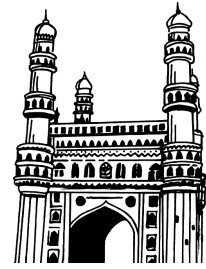


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INCOME TAX

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INCOME TAX

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Important Questions

UNIT - I

- 1. What is direct tax ? Explain its merits and demerits.**

Ans :

Refer Unit-I, Q.No. 4

- 2. Differentiate between direct and indirect taxes.**

Ans :

Refer Unit-I, Q.No. 8

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

Ans :

Refer Unit-I, Q.No. 9

- 4. Explain the history and features of income tax in India.**

Ans :

Refer Unit-I, Q.No. 10

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

Ans :

Refer Unit-I, Q.No. 17

- 6. How does income tax department determine the residential status of an individual?**

Ans :

Refer Unit-I, Q.No. 21

- 7. What is Agricultural Income? Explain different types of Agricultural Incomes.**

Ans :

Refer Unit-I, Q.No. 26

- 8. Explain how net agricultural income can be compused.**

Ans :

Refer Unit-I, Q.No. 30

UNIT - II

- 1. What are the Characteristics of a Salary?**

Ans :

Refer Unit-II, Q.No. 2

2. State the components of salary income.

Ans :

Refer Unit-II, Q.No. 3

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

Ans :

Refer Unit-II, Q.No. 6

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

Ans :

Refer Unit-II, Q.No. 8

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

Ans :

Refer Unit-II, Q.No. 10

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

Ans :

Refer Unit-II, Q.No. 11

7. Smt Ranshrita is working as sales promotion officer, her salary details are as follows: Basic pay: ` 21,000 p.m.; D.A.: ` 7,000 p.m.; HRA: ` 3,500 p.m. (she is living in her own house); Entertainment allowance: ` 1,000 p.m.; C.C.A. ` 1,500 p.m.; According to service conditions she is entitled to commission on sales and she has to bear expenses incurred in promoting sales.

During the previous year she earned a commission of ` 92,000 and expenses incurred in this connection ` 35,000. She claims these expenses as deduction. Professional tax paid by her ` 250p.m. Compute income from salary in the following situations:

(a) She is working in a Government Department.

(b) She is working in a Public Limited Company.

Sol :

Refer Unit-II, Prob. No. 21

8. Smt. Rama Devi Central Government employee received the following emoluments during the previous year 2019-20 Basic pay ` 37,000 p.m., D. A. 16,700 p.m., entertainment allowance ` 6,000 p.a. She received education allowance for her daughter 1,500 p.m. but actual fee is paid by her mother-in-law. She provided the following for her personal and official purpose

(i) laptop costing ` 55,000

(ii) Small motor car and employer pays all expenses including driver's salary ` 11,000 p.m.

Her contribution to S.P.F. is 12% of salary and 10% by the employer. Interest credited in PF @ 8.5% is ` 3,200. The employer presented gift worth ` 11,000 silver articles. The employer paid club membership fee ` 14,900 for the benefit of assessee and her family members.

Her payments: (i) Profession Tax ` 3,800.

Compute income from salary for the assessment year 2020-21.

Sol :

Refer Unit-II, Prob. No. 23

9. The following are the income particulars of Smt. Suryakala for the previous year ending on 31 st March, 2020. Net salary received ` 99,000.

Deductions made by the employer from Salary:

Income Tax ` 1,000.

Premium on L.I.P 2,500.

Professional Tax ` 1,200.

Recovery of Festival loan ` 13,500.

Provident Fund Contribution ` 5,000.

The Employer contributes 14% of basic salary to R.P.F. (Basic Salary of the assessee is ` 32,500)

The employer paid the following :

Telephone bill of the residence ` 42,500.

Electricity bill of the residence ` 32,900.

She went on official tour to Nagpur city for 3 months, where she is provided rent free accommodation, rent paid by the employer ` 7,500 p.m. During this period she is served with free food at a cost of ` 350 per day.

Compute the income from salary for the current assessment year.

Sol :

Refer Unit-II, Prob. No. 24

10. Mr. Ramana Rao works for a Government company at New Delhi and submits the following particulars for the financial year 2021-22.

(i) Basic pay ` 1,90,000

(ii) DA 25% of salary

(iii) Bonus ` 18,000

(iv) Arrears of salary ` 20,000

(v) Entertainment allowance ` 8,000

(vi) Conveyance allowance (75% spent) ` 12,000

(vii) Employer contribution to RPF 14% of salary

(viii) Interest credit to RPF @ 12% is ` 8,000

(ix) He has been provided with a rent free accommodation (owned by the employer) at Delhi whose fair rental value is ` 80,000 p.a. and cost of furniture is ` 41,000/-

(x) He is provided free supply of gas which costs to the employer ` 2,400/- Compute income from salary for the Assessment year 2020-21.

Sol :

Refer Unit-II, Prob. No. 26

UNIT - III

1. Define income from House Property. Under what conditions it is treated as income from House Property.

Ans :

Refer Unit-III, Q.No. 1

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

Ans :

Refer Unit-III, Q.No. 4

3. Explain in detail determination of Annual Value for Self-occupied House.

Ans :

Refer Unit-III, Q.No. 5

4. Sri Durga Prasad is the owner of a house, let out the house for 10 years on 15th May 2012 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 ₹. 16,000. During the previous year is received for ₹.10,000, Repairs ₹. 5,000, interest paid on the loan taken to purchase the house ₹. 16,000. During the previous year rent is received for 10 months and balance is due. Compute Income from House Property.

Sol :

Refer Unit-III, Prob. No. 3

5. 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 2020- 21.

Sol :

Refer Unit-III, Prob. No. 8

6. 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 2020-21.

Sol :

Refer Unit-III, Prob. No. 9

7. Mr. 'X' owns the following house properties for the assessment year 2020 - 21.

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. 2020-21

Sol :

Refer Unit-III, Prob. No. 10

UNIT - IV

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

Ans :

Refer Unit-IV, Q.No. 2

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

Ans :

Refer Unit-IV, Q.No. 3

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

Ans :

Refer Unit-IV, Q.No. 5

4. Explain the Miscellaneous Provisions under section 44.

Ans :

Refer Unit-IV, Q.No. 8

5. Profit and Loss account of Mr. Banwar Lal for the year ended 31 st March 2020 is as follows. Compute income from the business and tax liability for the assessment year 2020-21.

Dr.		Profit and Loss Account		Cr.	
Particulars		Particulars			
To Salaries (including proprietors salary 6,000)	75,000	By Gross Profit @15%		2,86,000	
To Gen. Insurance Premium	4,200	By Commission		8,400	
To Bad debts	11,500	By Profit on sale of long term Investment		21,000	
To Provisions for doubtful debts	5,000	By Bad debts recovered (allowed earlier as deduction)		15,000	
To Rent	7,000				
To Discount	2,460				
To Interest on loan	11,000				
To Annual licence fee	2,080				
To Value Added Tax	8,000				
To Income tax	12,000				
To Interest on capital	7,500				
To Net profit	1,84,660				
	3,30,400				3,30,400

Additional information:

- Present rate of gross profit is 15% and earlier it was 20%.
- 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 Rs. 30,000 is not recorded in the books.
6. For achieving the sales target one of the distributor presented a T.V. set worth Rs. 17,000.
7. Salary to employees is paid through bank except for watchman, whose monthly salary is ` 2,000 is paid in cash.

Sol :

Refer Unit-IV, Prob. No. 3

6. What do you mean by Deemed Profits?

Ans :

Refer Unit-IV, Q.No. 13

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

Ans :

Refer Unit-IV, Q.No. 18

8. 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 :

Refer Unit-IV, Prob. No. 13

UNIT - V

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

Ans :

Refer Unit-V, Q.No. 1

- 2. Discuss in detail about Deemed Transfer.**

Ans :

Refer Unit-V, Q.No. 6

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

Ans :

Refer Unit-V, Q.No. 9

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

Ans :

Refer Unit-V, Q.No. 10

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

Ans :

Refer Unit-V, Q.No. 13

- 6. 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 on 15th November, 2019 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 installments of ₹ 10,00,000. Upto the end of the previous year 1st instalment money received. Selling expenses 2%. CII 2012-13 = 200; 2014-15 = 240; 2019-20 = 289. Compute income from Capital Gain.**

Sol :

Refer Unit-V, Prob. No. 3

- 7. Shri Bhutani who is resident of India furnished the following particular of his investments for the previous year ended 31st March, 2020.**

(i) ₹ 10,000 units of Mutual Fund (Gross income ₹ 1,200);

(ii) ₹ 3,000 in Post Office Savings Bank Account which earns interest @ 4% per annum;

- (iii) ` 45,000 in Fixed Deposit Account with Allahabad Bank on which interest @ 9% is payable;
- (iv) 12% ` 40,000 Debentures (Listed) of Tea Company;
- (v) ` 2,000 interest received on National Development Bonds;
- (vi) ` 1,000 interest received on the debentures of a Co-operative Society;
- (vii) 10% U.P. State Electricity Board Bonds Rs 20,000;
- (viii) ` 10,000 in 7 Year Post Office National Savings Certificates interest @ 7% per annum is payable on the same every year;
- (ix) ` 36,000, 10% Tax-free Debentures of Agra Municipal Corporation. Interest being payable on 31st December;
- (x) ` 900 received by an Account Payee Cheque as interest on debentures (Listed) of a company in which public are substantially interested.
He collected the entire interest himself and claimed ` 200 as his own fees for collection of interest.
- (xi) Interest on post office National Saving certificates VIII issue ` 5,000.

Calculate the taxable income under the head 'Income from Other Sources' for the Assessment Year 2020-21.

Sol :

Refer Unit-V, Prob. No. 13

8. From the following information compute the income from other sources for the A.Y 2020-21
- (i) Card game loss ` 12,000
 - (ii) From the activity owning 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 :

Refer Unit-V, Prob. No. 15

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

Ans :

Refer Unit-V, Q.No. 16

10. Define Casual Income. How gross prize amount of various casual incomes are calculated?

Ans :

Refer Unit-V, Q.No. 21

11. Explain briefly about various Deductions u/s. 57.

Ans :

Refer Unit-V, Q.No. 23

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 TAXE

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. Modern 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 channelise 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 modern 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 is direct tax ? 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 within 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 is 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.

7. 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

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(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 :

(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 consciousness.

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 canon also emphasises 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 instalments 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 within 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 authorises 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 'assessee's'.

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)

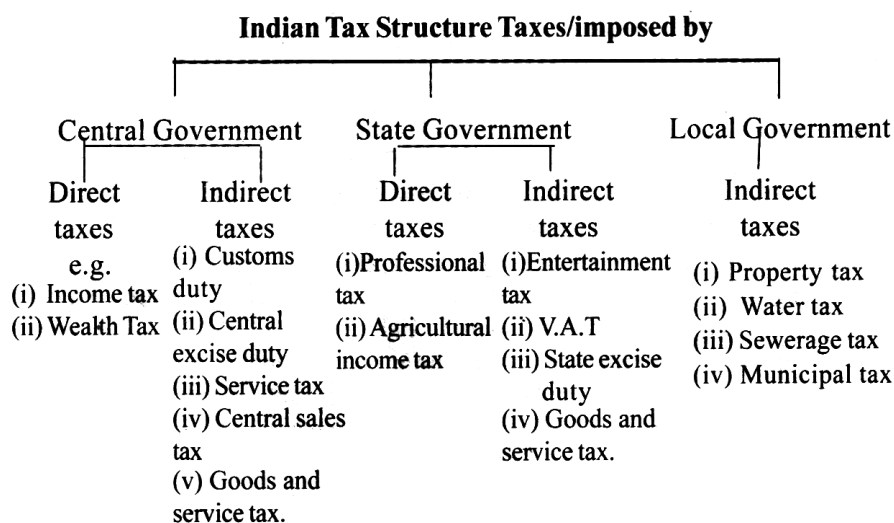
Q11. Explain the tax structure in India

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 minimise 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 FSN 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 2020-21.

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.

(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 2020-21 relevant previous year is 2019-20.

Determination of first previous year for a newly setup business/profession or for a new source of income

In the case of a newly started business/profession during the previous year or for a new source of income which came into existence during the previous year, the period of previous year will be from the date of commencement of the business/profession or from the date of new source of income came into existence to 31st March. For example, if a new business is started on 5-10- 2019, then the first previous year will be from 5-10-2019 to 31-3-2020. Similarly a new house is purchased or construction is completed on 26-6-2019 then the period of first previous year will be 26-6-2019 to 31-3-2020. The period of first previous year of a newly setup business/profession or for a new source of income will be either exactly 12 months (if the commencement date is 1-4- 2019) or less than 12 months but in no case it shall exceed 12 months period)

(vi) Person

According to Income Tax Act, 1961 the term person includes the following types of assessee 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, nowhere 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 loses 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. What is 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 into three categories (1) Non-Senior Citizens, (2) Senior Citizens and (3) Super Senior Citizens in order to ascertain the tax rate and to calculate tax liability. An individual whose age is below 60 years is considered as non-senior citizen, if the age lies between 60 years to 80 years then he/she will be treated as "Senior Citizen". If an individual's 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 country. 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.

3. 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 sc 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 3,50,000. 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 $\times$ 0.05 – 12,500
` 5,00,001 to ` 10,00,000	Total income $\times$ 0.2 – 87,500
` 10,00,001 and above	Total income $\times$ 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

- 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.
- Calculate surcharge @ 10% if income exceeds 50 lakhs, then calculate health and education cess @ 4%.
 $\therefore$ Tax Liability = Income tax + Surcharge + Health and Education cess
 $\therefore$ Tax Due or Refund of tax = Tax liability — Tax deducted at source – Advance Tax paid.

PROBLEMS

- 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

 $\therefore$ 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. During the previous year 2019-20 the total income of an assessee (whose age is 58 years) is ₹ 12,30,497 calculate the tax liability for the assessment year 2020-21.**Sol :**

The assessee is Non-senior citizen

Actual income = 12,30,497 Rounded off income = 12,30,500

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	→ 5,00,000	→ 20% of 5,00,000	= 1,00,000
10,00,001 and above	→ Balance 2,30,500	→ 30% of 2,30,500	= 69,150
	12,30,500		1,81,650

Short cut method:

= Total income X 0.3 (-) 1,87,500

= 12,30,500 X 0.3 (-) 1,87,500 = 1,81,650

Income tax = 1,81,650

Less: Tax Rebate Nil
1,81,650

Add: Health and Education Cess @ 4% = 7,266

1,88,916 or 1,88,920.

∴ Tax liability is ₹ 1,88,920

4. During the previous year 2019-20 the total income of an assessee (whose age is 70 years) is ₹ 11,50,000. Calculate the tax liability in the following situations for the assessment year 2020-21.

Situation (i): If the assessee is a male person.

Situation (ii): If the assessee is a female person.

Sol :

Tax Computation Total income = ₹ 11,50,000

During the previous year the age of the assessee is more than 60 years. So he/ she is considered as "Senior Citizen". In all the cases for both male and female assessee the rate of tax is same.

Income Slab	Income	Tax Rate Tax	Amount in ₹
First 3,00,000	3,00,000	Nil	Nil
3,00,001 to 5,00,000	2,00,000	5% of 2,00,000	10,000
5,00,001 to 10,00,000	5,00,000	20% of 5,00,000	1,00,000
10,00,001 and above Balance	1,50,000	30% of 1,50,000	45,000
	<u>11,50,000</u>		<u>1,55,000</u>

Short Cut Method:

Total income X 0.3 (-) ₹ 1,90,000

11,50,000 X 0.3 (-) ₹ 1,90,000 → ₹ 1,55,000

Income tax 1,55,000

Add : Health & Education Cess @4% 6,200

1,61,200

∴ Tax liability is ₹ 1,61,200.

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:

- Persons leaving India with an intention not to return to India during the relevant assessment year.
- Income of non-resident shipping companies.
- Income of discontinued business.
- 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 file 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/s 10(4B)	Fully exempted	Interest paid to a non-resident person belonging to an Indian origin.
7.	U/s 10(10AA)	Fully exempted	Amount received as leave encashment on retirement.
8.	U/s 10(10B)	Fully exempted	Retrenchment Compensation given to workers.
9.	U/s 10(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/s 10(23EA)	Fully exempted	Income of notified investor protection fund.
13.	U/s 10(23BBE)	Fully exempted	Any income of the Insurance Regulatory and Development Authority of India.
14.	U/s 10(23D)	Fully exempted	Income of mutual fund.
15.	U/s 10(10A)	Fully exempted	Commutated 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/s 10(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 of Residential Status****Q20. Define 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.

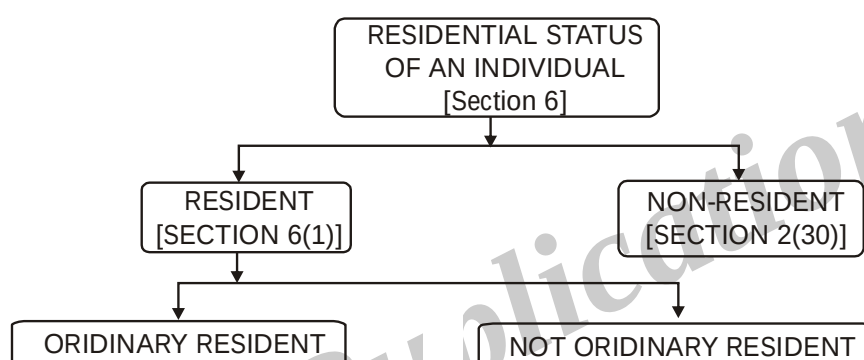
The term "Residential Status is a technical term and it is determined for deciding tax liability of a person". Citizenship is a general term and it grants the fundamental rights to an individual. Citizenship of a person does not change every year, but residential status of a person may change every year, 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 :****(Imp.)****1. Resident (Ordinary Resident) [Section 6(1) Section 6(6)(a) & (b)]**

To determine the residential status of an individual, section 6(1) prescribes two tests. An individual who fulfils any one of the following two tests is called Resident under the provisions of this Act. These tests are :

(a) If he is in India during the relevant previous year for a period amounting in all to 182 days or more.

OR

(b) If he was in India for a period or periods amounting in all to 365 days or more during the four years preceding the relevant previous year and he was in India for a period or periods amounting in all to 60 days or more in that relevant previous year.

Resident = Satisfying any one of the two conditions given u / s 6(1)

Explanation

- (a) In case of individual being a citizen of India who leaves India in any previous year as a member of the crew of an Indian ship as defined in clause (18) of section 3 of the Merchant Shipping Act 1958 (44 of 1958) or for the purposes of employment outside India the provisions of sub-clause (b) as given above shall apply in relation to that year as if the words "sixty days" have been substituted by "182 days".
- (b) In case of an individual being a citizen of India, or a person of Indian origin within the meaning of explanation to clause (e) of section 115 C, who being outside India, comes on a visit to India in any previous year, the provisions of sub-clause (b) shall apply in relation to that year as if for the words.

‘Sixty days occurring therein the words One hundred and eighty two days had been substituted. ’

After fulfilling one of the above two tests, an individual becomes resident of India but to become an ordinary resident of India an individual has to fulfill both the following two conditions :

- (1) He has been resident of India (fulfilling at least one test given above) in at least 2 previous years out of 10 previous years immediately prior to the previous year in question.
- (2) He has stayed in India for at least 730 days in 7 previous years immediately preceding the previous year in question.

This means that an individual will not become an ordinary resident of India by simply staying in India for a period of 182 days or more in a previous year. He will become ordinary resident only if he fulfills one of these two tests and was also fulfilling one of the tests in at least 2 previous years preceding the relevant previous year and did stay in India for at least 730 days in 7 previous years preceding the relevant previous year.

While calculating number of days for stay in India, day of departure was not included. But now as per decision of Authority for Advance Rulings, both, day of departure from India and day of arrival in India are to be counted as stay in India.

(i) For Indian citizen going abroad on a job or as a member of crew of an Indian ship

[Explanation (a)] In case of an Indian citizen :

- (a) Who is going outside India for a job and his contract for such employment outside India has been approved by the Central Government ; or
- (b) He is a member of crew of an Indian ship ;

test (a) u/s 6(1) remains the same but in test (b) 60 days have been replaced by 182 days.

The practical effect of this explanation is that in case of persons of Indian citizenship going abroad on a job approved by the Central Government only test (a) is to be applied during the year he is leaving India.

(ii) For Indian citizens and persons of Indian origin [Explanation (b)]

For such persons test (a) remains the same but in test (b) words ‘60 days’ have been replaced by 182 days.

The practical effect of this provision is that those persons who are Indian citizens or persons of Indian origin living outside India and when they come to visit India only test (a) of 6 (1) is to be applied.

A person shall be deemed to be of Indian origin if he or either of his parents or any of his grand parents was born in India or undivided India [Section 115 (c) explanation to clause (c)].

2. Resident but not Ordinarily Resident [Section 6(6)]

An individual who is resident u/s 6(1) can claim the beneficial status of N.O.R. if he can prove that :

- (a) He was non resident in India for 9 previous years out of 10 previous years preceding the relevant previous year.

OR

- (b) He was in India for a period or periods aggregating in all to 729 days or less during seven previous years preceding the relevant previous year.

An individual who is Resident u/s 6(1) can be subdivided into two categories :

(a) Ordinary Resident ; or (b) Not ordinarily Resident

To Summarise

Ordinary Resident = Satisfying any one of two conditions given u / s 6(1)
+ Satisfying both the additional conditions of Sec. 6(6)(a) & (b)
Not Ordinarily Resident = Satisfying any one of the two conditions given u / s 6(1)
+ Not satisfying any one or both the additional conditions

3. Non-resident [Section 2(30)]

Under section 2(30) of the Income-tax Act, 1961 an assessee who does not fulfil any of the two conditions given in section 6(1)(a) or (b) would be regarded as 'Non-resident' assessee during the relevant previous year for all purposes of this Act.

Non - resident = Not satisfying any one of the basic conditions given u / s 6(1)

Q22. Give a brief explanation about determining the residential status of HUF.

Ans :

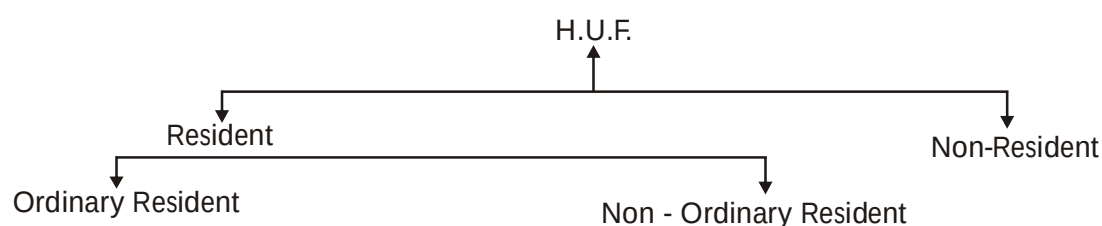
(Imp.)

A HUF can broadly be of two categories :

1. Resident
2. Non-Resident

A Resident HUF can again be of two sub-categories :

- a) Resident and Ordinarily Resident
- b) Resident and Not-Ordinarily Resident



A HUF is said to be a RESIDENT if the control and management of its affairs is situated wholly or partly in India.

A HUF is said to be a NON-RESIDENT if the control and management of its affairs is situated wholly outside India. Control and management means and includes the decisions making capacity regarding the affairs of the HUF.

Once a HUF is said to be resident in India, then it is necessary to further classify it into two sub-categories. For this, the additional conditions applicable to an individual are looked to with regard to the Karta of the HUF.

Additional Conditions

- a) The Karta is a Resident **in India** for at least 2 years out of last 10 previous years immediately preceding the relevant previous year;
- b) The Karta shall be **in India** for a period of 730 days or more during last seven previous years preceding the relevant previous year."

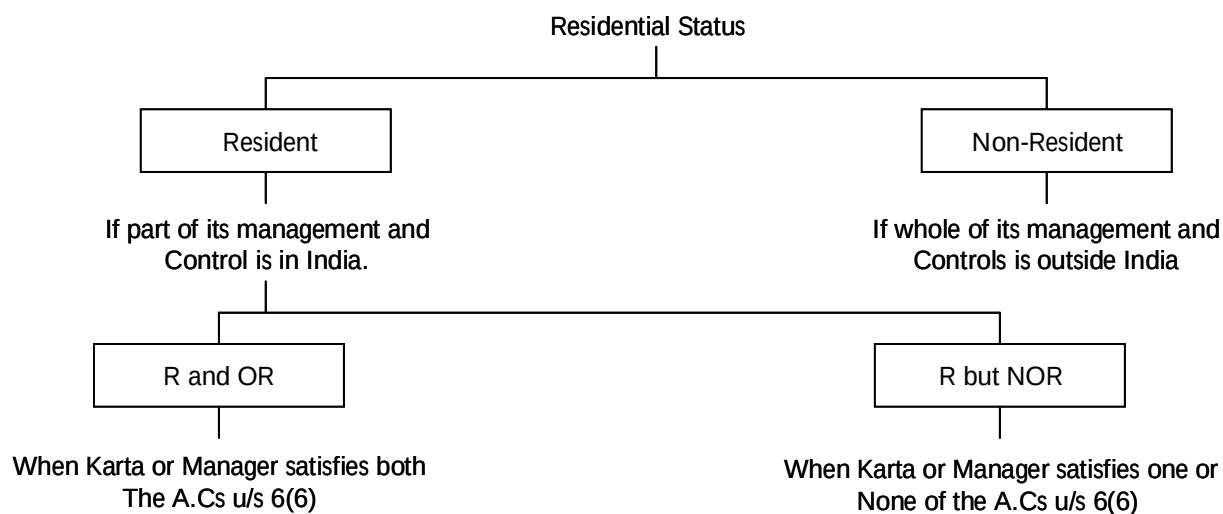
These persons may be either resident or non-resident in India for any previous year. A Firm, AOP, BOI and every other person is said to be a RESIDENT of India if the control and management of the affairs of such organization is situated wholly or partly in India during the relevant previous year. Here, the control and management generally lies in the hands of the partners or members of such organization.

If the Karta satisfies both the additional conditions, the HUF gets a status of ORDINARILY RESIDENT and if the Karta does not satisfy both the additional conditions, or satisfies only one of them, then the HUF gets a status of Not Ordinarily Resident of India.

These persons are said to be NON-RESIDENT of India if the control and management of the affairs of such person is situated wholly outside India during the relevant previous year. If the partners or members of such organizations are residents of India, then it is a normal presumption that such organization also is resident unless it is proved the other way.

Rules in Nutsell

Status	Basic Conditions	Additional
1. Resident and Ordinarily Resident	Control and Management wholly or Partially in India	Both
2. Resident but Not-Ordinarily Resident	Same as above	One or none
3. Non-Resident	Control as Management wholly outside India	Not Applicable



Ans :

The residential status of a company is to be determined on the basis of its incorporation or registration. Section 6(3) provides the following tests in this connection.

A company shall be said to be resident in India, in any previous year, if :

- a) it is an Indian company; or
- b) its place of effective management, at any time in that year, is in India.

A company shall be 'non-resident' if it is not resident in India during the relevant accounting year.

It means that, a company whose control and management is situated wholly or partially outside India, will be non-resident company.

Every other person includes body of individuals, a local authority and an artificial juridical person. They are either 'Resident' or "Non-Resident" but they cannot be Not ordinarily resident.

The test to be applied shall be the of control and management.

If it is situated wholly outside India, the assessee will be Non-resident.

If the control and management is wholly or partially situated in India, the status will be that of 'Resident'.

5. **Mr. Ram, an Indian citizen leaves India for the first time on 31st May 2015 and comes back on 15th May 2018. He again leaves India on 10th June 2019 to come back on 14th January 2020. He is living in India since then. Determine his status for the previous year 2019-20.**

Sol :

Determination of residential status of Mr. Ram

Relevant previous year 1-4-2019 to 31-3-2020 (A.Y. 2020-21)

Stay in India during this year

- (i) 1-4-2019 to 10-6-2019 (on 10th June he leaves India) = 71 days
- (ii) 14-1-2020 to 31-3-2020 [18 + 29 + 31] = 78 days

Total	<u>149 days</u>
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Test (a) of section 6(1) is not fulfilled as his stay in India is less than 182 days.

Test (b) (i) stay during 2019-20 exceeds 60 days ; and

(ii) stay during 4 previous years preceding the relevant previous year is :

2018-19	15-5-2018 to 31-3-2019	= 322 days
2017-18	Not in India	= Nil
2016-17	Not in India	= Nil
2015-16	1-4-2015 to 31-5-2015	= 61 days
Total		<u>= 383 days</u>

Mr. Ram fulfills second test of section 6(1) as he stays in India for more than 365 days in 4 previous years proceeding the previous year in question. So he becomes resident in India in the previous year 2019-20.

He becomes ordinary resident in India as he fulfills both the conditions of section 6(6). Hence he is Resident u/s 6(1) (b) and he is ordinarily resident u/s 6(6) as he was resident for more than 2 previous years out of 10 previous years preceding the relevant previous year and he was in India for more than 730 days out of 7 previous years preceding the relevant previous year.

6. Ascertain the residential status of the assessee in the following cases for the assessment year 2020-21 :

- (i) Mohan is a citizen of India. He left for Iran on 18th April 2019 and could not return to India till the end of the financial year 2019-20.
- (ii) Ramavtar left for U.S.A. on 10th March, 2017 after having lived in India for 20 years. He returned to India on 10th Sept. 2019.
- (iii) Rajinder is a citizen of India. He left on 15th May, 2019 for London for higher studies. He came back to India on 25 May, 2019. He maintained a dwelling place in India during his absence.

Sol ;

**Determination of residential status of Mr. Mohan, Ramavtar
and Rajinder for the current assessment year**

- (i) Mr. Mohan stayed in India for 18 days during the previous year 2019-20. As he did not stay in India during that year for required number of days, so his residential status during the previous year 2019-20 shall be non-resident.
- (ii) 2016-17—stayed in India for 344 days
 2017- 18 Nil
 2018- 19 Nil
 2019- 20—10th Sept. 2019 to 31st March 2020 = 203 days.

During the previous year, 2019-20. Ramavtar stayed in India for 203 days. Hence he is Resident u/s 6(1) (a) and he is ordinary resident u/s 6(6) as he was resident for more than 2 previous years out of 10 previous years preceding the relevant previous year and he did stay in India for more than 730 days out of 7 previous years preceding the relevant previous year.

- (iii) During the previous year 2019-20. Mr. Rajinder stayed in India for 45 days only. He is non-resident during the previous year (2019-20) as he does not fulfil any of the two tests of Section 6(1).

7. **Mr. Joseph, a foreigner, came to India from Poland for the first time on 1st April 2013. He stayed here continuously for 3 years and went to France on 1st April 2016. He, however, returned to India on 1st July 2016 and went to Poland on 1st December 2017. He again came back to India on 25th January 2020 on a service in India.**

What is his residential status for the A.Y. 2020-21.

Sol :

Mr. Joseph's stay in India from 1.4.2013 to 31.3.2020 is as under :

01-04-2013-31-03-2014	—	366 days
01-04-2014-31-03-2015	—	365 days
01-04-2015-31-03-2016	—	365 days
01-04-2016-31-03-2017 - 01-07-2016 - 31-03-2017	—	275 days
01-04-2017-31-03-2018 - 01-04-2017 - 01-12-2017	—	245 days
01-04-2018-31-03-2019	—	NIL
01-04-2019-31-03-2020 - 25-01-2020 - 31-03-2020	—	7 + 29 + 31 = 67 days

Assessment year 2020-21 (i.e., Previous year 2019-20)

Mr. Joseph did stay in India for 67 days in previous year 2019-20.

Mr. Joseph did stay in India during the preceding 4 previous years as under :

$$\frac{2018-19}{NIL} + \frac{2017-18}{245} + \frac{2016-17}{275} + \frac{2015-16}{365} = \frac{\text{Total}}{885 \text{ days}}$$

Mr. Joseph stayed in India for 67 days in the relevant previous year and also did stay in India for 885 days in 4 previous years preceding the relevant previous year and so has fulfilled second condition of section 6(1) hence he becomes resident of India for the previous year 2019-20.

Mr. Joseph shall be treated as ordinary resident of India as he was resident of India for more than 2 year out of ten previous years preceding the relevant previous year and also did stay in India for more than 730 days in 7 previous year preceding the relevant previous year.

1.7 INCIDENCE OF TAX

1.7.1 Types of Incomes

Q24. 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**Q25. 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

Q26. What is Agricultural Income? Explain different types of Agricultural Incomes.

Ans :

(Imp.)

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

On the basis of definition of agricultural income given above, it can be classified into five broad categories. These types of agricultural incomes are :

1. Any income received as rent or revenue from agricultural land

Rent can very simply be defined as a payment in cash or in-kind which the owner of the land receives from another person in consideration of a grant of a right to use land. When the owner of land is not performing agricultural operations himself but gives his land on contract basis, any amount received from the actual cultivator by the owner of the land shall be agricultural income. Such rent may be in cash or in-kind, i.e., a share in the produce grown by the cultivator.

The Privy Council decided in a case [C.I.T. vs. Kamakshya Narain Singh (1948) I.T.R. 395] that interest on arrears of rent payable in respect of agricultural land cannot be agricultural income, because it is neither 'rent' nor 'revenue derived from land'.

The word revenue is used in a very broad sense of return, yield or income and not only in a narrow sense of land revenue [C.I.T. v. Kamakshya Narain Singh], This term embraces income other than rent and that is why mutation fees received from the tenants on their getting occupancy holdings and fees paid by the tenants at the time of renewal of their lease, are revenue derived from land and as such exempted from tax.

In the above mentioned case the Privy Council has clearly laid down that revenue is derived from land only if the land is immediate and effective source of the revenue and not the secondary and indirect source. So any income or revenue which is indirectly derived from land cannot be presumed to be the agricultural income. This point is further clarified by the Supreme Court in a case Bacha Guddar v. C.I.T. that dividend paid by a company to its shareholders out of its agricultural income is not an income derived from land since the immediate and effective source of dividend income to the shareholder is the shareholding in the company and not the land.

Income from sale of agricultural land. The Finance Act, 1989 has added an explanation to section 2(IA) as a result of which any revenue derived from land shall not include and shall be deemed never to have included any income arising from the transfer of any land mentioned in section 2(14) (iii) (a) or (b). It has been made applicable retrospectively from 1-4-1970. It simply means that any income from transfer of urban agricultural land will not form part of agricultural income. It will be taxable income under the head "Capital Gains. ".

2. Income derived from Agriculture

Income derived from land situated in India by applying agricultural operations shall be agricultural income. If all the basic operations like preparation of land for sowing, planting, watering, harvesting etc. are applied, any income resulting from such operations shall be agricultural income. On the other hand, if grass, trees etc. have grown spontaneously or without the aid of human skill, effort, labour etc., any income resulting from the sale of such grass, trees or lease rent of such land shall not be agricultural income.

Agricultural income also includes income from orchards or from horticulture.

It is further to be noted that if a particular income is derived from land but without applying agricultural operations, such an income although derived from land cannot become agricultural income and so any income having remote connection with land cannot be called as agricultural income. Income from poultry and dairy farming, fisheries, mining, stone quarries, breeding and rearing of livestock, all these incomes although remotely linked with land but cannot be called agricultural incomes because of the absence of important characteristics of agricultural income, i.e., cultivation of land.

3. Any income accruing to the person by the performance of any process to render the produce marketable

If, in the ordinary course, a process is to be employed by the cultivator himself or the landlord who receives the produce as rent-in-kind, any income derived from such a process shall be

agricultural income. Such a process must be employed to render the produce fit for marketing. The process may be manual or mechanical. It should be noted that the produce should not change its original character in spite of the processing unless the produce cannot be sold in that form or condition.

Following points are to be noted in this connection :

- (a) The process must be one which is ordinarily employed by the cultivator.
- (b) The process is employed to render the produce fit to be taken to the market.
- (c) The produce must retain its original character in spite of process unless the produce is having no market if offered for sale in its original condition.

This can further be elaborated with following examples :

- (i) Unginned cotton can be sold in its original form and if any profit is attributable to the ginning operation, such a profit shall not be agricultural income as ginning operation is not a must to render the produce fit to be taken to the market [Sheolal Ramlal v. C.I.T. 4 I.T.C. 375],
- (ii) Tobacco leaves need to be dried to make them suitable for the market and thus profit earned by selling dried tobacco shall be agricultural income. [C.I.T. v. Katragadda Madhusudhana Rao 12 I.T.R. 1]
- (iii) Drying and curing of coffee after picking beans, husking of paddy, conversion of latex into sole crepe or smoked sheets. [C.I.T. v. Woodlands State Ltd. (1965) 58 I.T.R. 612] etc. are other examples of processes carried on to make the produce marketable.

4. Any income received by the person by the sale of produce raised or received as rent-in-kind

Any income derived by any person by the sale of agricultural produce raised by him or received as rent-in-kind shall also be agricultural income. Sometimes such person puts some extra effort by

selling the produce through his own shop, any extra profit raised due to shopping activities shall not be agricultural income.

5. Income from buildings used for agriculture

Any income derived from a building used for agricultural operations shall be agricultural income provided :

- (a) The building from where the income is received, is in the immediate vicinity of the land and is occupied by the owner, or by the cultivator or by the receiver of rent-in-kind.
- (b) Building is used as a dwelling house or a store house or other out-building.

The cultivator or the receiver of the rent-in-kind, by reason of his connection with the land, is in need of the house as a dwelling house or as a house to store the goods required for agricultural operations.

- (c) The land if assessed to land revenue in India or is subject to a local rate assessed and collected by officers of the Govt, and in case the land is not-assessed to land revenue or to local rate, it should not be situated within the urban areas.

Q27. What is agricultural income and explain conditions to be satisfied for an income to be treated as an agricultural income?

Ans :

Agricultural Income

According to the Section 10(1) of Income Tax Act 1961, the agricultural income is fully exempted from tax. This is 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.

Conditions

For an income to be considered as agricultural income, they have to satisfy certain conditions given under Income Tax Act, 1961, sec 2 (1 A).

1. Rent or revenue derived from the land.
2. The land is used for agricultural purpose.
3. Land must be situated in India.

1. Rent or Revenue Derived from the Land

If the assessee has given the land on lease and the tenant has used that land for agricultural purpose then the rent received by land lord from tenant which can be either in cash as a share in produce, will be treated as agricultural income.

Revenue means the amount received through sale of agricultural produce or any income which is directly related to land. The land can be situated either in rural or urban area.

2. The Land is used for Agricultural Purpose

Income will be considered as agricultural income only if the land is used for agricultural purpose or agricultural operations have taken place on that land.

Agricultural operation are classified as,

- (a) Basic Operation
- (b) Subsequent operation.

(a) Basic Operation

It means involvement of human skill and labour on the land before geemination of plants i.e., ploughing, seeding, planting, watering etc.

(b) Subsequent Operation

Any activity carried after getting the agriculture produce are known as subsequent operations like weeding, cutting, halvering, etc.

If both these operation have carried on the land then the income derived is considered as agricultural income.

3. Land Must be Situated in India

The land which is used for agricultural purpose and through which rent or revenue is derived should be situated in the boundaries of India only.

If the land is not situated in India, but it is used for agricultural purpose only and rent/revenue is derived from the land, but still it will not be considered as agricultural income. If the land is not situated in India then such income will be treated on income from other sources.

Following are some of the example for agricultural income,

- Any amount received through growing and selling of paddy, wheat, flowers etc.
- Sale of tobacco leaves.
- Sale of Straw.
- Any amount received as compensation from insurance company for damage of crops because of unseen contingencies.

Q28. 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 = Sale proceeds of industrial - M.V. of Agricultural - Industrial expenses		
Income	product (e.g., Sugar)	used as raw material
Note : Cost of calcuvation is not to be charged as expenses.		
(b) Agricultural Income = M.V. of Agricultural produce - Cost of cultivation		
	used as raw material	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 :

$$\begin{aligned} \text{Composite Income or Total Income} &= \text{Sale proceeds of Rubber (i.e., Industrial product)} \\ &\quad \text{Cost of cultivation (i.e., Agricultural expenses)} \\ &\quad \text{Industrial expenses} \end{aligned}$$

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/ = Sale proceeds of Tea - Cost of cultivation - Industrial Expenses		
Total Income	(i.e., Industrial Product)	(i.e., Agricultural 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(I)	75%	25%
Coffee grown, cured, roasted and grounded by the seller in India with or without mixing			
chicory or other flavouring ingredients	7B(IA)	60%	40%
Growing and Manufacture of Tea	8	60%	40%

1.9 HEADS OF INCOME

1.9.1 Gross Total Income – Total Income

Q29. 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 :

- Income from 'Salaries' [Sections 15-17];
- Income from 'House Property' [Sections 22-27];
- Income from 'Profits and Gains of Business or Profession' [Sections 28-44];
- Income from 'Capital Gains' [Sections 45-55] ; and
- 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.

Q30. Explain how net agricultural income can be compused.

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". All 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 and Answers

1. What are the objectives of Tax?

Ans :

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. Modern 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 channelise 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 modern approach are listed below.

1. Ensuring accelerated economic development.
2. Increasing employment opportunities.
3. Reducing regional imbalances.

2. 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.

(i) 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.

(ii) 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 canon also emphasises 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.

(iii) 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.

(iv) 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 instalments through bank.

3. Define 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.

4. Define Residential Status.

Ans :

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.

5. What are the conditions applicable for residential status of company and every other person ?

Ans :

Residential status of company

The residential status of a company is to be determined on the basis of its incorporation or registration. Section 6(3) provides the following tests in this connection.

1. Resident [Section 6(3)]

A company shall be said to be resident in India, in any previous year, if :

- a) it is an Indian company; or
- b) its place of effective management, at any time in that year, is in India.

2. Non-resident [Section 2(30)]

A company shall be 'non-resident' if it is not resident in India during the relevant accounting year.

It means that, a company whose control and management is situated wholly or partially outside India, will be non-resident company.

Residential Status of Every Other Person [Section 6(4)]

Every other person includes body of individuals, a local authority and an artificial juridical person. They are either 'Resident' or "Non-Resident" but they cannot be Not ordinarily resident.

The test to be applied shall be the of control and management.

If it is situated wholly outside India, the assessee will be Non-resident.

If the control and management is wholly or partially situated in India, the status will be that of 'Resident'.

6. 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

(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.

7. 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 is because, the agricultural income comes under the subject of State Government. Hence, Central Government cannot levy tax on it. Sec 2(1A) discusses 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 be 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.

8. What are the various sources of 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].

9. What are the characteristics of Tax?

Ans :

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.

10. Differentiate between direct and indirect taxes.

Ans :

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.

11. 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.

12. 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.

13. 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.

14. 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 2020-21.

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.

15. 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 2020-21 relevant previous year is 2019-20.

Determination of first previous year for a newly setup business/profession or for a new source of income

In the case of a newly started business/profession during the previous year or for a new source of income which came into existence during the previous year, the period of previous year will be from the date of commencement of the business/profession or from the date of new source of income came into existence to 31st March. For example, if a new business is started on 5-10- 2019, then the first previous year will be from 5-10-2019 to 31-3-2020. Similarly a new house is purchased or construction is completed on 26-6-2019 then the period of first previous year will be 26-6-2019 to 31-3-2020. The period of first previous year of a newly setup business/profession or for a new source of income will be either exactly 12 months (if the commencement date is 1-4- 2019) or less than 12 months but in no case it shall exceed 12 months period)

16. Person

Ans :

According to Income Tax Act, 1961 the term person includes the following types of assessee 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.

17. 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 loses 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.

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. Surcharge of 15 per cent is payable by an individual where the total income exceeds: [c]
(a) Rs. 7,50,000 (b) Rs. 10,00,000
(c) Rs. 1,00,00,000 (d) Rs. 75,00,000
5. The rate of tax that is leviable 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 or 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 beginning. 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 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 :

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 be 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 Chartered 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, whichever 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 chargeable 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.

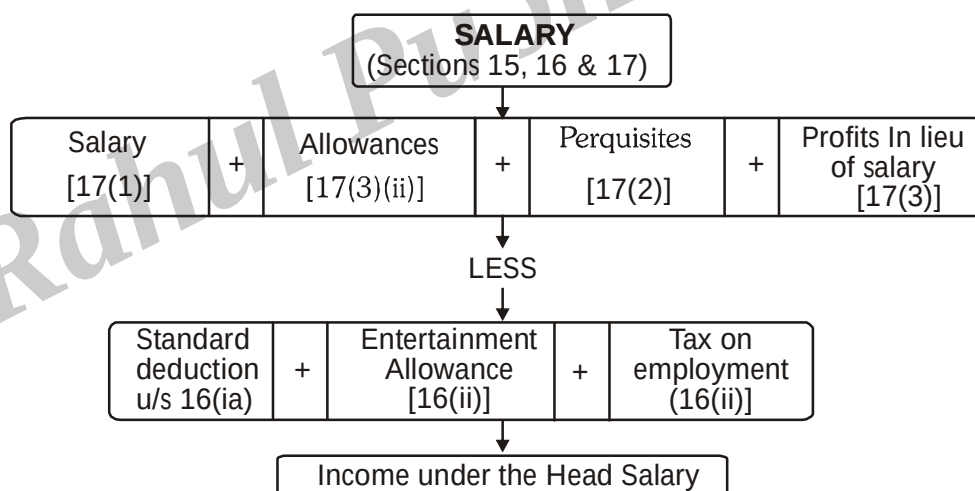
2.2 COMPUTATION OF SALARY INCOME u/s 17(1)

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:		
Entertainment allowance u/s 16 (ii)		XX
Professional Tax u/s 16 (iii)	XX	XX
Income from salary		XX

Q5. Define the following terms :

(i) **Basic pay**

(ii) **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. In 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) Gratuitous 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 'Gratuitous 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	6,160
Less 12% of salary being exempted	73,920	
Taxable Portion		
(ii) Interest credited to R.P.F. Balance @ 12%	64,000	13,333
Less exempted upto @ 9.5% (64,000 x 9.5%/12)	50,667	
Taxable portion		
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 :

- Statutory Provident Fund or the Fund to which the Act of 1925 applies (S.P.F.).
- Recognized Provident Fund (R.P.F.).
- Unrecognized Provident Fund (U.R.P.F.).
- Public Provident Fund (P.P.F.).

Treatment of Provident Funds

S.No.	Particulars	Fund governed by P.F. Act 1925 (S.P.F.) (For Govt or Semi Govt. Employees)	Recognized Provident Fund (R.P.F.) (For Private Sector)	Unrecognized P.F. (U.R.P.F.) (For Private Sector)
1.	Employee's own contribution.	Fully qualifies for deduction u/s 80C	Fully qualifies for deduction u/s 80C	Does not qualify for deduction u/s 80C
2.	Employer's contribution	Fully exempted	It is deemed to be received by employee. Excess of Employer's contribution to R.P.F. over 12% of salary is taxable.	Ignore for the time being
3.	Interest credited to Accumulated Balance.	Fully exempted	Exempted upto rate prescribed by the Government. Excess over this amount is taxable (i.e. 9.5%)	Ignore for the time being
4.	Refund/Transferred Balance of U.R.P.F. to R.P.F.	Fully exempted	Exempted in all cases except when employee leaves service of his own accord before completion of 5 years' continuous service. In such case the amount which has not been charged to tax is added in salary	In case of refund taxable portion is added in 89(1)]. In transferred balance amount which salary income of the year [Enter. to relief u/s would have been taxable had the fund been: RPF is added in salary

(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

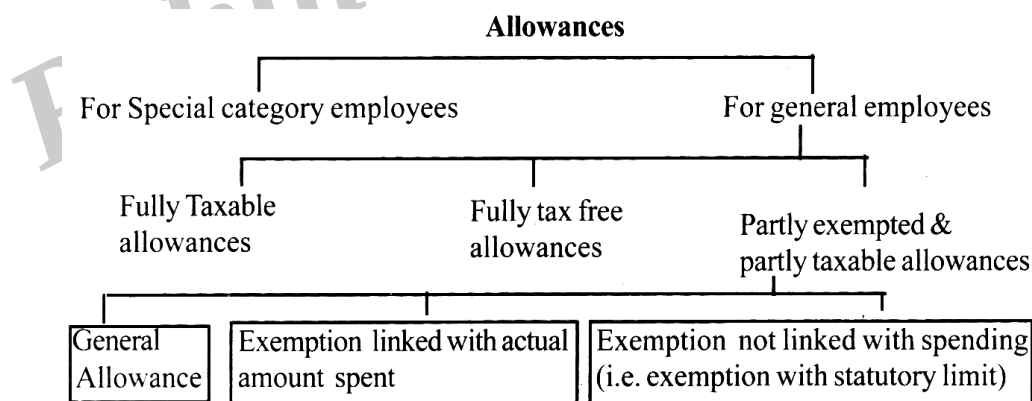
Any/All allowances received by the following persons is fully exempted from tax.

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.R.S.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: Foreign allowance: For government employees it is fully tax free and for others fully taxable.

Note: 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 (A) General Allowances (B) Exemption linked with actual expenditure (c) Exemption which does not linked with actual expenditure.

Q9. Define the following terms :

- (i) General Allowances
- (ii) Exemption of Allowance linked with actual expenditure incurred
- (iii) Exemption of Allowance not linked with actual expenditure

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.

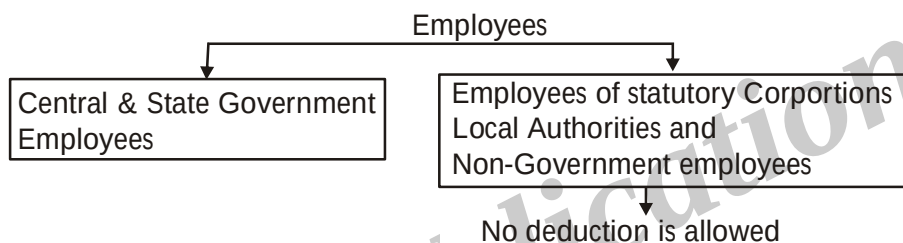
Note: If nothing is mentioned in the problem then the entertainment allowance received is to be treated for personal purpose only.

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(h).

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



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.10 (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:

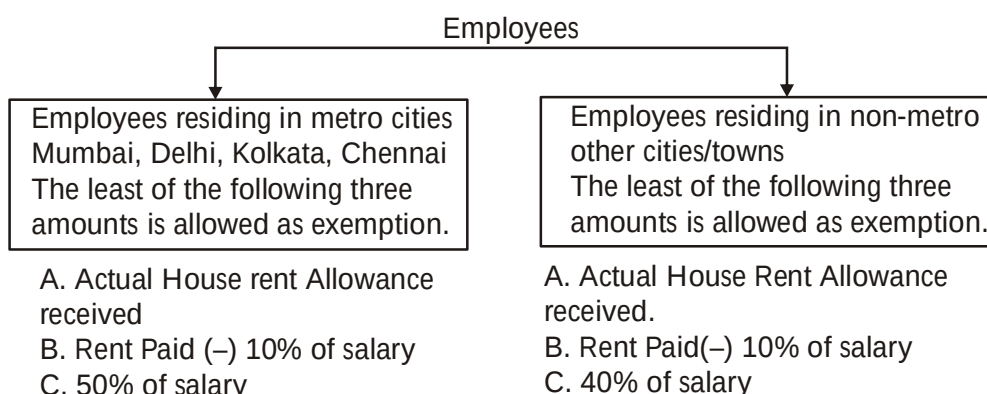
This allowance is allowed as exemption only when the assessee is paying rent of the house where he is presently residing.

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.

**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 expenditure 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.

- | | | |
|--|---|---|
| <ol style="list-style-type: none"> 1. Uniform allowance 2. Helper allowance 3. Daily allowance 4. Conveyance allowance 5. Transfer allowance 6. Academic allowance | } | → Actual amount spent 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 fully 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)

Least of the following two amounts,

(i) Actual allowance received

(ii) ₹ 1,600 p.m.

Note: For physically handicapped or physically challenged or blind 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 × 12) × $\frac{20}{100}$ | = 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 Rajendhar age 45 years is working in ministry of Home Government of India and his wife Smt. Nirmal Gosh age 40 years is working in ministry of Foreign Affairs Govt, of India .Their monthly salary particulars are given below.

Pay per month in	Basic	D.A	H.R.A	Entertainment allowance	C.C.A
Sri Rajendhar	28,000	100%	20%	10,000	2,000
Smt Nirmal Gosh	55,000	100%	20%	15,000	2,000

Both of them wants to claim deduction u/s 16 (ii) is it possible or not. Give your note as an I.T.O.

Sol :

Both of the Assesses are working in central Government. Hence, Both of them are eligible to get deduction U/S 16 (ii)

- i) Calculation of deduction U/S 16(ii) for Sri Rajendhar is as follows.

Deduction is allowed "Least" of the following :

- a) 20% salary = $(28,000 \times 12) \times \frac{20}{100}$ = Rs. 67,200
 b) Actual received allowance = $10,000 \times 12$ = Rs. 1,20,000
 c) Ceiling / Standard Amount = Rs. 5,000

From the above Rs.5,000 is the least amount. Hence, the deduction is allowed U/S 16(ii) is Rs.5,000

- ii) Calculation of deduction U/S 16(ii) for Smt. Nirmala Ghosh is as follows.

Deduction is allowed "Least" of the following :

- a) 20% of salary = $(55,000 \times 12) \times \frac{20}{100}$ = Rs.1,32,000
 b) Actual received allowance = $15,000 \times 12$ = Rs. 1,80,000
 c) Ceiling / Standard Amount = Rs. 5,000

From the above Rs. 5,000 is the least amount. Hence, the deduction is allowed U/S 16(ii) is Rs. 5,000.

3. Mr. Sahdev is in receipt of ` .1,62,000 as basic salary ` . 54,000 as House Rent Allowance and ` . 27,000 as Dearness Allowance. If the rent paid is ` . 62,000. Determine the taxable amount of house rent allowance in the following situations.

- (i) If he is a Government Employee and residing in Mumbai.
 (ii) If he is Non-Government Employee and residing in Mumbai.
 (iii) If he is residing in Hyderabad city.
 (iv) If he is residing in Madurai and staying in father-in-law's house without paying any rent.

Sol/ :

- (I) Assessee is living in mumbai and paying rent of the house. So, exemption can be given exemption is "Least" of the following.

(a) Actual allowance Received	= Rs. 54,000
(b) Rent paid -10% salary [62,000 – 16,200]	= Rs. 45,800
(c) 50% of salary [1,62,000 × 50/100]	= Rs 81,000

Exemption = Least from the above is Rs. 45,800

∴ Taxable HRA = Actual Allowance Received -Exempted allowance.

$$54,000 - 45,800 = \text{Rs.} 8,200$$

Note :

- (1) Salary means basic pay only.

(2) $10\% \text{ salary} = 1,62,000 \times \frac{10}{100} = \text{Rs.} 16,200$

- (ii) Assessee is living in mumbai and paying rent of the house. So, exemption can be given exemption is "Least" of the following.

(a) Actual allowance Received	= Rs. 54,000
(b) Rent paid -10% salary [62,000 – 16,200]	= Rs. 45,800
(c) 50% of salary [1,62,000 × 50/100]	= Rs 81,000

Exemption = Least from the above is Rs. 45,800

∴ Taxable HRA = Actual Allowance Received -Exempted allowance.

$$54,000 - 45,800 = \text{Rs.} 8,200.$$

- (iii) Assessee is residing Hyderabad and paying rent of the house. So, exemption can be given exemption is "Least" of the following.

(a) Actual allowance received	= Rs. 54,000
(b) Rent paid -10% salary [62,000 – 16,200]	= Rs. 45,800
(c) 40% of salary $\left[1,62,000 \times \frac{40}{100} \right]$	= Rs. 64,800

Exemption = Least from the above = Rs. 45,800.

∴ Taxable HRA = Actual HRA received -exemption HRA

$$54,000 - 45,800 = \text{Rs.} 8,200$$

Taxable HRA = Rs. 8,200.

Note :

- (i) Salary means Basic pay only

(ii) $10\% \text{ salary} = 1,62,000 \times \frac{10}{100} = \text{Rs.} 16,200$

- (iv) Assessee is residing in madurai and staying in father-in-law house, without paying any rent.

Assessee can't get any exemption u/s 10 (13A). Because, he is not satisfying the condition i.e. Assessee should be pay the rent of the house where he is presently residing.

Hence, Actual HA received is fully taxable. i.e. Taxable HRA = Rs. 54,000.

4. **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, ₹.6,000 as 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.

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 = $\left[5,000 \times 12 \times \frac{50}{100} \right] = ₹ 30,000$

∴ Exempted HRA = ₹ 12,000.

6. Compute taxable house rent allowance from one following information,**(i) Basic pay ` 60,000 p.m****(ii) Dearness allowance 80% of basic pay****(iii) House rent allowance 30% of basic pay and rent paid to accommodation in Delhi ` 30,000 p.m.****Sol :**

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

(i) Actual house rent allowance received = 2,16,000

$$\left[(60,000 \times 12) \times \frac{30}{100} \right] = \left[7,20,000 \times \frac{30}{100} \right]$$

(ii) Rent paid (-) 10% of salary = 2,88,000

$$\left[30,000 \times 12 - 7,20,000 \times \frac{10}{100} \right]$$

$$[30,000 \times 72,000]$$

(iii) 50% of salary = 3,60,000

$$\left[(60,000 \times 12) \times \frac{50}{100} \right] = \left[7,20,000 \times \frac{50}{100} \right]$$

Particulars	Amount (₹)
Actual allowance received	2,16,000
Less : Exempted	2,16,000
Taxable HRA	Nil

7. 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

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

- 8. Satya Krishna Prabhav 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 Prabhav

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
 = 10,800
 (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) Basic 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

$$\Rightarrow \text{Basic Pay} = 60,000 \times 12 = 7,20,000$$

$$\text{D.A} = 80\% \text{ of basic pay}$$

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

$$\text{H.R.A} = 30\% \text{ of Basic pay} = 2,16,000$$

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 – 72,000 = 2,88,000
 (c) 50% of salary (Metro city)

$$\begin{aligned} 50\% \text{ of salary} &= (7,20,000 \times \frac{50}{100}) \\ &= 3,60,000 \end{aligned}$$

Taxable HRA

= Actual Amount Received – Exempted Amount

= 2,16,000-2,16,000 = '0'

∴ Taxable HRA = Nil

2.5 PERQUISITES

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

Ans :

(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.

Types

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

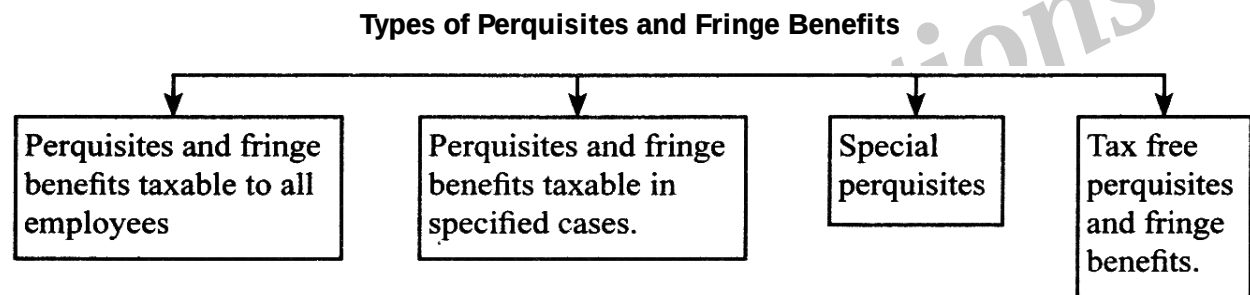


Fig.: Types of Perquisites and Fringe Benefits

1. Perquisites and Fringe benefits taxable to all employees

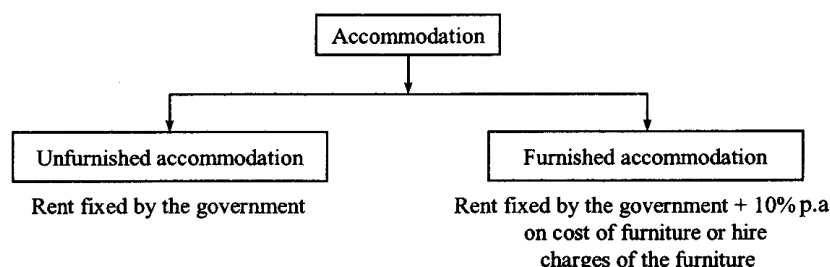
The following are the perquisites, which are taxable to all employees.

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))

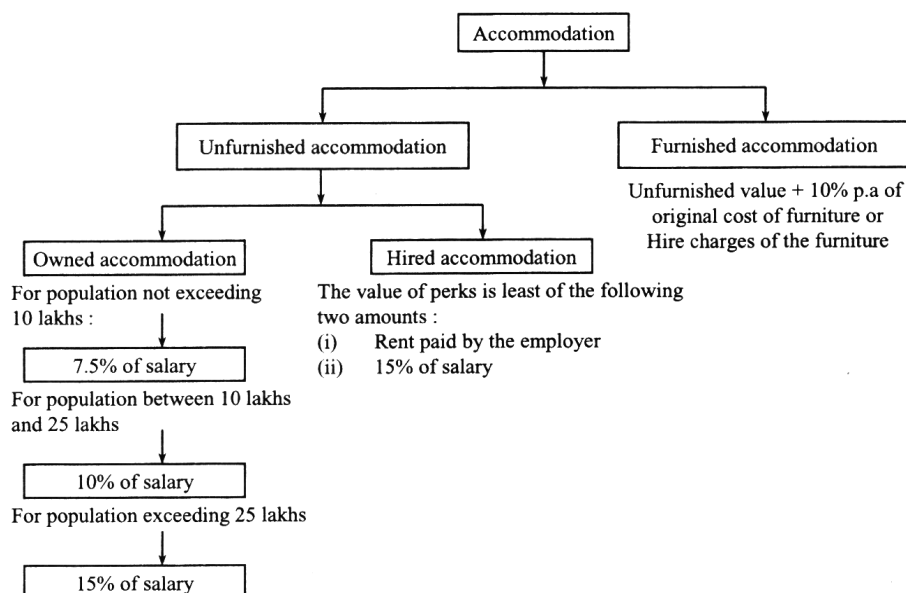
Government Employees

For government employees the value of perquisites is calculated as follows,



Other Employees

For other employees the value of perquisites is determined as follows,



Salary = Basic pay + Bonus (except gratuitous bonus) + Fees + Commission + D.P + All taxable allowances (D.A if it enters into retirement benefits) + Any payment made by the employer in the form of cash + IT or profession tax paid or reimbursed by the employer.

In case if employer is providing accommodation in hotel for both Government and other employees then the value of perks will be least of the following two amounts,

- (i) 24% of salary
- (ii) Actual charges paid or payable to hotel.

But if the assessee is satisfying the following three condition then the value of perks will become tax-free,

- (i) If accommodation is provided for less than 15 days
- (ii) If hotel is hired by the employer
- (iii) If accommodation is provided on transfer of employee from one place to another place.

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. 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?

6. 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 → -do-
 - 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.

7. 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

8. 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) Official 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.

9. 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

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 accommodation 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 accommodation fixed by the Government only.

As per the given details,

(i) Value of unfurnished accommodation	= 8,000 × 12 = Rs 96,000
Add : Hire charges of furniture	= 1,500 × 12 = Rs. 18,000
Value of Rent free Accommodation	<u>Rs. 1,14,000</u>

➤ 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 accommodation fixed by the Government only.

As per the given details

(i) Value of unfurnished accommodation	=	2,500 × 12 = Rs. 30,000
Add value of furniture (Note)	=	Rs. 6,500
Value of Rent free Accommodation		<u>Rs. 36,500</u>

Note: Calculation furniture value

(a) Value of furniture = Rs. 50,000.

$$\text{Provide Depreciation @10\% cost} = 5,000 \times \frac{10}{100} = 5,000$$

(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)	<u>Rs. 6,500</u>
----------------------------------	------------------

- 12. Smt. Vasundara is working in a Ltd. Co. in a town of Kerala State as Asst. Manager. Her salary particulars are as follows : Basic pay : ₹. 8,000 p.m.; D.A. 25% which enters into retirement benefit Bonus ₹. 21,000; she is provided with rent-free accommodation which is owned by the employer (the population of the town 12 lakhs) with the fair rental value of ₹. 3,000 p.m.; For the first three months only she was provided with a television set a refrigerator and a geyser which were hired for ₹. 500 p.m. and later she was provided with the furniture at a cost of ₹. 1,20,000. Compute the value of rent-free accommodation.**

Sol :

Smt. Vasundhara is working in a limited company. It means she is a Non-Government employees. then, Rent free Accommodation is calculate through the following :

(i) 10% of salary (Note i) i.e.	Rs. 14,100
Add (ii) Value of furniture (Note ii)	Rs. 10,500
Value of Rent free Accommodation	<u>Rs. 24,600</u>

Note (i) Calculation of salary.

Salary means Basic Pay + Bonus + DA only

$$= 8000 \times 12 + 8000 \times \frac{25}{100} \times 12 + 21,000$$

$$= 96,000 + 24,000 + 21,000.$$

$$= \text{Rs } 1,41,000$$

$$10\% \text{ of salary} = 1,41,000 \times \frac{10}{100} = \text{Rs. } 14,100$$

Note (ii) Value of furniture

(a) Hire charges of Television set, geyser and refrigerator

$$\text{for 3 months} = 500 \times 3 = 1500$$

(b) 10% cost of furniture for 9 month.

$$1,20,000 \times \frac{10}{100} \times \frac{9}{12} = 9000$$

Rs. 10,500

(iii) Employer provided own accommodation, and population is 12 lakhs. Hence, unfurnished Rent free accommodation value is 10% of salary.

13. Mr. Rajan is working with a private company in a small town in Krishna Dist of A.P. His salary particulars are as follows : Basic pay : ₹ 5,000 p.m.; D.A. : ₹ 3,200 p.m.; Project allowance : ₹ 400 p.m.; Medical allowance : ₹ 500 p.m.; uniform allowance : ₹ 300 p.m. and he spent ₹ 2,000 for his uniform in the year; he is provided with rent-free accommodation owned by the employer and the rental value for the similar accommodation is ₹ 600 p.m. The furniture costing ₹ 8,000 is provided by the company. Compute the value of rent-free accommodation.

Sol :

Assessee is a Non-Government employee and working in a small city, it assuming that population is Less than 10 Lakhs only. Hence, calculate through the following.

(i) Value of unfurnished house (7.5% of salary) Note (i) = Rs 5,430

Add Value of furniture (Note (ii)) = Rs 800

Value of Rent free Accommodation Rs. 6,230

Note (i) Salary means Basic Pay + All Taxable allowances.

➤ D.A. is not entering retirement benefits. So, it is not included to calculate salary.

Basic Pay = $5,000 \times 12 = 60,000$

Project allowance = $400 \times 12 = 4,800$

Medical allowance = $500 \times 12 = 6,000$

Uniform allowance = $(3,600 - 2,000) = 1,600$

Total salary. Rs. 72,400

Note :

(i) Calculation of 7.5% of Salary = $72,400 \times \frac{7.5}{100} = \text{Rs. } 5,430$

(ii) **Value of furniture**

Cost of furniture = Rs 8,000

10% of cost = $8,000 \times \frac{10}{100} = \text{Rs. } 800$

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. Commuted value 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 ` 5,00,00/-

1. Gratuity [Sec. 10 (10)]

Any amount of gratuity received on the death or retirement of an employee is exempt u/s 10 (10) as explained below.

(a) Government employees : In case of a government employee (central/ state/local government) any amount of gratuity received on the death or retirement of an employee shall be fully exempt u/s 10(10).

(b) Other employees : Other employees are categorized as :

- i) Covered under the Payment of Gratuity Act, 1972
- ii) Not covered under the Payment of Gratuity Act, 1972

Death-cum-retirement gratuity[Section 10(10)]

Gratuity refers to a lumpsum payment made by an employer to his employee at the time of leaving job in appreciation of his long and loyal services. Earlier it was a voluntary payment but now it has become a sort of compulsory payment for government employees, semi-government employees, and all other employees working in banks, universities, colleges, factories, etc.

I. At the time of leaving job

In this case, gratuity is received by employee on leaving job either due to voluntary retirement or due to statutory retirement on reaching the super annuation age. Gratuity so received by employee is taxable 'under the head salary' after claiming exemption as provided under section 10(10).

II. In the event of death of employee

Gratuity can also be received by the legal heirs of an ex-employee in the event of death of such employee. In this case, gratuity received shall be taxable in the hands of legal heirs under the head "Income from other Sources". In this case also, an exemption will be granted as provided under section 10(10).

A) Government Employee. Any death-cum retirement gratuity received by government employee is 'fully exempt.' Exemption U/S 10(10)(i)

Meaning of Government Employee. Government employees include :

- a) Employees of Central Government.
- b) Employees of State Government.
- c) Employees of Local Authority.
- d) Employees working in Defence.
- e) Employees of Statutory Corporations.

B) Non-Government Employees U/S 10(10) (ii) & (iii)

B-I. Non-Government employees receiving gratuity under payment of Gratuity Act, 1972 [POGA]. U/S 10(ii)

Certain non-government employees have been covered under the payment of Gratuity Act, 1972 by the Central Government and thus these non-government employees are required to pay gratuity as per the provisions of Gratuity Act, 1972.

Any gratuity received by such an employee shall be **exempt** to the extent of least of following 3 amounts :

- a) Actual Amount received
- b) 15 days salary (7 days in case of employees working in seasonal factories) for each completed year of service or part thereof in excess of six months on the basis of month salary last drawn;
- c) Notified limit ` 20,00,000

Gratuity actually received by the employee and balance shall be taxable.

Taxable Gratuity = Gratuity received - Exempt

Note :

- **Calculation of Length of Service/Service Period.** While calculating length of service, period exceeding 6 months is to be taken as full year (i.e., one year).

For example

- a) Service period of 26 years and 7 months shall be taken as 27 years.
- b) Service period of 26 years and 6 months shall be taken as 26 year.

- **Calculation of 15 days salary ?**

(a) In case of monthly rated employees. 15 days salary is to be calculated on the basis of monthly salary last drawn. Here, month is to be taken as of consisting of 26 days (maximum number of working days in a month) and hence monthly salary last drawn shall be assumed to be of 26 days and hence 15 days salary shall be calculated as follows :

$$15 \text{ days salary} = \frac{\text{Monthly salary last drawn}}{26 \text{ days}} \times 15 \text{ days}$$

- b) In case of piece rated employees.** 15 days salary/wages shall be calculated on the basis of average of the total wages/salary of a period of 3 months immediately preceding his retirement. Wages for overtime period are to be ignored.

Example :

Calculate wages for 3 months ending on the date of retirement

Less : Any amount received as overtime payment

Wages of 3 months

Divide by 3 to find out wages of one month

15 day's wages = Wages of one month * 15/26

Meaning of Salary. 'Salary' means salary last drawn by the employee and it also includes dearness allowance but does not include bonus and other allowances.

$$\text{Salary} = \text{Basic Salary} + \text{D.A. (whether enters or not)}$$

B-II. Non-Government Employees receiving gratuity (Not covered under payment of Gratuity Act). 1972 U/S 10(10)(iii)

Least of the following 3 amounts shall be exempt :

- Actual Amount received.
- 1/2 month salary for every completed year of service on the basis of average salary drawn during 10 months immediately preceding the month of retirement.
- Maximum notified limit, ₹ 20,00,000.

Gratuity actually received by the employee and balance shall be taxable

$$\text{Taxable gratuity} = \text{Actual gratuity received} - \text{Exempt}$$

Note :

- i) Calculation of length of service/service period.** While calculating length of service, only completed years are to be counted. Thus, any fraction or part of the year is to be ignored.

For example (i) If service period = 25 year 9 months, it is to be taken as 25 years. (i) If service period = 25 years 4 months, it is also to be taken as 25 years.

- ii) Calculation Half month's salary :** 1/2 month's salary is to be calculated on the basis of average salary drawn during the 10 months immediately preceding the month of retirement.

For example, if an employee retires on November 15, 2017, average salary is to be calculated by taking total salary drawn during past 10 months (i.e., from January 1, 2017 to October 31, 2016).

$$\text{Now } 1/2 \text{ month's salary} = \text{Average salary} \times 1/2$$

- iii) Meaning of Salary.** 'Salary' means salary last drawn by the employee and it also includes dearness allowance but does not include bonus and other allowances.

$$\text{Salary} = \text{Basic Salary} + \text{D.A. (whether enters or retirement benefit)}$$

2. Commutation of Pension Sec. 10 (10A)

Annuity or pension paid by the employer, whether voluntarily or under any contractual obligation, is chargeable to tax under the head 'salaries'. Pension is a periodic payment made by the employer to the employee after his retirement or death.

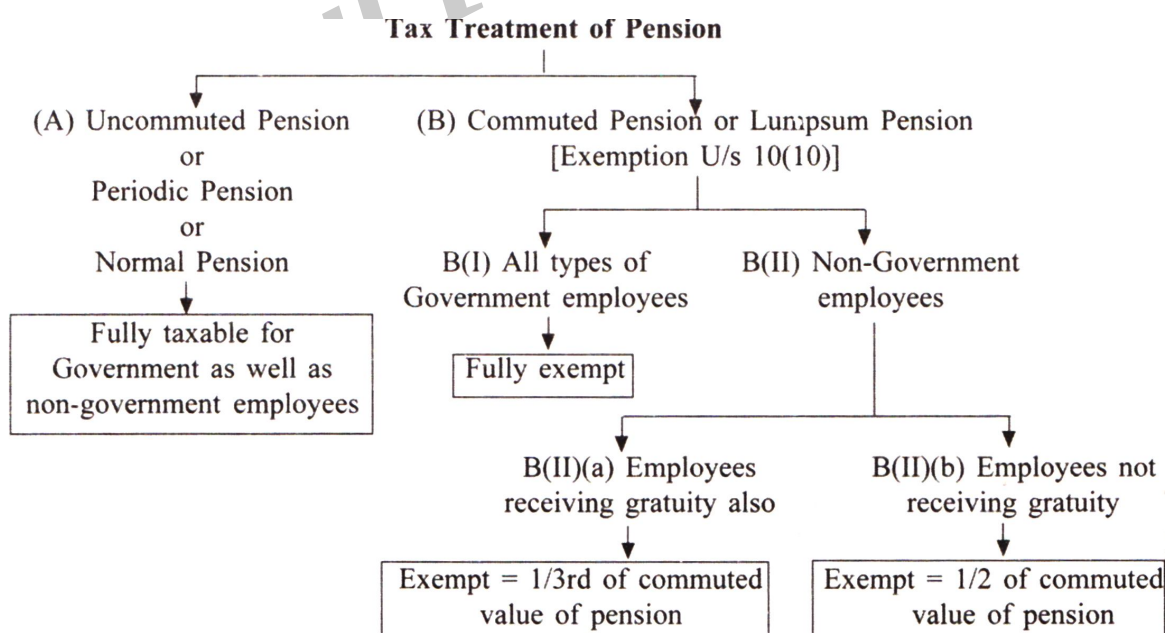
Commutation of Pension

Where an employee gets a lump-sum amount in lieu of periodic payment, it is known as commutation of pension.

Tax Liability of Pension

1. Uncommuted pension is fully taxable as salary in all cases of employees.
2. Commuted value of pension u/s Sec. 10 (10A) shall be exempt as under:
 - a) **Government employees :** (Including local bodies or corporations set up by govt) Any amount of commuted pension shall be fully exempt u/s 10
 - b) **Other employees :** Commuted value of pension received by non-government employees shall be exempt u/s 10 (10A) as under :
 - i) Where the employee does not receive any gratuity, the commuted value of one-half of such pension ($\frac{1}{2}$) to which he is normally entitled to receive shall be exempt. Any excess over such limit is taxable.
 - ii) Where the employee receives gratuity, the commuted value of one-third of the pension ($\frac{1}{3}$) which he is normally entitled to receive is exempt. Any excess over such limit is taxable.

Pension (Monthly and Commuted)



A) Tax Treatment of Uncommuted Pension

Uncommuted pension refers to the periodic/regular pension (generally monthly) received by an employee from ex-employer after retirement and until such an employee dies.

Tax Treatment. Fully Taxable whether the employee is a government employee or non-government employee.

It is taxable as salary income of such an ex-employee.

B) Tax Treatment of Commuted Pension

Commuted pension refers to lumpsum amount received by an employee from his employer in lieu of periodical pension. When an employee receives such lumpsum amount, it is called commutation of pension.

B (I) For all types of Government Employees. Fully exempt

Meaning of a Government Employee. It includes :

- a) Employees of Central Government; or
- b) Employees of State Government; or
- c) Employees of Local Authority; or
- d) Employees of a corporation set up under Central State or Provincial Act or under the Civil Pensions (Commutation) rules of the Central Government; or
- e) Employees of public sector undertakings; or
- f) Judges of Supreme Court or High Courts of India.

Disability Pension given to Armed Forces Personnels—It is fully exempted as per letter F.No. 200/51/99ITA-I issued by CBDT dated 6-5-2000.

B(II). For Non-Government Employees. Any amount received on commutation of pension shall be exempt as per the provisions of section 10(1 OA) :

B(II)(a). If employee receives gratuity also. The exempted amount shall be commuted value of one-third ($\frac{1}{3}$) of pension which he is normally entitled to receive.

B(II)(b). If employee does not receive gratuity. The exempted amount shall be commuted value of one-half ($\frac{1}{2}$) of such pension.)

Step 1 : Calculate commuted value for Total Pension (for 100%).

Step 2 : Calculate exempted amount.

Step 3 : Calculate taxable amount , if necessary.

PROBLEMS ON GRATUTY

14. 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.

- 15. Sri Vishnu Vardhan an employee of a limited company received on 1st July, 2019 ₹. 13,00,000 as gratuity. He retired after serving for 35 years. At the time of retirement his monthly salary was ₹. 54,740. If he is covered under the Gratuity Act calculate the un-exempted amount of gratuity.**

Sol :

Assessee is working in a Limited company. it means he is a Non-Government employee and covers under the Gratuity Act. Hence unexempted amount of Gratuity will be calculate through the following.

Taxable Gratuity = Actual Amount Received - Exempted Gratuity

Exempted Gratuity = Least of the following.

(i) Actual amount received = Rs. 13,00,000.

(ii) 15 days salary × No. of years of service completed.

$$54,740 \times \frac{15}{26} \times 35 = \text{Rs. } 11,05,327$$

(iii) Ceiling /standard Amount = Rs. 20,00,000

Exemption = Least from the above = Rs. 11,05,323.

Taxable Gratuity = 13,00,000 – 11,05,323

Taxable Gratuity = Rs. 1,94,677

- 16. 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)

$$= \text{Salary} = 38,000 + 18,500$$

$$\text{Salary} = \text{Rs. } 56,500.$$

Situation (ii) If Assessee is not not Governed by Payment of Gratuity Act.

Exemption of Gratuity = Least from the following

$$(i) \quad \text{Actual amount Received} = \text{Rs. } 14,00,000$$

$$(ii) \quad \frac{1}{2} \text{ Average of Salary} \times \text{No. years of Service completed}$$

$$\frac{1}{2} \times 38,000 \times 26 = \text{Rs. } 4,94,000$$

$$(iii) \quad \text{Ceiling Standard Amount} = \text{Rs. } 20,00,000$$

$$\text{Exemption} = \text{Least from the above} = \text{Rs. } 4,94,000$$

$$\text{Taxable Gratuity} = \text{Actual Amount received} - \text{Exemption}$$

$$\text{Taxable Gratuity} = 14,00,000 - 4,94,000$$

$$\text{Taxable Gratuity} = \text{Rs. } 9,06,000$$

Note : Salary means Basic pay only for last 10 months.

$$\text{Average Salary} = \frac{38,000 \times 10}{10} = \text{Rs. } 38,000$$

17. Mr. Harsha Vardhan retired from the Indian Army Services in 2001-2002 previous year and received ₹ 1,40,000 as gratuity. After two months, he joined in a limited company as Chief Security officer. During the previous year 2019-20 he retired from the service of limited company and received ₹ 25,60,000 as gratuity under Payment of Gratuity Act. Calculate tax liability for the assesment year 2020-21. If income from salary and other heads (excluding gratuity received) is ₹ 7,54,000.

Sol :

Computation of Tax liability of Mr Harsha Vardhan for the Assesment year 2020-21

Particular	Rs.
(I) Salary	
(i) Gratuity Note (i)	7,00,000
(ii) income from other sources	7,54,000
	14,54,000
Less : Standard deduction u/s 16(a)	40,000
Total Income	14,14,000

Slabs	Income limit (Rs.)	Taxable Income (Rs)	Tax rate %	Tax (Rs)
I	Up to 2,50,000	2,50,000	NIL	NL
II	2,50,001 to 5,00,000	2,50,000	5%	12,500
III	5,00,001 to 10,00,000	5,00,000	20%	1,00,000
IV	Above 10 Lakhs	4,14,000	30%	1,24,200
		14,14,000		2,36,700

Add : Health & Education Cess @ 4% $\left[2,36,700 \times \frac{4}{100} \right]$ 9,468

Net tax liability

2,46,168

Rounded off Tax liability is Rs. 2,46,170

Note (i) Calculator of Taxable Gratuity

Assessee is worked in limited company. it mean the is a Non -Government Employee and covering under Gratuity Act. Hence Taxable Gratuity to be calculate as follows.

Taxable Gratuity = Actual Received -Exemption Gratuity

Exhumation is least of the following.

(i) Actual amount received = Rs. 25,60,000

(ii) 15 days salary $\times$ No of years of service completed.

(iii) Ceiling /standard Amount = 20,00,000 – 1,40,000 = Rs. 18,60,000

Exemption = Least from the above = Rs.18,60,000

Taxable Gratuity = 25,60,000 – 18,60,000 = Rs. 7,00,000

➤ Salary last drawn and No. of years of Service details not given.

18. Sri Harshanth retired from the service after serving for 29 years. During the previous year he got 1/4 of his pension commuted and received ₹. 4,50,000. Calculate the taxable amount in the following cases.

i) If he is a Government employee.

ii) If he is a Non-Government employee and received gratuity.

iii) If he is a Non-Government employee and did not receive any Gratuity.

Sol :

Situation (i) Assessee is a Government Employee Hence, pension is fully exempted from the tax liability.

Taxable Pension = NIL

Actual Amount Received = Rs. 4,50,000

Exempted value = Rs. 4,50,000

Un- exempted/taxable amount = NIL

Taxable pension = NIL

Situation (ii) Assess is non Government employee and receiving gratuity. Then Taxable pension is calculates through the following.

$$\text{Exemption} = \frac{1}{3}^{\text{rd}} \text{ of computed value}$$

Step (i) computed value for total pension i.e. 100%

$$\frac{1}{4} = 4,50,000$$

$$1 = ?$$

$$\therefore \frac{4,50,000 \times 1}{\frac{1}{4}} = 4,50,000 \times \frac{4}{1} = \text{Rs.} 18,00,000$$

Step (ii) Calculate the exempted amount.

$$\text{Exemption} = \frac{1}{3}^{\text{rd}} \text{ of commuted value of Normal Pension}$$

$$\text{Exemption} = \frac{1}{3} \times 18,00,000 = \text{Rs. } 6,00,000$$

Step (iii) Calculation of Taxable Pension.

$$\text{Actual Received} = \text{Rs. } 4,50,000$$

$$\text{Less: Exempted pension} = \text{Rs. } 6,00,000$$

$$\text{Taxable or deficiency in exempted amount} = (\text{Rs. } -1,50,000)$$

Taxable amount is in negative . Hence Taxable amount is NIL.

Situation (iii) Assessee is Non-Government Employee and did not receive any gratuity.

$$\text{Exemption} = \frac{1}{2} \text{ of commuted value of normal pension}$$

Step (i) Computed value for total pension i.e. 100%

$$\frac{1}{4} = 4,50,000$$

$$1 = ?$$

$$\therefore \frac{4,50,000 \times 1}{\frac{1}{4}} = 4,50,000 \times \frac{4}{1} = \text{Rs} 18,00,000$$

Step (ii) Calculation of exempted pension i.e. $\frac{1}{2}$ of the commuted value of pension.

$$\frac{1}{2} \times 18,00,000 = \text{Rs.} 9,00,000$$

Step III Calculation of taxable Pension

Actual Received	=	Rs. 4,50,000
Less Exempted	=	Rs. 9,00,000
Taxable or deficiency in exempted pension	=	Rs. (– 4,50,000)

Taxable amount is in negative value. Hence, Taxable Amount is NIL.

19. Sri K.C. Arora retired from the service after serving for 25 years and received ₹.16,00,000 as leave encashment for 6 months. His employer allows him 1 month leave for 1 year of service. He has already encashed 6 months leave during his service period and availed 2-months leave. His average salary ₹. 36,000. Calculate taxable amount of leave encashment if

(i) He is a Government employee.

(ii) He is a Non - Government employee.

Sol :

Situation (i) Assessee is a Government Employee After retiring from the services, any Leave encashment received from the employer. It is fully exempted from the tax. Hence, Taxable Leave Encashment = NIL.

Situation (ii) Assessee is a Non-Government employee.

The exemption amount is "Least" of the following .

(i) Cash equivalent to balance of the Leave period at the time of retirement

$$36,000 \times 17 = \text{Rs. } 6,12,000 \text{ (Note i).}$$

(ii) 10 months of Average salary = $36,000 \times 10 = \text{Rs. } 3,60,000$.

(iii) Ceiling Standard Amount = Rs. 3,00,000.

Exemption = Least from above = Rs.3,00,000.

Note (i) Step I Calculation of Leave period one month for 1 year of service completed i.e. $1 \times 25 = 25$ months.

Step II, Calculation of balance of unavailed leave period at the time of retirement.

Total leave period = 25 months

Less Leave period availed during service period = 8 months.

Leave balance due at the time retirement = 17 months.

Taxable income = Actual Received – Exemption Amount

Taxable income = $16,00,00 - 3,00,000 = \text{Rs. } 13,00,000$

20. With the following information, compute the taxable amount of gratuity for an assessee who is non-govt employee for the AY 2020-21.

Gratuity received 15,00,000 on retirement (served for 29 years 8 months) last drawn salary 40,000, DA 18,500, CCA 3,000 and HRA 4,000 pm.

Case-1: If assessee is governed by payment of Gratuity Act.

Case-2: If assessee is not-governed by Gratuity Act.

Sol :

Case-1:

Assessee is a non-government employee and is governed by gratuity Act.

The taxable gratuity will be,

$$= \text{Actual amount received} - \text{Exempted Amount}$$

$$= 15,00,000 - 10,12,500$$

$$= \boxed{4,87,500} \rightarrow \text{Taxable gratuity}$$

Case-2:

Assessee is a non-government employee and is not governed by gratuity Act.

The taxable amount of gratuity will be,

$$= \text{Actual amount received} - \text{Exempted Amount}$$

$$= 15,00,000 - 6,00,000$$

$$= \boxed{9,00,000} \rightarrow \text{Taxable gratuity}$$

Working Note

Case-1

Calculating Exempted Amount

1. Calculate salary = Basic Pay + DA (of retiring month)

$$= 40,000 + 18,500 = 58,500$$

2. Calculate 15 days salary = $58,500 \times \frac{15}{26} = 33,750$.

3. Service period = (29 years + 8 months) = 30 years.

4. Exemption amount = least of the following three amounts,

i.e., Actual amount received = $\boxed{15,00,000}$

$$15 \text{ days salary} \times \text{year of service} = 33,750 \times 30 = 10,12,500$$

$$\text{Ceiling limit} = 20,00,000 \text{ Exempted Amount} = 10,12,500.$$

Case-2

Calculate salary = only basic pay = 40,000.

Calculating average salary, as previous 10 years salary details are not given, salary of retiring month is taken as, average service period = (29 years + 8 months) = 30 years.

Calculate Exempted Amt

Actual amt received = 15,00,000

$\frac{1}{2}$ of average salary x No. of years service completed

$$= \frac{1}{2} \times 40,000 = \boxed{6,00,000} \rightarrow \text{least amount.}$$

Ceiling limit = 20,00,000

Exempted gratuity = 6,00,000.

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)

Actual amount paid will be allowed as deduction i.e., if the tax is due but payment is not yet made then it shall not be allowed as deduction.

PROBLEMS

21. Smt Ranshrita is working as sales promotion officer, her salary details are as follows: Basic pay: ₹ 21,000 p.m.; D.A.: ₹ 7,000 p.m.; HRA: ₹ 3,500 p.m. (she is living in her own house); Entertainment allowance: ₹ 1,000 p.m.; C.C.A. ₹ 1,500 p.m.; According to service conditions she is entitled to commission on sales and she has to bear expenses incurred in promoting sales.

During the previous year she earned a commission of ₹ 92,000 and expenses incurred in this connection ₹ 35,000. She claims these expenses as deduction. Professional tax paid by her ₹ 250 p.m. Compute income from salary in the following situations:

- She is working in a Government Department.
- She is working in a Public Limited Company.

Sol :

(Imp.)

Situation 1: If she is working in a Government Department

Computation of Smt. Ranshrita's Income from Salary For the assessment year 2020-21

Particulars	Amount in ₹
Salary	
Basic Pay @ ₹ 21,000 p.m.	2,52,000
commission	92,000
Allowances	
D.A @ ₹ 7,000 p.m.	84,000
House Rent Allowance	42,000
C.C.A. @ ₹ 1,500 p.m.	18,000
Entertainment allowance @ ₹ 1,000 p.m	12,000
Perquisites	NIL
Profits in lieu of salary	NIL
Gross Income from salary	5,00,000
Deductions	
Standard Deduction u/s 16(ia)	50,000
Entertainment allowance u/s 16(ii)	5,000
Professional Tax u/s 16 (iii)	3,000
Income from Salary	4,42,000

Working Notes:

1. **House Rent Allowance:** Assessee is not paying rent of the house so exemption cannot be given

Actual allowance received (3,500 × 12)	=	42,000
Less: exemption	=	Nil
Un-exempted	=	42,000

2. **Standard deduction** : The deduction is least of the following two amounts.

(a) Gross Income from salary ` 5,00,000

(b) ` 50,000

3. **Entertainment Allowance**: The Assessee is Government employee so the deduction is the least of the following three amounts

(a) 20% of salary (a) $20\% \times 2,52,000$ (a) 50,400

(b) Actual amount of allowance received (b) 12,000 (b) 12,000

(c) ` 5,000 (c) 5,000 (c) 5,000

4. **Professional tax**: Actual amount paid will be allowed as deduction = $250 \times 12 = 3,000$

5. **Expenses related to commission** : Commission received from the employer is salary income. But expenses incurred to earn commission are not allowed as deduction.

$\therefore$ Income From Salary is ` 4,42,000.

Situation 2: She is working in a Public Limited Company.

Computation of Smt. Ranshrita's Income from Salary For the Assessment Year 2020-21

Particulars	Amount in `
Salary	
Basic Pay @ ` 21,000p.m.	2,52,000
Commission	92,000
Allowances	
D.A@ ` 7,000 p.m.	84,000
House Rent Allowance	42,000
C.C.A. @ ` 1,500 p.m.	18,000
Entertainment allowance @ ` 1,000 p.m	12,000
Perquisites	NIL
Profits in lieu of salary	NIL
Gross Income from salary	5,00,000
Deductions	
Standard Deduction u/s 16(ia)	50,000
Entertainment allowance u/s 16(ii)	Nil
Professional Tax u/s 16 (iii)	3,000
Income from Salary	4,47,000

Working Notes:

1. **House Rent Allowance :** Assessee is not paying rent of the house so exemption cannot be given.

Actual allowance received $(3,500 \times 12) = 42,000$

Less: exemption = nil

Un-exempted = 42,000

2. **Standard deduction :** The deduction is least of the following two amounts.

(a) Gross Income from salary ` 5,00,000

(b) ` 50,000

3. **Entertainment Allowance :** The Assessee is non-Government employee so no deduction is allowed.

4. **Professional tax :** Actual amount paid will be allowed as deduction = $250 \times 12 = 3,000$

5. **Expenses related to commission :** Commission received from the employer is salary income. But expenses incurred to earn commission are not allowed as deduction.

$\therefore$ Income From Salary is ` 4,47,000

22. **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 2020-21

Particulars	Amount (`)
Basic pay	2,88,000
Allowances:	
Dearness allowance	1,80,000
Entertainment allowance	55,000
Children hostel	16,800
Perquisites	
Rent free accommodation	60,000
Motor car	21,600
	<u>6,21,400</u>
Less: Deduction U/S 16 @	
Standard deducts on	40,000
Professional tax (200×12)	2,400
Taxable salary income	<u>5,79,000</u>

Working Notes

1. Basic pay $24,000 \times 12 = 2,88,000$

2. D. A $15,000 \times 12 = 1,80,000$

3. Hostel allowance

$2,000 \times 12 = 24,000$

Less: Exempted Amount $= 7,200$

$300 \text{ pm} \times 12 \times 2$

$16,800$

4. Rent free accommodation

Govt fixed $- 5,000 \times 12 = 60,000$

5. Entertainment allowance

Least of the following is exempted and remaining amount is taxable

$20\% \text{ of salary } (2,88,000 \times 20\%) = 57,600$

(-) Actual amount received $(5,000 \times 12) = 60,000$

$5,000$

Taxable amount = Actual Amount Received – Exempted Amount

$= 60,000 - 5,000 = 55,000$

6. Motor car for office and personal use

Expenses paid by employer

$1,800 \times 12 = 21,600$

- 23. Smt. Rama Devi Central Government employee received the following emoluments during the previous year 2019-20 Basic pay ` 37,000 p.m., D. A. 16,700 p.m., entertainment allowance ` 6,000 p.a. She received education allowance for her daughter 1,500 p.m. but actual fee is paid by her mother-in-law. She provided the following for her personal and official purpose**

(i) laptop costing ` 55,000

(ii) Small motor car and employer pays all expenses including driver's salary ` 11,000 p.m.

Her contribution to S.P.F. is 12% of salary and 10% by the employer. Interest credited in PF @ 8.5% is ` 3,200. The employer presented gift worth ` 11,000 silver articles. The employer paid club membership fee ` 14,900 for the benefit of assessee and her family members.

Her payments: (i) Profession Tax ` 3,800.

Compute income from salary for the assessment year 2020-21.

Sol :

(Imp.)

**Computation of Mrs. Rama Devi's Income from salary for the
Assessment Year 2020-21**

Particulars	Amount in `
Salary	
Basic Pay @ ` 37,000 p.m	4,44,000
Allowances	
D.A.@ ` 16,700p.m.	2,00,400
Entertainment Allowance	6,000
Children Education Allowance	16,800
Perquisites	
Gift from the employer	6,000
Club membership fee	14,900
Motor car	32,400
Gross income from salary	7,20,500
Deductions	
(i) Standard deduction u/s 16(ia) 50,000	
(ii) Entertainment Allowance u/s 16(ii) 5,000	
(iii) Profession Tax u/s 16(iii) 3,800	58,800
Income from salary	6,61,700

Working Notes:

- Entertainment Allowance:** The Assessee is Government employee so, the deduction is the least of the following three amounts

(a) 20% of salary	(a) $20\% \times 4,44,000$	(a) 88,800
(b) Actual amount of allowance received	(b) 7,000	(b) 7,000
- Education Allowance to children :** Actual amount spent is not considered and exemption is given without any restrictions. Exemption is least of the following two amounts.

(a) Actual allowance received	(a) $1,500 \times 12 = 18,000$
(b) 1,200 p.a. per child	(b) $1,200 \times 1 = 1,200$

Actual allowance received	= 18,000
Less: Exempted	= 1,200
Unexempted	= <u>16,800</u>
- Laptop:** The term movable asset does not include laptop, hence use of laptop is a tax free perquisite.
- Motor car:** Assessee's income from salary is more than ? 50,000 p.a., hence car becomes taxable perquisite.

The employer owns a car and it is used both for official as well as personal purpose, car is a small one so the value of the perquisite is as under.

Car value (1,800 × 12)	= 21,600
Add: Driver's salary (900 × 12)	= 10,800
Motor car value	= 32,400

Note: Actual salary paid to the driver is not to be considered.

5. **Employer's contribution to S.P.F.:** It is fully exempted from tax.
6. **Interest credited in S.P.F.:** It is fully exempted from tax.
7. **Gift from the employer :** It is exempted upto ` 5,000 so taxable perquisite value is ` 6,000 [11,000 (-) 5,000]
8. **Club membership fee:** It is paid for personal benefit, hence it is taxable perquisite/ Fringe benefit. The value of the perquisite is actual amount paid by the employer = ` 14,900.
9. **Standard deduction :** The deduction is least of the following two amounts.
 - (a) Gross Income from salary ` 7,20,500
 - (b) 50,000
10. **Profession Tax :** Actual amount paid will be allowed as deduction = 3,800.

24. **The following are the income particulars of Smt. Suryakala for the previous year ending on 31 st March, 2020. Net salary received ` 99,000.**

Deductions made by the employer from Salary:

Income Tax ` 1,000.

Premium on L.I.P 2,500.

Professional Tax ` 1,200.

Recovery of Festival loan ` 13,500.

Provident Fund Contribution ` 5,000.

The Employer contributes 14% of basic salary to R.P.F. (Basic Salary of the assessee is ` 32,500)

The employer paid the following :

Telephone bill of the residence ` 42,500.

Electricity bill of the residence ` 32,900.

She went on official tour to Nagpur city for 3 months, where she is provided rent free accommodation, rent paid by the employer ` 7,500 p.m. During this period she is served with free food at a cost of ` 350 per day.

Compute the income from salary for the current assessment year.

Sol :

(Imp.)

Computation of Smt. Suryakala's Income from Salary For the Assessment Year 2020-21

Particulars	Amount in `
Salary:	
Basic Pay	32,500
Employer's Contribution to R.P.F. in excess of 12% of salary	650
Allowances:	
Allowances	89,700
Perquisites:	
Electricity bill of the residence paid by the employer	32,900
Gross Income From Salary	1,55,750
Deductions:	
Standard deduction u/s 16(ia)	50,000
Profession Tax u/s 16(iii)	1,200
Income from Salary	1,04,550

Working Notes:

1. **Note:** Salary received is net salary and deductions made by the employer are to be added to get gross salary.

Net salary received 99,000

Add: Deductions made by the employer Income tax. 1,000

Premium on L.I.P. 2,500

Professional Tax 1,200

Recovery of Festival loan 13,500

P.F. Contribution 5,000 23,200

Gross Salary 1,22,200

Less : Basic pay 32,500

Allowances 89,700

2. **Employer's Contribution to R.P.F:**

Actual Contribution 14%

Less : Exempted 12%

Taxable 2% 2% of 32,500 = 650

3. **Rent free accommodation:** Rent free accommodation provided during official tour is not a perquisite.

4. **Free food :** Free food provided during official tour period is not a perquisite.

5. Telephone bill of the residence paid by the employer is tax free perquisite.

6. Electricity bill of the residence paid by the employer is taxable perquisite in all cases.

7. **Standard deduction :** The deduction is least of the following two amounts.

(a) Gross Income from salary ` 1,55,750

(b) ` 50,000

25. 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 2020-21

Particulars	Amount (`)
Salary	
Basic Pay	1,80,000
Arrears 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 ded U/S 16(a)	Nil
Professional Tax 16(iii)	Nil
Net Taxable Salary	2,83,000

Working Notes

1. Basic Pay $15,000 \times 12 = 1,80,000$
2. D.A. $4,000 \times 12 = 48,000$
3. Rent free accommodation

FRV	= 70,000
Govt.	= 25,000
Rent Fixed by Govt	= 25,000

(+) 10% cost of Furniture = 9,000

$$\left(90,000 \times \frac{10}{100} \right) \quad \underline{\underline{34,000}}$$

4. Deputation allowance is taxable
5. Own contribution SPF for govt, employee qualify for ded 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.

26. Mr. Ramana Rao works for a Government company at New Delhi and submits the following particulars for the financial year 2021-22.

(i) Basic pay ` 1,90,000

(ii) DA 25% of salary

(iii) Bonus ` 18,000

(iv) Arrears of salary ` 20,000

(v) Entertainment allowance ` 8,000

(vi) Conveyance allowance (75% spent) ` 12,000

(vii) Employer contribution to RPF 14% of salary

(viii) Interest credit to RPF @ 12% is ` 8,000

(ix) He has been provided with a rent free accommodation (owned by the employer) at Delhi whose fair rental value is ` 80,000 p.a. and cost of furniture is ` 41,000/-

(x) He is provided free supply of gas which costs to the employer ` 2,400/- Compute income from salary for the Assessment year 2020-21.

Sol :

(Imp.)

Computation of Mr. Ramana Rao's Income from Salary for the Assessment Year 2020-21

Particulars	Amount (₹)
Salary:	
Basic Pay	1,90,000
Bonus	18,000
Arrears of Salary	20,000
Employer's contribution to RPF in excess of 12%	3,800
Interest credited to RPF in excess of 9.5% rate	1,667
Allowances:	
DA (25% of salary)	47,500
Entertainment Allowance	8,000
Conveyance Allowance	3,000

Perquisites:	
Rent Free Accommodation	4,100
Free Supply of Gas	2,400
Gross Income from Salary	2,98,467
Deduction u/s 16:	
Entertainment Allowance u/s 16 (ii)	5,000
Income from Salary	2,93,467

Working Notes**1. Entertainment Allowance**

The assessee is a government employee, so the deduction is least of the following three amounts,

$$(i) \quad 20\% \text{ salary } 1,90,000 \left[1,90,000 \times \frac{20}{100} \right] = ₹ 38,000$$

$$(ii) \quad \text{Actual allowance received} = ₹ 8,000$$

$$(iii) \quad ₹ 5,000$$

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

2. Conveyance Allowance

The unspent amount of conveyance allowance is taxable,

$$\text{Actual allowance received} = ₹ 12,000$$

$$\text{Less: Amount spent (75\%)} \left[12,000 \times \frac{75}{100} \right] = ₹ 9,000$$

$$\text{Unspent amount} = ₹ 3,000$$

3. Employer Contribution to RPF

$$\text{Actual contribution} = 14\%$$

$$\text{Less: Exempted} = 12\%$$

$$\text{Unexempted} = 2\%$$

$$\therefore 2\% \text{ of } 1,90,000 = ₹ 3,800$$

4. Interest Credited to RPF

$$\text{Actual Interest Credited} = 12\%$$

$$\text{Less: Exempted} = 9.5\%$$

$$\text{Unexempted} = 2.5\%$$

$$\text{For } 12\% - 8,000$$

$$\text{For } 2.5\% - ?$$

$$= 8,000 \times \frac{25}{12}$$

$$= ₹ 1,667$$

5. Rent Free Accommodation

As assessee is a government employee, the rent fixed by government is taxable.

Note: Rent fixed by government is not given, only 10% on cost of furniture is considered i.e., 10% on 41,000 = 4,100.

6. Free Supply of Gas

It is a taxable perquisite.

27. 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 2020-21.

- (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 2020-21**

Particulars	Amount (₹)
Salary:	
Basic Pay	2,10,000
Contribution made by employer to employee under	21,000
New Pension Scheme [N.P.S] $2,10,000 \times \left[2,10,000 \frac{10}{100} \right]$	
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 $2,400 \times 12 = ₹ 28,800$.

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

It 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].

Short Question and Answers

1. Entertainment Allowance

Ans :

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(h).

The deduction is least of the following three amounts.

- (a) 20% of salary
- (b) Actual amount of allowance received plus receivable
- (c) ₹ 5,000.

2. 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:

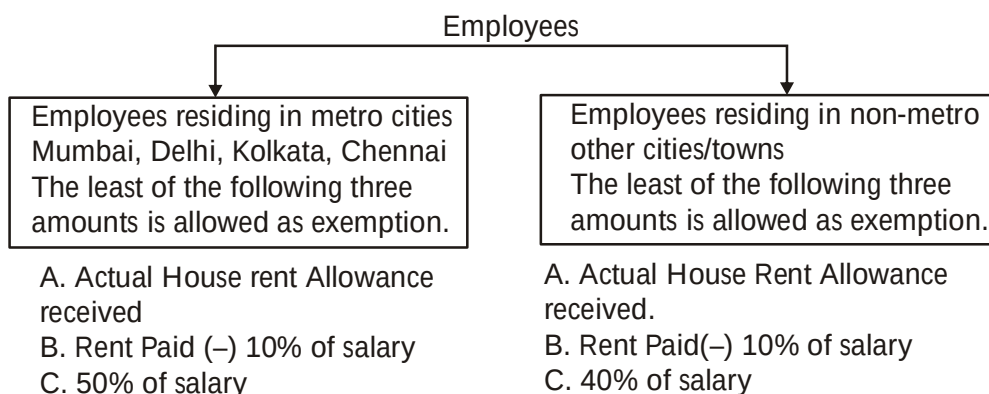
This allowance is allowed as exemption only when the assessee is paying rent of the house where he is presently residing.

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.



3. Perquisites

Ans :

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

4. Rent Free Accommodation.

Ans :

Salary = Basic pay + Bonus (except gratuitous bonus) + Fees + Commission + D.P + All taxable allowances (D.A if it enters into retirement benefits) + Any payment made by the employer in the form of cash + IT or profession tax paid or reimbursed by the employer.

In case if employer is providing accommodation in hotel for both Government and other employees then the value of perks will be least of the following two amounts,

- (i) 24% of salary
- (ii) Actual charges paid or payable to hotel.

But if the assessee is satisfying the following three condition then the value of perks will become tax-free,

- (i) If accommodation is provided for less than 15 days
- (ii) If hotel is hired by the employer
- (iii) If accommodation is provided on transfer of employee from one place to another place.

5. Bonus

Ans :

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) Gratuitous 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 'Gratuitous bonus'. This is taxable as perquisite under the head Income from salary.

6. Basic Pay

Ans :

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. In 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.

7. 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 :

- (i) Statutory Provident Fund or the Fund to which the Act of 1925 applies (S.P.F).
- (ii) Recognized Provident Fund (R.P.F).
- (iii) Unrecognized Provident Fund (U.R.P.F).
- (iv) Public Provident Fund (P.P.F).

8. Exemption of Allowance not linked with actual expenditure.

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)

Least of the following two amounts,

- (i) Actual allowance received
- (ii) ` 1,600p.m.

9. Club Membership

Ans :

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) Official 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.

10. Profits in Lieu of Salary.

Ans :

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. Commuted value 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 ` 5,00,00/-

11. 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)

Actual amount paid will be allowed as deduction i.e., if the tax is due but payment is not yet made then it shall not be allowed as deduction.

12. What is meant by Annual 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.

Rahul Publications

Exercise Problems

1. Swaminathan a senior citizen is working in Jeevan Jyothi Co. Ltd at Nagpur, (population is 21.23 lakhs) The salary particulars of him are as under:
- 1) Basic pay ` 21,400 p.m.
 - 2) Dearness allowance ` 12,500 p.m. (enters for retirement benefits).
 - 3) Entertainment allowance ` 3,000 p.m. (actual amount spent ` 1,000 p.m.)
 - 4) Uniform Allowance ` 15,000 p.a. (Actual amount spent on clothes for himself ` 12,000.)
 - 5) Leave encashment for one month ` 28,500.
 - 6) Pension: From the former employer ` 5,000 p.m. "L.I.C under Annuity Plan" ? 600 p.m.
He is provided with the following:
 - a) Rent free accommodation: Rent paid by the employer on this house ` 5,500 p.m. and the cost of furniture provided for three months is ` 1,20,000.
 - b) He is provided with free meals for 180 days during office hours through paid vouchers and cost of each meal is ` 65.
 - c) Credit card bill paid by the company ` 28,000.
 - d) The company presented a gift worth ` 4,500.
 - 7) To company sold the following assets on 2-2-2019.
 - (i) Motorcar for ` 3,00,000 (Purchased in April 2017 for ` 8,00,000)
 - (ii) Laptop ` 5,000 (Purchased in August, 2018 for ` 1,20,000).
- Compute the income from salary for the current assessment year.

[Ans : ` 8,46,800]

2. The following are the income particulars of Sri Devi Mohan for the previous year ending 31 st March 2020.

Net Salary received ` 5,47,250.	
Deductions from salary	
Contribution to C.M.'s Relief Fund (100% deduction)	800
Premium on group insurance scheme `	1,200
Income Tax (T.D.S)	26,000
L.I.P. on own policy	22,000
L.I.P. on wife's policy	10,900
Standard deduction	50,000
Professional Tax	3,600
R.P.F contribution	30,250
Recovery of vehicle loan	77,000
	2,21,750

Employer's contribution to R.P.F is 15% of salary (Basic pay ` 3,63,000) Interest credited in R.P.F @ 10.5% ` 24,500. Salary received includes D. A at a flat rate of ` 11,000 p.m. H.R.A. ` 13,750 p.m. and the remaining is entertainment allowance. He is living in his father's house for which no rent is paid.

He is provided with a motorcar of 1.75 litres, for personal and official use and the employer pays all the expenses.

Compute the income from salary.

[Ans : ` 7,57,423]

3. Smt. Suman Latha is working since 1-4-2010 as an Auditor in A.G Office (Central Govt Department) Compute Income from salary and tax liability.

1. Basic pay ` 13,500 p.m. D. A. ` 6,500 p.m.
2. Rent free furnished house in Hyderabad city is provided. Employer is paying ` 6,000 p.m. as rent but rent of similar accommodation is ` 7,000 p.m. Rent fixed by the Government is ` 1,400 p.m. Cost of furniture provided is ` 60,000.
3. Entertainment allowance ` 2,000 p.m.
4. During the previous year she took education loan at 2% (S.B.I rate is 10.05%) from the employer ` 2,00,000.
5. She contributed 12% of salary to pension scheme and equally contributed by the employer.
6. The employer provided the following:
 - (i) A small car for personal and official purpose, and all the expenses for private use are paid by herself,
 - (ii) Club membership fee for family members ` 7,500.
 - (iii) Expenses paid by the employer for private tour of family members ` 25,000.
7. Reimbursement of medical expenses in private hospital is ` 40,000.
8. Cost of training expenses paid by the employer ` 10,000.
9. She paid professional tax ` 2,000.

[Ans : ` 3,45,040]

4. Sri Shiva Prasad, Physically disabled person is working in a Central Government office since 1-4-2007. His salary particulars during the previous year 2019-20 are as under.

1. Basic pay ` 30,500 p.m.
2. D.P.25%
3. H.R.A.30%.
4. C.C.A ` 2,500 p.m.
5. Entertainment Allowance ` 5,000 p.m.
6. Transport Allowance ` 3,000p.m.
7. Contribution to New Pension Scheme 10% equally by the Government.
8. His son is studying in Central School, maintained by Government of India no fees is charged. The cost of education is ` 1,800 per child.
9. Reimbursement of medical expenses in a recognised hospital ` 85,000.
10. Income from other sources is ` 63,000.

He is living in a rented house in Hyderabad along with his brother, rent is shared equally by them. Rent of the house ` 12,000 p.m. Profession tax paid ` 350 p.m.

Compute income from salary.

[Ans : ` 6,08,900]

5. Sri Saikrishna is the managing Director of a company at Hyderabad. The following are the particulars of his emoluments and other related items for the previous year 2019-20. Calculate total income for the assessment year 2020-21.
1. Basic pay ` 65,000 p.m.; Commission on net profits @ 0.75% worked out to ` 2,46,000. D.A. 15%; C.C.A. ` 4,000 p.m.
 2. He is provided with Tata Indica Car for Office and Personal use with driver. All the expenses including driver's salary is paid by the employer.
 3. His daughter is having two wheeler scooter and the company paid 1,900 p.m. for maintenance expenses.
 4. He is the member of the following clubs and the company reimbursed the expenses. Lions club 15,000; Fathemaiddan Club ` 45,000 morning walker club ` 2,000; Health Club ` 8,000; Victoria Sports Club 23,500.
 5. Employer paid the following for Retirement Benefit.
 - i) Provident Fund (recognised) 14% of Salary.
 - ii) Gratuity Fund → 10% of Salary.
 - iii) Approved Superannuation Fund → 15% of Salary.
 6. On 1st July 2019 the company gave him interest free housing loan of ` 35,00,000 repayment starts after 3 years. S.B.I lending rate applicable is 8.15%.
 7. On 23rd November 2019, the company gave its music system for personal purpose. Without change in ownership. The cost of the music system in 2015 to the company is ` 50,000.
 8. Profession Tax paid ` 5,000

[Ans : 1) That part of portion of the D. A. which enters for retirement benefit is known as "Dearness pay (D.A.)".

2) Motor car : Assumption small car and its value is ` 32,400.

3) Scooter expenses: Expenses paid by the employer for any other automotive either to employer or for his family members is taxable perquisite. The value of the perquisite is

Actual expenses paid by the employer (–) 900 p.m. $[1,900 \times 12 (–) 900 \times 12] = 12,000$

4) Club expenses: Expenses paid for health club & sports club are tax free perquisites and any payment made to other clubs is taxable perquisite.

Note : Morning walkers club cannot be treated as "sports club".

5) Employer's contribution to Gratuity Fund : Presently this is treated as salary income when actually gratuity is received by the assessee exemption is given with same limit.

6) Employer's contribution to Approved Superannuation Fund is exempt upto ` 1,50,000.

7) Interest on Loan : From 1-7-2019 to 31-3-2020 = 9 months. Perquisite value = 8.15% of 35,00,000 for 9 months = 2,13,938.

8) Use of Musical instruments : Note : Perquisite value 10% cost = 10% of 50,000 = 5,000.

9) Income from salary ` 15,68,978]

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 2018. The gross salary of R for assessment year 2018-19 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 it 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 liters 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.

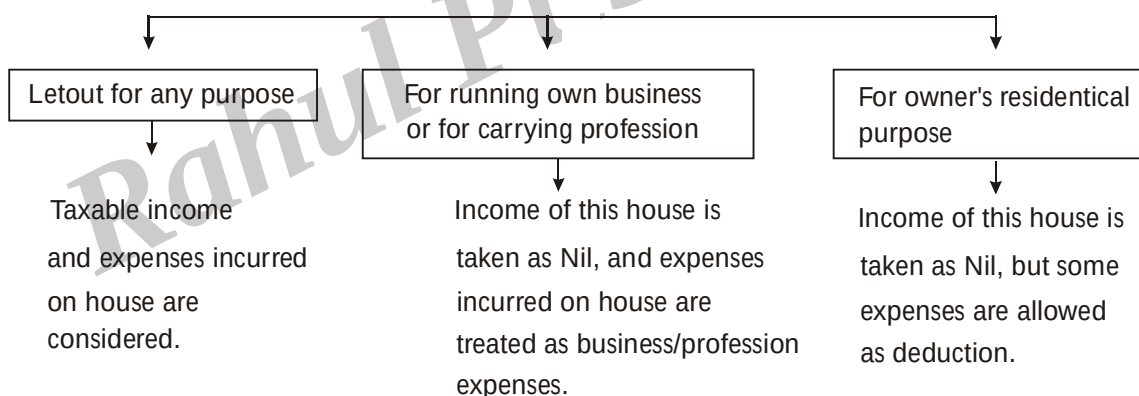
3.1 DEFINITION OF 'HOUSE PROPERTY'

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



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.

Non-House property Income

The following incomes will not be considered as income from house property.

- (i) If the house is used for agricultural purpose.
- (ii) If the income of a former ruler from any one palace was exempted before the commencement of the Constitution (26th Amendment) Act of 1971.
- (iii) Property income of a local authority.
- (iv) Property income of a registered trade union.
- (v) Income from house property held for charitable or religious purpose (temples etc.)
- (vi) Income from house property occupied for the purpose of running own business or carrying profession whose income is taxable.

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?****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, puggie 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 be 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 :

(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)

$$\text{A.R.V} = \text{Rent received (+) Rent Receivable} \pm \text{Special Adjustments}$$

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

$$\text{A.R. V} = \text{Rent received} + \text{Rent receivable or outstanding rent}$$

- (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.

$$\text{A.R. V} = \text{Rental value for 12 months period (-) cost of facilities provided}$$

- (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

$$\text{A.R. V} = \text{Rent received} + \text{Rent receivable or outstanding rent} - \text{Expenses related to the house paid by the owner}$$

- (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.

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.

$\text{Gross Annual Value (GA. V)} (-) \text{Municipal taxes paid} = \text{Net Annual Value (N.A.V)}$

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.

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)

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:

Let out property House is vacant for some period → and unrealized rent is also there.

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.

Hint

In order to have clarity we are using the term Actual Rental Value (adjusted) in such a case step 4 equation is as under.

Actual Rental Value (Adjusted) = Actual Rental Value (-) Rent for vacant period (vacancy loss)

Third Part:

Step 1: Calculating Gross Annual Value: The guide lines for determining Gross Annual Value is as under.

Guiding principles, rules for determining G.A.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.

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 AY

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 previous 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 deemed 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)

$A.R.V = \text{Rent received (+) Rent Receivable} \pm \text{Special Adjustments.}$

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 Value.

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 instructions 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) $\text{₹. } 30,000/2,00,000$

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) $\text{₹. } 30,000/2,00,000$

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 : Municipal 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?

Ans :

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 allowed as 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

Amendment to Section 80 EE

The existing provisions of section 80EE provide a deduction of upto ₹ 1 lakh in respect of interest paid on loan by an individual for acquisition of a residential house property. This benefit is available for the two assessment year beginning on the 1st day of April 2014 and the 1st day of April 2015.

In furtherance of goal of the government of providing “housing for all”, it is proposed to benefit first home buyers availing home loan, by providing additional deduction in respect of interest on loan taken for residential property from any financial institution upto ₹ 50,000. This includes a clause that

the loan should be sanctioned on or after 1st April, 2016 and the amount of loan should be less than ₹. 35 lakhs. Further more the value of the house should not exceed ₹. 50 lakhs and the individual should not own any other residential house under his name.

The deduction under the proposed section is over and above the limit of ₹.2 lakhs provided for a self occupied property u/s 24 of the Act.

These amendments will accordingly, apply in relation to the assessment year 2018-19 and subsequent assessment years.

Deduction under this section can be claimed irrespective of the residential status of the person i.e. resident or non-resident.

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 1-4-2019 to 31-3-2020.
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. **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 2020-21

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

2. 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 2020-21**

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) Fair 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

$$\text{Statutory Deduction} = ₹ 27,500 \times \frac{30}{100}$$

Statutory Deduction = 8,250

4. Interest on Loan

Interest on loan is allowed as deduction (i.e., ₹ 38,000).

3. Sri Durga Prasad is the owner of a house, let out the house for 10 years on 15th May 2012 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 ₹. 16,000. During the previous year is received for ₹.10,000, Repairs ₹. 5,000, interest paid on the loan taken to purchase the house ₹. 16,000. During the previous year rent is received for 10 months and balance is due. Compute Income from House Property. D dur

Sol :

(Imp.)

Computation of Sri. Durga Prasad's Income from House Property

For the assessment year 2020 - 21

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)	16,000	46,000
Income from House Property		54,000

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 + proportionate non- refundable deposit.

$(7,500 \times 10) (+) (7,500 \times 2) (+) (2,00,000 \div 10)$

$\Rightarrow 75,000 (+) 15,000 (+) 20,000$

$= 1,10,000.$

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 is 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 ` 16,000.

- 4. Smt. Sonia Khurana is the owner of a house property, which is let out for residential purpose on a monthly rent of ` 9,000 Municipal rental value is ` 7,500 per month and Fair rental value is ` 6,500 per month. During the previous year the tenant has not paid one month rent and proved to be irrecoverable . The construction of the house was commenced on 1-4-2017 and completed on 2-4-2019. For this purpose she borrowed ` 1,80,000 from HDFC on 1-4-2017 @ 12%. The interest due upto the date is paid and no amount of principal is repaid. Her other expenses are insurance premium ` 1,500; Municipal tax ` 6,000 (including ` 1,000 paid in advance for the next year) and ground rent ` 1,000. Compute the income from house property for the current assessment year.**

Sol:

**Computation of Smt. Sonia Khurana's Income from House property
For the assessment year 2020-21**

Particulars	Amount in `	Amount in `
Gross Annual Value		99,000
Less : Municipal taxes		5,000
Net Annual Value (N.A.V)		94,000
Deductions u/s 24		
Statutory deduction u/s 24(a)	28,200	
Interest on loan u/s 24 (b)	30,240	58,440
Income from House Property		35,560

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 (E.R.V), which is higher of the following two amounts.

(A) Municipal Rental Value (A) $7,500 \times 12 = 90,000$

(B) Fair Rental Value (B) $6,500 \times 12 = 78,000$

2. **Calculating Actual rental value (A.R.V)**

A.R.V = Rent for 12 months period (-) Unrealized rent of the current year.

= $9,000 \times 12 = 1,08,000$ (-) $9,000 \times 1 = 99,000$

Third part : Working notes for computation of income.

1. Calculating Gross Annual Value (G.A.V.), which is higher of the following two amounts.

- (A) Expected Rental Value (A) 90,000
(B) Actual Rental Value (B) 99,000

2. Municipal taxes

Municipal taxes paid in advance ` 1,000 is not allowed as deduction in the current assessment year i.e., only ` 5,000 is allowed as deduction for the assessment year 2020-21.

3. Statutory Deduction

30% of N.A.V = 30% of 94,000 = 28,200

4. Interest on loan :

- (A) Interest paid for the period prior to the completion of the construction is allowed as deduction in five equal installments.

Interest from 1-4-2017 to 31-3-2018 = $1,80,000 \times 12\%$ = 21,600

Interest from 1-4-2018 to 31-3-2019 = $1,80,000 \times 12\%$ = 21,600

43,200

Interest p.a. = $43,200 \div 5 = 8,640$

- B) Interest paid for the period after completion of construction

From 1-4-2019 to 31-3-2020 = $1,80,000 \times 12\%$ = 21,600

Total interest to be allowed as deduction = $8,640 + 21,600 = 30,240$

5. Insurance premium and ground rent etc : These expenses are not allowed as deduction.

- 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 2020 - 21

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) $FRV = ₹ 60,000$

$\therefore ERV = ₹ 60,000$

(b) Calculate ARV

$= \text{Monthly rent} - \text{Vacancy loss} = (6,000 \times 12) - (₹ 6,000 \times 3)$

$= ₹ 72,000 - ₹ 18,000 = ₹ 54,000$

(c) $GAV = ARV = ₹ 54,000$.

6. From the following particulars compute income from house property of Smt Lavanya.

M.R.V	₹ 6,000 p.m	Rent per month	₹ 6,600
F.R.V	₹ 6,500 p.m	Vacancy period	1 month
Standard range	₹ 5,800 p.m	Unrealized rent	1 month rent
Municipal taxes	₹ 10,800	Fire insurance premium	₹ 2,100
Interest on loan taken to repair the house	₹ 35,800		

Sol :

Computation of Smt. Lavanya Income from House Property
For the assessment year 2020-21

Particulars	Amount in ₹	Amount in ₹
Gross Annual Value (G.A.V)		69,600
Less: Municipal taxes		10,800
Net Annual Value (N.A.V)		58,800
Deductions u/s 24		
Standard deduction u/s 24 (a)	17,640	
Interest on loan u/s 24 (b)	35,800	53,440
Profit from house property		5,360

First part : Calculation part to find out Expected Rental Value & Actual Rental Value

1. Calculating Expected Rental Value (E.R.V.), which is higher of the following two amounts.

(A) Municipal Rental Value (A) $6,000 \times 12 = 72,000$

(B) Fair Rental Value (B) $6,500 \times 12 = 78,000$

2. Calculating Adjusted Expected rental value which is least of the following two amounts.

- (a) Expected rental value (a) 78,000
(b) Standard rent (b) $5,800 \times 12 = 69,600$

3. Calculating Actual Rental Value (A.R.V.)

A.R.V. = Rent for 12 month period (-) Unrealized rent.

$$= (6,600 \times 12) (-) (6,600 \times 1) = 72,600$$

Comment : A.R.V is more than E.R.V (Adjusted)

4. Calculating Actual Rental Value (Adjusted)

Actual Rental Value (-) Rent for vacant period = $72,600 (-) 6,600 = 66,000$

Comment : Actual Rental Value (Adjusted) is less than E.R.V Adjusted not only due to vacancy but also on account of other factors unrealized rent hence G.A.V E.R.V (Adj)

Third Part : Working notes for computation of income.

1. Calculating Gross Annual Value (G.A.V.)

Gross Annual Value = Expected Rental (Adj) Value = 69,600

2. Municipal taxes

Actual amount paid by the assessee is to be deducted from Gross Annual Value = 10,800

3. Standard deduction

30% of NAV $\rightarrow 30\%$ of 58,800 = 17,640

4. Fire insurance premium

This is not allowed as deduction.

5. Interest on loan

The loan is taken to repair the house, so interest on loan is allowed as deduction = 35,800.

7. 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.)

**Computation of Income from Home Property of Bala krishna for
Assessment year 2020-21**

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 $\left. \begin{array}{l} \text{ERV} - \boxed{9,00,000} \\ \text{Standard Rent} - 10,00,000 \end{array} \right\}$ the least amount is AERV

Compare $\left. \begin{array}{l} \text{AERV} - 9,00,000 \\ \text{ARV} - 11,00,000 \end{array} \right\}$ 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

$$= 60,000 \times \frac{1}{5} = 12,000$$

$$= \text{Current Year Interest} = 40,000$$

$$= \text{Total Interest} = 40,000 + 12,000 = 52,000$$

4. Pre-Construction Interest on Loan for Self - Occupied House

$$80,000 \times \frac{1}{5} = 16,000$$

$$\text{Current Year Interest} = 48,000$$

$$\text{Total Interest} = 48,000 + 16,000 = 64,000$$

8. 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 2020- 21.

Sol :

(Imp.)

**Computation of Income from House Property of Mr. Rana Pratap for
Assessment year 2020 - 21**

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
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

$$1. \quad \left. \begin{array}{l} \text{MRV} - ₹ 1,60,000 \\ \text{FRV} - ₹ 2,10,000 \end{array} \right\} \text{Which ever is higher}$$

$$\text{E.R.V} = ₹ 2,10,000$$

2. ERV with SRV

$$\left. \begin{array}{l} \text{ERV} - 2,10,000 \\ \text{SRV} - 1,80,000 \end{array} \right\} \text{Which ever is least}$$

$$\therefore \text{AERV} = 1,80,000$$

3. AERV with ARV

$$\left. \begin{array}{l} \text{AERV} 1,80,000 \\ \text{ARV} 1,40,000 \end{array} \right\} \text{Which ever is higher}$$

$$\therefore \text{G.A.V} = 1,80,000$$

Note : Assessee occupied the house from 1-2-2018

$\therefore$ ARV is calculated only for 10 months.

$$\text{GAV} = 1,80,000$$

9. **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 2020-21.

Sol :

(Imp.)

Computation of Ms. Sundari's Income from House Property for the Assessment year 2020-21

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

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

Step-3: Calculating Actual Rental Value

ARV = Rent for 12 months period - Unrealized rent

= 4,80,000 – 80,000

=

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

Municipal Taxes

It is charged over Municipal Rental Value

$$\text{i.e., } 3,60,000 \times \frac{12}{100} = 43,200$$

$$50\% \text{ of Municipal Taxes paid by tenant i.e., } 43,200 \times \frac{50}{100} = 21,600$$

∴ 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.

10 Mr. 'X' owns the following house properties for the assessment year 2020 - 21.

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. 2020-21

Sol :

(Imp.)

House-I (Let-out)**Computation of Mr. X Income from House Property for the Assessment Year 2020-21**

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 = ` 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

$$= ₹ 72,000 \times \frac{30}{100} = \frac{30}{100} = ₹ 21,600$$

House-II (Self Occupied)**Computation of Mr. X Income from House Property for the Assessment Year 2020-21**

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

11. Mr. Mahesh owns a house, whose Municipal value is 1,40,000, fair rental value is 1,38,000. He let out the house to Smt. Rani for the annual rent of ₹ 1,80,000. The tenant could not pay the rent for the month February and so was made to vacate the house. The house remained vacant for March.

As per rental deed the municipal taxes are to be borne by the tenant, but Smt. Rani failed to pay or such the dues were paid by the owner. Municipal taxes at 15% interest on loan taken amounted to ₹ 36,000 (loan taken for repairs) during the previous year the following expenses are occurred: Repairs 70,000, ground rent 840, collection charges 140 and other general expenses 3,000.

Compute income from house property and taxable amount if income from salary is 2,55,000/-.

Sol :

**Computation of Income from House Property of Mr. Mahesh for the
Assessment Year 2020-21**

Particulars	Amount (₹)	Amount (₹)
Gross Annual Value (GAV)		1,50,000
Less : Municipal taxes		Nil
Net Annual Value (NAV)		1,50,000
Deductions u/s 24 :		
Statutory deduction	45,000	
Interest on Loan	36,000	81,000
Income from House Property		69,000

Working Notes

1. Calculation of Gross Annual Value

Step-1: Calculation of Expected Rental Value

Which is higher of the following two amounts,

(a) Municipal Value = ₹ 1,40,000

(b) Fair Rental Value = ₹ 1,38,000

Step-2: Computation of Adjusted Expected Rental Value

Which is least of the following two amounts,

(a) Expected Rental Value = ₹ 1,40,000

(b) Standard Rent = ₹ 1,80,000

Step-3: Computation of Gross Annual Value (GAV)

Which is higher of the two amounts,

(a) Adjusted Expected Rental Value = ₹ 1,40,000

(b) Actual Rent = Standard Rent - Rent not Received

Standard Rent = ₹ 1,80,000

$$= \frac{1,80,000}{12} = 15,000$$

2 months rent not received = 15,000 × 2 = 30,000

= 1,80,000 – 30,000

= ₹ 1,50,000

∴ Gross Annual Value = ₹ 1,50,000

2. Municipal Taxes

Municipal taxes are to be borne by the tenant but paid by owner even though it is not allowed as deduction.

3. Statutory Deduction

Statutory Deduction = 30% of NAV

$$= ₹ 1,50,000 \times \frac{30}{100} = 45,000$$

4. Interest on Loan

Interest on loan taken for repairs is allowed as deduction.

Taxable Amount

Income from Salary = 2,55,000

Income from House property = 69,000

3,24,000

Tax Liability

= 3,24,000 × 0.05 – 12,500 = 3,700

Add: 4% Health and Education cess = 148

3,848

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. The use of the house is shown in the following chart.

2. 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, puggie 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.

3. Actual Rental value.

Ans :

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 be 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.

4. Municipal Rental Value.

Ans :

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 .

5. Expected Rental Value

Ans :

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.

Ans :

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. Deductions u/s 24 for Let out house.

Ans :

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 allowed as deduction.

8. 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.
 - (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

Rahul Publications

Exercise Problems

1. Sri Atmakaran Reddy owns two houses, their municipal valuation are, ₹. 30,000 and ₹. 48,000. The first house is let out for residential purpose for ₹. 46,000 p.a. and the second house is let out to a company for its registered office ₹. 54,000 p.a. Under the agreement 50% of the municipal taxes are to be borne by the tenant. He claims the following deductions: for the first house municipal taxes ₹. 3,000, repairs ₹. 12,000, brokerage paid to get tenant ₹. 3,000. For the second house municipal taxes ₹. 5,000, repairs ₹. 2,800, rent deed registration charges ₹. 1,000, annual charge is ₹. 1,000 interest on loan taken to purchase the second house ₹. 30,000 but only ₹. 10,000 is paid so far. Arrears of rent received from first house ₹. 16,000 which was not assessed earlier. The second house was vacant for 3 months. Compute the income from house property.

[Ans : ₹. 38,950]

2. Mr. Vishal Maheshwari owns a house, whose Municipal value is ₹. 1,40,000. Fair rental value is ₹. 1,38,000 He let out the house to Smt. Parmeshwari for an annual rent of ₹. 1,80,000. The tenant could not pay the rent for the month February and so was made to vacate the house. The house remained vacant for March. As per rental deed the municipal taxes are to be borne by the tenant, but Smt Parmeshwari failed to pay as such the dues were paid by the owner. Municipal Taxes at 15%. Interest on loan taken amounted to ₹. 40,000 (Loan taken for repairs).

[Ans : ₹. 65,000]

3. Smt Indira is the owner of two house properties. From the following particulars compute the income the income from house property tax liability if income from profession ₹ 6,09,300 and qualified saving ₹.1,00,000.

[Ans : ₹. 56,800]

4. Sri Srikanth owns a house Jaipur. Municipal Value ₹. 65,000 and Fair Rental Value ₹.78,000. During the previous year the house is used for his residential purpose. During the previous year the house is mortgaged with a bank for a loan of ₹. 5,00,000 @ 15% interest to renovate the house. Compute Income from House Property for the current assessment year.

[Ans : ₹. 30,000]

5. Sri Uma Maheshwar Rao, on 1st June 2019 he purchased a flat in Sri Satya Sai residential complex for his residence for ₹. 38 Lakhs, He availed a housing loan from ICICI Bank ₹. 24 Lakhs @ 14%. Compute his income from house property for the assessment year 2020-21.

[Ans : ₹. 2,00,000]

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 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.

(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 and 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 the 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.

4.1.1 Procedure for Computation of Income from Business

Q3. Briefly explain the points to be considered while computing business income.

Ans : (Imp.)

- (i) **Business carried on by the assessee :** Under section 28, the person who carried on the business is always changed. It is immaterial whether the assessee is doing the business or work himself or through some of his employees, agent, manager etc. The important point to be kept in mind is that the business should have been earned on by the assessee at any time during the previous year and not necessarily throughout the year or even in the assessment year. The assessee should have the right to carry on the business. In case a person is deprived of the right to carry on the business, the same person cannot be chargeable to tax under this head since he cannot be regarded as 'carrying on' the business. Guardians for minors or receivers or trustees may be assessed under this section in respect of profit of the business carried on by them.
- (ii) **Tax is levied on aggregated income from all business-professions carried on by the assessee during the previous year:** The net result of each business or profession earned on by the assessee is calculated separately but when tax is to be imposed, the result of all the businesses is aggregated and then whatever income comes, tax is imposed on that income. It means the loss from one business is set off against the profit of another business in this aggregation.
- (iii) **Speculation business:** The speculation business of the assessee is kept separate. If there is profit—it will be taxed along with other business income. But if there is speculation loss—it can be set off against profits of speculation business only and not against profits of any other business.

- (iv) **Profit on sale of assets on the winding up of a business:** The profit arising from some of the assets after winding up a business is not taxable but the profit on the sale of stock-in-trade is taxable. If the entire business is sold in one lot for a single unapportioned consideration and the assets include stock-in-trade, the profit in the sale of stock-in-trade is not separable; in such case the entire profit on sale of the business will not be taxable under this head.
- (v) **Tax on Real owner:** It is not only the legal ownership but also the beneficial ownership that has to be considered under section 28. The income is taxable in the hands of a person to whom it actually accrues. No tax can be levied on benamidar in whose name the business transactions are effected and who is not really entitled to the profits.
- (vi) **Tax on real income:** Tax is levied only on the real earned profits of the previous year. When there is expectation of profit, it cannot be taxed in anticipation. So the profit is taxed only when it has actually arisen. Further the profit must be really a gain to the person carrying on the business. Income or gain to be taxed must relate to the previous year. Each year is a self contained accounting period.
- (vii) **Business/Profession may be legal or illegal:** The income from legal business or profession as well as income from illegal business/profession is taxable under this head. However, income from illegal business/profession, assessee may have to face legal action, etc. under other Acts also.
- (viii) **Business/Profession income to be computed for each previous year:** Income or gain to be taxed must relate to the previous year in question.
- (ix) **Negative income from Business/Profession.** Negative income signifies loss from Business or Profession and can be set-off against other incomes as per prescribed rules.

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 (₹)	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 expressly 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.

8. 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 assessee's business then rate of deduction allowed is @100% of actual expenditure incurred.

9. Contribution given to any national laboratory is allowed @150% of actual amount given.

10. 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.

11. Any expenditure incurred towards know-how (before 1.4.98)

- The lump-sum consideration paid is allowed to be deduction in 6 equal instalments. 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.

12. 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

13. 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, & debentures, underwriting, brokerage and printing & 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.

14. Expenditure for Demerger or Amalgamation

The amount spend on amalgamation or demerger can be written off in 5 successive previous

year and every year $\frac{1}{5}$ th amount is allowed to be deducted.

15. 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.

16. 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 on 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 assessee 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

1. 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.
2. 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.

3. 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.
4. In case assessee is a firm. The remuneration allowable u/s 40(b) shall be deducted out of income computed u/s 44AD(1).
5. It will also be presumed that full depreciation has been calculated and deducted for calculating written down value of the assets.
6. Assessee can claim deductions under section 80.
7. 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.
8. The assessee may or may not opt 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 suffered 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. Sri Vishnu sharma is the owner of a business. Following is the Profit and Loss Account for the previous year 2019-20. Compute his income from business for the current assessment year 2020-21.

Dr.		Profit and Loss Account		Cr.	
Particulars	Amount	Particulars	Amount		
To Salary to staff	93,200	By Gross profit	8,05,300		
To Bonus	6,250	By Interest on bank deposits	15,100		
To Proprietor's Salary	18,000	By Sale of waste papers	300		
To Rent of the building	24,000				
To Interest on loan					
For Personal	5,000				
For Business	<u>7,000</u>				
	12,000				
To Printing and Stationery	800				
To Income tax	4,100				
To Cost of new Telephone	2,000				
To Telephone bill	18,000				
To Drawings	16,000				
To Repairs to building					
Current repairs	6,000				
Capital	15,000				
Capital expenditure	<u>32,000</u>				
	53,000				
To Provision for doubtful debts	2,860				
To Provision for warranties	9,000				
To Depreciation	11,200				
To Net profit	5,50,290				
	<u>8,20,700</u>				
					<u>8,20,700</u>

Additional Information

During the previous year due to negligence of an employee goods worth ` 4,000 were damaged fully and there is no insurance for it.

Sol :

Computation of Sri Vishnu Sharma's Income from Business for the Assessment Year 2020-21

Particulars		
Net profit as per Profit & Loss A/c		5,50,290
Add: Inadmissible expenses (Debited in P & L A/c)		
Proprietor's salary	18,000	
Interest on loan (personal)	5,000	
Income tax	4,100	
Drawings	16,000	
Capital expenditure	32,000	
Provision for Doubt ful debts	2,860	77,960
		6,28,250
Less: Incomes to shows under other heads (Credited in Profit & Loss A/c)		
(i) Interest on Bank Deposits	15,100	
Less : Admissible expenses, but not debited in Profit & Loss A/c		
(i) Depreciation	3,200	
(ii) Goods damage	4,000	22,300
		6,05,950
Add: Income not entered (credited) in Profit & Loss A/c		—
Income from Business		6,05,950

Explanatory Note :

- Salary to staff is admissible expenses, but proprietors salary is not admissible expenses because it a notional expenses. Hence, it is not allowed as business expenses.
- Interest on personal loan is a notional expense. Hence, it is not allowed as business expenses.
- Income tax in a personal expense. Hence, it is not allowed as business expenses.
- Drawings is an amount withdrawing from capital. Hence, it can't show as admissible expenses.
- Repair to Building inadmissible expenditure, assuming that agreement with the owner of the house to bear all the expenses.
- Capital expenditure is not allowed as deduction But, Depreciation is allowed on the expenditure
Depreciation = $32,000 \times 10/100 = \text{Rs. } 3,200$
- Interest on Bank deposits in income from the sources. Hence, it is not a part of business income.
- Damage to the goods is a business loss. Hence, it is allowed as admissible expenses.

2. Following is the Profit and Loss account of Smt. Pushpalatha. Compute income from business and calculate tax liability for the current assessment year.

Dr. Profit and Loss Account Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Salary 1,40,000		By Gross profit	9,04,400
Add: Outstanding 8,000	1,48,000	By Rent (sublet)	2,000
To Telephone expenses	15,000	By Profit on sale of	
To Rent	18,000	old machinery	68,000
To Legal expenses	9,000	By Profit on sale of	
For protecting the business	30,000	empty bags	2,000
For Personal suit	39,000	By Bad debts recovered	5,000
		(allowed earlier)	
To Motor car expenses	44,000		
To Income tax	12,000		
To Birthday party expenses	6,000		
To Annual day expenses			
of the shop	2,000		
To Service tax	16,000		
To Bad debts	8,600		
To Provision for doubtful debts	2,800		
To Depreciation	16,000		
To Net profit	6,54,000		
	9,81,400		9,81,400

Additional information:

- 50% use of motor car is attributable to business purpose.
- Depreciation allowed as per I.T. Act Rules ` 56,000.
- Part of the sales is export of goods. Due to foreign exchange rate fluctuations loss suffered ` 21,000.
- Income from other sources ` 1,11,200.

Sol :

(Imp.)

Computation of Pushpalatha's Income from Business for the Assessment Year 2020-21

Particulars		
Net profit as per Profit & Loss A/c		6,54,000
Add: Inadmissible expenses (Debited in P & L A/c)		
(i) Legal expenses personal	9,000	
(ii) Income tax	12,000	
(iii) Birth day party expenses	6,000	
(iv) Provision for Doubtful debts	2,800	
(v) Motor car expenses (personal use)	22,000	
(vi) Depreciation	16,000	
(vii) Rent	2,000	69,800
		7,23,800
Less: Income to shown under other heads (Credited in Profit & Loss A/c)		
(i) Profit on Sale of Machinery	68,000	
Less: Admissible expenses, but not debited in P & L A/C		
(i) Loss on currency exchange	21,000	
(ii) Admissible depreciation as per I.T. Rules	56,000	1,45,000
		5,78,800
Add: Income not entered [Credited] in Profit & Loss A/c		—
Income from Business		5,78,800

Calculation of Total Income

(i) Income from Business	: Rs. 5,78,800
(ii) Short-term capital gain on Machinery	: Rs. 68,000
(iii) Income from other sources	: Rs. 1,11,200
	<u>Rs. 7,58,000</u>

Calculation of Tax Liability

Slab	Income Level (Rs.)	Taxable Income (Rs.)	Tax Rate %	Tax (Rs.)
I	upto 2,50,000	2,50,000	NIL	NIL
II	2,50,001 to 5,00,000	2,50,000	5%	12,500
III	5,00,001 to 10,00,000	2,58,000	20%	51,600
		7,58,000		64,100
Add : Health & Education Cess @ 4% (64,000 × 4/100)				2,564
				66,664

Rounded of tax liability is Rs. 66,660

Explanatory Notes

1. Legal expenses paid for personal use it is a notional expense. Hence, it is not allowed as business expenses.
2. Income tax is a personal tax. Hence, it is not allowed as business expenditure.
3. Birthday party expenses is personal expenses. Hence, it is not allowed as business expenses.
4. Provision for Doubtful debts is not allowed as a business expenses.
5. Personal use of motor car is not a business expenses. Hence, it is not allowed as a business expenses.

$$\text{Value of personal uses} = 44,000 \times \frac{50}{100} = \text{Rs. } 22,000$$

6. Sub let income not considerable as a part of Rent. Hence In admissible rent to be calculate as follows.

Rent paid – Actual rent.

Actual rent = Rent per annum – Income from sub let

Actual rent = 18,000 – 2,000

Actual rent = Rs. 16,000

Inadmissible rent = 18,000 – 16,000 = Rs. 2,000.

7. Profit on sale of machinery in short term capital gain. Hence, it is considered as a Business Income. But it includes in total income. Which is a short-term capital and taxed on slab rate basis
8. Currency loss occurs due to foreign export business is a business loss. Hence, it is considered as a business loss.

3. **Profit and Loss account of Mr. Banwar Lal for the year ended 31 st March 2020 is as follows. Compute income from the business and tax liability for the assessment year 2020-21.**

Dr.		Profit and Loss Account		Cr.	
Particulars	`	Particulars	`		
To Salaries (including proprietors salary 6,000)	75,000	By Gross Profit @15%	2,86,000		
To Gen. Insurance Premium	4,200	By Commission	8,400		
To Bad debts	11,500	By Profit on sale of long term Investment	21,000		
To Provisions for doubtful debts	5,000	By Bad debts recovered (allowed earlier as deduction)	15,000		
To Rent	7,000				
To Discount	2,460				
To Interest on loan	11,000				
To Annual licence fee	2,080				
To Value Added Tax	8,000				
To Income tax	12,000				
To Interest on capital	7,500				
To Net profit	1,84,660				
	3,30,400				3,30,400

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 Rs. 30,000 is not recorded in the books.
6. For achieving the sales target one of the distributor presented a T.V. set worth Rs. 17,000.
7. Salary to employees is paid through bank except for watchman, whose monthly salary is ` 2,000 is paid in cash.

Sol :

(Imp.)

Computation of Mr. Banwar Lal's Income from Business for the Assessment Year 2020-21

Particulars		
Net profit as per Profit & Loss A/c		1,84,660
Add: In admissible expenses entered in debit side of profit & loss A/c		
(i) Proprietors salary	6,000	
(ii) Provisions for Doubtful debts	5,000	
(iii) Income tax	12,000	
(iv) Interest on Capital	7,500	
(v) Interest on Asset purchase	3,000	
(vi) Interest on personal loan	2,000	
(vii) Prepaid insurance	1,200	36,700
		2,21,360
Less: Income from other head entered in Credit side of Profit & Loss A/c		
(i) Profit on sale of investment	21,000	
Less: Admissible expenses not entered in debit side of Profit & Loss A/c		
(i) Out standing rent	2,000	
(ii) Depreciation on business assets	5,100	28,100
		1,93,260
Add: Income not entered in credit side of P & L A/c		
(i) Distributor presentation	17,000	
(ii) Profit on sale, which is not recorded (30,000 × 15/100)	4,500	21,500
Income from business		2,14,760

Explanatory Note

1. Percentage of Gross profit is not comparable for the previous year and present year.
2. Assessee in maintaining mercantile system. Hence, out standing income & expenses are allowed for deduction.
3. Accepting depreciation amount, which is approved by the income tax department is mandatory to accept.
4. Below Rs. 20,000 cash payment are admissible expenses.
5. Interest paid on purchasing of asset Rs. 3,000 and personal loan for Rs. 2,000 is not allowed as business expenditure.
6. Long term capital is taxed @ flat rate of 20%.
7. Salary to watchman is a revenue payment, for each time it is less than the Rs. 10,000/-. Hence it is allowed as deduction.

Computation of tax liability : Assesses income is less then the expemted income. Hence, Tax liability is Nil

4. **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 31st March 2020.**

Dr.		Profit and Loss Account		Cr.	
Particulars		Particulars			
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 Sales 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 of advertisement expenses ` 1,000 were spent on neon sign boards.
2. ` 1,000 were 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 Rs. 5,000 is advanced to purchase the raw materials to a supplier who is absconding from the country.

Sol :

(Imp.)

Computation of Mr. Vidyand's Income from Business for the Assessment Year 2020-21

Particulars		
Net profit		1,65,200
Add: In Admissible Expenses debited in Profit & Loss A/c		
(i) Drawings	8,000	
(ii) Income tax	4,500	
(iii) Interest on capital	2,000	
(iv) Bonus to proprietor	4,000	
(v) Donations	5,000	
(vi) Provision for doubtful debts	4,000	
(vii) Contribution to scientific research	10,000	
(viii) Computer purchased (Hardware)	76,000	
(ix) Computer purchased (Software)	8,000	
(x) Computer purchased Printer	12,000	
(xi) Neon sign board	1000	
(xii) Patents	28,000	
(xiii) Repairs	500	
(xiv) Legal expenses for purchase of land	1,000	1,64,000
Less: Income from other head shown in credit side of profit & loss A/c		3,29,200
(i) Interest on securities	10,000	
(ii) Income from House property	12,000	
(iii) Sale of Buildings	1,52,000	
(iv) Income from lottery	40,000	2,14,000
Less: Admissible expenses not entered in debit side of Profit & Loss A/c		
(i) Bad debts	5,000	
(ii) Depreciation on Neon Sign Board	100	
(iii) Depreciation on patents	7,000	
(iv) Depreciation on computer	33,600	
(v) Depreciation on printer	1,800	
(vi) Scientific research	15,000	62,500
		52,700

Add: Incomes not entered in profit & loss A/c		
(i) Legal expenses include purchase of land		
(ii) Investments understated.	70,000	70,000
Income from business		1,22,700

Explanatory Note

1. Expenditure incurred on Neon Sign Board is a capital expenditure. So, it is not allowed as a Business expenditure. But depreciation is allowed, as per the IT Rules allowed depreciation is 10% pa. Hence,

$$\text{Depreciation} = 1,000 \times \frac{10}{100} = \text{Rs. } 100$$

2. Repairs for let out house is not allowed as deductions.
3. Amount spent on purchase of land is not a Business Expenditure Hence it is not allowed as deduction.
4. Understated investments are purchased from Business income only, but it is a personal.
5. Supplier is absconded from the country, Hence the amount paid as advance is considered as Bad debts, and allowed as deduction on the basis of business loss.
6. Purchase of computer, (Hardware, Software and Printer) is a capital expenditure. Hence, it is not allowed as a revenue expenditure.
7. Depreciation provided on capital assets are as follows

(i) Depreciation computer (Hard ware + Soft ware) @ 40%

$$\text{Purchased cost} = 76,000 + 8,000 = \text{Rs. } 84,000$$

$$\text{Depreciation} = 84,000 \times \frac{40}{100} = \text{Rs. } 33,600$$

(ii) Depreciation on computer printer @ 15%

$$\text{Purchased cost} = \text{Rs. } 12,000$$

$$\text{Depreciation} = 12,000 \times \frac{15}{100} = \text{Rs. } 1,800$$

8. Contribution to scientific research is allowed upto 150% as deduction. Hence,

$$10,000 = 100\%$$

$$? \% = 150\%$$

$$= \frac{10,000 \times 150}{100} = \text{Rs. } 15,000$$

9. Sale of Building is short term capital gain. It includes in total income, and taxed at slab rate system.

5. The Profit and Loss Account of Mr. S. Vidya Sagar, Haridwar is as under Compute the income from business and tax liability for the current assessment year. If deduction u/s 80C is ₹ 72,000.

Dr.

Cr.

Particulars	Rs.	Particulars	Rs.
To Payment to Staff:		By Gross Profit	4,47,780
Salaries	30,000	By Interest from Customers	8,120
Allowances	18,000	By Interest on Advances to	
Bonus	6,000	employees	1,500
Perquisites	14,000	By Interest on Bank Deposits	13,200
Advances	21,000	By Rent Received	12,500
To Taxes:		By Bad debts recovered	
Municipal taxes	800	(Out of this ₹ 3,000 is	
(Business licence fee)		disallowed earlier)	7,000
Income Tax (Advance)	4,000	By Gross profit from	
Sales Tax	11,000	speculation business	3,30,000
Sales Tax payable	2,000		
To Scientific Research			
(i) In Home:			
Revenue expenses	5,000		
Capital expenses	30,000		
(ii) To outsiders:			
A Scientist	20,000		
Amaravathi University	11,000		
To Termination of agency	18,500		
To Club admission fee to manager	5,000		
To Membership fee of traders			
association	2,000		
To Fines			
For adulteration	3,000		
For late delivery of goods	500		
To Payment to Competitors			
For acquiring competing business	75,000		
For not to sell a product in his area	20,000		
To Speculation business expenses	1,80,000		
To Depreciation:			
On business assets	30,000		

On assets at the residence of the employees	5,000		
On assets at the residence of the owner	17,000		
To Rent of own premises	30,000		
To Net profit	2,61,300		
	8,20,100		8,20,100

Sol :

Computation of Mr. Vidya Sagar's Income from Business for Assessment Year 2020-21

Particulars	Rs.	Rs
Net Profit		2,61,300
Add : Inadmissible expenses debited in P & L A/c.		
(i) Advances to staff	21,000	
(ii) Income tax	4,000	
(iii) Fine for adultery	3,000	
(iv) Donation to individual for scientific research	20,000	
(v) Donation to amaravathi university for scientific research	11,000	
(vi) Acquiring competing business	75,000	
(vii) Speculation business expenses	1,80,000	
(viii) Depreciation on own assets	17,000	
(viii) Rent of own premises	30,000	3,61,000
		6,22,300
Less : Income from other heads shown in P & L A/c		
(i) Interest on bank deposits	13,200	
(ii) Rent received	12,500	
(iii) Bad debts to the extent disallowed earlier	3,000	
(iv) Profit from speculation business	3,30,000	3,58,700
Less : Admissible expenses not entered in debit side of P & L A/c.	—	
(i) Depreciation on scientific research		16,500
Add : Incomes not entered in P & L A/c	—	—
Income from business		2,47,100

Calculation of Income from other heads

1. Income from house property

Rent received (GAV) = 12,500

Less : Municipal taxes = NIL

Net amount value (NAV) 12,500

Less : Deductions

(i) Standard deduction U/s 24(i)

$$30\% \text{ of NAV} = 12,500 \times \frac{80}{100} = 3,750$$

(ii) Interest on loan U/s 24 (ii) = NIL

Income from house property 8,750

2. Income from speculation business

Gross profit from speculation business = Rs. 3,30,000

Less : Speculation business expenses = Rs. 1,80,000

Income from speculation business Rs. 1,50,000

3. Income from other sources (interest on bank deposits) Rs. 13,200

Calculation of Total Income

Particulars	Rs.
I. Income from salary	–
II. Income from house property	8,750
III. Income from business	2,47,100
IV. Income from capital gains	–
V. Income from other sources	1,63,200
Gross total income	4,19,050
Less : Deduction U/s 80 C	72,000
Deduction U/s 80 TTA	10,000
Total Income	3,37,050

Calculation of Tax Liability

Slab	Income Limit (Rs.)	Taxable Income (Rs.)	Tax Rate %	Tax (Rs.)
I	upto 2,50,000	2,50,000	NIL	NIL
II	2,50,001 to 5,00,000	87,050	5%	4352.5
		3,37,050		4352.5
	Tax Liability			
	Less : Rebate u/s 87(a)			2,500.00
				1,852.50
	Add : Health & Education Cess @ 4% $(1852.50 \times 4/100)$			74.10
	Net Tax Liability			1926.60

Rounded off Tax Liability Rs. 1930

Calculation of Tax Liability u/s 87(a)

(a) Actual Tax – Rs. 4,352.50

(b) Ceiling – Rs. 2,500

Rebate = Which ever least from the above = Rs. 2,500

Assessee's income is less than the Rs. 3,50,000

Hence, he is eligible for rebate U/S 87(a)

6. Compute Business Income for Previous Year 2019-20 of Tania Topu.

Dr.	Trading and Profit & Loss A/c		Cr.
Particular		Particular	
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 received 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. Tania Topu for Assessment Year 2020-21

Particular	Amount (₹)	Amount (₹)
Net Profit as per profit/loss account		1,81,910
Add: In admissible expenses		
Donation	1,500	
Drawings	7,200	
Life insurance premium	3,600	
Rent $\frac{1}{4}$ used for own		
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 on deduction from business income.
6. The car sold during previous year doesn't come under the head business income.
7. **Given below is the Profit and Loss Account of Mr. Adinarayana for the year ending 31.3.2019. Compute his Business Income.**

Dr.

Cr

Particulars	Amount (₹)	Particulars	Amount (₹)
To Salaries	1,56,000	By Gross Profit	4,25,000
To Rent and Taxes	86,000	By Rents of staff quarters	73,000
To Advertisement	97,000	By Sale of Machinery	56,000
To Life Insurance Premium	22,000	By Interest on Bank Deposits	28,000
To Fire Insurance Premium	25,000	By Refund of Sales Tax	34,000
To Drawings	55,000	By Recovery of Bad Debts	34,900
To Interest on Capital	22,000		
To Donations	29,000		
To Income Tax Reserve	25,000		
To Net Profit	1,33,900		
	6,50,900		6,50,900

Additional Information:

1. Allowable Depreciation ₹ 95,000
2. Loss made by employee by negligence ₹ 55,000
3. Bad Debts recovered were disallowed earlier
4. Advertisement includes Gifts of ₹ 25,000 given to customers.

Sol :

**Computation of Mr. Adinarayana's Income from Business for the
Assessment year 2020-21**

Particular	Amount (₹)	Amount (₹)
Net Profit as per Profit and Loss account		1,33,900
Add: Inadmissible Expenses:		
Life insurance premium	22,000	
Drawings	55,000	
Interest on capital	22,000	
Donations	29,000	
Income Tax Reserve	25,000	1,53,000
		2,86,900
Less: Incomes to be shown under other heads:		
Sale of Machinery	56,000	
Interest on Bank Deposits	28,000	
Bad debts recovered but disallowed earlier	34,900	1,18,900
		1,68,000
Less: Deductions:		
Depreciation		95,000
Income from Business		73,000

Working Notes**1. Salaries**

Salaries paid to staff is a business expenditure. Hence, it is allowed as deduction.

2. Rent and Taxes and Fire Insurance Premium

This expenses are paid for the building used for the business, hence it is allowed as deduction.

3. Advertisement

Advertisement through gifts are allowed as deduction, irrespective of their cost.

4. Life Insurance Premium and Drawings

These are personal expenditures, hence they are not allowed as deduction.

5. Donations

Donation is not allowed as deduction.

6. Interest on Capital and Income Tax Reserve

These are notional expenditures, hence they are not allowed as deduction.

7. Rent of Staff Quarters

It is a business income, hence it is allowed as deduction.

8. Sale of Machinery

It is a capital gain. Hence, it will come under the head "Income from other sources".

9. Interest on Bank Deposits

It is shown under the head "Income from other sources".

10. Refund of Sales Tax

It is a business income, hence it is allowed as deduction.

11. Recovery of Bad Debts

Bad debts disallowed earlier and received now will not be treated as income.

12. Depreciation

Depreciation allowed as per I.T Act is to be taken under the heading "Deductions".

13. Loss made by Employees by Negligence

It is an incidental loss to business, hence it is allowed as deduction.

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

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

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 existence 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 :

Real value of stock in case of under-valuation

$$= \text{value of stock} \times \frac{100}{(100 - \text{rate of under - valuation})}$$

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.
- 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. Pledge 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).

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.

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. manual 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 :

(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 he 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 within 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 or 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 → used for residential purpose	5%
Block No. 2	Buildings → used for non residential purpose such as office, factory, show room, godowns, etc.	10%
Block No. 3	Buildings → used for Hotels	10%
Block No. 4	Buildings → Temporary structures	40%
Block No. 5	Building → 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 → For all types of business	10%
Block No. 7	Plant and Machinery → (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 → This Block includes only Motor cars used in the general business	15%
Block No. 9	Plant and Machinery → 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 →	40%
	(ii) Life saving medical equipment →	40%
Block No. 11	Plant and Machinery → This Block includes containers including computer software.	40%
Block No. 12	Plant and Machinery → This Block includes computers including computer software.	40%
Block No. 13	Plant and Machinery → This Block includes equipment used for energy saving devices etc.	40%
Block No. 14	Plant and Machinery → Air and water pollution control equipment.	40%

Block No. 15	Intangible Assets → 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. (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 depreciation 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 provision about depreciation ?

Ans :

With effect from assessment year 2006-07 an additional depreciation @ 20% of actual cost of P & M is allowed if following conditions are fulfilled :

- a) The assessee is engaged in the business of manufacture or production of any article or thing or goods.
- b) In case any new plant and machinery is acquired and installed on or after 1-4-2005. qualify for additional/initial depreciation. In case new plant and machinery is acquired before 1-4-2005 but installed on or after 1-4-2005, then additional depreciation is not available.
- c) It is allowed in addition to normal depreciation and shall be taken into consideration for calculating written down value.
- d) To claim additional depreciation @ 20% of actual cost the condition of use for 180 days during the relevant previous year shall be applicable for this depreciation also. If used for less than 180 days in the previous year in which it is acquired, additional depreciation shall also be allowed @ 10% {i.e., for half year) and remaining 10% additional depreciation shall be allowed in the next previous year.
- e) The plant and machinery is new and it has not been used earlier either in India or outside India.
- f) The plant and machinery is not eligible to be written off @ 100% of its actual cost in any one previous year.
- g) The plant and machinery is not in the nature of office appliances or road transport vehicles.
- h) The return of income must be accompanied by the details of plant and machinery and expansion of installed capacity.

The return of income must be accompanied by a report by the chartered accountant that the deduction has been correctly claimed.

Additional depreciation is not allowed in case of following assets :

- i) Ships and aircrafts.
- ii) Old plant and machinery used either in India or outside India by any other person.
- iii) Any plant and machinery installed in office premises, residential accommodation and guest house.
- iv) Office appliances or road transport vehicles.
- v) Any other plant and machinery the whole of cost of which is going to be debited to his profit and loss account by way of depreciation or otherwise in any one previous year, vi) In the case of power generating units, additional depreciation is not available.

Grant of additional depreciation to Power Sector Undertakings [Section 32(iia)]

With effect from Assessment year 2013-14 an additional depreciation shall be allowed in case of new Plant and Machinery is acquired and installed after 31-3-2012 by an assessee engaged in the business of generation or generation and distribution of power and also to assesses engaged in the business of transmission of power. But a power generating unit claiming depreciation on straight-line basis will not be allowed any additional depreciation. New plant and machinery does not include ship and aircraft.

Grant of additional depreciation in succeeding previous year

In case new plant and machinery is put to use for less than 180 days in the previous year of its acquisition and installation, then additional depreciation shall also be allowed only upto 50% i.e., 50% of 35% in that year and balance 50% will be allowed in the immediate succeeding previous year.

Higher/Additional depreciation to undertakings located in notified backward area of Andhra Pradesh, Telangana, Bihar and West Bengal [Proviso to Section 32(1)(iia)]

Additional depreciation has been allowed to incentives manufacturing activity in specified backward areas.

Rate of Additional Depreciation

- i) @ 35% (i.e., 20% + additional @ 15%) if the asset is used for 180 days or more during that previous year.
- ii) 17.5% (A of 35%) if the asset is used for less than 180 days during that previous year.

Where an assessee sets up an undertaking or enterprise for manufacture or production of an article or thing and fulfills following conditions.

- i) New Plant or Machinery is acquired and installed in a notified backward area of Andhra Pradesh, Telangana, Bihar and West Bengal.
- ii) New Plant or machinery is acquired and installed between 1-4-2015 to 31-3-2020.
- iii) New Plant or machinery does not include ships, aircraft and machinery or plant which are currently not eligible for additional depreciation as per the existing proviso to Section 32(1)(iia).

Terminal Depreciation :

If the written down value of the asset sold out is more than the sale value (including scrap value) then the difference is known as terminal depreciation. In other words it is loss on sale of business asset.

Terminal W.D.V of the Sale value or scrap value

depreciation = sold out asset (-) or insurance claim received on asset destroyed.

Terminal depreciation is allowed as deduction while computing the income from business, for which the assessee has to satisfy the following conditions.

Conditions:

1. The assessee must follow straight line method of depreciation, e.g., presently straight-line method of depreciation is permitted for power generating / distributing units.
2. Asset must be used in the previous year for running the business.
3. Terminal depreciation is not allowed in the year of purchase. In the year of purchase if such loss is there, then the same is treated as short term capital loss.

Balancing charge

If the sale price is more than the W.D.V of the sold out asset, then the excess amount is known as balancing charge. In other words it is profit on sale of business asset.

$$\text{Balancing charge} = \begin{array}{l} \text{Sale value or scrap value} \\ \text{or insurance claim received} \end{array} - \begin{array}{l} \text{W.D.V of the} \\ \text{sold out asset on asset destroyed.} \end{array}$$

Balancing charge is treated as business income.

Conditions:

1. The assessee must follow straight line method of depreciation, e.g., presently straight-line method of depreciation is permitted for power generating /distributing units.
2. Asset must be used in the previous year for running the business.
3. Terminal depreciation is not allowed in the year of purchase. In the year of purchase if such loss is there, then the same is treated as short term capital loss.

Unabsorbed depreciation

If the business profits are not sufficient to deduct the depreciation, then the difference between the two amounts is known as unabsorbed depreciation loss. Unabsorbed depreciation can be carried forward indefinitely and can be set off from the profits and gains of subsequent years. The general practice to charge depreciation under the head profits and gains of business or profession. In such a case the following points are to be considered.

1. The unabsorbed depreciation loss of one business can be set off from the profits of another business in the same previous year.
2. If unabsorbed depreciation loss is there then it is deductible from other heads of income (except income from salary) in the same previous year.
3. If still unabsorbed depreciation loss is there then it can be carried forward to the subsequent years, with out any time limit and can be setoff from the income of all heads except "Income from salary".
4. In the year of setoff, current year depreciation and unabsorbed depreciation can be given as deduction to the extent of profits available / income from other heads (except income from salary).
5. If there is business loss (before charging depreciation), then the order of setoff is as follows:
 - (i) Current year business loss (before charging depreciation)
 - (ii) Current year depreciation.
 - (iii) Unabsorbed business loss of earlier period (s).
 - (iv) Unabsorbed depreciation of earlier period (s).

Special Note:

- (i) Unabsorbed depreciation of earlier period, if return is not filed in that year → It can be set off in future whenever profits are available or income is available in other heads (except income from salary)
- (ii) Unabsorbed business loss of earlier period, if return is not filed in that year → It can be set off in future whenever profits are available or income is available in other heads (except income from salary)

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 full 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

8. 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 2020-21

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 (W.N)**Calculation of Depreciation:**

New asset is used for more than six months.

Normal depreciation is allowed

$$5,00,000 \times 25\% = 1,25,000$$

$$3,00,000 \times 25\% = 75,000$$

$$2,00,000$$

9. M/s A & Bros, of Cuttack have following assets on 1-4-2019 :

S.No	Assets	WDV on 1-4-2019	Additions during the year	Scrap value of asset put out of use during the year	Rate of depreciation
1.	Plant & Machinery	42,20,000	6,90,000	2,10,000	15%
2.	Aircraft	34,50,000	-	-	40%
3.	Motor Buses & Lorries (used for hiring)	6,40,000	2,80,000	4,15,000	30%
4.	Imported car	NIL	3,60,000	-	15%
5.	Patent Rights	NIL	8,00,000	NIL	25%
6.	Technical Know-how	NIL	6,00,000	NIL	25%

Calculate the amount of depreciation which firm can claim for the assessment year 2020-21 and also calculate the WDV on 1-4-2020. New Bus was brought into use from 1-12-2019, Plant and Machinery on 1-7-2019 and Patent Rights and Technical Know-how on 1-11-2019 and imported car on 1-6-2019.

Sol :

S.No	Block of Assets	Depreciation	WDV/cost
1.	Plant and machinery and cars 15% Block WDV as on 1-4-2019 Add : Cost of new P & M + car (6,90,000 + 3,60,000) (use > 180 days) Total Less: money realised: scrap value of P & M destroyed WDV as on 31-3-2020 Depreciation @ 15% of 50,60,000 Additional depreciation on 6,90,000 @ 20% WDV as on 1-4-2020	 7,59,000 1,38,000	 42,20,000 10,50,000 52,70,000 2,10,000 50,60,000 8,97,000 41,63,000
2.	Plant and machinery 30% Block [motor lorries and buses] WDV as on 1-4-2019 Add : Cost of new bus acquired on 1-12-2019 Total Less : Money realised : on discarding the bus WDV as on 31-3-2020 Depreciation @ 30% of 7 2,80,000 for V4 year Depreciation on balance WDV (5,05,000 - 2,80,000) @ 30% WDV as on 1-4-2020	 42,000 67,500	 6,40,000 2,80,000 9,20,000 4,15,000 5,05,000 1,09,500 3,95,500

3. Plant and machinery 40% Block [Aircraft]	WDV as on 1-4-2019		34,50,000
	Add : Cost of new asset		NIL
	Total		34,50,000
	Less : Money realised : on discarding the bus		NIL
	WDV as on 31-3-2020		34,50,000
4. Intangible assets -25% Block	Depreciation @ 40%	13,80,000	13,80,000
	WDV as on 1-4-2020		20,70,000
	Cost of Patent rights on 1-11-2019		8,00,000
	Cost of Technical know-how on 1-11-2019		6,00,000
			14,00,000
	Less : Money realised		NIL
	WDV on 31-3-2020		14,00,000
	Dep. @ 25% for 1/2 years	1,75,000	1,75,000
	WDV as on 1-4-2020		12,25,00C
	Total depreciation	25,61,500	

10. A new industrial undertaking set up on 1-4-2019 has acquired following assets as per dates mentioned against each:

Asset	Date of acquisition	Date of use	Cost (₹)	Rate of dep
Machinery	31-3-2019	5-9-2019	6,00,000	15%
Electric Moter	1-7-2019	1-10-2019	78,000	15%
Plant	12-11-2019	15-12-2019	12,00,000	15%

Calculate amount of admissible depreciation and written down value as on 1-4-2020.

Sol :

Computation of depreciation and written down value

Particulars	WDV	Depreciation
Plant and machinery 15% Block		
WDV as on 1-4-2019	NIL	
Add: actual cost of new assets put into use during the year		
Machinery put into use from 5-9-2019	6,00,000	
Electric Motor put into use from 1-10-2019	78,000	
Plant put into use from 15-12-2019	12,00,000	
	18,78,000	
Less : money realised	NIL	
WDV as on 31-3-2020	18,78,000	

Depreciation :		
Asset acquired during the year but used for less than 180 days : Plant $[12,00,000 \times 15\% \times \frac{1}{2}]$		90,000
Additional depreciation for Vi year $[12,00,000 \times 20\% \times \frac{1}{2}]$		1,20,000
Other assets for full year $[18,78,000 - 12,00,000] 6,78,000 \times 15\%$		1,01,700
Additional depreciation for full year $[6,78,000 \times 20\%]$		1,35,600
		4,47,300
Total depreciation	4,47,300	
Written down value as on 1-4-2020	14,30,700	

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. Consultation 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	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		XXX
Total Professional Receipts		
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

11. Mr. Srinivas submits the following particulars for the year ended 31-3-2020. 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 2020-21

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
<i>Income from Business</i>		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., $60,000 - 40,000 = 20,000$.

12. Given below is the profit and loss account of Mr 'X' for the year ending 31 -3-2020.

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 2020-21

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.

13. 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 2020-21

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
Less: Deductions:		
Depreciation on ambulance van	21,000	
Depreciation on life saving medical equipment @ 40% $1,20,000 \times \left[1,20,000 \times \frac{40}{100} \right]$	48,000	69,000
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.

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. Profession

Ans :

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.

3. 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.

4. Unabsorbed depreciation

Ans :

If the business profits are not sufficient to deduct the depreciation, then the difference between the two amounts is known as unabsorbed depreciation loss. Unabsorbed depreciation can be carried forward indefinitely and can be set off from the profits and gains of subsequent years. The general practice to charge depreciation under the head profits and gains of business or profession. In such a case the following points are to be considered.

1. The unabsorbed depreciation loss of one business can be set off from the profits of another business in the same previous year.

2. If unabsorbed depreciation loss is there then it is deductible from other heads of income (except income from salary) in the same previous year.
3. If still unabsorbed depreciation loss is there then it can be carried forward to the subsequent years, with out any time limit and can be setoff from the income of all heads except "Income from salary".
4. In the year of setoff, current year depreciation and unabsorbed depreciation can be given as deduction to the extent of profits available / income from other heads (except income from salary).

5. Deemed Profits

Ans :

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.

6. 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.

7. 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.

8. What are the Expenses Expressly Disallowed as deduction in computing the profit of business.*Ans :*

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 on borrowings from outside India.
7. Interest royalty, technical service fees etc, paid without TDS outside India.
8. Wealth tax.

9. What are the differences between Capital and Revenue Expenses.*Ans :*

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. manual 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	5.	A payment made to discharge capital

10. Terminal Depreciation

Ans :

If the written down value of the asset sold out is more than the sale value (including scrap value) then the difference is known as terminal depreciation. In other words it is loss on sale of business asset.

Terminal W.D.V of the Sale value or scrap value

depreciation = sold out asset (-) or insurance claim received on asset destroyed.

Terminal depreciation is allowed as deduction while computing the income from business, for which the assessee has to satisfy the following conditions.

Conditions:

1. The assessee must follow straight line method of depreciation, e.g., presently straight-line method of depreciation is permitted for power generating / distributing units.
2. Asset must be used in the previous year for running the business.
3. Terminal depreciation is not allowed in the year of purchase. In the year of purchase if such loss is there, then the same is treated as short term capital loss.

Exercise Problems

1. Mr. Ram Kumar, a resident Individual furnishes the following particulars for the previous year relevant to the current assessment year. Compute income from business.

Profit and Loss Account for the year ending 31 st March 2020

Particulars	Amount in `	Particulars	Amount in `
To Salary to staff	1,13,000	By Gross Profit	5,99,000
To Staff welfare expenditure	36,000	By Sundry receipts	5,000
To Goods and Services Tax	42,000	By Profit on sale of land	2,08,000
To General expenses	5,000		
To Bad debts	9,500		
To Reserve bad and doubtful debts	12,000		
To Fire Insurance	4,000		
To Advertisement expenses	31,000		
To Int.on Ram Kumar's capital and loan	3,500		
To Expenditure on acquisition of copy right	75,000		
To Lumpsum Consideration for acquiring know-how	1,10,000		
To Loss on sale of shares	18,000		
To Provision for I.T	4,000		
To Net Profit	3,49,000		
	8,12,000		8,12,000

Other Information:

- Salary to staff includes salary paid to a relative which is unreasonable to the extent of ` 24,000.
- Advertisement expenses include ` 10,300 being cost of 15 brief cases, presented to the customers.
- For recovery of the amount due from debtors the assessee has not made any effort.
- W.D.V of machinery block with 15% depreciation is ` 4,20,000.
- W.D.V of furniture with 10% depreciation on first day of the previous year is ` 30,000. Half of it is sold out for ` 42,000.
- Copy rights and know how are acquired 2 months back.
- Outstanding salary is ` 16,800.
- Refund from Goods and Services Tax during the previous year is X. 8,150. (Pertaining to 2018-19 year).

[Ans : ` 3,02,225]

2. Mr. Anil Kumar furnishes the following particulars for the assessment year 2020-21. Compute income from business, Gross total income.

Profit and Loss Account for the Previous Year.

Expenditure	Amount in `	Income	Amount in `
To Salary to Staff	2,34,000	By Gross Profit	8,55,000
To Interest on bank loan	18,000	By Rent from Staff quarters	12,000
To Expenditure on promotion of family planning among the employees	3,000	By Sundry receipts	5,000
To Goods and Services tax	6,000	By Interest on Bank deposits	17,000
To Income tax	2,000	By Profit on sale of equity shares (long term)	6,000
To Gratuity to staff	90,000		
To Reserve for future losses	15,000		
To Reserve for bad debts	8,000		
To Reserve for payment of Income Tax	13,000		
To Car expenses	9,000		
To Office expenses	7,000		
To Rent & Repairs of buildings	3,000		
To Municipal taxes for staff quarters	7,000		
To Sundry expenses	13,000		
To Depreciation on			
Computer 18,000			
Car 3,000			
Furniture 5,000			
Buildings 3,000	29,000		
To Net Profit	4,38,000		
	8,95,000		8,95,000

Additional information:

- Salary to staff includes Mrs. Arun Kumar's salary ` 10,000 who is working as typist and Mr. Arun Kumar's salary is 24,000.
- Salary to staff includes salary of Mr. Naveen Chavla for a month, ` 32,000 paid in cash.
- A sale transaction of ` 50,000 is not recorded in the books and the profit is 10%.
- Gratuity paid to staff is 20% in excess than the statutory limit.

[Ans : ` 5,58,000]

3. The Trading and Profit and Loss Account of Mr. S.S. Reddy for the previous year relevant to the current assessment year is as under. Compute income from business and tax liability if income from other heads is 3,00,000. (including ₹ 21,500 interest on bank fixed deposits)

Trading and Profit and Loss Account

Particulars	Amount in ₹	Particulars	Amount in ₹
To Opening stock		By Sale of Finished goods	98,51,000
Raw materials 1,50,000		By Sale of Scrap	20,300
Finished goods <u>4,50,000</u>	6,00,000	By Closing stock	
To Purchase of raw materials	54,50,000	Raw materials 86,000	
To Carriage inwards	38,000	Finished goods <u>5,61,200</u>	6,47,210
To Wages	17,41,000		
To Gross Profit	26,89,500		
	<u>1,05,18,500</u>		<u>1,05,18,500</u>
To Salaries	11,05,100	By Gross Profit	26,89,500
To Staff welfare expenses	50,000	By Refund of income tax	16,000
To Transfer to Staff Welfare Fund	80,000	By Interest on refund of	3,200
To Income tax	42,800	income tax	
To GST	1,03,000	By Gift from Suppliers	11,300
To Advertisement	2,33,750		
To Interest	1,76,200		
To Legal expenses	45,000		
To Depreciation	1,58,000		
To General expenses	1,04,000		
To Net Profit	6,22,150		
	<u>27,20,000</u>		<u>27,20,000</u>

Additional Information:

- Staff welfare expenses include ₹ 17,500 towards the cost of new borewell and ₹ 4,000 for borewell maintenance expenses.
- Salaries includes ₹ 25,000 paid to wife, who is rendering the services, it is felt that she is under paid by ₹ 8,000 and it also includes ₹ 50,000 pension paid to former employees.
- A purchase of ₹ 1,00,000 and sale of ₹ 2,50,000 is not yet recorded.
- Actual opening stock finished goods is ₹ 3,00,000 and closing stock of rawmaterials is ₹ 1,02,000.
- Advertisement expenses includes ₹ 5,000 worth pens were distributed to the customers and on which the name of the business or logo of the product is not engraved /printed.

6. General expenses includes
 - a) Diwali expenses ` 5,000.
 - b) Donation to Central University ` 7,000.
 - c) Son's birthday celebration expenses ` 10,000.
7. Depreciation on borewell is not provided.
8. Legal expenses includes a fine of ` 20,000 for power pilferage.
9. Wages includes ` 3,000 for construction of safety wall near borewell.
10. Interest includes ` 30,000 interest paid on loan, the loan is taken on the condition that interest is paid @ 10% but loan amount not to be repaid.

[Ans : ` 2,52,220]

4. Income and expenditure account of Mr. Amresh kumar an advocate of Nalgonda for the year ending 31st March 2020 is as under. Compute the professional Income for the current assessment year and tax liability.

Expenditure	Amount	Income	Amount
To Office rent	69,000	By Rent received	1,84,000
To Office expenses	1,38,000	By Dividends	46,000
To Salaries to staff	92,000	By Special fees	92,000
To Court fees and Stamps	27,600	By Gifts from clients	55,200
To Income tax	13,800	By Interest on bank deposits	92,000
To Printing and Stationery	23,000	By Insurance claim	92,000
To Municipal tax (letout)	9,200	By Examiners fees	1,05,800
To Travelling expenses	23,000	By Legal fees	2,78,000
To Telephone charges	18,400		
To Shares purchased of Ltd co.	69,000		
To Books and Journals	27,600		
To Life Insurance premium (Wife)	18,400		
To Surplus	4,16,000		
	19,45,000		9,45,000

Other Information

1. Closing stock of court stamps ` 2,300.
2. Office expenses includes ` 23,000 as personal.

[Ans : ` 1,37,700]

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 is 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

For computing capital gains, assets have been divided into two categories :

(a) **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)].

- (b) 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)].

Capital Assets

Nature of Capital Assets

1. Financial Assets

Shares, listed debentures/
government, securities, units of UTI/
mutual funds, and zero coupon bonds
Unlisted shares (if transfer takes
place on or after 01.04.2016, land and
building (if transfer takes place on or after
01.04.17)

1. If CA is held for $\leq$ 1 year = it is a STCA
2. If CA is held for $>$ 1 year = it is a LTCA

2. Depreciation Assets

1. If CA is held for $<$ 2 Year = it is a STCA
2. If CA is held for $>$ 2 Year = it is a LTCA

3. Other Assets

- Always treated as STCA
1. If CA is held for $\leq$ 3 years = it is a STCA
 2. If CA is held for $>$ 3 years = it is a LTCA

Note:

1. STCA = Short Term Capital Assets
2. LTCA = Long Term Capital Assets
3. CA = Capital Asset
4. For determining the nature of capital assets, the period of holding shall be counted from the date of purchase to the date of sale of capital asset by the assessee. Further, if the asset is acquired by gift or will, the period of holding shall be counted from the date of purchase of capital asset by the previous owner to the date of sale of capital asset by the assessee.

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
- Within the limits of any municipality or cantonment board having a population of 10,000 or more or
 - 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 |
- 6.1/2% Gold Bonds 1977 or 7% Gold Bonds 1980 or National Defence Gold Bonds, 1980 issued by the Central Government.
 - Special Bearer Bonds, 1991.
 - Gold Deposit Bonds issued under Gold Deposit Scheme 1999.
 - 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 :

- Income arising from the transfer of a capital asset
- Effected in the previous year.

5.2 SHORT TERM AND LONG TERM CAPITAL ASSETS

Q4. Write a brief note on :

- Short Term Capital Assets
- 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.

- a security and shares of companies listed in a recognized Stock Exchange in India.
- a unit of an equity oriented fund.
- 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 adding 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 :

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 deducting 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. 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 :

$$\left[\begin{array}{l} \text{Cost of acquisition of shares held by the} \\ \text{assessee in the demerged company} \end{array} \right] \times \frac{\text{Net book value of assets transferred}}{\text{Net worth of demerged company before demerger}}$$

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.

$$\left[\begin{array}{c} \text{Cost of acquisition for assessee} \\ \text{forfeiting advance money} \end{array} \right] = \left[\begin{array}{c} \text{Cost of acquisition or} \\ \text{W.D.V. or F.M.V.} \\ \text{as on 1-4-2001} \end{array} \right] - \left[\begin{array}{c} \text{Advance money} \\ \text{received and forfeited} \end{array} \right]$$

- 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 lorry 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 in 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 into shares

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.

19. Cost of bonus shares

The Finance Act 1995 has made a major change in determining the cost of bonus shares to be called "financial asset." As per new amendment the cost of financial assets allotted to the assessee without any payment and on the basis of holding of any other financial asset, shall be taken as NIL. This amendment has come into effect from assessment year 1996-97. The cost of bonus shares allotted before 1-4-2001 is their fair market value as on 1-4-2001.

Cost of Original / Bonus / Right Shares

Date of Acquisition	Original	Bonus	Right
Before 1-4-2001	Actual Cost OR Fair Market value on 1-4-2001 whichever is higher	Fair Market value on 1-4-2001	Actual Cost paid OR Fair Market value on 1-4-2001 whichever is higher
After 1-4-2001	Actual Cost	Nil	Cost of purchase of right + amount paid to company

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

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) $\times \frac{\text{C.I.I of the year of transfer}}{\text{C.I.I. of 2001-02 i.e., 100}}$
2.	Long term capital assets acquired on or after 1-4-2001	Actual cost $\times \frac{\text{C.I.I of the year of transfer}}{\text{C.I.I of the year of purchase}}$

3. Cost of improvement incurred after 1-4-2001 $\text{Cost of improvement} \times \frac{\text{C.I.I. of the year of transfer}}{\text{C.I.I. of the year of improvement}}$
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 $\text{Actual cost or FMV on} \times \frac{\text{C.I.I. of the year of transfer}}{\text{C.I.I. of the year in which present seller became is owner}}$
- 1-4-2001 (whichever is more)

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 transaction 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.)

(i) Exemption for Long term Capital Gain from residential property (Sec.54) :

According to Sec 54 Capital Gain arising from the transfer of a house property used for residential purpose (Letout or Self occupied) exemption can be given.

Section 54	
1. Eligible assessee	Individual/HUF
2. Transferred asset	Residential House (letout or self occupied)
3. Investment in	Purchase/Construction of two houses for residential purpose in India. Note: If the capital gains are less than 2 crore. This benefit can be availed only once in life time.
4. Exemption	Least of the two : a) Cost of the new asset (+) amount deposited in Capital Gain Scheme in the bank. b) Capital Gain amount.
5. Time limit	Purchase of house within 1 year before or 2 year after the date transfer or Constructing the house within 3 years.
6. Revocation of exemption	(i) Not to transfer new house for 3 years from the date of transfer or (ii) Construction is not completed within 3 years.

(ii) Capital Gains on Agricultural Lands u/s 54B :

According to Sec 54 B capital gain arising from the transfer of agricultural land exemption can be given. The relevant provisions for transfer of agriculture land are as under :

Section 54 B	
1. Transfer of Agricultural land in Rural area.	It is not considered as capital asset, hence the question of capital gain does not arise.
2. Transfer of agricultural land in a urban area normal or voluntary transfer.	It is considered as capital asset and profit on sale or transfer is income from capital gain-Taxable income.
3. Transfer agricultural land - in an urban area	It is considered as capital Compulsory acquisition by the Government, asset but profit on transfer is an exempted income.

Section 54B	
1. Eligible assessee	Individual/HUF
2. Transferred asset	Agricultural land (used by the assessee or his parents at least 2 years before transfer)
3. Investment in	Purchase of agricultural land either in Rural or Urban area.
4. Exemption	Least of the two : a) Cost of New Agricultural Land (+) amount deposited in capital gain scheme in the bank. b) Capital gain amount.
5. Time limit	Purchase of new agricultural land within 2 years from the date of transfer.
6. Revocation of exemption	(i) Not to transfer new agricultural land for 3 years from the date of transfer (ii) Not Purchasing new agricultural land within 2 years.

(iii) Capital gain on compulsory acquisition of land and building which are used for industrial undertaking : Sec. 54D

Long term or short term capital gains from compulsory acquisition of land and buildings which are used for industrial undertaking exemption can be given.

Section 54D	
1. Eligible assessee	Any
2. Transferred asset	Compulsory Acquisition of land and buildings (by Government only) used for industrial purpose for 2 years before transfer.
3. Investment in	Land and building for industrial purpose.
4. Time limit	Within 3 years after receiving the compensation.
5. Exemption	Least of the two a) Cost of new asset (+) amount deposited in capital gain scheme in the bank. b) Capital gain amount.
6. Revocation of exemption	(i) Not to transfer new Land & Building for 3 years from the date of transfer (ii) Purchase of Land & Building within 3 years.

(iv) Long term capital gains on transfer of any capital asset-investment specified assets (bonds) - Sec 54EC.

If the long term Capital asset is transferred during the previous year and if gain is there, the assessee can claim this exemption if investment is made in specified bonds.

Section 54E C	
1. Eligible assessee	Any
2. Transferred asset	Any land or building or both (long term)
3. Investment in	Specified assets e.g. Bonds of Rural Electrification Corporation, National Highway Authority of India, Power Finance Corporation Limited, Indian Railway Finance Corporation etc.
4. Time limit	Within 6 months from the date of transfer.
5. Exemption	Least of the two : a) Actual amount invested b) 50 lakhs. Note : If investment is made in two previous years then also the limit is 50 lakhs on the whole i.e. not for each previous year.
6. Revocation of exemption	(i) No loan can be obtained against this new investment. (ii) Transfer of specified asset within 5 years. (iii) Not invested within 6 months from the date of transfer.

(v) Long term capital gain from other assets other than residential house and purchasing or constructing residential house (Sec 54F) :

According to Sec 54F, capital gain arising from the transfer of other assets i.e., other than residential house exemption can be given.

Section 54F	
1. Eligible assessee	Any
2. Transferred asset	Any asset other than residential house e.g. Land, Gold, Commercial buildings.
3. Investment in	One Residential House in India. Special Note : He should own one house only other than newly purchased/ constructed house.
4. Exemption	Least of the two : i) If cost of the new asset house is more than the consideration received then capital gain amount is fully allowed as exemption. (or) ii) If cost of the new asset house is less than the consideration received exemption is given proportionately etc.

4. Time limit.	Exempted capital gain $= \text{Capital Gain} \times \frac{\text{Cost of the new house}}{\text{Net Consideration}}$ Purchase of house before one year or 2 years after the date of transfer. or Not purchased/constructing the house within 3 years.
5. Revocation of	(i) House is not purchase within 2 years or exemption construction is not completed within 3 years from the date of transfer of original asset. (ii) If new asset is transferred within 3 years from the date of purchase/construction, then cost of acquisition of new asset is reduced by exempted capital gain.

(vi) Capital gain on shifting of Industrial undertaking from Urban Area to Non-Urban area - Capital gain on transfer of capital assets - Purchase of New Assets - Sec 54G :

If the assessee owns an industrial undertaking which is located in the urban area and wants to shift the unit into non-urban area and any gain on transfer of capital asset is eligible for exemption.

Section 54G	
1. Eligible assessee	Any
Nature of asset	Short term capital gain/Long term capital gain
2. Transferred asset	Shifting the industrial unit from Urban to non-urban area Plant & Machinery, Land & Building used for industrial purpose in urban area.
3. Investment in	(a) Investment in purchase of Plant & Machinery, Land & Building for industrial purpose in non-urban area, or b) Cost of shifting original assets to that area or c) Incurred notified expenses.
4. Exemption	Least of the two a) Actual amount invested in new assets (+) Shifting expenses (+) Amount deposited in Capital Gain Scheme. b) Capital gain amount.
5. Time limit	Purchase/construction of new asset and payment of shifting expenses shall take place before one year or within 3 years from the date of transfer.
6. Revocation	(i) Not to transfer within 3 years. or (ii) Not purchased/constructing the new asset within 3 years.

(vii) Capital gain on shifting of Industrial undertaking from Urban Area to Special Economic Zone - Capital gain on transfer of capital assets - Purchase of New Assets - Sec 54GA.

If the assessee owns an industrial undertaking which is located in the urban area and wants to shift the unit into Special Economic Zone and any gain on transfer of capital asset is eligible for exemption under Sec 54GA

Section 54GA	
1. Eligible assessee	Any
2. Nature of asset	Short term capital gain/Long term capital gain
3. Transferred asset	Shifting industrial undertaking from Urban area to Special Economic Zone (S.E.Z).
4. Investment in	a) Purchase of Land & Building, Plant & Machinery or b) Cost of shifting original assets to that area or c) Incurred notified expenses.
5. Exemption	Exemption least of the two a) Actual amount invested in new asset (+) Shifting expenses (+) Amount deposited in Capital Gain Scheme. b) Capital gain amount.
6. Time limit	3 years from the date of transfer or compensation received.
7. Revocation of exemption	If asset transferred with 3 years from the date of purchase

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 ₹ 7,00,000, 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 2019-20 is 289.

Sol :

**Computation of Mr. Gupta's Income from Capital Gain
For the Assessment Year 2020-21**

Particulars	Amount in ₹
Consideration received (Sale Price)	7,00,000
Less: Transfer Expenses or Selling expense	6,000
Net Consideration	6,94,000
Less: Indexed Cost of Acquisition	5,78,000
Income from Capital Gain	1,16,000

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

$$\begin{aligned} \text{Original cost of the asset} \times \frac{\text{Previous year Index}}{\text{Index of purchase year}} \\ = 2,34,000 \times \frac{289}{117} = 5,78,000 \end{aligned}$$

2. Mr. Suresh purchased an art piece of Moghul's period for ₹ 6,00,000 on 9th July 99 and ₹ 1,00,000 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 2020-21**

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	17,34,000
	18,37,000
Less: Indexed cost of Improvement	1,95,270
Income from Capital Gain	16,41,730

Working Notes :

- 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.
- Calculating indexed cost of acquisition** (earlier to 1-4-2001)

$$6,00,000 \times \frac{289}{100} = 17,34,000$$

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.

- Calculating indexed cost of improvement.**

$$1,00,000 \times \frac{289}{148} = 1,95,270$$

Note : For the previous year 2019-20 cost inflation index is 289.

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 on 15th November, 2019 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 installments of ₹ 10,00,000. Upto the end of the previous year 1st instalment money received. Selling expenses 2%. CII 2012-13 = 200; 2014-15 = 240; 2019-20 = 289. Compute income from Capital Gain.

Sol :

(Imp.)

**Computation of Sri Charan Desai's Income from Capital Gain
for the Assessment Year 2020-21**

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	20,23,000
2) Indexed cost of improvement - Construction of building	7,22,500
3) Indexed cost of improvement - Construction of additional rooms	3,61,250
Income from Capital gain	17,36,704

Working notes :

Special note : If the sale price or consideration is receivable in installments to calculate income from capital gain total consideration is considered i.e. due amount shall be ignored.

- Transferred Asset (Building) :** The asset is held by the assessee for more than two years, hence it is considered as long term capital asset.
- Transfer expenses :** 2% of 49,42,300 = 98,846
- Cost of acquisition :** The asset is purchased before 1-4-2001 so the cost of acquisition is higher of the following two amounts.
 - Actual cost 3,77,500
 - Fair market value on 1-4-2001 7,00,000

Hint: If the asset is purchased prior to 1-4-2001 Fair Market Value is opted and the cost inflation index is to be taken as 100.

- Calculating Indexed cost of acquisition.**

$$7,00,000 \times \frac{289}{100} = 20,23,000.$$

5. Calculating indexed cost of improvement - construction of building in year 2012-13.

$$5,00,000 \times \frac{289}{100} = 7,22,500$$

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

$$3,00,000 \times \frac{289}{240} = 3,61,250$$

4. X sells agricultural land situated in an urban area for ₹ 11,31,000 (brokerage paid (2 per cent on March 31, 2020 (cost of acquisition 2,70,000 on March 1, 2005 : it was used for agricultural purposes since 2005) On April 6, 2019, he purchases the following assets :

(a) agricultural land ₹ 1,50,000 ; and

(b) a residential house property : ₹ 500,000.

Find out the capital gains chargeable to tax for the assessment year 2020-21 C.I.I. for 2019-20 is 289 and for 2004-05 it was 113.

Sol :

Computation of Capital Gain for the Assessment year (2002)

Particulars	₹	₹
Sale Consideration		11,31,000
Brokerage (2% of ₹ 11,31,000)		22,620
Net consideration		11,08,380
Less indexed cost of acquisition (i.e., ₹ 2,70,000 × 289/113)		6,90,531
Long-term capital gain		4,17,849
Less : Exemptions U/s 54B	1,50,000	
U/s 54F : [i.e., ₹ 4,17,849 × ₹ 5,00,000/11,08,380]	1,88,495	3,38,495
Long-term capital gains		79,354

5. Ms. Veena sold a residential building at Jodhpur for ₹ 11,00,000 on 1-11-2019. The building was acquired for ₹ 2,10,000 on 1-11-2002. She paid brokerage @ 2% at the time of sale of the building. She invested ₹ 3.6 lakhs in purchase of a residential building in March 2020 and deposited ₹ 1 lakhs in National Highway Authority of India Capital Gains Bonds in March, 2020. Compute her taxable capital gain : Cost inflation index :

2002-03 105

2019-20 289

Sol :

Computation of taxable capital gain of Mrs. Veena for assessment year 2020-21

Particulars		
Sale consideration		11,00,000
Less : Brokerage as expenses on sale		22,000
Net consideration		10,78,000
Less : Indexed cost of acquisition $[2,10,000 \times 289/105]$		5,78,000
Long-term capital-gain		5,00,000
Less : Exemption u/s 54 : investment in purchase of house	3,60,000	
U/s 54EC (allowed as investment is made within 6 months)	1,00,000	4,60,000
Taxable capital gain		40,000

6. Mr. Chary sold his residential house for ₹ 26,50,000 on 20th August 2017 (CII = 272) which he purchased on 05.11.1988 for ₹ 1,02,000. Fair market value on 01.04.2001 is ₹ 8,00,000, selling expenses 2%. Compute the Income from Capital Gain and Tax Liability, if Income from Other Heads is nil.

Sol :

(Imp.)

**Computation of Mr. Chary's Income from Capital Gain
for the Assessment Year 2020-21**

Particulars	Amount ₹	Amount ₹
Consideration Received		26,50,000
Less : Selling Expense $\left[26,50,000 \times \frac{2}{100}\right]$		53,000
Net consideration		25,97,000
Less : Indexed cost of acquisition		23,12,000
Income from Capital Gain		2,85,000

Calculation of Tax Liability

Particulars	Amount ₹
Capital Gain	2,85,000
Less : Basic exemption income	2,50,000
Taxable capital gain	35,000
Flat tax rate 20% on 35,000	7,000
Add : Health and Education Cess @ 4% $7,000 \times \left[7,000 \times \frac{4}{100}\right]$	280
Tax Liability	7,280

Working Notes**Calculation of Indexed Cost of Acquisition**

$$\begin{aligned}
 \text{Fair Market Value of the Asset} &\times \frac{\text{C.I.I of the Year of Transfer}}{\text{C.I.I of 2001 - 02}} \\
 &= 8,00,000 \times \frac{289}{100} \\
 &= 23,12,000
 \end{aligned}$$

7. Mr. Ruth Supriya has purchased the new house by spending ₹ 2,50,000 and also deposited ₹ 1,00,000 in nationalized bank. She has spent this money out of sale consideration of ₹ 20,00,000 which she received on sale of her gold jewellery which she has purchased for ₹ 3,00,000 (15 years ago). Calculate her taxable capital gain and how much exemption she can claim u/s (54 F). CII for year of purchase = 150, Previous year = 289.

Sol :

Computation of Capital Gains for the Assessment year 2020-21

Particulars	Amount (₹)
Sale consideration received	20,00,000
Less: Selling expenses	Nil
Net consideration	20,00,000
Less: Indexed cost of acquisition	8,25,714
Capital Gain	11,74,286
Less: Exemption u/s 54 (F)	2,05,500
Income from Capital Gain	9,68,786

Working Notes

1. Indexed cost of acquisition = Cost of Jewellery × $\frac{\text{Index of Previous year}}{\text{Index of purchase year}}$
- $$= 3,00,000 \times \frac{289}{105} = 8,25,714$$

2. Exempted Capital Gain u/s 54 (F)

Consideration Received = 20,00,000

Net consideration is more than cost of new house, so exemption amount will be as follows,

$$\begin{aligned}
 \text{Exempted Capital Gam} &= \frac{\text{Capital Gain} \times \text{Cost of New House}}{\text{Net Consideration}} \\
 &= \frac{11,74,286 \times (2,50,000 + 1,00,000)}{20,00,000} \\
 &= 2,05,500
 \end{aligned}$$

8. Mr. Raju owned one residential house sold for ₹ 11,80,000 in Oct. 2016 which was actually purchased for ₹ 1,00,000 in 1982-83. He spent ₹ 10,000 for the construction of another room in 1984-85. Expenses incurred in the execution of sale deed were ₹ 10,000 which were born by him. Cost inflation index no.s in 1982-83, 84-85 and 2016-17 were 109, 125 and 1,125 respectively. Compute his capital gain.

Sol :

(Imp.)

Note: In the given question, sale of residential house was made in 2016 which was before the base year shifted from 1981 to 2001. Therefore, old C.I.I has been adopted for computing capital gain.

Computation of Mr. Raju's Income from Capital Gains for the Assessment year 2020-21

Particulars	Amount (₹)
Consideration received	11,80,000
Less : Sale deed expenses	10,000
Net consideration	11,70,000
Less : Indexed cost of acquisition	10,32,110
Indexed cost of improvement 90,000	11,22,110
Income from Capital Gain	47,890

Working Notes

1. Calculation of Indexed Cost of Acquisition

$$\text{Original cost of the asset} \times \frac{\text{Previous year index}}{\text{Index of purchase year}}$$

$$= 1,00,000 \times \frac{1,125}{109}$$

$$= ₹ 10,32,110$$

2. Calculation of Indexed Cost of Improvement

$$\text{Indexed cost of improvement} = \text{Cost of improvement} \times \frac{\text{Previous year index}}{\text{Index of the year of improvement}}$$

$$= 10,000 \times \frac{1,125}{125}$$

$$= ₹ 90,000$$

5.8 INCOME FROM OTHER SOURCES

Q14. Define Income from other sources.

Ans :

Introduction

Understanding the head of Income from Other Sources is residuary in nature. 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 :

This section operates only when a particular income cannot be included in any other head. Under section 56(1) every kind of income which is included in the total income under this Act and which is not chargeable to tax under any of the first four heads specified in section 14 is chargeable to income-tax under the head "Income from Other Sources". The onus will be on the assessee to prove that the particular income does not fall under any of the preceding four heads.

Instances of Incomes falling under Section 56(1) (General Incomes)

- i) Income derived by a coal mine owner from rent and royalties are included in this head.
- ii) Income earned by an assessee from licences granted to brick-makers, to erect brick kilns upon his land and to take away the brick-earth and use it for making bricks.
- iii) Remuneration received merely for being a director and not as employees, is not salary but income from other sources.
- iv) Income received by an assessee from a person other than his employer, e.g. university remuneration.
- v) Interest on loans, securities, deposits and current account also come under this head. (Interest on co-operative debentures).

Definition of interest u/s (28 A). 'Interest' means interest payable in any manner in respect of any money borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized.

- vi) Income received by a professional man as a university examiner.
- vii) Income received on sub-letting of the house.
- viii) Tips received by a waiter or taxi driver, not being given by his employer.
- ix) Family pension received by legal heirs of employee.
- x) Income from undisclosed sources (i.e., deemed incomes covered under sections 68, 69, 69A- 69B, 69C and 69D).

Important Note : With effect from Assessment Year 2013-14, income from undisclosed sources covered under sections 68 to 69D is taxable at a flat rate of 30%, without allowing any deduction

- xi) Income of other persons to be included in the income of Individual.
- xii) Income from writing articles by a non-journalist.
- xiii) Any withdrawal from National Saving Scheme upto an amount on which deduction u/s 80. CCA has been claimed.
- xiv) Income from agricultural land situated outside India.
- xv) Remuneration for lectures delivered outside India.
- xvi) Agency commission received by an agent of life insurance corporation, postal savings, Unit Trust of India or other mutual funds if it is not his regular business.
- xvii) Commission received by a director for standing as guarantor.
- xviii) Commission received by a director for underwriting the shares of a new company.
- xix) Gratuity received by a non-employee director.
- xx) Any annuity or pension received from LIC or other insurer u/s 80CCC.

5.8.2 Specific Incomes u/s. 56(2)

Q16. Explain briefly about Specific Incomes u/s. 56(2).

(OR)

List out the specific incomes 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.)

(i) Letting of Plant, Machinery or Furniture

If an assessee has let-out Plant, Machinery or Furniture, rent or hire charges received will be treated as income from other sources.

Note: If letting of these assets is part of the business then such rent will be treated as income under the head “Profits From The Business”.

If an asset is sold on Hire purchase agreement hire charges on such assets will be treated as “income from business”.

Deduction : The following deductions are allowed if the amount spent is reasonable one and is not in the nature of capital.

Expenditure	Deduction
(i) Repairs	Actual amount spent
(ii) Insurance premium	Actual amount spent
(iii) Any other expenditure incurred with a purpose to earn such income is allowed as deduction.	Actual amount spent
(iv) Depreciation	At the normal rate

Note: If an income which does not specifically come under any one of the four heads of income then it is included under the head "income from other sources". Expenditure incurred to earn the income will be allowed as deduction.

(ii) Family Pension Received By the Legal Heirs of a Deceased Employee

After the death of an employee, if the family pension received by the legal heirs of the deceased, it is treated as income from other sources.

Deduction : If the assessee is receiving the family pension, a standard deduction is allowed u/s 57(iia) which is least of the following two amounts,

- a) 1/3 of pension received
- b) 15,000

Note: Family pension means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death, e.g. if husband dies, family pension is paid to wife or if the children do not have both the parents, it is paid to the children till they attain the status of "Major" i.e., attaining the age of 18 years.

(iii) Gifts received u/s 56(2)(x)

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.

(iv) Interest received on compensation or enhanced compensation or delayed compensation. See 56(2)(viii)

From the assessment year 2010-11 this section is incorporated in the Income Tax Act. According to this section any interest received (not receivable) on compensation or enhanced compensation or delayed compensation is treated as income from other sources, i.e., Accrued or outstanding interest shall not be considered as income until it is actually received.

Deduction : U/s Sec 57. This deduction can be treated as "Standard or Statutory deduction". 50% of the interest received will be allowed as deduction and no other expenses will be allowed as deduction.

(v) Winning from Lotteries etc.:

Winning from lotteries, crossword puzzles, races (including Horse races) card games or any other such type of games. Gambling or betting will be taken as "Income from other sources".

The term 'lottery' includes winning from prizes awarded to any person by means of a draw of lots or chance. The term card game and other games includes an entertainment programme on television or any other electronic media in which participants compete to win the prize amount.

(vi) Interest on bank deposits:

Interest on all type of deposits held in a bank or co-operative society etc. are considered as "Income from other sources". If the interest received/receivable is less than ` 10,000 tax is not deducted at source.

If the interest amount exceeds ` 10,000 per annum in a normal situation tax is deducted at source @ 10%. In the following situations tax is deduction 20%.

- i) If the assessee has not furnished the details of PAN.
- ii) If the assessee has not submitted the details of KYC (Know-Your-Customer) Special Note : For interest on saving bank account only assessee can claim a deduction upto t. 10,000 from gross total income and not from the source of income earned.

(vii) Interest on company deposits:

It is treated as an item of income under the head "Income from other sources" and no deductions are allowed for this income.

(viii) Other specified incomes:

The following incomes are taxable under the head "Income from other sources".

- i) Income from subletting house/any other assets.
- ii) Income from agricultural land situated in foreign country.
- iii) Income from open plot of land.
- iv) Income from examination works of a university or any other organization received by a teacher.
- v) Income from insurance commission.
- vi) Income from salary of a Parliament/Assembly member.
- vii) Income from undisclosed sources.

Note : If still a new item of income is there and if such income cannot be taken in to any one of the heads of income viz., income from salary, house property etc. then such income is taken as income from other sources.

(ix) Compensation on termination of employment

Any compensation or other payment, due or received by any person from a person other than employer in connection with termination or modification of terms of employment is taxable under the head income from sources. However, if the amount is received from employer, then the amount is taxable as profits in lieu of salary under the head salaries.

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 :

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.

Chargeability of Income Under Interest on Securities

If cash method is followed by the assessee then the interest is taxable on "receipt basis" and if mercantile method is followed by the assessee interest is taxable on 'due basis'. The following interest are chargeable on securities,

1. Gross Interest (i.e., Net Interest + Tax deducted at source).
2. Arrears of interest received would be taxable in the year in which it is received or if it was not taxed previously.
3. Interest is paid either yearly/half yearly or quarterly basis. If such details or due dates are not given in the problem then it is assumed that interest is paid half yearly i.e., on 30th September or on 31st March.
4. Interest is collected on the due date from the person on whom the ownership belongs to on the due date. It should not be collected based on time period.
5. Interest is calculated on face value.
6. Profit or loss after selling the securities does not included in this head.

Interest on Securities Included Under this Head

Interest received on securities issued by the central govt., state govt., local authorities, limited companies/ foreign companies and public companies.

Interest on Securities not Included Under this Head

Interest received on securities issued by foreign govt., and interest on annuity deposits, loans, bank deposits, trade transactions and debentures issued by co-operative societies, clubs etc.

Interest Received but not Taxable Under this Head

Interest received from the following parties are not taxable under this head. They are,

- (i) Religious institutions
- (ii) Registered trade union
- (iii) Charitable institutions
- (iv) Local authorities like Panchayats, Municipal corporations, HUDA, H.W.D.A etc
- (v) Approved sports association and scientific research association
- (vi) Member of schedule tribes of tribal areas
- (vii) Approved super annuation fund, statutory P.F and R.P.F.
- (viii) Trustees of Universities or educational institutions

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,

$$\text{Gross Interest} = \text{Face Value} \times \text{Rate} \div 100$$

- (i) For Tax free commercial securities, first we need to calculate net interest then the gross interest.

$$\text{Net Interest} = \text{Face Value} \times \text{Rate} \div 100$$

$$\text{Gross Interest} = \text{Net Interest} \times 100 \div 90$$

- (ii) For less tax securities gross interest is calculated as, Gross interest = Face value $\times$ Rate $\div$ 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 $\times$ 100/90 (or) Net Interest $\times \frac{100}{100 - \text{Rate of TDS}}$

3. Less Tax Government Security

Gross interest = Interest received.

4. Less Tax-Commercial (Listed and Unlisted) Security

Gross interest = Net interest $\times$ 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 on tax free govt, securities		X X
2. Interest on tax free commercial securities (listed)		X X
3. Interest on tax free commercial securities (unlisted)		XX
4. Interest on less tax govt, securities		X X
5. Interest on less tax commercial securities (listed)		X X
6. Interest on less 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

$$\text{Value of taxable} = \text{Stamp duty value} - \text{Consideration paid}$$

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,

$$\text{Value of taxable income} = \text{F.M.V} - \text{Consideration value}$$

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 $\times \frac{100}{70}$.
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 $\times \frac{100}{70}$.
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 $\times \frac{100}{70}$.
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 :

- Family Pension**
- Rent received on let out of Furniture**
- 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 taxable income under the head 'income from Other Sources' shall be computed after allowing the following deductions as provided in section 57 :

1. In case of Dividends and Interest on Securities

From the dividend income, a deduction shall be allowed in respect of any sum spent by way of commission or remuneration to a banker or any other person as collection charges for realizing the dividend or Interest on Securities.

2. Repairs, depreciation, etc. in case of letting of machinery, plant or furniture with or without building

The following deductions shall be allowed from the income earned by letting of machinery, plant or furniture with or without building.

- (i) Expenditure incurred on current repairs of plant, machinery, furniture or building.
- (ii) Insurance premium paid regarding these assets.
- (iii) Depreciation on plant, machinery and furniture. Depreciation in respect of buildings will be allowed only if the assessee is the owner. It will not be allowed if the assessee is lessee or mortgagee in possession of the building.

3. Deduction in respect of employee's contribution in staff welfare schemes [57 (ia)]

Any amount received by employer from his employees as their contribution of provident fund, E.S.I. Fund or superannuation fund is deemed as income u/s 59(ic) if not taxable under the head "profits and gains of business or profession".

In case employer deposits any amount (out of these incomes) in these funds before prescribed due date, such amount is allowed as deduction u/s 57 (ia).

4. Standard Deduction out of Family Pension [Section 57 (ia)]

In case of income in the nature of family pension, a deduction of a sum equal to 33⅓% of such pension or ` 15,000 whichever is less, shall be allowed.

Family pension means a regular monthly amount payable by employer to the legal heirs of deceased employee.

5. Deduction from any other income [Section 57(iii)]

Any expenditure which is spent to earn an income chargeable to tax under this head shall be deducted from such income.

This deduction is not admissible to assessee being a foreign company.

6. Deduction from royalties received by authors

(Other than those writing for films) Actual expenses can be claimed as deduction.

7. Deduction regarding interest on compensation or enhanced compensation

In case assessee has received any income of this type, a deduction of a sum equal to 50% of such income shall be allowed and no deduction shall be allowed under other clause of this section.

PROBLEMS**9. 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**

$$\text{Net interest } 97,000 \times \frac{12}{100} = 11,640$$

$$\text{Gross interest } 11,640 \times \frac{100}{90} = 12,933$$

(b) Mumbai Municipal Corporation Bond

$$88,500 \times \frac{15}{100} = 13,275 \text{ (Grossing up is not needed)}$$

(c) 12 Years National Defence Certificates

This income is fully exempted from tax.

10. 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. 2019-20

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,

$\text{Gross Prize Amount} = \text{Net Prize Amount} \times \frac{100}{70}$

$$70,000 \times \frac{100}{70} = ` 1,00,000$$

11. 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 2020-21

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).

12. Harikrishnan, a resident individual, submits the following particulars of income for the previous year ending March 31, 2020 :

Dividend from REC International Ltd. ₹ 4,800. Dividend declared on 16-5-2019 by Sundaram Finance Ltd. ₹ 2,700, interest paid on capital borrowed for the purpose of investment in shares of Sundaram Finance Ltd. ₹ 4,200. Collection charges in respect of dividend ₹ 50.

Winnings from lottery : net amount ₹ 70,000, Tax deducted at source ₹ 30,000, Winnings from card games : ₹ 23,500. Interest on securities issued by the Government of Singapore ₹ 20,570.

Determine the income chargeable under the head "Income from other sources" for the assessment year 2020-21.

Sol :

Computation of Income from Other Sources for the Assessment year 2020 - 21

Particulars		
I. General Income 56(1)		
Interest on securities issued by Govt, of Singapore		20,570
II. Specific Incomes 56(2)		
(i) Dividend		
(a) R.E.C. International Ltd.—Exempted	NIL	
(b) Sundaram Finance Ltd.—Exempted	NIL	
Gross dividend	NIL	
Less expenses —		
(a) Interest on loan	Not allowed	
(b) Collection charges	<u>Not allowed</u>	
(ii) Winning from lottery : Net	70,000	
Add : TDS	30,000	
	1,00,000	
(ii) Winning from card games	23,500	
		1,23,500
Income from other Sources		1,44,070

13. Shri Bhutani who is resident of India furnished the following particular of his investments for the previous year ended 31st March, 2020.

- (i) ` 10,000 units of Mutual Fund (Gross income ` 1,200);
- (ii) ` 3,000 in Post Office Savings Bank Account which earns interest @ 4% per annum;
- (iii) ` 45,000 in Fixed Deposit Account with Allahabad Bank on which interest @ 9% is payable;
- (iv) 12% ` 40,000 Debentures (Listed) of Tea Company;
- (v) ` 2,000 interest received on National Development Bonds;
- (vi) ` 1,000 interest received on the debentures of a Co-operative Society;
- (vii) 10% U.P. State Electricity Board Bonds Rs 20,000;
- (viii) ` 10,000 in 7 Year Post Office National Savings Certificates interest @ 7% per annum is payable on the same every year;

(ix) ₹ 36,000, 10% Tax-free Debentures of Agra Municipal Corporation. Interest being payable on 31st December;

(x) ₹ 900 received by an Account Payee Cheque as interest on debentures (Listed) of a company in which public are substantially interested.

He collected the entire interest himself and claimed ₹ 200 as his own fees for collection of interest.

(xi) Interest on post office National Saving certificates VIII issue ₹ 5,000.

Calculate the taxable income under the head 'Income from Other Sources' for the Assessment Year 2020-21.

Sol :

(Imp.)

**Computation of taxable income under the head 'Income from other Sources'
for the Assessment year 2020-21**

Particulars	₹
Income from units of Mutual Fund Exempted	NIL
Income from interest on deposits in Post Office Saving Bank A/c Exempted upto ₹ 3,500	NIL
Interest on Fixed deposit with Allahabad Bank $[45,000 \times (9/100)]$	4,050
12% ₹ 40,000 listed debentures of a tea company	4,800
Interest received on National Development Bonds [Net received = Gross, as no TDS]	2,000
Interest on debentures of a Co-operative Society	1,000
10% ₹ 20,000 U.P. State Electricity Board Bonds	2,000
10,000, 7% Post Office National Saving Certificates—Exempted	NIL
36,000, 10% tax free debentures of Agra Municipal Corporation	
Net interest = 3,600 Gross up $3,600 \times (100/90)$	4,000
Interest on debentures (Listed) of a company	900
Interest on National Savings Certificates (VIII issue)	5,000
Income from Other Sources	23,750

14. 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 2020-21

Particulars	Amount(₹)	Amount (₹)
1. Winning from lottery		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	19,000
4. Rent from hiring machinery (₹ 2,000 × 12)		24,000
Less: Repairs	5,000	
Depreciation	8,000	11,000
5. Family pension (₹ 8,000 × 12)	96,000	
Less: Permissible deduction u/s 57(ia)	15,000	81,000
Income from Other Sources		2,95,000

Working Notes**1. Winning from Lottery**

$$42,000 \times \frac{100}{70} = ₹ 60,000$$

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

$$₹ 8,000 \times 12 = ₹ 96,000$$

$$₹ 96,000 \times \frac{1}{3} = ₹ 32,000$$

(ii) ₹ 15,000.

15. From the following information compute the income from other sources for the A.Y 2020-21

(i) Card game loss ₹ 12,000

(ii) From the activity owning 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 :

(Imp.)

Computation of Income from Other Sources for the Assessment Year 2020-21

	Particulars	Amount(₹)	Amount (₹)
1.	Loss from card games ₹ 12,000 (neither it can be set-off nor it can be carried forward)		Nil
2.	Profit from maintenance of horse race at Bangalore	20,000	
	Less: Loss from maintenance of horse race at Bombay	40,000	
	Loss : from maintenance of horse race is to be carried forward	– 20,000	Nil
3.	Dividend from Indian Companies (Exempted u/s 10(33)) (Exempted u/s 10(33))		Nil
4.	Betting on horse races		4,000
	Income from Other Sources		4,000

16. From the following particulars of Mr. Z compute income from other sources for the assessment year 2016-17.

- (i) ₹ 65,000 in fixed deposit with BOI, rate of interest 9% p.a.
- (ii) ₹ 1,20,000 debentures of a Co. (Rate of interest 12% p.a.)
- (iii) Winnings from lottery received ₹ 1,40,000, loss from Horse Race ₹ 32,000.
- (iv) Mr. Z received ₹ 85,000 gift from his father and ₹ 62,000 from friend as a gift during the P.Y.
- (v) Dividends from Indian company received ₹ 18,000, rate of TDS 10%.
- (vi) Rent from open plot ₹ 3,000 p.m. Municipal taxes paid ₹ 2,000 p.a.
- (vii) Rent received by let out of Plant and Machinery ₹ 55,000, Depreciation on P & M ₹ 12,000.
- (viii) Agriculture income from outside

Sol:

Note: Problem is solved as per assessment year 2020-21.

Computation of Mr. Z Income from Other Sources for the A.Y. 2020-21

	Particulars	Amount(₹)	Amount(₹)
(i)	₹ 65,000, 9% Fixed Deposit with BOI		5,850
(ii)	₹ 1,20,000, 12% Debentures of a Co.		14,400
(iii)	Winning from lottery		2,00,000
(iv)	Gift received from a friend		62,000

(v)	Rent from Open Plot	36,000	
	Less: Municipal Taxes p.a.	2,000	34,000
(vi)	Rent from letting out of Plant and Machinery	55,000	
	Less: Depreciation	12,000	43,000
(vii)	Agriculture income from outside India		18,000
	Income from Other Sources		3,77,250

Working Notes:**(i) Fixed Deposit with BOI**

$$65,000 \times \frac{9}{100} = ₹ 5,850$$

(ii) Debentures of a Co.

$$1,20,000 \times \frac{12}{100} = ₹ 14,400$$

(iii) Winning from Lottery and Loss from Horse Race

$$\begin{aligned} \text{Gross Amount} &= \text{Net Amount} \times \frac{100}{70} \\ &= 1,40,000 \times \frac{100}{70} \\ &= 2,00,000 \end{aligned}$$

Loss from Horse Race cannot be set-off against any other income.

(iv) Gift Received

Gift received from father is an exempted income.

(v) Dividend from Indian Company

Dividends from Indian company is an exempted income.

(vi) Rent from Open Plot

$$3,000 \times 12 = ₹ 36,000$$

(vii) Agriculture Income from Outside India

Agricultural income from outside India is treated as "Income from Other Sources".

Short Question and Answers

Q1. 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. 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.

3. Short Term Capital Assets

Ans :

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.

4. Long-term Capital Assets.

Ans :

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.

5. 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.

6. 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 transaction 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.

7. Define Income from other sources.

Ans :

Introduction

Understanding the head of Income from Other Sources is residuary in nature. 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.

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

Ans :

This section operates only when a particular income cannot be included in any other head. Under section 56(1) every kind of income which is included in the total income under this Act and which is not chargeable to tax under any of the first four heads specified in section 14 is chargeable to income-tax under the head "Income from Other Sources". The onus will be on the assessee to prove that the particular income does not fall under any of the preceding four heads.

Instances of Incomes falling under Section 56(1) (General Incomes)

- i) Income derived by a coal mine owner from rent and royalties are included in this head.
- ii) Income earned by an assessee from licences granted to brick-makers, to erect brick kilns upon his land and to take away the brick-earth and use it for making bricks.
- iii) Remuneration received merely for being a director and not as employees, is not salary but income from other sources.
- iv) Income received by an assessee from a person other than his employer, e.g. university remuneration.
- v) Interest on loans, securities, deposits and current account also come under this head. (Interest on co-operative debentures).

Definition of interest u/s (28 A). 'Interest' means interest payable in any manner in respect of any money borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized.

- vi) Income received by a professional man as a university examiner.
- vii) Income received on sub-letting of the house.

9. Letting of Plant, Machinery or Furniture.

Ans :

If an assessee has let-out Plant, Machinery or Furniture, rent or hire charges received will be treated as income from other sources.

Note: If letting of these assets is part of the business then such rent will be treated as income under the head "Profits From The Business".

If an asset is sold on Hire purchase agreement hire charges on such assets will be treated as "income from business".

Deduction : The following deductions are allowed if the amount spent is reasonable one and is not in the nature of capital.

Expenditure	Deduction
(i) Repairs	Actual amount spent
(ii) Insurance premium	Actual amount spent
(iii) Any other expenditure incurred with a purpose to earn such income is allowed as deduction.	Actual amount spent
(iv) Depreciation	At the normal rate

Note: If an income which does not specifically come under any one of the four heads of income then it is included under the head "income from other sources". Expenditure incurred to earn the income will be allowed as deduction.

10. 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.

11. Define the term interest on securities. Discuss the chargeability of income under interest on securities.

Ans :

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.

Chargeability of Income Under Interest on Securities

If cash method is followed by the assessee then the interest is taxable on "receipt basis" and if mercantile method is followed by the assessee interest is taxable on 'due basis'. The following interest are chargeable on securities,

1. Gross Interest (i.e., Net Interest + Tax deducted at source).
2. Arrears of interest received would be taxable in the year in which it is received or if it was not taxed previously.
3. Interest is paid either yearly/half yearly or quarterly basis. If such details or due dates are not given in the problem then it is assumed that interest is paid half yearly i.e., on 30th September or on 31st March.
4. Interest is collected on the due date from the person on whom the ownership belongs to on the due date. It should not be collected based on time period.
5. Interest is calculated on face value.
6. Profit or loss after selling the securities does not included in this head.

12. Explain the provisions regarding Gifts Received by an Individual.

Ans :

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.

13. Define Casual Income.

Ans :

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.

14. Plant and Machinery with/without Building

Ans :

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.

15. Rent Received on Let out of Furniture

Ans :

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.

Exercise Problems

1. Mr. Kursheed Alam Khan sold his residential property for ₹. 54,36,000. Before selling the house ₹. 75,000 is spent for repairs and renovation. Advertisement is given in local news papers for sale of the house ₹. 26,500 and other transfer expenses ₹. 11,000. The cost of acquisition is ₹. 4,00,000, 28 years ago, if F.M.V. On 1-4-01 is ₹. 9,50,000. He added one more floor in 2001-02 with a cost of ₹. 4,25,000 (C.I.I 100). After selling this building immediately he purchased a small house for ₹. 12,00,000 and deposited 1,00,000 in capital gain scheme in the bank. Calculate income from capital gain and tax liability if income from other heads ₹. 5,00,000.

[Ans : ₹.49,750]

2. Smt. Vanaja sold her residential house for ₹. 28,00,000. The cost of which 16 years back was ₹. 3,90,000 (cost inflation index 100). After selling the house within two months she had started constructing the house. The amount spent on construction upto the last day of the previous year ₹. 4,00,000 and she deposited ₹. 6,00,000 in the bank under Capital Gain Accounts Scheme 1988. Calculate income from capital gain and tax liability if income from other heads is ₹. 9,21,000.

[Ans : ₹.6,72,900]

3. Mr. Chunnilal of Bidar Town sold his 10 acres of agricultural land @ ₹. 5,00,000 per acre. Which he acquired 14 years ago @ ₹. 21,800 per acre (cost inflation index 109), after six months he purchased another agricultural land for ₹. 40,00,000. Calculate income from capital gain.

[Ans : ₹.4,22,000]

4. On 1st July '1975 Mr. Jagannath purchased an agricultural land in Kurnool for a price of ₹. 3,08,000. During the previous year relevant to the current assessment year he sold half of the property for ₹. 36,00,000 and immediately he purchased agricultural land for ₹. 9,30,000 in a village and a piece of land in Hyderabad city for ₹. 9,00,000. Calculate taxable income under the head capital gain, if F.M.V. On 1-4-01 is ₹. 21,00,000.

[Ans : Income from Capital gain is nil]

5. Mr. Narayan Reddy is owning a building since 1-5-82 and using for industrial purpose. The cost of the building is ₹. 92,000. During the previous year the State Government acquired the building by passing an ordinance and paid ₹. 14,26,000 as compensation. Immediately he purchased an old building for industrial purpose for ₹. 12,00,000 and spent ₹. 80,000 for its renovation. Calculate income from capital gain.

[Ans : Capital gain is ₹ Nil]

6. During the previous year Sri. K.Giri Babu sold his building situated in Bangalore for ₹. 14,30,000. The cost of which is ₹. 5,00,000 (10 years ago). Registration expenses incurred ₹. 40,000 and brokerage paid to purchase ₹. 10,000. After selling the building within three months he invested ₹. 4,00,000 in NABARD which has been notified as specified securities u/s 54EC. Compute the income from capital gain, if the selling expenses are ₹. 80,000 and cost inflated index in year of purchase was 137.

[Ans : Income from Capital gain is ₹ nil]

7. Sri Babu chary sold his house on 25th March 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 been purchased for 12,00,000. Calculate the amount of taxable capital gains for the current assessment year.

[Ans : ₹ 67,500]

8. Sri Rama krishna sold his Gold ornaments for ₹ 8,00,000 during the previous year. The cost of which is ₹ 1,20,000 (16 years ago). After selling the ornaments within two months he invested in Bonds ₹ 7,00,000 of Unit Tecil Chemicals and Hydro Power Limited, Mumbai. Which are notified as specified securities u/s 54 EC. Compute the income from capital gain if the selling expenses are 1.5% and cost inflated index in the year of purchase was 100.

[Ans : ₹ 4,41,200]

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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
11. Which of the following is not chargeable to tax under the head 'Income from other Sources': [c]
(a) Dividend from a Co-operative society
(b) Prize on Crossword puzzles
(c) Profit on sale of goodwill of a business
(d) Interest from Bank
12. An individual received pension Rs. 90,000 and family pension ` 60,000. How much standard deduction shall be allowed to him : [d]
(a) ` 20,000 (b) ` 25,000
(c) ` 40,000 (d) ` 15,000
13. Under which head the pension is taxable : [a]
(a) Salaries (b) Income from Other Sources
(c) Capital Gains (d) None of these
14. Income from sub-letting of House Property is : [a]
(a) Income from Other Sources (b) Property income
(c) Exempted (d) Capital Gains
15. Salary of a M.P. will be taxable under the head : [d]
(a) Salaries (b) Profits from Business and Profession
(c) Capital Gains (d) Income from Other Sources
16. The deduction allowable in respect of family pension taxable under "Income from Other Sources" is : [c]
(a) $33\frac{1}{3}\%$ of the pension
(b) 30% of the pension or ` 15,000, whichever is less
(c) $33\frac{1}{3}\%$ of the pension or ` 15,000, whichever is less
(d) Nil

17. Income from other sources is [c]
(a) Major head of income (b) Income from a single source
(c) Residuary head of income (d) Constant and regular income
18. Dividends from cooperative society are [b]
(a) Exempted income (b) Taxable income
(c) None of these
19. Grossing up of interest on securities is required when [c]
(a) They are Central Government securities
(b) The interest on bank deposits is less than ` 10,000
(c) Interest received is after T.D.S.
(d) None of these
20. Which of the following is not an 'income from other sources' ? [b]
(a) Winnings from crossword puzzles
(b) Profit on sale of building
(c) Gift in excess of ` 50,000 from an unrelated person
(d) Interest on fixed deposits in bank

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 _____.
11. Gift received from relative is fully _____ from tax.
12. Interest on tax free commercial securities is always be _____ up.
13. Dividends received from an _____ is taxable.
14. A loan is taken to purchase shares of an Indian company. Interest payable on the loan is deductible while computing income under the head _____ .
15. Particular Income cannot be included in any other is known as _____
16. Loss from lottery can not be _____ .
17. General Incomes are explained under Sec _____.
18. Deduction is allowed for family pension is _____
19. Tax is deductible from casual income at a rate of _____
20. TDS stands _____.

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
11. Exempts
12. Grossed
13. Indian company
14. Income from Other Sources
15. General Income
16. Set-off
17. 56(1)
18. $\frac{1}{3}$ rd of pensioner (or) Rs. 15,000 = WEL
19. (30% + cess)
20. Tax Deducted at Source

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FACULTIES OF COMMERCE
B.Com. IV – Semester (CBCS) Examination
(Common Paper for General / Computers / Computer Applications /
Advertising and Foreign Trade)
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. What are the objectives of Tax? | (Unit-I, SQA. 1) |
| 2. What are the conditions applicable for residential status of company and every other person ? | (Unit-I, SQA. 5) |
| 3. Entertainment Allowance | (Unit-II, SQA. 4) |
| 4. Satya Krishna Prabhav 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. | (Unit-II, Prob. 8) |
| 5. Unrealized Rent. | (Unit-III, SQA. 6) |
| 6. Deemed Profits | (Unit-IV, SQA. 5) |
| 7. Define Capital Gain. | (Unit-V, SQA. 1) |
| 8. Explain the provisions regarding Gifts Received by an Individual. | (Unit-V, SQA. 12) |

PART - B (5 × 12 = 60 Marks)

Note: Answer all the questions in not exceeding 4 pages each by using internal choice.

- | | |
|--|---------------------|
| 9. (a) Explain the various basic concepts of income tax. | (Unit-I, Q.No. 13) |
| OR | |
| (b) How would you determine the status of an individual? | (Unit-I, Q.No. 21) |
| 10. (a) State the various deductions that are allowed from salary income u/s 16. | (Unit-II, Q.No. 12) |
| OR | |
| (b) Mr. Ramana Rao works for a Government company at New Delhi and submits the following particulars for the financial year 2021-22. | (Unit-II, Prob. 26) |
| (i) Basic pay ` 1,90,000 | |
| (ii) DA 25% of salary | |
| (iii) Bonus ` 18,000 | |

- (iv) Arrears of salary ` 20,000
- (v) Entertainment allowance ` 8,000
- (vi) Conveyance allowance (75% spent) ` 12,000
- (vii) Employer contribution to RPF 14% of salary
- (viii) Interest credit to RPF @ 12% is ` 8,000
- (ix) He has been provided with a rent free accommodation (owned by the employer) at Delhi whose fair rental value is ` 80,000 p.a. and cost of furniture is ` 41,000/-
- (x) He is provided free supply of gas which costs to the employer ` 2,400/- Compute income from salary for the Assessment year 2021-22.

11. (a) Explain the determination of Gross Annual Value.

(Unit-III, Q.No. 4)

OR

- (b) Ms. Sundari is the owner of a property constructed at Mahaboobnagar on 31-08-2012. Particulars are furnished here under.

(Unit-III, Prob. 9)

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 2020-21.

12. (a) 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 31st March 2020.

(Unit-IV, Prob. 4)

From the examination of books of accounts the following other information is available.

1. Out of advertisement expenses ₹ 1,000 were spent on neon sign boards.
2. ₹ 1,000 were 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 Rs. 5,000 is advanced to purchase the raw materials to a supplier who is absconding from the country.

OR

- (b) Dr. Sudeep submitted the following income and expenditure account for the year ending 31-3-2020. Compute the income from profession. (Unit-IV, Prob. 13)

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/-

13. (a) Define Capital Gain. Explain different types of Capital Gains. (Unit-V, Q.No. 1)

OR

- (b) Harikrishnan, a resident individual, submits the following particulars of income for the previous year ending March 31, 2020 : (Unit-V, Prob. 12)

Dividend from REC International Ltd. ` 4,800. Dividend declared on 16-5-2019 by Sundaram Finance Ltd. ` 2,700, interest paid on capital borrowed for the purpose of investment in shares of Sundaram Finance Ltd. ` 4,200. Collection charges in respect of dividend ` 50.

Winnings from lottery : net amount ` 70,000, Tax deducted at source ` 30,000, Winnings from card games : ` 23,500. Interest on securities issued by the Government of Singapore ` 20,570.

Determine the income chargeable under the head "Income from other sources" for the assessment year 2020-21.

FACULTIES OF COMMERCE
B.Com. IV – Semester (CBCS) Examination
(Common Paper for General / Computers / Computer Applications /
Advertising and Foreign Trade)
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. What is Agricultural Income? (Unit-I, SQA. 7)
2. Calculate tax liability of Mr. Chary aged 35 years. If total income is ₹ 5,07,000. (Unit-I, Prob. 1)
3. What is provident fund? (Unit-II, SQA. 7)
4. Sri Vishnu Vardhan an employee of a limited company received on 1st July, 2019 ₹ 13,00,000 as gratuity. He retired after serving for 35 years. At the time of retirement his monthly salary was ₹ 54,740. If he is covered under the Gratuity Act calculate the un-exempted amount of gratuity. (Unit-II, Prob. 15)
5. Mr. 'X' owns the following house properties for the assessment year 2020 - 21. (Unit-III, SQA. 2)

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. 2020-21

6. Explain the concept of block of assets. (Unit-IV, SQA. 3)
7. What are the capital gain exempted u/s 10? (Unit-V, SQA. 6)
8. Mr. Chary sold his residential house for ₹ 26,50,000 on 20th August 2017 (CII = 272) which he purchased on 05.11.1988 for ₹ 1,02,000. Fair market value on 01.04.2001 is ₹ 8,00,000, selling expenses 2%. Compute the Income from Capital Gain and Tax Liability, if Income from Other Heads is nil. (Unit-V, Prob. 6)

PART - B (5 × 12 = 60 Marks)

Note: Answer all the questions in not exceeding 4 pages each by using internal choice.

9. (a) What is Agricultural Income? Explain different types of Agricultural Incomes. (Unit-I, Q.No. 26)

OR

- (b) Differentiate between direct and indirect taxes. (Unit-I, Q.No. 8)

10. (a) Define Allowances. What type of allowances received by an employee. (Unit-II, Q.No. 8)

OR

- (b) The following are the income particulars of Smt. Suryakala for the previous year ending on 31st March, 2020. Net salary received ₹ 99,000. (Unit-II, Prob. 24)

Deductions made by the employer from Salary:

Income Tax ₹ 1,000.

Premium on L.I.P 2,500.

Professional Tax ₹ 1,200.

Recovery of Festival loan ₹ 13,500.

Provident Fund Contribution ₹ 5,000.

The Employer contributes 14% of basic salary to R.P.F. (Basic Salary of the assessee is ₹ 32,500)

The employer paid the following :

Telephone bill of the residence ₹ 42,500.

Electricity bill of the residence ₹ 32,900.

She went on official tour to Nagpur city for 3 months, where she is provided rent free accommodation, rent paid by the employer ₹ 7,500 p.m. During this period she is served with free food at a cost of ₹ 350 per day.

Compute the income from salary for the current assessment year.

11. (a) Mr. 'X' owns the following house properties for the assessment year 2020 - 21.

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. 2020-21

OR

- (b) Explain the computation of annual value for Self-occupied House. (Unit-II, Q.No. 5)
12. (a) Profit and Loss account of Mr. Banwar Lal for the year ended 31 st March 2020 is as follows. Compute income from the business and tax liability for the assessment year 2020-21. (Unit-IV, Prob. 3)

Dr.		Profit and Loss Account		Cr.
Particulars		Particulars		
To Salaries (including proprietors salary 6,000)	75,000	By Gross Profit @15%		2,86,000
To Gen. Insurance Premium	4,200	By Commission		8,400
To Bad debts	11,500	By Profit on sale of long term Investment		21,000
To Provisions for doubtful debts	5,000	By Bad debts recovered (allowed earlier as deduction)		15,000
To Rent	7,000			
To Discount	2,460			
To Interest on loan	11,000			
To Annual licence fee	2,080			
To Value Added Tax	8,000			
To Income tax	12,000			
To Interest on capital	7,500			
To Net profit	1,84,660			
	3,30,400			3,30,400

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 Rs. 30,000 is not recorded in the books.
6. For achieving the sales target one of the distributor presented a T.V. set worth Rs. 17,000.
7. Salary to employees is paid through bank except for watchman, whose monthly salary is ` 2,000 is paid in cash.

OR

- (b) What is depreciation? Explain the conditions for charging depreciation ? (Unit-IV, Q.No. 18)

13. (a) Explain about the exemptions in respect of capital gains u/s 54. (Unit-V, Q.No. 13)

OR

- (b) Shri Bhutani who is resident of India furnished the following particular of his investments for the previous year ended 31st March, 2020. (Unit-V, Prob. 13)

- (i) ` 10,000 units of Mutual Fund (Gross income ` 1,200);
 - (ii) ` 3,000 in Post Office Savings Bank Account which earns interest @ 4% per annum;
 - (iii) ` 45,000 in Fixed Deposit Account with Allahabad Bank on which interest @ 9% is payable;
 - (iv) 12% ` 40,000 Debentures (Listed) of Tea Company;
 - (v) ` 2,000 interest received on National Development Bonds;
 - (vi) ` 1,000 interest received on the debentures of a Co-operative Society;
 - (vii) 10% U.P. State Electricity Board Bonds Rs 20,000;
 - (viii) ` 10,000 in 7 Year Post Office National Savings Certificates interest @ 7% per annum is payable on the same every year;
 - (ix) ` 36,000, 10% Tax-free Debentures of Agra Municipal Corporation. Interest being payable on 31st December;
 - (x) ` 900 received by an Account Payee Cheque as interest on debentures (Listed) of a company in which public are substantially interested.
He collected the entire interest himself and claimed ` 200 as his own fees for collection of interest.
 - (xi) Interest on post office National Saving certificates VIII issue ` 5,000.
- Calculate the taxable income under the head 'Income from Other Sources' for the Assessment Year 2019-20.

FACULTIES OF COMMERCE

B.Com. IV – Semester (CBCS) Examination

(Common Paper for General / Computers / Computer Applications /
Advertising and Foreign Trade)

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. What are the conditions applicable for residential status of company and every other person ? (Unit-I, SQA. 5)
2. Calculate tax liability of Sri Shyam Sunder if total income is ₹ 9,52,000. (Unit-I, Prob. 2)
3. House Rent Allowance (Unit-II, SQA. 2)
4. Compute taxable house rent allowance from one following information, (Unit-II, Prob. 6)
 - (i) Basic pay ₹ 60,000 p.m
 - (ii) Dearness allowance 80% of basic pay
 - (iii) House rent allowance 30% of basic pay and rent paid to accommodation in Delhi ₹ 30,000 p.m.
5. 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. 1)
6. What are the differences between Capital and Revenue Expenses. (Unit-IV, SQA. 9)
7. What is Basis of Charge ? (Unit-V, SQA. 2)
8. From the following information, compute Mr. Rao's income from interest on securities. (Unit-V, Prob. 9)
 - (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.

PART - B (5 × 12 = 60 Marks)

Note: Answer all the questions in not exceeding 4 pages each by using internal choice.

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) Explain exempted incomes from tax u/s 10 of IT Act 1961. (Unit-I, Q.No. 19)

10. (a) What are the Characteristics of a Salary?

(Unit-II, Q.No. 2)

OR

- (b) Mr. Ramana Rao works for a Government company at New Delhi and submits the following particulars for the financial year 2021-22.

(Unit-II, Prob. 26)

- (i) Basic pay ` 1,90,000
- (ii) DA 25% of salary
- (iii) Bonus ` 18,000
- (iv) Arrears of salary ` 20,000
- (v) Entertainment allowance ` 8,000
- (vi) Conveyance allowance (75% spent) ` 12,000
- (vii) Employer contribution to RPF 14% of salary
- (viii) Interest credit to RPF @ 12% is ` 8,000
- (ix) He has been provided with a rent free accommodation (owned by the employer) at Delhi whose fair rental value is ` 80,000 p.a. and cost of furniture is ` 41,000/-
- (x) He is provided free supply of gas which costs to the employer ` 2,400/- Compute income from salary for the Assessment year 2021-22.

11. (a)

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		

(Unit-III, Prob. 7)

OR

- (b) Define income from House Property. Under what conditions it is treated as income from House Property.

(Unit-III, Q.No. 1)

12. (a) Given below is the profit and loss account of Mr 'X' for the year ending 31 -3-2020. (Unit-IV, Prob. 12)

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.

OR

- (b) Briefly explain the points to be considered while computing business income. (Unit-IV, Q.No. 3)
13. (a) Explain the method of computing the income under capital gains. (Unit-V, Q.No. 10)

OR

- (b) Mr. Raju owned one residential house sold for ₹ 11,80,000 in Oct. 2016 which was actually purchased for ₹ 1,00,000 in 1982-83. He spent ₹ 10,000 for the construction of another room in 1984-85. Expenses incurred in the execution of sale deed were ₹ 10,000 which were born by him. Cost inflation index no.s in 1982-83, 84-85 and 2016-17 were 109, 125 and 1,125 respectively. Compute his capital gain. (Unit-V, Prob. 8)