [Section 41(4A)].

In case a deduction has been allowed u/s 36(l)(vm) in respect of any amount transferred to special reserve and subsequently some amount is withdrawn from such special reserve, the amount so withdrawn shall be deemed as income under the head "Profits & Gains" of the year in which amount is withdrawn. This provision shall remain applicable even if the business is no longer in existance in the year in which amount is withdrawn.

(vi) Setting off loss from deemed profit [Section 41(5)].

Any loss of a business incurred during the year in which it ceased to exist and which could not be set off against any other income of that previous year shall be set off against the above-mentioned deemed incomes. This does not apply to speculation loss.

Q14. Explain the concept of valuation of cost.

Ans :

The proper and correct valuation of stock is an important factor to arrive at the correct profits of any business undertaking. Correct or actual or real profits cannot be ascertained unless a proper method is adopted for the valuation of closing and opening stocks. The Income-tax Act is silent about this factor and so no method, whatsoever, is recommended by the Income-tax Act. Hence, it is valued according to the general accounting principles. An assessee may adopt any of the following methods for valuation of closing stocks :

(i) At cost price

(ii) At market price

(iii) At cost or market price whichever is less.

They are based upon the cost or market price of the stock, whichever is less. The businessmen are free to adopt any method, but once one method is adopted, the same is to be continued from year to year and the assessee cannot change the method of valuation to suit his own purposes. It can only be changed with the prior approval of the Assessing Officer. Another point to be noted in this case is that the value of closing stock must be the value of opening stock in the succeeding year.

Under (or) over-valuation of stock

Generally the opening and closing stocks are not valued at cost price. They are either under-valued or over-valued. In such cases the profit of the year is affected by such under-valuation or over-valuation. To remove the effect of such valuation we adopt the following procedure :

(i) Bring the stock to real value in the following manner :

$$\text{Real value of stock in case of under-valuation} = \text{value of stock} \times \frac{100}{(100 - \text{rate of under - valuation})}$$

$$\text{Real value of stock in case of over-valuation} = \text{value of stock} \times \frac{100}{(100 + \text{rate of under - valuation})}$$

(ii) If opening stock is under-valued—calculate the difference between the actual value debited and value calculated above. It means the P & L A/c is under-debited by the amount of such difference. So profit is reduced by the amount of such profit.

(iii) If opening stock is over-valued—it will mean that P & L A/c has been over-debited by such difference. Hence increase the profit by such difference.

(iv) In case closing stock is under-valued—the P & L A/c is under-credited by the amount of such difference. So increase the amount of profit by such difference.

(v) In case closing stock is over-valued—the P & L A/c is over-credited by the amount of profit by such difference. So reduced the amount of profit by such difference.

4.3 Revenue and Capital Nature of Incomes and Expenses

Q15. Explain about Capital and Revenue receipt.

Ans : **(Imp.)**

Receipts are of two types (1) Revenue Receipts and (2) Capital Receipts. If a receipt is regular or routine or recurring then it is known as Revenue receipt, which is to be considered as income and hence it is taxable. If the receipt is casual or non-recurring then it is capital receipt which may or may not be taxable for eg., the capital gain is taxable whereas other capital receipts are not taxable.

The Following Are the Examples of Capital Receipts and Revenue Receipts

Capital Receipts

1. Sale proceeds of capital assets e.g. land and buildings; plant and machinery etc.
2. Compensation received from one of the partners from other partner for relinquishing all his rights in the partnership.
3. Compensation received for loss of right to future remuneration :
4 Amount received for sale of know-how.
5. Compensation received for suspension of export licence.
6. Insurance policy amount received relating to a capital asset.
7. Sale proceeds of trees with roots which were of spontaneous growth.
8. Compensation received from transport organizations like Railways etc., for permanent disablement.

Revenue Receipts

1. Hire charges of capital assets.
2 Interest received on trade and non-trade transactions.
3. Sale proceeds of trees, which are cut at the stem but not with roots i.e., there is a possibility of growth in future.
4. Consideration received in lumpsum for future reduction in remuneration.
5. Lumpsum received in lieu of royalty.
6. Compensation received for premature termination of contract.
7. Compensation received from transport organizations like R.T.C., Railways etc., for temporary disablement.
8. Pugree received by the owner of the house property from tenant.
9. Lease rent received by the lessor (the lease rent is also known as salami or nazrana).

Q16. What are the differences between revenue receipt and capital receipt?

Ans :

S.No.	Capital Receipts	S.No.	Revenue Receipts
1.	It is the amount received from the sale of assets, shares and debentures.	1.	It is the amount received from the sale of goods and services.
2.	Capital receipts do not frequently occur, as they are non-recurring and irregular.	2.	Revenue receipts do not occur again and again, as they are recurring and regular.
3.	Main items of capital receipts are capital and loan, which affect financial position of the business.	3.	Main items of revenue receipts are sale of merchandise, discount and commission, which affect operating results of the business.
4.	Capital receipt is shown on the liabilities side of the balance sheet.	4.	Revenue receipt is shown on the credit side of the trading and profit and loss accounts.
5.	Capital receipt is received in exchange for the source of income.	5.	Revenue receipt is received which is substitution of income
6.	Capital receipt either decreases the value of an asset or increases the value of liability	6.	Revenue receipt neither increases nor decreases the value of asset or liability.

Q17. What are the differences between Capital and Revenue Expenses.

Ans : **(Imp.)**

Expenses are of two types (a) Revenue expenditure (b) Capital expenditure. If the benefit of the payment expires within one accounting year then it is known as revenue expenditure. If the benefit of the payment expires within one accounting year then it is known as revenue expenditure e.g. : Rent, Salaries paid etc.

a) If the benefit of payment accrues for more than one accounting year then it is known as revenue expenditure e.g. purchase of Machinery & Building etc.

b) While computing the income or loss from the business or profession only revenue expenses are allowed as deductions. The following are the differences between revenue and capital expenditure.

S.No.	Revenue Expenses	S.No.	Capital Expenses
1.	Routine or regular or recurring expenditure e.g. salaries, rent etc.	1.	Casual, irregular and non-recurring expenditure e.g. purchase of machinery, furniture etc.
2.	Revenue expenditure benefits for less than a year e.g. rent paid, telephone charges etc.	2.	Capital expenditure benefits for more than a year. eg : payment for know -how etc.
3.	If expenditure is incurred on assets to maintain the present efficiency then it is a revenue expenditure e.g. repairs to machinery.	3.	If the expenditure is incurred to improve the earning capacity then it is a capital expenditure. e.g. mannual into power run machine.
4.	If the purpose of purchase is to resell then the expenditure is revenue expenditure eg: purchase of goods (trading assets). **Note :** The nature of the business will decide whether an article or asset is a trading or non-trading one.	4.	If the purpose of purchase is not to resell but to use in the business then it is capital expenditure e.g. purchase of Plant and Machinery (non-trading assets).
5.	A payment made to discharge revenue liability is a revenue expenditure, e.g. compensation paid for breach of business contracts.	5.	A payment made to discharge capital liability is capital expenditure. e.g. compensation paid for breach of non business contracts.
6.	If payment is made to earn an income it is revenue expenditure e.g. wages, salaries, rent paid incurred to get sole distribution.	6.	If payment is made to acquire the source of the source of income it is a capital e.g. expenses of goods from a manufacturing company.
7.	It is shown in income statement.	7.	It is shown in balance sheet.

4.4 Depreciation

4.4.1 Meaning, Conditions for Charge of Depreciation

Q18. What is depreciation? Explain the conditions for charging depreciation ?

Ans : **(Oct.-21, Imp.)**

Depreciation is a very important item treated under the head Profit & Gains of Business or Profession. "In simple language depreciation is decrease in the value of an asset due to its wear and tear and passage of time. The Income-tax Act 1961 nowhere defines the term depreciation.

Depreciation is the process of allocating the cost of long-term asset to the time periods in which it is used in a systematic and rational manner.

Conditions for Charge of depreciation

To claim depreciation allowance, the following conditions are to be satisfied :

1. **Depreciation is allowed on capital assets only :** Depreciation is allowed in respect of capital assets only. They may be either 'tangible assets' or 'intangible assets"

a) **Tangible Assets :** Tangible assets are those assets that can be seen, felt, and used. e.g. buildings, plant, machinery, furniture etc.

b) **Intangible Assets:** Intangible assets can not be seen and felt. e.g. Technical knowhow, trademarks, Patents, copyrights, licences, franchisers or any other business or commercial rights.

2. **Asset must be owned by the assessee :** In order to avail the depreciation allowance that he is the owner of the asset on which ne wants to claim the depreciation.

3. **Asset must have actually been used for the purpose of assessee's business :** The asset in respect of which depreciation is claimed must have been used for the purpose of assessee's business or profession during any part of the accounting year

4. **Use of 180 days or more in the year of acquisition :** If any asset falling with in a block of assets is acquired by the assessee during the previous year and is used for the purposes of business or profession for a period of 180 days are more, full rate of depreciation is allowed otherwise 50 percent of the amount calculated at the percentage prescribed in the case of block of assets comprising of such asset.

5. Depreciation is allowed by the A.O. even if it is not claimed by the assessee.

6. **Sale of an asset:** Depreciation cannot be claimed on the asset which is not in existence at the time of assessment if any assets are sold during the year, such assets will not be with the business.

   On all the existing assets, depreciation is allowed on written down value method (W.D.V) except in the case of the year of acquisition where actual cost is taken into consideration for the calculation of depreciation.

   Calculation

   Step 1: Take the opening balance of W.D.V as on 1st April of the relevant P.Y.

   Step 2: Add the actual cost of any asset acquired during the year and falling in the same block of assets

   Step 3: Deduct any transfer consideration received on the sale, demolition or destruction, during the year in relation to the transferred falling in the same block of asset.

   The remaining balance is called W.D.V

   Note : In the year of acquisition, actual cost is treated as W.D.V

Q19. Explain the basis of depreciations.

(OR)

Explain the concept of block of assets.

Ans : **(Imp.)**

The depreciation is charged on a "block of assets" system. The rates of depreciation have been provided on block of asset basis. This scheme was introduced with effect from 1-4-1987.

i) **Block of assets [Section 2(11)].** The basis of charge of depreciation has been shifted from individual asset to block of asset. The assets have been divided into blocks on the basis of rates of depreciation prescribed under rule 5 of the income-tax Rules 1962. So, all assets having the same rate of depreciation and falling in the same nature will be put in the same block.

   According to [Section 2(11)], it means a group of assets falling within a class of assets comprising:

(a) Tangible assets being building, machinery, plant;

(b) Intangible assets being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature.

On the basis of Depreciation rate different types of Blocks are suggested as under :

S.No.	Nature of Asset	Rate of Depreciation
Block No. 1	Buildings $\rightarrow$ used for residential purpose	5%
Block No. 2	Buildings $\rightarrow$ used for non residential purpose such as office, factory, show room, godowns, etc.	10%
Block No. 3	Buildings $\rightarrow$ used for Hotels	10%
Block No. 4	Buildings $\rightarrow$ Temporary structures	40%
Block No. 5	Building $\rightarrow$ Acquired on or after 1-9-2002 for installing Plant & Machinery for a business unit engaged in providing infrastructure facilities	40%
Block No. 6	Furniture and Fittings $\rightarrow$ For all types of business	10%
Block No. 7	Plant and Machinery $\rightarrow$ (i) This block includes only Motor cars, Buses, Lorries used in the business for running them on hire.	30%
Block No. 8	Plant and Machinery $\rightarrow$ This Block includes only Motor cars used in the general business	15%
Block No. 9	Plant and Machinery $\rightarrow$ This block includes Plant and machinery used to manufacture the goods or for running the business.	15%
Block No. 10	Plant and Machinery (i) Aero Planes, Aero engines $\rightarrow$ (ii) Life saving medical equipment $\rightarrow$	 40% 40%
Block No. 11	Plant and Machinery $\rightarrow$ This Block includes containers including computer software.	40%
Block No. 12	Plant and Machinery $\rightarrow$ This Block includes computers including computer software.	40%
Block No. 13	Plant and Machinery $\rightarrow$ This Block includes equipment used for energy saving devices etc.	40%
Block No. 14	Plant and Machinery $\rightarrow$ Air and water pollution control equipment.	40%
Block No. 15	Intangible Assets $\rightarrow$ This Block includes intangible assets acquired on or after 1-4-1998. Examples for intangible assets are : Patents, Copyrights, Trade marks, Licences, know-how, Franchises, other commercial rights. (except good will). **Note :** On good will depreciation is not allowed.	25%

Block No. 16	Books → : (i) If the assessee is engaged in the business of lending libraries	40%
Block No. 17	Books → (i) If the books are used by the assessee who is having income from profession	
	(a) Annual Publication books eg : Finance Act, Annual Budget, etc.	40%
	(b) Other than annual publications eg: Text books, Reference books, etc.	40%

Special Note : If details of the publications is not given then make an assumption that they are "Annual Publication Books"

Summary Table :

S.No.	Depreciation on Assets	Use of the Asset in the in the previous year	Depreciation
1.	Newly purchased asset during the relevant previous year to the current assessment year	Used for less than 180 days	50% of normal depre-ciation is allowed.
2.	Newly purchased asset during the relevant previous year to the current assessment year	Used for more than 180 days	Normal depreciation for fully year is allowed.
3.	Assets purchased in the earlier earlier period.	Used for a minimum 1 day	Normal depreciation for fully year is allowed.
4.	Assets purchased in the earlier period.	Not used even for a day	No depreciation is allowed.

ii) Written Down Value

With the written down value of block of assets depreciation is computed as per prescribed rates on all assets. It should be exercised U/S 139(1) before the due date of filing income tax return.

ii) Straight Line Method

Any undertaking involved in power generation and distribution can calculate depreciation on straight line method or written down value method on assets acquired on or after 1-April-1997. Under straight line method, depreciation is computed on all assets except those on which depreciation is allowed on W.D.V.

Q20. What are the miscellaneous provisions about depreciation ?

Ans :

The provisions or conditions of section 32 of Income Tax Act, 1961 deals with the concept of depreciation. Some of the major provisions or conditions mentioned under section 32 are as follows,

1. Depreciation should be allowed based on block of assets.

2. Depreciation should be allowed to the asset's owner.
3. Depreciation assets should be used only for business or profession.
4. Depreciation should be allowed on asset only if the asset is used in the year of purchase.
5. No depreciation shall be charged in the year of sale of asset.
6. If an asset is used for less than 180 days, then 50% of depreciation is allowed.
7. Additional depreciation is allowed only on plant or machinery (excluding ships and aircraft) if purchased or installed after 31-03-2005.
8. Claim of depreciation is mandatory while computing income from business or profession.
9. No depreciation shall be allowed on motor cars manufactured outside India and purchased assessee of India after 28-2-1975 but before 1-4-2001.
10. 40% rate of depreciation shall be charged on motor taxies, lorries and trucks if these vehicles are hired out to outside persons.
11. The assessees who charging depreciation must submit information of asset to the concerned assessing officer.
12. Depreciation should always be charged on written down value method only,

Q21. Explain the computation of depreciation as per section 32 of Income Tax Act 1962.

Ans :

The section 32 of Income Tax Act 1962 suggested the following procedure to calculate the amount of depreciation,

Calculation of Depreciation

S.No.	Depreciation on Assets	Use of Asset	Depreciation
1.	Newly purchased asset.	Used less than 180 days or 6 months.	50% of normal depreciation.
2.	Newly purchased asset.	Used for more than 180 days or 6 months.	Normal depreciation is allowed for full year.
3.	Assets purchased in the earlier period.	Used for a minimum 1 day. for foil year.	Normal depreciation is allowed
4.	Assets purchased in the earlier period.	Not used even for a day.	No depreciation is allowed,

Method to Calculate Depreciation Under W.D.V

Particulars	Amount (`)
Opening Balance of W.D.V	xxx
Add: Purchases made during the previous year	
(including expenses if any)	xxx
	xxx
Less: Sale made during the previous year	xxx
Written down value/closing balance at the end	xxx

PROBLEMS

7. Calculate depreciation from the following information,

(i) WDV on 1 -4-2013 ` 5,00,000

(ii) Additions on 1 -6-2013 ` 5,00,000

(iii) Sale proceeds of part of it ` 2,00,000 on 1-11-2013

(iv) Rate of depreciation 25%.

Sol :

Calculating depreciation of WDV for the Assessment Year 2021-22

Block-15-(25%)

Particulars	**Amount (`)**
W.D.V on 1-4-2018	5,00,000
Add: Addition on 1-6-2018	5,00,000
	10,00,000
Less: Sale proceeds on 1-11-2018	2,00,000
	8,00,000
Less: Depreciation (W.N)	2,00,000
W.D.V on 31 -03-2018	6,00,000

Working Notes

Calculation of Depreciation

New asset is used for more than six months.

Normal depreciation is allowed

5,00,000 × 25% = 1,25,000

300,000 × 25% = 75,000

2,00,000

8. The particulars of depreciable assets of Mr. Roy for the P.Y. 2020-21 are given. Calculate depreciation for the P.Y. 2020-21.

	Assets	**WDV as on 1-4 2020 (`)**	**Additions (`)**	**Rate of Dep. (`)**
1.	Factory building	12,00,000	6,00,000 (1-2-10)	10%
2.	Plant and Machinery used in manufacturing business	30,00,000	15,00,000 (1-06-10)	15%
3.	Furniture	3,00,000	2,00,000 (31-08-10)	10%
4.	Motorcar	6,00,000	3,00,000 (31-12-10)	15%

Additional Information :

During the year 2020-21, one of the factory buildings is sold for X 20,00,000 and a part of the plant is sold for X 25,00,000. The entire furniture was sold for X 4,00,000 and out of six motor cars, two were sold for X 4,00,000. The selling expenses were X 40,000, X 20,000, X 10,000 and X 16,000 respectively.

Sol :

Calculation of Depreciation for Factory Building, Plant and Machinery, Furniture and Motor Car for the Assessment Year 2021-22.

1. Block (Factory Building with 10% Depreciation)

Particulars	Amount (`)
Opening Balance as on 1-4-2020	
Factory building	12,00,000
Add : Purchases during the year	6,00,000
	18,00,000
Less : Sale	20,00,000
Short term capital gain	2,00,000

Comment

At the end of the year, assessee is still having factory building and the sales price is more than the aggregate of opening balance and purchase. Thus, no depreciation is allowed under this block,

Short-term capital gain = X 20,00,000 – 18,00,000

= X 2,00,000 (treated as short-term capital gain)

Taxable short term capital gain = 2,00,000 – 40,000 = 1,60,000 (selling expenses)

II) Block (Plant and Machinery with 15% Depreciation)

Particulars		Amount (`)
Opening Balance as on 1-4-2020		30,00,000
Add: Purchase during the year		15,00,000
		45,00,000
Less: Sale		25,00,000
		20,00,000
Less: Depreciation (15% on 20,00,000)	3,00,000	
Additional Depreciation (20% on 15,00,000)	3,00,000	6,00,000
W.D.V (Closing Balance)		14,00,000

III) Block (Furniture with 10% Depreciation)

Particulars	Amount (`)
Opening Balance as on 1-4-2020	
Furniture	3,00,000
Add: Purchases during the year	2,00,000
	5,00,000
Less: Sale	4,00,000
	1,00,000
Add: Selling expenses	10,000
Short term capital loss	1,10,000

Note: No depreciation is allowed, as the entire block is transferred.

IV) Block (Motor Car with 15% Depreciation)

Particulars		Amount (`)
Opening Balance as on 1-4-2020		6,00,000
Add: Purchase during the year		3,00,000
		9,00,000
Less: Sale		4,00,000
		5,00,000
Less: Depreciation @ 15% on 3,00,000 = 45,000 × $\frac{1}{2}$ =	22,500	
Depreciation @ 15% on 2,00,000	30,000	52,500
		4,47,000

Total Depreciation

	Particulars	Amount (`)
1.	Factory building	Nil
2.	Plant and Machinery	6,00,000
3.	Furniture	Nil
4.	Motor car	52,500
	Total	6,52,500

4.5 Income From Profession

4.5.1 Rules – Procedure

Q22. What is the procedure for computation of income from profession ?

Ans : **(Imp.)**

Profession means all such human activities which require human skill and technical expertise. A doctor or a lawyer or an architect or a chartered accountant are the persons who, if not working with any employer, practice independently to earn their living. These include many people like beauticians, musicians, magicians, artists, etc.

Rules

They, being non-trading assesses, normally prepare their accounts under cash system (Receipts and Payments account) or under mercantile system (income and expenditure account). When they follow cash system, all receipts actually received and all payments actually made are considered with no respect to the year to which they belong. But when they are following mercantile system of accounting, only those incomes and expenses are to be taken into consideration which belong to the current / financial year.

Computation of Income from Profession

Format for computation of Income from Profession

In case of Doctor or Medical Practitioner

Particulars	`	`
Professional Receipts		
1. Fee for conducting operation xx		
2. Consulation fees	xx	
3. Visiting fees	xx	
4. Sale of medicines	xx	
5. Gifts received from patients for professional services rendered	xx	
6. Examiner's fees	xx	
7. Nursing home receipts	xx	
8. Value of any perquisite received by such person.		
9. Any other professional receipts	xx	
Total professional Receipts		xxx
Less : Professional Expenses		
1. Rent, Light, Water charges salary to staff, telephone expenses of clinic or hospital	xx	
2. Cost of medicines are determined in two ways		
a. If accounts are maintained on cash basis : Cost of actual medicines purchased during the previous year	xx	
or		
b. If accounts are maintained on mercantile basis : Opening stock + New purchases – Closing stock		

3. Depreciation on surgical equipment and X-ray Machines etc., at prescribed rates	xx	
4. Depreciation of books for professional purpose at prescribed rates.	xx	
5. Motor car Expenses: Depreciation relating to profession work.	xx	
6. Expenditure incurred to increase professional knowledge.	xx	
7. Hospital or clinic expenses.	xx	
8. Any other expenditure incurred during the year pertaining to profession.	xx	xxx
Income from profession		**xxx**

In case of Chartered Accountant

Particulars	`	`
Professional Receipts		
1. Audit fees.	xx	
2. Gain from accountancy work.	xx	
3. Institute fees	xx	
4. Examiners fees.	xx	
5. Gifts from clients	xx	
6. Consultancy services..	xx	
7. Any other professional receipt	xx	
Total Professional Receipts		xxx
Less : Professional Expenses		
1. Audit office expenditure...	xx	
2. Institute Expenses	xx	
3. Depreciation on book for professional purpose at prescribed rates.	xx	
4. Motor car expenses relating to professional work	xx	
5. Membership fees	xx	
6. Depreciation on office equipment or vehicles	xx	
7. Any other expenditure incurred to increase professional knowledge	xx	
8. Stipend to trainees	xx	
9. Subscriptions	xx	
10. Depreciation on office furniture	xx	xxx
Income from Profession		**xxx**

In case of Lawyer or an Advocate

Particulars	`	`
Professional Receipts		
1. Practicing Fees	xx	
2. Legal Fees	xx	
3. Special Commission	xx	
4. Presents from clients	xx	
5. Examiners Fees	xx	
6. Any other Professional Receipts		xx
Total Professional Receipts		xxx
Less: Professional Expenses		
1. Office Expenses		
2. Salary of staff, if any	xx	
3. Depreciation on professional books at prescribed rates	xx	
4. Depreciation of office equipment	xx	
5. Expenditure incurred to increase professional knowledge	xx	
6. Subscription	xx	
7. Purchase of stamp paper and court fees	xx	
8. Travelling Expenses	xx	xxx
Income from profession		**xxx**

4.5.2 Problems on Computation of Income from Profession

9. Dr. Sudeep submitted the following income and expenditure account for the year ending 31-3-2020. Compute the income from profession.

Expenditure	**Amount (`)**	**Income**	**Amount (`)**
To Purchase of medicines	50,000	By Consulting fees	3,05,000
To Purchase of life saving medical equipment on 1-5-2016	1,20,000	By Visiting fees	66,000
To Dispensary rent	24,000	By Sale of medicines	60,000
To Salary to nursing staff of Ltd. company	32,000	By Interest on debentures	18,000
To Telephone charges	8,000	By Pension	40,000
To Income tax	14,000	By Misc. income	290
To Subscription to journals	1,250		
To Gifts given to friends	2,000		
To Ambulance van expenses	18,500		
To House hold expenses	86,000		
To Public deposits in ‘X’ co ltd.	40,000		
To Net income	93,540		
	4,89,290		4,89,290

Additional Information:
Depreciation on Ambulance van is ` 21,000/-

Sol : **(Imp.)**

Computation of Income from Profession of Dr. Sudeep for the Assessment year 2021-22

Particulars	Amount (`)	Amount (`)
Receipts:		
Consulting Fees	3,05,000	
Visiting Fees	66,000	
Sales of Medicines	60,000	
Misc. income	290	4,31,290
Less: Payments:		
Purchase of Medicines	50,000	
Dispensary rent	24,000	
Salary to nursing staff	32,000	
Telephone charges	8,000	
Subscription to journals	1,250	
Ambulance van expenses	18,500	1,33,750
		2,97,540
Less: Deductions:		
Depreciation on ambulance van	21,000	
Depreciation on life saving medical	48,000	69,000
equipment @ 40% 1,20,000 $\times \left[1,20,000 \times \frac{40}{100}\right]$		
Income from Profession		2,28,540

Working Notes

1. **Interest on Debentures of Ltd Company**

   This income is to be shown under the head "Income from other sources".

2. **Pension**

   Pension received is salary income. Hence, it is not considered for deduction.

3. **Purchase of Life Saving Medical Equipment**

   It is a capital expenditure but depreciation on machinery will be allowed as deduction.

4. **Income Tax**

   It is a personal tax, hence it is not allowed as deduction.

5. **Gifts given to Friends and Household Expenses**

   These are personal expenditures, hence they are not allowed as deduction.

6. **Public Deposits in 'X' Co Ltd**

   Public deposits in 'X' Co Ltd is an investment.

10. Dr. Udam Singh is a Medical Practitioner. The following is the Receipts and Payments Account for the year ended 31-3-2021. Compute his Professional Income.

Recepits and Payments Account

Particulars	Amount (`)	Particulars	Amount (`)
To Opening Balance	82,000	By Dispensary expenses	42,000
To Consultancy fees	88,000	By Salary to staff	40,000
To Visiting fees	42,000	By Cost of Medicines	20,000
To Interests on Deposits	28,000	By Surgical Equipment	30,000
To Dividends	20,000	By Shares purchased	60,000
To Examiner's fees	40,000	By Printing and Stationery	6,000
To Gifts from Patients	30,000	By Telephone expenses	2,000
To Rent Received	12,000	By Life Insurance	4,000
		By Income Tax	6,000
		By Motor Car expenses	12,000
		By Driver's Salary	10,000
		By Balance C/d	1,10,000
	3,42,000		3,42,000

Other information

1. **Gifts include `12,000 received from his brothers.**
2. **Stock of Medicines on 31 -03-2018 ` 6,000**
3. **25% of motorcar used for personal purposes**
4. **Depreciate Surgical Equipment at 15%.**

Sol : **(July-19)**

Computation of Professional Income of Dr. Udam Singh Medical Practitioner for A.Y 2021-22

Particulars	Amount (`)	Amount (`)
Professional Receipts		
1. Consultancy fees		88,000
2. Visiting fees		42,000
3. Examiners fees		40,000
4. Gifts from patients		18,000
Total Receipts		**1,88,000**
Less: Professional Expenses		
Dispensary Expenses	42,000	
Salary to staff	40,000	
Cost of medicine	14,000	
Depreciation on surgical equipment	4,500	
Printing & Stationery	6,000	
Telephone Expense	2,000	
Motor Car	9,000	
Driver Salary	7,500	1,25,000
Income from profession		**63,000**

Working Notes

1. Gifts received from brothers has to be deducted from total gifts given under receipts side of the assessee.

$$= 30,000 - 12,000 = 18,000$$

2. Stock of medicine in closing stock. So deduct from cost of medicine

$$= 20,000 - 6,000 = 14,000$$

3. 25% of Motor Car is used for personal purposes and so only 75% is allowed on payment.

4. Depreciation on surgical equipment – 15%

$$= 30,000 \times \frac{15}{100}$$

$$= 4,500$$

5. Driver's salary $= 10,000 \times \frac{75}{100} = 7,500.$

11. Dr. Krishna submitted the following income and expenditure account for the year ending 31st March 2021. Compute the income from profession.

Expenditure	Amount (`)	Income	Amount (`)
To Purchase of medicines	50,000	By Consulting fees	3,05,000
To Purchase of life saving medical equipment on 01/05/2013	1,20,000	By Visiting fees	66,000
To Dispensary rent	24,000	By Sale of medicines	60,000
		By Interest on debenture	18,000
To Salary to staff of Ltd. Co.	32,000		
To Telephone charges	8,000	By Pension	40,000
To Income tax	14,000	By Misc. income	290
To Subscription to journals	1,250		
To Gifts given to friends	2,000		
To Ambulance van expenses	18,500		
To House hold expenses	86,000		
To Public deposits in X ltd.	40,000		
To Net income	93,540		
	4,89,290		4,89,290

Depreciation on Ambulance Van is ` 20,000.

Sol : **(Aug.-21, Imp.)**

Computation of Income from Profession of Dr. Krishna for the Assessment year 2021-22

Particulars	Amount (`)	Amount (`)
Receipts:		
Consulting Fees	3,05,000	
Visiting Fees	66,000	
Sales of Medicines	60,000	
Misc. income	290	4,31,290
Less: Payments:		
Purchase of Medicines	50,000	
Dispensary rent	24,000	
Salary to staff	32,000	
Telephone charges	8,000	
Subscription to journals	1,250	
Ambulance van expenses	18,500	1,33,750
		2,97,540
Less: Deductions:		
Depreciation on ambulance van	20,000	
Depreciation on life saving medical equipment	48,000	68,000
@ 40% $\left[1,20,000 \times \frac{40}{100}\right]$		
Income from Profession		2,29,540

Working Notes

1. **Interest on Debentures of Ltd Company**

   This income is to be shown under the head "Income from other sources".

2. **Pension**

   Pension received is salary income. Hence, it is not considered for deduction.

3. **Purchase of Life Saving Medical Equipment**

   It is a capital expenditure but depreciation on machinery will be allowed as deduction.

4. **Income Tax**

   It is a personal tax, hence it is not allowed as deduction.

5. **Gifts given to Friends and Household Expenses**

   These are personal expenditures, hence they are not allowed as deduction.

6. **Public Deposits in 'X' Co Ltd**

   Public deposits in 'X' Co Ltd is an investment.

12. Dr. R.K. Hegde submitted the following Income and Expenditure Account for the year ending 31st March 2021. Compute the Income from profession.

Expenses	Amount in `	Incomes	Amount in `
To Purchase of Medicines	50,000	By Consulting Fees	3,05,000
To Purchase of life saving medical equipment on 1-5-2019	1,20,000	By Visiting fees	66,000
To Dispensary rent	24,000	By Sale of Medicines	60,000
To Salary to nursing staff	32,000	By Interest on By Debentures of ltd. company	18,000
To Telephone charges	8,000	By Pension	40,000
To Income Tax	14,000	By Misc.Income	290
To Subscription tojournals	1,250		
To Gifts given to friends	2,000		
To Ambulance Van expenses	18,500		
To House hold expenses	86,000		
To Public Deposits in X Co. Ltd	40,000		
To Net Income	93,540		
	4,89,290		**4,89,290**

Depreciation on Ambulance Van is ` 20,000

Sol :

Preparing a statement to find out the Income From Profession for the assessment Year 2021-22

Particulars	Amount in `	Amount in `
Receipts		
Consultancy fees	3,05,000	
Visiting fees	66,000	
Sale of Medicines	60,000	
Misc. Income	290	4,31,290
Less: Payments		
Purchase of Medicines	50,000	
Dispensary Rent	24,000	
Salary to Nursing staff	32,000	
Telephone charges	8,000	
Subscription to journals	1,250	
Ambulance Van expenses	18,500	1 33 750
Deductions		2,97,540
Depreciation on Ambulance Van	20,000	
Depreciation on life saving medical equipment @ 40% (1,20,000 X 40%)	48,000	68,000
		2,29,450

Working Notes

1. Purchase of life saving medical equipment is capital expenditure and depreciation is allowed @ 40%.
2. Income Tax is a personal tax.
3. Gifts to friends is a personal expenditure
4. Public deposits in X Co.Ltd. is an investment.
5. Interest on debentures of Ltd. companies is income from other sources.
6. Pension received is salary income.

13. Sri Raju, a Chartered Accountant of Hyderabad, submitted the following particulars related to the previous year 2020-21. Compute the Income from profession and tax liability if income from other heads is ` 4,00,000. (including interest on bank deposits)

Receipts

Audit fee: Companies ` 3,00,000; Banking Companies ` 1,56,000; Firms ` 75,000; Others ` 81,000; Gifts from clients worth ` 22,500. Interest on bank deposits ` 3,200, Share of Income from H.U.F. ` 11,000; Financial Advices ` 1,05,000, Accountancy works ` 3,07,500.

Payments: Office rent ` 77,000; Telephone charges ` 32,000; Salaries to Staff ` 86,500, Stipend given to trainees ` 27,000; Subscription to journals ` 4,000; Car expenses ` 36,800; Electricity bill ` 17,800; Member ship fees paid to ICAI 2,500, Purchase of books ` 13,000. Purchase of computer ` 36,000.

Additional information:

(i) Depreciation on car ` 64,100.

(ii) One month rent ` 7,000 is outstanding.

(iii) Audit fee from the banks due is ` 75,000.

(iv) 25% of the car use is personal.

(v) Tax deducted at source ` 1,60,000.

Sol :

Computation of Sri Raju's Income from Profession for the assessment year 2021-22

Particulars		**Amount in `**	**Amount in `**
Receipts			
Audit fees:			
From Companies	3,00,000		
From Banking Companies	1,56,000		
From Firms	75,000		
From Others	81.000		
		6,12,000	
Financial advices		1,05,000	
Accountancy works		3,07,500	
Gifts from clients		22,500	10,47,000

Less: Payments		
Salaries to staff	86,500	
Telephone charges	32,000	
Office rent	77,000	
Stipend given to trainees	27,000	
Subscription to Journals	4,000	
Car expenses	27,600	
Electricity bill	17,800	
Membership fees	2,500	2,74,400
		7,72,600
Less: Deductions:		
Depreciation on:		
Books (13,000 X 40%)	5,200	
Car	48,075	
Computers (36,000X40%)	14,400	67,675
Income from Profession		7,04,925

Short Question and Answers

1. Business

Ans :

Business simply means any economic activity carried on for earning profits. Section 2(13) has defined the term as "any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce and manufacture". In the words of Justice S.R. Dass, "The word 'business' connotes some real, substantive and systematic or organised course, activity or conduct with a set purpose".

In this connection it is not necessary that there should be a series of transactions in a business and also it should be carried on permanently. Neither repetition nor continuity of similar transactions is necessary. As already defined under section 2(13), the income derived from any adventure in the nature of trade is also treated as business income.

2. What are the Expenses Expressly Disallowed as deduction in computing the profit of business.

Ans :

The expenses expressly disallowed as deduction in computing the profits of business are as follows,

i) Provision for doubtful/bad debts is not allowed as deduction but in case of rural branches of commercial banks, it is allowed as deduction.

ii) Provision for gratuity.

iii) Expenditure on advertisement in any souvenir, pamphlet, brochure, magazine etc., published by political party is disallowed.

iv) Personal taxes such as Income tax. Gift tax, advance payment of tax.

v) Provision for tax and arrears of income tax.

vi) Interest paid 0" borrowings from outside India.

vii) Interest royalty, technical service fees etc., paid without TDS outside India.

viii) Wealth tax.

ix) Payment of salary without TDS outside India.

x) Tax paid on prerequisites by the employers.

xi) Provision for non-compliance of TDS.

3. Deemed Profits

Ans :

Deductions allowed earlier but recovered later on [Section 41(1)].

The Finance Act 1992 has substituted the sub-section 41(0 by the following with effect from assessment year 1993-94 :

Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee (here-in-after referred to as first- mentioned persons) and subsequently during any previous year.

(a) The first mentioned person has obtained, whether in cash or in any other manner whatsoever any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by such person or value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to tax as the income of that previous year whether the business or profession in respect of which the allowance or deduction has been made, is in existence in that year or not.

(b) In case such benefit or cash is obtained by successor in business in manner whatsoever respect of which loss or expenditure was incurred by first-mentioned person the provisions mentioned in (a) above shall be applicable against such successor in business and he shall be liable to pay tax-on such deemed profit.

The words successor in business means :

(a) in case of amalgamation - the amalgamated company;

(b) in case of succession - the successor;

(c) in case a firm is succeeded by another firm, such other firm.

For the purposes of this section the expression "loss or expenditure or some benefit in respect of any such trading liability by way of remission or cessation thereof' shall include the remission or cessation of any liability by a unilateral act by the first mentioned person under clause (a) or the successor in business under clause (b) of that sub-section by way of writing off such liability in his accounts.

4. Explain the concept of valuation of cost.

Ans :

The proper and correct valuation of stock is an important factor to arrive at the correct profits of any business undertaking. Correct or actual or real profits cannot be ascertained unless a proper method is adopted for the valuation of closing and opening stocks. The Income-tax Act is silent about this factor and so no method, whatsoever, is recommended by the Income-tax Act. Hence, it is valued according to the general accounting principles. An assessee may adopt any of the following methods for valuation of closing stocks :

(i) At cost price

(ii) At market price

(iii) At cost or market price whichever is less.

They are based upon the cost or market price of the stock, whichever is less. The businessmen are free to adopt any method, but once one method is adopted, the same is to be continued from year to year and the assessee cannot change the method of valuation to suit his own purposes. It can only be changed with the prior approval of the Assessing Officer. Another point to be noted in this case is that the value of closing stock must be the value of opening stock in the succeeding year.

5. What are the differences between revenue receipts and capital receipts?

Ans :

S.No.	Capital Receipts	S.No.	Revenue Receipts
1.	It is the amount received from the sale of assets, shares and debentures.	1.	It is the amount received from the sale of goods and services.
2.	Capital receipts do not frequently occur, as they are non-recurring and irregular.	2.	Revenue receipts do not occur again and again, as they are recurring and regular.
3.	Main items of capital receipts are capital and loan, which affect financial position of the business.	3.	Main items of revenue receipts are sale of merchandise, discount and commission, which affect operating results of the business.
4.	Capital receipt is shown on the liabilities side of the balance sheet.	4.	Revenue receipt is shown on the credit side of the trading and profit and loss accounts.

6. What is depreciation?

Ans :

Depreciation is a very important item treated under the head Profit & Gains of Business or Profession. "In simple language depreciation is decrease in the value of an asset due to its wear and tear and passage of time. The Income-tax Act 1961 nowhere defines the term depreciation.

Depreciation is the process of allocating the cost of long-term asset to the time periods in which it is used in a systematic and rational manner.

7. Explain the concept of block of assets.

Ans :

The depreciation is charged on a "block of assets" system. The rates of depreciation have been provided on block of asset basis. This scheme was introduced with effect from 1-4-1987.

Block of assets [Section 2(11)]

The basis of charge of depreciation has been shifted from individual asset to block of asset. The assets have been divided into blocks on the basis of rates of depreciation prescribed under rule 5 of the income-tax Rules 1962. So, all assets having the same rate of depreciation and falling in the same nature will be put in the same block.

According to [Section 2(11)], it means a group of assets falling within a class of assets comprising:

(a) Tangible assets being building, machinery, plant;

(b) Intangible assets being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature.

8. Income from profession

Ans :

Profession means all such human activities which require human skill and technical expertise. A doctor or a lawyer or an architect or a chartered accountant are the persons who, if not working with any employer, practice independently to earn their living. These include many people like beauticians, musicians, magicians, artists, etc.

Exercise Problems

1. Profit and Loss account of Mr. Banwarlal for the year ended 31 st March 2021 'is as follows. Compute income from the business and tax liability for the assessment year 2021-22.

Partculars	Amount in `	Particulars	Amount in `
To Salaries (including		By Gross Profit @15%	2,16,000
proprietors salary 6,000)	75,000	By Commission	8,400
To Gen. Insurance Premium	4,200	By Profit on sale of	
To Bad debts	11,500	long term Investment	22,000
To Provisions for doubtful debts	5,000	By Bad debts recovered	15,000
To Rent	7,000	(allowed earlier as deduction)	
To Discount	2,460		
To Interest on loan	11,000		
To Annual licence fee	2,080		
To GST	8,000		
To Income tax	12,000		
To Interest on capital	7,500		
To Net profit	1,85,660		
	3,31,400		3,31,400

Additional Information:

1. Present rate of gross profit is 15% and earlier it was 20%.
2. The details of interest debited are: ` 6,000 for working capital; ` 2,000 for purchasing an asset; ` 3,000 is for personal loans.
3. Rent payable is ` 750 p.m. and prepaid insurance is ` 1,200.
4. Assessee is unwilling to claim ` 4,800. Telephone charges and ` 5,100 for depreciation on the business assets.
5. A sale of ` 40,000 is not recorded in the books.
6. For achieving the sales target one of the distributor presented a T. V. set worth ` 17,000.
7. Salary to employees is paid through bank except for watchman, whose monthly salary is ` 2,000 is paid in cash.

(Ans: ` 2,16, 260)

2. Sri Kamal Kishore is the proprietor of the business. His Proht and Loss account for the year ended 31 st March 2021 is as follows:

Profit and Loss Account

Particulars	Amount in `	Partiulars in `	Amount
To Establisment Expenses	84,000	By Gross Profit	5,71,840
To Rent, Rates and Taxes	32,900	By Interest on securities	
To General charges	1,000	(Net) (Tax deducted	
To Repairs and renewals	4,500	at source is 1,050)	5,200
To Loss on sale of land		(securities are part	
(used for business purpose)	31,800	of stock)	
To Life Insurance Premium	11,800	By Rent from	
To Pilgrimage expenses	3,750	House Property	22,960
To Pooja expenses in the shop	800		
To Security Transaction Tax	2300		
To Interest on bank loan	8,140		
To Profession tax	1350		
To Gen.insurance premium	1350		
To Advertising	30,000		
To Guest house expenses	24,000		
To Law Charges	450		
To Postage and Telegrams	250		
To Discount allowed	1,850		
To House hold expenses	16300		
To Provision for warranty on			
goods sold	1,500		
To Provision for Bad debts	1300		
To Gifts and Presents	3,300		
To Interest on capital	1,950		
To Provision for Depreciation	27,300		
To Provision for Income tax	4,000		
To Net Profit	3,04,510		
	6,00,000		16,00,000

Following further information is given:

1. Mr. Suresh is a trade debtor for ` 6,500 (for last 2 years) and it is decided to write it off as bad debt, but Income Tax Assessing Officer is objecting to it.
2. Amount of Income tax actually paid during the year is ` 4,200
3. Depreciation allowable is ` 30,000 as per I.T. Rules
4. Advertising expenses include ` 5,000 spent on special advertising campaign to expand the business in the new markets.
5. Shri. Kamal kishore carries on his business from rented premises, half of which is used as his residence Rent, rates and tax include ` 24,000 paid as rent of the premises during the year.
6. During the year a cash purchase of goods for ` 42,000 is settled through credit card.

Compute the Business Income of Mr. Kamal Kishore for the Current Assessment year.

(Ans: ` 3,56,000)

3. From the following Profit and Loss Account of Sri. Vidyanand cycle manufacturer and also a dealer for sale of lottery business, compute the Income under the head "Profits and Gains of Business or Profession" for the year ending on 31 st March 2021.

Profit and Loss Account

Particulars	Amount in `	Particulars	Amount in `
To Salaries to employees	26,000	By Gross profit	1,95,800
To Advertising expenses	7,000	By Interest on securities	10,000
To General expenses	4,000	By Income from house property	12,000
To Entertainment expenses	15,000	By Bad debts recovered	
To Bad debts	1,000	(allowed earlier)	5,200
To Drawings	8,000	By sale of buildings	1,52,000
To Goods and Services tax	2,000	By Winning from lottery	40,000
To Interest on capital	2,000	(Part of the business activity)	
To Repairs	1,000	By Compensation received	
To Patents acquired	28,000	from an employee for leaving	
To Legal expenses	8,000	the job without advance	
To Income Tax	4,500	notice	5,000
To Bonus	4,000		
To Bonus to the proprietor	4,000		
To Computer purchased (Hardware)	76,000		
To Computer expenses (Software)	8,.000		
To Printer for computer	12,000		
To Donations	5,000		
To Printing and stationery	2,000		

To Postage and Telegrams	500		
To Telephone	2,800		
To Provision for bad debts	4,000		
To Fire Insurance for Premium			
for goods	1,000		
To Contribution to Scientific			
Research to Delhi University	10,000		
To Interest on loan	7,000		
To Apprentices training expenses	12,000		
To Net Profit	1,65,200		
	4,20,000		4,20,000

From the examination of books of accounts the following other information is available.

1. Out ofadvenisemen; expenses ` 1,500 were spent on neon sign boards.
2 ` 1.000 ere spent on purchase of land are included in legal expenses.
3. Half of the repair expenses were on let out building.
4. Mr. Vidyanand is having enough money, inspite of that he took a loan with interest
5. During the inspection of the books it is found that investments purchased 4 years ago is understated by ` 70,000.
6. During the previous year ` 5,000 is advanced to purchase the raw materials to a supplier, who is absconding from the country.

(Ans: ` 1,28,200)

Choose the Correct Answer

1. Under the head Business or Profession, the method of accounting which an assessee can follow shall be : [c]
   (a) Mercantile system only (b) Cash system only
   (c) Mercantile or cash system only (d) Hybrid system
2. Business is included as per IT Act u/s [a]
   (a) 2(13) (b) 2(14)
   (c) 2(15) (d) None
3. A car is imported after 1- 4- 2005 by R Ltd. from London to be used by its employee. R Ltd. shall be allowed depreciation on such car at: [c]
   (a) 15% (b) 40%
   (c) Nil (d) 50%
4. Unabsorbed depreciation which could not be set off in the same assessment year, can be carried forward for: [b]
   (a) 8 Years (b) Indefinitely
   (c) 4 Years (d) None
5. Certain revenue and capital expenditure on scientific research are allowed as deduction in the previous year of commencement of business even if these are incurred: [b]
   (a) Five years immediately before the commencement of business
   (b) 3 years immediately before the commencement of the business
   (c) Any time prior to the commencement of the business
   (d) None
6. As per IT Act profession is defined U/s [c]
   (a) 2 (33) (b) 2(35)
   (c) 2(36) (d) None
7. Preliminary expenses incurred are allowed deduction in: [a]
   (a) 10 equal installments (b) 5 equal installments
   (c) full (d) None
8. In case the assessee follows mercantile system of accounting, bonus or commission to the employee are allowed as deduction on: [c]
   (a) Due basis (b) Payment basis
   (c) Due basis but subject to section 43B (d) None
9. Interest on money borrowed for the purpose of acquiring a capital asset pertaining to the period after the asset is put to use is to be: [b]
   (a) Capitalized (b) Treated as revenue expenditure
   (c) Both (a) and (b) (d) None
10. Expenditure incurred on purchase of animals to be used by the assessee for the purpose of carrying on his business & profession is subject to [b]
    (a) Depreciation
    (b) Deduction in the previous year in which animal dies or become permanently useless
    (c) Nil deduction
    (d) None

Fill in the blanks

1. A person spends the major portion of time and generating Income is known as ________ .
2. A firm business income is nil /negative. It shall still be allowed as deduction on account of remuneration to working partner to the maximum extent of ________ .
3. For person carrying on profession, tax audit is compulsory, if the gross receipts of the previous year exceeds: ________ .
4. Tax audit is compulsory in case a person is carrying on business whose gross turnover/sales/receipts, as the case may be, exceeds ________ .
5. In case an assessee in engaged in the business of civil construction, presumptive income scheme is applicable if the gross receipts paid or payable to him in the previous year does not exceed: ________
6. In the aforesaid case ,the income shall be presumed to be : ________ .
7. The maximum cash amount as expenditure is allowed ________ .
8. Bad debts is treated as ________ .
9. Depreciation is allowed up to on Furniture and fittings is ________ .
10. Gifts from clients is treated as ________ .

Answers

1. Vocation
2. Nil
3. Rs.10 lakhs
4. Rs. 40 lakhs
5. Rs. 40 lakhs
6. 8% of gross receipts
7. Rs. 20,000
8. Admissible expenses
9. 10%
10. Professional Income

UNIT V	**CAPITAL GAINS AND INCOME FROM OTHER SOURCES :** Introduction - Meaning – Scope of charge – Basis of charge – Short term and Long term Capital Assets – Transfer of Capital Asset – Deemed Transfer –Determination of Cost of Acquisition – Procedure for computation of Long-term and Short-term Capital Gains/Losses – Exemptions in respect of certain Capital Gains u/s. 54 – Problems on computation of capital gains - General Incomes u/s. 56(1) – Specific Incomes u/s. 56(2) – Dividends u/s. 2(22) – Winnings from lotteries Puzzles, crown world puzzles, Races – Interest on Securities – Gifts received by an Individual – Casual Income – Family Pension – Rent received on let out of Furniture- Plant and Machinery with/without Building – Deductions u/s. 57. (Theory only)

5.1 Capital Gains

5.1.1 Introduction, Meaning

Q1. Define Capital Gain. Explain different types of Capital Gains.

Ans : **(Imp.)**

Capital Gain arising on transfer of capital asset is charged to tax under the head "Capital Gains". Income from capital gains is classified as "Short Term Capital Gains" and "Long Term Capital Gains". In this part you can gain knowledge about the provisions relating to tax on Long Term Capital Gains.

Tax planning assumes a special role in the sale of capital assets. An income tax payer who knows the various provisions of Income Tax Law which go to reduce the incidence of income tax in relation to capital gains on the sale or otherwise transfer of a capital asset, would stand to benefit immensely. The duration of holding a capital asset and the various expenses and other deductions to be claimed for arriving at the final quantum of taxable capital gains have a direct bearing on the incidence of income tax in relation to the capital gains in respect of transfer of the capital assets. There are certain transactions which are not regarded as "transfer" and these are outside the orbit of capital gains tax

Meaning

Capital Asset the tax is to be levied on any profit or gain occurring on the transfer of a capital asset. Section 2(14) defines capital assets as :

(a) Property of any kind held by an assessee whether or not connected with his business or profession;

(b) Any security held by a Foreign Institutions Investor which has invested in such security in accordance with the regulations made under SEBI Act: 1992.

Deposit certificates issued under Gold Monetization Scheme, 2016 shall not be treated as a capital asset [w.e.f. A.Y. 2016-17].

Types

I. Short-Term Capital Asset

According to u/s 2(42A), any asset which is held by the assesses for a period not exceeding 3 years or 36 months then it is considered as short term capital asset. However, some of the assets can be treated as short-term capital assets, if they are held for not more than 12 months. They are listed below,

(a) A security including shares listed in a recognized stock exchange in India.

(b) A unit of an equity oriented fund.

(c) A zero coupon bond.

However, following assets can be treated as short-term capital assets, if they are held for not more than 24 months,

(i) An immovable property that can be land or building.

(ii) Unlisted shares of companies.

II. Long-Term Capital Asset

According to u/s 2(29A), if an asset is held by the assessee for more than 3 years or 36 months, then it is considered as long term capital asset. Similarly for equity and preference shares, should be held by the assessee for more than (12 months) a year.

III. Assets Exempted from Capital Assets

According to Section 2(14), the following assets are not considered as capital assets,

1. Stock-in-trade, consumable stores or raw material stored for profession or business.
2. Assets used by the assessee or his family members like TV, motor car, furniture, refrigerator etc. for personal use.
3. Agricultural land in India except urban agricultural land.
4. Gold deposit bonds issued in Gold deposit scheme 1999 from 1-4-2000.
5. (i) National defence Gold bonds 1980.
   (ii) 7% of gold bonds 1980.
   (iii) 6y% of gold bonds 1977.
6. Special bearer bonds 1991.
7. Deposit certificates issued under gold monetization scheme, 2015.

5.1.2 Scope of Charge

Q2. Explain the Scope of charge in capital gains.

Ans : **(Imp.)**

Under Section 2(14) following assets have been ‘specially excluded from the scope of the definition of capital assets :

(i) Any stock-in-trade, raw materials, consumable stores held by any assessee for the purposes of his business or profession.

(ii) Personal effects (movable property) including wearing apparel, motor car, electrical appliances, refrigerator, furniture etc.; ornaments excluding jewellery, archaeological collections, drawings, paintings, sculptures, or any work of art held for personal use by the assessee or any other member of his family dependent upon him.

(iii) Agricultural Land in rural India - But the land should not be situated

(a) Within the limits of any municipality or cantonment board having a population of 10,000 or more or

(b) Within distance measured aerially (shortest aerial distance) from any municipality or cantonment board as follows :

Distance	Population
Within 2 kilometers	10,001 – 1,00,000
Within 6 kilometers	1,00,001 – 10,00,000
Within 8 kilometers	More than 10,00,000

(iv) 6.½ % Gold Bonds 1977 or 7% Gold Bonds 1980 or National Defence Gold Bonds, 1980 issued by the Central Government.

(v) Special Bearer Bonds, 1991.

(vi) Gold Deposit Bonds issued under Gold Deposit Scheme 1999.

(vii) Deposit certificates issued under Gold Monetization Scheme, 2015. [w.e.f. A.Y. 2016-17].

5.1.3 Basis of Charge

Q3. What is Basis of Charge ?

Ans :

U/s 45(1) any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in section 54, be chargeable to income-tax under the head ‘capital gains’ and shall be deemed to be the income of the previous year in which the transfer took place unless such capital gains are exempt under sections 54, 54B, 54D, 54EC, 54F, 54G, 54GA and 54GB.

The above definition can be split up into two parts :

(a) Income arising from the transfer of a capital asset

(b) Effected in the previous year.

5.2 Short Term and Long Term Capital Assets

Q4. Write a brief note on :

(a) Short Term Capital Assets

(b) Long Term Capital Assets

Ans :

(a) Short Term Capital Assets

Short-term capital assets [Section 2 (42A)]. Short-term capital asset is that which is held by an assessee for not more than 36 months immediately preceding the date of its transfer.

But following assets shall be treated as short term capital assets if these assets are held by its owner (before transfer) for not more than 12 months.

(i) a security and shares of companies listed in a recognized Stock Exchange in India.

(ii) a unit of an equity oriented fund.

(iii) a zero coupon bonds.

Following assets shall be treated as short term capital assets if such assets are held by its owner (before transfer) for not more than 24 months.

(i) Unlisted shares of companies

(ii) An immovable property being land and building or both.

Any gain or loss accruing to the assessee on such assets shall be known as short-term capital gain or loss. [2(42B)].

(ii) Long-term Capital Assets [Section 2(29A)]

Assets which do not fall within the definition given in section 2(42A), i.e., the assets which are held by the assessee for a period exceeding 36/24 months 12 months as the case may be, months immediately preceding the date of their transfer, are called 'long-term capital assets'.

Any gain or loss accruing on such assets shall be known as long-term capital gain or loss. [2(42B)].

5.3 Transfer of Capital Asset

Q5. Explain in detail about Transfer of Capital Asset.

Ans : **(Imp.)**

According to u/s 2(47) of Income Tax Act, 1961, the term transfer of capital assets refers to change of ownership. It can be done by adopting any of the following ways,

1. Sale

If an asset is sold, then ownership will be automatically transferred to the buyer.

2. Exchange

Exchange takes place with the mutual transfer of ownership of one item with the other item.

3. Relinquishment

It refers to voluntarily surrendering of ownership in favour of another person.

4. Extinguishment

It means, the right of ownership comes to an end by operation of the law.

5. Compulsory Acquisition

If an asset of assessee is acquired by government in the public interest, such acquisition is known as compulsory acquisition.

6. Others

(i) Conversion of capital asset into stock in trade.

(ii) By an agreement, if possession is transferred without any consideration, then also such transaction is considered as transfer.

(iii) Transfer of share in cooperative society as a result of which transfer of immovable property takes place.

(iv) Maturity or redemption of a zero coupon bond.

5.4 Deemed Transfer

Q6. Discuss in detail about Deemed Transfer.

Ans : **(Imp.)**

When a person converts his capital asset into stock in trade, it is deemed as transfer, difference between cost price and price at which converted into stock in-trade is capital gain [With effect from 1-4-1984]

(i) Transfer of Asset by a Person to a Firm, AOP or BOI

When a person transfers his capital asset to a firm, AOP or BOI (body of individuals) and it is treated as his capital, it is deemed as its transfer. The difference between the price recorded in the books of Firm, AOP or BOI and cost shall be treated as capital gain.

(ii) Transfer of Asset by a Firm, AOP or BOI to a Person

It also amounts to transfer. The price recorded in the books of firm AOP, BOI is its cost and market value on the date of transfer is its sale price.

(iii) Compulsory Acquisition of Asset

Additional compensation received is deemed as income of the year in which it is received and not the year in which asset was taken over. With effect from 1.4.2004 in case asset is taken over under compulsory acquisition and assessment has been made on the basis of original compensation or enhanced compensation and later on such compensation is reduced by any authority, the assessment shall be rectified by taking the reduced compensation.

(iv) Re-purchase of Units acquired under Section 80 CCB

Amount invested in such units is fully taxable under the head 'Other Sources' but excess of amount realized over principal amount is capital gain. Provisions of section. 48 (indexing) are not applicable in this case.

(v) Capital Gain on Purchase by a company of its own shares or other securities [Section 46A]

In case of buy back of shares and securities by a company, the capital gain shall be computed by adducting indexed cost (U/S 48) of such shares and securities out of consideration received by the assessee from such company.

Q7. Which transfer is not recognized as transfer ? Explain.

Ans :

Under Section 47, the following transactions are not regarded as transfers. Hence, any gain arising from such transactions is also not taxable under the head 'Capital Gains'.

(i) Any distribution of capital asset on the total or partial partition of Hindu Undivided Family.

(ii) Any transfer of assets under a gift or will or an irrevocable trust.

(iii) Any transfer of capital assets by a company to its subsidiary company

(iv) Any transfer of capital assets by a subsidiary company to the holding company.

(v) Any transfer in a scheme of amalgamation of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company

(vi) Any transfer by a shareholder in a scheme of amalgamation of share or shares held by him in the amalgamating company

(vii) Any transfer of agricultural land in India affected before 1st March, 1970.

(viii) Any transfer of a capital asset, being any work of art, archaeological, scientific or art collection, book, manuscript drawing, painting photograph or print to the Government, or a University, or the National Museum, National Art Gallery, National Archives or any such other public museum, or institution as may be notified by the Central

Government in Official Gazette to be of national importance or to be of renown throughout any State or States.

(ix) Any transfer made on or before the 31st day of December 1998 by a person (not being a company) of a capital asset being membership of a stock exchange of a recognized stock exchange to a company in exchange of shares allotted by that company to the transfer. These shares cannot be transferred for 3 years.

(x) Any transfer of a capital asset, being land of a sick industrial company, under a scheme prepared and sanctioned under section 18 of the Sick Industrial Companies (Special Provisions) Act 1985 (1 of 1986) where such industrial company is being managed by its workers' cooperative

(xi) When any capital or intangible asset owned by a firm is transferred to a company which has succeeded the firm, it shall not be regarded as transfer

(xii) When any capital or intangible asset owned by a sole proprietary concern is transferred to a company which has succeeded the sole proprietary concern, it shall not be regarded as transfer if :

(a) All the assets and liabilities of the sole proprietary concern existing on the date of succession are taken over by the company,

(b) Shareholding of the sole proprietor in the company is not less than 50% of voting power on the date of succession and remains so for 5 succeeding years, and

(c) The sole proprietor does not receive any other benefit except allotment of shares in such company.

(xiii) In case there is transfer due to lending of securities by its holder under an agreement with the borrower and as per guidelines issued by Securities Exchange Board of India, or by R.B.I. it shall not be deemed as transfer.

(xiv) Any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by Central Government.

(xv) Any transfer of a capital asset, being share of a 'special purpose vehicle' to a business trust in exchange of units allotted by that trust to the transferor.

(xvi) Any transfer by a unit holder of a capital asset, being a unit or units, held by him in the consolidating a mutual fund, made in consideration of the allotment to him of a capital asset, being a unit or unconsolidated scheme of the mutual fund.

(xvii) Any redemption of Sovereign Gold Bonds by an individual shall not be treated as transfer and therefore shall be exempt from tax on capital gains.

5.5 Determination of Cost of Acquisition

Q8. Explain about cost of Acquisition.

Ans : **(Imp.)**

Actual Cost of Acquisition

Actual Cost of acquisition refers to the value at which the capital asset is acquired by the assessee. It also includes the expenses incurred for acquiring the asset. For example, interest paid on loan borrowed for the purchase of capital asset would constitute part of the actual cost. Legal expenses incurred in curing the defect in the title of the property are of capital nature and hence to be included in the cost of acquisition.

Cost of acquisition

Cost of acquisition means total of all the expenses incurred by the assessee for acquiring the asset i.e., purchase price and expenses incurred after purchase till its first use e.g. installation charges etc.

If the cost of the asset cannot be ascertained for some valid reasons the Fair Market Value is taken as cost of acquisition.

If the assessee has constructed or manufactured the asset then all expenses incurred by him on its construction or manufacture will be taken as cost of acquisition.

If the asset is purchased before 1-4-2001 then the cost of acquisition is higher of the following two amounts:-

(a) Actual cost,

(b) Fair Market Value on 1-4-2001.

The benefit is not allowed for (i) depreciable assets i.e. assets used in the business or profession like building and machinery and eligible for claiming depreciation. (ii) Intangible assets : Goodwill, tenancy rights, route permit licence, loom hours.

Indexed cost of acquisition

Indexed cost of acquisition means showing inflated or increased cost price instead of actual price. The increase is justified on account of inflation. The net result of indexed cost of acquisition is reduction in tax liability.

The increase in cost of acquisition is known as indexed cost of acquisition. This benefit is also permitted for the cost of improvement. The benefit of indexation is allowed **only for long term capital asset** i.e. in no case such benefit is allowed for short term capital asset.

The above said rule does not apply to :

1. Shares of debentures acquired by non residents in Indian companies in foreign currency.
2. Depreciable assets.
3. In case of Debentures and Bonds indexed cost of acquisition is not to be calculated i.e., the benefit of cost inflation index will not be available to the assessee.
4. Slump sale u/s 50B
5. Short term capital assets

But in other cases there are different rules to determine the cost of acquisition.

Q9. How do you determined the cost of Acquisition for various situations? Explain.

Ans : **(Imp.)**

- If assessee has purchased the capital asset, its purchase price should taken as the cost of acquisition.
- If the capital asset is acquired by the assessee under gift or will, the cost to the previous owner will be taken as the cost of acquisition of such capital asset.
- If the assessee acquires the capital asset before 1.4.81, Actual cost of the capital asset or Fair market value of the capital asset as on 1.4.81, which ever is higher, will be the cost of acquisition.
- Any advance money received and forfeited (retained) by the assessee, such amount , shall be deducted from the cost of acquisition, (if the advance money forfeited exceeds the cost of acquisition of the capital asset, such excess cannot be taxed as capital gain because there is no transfer of capital asset).

1. In case of assets acquired without paying any price [49 (1)]

Where the asset has become the property of the assessee in any of the ways enumerated below, the cost of acquisition shall be deemed to be the cost at which previous owner had acquired the same plus cost of any improvement by the said previous owner and after deducing depreciation allowed by him. These cases are:

(i) Any division of assets by H.U.F. among its members on its partial or total partition;

(ii) Assets received under a gift or will;

(iii) Assets received under succession, inheritance or devolution

(iv) Any transfer of asset by an individual into the common pool of H.U.F. - the cost to H.U.F. will be the cost borne by individual.

2. Shares in amalgamated company [49 (2)]

In case of amalgamation of a company into an Indian company the cost of acquisition of shares of amalgamated company shall be taken to be the cost of acquisition to him of the shares of the amalgamating company.

3. Cost of Acquisition in Shares and Debentures

The cost of shares received on conversion of debentures, deposit certificates or debenture stock shall be the cost at which original asset was acquired [Section 49(2A)].

4. Cost of Acquisition of Specified Security or Sweat Equity Shares [Section 49(2AA)]

With effect from assessment year 2010-11, where the capital gain arises from the transfer of specified security or sweat equity shares referred to in Section 17(2)(vi), the cost of acquisition of such security or shares shall be the fair market value which has been taken into account for the purposes of Section 17(2)(vi).

5. Cost of shares of resulting company [Section 49(2C)]

The cost of acquisition of shares of resulting company as a result of merger shall be :

$$\begin{bmatrix}\text{Cost of acquisition of shares held by the} \\ \text{assessee in the demerged company}\end{bmatrix} \times \frac{\text{Net book value of assets transferred}}{\text{Net worth of demerged company before demerger}}$$

6. Cost of original shares of demerged company [Section 49(2D)]

The cost of original shares held by assessee in the demerged company shall be deemed to have been reduced by the amount so arrived at u/s 49(2C)].

7. Cost on conversion of capital assets into trading assets or stock-in-trade

When a capital asset is converted into a trading asset then the cost of the capital asset which is so converted into stock-in-trade of assessee's business may be taken as the market value of those assets on the date of such conversion.

8. Succession of a private company or unlisted public company by a limited liability partnership

In case of a private company or unlisted public company is converted into Limited Liability Partnership (LLP), the cost of acquisition of such a LLP shall be the cost for which the predecessor company acquired the same.

9. Cost in case of deemed capital gain u/s 47 A [Section 49 (3)]

Where the capital gain arising from the transfer of a capital asset is deemed to be income chargeable under the head capital gains as a result of operation of provisions of section 47A, the cost of acquisition of such asset to the transferee company shall be the cost for which such asset was acquired by it.

10. Assets on which depreciation has been claimed [Section 50],

In case assets are sold during the previous year and some gain occurs, this capital gain is taxable under this head. Section 50 of the Income-tax Act provides the procedure for calculation of deemed capital gain/loss in case of depreciable assets.

11. Taxation of gain on slump sale

The term **'slump sale'** has been defined u/s 2(42C) and it means "transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets."

If values are assigned to some assets only for the purpose of stamp duty and registration, it shall not be regarded as assignment of values to each asset.

In simple words 'slump sale' means sale of running concern for a lump sum consideration. For computing capital gains in case of 'slump sale' the term W.D.V. has been defined under section 43(1)(6)(c)(i)(C). The W.D.V. of any block of assets shall be decreased by the amount of actual cost as reduced by the amount of depreciation actually allowed.

12. Special provision for full value of consideration in certain cases [Section 50C]

If the consideration for transfer of land **or** building **or** both is less than the value adopted or assessed **or** assessable by the authority of the State Govt., for registration of deed for the purpose of stamp duty, the value adopted or assessed or assessable by such authority shall be deemed as full consideration.

i) Where the date of agreement fixing the value of consideration and the date of registration of immovable property are not same then the stamp duty value may be taken as on the date of the agreement for transfer and not as on the date of registration for such transfer if the amount of consideration or a part thereof has been received by an account payee cheque or draft or by the use of Electronic Clearing System to a bank account on or before the date of agreement for such transfer.

ii) If the assessee claims that the value adopted or assessed or assessable by such authority is more than fair market value and such value has not been disputed in any appeal or no reference has been made to a court or the High Court, the Assessing Officer may refer it to the Valuation Officer to fix its value.

iii) If the value adopted or assessed or assessable by the Valuation Officer is more than the value fixed by the authority as per (1) above, the value fixed as per (1) above shall be taken as full consideration.

Fair Market Value of a capital asset to be the full value of consideration in certain cases: [Section 50D] [w.e.f. A.Y. 2013-14]

Where the consideration received **or** accruing as a result of the transfer of a capital asset by an assessee is not ascertainable **or** cannot be determined, then, for the purpose of calculating income under the head capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

13. Treatment of advance money received and forfeited during P.Y. 2013-14 or before [Applicable upto A.Y. 2014-15] [Section 51]

i) In case an asset was subject to negotiations for transfer and a deal was made.

ii) The deal was firmed up by receiving some amount as advance.

iii) Such advance was received by the assessee [present seller] and not by any previous owner.

iv) The cost of such asset shall be reduced by such advance money received and forfeited by the assessee. In case FMV on 1-4-1981 is adopted and advance money is received either before or after this date and is forfeited, it shall be reduced out of the F.M.V.

$$\begin{bmatrix}\text{Cost of acquisition for assessee}\\ \text{forfeiting advance money}\end{bmatrix} = \begin{bmatrix}\text{Cost of acquisition or}\\ \text{W.D.V. or F.M.V.}\\ \text{as on 1-4-2001}\end{bmatrix} - \begin{bmatrix}\text{Advance money}\\ \text{received and forfeited}\end{bmatrix}$$

v) In case advance money received and forfeited is more than cost of acquisition of such asset, nothing shall be taxable at the time of receipt. As and when such asset is sold, the excess of amount received and forfeited over cost of acquisition shall be assessed to tax as capital gain.

vi) If the amount of advance money is forfeited due to fault of buyer, it shall not be treated as capital loss in the hands of buyer but if advance money is received along with additional compensation due to the fault of seller, additional compensation received from seller shall be treated as capital gain in the hands of buyer.

Treatment of advance money received and forfeited during P.Y. 2014-15 or after wards [w.e.f. A.Y. 2015-16] [Provision to Section 51]

W.e.f. A Y. 2015-16, any sum of money received as an advance or otherwise in the course of negotiation for transfer of a capital asset and forfeited due to non transfer of such capital asset shall be treated as income U/H 'Income from other source and it is taxable in the hands of the recipient of advance money in the year in which advance received has been forfeited [Section 56(2) (ix)].

14. Cost of acquisition of goodwill [Section 55 (2) (a)]

In case goodwill was purchased, the cost shall be the price paid but in case it was not purchased the cost is taken as NIL.

The Finance Act 1994 has amended the above provision in following manner :

(a) In case the capital asset is goodwill, tenancy rights, stage carriage permits or loom hours the cost of acquisition will be :

   (i) Purchase price, if such asset was purchased ; and

   (ii) NIL in all other cases except those covered u/s 49 (1) (1) to (iv).

15. Adoption of fair market value [Section 55(2)(b) and (c)].

(i) Where the asset became the property of the assessee before 1st April 2001, it will mean the cost of acquisition of the asset to the assessee or the fair market value of the asset on 1st April 2001, at the option of the assessee. Assessee should adopt whichever of the two is higher.

(ii) Where the capital asset becomes the property of the assessee under any of the modes given in section 49, the assessee is given the option to adopt, "either the cost of the asset to the previous owner or its fair market value as on 1-4-2001, whichever is higher.

16. Cost of acquisition of shares [Section 55 (2) (v)]

When an assessee acquires capital asset in the form of shares or stock of a company on :

(a) Consolidation and division of the share capital of the company into shares of large denomination than its existing shares.

(b) Conversion of any shares into stock,

(c) Reconversion of any stock into shares,

(d) Sub-division of any of the shares of the company into shares of smaller amount, or

(e) Conversion of one kind of shares into another kind.

The cost of acquisition if these cases means the cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset has been derived.

17. Investment in debentures / bonds and then conversion intoshares

In case the amount invested in debentures or bonds is converted into shares either fully or partly, no capital gain arises because conversion of debentures into shares is not treated as 'transfer'. Capital gain (Long term/Short term) shall arise only when the converted shares are further sold or transferred.

18. When cost cannot be ascertained [Section 55 (3)]

Where the cost of particular asset, for which the previous owner had acquired the asset, cannot be ascertained, the cost of acquisition to the owner means the fair market value of the asset on the date on which it becomes the property of such owner.

5.5.1 Procedure for Computation of Long-term and Short-term Capital Gains/Losses

Q10. Write in detail about Procedure for computation of Long-term and Short-term Capital Gains?

(OR)

Explain the method of computing the income under capital gains.

Ans : **(Imp.)**

(i) Long-Term Capital Gain (LTCG)

As per Sec. 2 (29B), any capital gain arising from the transfer of a long-term capital asset is referred as long-term capital gain. It will be taxed at 20% flat rate (plus health and education cess and surcharge).

The capital gain shall be the excess of the full value of consideration over the aggregate of following,

(a) Expenses of transfer

(b) Indexed cost of acquisition of asset

(c) Indexed cost of improvement.

Procedure for Computation of Long-Term Capital Gain/Loss

The following discussion depicts the procedure for computation of long-term capital gain. They are,

Step-1:

Find out the full value of the consideration.

Step-2:

From the value of consideration deduct the following,

(a) Expenditure on transfer.

(b) Indexed cost of acquisition.

(c) Indexed cost of improvement.

Step-3:

From the obtained amount deduct the exemption provided by sections 54, 54B, 54D, 54EC, 54EE, 54F, 54G, 54 GA and 54 GB. Thus, the obtained amount is long-term capital gain.

Format for Calculating the Long-Term Capital Gain

Particulars	Amount (`)	Amount (`)
Full value of consideration	xxx	
Less: Expenses on Transfer	xxx	
Net Consideration		xxx
Less: (i) Indexed cost of acquisition	xxx	
(ii) Indexed cost of improvement	xxx	xxx
Long-term Capital Gain/Loss		xxx

(ii) Short-Term Capital Gain (STCG)

As per Sec. 2 (42B), any capital gain arising from the transfer of a short-term capital asset is referred as short-term capital gain. It is taxed on slab basis and it is included in the total income under income from other heads. For example, income from house property, income from salary etc.

It is the excess of the full value of consideration over the aggregate of following,

(a) Cost of improvement

(b) Expenses of transfer

(c) Cost of acquisition of the asset.

Procedure for Computation of Short-Term Capital Gain/Loss

The following discussion depicts the procedure for computation of short-term capital gain,

Step-1:

Find out the full value of consideration.

Step-2:

From the value of consideration deduct the following,

(a) Expenditure on transfer

(b) Cost of Acquisition

(c) Cost of Improvement

Step-3:

From the net consideration amount deduct the exemption provided by sections 54B, 54D, 54G and 54GA. Thus, the obtained amount is the short-term capital gain.

Format for Computation of Short-Term Capital Gain

Particulars	**Amount (`)**	**Amount (`)**
Full value of consideration		xxx
Less: Expenses on Transfer		xxx
Net Consideration		xxx
Less: (i) Cost of Acquisition	xxx	
(ii) Cost of Improvement	xxx	xxx
Short-term Capital Gain/Loss		xxx

Q11. Explain briefly the concept of cost of inflation index.

Ans :

As per provisions of section 48 the cost of an asset is to be inflated by Cost Inflation Index [CII] to be notified in respect of each previous year separately. The CII and the manner in which cost is to be inflated are given below :

Cost Inflation Index

S.No.	Financial Year	C.I.I
1.	2001-2002	100
2.	2002-2003	105
3.	2003-2004	109
4.	2004-2005	113
5.	2005-2006	117
6.	2006-2007	122
7.	2007-2008	129
8.	2008-2009	137
9.	2009-2010	148
10.	2010-2011	167
11.	2011-2012	184
12.	2012-2013	200
13.	2013-2014	220
14.	2014-2015	240
15.	2015-2016	254
16.	2016-2017	264
17.	2017-2018	272
18.	2018-2019	280
19.	2019-2020	289
20.	2020-2021	301

Manner of Indexing at a Glance [Section 48 (III)]

S.No.	Situation	Indexing
1.	Long term capital assets acquired before 1-4-2001	Actual cost or FMV on 1-4-2001 (whichever is more) $\times \dfrac{\text{C.I.I of the year of transfer}}{\text{C.I.I. of 2001-02 i.e., 100}}$
2.	Long term capital assets acquired on or after 1-4-2001	Actual cost $\times \dfrac{\text{C.I.L of the year of transfer}}{\text{C.I.L of the year of purchase}}$
3.	Cost of improvement incurred after 1-4-2001	Cost of improvement $\times \dfrac{\text{C.I.I. of the year of transfer}}{\text{C.I.I. of the year of improvement}}$
4.	Long term capital asset acquired by present seller under section 49(i) after 1-4-2001 but was acquired by previous owner before 1-4-2001	Actual cost or FMV on 1-4-2001 (whichever is more) $\times \dfrac{\text{C.I.I of the year of transfer}}{\text{C.I.L of the year in which present seller became is owner}}$

Q12. What are the various exemptions available under the head capital gains.

(OR)

What are the capital gain exempted u/s 10?

Ans :

1. **Income from sale of shares in certain cases [Section 10(36)]**

Any income arising from the transfer of a long-term capital asset, being an eligible equity share in a company purchased on or after the 1st day of March, 2003 and before the 1st day of March 2004 and held for a period of twelve months or more.

For the purposes of this clause, "eligible equity share" means

(i) any equity share in a company being a constituent of BSE-500 Index of the Stock Exchange, Mumbai as on the 1st of March, 2003 and the transactions of purchase and sale of such equity share are entered into on a recognized stock exchange in India;

(ii) any equity share, in a company allotted through a public issue on or after the 1st day of March, 2003 and listed in a recognized stock exchange in India before the 1st day of March, 2004 and the transaction of sale of such share is entered into on a recognized stock exchange in India.

2. **Any income from long-term capital asset being self cultivated urban agricultural land on compulsory acquisition [Section 10 (37)]**

In the case of an assessee, being an individual or a Hindu undivided family. Capital gain arising from the compulsory acquisition of self-cultivated urban agricultural land shall be fully exempted.

3. **Long Term Capital Gain on transfer of securities covered under Securities Transaction Tax [Section 10 (38)]**

Any income arising from the transfer of a long-term capital asset, being shares and the trans-action of sale of such securities is entered into in a recognized stock exchange in India on or after 1-10-2004 shall be fully exempted.

4. **Income from transfer of asset of an undertaking engaged in the business of generation, transmission or distribution of power [Section 10(40)]**

Income from transfer of capital asset of an undertaking engaged in the business of generation, transmission or distribution of power where such transfer takes place on or before 31.3.2006 and transfer is made to the Indian company as notified u/s 80IA.

5.6 EXEMPTIONS IN RESPECT OF CERTAIN CAPITAL GAINS U/S. 54

Q13. Explain about the exemptions in respect of capital gains u/s 54.

Ans : **(Imp.)**

The following are the deductions/exemptions u/s 54 from capital gains,

(i) Sec.-54

It consists of capital gains arising out of sale of house property and if the assessee uses that consideration amount for the purchase of other residential house, then exemption can be given to the assessee in the following manner:

1. Transferred asset → Residential house
2. Invested in → Purchase/construction of house
3. Exemption → Least of two amounts:
   (i) Cost of the new asset (+) Amount deposited in capital gain scheme
   (ii) Capital gain amount
4. Time limit of → For purchase of house within 1 year before or 2 years after date of transfer.

   or

   For construction of house within 3 years after date of transfer.

(ii) Sec.-54 B :

If capital gain arising from transfer of agricultural land, then exemption is given as follows,

1. Transferred asset → Agricultural land [used by assessee or his parents at least 2 years before transfer]
2. Invested in → Purchase of agricultural land either in rural or urban area
3. Exemption → Least of the two amounts:
   (i) Cost of new agricultural land (+) Amount deposited in capital gain scheme
   (ii) Capital gain amount
4. Time limit → Purchase of new agricultural land within 2 years of sale.

(iii) Sec.-54 D

If land and building is acquired by government for industrial purpose, then exemption can be given as follows,

1. Transferred Asset → Compulsory acquisition of land and building (by government only) used for industrial purpose for 2 years before transfer.
2. Invested in → Land and building for industrial purpose.
3. Timelimit → Within 3 years after date of transfer.
4. Exemption → Least of the two amounts:
   (i) Cost of land and building (+) Amount deposited in capital gain scheme.
   (ii) Capital gain amount.

(iv) Sec.-54 EC

If long term capital asset transferred and gain received is invested in specified bonds, then assessee can claim exemption as follows,

1. Transferred Asset → Long term capital asset
2. Invested in → Specified assets like bonds of Rural Electrification Corporation Ltd and National Highway Authority of India etc.

3. Timelimit → Within six months from the date of transfer

4. Exemption → Least of the two amounts:

   (i) Actual amount invested

   (ii) 50 lakhs.

(v) Sec.-54 F

It includes capital gain arising from transfer of other assets other than residential house then assessee can claim exemption as follows,

1. Transferred Asset → Any asset [except residential house e.g. land, gold and commercial buildings],

2. Invested in → Residential house [but assessee should own only one house]

3. Exemption → Least of the two amounts:

   (i) If cost of the new asset house is more than the consideration received, then capital gain is fully exempted.

   or

   (ii) If cost of the new asset house is less than the consideration received, then exemption will be given as,

$$\text{Exemption} = \text{Capital gain} \times \frac{\text{Cost of the new house}}{\text{Net consideration}}$$

4. Time limit → Purchase of house before 1 year or 2 years after sale or construct the house within 3 years after the date of transfer.

(vi) Sec.-54G

It includes capital gain on shifting industrial undertaking from urban to non-urban area or transfer and purchase of capital assets.

1. Transferred asset → Shift the unit from urban to non-urban and long term capital assets for industrial purpose in urban area.

2. Invested in → Purchase of long term capital assets for industrial purpose in non-urban area.

3. Exemption → Least of the two amounts:

   (i) Actual amount invested in new assets (+) Amount deposited in capital scheme + Shifting expenses.

   (ii) Capital gain amount.

4. Time limit → Shifting expenses and purchase or construction of new asset with in 3 years or before one year from the date of transfer.

(vii) Sec.-54 GA

It includes capital gain arising on shifting industrial undertaking from urban to special economic zone, the assessee can claim this exemption as follows,

1. Transferred asset → Shift from urban to S.E.Z
2. Invested in → Purchase of long term capital assets.
3. Exemption → Least of the two amounts:
   (i) Actual investment in new asset (+) Amount deposited in capital gain scheme + Shifting expenses.
   (ii) Capital gain amount.
4. Time limit → 3 years from the transfer date/compensation received.

5.7 Problems on Computation of Capital Gains

1. Mr. Gupta purchased Diamond Ring on 7th July, 2005 for `. 2,34,000 and is sold for 8,00,000, selling expenses 6,000 during the previous year relevant to the current assessment year. Calculate capital gain, if cost inflation index for 2005-06 is 117 and for the previous year 2020-21 is 301.

Sol :

Computation of Mr. Gupta's Income from Capital Gain For the Assessment Year 2021-22

Particulars	Amount in `.
Consideration received (Sale Price)	8,00,000
Less: Transfer Expenses or Selling expense	6,000
Net Consideration	7,94,000
Less: Indexed Cost of Acquisition	6,02,000
Income from Capital Gain	1,92,000

Working Notes:

1. Transferred Asset: (Diamond Ring) The asset is held by the assessee for more than three years, hence it is considered as long term capital asset.

2. Calculating Indexed cost of acquisition

$$\text{Original cost of the asset} \times \frac{\text{Previous Year Index}}{\text{Index of purchase year}}$$

$$= 2,34,000 \times \frac{301}{117} = 6,02,000$$

2. Mr. Suresh purchased an art piece of Moghul's period for ` 6,00,000 on 9th July 99 and ` 1,48,000 is spent for glass frame and illumination with electric lights in Oct 2009. He sold the asset for ` 36,00,000 during the previous year. If selling expenses are ` 29,000 calculate capital gain for the current assessment year. Cost inflation index for 2009-10 is 148.

Sol :

Computation of Mr. Suresh's Income from Capital Gain For the Assessment Year 2021-22

Particulars	Amount in `.
Consideration received (Sale Price)	36,00,000
Less: Transfer expenses (Selling Expenses)	29,000
Net Consideration	35,71,000
Less: Indexed Cost of Acquisition	18,06,000
	17,65,000
Less: Indexed cost of Improvement	3,01,000
Income from Capital Gain	14,64,000

Working Notes:

1. **Transferred Asset (Art work):** From the assessment year 2008-09 onwards "Art work" is considered as capital asset. The asset is held by the assessee for more than three years, hence it is considered as long term capital asset.

2. Calculating indexed cost of acquisition (earlier to 1-4-2001)

$$6,00,000 \times \frac{301}{100} = 18,06,000$$

Note: In this problem F.M.V on 1-4-2001 is not given hence cost of acquisition is equal to purchase price. The index for the period earlier to 1-4-2001 is to be taken as 100.

3. Calculating indexed cost of improvement

$$1,48,000 \times \frac{301}{148} = 3,01,000$$

Note: For the previous year 2020-21 cost inflation index is 301.

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3. Sri Charan Desai purchased a plot of land on 10th February, 1998 for `. 3,77,500 and spent `. 2,20,000 immediately for its levelling and filling the pits etc. During 2012-13 he constructed a residential house at a cost of `.5,00,000. During 2014-15 he has spent `. 3 lakhs for constructing additional rooms. Fair rental value of the plot on 1-4-2001 `. 7,00,000 and stamp duty value is 8,00,000, on 15th November, 2020 he sold the house for `. 49,42,300, under the agreement `.9,42,300 is payable on signing the agreement and the balance in 4 equal half yearly instalments of `. 10,00,000. Upto the end of the previous year 1st instalment money received. Selling expenses 2%. CI.I: 2012-13 =200; 2014-15= 240; 2020-21=301. Compute income from Capital Gain.

Sol :

Computation of Sri Charan Desai's Income from Capital Gain for the Assessment Year 2021-22

Particulars		Amount in ₹.
Total consideration 9,42,300 + (10,00,000) × 4		49,42,300
Less: Transfer expenses/Selling expenses/Brokerage		98,846
Net Consideration		48,43,454
Less: 1) Indexed cost of acquisition – Purchase of land	21,07,000	
2) Indexed cost of improvement – Construction of building	7,52,500	
3) Indexed cost of improvement – Construction of additional rooms	3,76,250	32,35,750
Income from Capital gain		16,07,704

Working notes :

Special note : If the sale price or consideration is receivable in instalments to calculate income from capital gain total consideration's considered i.e. due amount shall be ignored.

1. **Transferred Asset (Building) :** The asset is held by the assessee for more than two years, hence it is considered as long term capital asset.
2. **Transfer expenses:** 2% of 49,42,300 = 98,846
3. **Cost of .acquisition:** The asset is purchased before 1-4-2001 (SDV is given) so the cost of acquisition is higher of the following.

   (a) Actual cost. → 3,77,500

   (b) Lower of the following two: → 7,00,000

   i) Fair Market Value on 1-4-2001 → 7,00,000

   ii) Stamp duty value → 8,00,000

   If the asset is purchased prior to 1-4-2001 the cost inflation index is to be taken as 100.
4. **Calculating Indexed cost of acquisition.**

$$7,00,000 \times \frac{301}{100} = 21,07,000$$

5. **Calculating indexed cost of improvement - construction of building in year 2012-13.**

$$5,00,000 \times \frac{301}{200} = 7,52,500$$

6. **Calculating Indexed cost of improvement -levelling and other expenses-year 1998.**

   Cost of improvement incurred before 1-4-2001 shall be ignored.
7. **Calculating indexed cost of improvement - Additional rooms - year 2014-15**

$$3,00,000 \times \frac{301}{240} = 3,76,250$$

4. Mr. Vigneshwar sold his residential house for ` 32,50,000 on 15th August 2019-2020 (CII = 289) which he purchased on 10.08.1988 for ` 1,02,000. Fair market value on 01-04-2001 is ` 8,50,000 and selling expenses 2%. Compute the Income from Capital Gain and Tax Liability if Income from Other Heads is nil.

Sol : **(Oct.-21, Imp.)**

Computation of Mr. Vigneshwar's Income from Capital Gain for the Assessment Year 2021 -22

Particulars	Amount (`)
Consideration Received	32,50,000
Less : Selling Expense $\left[32{,}50{,}000 \times \frac{2}{100}\right]$	65,000
Net consideration	31,85,000
Less : Indexed cost of acquisition	25,58,500
Capital Gain	6,26,500

Calculation of Tax Liability

Particulars	Amount (`)
Capital Gain	6,26,500
Less : Basic exemption income	2,50,000
Taxable capital gain	3,76,500
Flat tax rate 20% on 3,76,500	75,300
Add : Health and Education Cess @ 4% (75,300 × $\frac{4}{100}$)	3,012
Tax Liability	78,312

∴ Rounded off value of Tax Liability is ` 78,310.

Working Notes

Calculation of Indexed Cost of Acquisition

$$\text{Fair Market Value of the Asset} \times \frac{\text{C.I.I of the Year of Transfer}}{\text{C.I.I of 2001 – 02}}$$

$$= 8{,}50{,}000 \times \frac{301}{100}$$

$$= 25{,}58{,}500$$

5. Sri Babu sold his house on 25th Mar, 2020 for ` 25,00,000. Selling expenses ` 10,000. This house has been purchased in the year 1998-99 for 2,00,000 and as on 2001 FMV is 2,50,000. He has invested 5,00,000 in the bonds of NHAI and a new house has purchased for ` 12,00,000. Calculate the amount of Taxable capital gains for current assessment year. CII for 2020-21 is 301.

Sol :

Computation of Capital Gains

Particulars	Amount (`)
Sale consideration received	25,00,000
Less: Selling expenses	10,000
Net consideration	24,90,000
Less: Indexed cost of acquisition	7,52,500
Capital Gain	17,37,500
Less: Exemption u/s 54 EC	5,00,000
Less: Exemption u/s	12,00,000
Taxable Capital Gains	37,500

Working Notes:

1. Indexed cost of Acquisition $= \text{Fair Market Value of Asset} \times \frac{\text{CII of the year of transfer}}{\text{CII of } 2001-02}$

$$= 2{,}50{,}000 \times \frac{301}{100} = \text{`}\ 7{,}52{,}500$$

2. Exemption U/s 54 EC:

   As the assessee has invested amount in the bonds of NHAI, the exemption amount will be least of following amount,

   (a) Actual amount = $\boxed{\text{` 5,00,000}}$

   (b) ` 50 Lakhs

3. Exemption u/s 54:

   Sri Babu has sold the house and purchased a residential house, therefore he can claim benefit u/s 54 The exempted amount is least of the following,

   (a) Capital gain = ` 17,37,500

   (b) Cost of new house = $\boxed{\text{` 12,00,000}}$

6. Mr. Sudhakar owns agricultural land in municipal limits since ` 1998, the FMV for same as on 1.4.2001 is ` 3,30,000. In January 2021, he sold for ` 15,00,000 and paid ` 18,200 on brokerage. In February 2021, he purchased agricultural land near municipal limits and paid advance of ` 2,50,000 and deposited ` 80,000 in bank under capital gain scheme. Calculate taxable gain and exemption u/s. 54 B if any [CII-2020-21 = 301,2001-02 = 100].

Sol :

Computation of Capital Gains for A.Y. 2021 -22

Particulars	Amount (`)
Sale consideration Received	15,00,000
Less: Selling expenses	20,000
	14,80,000
Less: Indexed cost of acquisition	9,93,300
Capital Gain	4,86,700
Less: Exemption u/s 54 (B)	3,30,000
Taxable Capital Gain	1,56,700

Working Notes:

1. Calculating Indexed Cost of Acquisition,

   Indexed cost of Acquisition $= 3{,}30{,}000 \times \frac{301}{100} = 9{,}93{,}300$

2. Selling expenses = 20,000.

3. Exemption u/s 54 B = Cost of new agricultural land + Money deposited in bank

   = 2.50.000 + 80.000 = 3.30.000.

5.8 Income From Other Sources

Q14. Define Income from other sources.

Ans :

Meaning

It includes incomes which are not taxable in other heads of income.

Income from Other Sources is one of the heads of income chargeable to tax under the Income tax Act. 1961. Any income that is not covered in the other four heads of income is taxable under income from other sources, because of this, it is known as residuary head of income. All the incomes excluded from income from salary, income from capital gains, income from house property , and income from business & profession (PGBP) are included in Income From Other Sources (IFOS), except those which are exempt under the Income Tax Act.

Any income chargeable under this head, if the following conditions are satisfied.

(i) The income must not be an exempted income.

(ii) The income must not be chargeable under any other head of income.

Types of Incomes

Incomes are classified to the following :

1. General Income (Sec.56(1)
2. Specified Incomes (Sec.56(2)

5.8.1 General Incomes u/s. 56(1)

Q15. Explain briefly about General Incomes u/s. 56(1).

Ans : **(Imp.)**

An Income which does not specifically fall under any one of the four heads of income viz. income from salary, income from house property, profits and gains of business or profession and capital gains is to be included under the head "Income from Other Sources". An income may be charged under the head only as a matter of last resort i.e. after it has been tested at each head and found inappropriate for inclusion there under. In other words, it is a residuary head. The following are the tests to be applied for each head of income.

1. Head of Income - Salary

Master and Servant relationship should exist between the payer and the receiver. Eg. Mr. Rao is working in X college as lecturer. Income received from this college is included under the head "Salary". If he is also working as part-time lecturer in Y college, in this case the relationship between the payer and receiver is contractor and contractee, hence remuneration received from college Y is not salary income (though the nature of job is same) but it is included under the head income from other sources. The other examples for income from other sources are salary received by MPs, MLAs; amounts received by teachers for setting the paper or valuing the paper from University or other institutions.

2. Head of Income - Income from house property1

If assessee owns a building and lets it out then the rent received will be treated as income from house property, the acid test is ownership of the building. On the contrary, if rent is received by subletting then it will be treated as an income from other sources.

3. Head of Income - Profits from business or profession

If the income is derived by risk bearing (not by chance element) it is categorised as business income. If an income is derived by practising the profession then it will be treated as profits or gain from profession, eg. Income derived by a doctor by running a clinic or nursing home. If the doctor is employed in a Govt, hospital or any other hospital then the income will be treated as salary income".

4. Head of income - Capital gains

If profit is derived by the sale or transfer of capital asset then it is included under the head capital gain.

5. Head of income - Other sources

An Income which cannot be included under any specific head is included under this head.

Income chargeable under this head i.e income from other source is computed in accordance with the method of accounting regularly followed by the assessee. If the books of accounts are kept on the basis of "Cash System", income is taxable on receipt basis and expenditure is allowed as deduction on the payment basis, whereas if the books of accounts are maintained on the basis of "Mercantile System", income is taxable and expenditure is deductable on due basis.

The following are some of the important items of income, which are included under the head Income from Other sources:

1. Interest on securities (Securities mean bonds issued by the Govt and debentures of a Ltd. Company), if the securities are not held as stock in trade by an assessee.
2. Dividends on preference shares, dividends received from Indian/domestic company (declared or distributed or paid).

3. Interest on debentures issued by co-operative societies, clubs etc.
4. Dividends on the shares of a co-operative society.
5. Interest on bank deposits.
6. Winning from card games, lotteries, crossword puzzles or from any kind of gambling or betting is in the nature of casual income.
7. Any sum received by the assessee from his employer as the contribution to any staff welfare scheme.
8. Rent or hire charges received by letting of plant, machinery or furniture etc.
9. Rent from subletting the house.
10. Royalty received.
11. Directors fees.
12. Examination remuneration received by a teacher.
13. Agricultural income from foreign lands.
14. Rent from lands.
15. Commission received (eg.Chit Fund Commission or Insurance Commission).
16. Interest on securities issued by a Foreign Government.
17. Remuneration received by MPs and MLAs.
18. Annuity received by lending trade marks or copy rights.
19. Interest on loan given.
20. Examinership remuneration received from employer not in the capacity of "Master" of the assessee or from any other person/institutions.
21. Interest on income tax or any other tax refunds.
22. Interest on security deposits either with the government or any other persons.
23. Gifts received on or after 1-10-2009 either in cash or kind in excess of the limit mentioned u/s 56(2)(x).
24. Interest received on compensation/enhanced or delayed compensation.
25. Forfeited advance money received for sale or transfer of capital asset on or after 1 -4-2014 is treated as income.
26. u/s 56(2)(xi)Any compensation or other payments by whatever name called in connection with modification of terms and conditions relating to such employment. This covers those payments which are not taxable under the head salary. Thus, it could cover payment of a person other than an employer or former employer. The compensation may be in the nature of revenue receipt or capital receipt.
27. Any sum received under a keyman insurance policy including the sum allocated by way of bonus of such policy.

5.8.2 Specific Incomes u/s. 56(2)

Q16. Explain briefly about Specific Incomes u/s. 56(2).

(OR)

List out the specific infomes with comes under the head of income from other sources.

(OR)

"Mention the different kinds of incomes specially mentioned as chargeable to tax under the head income from other sources.

Ans : **(Imp.)**

Following specified incomes are to be included under Section 56(2).

1. Letting of Plant, Machinery or Furniture

When an assessee received any income in form of rent or hire charges by letting plant, machinery or furniture is treated as income from other sources. The reasonable expenses incurred for such assets are allowed as deduction. It may includes,

(a) Repairs

(b) Insurance premium

(c) Depreciation.

However, if the assessee has the business of letting out plant and machinery, then the income received would be taxable under the head profits and gains of business or profession.

2. Interest Received on Compensation/ Enhanced Compensation/Delayed Compensation u/s 56(2)(viii)

If assessee received any interest on compensation, enhanced compensation or delayed compensation then such interest income is treated as income from other sources. This income is allowed as deduction u/s 57 in the form of "standard or statutory deduction" at flat 50% of the interest received. However, outstanding or accrued interest should not be considered as income from other sources until they actually received by the assessee.

3. Interest on Bank Deposits

If an assessee received interest income through any type of deposits held in bank or co-operative society etc such income is considered as income from other sources. Deduction will be allowed for such income only if it exceeds ` 10,000 p.a, if interest received does not exceed ` 10,000 then there will be no deductions. However, if it exceed ` 10,000 p.a, 10% tax is deducted at source and 20% is deducted when the assessee has not submitted the details of PAN and KYC (Know-Your-Customer).

4. Interest on Company Deposits

Interest on company deposits is treated as income from other sources and no deductions are allowed for such income.

5. Casual Incomes

Winning from lotteries, card games, crossword puzzles, races (including horse races), betting and gambling are treated as casual incomes, taxable under the head income from other sources.

6. Interest on Securities

The income from interest on securities is the amount of interest received by the investor after investing his money in the bonds which are issued by the government or through the debentures of a limited company.

7. Dividends

Dividend refers to the profits received by the shareholders from their company or mutual funds issued by the company to its unit holders.

8. Gifts Received u/s 56(2)(x)

If the gift is received by an individual on or after 1-10-2009 then provision of sec.56(2) (vii) are applied. New provisions introduced regarding gifts received by finance Act, 2017. Previously, the provisions were applicable only to individual or HUF. However, the new provision u/s 56(2) (x) is applicable to any person (i.e., individuals, HUF, Firm company etc.) who received gift in any previous year. As per new provision u/s (2) (x), gifts received either in cash or kind is taxable with certain exemption limits.

9. Family Pension

If family pension is received by the legal heirs, after the death of the employee is treated as income from other sources and is allowed as deduction u/s 57(ii)(a).

10. Other Specific Incomes

Some of the other specific incomes are listed below,

(i) Income from open plot of land.

(ii) Income from salary of a Parliament or Assembly Member/Legislative Council.

(iii) Income from agricultural land located in foreign country.

(iv) Income from subletting house or assets.

(v) Income from insurance commission.

(vi) Income from examination work and so on.

(vii) Income from undisclosed sources.

5.8.3 Dividends u/s. 2(22)

Q17. Define Dividend. What are the different types of Dividends determining under income tax?

Ans : **(Imp.)**

Dividend generally, means the sum paid to or received by a share holder in proportion to his shareholding in a company out of the total profit distributed. Dividend includes the sub clause (a) to (e) of section 2(22) of the Income Tax Act bring into the ambit of dividend certain distributions which would not have been considered as dividend in the ordinary sense. ‘Dividend’ includes following disbursements by the company to the share holders, to the extent of accumulated profits.

Types

“Individual” the provisions are as under. Dividends can be of three types.

(i) Dividends declared by a domestic/Indian company.

(ii) Dividends or any income distributed by mutual benefit funds.

(iii) Dividends declared by a foreign company.

(i) Dividends received from an Indian Company/ Domestic Company

Dividends/ interim dividends received on preference shares or equity shares from an Indian Company is exempted from tax u/s 10 (34) as the company declaring such dividend has already deducted dividend distribution tax before paying the dividend. However u/s 115BBDA if aggregate dividend received by any person (Individual, HUF, Firm, LLP, AOP, BOI, Artificial persons, and Local Authority, Private trustees) from domestic company or companies (declared or distributed or paid) exceeds ` 10,00,000 then excess amount is. taxable @ 10%. (Plus Surcharge (+) Health and Education Cess).

Exemption of u/s 115BBDA

a) A domestic company

b) Persons being Trust, Educational Universities, Hospitals claiming exemption

c) A trust or institution registered u/s 12A/12AA

(ii) Dividends declared by U.T.I (or) other Mutual Benefit Funds

Dividends/income received on the units of U.T.I or any Mutual Benefit Funds are exempted from tax.

(iii) Dividends declared by a foreign company

Net dividends received will be taken as the income under the head "Income from other sources". Interest paid on loan taken to purchase the shares of a foreign company is not allowed as deduction.

5.8.4 Interest on Securities

Q18. Define the term interest on securities. Discuss the chargeability of income under interest on securities.

Ans :

There is a specific method of computing the income from securities, the details are as under.

When an investor invests his money in the bonds issued by Government or debentures of a Limited Company, the interest received from them is considered as "Income from Interest on Securities".

If securities are held by the assessee as part of stock (i.e., if the assessee is a dealer in securities) then interest on securities will be treated as "Income from business".

Chargeability of interest on securities

Interest on securities may be taxed on receipt basis or on due basis depending upon the system of accounting followed by the assessee. If the assessee follows cash system of accounting, then the interest is taxable on "receipt" basis, otherwise if books are maintained on mercantile system then it is taxable on "due basis".

Special note : If the method of accounting followed by the assessee is not mentioned in the problem, then it is always assumed that the assessee is following mercantile method.

1. Gross interest is included in the Total Income of an assessee. (Net Interest + Tax deducted at source = Gross Interest).

2 Arrears of interest received is taxable in the year ofreceipt, ifnot taxed earlier.

3. Interest accrues on the due date but not according to the time that the security is held.

4. Interest may be paid either quarterly, or half yearly or yearly and if such details are not given then make an assumption that the interest is paid every half yearly. If due dates are not mentioned then 30th September and 31st March are to be taken as due dates.

5. Interest is always calculated on the face value of the security i.e. not on the book value or on the market value.
6. Interest accrues to the person on whose name, the securities stand (ownership) on due date.
7. Profit or loss on sale of securities will not come under this head.

   The same will be included under the head "Capital Gains" in general. But if the investments are part of stock in trade of a business,then the same will be included under the head "Profits and Gains from Business or Profession".

Interest on the following securities will be included under this Head:

(i) Securities issued by Central Government

(ii) Securities issued by State Government

(iii) Securities issued by Local Authorities.

(iv) Securities issued by Limited Companies (including Foreign Companies), (v) Securities issued by Public Corporations.

Interest on the following securities Do not come under this Head:

a) Securities issued by Foreign Governments.

b) Interest on loans.

c) Interest on Trade transactions.

d) Interest on Annuity Deposits.

e) Interest on bank deposits.

f) Interest on debentures issued by Clubs, Private Trusts, and Co-operative Societies.

Interest received by the following persons are not taxable

a) Local Authorities (Municipal Corporations, Panchayats etc.,)

b) Any Authority constituted by the Government under statute or Law for the purpose of Development of city or for Housing accommodation etc., (Ex. HUDA, H.W.D.A.)

c) Trustees ofEducational Institutions including Universities.

d) Statutory P.F., R.P.F. and an approved superannuation fund.

e) Member of Schedule Tribes living in tribal areas.

f) Registered Trade Union.

g) Approved Sports Association.

h) Approved Scientific Research Association.

i) Religious Institutions.

j) Charitable Institutions.

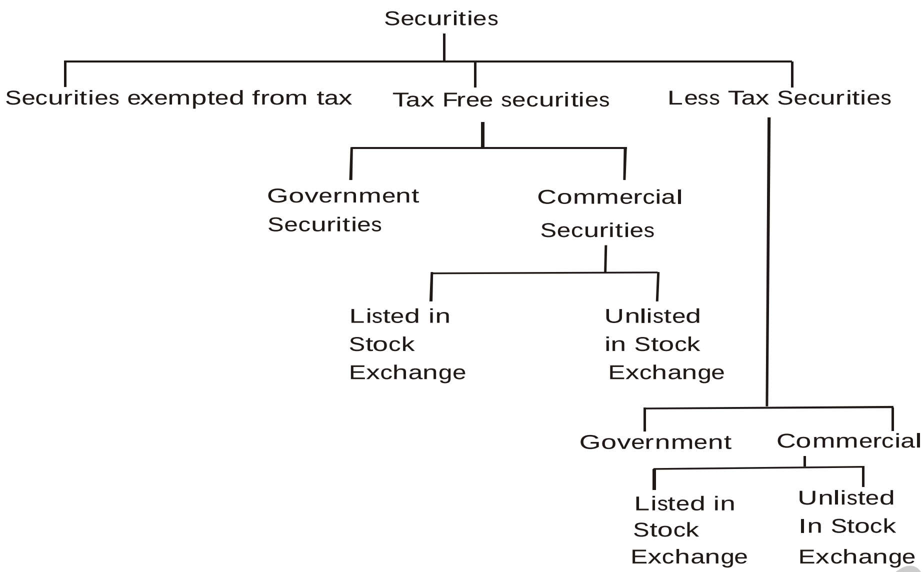
Types of Securities

From the Tax point of view, Securities are classified into three types. They are:

(i) Securities exempted from tax.

(ii) Tax free Securities.

(iii) Less tax Securities.



I. Securities exempted from tax

Tax due on these Securities is fully exempted from tax, as such the interest received by the assessee will not be included in the total income. These securities are issued by the Government. Interest on the following Securities is totally exempt from tax.

Note: Interest paid on loan taken for purchase of these securities will not be allowed as deduction.

1. 12 Years National Plan Savings Annuity Certificates.
2. Treasury Savings Deposit Certificate.
3. Post Office Cash Certificates.
4. National Plan Certificates.
5. National Plan Savings Certificates.
6. Post Office National Savings Certificates.
7. Post Office Savings Bank Accounts.(Exempt only to the extent of `. 3,500 in the case of individual)
8. Post Office Cumulative Time Deposits.
9. Scheme of Fixed Deposits governed by the Government Savings Certificates (Fixed Deposits) Rules 1968.
10. Scheme of Fixed Deposits governed by the Post Office (Fixed Deposits) Rules 1968.
11. NR1 Bonds - 1988 issued by State Bank of India.
12. NRI Bonds (Second series) Issued by the State Bank of India 1988.
13. 10.5% Tax Free bonds issued by HUDCO
14. 9.25% Tax Free Bonds issued by Rural Electrification Corporation Ltd.
15. 10.5% Secured, redeemable, non-convertible tax -free bonds issued by National Hydroelectric Power Corporation Ltd.
16. Interest payable by a Public Company registered in India with the main object of providing long term finance for purchase or construction of residential houses and eligible for deduction u/s 36(l)(viii).
17. Interest on Gold Deposit Bonds issued under the Gold Deposit Scheme 1999 notified by the Central Government.
18. Tax free Ahmedabad Municipal Corporation Bonds and Nagpur Municipal Corporation Bonds.

19. Interest on Bonds issued by a Local Authority or a State pooled finance entity and notified by Central Government.
20. Interest payable to the European Investment Bank, on a loan granted by it for financial co-operation entered into with the Central Government.
21. 8% Tax Free Bonds of India Infrastructure Finance Company Limited.
22. Secured Redeemable Non-convertible Railway Bonds issued by Indian Railway Finance Corporation.

Note: For exempted security no calculation is required only a note is to be appended.

II. Tax Free Securities: Tax payable by the holder of these securities is paid by the security issuing authority, i.e. tax is paid by the Government in the case of Tax Free Government Securities and Companies in the case of Tax Free Commercial Securities.

a) The Securities can be issued by the Government or Companies.

b) Gross interest will be included in the total income.

E A. Tax Free Government Securities : Gross interest is calculated as follows.

Gross interest = Face value x Rate -MOO E B. Tax Free Commercial Securities:

Note : Interest received by the assessee is net interest, so the same is to be converted into gross interest.

Step 1:

Calculate Net interest

Net Interest = Face value x Rate +100

Step 2:

Calculate Gross interest.: If the Securities are listed or unlisted in the Stock Exchange, the formula to calculate gross interest is same.

Gross Interest = Net Interest x 100 + 90

III. Less tax Securities Of the total interest due to a Security holder, tax is deducted by the issuing Authority i.e. payer of the interest. The interest received by the assessee is net interest and the same is to be grossed up and is to be included in the total income. These securities can be issued both by the Government and Commercial Authorities.

Gross Interest = Face Value × Rate +100.

Q19. Discuss the models of computing Interest on securities.

Ans :

Interest on securities can be computed by using the following three models,

Model-I: When Rate of Interest is Given

Information required under this model are,

(a) Face values and

(b) Rate of interest.

Under this model, for tax free government security, less tax-government security and less tax commercial security (unlisted or listed) gross interest can be computed with the following formula,

Gross Interest = Face Value × Rate ÷ 100

(i) For Tax free commercial securities, first we need to calculate net interest then the gross interest.

Net Interest = Face Value × Rate 100

Gross Interest = Net Interest × 100 ÷ 90

(ii) For less tax securities gross interest is calculated as, Gross interest = Face value × Rate 100.

Model-II: When Interest Amount is Given

Under this model, only amount of interest received is required to make the calculations of total interest. Different securities can be gross up in the following way,

1. Tax Free Government Security

Gross interest = Interest received.

2. Tax Free-Commercial (Listed and Unlisted) Security

Gross interest = Net interest × 100/90 (or) Net Interest × $\frac{100}{100 - \text{Rate of TDS}}$

3. Less Tax Government Security

Gross interest = Interest received.

4. Less Tax-Commercial (Listed and Unlisted) Security

Gross interest = Net interest x 100/90.

Model-III: Combination of Model-1 and Model-II

Under this model both rate of interest and amount of interest received is given in the problem.

Computation of Income from Interest on Securities Under the Head

Income from other Sources for the Assessment Year

Particulars	Amount (`)	Amount (`)
1. Interest ontax free govt, securities		x x
2. Interest ontax free commercial securities (listed)		x x
3. Interest ontax free commercial securities (unlisted)		xx
4. Interest onless tax govt, securities		x x
5. Interest onless tax commercial securities (listed)		x x
6. Interest onless tax commercial securities (unlisted)		x x
Gross Income from Interest on Securities		xxx
Less: Deductions u/s 57		
Collection charges	x x	
Interest paid on loan taken	x x	x x x x
Income from Interest on Securities		x x x x

5.8.5 Gifts Received by an Individual

Q20. Explain the provisions regarding Gifts Received by an Individual.

Ans :

If an individual received the gifts on or after 1-10-2009 the provision of sec 56(2)(vii) are to be applied from the assessment year 2010-11 onwards. Finance Act 2017 introduced new provision. Earlier provision for taxability of gifts were applicable only for individual and HUF. According to new provision sec. 56(2)(x) on 1-4-2017 onwards new provision for gift will be applicable for any person (Individual, HUF, Firm, Company etc.,) received gift from any person in any previous year. According to the new provision u/ s 56(2)(x) gifts received either in cash or in kind are taxable income with an exemption limit in few situations. This section is applicable even if the property is purchased for inadequate consideration. For taxation purpose the term “Gift” can be taken as receiving cash or property for no consideration or for lesser value. The consideration paid shall be compared either with stamp duty value or fair market value.

To understand the provision of this section let us study the meaning of few terms.

1. Cash
2. Property
3. Stamp Duty Value
4. Fair Market Value

1. **Cash :** The term cash includes currency notes/coins, cheques, drafts, fixed deposits, receipts or any other deposit which is easily transferable from ownership point of view.

2. **Property:** The term property includes the following:

   (i) Immovable property e.g.

      (a) land

      (b) buildings

      (c) Archaeological Collections

      (d) Drawings

      (e) Paintings

      (f) Sculptures and

      (g) Any work of art Bullion (gold or silver in the form of bars) etc.

   (ii) Shares and securities.

   (iii) Jewellery.

3. **Stamp Duty Value :** Tax to be paid for obtaining or preparing official documents is known as Stamp Duty. Generally stamp duty is levied at the time of transfer of property from one person to another. Stamp duty depends upon the valuation made by the Government for the property to be transferred. In most of the cities & towns, the State Governments have fixed the value of the property well in advance and if such valuation is not made by a competent authority then according to market price, value is fixed.

4. **Fair Market Value:** The value of an asset (other than immovable property) determined as per the prescribed method is known as fair market value.

Provision of Sec. 56(2)(x)

Following points highlights the provisions regarding gift received by an individual,

1. If value of gifts received in cash in the previous year is more than ` 50,000 and gift is received without consideration then total value of the gift become taxable income.
2. In case, if immovable property is received as gift and value of stamp duty exceeds ` 50,000 then stamp duty value is considered as value of taxable income.
3. In case if immovable property is received for consideration and value of stamp duty is more than the consideration value by ` 50,000 or more then

$$\boxed{\text{Value of taxable} = \text{Stamp duty value} - \text{Consideration paid}}$$

4. If movable property (like shares and gold ornaments etc.) is received as gift without consideration and fair market value of the property exceeds ` 50,000 then Total Fair Market Value of the property (F.M.V) is to be considered as taxable income value.
5. In case if movable property is received as gift for a consideration and difference between fair market value (FMV) and consideration value is more than ` 50,000 then,

$$\boxed{\text{Value of taxable income} = \text{F.M.V} - \text{Consideration value}}$$

Gifts Fully Exempted From Tax

The various gifts which are fully exempted from tax are listed below,

1. Gifts (In the form of cash or property) received by the assessee on the occasion of his/her marriage.
2. Gifts (cash or property) received as under will.
3. Cash or property is received as gift under inheritance.
4. Gifts cash or property) received on contemplation of death of the assessee.
5. Gifts (cash or property) received from local authority.
6. Gifts (cash or property) received from a registered trust u/s 12 AA.
7. Gifts received from a relative.
8. Gifts (cash or property) received from any foundation or university or educational institution or hospital or trust or institution referred u/s 10 (23c).

5.8.6 Casual Income - Winnings from lotteries Puzzles, Crown World Puzzles, Races

Q21. Define Casual Income. How gross prize amount of various casual incomes are calculated?

Ans : **(Imp.)**

Casual income is an income which is earned/received from an element of chance or may be from any investment, asset or the services rendered by the persons. In simple words, it can be defined as a non-recurring income which would not likely to occur again in the year. It is usually earned by a chance. Thus, casual income cannot be anticipated and does not required any agreement.

The income will be taxed at the flat rate of 30% which after adding health and education cess and surcharge will become 31.2%. However, tax is deducted at source 30% without health and education cess and surcharge. Following are the incomes which falls under this category,

1. Lotteries

Lotteries refer to a low-odd games of chance or process in which winners are selected randomly for a certain prize.

2. Crossword Puzzle

Crossword puzzle is a word game in which a person has to guess the answers from clues and write the answers in the white squares of a pattern of small black and white squares.

3. Race

Under Income Tax Act 1961 (Sec-194) race refers to horse racing and income from this is taxable.

4. Game Shows

Amount won game shows like Kaun Banega Crorepati are taxable under income tax act 1961.

5. Card Game

Card refers to a game that is played by using a set of playing cards and income from this is taxable.

Calculation of Gross Prize Amount

Calculation of gross prize amount of various casual income are given below,

1. Winnings from lottery must not exceed ` 10,000. If the received amount is more than ` 10,000, gross prize amount is calculated as, Net prize amount × $\frac{100}{70}$.
2. Winnings from horse race must not exceed ` 5,000. If it is more than ` 5,000, gross prize amount is calculated as, Net prize amount × $\frac{100}{70}$.
3. Winnings from games or T.V shows must not exceed ` 10,000 and received amount will be considered as gross amount.
4. Income earned from winnings of card games or T.V shows exceeds ` 10,000 then gross prize amount is calculated as net prize i.e., received amount × $\frac{100}{70}$
5. Winnings from other races, gambling, betting etc., are exempted from TDS.

5.8.7 Family Pension – Rent received on let out of Furniture- Plant and Machinery with/without Building

Q22. Define the following terms :

(i) Family Pension

(ii) Rent received on let out of Furniture

(iii) Plant and Machinery with/without Building

Ans :

(i) Family Pension

Family pension payable by the employer to heir of deceased employee shall be computed after allowing standard deduction. Such deduction is to be allowed either at 33.33% of family pension or ` 15,000, WEL.

(ii) Rent Received on Let out of Furniture

If an assessee owns plane machinery or furniture and it is let out to some other person, the rent so received by the assessee shall be chargeable to tax under this head provided letting of plant and machinery is not the business of the assessee.

(iii) Plant and Machinery with/without Building

The rent from a property is taxable under the head 'Income from House Property' but when an assessee let out plant, machinery or furniture which is inseparable from building, the rent of building so received will be taxable under the head 'Income from Other Sources'. The letting of plant, machinery or furniture not be the business of the assessee.

Rental Income from Machinery, Plant or Furniture

Rental income derived from letting out of machinery, plant or furniture without building, is to be computed after making the following deductions

(i) The amount incurred by the assessee on account of current repairs of the assets hired out.

(ii) The amount of insurance premium paid by assessee against damage of the assets hired out.

(iii) Depreciation in respect of assets hired out.

5.9 Deductions u/s. 57

Q23. Explain briefly about various Deductions u/s. 57.

Ans : **(Imp.)**

The various deductions u/s 57 are as follows,

1. Deductions on Dividends and Interest on Securities

A deduction is entitled with reference to any more amount spent as a commission or remuneration to a banker or any other person as collection charges for accomplishing the dividend or interest on securities.

Note: W.e.f AY 2021-22, no deduction shall be allowed from dividend income or income with regard to units of mutual fund specified u/s 10 (23 D). However, Deduction is allowed only for interest expenditure which has been incurred to earn the dividend income to the extent of 20% of total dividend income.

2. Repairs, Depreciation etc in case of Letting of Machinery, Plant or Furniture With or Without Building

Deductions entitled from income earned by letting of machinery, plant or furniture with or without building are as follows,

(i) Expenses on current repairs of plant, machinery, furniture or building.

(ii) Depreciation on plant, machinery and furniture.

(iii) Depreciation of buildings are entitled only if the assessee is the owner.

(iv) Depreciation is not entitled if the assessee is a lessee or mortgagee in ownership of the building.

(v) Insurance premium paid on plant, machinery, furniture or building.

3. Deductions in Respect of Employee's Contribution in Staff Welfare Schemes [57 (ia)]

U/s 59 (ic), any amount earned by employer from his employees as their contribution of Provident Fund, E.S.I fund or super annutation fund is considered as income, if not taxable under the head of "profits and gains of business or profession".

If the employer deposits any amount out of these incomes before disclosed due date, in such case, the amount is entitled as deduction u/s 57(ia).

4. Standard Deduction Out of Family Pension [Sec. 57[iia)]]

Family pension is referred to a regular monthly amount payable by employer to the legal heirs of deceased employee. The deductions entitled in case of income in the nature of family pension is,

(i) 33 'A% of pension (or)

(ii) ? 15,000.

Whichever is less is to be entitled.

5. Deductions from any Other Income [Sec. 57 (iii)]

Any expenses incurred to earn an income changeable to tax under this head is to be deducted from such income. This deduction is not valid to assessee being a foreign company. It is entitled as deduction of "Income from other sources". Interest paid on borrowed money is not chargeable against the assessee's business income. In order to claim such deductions, the following conditions must be fulfilled. They are,

(i) The expenses are to be incurred solely in order to earn such income.

(ii) It should not include in the nature of capital expenditure.

(iii) It should not include in the nature of personal expense.

(iv) It should not include in the relevant accounting year.

6. Deductions from Royalties Received by Authors

Actual Expenses can be claimed as deductions with an exemption to writing for films.

7. Deductions Regarding Interest on Compensation or Enhanced Compensation

Income received by assessee from deductions regarding interest on compensation or enhanced compensation, a deduction of a sum equal to 50% of such income is entitled and no deductions are considered under other clause of this section.

PROBLEMS

7. From the following information, compute Mr. Rao's income from interest on securities.

(a) ` 97,000 - 12% Tax free debentures of M/s. Ramam & Company.

(b) ` 88,500 - 15% Mumbai Municipal Corporation Bonds.

(c) ` 25,000 - 10% 12 years National Defence Certificates.

(d) Collection charges - ` 15,000.

Sol :

Computation of Mr. Rao's Income from Interest on Securities

	Particulars	Amount (`)
(a)	` 97,000-12% tax free debentures of M/s. Raman & Company (Gross interest)	12,933
(B)	` 88,500-15% Municipal corporation bond	13,275
	Gross Income from Interest on Securities	26,208
	Less: Deduction u/s 57:	
	Collection Charges	15,000
	Income from Interest on Securities	**11,208**

Working Notes

(a) Tax Free Debentures of M/s. Raman and Company

Net interest $97,000 \times \frac{12}{100} = 11,640$

Gross interest $11,640 \times \frac{100}{90} = 12,933$

(b) Mumbai Municipal Corporation Bond

$88,500 \times \frac{15}{100} = 13,275$ (Grossing up is not needed)

(c) 12 Years National Defence Certificates

This income is fully exempted from tax.

8. Compute income from other sources from the information given below:

(i) Gift from friend ` 75,000

(ii) Interest on bank deposits ` 18,500

(iii) Winnings from lottery ` 70,000 (Net)

(iv) Dividends from Reliance Industries ` 38,000 (Gross).

Sol :

Computation of Income from Other Sources for the A.Y. 2021-22

	Particulars	Amount (`)
(i)	Gift from friend	75,000
(ii)	Interest on Bank Deposits	18,500
(iii)	Winnings from lottery	1,00,000
	Income from Other Sources	**1,93,500**

Working Notes:

1. Dividends from Reliance Industries

Dividends from Reliance Industries are fully exempted from tax.

2. Winning from Lottery

Winning from lottery can be calculated by using the following formula,

$$\boxed{\text{Gross Prize Amount} = \text{Net Prize Amount} \times \frac{100}{70}}$$

$70{,}000 \times \frac{100}{70} =$ ` 1,00,000

9. Calculate the interest from the following securities:

15% tax free commercial securities ` 90,000 (Not listed)

10% tax free Reliance debentures ` 40,000 (Listed)

8% National Savings Certificates ` 75,000

Collection Charges ` 1,200.

Sol :

Calculation of Income from Interest on Securities for the Assessment Year 2021-22

Particulars	Amount (`)
Interest on 15% tax free commercial securities:	
Net interest $= 90{,}000 \times \frac{15}{100} = 13{,}500$	
$= 13{,}500 \times \frac{100}{90}$	15,000
Interest on 10% tax free debentures:	
$40{,}000 \times \frac{10}{100}$	4,000
Gross Income from Income from Securities	19,000
Less: Deductions u/s 57:	
Collection charges	1,200
Income from Interest on Securities	**17,800**

Working Notes

National Savings Certificate

It is exempted from tax u/s 10(15).

10. Mr. Ramraj received following incomes during the previous year relevant to current assessment year

(i) ` 20,000; 10% Preference Shares of Wipro Limited Company

(ii) ` 30,000; 12.5% Gold Deposit Bonds

(iii) ` 25,000; 5% Government of India Loan

(iv) ` 1,50,000; 6% Tax Free Debentures of Birla Company Limited

(v) ` 75,000; 4% (Less Tax) Telangana Government Bonds

(vi) ` 1,00,000; 2% Tax Free Kerala Government Securities

(vii) ` 15,000; 7.5% Nagpur Municipal Bonds

(viii) ` 40,000; 13% Tax free Debentures of Vandana ltd.

Collection charges are ` 450 and Interest on Loan taken to purchase Birla Company Debentures is ` 500. Compute Income from Securities for the assessment year 2021-2022

Sol : **(Oct.-21)**

Computation of Mr. Ramraj's Income from Interest on Securities for the Assessment Year 2021 -22

S.No.	Particulars	Amount (`)	Amount (`)
(i)	` 20,000, 10% preference shares of Wipro Limited Company		2,000
(ii)	` 30,000, 12.5% Gold Deposit Bonds (Exempted)		Nil
(iii)	` 25,000, 5% Government of India Loan		1,250
(iv)	` 1,50,000. 6% Tax Free Debentures of Birla Company Limited		10,000
(v)	` 75,000, 4% (Less Tax) Telangana Government Bonds		3,000
(vi)	` 1,00,000, 2% Tax Free Kerala Government Securities		2,000
(vii)	` 15,000, 7.5% Nagpur Municipal Bonds (Exempted)		Nil
(viii)	` 40,000, 13% Tax Free Debentures of Vandana Ltd.		5,778
	Gross Income from Securities		24,028
	Less: Deductions u/s 57:		
	Collection charges	450	
	Interest paid on loan taken to purchase Birla Company Debentures	500	950
	Income from Securities		23,078

Working Notes

1. Preference Shares of Wipro Limited Company

$$20{,}000 \times = \frac{10}{100} = \text{`}\ 2{,}000$$

2. Gold Deposit Bonds

Interest received on this security is an exempted income.

3. Government of India Loan

$$25{,}000 \times \frac{5}{100} = \text{`}\ 1{,}250$$

4. Tax Free Debentures of Birla Company Limited

$$\text{Net interest} = 1{,}50{,}000 \times \frac{6}{100} = \text{`}\ 9{,}000$$

$$\text{Gross interest} = 9{,}000 \times\ = \text{`}\ 10{,}000$$

5. (Less Tax) Telangana Government Bonds

$$75{,}000 \times \frac{4}{100} = \text{`}\ 3{,}000$$

6. Tax Free Kerala Government Securities

$$1{,}00{,}000 \times \frac{2}{100} = \text{`}\ 2{,}000$$

7. Nagpur Municipal Bonds

Interest received on on this security is an exempted income.

8. Tax Free Debentures of Vandana Ltd.

$$\text{Net interest} = 40{,}000 \times \frac{13}{100} = \text{`}\ 5{,}200$$

$$\text{Gross interest} = 5{,}200 \times \frac{100}{90} = \text{`}\ 5{,}778$$

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11. From the following particulars, compute the Income from Other Sources,

(i) Received winning from Lottery ` 42,000

(ii) Received from Agricultural land in England ` 1,24,000

(iii) Rent from sublet of the house ? 36,000 (Rent paid ` 16,000, repairs ` 1,000).

(iv) Rent from hiring the Machinery ` 2,000 p.m.

(Repairs ` 5,000, Depreciation ` 8,000).

(v) Family Pension ` 8,000 p.m.

Sol :

Computation of Income from Other Sources for the Assessment Year 2021 -22

S.No.	Particulars		Amount (`)	Amount (`)
1.	Winning from lottery (WN-1)			60,000
2.	Income from agricultural land in England			1,24,000
3.	Rent from sublet of the house		36,000	
	Less: Rent paid	16,000		
	Repairs	1,000	17,000	19,000
4.	Rent from hiring machinery (` 2,000 × 12)		24,000	
	Less: Repairs	5,000		
	Depreciation	8,000	13,000	11,000
5.	Family pension (` 8,000 × 12)		96,000	
	Less: Permissible deduction u/s 57(iia) (WN-3)		15,000	81,000
	Income from Other Sources			2,95,000

Working Notes

1. Winning from Lottery

The winning from lottery exceed ` 10,000, the gross prize amount is,

Net prize amount × $\frac{100}{70}$ i.e.,

$42{,}000 \times \frac{100}{70} =$ ` 60,000

2. Income from Agriculture Land in England

Income from agriculture land situated in foreign countries is treated as income from other sources.

3. Family Pension

Deduction will be the least of the following two amounts,

(i) $\frac{1}{3}$ of pension received

` 8,000 × 12 = ` 96,000

` 96,000 × $\frac{1}{3}$ = ` 32,000

(ii) ` 15,000.

12. From the following information compute the income from other sources for the A.Y 2021 -22

(i)	**Card game loss**	**` 12,000**
(ii)	**From the activity fowning and maintain horse for race purpose:**	
	(a) Loss at Bombay	**` 40,000**
	(b) Profit at Bangalore	**` 20,000**
(iii)	**Dividend (Gross) from Indian Companies**	**` 6,000**
(iv)	**Betting on Horse Races**	**` 4,000**

Sol :

Computation of Income from Other Sources for the Assessment Year 2021 -22

	Particulars	**Amount (`)**	**Amount (`)**
(i)	Loss from card games ` 12,000 (neither it can be set-off nor it can be carried forward)		Nil
(ii)	Profit from maintenance of horse race at Bangalore	20,000	
	Less: Loss from maintenance of horserace at Bombay	40,000	
	Loss from maintenance of horserace is to be carried forward	– 20,000	Nil
(iii)	Dividend from Indian Companies		6,000
(iv)	Betting on horse races		4,000
	Income from Other Sources		10,000

Short Question & Answers

1. Define Capital Gain.

Ans :

Capital Gain arising on transfer of capital asset is charged to tax under the head "Capital Gains". Income from capital gains is classified as "Short Term Capital Gains" and "Long Term Capital Gains". In this part you can gain knowledge about the provisions relating to tax on Long Term Capital Gains.

Tax planning assumes a special role in the sale of capital assets. An income tax payer who knows the various provisions of Income Tax Law which go to reduce the incidence of income tax in relation to capital gains on the sale or otherwise transfer of a capital asset, would stand to benefit immensely. The duration of holding a capital asset and the various expenses and other deductions to be claimed for arriving at the final quantum of taxable capital gains have a direct bearing on the incidence of income tax in relation to the capital gains in respect of transfer of the capital assets. There are certain transactions which are not regarded as "transfer" and these are outside the orbit of capital gains tax

Meaning

Capital Asset the tax is to be levied on any profit or gain occurring on the transfer of a capital asset. Section 2(14) defines capital assets as :

(a) Property of any kind held by an assessee whether or not connected with his business or profession;

(b) Any security held by a Foreign Institutions Investor which has invested in such security in accordance with the regulations made under SEBI Act: 1992.

2. Deemed Transfer.

Ans :

When a person converts his capital asset into stock in trade, it is deemed as transfer, difference between cost price and price at which converted into stock in-trade is capital gain [With effect from 1-4-1984]

(i) Transfer of Asset by a Person to a Firm, AOP or BOI

When a person transfers his capital asset to a firm, AOP or BOI (body of individuals) and it is treated as his capital, it is deemed as its transfer. The difference between the price recorded in the books of Firm, AOP or BOI and cost shall be treated as capital gain.

(ii) Transfer of Asset by a Firm, AOP or BOI to a Person

It also amounts to transfer. The price recorded in the books of firm AOP, BOI is its cost and market value on the date of transfer is its sale price.

(iii) Compulsory Acquisition of Asset

Additional compensation received is deemed as income of the year in which it is received and not the year in which asset was taken over. With effect from 1.4.2004 in case asset is taken over under compulsory acquisition and assessment has been made on the basis of original compensation or enhanced compensation and later on such compensation is reduced by any authority, the assessment shall be rectified by taking the reduced compensation.

3. Cost of acquisition.

Ans :

Cost of acquisition means total of all the expenses incurred by the assessee for acquiring the asset i.e., purchase price and expenses incurred after purchase till its first use e.g. installation charges etc.

If the cost of the asset cannot be ascertained for some valid reasons the Fair Market Value is taken as cost of acquisition.

If the assessee has constructed or manufactured the asset then all expenses incurred by him on its construction or manufacture will be taken as cost of acquisition.

If the asset is purchased before 1-4-2001 then the cost of acquisition is higher of the following two amounts:-

(a) Actual cost,

(b) Fair Market Value on 1-4-2001.

The benefit is not allowed for (i) depreciable assets i.e. assets used in the business or profession like building and machinery and eligible for claiming depreciation. (ii) Intangible assets : Goodwill, tenancy rights, route permit licence, loom hours.

4. Indexed cost of acquisition

Ans :

Indexed cost of acquisition means showing inflated or increased cost price instead of actual price. The increase is justified on account of inflation. The net result of indexed cost of acquisition is reduction in tax liability.

The increase in cost of acquisition is known as indexed cost of acquisition. This benefit is also permitted for the cost of improvement. The benefit of indexation is allowed **only for long term capital asset** i.e. in no case such benefit is allowed for short term capital asset.

The above said rule does not apply to :

1. Shares of debentures acquired by non residents in Indian companies in foreign currency.
2. Depreciable assets.
3. In case of Debentures and Bonds indexed cost of acquisition is not to be calculated i.e., the benefit of cost inflation index will not be available to the assessee.
4. Slump sale u/s 50B
5. Short term capital assets

But in other cases there are different rules to determine the cost of acquisition.

5. Long-Term Capital Gain (LTCG)

Ans :

As per Sec. 2 (29B), any capital gain arising from the transfer of a long-term capital asset is referred as long-term capital gain. It will be taxed at 20% flat rate (plus health and education cess and surcharge).

The capital gain shall be the excess of the full value of c.onsideration over the aggregate of following,

(a) Expenses of transfer

(b) Indexed cost of acquisition of asset

(c) Indexed cost of improvement.

14. Define Income from other sources.

Ans :

Introduction

It includes incomes which are not taxable in other heads of income.

Income from Other Sources is one of the heads of income chargeable to tax under the Income tax Act. 1961. Any income that is not covered in the other four heads of income is taxable under income from other sources, because of this, it is known as residuary head of income. All the incomes excluded from income from salary, income from capital gains, income from house property , and income from business & profession (PGBP) are included in Income From Other Sources (IFOS), except those which are exempt under the Income Tax Act.

Any income chargeable under this head, if the following conditions are satisfied.

(i) The income must not be an exempted income.

(ii) The income must not be chargeable under any other head of income.

17. Define Dividend.

Ans :

Dividend generally, means the sum paid to or received by a share holder in proportion to his shareholding in a company out of the total profit distributed. Dividend includes the sub clause (a) to (e) of section 2(22) of the Income Tax Act bring into the ambit of dividend certain distributions which would not have been considered as dividend in the ordinary sense. 'Dividend' includes following disbursements by the company to the share holders, to the extent of accumulated profits.

Types

"Individual" the provisions are as under. Dividends can be of three types.

(i) Dividends declared by a domestic/Indian company.

(ii) Dividends or any income distributed by mutual benefit funds.

(iii) Dividends declared by a foreign company.

18. Define the term interest on Securities.

Ans :

There is a specific method of computing the income from securities, the details are as under.

When an investor invests his money in the bonds issued by Government or debentures of a Limited Company, the interest received from them is considered as "Income from Interest on Securities".

If securities are held by the assessee as part of stock (i.e., if the assessee is a dealer in securities) then interest on securities will be treated as "Income from business".

9. Tax free Securities.

Ans :

Tax payable by the holder of these securities is paid by the security issuing authority, i.e. tax is paid by the Government in the case of Tax Free Government Securities and Companies in the case of Tax Free Commercial Securities.

a) The Securities can be issued by the Government or Companies.

b) Gross interest will be included in the total income.

E A. Tax Free Government Securities : Gross interest is calculated as follows.

Gross interest = Face value x Rate -MOO E B. Tax Free Commercial Securities:

Note : Interest received by the assessee is net interest, so the same is to be converted into gross interest.

Step 1:

Calculate Net interest

Net Interest = Face value x Rate +100

Step 2:

Calculate Gross interest.: If the Securities are listed or unlisted in the Stock Exchange, the formula to calculate gross interest is same.

10. Gifts Received by an Individual.

Ans :

If an individual received the gifts on or after 1-10-2009 the provision of sec 56(2)(vii) are to be applied from the assessment year 2010-11 onwards. Finance Act 2017 introduced new provision. Earlier provision for taxability of gifts were applicable only for individual and HUF. According to new provision sec. 56(2)(x) on 1-4-2017 onwards new provision for gift will be applicable for any person (Individual, HUF, Firm, Company etc.,) received gift from any person in any previous year. According to the new provision u/ s 56(2)(x) gifts received either in cash or in kind are taxable income with an exemption limit in few situations. This section is applicable even if the property is purchased for inadequate consideration. For taxation purpose the term "Gift" can be taken as receiving cash or property for no consideration or for lesser value. The consideration paid shall be compared either with stamp duty value or fair market value.

To understand the provision of this section let us study the meaning of few terms.

1. Cash
2. Property
3. Stamp Duty Value
4. Fair Market Value

Exercise Problems

1. Sri Sai Chand purchased gold ornaments for `. 2,05,000 in the financial year 2001-02. During the previous year he sold the ornaments for `.10,00,000. Transfer expenses `. 45,000. The cost inflation index in the year of purchase was 100 and in the year of sale is 301. Calculate income from capital gain.

   [Ans : Capital gain `. 3,37,950]

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2. Mr.Y.N.Charan sold his residential house for `. 28,50,000 on 10th August, 2020 (cost inflation index 301) which he purchased on 5-11-1988 for `. 1,02,000. Fair market value on 1-4-01 `. 8,00,000 and Stamp duty value is `. 9,00,000. If selling expenses are `. 53,000. Compute the income from capital gain and tax liability if income from other heads is nil.

   [Ans : `. 15,300]

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3. Smt. Ganga Bhavani purchased a residential house for 5,00,000 in 1997-98 financial year. During 2003-04 she constructed two rooms at a cost of `. 2,18,000, on 15-5-2020, she entered into a contract with Dr. Hari to sell the house for 22,30,000 and received 75,000 as advance, latter on Hari decided not to purchase the house and the advance received was forfeited on 12-12-2020 she sold the house for 21,60,000, the selling expenses are 2% . Calculate income from capital gain and tax liability if income from other heads is `. 6,30,000. The cost index inflation for 2003-04 is 109 and 2020-21 is 301.

   [Ans : `. 57,680]

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4. Sri Harsha is owning a house and used for residential purpose. The house which was constructed for `. 1,80,000 (40 years ago) on 11th July, 1995 he entered in an agreement to sell the house to Mr. Abraham for 8,00,000 and received 80,000 as advance. Mr. Abraham failed to pay the balance amount and consequently the advance amount is forfeited. The house is sold during the previous year for `.90,00,000 and the selling expenses were 1% F.M.Vat 1-4-01 was `. 15,00,000 and stamp duty value is `.14,00,000. During the previous year 2002-03 one more floor is added to the building at a cost of `.6,30,000 (Cost inflation Index is 105) and during 2008-09 `. 3,00,000 is spent for renovation and painting. (Cost inflation Index = 137) Calculate the income from capital gain and tax liability if income from other heads is `.1,00,000.

   [Ans : `. 6,20,010.]

Choose the Correct Answers

1. Capital gain is classified into ________ types [a]

   (a) Two (b) Three

   (c) Four (d) Five

2. Which of the following is not a capital asset [c]

   (a) House property (b) Jewellery

   (c) Stock-in-trade (d) Agricultural land in Delhi

3. A partnership firm sold a residential house. Under which section the firm can get exemption on Long-term Capital gains ? [d]

   (a) Sec. 54 (b) Sec. 54D

   (c) Sec. 54EC (d) Sec. 54F

4. The income tax rate on long-term capital gain for an individual is : [b]

   (a) 10% (b) 20%

   (c) 15% (d) 30%

5. For capital gain being long-term capital gain, an assessee should retain the asset for a period of [c]

   (a) More than 12 months, but below 24 months

   (b) Below 36 months

   (c) More than 36 months

   (d) 12 months

6. 'Cost inflation index number for the Financial Year 2018-19 is : [b]

   (a) 100 (b) 280

   (c) 264 (d) 200

7. In case of shares, long term capital gain will arise, if the assessee retains the shares with him for a period of : [c]

   (a) Less than 12 months (b) 12 Months

   (c) More than 12 months (d) None of these

8. Income from sale of household furniture is [b]

   (a) Taxable capital gain (b) Not taxable

   (c) Short term capital gain (d) Long term capital gain

9. Listed shares held for less than 12 months are [c]

   (a) Long term capital asset (b) Exempted capital asset

   (c) Short term capital asset (d) None of these

10. FMV on 1.4-2001 is applicable to assets [a]

   (a) Acquired prior to 1-4-2001 (b) Acquired after 1-4-2001

   (c) Transferred prior to 1-4-2001 (d) None of these

Fill in the Blanks

1. Sum received from sale of agricultural land shall be covered under the category of ______
2. Capital asset is defined U/sec. ______
3. To find out Long-term Capital Gain ; it's necessary to know the ______ of Asset
4. Gift of an asset can be treated as ______
5. Actual cost of improvement means ______
6. Realization expenses means ______
7. The rate of tax on LTCG is ______
8. Asset (other than shares and immovable property) transferred after a period of 36 months is called ______ asset.
9. Capital gain arises on the transfer of any ______.
10. Long term capital loss can be adjusted only against ______.

Answers

1. Income from other sources
2. 2(14)
3. Index Cost
4. Deemed transfer
5. Expenditure incurred on additions for Capital Assets
6. Expenses incurred on Sale consideration
7. 20%
8. Long term capital asset
9. Capital asset
10. Long term capital gain

FACULTY OF COMMERCE

B.Com. II Year IV Semester(CBCS) Examination

(Common Paper for General / Computers / Computer Applications / Advertising / Foreign Trade and Honours Courses)

Model Paper - I

INCOME TAX

Time: 3 Hours Max. Marks: 80

PART – A (5 × 4 = 20 Marks)

Note: Answer any five of the following questions not exceeding 20 lines each.

ANSWERS

1. Canon of equality **(Unit-I, SQA.1)**
2. What is gross total income? **(Unit-I, SQA.20)**
3. Define Salary. **(Unit-II, SQA.1)**
4. Compute Taxable House Rent Allowance exempted, from the following information:
   (a) Basi Pay ` 60,000 p.m.
   (b) Dearness Allowance 80% of Basic Pay
   (c) House Rent Allowance 30% of Basic Pay and rent paid to accommodation in Delhi ` 30,000 p.m. **(Unit-II, Prob.9)**
5. Interest on Home loan u/s 24(b) **(Unit-III, SQA.5)**
6. Sri Ragava Rao purchase a house in Kakinada in the year 1990 and using for residential purpose. During the previous year and relevant year the following particulars are furnished.

   MRV 25,000, FRV 30,000, the expenses paid are Municipal taxes 10%, Non-Agricultural land tax ` 1,000, Repairs 2,800, Insurance 500, and interest paid on loan taken to purchase the house 38,000. Compute income from house property. **(Unit-III, Prob.4)**
7. Explain the concept of block of assets. **(Unit-IV, Prob.7)**
8. Mr. Gupta purchased Diamond Ring on 7th July, 2005 for `. 2,34,000 and is sold for 8,00,000, selling expenses 6,000 during the previous year relevant to the current assessment year. Calculate capital gain, if cost inflation index for 2005-06 is 117 and for the previous year 2020-21 is 301. **(Unit-V, Prob.1)**

PART – B (5 × 12 = 60 Marks)

Note: Answer all the questions in not exceeding four pages each.

9. (a) What is Agricultural Income? Explain different types of Agricultural Incomes. **(Unit-I, Q.No.25)**

   OR

   (b) What do you mean by Canons of Taxation? Discuss the principles to be consider at the time of framing an ideal taxation policy. **(Unit-I, Prob.9)**

10. (a) Explain in detail about the Profits in Lieu of Salary and their treatment. **(Unit-II, Q.No.11)**

OR

(b) Veer Savarkar, a Govt, employee furnishes the following information:

(i) Basic Pay ` 15,000 p.m.

(ii) Dearness Allowance ` 4,000 p.m. (Enters into retirement benefits)

(iii) Arrears of Salary ` 15,000

(iv) Rent free accommodations owned by employer having a fair rental value. ` 70,000 per annum, cost of Furniture ` 90,000 rent fixed by Govt. ` 25,000 per annum.

(v) Deputation Allowance ` 6000 p.a.

(vi) Own contribution to SPF ` 20,000.

(vii) Employer's contribution to provident Fund ` 20,000.

(viii) Interest on Provident Fund @14% t 7,200.

(ix) Reimbursement of medical expenses ` 25,000 (Recognized hospitals)

Compute his Taxable Salary. **(Unit-II, Prob.18)**

11. (a) What is meant by Annual Value? Explain different factors that are to be considered in determining the annual value of the house property. **(Unit-III, Q.No.3)**

OR

(b) Ms. Sundari is the owner of a property constructed at Mahaboobnagar on 31-08-2012. Particulars are furnished here under.

Particulars	`
Municipal Rental Value	3,60,000
Fair Rental Value	3,90,000
Standard Rental Value	3,75,000
Actual Rental Value	4,80,000
Unrealized Rent	80,000
Municipal Taxes	12%
Interest on Loan	68,000
Preconstruction Interest	90,000
Actual Repairs	16,000
Sewerage Tax (due)	9,000
Education Cess	2,500
Fire Insurance Premium	4,000

(Unit-III, Prob.8)

12. (a) Mr. Gopal submits the following particulars for the year ended 31 st March, 2021. Compute his Income from Business.

Profit and Loss Account

Particulars	**Amount (`)**	**Particulars**	**Amount (`)**
To Salary	1,05,000	By Gross Profit	8,00,000
To Telephone Expenses	11,000	By Income from House Property	6,000
To Repairs	18,000	By Profit on Sale of Land	70,000
To Legal Expenses	39,000	By Interest on Securities	1,000
To Motor Car Expenses	44,000	By Bad Debts recovered	5,000
To Income Tax	10,000		
To Security Transaction Tax	6,000		
To Provision for Taxation	3,000		
To interest on Loan	12,000		
To Bad Debts	6,000		
To Provisions for Bad Debts	8,600		
To Depreciation	45,000		
To General Expenditure	42,000		
To Net Profit	5,32,400		
	8,82,000		8,82,000

Additional Information:

1. Interest paid on Loan for purchase of Machinery
2. As per the Income Tax Act allowable Depreciation is ` 30,000
3. Repairs included in Capital Expenditure ` 12,500, current year repairs ` 5,500
4. Proprietor Salary included in Salary ` 25,000
5. General expenditure included ` 15,000 paid as penalty for violation of Income Tax rules. **(Unit-IV, Prob.2)**

OR

(b) Explain the concept of block of assets. **(Unit-IV, Q.No.19)**

13. (a) List out the specific infomes with comes under the head of income from other sources. **(Unit-V, Q.No.16)**

OR

(b) Sri Charan Desai purchased a plot of land on 10th February, 1998 for `. 3,77,500 and spent `. 2,20,000 immediately for its levelling and filling the pits etc. During 2012-13 he constructed a residential house at a cost of `.5,00,000. During 2014-15 he has spent `. 3 lakhs for constructing additional rooms. Fair rental value of the plot on 1-4-2001 1`. 7,00,000 and stamp duty value is 8,00,000, on 15th November, 2020 he sold the house for `. 49,42,300, under the agreement `.9,42,300 is payable on signing the agreement and the balance in 4 equal half yearly instalments of `. 10,00,000. Upto the end of the previous year 1st instalment money received. Selling expenses 2%. CI.I: 2012-13 = 200; 2014-15 = 240; 2020-21 = 301. Compute income from Capital Gain. **(Unit-V, Prob.3)**

FACULTY OF COMMERCE

B.Com. II Year IV Semester(CBCS) Examination

(Common Paper for General / Computers / Computer Applications / Advertising / Foreign Trade and Honours Courses)

Model Paper - II

INCOME TAX

Time: 3 Hours | Max. Marks: 80

PART – A (5 × 4 = 20 Marks)

Note: Answer any five of the following questions not exceeding 20 lines each.

ANSWERS

1. PAN. **(Unit-I, SQA.16)**
2. Define Incidence of Tax. **(Unit-I, SQA.18)**
3. What is meant by annula accretion? **(Unit-II, SQA. 3)**
4. Mr. Jayaraman is working in Accountant's General office in Chennai. His salary particulars are as follows : Basic pay : `. 17,500 p.m; D.A. `. 2,800 p.m.; Servant allowance : `. 300 p.m.; he is provided with rent-free accomodation in Chennai. The rent of the accommodation as per Government rules is `. 8,000 p.m. He is also provided with a television set and a refrigerator that is hired for `. 1,500 p.m. Compute the value of rent free accommodation. **(Unit-II, Prob.10)**
5. Define Annual Value. **(Unit-III, SQA.3)**
6. Mr. Subhash chandra Bose owns a house property in Calcutta. Compute the Gross Annual Value MRV - ` 70,000; FRV- ` 72,000; SRV - ` 72,000; Actual Rent ` 85,000. **(Unit-III, Prob.3)**
7. Explain the concept of valuation of cost. **(Unit-IV, SQA.4)**
8. Mr. Suresh purchased an art piece of Moghul's period for ` 6,00,000 on 9th July 99 and ` 1,48,000 is spent for glass frame and illumination with electric lights in Oct 2009. He sold the asset for ` 36,00,000 during the previous year. If selling expenses are ` 29,000 calculate capital gain for the current assessment year. Cost inflation index for 2009-10 is 148. **(Unit-V, Prob. 2)**

PART – B (5 × 12 = 60 Marks)

Note: Answer all the questions in not exceeding four pages each.

9. (a) What do you mean by Canons of Taxation? Discuss the principles to be consider at the time of framing an ideal taxation policy. **(Unit-I, Q.No.9)**

OR

(b) How would you determine the status of an individual? **(Unit-I, Q.No.21)**

10. (a) Explain the term perquisites. List out any ten perquisites which are fully taxable. **(Unit-II, Q.No.10)**

OR

(b) Smt. Roja rani is an employee in a private company. Her basic salary is 15,000p.m, D.A. `. 3,000p.m., Transport allowance `.3,000p.m. (Actual amount spent `. 2,000) She receives the following medical benefits from the company during the previous year. Calculate income from salary current assessment year. Reimbursement of the following medical expenses incurred by Smt. Roja.

i) On treatment of herself by family Doctor `. 5,000.

ii) On treatment of herself employed daughter `. 4,000.

iii) On treatment of her Father-in-law dependent on her in a Nursing home `. 10,000.

iv) Medical allowance `. 1,000p.m.

vi) On treatment of her minor son abroad `. 1,02,000.

vii) On treatment of her son in a Government hospital `. 3,500 **(Unit-II, Prob.21)**

11. (a) Define Income from House Property. Under what conditions it is treated as income from House Property. **(Unit-III, Q.No.1)**

OR

(b) Mr. Rana Pratap owns a property in Hyderabad.

MRV – ` 1,60,000 ; FRV – ` 2,10,000; SRV – ` 1,80,000

The house is let out upto January 31st, 2018 (` 14,000 p.m.) From February 1st 2018 the house is self occupied by him. Municipal tax paid ` 16,000. Interest on loan for constructing the property ` 1,20,000. Compute his Income from House Property for AY 2021- 22. **(Unit-III, Prob.7)**

12. (a) Dr. Udam Singh is a Medical Practitioner. The following is the Receipts and Payments Account for the year ended 31-3-2021. Compute his Professional Income.

Recepits and Payments Account

Particulars	Amount (`)	Particulars	Amount (`)
To Opening Balance	82,000	By Dispensary expenses	42,000
To Consultancy fees	88,000	By Salary to staff	40,000
To Visiting fees	42,000	By Cost of Medicines	20,000
To Interests on Deposits	28,000	By Surgical Equipment	30,000
To Dividends	20,000	By Shares purchased	60,000
To Examiner's fees	40,000	By Printing and Stationery	6,000
To Gifts from Patients	30,000	By Telephone expenses	2,000
To Rent Received	12,000	By Life Insurance	4,000
		By Income Tax	6,000
		By Motor Car expenses	12,000
		By Driver's Salary	10,000
		By Balance C/d	1,10,000
	3,42,000		3,42,000

Other information

1. Gifts include `12,000 received from his brothers.
2. Stock of Medicines on 31 -03-2018 ` 6,000
3. 25% of motorcar used for personal purposes
4. Depreciate Surgical Equipment at 15%. **(Unit-Iv, Prob.10)**

OR

(b) Explain the Miscellaneous Provisions under section 44. **(Unit-IV, Q.No. 8)**

13. (a) From the following particulars, compute the Income from Other Sources,

(i) Received winning from Lottery ` 42,000

(ii) Received from Agricultural land in England ` 1,24,000

(iii) Rent from sublet of the house ` 36,000 (Rent paid ` 16,000, repairs ` 1,000).

(iv) Rent from hiring the Machinery ` 2,000 p.m.

(Repairs ` 5,000, Depreciation ` 8,000).

(v) Family Pension ` 8,000 p.m. **(Unit-V, Prob.11)**

OR

(b) Explain briefly about General Incomes u/s. 56(1). **(Unit-V, Q.No.15)**

FACULTY OF COMMERCE

B.Com. II Year IV Semester(CBCS) Examination

(Common Paper for General / Computers / Computer Applications / Advertising / Foreign Trade and Honours Courses)

Model Paper - III

INCOME TAX

Time: 3 Hours Max. Marks: 80

PART – A (5 × 4 = 20 Marks)

Note: Answer any five of the following questions not exceeding 20 lines each.

ANSWERS

1. Residential Status. **(Unit-I, SQA.17)**
2. Assessment Year **(Unit-I, SQA.13)**
3. What is provident fund? **(Unit-II, SQA.4)**
4. Mr. Ravi is employed in Public Works Department of Government of Telangana. His salary particulars are as under: Calculate the deduction allowed u/s 16(ii).

   Basic pay `. 6,000 p.m.; D.A. `. 800 p.m. (enters for retirement benefit)

   Education allowance `. 350 p.m.; Entertainment allowance `. 1,300 p.m **(Unit-II, Prob.3)**
5. Deductions for Self Occupied House **(Unit-III, SQA.6)**
6. Mrs. Rajani is having a property in Simla, which she has let-out to Mrs. Radha for a monthly rent of ` 6,000. The municipal value of the property is ` 20,000 p.a and fair rental value is ` 60,000. p.a. During the previous year, the house is vacant for 3 months. According to the agreement, the tenant has paid municipal taxes of ` 3,000. Mrs. Rajani paid an interest of ` 2,500 for a loan taken to construct the house. Compute her income from house property. **(Unit-III, Prob.5)**
7. Calculate depreciation from the following information,

   (i) WDV on 1-4-2013 ` 5,00,000

   (ii) Additions on 1-6-2013 ` 5,00,000

   (iii) Sale proceeds of part of it ` 2,00,000 on 1-11-2013

   (iv) Rate of depreciation 25%. **(Unit-IV, Prob.7)**
8. From the following information, compute Mr. Rao's income from interest on securities.

   (a) ` 97,000 - 12% Tax free debentures of M/s. Ramam & Company.

   (b) ` 88,500 - 15% Mumbai Municipal Corporation Bonds.

   (c) ` 25,000 - 10% 12 years National Defence Certificates.

   (d) Collection charges - ` 15,000. **(Unit-V, Prob.7)**

PART – B (5 × 12 = 60 Marks)

Note: Answer all the questions in not exceeding four pages each.

9. (a) "Income tax is a tax on income, but all incomes are taxable". Explain. **(Unit-I, Q.No.19)**

OR

(b) What are the conditions to be satisfied to treat any income as an agricultural incomes. **(Unit-I, Q.No.27)**

10. (a) Define Allowances. What type of allowances received by an employee. **(Unit-II, Q.No.8)**

OR

(b) Compute Income from salary of Mr. Gopi a private employee for the assessment year 2021-22

		`
(i)	Basic Pay	2,80,000
(ii)	D.A. 54,000	
(iii)	Entertainment allowance	10,000
(iv)	Commission	10,000
(v)	Medical allowances (fixed)	8,000
(vi)	Free supply water, gas & electricity	9,900
(vii)	Employers contribution to PFF	18,000
(viii)	House rent allowance (Rent paid at Chennai ` 18,000)	14,000
(ix)	Profession tax paid	2,400

(Unit-II, Prob.23)

11. (a) Explain in detail determination of Annual Value for Let-out House. **(Unit-III, Q.No.4)**

OR

(b) Mr. 'X' owns the following house properties for the assessment year 2021-22.

Particulars	**House I**	**House II**
Municipal value	60,000	40,000
Fair Rental value	75,000	60,000
Rent received	80,000	NA
How used	Let out	Own residence
Standard rent	50,000	40,000
Municipal taxes	10%	12%
Sewerage tax	2,000	3,000
Interest on loan	8,000	10,000
Ground rent	8,000	6,000
Land Revenue	4,000	3,000
Collection Charges	3,000	6,000

Compute income from house property for the A.Y. 2021-22 **(Unit-III, Prob.9)**

12. (a) What is depreciation? Explain the conditions for charging depreciation? **(Unit-IV, Q.No.18)**

OR

(b) Dr. Krishna submitted the following income and expenditure account for the year ending 31st March 2021. Compute the income from profession.

Expenditure	Amount (`)	Income	Amount (`)
To Purchase of medicines	50,000	By Consulting fees	3,05,000
To Purchase of life saving medical equipment on 01/05/2013	1,20,000	By Visiting fees	66,000
To Dispensary rent	24,000	By Sale of medicines	60,000
		By Interest on debenture	18,000
To Salary to staff of Ltd. Co.	32,000		
To Telephone charges	8,000	By Pension	40,000
To Income tax	14,000	By Misc. income	290
To Subscription to journals	1,250		
To Gifts given to friends	2,000		
To Ambulance van expenses	18,500		
To House hold expenses	86,000		
To Public deposits in X ltd.	40,000		
To Net income	93,540		
	4,89,290		4,89,290

Depreciation on Ambulance Van is ` 20,000. **(Unit-IV, Prob.11)**

13. (a) From the following information compute the income from other sources for the A.Y 2021 -22

(i)	Card game loss	` 12,000
(ii)	From the activity fowning and maintain horse for race purpose:	
	(a) Loss at Bombay	` 40,000
	(b) Profit at Bangalore	` 20,000
(iii)	Dividend (Gross) from Indian Companies	` 6,000
(iv)	Betting on Horse Races	` 4,000

(Unit-V, Prob.12)

OR

(b) How do you determined the cost of Acquisition for various situations? Explain. **(Unit-V, Q.No.9)**

FACULTIES OF COMMERCE

B.Com. IV – Semester (CBCS) Examination

(Common Paper for General / Computers / Computer Applications / Advertising / Foreign Trade and Honours Courses)

September / October - 2021

INCOME TAX

Time : 2 Hours] **[Max. Marks : 80**

PART - A (4 × 5 = 20 Marks)

Note: Answer any Four questions

ANSWERS

1. Canon of Equality **(Unit-I, SQA-1)**
2. Person **(Unit-I, SQA-15)**
3. Perquisites. **(Unit-II, SQA-7)**
4. Deductions U/S 16. **(Unit-II, SQA-9)**
5. Net Annual Value **(Unit-III, SQA-7)**
6. Block of Assets **(Unit-IV, SQA-7)**
7. Indexed Cost of Acquisition **(Unit-V, SQA-4)**
8. Tax Free Securities **(Unit-V, SQA-9)**

PART - B (4 × 15 = 60 Marks)

Note: Answer any Four questions

9. What are the conditions to be satisfied to treat any income as an Agricultural Income? **(Unit-I, Q.No.27)**
10. Explain about the Income Tax rules to determine the Residential status of an individual assessee. **(Unit-I, Q.No.21)**
11. Mr. Pratap an employee of Public Sector Company, furnishes the following information:
    (a) Basic Pay ` 11,60,000
    (b) Arrears of Salary ` 54,000
    (c) Advance Salary ` 10,000
    (d) Small Car was provides by the Employer, which he has used both for official and business purposes
    (e) Professional Tax paid ` 3,200 per annum
    (f) House Rent Allowance received ` 25,720, Exempted Allowance is ` 12,500

(g) Employee spent ` 15,000 as Medical expenses towards treatment in recognized hospital and the same amount has been reimbursed

(h) Entertainment Allowance is ` 42,620 and Deduction is ` 5,000 0) Employer paid Club Bill ` 5,000, Electricity ` 7,200 Compute his Taxable Salary. **(Unit-II, Prob.22)**

12. Explain differences types of perquisites that are part of Income from salary. **(Unit-II, Q.No.10)**

13. Mr. Kumar holds a house property which he lets out to Sri Shoban for ` 10,000 per month, Municipal Rental Value of the property is ` 7,500, Fair Rental Value is ` 8,500. During the previous year the tenant has not paid one month rent which is not recoverable. Expenses that are incurred by him Municipal Taxes ` 4,000, Insurance Premium paid is ` 10,200. Kumar took a loan of ` 11,00,000 for construction of the house and paid interest of ` 30,240. Calculate Income from House Property for the current assessment year. **(Unit-III, Prob.10)**

14. (i) What do you meant by Annual Value and explain different factors that are to be considered in determining the Annual Value of the House Property. **(Unit-III, Q.No.4)**

    (ii) Write about the deductions from Annual Value of house property. **(Unit-III, Q.No.6)**

15. Mr. Gopal submits the following particulars for the year ended 31st March, 2020. Compute his Income from Business.

Profit and Loss Account

Particulars	Amount (`)	Particulars	Amount (`)
To Salary	1,05,000	By Cross Profit	8,00,000
To Telephone Expenses	11,000	By Income from House Property	6,000
To Repairs	18,000	By Profit on Sale of Land	70,000
To Legal Expenses	39,000	By Interest on Securities	1,000
To Motor Car Expenses	44,000	By Bad Debts recovered	5,000
To Income Tax	10,000		
To Security Transaction Tax	6,000		
To Provision for Taxation	3,000		
To Interest on Loan	12,000		
To Bad Debts	6,000		
To Provisions for Bad Debts	8,600		
To Depreciation	45.000		
To General Expenditure	42,000		
To Net Profit	5,32,400		
	8,82,000		8,82,000

Additional Information

1. Interest paid on Loan for purchase of Machinery
2. As per the Income Tax Act allowable Depreciation is ` 30,000
3. Repairs included in Capital Expenditure ` 12,500, current year repairs ` 5.500
4. Proprietor Salary included in Salary ` 25,000
5. General expenditure included ` 15.000 paid as penalty for violation of Income Tax rules. **(Unit-IV, Prob.2)**

16. Explain various points that are to be considered to calculate depreciation. **(Unit-IV, Q.No.18)**

17. Mr. Vigneshwar sold his residential house for ` 32,50,000 on 15th August 2019-2020 (CII = 289) which he purchased on 10.08.1988 for ` 1,02,000. Fair market value on 01 -04-2001 is ` 8,50,000 and selling expenses 2%. Compute the Income from Capital Gain and Tax Liability if Income from Other Heads is nil. **(Unit-V, Prob.4)**

18. Mr. Ramraj received following incomes during the previous year relevant to current assessment year

(i) ` 20,000; 10% Preference Shares of Wipro Limited Company

(ii) ` 30,000; 12.5% Gold Deposit Bonds

(iii) ` 25,000; 5% Government of India Loan

(iv) ` 1,50,000; 6% Tax Free Debentures of Birla Company Limited

(v) ` 75,000; 4% (Less Tax) Telangana Government Bonds

(vi) ` 1,00,000; 2% Tax Free Kerala Government Securities

(vii) ` 15,000; 7.5% Nagpur Municipal Bonds

(viii) ` 40,000; 13% Tax free Debentures of Vandana ltd.

Collection charges are ` 450 and Interest on Loan taken to purchase Birla Company Debentures is ` 500. Compute Income from Securities for the assessment year 2020-2021. **(Unit-V, Prob.10)**