

BBA-304

# TAX PLANNING



**DIRECTORATE OF DISTANCE EDUCATION**

**SWAMI VIVEKANAND**

**SUBHARTI UNIVERSITY**

Meerut (National Capital Region Delhi)

# Contents

<b>UNIT 1: TAX PLANNING</b>	<b>1-16</b>
1.1 Learning Objectives	1
1.2 Introduction	2
1.3 Tax Planning	2
1.4 Tax Planning Differentiated from 'Tax Evasion' and 'Tax Avoidance'	3
1.5 Objectives of Tax Planning	4
1.6 Factors for Tax Planning	5
1.7 Methods of Tax Planning	6
1.8 Some of the areas of Tax Planning	6
1.9 Tax Planning and Corporate Planning	6
1.10 Tax on Distributed Profits of Domestic Companies	9
1.11 Bonus Shares (Capitalisation of Reserve and Surplus)	11
1.12 Summary	15
1.13 Keywords	15
1.14 Review Questions	15
1.15 Further Readings	16
<b>UNIT 2: INCOME TAX</b>	<b>17-100</b>
2.1 Learning Objectives	17
2.2 Introduction	18
2.3 Concept of Income	19
2.4 Historical Background of Income Tax	22
2.5 Overview of Income Tax Law in India	24
2.6 Basic Concepts of Income Tax	25
2.7 Agricultural Income	34
2.8 Income Tax Systems in India	61
2.9 Residential Status (Section 6)	69
2.10 Residential Status of a Company	77
2.11 Incidence of Tax	78
2.12 Scope of Income	80

2.13	Deemed Receipt and Accrual of Income in India	81
2.14	Categories of Income which are Deemed to Accrue or Arise in India	84
2.15	Summary	97
2.16	Keywords	99
2.17	Review Questions	100
2.18	Further Readings	100
<b>UNIT 3:</b>	<b>INCOME FROM SALARY AND HOUSPROPERTY</b>	<b>101-171</b>
3.1	Learning Objectives	102
3.2	Introduction	102
3.3	Meaning of Salary	103
3.4	Principles with Regard to Salary	105
3.5	Types of Allowances and Valuation	126
3.6	Types of Perquisites and Valuation	135
3.7	Deductions From Gross Salary	148
3	Income from House Property	154
3.9	Essential Conditions	154
3.10	Deemed Ownership	156
3.11	Exempted Incomes	157
3.12	Composite Rent	158
3.13	Annual Value	159
3.14	Computation of Annual Value	160
3.15	Deductions	163
3.16	Tax Treatment of Self Occupied Houses	164
3.17	Important Points	167
3.18	Summary	168
3.19	Keywords	169
3.20	Review Questions	170
3.21	Further Readings	171
<b>UNIT 4:</b>	<b>PROFIT OR GAIN IN BUSINESS OR PROFESSION</b>	<b>172-255</b>
4.1	Learning Objectives	172
4.2	Introduction	173
4.3	Meaning of Business and Profession	173
4.4	Principles with Regard to Profit or Gains from Business and Profession	175



4.5	Accounts Prepared by the Assessee for Computing Profits	178
4.6	Maintenance of Accounts, Compulsory Audit and Special Provisions	179
4.7	Capital Gain	209
4.8	Exemptions at a Glance	226
4.9	Income from other Sources	234
4.10	Interest on Securities	242
4.11	Bond Washing Transactions	247
4.12	Summary	252
4.13	Keywords	254
4.14	Review Questions	254
4.15	Further Readings	255

#### **UNIT 5: CLUBBING OF INCOME**

		<b>256-359</b>
5.1	Learning Objectives	256
5.2	Introduction	257
5.3	Aggregation of Income/Deemed Income	257
5.4	Assessment of Firms	294
5.5	Partnership Firm assessed as an Association of Person (PFAOP)- u/s 185	306
5.6	Tax Planning for Partnership Firms	311
5.7	Assessment of Association of Persons (AOP) & Body of Individual (BOI)	313
5.8	Alternate Minimum Tax (AMT)	318
5.9	Assessment of Companies	321
5.10	Minimum Alternate Tax (MAT) Sec 115JB	337
5.11	Dividend Distribution Tax (DDT)-Sec 115-O	347
5.12	Tonnage Tax: Shipping Companies	353
5.13	Summary	358
5.14	Keywords	359
5.15	Review Questions	359
5.16	Further Readings	359



# SYLLABUS

## BBA 2<sup>nd</sup> Year 3<sup>rd</sup> Semester

### Tax Planning

Course Code: B.B.A 304		
Course Credit: 4	Lecture: 04	Tutorial: 01
Course Type:	Generic Elective	
Lectures delivered:	30 L+10 T	

#### End Semester Examination System

Maximum Marks Allotted	Minimum Pass Marks	Time Allowed
70	28	3 Hours

#### Continuous Comprehensive Assessment (CCA) Pattern

Minor Tests(marks)	Assignment/ Tutorial/ Presentation	Attendance	Total
15	05	10	30

**Course Objective:** To introduce students to the basic concepts of tax planning under income-tax. To help them to apply the provisions and compute the total income and tax liability under various heads.

Unit	Contents	Hours
Unit I	Meaning of Tax Planning, Objectives and importance of Tax Planning; Types of Tax planning, Tax Evasion and Tax Avoidance	8
Unit II	Income tax concepts: Previous Year, Assessment Year, Person, Assessee, Income (including agricultural income), Gross Total Income, Total Income; Income which do not form part of total income, Residential Status and their incidence of tax.	12
Unit III	Computation of Income under the head Salary and House Property	12
Unit IV	Computation of Income under the Head Profits and gains from Business or Profession, Capital gains and Income from other sources.	16
Unit V	Clubbing of Income, Set-off and carry-forward of losses, Deductions from gross total income as applicable to an individual and Business Units; Computation of total income and tax liability of an individual.	12

**Course Outcome:** After studying this course the student should be able to

1. Understand basic concept of tax planning under Income tax.
2. Appraise different types of incomes and their taxability and expenses and their deductibility.
3. Calculate set-off and carry forward of losses

#### Text books:

1. V.B. Gaur & Narang, "Income Tax Law And Practice", Kalayani Publishers, 2001.
2. T.S. Reddy & Y. Hari Prasad Reddy, "Income Tax Law and Practice" Margham Publications, 2008.

**References:**

1. DrVinod K. Singhania, "Income Tax Law and Practice", Taxmann Publications Pvt. Limited, 2005.
2. V. Bala Chandran, S. Thothadri, "Taxation Law and Practice", Published by Asoke K. Ghosh, PHI Learning Private Limited, Volume 1, 2003
3. Dr. Girish Ahuja & Dr Ravi Gupta, "Direct Taxes Law & Practice", Bharat Publishers, 2001

**Weblinks**

1. [www.nptel.ac.in](http://www.nptel.ac.in)

# **Tax Planning**

Notes

## **(Structure)**

- 1.1 Learning Objectives
- 1.2 Introduction
- 1.3 Tax Planning
- 1.4 Tax Planning Differentiated from 'Tax Evasion' and 'Tax Avoidance'
- 1.5 Objectives of Tax Planning
- 1.6 Factors for Tax Planning
- 1.7 Methods of Tax Planning
- 1.8 Some of the Areas of Tax Planning
- 1.9 Tax Planning and Corporate Planning
- 1.10 Tax on Distributed Profits of Domestic Companies
- 1.11 Bonus Shares (Capitalisation of Reserve and Surplus)
- 1.12 Summary
- 1.13 Keywords
- 1.14 Review Questions
- 1.15 Further Readings

## **1.1 Learning Objectives**

After studying the chapter, students will be able to:

- Explain the concept of tax planning;
- Discuss corporate tax planning;
- Describe the Factors for Tax Planning;
- Explain the Tax on distributed profits of Domestic Companies.



## Notes

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**1.2 Introduction**

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Corporate planning process, of various phases like strategy formulation and functional plans, are very important. It is at this stage of strategy formulation corporate tax planning helps corporate planners. Depending upon the results of gap analysis, company develops strategy to fill the gap. It may be in any form like expansion, diversification or the closure of units.

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**1.3 Tax Planning**

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Tax planning is well thought out scheme of the tax payers to reduce their tax burden by methods which are sound and legal. It has assumed far-reaching importance in the confounded complexities of the taxation laws. The planning has proved a saviour of the economic life of the tax payer who can reduce the incidence of tax to the minimum if he can diligently and intelligently plan his tax affairs. On the other hand tax authority is to realize the maximum revenue from tax. Laws on taxation have been suffering from legislative experiments at amendments in order to remain content after what is left by the taxing authorities or is there any scope for him to counteract the onerous effects of the taxation laws on his pockets. So a tax payer attempts to take all possible advantages over the taxation laws. For this purpose the requirements of tax planning includes—

1. A sound knowledge of tax laws;
2. A thorough knowledge on judicial rulings and views of the Government on such rulings;
3. Readiness to stand adjusted to the correct legal position as a result of Supreme Court judgement or as a result of Parliament's effort to amend the law remedying the errors in drafting which surface in such rulings.

A tax planner has to follow the court rulings meticulously and at the same time he has to give proper attention to the mood of the Revenue Departments.

It may be pointed out that in the case of corporate assesses tax planning is an important segment of corporate planning. It should be conscious efforts made by companies to avoid 'tax-shocks' or 'tax-attacks' on their business, by systematically planning the financial or managerial decision-making after fully knowing the possible tax consequences of them. Tax planning, if properly linked with corporate planning, can result in great flexibility in business operations.

## 1.4 Tax Planning differentiated from 'Tax Evasion' and 'Tax Avoidance'

**Tax evasion :** It is a method of evading tax liability by dishonest means like suppression of sales, inflation of expenses, concealment of income, etc. For example, an employee may claim that the free domestic servant provided by his employer was a gardener (whose salary paid by the employer is a tax-free perquisite), although the possibility of providing a gardener by any sensible employer is remote, since the flat occupied by the employee is on the tenth floor of a multi storied building with no terrace or verandah.

This form of tax planning is deplorable. It is a dubious way of solving tax problems and should be condemned.

**Tax avoidance :** G.S.A. Wheat Craft says it is the art of dodging tax without actually breaking the law". It is a method of reducing tax liability by taking advantage of certain loopholes in the law. This is attempted by splitting legal heirs. wheat Craft analyses tax avoidance as a transaction which could not be adopted if the tax planning elements were absent. Thus tax avoidance involves: (i) a transaction entered into to avoid tax and with full legal backing; and (ii) a transaction which the legislature would not intend to encourage.

**Tax planning :** This is a method of planning the affairs by availing of incentives and benefits provided by the legislature and thus promoting the spirit behind the provisions made in the law. Tax planning is neither 'tax evasion' nor 'tax avoidance'. The Wanchoo Committee report brought out above distinctions as under :

"The distinction between tax evasion and tax avoidance, therefore, is largely dependent on the difference in methods of escape resorted to.

Some are instances of merely availing, strictly in accordance with law, the tax exemptions or tax privileges offered by the Government. Others are manoeuvres involving an element of deceit, misrepresentation of facts, falsification of accounts, including downright fraud. The first represents what is truly tax planning, the latter, tax evasion. However, between these two extremes, there lies a vast domain for selecting variety of methods, which, though technically satisfying it with a view to eliminating or reducing tax burden. It is these methods which constitute tax avoidance".

There is no dispute in accepting tax evasion as different from tax planning, but the subtle difference between tax avoidance and tax planning is often overlooked.



## Notes

In *McDowell Co. vs. CTO* (1989) 22 Taxman II (SC), it was held that "tax avoidance was the same as tax evasion. The thin line of distinction between tax avoidance and tax evasion was obliterated."..... "We now live in a welfare state whose financial needs, if backed by the law, have to be respected and met. We must recognize that there is as much moral sanction behind taxation laws as any other welfare legislation and it is a pretence to say that avoidance of taxation is not unethical ....."

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### 1.5 Objectives of Tax Planning

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Tax planning is an honest and valid approach to the taxation laws within their framework to achieve the objective of tax reduction and therefore, the objectives of tax planning cannot be regarded as offending any concept of taxation laws.

The prime objectives of tax planning may be summarized as follows :

1. **Reduction of tax liability:** One of the supreme objectives of tax planning is the reduction of tax liability of the tax payer and the resultant saving of earning for a better enjoyment of the fruits of the hard labour. By proper tax planning, a tax payer can oblige the administrators of the taxation laws to keep their hands off from his earnings.
2. **Minimisation of litigation:** Where a proper tax planning is resorted to by the tax payer in conformity with the provisions of the tax laws, the chances of unscrupulous litigation are certainly to be minimized and the taxpayer may be saved from the hardships and inconveniences caused by the unnecessary litigations which move often than not even knock the doors of the supreme judiciary.
3. **Productive investment:** The planning is a measure of awareness of the tax payers to the intricacies of the taxation laws and it is the economic consciousness of the income earner to find out the ways and means of the productive investment of the earnings which would go a long way to minimize his tax burden.

The taxation laws offer large avenues for the productive investment granting absolute or substantial relief from taxation. A tax payer has to be constantly aware of such legal avenues as are designed to open floodgates of his well-being, prosperity and piness. When earnings are invested in the avenues recognized by law, they are not only relieved of the burnt of taxation but they are also converted into means of further earnings.



4. **Healthy growth of economy:** The saving of earnings is the only basement upon which the economic structure of human life is founded. A saving of earnings by legally sanctioned devices is the prime factor for the healthy growth of the economy of a nation and its people. An income saved and wealth accumulated in violation of law are the scourges on the economy of the people. Generation of black money darkens the horizon of the national economy and leads the nation to avoidable economic destruction. In the suffocating atmosphere of black money, a nation sinks with its people. But tax planning is the generator of a superbly white economy where the nation awakens in the atmosphere of peace and prosperity, a phenomenon undreamed of otherwise.
5. **Economic stability :** Under tax planning, taxes legally due are paid without any headache either to the tax payer or to the tax collector. Avenues of productive investments are largely availed of by the taxpayers. Productive investments increase contours of the national economy embracing in itself the economic prosperity of not only the tax payers but also of those who earn the income not chargeable to tax. The planning thereby creates economic stability of the nation and its people by even distribution of economic resources.

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## 1.6 Factors for Tax Planning

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A tax planning may be for a short-term, that is to say, yearly like the annual plans of the government and it may also be for a long-term depending upon the exigencies of the sources of income, like five-year plans of the Government. But both types may be employed in a given situation because both are supplementary to each other and they may not be found overlapping. When a tax planner is prepared to do his job meticulously, efficiently and intelligently, he has to take into consideration the following factors :

- (i) Residential status;
- (ii) Complete information of financial position of tax payer;
- (iii) Heads of income;
- (iv) Latest legal position;
- (v) Form vs. substance: the subject is not to be charged to tax unless the charging provision clearly imposes to the obligation. There is no scope for presumption or intendment.

## 1.7 Methods of Tax Planning

Tax planning may be effective in every area of business management. Some of the important areas where planning may be attempted are :

- (i) Short-term tax planning
- (ii) Medium-term tax planning
- (iii) Long-term tax planning

## 1.8 Some of the areas of Tax Planning

Tax planning may be effective in every area of business management. Some of the important areas where planning may be attempted are

- (i) Location of business,
- (ii) Nature and size of business,
- (iii) Form of business organization and the pattern of its ownership,
- (iv) Specific management decisions like make-or buy, own or lease, capital structure, renew or replace, etc.
- (v) Employees' remuneration,
- (vi) Merger/amalgamation of companies,
- (vii) Double taxation relief,
- (viii) Personal taxation-Indian and non-residents,
- (ix) Tax implications in (a) receiving foreign collaboration & (b) giving foreign collaboration,
- (x) Tax incentives and export promotion,
- (xi) Advance ruling

## 1.9 Tax Planning and Corporate Planning

In the corporate planning process, of various phases like strategy formulation and functional plans, are very important. It is at this stage of strategy formulation corporate tax planning helps corporate planners. Depending upon the results of gap analysis, company develops strategy to fill the gap. It may be in any form like expansion, diversification or the closure of units. To make right choice it is necessary to induct taxation into the corporate planning process. The chart given in the following page represents the areas



where corporate planners should seek the guidance and advice of the corporate tax planner. This diagram seeks to establish linkages between corporate planning and tax planning. This linkage process is briefly explained below:

### **Production Planning**

The possible problems in production after setting out production plans are maintenance, capacity utilization, etc. Tax laws provide depreciation allowance and maintenance allowance like allowance for repairs, etc. Similarly, investment allowance, taxation of capital gains and deemed profits should be considered for acquiring more machines or selling obsolete machines and also for deciding the timing of either purchase or sale of assets.

### **Market Planning**

The assessee can claim export market deductions in addition to allowances for entertainment and advertisement expenditure u/s 37. However market plans depend upon strategy formulation which includes expansion, diversification and closure of certain units. Expansion involves promoting a new business undertaking adding one more department or amalgamation of two or three companies. For these the tax implications involved in a particular decision should be studied in depth.

Promoting a new business or opening a new department or amalgamation of two or more companies or closure of certain sick units, or splitting up of the business would involve either solving or creating some more production, marketing, personnel or financial problems. It is thus necessary that tax planning should be attempted not only by isolating each of the departmental problems but also integrating them.

**Financial Planning:** In financial management, capital structure decision have been considered as very important. Tax planning helps in deciding the capital gearing required and in computing the optimum capital mix and the cost of capital as well.

Similarly, since almost 39.5% of the taxable profits have to be paid to the government in the form of income-tax, it would be difficult to marshal the necessary working capital required to pay taxes regularly. This problem would become more complicated in the absence of tax management.

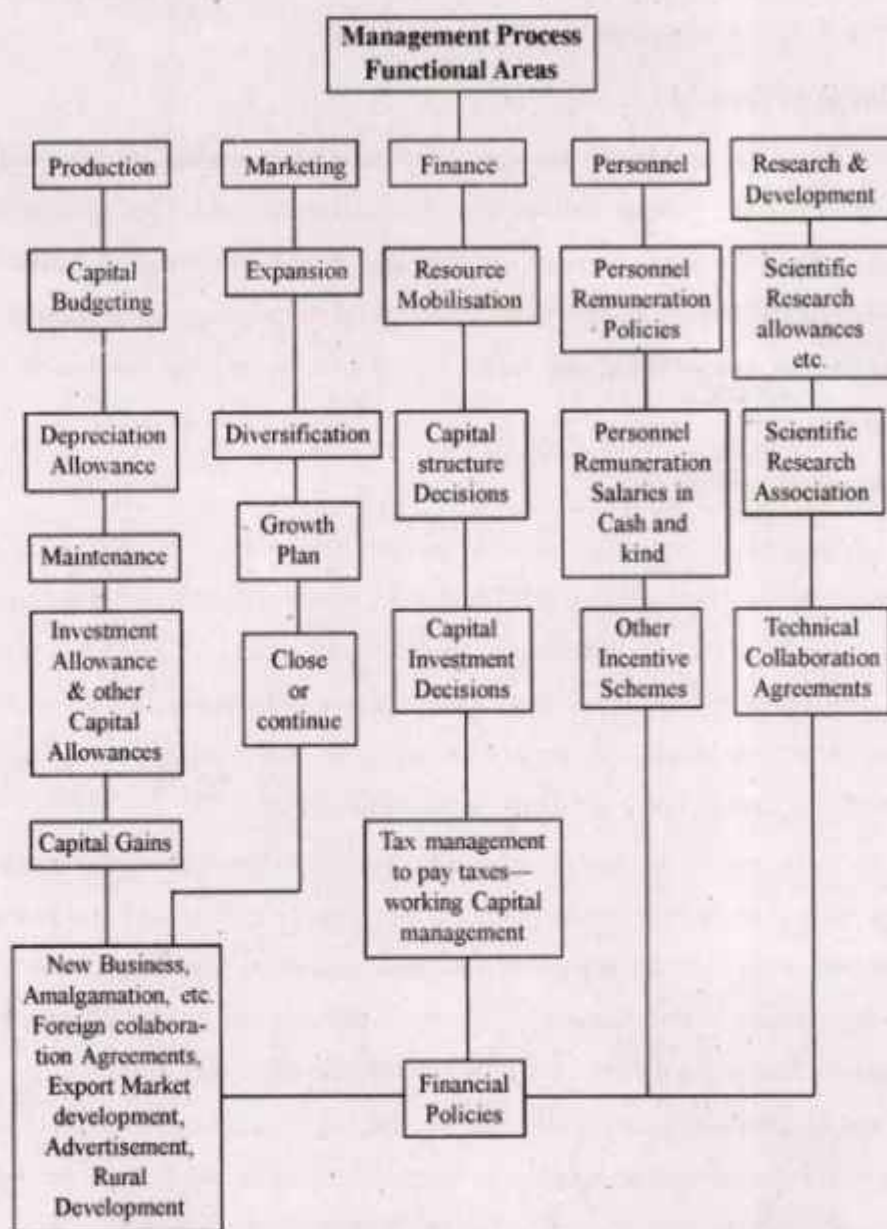
**Personnel planning :** Personnel management in companies is not only a social responsibility but has become a statutory obligation too. To arrive at proper remuneration plans and to evolve sound wage policies companies should pay the utmost attention to

### **Notes**



the tax implications involved in the fixation of salary, perquisites, allowances and other employee welfare benefits.

## Notes



**Research and development :** Without research and development efforts companies may be able to serve only the needs of yesterday and run the risk of being outdated in the market. The tax benefits have provided stimulus for expansion of research activity in industry. But without proper tax planning, companies might lose these tangible tax benefits. Conclusion : So far many companies have pursued corporate planning as an isolated legal exercise confined to the chambers of tax advisers and solicitors. However, it may be argued that tax planning should be integrated into overall corporate

long-range planning process. The scheme of corporate taxation is comprehensive affecting all important areas of corporate management.

Any planning exercise done exclusively for a single area creates imbalances in the master plan and leads to sub-optimal utilization of corporate resources. Such an integrated approach to the planning process requires that tax planning be an important and equal partner along with other segments like production planning, marketing planning, etc. Just as corporate planning is an incomplete endeavour without being fitted into the corporate planning framework, corporate planning should also go hand in glove with each other.

## Notes

### 1.10 Tax on Distributed Profits of Domestic Companies

**Tax treatment in the hands of shareholders if dividends are distributed during June 1, 1997 and March 31, 2002 or after March 31, 2003**—Tax treatment of dividend is as follows:

**Dividend received from a domestic company**—If dividend is covered by section 2(22) [not by clause (e) of section 2(22)] and declared, distributed or paid during June 1, 1997 and March 31, 2002 or after March 31, 2003, then it is not taxable in the hands of shareholders by virtue of section 10(34)/(33). On such dividend, the company declaring dividend will pay dividend tax under section 115-0. If a loan or advance is given which is deemed as dividend under section 2(22)(e), then such loan or advance is taxable under section 56 as "dividend" in the hands of recipient without claiming any deduction under section 80L or 80M.

**Dividend received from a non-domestic company**—If dividend is received from a company other than a domestic company, it is chargeable to tax in the hands of recipient.

#### 3.3.1 Basis of charge (Sec. 115-0(1))

A separate and additional charge has been created by section 115-0(1). It is subject to the following propositions

1. Tax on distributed profit is in addition to income-tax chargeable in respect of total income.
2. Only a domestic company (not a foreign company) is liable for above tax.
3. Any amount declared, distributed or paid by a domestic company by way of dividend shall be charged to dividend tax.
4. It is applicable whether the dividend is interim or otherwise.

## Notes

5. It is applicable only if such dividend is declared, distributed or paid on or after June 1, 1997 but before April 1, 2002 or after March 31, 2003.
6. It is applicable whether such dividend is paid out of current profit or accumulated profit.

**What is "dividend"**

Dividend declared, distributed or paid on or after June 1, 1997 but before April 1, 2002 or after March 31, 2003 is subject to dividend tax [for meaning of "dividend" for the purpose of section 115-0 the expression "dividend" shall have the same meaning as is given to "dividend" under section 2(22), but it shall not include sub-clause (e) of section 2(22)].

**Nature of tax**

The levy of additional tax is in addition to normal tax payable by a company. This additional tax incidence cannot be avoided even if no income-tax is payable by a domestic company on its total income computed under the provisions of the Act. Moreover, brought forward MAT credit under section 115JAA cannot be adjusted against the additional tax on dividend.

Rate of dividend tax-The amount of dividend tax is as follows :

Dividend tax	Surcharge	Education cess	Total	
(as a % of dividend)	(as a % of dividend)	(as a % of dividend)	(as a % of dividend)	
April 1, 2001 to May 31, 2001	20	0.40	—	20.40
June 1, 2001 to March 31 2002	10	0.20	—	10.20
April 1, 2002 to March 31, 2003	NA	NA	—	NA
April 1, 2003 to March 31, 2004	12.5	0.3125	—	12.8125
April 1, 2004 to March 31, 2007	12.5	0.3125	0.25625	17.06875
April 1, 2007 to March 31, 2008	15	10	2 EC 1% SHEC	16.998
April 1, 2008 to March 31, 2008	15	10	2 EC 3% SHEC	16.925



When the additional tax should be paid—The tax on distributed profit shall be paid within 14 days from the date of—

- a. declaration of any dividend; or
- b. distribution of any dividend; or
- c. payment of any dividend, whichever is the earliest.

Who is liable to pay tax—The principal officer of the domestic company and the company shall be liable to pay the aforesaid tax.

**Dividend tax is the final levy**—Tax on dividend paid by a domestic company shall be taken as the final tax payment in respect of the amount declared, distributed or paid as dividend. In respect of tax so paid, no credit is available to the company paying tax, or the recipient of dividend or to any other person. By virtue of section 10(33) or 10(34), dividend income (in respect of which tax is charged under section 115-0) will be exempt in the hands of recipient

**Dividend tax is not deductible**—The company (or the shareholders) cannot claim any deduction from taxable income in respect of dividend tax levied under section 115-0. Moreover, no deduction is available from the tax on dividend under any provision.

**Inter corporate dividend**—Section 80M has been re-introduced with effect from the assessment year 2003-04. A deduction under this section would be available to a domestic company, which receives dividend from another domestic company and distributes dividend out of its profits. The amount of deduction on the dividends, so received by a domestic company from another domestic company, shall be limited to the extent of dividends distributed by the recipient company on or before the due date of filing of return. Where any deduction, in respect of the amount of dividend distributed by the domestic company, has been allowed under section 80M in any previous year, no deduction shall be allowed in respect of such amount in any other provision.

### 1.11 Bonus shares (Capitalisation of Reserve and Surplus)

A stock dividend represents a distribution of shares in lieu of or in addition to the cash dividend (known as bonus in India) to the existing shareholders. This has the effect of increasing the number of outstanding shares of the company. The shares are distributed proportionately.

One of the conditions laid down in sub-clause (a) of section 2(22) is that distribution must entail the release of assets by the company to its shareholders. When, therefore, a company issues bonus shares by capitalisation of its profits, then there is no release of assets and, consequently, bonus shares are not taken as dividend. It, however, bonus

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shares are issued to preference shareholders, it amounts to distribution of dividend by virtue of sub-clause (b) of section 2(22).

If bonus shares are issued to equity shareholders, it does not amount to distribution of dividend at the time of issue of bonus shares, as there is no release of assets. But if bonus shares are redeemed (redemption is possible only in case if bonus shares are in the form of redeemable preference shares), there will be release of assets and in that event these would constitute dividend—*Shashibala Navnitlal v. CIT* [1964] 54 ITR 478 (Guj.).

Distribution of dividend in cash requires sufficient cash in the companies bank account. If the company does not have enough bank balance at the time of paying cash dividend, arrangement should be made to borrow funds. Moreover distribution of cash dividend will reduce both the cash balance and reserve account. As a result both the total assets and the net worth of the company are reduced.

One of the advantages to shareholders in the receipt of stock dividends is the beneficial treatment of such dividends with regard to income taxes. When a shareholder receives cash dividend from the company, this is included in his ordinary income and taxed at ordinary income tax rate. But the receipt of the stock dividends by the shareholder is not taxable as income. Further, the shareholder can sell the new shares received by way of the stock dividend to satisfy his desire for income and pay capital gain taxes, which are usually less than the income taxes on the cash dividends. The shareholder could sell a few shares of his original holding to derive capital gains. But selling the original shares are considered as a sale of principal by some shareholders. They do not mind selling the shares received by way of the stock dividend as they consider it a windfall gain and not a part of the principal.

**Example :** XYZ Ltd. is a company registered in India. The balance sheet of the company on March 31, 2022 is as under.

Liabilities	₹	Assets	₹
Preference share capital		Fixed assets (before depreciation)	15,00,000
(issued for cash)	4,00,000	Investment in share (market value	4,00,000
Equity share capital		₹ 13,00,000)	
issued for cash	6,00,000	Other assets	9,20,000
issued as bonus shares in 1960 and 1976 by capitalising profits	6,00,000		
General reserve	3,00,000		



## Notes

Investment allowance reserve	90,000		
Depreciation reserve	1,00,000		
Profit and Loss A/c balance as on April 1, 2020: ₹ 2,40,000 Add : Profit of the year ending March 31, 2022 ₹ 60,000	3,00,000		
Provision for taxation and dividend	2,30,000		
Current liabilities	2,00,000		
	28,20,000		28,20,000

**Note :** Profit and loss account balance on April 1, 2021 includes agricultural income of ₹ 30,000. As under the provisions of section 2(22), a payment/distribution is treated as dividend only to the extent of accumulated profits, one has to first ascertain "accumulated profits" to apply the deeming fiction of section 2(22). Accumulated profit, as on March 31, 2022, is calculated as under :

	₹	₹
Capitalise profit (i.e., bonus shares issue)		
[*not considered under section 2(22) (e)]	6,00,000	*
General reserve	3,00,000	3,00,000
Investment reserve, etc.	90,000	90,000
Depreciation reserve (*Not taken into account)	*	*
Balance of P&L A/c on April 1, 2021 (agricultural income, even if tax-free, forms part of accumulated profits)	2,40,000	2,40,000
Current profit of the year ending March 31, 2022	60,000	60,000
Provisions for taxation/dividend (*not considered, if it is a provision, may be considered if it is reserve)	*	*
Total	12,90,000	6,90,000

If the company declares and pays dividend of ₹ 10,00,000 on April 1, 2022 in cash, the entire amount would be treated as dividend as it does not exceed ₹ 12,90,000 and the company would have to pay dividend tax at the rate of 13.06875 per cent, i.e., ₹ 1,30,687.50.



## Notes

If the company distributes investment in shares on April 1, 2022 to its shareholders, the distribution would constitute dividend. Amount of dividend would be ascertained on the basis of market value of shares on the date of distribution. If, on the date of distribution, the market value of shares so distributed is ₹ 13,00,000, the distribution would amount to dividend to the extent of ₹ 11,40,899 (i.e.,  $100/113.06875 \times ₹ 12,90,000$ ) and the company would have to pay dividend tax at the rate of 13.06875 per cent, i.e., ₹ 1,49,101. If X holds 10 per cent share capital and receives shares

1,30,000 (being 10 per cent of ₹ 13,00,000), ₹ 1,14,090 (being 10 per cent of ₹ 11,40,899) would amount to dividend which would be exempt from tax and ₹ 15,910 would be return of capital which would be taken into consideration at the time of computation of capital gains when transfer of shares takes place.

If the company gets right shares of the company in which it is shareholder and renounces its right in favour of its own shareholders on April 10, 2022, the market value of rights is dividend and is chargeable in the hands of the company to dividend tax, as renouncement of right to subscribe share amounts to release of asset by the company. However, market value of right on the date of renouncement, in excess of accumulated profits (i.e., ₹ 12,90,000), is not chargeable to dividend tax in the hands of the company.

If the company issues bonus shares of ₹ 3,00,000 by capitalising general reserve to its equity shareholders, it is not treated as dividend and hence not chargeable to dividend tax in the hands of company, as it does not amount to release of asset by the company.

If the company issues redeemable preference shares on April 1, 2022 of ₹ 3,00,000 to its equity shareholders as bonus shares by capitalising general reserve, it will not amount to dividend. e.g., X, one of the shareholders receives preference share of ₹ 30,000 as bonus shares, no tax on ₹ 30,000 would be attracted at the time of issue of bonus shares. If the company redeems these preference shares and X receives ₹ 30,000 on May 10, 2022, ₹ 30,000 would be dividend (on which the company will have to pay dividend tax) as it amounts to release of assets (if the company is in possession of accumulated profits at the time of redemption).

If the company issues bonus shares to its preference shareholders on April 5, 2022, it amounts to dividend (to the extent of accumulated profit) and is chargeable in hands of the company to dividend tax, even if it does not amount to release of assets, as it is specially covered by section 2(22) (b).

If the company issues debentures or debenture-stock to its shareholders (equity or preference) the distribution will amount to dividend and is chargeable in the hands of the company to dividend tax, so long as it does not exceed ₹ 12,90,000.

If the company reduces its share capital and pays ₹ 8,00,000 on May 1, 2022 to its shareholders, it will amount to dividend under section 2(22)(d), as it does not exceed ₹ 12,90,000. Consequently, on ₹ 8,00,000, the company will have to pay dividend tax.

### 1.12 Summary

Market planning deductions in addition to allowances for entertainment and advertisement expenditure u/s 37. However market plans depend upon strategy formulation which includes expansion, diversification and closure of certain units. Expansion involves promoting a new business undertaking adding one more department or amalgamation of two or three companies.

### 1.13 Keywords

- **Chamberlains** : An official charged with the management of the living quarters of a sovereign or member of the nobility.
- **Bailiff** : The highest elected office in Stratford and the equivalent of a modern day mayor.

### 1.14 Review Questions

1. Explain the concept of Tax planning? What are the requirements of tax planning?
2. (a) Distinguish between 'Tax evasion' and 'Tax avoidance'  
(b) 'It is said that distinction between Tax planning and Tax avoidance is very thin and delicate'-Discuss.
3. (a) What are the objectives of Tax planning?  
(b) What are the areas where tax planning may be attempted?
4. What is the relevance of corporate planning with Tax planning? Show with a diagram the areas where the corporate planner may take the help of a tax planner.
5. "Corporate planner should take the help of tax planner in arriving at capital structure decisions". —Discuss.
6. What do you understand by capital mix? What consideration should management of a company take into account while deciding optimum capital mix?
7. Explain with a suitable example showing the tax effects on the financial leverage in making capital structure decisions?
8. What is dividend according to section 2(22) of the income tax act?

### Notes

**Notes**

9. "Stock dividend (bonus shares) has certain advantages to the company and also to the shareholders". —Discuss.
10. What are the provisions under the Income-Tax Act relating to deduction for inter-corporate dividend?

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**1.15 Further Readings**

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- Corporate Tax Planning—E. A. Srinivas.
- Corporate Tax Planning and Management—Ahuja & Gupta.
- Corporate Tax Planning and Management—G. Ahuja & R. Gupta.
- Direct Taxes—Law & Practice—V. K. Singhania & K. Singhania.



# **Income Tax**

Notes

**(Structure)**

- 2.1 Learning Objectives
- 2.2 Introduction
- 2.3 Concept of Income
- 2.4 Historical Background of Income Tax
- 2.5 Overview of Income Tax Law in India
- 2.6 Basic Concepts of Income Tax
- 2.7 Agricultural Income
- 2.8 Income Tax Systems in India
- 2.9 Residential Status (Section 6)
- 2.10 Residential Status of a Company
- 2.11 Incidence of Tax
- 2.12 Scope of Income
- 2.13 Deemed Receipt and Accrual of Income in India
- 2.14 Categories of Income which are Deemed to Accrue or Arise in India
- 2.15 Summary
- 2.16 Keywords
- 2.17 Review Questions
- 2.18 Further Readings

## **2.1 Learning Objectives**

After studying the chapter, students will be able to:

- Explain the concept of income;
- Discuss the historical background of tax;
- Elaborate the Income Tax Law in India;

## Notes

- Describe the basic concepts of income tax;
- Discuss agricultural income;
- Explain an overview of income tax systems in India;
- State the meaning and scope of residential status of an individual;
- Discuss the provisions of analysing the residential status of an individual;
- Explain incidence of tax and its importance;
- Elucidate the concept of deemed receipt and accrual of income in India.

## 2.2 Introduction

An income tax is a tax levied on the financial income of persons, corporations, or other legal entities. Various income tax systems exist, with varying degrees of tax incidence. Income taxation can be progressive, proportional, or regressive. When the tax is levied on the income of companies, it is often called a corporate tax, corporate income tax, or profit tax. Individual income taxes often tax the total income of the individual (with some deductions permitted), while corporate income taxes often tax net income (the difference between gross receipts, expenses, and additional write-offs). Every country generates income from 'Income Tax' in the form of direct tax levied by government. Income tax plays a vital role in the economy of every country in the world. Income tax Act was enacted in the year 1961. So, before one can embark on a study of the law of income tax, it is absolutely vital to understand some of the expressions found under the Income tax Act, 1961. The purpose of this Unit is to enable the students to comprehend basic expressions. Therefore, all such basic terms are explained and suitable illustrations are provided to define their meaning and scope.

Tax incidence on an assessee depends on his residential status. For instance, whether an income, accrued to an individual outside India, is taxable in India depends upon the residential status of the individual in India. Likewise, whether an income earned by a foreign national in India or outside India taxable in India depends on the residential status of the individual, rather than on his citizenship. Therefore, the determination of the residential status of a person is very significant in order to find out his tax liability. The inclusion of a particular income in the Total Income of a person for income-tax in India is based on his residential status. There are three residential statuses that we will study in detail this unit namely the Residents also referred to as Resident & Ordinarily Residents, the Resident but Not Ordinarily Residents and the Non-residents. There are several steps involved in determining the residential status of person. All residents are taxable for all their income, including income outside India. Non residents are taxable

only for the income received in India or Income accrued in India. Not Ordinarily Residents are taxable in relation to income received in India or income accrued in India and income from business or profession controlled from India.

## **2.3 Concept of Income**

## **Notes**

A basic income is an income unconditionally granted to all on an individual basis, without means test or work requirement. It is a form of minimum income guarantee that differs from those that now exist in various countries in three important ways:

1. It is being paid to individuals rather than households;
2. It is paid irrespective of any income from other sources;
3. It is paid without requiring the performance of any work or the willingness to accept a job if offered.

There is no specific definition of income but for statutory purposes there are certain items which are listed under the head income. These items include those heads also which normally will not be termed as income but for taxation we consider them as income. The definition of income as per the Income tax Act, 1961, begins with the words "Income includes". Income is a periodical monetary return with some sort of regularity. It may be recurring in nature. It may be broadly defined as the true increase in the amount of wealth which comes to a person during fixed period of time.

The definition of the term "income" in sec. 2 (24) is inclusive and not exhaustive. The term "income" not only indicates those things which are included in sec. 2(24), but also includes such thing which the term signifies according to its general and natural meaning.

Therefore, it is an inclusive definition and not an exhaustive one. Such a definition does not confine the scope of income but leaves room for more inclusions within the ambit of the term.

Certain important principles relating to income are enumerated below:

1. Income, in general, means a periodic monetary return which accrues or is expected to accrue regularly from definite sources. However, under the Income tax Act, 1961, even certain incomes which do not arise regularly are treated as income for tax purposes e.g. Winnings from lotteries, crossword puzzles.
2. Income normally refers to revenue receipts. Capital receipts are generally not included within the scope of income. However, the Income tax Act, 1961 has specifically included certain capital receipts within the definition of income e.g. capital gains i.e. gains on sale of a capital asset like land.



## Notes

3. Income means net receipts and not gross receipts. Net receipts are arrived at after deducting the expenditure incurred in connection with earning such receipts. The expenditure which can be deducted while computing income under each head is prescribed under the Income tax Act, 1961.
4. Income is taxable either on due basis or receipt basis. For computing income under the heads "Profits and gains of business or profession" and "Income from other sources", the method of accounting regularly employed by the assessee should be considered, which can be either cash system or mercantile system.
5. Income earned in a previous year is chargeable to tax in the assessment year. Previous year is the financial year, ending on 31st March, in which income has accrued/received.

Assessment year is the financial year (ending on 31st March) following the previous year. The income of the previous year is assessed during the assessment year following the previous year. For instance, income of previous year 2021-22 is assessed during the year 2020-21. Therefore, 2020-21 is the assessment year for assessment of income of the previous year 2021-22.

### Features of "Income"

The following features of income can help a person to understand the concept of income:

1. **Definite Source:** Income has been compared with a fruit or a crop from the field. Fruit comes from a tree and crop from fields. Thus, the source of income is definite in both the cases. The existence of a source for income is somewhat essential to bring a receipt under the charge of tax.
2. **Income must come from outside:** No one can earn income from himself. There can be no income from transaction between head office and branch office. Contributions made by members for the mutual benefit and found surplus cannot be termed as income of such group.
3. **Tainted Income:** Income earned legally or illegally remains income and it will be taxed according to the provisions of the Act. Assessment of illegal income of a person does not grant him immunity from the applicability of the provisions of other act.
4. **Temporary or Permanent:** Whether the income is permanent or temporary, it is immaterial from the tax point of view.
5. **Voluntary Receipt:** The receipts which do not arise from the exercise of a profession or business or do not amount to remuneration and are made for reasons purely of personal nature are not included in the scope of total income.

For the purposes of treatment of income for tax purposes it can be divided into three categories:

1. **Taxable Income:** These incomes from part of total income and are fully taxable. These are salaries, rent, business profits, professional gains, capital gain, interest dividend and so on.
2. **Exempted Income:** These incomes do not form part of total income either fully or partially. Hence, no tax is payable on such incomes.
3. **Rebateable (Tax Free Incomes):** These incomes form part of total income and are fully taxable. Tax is calculated on total income out of which a Rebate of Tax at average rate is allowed.

## Notes

### Vodafone Wins Tax Case in SC; Deal With Hutchison 'bona fide'

Vodafone on Friday got relief in its income tax case after the Supreme Court ruled its deal with Hutchison as 'bona fide'. The Supreme Court on Friday in a majority verdict has upheld Vodafone International Holdings BV's contention that the Income Tax department did not have jurisdiction over a US \$11.2 billion deal in May 2007 in which the British group acquired Hutchison Telecommunications International as part of a complex transaction to buy the latter's majority stake in its Indian telecom business. The Indian unit, called Hutchison Essar then, is today named Vodafone Essar.

The verdict has asked the tax department to return the ₹ 2,500 crore that Vodafone had submitted as interim tax liability.

The verdict sets aside the uncertainty over the tax claim on Vodafone, as also companies involved in such transactions, but in future similar deals may come under the ambit of the proposed Direct Tax Code (DTC), which is being currently debated in Parliament. It taxes similar deals subject to certain conditions.

The telecom giant had moved the Apex Court challenging the Bombay High Court judgement of September 8, 2010 which had held that Indian IT department had jurisdiction over the deal.

Through the US \$11.2 billion deal in May 2007, Vodafone acquired 67 per cent stake in the Hutchison-Essar Ltd (HEL) from Hong Kong-based Hutchison Group through companies based in Netherlands and Cayman Island.

The IT Department maintained that since capital gains were made in India through the deal, Vodafone was liable to pay the tax and issued a showcause notice to it, asking as to why it should not be treated as a representative assessee of the Vodafone International Holding.



Vodafone, however, challenged the show cause notice before the Bombay High Court saying it was share transfer carried outside India.

The appeal was rejected by the high court in December 2008 which was again challenged by Vodafone before the Apex Court.

## Notes

## 2.4 Historical Background of Income Tax

The concept of taxing income is a modern innovation and presupposes several things: a money economy, reasonably accurate accounts, a common understanding of receipts, expenses and profits, and an orderly society with reliable records. For most of the history of civilization, these preconditions did not exist, and taxes were based on other factors. Taxes on wealth, social position, and ownership of the means of production (typically land and slaves) were all common. Practices such as tithing, or an offering of first fruits, existed from ancient times, and can be regarded as a precursor of the income tax, but they lacked precision and certainly were not based on a concept of net increase.

In the year, Emperor Wang Mang of China instituted an unprecedented tax – the income tax – at the rate of 10 percent of profits, for professionals and skilled labour. (Previously, all Chinese taxes were either head tax or property tax.) A true income tax was first implemented in Britain by William Pitt the Younger in his budget of December 1798 to pay for weapons and equipment in preparation for the Napoleonic wars. Pitt's new graduated income tax began at a levy of 2d in the pound (0.8333%) on incomes over £60 and increased up to a maximum of 2s (10%) on incomes of over £200. Pitt hoped that the new income tax would raise £10 million but actual receipts for 1799 totalled just over £6 million (see UK income tax history for more information). The first United States income tax was imposed in July 1861, 3% of all incomes over 600 dollars (later rescinded in 1872).

Income tax in India was imposed by Sir James Wilson of British Government in the year 1860, to recover from losses of 1857's revolution. Another act was made in the year 1886, which can be treated as permanent base for Income tax system in India. This was amended several times in 1863, 1867, 1871, 1873 and 1878.

In the year 1922, 'Central Revenue Board' was established and Income Tax Act, 1922 was implemented with the help of this board. Direct Taxes Administration Enquiry Committee was appointed in the year 1958. In the year 1961, parliament announced new Income Tax Act, which came into enforcement from April, 1962. This act was based on report submitted by Mahavir Tyagi in 1959.



## Types of Taxes

1. **Direct Taxes:** Income Tax, Wealth Tax, Gift Tax etc.
2. **Indirect Taxes:** Excise, Customs duty, Sales tax etc.

However, Gift Tax was removed from 30th September, 1998 and Estate Duty was removed from the assessment year 1986-87.

## Notes

### Direct Tax & Indirect Tax

**There are two types of taxes: Direct Tax and Indirect**

**Tax Tax**, of which incidence and impact fall on the same person, is known as Direct Tax, such as Income Tax. On the other hand, tax, of which incidence and impact fall on two different persons, is known as Indirect Tax, such as GST, etc. It means, in the case of Direct Tax, tax is recovered directly from the assessee, who ultimately bears such taxes, whereas in the case of Indirect Tax, tax is recovered from the assessee, who passes such burden to another person & is ultimately borne by consumers of such goods or services.

### *Difference between direct taxes and Indirect Tax*

Direct taxation is defined as the tax which is directly levied on the citizens of a country. All individuals and business concerns have to pay direct taxes to the government on a regular basis. These direct taxes are calculated on every sources of income that accrues to the business of individual. On the other hand, the citizens of a country are charged certain levies indirectly as well. These indirect levies are known as indirect taxes. These are the taxes payable on an activity or a commodity. Tax is collected at the time of sale or purchases or rendering of services. Some common examples of indirect taxes are sales tax and excise tax.

### Importance of Income Tax

The importance of income tax is enumerated as below:

1. Income tax is the prime source of fund to the government.
2. It helps in removing inequalities of income levels among people.
3. It helps in eradication of poverty, as the government spends the amount collected through Income tax, for welfare of poor people.

### Principles of Income Tax

The "tax net" refers to the types of payment that are taxed, which included personal earnings (wages), capital gains, and business income. The rates for different types of income may vary and some may not be taxed at all. Capital gains may be taxed when realised (e.g. when

## Notes

shares are sold) or when incurred (e.g. when shares appreciate in value). Business income may only be taxed if it is significant or based on the manner in which it is paid. Some types of income, such as interest on bank savings, may be considered as personal earnings (similar to wages) or as a realised property gain (similar to selling shares). In some tax systems, personal earnings may be strictly defined where labour, skill, or investment is required (e.g. wages); in others, they may be defined broadly to include windfalls (e.g. gambling wins).

Tax rates may be progressive, regressive, or flat. A progressive tax taxes differentially based on how much has been earned. A tax system may use different taxation methods for different types of income. However, the idea of a progressive income tax has garnered support from economists and political scientists of many different ideologies, from Adam Smith in the *Wealth of Nations* to Karl Marx in the *Communist Manifesto*.

Personal income tax is often collected on a pay-as-you-earn basis, with small corrections made soon after the end of the tax year. These corrections take one of two forms: payments to the government, for taxpayers who have not paid enough during the tax year; and tax refunds from the government for those who have overpaid. Income tax systems will often have deductions available that lessen the total tax liability by reducing total taxable income. They may allow losses from one type of income to be counted against another. For example, a loss on the stock market may be deducted against taxes paid on wages. Other tax systems may isolate the loss, such that business losses can only be deducted against business tax by carrying forward the loss to later tax years.

## 2.5 Overview of Income Tax Law in India

Income tax is a tax levied on the total income of the previous year of every person. A person includes an individual, Hindu Undivided Family (HUF), Association of Persons (AOP), Body of Individuals (BOI), a firm, a company etc. Income tax is the most significant direct tax. The income tax law in India consists of the following components is shown in Figure 2.1.

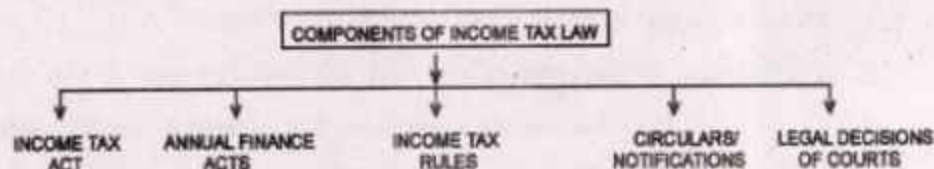


Figure 2.1. Components of Income Tax Law

The various instruments of law containing the law relating to income tax are explained below:

1. **Income tax Act:** The levy pay in India is governed by the Income tax Act, 1961. This Act came into force on 1st April, 1962. The Act contains 298 sections and XIV



schedules. These undergo change every year with additions and deletions brought about by the Finance Act passed by Parliament. In pursuance of the power given by the Income tax Act, 1961 rules have been framed to facilitate proper administration of the Income tax Act.

## Notes

2. **Finance Act:** Every year, the Finance Minister of the Government of India presents the Budget to the Parliament. Part A of the budget speech contains the proposed policies of the Government in fiscal areas. Part B of the budget speech contains the detailed tax proposals. In order to implement the above proposals, the Finance Bill is introduced in the Parliament. Once the Finance Bill is approved by the Parliament and gets the assent of the President, it becomes the Finance Act.
3. **Income tax Rules:** The administration of direct taxes is looked after by the Central Board of Direct Taxes (CBDT). The CBDT is empowered to make rules for carrying out the purposes of the Act. For the proper administration of the Income tax Act, the CBDT frames rules from time to time. These rules are collectively called Income tax Rules, 1962. It is important to keep in mind that along with the Income tax Act, 1961, these rules should also be studied.
4. **Circulars and Notifications:** Circulars are issued by the CBDT from time to time to deal with certain specific problems and to clarify doubts regarding the scope and meaning of the provisions. These circulars are issued for the guidance of the officers and/or assesses. The department is bound by the circulars. While such circulars are not binding the assesses they can take advantage of beneficial circulars.
5. **Case Laws:** The study of case laws is an important and unavoidable part of the study of income tax law. It is not possible for Parliament to conceive and provide for all possible issues that may arise in the implementation of any Act. Hence the judiciary will hear the disputes between the assesses and the department and give decisions on various issues. The Supreme Court is the Apex Court of the country and the law laid down by the Supreme Court is the law of the land. The decisions given by various High Courts will apply in the respective states in which such High Courts have jurisdiction.

## 2.6 Basic Concepts of Income Tax

Section 2 of the Act gives definitions of the various terms and expressions used therein. In order to understand the provisions of the Act, one must have a thorough knowledge of the meanings of certain key terms like 'person', 'assessee', 'income', etc. To understand the meanings of these terms we have to first check whether they are defined in the Act itself. If



## Notes

a particular definition is given in the Act itself, we have to be guided by that definition. If a particular definition is not given in the Act, reference can be made to the General Clauses Act or dictionaries. Students should note this point carefully because certain terms like "dividend", "transfer", etc. have been given a wider meaning in the Income tax Act, 1961 than they are commonly understood.

Some of the important terms defined under section 2 are given below:

- (1) **Assessee [Section 2(7)]**: 'Assessee' means a person by whom any tax or any other sources of money is payable under this act, and includes:
  - (a) every person in respect of whom any proceedings under this act have been taken for the assessment.
    - (i) of his income or of the income of any other person in respect of which he is assessable; or
    - (ii) of the loss sustained by him or by such other person; or
    - (iii) of the amount of refund due to him or to such other person;
  - (b) every person who is deemed to be an assessee under any provision of this Act.
  - (c) every person who is deemed to be an assessee in default under any provisions of this act.
- (2) **Person [Section 2(31)]**: The definition of 'assessee' leads us to the definition of 'person' as the former is closely connected with the latter. The term 'person' is important from another point of view also viz.; the charge of income tax is on every 'person'.

The definition is inclusive i.e. a person includes,

- an individual,
- a Hindu Undivided Family (HUF),
- a company,
- a firm,
- an AOP or a BOI, whether incorporated or not,
- a local authority, and
- every artificial juridical person e.g., an idol or deity.

We may briefly consider some of the above seven categories of assessee each of which constitute a separate unit of assessment.

- (i) **Individual**: The term 'individual' means only a natural person, i.e., a human being. It includes both males and females. It also includes a minor or a person

of unsound mind. But the assessment in such a case may be made under section 161(1) on the guardian or manager of the minor or lunatic. In the case of deceased person, assessment would be made on the legal representative.

- (ii) **HUF:** Under the Income tax Act, a Hindu Undivided Family (HUF) is treated as a separate entity for the purpose of assessment. It is included in the definition of the term "person" under section 2(31). The levy of income tax is on "every person". Therefore, income tax is payable by a HUF. "Hindu undivided family" has not been defined under the Income tax Act. The expression is however defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and unmarried daughters. The relation of a HUF does not arise from a contract but arises from status.

A Hindu is born into a HUF. A male member continues to remain a member of the family until there is a partition of the family. After the partition, he ceases to be a member of one family. However, he becomes a member of another smaller family. A female member ceases to be a member of the HUF in which she was born, when she gets married. Thereafter, she becomes a member of the HUF of her husband. Some members of the HUF are called coparceners. They are related to each other and to the head of the family. HUF may contain many members, but members within four degrees including the head of the family (kartha) are called coparceners. A Hindu coparcenary includes those persons who acquire by birth an interest in the joint coparcenary property. Only the coparceners have a right to partition. A Jain undivided family would also be assessed as a HUF, as Jains are also governed by the laws as Hindus.

- (iii) **Company [Section 2(17)]:** For all purposes of the Act the term 'Company', has a much wider connotation than that under the Companies Act. Under the Act, the expression 'Company' means:

- (a) any Indian company as defined in section 2(26); or
- (b) any body corporate incorporated by or under the laws of a country outside India, i.e., any foreign company; or
- (c) any institution, association or body which is assessable or was assessed as a company for any assessment year under the Indian Income tax Act, 1922 or for any assessment year commencing on or before 1.4.1970 under the present Act;

or

## Notes

## Notes

(d) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the CBDT to be a company for such assessment years as may be specified in the CBDT's order.

(iv) **Firm:** The terms 'firm', 'partner' and 'partnership' have the same meanings as assigned to them in the Indian Partnership Act. In addition, the definitions also include the terms as they have been defined in the Limited Liability Partnership (LLP) Act, 2008. However, for income tax purposes a minor admitted to the benefits of an existing partnership would also be treated as partner. This is specified under section 2(23) of the Act. A partnership is the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all. The persons who have entered into partnership with one another are called individually 'partners' and collectively a 'firm'.

(v) **Association of Persons (AOP):** When persons combine together for promotion of joint enterprise they are assessable as an AOP when they do not in law constitute a partnership. In order to constitute an association, persons must join in a common purpose, common action and their object must be to produce income; it is not enough that the persons receive the income jointly. Co-heirs, co-legatees or co-donees joining together for a common purpose or action would be chargeable as an AOP.

**Body of Individuals (BOI):** It denotes the status of persons like executors or trustees who merely receive the income jointly and who may be assessable in like manner and to the same extent as the beneficiaries individually. Thus co-executors or co-trustees are assessable as a BOI as their title and interest are indivisible.

Income tax shall not be payable by an assessee in respect of the receipt of share of income by him from BOI and on which the tax has already been paid by such BOI.

(vi) **Local Authority:** The term means a municipal committee, district board, body of port commissioners or other authority legally entitled to or entrusted by the Government with the control or management of a municipal or local fund.

(vii) **Artificial Persons:** This category could cover every artificial juridical person not falling under other heads. An idol or deity would be assessable in the status of an artificial juridical person.



(3) **Income [Section 2(24)]:** Section 2(24) of the Act gives a statutory definition of income. This definition is inclusive and not exhaustive. Thus, it gives scope to include more items in the definition of income as circumstances may warrant. At present, the following items of receipts are included in income:

- Profits and gains.
- Dividends.
- Voluntary contributions received by a trust/institution created wholly or partly for charitable or religious purposes or by an association or institution referred to in section 10(21) or section (23C)(iii ad)/(iii ae)/(iv)/(v)/(vi)/(via) or an electoral trust—

Research association approved under Section 35(1) (ii)	10(21)
Universities and other educational institutions	10(23C) (iiiad) and (vi)
Hospitals and other medical institutions	10(23C) (iii ae) and (via)
Notified funds or institutions established for charitable purposes	10(23C) (iv)
Notified trusts or institutions established wholly for public religions and charitable purposes	10(23C) (v)
Electoral trust	138

- The value of any perquisite or profit in lieu of salary taxable under section 17.
- Any special allowance or benefit other than the perquisite included above, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.
- Any allowance granted to the assessee to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.
- The value of any benefit or perquisite whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company or by a relative of the director or such person and any sum paid by any such company in respect of any obligation which, but for such payment would have been payable by the director or other person aforesaid.

## Notes

- The value of any benefit or perquisite, whether convertible into money or not, which is obtained by any representative assessee mentioned under section 160(1) (iii) and (iv), or by any beneficiary or any amount paid by the representative assessee for the benefit of the beneficiary which the beneficiary would have ordinarily been required to pay.
- Deemed profits chargeable to tax under section 41 or section 59.
- Profits and gains of business or profession chargeable to tax under section 28.
- Any capital gains chargeable under section 45.
- The profits and gains of any insurance business carried on by Mutual Insurance Company or by a co-operative society, computed in accordance with Section 44 or any surplus taken to be such profits and gains by virtue of the provisions contained in the First Schedule to the Act.
- The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members.
- Any winnings from lotteries, cross-word puzzles, races including horse races, card games and other games of any sort or from gambling, or betting of any form or nature whatsoever. For this purpose.
- "Lottery" includes winnings, from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;
- "Card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode; in which people compete to win prizes or any other similar game.
- Any sum received by the assessee from his employees as contributions to any Provident Fund (PF) or superannuation fund or Employees State Insurance Fund (ESI) or any other fund for the welfare of such employees.
- Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy will constitute income.
- Any sum referred to clause (ya) of Section 28. Thus, any sum, whether received or receivable in cash or kind, under an agreement for not carrying out any activity in relation to any business; or not sharing any know-how, patent, copy right, trademark, licence, franchise, or any other business or commercial right of a similar nature, or information or technique likely to assist in the manufacture



or processing of goods or provision of services, shall be chargeable to income tax under the head "profits and gains of business or profession".

- Any sum of money or value of property referred to in section 56(2)(vii) or section 56(2)(viii).
- Any consideration received for issue of shares as exceeds the fair market value of shares referred to in section 56(2)(viib).

## Notes

(4) **Dividend [Section 2(22)]**: The term 'dividend' as used in the Act has a wider scope and meaning than under the general law. According to section 2(22) of the Act, the following receipts are deemed to be dividend:

- (a) ***Distribution of accumulated profits, entailing the release of company's assets***: Any distribution of accumulated profits, whether capitalised or not, by a company to its shareholders is dividend if it entails the release of all or any part of its assets. For example, if accumulated profits are distributed in cash it is dividend in the hands of the shareholders. Where accumulated profits are distributed in kind, for example by delivery of shares etc. entailing the release of company's assets, the market value of such shares on the date of such distribution is deemed dividend in the hands of the shareholder [section 2(22)(a)].
- (b) ***Distribution of debentures, deposit certificates and bonus shares to preference shareholders***: Any distribution to its shareholders by a company of debenture stock or deposit certificate in any form, whether with or without interest, and any distribution of bonus shares to preference shareholders to the extent to which the company possesses accumulated profits, whether capitalised or not, will be deemed as dividend. The market value of such bonus shares is taxable in the hands of the preference shareholder. In the case of debentures, debenture stock etc., their value is to be taken at the market rate and if there is no market rate they should be valued according to accepted principles of valuation [section 2(22)(b)].

Accumulated profits include all profits of the company up to the date of liquidation whether capitalised or not. But where liquidation is consequent to the compulsory acquisition of an undertaking by the Government or by any corporation owned or controlled by the Government, the accumulated profits do not include any profits of the company prior to the 3 successive previous years immediately preceding the previous year in which such acquisition took place subject to certain exceptions.



## Notes

**(5) India [Section 2(25A)]:** The term 'India' means:

- (i) the territory of India as per article 1 of the Constitution,
- (ii) its territorial waters, seabed and subsoil underlying such waters,
- (iii) continental shelf,
- (iv) exclusive economic zone, or
- (v) any other specified maritime zone and the air space above its territory and territorial waters.

Specified maritime zone means the maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and the Maritime Zones Act, 1976.

**(6) Assessment Year:** The term has been defined under section 2(9). This means a period of 12 months commencing on 1st April every year. The year in which tax is paid is called the assessment year while the year in respect of the income of which the tax is levied is called the previous year. Income of previous year of an assessee is taxed during the next following assessment year at the rates prescribed by the relevant Finance Act**(7) Previous Year [Section 3]:** It means the financial year immediately preceding the assessment year. The income earned during the previous year is taxed in the assessment year.

Business or profession newly set up during the financial year: In such a case, the previous year shall be the period beginning on the date of setting up of the business or profession and ending with 31st March of the said financial year.

If a source of income comes into existence in the said financial year, then the previous year will commence from the date on which the source of income newly comes into existence and will end with 31st March of the financial year.

Income earned by an individual during the previous year 2021-22 is taxable in the immediately following assessment year 2022-23 at the rates applicable for the assessment year 2022-23.

Similarly, income earned during the previous year 2022-23 by a company will be taxable in the assessment year 2023-24 at the rates applicable for the assessment year 2023-24.

**(8) Gross Total Income:** 'Gross Total Income' may be defined as the aggregate of income computed in accordance with the provisions of this act before making any deduction under Chapter-VI A of Income Tax Act, 1961.

(9) **Total Income:** Any assessee has to pay income tax on different types of income derived on the basis of residential status. As per section 45 of Income Tax Act, 1961 'Total Income' means, income shown in Section 5 of Income Tax Act, 1961:

- (a) Salary Income,
- (b) Income from House property,
- (c) Income from Business and Profession,
- (d) Capital gains, and
- (e) Income from other sources.

These five are also called as 'Heads of Income'. The income is determined under different sections. But some of the incomes which are exempted are not included in Total Income.

#### Comparison between Gross Total Income [GTI] Vs Total Income

Parameter of Comparison	Gross Total Income	Total Income
Meaning	Refers to income earned by an individual, or an entity from all the heads, before taxes or, other deductions are implied.	Total income is the income estimated after deductions under section 80 from Gross Total income have been subtracted.
Represents	Represents revenue generated, or income earned before the taxes and other deductions have been made.	On the other hand, total income represents the income on which tax liability is determined.
Importance	It is the aggregate of the incomes earned by all the heads, it denotes the deductions that are to be made.	Whereas, in the case of total income, it is necessary to calculate total income to ascertain an individual's tax liability as per his, or her income.
Formula	Gross total income = Total income (sum of all heads) + the deductions under Section 80 from Gross Total Income.	Total Income = Gross Total Income – Deductions under Section 80 from Gross Total Income.
Tax	Tax is not levied on gross total income.	Tax is levied on the total income.

#### Notes



## Notes

## 2.7 Agricultural Income

Agricultural income is defined in section 2(1A) to mean, inter alia, income derived from land which is situated in India and is used for agricultural purposes. Also the income from a farm house, except the income from non-agricultural activity, is agricultural income. Such agricultural income is exempt from tax under section 10(1). From the assessment year 2009-10, any income derived from saplings or seedlings grown in a nursery is agricultural income.

Agriculture income does not include fisheries and mines. Also on an agricultural land, the income from poultry farming, dairy farming and aquaculture are not agricultural income. According to Section 10 (1) of Income Tax Act, 1961, 'Agricultural Income' is exempted from tax. However, income from agricultural sources will be included in 'total income', to determine tax-liability. It is to remember that 'Agricultural-Income' comes under purview of respective state governments.

Section 2 (1) states that the following conditions are to be satisfied to that 'income' as 'agricultural income':

1. Income should be received from land.
  2. That 'Land' should be used for agricultural purpose.
  3. The said 'land' should be existing in India.
- 1. Income should be received from land:** Income received in the form of cash or agricultural produce from the lease holder to the land lord is treated as 'agricultural income'. If the leaseholder gives the land to sub-lease, such income is also treated as 'agricultural income'.
- Example:** 10 bags of paddy sold @ ` 500/- per bag. Income received in the form of rent or income received by the sale of agricultural products is also treated as 'agricultural income'.
2. **Land should be used for agricultural purpose:** Agricultural works can be categorised in to two types:
    - (a) Primary works or elementary works
    - (b) Ancillary works
  3. **Land must be situated in India:** Income received from agricultural land situated in countries other than India, can not be treated as agricultural income.

### Certain income which is treated as Agricultural Income

Following are the certain incomes which are treated as agricultural income:

- (a) Income from sale of replanted trees.
- (b) Rent received for agricultural land.



- (c) Income from growing flowers and creepers.
- (d) Share of profit of a partner from a firm engaged in agricultural operations.
- (e) Interest on capital received by a partner from a firm engaged in agricultural operations.
- (f) Income derived from sale of seeds.

## Notes

**Certain income which is not treated as Agricultural Income**

Following are the certain incomes which are not treated as agricultural income:

- (a) Income from poultry farming.
- (b) Income from bee hiving.
- (c) Income from sale of spontaneously grown trees.
- (d) Income from dairy farming.
- (e) Purchase of standing crop.
- (f) Dividend paid by a company out of its agriculture income.
- (g) Income of salt produced by flooding the land with sea water.
- (h) Royalty income from mines.
- (i) Income from butter and cheese making.
- (j) Receipts from TV serial shooting in farm house are not agriculture income.

**Partly Agriculture Income**

Partly agricultural income consists of both the element of agriculture and business, so non-agricultural part of the income is taxed. Some examples for partly agricultural income are given below:

1. **Profit of business other than Tea:** This rule applicable to agricultural produce like cotton, tobacco, sugarcane, etc., here the market value of the agricultural produce raised by the Assessee for utilizing it as raw material for his business will be deducted out of the total profit of such Assessee while calculating tax on his income.
2. **Profit from Tea manufacturing:** If a person using his own tea leaves grown by him for his tea manufacturing business, then 60% of his income will be treated as agricultural income and the remaining 40 % will be treated as business income. So he has to pay tax on that remaining 40% of income.
3. **Income from the manufacturing of Centrifuged Latex or Cenex:** If a person manufacturing centrifuged latex by using his own made raw then, 65 % of the

income derived from the sale of the same is treated as agricultural income so he has to pay tax remaining part of the income.

#### 4. Income from the coffee manufacturing:

- 75% of the income derived from the sale of coffee grown and cured by the seller in India is deemed to be agricultural income 25% is taken as business income.
- 5% the income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India is deemed to be agricultural income 40% is taken as business income.

### Notes

#### Illustration 1

Mr. Ramsanth had estates in Rubber, tea and coffee. He derives income from them. He furnishes the following particulars of his income for the year ending 31-3-2021. Manufacture of rubber ₹ 5,00,000 Manufacture of coffee grown and cured ₹ 3,50,000 Manufacture of tea ₹ 7,00,000 Compute taxable income of Ramsanth for the A.Y. 2021-22.

#### Solution:

##### Computation of Taxable income for the A.Y. 2021-22:

Manufacture of rubber ( 35% is non-agricultural income)	175,000
Manufacturing of Coffee (25% is non-agricultural income)	87,500
Manufacturing of tea ( 40% is non-agricultural income)	2,80,000
Taxable Income	5,42,500

#### Illustration 2

X Ltd. grows sugarcane to manufacture sugar. Details for the previous year 2021-22 are as follows:

Particulars	₹ in lacs.
Cost of cultivation of sugarcane (5,000 tons)	10
Sugarcane sold in market (1,000 tons)	3
Sugarcane used for sugar manufacturing (4,000 tons)	—
Cost of conversion	5
Sugar produced & sold in market	25

Compute income of X Ltd.

## Computation of income of X Ltd. for the A.Y. 2021-22

₹ in lacs

Particulars	Manufacturing	Agriculture
Sale of agro product in market	—	3
Sale of manufactured product in market	25	—
Notional sale of agro product used in the process of manufacturing (4,000 ton * ₹ 3 lacs per 1000 ton)	—	12
Revenue [A]	25	15
Less: Expenses incurred		
Cost of conversion	5	—
Market value of sugarcane used (4,000 ton * ₹ 3 lacs per 1000 ton)	12	—
Cost of cultivation	—	10
Expenditure [B]	17	10
Income [A – B]	8	5

Notes

**Assessment of Agricultural Income**

Agricultural income is totally exempt from income tax. However, the agricultural income is integrated with non agricultural income in certain cases of assesses. The integration is done where assessee has both agricultural and non agricultural income. For the assessment of agricultural income both agricultural and non agricultural income of an assessee is determined as per the various rules prescribed by the income tax Act.

**Computation of Agricultural Income**

Agricultural income of an assessee can be computed as per the rules given below.

1. Rent or revenue derived from agricultural land will be computed on the same basis as is adopted for the computation of income under the head income from other sources
2. Income derived from agricultural house property is computed as if it were income chargeable to income tax under the head income from house property
3. Income derived from agricultural operations is computed as if it were income chargeable to income tax under the head profit or gains from business or profession.



## Notes

4. Loss incurred in agriculture will be allowed to be set off only against gains from agriculture.
5. Any sum payable to the government in the form of tax charged by the state government on agriculture will be allowed as a deduction.

### Method of Integration

1. Net agricultural income is integrated with non agricultural income.
2. Income tax is calculated on this integrated income at the rates prevailing each assessment year.
3. Then income tax will be calculated on the net agricultural income as increased by an amount of ₹ 250000 or 300000 or ₹ 500000 as the case maybe.
4. Income tax calculated under 3 above is deducted from the income tax calculated 2 above.

### Impact of Agricultural Income on Tax Computation

Sec. 10(1) of the Act exempts agricultural income from tax as our Constitution does not provide power to the Parliament to levy tax on agro-income. However, since 1973 an indirect method has been found, to levy tax on agro-income. According to this method, agricultural income is included in the total income of the assessee for deciding the tax slab of the assessee. The way to apply higher rate of tax-slab on non-agricultural income by including agricultural income in the total income of the assessee are as under:

Conditions for including agricultural income in the total income of the assessee

1. The assessee is an individual, a Hindu-undivided family, a body of individual, an association of person or an artificial juridical person.
2. The assessee has non-agricultural income exceeding the maximum amount of exemption (i.e. in case of Senior citizen ₹ 3,00,000, Super Senior citizen ₹ 5,00,000 and in case of other Individual/ HUF/AOP/BOI/artificial juridical person ₹ 2,50,000)
3. The agricultural income of the assessee exceeds ₹ 5,000.

### Treatment

**Step 1:** Compute income tax on total income of assessee including Agro-income.

**Step 2:** Compute income tax on (Agro-income + Maximum exempted limit)

**Step 3:** Tax liability before cess = (Tax as per step 1) - (Tax as per step 2)

### Illustration 3

### Income Tax

Mr. X aged 42 years has non-agro income of ₹ 3,25,000 and agro income of ₹ 2,55,000. Compute his tax liability for the A.Y. 2021-22.

#### Solution:

Computation of tax liability of Mr. X for the A.Y. 2021-22

Particulars	₹
Income Tax on ₹ 5,80,000 (i.e. agro income ₹ 2,55,000 + non agro ₹ 3,25,000)	28,500
Less: Tax on ₹ 5,05,000 (i.e. agro income ₹ 2,55,000 + maximum exempted limit ₹ 2,50,000)	13,500
Tax liability	15,000
Less: Rebate u/s 87A	12,500
	2,500
Add: Health & Education Cess (4% of ₹ 2,500)	100
Tax and cess payable (Rounded off u/s 288B)	2600

Note: 1 - Calculation of income tax on 5,80,000

First ₹ 250000	nil
Next ₹ 250000 @5%	12500
Next ₹ 80000 @ 20%	16000
	<b>28500</b>

Note 2 Calculation of income tax on 5,05,000

First ₹ 250000	nil
Next ₹ 250000 @5%	12500
Next ₹ 5000 @ 20% 1000	<b>13500</b>

### Casual Income

Any receipt which is of a casual and non-recurring nature is called casual income. Casual income includes the following receipts:

1. Winning from lotteries,
2. Winning from crossword puzzles,
3. Winning from races (including horse races),
4. Winning from card games and other games of any sort,
5. Winning from gambling or betting of any form or nature.

### Capital and Revenue Receipts and Expenditure

Receipts which are non-recurring (not received again and again) by nature and whose benefit is enjoyed over a long period are called "Capital Receipts", e.g. money brought into

### Notes

## Notes

the business by the owner (capital invested), loan from bank, sale proceeds of fixed assets etc. Capital receipt is shown on the liabilities side of the Balance Sheet. receipts which are recurring (received again and again) by nature and which are available for meeting all day to day expenses (revenue expenditure) of a business concern are known as "Revenue receipts", e.g. sale proceeds of goods, interest received, commission received, rent received, dividend received etc.

**Distinction between Capital Receipt and Revenue Receipt**

No.	Revenue receipt	Capital receipt
1.	It has short-term effect. The benefit is enjoyed within one accounting period.	It has long-term effect. The benefit is enjoyed for many years in future.
2.	It occurs repeatedly. It is recurring and Regular in nature.	It does not occur again and again. It is Non recurring and irregular in nature.
3.	It is shown in profit and loss account on the credit side.	It is shown in the Balance Sheet on the liability side.
4.	It does not produce capital receipt.	Capital receipt, when invested, produces revenue receipt e.g. when capital is invested by the owner, business gets revenue receipt (i.e. sale proceeds of goods etc.).
5.	This does not increase or decrease the value of asset or liability.	The capital receipt decreases the value of asset or increases the value of liability e.g. sale of a fixed asset, loan from bank etc.
6.	Sometimes, expenses of capital nature are to be incurred for revenue receipt, e.g., purchase of shares of a company is capital expenditure but dividend received on shares is a revenue receipt.	Sometimes expenses of revenue nature are to be incurred for such receipt e.g. on obtaining loan (a capital receipt) interest is paid until its repayment.

**Difference between Capital Expenditure and Revenue Expenditure**

No.	Revenue expenditure	Capital expenditure
1.	Its effect is temporary, i.e. the benefit is received within the accounting year.	Its effect is long-term, i.e. it is not exhausted within the current accounting year-its benefit is received for a number of years in future.
2.	Neither an asset is acquired nor is the value of an asset increased.	An asset is acquired or the value of an existing asset is increased.



3.	It has no physical existence because it is incurred on items which are used by the business.	Generally it has physical existence except intangible assets.
4.	It is recurring and regular and it occurs repeatedly.	It does not occur again and again. It is Non recurring and irregular.
5.	This expenditure helps to maintain the business.	This expenditure improves the position of the business.
6.	The whole amount of this expenditure is shown in trading P & L A/c or income statement.	A portion of this expenditure (depreciation on assets) is shown in trading & P & L A/c and the balance are shown in the balance sheet on asset side.
7.	It does not appear in the balance sheet.	It appears in the balance sheet until its benefit is fully exhausted.
8.	It reduces revenue (profit) of the business. It does not reduce the revenue of the concern.	

### Exempted Income

#### Income Which Do Not Form Part of Total Income

Sec. 10 enlists the various income which are exempt from tax i.e. does not form part of total income of the assessee. These are –

##### *Agricultural Income [Sec. 10(1)]*

Fully exempted

##### *Member's Share in Income of HUF [Sec. 10(2)]*

Any sum received by an individual as a member of a Hindu undivided family–

- Where such sum has been received out of the income of the family; or
- Where such sum has been received out of the income of an impartibly estate belonging to the family.

##### *Share of Profit from a Firm [Sec. 10(2A)]*

Share in the total income of the firm is exempt in the hands of partner.

##### *Interest Income of Non-resident [Sec. 10(4)/(4B)]*

- Interest on specified securities or bonds, including premium on redemption of such bonds is exempted in the hands of a non-resident [Sec. 10(4)(i)]

Notes

- Interest on Non-Resident (External) Account in any bank in India to a person who is a resident outside India as per as defined in sec. 2(w) of the Foreign Exchange Management Act, 1999 or is a person who has been permitted by the Reserve Bank of India to maintain the aforesaid Account
- Interest on notified savings certificates issued before 1-6-2002 by the Central Government to a non resident, being a citizen of India or a person of Indian origin [Sec. 10(4B)]

***Leave Travel Concession [Sec. 10(5)]***

Refer chapter Salaries.

***Remuneration to Person who is not a Citizen of India in certain cases [Sec. 10(6)]***

Following remuneration to an individual who is not a citizen of India shall be exempt –

- Remuneration received by him as an official of an embassy, high commission, legation, commission, consulate, or the trade representation of a foreign state or as a staff of any of these officials provided corresponding Indian officials in that foreign country enjoy similar exemptions in their country - Sec. 10(6)(ii).
- Remuneration received as an employee of a foreign enterprise for services rendered by him during his stay in India provided
  - (a) the foreign enterprise is not engaged in any business or profession in India;
  - (b) his stay in India does not exceed 90 days in aggregate; and c) such remuneration is not liable to be deducted from the income of the employer under this Act - Sec. 10(6)(vi)
- Remuneration for services rendered in connection with his employment on a foreign ship provided his total stay in India does not exceed 90 days in the previous year - Sec. 10(6)(viii)
- Remuneration received as an employee of the Government of a foreign State during his stay in India in connection with his training in any undertaking owned by Government, Government company, subsidiary of a Government company, corporation established by any Central, State or Provincial Act and any society wholly financed by the Central or State Government – Sec. 10(6)(xi)

***Tax paid by Government on Royalty or Fees for Technical Service [Sec. 10(6A)]***

Income Tax

***Tax paid by Government on Income of a Non-resident or a Foreign Company [Sec. 10(6B)]***

Notes

***Tax paid on Income from Leasing of Aircraft [Sec. 10(6BB)]***

Tax paid by an Indian company on income arising from leasing of aircraft, etc. to the Government of a foreign state or foreign enterprise under an approved agreement entered into with such Indian company engaged in the business of operation of aircraft, provided such agreement was entered into between 1-4-1997 and 31-3-1999 or after 31-3-2007.

***Fees for Technical Services in Project connected with Security of India [Sec. 10(6C)]***

Any income arising to notified foreign company by way of royalty or fees for technical services received in pursuance of an agreement entered into with Central Government for providing services in or outside India in projects connected with security of India.

***Income from service provided to National Technical Research Organization [Sec. 10(6D)]***

Any income arising to a non-resident or to a foreign company, by way of royalty from, or fees for technical services rendered in or outside India to, the National Technical Research Organization. Allowance or Perquisite paid Outside India [Sec. 10(7)] Any allowance or perquisite paid outside India by the Government to a citizen of India for rendering services outside India.

Remuneration received for Co-operative Technical Assistance Programmes with an Agreement entered into by the Central Government in certain cases [Sec. 10(8)] Remuneration received by Non-resident Consultant or Employee or Family Member of such Consultant [Sec. 10(8A), (8B) & (9)]

***Death-cum-retirement-gratuity [Sec. 10(10)]***

Explained under the head salaries

***Commutation of Pension [Sec. 10(10A)]***

Explained under the head salaries



**Leave Encashment [Sec. 10(10AA)]**

Explained under the head salaries

**Notes****Workmen's Retrenchment Compensation [Sec. 10(10B)]**

Explained under the head salaries

**Compensation under Bhopal Gas Leak Disaster Act, 1985 [Sec. 10(10BB)]**

Compensation received by victims of Bhopal gas leak disaster is fully exempted

**Compensation for any Disaster [Sec. 10(10BC)]**

Any amount received or receivable from the Central Government or a State Government or a local authority by an individual or his legal heir by way of compensation on account of any disaster, except the amount received or receivable to the extent such individual or his legal heir has been allowed a deduction under this Act on account of any loss or damage caused by such disaster.

**Payment under Voluntary Retirement Scheme [Sec. 10(10C)]**

VRS compensation is not eligible for section 89(1) relief. (Explained under the head salaries)

**Tax paid by Employer on behalf of Employee on Nonmonetary Perquisites u/s 17(2) [Sec. 10(10CC)]**

Explained under the head Salaries.

**Sum received under a Life Insurance Policy [Sec. 10(10D)]**

Any sum received under a life insurance policy including bonus on such policy is wholly exempt from tax. However, exemption is not available on

- (1) any sum received u/s 80DD(3) or u/s 80DDA(3); or
- (2) any sum received under a Keyman insurance policy; or
- (3) any sum received under an insurance policy issued on or after 1-4-2012 in respect of which the premium payable for any of the years during the term of the policy exceeds 10% of the actual capital sum assured.

**Payment from Statutory or Public Provident Fund [Sec. 10(11)]**

Amount withdrawn from the statutory provident fund is fully exempted.

**Payment from Sukanya Samriddhi Account [Sec.10(11A)]**

Any payment from an account, opened in accordance with the Sukanya Samriddhi Account Rules, 2014 made under the Government Savings Bank Act, 1873.

**Payment from Recognized Provident Fund [Sec.10(12)]**

Fully exempted

**Payment from National Pension Trust [Sec. 10(12A) & 10(12B)]**

Any payment from the National Pension System Trust to an assessee on closure of his account or on his opting out of the pension scheme referred to in sec. 80CCD, to the extent it does not exceed 40% of the total amount payable to him at the time of such closure or his opting out of the scheme [Sec. 10(12A)] Any payment from the National Pension System Trust to an employee under the pension scheme referred to in sec. 80CCD, on partial withdrawal made out of his account in accordance with the terms and conditions, specified under the Pension Fund Regulatory and Development Authority Act, 2013, to the extent it does not exceed 25% of the amount of contributions made by him [Sec. 10(12B)]

**Payment from Approved Superannuation Fund [Sec. 10(13)]**

Any payment from an approved superannuation fund made

- on the death of a beneficiary; or
- to an employee in lieu of or in commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement; or
- by way of refund of contributions on the death of a beneficiary; or
- by way of refund of contributions to an employee on his leaving the service (otherwise than by retirement at or after a specified age or on his becoming incapacitated prior to such retirement) to the extent to which such payment does not exceed the contributions made prior to 1-4-1962 and any interest thereon.
- by way of transfer to the account of the employee under a pension scheme referred to in sec. 80CCD and notified by the Central Government

**House Rent Allowance [Sec. 10(13A)]**

Explained under the head Salaries.

## Notes

Any special allowance or benefit but not a perquisite is specially granted to meet certain expenditure incurred during employment. In this case actual expenditure incurred will be exempted on the fulfillment of certain condition mentioned in this section.

**Notes****Interest on Securities [Sec. 10(15)]**

- (1) Interest, premium on redemption or other payment on notified securities, bonds or certificates
- (2) Interest in the hands of an individual and Hindu undivided family on Specified Capital Investment Bonds or Specified Relief Bonds
- (3) Interest on specified bonds to non resident or his nominees if such bonds are purchased by a non resident Indian in foreign exchange; and
- (4) The interest and principal received in respect of such bonds, whether on their maturity or otherwise, is not allowable to be taken out of India. Interest on securities held by the Issue Department of the Central Bank of Ceylon;
- (5) Interest payable to any bank incorporated in a country outside India and authorized to perform central banking functions in that country on any deposits made by it, with the approval of the RBI, with any scheduled bank;
- (6) Interest payable on a loan advanced by the Nordic Investment Bank for an approved project;
- (7) Interest payable to the European Investment Bank for financial co-operation agreement;
- (8) Interest payable by a Government, local authority, certain industrial undertakings or financial institution on money borrowed before 1/6/2001.
- (9) Interest on securities held by the Welfare Commissioner, Bhopal Gas Victims or deposits for the benefit of the victims of the Bhopal gas leak disaster.
- (10) Interest on Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetization Scheme, 2015.
- (11) Interest on specified bonds issued by a local authority or by a State Pooled Finance Entity.
- (12) Interest received by a non-resident or a person who is not ordinarily resident, in India on a deposit made on or after 1-4-2005 in an offshore banking unit referred in the Special Economic Zones Act, 2005.



### ***Scholarship [Sec. 10(16)]***

Income Tax

Scholarships granted to meet the cost of education.

Notes:

- (a) Cost of education also includes incidental expenses incurred for education.
- (b) The exemption is irrespective of actual expenditure.

Notes

### ***Daily Allowance, etc. to MP and MLA [Sec. 10(17)]***

Any income by way of

- (a) Daily allowance received by any person by reason of his membership of Parliament or of any State Legislature or of any Committee thereof;
- (b) Any allowance received by any person by reason of his membership of Parliament;
- (c) Constituency Allowance received by any person by reason of his membership of State legislature;

### ***Awards and Rewards [Sec. 10(17A)]***

Any payment made, whether in cash or in kind

- (a) in pursuance of any award instituted in the public interest by the Central Government or any State Government or by any other approved body; or
- (b) as a reward by the Central Government or any State Government for approved purposes.

### ***Pension to receiver of Gallantry Awards [Sec. 10(18)]***

Any income by way of

- (a) pension received by an individual who has been in the service of the Central or State Government and has been awarded "Param Vir Chakra" or "Maha Vir Chakra" or "Vir Chakra" or such other notified gallantry award ; or
- (b) family pension received by any member of the family of such individual.

### ***Family Pension to Widow or Children of Armed Force[Sec. 10(19)]***

Family pension received by the widow or children or nominated heirs, of a member of the armed forces (including para-military forces) of the Union, where the death of such member has occurred in the course of operational duties, in such circumstances and subject to such conditions, as may be prescribed.

**Palace of Ex-ruler [Sec. 10(19A)]**

The annual value in respect of any one palace, which is in the occupation of an ex-ruler

**Notes****Income of Local Authority [Sec. 10(20)]**

Following income of a local authority is exempt

- (a) Income chargeable under the head Income from House Property, Capital Gains or Income from other Sources
- (b) Income from the supply of commodities (other than water or electricity) or services, within its own jurisdiction
- (c) Income from the supply of water services or electricity within or outside its jurisdiction

**Income of Scientific Research Association [Sec. 10(21)]**

Any income of a scientific research association [being approved for the purpose of Sec. 35(1)(ii)] or research association which has its object, undertaking research in social science or statistical research [being approved and notified for the purpose of Sec. 35(1)(iii)], is exempt provided such association—

- (a) applies its income, or accumulates it for application, wholly and exclusively to the objects for which it is established; and
- (b) invest or deposit its funds in specified investments.

**Income of News Agency [Sec. 10(22B)]**

Any income of specified news agency (Press Trust of India Ltd., New Delhi) set up in India solely for collection and distribution of news shall be exempt provided:

- (a) The news agency applies its income or accumulates it for application solely for collection and distribution of news; and
- (b) It does not distribute its income in any manner to its members.

**Income of Professional Institutions [Sec. 10(23A)]**

Any income (other than income chargeable under the head "Income from house property" or any income received for rendering any specific services or income by way of interest or dividends derived from its investments) of professional association shall be exempt provided.

- (a) Such association or institution is established in India having as its object the control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or other specified profession;
- (b) Such association or institution applies its income, or accumulates it for application, solely to the objects for which it is established; and
- (c) The association or institution is approved by the Central Government.

***Income of Regimental Fund [Sec. 10(23AA)]***

Any income received by any person on behalf of any Regimental Fund or Non-public Fund established by the armed forces of the Union for the welfare of the past and present members of such forces or their dependants is exempt.

***Income of specified Employee Welfare Fund [Sec.10(23AAA)]***

***Income of specified Pension Fund [Sec. 10(23AAB)]***

***Income of trust for Development of Khadi and Village Industries [Sec. 10(23B)]***

***Income of Khadi and Village Industries Boards [Sec. 10(23BB)]***

***Income of body formed for Administration of Public Religious or Charitable Trusts [Sec. 10(23BBA)]***

Any income of anybody established under any Central, State or Provincial Act which provides for the administration of any public, religious or charitable trusts or endowments including Maths, Temples, Gurudwaras, Wakfs, Churches or other places of public religious worship or societies for religious or charitable purposes.

***Income of European Economic Community [Sec.10(23BBB)]***

***Income of SAARC Fund [Sec. 10(23BBC)]***

***Income of ASOSAI-SECRETARIAT [Sec. 10(23BBD)]***

***Income of Insurance Regulatory Authority [Sec.10(23BBE)]***

***Income of the Central Electricity Regulatory Commission [Sec. 10(23BBG)]***

***Income of the Prasar Bharati (Broadcasting Corporation of India) [Sec. 10(23BBH)]***



**Income of Certain Funds [Sec. 10(23C)]**

Any income received by any person on behalf of

**Notes**

1. The Prime Minister's National Relief Fund; [sec. 10(23C)(i)]
2. The Prime Minister's Fund (Promotion of Folk Art); [sec. 10(23C)(ii)]
3. The Prime Minister's Aid to Students Fund; [sec. 10(23C)(iii)]
4. The National Foundation for Communal Harmony; [sec. 10(23C)(iia)]
5. The Swachh Bharat Kosh; [sec. 10(23C)(iiia)]
6. The Clean Ganga Fund; [sec. 10(23C)(iiiaa)]
7. The Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund; [sec. 10(23C)(iiiaaa)]
8. Any other charitable fund or institution notified by the prescribed authority (subject to condition) [sec. 10(23C)(iv)]
9. Any trust or institution wholly for public religious purposes or wholly for public religious and charitable purposes notified by the prescribed authority (subject to conditions) [sec. 10(23C)(v)]
10. Any university or other education institutions, (wholly or substantially financed by Government or having annual receipt upto Rs. 1 crore) existing solely for education purposes and not for profit. [sec. 10(23C)(iiia), (iiiaa) (vi)].
11. Any hospital or other institution (wholly or substantially financed by Government or having annual receipt up to Rs. 1 crore) for treatment of person suffering from illness or mental defectiveness or during convalescence or requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for profit. [sec. 10(23C)(iiiaa), (iiiaa) and (via)].

**Income of Mutual Fund [Sec. 10(23D)]**

Any income of

- (a) A Mutual Fund registered under the Securities and Exchange Board of India Act, 1992 or regulation made there under;
- (b) A Mutual Fund set up by a public sector bank or a public financial institution or authorized by the Reserve Bank of India and subject to certain notified conditions.

**Income of Securitization Trust [Sec. 10(23DA)]**

Any income of a securitization trust from the activity of securitization.

- "Securitization" shall have the same meaning as assigned to it,
  - (a) in regulation 2(1)(r) of the Securities and Exchange Board of India (Public Offer and Listing of Securitized Debt Instruments) Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 and the Securities Contracts (Regulation) Act, 1956; or
  - (b) in clause (z) of sub-section (1) of section 2 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; or
  - (c) under the guidelines on securitization of standard assets issued by the Reserve Bank of India;
- "Securitization trust" shall have the meaning assigned to it in the Explanation below sec. 115TCA

***Income of Investor Protection Fund [Sec. 10(23EA)]***

Income (by way of contribution received from recognized Stock exchange and members thereof) of Investor Protection Fund set up by the recognized Stock Exchanges in India as the Central Government may by notification in Official Gazette specify shall be exempt.

***Income of Investor Protection Fund set up by Commodity Exchange [Sec. 10(23EC)]***

***Income of Investor Protection Fund of Depositories [Sec. 10(23ED)]***

Any income, by way of contributions received from a depository, of notified Investor Protection Fund set up in accordance with the regulations by a depository.

However, where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part with a depository, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall, accordingly, be chargeable to income-tax.

***Income of Core Settlement Guarantee Fund [Sec. 10(23EE)]***

Any specified income of such Core Settlement Guarantee Fund, set up by a recognized clearing corporation in accordance with the regulations notified by the Central Government.

However where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part with the specified



## Notes

person, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared.

***Income of Ventures Capital Fund or Venture Capital Company [Sec 10(23FB)]***

Any income of a venture capital company or venture capital fund from investment in a venture capital undertaking.

However, w.e.f. A.Y. 2016-17, the exemption is not applicable to any income of a venture capital company or venture capital fund, being an investment fund specified in clause (a) of the Explanation 1 to sec. 115UB

***Non-business income of Investment Fund [Sec.10(23FBA)]***

Any income of an investment fund other than the income chargeable under the head "Profits and gains of business or profession".

***Income of Unit holder [Sec. 10(23FBB)]***

Any income, referred to in sec. 115UB, to a unit holder of an investment fund, being that proportion of income which is of the same nature as income chargeable under the head "Profits and gains of business or profession".

- For the purposes of sec. 10(23FBA) and (23FBB), "investment fund" shall have the meaning assigned to it in clause (a) of the Explanation 1 to sec. 115UB.

***Income of Business Trust [Sec 10(23FC)]***

Any income of a business trust by way of

- (a) interest received or receivable from a special purpose vehicle; or
- (b) dividend referred to in sec. 115-O(7)

- "Special purpose vehicle" means an Indian company in which the business trust holds controlling interest and any specific percentage of shareholding or interest, as may be required by the regulations under which such trust is granted registration.

***Income of Real Estate Investment Trust [Sec. 10(23FCA)]***

Any income of a business trust, being a real estate investment trust, by way of renting or leasing or letting out any real estate asset owned directly by such business trust.

***Distributed Income to unit holder of a Business Trust [Sec 10(23FD)]***

Any distributed income, referred to in section 115UA, received by a unit holder from the business trust, not being that proportion of the income which is of the same nature as the income referred to in 10(23FC)(a) or 10(23FCA)



### ***Income of Trade Union [Sec. 10(24)]***

### ***Income Tax***

Any income chargeable under the heads "Income from house property" and "Income from other sources" of –

### **Notes**

- (a) a registered union within the meaning of the Indian Trade Unions Act, 1926, formed primarily for the purpose of regulating the relations between workmen and employers or between workmen and workmen.
- (b) an association of registered unions

### ***Income of specified Provident Funds, etc. (e.g. RPF,***

### ***Superannuation fund, Approved gratuity fund) [Sec. 10(25)]***

### ***Income of Employees' State Insurance Fund [Sec. 10(25A)] Income of Scheduled Tribe [Sec. 10(26)]***

Following income of member of a Scheduled Tribe is exempt

- (a) from any source in specified areas or States; or
- (b) by way of dividend or interest on any securities.
- (c) provided he resides in specified area or States.

### ***Income of Sikkimese [Sec. 10(26AAA)]***

Following income of an individual, being a Sikkimese, is exempt:

- (i) from any source in the State of Sikkim; or
- (ii) by way of dividend or interest on securities:

**Note:** The exemption is not available to a Sikkimese woman who, on or after 1/4/2008, marries an individual who is not a Sikkimese. Income of an Agricultural produce Market

### ***Committee [Sec. 10(26AAB)]***

Income of an agricultural produce market committee or board constituted under any law for the time being in force for the purpose of regulating the marketing of agricultural produce is exempt.

### ***Income of Corporation for promoting the Interests of the Members of the Scheduled Castes or the Scheduled Tribe or Backward Classes [Sec. 10(26B)]***

### ***Income of Corporation for promoting Interest of Members of a Minority Community [Sec. 10(26BB)]***

***Income of Corporation for the Welfare and Economic Upliftment of Ex-servicemen [Sec. 10(26BBB)]***

## Notes

***Income of a Co-operative Society for promoting the Interests of the Members of Scheduled Castes or Scheduled Tribes [Sec. 10(27)]***

***Income of specified Boards [Sec. 10(29A)]***

Any income accruing or arising to The Coffee Board; The Rubber Board; The Tea Board; The Tobacco Board; The Marine Products Export Development Authority; The Coir Board; The Agricultural and Processed Food Products Export Development Authority and The Spices Board.

***Subsidy received from Tea Board [Sec. 10(30)]***

Any subsidy received from or through the Tea Board under any scheme for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea as the Central Government may specify, is exempt

***Subsidy received from other Board [Sec. 10(31)]***

Any subsidy received from or through the concerned Board (like Coffee Boards, Rubber Board, etc.) under any such scheme for replantation or replacement of rubber plants, coffee plants, cardamom plants or plants for the growing of such other commodity or for rejuvenation or consolidation of areas used for cultivation of rubber, coffee, cardamom or such other specified commodity is exempt.

***Income of Minor [Sec. 10(32)]***

Income up to Rs. 1,500 is exempt in respect of each minor child whose income is clubbed u/s 64(1A).

***Income on Transfer of Units of US 64 [Sec. 10(33)]***

Any income arising from the transfer of a capital asset, being a unit of the Unit Scheme, 1964 where such transfer takes place on or after the 1st day of April, 2002.

***Dividend Income [Sec. 10(34)]***

Any income by way of dividend declared, paid or distributed by a domestic company. The exemption is not available on dividend chargeable to tax in accordance with the provisions of sec. 115BBDA.

***Income of Shareholder on Buy-back of Shares [Sec. 10(34A)]***

Any income arising to an assessee, being a shareholder, on account of buy back of shares (not being listed on a recognised stock exchange) by the company, which pay additional income tax u/s 115QA.

Notes

***Income from Units [Sec. 10(35)]***

Any income (other than income on transfer of unit) on the following units –

- (a) income received in respect of the units of a Mutual Fund specified u/s 10(23D);
- (b) income received in respect of units from the Administrator of the specified undertaking as defined in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002;
- (c) income received in respect of units from the company specified in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002.

***Capital Gain on compulsory Acquisition of Urban Land [Sec. 10(37)]***

Refer Chapter Capital Gains

***Capital Gain on transfer under Land Pooling Scheme for Andhra Pradesh [Sec. 10(37A)]***

Refer Chapter Capital Gains

***Specified Income, Arising from any International Sporting Event [Sec. 10(39)]***

Any specified income, arising from any international sporting event held in India, to the person(s) notified by the Central Government in Official Gazette, if such international sporting event–

- (a) is approved by the International body regulating the international sport relating to such event;
- (b) has participation by more than 2 countries;
- (c) is notified by the Central Government in the Official Gazette for the purpose of this clause.

**Note:** For the purpose of this clause “the specified income” means the income, of the nature and to the extent, arising from the international sporting event, which the Central Government may notify in this behalf.



## Notes

***Reconstruction or Revival of Power Generation Subsidiary Company [Sec. 10(40)]***

Any income of any subsidiary company by way of grant or otherwise received from an Indian company, being its holding company engaged in the business of generation, transmission or distribution of power, if such receipts is for the settlement of dues in connection with reconstruction or revival of an existence business of power generation.

**Note:** The above clause is applicable if reconstruction or revival of any existing business of power generation is by way of transfer of such business to the Indian company notified u/s 80-IA (4)(v)(a).

***Income of a Non-profit Body or Authority specified by the Central Government [Sec. 10(42)]***

Any specified income arising to a body or authority which -

- has been established or constituted or appointed under a treaty or an agreement entered into by the Central Government with tow or more countries or a convention signed by the Central Government;
- is established or constituted or appointed not for the purpose of profit;
- is notified by the Central Government.

***Reverse Mortgage [Sec. 10(43)]***

Any amount received by an individual as a loan, either in lump sum or in installment, in a transaction of reverse mortgage is exempt.

***New Pension Trust [Sec. 10(44)]***

Any income received by any person for, or on behalf of, the New Pension System Trust is exempt

***Allowance or Perquisite to member of Union Public Service Commission [Sec. 10(45)]***

Any allowance or perquisite, as may be notified by the Central Government in the Official Gazette in this behalf, paid to the Chairman or a retired Chairman or any other member or retired member of the Union Public Service Commission is exempt

***Specified Income of notified body or authority or Board or Trust or Commission [Sec. 10(46)]***

Any specified income arising to a body or authority or Board or Trust or Commission (by whatever name called), or a class thereof, which—

- (a) has been established or constituted by or under a Central, State or Provincial Act, or constituted by the Central
- (b) Government or a State Government, with the object of regulating or administering any activity for the benefit of the general public;
- (c) is not engaged in any commercial activity; and
- (d) is notified by the Central Government in the Official Gazette

### ***Infrastructure Debt Fund [Sec. 10(47)]***

Any income of notified infrastructure debt fund is exempt.

### ***Import of Crude Oil [Sec. 10(48)]***

Any income received in India in Indian currency by a foreign company on account of sale of crude oil or other notified goods or service to any person in India provided:

- (a) receipt of such income in India by the foreign company is pursuant to an agreement or an arrangement entered into by the Central Government or approved by the Central Government;
- (b) having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Government in this behalf; and
- (c) the foreign company is not engaged in any activity, other than receipt of such income, in India.

### ***Storage of Crude Oil [Sec. 10(48A)]***

Any income accruing or arising to a foreign company on account of storage of crude oil in a facility in India and sale of crude oil there from to any person resident in India provided:

- (i) the storage and sale by the foreign company is pursuant to an agreement or an arrangement entered into by the Central Government or approved by the Central Government; and
- (ii) having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Government in this behalf.

***Sale of leftover stock of crude oil [Sec. 10(48B)]***

Any income accruing or arising to a foreign company on account of sale of leftover stock of crude oil, if any, from the facility in India after the expiry of the agreement or the arrangement referred to sec. 10(48A) or on termination of the said agreement or the arrangement, in accordance with the terms mentioned therein, as the case maybe.

***Equalization Levy [Sec. 10(50)]***

Any income arising from any specified service provided on or after the date on which the provisions of Chapter VIII of the Finance Act, 2016 comes into force and chargeable to equalization levy under that Chapter.

***Expenditure related to Exempted Income [Sec. 14A]***

For the purposes of computing the total income, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income, which does not form part of the total income under this Act. Where the AO is not satisfied with the correctness of the claim of such expenditure by assessee, he can determine the disallowable expenditure in accordance with the method prescribed by the CBDT.

***Special Provision in respect of Newly Established Units in SEZ [Sec. 10AA]  
Applicable to: All assessee***

Conditions to be satisfied

- (1) The assessee is an entrepreneur as defined in Sec. 2(j) of SEZ Act, 2005.
- (2) The undertaking has begun or begins to manufacture or produce articles or things or provide services on or after 01/04/2005 but before 31/03/2020 in any SEZ.
- (3) New Business: Business should not be formed by splitting up or reconstruction of an existing business.

***Exception:***

However, this condition is not applicable when conditions given u/s 33B are satisfied, which are as follows –

- (a) The business of an industrial undertaking carried on in India is discontinued in any previous year by reason of extensive damage to, or destruction of, any building, machinery, plant or furniture owned by the assessee being used for business purpose.



- (b) Such damage was caused due to –
- (i) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or
  - (ii) riot or civil disturbance; or
  - (iii) accidental fire or explosion; or
  - (iv) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war),
- (c) Such business is re-established, reconstructed or revived by the assessee at any time before the expiry of 3 years from the end of previous year in which such damage was caused.
- (4) New Plant and Machinery: Such undertaking should not be formed by transfer of machinery or plant previously used for any purpose

## Notes

**Exception:**

- (a) A plant or machinery is deemed as a new asset if the following conditions are satisfied –
- (i) Such plant or machinery is imported into India;
  - (ii) Depreciation on such asset has not been allowed under this Act to any person; and
  - (iii) The assessee was the first user of such asset in India.
- (b) Where the total value of old plant and machinery transferred to the new business does not exceed 20% of total value of plant and machinery used in such business, then this condition is deemed to be satisfied.
- (5) A report of a chartered accountant in Form 56F must be filed with the return of income certifying that the deduction has been correctly claimed.

**Income from Salaries****Basic Elements of Salary**

- Payer and payee must have employer and employee (or Master & Servant) relationship; and
- Payment must have been made by the employer in such capacity Employer-employee relationship A payment can be construed as salary only if the payer is the employer and payee is the employee of the payer.

Notes

- Criteria for employer-employee relationship: The key criteria to hold this relationship is that, employee is always bound to work as per direction and supervision of the employer.
- Payment in employer's capacity: To treat any payment as salary it is necessary that payer, being the employer, must have made the payment in such (employer's) capacity.
- Contract of service Vs contract for service: In "contract of service", the employer can direct and control the duties and the manner of performance of employee hence employer employee relationship exists in such contract. However, in case of "contract for service" the contracted can simply decide and quote the object or target to be achieved but cannot decide or direct the manner of performance.
- Agent and Principal: If a person is acting as an agent for his principal, any commission or remuneration earned by the agent is not taxable under the head "Salaries". This is because, an agent is not the employee of his principal.
- Salary received by a partner from its firm shall not be taxable as salary, because there is no employer-employee relationship between the firm and the partner. Such salary shall be taxable under the head "Profits & gains of business or profession".
- Salary received by proprietor from his proprietorship firm is not an income. As proprietor and proprietorship firm are the same person and no one can earn from himself.
- Remuneration to director from his company can be treated as salary only if the director is employee of the company, otherwise the same shall be taxable under the head "Income from other sources". Note: Directors' sitting fee is taxable under the head "Income from other sources".
- Pension received by the widow or legal heir of deceased employee is not taxable as salary as no employer-employee relationship exists between the payer and the payee. However such amount shall be taxable under the head "Income from other sources".
- Remuneration received by Judges is taxable under the head "Salaries" even though they are not having any employer.

Concluding the above discussions, a payment received for services rendered, from a person other than employer, is not taxable under the head "Salaries" but may be taxed under the head "Profits & gains of business or profession" or "Income from other sources".

State whether the following receipts should be treated as salary or not?

- A teacher receives emoluments in kind from school in which he teaches.  
Yes, it is immaterial whether salary has been received in cash or in kind.
- A teacher of a college receives fees from a University for checking answer sheets.

No, as employer – employee relationship does not exist between payer and payee. (College-teacher is not the employee of the University). Such receipt shall be taxable under the head 'Income from other sources'.

- A payment made to the Member of the Parliament or the State legislature. No, as employer-employee relationship does not exist.

A member of the Parliament or the State legislature is not treated as employee of the Government. Payment received by them shall be taxable under the head "Income from other sources".

## Notes

## 2.8 Income Tax Systems in India

The Indian Income Tax department is governed by the Central Board for Direct Taxes (CBDT) and is part of the Department of Revenue under the Ministry of Finance.

The government of India imposes an income tax on taxable income of individuals, Hindu Undivided Families (HUFs), companies, firms, cooperatives societies and trusts (Identified as body of Individuals and Association of Persons) and any other artificial person. Levy of tax is separate on each of the persons. The levy is governed by the Indian Income Tax Act, 1961.

1. **Charge to Income tax:** Income tax is a tax payable, at the rate enacted by the Union Budget (Finance Act) for every Assessment Year, on the Total Income earned in the Previous Year by every Person. The charge ability is based on the nature of income, i.e., whether it is revenue or capital.

Section 4 of the Income tax Act, 1961 is the charging section which provides that:

- (i) tax shall be charged at the rates prescribed for the year by the annual Finance Act;
- (ii) the charge is on every person specified under section 2(31);
- (iii) tax is chargeable on the total income earned during the previous year and not the assessment year. (There are certain exceptions provided by sections 172, 174, 174A, 175 and 176);
- (iv) tax shall be levied in accordance with and subject to the various provisions contained in the Act.



## Notes

This section is the back bone of the law of income tax in so far as it serves as the most operative provision of the Act. The tax liability of a person springs from this section.

2. **Rates of Tax:** Income tax is to be charged at the rates fixed for the year by the annual Finance Act. Section 2 of the Finance Act, 2012 read with Part I of the First Schedule to the Finance Act, 2012 specifies the rates at which income tax is to be levied on income chargeable to tax for the A.Y. 2023-24. Part II lays down the rate at which tax is to be deducted at source during the financial year 2023-24 i.e. A.Y. 2013-14 from income subject to such deduction under the Act; Part III lays down the rates for charging income tax in certain cases, rates for deducting income tax from income chargeable under the head "salaries" and the rates for computing advance tax for the financial year 2023-24 i.e. A.Y. 2013-14. Part III of the First Schedule to the Finance Act, 2012 will become Part I of the First Schedule to the Finance Act, 2013 and so on.

### TAX RATES FOR THE A.Y. 2021-22

#### *Individual/HUF/Association of Persons/Body of Individuals/Artificial Juridical Person*

##### In case of Super Senior citizen

Total Income Range	Rates of Income Tax
Up to ₹ 5,00,000	Nil
₹ 5,00,001 to ₹ 10,00,000	20% of (Total income – ₹ 5,00,000)
₹ 10,00,001 and above	₹ 1,00,000 + 30% of (Total income – ₹ 10,00,000)

Super Senior Citizen means an individual who is resident in India and is of at least 80 years of age at any time during the relevant previous year (i.e. any resident person, male or female, born before 02-04-1941).

##### In case of Senior citizen

Total Income Range	Rates of Income Tax
Up to ₹ 3,00,000	Nil
₹ 3,00,001 to ₹ 5,00,000	5% of (Total Income – ₹ 3,00,000)
₹ 5,00,001 to ₹ 10,00,000	₹ 10,000 + 20% of (Total income – ₹ 5,00,000)
₹ 10,00,001 and above	₹ 1,10,000 + 30% of (Total income – ₹ 10,00,000)

Senior Citizen means an individual who is resident in India and is of at least 60 years of age at any time during the relevant previous year. (i.e., a resident person, male or female, born on or after 02-04-1941 but before 02-04-1961)

Total Income Range	Rates of Income Tax
Up to ₹ 2,50,000	Nil
₹ 2,50,001 to ₹ 5,00,000	5% of (Total Income – ₹ 2,50,000)
₹ 5,00,001 to ₹ 10,00,000	₹ 12,500 + 20% of (Total income – ₹ 5,00,000)
₹ 10,00,001 and above	₹ 1,12,500 + 30% of (Total income – ₹ 10,00,000)

1. born on or after 02-04-1961 or non-resident individual

### Rebates

Rebate under section 87A: In order to provide tax relief to the individual tax payers who are in the 5% tax slab, section 87A provides a rebate from the tax payable by an assessee, being an individual resident in India, whose total income does not exceed ₹ 500000. The rebate shall be equal to the amount of income tax payable on the total income for any assessment year or an amount of ₹ 12500 whichever is less.

However, rebate under section 87A is not available in respect of tax payable @10% on long-term capital gains taxable under section 112A.

**Applicable to:** Resident Individual

**Conditions to be satisfied:** Total income of the assessee does not exceed ₹ 5,00,000.

**Quantum of Rebate:** Lower of the following:

- (a) 100% of tax liability as computed above; or
- (b) ₹ 12,500/-

### Illustration

Compute rebate u/s 87A in the following cases:

Particulars	Case 1	Case 2	Case 3	Case 4	Case 5	Case 6
Assessee	Individual	Individual	Senior Citizen	Senior Citizen	Individual	HUF
Residential status	Resident	Resident	Non-Resident	Resident		
Total Income	₹ 4,90,000 ₹ 5,12,000	₹ 4,25,000	₹ 5,40,000	₹ 2,60,000	₹ 2,65,000	
Tax on above	₹ 12,000	₹ 14,900	₹ 6,250	₹ 18,000	₹ 500	₹ 750
Rebate u/s 87A	₹ 12,000	Nil	₹ 6,250	Nil	Nil	Nil

## Notes

Reason		Total income exceeds ₹ 5 lacs		Total income exceeds ₹ 5 lacs	Assessee is non-resident	Assessee is not an individual
Tax after rebate	Nil	₹ 14,900	Nil	₹ 18,000	₹ 500	₹ 750

**Surcharge**

Surcharge is an additional tax payable over and above the income tax.

Surcharge is levied as a percentage of income-tax. Surcharge at the following rate is also payable on tax as computed above after rebate u/s 87A.

Total Income	Rate of Surcharge
Total income does not exceed ₹ 50 lacs	Nil
Total income exceeds ₹ 50 lacs but does not exceed ₹ 1 crore	10% of tax
Total income exceeds ₹ 1 crore but does not exceed ₹ 2 crores	15% of tax
Total income exceeds ₹ 2 crores but does not exceed ₹ 5 crores	25% of tax*
Total income exceeds ₹ 5 crores	37% of tax*

\* Where the total income includes dividend, any income chargeable u/s 111A and 112A, the surcharge on the amount of income-tax computed on that part of income shall not exceed 15%. In other words, surcharge higher than 15% is applicable only on tax on income other than dividend, income covered u/s 111A and 112A.

**Health & Education Cess**

**Applicable on:** All assessee

**Rate of cess:** 4% of Tax liability after Surcharge

**Marginal Relief**

To provide relaxation from levy of surcharge to a taxpayer where the total income exceeds marginally above ₹ 50 lakh or ₹ 1 crore or 2 crores or 5 crores, the concept of marginal relief is designed.

**Condition:** Total income exceeds ₹ 50,00,000 (or ₹ 1 crore or 2 crores or 5 crores)

**Relief:** Marginal relief is provided to ensure that the additional income tax payable including surcharge on excess of income over ₹ 50,00,000 or ₹ 1,00,00,000 or ₹ 2,00,00,000 or ₹ 5,00,00,000 is limited to the amount by which the income is more than ₹ 50,00,000 or ₹ 1,00,00,000 or ₹ 2,00,00,000 or ₹ 5,00,00,000.



Marginal relief = Calculated Surcharge - 70% (Income - ₹ 50,00,000) (if positive)

Income Tax

Or

Marginal relief = [(Income tax + surcharge) on income] - [(Income tax on ₹ 50,00,000) + (Income - ₹ 50,00,000)]

Notes

Similar relief shall also be provided where income exceeds marginally above ₹ 1 crore or ₹ 2 crores or ₹ 5 crores. In that case, the aforesaid equation shall be changed accordingly.

### Illustration

Compute tax liability of the assessee (52 years) whose total income is: (Case 1) ₹ 49,90,000 (Case 2) ₹ 50,10,000; (Case 3) ₹ 60,00,000

Particulars	Working	Case 1	Case 2	Case 3
Tax liability before Rebate	₹ 2,50,000 * Nil	Nil	Nil	Nil
	₹ 2,50,000 * 5%	12,500	12,500	12,500
	₹ 5,00,000 * 20%	1,00,000	1,00,000	1,00,000
	Balance Income * 30%	11,97,000	12,03,000	15,00,000
Total		13,09,500	13,15,500	16,12,500
Less: Rebate u/s 87A	As income exceeds ₹ 5,00,000	Nil	Nil	Nil
Liability [A]	13,09,500	13,15,500	16,12,500	
Add: Surcharge	B = [10% of (A)]	Nil	1,31,550	1,61,250
Tax and surcharge payable 13,09,500	14,47,050	17,73,750		

Analysis of case (1) and case (2)

Increase in income	₹ 20,000
Liability for surcharge increased	₹ 1,31,550

Now, computation of tax liability is made after considering marginal relief:

Particulars	Working	Case 1	Case 2	Case 3
Liability [A]	13,09,500	13,15,500	16,12,500	
Add: Surcharge	B = [10% of (A)]	Nil	1,31,550	1,61,250
Tax and surcharge		13,09,500	14,47,050	17,73,750
Less: Marginal relief	[(B) - {70% (50,10,000 - 50,00,000)}]	Nil	1,24,550	Nil
Effective Surcharge [C]		Nil	7,000	1,61,250

## Notes

<b>Liability after surcharge</b>	<b>[A + C]</b>	<b>13,09,500</b>	<b>13,22,500</b>	<b>17,73,750</b>
Add: Health & Education cess	4% of above	52,380	52,900	70,950
<b>Total</b>	<b>Rounded off u/s 288B</b>	<b>13,61,880</b>	<b>13,75,400</b>	<b>18,44,700</b>

**Taxpoint:** The concept of marginal relief is not applicable in case of cess.

An Individual / HUF can opt for alternative tax regime u/s 115BAC.

### Firm or Limited Liability Partnership (LLP)

A partnership firm (including limited liability partnership) is taxable at the rate of 30%

**Surcharge:** 12% of income-tax (if total income exceeds ₹ 1 crore otherwise Nil)

**Marginal Relief:** Available

**Health & Education Cess:** 4% of tax liability after surcharge

#### Company

Company	Rate
In the case of a domestic company	
-Where its total turnover or gross receipts during the previous year 2018-19 does not exceed ₹ 400 crore	25%
- In any other case	30%
In the case of a foreign company	40%

#### Surcharge

Total Income	Domestic Company	Foreign Company
If total income exceeds ₹ 10 crore	12%	5%
If income exceeds ₹ 1 crore but does not exceed ₹ 10 crore	7%	2%
If income does not exceed ₹ 1 crore	Nil	Nil

**Marginal Relief:** Available at both points (i.e., income exceeds ₹ 1,00,00,000 or ₹ 10,00,00,000)

**Health & Education Cess:** 4% of tax liability after surcharge

### Computation of Total Income of Individuals

Income-tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961. The procedure for computation of total income for the purpose of levy of income-tax is detailed hereunder –

**Step 1 – Determination of the residential status of the Assessee:**

The residential status of a person has to be determined to ascertain which income is to be included in computing the total income.

- In case of an individual, the number of days of his stay in India during the relevant previous year and/or the earlier previous years would determine his residential status.
- An individual/HUF can be either a –
  - Resident and ordinarily resident
  - Resident but not ordinarily resident
  - Non-resident

Notes

**Step 2 – Classification of income under different heads**

There are five heads of income, namely, -

- Salaries,
- Income from house property,
- Profits and gains of business or profession
- Capital Gains
- Income from other sources

**Step 3 – Exclusion of income not chargeable to tax:**

There are certain incomes which are wholly exempt from income tax e.g. agricultural income. These incomes have to be excluded while calculating Gross Total Income. The same time certain incomes are partially exempt from income tax e.g. House Rent Allowance, Education Allowance etc.. These incomes are excluded only to the extent of the limits specified in the Act. The balance income over and above the prescribed limits would enter computation of total income and have to be classified under the relevant head of income.

**Step 4 – Computation of income under each head:**

Income is to be computed in accordance with the provisions governing a particular head of income. As per the rules certain deductions and allowances are allowed. These deductions are allowed while computing income under each head.

**Step 5 – Clubbing of income of spouse, minor child etc.:**

In case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive. That means if income increases the tax amount to be paid also increases.



## Notes

We can see that some taxpayers who have the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been included in the Income-tax Act. As per the provisions of income tax act income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person when it is seen that the income is diverted for avoiding tax.

### Step 6 – Set-off or carry forward and set-off of losses:

An individual may have different sources of income under the same head of income. He might have profit from one source and loss from the other. As per the provision we can set off the losses under one head or from other heads or can carry forwards for the coming assessment years. All provisions related to that should be considered while computing total income of the Assessee.

### Step 7 – Computation of Gross Total Income:

The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

### Step 8 – Deductions from Gross Total Income:

There are deductions prescribed from gross total income. The allowable deductions in case of an individual are deductions under sections 80C, 80CCC, 80CCD, 80CCF, 80D, 80DD, 80DDB, 80E, 80G, 80GG, 80GGA, 80GGC, 80-IA, 80-IAB, 80- IB, 80-IC, 80-ID, 80-IE, 80JJA, 80QQB, 80RRB, 80TTA and 80U. These deductions are allowed as per the rules prescribed in the income tax act.

### Step 9 – Compute Total income:

After allowing all deductions allowable, we can compute total income.

### Step 10 – Application of the rates of tax on the total income:

For individuals, there is a slab rate and basic exemption limit. At present, the basic exemption limit is ₹ 2,50,000. This means that no tax is payable by individuals with total income of up to ₹ 2,50,000. The rates of tax and level of total income are as under–

Level of total income	Rate of tax
-----------------------	-------------

(A) Normal Rates:

(B) Individual- Senior citizen (60 years or more but less than 80 years):

(C) Individual- Super senior citizen (80 years or more):

Notes

Step 10 – Rebate under section 87A (where total income  $\leq$  ₹ 5,00,000)/ Surcharge (where total income  $>$  ₹ 50,00,000)

### Step 11– Health and Education cess (HEC) on Income-tax

The income-tax is to be increased by health and education cess@4% on income-tax plus surcharge/ minus rebate under section 87A, wherever applicable. This cess is payable by all assesseees who are liable to pay income-tax irrespective of their level of total income.

### Step 12 – Advance tax and tax deducted at source

Although the tax liability of an assessee is determined only at the end of the year, tax is required to be paid in advance in four installments on the basis of estimated income i.e., on or before 15th June, 15th September, 15th December and 15th March. However, residents opting for presumptive taxation scheme can pay advance tax in one installment on or before 15th March instead of four installments. In certain cases, tax is required to be deducted at source from the income by the payer at the rates prescribed in the Income-tax Act, 1961 or the Annual Finance Act. Such deduction should be made either at the time of accrual or at the time of payment, as prescribed by the Act.

### Step 13: Tax Payable/Tax Refundable

After adjusting the advance tax and tax deducted at source, the assessee would arrive at the amount of net tax payable or refundable. Such amount should be rounded off to the nearest multiple of ₹ 10 as per section 288B.

The assessee has to pay the amount of tax payable (called self assessment tax) on or before the due date of filing of the return. Similarly, if any refund is due, assessee will get the same after filing the return of income.

## 2.9 Residential Status (Section 6)

The incidence of tax on any assessee depends upon his residential status under the Act. Therefore, after determining whether a particular amount is capital or revenue in nature, if the receipt is of a revenue nature and chargeable to tax, it has to be seen whether the assessee is liable to tax in respect of that income. The taxability of a particular receipt would thus

depend upon not only the nature of the income and the place of its accrual or receipt but also upon the assessee's residential status.

The following norms one has to keep in mind while deciding the residential status of an assessee:

## Notes

1. **Different taxable entities:** All taxable entities are divided in the following categories for the purpose of determining residential status:

- (a) An individual;
- (b) A Hindu undivided family;
- (c) A firm or an association of persons;
- (d) A joint stock company; and
- (e) Every other person.

2. **Different residential status:** An assessee is either: (a) resident in India, or (b) non-resident in India.

However, a resident individual or a Hindu undivided family has to be (a) resident and ordinarily resident, or (b) resident but not ordinarily resident.

All other assessee who includes a firm, an association of persons, a joint stock company and every other person) can either be:

- (a) Resident in India; or
- (b) Non-resident in India.

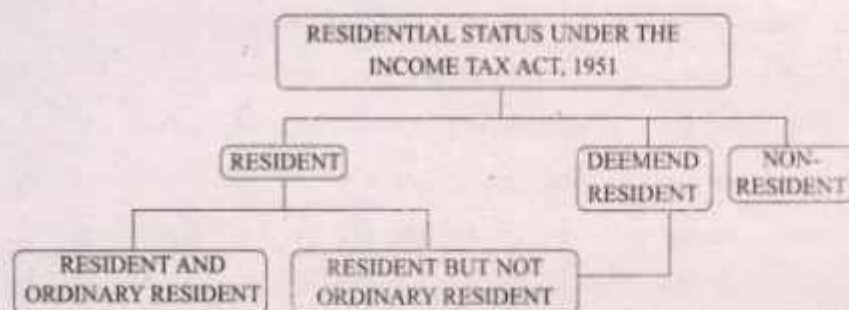
3. **Residential status for each previous year:** Residential status of an assessee is to be determined in respect of each previous year as it may vary from previous year to previous year.

4. **Different residential status for different assessment years:** An assessee may enjoy different residential status for different assessment years. For instance, an individual who has been regularly assessed as resident and ordinarily resident has to be treated as non-resident in a particular assessment year if he satisfies none of the conditions of section 6(1).

5. **Resident in India and abroad:** It is not necessary that a person, who is "resident" in India, cannot become "resident" in any other country for the same assessment year. A person may be resident in two (or more) countries at the same time. It is, therefore, not necessary that a person who is resident in India will be non-resident in all other countries for the same assessment year.

Therefore you can say that for all purposes of income-tax, taxpayers are classified into three broad categories on the basis of their residential status as stated below and as reflected in Figure 2.2 below:





**Figure 2.2. Residential Status of Individual**

The residential status of an assessee must be ascertained with reference to each previous year. A person who is resident and ordinarily resident in one year may become non-resident or resident but not ordinarily resident in another year or vice versa. The provisions for determining the residential status of assessee are:

## Determination of Residential Status

### Individual [Sec. 6(1)]

First of all, an individual is classified as resident or nonresident and again a resident individual may further be categorized as Ordinarily Resident or Not Ordinarily Resident in India.

### Resident in India

An individual is said to be a resident in India, if he satisfies any one of the following conditions -

- (i) He is in India in the previous year for a period of 182 days or more [Sec. 6(1)(a)];  
or
- (ii) He is in India for a period of 60 days or more during the previous year and for 365 or more days during 4 previous years immediately preceding the relevant previous year [Sec. 6(1)(c)]

### Deemed Resident in India (Sec. 6 (1A))

From the Assessment year 2021-22, the concept of 'deemed resident', has been introduced under section 6 (1A). Accordingly, a person shall be deemed to be resident in India if the following conditions are satisfied.

- (a) Person is a citizen of India;
- (b) Total income during the year (Other than from foreign sources) is more than 15 lakh;

- (c) The income is not liable to tax in any other country or territory.

(There are many countries where income tax is not levied. Examples - UAE, Qatar, Kuwait, Monaco, Oman, Bahamas, Panama. Moreover, as per the double taxation avoidance agreement with the Govt. of India, income may not be subjected to tax abroad. Sec. 6(1A) aims to levy tax on such persons). "Income from foreign sources" does not include income from business controlled from India or profession set up in India.

## Notes

Deemed resident is considered as 'resident but not ordinarily resident' in all cases. Basic conditions or additional conditions discussed earlier are not relevant in the case of 'deemed resident' under Sec. 6(1A). The concept of deemed resident is applicable only in the case of Indian Citizens who do not become resident in India as per the general provisions of residential status under section 6(1). It is not applicable in the case of foreign citizens, even though the parents are of Indian origin.

### Non-Resident in India

An assessee who is not satisfying sec. 6(1) shall be treated as a non-resident in India for the relevant previous year.

### Illustration 1

Mr. X came to India first time during the P.Y. 2020-21. During the previous year, he stayed in India for (i) 58 days; (ii) 185 days; & (iii) 149 days. Determine his residential status for the A.Y. 2021-22.

### Solution:

- (1) Since Mr. X resides in India only for 58 days during the P.Y. 2020-21, he does not satisfy any of the conditions specified in sec. 6(1). He is, therefore, a non-resident in India for the P.Y. 2020-21.
- (2) Since Mr. X resides in India for 185 days during the previous year 2020-21, he satisfies one of the conditions specified in sec. 6(1). He is, therefore, a resident in India for the P.Y. 2020-21.
- (3) Mr. X resides in India only for 149 days during the previous year 2020-21. Though he resided for more than 60 days during the previous year but in 4 years immediately preceding the previous year (as he came India first time), he did not reside in India. Hence, he does not satisfy any of the conditions specified in sec. 6(1). Thus, he is a non-resident for the P.Y. 2020-21.

## Illustration 2

Simon, a British national, comes to India for the first time during 2016-17. During the financial years 2016-17, 2017-18, 2018-19, 2019-20 and 2020-21, he was in India for 55 days, 60 days, 80 days, 160 days and 70 days respectively. Determine his residential status for the assessment year 2021-22.

## Notes

### Solution:

During the previous year 2020-21, Simon was in India for 70 days & during 4 years immediately preceding the previous year, he was in India for 355 days as shown below:

Year	2016-17	2017-18	2018-19	2019-20	Total
No of days stayed in India	55	60	80	160	355

## Illustration 3

Miss Paul, an Indian citizen, left India for first time on 1st April, 2020 for joining job in Tokyo. She came to India on 11th October, 2020 for only 190 days. Determine her residential status for P.Y. 2020-21.

### Solution:

Number of days Miss Paul stayed in India can be calculated as under:

P.Y.	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
2020-21	1	-	-	-	-	-	21	30	31	31	28	31	173
2020-21	18	-	-	-	-	-	-	-	-	-	-	-	18

Since she left India for employment purpose, hence for becoming resident she has to stay in India for at least 182 days. However, she is in India for only 173 days during the previous year, thus she is a non-resident for the P.Y. 2020-21.

## Resident and Ordinarily Resident

If a resident individual satisfies the following two additional conditions, he will be treated as resident & ordinarily resident in India -

- He has been resident in India [as per sec. 6(1)] in at least 2 out of 10 previous years immediately preceding the relevant previous year and
- He has resided in India for a period of 730 days or more during 7 previous years immediately preceding the relevant previous year.

**Tax point:** To be a Resident & Ordinarily resident in India, one has to satisfy at least one condition of sec. 6(1) & both the additional conditions of sec. 6(6).



**Resident but not ordinarily resident**

If a resident individual does not satisfy both additional conditions as given u/s 6(6), he is "Resident but not ordinarily resident in India".

**Illustration 4**

Mr. Y, aged 19 years, left India for first time on May 31, 2020. Determine his residential status for the previous year 2020-21 if:

- (i) He left India for employment purpose
- (ii) He left India on world tour.

**Solution:**

During the previous year 2020-21, Mr. X was in India for 61 days as shown below –

P.Y.	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
2020-21	30	31	-	-	-	-	-	-	-	-	-	-	61

During the previous year 2020-21, X stayed in India for 61 days. Further, he was in India for more than 365 days during 4 years immediately preceding the relevant previous year (as he left India for first time).

- i. Since he left India for employment purpose, condition of sec. 6(1)(c) shall not be applicable on such assessee. He will be treated as resident in India, if and only if, he resided in India for at least 182 days during the previous year. Hence, Mr. X is a non-resident in India for the previous year 2020-21.
- ii. Since he left India on world tour, which is not an exception of sec. 6(1), satisfaction of any one condition of sec. 6(1) makes him resident in India for the previous year 2020-21. As he satisfies 2nd condition of sec. 6(1) [shown above], he is resident in India. Further, he also satisfies dual conditions specified u/s 6(6) (since he left India for first time). Therefore, he is an ordinarily resident for the previous year 2020-21.

**Illustration 5**

Mr. Z came India for first time on July 24, 2016. From July 24, 2016 to December 25, 2017 he was in India. Again, he came to India on August 5, 2020 for employment purpose & left India on November 25, 2020 permanently. Determine his residential status for the previous year 2020-21 assuming -

(a) He is a foreign citizen

(b) He is an Indian citizen

**Solution:**

During the previous year 2020-21, X was in India for 113 days as shown below:

Year	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
2020-21	-	-	-	-	27	30	31	25	-	-	-	-	113

Further, he was in India for more than 365 days during 4 years immediately preceding the previous year as shown below:

Year	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
16-17	-	-	-	8	31	30	31	30	31	31	28	31	251
17-18	30	31	30	31	31	30	31	30	25	-	-	-	269
18-19	-	-	-	-	-	-	-	-	-	-	-	-	-
19-20	-	-	-	-	-	-	-	-	-	-	-	-	-

As he satisfies condition given in sec. 6(1)(c), he is a resident in India.

Further, he was resident during 2 out of 10 years immediately preceding the relevant previous year but he was in India only for 520 days in 7 years immediately preceding the relevant previous year. As he is not satisfying dual conditions of sec.

6(6), he is a resident but not ordinarily resident in India for the previous year 2020-21.

**Note:** His status shall remain same in both the cases as -

a) Foreign citizens are not covered by 'exceptions to sec. 6(1)(c)'.

b) Coming in India for employment purpose is not covered by 'exceptions to sec. 6(1)(c)'.

**Illustration 6**

Ross Taylor, a foreign citizen, resides in India during the previous year 2020-21 for 83 days. Determine his residential status for previous year 2020-21 assuming his stay in India during the last few previous years are as follows -

Year	Days	Year	Days	Year	Days	Year	Days
2005-06	220 days	2009-10	36 days	2013-14	137 days	2017-18	175 days
2006-07	15 days	2010-11	115 days	2014-15	265 days	2018-19	15 days
2007-08	257 days	2011-12	123 days	2015-16	310 days	2019-20	67 days
2008-09	110 days	2012-13	65 days	2016-17	121 days		

**Solution:**

During previous year 2020-21, Ross Taylor was in India for 83 days & during 4 years immediately preceding the previous year, he was in India for 378 days as shown below:

**Notes**

Year	2016-17	2017-18	2018-19	2019-20	Total
days stayed in India	121	175	15	67	378

## Notes

Thus, he satisfies one of the conditions specified u/s 6(1) & consequently, he becomes resident in India in the P.Y. 2020- 21. Further, to determine whether Ross Taylor is an ordinarily resident or not, he needs to satisfy both conditions laid down u/s 6(6).

Year	Presence in India (In Days)	Resident or Non resident	Condition satisfied to become a resident
2019-20	67	Resident	6(1)(c)
2018-19	15	Non Resident	None
2017-18	175	Resident	6(1)(c)
2016-17	121	Resident	6(1)(c)
2015-16	310	Resident	Both
2014-15	265	Resident	Both
2013-14	137	Non Resident	None
2012-13	65	Resident	6(1)(c)
2011-12	123	Resident	6(1)(c)
2010-11	115	Resident	6(1)(c)

Condition (i) of sec. 6(6) requires that an individual should be resident in India for at least 2 out of 10 years preceding the relevant previous year. Ross Taylor was resident in India for 8 out of 10 years immediately preceding the previous year. Thus, he satisfies this condition.

Condition (ii) of sec. 6(6) requires that an individual should be present in India for at least 730 days during 7 years preceding to relevant previous year. Ross Taylor was in India for 1090 days during 2013-14 to 2019-20. Hence, he satisfies this condition also.

Ross Taylor satisfies condition (ii) of sec. 6(1) as well as both the conditions of sec. 6(6). Thus, he is a resident and ordinarily resident in India for the previous year 2020-21.

### Hindu Undivided Family (HUF) [Sec. 6(2)]

An HUF can be either a resident or non-resident in India. Again, a resident HUF can further be classified as 'Ordinarily resident' and 'Not ordinarily resident'.

**Resident HUF:** When the control & management of affairs of HUF is wholly or partly situated in India during the relevant previous year, then it is treated as resident in India.

### Control & Management means -

- controlling & directive power;



- actual control & management (mere right to control & manage is not enough);
- central control & management and not the carrying out of day to day affairs.

The place of central control & management is situated where the head, the seat & the directing power is situated.

## Notes

**Non-resident HUF:** An HUF is non-resident in India if the control & management of its affairs is wholly situated outside India.

**Ordinarily resident in India:** If the 'karta' or manager of a resident HUF satisfies both additional conditions given u/s 6(6), HUF is said to be an ordinarily resident. If the 'karta' or manager of a resident HUF do not satisfies both additional conditions given u/s 6(6), HUF is said to be a not- ordinarily resident.

**Tax point:** Residential status of the Karta for the previous year is not important but his status for preceding 10 years is important.

### Company [Sec. 6(3)]

**Resident Company:** An Indian company is always a resident in India.

A non-Indian company is said to be a resident in India, if its place of effective management, in that year, is in India.

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

**Non-Resident Company:** If place of effective management, in that year, is not in India, the said company is non-resident in India for the relevant previous year.

**Tax point:** In case of company, there is no sub-division like 'Ordinarily resident' or 'Not ordinarily resident'.

## 2.10 Residential Status of a Company

An Indian company is always resident in India. A foreign company is resident in India only if during the previous year, control and management of its affairs is situated wholly in India. Conversely, a foreign company is treated as non-resident if during the previous year, control and management of its affairs is either wholly or partly situated out of India.

A company can never be ordinarily or not ordinarily resident in India. In case of a foreign company even the slightest control and management is exercised from outside India, it would be treated as a non-resident.

## Notes

The term "control and management" refers to the "head and the brain" which directs the affairs of policy, finance, disposal of profits and vital things concerning the management of the company. Usually the control and management of a company's affairs is situated at the place where meetings of its board of directors are held. In case of a subsidiary company managed by its local board of directors, it is difficult to establish that control and management of its affairs vests at the place where the parent company resides.

## 2.11 Incidence of Tax

The study of incidence is very important. The tax system is not merely aimed at raising a certain amount of revenue, but the aim is to raise it from those sections of the people who can best bear the tax. The aim, in short, is to secure a just distribution of the tax burden. This obviously cannot be done unless an effort is made to trace the incidence of each tax levied by the State. We must know who pays it ultimately in order to find out whether it is just to ask him to pay it, or whether the burden imposed on him is according to the ability of the tax-payer or not. If the tax system is to conform to Adam Smith's first canon of taxation, viz., the canon of equality, it becomes imperative to make a careful study of the reactions and repercussions of each tax and find out its final resting place.

There are certain taxes, called direct taxes, which are borne by the people who pay them first. The incidence in such cases is apparent. But the tax system of a country is not merely composed of direct taxes. There are indirect taxes also whose reactions are a complicated affair. These taxes are intended to be shifted. But in actual practice, on account of economic friction, the shifting may not take place at all or it may be partial, or the tax may be shifted on to a class of people quite different from those intended to bear it.

If Public Finance is to serve as an instrument of social justice, the question of incidence at once assumes great importance. The rich have to be taxed and the proceeds have to be spent for the benefit of the poor. If you have to tax the rich, the incidence must be on the rich, otherwise the object is not served. We must, therefore, follow each tax and make sure that it finds a rich home to rest in.

As per section 5, incidence of tax on a taxpayer depends on his residential status and also on the place and time of accrual or receipt of income. In order to understand the relationship between residential status and tax liability, one must understand the meaning of "Indian income" and "foreign income".

1. **Indian income:** Any of the following three is an Indian income:

- (a) If income is received (or deemed to be received) in India during the previous year and at the same time it accrues (or arises or is deemed to accrue or arise) in India during the previous year.



- (b) If income is received (or deemed to be received) in India during the previous year but it accrues (or arises) outside India during the previous year.
- (c) If income is received outside India during the previous year but it accrues (or arises or is deemed to accrue or arise) in India during the previous year.

2. **Foreign income:** If the following two conditions are satisfied, then such income is "foreign income":

- (a) Income is not received (or not deemed to be received) in India; and
- (b) Income does not accrue or arise (or does not deemed to accrue or arise) in India.

The above provisions may be explained in brief as follows:

**Table : Conditions for Deciding Status of Income**

Whether income is received (or deemed to be received) in India during the relevant year	Whether income accrues (or arises or is deemed to accrue or arise) in India during the relevant year	Status of the income
Yes	Yes	Indian income
Yes	No	Indian income
No	Yes	Indian income
No	No	Foreign income

Following table shows the overall scope of income and its income tax charge ability in case of Resident and Non-resident:

**Table : Income Tax Chargeability in Case of Resident and Non-resident**

Nature of Income	Tax incidence in case of		
	Resident & ordinarily resident	Resident but not ordinarily resident	Non-resident
Income accrued or deemed to be accrued and received or deemed to be received in India	Taxable	Taxable	Taxable
Income accrued outside India but received or deemed to be received in India.	Taxable	Taxable	Taxable
Income accrued or deemed to be accrued in India but received outside India.	Taxable	Taxable	Taxable



## Notes

Income accrued and received outside India from a business controlled in or profession set-up in India.	Taxable	Taxable	Taxable
Income accrued and received outside India from a business controlled or profession setup outside India.	Taxable	Taxable	Not Taxable
Income accrued and received outside India in the previous year (it makes no difference if the same is later remitted to India).	Taxable	Not taxable	Not taxable
Income accrued and received outside India in any year preceding the previous year and later on remitted to India in current financial year.	Not taxable	Not taxable	Not taxable
<b>Note:</b> In case of resident assessee like company, firm etc. (Other than Individual and HUF) in which there is no classification as 'Resident but not ordinarily resident', income accrued and received outside India from a business controlled or profession setup outside India shall be taxable.			

For any other taxpayer like company, firm, co-operative society, association of persons, body of individual, etc. the incidence of tax would include:

**Table : Incidence of Tax for Resident/non-resident Indians**

Types of Income	Resident in India	Non-resident in India
Indian income	Taxable in India	Taxable in India
Foreign income	Taxable in India	Not taxable in India

## 2.12 Scope of Income

Section 5 provides the scope of total income in terms of the residential status of the assessee because the incidence of tax on any person depends upon his residential status. The scope of total income of an assessee depends upon the following three important considerations:

- the residential status of the assessee;
- the place of accrual or receipt of income, whether actual or deemed; and
- the point of time at which the income had accrued to or was received by or on behalf of the assessee.

The ambit of total income of the three classes of assesses would be as follows:

- 1. Resident and ordinarily resident:** The total income of a resident assessee would, under section 5(1), consist of:

- (i) income received or deemed to be received in India during the previous year;
- (ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year; and
- (iii) income which accrues or arises outside India even if it is not received or brought into India during the previous year.

## Notes

In simpler terms, a resident and ordinarily resident has to pay tax on the total income accrued or deemed to accrue, received or deemed to be received in or outside India.

2. **Resident but not ordinarily resident:** Under section 5(1), the computation of total income of resident but not ordinarily resident is the same as in the case of resident and ordinarily resident stated above except for the fact that the income accruing or arising to him outside India is not to be included in his total income. However, where such income is derived from a business controlled from or profession set up in India, then it must be included in his total income even though it accrues or arises outside India.
3. **Non-resident:** A non-resident's total income under section 5(2) includes:
  - (i) income received or deemed to be received in India in the previous year; and
  - (ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year.

### 2.13 Deemed Receipt and Accrual of Income in India

In addition to the above mentioned criteria it must also be understood that the taxability of a certain item as income would also depend upon the method of accounting followed by the assessee. This is because under the cash system of accounting an income would be taxable only when it is received by the assessee himself or on his behalf. But under the mercantile system it would be taxable once the assessee gets the legal right to claim the amount. However, it has been specifically provided that in the case of income from salaries, the liability to tax arises immediately when the income is due to the assessee irrespective of the method of accounting followed. Likewise, in the case of dividends, the income would be included in total income of the shareholder under section 8 in the year in which the final dividend is declared and, in the case of interim dividend, in the year in which they are made unconditionally available to the shareholders.

Thus at this point of time to understand the incidence of tax efficiently it is essential to understand, which are the income that are deemed to be received in India, the meaning of income accruing or arising in India and the income deemed to accrue or arise in India. The same is explained in this section of the unit.



## Notes

Income accrued in India is chargeable to tax in all cases irrespective of residential status of an assessee. The words "accrue" and "arise" are used in contradistinction to the word "receive". Income is said to be received when it reaches the assessee; when the right to receive the income becomes vested in the assessee, it is said to accrue or arise.

### Meaning of "Income Received or Deemed to be Received"

All assesses are liable to tax in respect of the income received or deemed to be received by them in India during the previous year irrespective of:

- (i) their residential status, and
- (ii) the place of its accrual.

Income is to be included in the total income of the assessee immediately on its actual or deemed receipt. The receipt of income refers to only the first occasion when the recipient gets the money under his control. Therefore, when once an amount is received as income, remittance or transmission of that amount from one place or person to another does not constitute receipt of income in the hands of the subsequent recipient or at the place of subsequent receipt.

### Income Deemed to be Received

Under section 7, the following shall be deemed to be received by the assessee during the previous year irrespective of whether he had actually received the same or not -

- (i) The annual accretion in the previous year to the balance to the credit of an employee participating in a Recognised Provident Fund (RPF). Thus, the contribution of the employer in excess of 12% of salary or interest credited in excess of 9.5% p.a. is deemed to be received by the assessee.
- (ii) The taxable transferred balance from unrecognised to recognised provident fund (being the employer's contribution and interest thereon).
- (iii) The contribution made by the Central Government or any other employer in the previous year to the account of an employee under a pension scheme referred to under section 80CCD.

### Meaning of Income 'Accruing' and 'Arising'

Accrue refers to the right to receive income, whereas due refers to the right to enforce payment of the same. For example, salary for work done in December will accrue throughout the month, day to day, but will become due on the salary bill being passed on 31st December or 1st January.



Similarly, on Government securities, interest payable on specified dates arise during the period of holding, day to day, but will become due for payment on the specified dates.

It must be noted that income which has been taxed on accrual basis cannot be assessed again on receipt basis, as it will amount to double taxation. For example, when a loan to a director has already been treated as dividend under section 2(22) (e) and later dividend is declared, distributed and adjusted against the loan, the same cannot be treated as dividend income again.

With a view to removing difficulties and clarifying doubts in the taxation of income, Explanation 1 to Section 5 specifically provides that an item of income accruing or arising outside India shall not be deemed to be received in India merely because it is taken into account in a balance sheet prepared in India.

Further, Explanation 2 to Section 5 makes it clear that once an item of income is included in the assessee total income and subjected to tax on the ground of its accrual/deemed accrual or receipt, it cannot again be included in the person's total income and subjected to tax either in the same or in a subsequent year on the ground of its receipt - whether actual or deemed.

### **Income Deemed to Accrue or Arise in India (Section 9)**

Certain types of income are deemed to accrue or arise in India even though they may actually accrue or arise outside India. The categories of income which are deemed to accrue or arise in India are:

- (i) Any income accruing or arising to an assessee in any place outside India whether directly or indirectly
  - (a) Through or from any business connection in India,
  - (b) Through or from any property in India,
  - (c) Through or from any asset or source of income in India, or
  - (d) Through the transfer of a capital asset situated in India.

This principle which supports the source country's right to tax the gains derived from off shore transactions where the value is attributable to the underlying assets, is recognised internationally by several countries.

Consequently, Explanation 4 of the section has been inserted to clarify that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".

Further, Explanation 5 has been inserted to clarify that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

## Notes

- (ii) Income, which falls under the head "Salaries", if it is earned in India. Any income under the head "Salaries" payable for rest period or leave period which is preceded and succeeded by services rendered in India, and forms part of the service contract of employment, shall be regarded as income earned in India.
- (iii) Income from 'Salaries' which is payable by the Government to a citizen of India for services rendered outside India. However, allowances and perquisites paid outside India by the Government are exempt.
- (iv) Dividend paid by an Indian company outside India.
- (v) Interest.
- (vi) Royalty.
- (vii) Fees for technical services.

The above mentioned categories of different of income which are deemed to accrue or arise in India are further explained in the subsequent section. Thus the categorisation of income which is deemed to accrue or arise in India can be summarised as below:

**Table : Categorisation of Income Deemed to Accrue in India**

Nature of income	Whether income is deemed to accrue or arise in India
Income from business connection in India	Yes
Income from any property, asset or source of income in India	Yes
Capital gain on transfer of a capital asset situated in India	Yes
Income from salary if service is rendered in India	Yes
Income from salary (not being perquisite/allowance) if service is rendered outside India (provided the employer is Government of India and the employee is a citizen of India)	Yes
Income from salary if service is rendered outside India (not being a case stated above)	No
Dividend paid by the Indian company	Yes

## 2.14 Categories of Income which are Deemed to Accrue or Arise in India

As mentioned above there are seven main categories of income which are deemed to accrue or arise in India even though they may actually accrue or arise outside India. These are explained below as:



**1. Income from business connection:** The expression "business connection" has been explained in Explanation 2 to section 9(1)(i) to encompass the following:

- (i) "Business connection" shall include any business activity carried out through a person acting on behalf of the non-resident.
- (ii) He must have an authority which is habitually exercised to conclude contracts on behalf of the non-resident. However, if his activities are limited to the purchase of goods or merchandise for the non-resident, this provision will not apply.
- (iii) Where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, a business connection is established.
- (iv) Business connection is also established where he habitually secures orders in India, mainly or wholly for the non-resident. Further, there may be situations when other non-residents control the above-mentioned non-resident. Secondly, this non-resident may also control other non-residents. Thirdly, all other non-residents may be subject to the same common control, as that of the non-resident. In all the three situations, business connection is established, where a person habitually secures orders in India, mainly or wholly for such non-residents.

"Business connection", however, shall not be held to be established in cases where the non-resident carries on business through a broker, general commission agent or any other agent of an independent status, if such a person is acting in the ordinary course of his business.

A broker, general commission agent or any other agent shall be deemed to have an independent status where he does not work mainly or wholly for the non-resident. He will however, not be considered to have an independent status in the three situations explained in (iv) above, where he is employed by such a non-resident. Where a business is carried on in India through a person referred to in (ii), (iii) or (iv) mentioned above, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India.

- 2. Income from property, asset or source of income:** Any income which arises from any property which may be either movable, immovable, tangible or an intangible property would be deemed to accrue or arise in India.
- 3. Income through the transfer of a capital asset situated in India:** Capital gains arising from the transfer of a capital asset situated in India would be deemed to accrue or arise in India in all cases irrespective of the fact whether



## Notes

- (i) the capital asset is movable or immovable, tangible or intangible; (ii) the place of registration of the document of transfer etc., is in India or outside; and (iii) the place of payment of the consideration for the transfer is within India or outside.

Explanation 1 to section 9(1)(i) lists out income which shall not be deemed to accrue or arise in India. They are given below:

- (a) *In the case of a business, in respect of which all the operations are not carried out in India:*

*Explanation 1(a) to section 9(1)(i):* In the case of a business of which all the operations are not carried out in India, the income of the business deemed to accrue or arise in India shall be only such part of income as is reasonably attributable to the operations carried out in India. Therefore, it follows that such part of income which cannot be reasonably attributed to the operations in India, is not deemed to accrue or arise in India.

- (b) *Purchase of goods in India for export: Explanation 1(b) to section 9(1)(i):* In the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export.

- (c) *Collection of news and views in India for transmission out of India: Explanation 1(c) to section 9(1)(i):* In the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India.

- (d) *Shooting of cinematograph films in India: Explanation 1(d) to section 9(1)(i):* In the case of a non-resident, no income shall be deemed to accrue or arise in India through or from operations which are confined to the shooting of any cinematograph film in India, if such non-resident is:

- an individual, who is not a citizen of India; or
- a firm which does not have any partner who is a citizen of India or who is resident in India; or
- a company which does not have any shareholder who is a citizen of India or who is resident in India.

4. **Income from salaries:** Under section 9(1)(ii) income which falls under the head 'salaries', would be deemed to accrue or arise in India, if it is in respect of services

rendered in India. Thus Section 9 (i)(ii) of the Act requires that salaries are to be considered as deemed to be accrued or arise in India only if it is "earned in India". Further, the salaries payable for services rendered in India shall be regarded as income earned in India, though it may be paid in India or outside, i.e. the payment or receipt of salary is immaterial. What is important is the place of rendering of services? Section 9(2) makes an exception to the aforesaid rule in the case of certain retired civil servants and judges permanently residing outside India.

Section 9(1)(iii) provides that the salaries are chargeable to tax if the same is payable by the Government to an Indian Citizen for services rendered outside India. The residential status and the place of receipt of salary are not relevant for the purpose of this sub-section. For income to be treated as deemed to accrue or arise in India following four conditions needs to be satisfied:

- Income should be chargeable under the head "Salaries"
- Salary should be payable by Government of India
- The recipient should be an Indian Citizen, irrespective of their residential status
- The services should be rendered outside India

**5. Income from dividends:** All dividends paid by an Indian company must be deemed to accrue or arise in India. Under section 10(34), income from dividends referred to in section 115-O are exempt from tax in the hands of the shareholder. It may be noted that dividend distribution tax under section 115-O does not apply to deemed dividend under section 2(22) (e), which is chargeable in the previous year in which such dividend is distributed or paid.

**6. Interest:** Under section 9(1)(v), an interest is deemed to accrue or arise in India if it is payable by -

- (i) the Central Government or any State Government;
- (ii) a person resident in India except where it is payable in respect of any money borrowed and used for the purposes of a business or profession carried on by him outside India or for the purposes of making or earning any income from any source outside India;
- (iii) a non-resident when it is payable in respect of any debt incurred or moneys borrowed and used for the purpose of a business or profession carried on in India by him. Interest on money borrowed by the non-resident for any purpose other than a business or profession, will not be deemed to accrue or arise in India. Thus, if a nonresident 'A' borrows money from a non-resident



'13' and invests the same in shares of an Indian company, interest payable by 'A' to '13' will not be deemed to accrue or arise in India.

## Notes

7. **Royalty:** Royalty will be deemed to accrue or arise in India when it is payable by:

- (i) the Government; or
- (ii) a person who is a resident in India except in cases where it is payable for the transfer of any right or the use of any property or information or for the utilisation of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or
- (iii) a non-resident only when the royalty is payable in respect of any right, property or information used or services utilised for purposes of a business or profession carried on in India or for the purposes of making or earning any income from any source in India.

Lump sum royalty payments made by a resident for the transfer of all or any rights including the granting of a license in respect of computer software supplied by a non-resident manufacturer along with computer hardware under any scheme approved by the Government under the Policy on Computer Software Export, Software Development and Training, 1986 shall not be deemed to accrue or arise in India.

The term 'royalty' means consideration also including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head 'Capital gains' for:

- (i) The transfer of all or any rights including the granting of license, in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (ii) The imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iii) The use of any patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iv) The imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
- (v) The use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 441313;



- (vi) The transfer of all or any rights including the granting of license, in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films;
- (vii) The rendering of any service in connection with the activities listed above. The definition of 'royalty' for this purpose is wide enough to cover both industrial royalties as well as copyright royalties. The deduction specially excludes income which should be chargeable to tax under the head 'capital gains'.

Consideration for Use or Right to Use of Computer Software is Royalty within the Meaning of Section 9(1)(vi)

As per section 9(1)(vi), any income payable by way of royalty in respect of any right, property or information is deemed to accrue or arise in India. The term "royalty" means consideration for transfer of all or any right in respect of certain rights, property or information. There have been conflicting court rulings on the interpretation of the definition of royalty, on account of which there was a need to resolve the following issues—

Does consideration for use of computer software constitute royalty?

- (i) Is it necessary that the right, property or information has to be used directly by the payer?
- (ii) Is it necessary that the right, property or information has to be located in India or control or possession of it has to be with the payer?
- (iii) What is the meaning of the term "process"?

In order to resolve the above issues arising on account of conflicting judicial decisions and to clarify the true legislative intent, Explanations 4, 5 & 6 have been inserted with retrospective effect from 1st June, 1976.

Explanation 4 clarifies that the consideration for use or right to use of computer software is royalty by clarifying that, transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Consequently, the provisions of tax deduction at source under section 194J and section 195 would be attracted in respect of consideration for use or right

## Notes

to use computer software since the same falls within the definition of royalty.

Explanation 5 clarifies that royalty includes and has always included consideration in respect of any right, property or information, whether or not,

- (a) the possession or control of such right, property or information is with the payer;
- (b) such right, property or information is used directly by the payer;
- (c) the location of such right, property or information is in India.

Explanation 6 clarifies that the term "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, and optic fibre or by any other similar technology, whether or not such process is secret.

**8. Fees for technical services:** Any fees for technical services will be deemed to accrue or arise in India if they are payable by:

- (i) the Government;
- (ii) a person who is resident in India, except in cases where the fees are payable in respect of technical services utilised in a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India;
- (iii) a person who is a non-resident, only where the fees are payable in respect of services utilised in a business or profession carried on by the non-resident in India or where such services are utilised for the purpose of making or earning any income from any source in India.

A fee for technical services means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including providing the services of technical or other personnel). However, it does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'.

***Income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fee for technical services to be taxed irrespective of territorial nexus (Explanation to section 9)***

Income by way of interest, royalty or fee for technical services which is deemed to accrue or arise in India by virtue of clauses (v), (vi) and (vii) of section 9(1), shall be included in the total income of the non-resident, whether or not:

- (i) the non-resident has a residence or place of business or business connection in India; or
- (ii) the non-resident has rendered services in India. In effect, the income by way of fee for technical services, interest or royalty, from services utilised in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

## Notes

**Kinds of Income**

1. **Income received in India:** Income received in India is taxable in all cases (whether accrued in India or elsewhere) irrespective of residential status of the assessee, therefore it is significant to know the meaning of income received in India. If the place, where the recipient gets the money (on first occasion) under his control, is in India, it is said to be income received in India.

2. **Income Deemed to be Received in India**

Following incomes shall be deemed to be received in India and taxable in hands of all assessee irrespective of their residential status –

- (a) The annual accretion in the previous year to the balance at the credit of an employee participating in a recognized provident fund, to the extent provided in Rule 6 of part A of the IV schedule i.e.-
  - iii. Employer's contribution to the recognized provident fund in excess of 12% of salary.
  - iv. Interest credited on the above balance by a rate exceeding 9.5% [Sec. 7(i)]
- (b) The transferred balance in recognized provident fund, to the extent liable to income tax [Sec. 7(ii)]
- (c) The contribution made, by the employer in the previous year, to the account of an employee under a pension scheme notified u/s 80CCD [Sec. 7(iii)]
- (d) Tax Deducted at source [Sec. 198]
- (e) Deemed profit.
- (f) Income from undisclosed sources

3. **Income which accrues or arises in India**

Income is said to accrue or arise of an assessee only when he obtains a rights to receive it. Accrual simply means the amount earned. No amount can be said to accrue unless it is actually due.

4. **Income deemed to accrue or arise in India [sec. 9]:**



## Notes

Following incomes are deemed to accrue or arise in India:

Sec. 9(1)(i)	Income from connection in India
Sec. 9(1)(ii)	Salary earned in India
Sec. 9(1)(iii)	Salary from Govt. by an Indian citizen for services rendered outside India
Sec. 9(1)(iv)	Income from dividend paid by an Indian company
Sec. 9(1)(v)	Income from interest payable by specified person
Sec. 9(1)(vi)	Income from royalty
Sec. 9(1)(vii)	Income from technical services

**Illustration 1**

Miss Juliet, a foreign national, comes India every year for 90 days since 2005-06.

- Determine her residential status for the previous year 2020-21.
- Will your answer differ, if she comes India for 100 days instead of 90 days every year.

**Solution:**

- Since Miss Juliet stayed for 90 days during the previous year 2020-21 and for 360 days ( $90 \text{ days} \times 4 \text{ years}$ ) during the 4 years immediately preceding the previous year, hence, she is not satisfying any of the conditions of sec. 6(1). Thus, she is a non-resident for the previous year 2020-21.
- Since Miss Juliet stayed for 100 days during the previous year 2020-21 and for 400 days ( $100 \text{ days} \times 4 \text{ years}$ ) during the 4 years immediately preceding the previous year, hence, she is satisfying sec. 6(1)(c). Thus, she is resident for the previous year 2020-21. Further, she resides for only 700 days ( $100 \text{ days} \times 7 \text{ years}$ ) during the 7 years immediately preceding the previous year. Hence, she does not satisfy one of the conditions of sec. 6(6). Thus, she is resident but not ordinarily resident for the previous year 2020-21.

**Illustration 2**

Mr. Moin, a British national, joined XYZ Co. Ltd. as an engineer in India on 1st May, 2010. On 31st December, 2011, he went to Sri Lanka on deputation. On 1st April, 2016, he came back to India and left for Sri Lanka again on 31st May, 2016. He returned to India and joined his original post on 1st July, 2020. Determine his residential status for the A.Y. 2021-22.

**Solution:**

Number of days Mr. Moin stayed in India in past few years can be calculated as under:

## Notes

S.N.	P.Y.	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
0	20-21	-	-	-	31	31	30	31	30	31	31	28	31	274
1	19-20	-	-	-	-	-	-	-	-	-	-	-	-	0
2	18-19	-	-	-	-	-	-	-	-	-	-	-	-	0
3	17-18	-	-	-	-	-	-	-	-	-	-	-	-	0
4	16-17	30	31	-	-	-	-	-	-	-	-	-	-	61
5	15-16	-	-	-	-	-	-	-	-	-	-	-	-	0
6	14-15	-	-	-	-	-	-	-	-	-	-	-	-	0
7	13-14	-	-	-	-	-	-	-	-	-	-	-	-	0
8	12-13	-	-	-	-	-	-	-	-	-	-	-	-	0
9	11-12	30	31	30	31	31	30	31	30	31	-	-	-	275
10	10-11	-	31	30	31	31	30	31	30	31	31	28	31	335

On the basis of data drawn, residential status of Mr. Moin in last few years can be decided as under:

Since assessee resided in India for 274 days in the previous year 2020-21, hence he satisfies sec. 6(1)(a). Therefore, he is resident in India.

Further, since he is resident in India for 2 years out of 10 years preceding the previous year (as shown in above working), but resided in India for less than 730 days out of 7 immediately preceding years, hence he does not satisfy one of the conditions of sec. 6(6), therefore, he is resident but not ordinarily resident.

Year	Previous Year	Presence in India (In days)	Resident (R) or Non Resident (NR)	Condition satisfied to become a resident
1	2019-2020	0	NR	None
2	2018-2019	0	NR	None
3	2017-2018	0	NR	None
4	2016-2017	61	NR	None
5	2015-2016	0	NR	None
6	2014-2015	0	NR	None
7	2013-2014	0	NR	None
8	2012-2013	0	NR	None
9	2011-2012	275	R	6(1)(a)
10	2010-2011	335	R	6(1)(a)

Since assessee resided in India for 274 days in the previous year 2020-21, hence he satisfies sec. 6(1)(a). Therefore, he is resident in India.

Further, since he is resident in India for 2 years out of 10 years preceding the previous year (as shown in above working), but resided in India for less than 730 days out of 7

immediately preceding years, hence he does not satisfy one of the conditions of sec. 6(6), therefore, he is resident but not ordinarily resident.

**Conclusion:** Resident but not ordinarily resident.

## Notes

### Illustration 3

State how the following incomes are to be assessed in the hands of an assessee who is

- Resident
  - Non-resident and
  - Non resident
- Salary received during the year for employment outside India from government of India ₹ 50000.
  - Profits earned in UK and received in India ₹ 35000
  - Salary drawn for employment in Singapore office of an Indian company for two months ₹ 7500
  - Dividend received from an Indian company ₹ 8000
  - Profit earned from business transaction outside India and kept in Punjab national bank ₹ 25000

### Solution:

#### Computation of total income

Particulars of income	Resident	Not ordinarily resident	Non resident
Income accruing or arising in India. But received outside India	50000	50000	50000
Profit earned in UK and received in India	35000	35000	35000
Salary drawn for employment in Singapore from an Indian company	7500	Nil	Nil
Profit earned from business transaction outside India and kept in Punjab national bank	25000	Nil	Nil
	117500	85000	85000

**Note:** dividend from a domestic company is exempt in all cases.

### Illustration 4

From the following particulars submitted by Miss. Rekha as regards her income in the previous year 2020-21 compute her gross total income if she is



- Resident and ordinary resident
  - Resident but not ordinary resident and
  - Non resident
- Income from agriculture in Srilanka received in Srilanka and remitted to India. ₹ 25000
  - Pension from an Indian employer received abroad ₹ 12000
  - Past untaxed profits brought to India ₹ 50000
  - Rental income from the property in Nepal received outside India ₹ 17000
  - Annual value of a single self-occupied property in India ₹ 3600

**Solution:****Computation of gross total income of Miss Rekha**

Particulars of income	Resident	Not ordinarily resident	Non-resident
Salary	12000	12000	12000
House property let out In Nepal 17000 Less 30% 5100	11900	Nil	Nil
Agriculture income in Srilanka	25000	Nil	Nil
Past un expected income	Nil	Nil	Nil
Total income	48900	12000	12000

**Illustration 5**

Mr. Vinod has the following incomes during the assessment year 2021-22. Compute his total income for the assessment year 2021-22 if he is resident of India, not ordinarily of India and non resident of India.

- Capital gain on sale of a house in Mumbai ₹ 40000
- Salary received outside India for rendering service in India ₹ 50000
- Interest received from government of India (received outside India) ₹ 15000
- Technical fees received from an India company (received in India for advice given in respect of project outside India) ₹ 80000
- Income from a business situated outside India (controlled wholly outside India) ₹ 25000

**Solution:****Total Income of Mr. Vinod for the Assessment Year 2021-22**

## Notes

Particulars of Income	Resident	Not ordinarily resident	Non-resident
Capital gain on sale of a house	40000	40000	40000
Salary received outside India for rendering service in India	50000	50000	50000
Interest received from government of India	15000	15000	15000
Technical fees received from an India company	80000	80000	
Income from a business situated outside India	25000		
Income from business connection in India	35000	35000	35000
Total Income	245000	220000	140000

**Case Study: Make it Count: Residential Status Key to Taxation**

An individual is taxed in India based on his tax residential status—which, in turn, depends on the number of days he is in India during a tax year (April 1 to March 31). Based on this calculation, an individual may be Resident and Ordinarily Resident (ROR), Resident but Not Ordinarily Resident (RNOR), or Non-resident (NR). While an ROR is liable to tax in India on worldwide income, an RNOR or NR is taxed in India primarily on income sourced in India. It is vital to correctly determine an individual's tax residential status for a particular tax year — if not, he/she could end up paying tax on their worldwide income in India; or, their foreign income, which is liable to tax in India, could escape the tax net.

One is, therefore, faced with the task of keeping track of the days a person is in India during a tax year. The challenge is: how do you count the number of days in India?

Does one consider calendar days, or is every 24 hours spent on Indian soil counted as one day? Is only a full day spent in India counted as a day, or is a fraction of the day also counted? If a fraction of the day is to be counted as a whole day, are the days of arrival and departure both counted as days in India? What happens if one spends less than 24 hours in India during a trip?

The Income Tax Act and Rules do not offer any answers. However, this issue has previously been a subject of litigation, and one can draw guidance from the judicial authorities' interpretation of the term 'days in India'.

In the case of Manoj Kumar Reddy, the Bangalore Tribunal noted that while computing the period for which an assessee is in India, the count should begin from the date of arrival of the assessee in India to the date he leaves the country. The Tribunal drew guidance from the provisions of the General Clauses, Act and concluded that in counting days in this manner, the first day should be excluded. Hence, when counting the 'days', the day of arrival should be ignored.

The Bangalore Tribunal's view was followed by the Mumbai Tribunal in the case of Fausta C. Cordeiro, wherein it held that the arrival date is to be excluded from the count, particularly when the assessee arrived late in the day.

Based on the Tribunals' views, one may consider counting on the basis of calendar days, excluding the day of arrival but including the day of departure, even if it is a fraction of a day. Thus, if an individual arrives in the evening and leaves the next morning, he would have been in India (for tax purposes) for one day.

A word of caution: tax officials tend to count both the day of arrival and day of departure as 'days in India', irrespective of whether it is a full day or a few hours. Hence, the 'days in India' in the example above would be two days, not one. So, when you zoom in and out of India on business or for pleasure, don't forget to keep a tab on your 'days in India', lest you are entangled in the tax net.

#### Questions:

1. Study and analyse the case.
2. Write down the case facts.
3. What do you infer from it?

## 2.15 Summary

Every country generates income from 'Income Tax' in the form of direct tax levied by government. Income tax plays a vital role in the economy of every country in the world. Income tax act was enacted in the year 1961.

Income, in general, means a periodic monetary return which accrues or is expected to accrue regularly from definite sources.

The "tax net" refers to the types of payment that are taxed, which included personal earnings (wages), capital gains, and business income. The rates for different types of income may vary and some may not be taxed at all.

Tax rates may be progressive, regressive, or flat. A progressive tax taxes differentially based on how much has been earned. A tax system may use different taxation methods for different types of income.

The Indian Income Tax department is governed by the Central Board for Direct Taxes (CBDT) and is part of the Department of Revenue under the Ministry of Finance.

The Government of India imposes an income tax on taxable income of individuals, Hindu Undivided Families (HUFs), companies, firms, co-operative societies and trusts (Identified as body of Individuals and Association of Persons) and any other artificial person. Levy of tax is separate on each of the persons.



Income tax is to be charged at the rates fixed for the year by the annual Finance Act.

Income from agricultural sources will be included in 'total income', to determine tax-liability.

## Notes

The levy is governed by the Indian Income Tax Act, 1961.

Tax incidence on an assessee depends on his residential status. Whether an income earned by a foreign national in India or outside India taxable in India depends on the residential status of the individual, rather than on his citizenship. Therefore, the determination of the residential status of a person is very significant in order to find out his tax liability.

There are three residential statuses that we will study in detail this unit namely the Residents also referred to as Resident & Ordinarily Residents, the Resident but not Ordinarily Residents and the non-residents.

Residential status of an assessee is to be determined in respect of each previous year as it may vary from previous year to previous year. An assessee may enjoy different residential status for different assessment years. For instance, an individual who has been regularly assessed as resident and ordinarily resident has to be treated as non-resident in a particular assessment year if he satisfies none of the conditions of section 6(1).

Under section 6(1), an individual is said to be resident in India in any previous year, if he satisfies any one of the conditions like he has been in India during the previous year for a total period of 182 days or more, or he has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year. If the individual satisfies any one of the conditions mentioned above, he is a resident. If both the above conditions are not satisfied, the individual is a non-resident also referred to as NRI.

Only individuals and HUF can be resident but not ordinarily resident in India. All other classes of assesses can be either a resident or non-resident. An individual is said to be a resident and ordinarily resident if he satisfies both the following conditions:

- (i) He is a resident in any 2 out of the last 10 years preceding the relevant previous year, and
- (ii) His total stay in India in the last 7 years preceding the relevant previous year is 730 days or more.

If the individual satisfies both the conditions mentioned above, he is a resident and ordinarily resident but if only one or none of the conditions are satisfied, the individual is a resident but not ordinarily resident.

Every Indian company is resident in India irrespective of the fact whether the control and management of its affairs is exercised from India or outside. But a company, other than an Indian company, would become resident in India only if the entire control and management of its affairs is in India. The control and management of the affairs of company are said to be exercised from the place where the director's meetings (not shareholders' meetings) are held, decisions taken and directions issued.

As per section 5, incidence of tax on a taxpayer depends on his residential status and also on the place and time of accrual or receipt of income. In order to understand the relationship between residential status and tax liability, one must understand the meaning of "Indian income" and "foreign income".

The scope of total income of an assessee depends upon the following three important considerations like the residential status of the assessee, the place of accrual or receipt of income, whether actual or deemed and the point of time at which the income had accrued to or was received by or on behalf of the assessee.

## 2.16 Keywords

- **Assessee:** He/She is a person by whom any tax or any other sources of money is payable.
- **Company:** A voluntary association formed and organised to carry on a business.
- **Direct Tax:** A tax that is paid directly by an individual or organisation to the imposing entity
- **Dividend:** Dividends are payments made by a corporation to its shareholder members. It is the portion of corporate profits paid out to stockholders.
- **Flat Tax:** A flat tax (short for flat tax rate) is a tax system with a constant marginal rate, usually applied to individual or corporate income.
- **Income Tax:** An income tax is a tax levied on the income of individuals or businesses (corporations or other legal entities).
- **Indirect Tax:** Indirect taxes are those paid by consumers when they buy goods and services.
- **Tax Net:** It refers to the types of payment that are taxed and include personal earnings (wages), capital gains, and business income.
- **Assessee:** He/She is a person by whom any tax or any other sources of money is payable.
- **Company:** A voluntary association formed and organised to carry on a business.



## Notes

- **Direct Tax:** A tax that is paid directly by an individual or organisation to the imposing entity
- **Gross Total Income:** It is an individual's total personal income before taking taxes or deductions into account.
- **Income Tax:** An income tax is a tax levied on the income of individuals or businesses (corporations or other legal entities).
- **Indirect Tax:** Indirect taxes are those paid by consumers when they buy goods and services.
- **Regressive Tax:** A regressive tax is a tax imposed in such a manner that the tax rate decreases as the amount subject to taxation increases.
- **Tax Net:** It refers to the types of payment that are taxed and include personal earnings (wages), capital gains, and business income.

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### 2.17 Review Questions

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1. What is Historical Background of Income Tax?
2. Explain the Overview of Income Tax Law in India.
3. Describe the Basic Concepts of Income Tax.
4. What is Agricultural Income?
5. Explain the Income Tax Systems in India.
6. Describe the Residential Status of a Company.
7. What is Incidence of Tax?
8. Explain the Scope of Income.
9. Explain the deemed receipt and Accrual of Income in India.
10. Discuss the Categories of Income which are Deemed to Accrue or Arise in India.

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### 2.18 Further Readings

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- Ahuja, G. K. & Gupta, Ravi, *Systematic Approach to Income Tax*, Bharat Law House.
- Aggarwal, K., *Direct Tax Planning and Management*, Atlantic Publications.
- Lakhotia, R.N., *Income Tax Planning Handbook*, Vision Books.
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- Srinivas E. A., *Handbook of Corporate Tax Planning*, Tata McGraw Hill.



# **Income from Salary and House Property**

Notes

**(Structure)**

- 3.1 Learning Objectives
- 3.2 Introduction
- 3.3 Meaning of Salary
- 3.4 Principles with Regard to Salary
- 3.5 Types of Allowances and Valuation
- 3.6 Types of Perquisites and Valuation
- 3.7 Deductions From Gross Salary
- 3.8 Income from House Property
- 3.9 Essential Conditions
- 3.10 Deemed Ownership
- 3.11 Exempted Incomes
- 3.12 Composite Rent
- 3.13 Annual Value
- 3.14 Computation of Annual Value
- 3.15 Deductions
- 3.16 Tax Treatment of Self Occupied Houses
- 3.17 Important Points
- 3.18 Summary
- 3.19 Keywords
- 3.20 Review Questions
- 3.21 Further Readings

## Notes

**3.1 Learning Objectives**

After studying the chapter, students will be able to:

- Understand the term salary;
- Understand the concept of profits in lieu of salary;
- Understand the meaning of provident fund and their types for a salaried person;
- Calculate the taxable part of allowance;
- Know the types of perquisite;
- The meaning and chargeability of house property;
- Concept of let out houses and self-occupied houses;
- Deductions available from annual value;
- Computation of taxable income from house property.

**3.2 Introduction**

A person has to pay tax on his total/taxable income earned by him in the previous year on the basis of his residential status. As per section 14 of Income-tax Act 1961, all incomes for the purpose of charge of income tax and computation of total income, are classified under the following five heads:

- (i) Income from salary (Section 15, 16 and 17)
- (ii) Income from house property (Section 22 to 27)
- (iii) Profits and gains of business and profession (Section 28 to 44-D)
- (iv) Income from capital gains (Section 45 to 55)
- (v) Income from other sources (Section 56 to 59)

In this unit, you will learn about the meaning of salary and the items included under the term 'income from salary'.

In the previous unit, you have learnt about the concept of salary and the terms included under the term 'salary' like basic salary, allowance, perquisite, profits in lieu of salary, provident fund etc. In this unit, you will learn about the types of allowances and perquisites including their valuation for income tax purpose.

The annual value of property consisting of any buildings or lands appurtenant thereto of which assessee is the owner shall be subject to Income-tax under the head 'Income from house property' after claiming deduction under section 24 provided such property, or any portion of such property is not used by the assessee for the purposes of any business or profession carried on by him.

### 3.3 Meaning of Salary

#### Notes

Salary is the payment made by the employer to the employee in consideration of his services rendered in favour of the employer. The employer may be an individual, a firm, an association of persons etc. So, any payment received from a person other than employer, will be taxed either under the head of 'Profits and gains of business or profession' or under the head 'income from other sources'. For the purpose of income tax, salary includes the monetary values of those benefits and facilities provided by the employer which are taxable. The income-tax Act, 1961 does not define salary. It merely states as to what is included under 'income from salary'. Thus, Section 15 and 17(1) of the Act are inclusive under the term 'income from salary'.

According to Section 15 of Income-tax Act, 1961, the following shall be chargeable to tax under the head 'salary':

1. **Salary due:** Any salary due from an employer or a former employer to an assessee in the previous year, whether it is paid or not.
2. **Salary received:** Any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though it is not due to him.
3. **Arrears of salary:** Any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if this has not been charged to income-tax in any earlier previous year.

#### Income from Salaries

##### Basic Elements of Salary

- Payer and payee must have employer and employee (or Master & Servant) relationship; and
- Payment must have been made by the employer in such capacity.

##### Employer-employee Relationship

A payment can be construed as salary only if the payer is the employer and payee is the employee of the payer.

- **Criteria for employer-employee relationship:** The key criteria to hold this relationship is that, employee is always bound to work as per direction and supervision of the employer.
- **Payment in employer's capacity:** To treat any payment as salary it is necessary that payer, being the employer, must have made the payment in such (employer's) capacity.



## Notes

- **Contract of service Vs contract for service:** In "contract of service", the employer can direct and control the duties and the manner of performance of employee hence employer employee relationship exists in such contract. However, in case of "contract for service" the contractee can simply decide and quote the object or target to be achieved but cannot decide or direct the manner of performance.
- **Agent and Principal:** If a person is acting as an agent for his principal, any commission or remuneration earned by the agent is not taxable under the head "Salaries". This is because, an agent is not the employee of his principal.
- **Salary received by a partner from its firm shall not be taxable as salary,** because there is no employer-employee relationship between the firm and the partner. Such salary shall be taxable under the head "Profits & gains of business or profession".
- **Salary received by proprietor from his proprietorship firm is not an income.** As proprietor and proprietorship firm are the same person and no one can earn from himself.
- **Remuneration to director** from his company can be treated as salary only if the director is employee of the company, otherwise the same shall be taxable under the head "Income from other sources". Note: Directors' sitting fee is taxable under the head "Income from other sources".
- **Pension received by the widow** or legal heir of deceased employee is not taxable as salary as no employer-employee relationship exists between the payer and the payee. However such amount shall be taxable under the head "Income from other sources".
- **Remuneration received by Judges** is taxable under the head "Salaries" even though they are not having any employer.

Concluding the above discussions, a payment received for services rendered, from a person other than employer, is not taxable under the head "Salaries" but may be taxed under the head "Profits & gains of business or profession" or "Income from other sources".

**Illustration**

State whether the following receipts should be treated as salary or not?

- A teacher receives emoluments in kind from school in which he teaches. Yes, it is immaterial whether salary has been received in cash or in kind.

- **A teacher of a college receives fees from a University for checking answer sheets.** *Income from Salary and House Property*

No, as employer – employee relationship does not exist between payer and payee. (College-teacher is not the employee of the University). Such receipt shall be taxable under the head 'Income from other sources'.

- **A payment made to the Member of the Parliament or the State legislature.**

No, as employer-employee relationship does not exist.

A member of the Parliament or the State legislature is not treated as employee of the Government. Payment received by them shall be taxable under the head "Income from other sources".

Notes

### 3.4 Principles with Regard to Salary

The important principles regarding income from salary are:

1. **Relationship of employer and employee:** A payment will be regarded as salary only when there exist a relationship of employer and employee between the payer and the payee. If there does not exist the relationship of employer and employee between the payer and payee then, any payment made by the payer will not be taxed under 'income from salary'. For example, allowances received by MP's/MLA's; exam remuneration received by a teacher etc types of payment will be taxed under the head 'income from other sources'.
2. **Salary and wages:** As per law, there is no difference between salary and wages. Wages receivable by a labourer and the salary receivable by the Prime Minister of India, are taxable under the head 'income from salary'.
3. **Salary becoming taxable on due basis:** The salary becomes taxable when it becomes due. It is immaterial when will it be paid. For example, Mr. Rahim does not get salary for 2 months upto 31st March, yet it shall be included in income of this year because it has become due.
4. **More than one source of salary:** An assessee may receive salary from more than one employer during the same previous year due to change in employment or due to his job nature (part-time employee with several employers). Salary received from each employer is taxed under the head 'income from salary'.
5. **Deductions from salary by the employer:** Some deductions (from employee's salary) may be compulsory or optional or under a contract on behalf of employee made by the employer. In every case deductions from salary are regarded as



## Notes

application of income. These deductions may be employee's contribution to provident fund, rent of the accommodation belonging to the employer and occupied by the employee, installment of loan/interest (the loan being taken from the employer), premium on the life insurance policy on the life of the employee, any other deduction which the employer makes at the direction of the employee.

6. **Voluntary payments:** Every payment, in cash or in kind, made by an employer to his employee in consideration of his services is taxed under the head 'income from salary'. Thus salary, perquisite or allowance may come as a gift to an employee, yet it would be taxable.
7. **Tax-free salary:** If an employer pays tax-free salary to his employee, income-tax on such salary is paid by the employer on behalf of his employee. In such a case the amount of tax paid by the employer is regarded as perquisite in the hands of the employee. The employee shall pay income-tax on the salary, perquisites (including the payment of income-tax by the employer) and allowances received by him from his employer. Out of the total tax-liability of the employee, the tax paid by the employer is deducted and the remaining amount is paid by the employee. The tax paid to the department is deemed as tax paid on behalf of the employee.
8. **Loan from employer:** The amount of loan taken from the employer will not be regarded as advance salary and will not be included in total income of recipient employee.
9. **Salary to partner:** Any salary received by a partner from his own firm will not be chargeable under the head 'salary' and it will be taxed under the head 'income from business or profession'.
10. **Surrendering of salary:** If an employee surrenders his whole salary or a part of it, this surrendered salary shall be included while computing his taxable salary. If there has been a contract between the employer and employee not to take salary or partial salary, then salary not taken shall not be included in taxable income under the head 'income from salary'.
11. **Time of accrual of salary:** Salary of the previous year is taxed during the current year. Previous year begins on 1st April and ends on 31st March preceding the assessment year. Salary earned during 1st April to 31st March is included in the salary income chargeable during the assessment year. For example, if a person worked for 5 months with one employer and for 6 months with the other. In such a case his salary of 11 months will be included in his total income.



## Principles of Salary

1. Employee employer relationship
2. Salary from a former employer
3. Place of accrual of salary income
4. Foregoing salary
5. Tax free salary
6. Surrender of salary
7. Accrual basis
8. Payment made after termination

## Scope of Salary

1. Basic salary or wages
2. Advance pay
3. Arrears of salary
4. Dearness pay
5. Annuity
6. Pension

## Computation of Salary, at a Glance...

Computation of income under the head "Salaries" of ..... for the A.Y. ....

Particulars	Details	Amount
Basic Salary		*****
Fees		*****
Commission		*****
Bonus		*****
Gratuity		*****
Leave Encashment		*****
Pension		*****
Retrenchment Compensation		*****
Compensation received under Voluntary Retirement Scheme		*****
<b>Allowances:</b>		
Dearness Allowance (DA) /Dearness Pay (DP)	****	
House Rent Allowance	****	
Children Education Allowance	****	

Income from Salary and  
House Property

Notes

## Notes

Children Hostel Allowance	****	
Entertainment Allowance	****	
Medical Allowance	****	
Conveyance Allowance	****	
City Compensatory Allowance	****	
Uniform Allowance	****	
Professional Development Allowance	****	
Transport Allowance	****	
Other Allowances	****	*****
<b>Perquisites u/s 17 (2)</b>		
Any Obligation of Employee paid by Employer	****	
Accommodation	****	
Shares and securities issued under ESOP	****	
Employer's Contribution to Superannuation Fund	****	
Gas, Electricity & Water	****	
Medical Facility	****	
Other fringe benefits	****	*****
Leave Travel Concession		*****
Contribution of Employer to Provident Fund		*****
Interest on Recognised Provident Fund		*****
Any other item		*****
Gross Salary		*****
<b>Less: Deduction u/s 16</b>		
(ia) Standard Deduction	****	
(ii) Entertainment Allowance	****	
(iii) Tax on employment/Professional tax	****	****
<b>Taxable Salary</b>		*****

**Main Items Included in Salary**

For computing taxable income under the head 'income from salary', Gross Salary shall be first calculated. The term 'gross salary' includes the following:

- (I) Salary
- (II) Allowances
- (III) Perquisites
- (IV) Profits in Lieu of Salary

These can be depicted by the following chart:

*Income from Salary and House Property*

Gross Salary			
(I) Salary	(II) Allowances	(III) Perquisites	(IV) Profits in Lieu of Salary
Salary or wages	Fully taxable	Taxable for all employees	Compensation received
Bonus	Partially exempt	Taxable for specific employees	Any payment received by an employee from his employer or former employer in appreciation of the employee's services
Fee, commission	Fully exempt	Tax-free for all employees	Amount received from a provident fund or other fund
Overtime payments			
Annuity			
Advance salary			
Annual accretion in employee's recognised provident fund			
Encashment of earned leave or leave salary			
Death-cum-retirement gratuity			
Pension			
Compensation on Retrenchment Amount received on voluntary retirement			

Notes

### Salary

According to Section 17(1) of the Income-tax Act, 1961 the term 'Salary' includes the following receipts :



## Notes

1. **Salary or wages:** The base of appointment in any service is basic salary. The basic salary of an employee is that part of salary which does not include any type of allowance. If certain deductions are made from the salary, while making payments to the employee like deduction of contribution in provident fund by the employee, deduction of income-tax or any other deduction, then the total of these deductions is included in the net amount of salary received by an employee and thus it becomes basic salary.
2. **Bonus:** Bonus paid by employer to his employees is taxable as salary, in the year of receipt.
3. **Fees, commission:** The whole of the amount received by an assessee as fees, commission and other monetary receipts which are also termed as allowances are included in the total income of the assessee. The fees or commission paid to a person other than the employee, will not be taxable as salary. Commission may be based in the form of some percentage of sale or profit.
4. **Overtime payments:** An employer may give to his employee the payments for the period excess of prescribed hours. Its whole amount will be included in gross salary of the employee.
5. **Annuity:** An employer may give annual grant to his employee which is known as 'Annuity'. It is taxable under the head 'income from salary'. Annuity may be given by the employer voluntarily or under an agreement. If the annuity is paid by LIC, it shall not be taxable under the head salary. In that case, it will be included under the head 'income from other sources'.
6. **Advance salary:** Advance salary means the salary received by an employee before it is earned by him. Advance salary is included in the taxable income of the recipient, but it is not so included when it becomes due.
7. **Annual accretion in employee's recognised provident fund:** There may be annual accretion in employee's recognized provident fund due to following two reasons:
  - (a) **Employer's contribution in Provident Fund:** An employer has to contribute some amount in employee's recognized provident fund which becomes employee's salary. If this amount exceeds 12% of employee's salary, this excess amount shall be included in employee's salary.
  - (b) **Interest on Provident Fund:** If the amount of interest on recognized provident fund exceeds 9.5%, this excess amount shall be included in salary.

[For this, 'Salary' means: Basic Salary + Dearness Pay + Dearness Allowance (if it is under the terms of employment) + Commission on sale at a fixed percentage].

## Notes

**8. Encashment of earned leaves or leave salary:** Earned leaves are the leaves which, if not availed of by an employee, are converted into equivalent cash salary and paid to the employee. If the earned leaves are encashed during service, whole amount of cash received shall be taxable to all types (Government or Non-government employees) of employees. But, when an employee takes retirement from the service or resigns from service, he is given some amount for his earned leave. It is called encashment of earned leave or leave salary. Some part of this money received by the employee is taxable and remaining part shall be exempted. The provisions of Income-tax Act, 1961 regarding exemption of encashment of earned leave are given below:

- (a) Government Employee: The whole amount of sum received by the employee of Central and State Government shall be exempted.
- (b) Non-government employees (including employees of Local Authority, Statutory Corporation and Enterprises of Public Sector): Least amount of following four items shall be tax-free and the remaining amount shall be included in salary.
  - (i) Actual amount of encashment of earned leave received, or
  - (ii) Salary of maximum 10 months, calculated on the basis of average salary of 10 months preceding immediately from the retirement, or
  - (iii) Calculated amount of encashment of leave for the approved period not taken during the service (Maximum period of 30 days for each completed year is approved for encashment of earned leave), or
  - (iv) Declared amount by the Government (The Central Government has right in this respect to notify in the Gazette a maximum exempted amount of leave salary). The maximum exemption is ₹ 3,00,000.

[For this, 'Salary' means: Basic Salary + Dearness Pay + Dearness Allowance (If under terms of employment) + Commission at fixed rate on sale done by employee].

### Illustration 1

Mr. Neeraj retired on 1.1.2016 after serving 34 years 9 months in a company. From the following particulars, compute taxable amount of earned leave:



## Notes

- (i) Salary ₹15,000p.m from 1.1.2015 to 31.12.2015.
- (ii) Leave granted one and half month for each one year's service.
- (iii) Leave taken during service for 30 months.
- (iv) Balance of leave in account 21 months.
- (v) ₹1,68,000 received for encashment of earned leave on retirement.

**Solution:**

- (a) Leave (one month's leave for each completed year of service) 34 months
- (b) Leave availed 30 months
- (c) Leave due as per law (30 days × 34 years) – (30 days × 30 months) = 120 days/4 months
- (d) Exempted amount would be least of the following:
  - (i) Amount of encashment received ₹1,68,000
  - (ii) 10 month's average salary ₹15,000 × 10 ₹1,50,000
  - (iii) Cash equivalent to 4 months  
@ average salary ₹60,000 (₹ 15,000 × 4)
  - (iv) Maximum exemption limit ₹3,00,000

So, the exempted amount of encashment is ₹60,000 and the taxable amount will be ₹1,08,000 (₹1,68,000 – ₹60,000).

- 9. Death-cum-retirement gratuity:** Gratuity is a gratuitous payment made by the employer to his employee, for services rendered, at the time of retirement or death, whichever is earlier, of the employee. Thus, it is a retirement benefit. It is paid by the employer either under a contract of employment or under the Payment of Gratuity Act 1972. The amount of gratuity is paid to the employee, if he survives at the time of retirement, or to his wife or children, if he dies before retirement. Some part of the gratuity is exempt and the remaining part shall be taxable.

The amount of gratuity received by employee is taxable under head 'income from salary' while the amount of gratuity received by the heirs of the employee is taxable under the head 'Income from other sources'.

For computing taxable gratuity, the employees have been divided into two categories:

- (A) Government employees [section 10(10)(i)]:** The employees of Central Government, State Government and Local Authority are included in this



category. The whole amount of gratuity received by these employees or their heirs is exempt. *Income from Salary and House Property*

**(B) Non-government employees [section 10(10)(ii) and section 10(10)(iii)]:**

- (i) *Employees who covered under Payment of Gratuity Act, 1972 [section 10(10)(ii)]* - The employees working in Government factories, semi-government factories, private factories, ports, railways, etc, are covered under this Act.

*Exempted Gratuity* - Least amount of the following three amounts shall be exempt and remaining amount shall be included in the salary:

- (i) Actual amount of gratuity received; or,
- (ii) Salary of 15 days for the service of each completed year. Wages of 7 days in case of employees working in seasonal institutions (in place of 15 days)

Computation of 15 day's salary :

Salary for last month (including D.A × 15)

26

- (iii) ₹10,00,000.

*Note:* (a) 6 months or more than 6 months will be treated as one year and salary of last month will be taken for this purpose.

- (b) For the above case, *Salary* means monthly basic salary last drawn + Dearness pay + Dearness allowance (whether it is under the terms of employment or not; and 1 month will be considered for 26 days.
- (c) If an employee gets salary or wages under piece rate or contract system, average of three months salary/wages immediately preceding retirement/death shall be considered. In that case, computation of 15 day's salary will be:

Average monthly salary or wages for 3 months × 15)

26

**Illustration 2**

After serving for 32 years and 7 months in Hindustan Chemicals Ltd. Mr. Ramesh, who is covered by Payment of Gratuity Act, retires from service on 30<sup>th</sup> April, 2016. The company pays him a gratuity of ₹95,000. His monthly basic salary at the time of retirement was ₹7,200. You are required to determine the amount of exempted gratuity under section 10(10) of Income-tax Act.

Notes

## Notes

**Solution:**

As per the given information, Mr. Ramesh is covered under Payment of Gratuity Act, 1972. His total service period is 32 years 7 months; hence 33 years of service will be taken. For computing of 15 day's salary, salary of last month will be taken and 15/26 of this salary will be done.

$$15 \text{ day's salary} = ₹7,200 \times \frac{15}{26} = ₹4,153.84$$

The amount of exempted gratuity will be least of the following:

- (i) ₹95,000 (actual amount)
- (ii) ₹4,153.84 × 33 = ₹1,37,076.72
- (iii) ₹20,00,000.

So, the exempted Gratuity will be ₹95,000.

- (ii) *Employees covered under Payment of Gratuity Act, 1972 [section 10(10) (iii)]* - The non-government employees, employees of a corporation established under any Act of Central or State Government are not covered under Payment of Gratuity Act.

**Illustration 3**

Kishore, an employee of XYZ Ltd., receives ₹ 2,05,000 as gratuity under the Payment of Gratuity Act, 1972. He retires on 10th September, 2020 after rendering service for 35 years and 7 months. The last drawn salary was ₹ 2,700 per month. Calculate the amount of gratuity chargeable to tax.

**Solution:**

Computation of taxable gratuity of Mr. Kishore

Particulars	Details (₹)	Amount (₹)
Gratuity received		2,05,000
Less: Minimum of the following is exempted as per Sec 10(10)(ii):		
(a) Actual gratuity received	2,05,000	
(b) Statutory Amount	20,00,000	
(c) $15/26 \times \text{completed year of service} \times \text{salary p.m.}$ [ $15/26 \times 36 \times ₹ 2,700$ ]	56,077	56,077
<b>Taxable Gratuity</b>		<b>1,48,923</b>

**Exempted Gratuity:** Least amount of the following three amounts shall be exempt and remaining amount shall be included in the salary:

- (i) Actual amount of gratuity received; or,
- (ii) Salary for the service period on the basis of half month's salary for each completed year. (Complete years shall be taken. Months shall not be considered even they are more than 6); or,
- (iii) ₹20,00,000.

For the above case, Salary means Basic salary + Dearness pay + Dearness allowance (if it is under the terms of employment) + Commission at fixed rate on sale.

**Note:** (I) The average salary of preceding 10 months immediately retirement shall be taken.

## Notes

### Illustration 4

After serving for 25 years and 7 months in a cloth mill of Indore, Mr. Raju retires from service on 30th April, 2016. The company pays him a gratuity of ₹4,40,000. During 10 months ending, he was drawing a monthly salary was ₹30,000 and conveyance allowance of ₹3,400. You are required to determine the amount of exempted gratuity under section 10(10) of Income-tax Act.

### Solution:

As per the given information, Mr. Raju is not covered under Payment of Gratuity Act, 1972. So, the total service period will be taken of 25 years. The average salary for 10 months is ₹30,000.

The amount of exempted gratuity will be least of the following:

- (i) ₹4,40,000 (actual amount); or
- (ii)  $₹15,000 \times 25 = ₹3,75,000$  (on the basis of half month's salary for each completed year of service); or
- (iii) ₹20,00,000.

So, the exempted Gratuity will be ₹3,75,000 and the taxable gratuity will be ₹65,000 (₹4,40,000 – ₹3,75,000).

1. **Pension:** Pension is a periodical or lump sum payment made by the employer to his employee after his retirement from service. Retired employee, means an employee who has completed his full term of service and has ceased to be in service on attaining the age of superannuation or retirement. The pension is given in two forms:

- (a) **Uncommuted Pension:** Pension given on monthly basis is called uncommuted pension. The whole amount of it shall be taxable under the head 'income from salary'.



## Notes

- (b) **Commutated Pension:** Commuted means, some part of whole pension is discounted in cash. The lump-sum amount is given in cash to the employee by the employer. Its remaining part is given monthly. So, some part of commuted pension received by the employee is included in salary and some part of this commuted pension is exempt.

The exemption rules are:

- (i) **Commutated pension to Government employees:** Commuted pension received by the employee of Central Government, State Government, justices of high court/supreme court, local authority and employees of a corporation established under Central or State Act or employees of public undertaking shall be fully exempted.
- (ii) **Commutated pension to Non-Government employees:** Commuted pension received by the employee from any other employer shall be exempt upto the following limit:
  - (a) If the employee gets gratuity along with the pension -  $1/3^{\text{rd}}$  part of total pension shall be exempt.
  - (b) If the employee does not get gratuity -  $1/2$  part of total pension shall be exempt.
- (iii) Any payment, made in the form of commuted pension from pension fund created by the LIC since 1.8.1996 or any other insurer, shall not be taxable for it, it is essential that employee has given contribution himself in this fund.

**Illustration 5**

Mr. Dhasmana is getting a pension of ₹ 12,000p.m from a company. During the previous year, he got  $2/3^{\text{rd}}$  commuted pension and received ₹7,38,000. Compute the exempted amount of pension, if (i) he also received gratuity, (ii) he did not receive gratuity.

**Solution:**

- (i) *When Mr. Dhasmana received gratuity –*

Commutated value of  $2/3^{\text{rd}}$  pension ₹7,38,000

Commutated value of full pension = ₹7,38,000  $\times \frac{3}{2}$  ₹11,07,000

Exempted amount = Commuted value of  $1/3^{\text{rd}}$  pension (₹11,07,000)  
= ₹3,69,000.

(ii) When Mr. Dhasmana did not received gratuity –

Income from Salary and  
House Property

Commuted value of 2/3rd pension ₹7,38,000

Commuted value of full pension =  $₹7,38,000 \times \frac{3}{2}$  ₹11,07,000

Exempted amount = Commuted value of 1/2 pension (₹11,07,000)

= ₹5,53,500.

Notes

**11. Compensation on Retrenchment:** Any compensation received by a workman under the Industrial Dispute Act 1947, at the time of retrenchment is exempt from tax to a specified limit.

**Retrenchment includes:** retrenchment on account of closure of business or, transfer of employee from one service to another. The least of the following amounts shall be exempt:

- (i) Actual amount of compensation received;
- (ii) Salary for service period calculated on the basis of 15 day's average salary for each completed calender year (6 months or more shall be treated as one year);
- (iii) Maximum amount declared by Central Government ₹5,00,000.

**Average Salary means:**

- (i) In case the workman gets salary on monthly basis, then average salary of the last 3 calendar months immediately preceding the month in which the service is retrenched.
- (ii) In case the workman gets wages on weekly basis, then average wages of the last 4 complete weeks immediately preceding the week in which the service is retrenched.
- (iii) In case the workman gets wages on daily basis, then average wages of last 12 full working days immediately preceding the day on which the service is retrenched.

**Salary means:** Basic Salary + All monetary receipts + Actual monetary of perquisites (Excluding gratuity and employers contribution for employee's welfare.

**Note:** A workman means that workman who is covered under Industrial Dispute Act. It does not include manager, administrator whose salary is more than ₹1,600 and who render their services for managerial affairs, personnel employed in army, police/navy services.

**Illustration 6**

Mr. Rajpal is employed as a clerk in a factory since 1<sup>st</sup> October, 2003. He is getting ₹15,600p.m. as salary and ₹2,600p.m. as dearness allowance since 1<sup>st</sup> Jan., 2011. His services were terminated on account of retrenchment of employees on 1<sup>st</sup> August, 2021 and he was paid ₹1,44,000 as compensation. Compute his exempted amount of compensation for the assessment year 2022-23.

**Solution:**

Total period of service is 13 years.

Average salary is ₹15,600 + ₹2,600 = ₹18,200.

Total no. of days during 3 months prior to retrenchment (May + June + July) = 92 days.

*Least amount of the following shall be exempted amount of compensation –*

(i) Actual amount of compensation – ₹1,44,000.

(ii) ₹1,15,728 (on the basis of 15 day's salary for 13 years)

$$\frac{18,200 \times 3 \times 15 \times 13}{92}$$

(iii) ₹5,00,000 (Maximum as per law).

Exempted compensation = ₹1,15,728.

Taxable compensation = ₹28,272 (₹1,44,000 – ₹1,15,728).

- 12. Amount received on voluntary retirement** – Any compensation received by an employee on his voluntary retirement or termination of service is exempt from tax to some extent as per the provisions of law.

**Allowances**

Allowance is a fixed monetary amount paid by the employer to the employee (over and above basic salary) for meeting certain expenses, whether personal or for the performance of his duties. The money paid as allowance is also part of gross salary. A salaried person may get some other cash receipts in the form of allowances besides the basic salary. Some of allowances are exempt for all types of employees while some allowances are partially exempt.

**Allowances at a glance:**

General Allowance	House Rent Allowance, City Compensatory Allowance, Tiffin Allowance, Medical Allowance, Servant Allowance, Entertainment Allowance
-------------------	--



Allowance u/s 10(14)(i), deductions from which depends upon actual expenditure [Rule 2BB(1)]	Travel or Transfer allowance, Daily Allowance, Conveyance Allowance, Assistant Allowance, Professional Development Allowance, Uniform Allowance
Allowance u/s 10(14)(ii), deductions from which do not depend upon actual expenditure [Rule 2BB(2)]	Few of these allowances are: Children Education Allowance, Children Hostel Allowance, Truck Drivers' Allowance, Transport Allowance, Tribal Areas Allowance, Special Compensatory Allowance, Border Area Allowance, etc.
Allowances to a Government employee being an Indian citizen working outside India [Sec. 10(7)]	
Allowances received from UNO	
Compensatory allowance under Article 222(2) of the Constitution	
Allowance to judges of the High Court and the Supreme Court	
Allowances to teacher / professor from SAARC Member States	
Allowance or Perquisite to member of Union Public Service	
Commission [Sec. 10(45)]	
Any other Allowance	

*Income from Salary and House Property*

## Notes

### Perquisites

Perquisite denotes a personal advantage. The term 'perquisites' means any benefit, attached to an office or position in addition to his salary/wages and allowances. It may be given in cash or in kind. If it is given in kind, it should be capable of being measured in terms of money. If the employee does not avail these benefits/amenities, he will not be given money in place of these. Some examples of perquisites/amenities are facility of hotel, boarding and lodging, accommodation for employees, expenses on entertainment incurred by the employer, use of telephone, facility of guest house etc. The perquisites are chargeable under the head 'salaries' only if there are:

- Allowed by an employer to his employee;
- Given during the duration of his service;
- Directly depending on the employment;
- Being of the nature of personal benefits;
- Derived by virtue of employer's authority.

**Note:** The description of all types of perquisites and their valuation for tax purpose is discussed in the next unit of this block.

According to Section 17(3), profits in lieu of salary include any profits in lieu of or in addition to salary/wages. It includes the followings –

## Notes

1. **Compensation received:** The amount of any compensation due to or received by an assessee from his employer or former employer, or in connection with the termination of his employment/modification of the terms and conditions relating to his employment, is taxable under the head 'Salary' as 'profits in lieu of salary'. It does not matter whether the compensation is received by the employee as a matter of right or is given to him voluntarily by the employer.
2. **Any payment:** This includes any payment due or received by an assessee from his employer or former employer in appreciation of the employee's services. But if a sum is paid to an employee by his present/former employer not in token of appreciation of the services rendered but as a personal gift for the personal qualities of the employee, such payment is not taxable in the hands of employee under the head 'salary'.
3. **Amount received from an unrecognised provident or other fund:** Any payment made from an unrecognised provident fund or other fund to the extent of employer's contributions and interest on such contributions, or any sum received under a Keyman insurance policy including the amount of bonus will be included. However, the interest on the employee's contributions to an unrecognised provident fund or superannuation fund is not exempt from tax but it is included in his total income under the head 'income from other sources'. In brief, the employer's contribution and interest thereon is taxable under the salary head and interest on employee's contribution is taxable under the head of income from other sources.
4. **Payment before joining or after retirement –** This includes:
  - (i) Any amount due or received by any assessee, whether in lump-sum or otherwise, before joining any employment with that person; or
  - (ii) Any amount due or received by any assessee, whether in lump-sum or otherwise, after cessation of his employment with that person.

**Exceptions:** The following amounts received by an employee are not included in salary income as 'profits in lieu of salary' because these are partially exempt and partially taxable:

- (i) Death-cum-retirement gratuity (Exempt portion) [u/s 10(10)]
- (ii) Commuted pension (Exempt portion) [u/s 10(10-A)]



- (iii) Compensation (Exempt portion) [u/s 10(10-B)]
- (iv) Payment from statutory and public provident fund [u/s 10(11)]
- (v) Payment from recognised provident fund [u/s 10(12)]
- (vi) Payment from approved superannuation fund [u/s 10(13)]
- (vii) House rent allowance (Exempt portion) [u/s 10(13-A)]

### Illustration 7

Mr. Chauhan has the following salary structure:

(a) Basic Salary ₹ 5,000 p.m.	(b) Entertainment Allowance ₹ 1,000 p.m.
(c) Education Allowance ₹ 500 p.m. (he has three children)	(d) DA ₹ 3,000 p.m.
(e) Fees ₹ 5,000 p.a.	(f) Bonus ₹ 10,000 p.a.
(g) Professional tax of employee paid by employer ₹ 2,000 for the year	

He has been provided a rent-free accommodation in Mumbai. 60% of DA only forms part of retirement benefits.

Compute taxable value of accommodation in the hands of Mr. Chauhan in the following cases:

- (i) The employer owns such accommodation.
- (ii) The employer hires such accommodation at a monthly rent of ₹ 900.

### Solution:

Taxable value of rent-free accommodation for the A.Y. 2021-22

Particulars	Basis of determination	Taxable Perquisite
(i) Owned by employer	15% of Salary (Working)	₹ 16,830
(ii) Hired by employer	15% of Salary or Actual rent paid by employer, whichever is lower	₹ 10,800

**Working:** Salary for the purpose of Rent-free accommodation:

Particulars	Details	Amount (₹)	Amount (₹)
Basic Salary		60,000	
Bonus		10,000	
Fees		5,000	
<b>Allowances</b>			
Dearness allowance	₹ 36,000 × 60%	21,600	
Entertainment Allowance		12,000	



Education Allowance	₹ 6,000 – ₹ 2,400	3,600	37,200
Gross Taxable Salary	1,12,200		

## Notes

**Note:** Professional tax paid on behalf of employee is a perquisite; hence the same shall not be included in salary for the aforesaid purpose.

**Illustration 8**

In above illustration, how shall answer differ if the property is situated in a city where population is only 14,60,000.

**Solution:**

Taxable value of rent free accommodation for the A.Y.2021-22

Particulars	Basis of determination	Taxable value of Perquisite
Owned by employer	10% of Salary (as per the above working)	₹ 11,220
Hired by employer 15% of Salary or Actual rent paid by employer, whichever is lower	₹ 10,800	

**Illustration 9**

Miss Sree has the following salary structure:

- Basic salary 15,000 p.m.
- Dearness Allowance 5,000 p.m. (not forming part of retirement benefit)
- Hostel Allowance 1,000 p.m. (does not have any child)
- Tiffin Allowance 500 p.m.
- Transport Allowance 200 p.m.
- Bonus 20,000 p.a.
- Commission 15,000 p.a.
- Free refreshment in office worth 5,000 p.a.
- Mobile phone facility by employer 900 p.m.
- Computer facility worth 10,000 p.a.

She has been provided a Rent-free Accommodation (owned by employer) in Kolkata. The house was allotted to her with effect from 1/5/2020 but she could occupy the same only from 1/6/2020. Find her gross taxable salary.

**Solution:**

*Income from Salary and  
House Property*

Computation of gross taxable salary of Miss Sree for the A.Y. 2021-22

Particulars	Details	Amount (₹)	Amount (₹)
Basic Salary			1,80,000
Bonus			20,000
Commission			15,000
<b>Allowances:</b>			
Dearness Allowance		60,000	
Hostel Allowance (Fully taxable as she has no child)		12,000	
Tiffin Allowance		6,000	
Transport Allowance		2400	80,400
Perquisite u/s 17(2):			
Free Refreshment (not taxable)		Nil	
Mobile or telephone facility		Nil	
Computer facility		Nil	
Rent Free Accommodation	Working	29,425	29,425
Gross Salary		3,24,825	

Notes

**Working:** Salary for the purpose of rent-free accommodation

Basic Salary	1,80,000
Bonus	20,000
Commission	15,000
<b>Allowances</b>	
Dearness allowance	Nil
Hostel Allowance	12,000
Tiffin Allowance	6,000
Transport Allowance	2,400
Total	2,35,400
Value of Rent-Free Accommodation (being $15\% \times ₹ 2,35,400 \times 10/12$ )	29,425

**Provident Fund**

The word 'Provident' means to provide for the future, hence this fund is providing on the retirement of the employee from his service along with interest. This fund is build by the deduction from the salary of the employee every month at a certain rate and the employer also makes his own contribution to this fund. These contributions are invested to earn interest, which is also credited to the employee's provident fund account. If unfortunately, the employee dies during the tenure of his service, the amount of this fund is received by his wife and children or legal heirs, which is of great help to them. These funds are of following kinds:

## Notes

1. **Statutory Provident Fund:** This provident fund is maintained by Government or Semi-Government (local authorities, educational institutions, nationalized banks, etc.) offices. It is that Provident Fund in which Indian Provident Fund Act, 1925 applies.
2. **Recognised Provident Fund :** This provident fund is maintained by scheduled banks, factories and business houses. These funds are recognised by the Chief Commissioner or Commissioner of Income Tax according to the provisions of Income-tax Act.
3. **Unrecognised Provident Fund:** Any institution or organization can maintain this fund. These funds are neither statutory nor recognised. It is approved by the P.F. Commissioner. This is maintained by private sector organizations.

## Provisions of Income Tax regarding Provident Fund

Particulars	Statutory Provident Fund	Recognised Provident Fund (R.P.F)	Un-recognised Provident Fund
Employee's contribution	Employee's contribution is included in taxable salary. Employee is paid his monthly salary after deducting his contribution to provident fund. But his full salary is included in taxable income. Thus, his contribution to provident fund is included in his salary. But the entire contribution upto ₹1,50,000 qualifies for deduction u/s 80C.	Employee's contribution is included in taxable salary. Employee is paid his monthly salary after deducting his contribution to provident fund. But his full salary is included in taxable income. Thus, his contribution to provident fund is included in his salary. But the entire contribution upto ₹1,50,000 qualifies for deduction u/s 80C.	Employee's contribution is included in taxable salary. Employee is paid his monthly salary after deducting his contribution to provident fund. But his full salary is included in taxable income. Thus, his contribution to provident fund is included in his salary. But his contribution does not qualify for deduction u/s 80C.



Employer's contribution	Tax Free	Tax free upto 12% of salary. Excess over 12% of salary is included in salary.	Tax Free
Interest credit to provident fund	Tax Free	Tax free, if rate of interest doesn't exceed 9.5%. Interest in excess of above rate is included in salary.	Tax Free
Lump sum payment at the time of retirement/ termination of service etc.	Tax free u/s 10(11)	Tax free u/s 10(12) provided: - the employee has served continuously for atleast 5 years. - He has been removed from service on account of retrenchment, illness or closure of business or closure of business.	Lump sum upto the amount equal to employee's contribution is exempt. Employer's contribution and interest there on is included in salary income. Interest on employee's contribution is taxable under the head 'income from other sources'.
<b>Salary = Basic Salary + Dearness Pay + Dearness Allowance (on the terms of service) + Commission or sales at a prescribed rate.</b>			

*Income from Salary and House Property*

## Notes

### Illustration 10

Shree Nagender is employed on ₹20,000p.m. salary and ₹1,500p.m. dearness allowance. He contributes 12% of his salary and dearness allowance in a provident fund (P.F.) whereas his employer contributes 14%. Interest on provident fund is determined @ 14% which is ₹2,402 for the previous year. This interest has been credited in fund upto 31-08-2020. He gets house rent allowance also of ₹900p.m. He gives rent for the house used for his own residence. What would be salary for the assessment year 2021-22, if provident fund is (a) Statutory, (b) Recognised, (c) Unrecognised?

**Solution:**

Computation of Gross Salary

(for the assessment year 2021-22)

Notes

	Statutory P.F ₹	Recognised P.F ₹	Unrecognised P.F ₹
Salary (₹ 20,000 × 12)	2,40,000	2,40,000	2,40,000
Dearness allowance (₹1,500 × 12)	18,000	18,000	18,000
Employer's contribution to R.P.F. (excess of 12% of salary)	-	5,160	-
Interest on P.F. (excess of 9.5%)	-	772	-
House rent allowance	900	900	900
<b>Gross Salary</b>	<b>₹ 2,58,900</b>	<b>₹ 2,64,832</b>	<b>₹ 2,58,900</b>

**3.5 Types of Allowances and Valuation**

As we know that, the allowance is a fixed monetary amount paid by the employer to the employee for meeting certain expenses, whether personal or for the performance of his duties. For the purpose of tax treatment, we divide these allowances into three different categories i.e., fully taxable allowances, partially exempt allowances and fully exempted allowances.

**Fully Taxable Allowances**

The main allowances under this category are:

1. **Dearness Allowance:** As is clear by its name, this allowance is paid to compensate the employee against the rise in price level in the economy. It may be paid under the terms of employment or otherwise. In both the cases it is included in salary. But where this allowance is given under the terms of employment it forms part of the basic salary. It is deemed under the terms of employment under the following conditions:
  - (a) When it is included in the 'salary' for the purpose of computation of annual contribution in a recognised provident fund; and
  - (b) When it is included in the 'salary' for the purpose of computation of all retirement benefits (like provident fund, pension, leave encashment, gratuity etc.) payable to an employee. But, if dearness allowance or dearness pay is part of salary for computing only some (not all) of the retirement benefits, then it is not considered as part of salary or under the terms of employment.

2. **City Compensatory Allowance:** This allowance is paid to employees who are posted in big cities. The purpose is to compensate the high cost of living in cities like Delhi, Mumbai etc. However, it is fully taxable.
3. **Tiffin/Lunch Allowance:** It is given for lunch to the employees.
4. **Non practicing Allowance:** This is normally given to those professionals (like medical doctors, chartered accountants etc.) who are in government service and are banned from doing private practice. It is to compensate them for this ban. So, it is fully taxable and comes under the category of fully taxable allowances.
5. **Warden or Proctor Allowance:** These allowances are given in educational institutions for working as a 'warden' of the hostel or as a Proctor in the institution.
6. **Overtime Allowance:** It is paid in lieu of payments for overtime salary or wages.
7. **Fixed Medical Allowance:** Medical allowance is fully taxable even if some expenditure has actually been incurred for medical treatment of employee or family.
8. **Servant Allowance:** It is fully taxable whether or not servants have been employed by the employee.
9. **Other Allowances:** There may be several other allowances like family allowance, night allowance, education allowance, rural allowance, holiday allowance etc. These are also fully taxable.

### Partially Taxable Allowances

This category includes allowances which are exempt upto certain limit. The main allowances under this category are:

1. **Children Education Allowance:** This allowance is exempt to the extent of ₹100 per month per child for maximum of 2 children. *For example*, an employee gets ₹200p.m per child as education allowance for his three children. The employee gets ₹7,200 during the previous year. The allowance chargeable to tax is ₹4,800 as ₹200p.m. (maximum limit) is exempt.
2. **Children Hostel Allowance:** Any allowance granted to an employee to meet the hostel expenditure on his child is exempt to the extent of ₹300p.m per child for maximum of 2 children. *For example*, an employee gets ₹400p.m per child as hostel allowance for his three children. The employee gets ₹14,400 during the previous year. The allowance chargeable to tax is ₹7,200 as ₹600 p.m. (maximum limit) is exempt.
3. **Transport Allowance:** This allowance is generally given to government employees to compensate the cost incurred in commuting between place of



## Notes

residence and place of work. An amount upto ₹1,600p.m paid is exempt. However, in case of blind and orthopaedically handicapped persons, it is exempt upto ₹3,200p.m.

4. **Daily allowance:** Any allowance which is granted for tour or for the period of journey in connection with transfer, to meet the ordinary daily expenses incurred by an employee during his absence from his normal place of duty, is exempt from tax to the extent the amount is utilised for the purpose. For example, Mr. Raju received a daily allowance at ₹250 per day for 10 days, during his tour period, by his employer. He, during his 10 days tour, spent ₹2,000 only. Then, the allowance chargeable to tax is of ₹500 (₹2,500 – ₹2,000).
5. **Conveyance allowance:** Any allowance which is granted to meet the expenditure on conveyance in performance of duties of an office is termed as conveyance allowance. It is exempt from tax to the extent it is spent on such conveyance provided that free conveyance is not provided by the employer. If the employee has been provided free conveyance the whole of such allowance will be chargeable to tax. For example, Mr. Singh is employed in a company for collecting the amounts from its debtors. Besides salary, he is also getting the conveyance allowance of ₹1,000 p.m. for the purpose. During the previous year he spent ₹10,000 on conveyance in performance of such duty. In this case, ₹2,000 (₹12,000 – ₹10,000) is chargeable to tax. If the amount spent would have been ₹12,000 or more, the whole allowance would have been exempt from tax. But if the employee would have been provided free conveyance by the employer, the whole allowance would have been taxable.
6. **House Rent Allowance (H.R.A.) [Sec 10(13A)]:** An allowance granted to a employee by his employer to meet expenditure incurred on payment of rent in respect of residential accommodation occupied by him is exempt from tax to the extent of least of the following three amounts:
  - (a) House Rent Allowance actually received by the assessee; or
  - (b) Excess of rent paid by the assessee over 10% of salary; or
  - (c) An amount equal to 50% of salary (if the accommodation is situated in Mumbai, Kolkata, Delhi, Chennai) or, an amount equal to 40% of salary (if the accommodation is situated in any other place).

**Note:**

- (a) Salary for the purpose of HRA = Basic Salary + Dearness Allowance (if part of salary) + Commission (if fixed % of turnover).

- (b) The exemption of HRA depends upon the basic salary, place of residence, rent paid and HRA received by the employee. *Income from Salary and House Property*
- (c) If an employee is living in his own house or is living in a house for which he is not paying any rent, full amount of HRA receivable by the employee is taxable.

## Notes

### Illustration 1

Mr. A resides in Chennai. He is paid ₹3,60,000 as basic salary. He also gets ₹1,00,000 as house rent allowance. The rent paid by him is ₹75,000. Calculate exempt HRA and taxable HRA.

#### Solution:

##### Calculation of HRA

(i) Actual HRA received = ₹1,00,000

(ii) Excess of rent paid by the assessee over 10% of salary = ₹39,000 (₹75,000 – ₹36,000)

(iii) 50% of salary (₹3,60,000) = ₹1,80,000

Therefore, ₹39,000 shall be exempted and the balance ₹61,000 (₹1,00,000 – ₹39,000) shall be included in gross salary as taxable HRA.

### Illustration 2

Mr. Y, a resident of Ajmer, receives ₹ 48,000 as basic salary during the previous year 2020-21. In addition, he gets ₹4,800 as dearness allowance forming part of basic salary, 7% commission on sales made by him (sale made by X during the relevant previous year is ₹ 86,000) and ₹ 6,000 as house rent allowance. He, however, pays ₹ 5,800 as house rent. Determine the quantum of exempted house rent allowance.

#### Solution:

Computation of taxable house rent allowance of X for the A.Y. 2021-22

Particulars	Details (₹)	Amount (₹)
House Rent Allowance Received	6,000	
Less: Minimum of the following being exempted u/s 10(13A)		
(a) Actual Amount Received	6,000	
(b) 40% of Salary (Note)	23,528	
(c) Rent paid – 10% of salary [₹ 5,800 – ₹ 5,882]	Nil	Nil
Taxable House Rent Allowance		6,000

**Note:** Salary for the purpose of HRA

Basic salary	₹ 48,000
Dearness Allowance	₹ 4,800
Commission (7% of ₹ 86,000)	₹ 6,020
Total	₹ 58,820

Hence, exemption u/s 10(13A) is Nil.

**Illustration 3**

Compute the taxable house rent allowance of Mr. Harikumar from the following data:

1. Basic Salary ₹ 5,000 p.m., D.A. ₹ 2,000 p.m., HRA ₹ 4,000 p.m., Rent paid ₹ 4,000 p.m. in Pune.
2. On 1/07/2020, there is an increment in Basic salary by ₹ 1,000.
3. On 1/10/2020, employee hired a new flat in Kolkata at the same rent as he was posted to Kolkata.
4. On 1/01/2021, employee purchased his own flat and resides there.

**Solution:****Computation of taxable house rent allowance of Mr. Harikumar for the A.Y. 2021-22**

Particulars	Details (₹)	Amount (₹)	Amount (₹)
House Rent Allowance Received (from 1.4.2020 to 30.6.2020)		12,000	
Less: Minimum of the following being exempted u/s 10(13A)			
(a) Actual Amount Received	12,000		
(b) 40% of Salary [(₹ 5,000 + ₹ 2,000) × 3]	8400		
(c) Rent paid – 10% of salary (₹ 12,000 – ₹ 2,100)	9900	8400	3600
House Rent Allowance Received (from 1.7.2020 to 30.9.2020)		12,000	
Less: Minimum of the following being exempted u/s 10(13A)			
(a) Actual Amount Received	12,000		
(b) 40% of Salary [(₹ 6,000 + ₹ 2,000) × 3]	9600		
(c) Rent paid – 10% of salary (₹ 12,000 – ₹ 2,400)	9600	9600	2400
House Rent Allowance Received (from 1.10.2020 to 31.12.2020)	12,000		



Less: Minimum of the following being exempted u/s 10(13A)			
(a) Actual Amount Received	12,000		
(b) 50% of Salary [(₹ 6,000 + ₹ 2,000) × 3]	12,000		
(c) Rent paid – 10% of salary (₹ 12,000 – ₹ 2,400)	9600	9600	2400
House Rent Allowance Received (from 1.1.2021 to 31.3.2021)			
(Fully taxable as assessee resides in his own house)		12000	
Taxable House Rent Allowance		20400	

*Income from Salary and House Property*

Notes

### **Special allowance exempt u/s 10(14)**

Allowances, deduction from which depends on actual expenditure [Sec. 10(14)(i)]

Allowance	Meaning
Travel or transfer Allowance	An allowance, by whatever name called, to meet the cost of travel on tour. Cost of travel includes any sum paid in connection with transfer, packing and transportation of personal effects on such transfer.
Daily Allowance	An allowance, by whatever name called, granted on tour (or for the period of journey in connection with transfer) to meet the ordinary daily charges incurred by employee on account of absence from his normal place of duty.
Conveyance Allowance	Any allowance granted to meet the expenditure on conveyance in performance of duties of the office, provided free conveyance is not provided by the employer. Taxpoint: Expenditure for covering the journey between office and residence is not treated as expenditure in performance of duties of office and consequently not covered under this allowance. (Refer Transport allowance)
Helper / Assistant Allowance	Any allowance (by whatever name called) to meet the expenditure of assistant or helper, provided such helper is appointed for the performance of duties of an office. Taxpoint: Servant allowance is fully taxable.
Research Allowance	Any allowance, by whatever name called, granted to encourage academic, research and other professional pursuits. This allowance may also be termed as Professional Development / Academic allowance

Uniform Allowance	Any allowance, by whatever name called, to meet the expenditure on purchase or maintenance of uniform wear, during the performance of duties of an office. Taxpoint: Uniform allowance is different from Dress allowance. Dress allowance is fully taxable.
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**Tax Treatment of aforesaid allowances:**

Minimum of the following shall be exempted:

- (a) Actual amount received; or
- (b) Actual expenditure incurred for such purpose.

**Allowances, deduction from which do not depend on actual expenditure [Sec. 10(14)(ii)]**

**Children Education Allowance**

An allowance to meet the expenses in connection with education of children, by whatever name called. Treatment: Minimum of the following is exempted from tax -

- (a) ₹ 100 per month per child (to the maximum of two children)
- (b) Actual amount received for each child (to the maximum of two children)

**Children Hostel Allowance**

An allowance to meet the hostel expenses of children, by whatever name called.

Treatment: Minimum of the following is exempted from tax -

- (a) ₹ 300 per month per child (to the maximum of two children)
- (b) Actual amount received for each child (to the maximum of two children)

Notes for Children Education Allowance and Hostel Allowance:

- (a) Child includes adopted child, step-child but does not include illegitimate child and grandchild.
- (b) Child may be major or minor child.
- (c) Deduction is available irrespective of actual expenditure incurred on education of child.

(vii) *Entertainment Allowance* - This allowance is first included in gross salary under allowances and then deduction is given to only central and state government employees under Section 16(ii). [For details, see heading no. 3.5 of this unit].

**Fully Exempt Allowances**

This category includes allowances which are fully exempt from tax. The main allowances under this category are:

1. **Academic Allowance:** This allowance is given for encouraging the various academic research. It shall be exempt upto the actual expenditure. If the academic allowances is not spent fully, remaining amount not spent shall be taxable. *Income from Salary and House Property*
2. **Uniform Allowance:** This allowance is given to meet the expenditure in connection with purchasing and maintaining uniforms during the official duties.
3. **Allowance to High Court Judges:** Any allowance paid to a High Court and Supreme Court Judges of whatever nature are fully exempt from tax.
4. **Allowance received from United Nations Organisation (UNO):** All allowances paid by the UNO to its employees are fully exempt from tax.
5. **Allowance received by a teacher from SAARC Members States:** Allowances received by a resident teacher/professor/research scholar from any SAARC Member States is exempt for first two years of their arrival in the Member States subject to the fulfilment of their conditions.
6. **Allowance to chairman or members of UPSC:** Any allowance of the nature of transport allowance and sumptuary allowance granted to chairman or any other member of Union Public Service Commission (UPSC) is exempt u/s 10(45) of the Income-tax Act, 1961.
7. **Foreign allowance:** This allowance is usually paid by the government to its employees being Indian citizen posted out of India for rendering services abroad. It is fully exempt from tax.

## Notes

### Illustration 4

Mr. X has the following salary structure –

Basic pay ₹ 10,000 p.m.

Commission (fixed) ₹ 2,000

DA ₹ 1,000 p.m.

Entertainment allowance ₹ 2,000 p.m.

X contributes ₹ 20,000 to provident fund. Employer also makes a matching contribution. Compute gross salary of if –

- Mr. X is a Government employee and such provident fund is a statutory provident fund.
- Mr. X is an employee of Y Ltd. and such fund is a recognized fund.
- Mr. X is an employee of Z Ltd. and such fund is an unrecognized fund.



## Notes

## Solution:

Computation of taxable salary of Mr. X for the A.Y. 2021-22

Particulars	Case A		Case B		Case C	
	Details	Amount	Details	Amount	Details	Amount
Basic		1,20,000		1,20,000		1,20,000
Commission		2,000		2,000		2,000
<b>Allowances</b>						
Dearness allowance	12,000		12,000		12,000	
Entertainment allowance	24,000	36,000	24,000	36,000	24,000	36,000
contribution to PF	20,000		20,000		20,000	
Less: Exempted	20,000	Nil	15,840	4,160	20,000	Nil
<b>Gross Salary</b>		<b>1,58,000</b>		<b>1,62,160</b>		<b>1,58,000</b>

## Notes

1. Contribution to statutory and unrecognised provident fund is fully exempted.
2. Contribution to recognised provident fund is exempt upto 12% of salary. Salary for such purpose –

Particulars	Amount (₹)
Basic	1,20,000
Commission (as fixed)	Nil
Dearness allowance	12,000
Total	1,32,000

## Illustration 5

Mr. Sharma has been appointed as an accountant of ABC Ltd as on 1/4/2018, since then he is working with the same company. The salary structure and increment details are as under:

Basic ₹ 5000 - 1000 - 8000 -1500 - 14000

D.A. ₹ 3000 – 500 – 5000 – 1000 - 10000

He and his employer contribute to URPF 14% of basic and DA.

Every year 9% interest is credited to such fund. As on 1/4/2020, the fund gets recognition. Hence, the accumulated balance in URPF was transferred to RPF. Comment on tax treatment of such transferred balance.

## Solution:

Statement showing treatment of transferred balance:

Year	Employer's contribution to fund	Exempted amount considering the fund as RPF	Difference
2018-2019	14% of (60,000 + 36,000) i.e. ₹ 13,440	12% of ₹ 96,000 i.e. ₹ 11,520	₹ 1,920
2019-2020	14% of (72,000 + 42,000) i.e. ₹ 15,960	12% of ₹ 1,14,000 i.e. ₹ 13,680	₹ 2,280
Total			₹ 4,200

### 3.6 Types of Perquisites and Valuation

As we know that perquisite means any benefit in cash or kind in addition to salary and allowances. For income tax purposes, we limit the scope of perquisites to the benefits received in kind and which are convertible in terms of money. So, valuation of perquisites means the ascertainment of the monetary value of the perquisite provided by the employer to his employee. As per Section 17(2) of Income-tax Act 1961, perquisites may be classified into different categories like taxable perquisites for all employees, taxable perquisites for specific employees and tax-free perquisites for all employees. The explanation and valuation are given below for the purpose of income tax.

#### Taxable Perquisites for All Employees

These are general perquisites. So, these are taxable in the hands of every employee assessee. The value of these facilities shall be taxable for all types of employees (Government or Private) to whom these facilities have been provided. The provisions for the valuation of perquisites are comes under Income-tax Rules, 1962. These perquisites may be followings:

1. **Rent-free Accommodation:** The value of rent-free accommodation provided to the assessee by his employer is taxable perquisite in the hands of every employee (Government and Non-Government). The accommodation provided by the employer to his employee may be of any of the following two categories—
  - (i) **Unfurnished accommodation:** The accommodation which is not fitted with furniture or other facilities (like TV, AC, Refrigerator etc.) is termed as unfurnished.
  - (ii) **Furnished accommodation:** The accommodation which is equipped with furniture or other facilities is termed as furnished.

[Sec.17(2)(i)]

## Notes

**Valuation in case of Government employees -**

- (a) **Unfurnished accommodation:** According to the license fee framed by the Government. The licensing fee (different for different types of employees as per their status) of the house is that fee which has been determined by the Government for the valuation of house.

*Taxable value of house = Licensing fee of the house*

- (b) **Furnished accommodation:**

*Taxable value of house = Valuation as unfurnished + 10% p.a of the cost of furniture installed in the accommodation (if the furniture is owned by the Government).*

*or,*

*Taxable value of house = Valuation as unfurnished + Actual rent/hire charges of furniture installed in the accommodation paid by Government (if the furniture has been taken on hire by the Government).*

**Valuation in case of Non-Government employees -**

- (a) **Unfurnished accommodation:**

*When the accommodation is owned by the employer:*

*Taxable value of house = 15% of salary in respect of the period during which the said accommodation was occupied by the employee during the previous year.*

**Note:** 15% of salary in cities having population exceeding 25 lakhs; 10% of salary in cities having population in between of 10 to 25 lakhs; 7.5% of salary in cities having population not exceeding more than 10 lakhs.

*When the accommodation is taken on lease/rent by the employer -*

*Taxable value of house = 15% of salary (in all cases) or, Lease rent payable by the employer [whichever is less].*

- (b) **Furnished accommodation -**

*When the accommodation is owned by the employer or the accommodation is taken on lease/rent by the employer (both cases) -*

*Taxable value of house = Valuation as unfurnished + 10% p.a of the cost of furniture installed in the accommodation (if the furniture is owned by the Government).*

*or,*



*Taxable value of house = Valuation as unfurnished + Actual rent/hire charges of furniture installed in the accommodation paid by employer (if the furniture has been taken on hire by the Government).* *Income from Salary and House Property*

**Valuation in case of hotel accommodation** – If any employee (Government or Private) has been provided with an accommodation in a hotel, then such accommodation is treated as furnished.

*Taxable value = 24% of salary in respect of the period during which the said hotel was occupied by the employee during the previous year or, Actual charges payable by the employer to such hotel [whichever is less].*

**Note:** The meaning of 'Salary' for the purpose of the valuation of rent-free accommodation is -

- (i) Basic salary;
- (ii) Dearness allowances or dearness pay (if it is under the terms of employment);
- (iii) Bonus, Commission;
- (iv) All taxable allowances (excluding the not taxable portion);
- (v) All monetary payments (which is taxable).

### Illustration 1

Shri Vishnu is employed in Mumbai. Particulars of his income for the previous year 2020-21 are given below:

Basic Salary ₹25,000p.m

Dearness Allowance ₹5,000p.m (40% is computed for retirement benefits)

Bonus ₹20,000p.a

Commission ₹15,000p.a

Entertainment Allowance ₹3,000p.m

Employer has paid personal loan of Vishnu ₹7,000

Fair rental value of rent of free house provided by the employer ₹1,00,000p.a

Value of furniture provided ₹2,00,000

Find out Shri Vishnu's income from salary for the assessment year 2020-21.

### Solution:

Computation of Income from Salary

Basic Salary (₹25,000 × 12) ₹3,00,000

Dearness Allowance (₹5,000 × 12) ₹60,000

Notes

## Notes

Bonus ₹20,000

Commission ₹15,000

Entertainment Allowance ( $₹3,000 \times 12$ ) ₹36,000

Personal loan paid by employer ₹7,000

\*Value of rent-free furnished house ₹79,250

**Gross Salary ₹5,17,250**

Less: Deductions u/s 16 (discussed in heading no. 3.5) Nil

**Income from Salary ₹5,17,250**

*Working Note:*

1. It is assumed that the house is owned by the employer.
2. *Salary for rent-free accommodation* \* = ₹3,00,000(Basic Salary) + ₹24,000(D.A.) + ₹20,000(Bonus) + ₹15,000(Commission) + ₹36,000(E.A.) = ₹3,95,000.  
 Value of unfurnished accommodation = ₹59,250 (15% of ₹3,95,000)  
 Value of furnished accommodation = ₹59,250 + ₹20,000(10% of furniture cost) = ₹79,250.
3. *Entertainment allowance shall not be deductible u/s 16 in case of non-government employees.*

- (2) **Concessional Rent-free Accommodation:** The value of rent-free accommodation provided to the assessee at a concessional rate by his employer is a perquisite in the hands of the employee. Normally, the employer deducts a fixed sum from the salary of his employee towards the rent of the accommodation provided to him. The sum so deducted as rent is less than the actual fair rental value of the accommodation. If the employee pays fair rent of the accommodation, it cannot be said that he is receiving any concession in the matter of rent. So, there would be no perquisite in such case. But when the rent paid by him or deducted from his salary is less than the fair rental value of the accommodation, he is said to have received concession in the matter of rent. This would be a perquisite. The accommodation provided to an employee at concessional rent may be either furnished or unfurnished.

[Sec.17(2)(ii)]

**Valuation in case of Government employees -**

- (a) **Unfurnished accommodation:** Value of concession in rent = Licensing fee of the house
- (b) **Furnished accommodation:** Value of concession in rent = Valuation as unfurnished + 10% p.a of the cost of furniture

- (a) **Unfurnished accommodation:** When the accommodation is owned by the employer - Value of concession in rent = 15% of salary in respect of the period during which the said accommodation was occupied by the employee during the previous year.

*Note:* 15% of salary in cities having population exceeding 25 lakhs; 10% of salary in cities having population in between of 10 to 25 lakhs; 7.5% of salary in cities having population not exceeding more than 10 lakhs).

*When the accommodation is taken on lease/rent by the employer -*

*Value of concession in rent = 15% of salary (in all cases) or, Lease rent payable by the employer [whichever is less].*

- (b) **Furnished accommodation:** When the accommodation is owned by the employer or the accommodation is taken on lease/rent by the employer (both cases) -

*Value of concession in rent = Valuation as unfurnished + 10% p.a of the cost of furniture*

**Valuation in case of hotel accommodation -**

*Value of concession in rent = 24% of salary in respect of the period during which the*

*said hotel was occupied by the employee during the previous year or, Actual charges payable by the employer to such hotel [whichever is less].*

- (3) **Payment of Employee's Obligations by Employer:** Where the employer makes any such payment on behalf of his employee, then the actual amount of such payment is taxable perquisite in the hands of the employee's salary. Some examples of such obligations are:

- (i) Payment of personal loan on behalf of employee;
- (ii) Medical expenses reimbursement in excess of ₹15,000;
- (iii) Premium paid for life insurance or an annuity of the employee;
- (iv) Payment of employee's hotel bills;
- (v) Payment of gas, electricity and water bills;
- (vi) Payment of educational fee of employee's children;
- (vii) Payment of salary of domestic servant appointed by the employee;
- (viii) Payment of income-tax on employee's salary etc.

[Sec.17(2)(iv)]



## Notes

*Value* = Actual obligation of employee or Amount paid by the employer [whichever is less].

- (4) **Payment of Employee's Life Insurance and Annuity Premium:** The amount payable by an employer directly or indirectly to effect an assurance on the life of employee would be taxable perquisite in the hands of every such employee. Such funds are other than recognised provident fund or approved superannuation etc. These payments shall be included in the gross salary of the employee even the payment has not been done by the employer during the previous year. It means this payment shall be taxable in the hands of employees on due basis. For example, the responsibility of paying insurance premium due in 18-3-2017 by the employer, is paid actually in 16-4-2017. But this premium shall be included in gross salaries of financial year 2016-17 and shall be taxable in the assessment year 2017-18. If the premium is paid by the employer under certain schemes, like employee's state insurance scheme then, it will not be the perquisite for the employee because this scheme is in the interest of the employee.

[Sec.17(2)(v)]

*Value* = Life or annuity premium actually paid by the employer (including any penalty or interest on it).

- (5) **Specified Security or Sweat Equity Shares Allotted/Transferred to an Employee** – 'Sweat equity shares' means equity shares issued by a company to its employees/directors at a discount. If the employer has directly or indirectly allotted/transferred specified security/sweat equity shares to the employee, free of cost or at a concessional rate, it will be a taxable perquisite in the hands of employee.

[Sec.17(2)(vi)]

*Value* = Fair market value of such security as on the date of transfer by the employer – The amount actually paid by the employee in respect of such security.

- (6) **Employer's Contribution to an Approved Superannuation Fund** – If the employer contributes some amount to the approved superannuation fund of the employee then, such contribution is also comes under taxable perquisite in the hands of the employee to the extent, it exceeds ₹1,00,000.

[Sec.17(2)(vii)]

*Value* = Actual amount contributed by the employer – ₹1,00,000.

- (7) **Value of Any Other Fringe Benefit** - Fringe means additional or supplemented. So, fringe benefits are those benefits which are being provided to the employees

by the employer in addition to their normal salaries, wages and allowances. These are paid to the employees for stimulate their interest in the work. So, the value of these fringe benefits would be included in the employee's salary (taxable perquisite) in excess of a specified limit. Some fringe benefits which are taxable in the hands of all employee are:

*Income from Salary and House Property*

## Notes

- Provision of interest-free or concessional loan.
- Value of travelling/touring and other expenses paid/reimbursed by the employer.
- Value of free meal (taxable, if the value exceeds ₹50 per meal).
- Value of any gift, voucher or token (taxable, if the total value exceed ₹5,000).
- Expenses on credit cards, club membership etc.

### Taxable Perquisites For Specific Employees

Sometimes the employer gives his employees perquisites in the form of facilities or kind instead of paying monetary obligations or reimbursement of expenses to the employees. The value of these non-monetary facilities shall be taxable only in the hands of a specific employees under section 17(2)(iii). The specific employee should be a full time/part time director in the employer's company *or*, he has acquired at least 20% or more equity shares in employer's company *or*, an employee whose taxable monetary income under the head 'income from salary' exceeds ₹50,000. So, the perquisites which are taxable in the hands of specified employees are termed as 'specific perquisites'. These are of following categories:

**(1) Motor Car Facility** – The taxable value of motor car provided by the employer to his employee shall be included in employee's salary. The employer may provide any one of following types of cars to the employee. On the other hand, the employee may have his own car which may be any one of the following types:

**Small Car** – Small car is that which is having engine capacity upto 1.6litres (1600 cc) or less.

**Large Car** – Large car is that which is having engine capacity of more than 1.6litres.

The following situations may occur in this connection:

#### Case A – When motor car is owned or hired by the employer :

- If the motor car is used for official purpose* – In this case, the total taxable value of the perquisite shall be zero provided that the employer keeps the record of this.
- If the motor car is used for private affairs by the employee or his family member and the running/maintenance expenses fully paid by the employer* – In this



## Notes

case, the value shall be determined as the sum actually spent by the employer for running and maintenance expenses of car (including wear and tear) and the remuneration paid by the employer to the car driver (if any).

Value = Amount spent on running and maintenance expenses of motor car by the employer + Remuneration of driver (if any) + 10% of actual cost of car/hire charges, if car is taken on hire (normal wear and tear) – Amount charged from employee for such use.

(c) *If the motor car is used partly for official and partly for private affairs by the employee or his family member* – In this case, the total taxable value of this perquisite shall be determined under following rates –

(i) If the whole expenses (running and maintenance) related with car are borne by the employer or reimbursed to the employee –

Value = ₹1,800p.m (if capacity of the engine of car is upto 1600cc).

₹2,400p.m (if capacity of the engine of car is 1600cc or more).

₹900p.m for driver (if any).

*Note:* If the actual expenses are more than ₹1,800, deduction of actual expenses may be claimed provided the employer keeps some records.

(ii) If the whole expenses (running and maintenance) related with car are borne by the employee –

Value = ₹600p.m (if capacity of the engine of car is upto 1600cc).

₹900p.m (if capacity of the engine of car is 1600cc or more).

₹900p.m for driver (if any).

#### **Case B – When motor car is owned by the employee himself -**

(a) *If the motor car is used for official purpose* – In this case, the total taxable value of the perquisite shall be zero provided that the employer keeps the record of this.

(b) *If the motor car is used for private affairs by the employee or his family member and the running/maintenance expenses fully paid by the employer* – In this case, the value shall be determined as the sum actually spent by the employer on the private use of car by the employee, shall be included in the employee's salary.

(c) *If the motor car is used partly for official and partly for private affairs by the employee or his family member* – In this case, the total taxable value of this perquisite shall be determined under following rates –

(i) If the whole expenses (running and maintenance) related with car are borne by the employer or reimbursed to the employee –



Value = ₹1,800p.m (if capacity of the engine of car is upto 1600cc).

₹2,400p.m (if capacity of the engine of car is 1600cc or more).

₹900p.m for driver (if any).

Less: The amount recovered from the employee.

Note: If the actual expenses are more than ₹1,800, deduction of actual expenses may be claimed provided the employer keeps some records.

(ii) If the whole expenses (running and maintenance) related with car are borne by the employee – In that case, it will not be perquisite. Hence, its valuation shall be nil/zero.

**Case C – Facility to provide more than one car to the employee by the employer:** If the employer has more than one car or he has hired more than one car and the employee is entitled to use any one or all car frequently, the taxable value of this perquisite shall be determined in the following manner:

- (i) The valuation of one car shall be done on the assumption that this car is being used for official purpose partially and for private purpose partially. In this case, ₹1,800p.m or ₹2,400p.m (depends upon car cc) and ₹900 (if driver is provided).
- (ii) The valuation of remaining other cars shall be done on the assumption that these cars are being used exclusively for private purpose. This means –

Value = Total expenses paid by the employer + total remuneration of driver +

10% cost of motor car – any amount paid by the employee or received Note: The valuation of separate car shall be done as per process described above and the least of these valuations shall be taxable value of car. These valuations shall be in the interest of the employee.

**Case D – Facility to provide any vehicle other than motor car:** Where the employee owns any automotive conveyance (other than car) and running/maintenance expenses are borne by the employer, then valuation will be as follows -

- (i) When it is used wholly for official purpose -

Value = Nil or Zero.

- (ii) When it is used partially for official and partially for private purpose -

Value = Actual expenditure incurred by the employee – amount used for official purpose or ₹900 (whichever is higher) – the amount recovered from the employee.

Note: (i) Car provided to a Judge of High Court/Supreme Court is exempt from tax.

(ii) For the valuation of motor car, the expression 'month' means a full calendar month. So, any part of the month is ignored. For instance, if an assessee used a car for 10.5 months, its valuation will be taken for 10 months only.

## Notes

## Notes

**(2) Sweeper, Gardener, Watchman Facility:** The value of the perquisite in the case of sweeper, gardener, watchman shall be:

Salary paid or payable to the servant \*\*\*\*

Less: Amount recovered from employee \*\*

Value of Perquisite \*

**(3) Gas, Electricity or Water Facility:** The value of the perquisite shall be:

Amount paid by the employer to the agency providing gas, electricity or water or where, such supply is made from resources owned by the employer \*\*\*\*

Less: Amount recovered from the employee \*\*\*

Value of Perquisite \*

**(4) Education Facility -**

(1) Where the educational institution is owned or maintained by the employer or where free educational facilities are allowed in any other educational institution by reason of his being in employment of that employer, the value for the educational facility of the employee's children shall be:

- If the cost of such education or value of the benefit per child does not exceed ₹1,000 p.m. = NIL

- If the cost or value exceeds ₹1,000 p.m. per child = Cost of such education in a similar institution in or near the locality - ₹1000 - Amount recovered from the employee.

(2) Education facility provided in any other educational institution to children or other household members of the employee - The value of facility shall be the expenditure incurred by the employer.

**(5) Transport Facility -**

Where an undertaking is engaged in the carriage of passengers or goods and it provides to any employee/any member of his household for private journey free of cost or at concessional fare, in any conveyance owned or leased by the undertaking for the purpose of transport of passengers or goods, the value of the benefit shall be the value at which such benefit is offered by the undertaking to the public.

If any amount is paid or recovered from the employee for such benefit or amenity, it shall be deducted from the aforesaid value.

*Note:* In case of an employee of an Airline or the Railways, the value of transport facility shall be exempt.

### Illustration 2

Shree Gupta is a GM in a transport company on a salary of ₹11,000p.m. The company has provided him with accommodation for which 10% of his salary is deducted. Actual

rent paid by the company for the accommodation is ₹54,000p.a. He is also receiving entertainment allowance of ₹500p.m. He is provided by the company with a car having engine cubic capacity of 1.8 litres for his personal and official use but running and maintenance personal expenses for the same are borne by the assessee himself. Member's of the assessee's family have visited a number of places in company's buses for which no fare had been charged. Total fare for all buses visits during the accounting year amounted to ₹7,200. He is receipt of bonus equivalent to 2 months salary. Compute his Gross Salary for the previous year 2021-22.

*Income from Salary and House Property*

## Notes

### Solution:

#### Computation of Income from Salary

(for the assessment year 2021-22)

Salary ( $₹11,000 \times 12$ ) ₹1,32,000

Bonus ( $₹11,000 \times 2$ ) ₹22,000

Entertainment Allowance ( $₹500 \times 12$ ) ₹6,000

Use of company buses for personal use ₹7,200

Car ( $₹900 \times 12$ ) ₹10,800

\*Value of concessional house ₹10,800

**Gross Salary ₹1,88,800**

Less: Deductions u/s 16 (discussed in heading no. 3.5) Nil

**Income from Salary ₹1,88,800**

*Working Note:*

1. Valuation of Concessional House\* =

Salary = ( $₹1,32,000 + ₹22,000 + ₹6,000$ ) = ₹1,60,000

15% of Salary or Rent ₹54,000 (whichever is less) ₹24,000

Less: 10% of salary being rent deducted ₹13,200

Valuation of concessional house ₹10,800

### Tax-Free Perquisites for all Employees

The following perquisites are exempted from tax in the hands of every employee assessee -

#### 1. Medical Facility – (a) for treatment within India:

- The value of any medical treatment provided free to an employee or any member of his family in any hospital maintained by the employer.



## Notes

- Any sum paid by the employer in respect of any expenditure incurred by the employee on medical treatment of himself/members of his family in a hospital maintained/approved by government.
- Premium paid by the employer on the health insurance of the employee/members of his family.
- If the medical treatment of the employee/member of his family is done at any private hospital, nursing home or clinic other than above, the exemption will be restricted to ₹ 15,000.

*(b) for treatment outside India:*

- Any expenditure incurred by the employer on the medical treatment of the employee/member of his family outside India, is exempt in full.
- Any expenditure incurred by the employer on travel and stay abroad of the employee/member of his family for medical treatment, is also exempt in full.
- Any expenditure incurred by the employer on travel and stay abroad of one attendant who accompanies the patient for his treatment, is exempt in full.

*Note:* The expenditure on medical treatment and stay abroad will be exempt to the extent permitted by the Reserve Bank of India; and the expenditure on travel shall be exempt in the case of an employee whose gross total income (excluding this expenditure) does not exceed ₹2 lakh.

2. **Tour and Travel Facility:** Any conveyance, tour and travel (including foreign travel) facility provided by the employer to an employee is also exempt perquisite in the hands of the employee.
3. **Accommodation in a 'Remote Area':** Accommodation provided in a remote area to an employee working at a mining site or a project execution site of similar nature is an exempt perquisite.
4. **Transport Facility:** Transport/Conveyance provided by an employer to his employee from his residence to office and from office to his residence, is exempt in full.
5. **Telephone/Mobile Facility :** Telephone or mobile phone provided by the employer to an employee at his residence whose bill is also paid by the employer, is regarded as tax-free perquisite. The telephone/mobile may be used for his personal purpose.
6. **Refreshment Facility :** Refreshment (tea or snacks) provided to all employees during working hours in office premises is exempt from tax.

7. **Lunch/Dinner** : Lunch or dinner provided to an employee during working hours is an exempt perquisite provided that cost of such lunch/dinner to the employee is ₹50 or less per meal. *Income from Salary and House Property*

## Notes

8. **Employer's Contribution**: Contribution made by an employer to employee's group insurance scheme/pension scheme, is a tax-free perquisite.
9. **Payment of Accident Insurance Premium** : Annual premium paid by the employer on accidental insurance policy of his employee, is a tax-free perquisite if the beneficiary is the employer.
10. **Family Planning Facility** : Any amount spent by the employer on employees to encourage family planning among them and the medical aid or expenditure incurred on it, is a tax-free perquisite.
11. **Scholarship to Employee's Children** : Scholarship given by the employer to the children of an employee, is a tax-free perquisite.
12. **Interest Free Loan** : Any loan provided by the employer to an employee either free of interest or at concessional rate of interest is a tax-free perquisite, if the amount of loan does not exceed ₹20,000.
13. **Refresher Course or Training Facility** : Any amount spent by the employer on training of employees (including lodging and boarding expenses) for a refresher course, is a tax-free perquisite.
14. **Conference** : Any expenditure incurred by the employer for an employee in connection with a conference, such as conveyance, tour and travel, hotel expenditure or boarding and lodging expenses etc are the exempt perquisite.
15. **Travelling Expenses Paid or Reimbursed** : Actual travelling expenses paid or reimbursed by the employer for the journey undertaken by the employee for business purpose are exempt.
16. **Free Education Facility** : If education facility is provided by the employer to his employees children in an educational institute owned or maintained by the employer, such facility is an exempt perquisite to the maximum extent of ₹1,000 per month per child. There is no restriction on number of children.
17. **Perquisites Given in Foreign Country** : Perquisites given outside India by the Government to a Indian citizen for rendering services outside India, are tax-free perquisites.
18. **Goods Sold at Concessional Rates** : Goods manufactured by the employer sold to his employees at concessional rates, is a tax-free perquisite.
19. **Ration** : Free rations to personnel of armed forces are a tax-free perquisite.



- 20. Free Accommodation to Ministers :** Rent-free furnished residence (including maintenance) provided to a Union Minister, an Officer of Parliament or to an opposition leader in Parliament is regarded as tax-free perquisites.

## Notes

### 3.7 Deductions From Gross Salary

The following deductions are allowed from gross salary in computing taxable salary or income from salary of a salaried employee are -

- (1) Entertainment allowance [Sec. 16(ii)]:** If a Government (Central Government or a State Government) employee is getting any entertainment allowance, it is first included in his salary income and thereafter, before computing taxable salary, a deduction, in respect of this allowance, is allowed under the Act. This deduction is the least of the following amounts:-

(a)  $\frac{1}{5}$  or 20% of the basic salary;

or

(b) ₹5,000;

or

(c) Actual entertainment allowance granted during the previous year.

*Note:*

1. Salary means the basic salary and does not include any allowance, benefit or perquisite etc. Thus, dearness pay, which forms part of the basic salary, is not included in the salary for computing this deduction.
2. Expenditures in connection with entertainment of customers, incurred by a government employee do not in any way affect this deduction. This deduction will be allowed as per rules discussed here irrespective, of the fact that some expenditure has been incurred by the employee who is getting this allowance, on the entertainment of customers. This deduction is allowed even if no amount is spent out of this allowance.
3. This deduction cannot exceed the actual amount received as entertainment allowance.
4. No deduction on account of entertainment allowance is given to a non-government employee.

- (2) Professional tax or tax on employment [Sec. 16 (iii)]:** Any amount paid by the assessee as professional tax or on account of a tax on employment within the meaning of clause (2) of article 276 of the constitution, levied by or under any law, will be allowed as deduction from his gross salary. In this connection following points need attention:



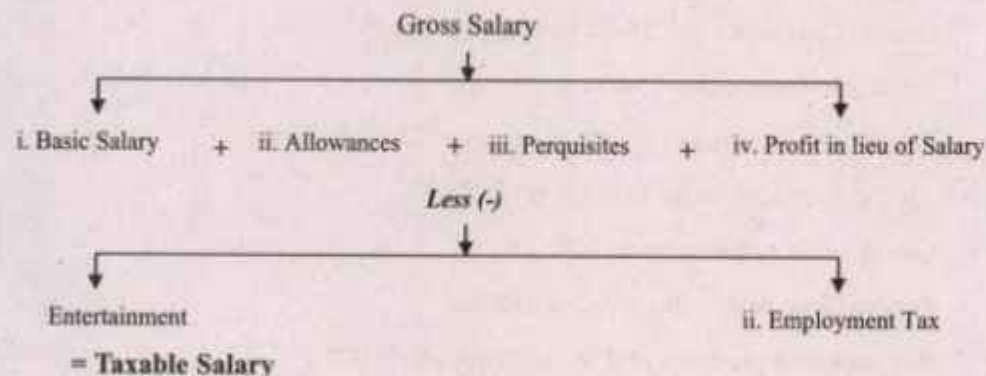
- (i) Professional tax is deductible only in the year in which it is paid. Professional tax due but not paid during the previous year shall not be allowed as deduction. *Income from Salary and House Property*

- (ii) There is no monetary ceiling for this deduction. Thus, if an assessee pays ₹5,000 as professional tax during the previous year, he is entitled to deduction of ₹5,000. However, the State Govt. cannot impose more than ₹2,500 p.a.

- (iii) If the employer pays such tax on behalf of the employee, then it is treated as general perquisite u/s 17(iv) i.e. payment of obligation. It is first included in salary as perquisite and then deduction is allowed from the gross salary.

## Notes

So, the process of computation of taxable salary can be depicted by the following chart –



### Illustration 3

The following particulars relate to the income of Mr. Rajendra for the year ending 31st March, 2022:

Basic salary @ ₹15,000 p.m.

Dearness allowance @ 20% of salary;

Bonus and commission ₹3,000 p.a.;

His own contribution to provident fund is equal to 12% of salary and the employer also contributes the same amount;

Interest deposited to recognized provident fund @ 8.5% ₹3,000;

He has been provided with a facility of 1800 cc car for personal as well as official use.

The entire expenses of car are borne by the employer company;

He has been provided with a furnished house in Auraiya, a city with a population of 6 lakhs, by the employer for which the employer company charges 10% of

## Notes

basic salary. The rental value of the house is ₹1,250 p.m. The cost of furniture and other air-conditioning equipments equipped in the house amounted to ₹5,000 and ₹10,000 respectively. Their written-down value ₹4,000 and ₹8,000 respectively;

The employer has paid his personal loan of ₹5,000 and also paid the life insurance premium of ₹2,000 on his life insurance policy.

The employee paid ₹1,500 as professional tax to the State Government.

Compute the income from salary of Mr. Rajendra for the assessment year 2022-23.

**Solution:**

Computation of Income from Salary

(for the assessment year 2022-23)

Salary (₹15,000 × 12) ₹1,80,000

Dearness allowance @ 20% of basic salary ₹36,000

Bonus and commission ₹3,000

Employer's contribution to RPF in excess of 12% of salary NIL

Car Facility (1800 cc @ ₹2,400p.m.) ₹28,800

Concessional rent-free house NIL

Personal loan paid by the employer ₹5,000

Life insurance premium paid by the employer ₹2,000

**Gross Salary ₹2,54,800**

Less: Professional tax (Deductions u/s 16) ₹1,500

**Taxable Salary/Income from Salary ₹2,53,300**

*Working Note:*

1. Value of concessional rent-free furnished house is as follows -

Valuation = 7.5% of ₹1,83,000 (salary, bonus/commission) + 10% of cost of furniture or A.C (₹15,000) – Rent paid by the assessee (10% of ₹1,80,000 of basic pay) = NIL

**Illustration 4**

Mrs. 'A' a resident individual, is directed in 'ABC' Ltd., New Delhi. She furnishes the following particulars for the year ending on 31st march, 2022:

Salary @ ₹30,000 p.m.

Dearness allowance @ 10% of salary;

Children education allowance (for two children) ₹3,600

Entertainment allowance ₹500p.m

Payment of employee's gas, electricity and water bills ₹4,200

Own contribution to recognized provident fund ₹36,000 and the employer's contribution to this fund ₹46,000

Bonus ₹10,000

She is provided with a 1500 cc car which is owned by the employer and all the expense of its running and maintenance expenses are met by the employer. She is also provided with a driver for the said car for which no charge is made from her by the employer.

'A' uses the car for the personal purpose also.

Life insurance premium paid by the employer amounted to ₹5,000

She is provided with rent-free unfurnished accommodation for which annual rent of ₹60,000 is paid by the company.

Compute her taxable salary for the assessment year 2022-23.

## Notes

### Solution:

#### Computation of Income from Salary

(for the assessment year 2022-23)

Salary ( $₹30,000 \times 12$ ) ₹3,60,000

Dearness allowance @ 10% of basic salary ₹36,000

Bonus ₹10,000

Education allowance ( $₹3,600 - ₹2,400$ ) ₹1,200

Entertainment allowance ₹6,000

Employer's contribution to RPF in excess of

12% of salary [ $₹46,000 - ₹43,200$  (12% of ₹3,60,000)] ₹2,800

Rent-free accommodation ₹56,580

Car Facility ( $₹1800 + ₹900$  (driver)) ₹32,400

Life insurance premium paid by the employer ₹5,000

Payment of gas, electricity and water ₹4,200

**Gross Salary ₹5,14,180**

Less: Deductions u/s 16 -----

**Taxable Salary/Income from Salary ₹5,14,180**

Working Note:

1. Value of rent-free house is as follows -



Valuation = Rent payable or 15% of salary @ ₹3,77,200 (whichever is less)  
 = ₹60,000 or ₹56,580 [15% of ₹3,60,000 + ₹10,000(bonus) +  
 ₹1,200(E.A.) + ₹6,000(E.A.) = ₹3,77,200]. Hence, ₹56,580.

## Notes

2. Deduction for entertainment allowance is not allowed in case of private employee.

## Illustration 5

Mr. Mugal joined Star Ltd. on 1/4/2021. Details regarding his salary are as follows:

Particulars	Amount (₹)
Basic	5,000 p.m.
Dearness Allowance	2,000 p.m. (50% considered for retirement benefit)
Education Allowance	1,000 p.m. (he has 1 son and 3 daughters)
Hostel Allowance	2,000 p.m. (none of the children is sent to hostel)
Medical Allowance	1,000 p.m. (total medical expenditure incurred ₹ 3,000)
Transport Allowance	1,800 p.m. (being used for office to residence & vice versa)
Servant Allowance	1,000 p.m.
City compensatory Allowance	2,000 p.m.
Entertainment Allowance	1,000 p.m.
Assistants Allowance	3,000 p.m. (paid to assistant ₹ 2,000 p.m.)
Professional Development Allowance	2,000 p.m. (actual expenses for the purpose ₹ 8,000 p.m.)
Bonus	24,000 p.a.
Commission	9,000 p.a.
Fees	5,000 p.a.

Compute his gross taxable salary for the assessment year 2021-22.

## Solution:

Computation of gross taxable salary of Mr. Mugal for the A.Y.2021-22

Particulars	Details (₹)	Amount (₹)	Amount (₹)
Basic Salary			60,000
Bonus			24,000
Commission			9,000
Fees			5,000

Allowances			
Dearness Allowance		24,000	
Education Allowance	12,000		
Less: Exemption ( $\text{₹ } 100 \times 2 \times 12$ )	2,400	9,600	
Hostel Allowance	24,000		
Less: Exemption ( $\text{₹ } 300 \times 2 \times 12$ )	7,200	16,800	
Medical Allowance		12,000	
Transport Allowance	21,600		
Less: Exemption	Nil	21,600	
Servant Allowance		12,000	
City Compensatory allowance		24,000	
Entertainment Allowance		12,000	
Assistance Allowance		36,000	
Less: Exemption (Being actual expenditure)	24,000	12,000	
Professional development allowance	24,000		
Less: Exemption (Actual expenditure max. of amount received)	24,000	Nil	1,44,000
Gross Taxable Salary		2,42,000	

*Income from Salary and House Property*

Notes

### Illustration 6

Rasheed aged 48 years is an accountant and employed by GLF Ltd. He gets ₹ 1,00,000.00 per month as salary and ₹ 1,00,000 per annum as bonus. Besides, GLF Ltd. provides the following.

1. Transport allowance: 1,600 per month
2. Medical facility in a hospital which is owned by GLF. Cost for providing this facility to Rasheed ₹ 30,000
3. Medical facility in a government hospital ₹ 38,000.
4. Medical facility in a private hospital (same hospital is recommended by the government for the medical treatment of government employees.) ₹ 18,000
5. Medical facility (rule 3A) in a hospital approved by the chief commissioner: ₹ 63,000
6. Medi claim insurance premium paid by GLF Ltd for Rasheed and his family ₹ 25,000
7. Reimbursement by GLF Ltd. Of other medical expenditure: ₹. 18,000.

**Solution:**

Income of Rasheed from salary can be calculated as follows:

Notes

Particulars	AY 2020-21	AY 2021-22
Basic salary	12,00,000	12,00,000
Bonus	1,00,000	1,00,000
Transport allowance	Nil	19,200
Medical facility in GLF Ltd's hospital	Nil	Nil
Medical facility in government hospital	Nil	Nil
Medical facility in private hospital	Nil	Nil
Medical facility (Rule 3A)	Nil	Nil
Medi-claim insurance premium paid by GLF Ltd	Nil	Nil
Reimbursement of other medical expenditure (reimbursement up to ₹ 15,000 is not chargeable to tax for the assessment year 2020-21)	3,000	18,000
Gross salary	13,03,000	13,37,200
Less: standard deduction us 16(ia)	Nil	Nil
Income under the head salaries	13,03,000	12,97,200

### 3.8 Income from House Property

As per section 22 The annual value of property consisting of any buildings or lands appurtenant thereto of which assessee is the owner shall be subject to Income-tax under the head 'Income from house property'

The basis of calculating income from house property is the annual value. This is the inherent capacity of the property to earn income. Income from house property is perhaps the only income that is charged to tax on a notional basis. The charge is not because of the receipt of any income but is on the inherent potential of house property to generate income. The annual value is the amount for which the property might reasonably be expected to let from year to year.

### 3.9 Essential Conditions

The following three conditions must be satisfied before the income of the property can be taxed under the head "Income from House Property":

- (i) The property must consist of buildings and lands appurtenant thereto.
- (ii) The property may be used for any purpose, but it should not be used by the owner for the purpose of any business or profession carried on him, the profit of which



is chargeable to tax. If the property is used for own business or profession it shall not be chargeable to tax. *Income from Salary and House Property*

(iii) The assessee should be the owner of such house property.

**Income from buildings or lands appurtenant thereto:** Income tax is payable by assessee on the income of any building or land appurtenant thereto, Income from an open land not attached to any building is not chargeable to income-tax under this head; Income from open land will be taxed under this head only when it is attached to a building. Open land attached to a building may be in the shape of courtyard or a compound or playground or a lawn or a parking place etc. The word 'Building' has not been defined in Income tax Act, 1961. Building, as defined in different leading cases by courts, means a place regarded as building. An enclosure without roof may be regarded as building such as stadium an open air swimming pool, music house, dancing home etc. But a residential building the way to the house, gallery, kitchen-garden, play-ground, garage and a place for keeping animals etc. Income from building whether situated in India or outside India is taxable under the head 'Income from house property'. Tax on foreign buildings is chargeable from house property; A land would be called land appurtenant to building if it is indivisible part and parcel of the building for its use and enjoyment by the occupier and the land is not yielding any income assessable under the head other than 'Income from house property.'

**Property is not used by the assessee for his business or profession:** If the property or a portion of it is occupied by the assessee for the purpose of his own business or profession and the profits of such business or profession are taxable, the annual value of such property or such portion is not taxable under income from house property.

**Assessee should be the owner of the property:** An assessee is chargeable to income-tax on income from buildings or lands attached thereto if he is the owner of such buildings or lands attached thereto. Ownership means the legal ownership and not beneficial ownership; The owner is that person who can exercise the rights of the owner not on behalf of the owner but his own right. It is not necessary that the owner of a house must also be the owner of a house on land on which the house is constructed. Thus the person constructing a house on land taken on lease is deemed to be the owner of the house. Similarly, if an assessee is in occupation of a building as owner as a matter of fact, though the sale-deed may not, yet have been executed, he would still be deemed as owner of the building and liable to tax on its income. If the property is in the name of one person whereas its real owner is somebody else. Assessing officer may find out the real owner and fix on him the tax-liability. A receiver appointed by the court to manage a property cannot be assessed as the owner of the property.

## Notes

So it is clear that tax-liability on the income of the house property is of the owner of such house property. If any house property is mortgaged, the mortgagor and not the mortgagee is the owner of the house property. Similarly, lessor is the owner of the property leased to the mortgagee or lessee, it will be chargeable to tax under the head 'Income from other sources', if a tenant sub-lets a property and earns some income from it, such income would be taxable under the head 'Income from other Sources'.

### 3.10 Deemed Ownership

**Deemed ownership-** According to Section 27 of the Act, the following persons are treated as deemed owner of the house property:-

1. **Transfer without adequate consideration:** An individual who transfers, without adequate consideration any house property to his or her spouse, not being transfer in connection with an agreement to live apart, or to a minor child not being a married daughter, shall be deemed to be the owner of the house property so transferred.
2. **Holder of an impartible estate:** The holder of an impartible estate shall be deemed to be the individual owner of all the properties comprised in the estate.
3. **House allotted or leased under any house building scheme:** A member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a house building scheme of the society, company or association, as the case may be, shall be deemed to be the owner of that building or part thereof.
4. **Person in possession of any building:** A Person, who is allowed to take or to retain possession of any building or part thereof in part performance of a contract, shall be deemed to be the owner of that building or part thereof.
5. **Acquiring rights in a building:** A person who acquires any rights (excluding any right by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof, shall be deemed to be the owner of that building or part thereof.
6. **Acquiring property under a power of attorney transaction:** If a person has acquired a property under 'power of attorney transaction', he shall be deemed of the property although he may not be a 'registered owner' of the property. Thus, if under an agreement of purchase and sale, the purchaser who has not actually made payment but he is ready to make payment on its becoming due, the



purchaser shall be deemed as owner of the property. Similarly, if the purchaser has taken possession of the property or has right to enter upon and exercise acts of possession effectively; he shall be deemed as owner of the property.

### 3.11 Exempted Incomes

**Fully exempt incomes-** The following incomes, though received from house property, are fully exempt from income-tax as per the provisions of Income-tax Act 1961:-

- (1) Income from a farm house, situated on or near the agricultural land which is used by the agriculturist for his own residence or for keeping the agricultural implements or for storing the produce of the land, is exempt from income-tax.
- (2) The annual value of any one palace in the occupation of an ex-ruler is exempt u/s 10 (19-A)
- (3) Income from house property owned by the following is exempt from tax:-
  - (i) The income of a local authority which is chargeable under the head 'Income from house property' is exempt u/s 10 (20)
  - (ii) Property income of an approved scientific research association is exempt u/s 10 (21).
  - (iii) Property income of any university or other institution existing solely for educational purposes and not for purpose of profit is exempt u/s 10 (23-C).
  - (iv) Property income of any hospital or other institution existing solely for philanthropic purposes and not for purpose of profit is exempt u/s 10 (23-C).
  - (v) Property income of a registered trade union is exempt u/s 10(24).
  - (vi) Property income of a person who is resident of Ladakh, is exempt u/s 10(26A)
  - (vii) Property income of a political party, is exempt u/s 13-A.
  - (viii) Property income held by a trust wholly for religious and charitable purposes is exempt u/s 11.
- (4) Income from house property used by the owner for his own business or profession, the profits of which are chargeable to tax, is exempt u/s 22.
- (5) Income from residential self-occupied house of the assessee is exempt from tax u/s 23 (2).



- (6) Income of a residential house owned by the assessee which could not be occupied by him or no profit could be derived from it by the assessee on account of his residing at some other place due to his employment or business purposes is exempt u/s 23 (3).

### Partly Exempt Incomes

The following property income are included in assessee's total income but are not liable to tax-

- (1) Income derived by a co-operative society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities is wholly deductible u/s 80-P (2) (c).
- (2) Property income of a co-operative society is fully deductible u/s 80-P (f), provided the Gross total income of the society does not exceed ₹ 20,000 and the society engaged in the performance of any manufacturing operations with the aid of power.

### 3.12 Composite Rent

In certain cases, the owner charges rent from the tenant not only on account of rent for the house property but also on account of various facilities/services provided with the house. Such rent is known as composite rent. The said composite rent can fall under 2 categories:

1. Composite rent on account of rent for the property and for various facilities/services provided along with the house like lift, gas, water, electricity, watchmen and air conditioning etc. In this case such composite rent should be split up and the portion of rent attributable to the letting of the premises shall be assessable as 'Income from House Property'. The other portion of the composite rent received for rendering facilities or services shall be assessable as "Income from Other Sources".
2. Composite rent on account of rent for the property and the hire charges of machinery, plant or furniture belonging to the owner. In this case if the letting of the property is separable from the letting of the other assets, then the portion of the rent attributable to the letting of the premises shall be assessable as "Income from House Property" and the other portion of the composite rent for letting other assets shall be assessable either as "Profits and Gains of Business or Profession" or "Income from Other Sources". On the other hand, if the letting

of the property is inseparable from the letting of other assets like machinery, furniture the entire income would be taxable as "Profits and Gains of Business or Profession" or "Income from Other Sources".

*Income from Salary and House Property*

### 3.13 Annual Value

### Notes

As per section 23 (1) (a) the annual value of any property shall be the sum for which the property might reasonably be expected to be let from year to year. It may neither be the actual rent derived nor the municipal valuation of the property. It is something like notional rent which could have been derived, had the property been let. In determining the annual value there are four factors which are normally taken into consideration. These are:

- **Actual rent received or receivable:** It is the actual amount of rent received from a rented property. Actual rent received/receivable is an important factor in determining the annual value of a property though this is not the only decisive factor. The actual rent could be dependent upon various considerations. There could be circumstances where the owner agrees to bear certain obligations of the tenant e.g. the water and electricity bills of the tenant may be payable by the owner. In this case the de facto rent (ie. what should have been the actual rent) will be calculated by reducing from the rent received/ receivable the amount spent by the owner on meeting the obligation of water and electricity bills of the tenant as we have to tax rent from house property under this head and not the amount recovered for other services provided in the nature of electricity and gas bills. On the other hand, if any obligation of water and electricity bills of the owner is met by the tenant, the de facto rent will be computed by adding to the rent received/ receivable, the amount spent by the tenant in discharging the obligation of the landlord.
- **Municipal Value:** This is value as determined by the municipal authorities for levying municipal taxes on house property. Municipal authorities normally charge house tax/municipal taxes on the basis of annual letting value of such house property, which is determined by its based upon many considerations. Such valuation is a strong evidence of the earning capacity of the property.
- **Fair rent of property:** Fair rent is the rent which is similar property can fetch in the same or similar locality, if it is let out for a year.
- **Standard rent:** The standard rent is fixed under the Rent Control Act. If the standard rent has been fixed for any property under the Rent Control Act, the owner cannot be expected to get a rent higher than the standard rent fixed, under



the Rent Control Act. Therefore, this is also an important factor in determining the annual value.

## Notes

### 3.14 Computation of Annual Value

The annual type of any property shall be the sum for which the property might reasonably be expected to be let from year to year. As per the act the annual value is the value after deduction of municipal taxes and unrealized rent (if any). The annual value may be determined in the following two steps-

- (1) Determine the gross annual value.
- (2) From the gross annual value deduct municipal taxes actually paid by owner paid by owner during previous year.

The balance shall be the annual value or net annual value. Annual value has to be determined for following categories of house property:

#### Annual Value of Let out house property:

Where the property or any part of the property is let out throughout the previous year the gross annual value shall be computed as under-

- (1) Compare fair rent and municipal valuation and select the higher.
- (2) Compare the rent so selected with standard rent and lower of the two shall be considered to be expected rent.
- (3) Compare expected rent with rent received or actual rent and the higher shall be considered to be gross annual value.

Where the property or any part of the property was vacant throughout the previous year or part of the previous year the gross annual value shall be computed as under-

In above cases expected rent shall be computed for 12 months but while computing actual rent, rent for the vacancy period shall be excluded and gross annual value shall be higher of expected rent and actual rent, but if the actual rent is less than the expected rent owing to vacancy in this case actual rent shall be gross annual value.

#### Annual Value of Self-occupied house property:

Self-occupied house property means the house property used by its owner for his own residential purpose. In order to determine the annual value of such house property, it has been classified into the following:

- (1) House property fully utilized throughout the previous year for self residential purpose [Sec 23(2) (a)] – Where the property consists of a house



or part of a house in the occupation of the owner for his own residence, the annual value of such house or part of the house shall be taken to be Nil, if the following two conditions are satisfied:-

- (a) The property or part thereof is not actually let during whole or any part of the previous year; and
- (b) The owner has not derived any other benefit from the property during the previous year.

It must be noted that no deduction is allowed in respect of such building. But the deduction for interest on loan taken for the purchase, construction or renewal of the building is allowed subject to maximum of ₹ 30,000 or ₹ 2, 00,000 as the case may be, for the entire previous year.

**(2) House property not fully utilized for self-residential purpose [Sec. 23(2)]**

**(b) & 23(3)]** – Such house property can be divided into three groups :-

- (i) **House property which is not actually occupied by the owner** – Where the property consists of house or part of a house which is not actually occupied by the owner during the previous year and the following are satisfied, the annual value of such property (house or part of the house) shall be taken to *NIL*.

- (a) The house property is not actually occupied by the owner by reason of the fact that owing to his employment, business or profession carried on at any other place;
- (b) He resides at that other place in a building not owned by him;
- (c) Such house property or part thereof is not actually let-out during whole or any part of the previous year; and
- (d) The owner has derived no other benefit from such house property.

- (ii) **House property a part of which is self-occupied and remaining part is let out**- Where the property consists of a house which has two or more independent residential units, one of which is self-occupied for own residential purposes and other unit or units are let-out, value of such house property, shall be computed as follows :-

- (a) Annual value of residential unit shall be taken to be 'Nil'.
- (b) Annual value of rented unit or units shall be computed in the same manner discussed earlier in this chapter under the heading 'annual value of let-out house property.'

Notes

Notes

- (iii) **House property which is self-occupied for a part of the previous and let-out for the remaining part of the previous year-** Where the property consists of a house which is let-out for a part of the previous year and self-occupied for the remaining part of the previous year, annual value of such house property shall be computed as if the necessary is let-out throughout the previous year. No concession for self-occupied period will be given. Its expected rent shall be taken for full year but actual rent received or receivable shall be taken only for the period for which it is actually let out.
- (3) **More than one self-occupied house properties [Sec. 23 (4)]** – If an assessee is owner of more one house and uses, then them for his own residence, the annual value of only of these self-occupied houses is taken as 'Nil'. Remaining houses shall be deemed to be let out and their annual value shall be calculated as let out houses. Which of the houses is treated as self-occupied are deemed to be let out house. The assessee should choose the house in such a manner that his taxable income form house property is the minimum. Such option can be changed from year to year.
1. **The tenancy is bonafide.**
  2. The defaulting tenant has vacated, or steps have been taken to compel him to vacate the property.
  3. **The defaulting tenant is not in occupation of any other property of the assessee.**
  4. The assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.

### Municipal Taxes

Municipal taxes (like house tax, service tax, local tax) levied by any local authority in respect of the house property are deductible only if these taxes are borne and actually paid by the owner during the previous year. It doesn't matter whether the taxes belong to the earlier years, current year or next years.

If property is situated in a foreign country, municipal taxes levied by foreign local authority are deductible (if such taxes are paid by the owner).

### Unrealized Rent

Unrealized rent is the rent which the owner could not realize.



Unrealized rent shall be excluded from rent received/ receivable only if the following conditions are satisfied [Conditions of Rule 4]:

*Income from Salary and House Property*

### 3.15 Deductions

Notes

#### Standard Deduction

**30% of Net Annual Value** is deductible from annual value irrespective of any expenditure incurred by the assessee. Thus, no deduction can be claimed in respect of expenses on insurance, ground rent, land revenue, repairs, collection charges, electricity, water supply, salary of liftman, etc.

#### Interest on Borrowed Capital

Interest on borrowed capital is allowable as deduction, if capital is borrowed for the purpose of purchase, construction, repair, renewal or reconstruction of the property.

**Let out property:** Interest on loan is allowable as a deduction on accrual basis if the money borrowed is utilized for acquiring, constructing, repairing, renewing or reconstructing the house property. In case of let out property, the whole amount of interest on loan is allowed as deduction. Interest on a loan taken to repay an earlier loan taken for house property; is also deductible. But interest payable on unpaid interest is not deductible. If the amount borrowed is not utilized for the purpose mentioned above, deduction for interest will not be allowed and if it has already been allowed, it will be withdrawn by the reassessment. Similarly no deduction will be given for brokerage or commission for arranging the loan.

**Self occupied Property:** If the loan has been utilized to acquire or construct self-occupied house property, interest on such loan is allowed as deduction upto a maximum of ₹ 30,000 per annum. Interest in excess of ₹ 30,000 p.a. will not be deductible.

But if the loan is taken for acquisition or construction of house property on or after April 1, 1999 and acquisition or construction of property is completed within three years from the end of the financial year in which the capital was borrowed, then the interest on capital borrowed will be deductible up to ₹ 2,00,000 instead of ₹ 30,000 provided the person extending loan certifies that such interest is payable in respect amount outstanding under an earlier loan taken for such acquisition or construction.

It must be kept in mind that maximum limit of ₹ 2,00,000 is only to the borrowed capital which has been taken only to acquire or to construct the house property. If the loan is taken to repair, renewal or reconstruction of the house, then the ceiling limit shall be only ₹ 30,000 even if the loan is taken on or after April 1, 1999.



In other words deduction of 30,000 is allowed for the purpose of repair, renewal, or reconstruction of the house property and deduction of 2,00,000 is allowed only for acquisition or construction of house property, subject to above conditions being satisfied.

## Notes

**Interest of pre-construction period:-** Interest on loan, taken for the purposes of construction or acquisition pertaining to the period prior to the previous year in which such property has been acquired or constructed, will be deducted in five equal annual installments beginning with the previous year in which the house is acquired or constructed. The first installment is deductible in the year in which construction of property is completed or in which property is acquired. For this purpose 'pre-construction period' means the period beginning on the date of borrowing and ending on 31st March immediately before the date of completion of construction/date of acquisition or date of repayment of loan, whichever is earlier.

Interest of the previous year in which the construction is completed or acquisition is made is allowed as, deduction during the assessment year if the construction is completed or the acquisition is made on the last date of the previous year 2016-17 shall be deducted in the assessment year 2017-18 and the interest up to March 31, shall be 'pre-construction period interest'.

### 3.16 Tax Treatment of Self Occupied Houses

Self – Occupied Property	Tax Treatment
If such property is used by the owner for the purpose of carrying on his business or profession	No income is taxable under the head "Income from house property" but taxable under the head "Profits and gains of business or profession"
[Sec. 23(2)(a)]: If such property is used throughout the previous year for own residential purposes, it is not let out or put to any other use	Annual value will be nil. Only interest on borrowed capital is deductible subject to a maximum ceiling of 30,000 or 2,00,000 depending upon the case.
[Sec. 23(2)(b)]: If such property could not be occupied throughout the previous year because employment, business or profession of the owner is situated at some other place and he has to reside at that other place in a building not owned by him	Annual value will be nil. Only interest on borrowed capital is deductible subject to a maximum ceiling of 30,000 or 2,00,000 depending upon the case
When a part of the property (being independent residential unit) is self-occupied and the other part is let out	Income from the independent unit (which is self-occupied) will be taxable as <b>self-occupied</b> property and income from the unit which is let out is taxable as if the unit is <b>let out</b>

When such property is self-occupied for a part of the year and let out for the other part of the year	Taxable as a <b>let out</b> property
Where a person has occupied more than one property for his own residential purpose	Only one property (according to his own choice) is treated as <b>self-occupied</b> and all other properties will be taken as <b>deemed to be let out</b>

## Notes

### Example:

Shri Sunil Sharma is the owner of house which was completed on 1st January, 2022 and let-out to a man for residential purpose on a monthly rent of ₹ 2,500. Its municipal value is ₹ 35,000. Fair rent of the locality is considered to be ₹ 40,000. The owner has paid municipal tax @ 10% of municipal value. The owner claims the following expenses: (i) Fire insurance premium ₹ 1,200; (ii) Ground rent ₹ 1,750; (iii) Repairs and white-washing and painting etc. ₹ 5,000; (iv) Water connection ₹ 3,000; (v) Collection charges ₹ 1,500; (vi) Interest on loan taken from a housing board ₹ 2,250.

Determine taxable income from house property for the assessment year 2022-23

### Solution:

#### Taxable Income from House Property of Sunil Sharma

(For the assessment year 2022-23)

Higher of municipal value or fair rent; or Rent received / receivable (whichever is greater)	₹ 40,000
Less: Municipal taxes paid by the owner @ 10% of MV	3,500
Annual value	36,500
Less: <b>Deductions :</b>	₹
Standard deduction @30% of annual value 10,950	13,200
Interest on loan 2,250	
Income from house property 2,500 p.m	<b>23,300</b>

Rent payable under Rent control Act ₹ 28,000. Fair rent of the house is ₹ 36,000. He paid municipal taxes @ 20% of the municipal value. He also pays education & health cess @ 5% of the municipal value. The construction of the property was completed on 1st August, 2014. He incurred the following expenses which he claimed deduction :- (i) Interest on loan ₹ 6,000 (ii) Repairs & collection charges ₹ 8,000; (iii) Insurance premium paid ₹ 1,000; (iv) Ground rent due for the previous year but not paid ₹ 1,500; and (v) Land revenue due ₹ 500.

**Solution:****Taxable Income from House Property of Manoj-Devgun**

(For the assessment year 2022-23)

Higher of MV or FR not exceeding the standard rent	₹
Or.	30,000
Rent received/receivable	6,000
(whichever is greater) ₹	24,000
Less: Municipal taxes paid by the owner @ 20% of MV 4,800	
Education & health cess @ 5% of MV 12,00	
Annual value	
	₹
Less: <b>Deductions :</b>	13,200
Standard deduction @30% of annual value 7,200	
Interest on loan for the previous year 6,000	
Income from house property	<b>10,800</b>

**Example:** Mr. Harjeet Singh is owner of a big house, the construction of which was completed in April, 2018. 50% of the floor area is let-out for residential purposes on a monthly rent of ₹ 4,000; this portion remains vacant for 1 month during the year 2021-22. 25% of the floor area is used by the owner for his profession, while remaining 25% of the floor area is utilized for the purpose of his residence. Other particulars of the house are as follows-

₹

Municipal valuation 90,000

Standard rent 1,00,000

Municipal taxes (paid) 15,000

Repairs 7,000

Interest on capital borrowed for repairs 35,000

Compute the taxable income from house property of Mr. Harjeet singh for the assessment year 2022-23

**Solution:****Computation Fo Taxable Income From H.P of Mr. Harjeet Singh**

(For the assessment year 2022-23)



## Notes

<b>50% of the house : (Let-out)</b>	₹
MV. (₹ 45,000) not exceeding the standard rent (₹ 50,000)= 45,000	
Or.	
Actual Rent received/receivable of ½ portion (₹ 44,000, as actual rent received is less only due to vacancy, hence actual rent received will be Gross annual value	
	₹
Annual value	44,000
Less: Municipal taxes (1/2 of ₹ 15,000)	7,500
Less: <b>Deductions :</b>	36,500
Standard deduction @30% of annual value 10,950	28,450
½ of interest on loan taken for repairs 17,000	8,050
Income from 50% portion of house	
<b>25% of the house:</b> (used for own profession not taxable under this head)	Nil
<b>25% of the house:</b> (self-occupied)	
Annual value Nil	
Less : Deductions- Interest on loan (¼ of ₹ 35,000) 8,750	(-) 8,750
Income from self occupied portion (loss)	(-) 700
Income from house property (loss)	

### 3.17 Important Points

**Recovery of Unrealized Rent:** Where a deduction has been allowed (in the assessment year 2001-02 or earlier years) in respect of unrealized rent and subsequently during any previous year the assessee has realized any amount in respect of such rent, the amount so realized will be chargeable to tax under the head "Income from house property" without making any deduction under sections 23 and 24.

**Property of Co-Owners:** Where a property is owned by two or more persons jointly and their respective shares are definite and ascertainable, income from such property shall not be assessed as association of persons, but the share of each such person from the property shall be included in their total income. If any portion of the house property of a co-owner is occupied him for his own residence, that portion will be treated as self occupied house and its annual value will be NIL.

**Interest Not Deductible:** Any interest chargeable under the act, which is payable outside India on which tax has not been paid or deduct at source in respect of which there is no person in India who may be treated as an agent, shall not be deducted in computing the Income from house property.

## Notes

**House Property In Abroad:** Income from house property situated in abroad is taxable only in the case of residents. If such property is taxed in India it will be taxable under the head Income from house property and its annual value shall be computed as if the property is situated in India.

**Self Occupation Relief:** Self-occupation relief is available to an individual and Hindu undivided family only, because only a natural person can occupy a house for his residential purpose. Thus, a firm a limited company, an association of persons, club, corporation or an institution can not claim this concession as they cannot occupy a house for residential purposes.

**Loss From House Property:** Annual value of self occupied house is taken as NIL. Only interest on loan is deductible from annual value up to 30,000 or 2, 00,000 as the case may be. Therefore, there may be a loss in respect of such property up to a maximum of 30,000 or 2, 00,000.

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### 3.18 Summary

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Salary is the payment made by the employer to the employee in consideration of his services rendered in favour of the employer. The employer may be an individual, a firm, an association of persons etc. According to section 17(1) of the Income-tax Act, 1961, Salary includes basic salary/wage, pension, bonus, commission, overtime payments, annuity, advance salary, leave salary, death-cum-retirement gratuity, compensation on retrenchment, amount received on voluntary retirement etc. Hence, it is not only includes the cash received but also the monetary value of facilities and benefits attached with the employee's work. For the income tax purpose, salary is the sum of the taxable part of basic salary, allowances, perquisite and profit in lieu of salary.

Dearness allowance, city compensatory allowance, tiffin/lunch allowance, non practicing allowance, warden or proctor allowance, overtime allowance, fixed medical allowance, servant allowance, Children education allowance, children hostel allowance, transport allowance, daily allowance, conveyance allowance, house rent allowance (H.R.A.), Academic allowance, uniform allowance, allowance to high court judges, allowance received from United Nations Organisation (UNO), allowance to chairman or members of UPSC, foreign allowance.

Rent-free accommodation, concessional rent-free accommodation, payment of employee's obligations by employer, payment of employee's life insurance and annuity premium, specified security or sweat equity shares allotted/transferred to an employee, employer's contribution to an approved superannuation fund, value of any other fringe



benefits, Motor car facility, sweeper, gardener, watchman facility, gas, electricity or water facility, education facility, transport facility.

*Income from Salary and House Property*

Medical facility, tour and travel facility, accommodation in a 'remote area', telephone facility, refreshment facility, payment of accident insurance premium, family planning facility, scholarship to employee's children, interest free loan, training facility, travelling expenses paid or reimbursed, free education facility, perquisites given in foreign, goods sold at concessional rates, ration, free accommodation to ministers.

The annual value of a property consisting of any buildings or lands appurtenant thereto of which assessee is the owner shall be chargeable to tax under the head Income from house property.

A property might remain vacant for any period of time during the year. It is obvious that the owner of the house property shall not receive any rent during such period. Such a loss arising to the owner of the house property is called loss due to vacancy.

30% of annual value is deductible as standard deduction in respect of expenses on insurance, ground rent, land revenue, repairs, collection charges etc. Interest on borrowed capital is allowable as deduction, if capital is borrowed for the purpose of purchase, construction, repair, renewal or reconstruction of the property. Where the property consists of a house or part of a house in the occupation of the owner for his own residence, the annual value of such house or part of the house shall be taken to be Nil. The owner of the house property will get a deduction of interest on loan up to 30,000 or 2,00,000.

If a deduction has been allowed in respect of unrealized rent and subsequently during any previous year the assessee has realized any amount in respect of such rent, the amount so realized will be chargeable to tax without making any deduction.

## Notes

### 3.19 Keywords

- **Advance Salary:** It means the salary received by an employee before it is earned by him.
- **Earned Leave:** These are the leaves which, if not availed of by an employee, are converted into equivalent cash salary and paid to the employee.
- **Gratuity:** It is a gratuitous payment made by the employer to his employee, for services rendered, at the time of retirement or death, whichever is earlier, of the employee.
- **Pension:** It is a periodical or lump sum payment made by the employer to his employee after his retirement from service. The pension is given in two forms i.e., uncommuted Pension and commuted Pension.



## Notes

- **Annual value:** the annual value of any property shall be the sum for which the property might reasonably be expected to be let from year to year.
- **Fair rent:** Fair rent is the rent which is similar property can fetch in the same or similar locality, if it is let for a year.
- **Self occupied house property:** Self-occupied house property means the house property used by its owner for his own residential purpose

### 3.20 Review Questions

1. What items are included under the head 'Salaries as per Income-tax Act, 1961'?
2. What are included in profits in lieu of salary?
3. Discuss different types of provident funds of which a salaried employee may be a member.
4. What are the provisions of Income tax Act, 1961 regarding the commuted pension and gratuity?
5. Salaries arise in the hands of employees. Comment on this statement and state as to what incomes are taxable under the head salaries.
6. Discuss the allowances which are included in the computation of taxable salary.
7. Km. Renu, resident of Goa, is employed in a company on ₹15,600p.m. She gets dearness allowance @ ₹3,000p.m under the terms of employment and a commission @5% on total sale effected by him which amounts to ₹2,50,000 during previous year. She gets house rent allowance @ ₹2,500p.m, whereas she pays rent @ ₹4,750p.m. Calculate taxable HRA.
8. Mr. Rehman, an employee in the department of education Govt. of Uttar Pradesh, gets ₹16,000p.m. as salary and ₹4,000p.m. as entertainment allowance. He has been provided with a concessional rent-free house, owned by the Govt. of Uttar Pradesh, for which the Govt. deducts 10% of his basic salary. Licence fee determined by the State Govt. for this house is ₹23,500p.a. He is also provided with a 2000 cc car of the Govt. for his official & private use. All expenses of car are incurred by the Govt. Compute his taxable salary for the assessment year 2022-23.
9. State the provisions of Income-tax Act relating to those perquisites which are taxable in case of specific employees.
10. Compute taxable income under the head 'Salary' of Mr. Bhatnagar (an employee of a company) for the assessment year 2022-23:

Salary @ ₹5,000 p.m;

Dearness allowance ₹3,500p.m;

Entertainment allowance ₹1,000p.m;

Employer's contribution to recognised provident fund is ₹7,400. His own contribution was ₹7,400;

Interest @ 10%p.a. on credit balance of recognized provident fund amounted to ₹10,000;

City compensatory allowance ₹5,00p.m;

Medical allowance ₹1,200p.m;

He has been provided with a large car facility for personal as well as official use. The employer bears all expenses of the car.

He has been provided with a unfurnished house by the employer in a city (population 12 lakh). The fair rental value of the house is ₹30,000p.a. Employer charges ₹500p.m from him as rent.

*Income from Salary and  
House Property*

Notes

### 3.21 Further Readings

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## Notes

## Profit or Gain in Business or Profession

**(Structure)**

- 4.1 Learning Objectives
- 4.2 Introduction
- 4.3 Meaning of Business and Profession
- 4.4 Principles with Regard to Profit or Gains from Business and Profession
- 4.5 Accounts Prepared by the Assessee for Computing Profits
- 4.6 Maintenance of Accounts, Compulsory Audit and Special Provisions
- 4.7 Capital Gain
- 4.8 Exemptions at a Glance
- 4.9 Income from other Sources
- 4.10 Interest on Securities
- 4.11 Bond Washing Transactions
- 4.12 Summary
- 4.13 Keywords
- 4.14 Review Questions
- 4.15 Further Readings

### 4.1 Learning Objectives

After studying the chapter, students will be able to:

- Understand the term business and profession;
- Understand the main principles with respect to income from business or profession;
- Understand the special provisions under this head;



- Understand the expenses and deductions which are expressly allowed;
- Understand the deductions under expenditure on scientific research;
- The meaning and types of capital assets and capital gain;
- Computation of capital gain;
- Income taxable under this head;
- Provisions of dividend, interest and other incomes.

## Notes

### 4.2 Introduction

As per Income-tax Act the 'Profit and gains of business and profession', is the third head of income. The Government of India gets maximum income in the form of Income-tax from this head of income in comparison to other heads of income. Sections 28 to 44D of income-tax Act, 1961 relate to this head of income. Section 2(13) of income-tax Act deals with the term 'business', whereas Section 2(36) deals with the term 'profession'.

This unit 'profit and gains from business and profession and tax planning', tell us the provisions as per Income-tax Act about the expenses and deductions which are expressly allowed (Section 30 to 37) and also the expenses which are expressly disallowed. Expenses expressly allowed means those deductions which are deductible, whereas the expenses which are disallowed are not deductible in the computation of taxable income of business or profession.

Any profit arising from the transfer of capital asset is taxable under the head Income from capital gain. Capital gain is divided into two parts short term capital gain and long term capital gain.

In this unit we learn all the aspects in relation to computation of capital gain and various exemptions available from capital gain.

### 4.3 Meaning of Business and Profession

**Business:** According to Section 2(13) of the Act, business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. The word 'business' suggests some real, substantial which systematic or organised course of activity or conduct with set purposes of earning profits. Business does not include the activities of trade, commerce or manufacture only, but it also includes the activities of rendering services. So, business is an extensive word. Under this word, all types of business transactions, manufacture of goods, industrial activities, banking activities and transportation activities are included. For example, Cinema is a commercial asset and any profit derived therefrom by letting out the same would be

## Notes

assessable as business profit. So, there are various words which are used in the term 'business' are explained as under:

**Trade:** Under trade, sale-purchase of goods and commodities are included. The person who does trade is called trader, who purchases and sales the goods with the aim of earning profits.

**Commerce:** The word commerce is wider than the word trade. All trading activities are the part of commercial activities. Apart from it, road transport, rail transport, telephone and other communication, bank, insurance activities are included in commerce.

**Manufacturing:** Raw material converted into finished goods under any process is included under manufacturing; e.g., preparation of sugar from sugarcane is a manufacturing or productive process. So, making or producing goods means transforming the shape of commodity in such a way that it becomes a new commercial goods for trading purposes. Thus, when raw material is changed into finished goods, it is manufacture.

**Adventure:** With the aim of sale and purchase in the business, the work of keeping stock is known as adventure.

**Profession:** In simple words, profession refers to all such human activities which are undertaken to earn a living and which are performed on account of one's intellectual skill or knowledge, acquired only after patient study and application. For example, Chartered Accountants, Advocates, Engineers, Architects, Financial Adviser etc are the persons whose activities are termed as profession. A company (being an artificial person) does not have a mind and body and, therefore, cannot be engaged in profession. According to Section 2(36) of the Act, *profession includes vocation*. This includes such activities which are performed by a person on account of his natural ability for some particular work. It includes all such activities which are performed for living, story or play writer, pujari doing religious work, agency work, brokerage, music, dance, robbery, magic activities etc all are included in the activities of vocation. So, a person can have more than one vocation. Actually, the primary objective of vocation is not always to earn profits. It need not be for making any income, nor need it involve any systematic and organised activity. But if a person passes his life by such activities for which he has natural abilities and some profits arise therefrom, such profits are treated as professional income (like income of singers, artists, actors, worshippers etc). So, in profession, vocation is also included.

**Note:** There is difference in words of business, trade, profession and vocation, but for income-tax purposes, there is no difference in them. All the income received by any of these sources is included under the head 'Income from Business or Profession'.



"Income from other sources" is the residual head of income. Hence, any income which is not specifically taxed under any other head of income will be taxed under this head.

In this unit we learn all the aspects in relation to income from other sources and various provisions for tax planning for this head.

#### **4.4 Principles with Regard to Profit or Gains from Business and Profession**

The important principles which will be kept in mind by the assessee while computing income chargeable under the head of profit and gains of business and profession are –

- 1. Business or profession carried on by the assessee:** As per section 28 of the Act, profits and gains of only those business or profession are chargeable under the head 'profits and gains from business and profession' which are carried on by the assessee. Carrying on by the assessee means the ownership of the assessee. It is not necessary that the assessee should actually carry on the business or profession but he must have legal right to carry on it. He may carry on the business or profession through his agents, employees and managers. The very essence is that the assessee has right to carry on the business or profession.
- 2. Business or profession should be carried on during the previous year:** As per section 28 of the Act, the profits and gains of only those business or professions are chargeable to tax under this head, which were carried on at any time during the previous year.
- 3. Legal or illegal business or profession:** Both types of profits received are taxable under this head. But the loss of illegal business cannot be set-off out of profits of a legal business.
- 4. Salary, bonus, commission, interest received to a partner from the firm:** Salary, bonus, commission, interest received etc. to a partner from the firm is taxable under this head.
- 5. Contract not to conduct any trade:** Sometimes, there may be a contract between two parties that one of them shall not carry a particular trade or he will not use any right for using technical knowledge, patent, copyright, license or similar to this nature. For not doing such trade or for depriving of using these rights, he can get cash or any commodity. This shall be taxable income to be included under the head 'income from salary'.



## Notes

6. **'Speculation profits:** Profits from speculation are taxable under the head the 'profit and gains from business and profession', but the profits or losses of speculation business are treated and taxed separately. The reason of its calculation separately is that the loss of speculation can only be set-off out of profits of speculation.
7. **Profits from all business or professions are to be taxed under one head:** An assessee may own several business or professions. Every business or profession is a separate source of income under the head 'profit and gains from business and profession'. Profits of every business or profession are computed separately and, then, aggregated in one head. If there is loss in any business or profession it will be adjusted from profits of other business or professions. However, the profits and losses of speculation business are treated separately.
8. **Business or profession established outside India:** Profit and gains of a business and profession, established outside India are taxable in the hands of a resident assessee and are also chargeable to tax under the head 'profit and gains from business and profession'. Profits of a business established in India or established outside India are equally taxable under section 28 of the Act.
9. **The purpose of business or profession is not necessarily to earn profit:** This is not necessary that the purpose of a business or profession carried on by an assessee, is to earn profits or that such business or profession yields profit. Co-operative societies and mutual insurance companies come under the preview of business, though they may or may not earn profit.
10. **Profit of closed business or profession:** Where a business or profession is closed down, any profit arising on the sale of the assets of such business or profession, is not business profit, rather it is capital gain. But if the assets include stock, the profit arising on the sale of stock shall be business profit.
11. **Computation of profits on commercial principles:** Profits or losses of a business or profession should be computed on the basis of general commercial principles. Generally, accepted accounting and commercial principles should be followed while calculating business or professional profits. Capital gains and capital expenditures should be separated from revenue profits and revenue expenses. Thus, only such profits from business or profession are chargeable to tax as are computed after keeping the generally accepted commercial and accounting principles.

- 12. Business incomes not taxable under this head** The following income, though arise from business, are not taxable under the head 'profit and gains of business and profession':
- (a) Rent from house property is taxable under the head 'Income from house property' even if the assessee is dealing in the business of buying, selling, constructing or letting on hire of houses and the house property is kept with him as stock.
  - (b) Dividend on share is taxable under the head 'income from other sources' even if the assessee is dealing in purchase and sale of such shares on which dividend has arisen and the shares are held as stock-in-trade by the recipient of dividend.
  - (c) Winnings from lotteries, races etc. are taxable under the head 'income from other sources' even if it is derived as a regular business activity.
- 13. Interest on securities:** Normally, interest on securities is taxable under the head of 'income from other sources'. But, if the securities are kept by the assessee as stock-in-trade (when he/she deals in the purchase and sale of securities), then any interest received on such securities will be taxed under the head 'profit and gains of business and profession'.
- 14. Rewards to players:** Any reward received by a professional player is taxable under this head. Any reward received by a non-professional player is deemed to be a personal gift and is not taxable.
- 15. Conversion of agricultural land for commercial purposes:** If an agricultural land is divided into commercial plots and are sold for construction of houses on it, the additional profit arising from such activity is treated business profits instead of capital profits.
- 16. Insurance money:** If any insurance money (including bonus) is received under 'Keyman Insurance Policy' from 01-10-1996, it is taxable.
- 17. Rental income from accommodation provided to employees:** It is the duty of the employer to provide residential accommodation to the employees. The housing accommodation is an amenity which is provided for the purposes of business. Thus, if the assessee employer owns certain buildings which are occupied by its employees on rent, the rental income shall be assessable as business income and not as income from house property.
- 18. Underwriting commission:** Commission received or receivable by an underwriter is taxable under this head, but the commission received on the shares purchased by them is not a taxable income.



## 4.5 Accounts Prepared by the Assessee for Computing Profits

### Notes

Tax is not imposed on the gross receipts of business or profession under this head, but the profit is calculated for the purpose of income-tax. So, for calculating such profits or losses from his business or profession, an assessee prepares any of the following accounts:

- Profit and Loss Account or Income and Expenditure Account
- Receipt and Payment Account

Normally, the trading and manufacturing enterprises prepare profit and loss account to ascertain profit or loss, whereas Chartered Accountants, Advocates, Architects etc prepare income and expenditure account to find out their profit or loss. The vocational persons find out their profits/losses by preparing receipt and payment account.

So, the calculation of profit can be made by an assessee with the help of Profit and Loss Account, Income-Expenditure Account and Receipt and Payment Account related to business or profession, but the profits shown by these accounts may not be correct from the point of view of Income-tax. So, from income-tax point of view, the amount of profits may differ and the accounts prepared by the assessee are to be revised, due to some reason like, there may be certain expenses, which are shown in accounts prepared by assessee, which are not allowed to be deducted totally or partially, while they have been deducted in arriving profits. In the same manner, there are certain incomes which are written in Profit and loss or Income and Expenditure Account while they are taxable under any other head of income. This is why revision in the accounts (Profit & Loss Account or Income & Expenditure Account or Receipt and Payment Account) is essential, which are prepared by the assessee. The items are as under:

- (i) Certain expenditure shown less or more than the actual amount.
- (ii) Certain expenses, allowed by Act, but assessee have not deducted them.
- (iii) Personal expenses are written in Profit and Loss Account.
- (iv) Many expenses are there which are not related to previous year.
- (v) The assessee writes certain incomes in Profit and Loss Accounts, which are not taxable under the head 'income from business or profession' but they are taxable under the head 'income from other sources'.
- (vi) There may be certain incomes which have not been included by the assessee in the accounts, while they should be included. This is why correction in accounts becomes necessary.

### Rules of Correction in Accounts

As per the provisions of Income-tax Act, corrected Profit and Loss Account, Income Expenditure Account or Receipt and Payment Account are prepared, so that correct amount of



profit may be calculated which is taxable under the head 'income from business or profession'.

The rules of correction in the accounts for the purpose of income-tax are as under:

## Notes

1. **Adding disallowed expenses:** All expenses which are disallowed by the Income-tax Act are to be added in the profits shown in the accounts prepared by the assessee provided there have already been deducted at the time of preparing Profit and Loss Account. If any expense is disallowed partially, the disallowed portion shall be added up.
2. **Deducting expenses to be deductible:** The expenses which are related to business and have not been deducted, now should be deducted from the profits ascertained by Profit and Loss Account.
3. **Deduction of taxable income under other heads:** If any income has been shown in the accounts which are not taxable under the head 'Business or Profession', such income will be deducted out of profit computed.
4. **Added of income:** If any income which is relating to trade has been left out it should be added in the profits shown by Profit and Loss Account.
5. **Personal expenses:** All the personal and domestic expenses debited in Profit and Loss Account, are to be added in the profit shown by Profit and Loss Account.
6. **Capital losses:** Capital losses debited in Profit and Loss Account by the assessee are to be added in profit so computed.
7. **Payments of direct taxes:** Payments of direct taxes like income-tax if these have been debited in accounts, now will be added in profit computed.

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## 4.6 Maintenance of Accounts, Compulsory Audit and Special Provisions

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### Maintenance of Accounts

As per section 44AA, assesses have to maintain certain accounts compulsorily regarding their business or profession. In this connection professions have been divided under following categories:

1. **Specific Profession :** This includes medical, engineering or architectural profession or interior decoration or technical consultancy or any other profession as is notified by the CBDT in Official Gazette. Under this -
  - (i) If the total income of the assessee doing scheduled profession as notified by CBDT and the gross income is more than ₹1,50,000 in anyone year prior to three years of previous year, then such assessee come under specific profession and they have to maintain prescribed books and other

## Notes

documents (like journal, ledger, cash book, original copy of bills etc.) compulsorily.

- (ii) If the gross annual receipts are not more than ₹60,000 of these professions, the keeping of the prescribed books and other documents are not compulsory, but they have to maintain such accounts and books, because on the basis of that, taxable income may be computed by the Assessing Officer (AO).

**2. Non-specific Profession :** This includes those businesses or professions which are not covered by any of the category mentioned above. Under this -

- (i) if any person is doing profession (except specified profession) and prior to 3 years before the previous year, the annual income is more than ₹1,20,000 or the gross receipt is more than ₹10,00,000p.a, the assessee is not required to maintain prescribed books and other documents, but he has to keep such essential accounts, because on the basis of that, the assessing officer may compute the taxable income of the assessee.
- (ii) if the income or gross receipt of assessee is not more than the above mentioned limit, there is no need to maintain any types of account.

**3. Business under Sections 44AD and 44AE :** Where the assessee claims that the profits and gains of eligible business (Sec. 44AD) or plying, hiring or leasing goods carriage (Sec. 44AE) are lower than the deemed profits under these sections, he has to maintain the books of account of such business.

### Compulsory Audit [Sec. 44AB]

It is compulsory to specific persons engaged in any business or profession to get their accounts audited compulsorily. The following person shall get their accounts of previous year audited by a Chartered Accountant or by a qualified auditor before the specified date and a further report by an accountant in the prescribed form duly signed and verified by such Chartered Accountant or auditor:

1. Every person carrying on business, if his total sales or gross receipts in business exceeds ₹1 crore in any previous year; or
2. Every person carrying on profession, if his gross receipts in profession exceed ₹25 lakh in any previous year; or
3. Every person carrying on the business of plying, hiring or leasing goods carriages (Sec. 44 AE), or of exploration of mineral oils (Sec. 44BB), and the assessee has claimed his income to be lower than the deemed profits or gains of such business in any previous year; or



4. Every person carrying on the eligible business like civil construction work (Sec. 44 AD) and he has claimed that the income of their profession is less than the deemed income, they have to get their accounts audited compulsorily and they have to produce an evidence that their income is less than the prescribed limit.

*Profit or Gain of  
Business or Profession*

## Notes

### Special Provisions

There are some special provisions for computing profits and gains in particular businesses:

- (a) **Special provisions for computing profits and gains of business on presumptive basis [Sec. 44AD]** : This is applicable on resident individuals, HUFs and partnership firms and covers all small businesses with total turnover or gross receipts of up to ₹1 crore (except the business of plying, hiring and leasing goods carriages covered under section 44AE). The eligible rate of tax would be 8% of total turnover or gross receipts, but this scheme would not apply to an assessee who is availing deductions under section 10AA or deduction under any provisions of Chapter VI-A. The intention of widening the scope of this scheme is to reduce the compliance and administrative burden on small businessmen and relieve them from the requirement of maintaining books of account. Such assessee opting for the presumptive scheme are not required to maintain books of account under section 44AA or get them audited under section 44AB.
- (b) **Special provisions for computing profits and gains of business of plying, hiring or leasing goods carriages [Sec. 44AE]** : This section provides for estimating business income of an owner of trucks from the plying, hire or leasing of such trucks. The scheme applies to persons owning not more than 10 trucks at any time during the previous year. The estimated income from each truck in case of a heavy or light goods vehicle will be deemed to be ₹7,500 for every month or part of a month during which the truck is owned by the assessee for the previous year. The assessee joining the scheme will not be required to maintain books of account under section 44AA or get them audited under section 44AB.

### Illustration 1

Mr. Rastogi owns the following commercial vehicles:

- (i) 2 heavy goods vehicles – for 5 months and 10 days
- (ii) 2 light commercial vehicles – one for 12 months and the other for 9 months and one day.

Compute his income from business, if he opts for the scheme u/s 44AE.



His profits and gains from 2 heavy goods vehicles  $\text{₹}7,500 \times 6 + \text{₹}7,500 \times 6 = \text{₹}90,000$ .

His profits and gains from 2 light commercial vehicles  $\text{₹}7,500 \times 12 + \text{₹}7,500 \times 10 = \text{₹}1,65,000$ .

## Notes

Hence, his total income from business will be  $\text{₹}2,55,000$  ( $\text{₹}90,000 + \text{₹}1,65,000$ ).

*Note:* In second situation, the goods carrier was used for 9 months and one day.

So, the income of 10 months shall be taxable.

(c) **Special provision for computing the profits and gains of shipping business in case of non-residents [Sec. 44B]** : In the case of a non-resident assessee, engaged in the business of operation of ships, 7.5% of the aggregate of the following amounts shall be deemed to be profits and gains of such business chargeable under the head 'profit and gains of business and profession' -

- (i) the amount received or receivable, whether within India or outside, by the assessee or by any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India.
- (ii) the amount received or deemed to be received in India by the assessee himself or by any other person on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

(d) **Provisions for computation of taxable income from activities connected with exploration of mineral oils [Sec. 44BB]** : In the case of a non-resident assessee, engaged in the business of providing services and facilities in connection with exploitation of mineral oils, 10% of the aggregate of the following amounts shall be deemed to be profits and gains of such business chargeable under the head 'profit and gains from business and profession':

- (i) the amount received or receivable, whether within India or outside, by the assessee or by any person on his behalf for services and facilities in connection with extraction or production of mineral oils in India; and,
- (ii) the amount received or deemed to be received in India by or on behalf of the assessee for services and facilities in connection with extraction or production of mineral oils outside India.

(e) **Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents [Sec. 44BBA]** : In the case of a non-resident assessee, engaged in the business of operation of aircraft, 5% of the aggregate of the following amounts shall be deemed to be the profits and gains chargeable to tax under the head 'profit and gains of business and profession' -

- (i) The amount received or receivable, whether within India or outside, by the assessee or by any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India.
- (ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

## Notes

**Illustration 2**

Mr. Rajesh, a non-resident, operates an aircraft between Thailand and Delhi. He received the following amounts in the course of the business of operation of aircraft during the year ending 31.3.2017:

- (i) ₹ 1 crore in India on account of carriage of passengers from Delhi.
- (ii) ₹ 2 crore in India on account of carriage of goods from Delhi.
- (iii) ₹ 1 crore in India on account of carriage of passengers from Thailand.
- (iv) ₹ 2 crore in Thailand on account of carriage of passengers from Delhi.

The total expenditure incurred by Mr. Rajesh for the purposes of the business during the year ending 31.3.2017 was ₹1.8 crore. Compute the income of Mr. Rajesh chargeable to tax in India under the head 'profit or gains of business and profession' for the assessment year 2017-18.

**Solution:**

Keeping in view the provisions of section 44BBA, the income of Mr. Rajesh chargeable to tax in India under the head 'profit and gains of business and profession' is worked out hereunder -

Amount received in India on account of carriage of passengers from Delhi	3,00,00,000
Amount received in India on account of carriage of goods from Delhi	2,00,00,000
Amount received in India on account of carriage of passengers from Thailand	1,00,00,000
Amount received in Thailand on account of carriage of passengers from Delhi	2,00,00,000
	8,00,00,000

Income from business under section 44BBA at 5% of ₹8,00,00,000 is ₹40,00,000, which is the income of Mr. Rajesh chargeable to tax in India under the head 'profit and gains of business and profession' for the A.Y.2017-18.



Under sections 30 to 37 of Income-tax Act, the expenses and deductions expressly allowed under the head 'income from business or profession' are as under:

## Notes

1. **Expenses relating to Building [Sec. 30]:** The expenses relating to building are as under:
  - (a) **Rent of Building:** The rules of deduction of rent of building used in trade are as under:
    - (i) *Rented Building:* The whole amount of rent is deducted.
    - (ii) *Self house of Assessee:* No amount of rent will be deducted.
    - (iii) *Residence of Assessee in partial part of Building:* The proportionate rent of building used in business is an allowable expense.
    - (iv) *Use of Building by Employees of Trade:* Rent of building will be an allowable deduction of the business.
    - (v) *Use of Partners Building of the Business in the Partnership Business:* The rent payable to partner by the firm is an allowable expenditure of the business.
  - (b) **Current Repair to Building:** Actual expenses on the repair of the business building is allowable expenditures. Expenses on white wash of the building are covered under current repair. If repair is of capital nature, its deduction will not be allowed.
  - (c) **Rent of Land and Municipal Tax.** It is allowed expenses.
2. **Expenses of Machine, Furniture and Plant [Sec. 31] :** The following expenses are allowed on machine, furniture and plant used in the trade of assessee:
  - (a) Actual expenses paid on repair and maintenance of machine, furniture and plant, if the sum spent on the repair is of capital nature, its deduction shall not be allowed.
  - (b) If the above assets are taken on rent basis, the actual rent paid is an allowable expenditure.
3. **Depreciation [Sec. 32]:** Depreciation on tangible assets (like building, plant, machine, furniture) and intangible assets (like patent, copyright, trademark) used by assessee for the business are allowable expenditure. Under this, all assets have been divided into four main categories and rates of depreciation as prescribed by Rule 5(1) are as –



## Part A – Tangible Assets

*Profit or Gain of  
Business or Profession*

### Category I – Buildings

1. Buildings which are used mainly for residential purposes – 5%
2. Buildings which are not used mainly for residential purposes – 10%
3. Purely temporary erections like wooden structure – 100%

### Category II – Furniture and Fittings

1. Furniture and fittings (including electrical fittings) – 10%

### Category III – Plant and Machinery

1. Motors buses or lorries used in business of running them on hire – 30%
2. Aeroplanes – 40%
3. Air/water pollution control equipments – 100%
4. Computers including computer software – 60%
5. Annual publications owned by assesses carrying on a profession – 100%
6. Plant and machinery (general rate) – 15%

### Category IV – Ships

1. Ocean-going ships – 20%
2. Speed boats operating on inland water – 20%

Notes

## Part B – Intangible Assets

Know-how, patents, copyrights, trademarks, licenses, franchises or any commercial rights – 25%

4. **Investment in New Plant or Machinery [Sec. 32AC]** : This deduction is allowed to a company assessee on the fulfilment of following conditions:
- (a) The company is engaged in the business of manufacture or production of any article or thing;
  - (b) The company acquires and installs 'new asset' after 31<sup>st</sup> March, 2013 but before 1<sup>st</sup> April, 2017;
  - (c) The aggregate amount of actual cost of such new assets, acquired during any previous year and installed on or before 31<sup>st</sup> March, 2017, exceeds ₹25 lakhs.

*Following deduction in respect of investments in new assets is allowed:*

15% of the actual cost of such new assets acquired and installed during the relevant previous year. If new asset exceeding ₹25 crores is acquired

## Notes

and installed in the financial year 2014-15, 2015-16 and 2016-17, then this deduction shall be allowed during the relevant assessment years i.e. 2015-16, 2016-17 and 2017-18. However, if the acquisition of plant and machinery of the specified value is made in the previous year, its installation may be made upto 31-3-2017 order to avail the deduction of 15%. Thus, no deduction shall be allowed from the assessment year 2018-19.

If the installation of the new asset is in a year other than the year of acquisition, this deduction shall be allowed in the year in which the new asset is installed. Thus, in all 15% of the cost of 'new assets' is allowed as deduction only once.

*Meaning of New assets* - New assets, means any new plant or machinery (other than ship or aircraft) but does not include the following:

- (i) any plant or machinery which before the installation by the assessee was used either within or outside India by any other person; or
- (ii) Any plant or machinery in any office premises or any residential accommodation or a guest house; or
- (iii) Any office appliances including computers and computer software; or
- (iv) Any vehicle; or
- (v) Any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether as depreciation or otherwise) in computing the income under the head 'profit and gains from business and profession' of any previous year.

**Withdrawal of deduction:** This 'New assets' should not be sold or otherwise transferred within a period of 5 years from the date of its installation. If the new asset is sold or transferred within 5 years from its installation, the amount of deduction allowed to the assessee shall be deemed to be the income of the assessee of the previous year in which such sale or transfer takes place. Such deemed income shall be taxable under the head 'Profit and gains from business and profession' in addition to the capital gain which may also arise and taxable under the head 'Capital gains' on such sale or transfer.

If the new asset is sold or otherwise transferred in connection with the amalgamation or demerger within a period of 5 years from the date of its installation, the deduction allowed previously shall not be withdrawn. But



amalgamated company or the resulting company, as the case may be, shall not sale or transfer such 'new asset' within 5 years from its installation by the amalgamated or merged company. Thus, the condition of 5 years shall continue to apply in the case of amalgamated or resulting company.

*Profit or Gain of  
Business or Profession*

## Notes

- (5) **Expenditure on Scientific Research [Sec. 35(1)]**: Any expenditure, whether of revenue nature or capital nature incurred for carrying out the scientific research is termed as expenditure on scientific research. So, scientific research means the extension knowledge in the field of natural and applied sciences including agriculture, animal husbandry or fisheries. The following deductions shall be allowed in respect of expenditure on scientific research:

- (a) **Revenue expenditure incurred by the assessee**: Where the assessee himself is engaged in the scientific research and any revenue expenditure is incurred on scientific research related to business then, such expenditure shall be allowed as deduction. Thus, any amount spent by the assessee on payment of any salary to an employee engaged in such scientific research, or on the purchase of materials used in such scientific research, shall be allowed as deduction during the previous year.
- (b) **Payment to approved research association, educational or other institutions**: Where the assessee is himself not engaged in scientific research and any sum is paid by him to a research association, which carry on the scientific research, or to a University/institution to be used for scientific research shall be allowed as deduction of an amount equal to 1.75 times of such sum paid. But such association or institution must be approved by the Central Government for the purpose of scientific research.
- (c) **Payment to an Indian company for scientific research**: Any sum paid to a company to be used by it for scientific research shall be allowed as deduction of an amount equal to 1.25 times of such sum paid. For availing this deduction the company shall have to fulfill the following conditions: (i) it is registered in India; (ii) it has as its main object the scientific research and development; (iii) it is approved by the prescribed authority for the purposes of this deduction; (iv) it fulfils such other conditions which may be prescribed time to time.
- (d) **Payment to a University, College or other institution for social science or statistical research**: Any sum paid to a research association which has



## Notes

as its object the undertaking of research in social science or statistical research or to a university/college or other institution for research in social science or statistical research shall be allowed as deduction of an amount equal to 1.25 times of such sum paid. But such University, College or other institution must be approved, by the Central Government for the purpose of this deduction.

- (e) **Capital expenditure on scientific research [Sec. 35(2)]:** Deduction in respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee, shall be allowed as given below:-
- (i) The whole of such capital expenditure, incurred within the three years immediately preceding the commencement of the business, shall be allowed as deduction in the previous year in which the business is commenced.
  - (ii) No deduction for depreciation shall be allowed in respect of the assets used for scientific research either in the year in which the capital expenditure is incurred or in a subsequent year.
  - (iii) No deduction shall be admissible in respect of any expenditure incurred on acquisition of land even though the land has been purchased for the purposes of scientific research.
- (f) **Payment to a national laboratory etc. [Sec. 35(2AA)]:** Where the assessee pays any sum to a national laboratory or a university or an Indian Institute of Technology (IIT) or a specified person (approved by the prescribed authority) with the specific direction that the said sum shall be used for scientific research programme approved by the prescribed authority then, a deduction equal to 2 times of the sum so paid, shall be allowed.
- (g) **Expenditure on scientific research on approved in house research and development facility [Sec. 35(2AB)]:** If a company engaged in the business of bio-technology or in any business of manufacturer or production of any article or thing, not being an article or thing specified in the list of the 11<sup>th</sup> Schedule, incurs any expenditures on scientific research (excluding the cost of any land or building) on approved in-house research and development facility then, there shall be allowed a deduction of a sum equal to 2 times of expenditure; but no deduction shall be allowed in respect of such expenditure under any other provision of this Act or which is incurred after 31<sup>st</sup> March, 2017.

- (h) **Consequences on amalgamation [Sec. 35(5)]**: If under amalgamation, the amalgamating company transfers any capital asset, either to be used for scientific research by the amalgamating company, to the amalgamated Indian company then, the amalgamated company would be entitled to all those deductions in respect of that asset which would have been available to the amalgamating company as if no transfer had taken place. The amalgamating company shall not be allowed any other deduction in respect of the asset so transferred.
- (6) **Expenditure on Acquisition of Patent rights or Copyrights [Sec. 35A]**: Patent or copyrights means the right to use any know-how, secret formula, designs and specifications. Such capital expenditure is considered as intangible asset which is chargeable to depreciation @ 25% of its written-down value u/s 32. The capital expenditure incurred otherwise than of acquisition of these assets is not deductible and the expenditure of revenue nature is allowable u/s 37(1) of the Act. If the right has been transferred under a scheme of amalgamation, the amalgamated Indian company shall be entitled to avail the remaining instalments as deduction as these would have been allowed in case of amalgamating company. But, if this right has been transferred under a scheme of demerger, the resulting Indian company shall be entitled to avail the remaining instalments as deduction as these would have been allowed in case of amalgamating company.
- (7) **Expenditure on Know-how [Sec. 35AB]**: Know-how means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral deposits. This deduction is not available in respect of capital expenditure incurred on the acquisition of know-how on or after April 1, 1998. This is an intangible asset. The depreciation @ 25% of its written down value is, however, allowed in respect of such expenditure (asset) incurred on or after April 1, 1998.
- (8) **Expenditure incurred on Agricultural Extension Project [Sec. 35CCC]** : If an assessee has incurred any expenditure on any project relating to extension and development of agriculture in the previous year, deduction of 150% of such expenditures shall be allowed under this section. Here it is notable that such project should be notified by CBDT.
- (9) **Expenditure incurred on any Skill Development Project [Sec. 35CCD]** : If a company incurs any expenditure on a project which is related for the development of skill of the employees, a deduction of 150% of such expenditures shall be allowed. This project should be notified by CBDT. Here it is essential to mention



that cost of land and building shall not be included in the expenditures of this project.

- (10) **Deduction in respect of Preliminary Expenses [Sec. 35D]** : This deduction shall be claimed by Indian Company or resident non-corporate assessee. Preliminary expenses are incurred prior to commencement of trade or/and after which are related for the development or with the establishment of new unit. Preliminary expenses are admissible in 5 equal instalments or 1/5th of total preliminary expenses allowed every year. This deduction shall commence from the year of starting the trade completing the development work or with the year of starting the new unit.

*The preliminary expenses include the following expenses:*

- (i) Expenses for preparing project/feasibility report, expenses of market survey, expense on engineering services relating to trade of assessee.
- (ii) Legal expenses relating for preparing the draft of contract made between assessee and other persons.
- (iii) In the case of a company assessee the following expenses will also be included in preliminary expenses (except the above expenses): legal expenses in drafting memorandum and articles of association of company, printing expenses of memorandum and articles of association, registration fee of the company, underwriting commission and brokerage on the issue of shares and debentures of the company and expenses on preparation, typing, printing and advertisement of prospectus etc.

**Maximum ceiling of deduction:** The maximum amount allowable for deduction can be upto a maximum of 5% of project cost in case of non-corporate company and in case of company or at the option of the company either 5% of project cost or 5% of capital employed in the company (whichever is more in these two). In both the cases, deduction of preliminary expenses shall not exceed that amount which has been paid in actual.

- (11) **Amortisation of Expenditure in case of Amalgamation or Demerger [Sec. 35DD]** : If an Indian company makes such payments after 31<sup>st</sup> March, 1999 wholly and exclusively for the purpose of amalgamation or demerge of any undertaking, the assessee shall be allowed a deduction of any amount equal to 1/5<sup>th</sup> of such expenditure for each of the 5 successive previous years beginning with the previous year in which the amalgamation or demerger takes place.
- (12) **Amortisation of Expenditure under Voluntary Retirement Scheme [Sec. 35DDA]** : If an assessee is paid any sum in any previous year under scheme



of voluntary retirement, a deduction of  $\frac{1}{5}$ th of the amount paid by assessee shall be allowed in computing the profits of that previous year. Deduction of remaining amount shall be allowed during the next four years. No other deduction regarding these expenses shall be allowed, under the provision of Income-tax Act.

*Profit or Gain of  
Business or Profession*

## Notes

- (13) **Expenses on the Discovery of Minerals [Sec. 35E]** : These expenses are allowed to Indian company or non-company residential person. It includes expenses on discovery of minerals or expenses incurred in the development of mines, but no deduction is allowed on capital expenses incurred on land, building etc. Deduction will be  $\frac{1}{10}$ th every year of these expenses. If, in any year the income of minerals is less than  $\frac{1}{10}$ th portion, the deduction will be equal to income and the balance will be carry forward upto a maximum period of 10 years only.
- (14) **Insurance Premium [Sec. 36(1)(i)]** : The amount of any premium paid in respect of insurance against risk of damage or destruction of stores for the purpose of business or profession, shall be allowed in full, as deduction.
- (15) **Interest on Borrowed Capital [Sec. 36(1)(iii)]** : The amount of interest paid in respect of capital borrowed for the purpose of the business or profession is allowed as deduction. But, no deduction shall be allowed regarding any amount of interest paid on borrowed capital which is taken for the extension of existing business for acquiring new asset, and such amount of interest relates for the period beginning from the date on which the capital was borrowed to acquire the asset till the date on which such asset was put to use first time. In addition to that, expenses such as costs of stamps, registration fees, brokerage etc incurred by the assessee in connection with the raising of loans are inadmissible deductions.
- (16) **Discount on Zero Coupon Bonds [Sec. 36 (1)(iiia)]** : Zero coupon bond is a bond issued by a infrastructure capital company, or public sector company or scheduled bank. The difference between the amount received, at the time of issue, and the amount payable on redemption or maturity by the issuing company, is termed as discount on Zero coupon bonds. Discount on Zero coupon Bonds will be allowed as deduction on prorata basis. Such deduction, shall be allowed for a period of full period of life of bonds on prorata basis. Prorata basis means that total discount of the zero coupon bonds shall be spread over a period of life of such bonds.

$$\text{Prorata Discount} = \frac{\text{bonds coupon zero on discount Total}}{\text{Full period of life of zero coupon bond (in years/months/days)}}$$

- (17) **Employer's Contribution to Recognised Provident Fund [Sec. 36(1)(iv)]** : Employer's contribution towards recognised provident fund or an approved superannuation fund is allowable as deduction subject to such limits prescribed for the purpose of recognising the provident fund or approving the superannuation fund.
- (18) **Employer's contribution towards Pension Scheme [Sec. 36(1)(iva)]** : Any sum paid by the employer by way of contribution towards a pension scheme, as referred to in section 80CCD (notified by the Central Government) on account of an employee. This contribution shall be allowed as deduction as business expenditure upto 10% of the salary of the employee in the previous year. Here, *Salary* means basic salary + dearness allowance (if it is under the terms of employment) + commission on turnover at rate of fixed percent. This excludes all other allowances and perquisites.
- (19) **Employer's contribution to Approved Gratuity Fund [Sec. 36(1)(v)]** : Employer's contribution towards an approved gratuity fund, created by him for the exclusive benefit of his employees, is allowable as deduction to the extent of 8.33% of the annual salary of each employee.
- (20) **Family Planning Expenditure [Sec. 36(1)(ix)]** : Any expenditure incurred by a company for promoting family planning amongst its employees, is fully allowable as deduction.
- (21) **Banking Cash Transaction Tax [Sec. 36(1)(xiii)]** : Banking cash transaction tax paid by the assessee during the previous year on the taxable banking transactions entered into by him will be allowed as deduction while computing his income from business or profession. Thus, this deduction is available only under the head 'income from business or profession' only instead of other heads.
- (22) **Contribution towards Credit Guarantee Fund Trust [Sec. 36(1)(xiv)]** : Any contribution made by a public financial institution to such credit guarantee fund trust for small industries, which is notified by the Central Government for this purpose, is allowed as deduction in computing taxable income under this head.
- (23) **Securities Transaction Tax [Sec. 36(1)(xv)]** : Any amount of securities transaction tax paid by an assessee during the previous year in respect of taxable securities transactions entered into the course of business shall be allowed as



deduction subject to the condition that such income from taxable securities transaction is included under the head 'profit and gains from business and profession'.

*Profit or Gain of  
Business or Profession*

## Notes

**(24) Commodities Transaction Tax [Sec. 36(I)(xvi)] :** An amount equal to the commodities transaction tax paid by the assessee in respect to the taxable commodities transaction entered into in the course of his business, during the previous year, shall be allowed as deduction, if the income arising from such taxable commodities transactions is included in the income computed under the head 'profit and gains from business and profession'.

**(25) Expenditure by Co-operative Society for purchase of Sugarcane [Sec. 36(I)(xvii)] :** Deduction will be allowed in respect of expenditure incurred by a co-operative society (engaged in the business of manufacture of sugar) for purchase of sugarcane at a price which is equal to or less than the price fixed on approved by the Government.

**(26) General Deductions [Sec. 37] :** According to Section 37, any expenditure not covered under sections 30 to 36, are allowable as deduction subject to the fulfilment of following conditions:

- (i) It is not deductible under sections 30 to 36.
- (ii) It is not a capital expenditure.
- (iii) It is not a personal expenditure of the assessee.
- (iv) It is exclusively for the purpose of business or profession.
- (v) It is incurred during the previous year.

The following are the few examples of admissible general deductions under this section:

- (a) Expenses incurred in the purchase, manufacture and sale of goods
- (b) Expenses incurred in the day to day running of the business.
- (c) Royalties paid in connection with mines.
- (d) Reasonable expenses incurred on the occasion of Dussehra, Diwali, Commencement of business etc.
- (e) Welfare expenditure incurred by the assessee.
- (f) Payment of excise duty.
- (g) Annual listing fee paid to Stock Exchange by public limited company is allowable.
- (h) Expenditure incurred in alterations in the Memorandum or Articles of Association of a company subject to the provisions under Companies Act.
  - (i) Loss of stock by fire.
  - (j) Loss of stock-in-trade by enemy bombing.



The following expenses are expressly disallowed (shall not be deducted), in computing the taxable profits from business or profession, as per the provisions of the Act:

## Notes

- (1) **Expenditure on advertisement to a political party [Sec. 37(2B)]** : No deduction shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, pamphlet etc. published by a political party.
- (2) **In case of any assessee [Sec. 40(A)]**: In case of any assessee, the following expenses are expressly disallowed:

- (i) **Payments outside India etc.**: Any interest, royalty, fees for technical services etc., which is payable outside India or in India to a non-resident/a foreign company on which tax is deductible at source and such tax has not been deducted at source or after deduction has not been paid on or before the due date of filing the return of income specified in Sec. 139(1) shall not be allowed as a deduction.

However, if in respect of any such sum tax has been deducted in any subsequent year, or has been deducted in the previous year but paid after the due date specified in Sec. 139(1), such sum shall be allowed as a deduction in computing the income of that year in which such tax has been paid.

- (ii) **Payments to residents**: Any payment to a resident on which tax is deductible at source and such tax has not been deducted or, after deduction has not been paid on or before the due date of filing the return of income specified in Sec. 139(1), then 30% of such sum shall not be allowed as a deduction.

However, if in respect of such sum tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in Sec. 139(1), then 30% of such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

- (iii) **Tax on profits and gains**: Any paid on account of any tax levied on the profits and gains of any business or profession shall not be allowed as a deduction.
- (iv) **Amount paid to State Government**: Any amount paid as royalty, license fee, service fee/charge etc., which is levied exclusively on a State Government undertaking by the State Government; or any amount which is appropriated,

whether directly or indirectly, from a State Government undertaking by the State Government, shall not be allowed as a deduction.

*Profit or Gain of  
Business or Profession*

## Notes

- (v) **Salaries payable outside India or to a non-resident:** It is not allowed as a deduction, if tax has not been paid thereon nor deducted at source.
  - (vi) **Payment to Provident Fund:** Any payment to a provident or other funds shall not be allowed as a deduction unless it is ensured that tax shall be deducted at source from any payments made from the fund provided it is chargeable to tax.
  - (vii) **Tax on perquisites of employee:** Any tax actually paid by an employer on the value of perquisites provided to an employee which is exempt u/s 10(10CC).
- (3) **In case of a partnership [Sec. 40(b)]:** In case of a partnership, the following payments made by any partnership firm shall not be allowed as deduction in computing taxable income of such firm:
- (i) Any payment of salary, bonus, commission or remuneration paid to any partner, who is not a working partner.
  - (ii) Payment of salary, etc. to working partners will be allowed as a deduction, only if it is authorised by and is in accordance with the terms of partnership deed. It is further provided that the terms of partners deed will not have retrospective effect in this respect.
  - (iii) Any payment of interest, in excess of 12% p.a., to any partner, by a firm.
  - (iv) In the case of working partners payment of salary, bonus, commission or remuneration to all partners taken together will be allowed as a deduction subject to the following limit:
    - (a) On the first ₹3,00,000 of the book profit or in case of a loss – Maximum allowable amount will be ₹1,50,000 or @ 90% of the book profit (whichever is more).
    - (b) On the balance of the book profit – Maximum allowable amount will be @ 60%.
- (4) **In case of an Association of Persons (AOP)/Body of Individuals (BOI) [Sec. 40(ba)]:** In the case of AOI and BOI (other than a company or a co-operative society) any interest, salary, bonus, commission etc. made by such association/body to a member of such association/body is expressly disallowed. Interest paid by the association/body on any loan given by its member to the association/body, is also disallowed. But the interest on loan taken by the association/body from any other concern is allowed even if any member of the association/body



## Notes

has any interest in that concern. In this connection the following provisions, are worth noting:

- (i) If the association or body pays any interest to any of its member who also pays interest to the association/body, the interest disallowed shall be the amount by which the interest paid by the association/body to its member exceeds the interest paid by its members to the association/body.
  - (ii) If an individual is a member in the association/body in a representative capacity and he has given loan to the association/body in his individual capacity, the interest paid by the association/body to such member shall be allowed as deduction.
  - (iii) If an individual is a member in the association/body in his personal capacity, interest by the association/body to such member shall be allowed as deduction if such interest is received by him in a representative capacity.
- (5) **Excessive payments to a relative [Sec. 40A(2)]** : If an assessee incurs any expenditure by way of payment to a relative shall be disallowed, if the Assessing Officer considers it to be excessive or unreasonable having regard to all the circumstances of the case. Only the excessive or unreasonable part is to be disallowed. For this purpose, relative means the husband/wife/brother/sister or any person which has a substantial interest in the business.
- (6) **Payments in cash [Sec. 40A(3)]** : If an assessee makes a payment or aggregate of payments made to a person in a day of any expenditure exceeding ₹20,000 otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft, the whole of such expenditure shall not be allowed as deduction. However, where the payment is made for plying, hiring or leasing goods carriages, the limit of disallowance shall be exceeding ₹35,000 instead of exceeding ₹20,000.
- (7) **Provision of Gratuity [Sec. 40A(7)]** : If the assessee has made any provision for the payment of gratuity (other than approved gratuity fund) to his employees on their retirement/termination of their employment for any reason, such provision shall not be allowed as deduction in computing the taxable profits for business or profession.
- (8) **Deductions allowable only on actual payment basis [Sec. 43B]** : The following amounts shall be deducted only on 'actual payment' basis:
- (i) Any sum payable by the assessee by way of tax or duty/fee under any law.



- (ii) Any sum payable by the assessee as an employer by way of contribution to any provident/ gratuity fund or any other fund for the welfare of employees.

*Profit or Gain of  
Business or Profession*

- (iii) Any sum payable by the assessee as interest on any loan or borrowing from any public financial institution.

- (iv) Any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee.

**(9) Other expenses :** In addition to above, the following expenses and losses are also not allowable as deduction in computing the profits and gains of business or profession:

- (i) Personal expenses (drawing) of proprietor or partners.
- (ii) Amount paid as charity or gifts.
- (iii) Litigation expenses for registration of shares.
- (iv) Contribution to a political party.
- (v) Insurance premium paid by a firm on LIC policies of its partners.
- (vi) Expenditure on shifting of registered office.

## Notes

### Illustration 3

From the following Profit and Loss account of Mr. Amar for the year ended 31st March, 2022, find out his taxable income from business or profession head –

Office expenses and salaries	₹ 65,720	Gross profit	₹ 5,28,635
General expenses	32,640	Interest on Govt. Securities (gross)	11,800
Interest on bank loan	5,480	Discount	400
Interest on capital	21,580	Bad debts recovered	1,440
Provisions for bad debts	10,835	Profit on sale of long-term investments	20,750
Bad debts	4,000	Sundry receipts	10,350
Audit fees	20,300		
Rent	12,030		
Income tax	21,760		
Charity and donation	4,485		
Legal expenses	3,370		
Compensation to a retrenched employee	41,500		
Addition to building	51,500		
Net profit	2,78,175		
	<b>5,73,375</b>		<b>5,73,375</b>

In computing the income, the following facts should be taken into consideration – (i) Rent includes ₹600 in respect of the rent of the office building belonging to the proprietor himself. (ii) General expenses include ₹10,000 in respect of new furniture purchased during the year. (iii) Allowable depreciation as per law is ₹3,275. (iv) Legal expenses include a sum of ₹1,000 being penalty by the customs authority.

**Solution:**

Computation of Income from Business or Profession of Mr. Amar  
for the assessment year, 2022-23

	₹	₹
Balance as per P & L a/c (Profit)		2,78,175
<i>Add: Expenses expressly disallowed but debited to P &amp; L a/c:</i>		
Interest on capital	21,580	
Provisions for bad debts	10,835	
Rent of own building	600	
Cost of new furniture being capital expenses	10,000	
Income tax	21,760	
Charity and donation	4,485	
Penalty	1,000	
Addition to building being capital expenses	52,500	
		<u>1,22,760</u>
<i>Less: Income not taxable under this head but credited to P&amp;L a/c:</i>		4,00,935
Interest on securities		
Profit on sale of long-term investments being capital gains	11,800	
<i>Less: Expenses expressly allowed but not debited to P&amp;L a/c:</i>		
Depreciation	20,750	
Depreciation on new furniture @ 10%	3,275	
	1,000	36,825
<b>Taxable income</b>		<b>3,64,110</b>

**Note:** 1. Compensation to the retrenched employee is allowed deduction. It is presumed that the employee was retrenched in the interest of the concern.

2. Penalty imposed by the customs authority is not deductible.

3. Depreciation on new furniture purchased during the year will be allowed @ 10%.

**Illustration 4***Profit or Gain of  
Business or Profession*

Dr. Satish is a Medical practitioner. He gives you the following summary of cash book for the year ended 31.03.2022:

	₹		₹
To Balance	10,000	By rent of clinic	18,000
To consultation fee	60,000	By purchase of medicines	38,000
To visiting fee	45,000	By staff salaries	24,000
To gifts and presents	8,000	By surgical equipments	40,000
To sale of medicine	42,000	By motor car expenses	8,000
To dividend from UTI	6,000	By purchase of motor car	1,40,000
To life insurance maturity	1,00,000	By house hold expenses	7,000
To interest from national defence bonds	6,000	By closing balance	2,000
	<b>2,77,000</b>		<b>2,77,000</b>

**Notes****Other Information:**

- 50% of the motor car expenses incurred in connection with profession. Car was purchased in December 2021.
  - Household expenses includes ₹6,800 for life insurance premium.
  - Gifts and presents include ₹3,000 from relatives
  - Closing stock of medicine ₹12,000 and on 01.04.2021, opening stock was ₹4,000.
- Compute his professional gain for the assessment year 2022-23.

**Solution:**

Computation of Income from Business or Profession of Dr. Satish  
for the assessment year, 2022-23

Consultation fee	60,000	
Visiting fee	45,000	
Gifts (₹8000 – ₹3000)	5,000	
Sale of medicines	42,000	<u>1,52,000</u>
Less: Allowed deductions		1,52,000
Rent	18,000	
Medicines (₹4,000 + ₹38,000 – ₹12,000)	30,000	
Salaries	24,000	
Depreciation on surgical equipments	6,000	
Car expenses 50%	4,000	
Depreciation on car	5,250	87,250
<b>Income from profession</b>		<b>64,750</b>



**Note:** 1. Computation of depreciation on car –

Car has been used for less than 180 days during previous year i.e., ₹ 1,40,000 @ 7.5% = ₹ 10,500

Less: 50% for personal use @ ₹ 10,500 = ₹ 5,250.

Hence allowable depreciation will be ₹ 5,250 (₹ 10,500 – ₹ 5,250).

### Illustration 5

From the following Profit and Loss account of Shri Radhey Lal (the proprietor of a flour mill) for the year ended 31st March, 2017, find out his income from business –

	₹		₹
Trade expenses	450	Gross profit	2,35,900
Establishment charges	2,200	Dividends from a co-operative society	
Rent, rates and taxes	1,400	Rent from property	2,600
Discount and allowance	200	Bad debts recovered	500
Income tax	700	(allowed as deduction in an earlier year)	2,000
Advertisement expenses	1,450		
Postage and Telegrams	100		
Gifts and presents for publicity	125	Gifts and presents for publicity	125
Fire insurance premium	250	Fire insurance premium	250
Charities	375	Charities	375
Donations	400	Donations	400
Repairs and Renewals	250	Repairs and Renewals	250
Audit fees	250	Audit fees	250
Net profit transferred to capital account	2,32,850	Net profit transferred to capital account	2,32,850
	<b>2,41,000</b>		<b>2,41,000</b>

### Solution:

Computation of Income from Business of Shri Radhey Lal  
for the assessment year, 2022-23

	₹	₹
Balance as per P & L a/c (Profit)		2,32,850
Add: Expenses expressly disallowed but debited to P & L a/c:		
Income tax	700	
Charities	375	
Donations	400	
		<b>1,475</b>

Less: Income not taxable under this head but credited to P&L a/c:		2,34,325
Income from property (being not business income)	500	
Dividend (being not business income)	2,600	
		3,100
Income from business		2,31,225

Profit or Gain of  
Business or Profession

Notes

### Illustration 6

The net profit of business of Mr. Vijayan as disclosed by its profit and loss account were ₹ 3,25,000 after charging the following.

(a) Municipal taxes on house property let out	3,000
(b) Bad debts written off	15,000
(c) Provision for doubtful debts	16,000
(d) Provision for taxation	15,000
(e) Depreciation	25,000
(f) Depreciation allowable	20,000

Ascertain taxable business profit?

### Solution:

Net profit		3,25,000
Add:		
Municipal taxes	3,000	
Provision for bad debts	16,000	
Provision for taxation	15,000	
Excess depreciation	5,000	39,000
<b>Business Profit</b>		<b>3,64,000</b>

### Illustration 7

The following is the receipt and payment account maintained by a registered medical practitioner. An abstract of receipts and payments is given below. You are required to compute his income from profession and also compute his total income for the assessment year 2021-22.

## Notes

Balance b/d	78,000	Cost of medicine	8,000
Consultation fees	42,000	Surgical tools	6,000
Sale of medicine	15,000	Rent of dispensary	1,400
visiting fees	20,000	Motor car	1,00,000
interest on govt. securities	3,500	Car expense	6,000
rent from property	3,000	Salaries	5,300
loan from bank for private use	2,000	Life insurance premium	2,500
		Interest on bank loan	200
		Property insurance	500
		OYT deposit	8,000
		Balance c/d	25,600
	1,63,500		1,63,500

Additional information:

1. Half of the motor car expenses are meant for personal use
2. Depreciation allowable on car is 15% and surgical tools @ 25%

**Solution:**

Computation of income from profession and house property

Particulars	₹	₹
Gross professional income		
Sale of medicine	15,000	
Visiting fees	20,000	
Consultation fee	42,000	77,000
Less: Professional expenses:		
Cost of medicine	8,000	
Rent of dispensary	1,400	
Salaries	5,300	
Car expenses –half	3,000	
Surgical tools @25%	1,500	
Depreciation on car (100000*15/100*1/2)	7,500	
OYT deposit	8,000	34,700
Income from profession		42,300
Income from house property	3,000	
Less 30% of AV	900	2,100
Income from other sources		3,500
<b>Gross total income</b>		<b>47,900</b>



### Illustration 8

*Profit or Gain of  
Business or Profession*

Mr. X, a grower and manufacturer of tea, purchased machinery (15%) on 10-04-2019 for ₹ 10 lakh. He computed depreciation for A.Y. 2021-22 as given below; needs your comment on his working:

Particulars	Amount
Opening W.D.V. as on 1/4/2019	Nil
Add: Assets purchased during the year	10,00,000
	10,00,000
Less: Depreciation for the P.Y. 2019-20 [ $₹ 10,00,000 \times 15\% \times 40\%$ ]	60,000
(As he is engaged in the business of growing and manufacturing tea; hence 60% is considered as part of agricultural income)	
Opening W.D.V. as on 1/4/2020	9,40,000
Less: Depreciation for the P.Y. 2021-22 [ $₹ 9,40,000 \times 15\% \times 40\%$ ]	56,400
Opening W.D.V. as on 1/4/	8,83,600

Further, compute his business income for A.Y. 2021-22 assuming that his income before depreciation and without reducing element of agricultural income is ₹ 8,00,000/-

#### Solution:

The method of computation of depreciation followed by Mr. X is not correct as Expl. 7 to sec.43(6) provides that: "Where the income of an assessee is derived, in part from agriculture and in part from business chargeable to income-tax under the head "Profits and gains of business or profession", for computing the written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire income is derived from the business of the assessee under the head "Profits and gains of business or profession" and the depreciation so computed shall be deemed to be the depreciation actually allowed under this Act." The correct computation of depreciation are as follow:

Particulars	Amount
Opening W.D.V. as on 1/4/2019	Nil
Add: Assets purchased during the year	10,00,000
	10,00,000
Less: Depreciation for the P.Y. 2019-20 [ $₹ 10,00,000 \times 15\%$ ] (Considering the entire income as taxable income)	1,50,000
Opening W.D.V. as on 1/4/2020	8,50,000
Less: Depreciation for the P.Y. 2021-22 [ $₹ 8,50,000 \times 15\%$ ]	1,27,500
Opening W.D.V. as on 1/4/2021	7,22,500

Notes

## Notes

## Computation of business income of Mr. X for A.Y. 2019-20

Particulars	Amount
Income before depreciation and without reducing element of agricultural income	8,00,000
Less: Depreciation	1,27,500
	6,72,500
Less: Agricultural Income being 60% of above	4,03,500
Profits and Gains of Business or Profession	2,69,000

## Illustration 9

From the following figures, you are required to calculate the depreciation admissible during the previous year.

	Plant and machinery	building
Written down value at the beginning of the year	3,75,000	15,00,000
Purchased during the year	4,50,000	nil
Sales during the year	7,75,000	3,00,000

## Solution:

## Calculation of Depreciation

Particulars	Plant and Machinery	Building
WDV at the beginning	3,75,000	15,00,000
Add: purchase	4,50,000	Nil
	8,25,000	15,00,000
Less: sales	7,75,000	3,00,000
WDV	50,000	12,00,000
Less Depreciation	7,500	1,20,000
	42,500	1,08,000

## Illustration 10

Sri Ram Gopal is the owner of a business. His Profit & Loss Account for the year ended on 31st March, 2021 is given below:

	₹		₹
To Establishment Charges	5,110	By Gross Profit	80,870
To Salaries	10,000	By Interest on Govt. Securities (Net)	5,352
To Rent, Rates & Taxes	2,900	By Rent from House Property	5,400

## Notes

To Sundry Expenses	7,050		
To Household Expenses	1,380		
To Provision for Bad Debts	1,200		
To Loss on Sale of Motor-car (used for private purpose)	1,800		
To Insurance Premium (including life insurance ₹ 1,790)	2,880		
To Interest on Bank Loan	1,380		
To Provision for Depreciation	6,400		
To Advertisement in a Magazine of Political Party	500		
To Net Profit	51,022		
₹	91,622	₹	91,622

Following additional information are given:

- Bad debts written-off during the year 650.
- Admissible depreciation as per I.T. rules 1,600.
- Sri Ram Gopal is running his business in rented property, half of which is used by him for his own residence. Rent of 2,400 in respect of this house is included in Rent, Rates and Taxes.
- Salary of 2,000 was paid to Shri Ram Gopal. It has been recorded in the item salaries.

Compute Sri Ram Gopal's taxable income from business or profession for the assessment year 2021-22.

**Solution:**

### COMPUTATION OF BUSINESS INCOME OF SRI RAM GOPAL (for the Assessment Year 2021-22)

Net Profit as per Profit & Loss Account		51,022
<b>Add: Expenses disallowed but debited to P. &amp; L. A/c:</b>		
Salary to Proprietor	2,000	
Rent (for half portion)	1,200	
Household Expenses	1,380	
Provision for Bad Debts	1,200	
Loss on Sale of Car	1,800	
Life Insurance Premium	1,790	



## Notes

Provision for Depreciation	6,400	
Advertisement in a Magazine	500	16,270
		<b>67,292</b>
Less: Expenses allowed but not debited to P. & L. A/c		
Bad Debts	5,352	
Depreciation	5,400	10,752
<b>Income from Business</b>		<b>54,290</b>

**Note:** Advertise in a magazine of political party though it is for the benefit of business, is disallowed.

**Illustration 11**

From the following Profit & Loss Account of Mr. Raj Kumar for the year ended 31st March, 2021, compute income from business or profession:

	₹		₹
General Expenses	4,000	Gross Profit	1,10,000
Bad Debts	2,500	Commission	10,000
Bad Debts Provision	1,500	Brokerage	15,000
Fire Insurance	750	Winning from Crossword Puzzles	10,000
Staff Salary	20,000	Interest on 7% National Plan Certificates	1,000
Discount to Dealers	2,500		
Salary of Raj Kumar	5,000		
Interest on Overdraft	5,000		
Interest on Loan of Smt. Raj Kumar	2,500		
Interest on Capital of Mr. Raj Kumar	3,500		
Depreciation on Machinery	8,000		
Advertisement Expenses	7,500		
Contribution of Employees' Provident Fund	5,000		
Theft by Cashier	1,000		
Net Profit	77,250		
	<b>1,46,000</b>		<b>1,46,000</b>

Other information are as follows:

- Depreciation allowed on machinery is ₹ 6,500
- Advertisement expenses include ₹ 4,000 spent on a neon sign board affixed on the office premises. It also includes ₹ 1,000 in respect of an advertisement for the lost papers of Mr. Raj Kumar's building.

- (c) Income of ₹ 750 accrued during the previous year is not recorded in Profit & Loss Account.

*Profit or Gain of  
Business or Profession*

- (d) General expenses include an amount of ₹ 1,100 spent on the party of a friend.

**Solution:**

**Notes**

**INCOME OF MR. RAJ KUMAR FROM BUSINESS OR  
PROFESSION (for the Assessment Year 2021-22)**

Net Profit as per Profit & Loss Account	₹	₹ 77,250
Add: Expenses disallowed but debited to P. & L. A/c:		
(1) Expenses of Party	1,100	
(2) Provision for Bad Debts	1,500	
(3) Exp. On Neon-sign Board	4,000	
(4) Advertisement for private purpose	1,000	
(5) Salary of Raj Kumar	5,000	
(6) Interest on Capital	3,500	
(7) Excess Depreciation (₹ 8,000-6,500)	1,500	17,600
Add: Incomes accrued but not credited to P. & L. A/c		750
		95,600
<b>Less: Incomes or receipt not taxable under this head but credited to P. &amp; L. A/c:</b>		
(1) Winning from Crossword Puzzles	10,000	
(2) Interest on 7% National Plan Certificates	1,000	11,000
		84,600
Less: Depreciation @ 10% on Neon -sign Board	400	
Income from Business	84,200	

**Notes:**

- (1) Capital expenditure on advertisement is not admissible w.e.f. A.Y. 1998-99, hence expenditure on neon-sign board is not deductible. This expenditure is subject to depreciation @ 10% taking it in the Block of Furniture.
- (2) Winning from crossword puzzles is taxable under head 'Income from Other Sources'.
- (3) Interest on 7% NPC is not taxable under this head. However it is also exempt u/s 10.
- (4) Theft by cashier is allowed.

## Illustration 12

Dr. Suresh is a medical practitioner. He is a consulting physician of XYZ Co. Ltd. on a monthly retainer fee. The doctor maintains a record of his receipts and payments and for the year ended 31st March, 2021, the following information is abstracted therefrom:

## Notes

Receipts	₹
Consultation fee received	80,000
Retainer Fee received from XYZ Co. Ltd.	6,000
Interest on Bank Deposit (Nationalized Bank)	20,000
<b>Payments:</b>	
Rent and Electricity Charges for the Clinic	14,000
Telephone Charges	3,000
Printing and Stationery	1,500
Car Maintenance Expenses	12,000
Wages for Clinic Assistant	3,600
Life Insurance Premium	2,400
Car Insurance Premium	2,000

The written down value of the car and the furniture of the Clinic as on 1-4-2020 were ₹ 40,000 and ₹ 3,000 respectively. 20% of the use of the car and the telephone is attributable to personal and private purpose. Prepare a statement showing the Gross Total Income of Dr. Suresh for the assessment year 2021-22.

## Solution:

## COMPUTATION OF GROSS TOTAL INCOME (for the Assessment Year 2021-22)

1. Profits and Gains of Profession:	₹	
Consultation Fee		80,000
Retainer Fee from XYZ Co. Ltd.		6,000
	Gross Fee Received	86,000
Less: Admissible Expenses:	₹	₹
Rent & Electricity		14,000
Telephone Charges	3,000	
Less: Attributable to Personal Use (20%)	600	2,400
Printing and Stationery		1,500
Car Maintenance	12,000	
Less: Personal Use (20%)	2,400	9,600
Wages of Clinic Assistant	3,600	
Depreciation on Car @ 15% on ₹ 40,000	6,000	



Less: 20% Attributable to Personal Use	1,200	4,800	
Car Insurance (80% of ₹ 2,000)		1,600	
Depreciation on Furniture (10%)		300	37,800
	Income from Profession		48,200
2. Income from other Sources:			
Interest on Bank Deposit	20,000		
<b>Gross Total Income</b>	<b>68,200</b>		

## Notes

### 4.7 Capital Gain

Any profits or gains arising from the transfer of a capital asset in the previous year, shall 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 gain is exempt u/s 54, 54B, 54D, 54EC, 54EE, 54F, 54GA, or 54GB.

The following are the essential conditions for taxing capital gains:

- (A) there must be a capital asset;
- (B) the capital asset must have been transferred;
- (C) there must be profits or gains on such transfer, which will be known as capital gain;
- (D) Such capital gain should not be exempt u/s 54, 54B, 54D, 54EC, 54EE, 54F, 54GA, or 54GB.

#### Capital Assets

According to section 2 (14) Capital asset means property of any kind held by the assessee whether connected with his business, profession or not. Capital asset may be tangible or intangible, movable or immovable, fixed or floating. It includes plant, machinery, land, building, jewellery, investment, shares, debentures, goodwill, copyright, license, permits etc.

**Exception:** The term capital asset does not include the following:

- (i) Commercial goods: Any stock-in-trade, consumable stores or raw materials held for the purposes of his business or profession.
- (ii) Personal Assets: Movable assets (including wearing clothes and furniture) held for personal use by the assessee or any member of his family dependent on him. Thus a car or any other vehicle, refrigerator, television or other electrical appliances are included in this.

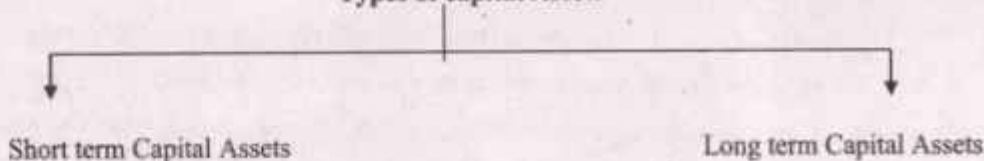
**Exceptions:** The following assets will not be treated as personal effect and liable to tax:

- (a) Archaeological collections, (b) drawings, (c) paintings, (d) sculptures, (e) any work of art, (f) jewellery for personal use.

## Notes

**Jewellery Includes**

- (a) Ornaments made of gold, silver, platinum, or any other precious metal, whether or not worked or sewn into any wearing apparel.
- (b) Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.
- (iii) Agricultural land: Agricultural land in India provided it is not situated;
  - (a) within the limits of any municipality or a cantonment board, having a population of 10,000 or more; or
  - (b) In areas lying within a distance not exceeding 8 km from the local limits of such municipalities or cantonment boards. if the agricultural land is situated within the area measured aerially specified below it shall form part of capital asset.
    - (1) Not being more than two kilo meters from the local limits and which has population of more than ten thousand but not exceeding one lakh; or
    - (2) Not being more than six kilo meters from the local limits and which has population more than one lakh but not exceeding ten lakh; or
    - (3) Not being more than eight kilo meters from the local limits and which has population more than ten lakh
- (iv) Gold bonds 6½ Gold Bonds, 1977 or 7% Gold Bonds, 1980 or National Defence Gold Bonds 1980 issued by the Central Government.
- (v) Special Bearer Bonds 1991.
- (vi) Gold deposit Bonds. Gold deposit Bonds issued under the Gold Deposit Scheme, 1999 or deposit certificate issued under gold monetization scheme notified by the Central Government.

**Types of capital Assets**

- (1) **Short-term capital asset [Section 2(42A)]:** A capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer is

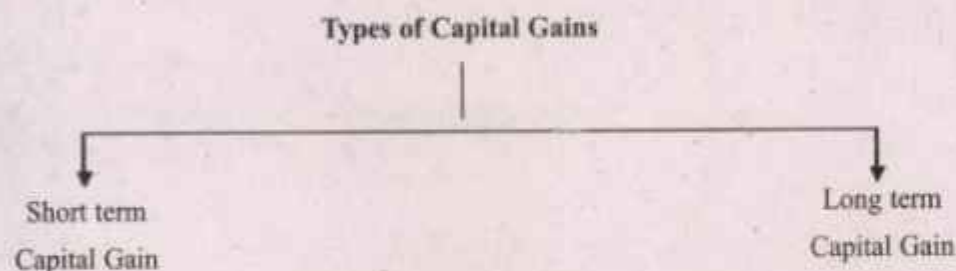
known as a short term capital asset. However, the following assets shall be treated as short-term capital assets if they are held for not more than 12 months (instead of 36 months mentioned above) immediately preceding the date of its transfer :

- (a) a security including shares listed in a recognized stock exchange in India,
- (b) a unit of unit trust of India
- (c) a zero coupon bond
- (d) approved mutual fund

- (2) **Long-term capital asset [ Section 2(29A)]**: It means a capital asset which is not a short-term capital asset. In other words, (if the asset is held by the assessee for more than 36 months or 12 months, as the case may be, such an asset will be treated as a long-term capital asset.

### Types of Capital Gain

Capital gain Arises from the transfer of short term capital asset is known as short term capital gain & capital gain arises from the transfer of long term capital asset is known as long term capital gain.



### Computation of Capital Gain

#### Calculation of Short Term Capital Gain

Computation of Taxable Income from Capital Gains

(For the A.Y. 2022-23)

Sales consideration		-
Less:- (i) Cost of acquisition	-	
(ii) Cost of Improvement	-	
(iii) Selling expenses	-	-
<b>SHORT TERM CAPITAL GAIN</b>		-



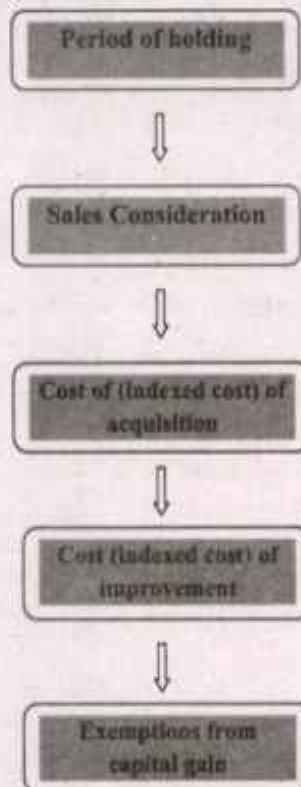
**Calculation of Long term Capital Gain**

Computation of Taxable Income from Capital Gains

(For the A.Y. 2022-23)

Notes

Sales consideration		-
Less:- (i) Indexed Cost of acquisition	-	
(ii) Indexed Cost of Improvement	-	
(iii) Selling expenses	-	-
LONG TERM CAPITAL GAIN		-

**Fig. Computation of Capital Gain****Transfer of Assets****What is transfer [Section 2(47)] :** Transfer, in relation asset, includes:

1. the sale, exchange or relinquishment of the asset; or
2. the extinguishment of any rights therein; or
3. the compulsory acquisition thereof under any law; or
4. in case where the asset is converted by the owner thereof into, or is treated by him, as stock-in trade of business carried on by him, such conversion or treatment; or
5. the maturity or redemption of zero coupon bonds; or

6. any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882; or
7. any transaction (whether by way of becoming a member of, or acquiring shares in a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of any immovable property.

## Notes

**Transaction not regarded as transfer [Section 46 and 47] :** The meaning of transfer is given in section 2(47), whereas transaction although there is transfer, are covered u/ss 46 and 47. In the following transactions although there is a transfer, but these are not considered to be transfer for purposes of capital gains:

1. where the assets of a company are distributed to its shareholders on liquidation of a company, such distribution shall not be regarded as transfer in the hands of the company;
2. any distribution of capital assets on the total or partial partition of Hindu Undivided Family;
3. any transfer, of a capital asset under a gift or will or an irrevocable trust;
4. any transfer, of a capital asset by a company to its 100% subsidiary company provided the subsidiary company is an Indian company;
5. any transfer of a capital asset by a company to its 100% subsidiary company to its holding company, if the holding company is an Indian company.
6. 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;
7. any transfer, in a scheme of amalgamation of a shares held in an Indian company by the amalgamating foreign company to the amalgamated foreign company if-
  - (a) at least 25% of the shareholders of the amalgamating foreign company continue to remain shareholder of the amalgamated foreign company, and
  - (b) such a transfer does not attract capital gains tax in the country, in which the amalgamating company is incorporated;
8. any transfer, in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government of a capital asset by the banking company to the banking institution;

Notes

9. any transfer, in business reorganization, of a capital asset by the predecessor co-operative bank to the SUCCESSOR CO-OPERATIVE bank;
10. any transfer, in demerger, of a capital, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company;
11. any transfer, by a shareholder in a business reorganization of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank;
12. any transfer, or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.
13. any transfer, by a shareholder in a scheme of amalgamation, of shares held by him in the amalgamating company if:
  - (a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company, and
  - (b) the amalgamated company is an Indian company;
14. any transfer of bonds or Global Depository Receipts referred to in section 115AC (1) i.e. Notified bonds/GDRs of an Indian company or bonds/shares of a public sector company purchased in foreign currency, made outside India by a non-resident to another non-resident.
15. any transfer of urban agricultural land in India before 1-3-1970;
16. 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 National Archives or any such other public museum or institution, as may be notified by the Central Government in the Official Gazette to be of national importance or to be of renown throughout any State or States;
17. any transfer, by way of conversion of bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company;
18. any transfer, by way of conversion of bonds referred to in section 115AC(1) (a) (i.e. Notified bonds of public sector company bought by non-resident in foreign currency) into shares or debentures of any company (inserted by the Finance Act, 2008, w.e.f. A.Y. 2008-09);
19. any transfer, of a capital asset being land of a sick industrial company made under a scheme prepared and sanctioned under section 18 of the Sick Industrial



Companies (Special Provisions) Act, 1985 where such sick industrial company is being managed by its worker's co-operative';

*Profit or Gain of  
Business or Profession*

20. any transfer, of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm.
21. any transfer under the Security Lending Scheme, 1997 for lending of any securities under an agreement or arrangement, which the assessee has entered into with the borrower of such securities and which is subject to the guidelines issued by the SEBI or RBI, in this regard; and
22. any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government. It may be observed that the above transactions are not transfer for purposes of capital gains.

## Notes

### Cost of Acquisition

Cost of acquisition is the price which the assessee has paid for acquisition of the asset; it includes all expenses incurred to acquire it. Interest paid on money borrowed for the purchase of capital asset would constitute part of the cost of acquisition. Cost of acquisition can be calculate as under:

**Cost to the previous owner deemed to be the cost of acquisition.** If the asset is acquired by an assessee in the following circumstances the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it. It will be increased by the cost of any improvement of the assets incurred by the previous owner of the assessee.

*Circumstances when cost of previous owner is taken as cost of acquisition:*

- (a) on any distribution of asset on the total or partial partition of a Hindu undivided family; or
- (b) by succession, inheritance or devolution; or
- (c) on succession of a sole proprietary concern by a company.
- (d) under gift or Will; or
- (e) on any distribution of assets on the liquidation of a company; or
- (f) on the transfer by a subsidiary company to its Indian company to the amalgamated company if the amalgamated company is an Indian company ; or
- (g) on the transfer of capital asset by amalgamated company to the amalgamated company if the amalgamated company is an Indian company; or

## Notes

- (h) when any of the members of a H.U.F. converts his self-acquired property into H.U.F. property (The cost of the property to the H.U.F. will be taken as the cost of the property to the individual converting the property) ; or
- (i) on transfer of capital asset by a private company or unlisted public company at the time of conversion into a limited liability partnership; or
- (j) under a transfer to a revocable or an irrevocable trust.

**Cost of acquisition of a Capital asset acquired after 1-4-1981.** If the asset is acquired by an assessee after 1<sup>st</sup> April, 1981 the purchase price plus all expenses incurred to acquire it will be treated as cost of acquisition.

**Cost of acquisition of a Capital asset acquired before 1-4-1981.** Where the capital asset became property of the assessee 1<sup>st</sup> April, 1981, the cost of acquisition of the asset may, at the option of the assessee, be taken to be any one of the following: (which is beneficial to assessee)

1. The cost of the asset to the assessee ; or
2. The fair market, value of the asset on 1<sup>st</sup> April, 1981.

**Cost of Share or Security :**

1. Where share or security was acquired before 1<sup>st</sup> April, 1981, the cost of acquisition will be taken the actual cost or fair market value on 1<sup>st</sup> April, 1981 whichever is beneficial to the assessee.
2. If it is acquired after 1<sup>st</sup> April, 1981, the actual cost will be the cost of acquisition

**Cost of Bonus Shares:** The cost of bonus shares or security, which is received by the assessee without any payment on the basis of his holding any financial asset, will be as under:

1. Where bonus share or security was received prior to 1<sup>st</sup> April 1981, the fair market value on 1<sup>st</sup> April, 1981;
2. Where bonus share or security was received after 1<sup>st</sup> April 1981 = NIL.

**Cost of acquisition of Right Issue :** In the case where an assessee by holding a share or any other security becomes entitled to subscribe additional shares or security (known as financial asset) on the basis of right issue, the cost of acquisition shall be :-

1. On the basis of entitlement if the assessee subscribed to right issue – Amount actually paid to acquire it.
2. If the assessee renounced the right in favor of any other person – Nil.



3. If the assessee has purchased the right to subscribe for the additional shares/security (financial asset) – Purchase price paid to purchase the right plus the amount paid to the company for acquiring the rights shares/security.

Cost of acquisition of Goodwill, trademark etc.: The cost of acquisition in relation to (a) goodwill of business, a trademark or brand name associated with a business; (b) a right to manufacture, produce or process any article or thing, right to carry on any business; (c) tenancy rights; (d) stage carriage permits; or (e) loom hours shall be determined as under :

1. If the asset case – Nil. However this will not cover the cases specified in section 49(1).
2. In any other case- Nil. However this will not cover the cases specified in section 49(1)
3. Case covered under section 49(1). Cost to the previous owner.

### Cost of Improvement

Cost of improvement is capital expenditure incurred by an assessee in making any additions/ improvement to the capital asset. It also includes any expenditure incurred to protect or complete the title to the capital assets or to cure such title. Cost of improvement includes only expenditure on improvement incurred on or after April 1, 1981 (whether incurred by the previous owner or by the assessee).

### Indexed Cost of Acquisition & Improvement

Indexed cost of acquisition and improvement is an amount which bears to the cost of acquisition and improvement, the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the asset was purchased or improvement to the asset took place

### Cost Inflation Index:

In relation to a previous year, means such Index as the Central Government may, having regard to 75% of average rise in Consumer Price Index for urban non-manual employees for the immediately preceding previous year to such year, by notification in the Official Gazette.

### Indexed cost of Acquisition

$$\text{Cost of Acquisition} \times \frac{\text{Cost Inflation Index in the year of Transfer}}{\text{Cost Inflation Index of the year of Purchase}}$$

Or of 1981-82 whichever is later



**Indexed cost of Improvement**

$$\text{Cost of Improvement} \times \frac{\text{Cost Inflation Index in the year of Transfer}}{\text{Cost Inflation Index of the year of Improvement}}$$

Notes

Cost Inflation Index (CII) as notified by the Central Government is as under:

Financial Year	Index	Financial Year	Index
2001-02	100	2011-12	184
2002-03	105	2012-13	200
2003-04	109	2013-14	220
2004-05	113	2014-15	240
2005-06	117	2015-16	254
2006-07	122	2016-17	264
2007-08	129	2017-18	272
2008-09	137	2018-19	280
2009-10	148	2019-20	289
2010-11	167	2021-22	301

**Note:** Indexed cost of acquisition has to be ascertained with reference to the date of acquisition and not with reference to the date when such asset became a capital asset.

**Capital Gain Exemptions**

Capital gains arising from the Transfer of Residential House Property [Sec. 54]:

Capital gain arising from the transfer of a house property or land appurtenant thereto is exempt from tax provided the following conditions are satisfied:

1. A residential house property whose income is taxable under the head "Income from house property" should be transferred by an individual or a HUF. The exemption is available whether the residential house property is self-occupied or let out.
2. The house property which is transferred should be a **long-term capital asset**.
3. To claim exemption, the taxpayer will have to purchase another residential house property (old or new) or construct **another residential** house property within 1 year before, or within 2 years after, the date of transfer of the residential house property in case of purchase option in case of construction option, the construction should be completed within 3 years from the date of transfer of residential house property.

**Amount of exemption:**

The amount of exemption is lower of the following:

- (a) the amount of capital gain generated on transfer of residential house property;  
or
- (b) If the amount of capital gain is not utilized for the purchase of new house, the taxpayer should deposit the amount in "Capital gains deposit account scheme" on or before the due date of submission of return of income which will have to be utilized for purchase/ construction of the **new** (old or new) property within the specified period. On the basis of amount utilized in acquiring the new (old or new) property and amount deposited in the deposit account, the Assessing Officer will give exemption under section 54.

#### Consequences:

In this case, for the purpose of computing capital gain on such transfer, cost of acquisition of the new house property shall be reduced by the amount of capital gain exempt under this section i.e., section 54 earlier, and such capital gain will always be a short-term capital gain.

If the amount deposited is not utilized fully for purchase or construction of new (old or new) residential property within the stipulated period, then the amount **not so utilized** shall be treated as LTCG of the previous year in which the period of 3 years from the date of transfer of original asset expires. In such a case, the assessee can withdraw the unutilized amount at any time after the expiry of 3 years from the date of the transfer of the original asset in accordance with the aforesaid scheme.

#### Capital gains arising from the Transfer of Land Used for Agricultural Purpose [Sec. 54 B]:

Capital gains arising from the transfer of agricultural land are exempt from tax provided the following conditions are satisfied:

1. The taxpayer is an **individual** or Hindu undivided family
2. The agricultural land was used by the taxpayer or his parents for agricultural purposes for a **period of two years** immediately preceding the date of transfer.
3. The taxpayer has purchased another land for agricultural purposes within a period of **2 years** from the date of such transfer. In case capital gain arises on compulsory acquisition of agricultural land by the Government, the time limit of 2 years shall apply from the date of receipt of compensation. The new land may be in urban area or rural area.

#### Amount of Exemption

- (a) The amount of capital gain generated on transfer of agricultural land is exempt up to the cost of new agricultural land.



## Notes

- (b) If the taxpayer is not able to acquire the new agricultural land than taxpayer should deposit the amount in "Capital gains deposit account scheme" on or before the due date of submission of return of income which will have to be utilized for purchase of new agricultural land within the specified period. On the basis of amount utilized in acquiring the new agricultural land and amount deposited in the deposit account, the Assessing Officer will give exemption under section 54B.

**Consequences:**

In case the new agricultural land is transferred within a period of 3 years of its purchase, the capital gain which was exempt earlier under section 54B shall be reduced from the cost of the new agricultural land for the purpose of computation of capital gain in respect of the new agricultural land and it will be a short-term capital gain.

It is to be noted that if the new agricultural land is situated in a rural area, the gain arising on its transfer is not chargeable to tax as an agricultural land situated in a rural area is not a "capital asset" under section 2(14).

By withdrawing from the deposit account, new agricultural land can be purchased within the period given above.

If the amount deposited is not utilized fully for purchase of new agricultural land within the stipulated period, then the amount not so utilized shall be treated as capital gain of the previous year in which the period of **2 years from the date of transfer of original asset expires**. It will be taxable as long-term or short-term capital gains depending upon the original capital gain.

**Capital gains on Compulsory Acquisition of Land and Building, forming part of industrial undertaking [Sec. 54D]:**

Capital gain arising by way of **compulsory acquisition** of land or building if the following conditions are satisfied:

1. The taxpayer may be an individual, HUF, firm, company or any other person.
2. The land or building should be used by the assessee for the purpose of industrial undertaking for at least two years before the date of compulsory acquisition.
3. Assessee has purchased any other **land or building** within a period of **3 years** from the date of **receipt of compensation** or constructed a building within such period.
4. Newly acquired land or building should be used for the purposes of shifting or re-establishing the said undertaking or setting up another industrial undertaking.

**Amount of exemption:**

- (a) If the amount of capital gain is less than the cost of new asset the entire capital gain shall be exempt.



- (b) If the amount of capital gain is greater than the cost of new asset the cost of new asset shall be exempt.
- (c) If the amount of capital gain is not utilized by the assessee before the filing of return the taxpayer should deposit the amount in "Capital gains deposit account scheme" on or before the due date of submission of return of income which will have to be utilized for purchase/ construction of new land and building within the specified period. On the basis of amount deposited in the deposit account, he will be entitled for exemption.

### Consequences:

If the new land and building is transferred within a period of 3 years from the date of its acquisition (or completion of construction), the capital gain which was exempt under this section earlier, shall be reduced from the cost of the new asset for the purpose of computation of capital gain in respect of the transfer of the new asset.

By withdrawing from the deposit account, new land and building can be purchased within the period given above.

If the amount deposited is not utilized fully for purchase/ construction of new land and building within the stipulated period, then the amount not so utilized shall be treated as capital gain of the previous year in which the period of 3 years from the date of receipt of compensation expires. It will be taxable as long-term or short-term capital gains depending upon the original capital gain.

### Capital gain from transfer of Long Term Capital Asset for Specified assets [Section 54EC]:

Long term capital gain arising from the transfer of any capital asset is exempt in the following circumstances:

1. The taxpayer may be an individual, firm, company or any other person.
2. The asset transferred is a **long-term capital asset**.
3. The assessee should invest the amount of capital gain in **long-term specified assets**.

Within **6 months** from the date of transfer of the asset,

"Long-term specified assets" means any bond redeemable after **3 years** issued by:

- (a) the National Highways Authority of India (NHAI); or
- (b) the Rural Electrification Corporation Ltd.

#### Amount of exemption:

- (a) If the amount of capital gain is less than the cost of long term specified asset the entire capital gain shall be exempt.

## Notes

- (b) If the amount of capital gain is greater than the cost of long term specified asset the cost of new asset shall be exempt.

The following points should be noted in this regard:

1. The cost of specified assets which is considered for the purpose of section 54EC shall not be eligible for deduction under section 80C.
2. The investment made (on or after April 1, 2007) in the long-term specified assets noted above by an assessee during any financial year cannot exceed 50 lakh.

### Consequences:

If the specified assets are transferred (or converted into money or any loan/ advance is taken on the security of specified assets) within a period of 3 years from the date of their acquisition, the amount of capital gains arising from the transfer of original asset which was not charged to tax, will be deemed to be the income by way of LTCG of the previous year in which specified assets are transferred.

### Capital gains on transfer of a Long-Term Capital Asset other than a House Property [Sec. 54F]:

Any long term capital gain from the transfer of any capital asset, other than residential house property shall be exempt if following conditions are satisfied:

1. The taxpayer is an **individual or HUF**.
2. The capital asset which is transferred is a long-term capital asset but **other than a residential** house property.
3. To claim exemption, the taxpayer will have to purchase another residential house property or construct **another residential** house property within 1 year before, or within 2 years after, the date of transfer of the residential house property in case of purchase option. In case of construction option, the construction should be completed within 3 years from the date of transfer of asset.
4. The assessee does not own more than one residential house on the date of transfer of asset other than the house purchased for claiming exemption under this section.

### Amount of exemption:

- (a) If the net consideration of asset is less than the cost of new house, the entire capital shall be exempt.
- (b) If the net consideration of asset is greater than the cost of new house then the exemption shall be allowed in the same proportion in which the cost of new house bears to the net sales consideration.



- (c) To claim exemption under section 54F, the taxpayer should deposit the amount in "Capital gains deposit account scheme" on or before the due date of submission of return of income which will have to be utilized for purchase/ construction of the new house within the specified period. On the basis of amount deposited in the deposit account, the Assessing Officer will give exemption under section 54F.

### Consequences:

In the following circumstances, exemption granted under section 54F may be withdrawn:

Defaults	Consequences
If the assessee transfers the new house within 3 years of its purchase/ construction.	Capital gain which arises on the transfer of the new house will be taken as <b>STCG</b> . Besides, the capital gain which was exempt under section 54F shall be treated as <b>LTCG</b> of the year in which the new house is transferred.
If the assessee purchases, within a period of 2 years from the date of transfer of original asset, or constructs within a period of 3 years from the date of transfer of such asset, a residential house other than the new house	Capital gain which was exempt under section 54F shall be deemed to be income by way of <b>LTCG</b> of the year in which another residential house is purchased or constructed.

By withdrawing from the deposit account, new house can be purchased/ constructed within the period given above.

If the amount deposited is not utilized fully for purchase or construction of new house within the stipulated period, then the following amount shall be treated as **LTCG** of the previous year in which the period of 3 years from the date of transfer of original asset expires.

### Capital gain on transfer of assets in cases of shifting of industrial undertakings from urban areas [Section 54G]:

Any capital gain, (short-term/long-term), arising to any industrial undertaking from the transfer of asset being machinery or plant or building or land or any rights in building or land effected in the course of or in consequence of shifting from an urban area to any other area, shall be exempt if following conditions are satisfied:

1. The transfer is effected in the course of or in consequence of shifting the undertaking from an urban area to any other area.



## Notes

2. Asset transferred is machinery; plant, building, land or any right in building or land used for the business of industrial undertaking in an urban area.
3. The capital gain is utilized within one year before or 3 years after the due date of transfer for the specified purpose. specified purpose includes the following:
  - (a) for purchase of new machinery or plant for the purpose of business of the Industrial Undertaking in the area to which the said undertaking is shifted;
  - (b) acquisition of building or land or construction of building for tax payer's business in that other area;
  - (c) expenses on shifting of the old undertaking and its establishment to other area; or
  - (d) Incurring of expenditure on such other purposes as specified by the Central Government for this purpose.
  - (e) The newly acquired asset must be held by the assessee for three years from the date of their acquisition.

### Quantum of Deduction

1. If the capital gain, on transfer of the original asset, is equal to or less than the cost and expenses incurred for the above specified purposes, the entire capital gain shall be exempt.
2. If the capital gain on transfer of the original asset, is greater than the cost and expenses incurred for the specified purposes than the exemption shall be allowed to the extent of the cost and expenses incurred.
3. Where the capital gain is not utilized by the assessee towards the cost and expenses incurred in relation to all or any of the above purposes before the due date of filing of return, it is deposited by him in the Capital gain account scheme, he will be entitled to exemption.
4. If the amount deposited is not utilized fully or partly for above purposes within three years from the date of transfer then the amount not so utilized shall be charged as capital gain.

### Exemption of capital gain on transfer of assets of shifting of industrial undertaking from urban area to any Special Economic Zone [Section 54GA]

Any capital gain arising from the transfer of a capital asset being machinery or plant or building or land or any rights in building or land except furniture and fitting used for the purposes of the business of an industrial undertaking situate in an urban area, effected in the course of or in consequence of shifting of such industrial undertaking

to any Special Economic Zone whether developed in any urban area or any other area, shall be exempt to the extent, such capital gain is invested for the specified purpose with in 1 year before or 3 years after the due date of its transfer.

*Profit or Gain of  
Business or Profession*

The conditions for claiming exemptions are as under:

1. The transfer is affected in the course of or in consequence of shifting the undertaking from an urban area to any Special Economic Zone. The Special Economic Zone may be developed in any urban area or any other area.
2. Asset transferred is machinery, plant, building, land or right in building or land used for business of industrial undertaking in an urban area;
3. The capital gain arising on the asset transferred may be short-term or long-term capital gain. Normally, it will be short-term capital gain because most of the asset of the industrial undertaking will be depreciable assets.
4. The capital gain is utilized within 1 year before or 3 years after the due date of transfer for the specified purpose.

*Specified purpose includes the following:*

- (a) for purchase of new machinery or plant for the purpose of business of the industrial undertaking in the Special Economic Zone to which the said undertaking is shifted;
  - (b) Acquisition of building or land or construction of building for the purpose of the assessee's business in the Special Economic Zone.
  - (c) expenses on shifting of the old undertaking and its establishment to the Special Economic Zone; and
  - (d) incurring of expenditure on such other purposes as specified by the Central Government for this purpose.
5. If the amount on net consideration which has been received by the company for the issue of equity shares by the individual or HUF is not utilized by the company for the purchase of a new asset (eligible plant and machinery) before the due date of furnishing the return of income under section 139, the unutilized amount should return furnished by the assessee shall be accompanied by proof of such deposit having been made. The amount so utilized and the amount so deposited in the deposit scheme shall be deemed to be the cost of new asset (eligible plant and machinery).

**Exemption of Long-term capital gain on transfer of residential property  
invested in a new manufacturing SME company [Section 54GB]**

Notes



## Notes

Any capital gain of individual or HUF arising from the transfer of a long-term capital asset being a residential property (a house or plot of land) shall be proportionate to the net consideration price so invested in the subscription of equity shares of a new start-up SME company in the manufacturing sector company before the due date of furnishing the return of income under section.

The above exemption shall be allowed if the following conditions are satisfied:

1. There should be a long-term gain from the transfer of a residential property (i.e. a house or plot of land)
2. Such long-term capital gain should arise to an individual or HUF.
3. The amount of net consideration should be utilized by the individual or HUF before the due date of furnishing of return of income for subscription in equity shares of a eligible company. If the full amount of net consideration is not utilized for subscription in equity shares, the exemption shall be allowed proportionate to the amount so invested.
4. The amount of subscription as share capital is to be utilized, by the company for the purchase of new asset (eligible plant and machinery) within a period of one year from the date of subscription in the equity shares.
5. The equity shares of the company or the new asset acquired by the company should not be sold or otherwise transferred by the individual/HUF or the company as the case may be a period of 5 years from the date of their acquisition.

*Eligible company:* It means a company which fulfils the following conditions:

1. It is a company incorporated in India during the period from 1st April of the previous year relevant to the assessment year in which capital gain arises to the due date of furnishing the return of income.
2. It is engaged in the business or manufacture of an article or thing.
3. It is a company in which the assessee has more than 50% share capital or more than 50% voting rights after the subscription in shares by him.
4. It is a company which qualifies to be a small or medium enterprise.

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### 4.8 Exemptions at a Glance

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**Exemptions:** Exemptions of capital gains available only to individual and/or HUF assessee Section 54, 54B and 54F



Notes

Provisions	Capital gains on sale of residential property used for residential property Section 54	Capital gains on sale of urban agricultural land and used for another agriculture land Section 54B	Capital gain on sale of LTCA not to be charged in case of investment in residential house; Section 54F
(a) Assessee	Individual/HUF	Individual	Individual/HUF
(b) Asset transferred	Residential house property being buildings or lands appurtenant thereto	Agricultural land used by individual or his parent for agricultural purposes during 2 years preceding date of transfer	Any capital asset not being residential house property Exemption is not available if assessee owns more than 2 residential houses including a new house.
(c) Nature of Asset	LTCA	LTCA/STCA	LTCA
(d) New asset to be purchased/ construction	Residential house property i.e. buildings or lands appurtenant thereto	Agricultural land (in urban or rural area)	Residential house property i.e. buildings or lands appurtenant thereto
(e) Time-limit for purchase/ construction	Purchase: Within 1. year before or 2 years after the date of transfer. Construction: complete construction within 3 years year from date of transfer	Purchase within 2 years from the date of transfer.	Purchase : Within 1 year before or 2 years after date of transfer; and Construction : Complete construction within 3 year from date of transfer.
(f) Deposit scheme (Discussed later)	Applicable	Applicable	Applicable
(g) Amount of Exemption *	Lower of – Capital gains or investment in	Lower of – capital gains or cost of new asset	Cost of new house x Capital gains + Net Consideration

Section 54D, 54EC, 54G and 54GA

Notes

Provisions	Compulsory acquisition of land & buildings Section 54D	Investment in certain bonds: Section 54EC	Shifting of undertaking to rural area: Section 54G	Shifting of undertaking to SEZ: Section 54GA
(a) Assessee	Any Person	Any Person	Any Person	Any Person
(b) Asset transferred	Compulsory acquisition of land or building which was used in the business of industrial undertaking during 2 years prior to date of transfer.	Any long capital asset.	Transfer of plant, machinery or land or building for shifting industrial undertaking from urban area to rural area.	Transfer of plant, machinery or land or building for shifting industrial undertaking from urban area to Special Economic area.
(c) Nature of Asset	Short term/ Long term	Long term	Short term/ Long term	Short term/ Long term
(d) New asset to be purchased/constructed	New land or buildings for the industrial undertaking	Bonds, redeemable after 3 years issued- (a) by National highway Authority of India; or (b) by Rural Electrification Corporation, maximum exemption limit being ₹ 50 lakhs (Amended by F.A 2007 w.e.f. 1-4-08)	(a) Purchase construction of plant, machinery, land or building in such rural area or, (b) Shifting original assets to that area or, (c) Incurring notified of transfer	(a) Purchase constructed of plant, machinery, land or building in such SEZ or, (b) Shifting original assets to SEZ or, (c) Incurring notified of expenses.

(e) Time-limit for purchase/construction	within 3 years from date of receipt of initial compensation.	Within 6 months from the date of transfer of original asset.	Within 1 year before or 3 years after the date of transfer	Within 1 year before or 3 years after the date of transfer
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### Losses under the head Capital Gain

Where the assessee has suffered loss on transfer of certain capital asset and earned profit on transfer of other assets, he is entitled to set off such losses against such gains. Any loss remaining unadjusted under the head capital gain however, cannot be set off against income under the other heads, eg. salaries, house property, business or profession and other sources. But it shall be carried forward for set off against capital gains in the subsequent assessment years. However, no loss shall be carried forward for more than eight assessment years from the year for which the loss was computed.

### Illustration 13

Mr. Divesh had purchased a golden ring as on 17/8/2019 for ₹20,000. On 1/05/2020, he has sewn a diamond on it costing ₹ 25,000. On 1/08/2020, he sold such ring for ₹ 80,000 and incurred brokerage for arranging customer ₹ 5,000. Compute capital gain.

### Solution:

#### Computation of capital gain of Mr. Divesh for the A.Y. 2019-20

Particulars	Details (₹)	Amount (₹)
Sale consideration		80,000
Less: Expenses on transfer		5,000
Net sale consideration		75,000
Less: (i) Cost of acquisition	20,000	
(ii) Cost of improvement	25,000	45,000
<b>Short Term Capital Gain</b>		<b>30,000</b>

### Illustration 14

On 23rd December, 2020, Rajat sold 500 grams of gold, the sale consideration of which was ₹ 13,50,000. He had acquired this gold on 20th August, 2000 for ₹ 4,00,000. Fair market value of 500 grams of gold on 1st April, 2001 was ₹ 3,60,000. Find out the amount of capital gain chargeable to tax for the assessment year 2021-22.

### Solution:

#### Computation of capital gains of Rajat for the A.Y. 2021-22



## Notes

Particulars	Working	Amount
Sale consideration		13,50,000
Less: Expenses on transfer		Nil
Net Sale consideration		13,50,000
Less: Indexed cost of acquisition	₹ 4,00,000 × 301/100	12,04,000
Long term capital gain		1,46,000

If an asset is acquired before 1/4/2001 then its cost of acquisition will be higher of the following:

- (a) Actual cost of acquisition; or (b) Fair market value of the asset as on 1/4/2001

**Illustration 15**

Mr. Kiran provides you the following information relating to the sale of his only residential house. Calculate his capital gain for the assessment year 2021-22.

Sold the house in Sept 2020		50,00,000
Expenditure incurred in connection with transfer	25,000	
House purchased in January 1987		2,40,000
Fair market value on 1st May 2001		4,20,000
Purchased another residential house in January 2021		10,50,000
Invested in bond issued by NHA u/s 54EC in Jan 2021		8,50,000
The cost of inflation index in 2001-02 was 100 and for 2021-22 – 301		

**Solution:****Calculation of capital gains for the assessment year 2021-22**

Particulars	₹
Sale of house in September 2020	50,00,000
Less: expenses of sale	25,000
Net sales consideration	49,75,000
Less: Indexed cost of acquisition $420000/100 \times 301$	12,64,200
Capital gain	37,10,800
Less: exemption u/s 54 being the cost of house	
Purchased within one year	10,50,000
	26,60,800
Less: exemption u/s 54EC	8,50,000
Long Term Capital Gain	18,10,800

**Illustration 16**

Mr. A sold his property for ₹ 3,76,000 in December 2020 incurring an expense of ₹ 6,000 which was purchased in January 2019 for ₹ 2,40,000. Find out taxable capital gain?

**Solution:**

*Profit or Gain of  
Business or Profession*

Here the capital gain is short term Sale of property.

Sale Consideration	3,76,000
Less: expenses	6,000
	3,70,000
Less: cost of acquisition	2,40,000
Taxable capital gain	1,30,000

Notes

**Illustration 17**

Calculate capital gain from the following data. Sold self generated goodwill for a business ₹ 7,00,000 bonus shares in Kairali Ltd (not listed) and (being short term capital assets) sold for ₹ 4,00,000. Business income ₹ 30,000. Long term capital loss in the transfer of a building ₹ 20,000. Face value of bonus shares sold ₹ 3,00,000.

**Solution:****Computation of capital gain**

<b>Calculation of long term capital gain</b>	
Selling price of self generated goodwill	7,00,000
Less: cost	Nil
Long term capital gain	7,00,000
Less: long term capital loss on building	20,000
Long term capital gain	6,80,000
<b>Calculation of short term capital gain</b>	
Selling price of bonus shares	4,00,000
Less: cost	Nil
Short term capital gain	4,00,000
Taxable capital gain $6,80,000 + 4,00,000 = 10,80,000$	

**Illustration 18**

Mr. Arun converts his capital asset acquired for an amount of ₹ 50,000 in June, 2003 into stock-in-trade in the month of November, 2016. The fair market value of the asset on the date of conversion is ₹ 4,50,000. The stock-in-trade was sold for an amount of ₹ 6,50,000 in the month of September, 2020. What will be the tax treatment?

Financial year	Cost Inflation Index
2003-04	109
2016-17	264

## Notes

**Solution:**

The capital gains on the sale of the capital asset converted to stock-in-trade is taxable in the given case. It arises in the year of conversion (i.e. P.Y. 2016-17) but will be taxable only in the year in which the stock-in-trade is sold (i.e. P.Y. 2021-22). Profits from business will also be taxable in the year of sale of the stock-in-trade (P.Y. 2021-22).

The long-term capital gains and business income for the A.Y. 2021-22 are calculated as under:

Particulars	₹	₹
Profits and Gains from Business or Profession		
Sale proceeds of the stock-in-trade	6,50,000	
Less: Cost of the stock-in-trade (FMV on the date of conversion)	4,50,000	2,00,000
Long Term Capital Gains		
Full value of the consideration (FMV on the date of the conversion)	4,50,000	
Less: Indexed cost of acquisition ( $₹ 50,000 \times 264/109$ )	1,21,101	3,28,899

Note: For the purpose of indexation, the cost inflation index of the year in which the asset is converted into stock-in-trade should be considered.

**Illustration 19**

Mr. Sumesh purchased 100 equity shares of M/s ABC Co. Ltd. on 01-04-2005 at rate of ₹ 1,000 per share in public issue of the company by paying securities transaction tax.

Company allotted bonus shares in the ratio of 1:1 on 01.12.2019. He has also received dividend of ₹ 10 per share on 01.05.2020.

He has sold all the shares on 01.10.2020 at the rate of ₹ 4,000 per share through a recognized stock exchange and paid brokerage of 1% and securities transaction tax of 0.02% to celebrate his 75th birthday.

Compute his total income and tax liability for Assessment Year 2021-22, assuming that he is having no income other than given above. Fair market value of shares of M/s ABC Co. Ltd. on 31.1.2018 is ₹ 2,000.

**Solution:**

Computation of total income and tax liability of Mr. Sumesh for A.Y. 2021-22

Particulars	₹
<b>Long term capital gains on sale of original shares</b>	
Gross sale consideration ( $100 \times ₹ 4,000$ )	4,00,000



Less: Brokerage@1%	4,000
Net sale consideration	3,96,000
Less: Cost of acquisition (100 x ₹ 2,000) (Refer Note 2)	2,00,000
<b>Long term capital gains</b>	<b>1,96,000</b>
<b>Short term capital gains on sale of bonus shares</b>	
Gross sale consideration (100 × ₹ 4,000)	4,00,000
Less: Brokerage@1%	4,000
Net sale consideration	3,96,000
Less: Cost of acquisition of bonus shares	NIL
<b>Short term capital gains</b>	<b>3,96,000</b>
<b>Income from other sources</b>	
Dividend received from M/s ABC Co. Ltd. is taxable in the hands of shareholders [200 shares x 10 per share]	2,000
<b>Total Income</b>	<b>5,94,000</b>
<b>Tax Liability</b>	
Tax on dividend	Nil
15% of (₹ 3,96,000- ₹ 2,98,000, being unexhausted basic exemption limit)	14,700
10% of (₹ 1,96,000- ₹. 1,00,000)	9,600
	24,300
Add: Health and education cess @4%	972
<b>Tax payable</b>	<b>25,272</b>
<b>Tax payable (rounded off)</b>	<b>25,270</b>

## Notes

### Notes:

- (1) Long-term capital gains exceeding ₹ 1 lakh on sale of original shares through a recognized stock exchange (STT paid at the time of acquisition and sale) is taxable under section 112A at a concessional rate of 10%, without indexation benefit.
- (2) Cost of acquisition of such equity shares acquired before 1.2.2018 is higher of
  - Cost of acquisition i.e., ₹ 1,000 per share and
  - lower of Fair market value of such asset i.e., ₹ 2,000 per share and Full value of consideration i.e., ₹ 4,000 per share. So, the cost of acquisition of original share is ₹ 2,000 per share.
- (3) Since bonus shares are held for less than 12 months before sale, the gain arising there from is a short-term capital gain chargeable to tax@15% as per section 111A after adjusting the unexhausted basic exemption limit (₹ 3,00,000 less ₹ 2,000, being the amount of dividend). Since Mr. Sumesh is over 60 years of age, he is entitled for a higher basic exemption limit of ₹ 3,00,000 for A.Y. 2021-22.

- (4) Brokerage paid is allowable since it is an expenditure incurred wholly and exclusively in connection with the transfer. Hence, it qualifies for deduction under section 48(i).
- (5) Cost of bonus shares will be Nil as such shares are allotted after 1.04.2001.
- (6) Securities transaction tax is not allowable as deduction.

## 4.9 Income from other Sources

As per section 56(1), income of every kind, which is not to be excluded from the total income under this act, shall be chargeable to income-tax, under the head "Income from Other Sources" if it is not chargeable to Income-tax under any of the first four head's specified in the section 14.

In other words, the following conditions must be satisfied before an income can taxed under the head "Income from other Sources":

- (i) There must be an income;
- (ii) Such income is not exempt under the provisions of this Act;
- (iii) Such income is not chargeable to tax under any first four heads viz., "Income from Salary", Income from house property, Income from business or profession and income from capital gain.

Income from other sources is, therefore, a residuary head of income.

### Chargeable Incomes (Specific)

The following incomes shall be chargeable to income tax under the head 'Income from Other Sources':

- (1) Dividends (Dividend received from domestic and Indian company is exempt from tax under section 10(34)).
- (2) Income from winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any short or from gambling or betting of any form or nature whatsoever.
- (3) Any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set-up under Employees' State Insurance Act 1948.
- (4) Income by way of interest on securities.
- (5) Income from machinery, plant or furniture let on hire if the income is not chargeable to income tax under the head 'Profits and Gains of Business or Profession'.



- (6) Income from letting on hire machinery, plant or furniture and also buildings, and the letting of the buildings is inseparable from the letting of the said machinery plant or furniture, if it is not chargeable to income tax under the head 'Profits and Gains of Business or Profession'.
- (7) Income received under a Keyman insurance policy including bonus on such policy, if such income is not chargeable to income tax under the head 'Profits and Gains of Business or Profession' or under the head 'Salaries'.
- (8) An individual or HUF receives, in any previous year from any person or persons:

Asset	Amount to be included in income
(a) Any sum of money, without consideration, the aggregate value of which exceeds 50,000	The whole of the aggregate value of such sum.
(b) Any immovable property (i) without consideration, the stamp duty value of which exceeds 50,000;	The stamp duty value of such property.
(ii) for a consideration which is less than the stamp duty value of the property by an amount exceeding 50,000.	The stamp duty value (on the date of agreement) of such property as exceeds such consideration.
(c) Any property other than immovable property:	
(i) without consideration, the aggregate fair market value of which exceeds 50,000;	The whole of the aggregate fair market value of such property.
(ii) for a consideration of which is less than the aggregate fair market value of the property by an amount exceeding 50,000.	The aggregate fair market value of such property as exceeds such consideration.

- from any trust or institution registered u/s 12AA; or
- from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust institution referred to in Sec. 10(23)

Explanation:

(A) Property means the following capital asset of the assessee, namely:

- immovable property being land or building or both
- shares and securities;
- jewellery;



## Notes

(iv) archaeological collections;

(v) drawings;

(vi) paintings;

(vii) sculptures;

(viii) any work of art; or

(i) Bullion

(B) Relative, means:

(a) In case of an individual :

(i) spouse of the individual ;

(ii) brother or sister of the individual;

(iii) brother or sister of the spouse of the individual;

(iv) brother or sister of either of the parents of the individual;

(v) any lineal ascendant or descendant of the individual;

(vi) any lineal ascendant or descendant of the spouse of the individual;

(vii) Spouse of the person referred to in (ii) to (vi)

**Illustration 1**

Mr. X gets the following gifts in the previous year 2021-22. What shall be the taxability of gift under each situation for the assessment year 2021-22

- (i) Gift of ₹ 60,000 on Aug .12 2021 from his friend
- (ii) Gift of ₹ 21,000 each from his two friends on Dec. 25, 2021 on his marriage.
- (iii) Gift of ₹ 68,000 on Oct 5, 2021 from brother of his father
- (iv) Gift of ₹ 35,000 on Nov 11, 2021 from friend of his wife on the occasion of his marriage.
- (v) Gift of ₹ 26,000 on Jan 15, 2022 from father in law of his brother
- (vi) Gift of ₹ 41,000 on May 31, 2021 from his friend.

**Solution:****Computation of Taxable Gifts of Mr. X****(For the assessment year 2022-23)**

Particulars	Amount (₹)
(i) Gift from friend	
{Aggregate of sum of money received in the previous year Exceeds ₹ 50, 000}	60,000
(ii) Gift on occasion of marriage from friends	Exempt

(iii) Gift from brother of father (Being from relative)	Exempt
(iv) Gift on occasion of marriage from friend of wife	Exempt
(v) Gift from father in law of brother (Being from non-relative)	26,000
(vi) Gift from friend	41,000
<b>Income from other sources</b>	<b>1, 27,000</b>

**Note:** Since aggregate of sum of money received as gift exceeds ₹ 50,000 entire amount of ₹ 1, 27,000 is taxable.

9. Where a firm or a company (not being a company in which public are substantially interested) receives from any person or persons any property, being shares of a company (not being a company in which the public are substantially interested)

- (i) without consideration, the aggregate fair market value of which exceeds ₹ 50,000, the whole of the aggregate fair market value of such property;
- (ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding ₹ 50,000, the aggregate fair market value of such property as exceeds such consideration.

However this provision shall not apply to such property received, where the transfer is not regarded as transfer u/s 47 in the cases of amalgamation, demerger or business reorganization.

10. Interest received on compensation or on enhanced compensation shall be deemed to be the income of the previous year in which it is received.

11. W.e.f A.Y. 2021-22, the following shall also be treated as income:

Where a closely held company issues shares to a resident person for a consideration exceeding the face value of such shares, the deemed income shall be consideration received- fair market value of the shares.

However, this provision shall not apply where the consideration for issue of shares is received (i) by a venture capital undertaking from a venture capital company or a venture capital fund; or (ii) by a company from a class or classes of persons as may be notified by the Central Government.

Explanation; Fair market value of the shares shall be the value

- (i) as determined in accordance with prescribed method; or
- (ii) as determined on the basis of assets, including intangible assets being good will, know-how patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, on the date of issue of shares, whichever is higher.



**Chargeable Incomes (Others)**

There are some other incomes which are also chargeable under the head income from other sources'. For example:

- (1) All interest other than interest on securities, such as, interest on bank deposits, interest on loan, etc.
- (2) Income of a tenant from sub-letting the whole or a part of the house property.
- (3) Remuneration received by a teacher or a lawyer for doing examination work
- (4) Income of Royalty.
- (5) Interest on securities of foreign government
- (6) casual income (Income of non-recurring nature)
- (7) Income from letting of a business as whole
- (8) Interest paid by the government on excess payment of advance tax
- (9) Directors fees.
- (10) Rent of land not appurtenant to any building or Ground rent
- (11) Agricultural Income from land situated outside India.
- (12) Income from markets, ferries and fisheries, etc.
- (13) Income from leasehold property.
- (14) Income received after discontinuance of business
- (15) Remuneration received for writing articles in Journals.
- (16) Income from undisclosed sources :
  - (i) Cash credits which are unexplained. (Sec. 68)
  - (ii) Unexplained Investments (Sec. 69)
  - (iii) Unexplained Money. (Sec. 69A)
  - (iv) Unexplained Expenditure. (Sec. 69C)
  - (v) Amount borrowed or repaid on Hundi otherwise than through an account payee cheque drawn on a bank.
- (17) Interest received by an employee on his own contributions to an unrecognized provident fund
- (18) Salary of a Member of Parliament, Member of Legislative Assembly or Council.
- (19) Insurance Commission not chargeable under the head 'business or profession'
- (20) Rent of trademark.
- (21) Director's Commission for giving guarantee to bank
- (22) Director's Commission for underwriting shares of a new company.

Notes



- (23) Gratuity received by a director who is not employee of the company.
- (24) Family, pension received by the widow and heirs of deceased employees. However, the following family pensions are exempt:

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Business or Profession*

- (i) Pension received by the widow of an employee of the U.N.O.
- (ii) Family pension received by any member of the family of gallantry awardees.

[Sec. 10(18)]

'Family' means:

- (a) the spouse and children of the individual; and
  - (b) the parents, brothers and sisters of the individual, wholly or mainly dependent on the individual.
- (iii) Family pension received by the widow or children or nominated person of a member of the armed forces (including para-military forces) of the union, where the death of such member occurred in the course of operational duties shall be exempt provided the prescribed conditions are satisfied.

Notes

**1/3 of family pension and 15000 whichever is less is exempt from tax.**

- (25) Amount withdrawn from deposit in National Savings scheme, 1987 on which deduction u/s 80CCA has been allowed including interest thereon.
- (26) *Receipts by Cricketers selected to play for India:*
- (a) *Test Matches in India*. Amount actually received by the player from the Cricket control board is taxable after allowing a deduction of an amount equal to 75% of such receipt in respect of reasonable expenses incurred to earn such income.
  - (b) *Other Matches in India*. Generally the entire receipts by the player (from the Board will be deemed to have been spent, for earning such income and hence not taxable.
  - (c) *Matches outside India*. A player will be allowed a deduction of 50% of the amount received for playing in foreign countries and the balance will be taxable.
- (27) Tips received by a waiter or taxi-driver, not being given by his employer.

### **Deductions Allowed**

The income chargeable under the head 'Income from other Sources' shall be computed after making the following deductions:

## Notes

- (1) In the case of interest on securities/dividend any reasonable sum paid by way of commission or remuneration to a bank or any other person for the purpose of realizing such income on behalf of the assessee is deductible.
- (2) Interest on loan taken for the purpose of investment in securities/shares will be deductible if it is actually used for the aforesaid purpose. If dividend is exempt, aforesaid deductions will not be allowed.
- (3) If employees' contribution to provident fund, etc. are treated as the income of the assessee (employer) and it is included in his income from other sources, a deduction of the sum, credited by the employer to the employee's account in the relevant fund on or before the 'due date', will be allowed under this head.
- (4) In the case of income in the nature of family pension received by the widows or heirs of deceased employee, a deduction of a sum equal to 33 $\frac{1}{3}$ % of such income or Rs 15,000, whichever is less, will be allowed.
- (5) In the case of income from letting of machinery, plant or furniture with or without buildings, which is chargeable to tax under the head 'Income from Other sources' the deductions in respect of the following shall be allowed in the same manner as they are allowed under the head 'Profits and Gains of Business or Profession':
  - (i) Expenditure incurred regarding current repairs of machinery, plant, furniture or building.
  - (ii) Insurance premium paid regarding building, machinery, plant or furniture against risk of damage or destruction of the assets.
  - (iii) Depreciation on building, machinery, plant or furniture.
- (6) In case of sub-letting of a house the rent, repairs charges, etc. regarding sub-let portion are deductible.
- (7) Although income from units is exempt in the hands of the unit holders, but the mutual funds or specified company shall be liable to pay additional income tax on the amount of income distributed by it.
- (8) From interest received on compensation or enhanced compensation, fifty % of such income shall be deducted and no other deduction shall be allowed in this respect.
- (9) Any other expenses, not being in the nature of capital expenses, incurred wholly or partly for the making of taxable income in the previous year shall be allowed as deduction.



## Deductions Disallowed

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The following amounts shall not be deductible in computing income under the head 'Other Sources':

- (1) Any personal expenses of the assessee.
- (2) Any interest chargeable under this Act, which is payable outside India and has been paid without deduction of tax at source or without paying tax thereon.
- (3) Any sum paid on account of Wealth tax.
- (4) Cash payments exceeding ₹ 20,000 /, ₹ 35,000. Sec. 40A(3) provides for the disallowance of 100% expenditure in respect of which payments is made in a sum exceeding ₹ 20,000/, ₹ 35,000 otherwise than by an account payee cheque on a bank or by an account payee bank draft.
- (5) Expenses incurred in relation to exempted income, in not deductible.
- (6) Expenses or losses in connection with income from lottery, crossword puzzles, races including horse races, card games, gambling or betting of any nature, shall not be deductible in computing the said income. However, this prohibition will not apply in respect of the income of an assessee, being the owner of horses maintained by him for running in horse races, from the activity of owning and maintaining such horses.

## Notes

### Illustration 2

Sudhir died on 31st July, 2020 while being in Central Government service. In terms of rules governing his service, his widow Mrs. Sudhir is paid a family pension of ₹ 10,000 p.m. and dearness allowance of 40% thereof. State whether the amount of family pension is assessable in her hands, and if so, under what head of income. Can she claim any relief/deduction on such receipt? Compute taxable income for the assessment year 2021-22 and tax thereon.

### Solution:

#### Computation of gross total income of Mrs. Sudhir for the A.Y. 2021-22

Particulars	Details	₹
Income from other sources		
Family pension [(₹ 10,000 + ₹ 4,000) x 8] [From 01-08-2020 to 31-03-2021]		1,12,000
Less: Standard deduction being minimum of the following:		
(a) 1/3rd of the pension		37,333



## Notes

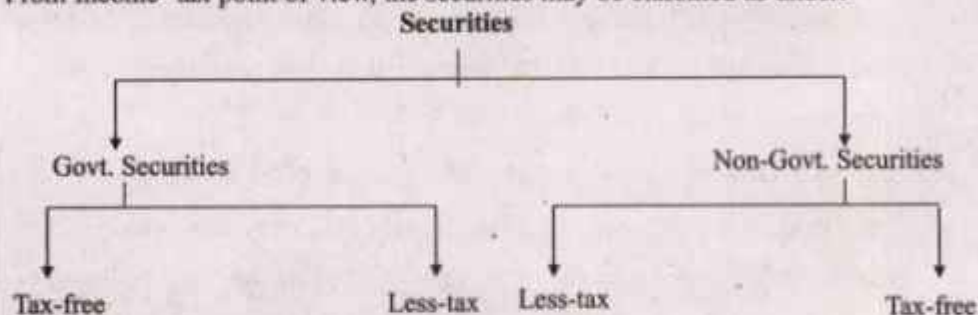
(b) Statutory limit		15,000
Total Income	97,000	
Tax on above	Nil	

It is assumed that other income of Mrs. Sudhir is nil.

## 4.10 Interest on Securities

### Kinds of Securities

From Income- tax point of view, the securities may be classified as under:-



Securities are of four types :

- (1) **Tax-free Government Securities:** These securities are those, the interest on which is fully exempt from tax under section 10(15). Interest is neither included in total income nor it is taxed.

*Interest on the following securities, bonds, deposits, etc is fully exempt from tax :*

- (i) 12-Year National Savings Annuity Certificates.
- (ii) National Defence Gold Bonds, 1980.
- (iii) Special Bearer Bonds, 1991.
- (iv) Treasury Savings Deposit Certificates (10Years)
- (v) Post office Cash Certificates (5Years)
- (vi) National Plan Certificates (10Years)
- (vii) National Plan Savings Certificates (12Years)
- (viii) P.O. National Saving Certificates (12Years/7 Years)
- (ix) P.O. Savings Bank Account:
  - (a) Individual account – Maximum exemption limit ₹ 3,500.
  - (b) Joint account – Maximum exemption limit ₹ 7,000.
- (x) P.O. Cumulative Time Deposit Account (15Years)

## Notes

- (xi) Fixed Deposit Scheme governed by the Post office (fixed Deposit) Rules, 1968.
- (xii) Fixed Deposit Scheme governed by the Government Savings Certificates (fixed Deposit) Rules, 1968.
- (xiii) Special Deposit Scheme, 1981
- (xiv) Public Account in P.O. (Upto ₹ 5,000) [Notification No. G.S.R. 607(E) dated 9.6.1989 178]
- (xv) Gold Deposit Bonds, 1999.
- (xvi) Bonds issued by local authority and specified by the Central Government.

**(2) Less Tax Government Securities:** Such securities are issued either by the Central Government or a State Government. These are taxable securities, but no tax is deducted at source on such securities. Hence, the interest on such securities will not be grossed up.

**(3) Tax-free Non-Government Securities:** These are issued by a local authority or statutory corporation or a company, in the form of debentures or bonds. Really speaking their interest is not tax-free, because tax due on this interest is payable by the company, or local authority or corporation concerned. These are called tax-free, because the assessee has not to pay tax on it from his own pocket. The tax paid by the company on this interest is deemed to have been paid on behalf of the assessee, hence the amount of tax paid on any interest due to an assessee is grossed up amount is included in his income. The amount of tax paid by the company on this interest is deducted from the total tax payable by the assessee. for example, if a company has issued 10% Tax-free Debentures, the debentures holder will receive the entire amount of interest calculated at 10% but the amount to be included in the income of the debenture holder will be the amount actually received by him as interest plus income tax thereon paid by the company.

**(4) Less -Tax Non-Government Securities:** These may be called "Taxable Securities". In the case of these securities, income tax is deducted at source on the amount of interest calculated at the percentage stated on the securities and balance of the amount of interest left after deduction of the aforesaid income tax is paid to the security-holder.

If the rate percent of interest is given it is not grossed up as it is already the gross amount be grossed up.

In any case, it is the gross amount of interest that is included in the income of an assessee.

**Grossing up of Interest**

Tax is to be deducted at source on interest on securities at the prescribed rates of tax. For income tax purpose what is to be charged to tax is the gross amount of interest.

**Notes**

*The following are the rules of grossing up interest on securities:*

- (1) If the rate of interest is given, only the interest on tax-free commercial securities is grossed up and interest on all other securities is not grossed up.
- (2) Interest on tax-free commercial securities is always grossed up whether its rate per cent is given or the amount received is given
- (3) Interest on less-tax securities is grossed up when the amount received is given.

**Net interest can be gross up as under:**

$$\frac{\text{Net Interest} \times 100}{100 - \text{Rate of TDS}}$$

**Deduction of Tax at Source**

The tax payer pays tax on income of previous year. The government collects amount of tax directly from the source to avoid delay payment and tax evasion. The recipient of income receives net amount of income. TDS is deduct at the time of receipt of income. The person responsible for deduction of tax at source issues a certificate, meaning there in the amount of tax deducted, to the person from whose interest such deduction is made.

Some of the examples of tax deduction at source are salary payment, interest on securities, lottery, crossword, horse race, game show, insurance commission, contract payment etc. According to section 193 of the Act. The person who pays, any interest on security to a resident shall deduct income-tax there from. Such deduction of tax is called as '*deduction of tax at source*'. Such amount of tax shall be deducted at the time of credit of such interest to the account of payee, or at the time of payment thereof in cash or by a cheque or draft or any other mode, whichever is earlier. Tax so deducted and deposited is treated as tax deposited on behalf of the person from whose interest it has been deducted at source. Such person at the time of his own assessment will get rebate, of this amount from his income-tax liability. The rates of deduction of tax at source are determined by the Finance Act passed every year.

*The following provisions relate to the deduction of tax at source: -*

- (1) As per section 193, the person responsible for paying any income by way of interest on securities shall deduct income tax, at the rates given in Part II of



the First Schedule to the Finance Act, on the amount of interest payable at the time : -

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Business or Profession*

## Notes

- (a) When such interest is credited to the account of the payee, or
- (b) When such interest is paid in cash by issue of a cheque or draft or by any other mode (whichever is earlier)
- (2) As per section 203; every person who deducts tax at source shall furnish to the person from whom such deduction is made, a certificate to the effect that tax has been deducted specifying therein the amount so deducted, the rate at which the tax has been deducted and such other particulars as may be prescribed. Such certificate is issued in Forms 16 -A
- (3) When there are two or more joint owners of a security, the payment of interest and the deduction of tax at source shall be deemed to be in the proportion of their ownership.

### **Persons Not Subject to TDS**

If the securities are held by the following persons, no deduction of tax at source will be made because if the securities are held by these persons, interest on securities is exempt from tax under section 10, 11 and 13 A: -

- (i) Local authority u/s 10(20);
- (ii) Approved scientific research association u/s 10(21);
- (iii) Any regimental fund or Non-public Fund u/s 10(23AA);
- (iv) Any institution established solely for the development of khadi or village industries u/s 10(23B);
- (v) Authority established for khadi or village industries u/s 10 (23BB)
- (vi) Anybody for the administration of public religious trusts or endowments u/s 10 (23BBA);
- (vii) The Prime Minister's National Relief Fund, the Prime Minister's fund for (Promotion of Folk Art), the Prime Minister's Aid to student fund, u/s 10(23C);
- (viii) Registered trade union u/s 10(24);
- (ix) Statutory provident fund, recognized provident fund, approved superannuation fund and approved gratuity fund u/s (25);
- (x) Member of a schedule tribe u/s 10(26);
- (xi) Anybody corporation or institution for promoting the interest of members of scheduled castes or scheduled tribes u/s 10 (26B);

- (xii) Public charitable and religious trust or institution u/s 11;
- (xiii) Any political party registered with the election commission of India u/s 13A; and
- (xiv) Any notified fund, body or authority.

## Notes

**Grossing up of Lottery, Crossword, Gambling, other Games Etc.**

Tax is also to be deducted at source on income from lotteries, horse races, t.v.show, crosswords etc. at the prescribed rates of tax. For income tax purpose what is to be charged to tax is the gross amount of winning.

If winning from above does not exceed 10000 or winning from race does not exceed 5000 no tax shall be deducted at source

If such winning exceeds the above limits then tax shall be deducted at prescribed rates and in this case the gross amount shall be included in the income.

**Net amount can be gross up as under:**

$$\frac{\text{Net Interest} \times 100}{100 - \text{Rate of TDS}}$$

**Illustration 1**

Mr. Sunil Kumar resident Indian provides The particulars of his income for the financial year 2021-22 are as follows:

- (1) Received ₹ 24,000 @ 2,000 p.m as family pension from the Government.
- (2) Received a sum of ₹ 14,000 for writing articles in various journals.
- (3) Received a sum of ₹ 6,000 as royalty from Mehta & Company to whom he has given right to publish his book on Commerce.
- (4) He has some machines which he lets-out on rent. The rent received in this respect amounts to ₹ 31,400. Repair charges on machines are ₹ 2,400.
- (5) Received ₹ 10,800 as rent from agricultural land given to a contractor.
- (6) Interest received on Post-office Savings Bank Account ₹ 1,600.
- (7) Remuneration received for TV show ₹ 3,000.

Compute his taxable income under the head 'Income from other sources' for the assessment year 2022-23.

**Solution:****Computation of Taxable 'Income from other Sources' of Mr. Sunil Kumar**

(For the assessment year, 2022-23)



Family pension @ 2,000 p.m. ₹ 24,000	₹
Less: Standard deduction 1/3 of pension or ₹ 15, 000 (whichever is less) 8,000	16,000
Remuneration for writing articles	14,000
Royalty received from Mehta & Company	6,000
Rent on machines 31, 400	
Less: Repairs 2,400	29,000
Rent from agricultural land	10,800
Interest on Post-Office saving Bank A/c	Exempt
Remuneration from TV show	3,000
<b>Income from other sources</b>	<b>78,800</b>

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## Notes

### 4.11 Bond Washing Transactions

It is a device to avoid tax by high income group of assessee by transferring securities to low-income class of assessee on the eve of the due date of interest. Generally, interest on securities is payable half-yearly or yearly and these dates are fixed. As the whole amount of interest is regarded as the income of the person who happens to be the owner at the time when the interest becomes due, some tactful persons sell their securities a few days before the expiry of the due date of interest. Thus, they do not remain the owner of the securities on the due date. They sell their securities to such persons whose total income including the income from interest on securities either does not exceed the minimum taxable limit or if it exceeds that limit it is lesser than that of the seller so that either no tax will be payable on the interest or it will be payable at the lower rate. Thus, the seller escapes tax completely; and buyer also does not pay tax on it as his income limit, he will pay tax at lower rate of tax, which is, in fact, secretly paid by the seller on behalf of the buyer. Thus, by this device, the Income Tax Department suffers loss of revenue. In order to prevent this device of avoiding tax, it has been provided that the Assessing Officer can include such an income from interest on securities in the total income of the person who is actually the owner of the securities and who wants to escape tax by adopting this device.

**Exceptions:** The Assessing Officer shall not apply the above rule in the following cases:

- (1) If the assessee proves to the satisfaction of the Assessing Officer that there has been no avoidance of income tax; or



- (2) If the assessee proves that the avoidance of income tax is exceptional and not systematic; and there was no avoidance of income tax in any of the three preceding year.

## Notes

In connection with such transactions the Assessing Officer has the power to enforce the assessee to furnish the required information.

**Deductions [Sec. 57]:**

The following expenditures are allowed as deductions from income chargeable to tax under the head 'Income from Other Sources':

S.N.	Section	Nature of Income	Deductions allowed
1.	57(i)	Dividend or Interest on securities	Any reasonable sum paid by way of commission or remuneration to banker or any other person for purpose of realizing dividend (other than dividends referred to in section 115-O) or interest on securities
2.	57(ia)	Employee's contribution towards Provident Fund, Superannuation Fund, ESI Fund or any other fund setup for the welfare of such employees	If employees' contribution is credited to their account in relevant fund on or before the due date
3.	57(ii)	Rental income letting of plant, machinery, furniture or building	Rent, rates, taxes, repairs, insurance and depreciation etc.
4.	57(iia)	Family Pension 1/3rd of family pension subject to maximum of ₹ 15,000.	
5.	57(iii)	Any other income	Any other expenditure (not being capital expenditure) expended wholly and exclusively for earning such income
6.	57 (iv)	Interest on compensation or enhanced compensation	50% of such interest (subject to certain conditions)
7	58(4) Proviso	Income from activity of owning and maintaining race horses.	All expenditure relating to such activity. Expenses not deductible [Section 58]

**Expenses not deductible [Section 58]***Profit or Gain of  
Business or Profession*

S.N.	Section	Nature of Income
1.	58(1)(a)(i)	Personal expenses
2.	58(1)(a)(ii)	Interest chargeable to tax which is payable outside India on which tax has not been paid or deducted at source
3.	58(1)(a)(iii)	'Salaries' payable outside India on which no tax is paid or deducted at Source
4.	58(1A)	Wealth-tax
5.	58(2)	Expenditure of the nature specified in section 40A
6.	58(4)	Expenditure in connection with winnings from lotteries, crossword puzzles, races, games, gambling or betting

**Notes****Interest Exempted**

The following interest income is exempt from income tax:

- (1) Interest on notified securities, bonds, certificates, deposits, etc
- (2) Interest on notified capital investment bonds
- (3) Interest on notified relief bonds
- (4) Interest on notified bonds in the hands of non residents
- (5) Interest on non-resident account in the hands of nonresident Indian in any bank India in accordance with the provisions of the foreign exchange regulation Act 1973.
- (6) Interest on notified savings certificate
- (7) Interest on gold deposit bonds, 1999 or deposit certificate under gold monetization scheme 2015.
- (8) Dividend from domestic company:- any income by way of dividend from a domestic company shall be exempt.

**Illustration 2**

Compute income from "income from other sources" from the following particulars submitted by Mr. Soman.

1. Dividend (gross)	9600
2. Expenses incurred for its collection	500
3. Receipt from letting of plant and machinery	10000
4. Repairs of plant and machinery	4000
5. Insurance premium in respect of plant and machinery	2000
6. Depreciation allowed for letting	4000

**Solution:****Computation of Income from other Sources**

Particulars	Details	₹
Receipts from letting of plant and machinery	10000	
Less: admissible expenses		
Repairs of plant and machinery	4000	
Insurance premium in respect of plant and machinery	2000	
Depreciation allowed for letting	4,000	10,000
<b>Income from Other Sources</b>		Nil

**Illustration 3**

Mr. vasu received the following incomes during 2018-19. Compute taxable income under the head income from other sources separately for each case.

A. 1. Winning from Sikkim lottery (net)	14000
2. winning from horse race	2000
3. winning from crossword puzzle	7000
B. 1. Winning from lottery	2000
2. winnings from horse race	22400

**Solution:**

Particulars	₹	₹
A. 1. Winning from Sikkim lottery ( $14000 \times 100/70$ )	20000	
2. winning from horse race	2000	
3. winning from crossword puzzle ( $7000 \times 100/70$ )	10000	
<b>Income from Other Sources</b>		<b>32000</b>
B. 1. Winning from lottery	2000	
2. winnings from horse race ( $22400 \times 100/70$ )	32000	
<b>Income from Other Sources</b>	<b>34000</b>	
<b>Total</b>		<b>66000</b>

**Illustration 4**

Compute taxable income under the head Income from other sources of Mrs. X from the following data:

Particulars	Amount
Private tuition fee received	10000
Winning from lottery	2000
Award from KBC (a TV show) [Gross]	320000



## Notes

Pension from employer of deceased husband	25000
Interest on bank deposit	25000
Directors fee (Gross)	5000
Letting out of vacant land	25000
Remuneration for checking the examination copy of employer's school	10000
Remuneration for checking the examination copy of C.A	10000
Income tax refund	5000
Interest on income tax refund	100
Composite rent (related expenditures are ₹ 5,000)	10000
Rent on sub-letting of house property (rent paid to original owner ₹ 12,000)	20000
Income tax paid	2000
Payment made for personal expenses	18000
Payment made to LIC as premium	2000

### Solution:

Particulars	Details	Amount
Private tuition fee received		10000
<b>Casual Income</b>		
Winning from lottery		2000
Award from KBC (a TV show) [Gross]		320000
Pension from employer of deceased husband	25000	
Less: Standard deduction		
a) 1/3rd of amount received (i.e. ₹ 8,333)		
b) ₹ 15,000	8333	16667
Interest on bank deposit		25000
Directors fee (Gross)		5000
Letting out of vacant land		25000
Remuneration for checking the examination copy of employer's school	Taxable as Salary -Salary	—
Remuneration for checking the examination copy of C.A		10000
Income tax refund	Not an Income	—
Interest on income tax refund		100
Composite rent	10000	
Less: Expenditure	5000	5000

Rent on sub-letting of house property	20000	
Less: Rent paid to original owner	12000	8000
<b>Income from Other Sources</b>		<b>426767</b>

## Notes

**4.12 Summary**

Salary, bonus, commission, interest received etc, to a partner from the firm is taxable under the head of profit and gains of business and profession. Normally, the trading and manufacturing enterprises prepare profit and loss account to ascertain profit or loss, whereas Chartered Accountants, Advocates, Architects etc prepare income and expenditure account to find out their profit or loss. The vocational persons find out their profits/losses by preparing receipt and payment account. So, the calculation of profit can be made by an assessee with the help of Profit and Loss Account, Income-Expenditure Account and Receipt and Payment Account related to business or profession, but the profits shown by these accounts may not be correct from the point of view of Income-tax. So, from income-tax point of view, the amount of profits may differ and the accounts prepared by the assessee are to be revised. For correction in accounts, the incomes and disallowed expenses will be added, whereas undeductable expenses and untaxable incomes will be subtracted. As per section 44AB, it is compulsory to specific persons engaged in any business or profession to get their accounts audited compulsorily by a Chartered Accountant or by a qualified auditor.

As per Sections 30 to 37 of Income-tax Act, the important expressly allowed expenses and deductions are - Expenses relating to building [Sec. 30], Expenses of machine, furniture and plant [Sec. 31], Depreciation [Sec. 32], Investment in new plant or machinery [Sec. 32AC], Expenditure on scientific research [Sec. 35(1)], Expenditure on acquisition of patent rights or copyrights [sec. 35a], Expenditure on know-how [sec. 35ab], Expenditure incurred on agricultural extension project [sec. 35ccc], Expenditure incurred on any skill development project [sec. 35ccd], Deduction in respect of preliminary expenses [sec. 35d], Amortisation of expenditure in case of amalgamation or demerger [sec. 35dd], Amortisation of expenditure under voluntary retirement scheme [sec. 35dda], Expenses on the discovery of minerals [sec. 35e], Insurance premium [sec. 36(1)(i)], Interest on borrowed capital [sec. 36(1)(iii)], Discount on zero coupon bonds [sec. 36(1)(iiia)], Employer's contribution to recognised provident fund [sec. 36(1)(iv)], Employer's contribution towards pension scheme [sec. 36(1)(iva)], Employer's contribution to approved gratuity fund [sec. 36(1)(v)], Family planning expenditure [sec. 36(1)(ix)], Banking cash transaction tax [sec. 36(1)(xiii)], Contribution towards



credit guarantee fund trust [sec. 36(1)(xiv)], Securities transaction tax [sec. 36(1)(xv)], Commodities transaction tax [sec. 36(1)(xvi)], Expenditure by co-operative society for purchase of sugarcane [sec. 36(1)(xvii)] and General deductions [sec. 37].

The important expenses which are expressly disallowed are Expenditure on advertisement to a political party [Sec. 37(2B)], Assessee's case [Sec. 40(a)], Partnership case [Sec. 40(b)], AOP or BOI case [Sec. 40(ba)], Excessive payments to a relative [Sec. 40A(2)], Payments in cash [Sec. 40A(3)], Provision of Gratuity [Sec. 40A(7)], Deductions allowable only on actual payment basis [Sec. 43B] etc.

Any profit arising from the transfer of capital asset is taxable under the head Income from capital gain. Capital gain is divided into two parts short term capital gain and long term capital gain.

Capital asset means property of any kind held by the assessee whether connected with his business, profession or not.

Cost of acquisition is the price which the assessee has paid for acquisition of the asset; it includes all expenses incurred to acquire it. Interest paid on money borrowed for the purchase of capital asset would constitute part of the cost of acquisition.

Cost of improvement is capital expenditure incurred by an assessee in making any additions/ improvement to the capital asset.

Various types of exemptions are available u/s 54, 54B, 54D, 54EC, 54EE, 54F, 54GA, and 54GB for purchase or investment in different assets.

Income of every kind, which is not to be excluded from the total income under this act, shall be chargeable to income-tax, under the head "Income from Other Sources" if it is not chargeable to Income-tax under any of the first four head's of Income.

Any expenses, not being in the nature of capital expenses, incurred wholly or partly for the making of taxable income in the previous year shall be allowed as deduction.

Expenses incurred in relation to exempted income, in not deductible.

Expenses or losses in connection with income from lottery, crossword puzzles, races including horse races, card games, gambling or betting of any nature, shall not be deductible in computing the said income.

Tax deduction at source means payment of tax at the time of receiving of Income. The main purpose of deduction of tax directly from the source to avoid delay payment and tax evasion. The recipient of income receives net amount of income. TDS is deduct at the time of payment.



## Notes

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**4.13 Keywords**


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- **Business** : This includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce (road/rail transport, communication, bank, insurance activities) or manufacture.
- **Trade**: means buying and selling of the goods or exchange of goods for money or other goods. The primary objective of these activities of buying and selling is to earn profits.
- **Holding period**: The total period for which asset was held by assessee together with the period of ownership of previous holder is called period of holding.
- **Exchange**: Exchange means voluntary conveyance of property in the goods by one person to another for consideration in kind.
- **Extinguishment**: It means to put a total end to something. Destruction or annihilation of contract, rights, interest, debt or other obligation by law.

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**4.14 Review Questions**


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1. Explain the meaning of Vocation, Profession and Business.
2. Discuss the provisions for maintenance of accounts u/s 44AA for non-specific profession.
3. Write short notes on – (i) Compulsory audit, (ii) Specific profession.
4. What is the method of correcting profit and loss account by a businessman from the point of Income-tax?
5. Discuss the rules of correction in the accounts for the purpose of income-tax.
6. Will the provisions of Section 40A(3) be attracted in the following cases:
  - i. Mr. X purchased goods worth ₹12,000, ₹15,000 and ₹10,000 against three bills from Mr. Y and made the payment of ₹37,000 in cash at one time.
  - ii. Mr. X made a payment of ₹40,000 as donation in cash to National Defence Fund.
7. What are the admissible deductions in computing the taxable income from 'business or profession' head? Discuss.
8. What expenses are disallowed to a businessmen in computing taxable profits?
9. Discuss the basic concepts in determination of taxable income under the head 'business or profession'.
10. State the admissible General Deductions u/s 37 under the head 'business or profession' with examples.

## Notes

11. What is "Capital gain"? Discuss the types and procedure of computation of capital gain.
12. Explain the term "Cost of acquisition" with regards to various types of capital assets.
13. Discuss the various types of exemptions available for various capital assets.
14. Ram died on 31st July 2020 while being in Central Government service. In terms of rules governing his service, his widow Mrs. Ram is paid a family pension of ₹ 10,000 p.m. and dearness allowance of 40% thereof. State whether the amount of family pension is assessable in her hands, and if so, under what head of income. Can she claim any relief/deduction on such receipt? Compute taxable income for the assessment year 2021-22 and tax thereon.
15. Mr. Ramesh purchased 100 equity shares of M/s ABC Co. Ltd. on 01-04-2005 at rate of ₹ 1,000 per share in public issue of the company by paying securities transaction tax. Company allotted bonus shares in the ratio of 1:1 on 01.12.2019. He has also received dividend of ₹ 10 per share on 01.05.2020.  
He has sold all the shares on 01.10.2020 at the rate of ₹ 4,000 per share through a recognized stock exchange and paid brokerage of 1% and securities transaction tax of 0.02% to celebrate his 75th birthday.  
Compute his total income and tax liability for Assessment Year 2021-22, assuming that he is having no income other than given above. Fair market value of shares of M/s ABC Co. Ltd. on 31.1.2018 is ₹ 2,000.

### 4.15 Further Readings

- Jain, R.K. 2017. Income Tax Planning and Management. SBPD Publications, Agra.
- Singhania, V.K. and Singhania, K. 2017. Direct Taxes Law and Practice with Special Reference to Tax Planning, 57th Edition. Taxmann Publications, New Delhi.
- Agarwal, B.K. and Agarwal, Rajeev. 2017. Income Tax Law and Accounts. Nirupam Sahitya Sadan, Agra.

## Notes

## Clubbing of Income

**(Structure)**

- 5.1 Learning Objectives
- 5.2 Introduction
- 5.3 Aggregation of Income/Deemed Income
- 5.4 Assessment of Firms
- 5.5 Partnership Firm assessed as an Association of Person (PFAOP)- u/s 185
- 5.6 Tax Planning for Partnership Firms
- 5.7 Assessment of Association of Persons (AOP) & Body of Individual (BOI)
- 5.8 Alternate Minimum Tax (AMT)
- 5.9 Assessment of Companies
- 5.10 Minimum Alternate Tax (MAT) Sec 115JB
- 5.11 Dividend Distribution Tax (DDT)-Sec 115-O
- 5.12 Tonnage Tax: Shipping Companies
- 5.13 Summary
- 5.14 Keywords
- 5.15 Review Questions
- 5.16 Further Readings

### 5.1 Learning Objectives

After studying the chapter, students will be able to:

- Explain the Aggregation of Income/Deemed Income;
- Discuss the Alternate Minimum Tax (AMT);
- Describe the Dividend Distribution Tax (DDT)-Sec 115-O ;
- Understand the tax planning for Partnership Firms;
- Describe the assessment of companies.



## 5.2 Introduction

An individual means a woman, man, minor child or any human being. An individual has to pay income tax on his total income at a graded scale of tax rates ruling during the concerned assessment year. In addition to his own income under different heads, an individual may also get a share of income from his membership in the various other institutions and some incomes of others are also to be included in the total income.

On the other hand, partnership is a relationship between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. These persons are called *partners* and collectively they are called *firm*. In income tax, the term partner also includes, a minor admitted to the benefits of partnership, and a partner of a limited liability partnership.

A company is a juristic person having an independent and separate legal entity from its shareholders. Income of the company is computed and assessed separately in the hands of the company. The company is liable to pay tax at a flat rate like a firm. For the purpose of assessment of companies the understanding of the meaning of a company and various types of companies is very essential.

## Notes

## 5.3 Aggregation of Income/Deemed Income

In certain cases, some amounts are deemed as income in the hands of the assessee though they are actually not in the nature of income. These cases are contained in sections 68, 69, 69A, 69B, 69C and 69D. The Assessing Officer may require the assessee to furnish explanation in such cases. If the assessee does not offer any explanation or the explanation offered by the assessee is not satisfactory, the amounts referred to in these sections would be deemed to be the income of the assessee. Such amounts have to be aggregated with the assessee's income.

1. **Cash Credits (Sec 68):** Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.
2. **Unexplained Investments (Sec 69):** Where in the financial year immediately preceding the assessment year the assessee has made investments which are not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the value of the investments may be deemed to be the income of the assessee of such financial year.
3. **Unexplained Money, etc., (Sec 69A):** Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article

## Notes

and such money, bullion, jewellery or valuable article is not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of acquisition of the money, bullion, jewellery or other valuable article, or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the money and the value of the bullion, jewellery or other valuable article may be deemed to be the income of the assessee for such financial year.

**4. Amount of Investments, etc., Not Fully Disclosed in Books of Account (69B):**

Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article, and the Assessing Officer finds that the amount expended on making such investments or in acquiring such bullion, jewellery or other valuable article exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of income, and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the excess amount may be deemed to be the income of the assessee for such financial year.

**5. Unexplained Expenditure, etc., (69C):** Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof, or the explanation, if any, offered by him is not, in the opinion of the Assessing Officer, satisfactory, the amount covered by such expenditure or part thereof, as the case may be, may be deemed to be the income of the assessee for such financial year.

Provided that, notwithstanding anything contained in any other provision of this Act, such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as a deduction under any head of income.

**6. Amount Borrowed or Repaid on Hundi (69D):** Where any amount is borrowed on a hundi from, or any amount due hereon is repaid to, any person otherwise than through an account payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount aforesaid for the previous year in which the amount was borrowed or repaid, as the case may be:

Provided that, if in any case any amount borrowed on a hundi has been deemed under the provisions of this section to be the income of any person, such person shall not be liable to be assessed again in respect of such amount under the provisions of this section on repayment of such amount. For the purposes of this section, the amount repaid shall include the amount of interest paid on the amount borrowed.



## Income of other persons included in assessee's total income/Clubbing of Income

## Clubbing of Income

As the term suggests, clubbing of income means adding or including the income of another person (mostly family members) to one's own income. This is allowed under Section 64 of the IT Act. However, certain restrictions pertaining to specified person(s) and specified scenarios are mandated to discourage this practice.

## Notes

### Specified Persons to Club Income

Income of any and every person cannot be clubbed on a random basis while computing total income of an individual and also not all income of specified person can be clubbed. As per Section 64, there are only certain specified income of specified persons which can be clubbed while computing total income of an individual.

#### Specified scenarios when you can club income

Section	Specified Person	Specified Scenario	Income to be clubbed
Section 60	Any person	Transferring income without transferring asset either by way of an agreement or any other way,	Any income from such asset will be clubbed in the hands of the transferor
Section 61	Any person	Transferring asset on the condition that it can be revoked	Any income from such asset will be clubbed in the hands of the transferor
Section 64(1A)	Minor child	Any income arising or accruing to your minor child where child includes both step child and adopted child. The clubbing provisions apply even to minor married daughter.	Income will be clubbed in the hands of higher earning parent. Note: (a) If marriage of child's parents does not subsist, income shall be clubbed in the income of that parent who maintains the minor child in the previous year (b) If minor child's income is clubbed in the hands of parent, then exemption of ₹ 1,500 is allowed to the parent. (c) Exceptions to clubbing Income of a disabled child (disability of the nature specified in section 80U)



## Notes

			<p>(d) Income earned by manual work done by the child or by activity involving application of his skill and talent or specialised knowledge and experience</p> <p>(e) Income earned by a minor child. This would also include income earned from investments made out of money gifted to the adult child. Also, money gifted to an adult child is exempt from gift tax under gifts to 'relative'.</p>
Section 64(1)(ii)	Spouse**	If your spouse receives any remuneration irrespective of its nomenclature such as Salary, commission, fees or any other form and by any mode i.e., cash or in kind from any concern in which you have substantial interest*	Income shall be clubbed in the hands of the taxpayer or spouse, whose income is greater (before clubbing). Exception to clubbing: Clubbing is not attracted if spouse possesses technical or professional qualifications in relation to any income arising to the spouse and such income is solely attributable to the application of his/her technical or professional knowledge and experience
Section 64(1)(iv)	Spouse**	Direct or indirect transfer of assets to your spouse by you for inadequate consideration	<p>Income from out of such asset is clubbed in the hands of the transferor. Provided the asset is other than the house property.</p> <p>Exceptions to clubbing No clubbing of income in following cases:</p> <p>(a) Where asset is received as part of divorce settlement</p>

## Notes

			<p>(b) If assets are transferred before marriage</p> <p>(c) No husband and wife relationship subsists on the date of accrual of income</p> <p>(d) Asset is acquired by the spouse out of pin money (i.e. an allowance given to the wife by her husband for her personal and usual household expenses)</p>
64(1)(vi)	Daughter-in-law	Transfer of assets transferred directly or indirectly to your daughter in-law by you for inadequate consideration	Any income from such assets transferred is clubbed in the hands of the transferor
64(1)(vii)	Any person or association of person	Transferring any assets directly or indirectly for an inadequate consideration to any person or association of persons to benefit your daughter in-law either immediately or on deferred basis	Income from such assets will be considered as your income and clubbed in your hands

## Notes

64(1) (viii)	Any person or association of person	Transferring any assets directly or directly for an inadequate consideration to any person or association of persons to benefit your spouse either immediately or on deferred basis	Income from such assets will be considered as your income and clubbed in your hands
Section 64(2)	Hindu Undivided Family	In case, a member of HUF transfers his individual property to HUF for inadequate consideration or converts such property into HUF property	Income from such converted property shall be clubbed in the hands of individual

**\*An individual is said to have the Substantial Interest in the concern if -**

In case of a company, individual either by himself or along with his relative/s beneficially owns shares having 20% or more voting power (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits)

In any other case, such individual either alone or along with his relative/s is entitled to 20% or more of profits in the aggregate of such concern at any time during the previous year.

**\*\*Income from reinvestment of clubbed income by a spouse is not clubbed in the hands of individual.**



### Illustration 1

Mr P owns a shop which fetches a rent of ₹ 12,000 per month. He transfers the rent to his friend Mr Q but retains the ownership of the shop.

#### Solution:

In this case, because Mr P has transferred the income without transferring the asset. Hence, as per section 60 of the income tax act, Mr P must include the rental income while computing his total income.

### Illustration 2

Mr Jay is beneficially holding 21% equity shares of PTK Pvt. Ltd. Mrs Jay is employed as a finance manager in PTK Pvt. Ltd.

The monthly salary received from Mrs PTK Pvt. Ltd. is ₹ 40,000. Mrs Jay is not having any qualification, experience or knowledge of finance.

#### Solution:

In this situation, Mr Jay has a substantial interest in PTK Pvt. Ltd. with 21% share holding. But Mrs Jay is employed without any qualification and technical knowledge of finance. Hence, salary or payment received by Mrs Jay from PTK Pvt. Ltd. will be clubbed with the income of Mr Jay as per section 64(1)(ii) of the income tax act.

In the above case, if Mrs Jay had the qualification and knowledge for the finance manager post in PTK Pvt. Ltd., then income earned by Mrs Jay will not be clubbed in the income of Mr Jay.

### Illustration 3

Mr Lucky holds gifted ₹ 6,00,000 to his wife. Mrs Lucky has then invested the same amount in the fixed deposit. Mrs lucky receives the interest of 5,000 p.a. from such fixed deposit.

#### Solution:

As Mr Lucky has transferred Cash (asset) without adequate consideration and it was converted into another asset by Mrs Lucky. Hence, interest earned of ₹ 5,000 from the converted asset (fixed deposit) will be clubbed in the income of Mr Lucky as per section 64(1)(iv) of the income tax act.

### Notes

## Notes

**Note:**

If in the above case Mr lucky transfers the cash as a settlement for divorce then clubbing provisions will not apply. Also, if the cash was transferred before marriage and interest is accrued after marriage, no income shall be clubbed in the hands of Mr. Lucky.

Hence, husband-wife relationship should remain at the time of transfer of asset and also at the time of accrual of income.

**Illustration 4**

Mr. & Mrs. Sushil Kumar have income under the head "Profits & gains of business or profession" of ₹ 3,00,000 and ₹ 4,00,000 respectively. They have 7 children. From the following details compute taxable income of Mr. and Mrs. Sushil Kumar for the A.Y. 2021-22:

- 1st child (aged 26 years) is a chartered accountant. His annual income from profession is ₹ 4,00,000. His income from house property for the P.Y. 2021-22 is ₹ 30,000. He has a son (4 years old) who has earned interest on fixed deposit of ₹ 5,000.
- 2nd child (aged 17 years being a married daughter) who is a stage singer, earned income of ₹ 1,00,000 during the P.Y. 2021-22. She earned interest on fixed deposit ₹ 8,000. Such fixed deposit has been made out of such singing income.
- 3rd child (aged 16 years) is suffering from disability specified u/s 80U (to the extent 55%) blind. He has received interest income of ₹ 40,000 for loan given to a private firm. He is dependent on Mrs. Sushil Kumar.
- 4th child (aged 14 years) has earned income of ₹ 45,000 during the P.Y. 2021-22 out of his physical and mental effort. Expenditure incurred to earn such income is ₹ 15,000. His loss from house property is ₹ 30,000.
- 5th child (aged 12 years) is a partner in a partnership firm from which he earned interest income (taxable) of ₹ 40,000 and share of profit of ₹ 35,000. Other two partner of the firm are Mr. & Mrs. Sushil Kumar.
- 6th child (aged 9 years) has 1,000 debentures of ₹ 100 each of a public sector company acquired through will of his Grandfather. Interest income on such debenture is ₹ 10,000. Expenditure incurred to collect such interest is ₹ 200. Such debenture was sold and long-term capital gain earned ₹ 25,000.
- 7th child (aged 7 years) has earned interest on fixed deposit ₹ 500.

**Solution:***Clubbing of Income*

Computation of total income of Mr. and Mrs. Sushil Kumar for the A.Y. 2021-22

Particulars	Mr. Sushil Kumar		Mrs. Sushil Kumar	
	Details	Amount	Details	Amount
Income from house property				-30000
Income of 4th Child: Loss from house property				
Profits & gains of business or profession		300000	400000	
Business Income				
Interest from partnership firm			40000	
Share of profit [Exempt u/s 10(2A)]			Nil	
Less: Exemption u/s 10(32)			-1500	438500
Capital gains				25000*
Income of 6th Child				
Long term capital gain				
[#Deduction can be claimed once]				
Income from other sources			8000	
Income of 2nd Child				
Interest income				
Less: Exemption u/s 10(32)			-1500	6500
Income of 6th Child			9800	
Interest on debenture [10000 - 200]				
Less: Exemption u/s 10(32)			-1500	8300
Income of 7th Child				
Interest on Fixed Deposit			500	
Less: Exemption u/s 10(32)			-500	Nil
Gross Total Income		300000		448300
Less: Deduction u/s 80DD		Nil		75000
Total Income		300000		373300

Notes

**Notes:**

1. In case income of a minor child is clubbed in hands of parent as per provision of sec. 64(1A), the assessee (parent) can claim exemption of an amount being minimum of the following:

₹ 1,500; or Income so clubbed



## Notes

2. Income of the first child shall not be clubbed with the income of Mrs. Sushil Kumar as he is a major. Income of grand child (son of first child) will be clubbed with the income of his parent.
3. The clubbing provision of sec. 64(1A) shall not apply where
  - the income arises or accrues to the minor child due to any manual work done by him; or
  - the income arises or accrues to the minor child due to his skill, talent, specialized knowledge or experience; or
  - the minor child is suffering from any disability of nature as specified u/s 80U.
4. Income shall be first computed head wise in the hands of recipient and then clubbing shall be carried out head wise.

### Set-off and Carry Forward of Losses (Sec 70-80)

#### Introduction

The concept of set off and carried forward comes into picture only when there is loss any source of income (except salary). To make it clear it that to be studied of in two separations.

- **Inter sources adjustments (with in the same head of income)- sec 70**
- **Inter head adjustments (with overhead of income )- sec 71**

#### Points to be kept in mind in case of set-off of losses

1. Loss from speculative business cannot be set-off from any other income except income from speculative business.
2. Long-term capital loss can be set-off only from long term capital gain.
3. Loss from owning and maintaining of race horses can be set-off only from any income earned from owning and maintaining of horse races.
4. Any other loss can be set-off from any other heads of income [house property loss, Non speculative business loss, Short-term loss and other source loss]
5. Loss from business can be set-off from House property, Capital gains and other sources except salaries.

#### Carry-forward and set-off of losses

1. **Income from salary:** The question of carry-forward and set-off will not arise in this head of income because there will be no loss under this head of income.

**2. Income (loss) from House property**

- Loss which cannot be adjusted during a financial year can be carried forward
- Loss can be carried forward for a period of 8 years.
- Carried forward loss should be set-off only from House property income and not from any other income.
- Return of loss should be filed within the time limit.

**3. Income [loss] from business: Non-speculative business loss**

- Loss which cannot be adjusted during a financial year can be carried forward
- Loss can be carried forward for a period of 8 years
- Carried forward loss should be set-off only from Business or professional income and not from any other income.
- It is not necessary that loss should belong to the same business. Continuity of business is not necessary to carry forward and set-off.
- Return of loss should be filed within the time limit.
- Speculative business loss
- Loss can be carried forward and set-off only from speculative income.
- Loss can be carried forward for a period of 4 years
- It is not necessary that loss the same business should be continued.
- Return of loss should be filed within the time limit.

**4. Income [loss] from capital gains**

- Loss which cannot be adjusted during a financial year can be carried forward
- Loss should be adjusted only from capital gains.
- Long-term capital loss can be carried forward and set-off only from long-term capital gain and not from short-term capital gain.
- Short-term capital loss can be carried forward and set-off from both long-term and short-term gains.
- Loss can be carried forward for a period of 8 years.
- Return of loss should be filed within the time limit.

**5. Income [loss] from other sources**

- Loss from owning and maintaining of race horse comes under this head.
- Such loss can be carried-forward and set-off only against any income from owning and maintaining of race horses.

- Loss can be carried forward for a period of 4 years.
- Return of loss should be filed within the time limit.

## Notes

**Illustration 5**

Mr. Neeraj (aged 35 years) submits the following particulars pertaining to the A.Y. 2021-22:

Particulars	₹
Income from salary (computed)	4,00,000
Loss from self-occupied property	(-) 70,000
Loss from let-out property	(-) 1,50,000
Business loss	(-) 1,00,000
Bank interest (FD) received	80,000

Compute the total income of Mr. Neeraj for the A.Y. 2021-22.

**Solution:****Computation of total income of Mr. Neeraj for the A.Y. 2021-22**

Particulars	Amount (₹)	Amount (₹)
Income from salary		
Less: Loss from house property of ₹2,20,000 to be restricted to ₹ 2 lakhs by virtue of section 71(3A)	4,00,000	
Balance loss of ₹ 20,000 from house property to be carried forward to next assessment year	(-) 2,00,000	2,00,000
Income from other sources (interest on fixed deposit with bank)	80,000	
Business loss set-off		
Business loss of ₹ 20,000 to be carried forward for set-off against business income of the next assessment year	(-) 1,00,000	
Gross total income [See Note below]		
Less: Deduction under Chapter VI-A		
Total income		2,00,000
		Nil
		2,00,000

**Note:** Gross Total Income includes salary income of ₹ 2,00,000 after adjusting loss of ₹ 2,00,000 from house property. The balance loss of ₹ 20,000 from house property to be carried forward to next assessment year for set-off against income from house property of that year.



Business loss of ₹ 1,00,000 is set off against bank interest of ₹ 80,000 and remaining business loss of ₹ 20,000 will be carried forward as it cannot be set off against salary income.

### Illustration 6

Mr. Sreenath, a resident individual, furnishes the following particulars of his income and other details for the previous year 2021-22:

Sl. No.	Particulars	₹
(i)	Income from salary (computed)	18,000
(ii)	Net annual value of house property	70,000
(iii)	Income from business	80,000
(iv)	Income from speculative business	12,000
(v)	Long term capital gain on sale of land	15,800
(vi)	Loss on maintenance of race horse	9,000
(vii)	Loss on gambling	8,000

Depreciation allowable under the Income-tax Act, 1961, comes to ₹ 8,000, for which no treatment is given above. The other details of unabsorbed depreciation and brought forward losses (pertaining to A.Y. 2021-22) are:

Sl. No.	Particulars	₹
(i)	Unabsorbed depreciation	9,000
(ii)	Loss from speculative business	16,000
(iii)	Short term capital loss	7,800

Compute the gross total income of Mr. Sreenath for the Assessment year 2021-22, and the amount of loss that can or cannot be carried forward.

### Solution:

#### Computation of Gross Total Income of Mr. Sreenath for the A.Y. 2021-22

Particulars	₹	₹
(i) Income from salary		18,000
(ii) Income from House Property		
Net Annual Value	70,000	
Less: Deduction under section 24(30% of ₹ 70,000)	21,000	49,000
(iii) Income from business and profession		
(a) Income from business	80,000	
Less : Current year depreciation	8,000	
		72,000

### Notes

## Notes

Less : Unabsorbed depreciation	9,000	63,000
(b) Income from speculative business	12,000	
Less : Brought forward loss from speculative business	12,000	Nil
(Balance loss of ₹ 4,000 (i.e. ₹ 16,000 – ₹ 12,000) can be carried forward to the next year)		
(iv) Income from capital gain		
Long-term capital gain on sale of land	15,800	
Less: Brought forward short-term capital loss	7,800	8,000
Gross total income		1,38,000

Amount of loss to be carried forward to the next year

Particulars	₹
Loss from speculative business (to be carried forward as per section 73)	4,000
Loss on maintenance of race horses (to be carried forward as per section 74A)	9,000

**Notes:**

1. Loss on gambling can neither be set-off nor be carried forward.
2. As per section 74A(3), the loss incurred on maintenance of race horses cannot be set-off against income from any other source other than the activity of owning and maintaining race horses. Such loss can be carried forward for a maximum period of 4 assessment years.
3. Speculative business loss can be set off only against income from speculative business of the current year and the balance loss can be carried forward to A.Y. 2022-23. It may be noted that speculative business loss can be carried forward for a maximum of four years as per section 73(4).

**Deduction From Gross Total Income [Section 80C To 80U]****Introduction**

After computing the total income under each head and after giving effect to the provisions for clubbing of income and set off of losses, which gives the Gross Total Income, deductions described under this lesson are allowed i.e., deductions under section 80C to 80U of the Income Tax Act are allowed to assesses.

**Basic Rules Governing Deductions (80C to 80 U)**

- Gross Total Income means income from all the heads namely income from salary, house property, profits and gains from business or profession, capital gains and

other sources combined together after giving effects to provisions of clubbing of income and set off of losses.

*Clubbing of Income*

- Deductions from section 80C to 80U are deducted from Gross Total Income to arrive at total income of the assessee which is also known as taxable income.
- However deductions are not allowed from the following items although they form part of Gross Total Income:
  1. Short term capital gain under sec 111A
  2. Long term capital gain
  3. Lotteries
  4. Income under Sections 115A, 115AB, 115AC, 115ACA, 115AD, 115BBA, 115D

Notes

### Important Points:

1. Deductions from gross total income are available only to assessee when the gross total income is a positive figure. If however, the gross total income is nil or is a loss, the question of any deduction from the gross total income does not arise. In other words, the total aggregate of deductions cannot exceed the gross total income.
2. Deductions cannot be claimed twice in the same assessment year.
3. Deduction is allowed only to assessee.
4. Certain deductions like under 80-IA, 80-IAB, 80-IC, 80-ID, 80-IE can only be claimed when income tax return is furnished for assessment year on or before the due date specified under sec 139(1).

### Deduction Under Chapter VI-A In Respect of 'Payments'

Section	Nature of Payment	Who can Claim
80C	Life Insurance Premium, Provident Fund Contribution (Maximum : ₹ 1,50,000)	Individuals
80CCC	Pension Fund [ Maximum : ₹1,50,000	Individuals
80CCD (1)	Deduction available in respect of Employee's / Assesses Contribution to National Pension Scheme (NPS) [Section 80CCD(1)]	Individuals
80CCD (1B)	Additional Deduction of ₹ 50,000 is available in respect of Employee's / Assesses Contribution to National Pension Scheme (NPS) [Section 80CCD(1B)]	Individuals
80CCD(2)	Deduction available in respect of Employer's Contribution to National Pension Scheme (NPS) [Section 80CCD(2)]	Employees



## Notes

80D	Deduction in respect of Health or Medical Insurance Premium	Individual/HUF
80DD	Deduction in respect of Maintenance Including Medical Treatment of a Dependent who is a Person with Disability	Resident Individual/ Resident HUF
80DDB	Deduction in respect of Medical Treatment, etc.	Resident Individual/ Resident HUF
80E	Payment of interest of Loan taken for higher studies	Individual
80EE	Deduction in respect of Interest on Loan taken for Residential House Property	Individual
80G	Deduction in respect of Donations to certain Funds, Charitable Institutions, etc. [Section 80G]	All Assesse
80GG	Deduction in respect of Rents Paid [Section 80GG]	Individual
80GGA	Deduction in respect of certain Donations for Scientific Research or Rural Development [Section 80GGA]	All assesses not having any income chargeable under the head 'Profits and gains of business or profession'
80GGB/ GGC	Contribution to Political Parties	

**Deduction Under Chapter VI-A In Respect of 'Certain Incomes'**

80-IA	Deduction in respect of Profit and Gains from Industrial Undertaking or Enterprises engaged in infrastructure Development [Section 80IA]	All Assesse
80-IAB	Deduction in respect of profits and gains by an undertaking or an enterprise engaged in development of Special Economic Zone (SEZ)	Developers
80-IAC	Special Provision in respect of Eligible Business of Eligible Start Up [Section 80-IAC] [W.e.f. A.Y. 2017-18]	Companies /LLPs
80-IB	Deduction in respect of Profit & Gain from certain Industrial Undertaking other than Infrastructure Development Undertaking [Section 80-IB]	All Assesse

80-IBA	Deduction in respect of Profits and Gains from Housing Projects [Section 80-IBA]	All Assesse
80-IC	Deduction in respect of Profits and Gains of Certain Undertaking or Enterprises in certain Special Category States. [Section 80-IC]	All Assesse
80-ID	Deduction in respect of Profits and Gains from Business of Hotels and Convention center in NCR	All Assesse
80-IE	Deduction in respect of certain undertaking in North-Eastern States	All Assesse
80-JJA	Deduction In Respect of Profit And Gains From Business of Collecting And Processing of Bio-Degradable Waste	All Assesse
80-JJAA	Deduction In Respect of Employment of New Employees [Section 80-JJAA] w.e.f. A.Y. 2017-18	All Assesse
80LA	Deduction in respect of certain incomes of Offshore Banking Units and International Financial Services Centre	Scheduled Banks
80P	Deduction in respect of income of Cooperative Societies	Co-operatives Societies
80PA	Deduction in respect of income of Farm [W.e.f. A.Y. 2019-20]	Producer Companies
	Producers Companies	
80QQB	Deduction in respect of royalty income, etc., of authors of certain books other than text books [Maximum ₹ 3,00,000]	Resident Individuals
80RRB	Deduction in respect of royalty on patents [ Maximum ₹ 3,00,000]	Resident Individuals
80TTA	Deduction in respect of interest on deposits in savings accounts to the maximum extent of ₹ 10,000 Individuals /HUF	
80TTB	Senior citizen to be allowed a deduction of ₹ 50,000 on account of interest on deposits with Banks / cooperative bank / post office. [W.e.f. A.Y. 2019-20]	Senior Citizens
80U	Deduction in case of a person with disability [ Maximum : ₹1,25,000]	Resident Individuals

**Illustration 7 [80 CCE]**

The gross total income of Mr. Vinod for the A.Y.2021-22 is ₹ 8,00,000. He has made the following investments/payments during the F.Y.2021-22 –

**Notes**

	Particulars	₹
(1)	Contribution to PPF	1,10,000
(2)	Payment of tuition fees to Apeejay School, New Delhi, for education of his son studying in Class XI	45,000
(3)	Repayment of housing loan taken from Standard Chartered Bank	25,000
(4)	Contribution to approved pension fund of LIC	1,05,000

Compute the eligible deduction under Chapter VI-A for the A.Y. 2021-22.

**Solution:****Computation of deduction under Chapter VI-A for the A.Y. 2021-22**

Particulars	₹
Deduction under section 80C	
- Contribution to PPF	1,10,000
- Payment of tuition fees to Apeejay School, New Delhi, for education of his son studying in Class XI	45,000
- Repayment of housing loan	25,000
	1,80,000
Restricted to ₹ 1,50,000, being the maximum permissible deduction u/s 80C	1,50,000
Deduction under section 80CCC	
- Contribution to approved pension fund of LIC ₹1,05,000	1,05,000
	2,55,000
As per section 80CCE, the aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to ₹ 1,50,000	
Deduction allowable under Chapter VIA for the A.Y. 2021-22	1,50,000

**Illustration 8 [80 D]**

Mr. Krishnan, aged 40 years, paid medical insurance premium of ₹ 22,000 during the P.Y. 2021-22 to insure his health as well as the health of his spouse and dependent children. He also paid medical insurance premium of ₹ 33,000 during the year to insure the health of his mother, aged 67 years, who is not dependent on him. He incurred medical expenditure of ₹ 20,000 on his father, aged 71 years, who is not covered under mediclaim policy. His father is also not dependent upon him. He contributed ₹ 6,000 to



Central Government Health Scheme during the year. Compute the deduction allowable under section 80D for the A.Y. 2021-22.

*Clubbing of Income*

### Solution:

Deduction allowable under section 80D for the A.Y.2021-22

Particulars	₹	₹
(i) Medical insurance premium paid for self, spouse and dependent children	22,000	
(ii) Contribution to CGHS	6,000	
restricted to	28,000	25,000
(iii) Mediclaim premium paid for mother, who is over 60 years of age	33,000	
(iv) Medical expenditure incurred for father, who is over 60 years of age and not covered by any insurance	20,000	
Restricted to	53,000	50,000
		75,000

Notes

### Illustration 9 [80 DD]

Mr. X is a resident individual. He deposits a sum of ₹ 50,000 with Life Insurance Corporation every year for the maintenance of his handicapped grandfather who is wholly dependent upon him. The disability is one which comes under the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995. A copy of the certificate from the medical authority is submitted. Compute the amount of deduction available under section 80DD for the A.Y. 2021-22.

(1) What will be the deduction if Mr. X had made this deposit for his dependant father?

### Solution:

Since the amount deposited by Mr. X was for his grandfather, he will not be allowed any deduction under section 80DD. The deduction is available if the individual assessee incurs any expense for a dependant disabled person. Grandfather does not come within the definition of dependant.

(1) Since the expense was incurred for a dependant disabled person, Mr. X will be entitled to claim a deduction of ₹ 75,000 under section 80DD, irrespective of the amount deposited. In case his father has severe disability, the deduction would be ₹ 1,25,000.

Deduction in respect of donations to certain funds, charitable institutions etc.  
[Section 80G]

## Notes

**(1) Eligible assessee:** An assessee who pays any sum as donation to eligible funds or institutions, is entitled to a deduction, subject to certain limitations, from the gross total income.

**(2) Quantum of deduction:** There are four categories of deductions. The following table gives the details of the institutions and funds to which donations can be made for the purpose of claiming deduction under section 80G,

### **I. Donation qualifying for 100% deduction, without any qualifying limit**

- (1) The National Defence Fund set up by the Central Government
- (2) Prime Minister's National Relief Fund.
- (3) Prime Minister's Armenia Earthquake Relief Fund
- (4) The Africa (Public Contributions-India) Fund
- (5) The National Children's Fund
- (6) The National Foundation for Communal Harmony
- (7) Approved University or educational institution of national eminence
- (8) Chief Minister's Earthquake Relief Fund, Maharashtra
- (9) Any fund set up by the State Government of Gujarat exclusively for providing relief to the victims of the Gujarat earthquake
- (10) Any Zila Saksharta Samiti constituted in any district for improvement of primary education in villages and towns and for literacy and post-literacy activities
- (11) National Blood Transfusion Council or any State Blood Transfusion Council whose sole objective is the control, supervision, regulation or encouragement in India of the services related to operation and requirements of blood banks
- (12) Any State Government Fund set up to provide medical relief to the poor
- (13) The Army Central Welfare Fund or Indian Naval Benevolent Fund or Air Force Central Welfare Fund established by the armed forces of the Union for the welfare of past and present members of such forces or their dependents.
- (14) The Andhra Pradesh Chief Minister's Cyclone Relief Fund, 1996
- (15) The National Illness Assistance Fund
- (16) The Chief Minister's Relief Fund or Lieutenant Governor's Relief Fund in respect of any State or Union Territory
- (17) The National Sports Fund set up by the Central Government

(18) The National Cultural Fund set up by the Central Government

(19) The Fund for Technology Development and Application set up by the Central Government

(20) National Trust for welfare of persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities

(21) The Swachh Bharat Kosh, set up by the Central Government, other than the sum spent by the assessee in pursuance of CSR u/s 135(5) of the Companies Act, 2013

(22) The Clean Ganga Fund, set up by the Central Government, where such assessee is a resident, other than the sum spent in pursuance of CSR u/s 135(5) of the Companies Act, 2013

(23) The National Fund for Control of Drug Abuse

(24) Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM Cares Fund)

Notes

## **II. Donation qualifying for 50% deduction, without any qualifying limit**

(1) The Jawaharlal Nehru Memorial Fund

(2) Prime Minister's Drought Relief Fund

(3) Indira Gandhi Memorial Trust

(4) Rajiv Gandhi Foundation

## **III. Donation qualifying for 100% deduction, subject to qualifying limit**

(1) The Government or to any approved local authority, institution or association for promotion of family planning

(2) Sum paid by a company as donation to the Indian Olympic Association or any other association/institution established in India, as may be notified by the Government for the development of infrastructure for sports or games, or the sponsorship of sports and games in India

## **IV. Donation qualifying for 50% deduction, subject to qualifying limit**

(1) Any Institution or Fund established in India for charitable purposes fulfilling prescribed conditions

(2) The Government or any local authority for utilisation for any charitable purpose other than the purpose of promoting family planning

(3) An authority constituted in India by or under any other law enacted either for dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or both



## Notes

(4) Any Corporation established by the Central Government or any State Government for promoting the interests of the members of a minority community

(5) for renovation or repair of Notified temple, mosque, gurdwara, church or other place of historic, archaeological or artistic importance or which is a place of public worship of renown throughout any State or States

(3) Qualifying limit: The eligible donations referred to in III and IV should be aggregated and the sum total should be limited to 10% of the adjusted gross total income. This would be the maximum permissible deduction. The donations qualifying for 100% deduction would be first adjusted from the maximum permissible deduction and thereafter 50% deduction of the balance would be allowed.

### Steps for Computation of Qualifying Limit

Step 1: Compute adjusted total income i.e., the GTI as reduced by the following:

- (i) Deductions under Chapter VI-A, except under section 80G
- (ii) Short-term capital gain taxable under section 111A
- (iii) Long-term capital gains taxable under sections 112 & 112A
- (iv) Any income on which income-tax is not payable

Step 2: Calculate 10% of adjusted total income

Step 3: Calculate the actual donation, which is subject to qualifying limit (Total of Category III and IV donations, shown in the table above)

Step 4: Lower of Step 2 or Step 3 is the maximum permissible deduction.

Step 5: The said deduction is adjusted first against donations qualifying for 100% deduction (i.e., Category III donations). Thereafter, 50% of balance qualifies for deduction under section 80G.

### (4) Other points:

(i) Where an assessee has claimed and has been allowed any deduction under this section in respect of any amount of donation, the same amount will not qualify for deduction under any other provision of the Act for the same or any other assessment year.

(ii) Donations in kind shall not qualify for deduction.

(iii) No deduction shall be allowed in respect of donation of any sum exceeding ₹ 2000 unless such sum is paid by any mode other than cash.

(iv) The deduction under section 80G can be claimed whether it has any nexus with the business of the assessee or not.

(v) As per Circular No.2/2005 dated 12.1.2005, in cases where employees make donations to the Prime Minister's National Relief Fund, the Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund through their respective employers, it is not possible for such funds to issue separate certificate to every such employee in respect of donations made to such funds as contributions made to these funds are in the form of a consolidated cheque. An employee who makes donations towards these funds is eligible to claim deduction under section 80G. It is, hereby, clarified that the claim in respect of such donations as indicated above will be admissible under section 80G on the basis of the certificate issued by the Drawing and Disbursing Officer (DDO)/ Employer in this behalf.

## Notes

**Illustration 10**

Mr. Ganesh aged 58 years, has gross total income of ₹ 7,75,000 comprising of income from salary and house property. He has made the following payments and investments:

(i) Premium paid to insure the life of her major daughter (policy taken on 1.4.2017) (Assured value ₹ 1,80,000) – ₹ 20,000.

(ii) Medical Insurance premium for self – ₹ 12,000;

Spouse – ₹ 14,000.

(iii) Donation to a public charitable institution registered under 80G – ₹ 50,000 by way of cheque.

(iv) LIC Pension Fund – ₹ 60,000.

(v) Donation to National Children's Fund - ₹ 25,000 by way of cheque

(vi) Donation to Jawaharlal Nehru Memorial Fund - ₹ 25,000 by way of cheque

(vii) Donation to approved institution for promotion of family planning - ₹ 40,000 by way of cheque

(viii) Deposit in PPF – ₹ 1,00,000

Compute the total income of Mr. Ganesh for A.Y. 2021-22.

**Solution:****Computation of Total Income of Mr. Ganesh for A.Y. 2021- 22**

Particulars	₹	₹
Gross Total Income	7,75,000	
Less: Deduction under section 80C		
Deposit in PPF	1,00,000	

## Notes

Life insurance premium paid for insurance of major daughter (Maximum 10% of the assured value ₹1,80,000, as the policy is taken after 31.3.2012)	18,000	
		1,18,000
Deduction under section 80CCC in respect of LIC pension fund	60,000	
As per section 80CCE, deduction under section 80C & 80CCC is restricted to	1,78,000	1,50,000
Deduction under section 80D		
Medical Insurance premium in respect of self and spouse	26,000	
Restricted to	25,000	
Deduction under section 80G (See Working Note below)	87,500	
Total income	5,12,500	

Working Note: Computation of deduction under section 80G

	Particulars of donation	Amount donated (₹)	% of deduction	Deduction u/s 80G (₹)
(i)	National Children's Fund	25,000	100%	25,000
(ii)	Jawaharlal Nehru Memorial Fund	25,000	50%	12,500
(iii)	Approved institution for promotion of family planning	40,000	100%, subject to qualifying limit	40,000
(iv)	Public Charitable Trust	50,000	50% subject to qualifying limit (See Note below)	10,000
				87,500

**Note** - Adjusted total income = Gross Total Income – Amount of deductions under section 80C to 80U except section 80G i.e., ₹ 6,00,000, in this case.

₹ 60,000, being 10% of adjusted total income is the qualifying limit, in this case.

Firstly, donation of ₹ 40,000 to approved institution for family planning qualifying for 100% deduction subject to qualifying limit, has to be adjusted against this amount. Thereafter, donation to public charitable trust qualifying for 50% deduction, subject to qualifying limit is adjusted. Hence, the contribution of ₹ 50,000 to public charitable



trust is restricted to 20,000 (being, ₹ 60,000 - ₹ 40,000), 50% of which would be the deduction under section 80G. Therefore, the deduction under section 80G in respect of donation to public charitable trust would be ₹ 10,000, which is 50% of ₹ 20,000.

## Tax Rates for the A.Y. 2021-22

Individual/HUF/Association of Persons/Body of Individuals/Artificial Juridical Person

### In case of Super Senior citizen

Total Income Range	Rates of Income Tax
Up to ₹ 5,00,000	Nil
₹ 5,00,001 to ₹ 10,00,000	20% of (Total income - ₹ 5,00,000)
₹ 10,00,001 and above	₹ 1,00,000 + 30% of (Total income - ₹ 10,00,000)

Super Senior Citizen means an individual who is resident in India and is of at least 80 years of age at any time during the relevant previous year (i.e. any resident person, male or female, born before 02-04-1941).

### In case of Senior citizen

Total Income Range	Rates of Income Tax
Up to ₹ 3,00,000	Nil
₹ 3,00,001 to ₹ 5,00,000	5% of (Total Income - ₹ 3,00,000)
₹ 5,00,001 to ₹ 10,00,000	₹ 10,000 + 20% of (Total income - ₹ 5,00,000)
₹ 10,00,001 and above	₹ 1,10,000 + 30% of (Total income - ₹ 10,00,000)

Senior Citizen means an individual who is resident in India and is of at least 60 years of age at any time during the relevant previous year. (i.e., a resident person, male or female, born on or after 02-04-1941 but before 02-04-1961).

### In case of other Individual / HUF / Association of Persons / Body of Individuals / Artificial Juridical Person

Total Income Range	Rates of Income Tax
Up to ₹ 2,50,000	Nil
₹ 2,50,001 to ₹ 5,00,000	5% of (Total Income - ₹ 2,50,000)
₹ 5,00,001 to ₹ 10,00,000	₹ 12,500 + 20% of (Total income - ₹ 5,00,000)
₹ 10,00,001 and above	₹ 1,12,500 + 30% of (Total income - ₹ 10,00,000)

1. born on or after 02-04-1961 or non-resident individual

## Rebates (Section 87A)

In order to provide tax relief to the individual tax payers who are in the 5% tax slab, section 87A provides a rebate from the tax payable by an assessee, being an individual

resident in India, whose total income does not exceed ₹ 500000. The rebate shall be equal to the amount of income-tax payable on the total income for any assessment year or an amount of ₹ 12500 whichever is less. However, rebate under section 87A is not available in respect of tax payable @10% on long-term capital gains taxable under section 112A.

**Applicable to:** Resident Individual

**Conditions to be satisfied:** Total income of the assessee does not exceed ₹ 5,00,000.

**Quantum of Rebate:** Lower of the following:

- (a) 100% of tax liability as computed above; or
- (b) ₹ 12,500/-

### Illustration 11

Compute rebate u/s 87A in the following cases:

Particulars	Case 1	Case 2	Case 3	Case 4	Case 5	Case 6
Assessee	Individual	Individual	Senior Citizen	Senior Citizen	Individual	HUF
Residential status	Resident	Resident	Non-Resident	Resident		
Total Income	₹ 4,90,000	₹ 5,12,000	₹ 4,25,000	₹ 5,40,000	₹ 2,60,000	₹ 2,65,000
Tax on above	₹ 12,000	₹ 14,900	₹ 6,250	₹ 18,000	₹ 500	₹ 750
Rebate u/s 87A	₹ 12,000	Nil	₹ 6,250	Nil	Nil	Nil
Reason		Total income	income exceeds ₹ 5 lacs	Total income exceeds ₹ 5 lacs	Assessee is nonresident Assessee is not an individual	
Tax after rebate	Nil	₹ 14,900	Nil	₹ 18,000	₹ 500	₹ 750

### Surcharge:

Surcharge is an additional tax payable over and above the income-tax. Surcharge is levied as a percentage of income-tax. Surcharge at the following rate is also payable on tax as computed above after rebate u/s 87A.

Total Income	Rate of Surcharge
Total income does not exceed ₹ 50 lacs	Nil
Total income exceeds ₹ 50 lacs but does not exceed ₹ 1 crore	10% of tax
Total income exceeds ₹ 1 crore but does not exceed ₹ 2 crores	15% of tax
Total income exceeds ₹ 2 crores but does not exceed ₹ 5 crores	25% of tax*
Total income exceeds ₹ 5 crores	37% of tax*

## Notes

\* Where the total income includes dividend, any income chargeable u/s 111A and 112A, the surcharge on the amount of income-tax computed on that part of income shall not exceed 15%. In other words, surcharge higher than 15% is applicable only on tax on income other than dividend, income covered u/s 111A and 112A.

## Health &amp; Education Cess

**Applicable on:** All assessee

**Rate of cess:** 4% of Tax liability after Surcharge Marginal Relief

To provide relaxation from levy of surcharge to a taxpayer where the total income exceeds marginally above ₹ 50 lakh or ₹ 1 crore or 2 crores or 5 crores, the concept of marginal relief is designed.

**Condition:** Total income exceeds ₹ 50,00,000 (or ₹ 1 crore or 2 crores or 5 crores)

**Relief:** Marginal relief is provided to ensure that the additional income tax payable including surcharge on excess of income over ₹ 50,00,000 or ₹ 1,00,00,000 or ₹ 2,00,00,000 or ₹ 5,00,00,000 is limited to the amount by which the income is more than ₹ 50,00,000 or ₹ 1,00,00,000 or ₹ 2,00,00,000 or ₹ 5,00,00,000.

Marginal relief = Calculated Surcharge - 70% (Income - ₹ 50,00,000) (if positive)

Or

Marginal relief = [(Income tax + surcharge) on income] - [(Income tax on ₹ 50,00,000) + (Income - ₹ 50,00,000)]

Similar relief shall also be provided where income exceeds marginally above ₹ 1 crore or ₹ 2 crores or ₹ 5 crores. In that case, the aforesaid equation shall be changed accordingly.

## Illustration 12

Compute tax liability of the assessee (52 years) whose total income is: (Case 1) ₹ 49,90,000 (Case 2) ₹ 50,10,000; (Case 3) ₹ 60,00,000



## Notes

Particulars	Working	Case 1	Case 2	Case 3
Tax liability before Rebate	₹ 2,50,000 * Nil	Nil	Nil	Nil
	₹ 2,50,000 * 5%	12,500	12,500	12,500
	₹ 5,00,000 * 20%	1,00,000	1,00,000	1,00,000
	Balance Income * 30%	11,97,000	12,03,000	15,00,000
Total		13,09,500	13,15,500	16,12,500
Less: Rebate u/s 87A	As income exceeds ₹ 5,00,000	Nil	Nil	Nil
Liability [A]		13,09,500	13,15,500	16,12,500
Add: Surcharge	B = [10% of (A)]	Nil	1,31,550	1,61,250
Tax and surcharge payable	13,09,500	14,47,050	17,73,750	

## Analysis of case (1) and case (2)

Increase in income	₹ 20,000
Liability for surcharge increased	₹ 1,31,550

Now, computation of tax liability is made after considering marginal relief:

Particulars	Working	Case 1	Case 2	Case 3
Liability [A]	13,09,500	13,15,500	16,12,500	
Add: Surcharge	B = [10% of (A)]	Nil	1,31,550	1,61,250
Tax and surcharge	13,09,500	14,47,050	17,73,750	
Less: Marginal relief	[(B) – {70%(50,10,000 – 50,00,000)}]	Nil	1,24,550	Nil
Effective Surcharge [C]	Nil	7,000	1,61,250	
Liability after surcharge	[A + C]	13,09,500	13,22,500	17,73,750
Add: Health & Education cess	4% of above	52,380	52,900	70,950
Total	Rounded off u/s 288B	13,61,880	13,75,400	18,44,700

**Tax point:** The concept of marginal relief is not applicable in case of Cess.

An Individual / HUF can opt for alternative tax regime u/s 115BAC.

## Firm or Limited Liability Partnership (LLP)

A partnership firm (including limited liability partnership) is taxable at the rate of 30%

Surcharge: 12% of income-tax (if total income exceeds ₹ 1 crore otherwise Nil)

**Marginal Relief:** Available

*Clubbing of Income*

**Health & Education Cess:** 4% of tax liability after surcharge

### Company

Company	Rate
In the case of a domestic company	
- Where its total turnover or gross receipts during the previous year 2018-19 does not exceed ₹ 400 crore	25%
- In any other case	30%
In the case of a foreign company	40%

Notes

### Surcharge

Total Income	Domestic Company	Foreign Company
If total income exceeds ₹ 10 crore	12%	5%
If income exceeds ₹ 1 crore but does not exceed ₹ 10 crore	7%	2%
If income does not exceed ₹ 1 crore	Nil	Nil

**Marginal Relief:** Available at both points (i.e., income exceeds ₹ 1,00,00,000 or ₹ 10,00,00,000)

**Health & Education Cess:** 4% of tax liability after surcharge

### Computation of Total Income of Individuals

Income-tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961. The procedure for computation of total income for the purpose of levy of income-tax is detailed hereunder –

#### Step 1 – Determination of the residential status of the Assessee:

The residential status of a person has to be determined to ascertain which income is to be included in computing the total income.

- In case of an individual, the number of days of his stay in India during the relevant previous year and/or the earlier previous years would determine his residential status.
- An individual/HUF can be either a –
- Resident and ordinarily resident
- Resident but not ordinarily resident
- Non-resident

**Step 2 – Classification of income under different heads**

There are five heads of income, namely, -

- Salaries,
- Income from house property,
- Profits and gains of business or profession
- Capital Gains
- Income from other sources

**Step 3 – Exclusion of income not chargeable to tax:**

There are certain incomes which are wholly exempt from income-tax e.g. agricultural income. These incomes have to be excluded while calculating Gross Total Income. The same time certain incomes are partially exempt from income tax e.g. House Rent Allowance, Education Allowance etc.. These incomes are excluded only to the extent of the limits specified in the Act. The balance income over and above the prescribed limits would enter computation of total income and have to be classified under the relevant head of income.

**Step 4 – Computation of income under each head:**

Income is to be computed in accordance with the provisions governing a particular head of income. As per the rules certain deductions and allowances are allowed. These deductions are allowed while computing income under each head.

**Step 5 – Clubbing of income of spouse, minor child etc.:**

In case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive. That means if income increases the tax amount to be paid also increases. We can see that some taxpayers who have the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been included in the Income-tax Act. As per the provisions of income tax act income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person when it is seen that the income is diverted for avoiding tax.

**Step 6 – Set-off or carry forward and set-off of losses:**

An individual may have different sources of income under the same head of income. He might have profit from one source and loss from the other. As per the provision we can set off the losses under one head or from other heads or can carry forwards for the coming assessment year. All provisions related to that should be considered while computing total income of the Assessee.



**Step 7 – Computation of Gross Total Income:**

The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

**Step 8 – Deductions from Gross Total Income:**

There are deductions prescribed from gross total income. The allowable deductions in case of an individual are deductions under sections 80C, 80CCC, 80CCD, 80CCF, 80D, 80DD, 80ddb, 80E, 80G, 80GG, 80GGA, 80GGC, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE, 80JJA, 80QQB, 80RRB, 80TTA and 80U. These deductions are allowed as per the rules prescribed in the income tax act.

**Step 9 – Compute Total income:**

After allowing all deductions allowable, we can compute total income.

**Step 10 – Application of the rates of tax on the total income:**

For individuals, there is a slab rate and basic exemption limit. At present, the basic exemption limit is ₹ 2,50,000. This means that no tax is payable by individuals with total income of up to ₹ 2,50,000. The rates of tax and level of total income are as under –

**Level of total income Rate of tax****(A) Normal Rates:**

	Level of total income	Rate of tax
(i)	where the total income does not exceed ₹ 2,50,000	NIL
(ii)	where the total income exceeds ₹ 2,50,000 but does not exceed ₹ 5,00,000	5% of the amount by which the total income exceeds ₹ 2,50,000
(iii)	where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000;	₹ 12,500 plus 20% of the amount by which the total income exceeds ₹ 5,00,000
(iv)	where the total income exceeds ₹ 10,00,000	₹ 1,12,500 plus 30% of the amount by which the total income exceeds ₹ 10,00,000

## Notes

**(B) Individual- Senior citizen (60 years or more but less than 80 years):**

	Level of total income	Rate of tax
(i)	where the total income does not exceed ₹ 3,00,000	NIL
(ii)	where the total income exceeds ₹ 3,00,000 but does not exceed ₹ 5,00,000	5% of the amount by which the total income exceeds ₹ 3,00,000
(iii)	where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000;	₹ 10,000 plus 20% of the amount by which the total income exceeds ₹ 5,00,000
(iv)	where the total income exceeds ₹ 10,00,000	₹ 1,10,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000

**(C) Individual- Super senior citizen (80 years or more):**

	Level of total income	Rate of tax
(i)	where the total income does not exceed ₹ 5,00,000	NIL
(ii)	where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000;	20% of the amount by which the total income exceeds ₹ 5,00,000
(iv)	Where the total income exceeds ₹ 10,00,000	₹ 1,00,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000

**Step 10 – Rebate under section 87A (where total income  $\leq$  ₹ 5,00,000)/  
Surcharge (where total income  $>$  ₹ 50,00,000)**

**Step 11– Health and Education cess (HEC) on Income-tax**

The income-tax is to be increased by health and education cess@4% on income-tax plus surcharge/ minus rebate under section 87A, wherever applicable. This cess is payable by all assesseees who are liable to pay income-tax irrespective of their level of total income.

**Step 12 – Advance tax and tax deducted at source**

Although the tax liability of an assessee is determined only at the end of the year, tax is required to be paid in advance in four installments on the basis of estimated income i.e., on or before 15th June, 15th September, 15th December and 15th March.

However, residents opting for presumptive taxation scheme can pay advance tax in one installment on or before 15th March instead of four installments. In certain cases, tax

is required to be deducted at source from the income by the payer at the rates prescribed in the Income-tax Act, 1961 or the Annual Finance Act. Such deduction should be made either at the time of accrual or at the time of payment, as prescribed by the Act.

### Step 13: Tax Payable/Tax Refundable

After adjusting the advance tax and tax deducted at source, the assessee would arrive at the amount of net tax payable or refundable. Such amount should be rounded off to the nearest multiple of ₹ 10 as per section 288B.

The assessee has to pay the amount of tax payable (called self assessment tax) on or before the due date of filing of the return.

Similarly, if any refund is due, assessee will get the same after filing the return of income.

### Illustration 13

From the following particulars furnished by Mr. Aravind for the year ended 31.3.2021, you are requested to compute his total income and tax payable for the assessment year 2021-22.

1. Mr. Aravind retired on 31.12.2020 at the age of 58, after putting in 25 years and 9 months of service, from a private company at Mumbai.
2. He was paid a salary of ₹ 25,000 p.m. and house rent allowance of ₹ 6,000 p.m. He paid rent of ₹ 6,500 p.m. during his tenure of service.
3. On retirement, he was paid a gratuity of ₹ 3,50,000. He was covered by the payment of Gratuity Act. Mr. Aravind had not received any other gratuity at any point of time earlier, other than this gratuity.
4. He had accumulated leave of 15 days per annum during the period of his service; this was encashed by Mr. Aravind at the time of his retirement. A sum of ₹ 3,15,000 was received by him in this regard. His average salary may be taken as ₹ 24,500. Employer allowed 30 days leave per annum.
5. After retirement, he ventured into textile business and incurred a loss of ₹ 80,000 for the period upto 31.3.2021.
6. Mr. Aravind has deposited ₹ 1,00,000 in public provident fund.

### Solution:

#### Computation of total income of Mr. Aravind for A.Y. 2021-22

Particulars	₹	₹
Income from Salaries		
Basic salary (₹ 25,000 × 9 months)		2,25,000

### Notes



## Notes

House rent allowance:		
Actual amount received ( $\text{₹ } 6,000 \times 9 \text{ months}$ )		54,000
Less : Exemption under section 10(13A)(Note 1)	36,000	18,000
Gratuity:		
Actual amount received	3,50,000	
Less: Exemption under section 10(10)(ii) (Note 2)	3,50,000	-
Leave encashment:		
Actual amount received	3,15,000	
Less : Exemption under section 10(10AA) (Note 3)	2,45,000	70,000
Gross Salary		3,13,000
Less: Standard deduction under section 16(ia)		50,000
Profits and gains of business or profession		2,63,000
Business loss of ₹ 80,000 to be carried forward as the same cannot be set off against salary income		Nil
Gross Total income		2,63,000
Less : Deduction under section 80C		
Deposit in Public Provident Fund		1,00,000
Total income		1,63,000
Tax on total income		Nil

**Notes:**

**(1) As per section 10(13A), house rent allowance will be exempt to the extent of least of the following three amounts:**

	₹
(i) HRA Actually Received ( $\text{₹ } 6000 \times 9$ )	54000
(ii) Rent paid in excess of 10% of Salary ( $\text{₹ } 6500 - \text{₹ } 2500 \times 9 \text{ Months}$ )	36000
(iii) 50% Salary	112500

**(2) Gratuity of ₹ 3,50,000 is exempt under section 10(10)(ii), being the minimum of the following amounts:**

	₹
(i) Actual amount received	3,50,000
(ii) Half month salary for each year of completed service [ $(\text{₹ } 25,000 \times 15/26) \times 26 \text{ years}$ ]	3,75,000
(iii) Statutory limit	20,00,000

**(3) Leave encashment is exempt upto the least of the following:**

	₹
(i) Actual amount received	3,15,000
(ii) 10 months average salary ( $\text{₹ } 24,500 \times 10$ )	2,45,000

(iii) Cash equivalent of unavailed leave calculated on the basis of maximum 30 days for every year of actual service rendered to the employer from whose service he retired (See Note 4 below)	3,06,250
(iv) Statutory limit	3,00,000

(4) Since the leave entitlement of Mr. Aravind as per his employer's rules is 30 days credit for each year of service and he had accumulated 15 days per annum during the period of his service, he would have availed/taken the balance 15 days leave every year.

Leave entitlement of Mr. Aravind on the basis of 30 days for every year of actual service rendered by him to the employer	= 30 days/year x 25 = 750 days
Less: Leave taken /availed by Mr. Aravind during the period of his service	= 15 days/year x 25 = 375 days
Earned leave to the credit of Mr. Aravind at the time of his retirement	375 days
Cash equivalent of earned leave to the credit of Mr. Aravind at the time of his retirement	= $375 \times ₹ 24,500 / 30 = ₹ 3,06,250$

#### Illustration 14

Mr. Philip has following salary structure –

Particulars	₹
Basic salary	8,000 p.m.
Dearness allowance	1,000 p.m.
Entertainment allowance	500 p.m.
Children education allowance (for 3 children)	1,000 p.m.
Contribution to RPF by his employer	10,000 p.a.
Own contribution to RPF	10,000 p.a.

His employer also provides rent-free furnished accommodation at Kolkata for which his employer paid ₹ 12,000 p.m. (₹ 2,000 for furniture and ₹ 10,000 for accommodation). However, he is charged ₹ 1,000 p.m. for accommodation and ₹ 1,000 p.m. for furniture. He also supplied following details for computing total income –

1. Fixed Deposit interest ₹ 42,000
2. Rent received ₹ 1,50,000 from a house at Mumbai
3. Income from royalty on a book (artistic nature) @ 20% ₹ 3,20,000
4. He contributed ₹ 5,000 to approved scientific research association

## Notes

5. He contributed ₹ 10,000 to a political party
6. Interest on Government securities ₹ 14,000
7. Investment in PPF ₹ 25,000
8. His date of birth is 07-09-1979.

**Solution:****Computation of total income of Mr. Phillip for A.Y. 2021-22**

Particulars	Amount	Amount	Amount	Amount
Income from Salaries				
Basic			96,000	
Allowances				
Dearness Allowance		12,000		
Entertainment Allowance		6,000		
Children Education Allowance	12,000			
Less: Exempted ( $₹ 100 * 12 * 2$ )	2,400	9,600	27,600	
Perquisites				
Rent free furnished accommodation				
- For accommodation, lower of 15% of salary (W Note 1) or rent paid	18,540			
- For furniture	24,000			
	42,540			
Less: Rent paid for accommodation and furniture	24,000	18,540	18,540	
Employer's contribution to RPF		10,000		
Less: Exempted [12% of salary (W.Note 1)]		12,960	Nil	
			1,42,140	
Less: Standard Deduction u/s 16(ia)			50,000	92,140
Income from House Property				
Gross Annual Value (being rent received)			1,50,000	
Less: Municipal tax paid			Nil	
Net Annual Value (NAV)			1,50,000	
Less: Deduction u/s				
24(a) Standard Deduction @ 30% of NAV		45,000		
24(b) Interest on loan		Nil	45,000	1,05,000



## Notes

Income from Other Sources				
Fixed Deposit interest			52,000	
Royalty income			3,20,000	
Interest on Government securities			14,000	3,86,000
Gross Total Income				5,83,140
Less: Deduction u/s				
80C: Own contribution to RPF		10,000		
Contribution to PPF		25,000	35,000	
80GG (House rent paid) being minimum of				
(a) ₹ 5,000 p.m. × 12		60,000		
(b) 25% of Adjusted GTI (W.Note 2)		73,285		
(c) Rent paid over 10% of Adjusted GTI (W.Note 2) (12,000 – 29,314)		Nil	Nil	
80GGA: Donation to scientific research association			5,000	
80GGC: Contribution to political party			10,000	
80QQB: Royalty income being minimum of				
(a) 100% of income		32,000		
(b) 15% of sale value of the book [(3,20,000/20) × 15]		2,40,000		
(c) Statutory amount		3,00,000	2,40,000	(2,90,000)
Total Income				2,93,140

## Working Note

## (1) Salary for the purpose of –

Particulars	Accommodation	RPF
Basic salary	96,000	96,000
Dearness allowance	12,000	12,000
Entertainment allowance	6,000	–
Children Education allowance	9,600	–
Total	1,23,600	1,08,000

(2) **Adjusted GTI** = Gross taxable income – Long term capital gain – STCG being covered by sec. 111A – All deduction under 80's other than sec. 80GG – Income u/s 115A, etc.

$$= ₹ 5,83,140 - ₹ (35,000 + 5,000 + 10,000 + 2,40,000) = ₹ 2,93,140$$

## 5.4 Assessment of Firms

What is a partnership?

- A partnership is an association of two or more persons.
- There must be agreement entered into by all persons.
- The agreement is to carry on some business
- The business is to be carried on by all or by any one of them acting on behalf of all and for benefit of all.
- The agreement is to share profits and losses of business.

### Who can be a Partner?

Individuals who are major and sound mind can be a partner of a firm and the minor can be admitted as a partner to the benefit of the partnership but there must be at least two adults. A firm and HUF cannot be a partner of a firm. Under the company act 2013 two or more company can be partner likewise a trust and be

From the Assessment Year 1993-94 partnership firm has been classified for the purpose of computation of income and its assessment as under:

1. **Partnership Firm assessed as such (PFAS)** - a firm which fulfils the conditions of section 184.
2. **Partnership Firm assessed as an Association of Person (PFAOP)** - a firm which fails to fulfill the section 184 (u/s 185).

#### Assessment of firm as such (PFAS)- Sec .184

Where a firm wants to avail the status of PFAS, it has to satisfy the following conditions: -

1. The firm shall be evidenced by an instrument and the individual shares of the partner shall be specified therein. [Sec. 184(1)]
2. A certified copy of the instrument of partnership shall accompany the return of income of the Previous Year relevant to the Assessment [Sec.184(2)]
3. Wherever during a Previous Year, a change takes place in the constitution of the firm or in the sharing ratio of partners, a certified copy of the revised instrument

of partnership must be submitted along with the return of income of the concerned year of assessment. [Sec. 184(4)]

4. There should not be any failure on the part of the firm as is specified in Sec. 144 [Sec.184(5)]

It may be mentioned that once a firm is assessed as PFAS after fulfillment of the above conditions, it will be assessed as PFAS, for every subsequent year provided there is no change in either firm's constitution or partner's profit-sharing ratio. However, there should not be any failure mentioned in Sec. 144. [Sec. 184(3)]

A partnership deed shall be certified in writing by all the major partners. Where, however, the firm is dissolved and the return is filed after its dissolution, then the copy of deed may be certified by all the major partners in the firm immediately before its dissolution. Where a partner is dead, then it will have to be certified by his legal representative.

If a firm does not comply with the provisions of section 184 for any assessment year, the firm assessed as Association of person (PFAOP) and no deduction by way of payment of interest, salary, bonus, commission, or remuneration by whatever name called, made by the firm.

### Computation of Total Income

Total income of the firm can be computed by calculating income from different heads and they are

1. Income from house property
2. Income from profit and gain from business or profession
3. Capital gain
4. Income from other source

(Salary income head is not included)

While computing total income of the firm the following points are to be noted

- If a partner of the firm started a competitive business without the permission of other partners, any income derived from that business shall be included in the income of the firm
- If there is any income of the firm even after its dissolution such income shall be assessed in the hands of the firm
- If the partners individually gift property of the firm to their wives, then the income from such gifted property is assessable in the hands of the firm's name

### Notes



- If there is any overriding title on the assets and income of the firms, the amount payable on account of such title will be deducted from the income of the firm.

## Notes

**Deductions while Computing of Income**

The following provisions should be given due consideration while computing income of a firm-

1. Provision relating to deductibility of remuneration paid to partners by firm.
2. Provision relating to deductibility of interest paid to partners by firm.

**A. Rules regarding remuneration of partners are as follows-**

- Any payment of salary, remuneration or commission paid to a partner who is not a working partner (sleeping partner) is disallowed,
- Any remuneration paid to a working partner not in accordance with the partnership deed is not allowed,

**Limits of Remuneration to working partners.**

The limits of remuneration payable to working partners under the act are as follows-

1. On First ₹ 3,00,000 of book profit or in case of loss- ₹1,50,000 or 90% of book profit whichever is more,
2. On balance of the book profit- up to 60% of the book profit.

**Maximum Amount as Permitted by Section 40(b)**

Book Profit	Amount deductible u/s 40(b)
If book profit is negative	1,50,000
• In case of profit - on first 3 lakhs of book profit	₹ 1,50,000 or 90% of book profit whichever is more
On balance of book profit	60% of book profit

**Notes:**

**Book profit:** It means the net profit as shown in the profit & loss account for the previous year computed in accordance with the income tax rules after adding back the full amount of remuneration given to partners. Income chargeable under capital gain, income from house property, and income from other sources should not be part of book profit.

- In case of loss or book profit is less than ₹1,50,000- the maximum amount of remuneration payable will be ₹ 1,50,000.

- **Working Partner;** Section 40(b) explanation defines as; An individual, who is a partner of the firm; Such an individual is actively engaged in conducting the affairs of the business/profession of the firm.

## B. Rules regarding Interest paid to partners:

The interest to partners will be deductible after complying provisions of Section 184 and 40(b) of the Income Tax Act 1961. Section 40(b); following conditions should be satisfied.

1. Payment of interest should be authorized by Partnership Deed.
2. Payment of interest should pertain to the period after Partnership Deed.
3. Rate of interest should not exceed @12pa.

**Note:** if rate of interest exceeds @12pa, then excess amount paid @12% will not be allowed to be deductible. The above provision is not applicable if interest is paid to a person, acting otherwise than in a representative capacity.

### Illustration 15

X, Y and Z are the partners of a firm with equal shares. The profit and loss account for the year ended 31.3.2021 shows a net profit of ₹ 2,80,000 after debiting ₹ 7,000 for interest paid to X at 20%, ₹ 60,000 for salary paid to Y and ₹ 44,000 for rent of the business premises paid to Z. Compute the book profit of the firm if the firm fulfills the condition of section 184.

### Solution:

#### Computation of the book profit of the firm

Net profit as per P&L account	2,80,000
Add: Remuneration to the partners debited to P&L account	
(i) Salary paid to Y	60,000
Add: interest paid to partners in excess of 12%	
(₹ 7,000 – ₹ 4,200)	2,800
Book profit =	3,42,800
Maximum amount permissible remuneration as per sec: 40b.	
Book Profit =	₹ 3,42,800
For the first ₹ 3,00,000:	
₹ 1,50,000 or ₹ 2,70,000 (90% of 3,00,000)	2,70,000
On the balance 42,800 @ 60%	25,680
Maximum amount deductible as per section 40b	₹ 2,95,680

**Taxable income of Firm shall be computed as follows:**

**Step 1:** Income under the different heads of income - First find out income under the four heads of income.

**Step 2:** Adjustment of losses of the current year and earlier years - Losses should be set off according to the provisions of sections 70 to 78. The income after adjustment of losses is the gross total income.

**Step 3:** Deduction from gross total income – a firm can claim the following deductions

- **80G:** Contribution to certain relief and charitable institution.
- **80GGA:** Donation to scientific research and rural development
- **80GGC:** Contribution to political party
- **80IA:** Profit from enterprise engaged in infrastructure development
- **80IAB:** Profit from enterprise engaged in infrastructure development
- **80IAC:** Profit and gain other than infrastructure development undertaking
- **80IB:** Profit and gain other than infrastructure development undertaking
- **80IBA:** Profit and gain from Housing projects
- **80IC:** Profit and gain from enterprise in special category status
- **80IE:** Profit and gain from enterprise in special category status
- **80JJA:** Profit and gain from enterprise of collecting and processing of bio-degradable waste
- **80JAA:** Deduction in respect of employment of new employees.

However, the deduction under the aforesaid section will not be allowed against short-term capital gain (Sec: 111A) and long term capital gain (u/s -112)

**Step 4 -Rounding off** - The balance should be rounded off to the nearest 10. It is called as net income or taxable income or total income.

**Carry forward & set-off of loss in case of change in the constitution of firm:**

Section 78 contains provisions relating to carry forward and set off of loss in case of change in constitution of a partnership firm due to death or retirement of a partner (i.e. when a partner goes out of firm by retirement or death). In such a case, the share of loss attributable to the outgoing partner cannot be carried forward by the firm. Restriction of section 78 is applicable only in case of loss and is not applicable in case of adjustment of unabsorbed depreciation, unabsorbed capital expenditure on scientific research or family planning expenditure.



Book profit of the firm -----

Less: Remuneration paid to working partner

Least of the following

1. Actual remuneration -----
2. Statutory limit u/s- 40b -----

**Profit and gain of Business or profession of the firm -----**

Add: income from all other source -----

Gross total income (GTI) -----

Less: Deduction u/s 80C to 80U -----

**Total Income -----**

### **Calculation of Tax Liability:**

Step 1: Determine Net Income and tax payable

1. Short term capital gains u/s 111A – 15%.
2. Long term capital Gains – 10% / 20% (sec112).
3. Long term capital Gains u/s 112A (exceeding 1 lakh)– 10%
4. Casual incomes - 30%.
5. Other incomes (remaining all incomes)– 30%.

Step 2: Add: Surcharge -12% if total income exceeds one crore.

Step 3: Add: Health & Education cess- 4% on tax and surcharge.

Step 4: Deduct rebate if applicable

Step 5: Add interest payable (if any)

Step 6: Deduct amount of prepaid taxes paid (Advance Tax, Tax Deducted at Source, etc.)

The Balance so arrived is the amount of tax to be paid.

### **Computation of income of a partner from the firm (PFAS).**

#### **A. Treatment of share of income from firm assessed u/s 184-**

2. It's fully exempted from tax u/s 10(2A) and as such is not added in individual income of partners.

Notes

## Notes

## 1. Interest.

1. If interest was disallowed in firm, it should not be added back to individual income since it is already taxed.
2. If interest was fully allowed by the firm, it should be added to individual income fully, since it is not yet taxed.
3. If interest was allowed by the firm @ 12%, disallowing excess, the 12% amount should be added to individual income.

## 2. Remuneration.

1. If it was fully allowed, it shall be fully added.
2. If it was allowed up to certain limit, then,

$$\text{Restricted remuneration} \times \frac{\text{Actual remuneration of a partner}}{\text{Total remuneration of all partner}}$$

## Illustration 16

M&N Partnership firm have a net profit for the previous year 2019-2020 is ₹ 1,04,000 after providing the interest and salary to partner. The firm has two working partners sharing profit and losses equally as per partnership deed. Both partners draw a remuneration of ₹ 2,16,000 each. In respect of their total capital contribution of ₹ 10,00,000 the partners get an interest @ 15% p.a amounting to ₹ 1,50,000 in total. Compute the total income of the firm and taxable income of the firm.

## Solution:

Computation of book profit of the firm

Net profit	1,04,000
Add:	
(i) interest to partners in excess of the 12% p.a. on capital (1,50,000)	30,000
(ii) remuneration to partners	4,32,000
Book profit	5,66,000
<b>Taxable income of the firm</b>	
Net profit as per P&L account	1,04,000
Add disallowed amount as section 40(b)	
Remuneration paid to partners	4,32,000

## Notes

Less allowable amount	
i. 90% of the first	₹ 3,00,000
of the book profit	2,70,000
ii. 60% of the balance of the book profit (2,66,000 60%) 1,59,600	4,29,600
Remuneration disallowed (4,32,000 – 4,29,600)	2,400
Interest paid to partners	1,50,000
Less: allowable up to 12% p.a. on capital	
(10,00,000 12%) 1,20,000	30,000
Taxable income	136400

**Illustration 17**

X, Y and Z are the working partners of a partnership firm. Sharing profit and losses in the ratio of 3:2:1. The profit and loss account of the firm for the year 31st March 2020

To purchases	9,50,000	By sales	17,00,000
To salary and wages	2,00,000	By closing stock	2,40,000
To depreciation	1,50,000	By interest on drawings to C	10,000
To general expenses	200000	By interest on Govt. securities	5,000
To salary to partners		By LTCG on sale of land	3,00,000
X: 108000			
Y: 96000			
Z: 84000	2,88,000		
To interest on capital			
X: 10500			
Y: 9000			
Z: 6000	25,500		
To commission (X)	50,000		
To net profit	3,91,500		
	2,25,5000		2,25,5000



## Notes

1. Closing stock is undervalued by 20%
2. General expenses include a donation of ₹ 10,000 to an approved board
3. Depreciation allowable as per section 32 is ₹ 1,32,000
4. B/F unabsorbed depreciation of ₹ 1,45,000 relating the previous year 2016-2017
5. Purchases includes one bill of ₹ 30,000 which was paid in cash
6. The firm has fulfilled all condition mentioned in section 184
7. The interest on drawings from the partner is also the part of the deed
8. The payment of interest, salary, commission etc to partners is as per deed

You are required to calculate book profit, remuneration of partners and tax liability of the firm.

**Solution:****Calculation of book profit for the assessment year 2021-2022**

Net profit as per P/L account	3,91,500
Add: Disallowed expenses	
Donation	10,000
Excess depreciation	20,000
Purchases paid in cash	30,000
Salary to partners	2,88,000
Interest on capital in excess of 12%	
X: $10500 \times 3/15 = 2100$	
Y $9000 \times 3/15 = 1800$	
Z $6000 \times 3/15 = 1200$	5,100
Commission to A 50000	4,03,100
Add: Undervalued stock ( $240000 \times 100/80$ ) – 240000	60,000
Less Non business income	8,54,600
Interest on govt. security	5,000
LTCG on land 300000	3,05,000
Unabsorbed depreciation	1,45,000
<b>Book profit</b>	<b>4,04,600</b>

**Calculation of remuneration of the partners as per 40b**

Book profit	4,04,600
On the first 300000 of the book profits 90%	2,70,000

On the balance 104600 of the Book profit – 60%	62,760
Allowable remuneration	3,32,760
from business ₹ ₹	
Book profit	4,04,600
Less remuneration to partners as per 40b	332760
Actual 338000 (whichever is less)	
Business income	71,840
Income from LTCG	300000
Income from other source	5000
Gross total income	376840
Less: Deduction under section 80G	3842
Donation to board with limit 50%	
10% of adjusted GTI (excluding LTCG) 76840 = 7684	
50% of the limit (7684) = 3842	
<b>Total income</b>	<b>3,72,998</b>
Rounded off to 3,73,000.	

Clubbing of Income

Notes

#### Computation of Tax Liability

Tax on normal income 73000 × 30%	21,900
On LTCG 300000 × 20% 81900	60,000
Add Health and Education Cess 4%	3,276
<b>Tax Liability</b>	<b>₹ 85,176</b>

#### Illustration 18

A, B and C are partners in a firm, sharing profits and losses in the proportions of 2/5th, 2/5th and 1/5th respectively. The Profit and Loss Account for the year ended 31st March 2020 is as follows:

Particulars	₹	Particulars	₹
To Sundry Trade	1,02,000	By Gross Profit b/d	4,78,200
Expenses	26,000	By Interest on	10,000
To Interest on Capital @	30,000	Securities (Gross)	
13%:	72,000		
A 13,000	36,000		
B 6,500			
C 6,500			
To Rent to B			
To Salary to B			
To Commission to C			
To Net Profit			
	2,22,200		
<b>Total</b>	<b>4,88,200</b>	<b>Total</b>	<b>4,88,200</b>

Compute the total income of the firm and taxable income of the three partners in the firm. B and C are working partners.

**Solution:**

## Notes

**Computation of Book Profit for the AY 2020 – 21**

Particulars	₹	₹
Net Profit as per P. & L. A/c	2,000	2,22,200
Add: Items not allowed:	72,000	1,10,000
Int. on Capital in excess of 12%:	36,000	3,32,000
A 1,000		
B 500		
C 500		
Salary to B		
Commission to C		
Less: Income not chargeable under this head: Interest on Securities	10,000	10,000
<b>Book Profit</b>		<b>3,22,200</b>

**Calculation of remuneration to working partners**

Particulars	₹	₹
Book Profit	2,70,000	3,22,200
Less: Remuneration to working partners B and C:	13,320	
On ₹ 3,00,000 @ 90%	2,83,320	
On ₹ 22,200 @ 60%		
or		
₹ 1,08,000 as per deed (salary to B 72,000 and commission to C 36,000), whichever is less	1,08,000	1,08,000
<b>Business Income</b>		<b>₹ 2,14,200</b>

**Statement of Total Income**

Particulars	₹
(i) Income from Business	2,14,200
(ii) Income from other sources	10,000
<b>Total Income</b>	<b>2,24,200</b>



**Taxable Income of Partners from firm***Clubbing of Income*

Particulars	A (₹)	B (₹)	C (₹)
(i) Income from Business or profession	12,000	6,000	6,000
Interest on Capital	-	72,000	-
Salary to B	-	-	36,000
Commission to C			
(ii) Income from HP		21,000	
Rent to B: 30,000			
Less: Standard deduction: 9,000			
<b>Total</b>	<b>12,000</b>	<b>99,000</b>	<b>42,000</b>

Notes

Note: (1) Share of partners (A, B and C) in total income ₹ 2,24,200 is exempt u/s 10(2A).

**Illustration 19**

The Profit and Loss Account of M/s XY Glass Works for the year ending on 31st March, 2020 is:

	₹		₹
Stock	1,30,000	Sales	4,50,000
Purchases	1,50,000	Stock	25,000
Penalties and Fines	59,000	Rent from House Property	12,000
Office Expenses	6,000		
Selling Expenses	8,000		
Interest to Partners	6,000		
Net Profit	1,28,000		
	<b>₹ 4,87,000</b>		<b>₹ 4,87,000</b>

Additional information.

- Interest of ₹ 6,000 @ 8% has been paid to X on capital.
- Penalties and fines have been levied because of illegal sale and purchase of glass.
- Remuneration payable to partners: X ₹ 2,00,000 and Y ₹ 1,00,000 has not been debited to Profit & Loss Account.
- Shri X and Y are equal partners in the firm.

Compute the tax payable by the firm and the total income of the partners.

## Computation of Tax payable by the firm

## Notes

Income from business	₹	
Net Profit	1,28,000	
Less: Rent from House	12,000	
	1,16,000	
Add: Disallowed Expenses:		
Penalties and Fines	59,000	
Book Profit	1,75,000	
Less: Remuneration to Partners: 90% of ₹ 1,75,000; or ₹ 3,00,000, whichever is less	1,57,500	
Business Income	(a) 17,500	
Income from House Property		
Rent (A.V.)	12,000	
Less: 30% of A.V.	3,600	
Income house property	(b) 8,400	
G.T.I. being T.I. (a + b)	25,900	
Tax on ₹ 25,900 @ 30%	7,770	
Add: Education cess @ 4%	311	
Tax Payable	₹ 8,081	
Rounded off ₹ 8,000.		
Computation of total income of Partners		
	X (₹)	Y (₹)
Interest	6,000	-
Remuneration 2:1	1,05,000	52,500
Share in Profit (Exempt)	-	-
Total Income	₹ 1,11,000	52,500

### 5.5 Partnership Firm assessed as an Association of Person (PFAOP)- u/s 185

When a firm fails to fulfil the conditions of section 184, it will be assessed under section 185 and will be assessed as an AOP. Section 185 will be applicable to a partnership firm which hasn't submitted a copy of its partnership deed duly signed by all partners.

Such firm will be assessed as a PFAOP u/s 185 in the following manner.

- Any payment to a partner under whatever name called (salary, remuneration, commission etc.) is disallowed.
- Partnership deed expenses are disallowed.
- Interest on capital paid to partners is disallowed.
- Rent paid to partner for the premises used by firm are allowed.

*Clubbing of Income*

## Notes

**Taxable income shall be computed as follows:**

**Taxable income of Firm shall be computed as follows:**

Step 1: Income under the different heads of income - First find out income under the four heads of income.

Step 2: Adjustment of losses of the current year and earlier years - Losses should be set off according to the provisions of sections 70 to 78. The income after adjustment of losses is the gross total income.

Step 3: Deduction from gross total income – a firm can claim the following deductions

- 80G: Contribution to certain relief and charitable institution.
- 80GGA: Donation to scientific research and rural development
- 80GGC: Contribution to political party
- 80IA: Profit from enterprise engaged in infrastructure development
- 80IAB: Profit from enterprise engaged in infrastructure development
- 80IAC: Profit and gain other than infrastructure development undertaking
- 80IB: Profit and gain other than infrastructure development undertaking
- 80IBA: Profit and gain from Housing projects
- 80IC: Profit and gain from enterprise in special category status
- 80IE: Profit and gain from enterprise in special category status
- 80JJA: Profit and gain from enterprise of collecting and processing of bio-degradable waste
- 80JJAA: Deduction in respect of employment of new employees.

Step 4 -Rounding off - The balance should be rounded off to the nearest 10. It is called as net income or taxable income or total income.

**Calculation of Tax Liability:**

Step 1: Determine Net Income and tax payable

1. Short term capital gains u/s 111A – 15%.
2. Long term capital Gains – 10% / 20% (sec112).



## Notes

3. Long term capital Gains u/s 112A (exceeding 1 lakh)– 10%
4. Casual incomes - 30%.
5. Other incomes (remaining all incomes)– 30%.

Step 2: Add: Surcharge -12% if total income exceeds one crore.

Step 3: Add: Health & Education cess- 4% on tax and surcharge.

Step 4: Deduct rebate if applicable

Step 5: Add interest payable (if any)

Step 6: Deduct amount of prepaid taxes paid (Advance Tax, Tax Deducted at Source, etc.)

The Balance so arrived is the amount of tax to be paid

### Treatment of share of income from firm assessed u/s 185-

It's fully exempted from tax u/s 10(2A) and as such is not added in individual income of partners.

### Treatment of remuneration and interest received from firm-

It is not added in individual income of partners since it's already taxed.

### Illustration 20

A, B and C are partners in a firm assessed under section 185 sharing profits and losses equally. The following is the profit and loss account of the firm:

Particulars	₹	Particulars	₹
Manufacturing expenses	9,000	Gross sales	50,000
Establishment expenses	6,000	Interest on securities.	3,000
	3,000		
Depreciation	4,000		
Sundry expenses	6,000		
Salary to A	4,000		
Commission to B	6,000		
Interest on capital	15,000		
A 1,000			
B 2,000			
C 3,000			
Net profit			
A 5,000			
B 5,000			
C 5,000			
	53,000		53,000

**Solution:***Clubbing of Income***Computation of Firm's business income**

Net profit as per P/L statement	15,000
Add: Inadmissible expenses	16,000
Salary to A 6,000	
Commission to B 4,000	
Interest on capital	
A 1,000	
B 2,000	
C 3,000	31,000
Less: Incomes taxable under other heads	
Interest on securities, 3,000	
<b>Business income</b>	<b>28,000</b>

Notes

**Computation of firm's Total Income**

Income from Business	28,000
Income from other sources (interest on security)	3,000
<b>Total income.</b>	<b>31,000</b>

**Firm's Tax liability**

Tax @ 30% of 31,000	9,300
Add: Education cess @ 4%	372
<b>Tax payable</b>	<b>9,672</b>

**Illustration 21**

X, Y and Z are partners of a firm assessed under section 185 sharing profits and losses in the proportion 2:2:1 respectively. P&L account is given below:

Interest on bank loan	150
Discount	75
Reserve for bad debt	125
Bad debts written off	80
Payment to retiring partner	1,000
Interest on capital	1,500
X 300	
Y 400	
Z 800	
<b>Net profit</b>	<b>16,870</b>

## Notes

- Salaries and wages include a partnership salary of 500/ month to Y.
- General charges include a sum of 3,000 paid to save business reputation.
- Motor car was used wholly for business purpose. At the time of the sale the written value of the car was 25,000 while it was sold for 25,800.

**Solution:****Computation of Firm's business income.**

Net profit as per P/L statement	16,870
Add: Inadmissible expenses	125
Reserves for bad debt	
Payment to retiring member	1,000
Interest on capital	1,500
X 300	6,000
Y 400	
Z 800	
Salary to Y @ 500 p.m	25,495
Less: Incomes taxable under other heads	
Capital gain (800 + 400) 1,200	
<b>Business income</b>	<b>24,295</b>

**Computation of firm's Total Income**

Income from Business	24,295
Capital Gains	1,200
STCG on car 800	
LTCG on investments 400	
<b>Total income</b>	<b>25,495</b>

**Firm's Tax liability**

Tax on LTCG of 400 @ 20%	80
Tax @ 30% of 25,500	7,650
	7,730
Add: Education cess @ 4%	309
<b>Tax payable</b>	<b>8,039</b>



**Assessment of Limited Liability Partnership (LLP).**

A Limited Liability Partnership (LLP) is a body corporate formed or incorporated under the Limited Liability Partnership Act, 2008. It is a legally separate entity from its partners. It has perpetual succession i.e. any change in its partners will not have any impact on its existence, rights and liabilities. It is a corporate business form which gives benefits of limited liability of a company and the flexibility of a partnership. It contains elements of both a company as well as a partnership firm and thus it is called a hybrid between a partnership and a company.

The Income-tax Act provides for the same taxation regime for a Limited Liability Partnership as is applicable to a partnership firm, so an LLP being treated as a firm for taxation. It also provides tax neutrality (subject to fulfilment of certain conditions) to conversion of a Private Limited Company or an Unlisted Public Company into an LLP. However, Presumptive Tax Scheme u/s 44AD is not applicable to LLP.

**Calculation of Total income:**

Total income is calculated as per the rules prescribed for partnership firms.

**Remuneration and interest.**

Remuneration and interest to partners are deductible if condition of section 40(b) and 184 are satisfied (same as a firm)

**Taxability:**

Income tax rates are also the same rates applicable to partnership firms

**5.6 Tax Planning for Partnership Firms**

Partnership is the form of business, which is owned by two or more general partners. Each of the partners is liable for the debts of the business. Although the partnership must file a separate tax return, each general partner is required to report his pro rata share of the partnership's income on his individual income tax return. A partnership agreement is a practical necessity for this form of business organisation. A deed of partnership must be drafted which set out the terms and conditions of the partnership. A Partnership firm may be -- a limited liability partnership or an unlimited liability partnership as per income tax rules. Various types of partners are as follows:

1. Ordinary/General Partners: take an active part in the running of the business.
2. Sleeping Partners: invest in the business but do not take an active part in the business.

## Notes

3. Limited Liability Partners: assets will not be lost if the business goes bankrupt.  
Tax planning points regarding partnership firm and its partners are given below.

The Indian Partnership Act, 1932, defines partnership as a "relationship between persons who have agreed to share the profits of business carried on by all or any of them acting for all". This definition gives three minimum requirements to constitute a partnership: -

1. There must be an agreement entered into orally or in writing by the persons who desire to form a partnership.
2. The object of the agreement must be to share the profits of business intended to be carried on by the partnership.
3. The business must be carried on by all the partners or by any of them acting for all of them.

Under the Act, persons who have entered partnership with one another are individually called as 'partners' and collectively as 'firm' and the name under which they run their business is called the 'firm name'. Partnership firm arises from a contract between two or more

persons who contribute some tangible and some intangible assets together with an objective of earning profit there from which will be shared between them in predefined portion. Therefore, to get the status of partnership under income tax act and to reduce the tax liability following points should be noted,

1. The firm should be evidenced by an instrument [Section 184(1i)]. Partnership is evidenced by a partnership deed and a certified copy thereof, which is duly signed by all partners, and is filed along with the Return of Income.
2. The individual shares of the partners in the asset of the firm and the profits (or losses) should be specified in the instrument [Section 184(1ii)].
3. A certified copy of the instrument of partnership shall accompany the return of income of the previous year in respect of which assessment of the firm is first sought [Section 184(2)].
4. Whenever changes take place in the constitution of the firm due to death or resignation of the partner or in the profit sharing ratio of the existing partners, a certified copy of the revised instrument of partner shall be submitted along with return of income of the related year. Where a minor is admitted to the benefit of the firm and the shares of the partners are unequal, it is necessary to specify how the shares of loss of the minor will be borne by the major partner.



5. While computing the income of the firm under the head 'Profits and gains of business or profession', besides the deductions which are allowed u/s 30 to 37, special deduction is allowed to the firm on account of remuneration to working partners and interest paid to the partners. However, it is subject to certain limits laid down u/s 40(b).
6. Share of profit which a partner receives from the firm (after deduction of remuneration and interest allowable) shall be fully exempt in the hands of the partner. However, only that part of the interest and remuneration which was allowed as a deduction to the firm shall be taxable in the hands of the partners in their individual assessment under the head 'profits and gains of business or profession'.
7. The firm will be assessed as a firm provided conditions mentioned under section 184 are satisfied. In case these conditions are not satisfied in a particular assessment year, although the firm will be assessed as firm, but no deduction by way of payment of interest, salary, bonus, commission or remuneration, by whatever name called, made to the partner, shall be allowed in computing the income chargeable under the head "profits and gains of business or profession" and such interest, salary, bonus, commission or remuneration shall not be chargeable to income-tax in the hands of the partner.

## 5.7 Assessment of Association of Persons (AOP) & Body of Individual (BOI)

### Association of Persons (AOP) :

Where two or more persons voluntarily joint together in a common purpose or action with the object of producing income, Profits and Gains, they are said to have formed an Association of Persons.

### Body of Individuals (BOI):

It is a conglomerate of individuals who happen to have come together to carry on sum activity with a view to earn income i.e., co-heirs inheriting shares or securities.

### Distinction between AOP & BOI:

1. AOP may consist of non-individuals, but BOI has to consist of individuals only
2. An AOP is a voluntary combination of persons in a joint enterprise or common action to produce income whereas in case of BOI will only consist of two or more persons, may or may not have any common object.
3. A BOI may become an AOP, but not vice versa.



## Notes

**1. Charge of tax where shares of members are known**

- Where the total income of any members of the association of persons for the previous year (excluding their share of income from association of person) exceed the exempted limit of income tax, tax will be charged on the total income of the AOP at Maximum Marginal Rate (MMR) of 30 %, i.e. the highest slab applicable to an individual.
- In the case of total income of any members of AOP does not exceed the exempted limit, the total income of AOP shall be taxed at the same rate at which are prevalent to the individual (general rate )
- In the case of AOP has any members whose total income (in case of foreign company only) is taxable at the rate higher than maximum marginal rate the total income of AOP can be divided into two

1. The Share of income of the members whose total income is assessable at the right higher than MMR

2. Balance total income of AOP/BOI shall be assessed to Tax at MMR

**2. Charge of tax where shares of members are not known.**

- If the shares are indeterminate or unknown, tax shall be charged at the MMR.
- If any member has income chargeable to rate higher than MMR, tax shall be charged on its total income at such higher rate. (eg: foreign company as a member of AOP).

Nature.	Where shares of members are determinate and known	Where shares of members are indeterminate or unknown
1. None of the members having taxable income as individual.	At the rates applicable to individual	At the maximum taxable marginal rate (30%)
2. Any member having income chargeable to tax	At the maximum taxable marginal rate (30%)	At the maximum taxable marginal rate (30%)

The amount of tax calculated shall be increased by a surcharge at the rate of 12% of such income tax in case the total income exceeds ₹1 crore.

**Ascertainment of member's share in AOP/BOI where shares are determinate and its taxability [Sec. 67A, 86 & 110]**

**1. Ascertainment of share in AOP/BOI [Sec. 67A]**

Total income of the AOP/BOI -----

**Less:** Interest, salary, commission or other remuneration

paid to any member -----

Balance apportionable to the members in proportion  
to their shares -----

Share of income allotted to a member -----

**Add:** Salary, interest, commission or other remuneration  
received by the member of the AOP or BOI -----

Total share -----

**Less:** Interest paid on capital borrowed for the purpose of  
Investment in the AOP/BOI -----

Net assessable share income -----

## Notes

### 2. Tax treatment of share income of members [Sec. 86 and Sec. 110]

In computing total income of an assessee, the chargeability of the share income of a member of an AOP or BOI depends on whether the AOP or BOI is chargeable to tax at the maximum marginal rate or at slab rate or is not chargeable to tax at all.

Tax-treatment in the three cases is discussed below:

1. Where AOP or BOI is chargeable to tax at a maximum marginal rate or any higher rate, the share of profit of a member is exempt from tax. Thus, it is not to be included in the total income of the member [Sec. 86(a)]
2. Where AOP or BOI is not taxed at the maximum marginal rate but it is taxed at slab rates, the share of profit of a member from AOP or BOI is to be included in the total income of the member only for rate purposes. The member is entitled to a rebate of tax on the entire share of profit at the average rate of tax applicable to total income. [Sec. 86(b)].
3. Where AOP or BOI is not chargeable to tax at all, the share of profit of a member from AOP or BOI is included in his total income and he will pay tax on it. He is not entitled to any rebate of tax on such profits [Proviso to Sec. 86(b)].

Taxation of AOP/BOI [Sec 167B ]	Tax treatment of share income for the members of AOP/BOI [Sec. 86 & 110]
1. AOP or BOI is taxed at maximum marginal rate or at a higher rate.	Share income of the member is not taxable.
2. AOP or BOI is taxed at normal rates applicable	Share income computed u/s 67A is included into an Individual. The total income of the member but rebate u/s 110 at the average of tax in respect of such share income has to be allowed



## Notes

3. AOP or BOI is not taxed at all (when their total income is less than taxable limit)

Share income will be included in the total income of the member and taxed at the rates applicable to him.

**Rebate of Tax u/s 86.**

1. If total income of AOP/BOI is taxable at MMR, then share of income from AOP/BOI should not be included in the individual income of members.
2. If total income of AOP/BOI is not taxable at all (when there no partner having taxable individual income), the share of income from AOP/BOI should be added to the individual incomes of partners and it is fully taxable. No rebate in this case.
3. If the AOP/BOI is taxable at rates applicable to individual, the share from the income of AOP/BOI should be added to the partner's total income and shall be eligible for rebate of tax at average rate on such share.

Average rate = Total Tax

**Illustration 22**

The Profit and Loss Account of an AOP of M/s A and B, sharing profits and losses in the ratio of 3:2 for the previous year ending on 31st March 2020 is as follows:

Particulars	₹	Particulars	₹
- Cost of Goods sold	5,45,000	- Sales	9,50,000
- Remuneration of Partners	3,00,000	- Dividends	20,000
- Remuneration to Employees	1,70,000	Short term	3,50,000
- Interest to Partners	15,000	Capital Gains	
- Other Expenses	1,00,000		
- Sales tax outstanding	10,000		
- Net Profit	1,80,000		
	13,20,000		13,20,000

Additional information is given below:

1. Other expenses include the following:
  1. Entertainment expenses ₹ 20,000.
  2. V.I.P. bags, costing of ₹ 1,500 each given to ten dealers who exceeded the sales target fixed under Sales Promotion Scheme.
  3. ₹ 32,500 paid in cash to an advertising agency.
  2. Outstanding sales – tax was paid on 14th July 2020.
  3. The firm is not evidenced by instrument.
  4. Other taxable incomes of A ₹ 2,45,000 and B ₹ 1,00,000.



You are required to compute for the assessment year 2020 – 21:

*Clubbing of Income*

1. Total income of the firm; and
2. Tax liability of the firm on its total income.

**Solution:**

**Notes**

**Computation of Income from Business**

Particulars	₹	₹
Net Profit as per Profit and Loss Account	15,000	1,80,000
Add: Inadmissible Payments:	-	3,47,500
Interest to Partners	-	
Entertainment: Fully allowed	32,500	
Sales Promotion Expenses: Fully allowed	3,00,000	
100% of ₹ 32,500 cash payment		
Remuneration to Partners		
Total		5,27,500
Less: (i) Dividend	20,000	3,70,000
(ii) Short-term Capital Gain	3,50,000	
<b>Income from Business</b>		<b>1,57,500</b>

**Computation of Total Income of the Firm**

Particulars	₹
Profits and Gains of Business	1,57,500
Short – term capital gain	3,50,000
Income from Other Sources: Dividend	Exempt
<b>Total Income</b>	<b>5,07,500</b>

**Computation of Tax Liability of the Firm**

Particulars	₹
On 2,50,000	Nil
Next 2,50,000 @ 5%	12,500
Remaining 7,500 @ 20%	1500
Total	14,000
Add health and education cess @ 4%	560
<b>Final Tax Liability</b>	<b>14,560</b>

**Computation of Total Income of Partners A and B**

Particulars	A (₹)	B (₹)
Share from Profit of firm	3,04,500	2,03,000
@ 3:2 of 5,07,500	2,45,000	1,00,000
Other taxable incomes		
<b>Total income</b>	<b>5,49,500</b>	<b>3,03,000</b>

Notes

Computation of Tax liabilities of Partners		
Particulars	A's Total Income (5,49,500)	B's total Income (3,03,000)
On 2,50,000	Nil	Nil
Next 2,50,000 @ 5%	12,500	2,650
Remaining Amount @ 20%	9,900	-
Total	22,400	2,650
Less: Rebate under section 87A	N.A	2,650
Less: Rebate applicable under section 86.	12,413	N.A
22,400		
Add: Health and education cess @ 4%	9,987 400	Nil
<b>Final Tax liability</b>	<b>10,387</b>	<b>Nil</b>

### 5.8 Alternate Minimum Tax (AMT)

**(Applicable to all non-corporate Assessee: Individual, Firm, AOP BOI etc.)**

Where the regular Income Tax payable for a Previous Year by a person (other than a company) is less than the Alternate Minimum Tax payable for such Previous Year, the Adjusted Total Income shall be deemed to be the total income of such person and he shall be liable to pay Income-tax on such Total Income at the rate of 18.5%.(Sec 115 JC to 115JF)

#### **To whom Alternate Minimum Tax shall be applicable.**

The provisions of Alternate Minimum Tax shall apply to a non-corporate assessee who has claimed any deduction under:

1. Sections 80-IA to 80RRB other than section 80P; or
2. Section 10AA; Or
3. Section 35AD

#### **To whom Alternate Minimum Tax shall not be applicable.**

The provisions of Alternate Minimum Tax under shall not apply to-

1. an Individual; or
2. a Hindu Undivided Family; or

3. an Association of Persons or a Body of Individuals or
4. an Artificial Juridical Person.

If the Adjusted Total Income of such person does not exceed ₹. 20,00,000

Computation of adjusted total income

– Total income of the person -----

– Add: Deductions claimed u/s 80IA, 80IAB, 80IC,

80ID, 80IE, 80JJA, 80LA, 80QQB, 80RRB,

10AA and 35AD. -----

**Adjusted total income. -----**

### **Steps in calculation of tax liability if AMT applicable:**

**Step 1:** Calculate the regular Income-tax liability of the non-corporate assessee.

**Step 2:** Calculate Adjusted Total Income of the non-corporate assessee.

**Step 3:** Calculate Alternate Minimum Tax = 18.5% of the adjusted total income + surcharge if any + education cess (4%)

**Step 4:** Compare tax liability computed under Step 1 and Alternate Minimum Tax computed under Step 3. If amount computed under Step 1 is equal to or more than amount computed under Step 3, then the provisions of Alternate Minimum Tax will not apply.

**Step 5:** If amount computed under Step 1 is less than amount computed under Step 3, then amount computed under Step 3 will be deemed as tax liability of the non-corporate assessee for such Previous Years. In this case, the excess amount computed under Step 3 over the amount computed under Step 1 will be available as credit and can be carried forward and set off against regular tax liability of the non-corporate assessee of the next year or subsequent years.

### **Tax credit for AMT:**

- Tax credit (AMT credit) is the difference between the tax paid under AMT and the tax payable on total income.
- The tax credit will be allowed to be carry forward for a maximum of 15 assessment years.
- The setoff will be allowed to the extent of an amount equal to the difference between the tax payable on the total income and the tax payable under AMT.
- Suppose tax credit for AY 2021-22 is ₹ 40,000. The tax payable on total income for AY 2021-22 is ₹ 1,00,000 and tax payable under AMT is ₹ 80,000, here 20,000 can be set off in the AY 2021-22 and the assessee will pay ₹ 80,000 only.



- Tax credit allowable even if adjusted total income does not exceed ₹ 20 lakh in the year of set-off.

## Notes

**Illustration 23**

From the following information, compute tax liability of a super senior citizen (keeping in view of provisions of AMT) for the AY 2020-21

Pension	6,50,000
Royalty on books	19,00,000
Expenses to earn royalty	1,00,000
Deposit in PPF	1,50,000
Donation to prime minister's national relief fund	50,000

**Solution:****Computation of Total Income as per Normal Provisions of IT Act.**

Particulars	₹	₹
(a) Income from salary	6,50,000	6,00,000
Pension	50,000	
Less: Standard deduction		
(b) Income from other sources	19,00,000	18,00,000
Royalty on Books	1,00,000	
Less: Expenses to earn Royalty		
Gross total Income		24,00,000
Less: Deductions from GTI	1,50,000	5,00,000
(i) 80C Deposit in PPF	50,000	
(ii) 80G donation to PM's National Relief fund	3,00,000	
(iii) 80QCB royalty income		
Total Income		19,00,000

**Computation of Adjusted total income for AMT**

Total Income computed as per IT Act	19,00,000
Add: AMT applicable deduction	3,00,000
80QCB royalty income	
Adjusted Total Income	22,00,000

**Computation of Tax liability on Total Income of ₹ 19,00,000**

Particulars	₹
On first 5,00,000	Nil
On next 5,00,000 @ 20%	1,00,000
On next 9,00,000 @ 30%	2,70,000

Total	3,70,000
Add: Health and education cess @ 4%	14,800
Final tax liability	3,84,800

**Computation of AMT on Adjusted total Income**

Particulars	₹
Adjusted Total Income 22,00,000 AMT @ 18.5%	4,07,000
Add: Health and Education cess @ 4%	16,280
AMT	4,23,280

**Statement of Final Tax Liability**

Income tax as per Normal Provisions	3,84,800
Alternate Minimum tax	4,23,280
Final Tax liability: Whichever is higher	4,23,280
AMT Credit	38,480

**Notes****5.9 Assessment of Companies**

Income tax being direct tax is a major source of revenue for the Central Government. The entire amount of income tax collected by the Central Government is classified under the head:

1. Corporation Tax (Tax on the income of the companies) and
2. Income Tax (Tax on income of the non-corporate assesses).

Corporate taxation refers to taxation of companies (as defined under income tax act, 1961) and is a major source of revenue to the government. Under income tax act, 1961, a company is liable to pay tax on its income at a flat rate (just as partnership firm) without any basic exemption limit as applicable to an individual or HUF

**'Corporate tax' or 'company tax'**

The tax collected from companies (as defined under the income tax act, 1961) is called "company tax" or "corporate tax". It is interesting to note that the proceeds of corporate tax are retained by the central government and are not shared with state governments

Definition of "Company": as per section 2(17), company means:

1. Any Indian company, or
2. Anybody corporate incorporated by or under the laws of a country outside India, or
3. Any institution, association or body which was assessed as a company for any assessment year under the income-tax act, 1922 or was assessed

## Notes

4. under this act as a company for any assessment year commencing on or before 1.4.1970, or
5. Any institution, association, or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of CBDT to be a company.

**Types of Companies**

Companies are classified in to five according to the taxation point of view,

1. Indian Company
  2. Domestic company
  3. Foreign company
  4. Widely held company
  5. Closely held company
1. **Indian Company:** Section 2(26) of the Income Tax Act, 1961 defines the expression "Indian Company" as a company formed and registered under the Companies Act, 1956 and includes:
    1. a company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir, and the Union Territories specified in (e) below);
    2. any corporation established by or under a Central, State or Provincial Act;
    3. any institution, association or body which is declared by the Board to be a company under Section 2(17) of the Income Tax Act, 1961;
    4. in the case of State of Jammu & Kashmir, any company formed and registered under any law for the time being in force in that State; and
    5. in the case of any of the Union Territories of Dadra and Nagar Haveli, Goa, Daman and Diu and Pondicherry, a company formed and registered under any law for the time being in force in that Union Territory;
  2. **Domestic Company:** Section 2(22A) of the Income Tax Act, 1961, defines domestic company as an Indian company or any other company which, in respect of its income liable to tax under the Income Tax Act, has made the prescribed arrangements for the declaration and payment within India, of the dividends (including dividends on preference shares) payable out of such income.
  3. **Foreign Company:** Section 2(23A) of the Income tax Act defines foreign company as a company, which, is not a domestic company. However, all non-Indian companies are not necessarily foreign companies. If a non-Indian company has



made the prescribed arrangements for declaration and payments of dividends within India, such a non-Indian company must be treated as a "domestic company" and not as a "foreign company".

**4. Company in which public are substantially interested (a widely held company)**

Section 2(18) of the Income Tax, Act defines the expression "company in which the public are substantially interested".

1. If it is a company owned by the Government or the Reserve Bank of India or in which not less than 40 per cent of the shares, whether singly or taken together, are held by the Government or the Reserve Bank of India or a corporation owned by the Reserve Bank of India; or
2. If it is a company which is registered under Section 25 of the Companies Act, 1956; or
3. If it is a company, having no share capital and if, having regard to its objects, the nature and composition of its membership and other relevant considerations, it is declared by an order of the Board (CBDT) to be a company in which the public are substantially interested. However, such a company shall be deemed to be one in which the public are substantially interested only for the assessment year(s) as may be specified in the declaration; or
4. If it is a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under Section 620A of the Companies Act, 1956 to be a Nidhi or Mutual Benefit Society; or
5. If it is a company in which shares carrying not less than 50 per cent of the voting power have been allotted unconditionally to or acquired unconditionally by, and are throughout the relevant previous year beneficially held by, one or more cooperative societies; or
6. If it is a company which is not a private company as defined in Section 3 of the Companies Act, 1956 and equity shares of the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in the profits, i.e. preference shares) were, as on the last day of the relevant previous year, listed in a recognized stock exchange in India;
7. If it is a company which is not a private company within the meaning of the Companies Act, 1956, and the shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 50 per cent (40 per cent in case of an industrial

## Notes

## Notes

company) of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant accounting year beneficially held by (a) the Government, or (b) a corporation established by a Central or State or Provincial Act, or (c) any company in which the public are substantially interested or a wholly owned subsidiary company.

5. **Closely held company:** A Company in which the public is not substantially interested is known as a closely held company. The distinction between a closely held and widely held company is significant from the following viewpoints.
  1. Section 2(22) (e), which deems certain payments as dividend, is applicable only to the shareholders of a closely-held company; and
  2. A closely held company is allowed to carry forward its business losses only if the conditions specified in Section 79 are satisfied.

#### **Residential status of a company [section 6(3)]**

Determination of total income of a company depends upon its residential status during the relevant previous year. The residential status of the company is determined either.

1. On the basis of its incorporation (registration); or
2. On the basis of Place of Effective Management (POEM).

Based on residential status, companies can be classified in to two categories

- i. Resident companies
- ii. Non-resident companies.

#### **Resident companies [section 6(3)]**

A company is said to be resident in India in any previous year

1. It is an Indian company; or
2. During the relevant previous year, its Place of Effective Management (POEM) in that year is in India.

Note-

- Place of Effective Management (POEM) means a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made.
- The POEM is required to be determined each year since the residential status is required to be ascertained each year.

- The provisions of POEM will not be applicable to a Company having turnover of ₹ 50 crores or less in a financial year.
- An Indian company is always resident for income tax purpose even if the POEM is situated outside India
- A non-Indian company or a foreign company will be treated as resident of India for any previous year only if the POEM during the relevant previous year is situated in India.

### **Non-resident company [section 2(30)]**

A company will be a non-resident in any previous year if:

1. It is not an Indian company and
2. Its place of effective management (POEM), in that year, is not in India.

Note-

- POEM in case of a Company engaged in active business outside India shall be presumed to be outside India if the majority meetings of the board of directors of the company are held outside India.

### **Incidence of tax- scope of total income (section 5)**

#### **Income of a resident company**

1. Income received or deemed to be received in India during the previous year by or on behalf of such company
2. Income which accrues or arises or is deemed to accrue or arise to it in India during the previous year;
3. Income which accrues or arises to it outside India during the previous year. It is assessment of companies important to note that under this clause only income accruing or arising outside India is included. Income deemed to accrue or arise outside India is not included in the hands of residents. Hence, net dividends received from foreign companies are includible in income and not the gross dividends.

#### **Income of a non-resident company**

1. Income received or deemed to be received in India in the previous year by or on behalf of such company;
2. Income which accrues or arises or is deemed to accrue or arise to it in India during the previous year.



**Computation of Total Income of a Company**

The total income of a company can be computed in same procedure which is discussed in assessment of individuals. In short, we can summaries it as below.

**Notes**

1. Find out the taxable income under each head of income after deducting the losses and allowances brought forward from earlier years.
2. The total of all balances of heads of income (income from house property + profits or gains of business or profession + capital gains + income from other sources) is termed as gross total income.
3. Deductions are to be made as per section 80G, 80GGA, 80GGB, 80IA, 80IAB, 80IB, 80IC, 80ID, 80IE, 80JJA, 80JJAA, and 80LA.
4. The balance is the total income of the company.

**Permissible deduction for Company**

1. Deduction in respect of donations to certain funds, charitable institutions, etc. [Section 80G]

Deduction u/s 80g is available on account of any donation made by the assessee to specified funds or institutions. In some cases, deduction is available after applying a qualifying limit while in others, it is allowed without applying any qualifying limit. Again, in some cases, deduction is allowed to the extent of 100% of the donation and in some cases it is allowed to the extent of 50% of the donation.

Essential conditions for claiming deduction under this section:

1. Deduction under this section is allowed to all assessee, whether company or non-company, whether having income under the head 'profits and gains of business or profession' or not.
2. The donation should be of a sum of money. Donations in kind do not qualify for deduction.
3. The donation should be made only to specified funds/institutions.
4. No deduction shall be allowed under this section in respect of donation of any sum exceeding ₹ 2,000 unless such sum is paid by any mode other than cash.
5. For availing deduction under this section it is obligatory on the part of the assessee to produce proper proof of payment. Where the payment is not proved by production of proper receipt, etc., the deduction under section 80G is not available.
2. Deduction in respect of certain donations for scientific research or rural development [Section 80GGA].

Deduction is permissible to an assessee whose "gross total income" does not include income chargeable under the head "profits and gains of business or profession". 100% deduction is available in respect of the payments made during the previous year to the following institutions:

1. To an approved research association, university, college or other institution to be used for scientific research (business assessee were allowed this deduction u/s 35);
2. To an approved research association which has as its objects the undertaking of research in social sciences or statistical research or to university, college or other institution for research in social science or statistical research (business assessee were allowed this deduction u/s 35);
3. To an association or institution engaged in any approved programme for rural development, or which is engaged in training of persons for implementation of rural development programmers, or to a notified rural development fund or to the notified national urban poverty eradication fund (business assessee were allowed this deduction u/s 35cca). In this case the assessee should furnish a certificate as is required under section 35CCA;
4. To a public sector company or a local authority, or to an association or institution approved by the national committee, for carrying out any eligible project or scheme (business assessee was allowed this deduction u/s 35ac). In this case also the assessee should furnish a certificate as a required under section 35ac.
3. Deduction in respect of contributions given by companies to political parties [Section 80GGB].

Any sum contributed by an Indian company in the previous year to any political party or an electoral trust shall be allowed as deduction while computing its total income. No deduction shall be allowed under this section in respect of any sum contributed by way of cash.

4. Deduction in respect of profits and gains from undertakings or enterprises engaged in infrastructure development, etc. [Sec 80IA]

The deduction allowed to a company in respect of any profit and gains derived from the business related with the provision of infrastructure facility, telecommunication service industrial park and generation and distribution of electricity 100% of profits and gains derived from such business for 10 consecutive assessment years out of 15 years beginning with the year in which undertaking or the enterprise develops and begins to operate any infrastructure facility or generates power or commences transmission or distribution of power or undertakes substantial renovation or modernization.

## Notes



## Notes

5. Deduction in respect of profits and gains by an undertaking or an enterprise engaged in development of Special Economic Zone (SEZ) [Section 80-IAB]:

The deduction under the new section is available where the gross total income of an assessee, being a developer, includes any profits and gains derived by an undertaking or an enterprise from any business of developing a special economic zone, notified on or after 1.4.2005 under the special economic zones act, 2005. provided that the provisions of this section shall not apply to an assessee, being a developer, where the development of special economic zone begins on or after 1.4.2017. the deduction shall be allowed of an amount equal to 100% of the profits and gains derived from such business for 10 consecutive assessment years. The deduction may, at the option of the assessee, be claimed by him for any 10 consecutive assessment years, out of 15 years beginning from the year in which a special economic zone has been notified by the central government.

6. Deduction in respect of profits and gains from new industrial undertaking (Section 80IB):

The deduction under this section is available to an assessee whose gross total income includes any profits and gains derived from the business of: commercial production and refining of mineral oil; processing, preservation and packaging of fruits or vegetables, meat and meat products or poultry or marine or dairy products; integrated business of handling, storage and transportation of food grains; operating and maintaining a hospital located anywhere in India other than the excluded area.

7. Industrial undertaking producing or refining mineral oil in the north eastern region or in any part of India [Section 80-IB(9)]:

Deduction under this section is allowed if an undertaking fulfills any of the following conditions:

- (a) It is located in the northeastern region and has begun or begins commercial production of mineral oil before 1.4.1997 or on or after 1.4.1997 but not later than 31.3.2017.
- (b) It has begun or begins commercial production on or after 1.4.1997 but not later than 31.3.2017 where it is in any other part of India.
- (c) It is engaged in the business of refining of mineral oil on or after 1.10.1998 but not later than 31.3.2012.
- (d) It is engaged in commercial production of natural gas in licensed blocks and begins commercial production of natural gas on or after 1.4.2009.



Deduction shall be available @ 100% of eligible profits for 7 assessment years commencing from the initial assessment year.

## Notes

8. Undertaking engaged in the business of processing, preservation and packaging of fruits or vegetables or meat and meat products or poultry or marine or dairy products or integrated business of handling, storage and transportation of food grains [section 80-IB(11a)] essential condition:
  - (a) It must begin or operate the business of processing, preservation and packaging of fruits or vegetables or integrated business of handling, storage and transportation of food grains on or after 1.4.2001. The business of processing preservation and packaging of meat and meat products or poultry or marine or dairy products should commence on or after 31.3.2009.
  - (b) Profit is eligible for deduction (owned by a company) first 5 years 100 %, next 5 years 30%. owned by any other assessee first 5 years 100%, next 5 years 25%.
9. Deduction in respect of certain undertakings in Himachal Pradesh, Sikkim, Uttaranchal, and north-eastern states [Section 80-IC]
 

one must satisfy the following conditions to claim deduction

  - (a) Not formed by splitting up or reconstruction of existing business.
  - (b) The industrial undertaking is not formed by splitting up, or the reconstruction, of a business already in existence.
  - (c) Not formed by transfer of old plant and machines –
  - (d) Industrial undertaking should be set up in certain special category of states
  - (e) Manufacture/production of specified goods –

Deduction should be claimed in the return of income –deduction under section 80-IC is not available unless it is claimed in the return of income.
10. Deduction in respect of profits and gains from business of hotels / convention centers in specified area [Section 80-ID] conditions -
  - (a) The taxpayer engaged in the business of hotel located in a specified area. Alternatively, the taxpayer is engaged in the business of building, owning and operating a convention Centre located in specified area.
  - (b) The aforesaid business is not formed by the splitting up, or the reconstruction, of a business already in existence [subject to a few exceptions].
  - (c) The aforesaid business is not formed by the transfer to a new business of machinery or plant previously used for any purpose [subject to a few exceptions].

## Notes

- (d) Audit report should be submitted† along with the return of income.
- (e) Return of income is submitted on or before the due date of submission of return of income given under section 139(1).
- (f) Deduction under section 80-Id is not available unless it is claimed in the return of income

If the above conditions are satisfied, 100% of the profit and gains derived from the aforesaid business is deductible for five consecutive assessment years beginning from the initial assessment year. Initial assessment year for this purpose means the assessment year relevant to the previous year in which the business of the hotel starts functioning or the previous year in which the convention center starts operating on a commercial basis.

11. Deduction to certain undertakings set-up in northeastern states [Section 80-IE]. deduction under this section is allowed to an assessee whose gross total income includes any profits and gains derived by an undertaking which fulfills the following conditions:
  - (a) It has during the period beginning on 1.4.2007 and ending before 1.4.2017 begun or begins in any of the north-eastern states: to manufacture or produce any eligible article or thing; to undertake substantial expansion to manufacture or produce any eligible article or thing; to carry on any eligible business.
  - (b) 100% of the profits and gains derived from such business for 10 consecutive assessment years commencing with the initial assessment year.
12. Deduction in respect of profits and gains from business of collecting and processing of bio-degradable waste [Section 80JJA] where the gross total income of an assessee includes any profits and gains derived from the business of collecting and processing or treating of bio-degradable waste for:
  - (a) Generating power, or
  - (b) Producing, bio-fertilizers, bio-pesticides or other biological agents, or
  - (c) Producing biogas, or
  - (d) Making pellets or briquettes for fuel, or
  - (e) Organic manure,

The whole of such profits or gains shall be allowed as a deduction for a period of 5 (five) consecutive assessment years beginning with the assessment year relevant to the previous year in which such business commences.



13. Deduction in respect of employment of new workers / employees [ Section 80-JJAA] no deduction under section 80JJAA(1) shall be allowed,—

- (a) If the business is formed by splitting up, or the reconstruction, of an existing business: however, nothing contained in this clause shall apply in respect of a business which is formed as a result of re-establishment, reconstruction or revival by the assessee of the business in the circumstances and within the period specified in section 33B;
- (b) If the business is acquired by the assessee by way of transfer from any other person or as a result of any business reorganization;
- (c) Unless the assessee furnishes along with the return of income the report of a chartered accountant giving such particulars in the report as may be prescribed.

14. 30% of additional employee cost to be allowed as deduction for 3 assessment years [Section 80JJAA(2)]:where the gross total income of an assessee to whom section 44ab applies, includes any profits and gains derived from business, there shall, subject to the conditions specified in section 80jjaa(2), be allowed a deduction of an amount equal to 30% of additional employee cost incurred in the course of such business in the previous year, for 3 assessment years including the assessment year relevant to the previous year in which such employment is provided.

15. Deduction for income of offshore banking units and international financial services Centre [section 80-LA]to whom the deduction will be allowed:

- (a) Being a scheduled bank, or, any bank incorporated by or under the laws of a country outside India; and having an offshore banking unit in a special economic zone; or
- (b) Being a unit of an international financial services center.
- (c) Income in respect of which deduction will be allowed:
- (d) The deduction will be allowed on account of the following income included in the gross total income of the assessee: any income:
- (e) From an offshore banking unit in a special economic zone;
- (f) From the business, referred to in section 6(1) of the banking regulation act, 1949, with an undertaking located in a special economic zone or any other undertaking which develops, develops and operates or operates and maintains a special economic zone;



- (g) From any unit of the international services center from its business for which it has been approved for setting up in such a center in a special economic zone.

A deduction of 100% of such income for 5 consecutive assessment years beginning

## Notes

with the assessment year relevant to the previous year in which the permission, under section 23(1)(a) of the banking regulation act, 1949 or permission or registration under the SEBI act, 1992 or any other relevant law was obtained; 50% of such income for the next 5 consecutive assessment years.

### Computation of Tax on Companies

A company is assessed in its own name it have a separate legal existence so that the tax paid by the company is not deemed to have paid on behalf of its shareholders. As mentioned earlier the company have to pay tax at a flat rate except on those income which have a separate tax rate prescribed under this Act. Incomes having special rates of tax are-

1. Short term capital gains u/s 111A – 15%.
2. Long term capital Gains – 10% / 20% (sec 112).
3. Long term capital Gains u/s 112A (exceeding 1 lakh)– 10%
4. Casual incomes - 30%.

Remaining incomes are taxed at flat rate based on different classification of companies. The tax liability of companies belonging to the different classification are:

1. Domestic companies
  - (a) Domestic companies (whose turnover in F.Y 2017-18 was up to 400 crore).
  - (b) Domestic companies (whose turnover in F.Y 2017-18 was more than 400 crore)
  - (c) Domestic manufacturing companies under section 155BAA.
  - (d) Domestic new manufacturing companies under section 155BAB.
2. Tax liability of foreign company
  1. **Domestic companies:** As per section 2(22a) domestic company means an Indian company, or any other company which, in respect of its income liable to tax under this act, has made the prescribed arrangement for the declaration and payment, within India, of the dividend payable out of such income. A domestic company taxable at 30% however the tax rate is 25% if turnover or gross receipt of the company does not exceed ₹ 400 crore in the previous year.

1. Domestic company which is claiming exemptions and whose turnover in F.Y 2017-18 was up to 400 crore.

*Clubbing of Income*

Particulars	Rates applicable
Income tax	25%
Surcharge(subject to marginal relief)	7% if total income exceeds 1 crore
12% if total income exceeds 12 crores	
Health & education Cess	4% of income tax + surcharge

Notes

2. Domestic company which is claiming exemptions and whose turnover in F.Y 2017-18 was more than 400 crores.

Particulars	Rates applicable
Income tax	30%
Surcharge (subject to marginal relief)	7% if total income exceeds 1 crore
12% if total income exceeds 12 crores	
Health & education cess	4% of income tax + surcharge

#### Illustration 24

The statement of profit and loss of XYZ Ltd. for the year ended 31 march 2020 shown a net profit of ₹1,00,00,000 the statement of profit and loss includes the following

1. Opening and closing stock were ₹8,70,000 and ₹12,50,000 respectively, which were valued at 5% below cost.
2. Expenses for obtaining a loan from financial institution for acquiring new machinery ₹60,000
3. Advertisement in souvenir of political party paid by cheque ₹ 2,50,000.
4. A fine of ₹ 11,000 paid for breach of custom regulation
5. Income tax paid ₹ 5,00,000 for the assessment 2019-20
6. Donation paid to a charitable institution ₹ 2,00,000 by cheque for an approved charitable institution
7. The company has paid ₹ 1,50,000 on account of underwriting commission for fresh issue of shares.
8. Further information
  - i. The company deposited ₹ 25,00,000 as advance tax.
  - ii. Rent from house property ₹ 23,000 let out to outsiders after deduction of repairs ₹ 1,000 and municipal tax ₹ 3,000.
  - iii. Dividend from non-domestic company ₹7,5000

iv. Long term capital gain ₹ 70,000.

Compute total income of XYZ ltd for the assessment year 2021-22 and calculate tax liability assuming that it's a Domestic company which is claiming exemptions and whose turnover in F.Y 2017-18 was less than 400 crore.

## Notes

**Solution:****Computation of total income for the AY 2021-22**

Net profit as per profit and loss account		1,00,00,000
Add: Disallowed expenses		62,500
Undervaluation of closing stock @ 5%		----
Expenses obtaining loan (allowable)		2,50,000
Ads in souvenir political party		5,00,000
Income tax paid		2,00,000
Donation		1,20,000
Underwriting commission (4/5)*		11,000
Fine of breach of custom regulation		
Less	43,500	11,00,000
Under valuation of opening stock		
<b>Income from business</b>		<b>1,11,00,000</b>
Income from House property	27,000	16,800
GAV	3,000	
Less municipal tax paid	24,000	
Annual value	7,200	
Less 30% of A.V		
Income from house property		
Capital gain		70,000
Income from other source		75,000
Dividend from non-resident company		
<b>Gross total income</b>		<b>12,61,800</b>
Less deduction u/s 80 G		1,00,000
50% of the donation 2,00,000		
<b>Total income</b>		<b>11,61,800</b>

\*Only 1/5th Underwriting commission is deductible every year to a maximum of 5 years.

**Computation of tax liability**

Tax on LTCG ₹ 70,000 @ 20%	14,000
----------------------------	--------



Other income	29,67,056
11,091,800 @ 25% 27,72,950	
Add: surcharge of 7% 1,94,106	
Add:	
health and education Cess @ 4% 1,18,682	30,85,738
Less advance tax	30,99,738
	25,00,000
<b>Tax liability</b>	<b>5,99,738</b>

## Notes

**Domestic manufacturing companies under section 115baa.:**

In order to give reduced rate of tax for domestic companies, a domestic company shall pay tax at lower rate of 22% for every previous year plus surcharge of 10% and cess of 4%. The effective rate being 25.17%, if the following condition complied with :

i. Such companies should not avail any exemption and therefore the total income of the company shall computed without claiming any deduction u/s 10AA (sez), Sec 32, 32AD, 32AB, 33ABA, 35, 35AD, 35CCC, 35CCD, 80(IA, IAB, IAC...etc.) and set-off and carry forward of losses if incurred on above mentioned deductions.

ii. Such company will have to be exercised their option to be taxed on or before the due date of filing of income tax return

iii. Such companies will be exempted from MAT rules.

iv. There is no restriction on turnovers and the company need to be a new company. Any existing company can migrate to the new section at any point

Particulars	Rates applicable
Income tax	22%
Surcharge	10% if total income exceeds 1 crore
Health & education cess	4% of income tax + surcharge

**Domestic new manufacturing companies under section 115BAB**

The taxation law ordinance 2019 has inserted a section 115BAB especially for new manufacturing companies. The government has introduced a new tax regime for the new manufacturing company which offers a low tax rate of 15% plus surcharge and cess to promote new manufacturing set-up. Rate applicable will be effective rate of 17.168%. The domestic company has to satisfy the following condition in order to be taxed at reduced rate.

i. The company has been set up and organized on or after 10th October 2019 and has commenced manufacturing on or before 31/03/2023.

ii. Not be formed after splitting up and reconstruction of a business already in existence.

## Notes

iii. The company should be engaged in the business of manufacturing or production of any article or thing, and research in relation to such article or thing.

iv. The total income of the company should calculate without claiming tax exemption and incentives. The total income of the company shall compute without claiming any deduction u/s 10AA (sez), Sec 32, 32AD, 32AB, 33ABA, 35, 35AD, 35CCC, 35CCD, 80(IA, IAB, IAC.Etc.) and set-off and carry forward of losses if incurred on above mentioned deductions.

Particulars	Rates applicable
Income tax	15%
Surcharge	10% if total income exceeds 1 crore
Health & education cess	4% of income tax + surcharge

2. **Foreign Company:** A company with residential status in India will be taxed on its global income whether earned in India or outside India. A non-resident company will be taxed only on income received, accrued or arise in India. A non-resident or foreign company are taxed at 40% of total income, plus an additional surcharge @ 2% of tax where total income exceeds one crore but don't exceeds 12 crore or additional surcharge @ 5% if income exceeds 12 crores. An additional surcharge of @ 4% health and educational cess.

Particulars	Rates applicable
Income tax	40%
Surcharge	2% if total income exceeds 1 crore 5% if total income exceeds 12 cores
Health & education cess	4% of income tax + surcharge

### Tax on certain dividend received from foreign companies.

Dividend received from a foreign company is charged to tax 30% in the hand of an Indian company however section 115BBD provides concessional rate of tax in respect of dividend received by an Indian company from a specified foreign company holding 26% or more nominal value of equity then the tax shall be the aggregate of the following

@ 15% of Income tax such dividend income (gross) -----

Add: surcharge

1. @ 7% if total income exceeds One crore rupee. -----

2. @ 12%, if total income exceeds 10 crore rupees. -----

Add: Health and education cess. @ 4% On the amount of income Tax and surcharge -----



## 5.10 Minimum Alternate Tax (MAT) Sec 115JB

### Notes

At times it may happen that a taxpayer, being a company, may have generated income during the year, but by taking the advantage of various provisions of Income-tax Law (like exemptions, deductions, depreciation, etc.), it may have reduced its tax liability or may not have paid any tax at all. Due to increase in the number of zero tax paying companies, MAT was introduced by the Finance Act, 1987 with effect from assessment year 1988-89. Later on, it was withdrawn by the Finance Act, 1990 and then reintroduced by Finance (No. 2) Act, 1996, w.e.f. 1-4-1997. The objective of introduction of MAT is to bring into the tax net "zero tax companies" which in spite of having earned substantial book profits and having paid handsome dividends, do not pay any tax due to various tax concessions and incentives provided under the Income-tax Law. Since the introduction of MAT, several changes have been introduced in the provisions of MAT and today it is levied on companies as per the provisions of section 115JB.

### Computation of MAT under section 115JB

As per the MAT provision the tax liability of a company will be higher of the following two.

1. Tax liability of accompany computed a per normal provision of the income tax law or normal tax liability.
2. Tax computed @ 15% (from AY 2021-22) add surcharge and education cess of book profit computed as per MAT rules.

That is, as per section 115JB, every company is liable to pay MAT, if the income tax payable on the total income, computed as per the normal provisions of the income tax is less than the tax computed under MAT provisions, however the provision of the MAT are not applicable on

(a) Domestic companies which have opted for tax regimes under section 115BAA or 115BAB

(b) Any income accruing or arising to a company from the life insurance business referred to in section 115B

(c) Shipping company the total income of which is subject to tonnage taxation.

### Computation of Book Profit - (Section 115JB)

As per 115JB(2) "book profit" means the net profit as shown in the statement of profit and loss statement prepared in accordance with schedule iii to the company act, 2013 as increased and decreased by the following:



**Book profit under section 115 JB**

Particulars	
<b>Net profit as per Profit &amp; Loss A/c prepared in accordance with the Companies Act</b>	----
<b>Add: Following items</b> (if they are debited to the P & L A/c)	
Income-tax paid/payable and the provision (including interest, cess, surcharge)	----
Amounts carried to any reserves by whatever name called (excluding debenture redemption reserve)	
Provisions for unascertained liabilities	----
Provisions for losses of subsidiary companies	----
Dividends paid/proposed	----
Expenditure related to incomes which are exempt under section 10	----
Expenditure relatable to share of an assessee in the income of an AOP or BOI on which no income-tax is payable section 86.	----
Expenditure relatable to income accruing or arising to a foreign company, from:	----
(a) capital gains arising on transactions in securities; or	
(b) interest, royalty, or fees for technical services chargeable to tax at less than the rate of MAT	
Notional loss on transfer of a business trust	----
Expenditure relatable to income by way of royalty in respect of patent chargeable to tax under section 115BBF	----
Amount of depreciation debited to P & L A/c	----
Deferred tax and the provision thereof	----
Provision for diminution in the value of any asset	----
The amount standing in revaluation reserve relating to revalued assets.	----
The amount of gain on transfer of units of business trust	----
<b>Less: Following items</b> (if credited to the P & L A/c)	
Amount withdrawn from any reserve or provision	----
Incomes which are exempted under section 10	----
Amount of depreciation (excluding the depreciation on revaluation of assets)	----
Amount withdrawn from revaluation reserve (to the extent it does not exceed the amount of depreciation on revaluation of assets)	----
Share of Assessee income of an AOP or BOI, on which no income-tax is payable in accordance with the provisions of section 86.	----

## Notes

Income accruing or arising to a foreign company, from: (a) capital gains arising on transactions in securities; or (b) interest, royalty, or fees for technical services chargeable to tax at less than the rate of MAT	----
Notional gain on transfer of a capital asset of a business trust	----
Income by way of royalty in respect of patent chargeable to tax under section 115BBF	----
Amount of brought forward loss or unabsorbed depreciation, whichever is less as per books of account	----
Profits of a sick industrial company till its net worth becomes zero/positive	----
Deferred tax, if credited to P&L account	----
<b>Book profit for the Computation of MAT</b>	----

**Tax Credit as per MAT – Sec 115JAA**

A company has to pay higher of normal tax liability or liability as per MAT provision. If in a year the company pay liability as per MAT, then its entitled to claim credit of MAT paid over and above the normal rate of tax liability in the subsequent year. The tax credit shall be the difference between the tax paid under MAT and the tax payable on total income as per IT act.

- MAT credit is allowed when a company paid tax under MAT, in subsequent years.
- The tax credit shall be the difference between the tax paid under MAT and the tax payable on total income as per IT Act.
- MAT credit can carry forward for a maximum of 15 assessment years (w.e.f AY 2018-19).
- The credit will be allowable when the tax payable under IT Act is more than the tax payable.
- No interest is payable on tax credit.

**Illustration 25**

The tax liability of XY Ltd for the financial year 2021-22 under normal provision of the income tax act is ₹ 18,40,000 and liability as per provision of MAT is ₹ 18,00,000. It has brought forward MAT credit of ₹ 2,00,000. Find out the tax liability of the company after adjusting MAT credit?



## Notes

## Solution:

Particulars	₹
Tax liability as per normal provision of income tax	18,40,000
Tax liability as per MAT provision	18,00,000
Difference	40,000
Hence out of 2,00,000 MAT credit only 40,000 can claim in the current year	
So, the tax liability for the current year is (18,40,000 – 40,000)	18,00,000
And MAT credit carry forwarded is (2,00,000 – 40,000)	1,60,000

**Note:** Set off in respect of brought forward MAT credit shall be allowed in subsequent years to the extent of the difference between the tax on total income as per the normal provision and MAT provision.

## Illustration 26

ABC Ltd, A domestic Company furnishes the following particulars in respect of AY 2021-22. You are required to find his total income and tax liability after considering the Provisions of Sec 115JB.

- Net profit as per Profit and Loss account: ₹ 2.1 crore.
- Profit and Loss statement includes:
  - Credits: Dividend from Indian Companies: ₹ 10 lakhs  
Share of Profit from AOP: 40 lakhs  
Short term capital Gain 20 lakh.
  - Debits: Depreciation on SLM basis: 60 lakhs. Provision for loss of subsidiary: 10 lakhs.
- Depreciation allowable as per income tax rules: ₹ 90 lakhs.
- Losses brought forward as per IT rules:
  - Business loss: 20 lakhs.
  - Unabsorbed depreciation: 50 lakhs.

Note: The turnover of ABC Ltd for the PY 2017-18 was 120 crores.

## Solution:

## Computation of Total Income As per Income tax Act

Particulars	₹ (lakhs)	₹ (lakhs)
Net profit as per Profit and Loss account.	60	210
Add: Depreciation as per books of account		
Provision for losses of subsidiary	10	70
<b>Total</b>		<b>280</b>



Less: Dividend income: Exempt 10(34)	10	160
Share of Profit from AOP	40	
Depreciation as per income tax rules	90	
Short term capital gain	20	
Business Income		120
Less: Set-off of b/f Business Loss:		20
		100
Short term Capital Gains		20
		120
Less: Unabsorbed depreciation		50
<b>Total Income as Per Income tax Act</b>		<b>70</b>

**Computation of Book Profit Under Sec 115JB**

Particulars	₹ (lakhs)	₹ (lakhs)
Net profit as per Profit and Loss account.	60	210
Add: Depreciation as per books of account	10	70
Provision for losses of subsidiary		
<b>Total</b>		<b>280</b>
Less: Dividend income: Exempt 10(34)	10	
Share of Profit from AOP	40	
Depreciation as per income tax rules	60	
B/F Business loss or Unabsorbed depreciation whichever is less	20	130
<b>Book profit under Sec 115JB</b>		<b>150</b>

**Computation of tax liability under normal provisions of IT Act**

Particulars	₹
Total income 70 lakh @ 25%	17,50,000
Add: surcharge	-----
Add: Health and Education cess	70,000
<b>Tax liability under normal provisions</b>	<b>18,20,000</b>

**Computation of tax liability MAT**

Particulars	₹
Total income 150 lakh @ 15%	22,50,000
Add: surcharge @ 7%	1,57,500
	24,07,500
Add: Health and Education cess	96,300
<b>Tax liability under MAT</b>	<b>25,03,800</b>

**Final Tax Liability of ABC Ltd.**

Tax liability as per Normal Provisions	18,20,000
Tax Liability as per MAT rules	25,03,800
Final tax liability (whichever is higher)	<b>25,03,800</b>
MAT credit	6,83,800

**Illustration 27**

A domestic company submits the following particulars of its income for the previous year ending on 31.03.2020:

1. Profits of business after deduction of donations to approved charitable institution ₹ 4,00,000
2. Donation to charitable institution by cheque ₹ 50,000
3. Interest on Government securities ₹ 20,000
4. Dividend from domestic company (Gross) ₹ 60,000
5. Long Term Capital Gain ₹ 1,00,000
6. Book Profits u/s 115JB ₹ 10,00,000

During the financial year 2018 -19 the company deposited ₹ 50,000 in IDBI. The company distributed a dividend of ₹ 1,00,000 on 06/09/2019. Compute the taxable income of the company and tax payable by it for AY 2021-22. Assume the turnover of the company is less than 400 crores.

**Solution:****Computation of total Income (for the AY 2021-22)**

	₹
Income from Business	4,50,000
Business Profit 4,00,000	1,00,000
Add: Donations 50,000	20,000
Capital Gain	
LTCG	
Income from other sources	
Interest on Govt. securities 20,000	
Dividend from a domestic company exempt	
<b>Gross Total Income</b>	<b>5,70,000</b>
Less: Donation u/s 80G	
Qualifying limit(5,70,000-1,00,000) 10% 47,000 - 50% of 47,000	23,500
<b>Total Income</b>	<b>5,46,500</b>
Computation of Tax payable. (for the Assessment Year 2021-22)	

Total Income ₹ 5,46,500	
Tax on ₹ 1,00,000 LTCG @ 20%	20,000
Tax on other income ₹ 4,46,500 @ 25%	1,11,625
1,31,625	
Add: Surcharge	Nil
1,31,625	
Add: Education cess @ 4%	5,265
<b>Tax on Total Income (a)</b>	<b>1,36,890</b>
Book Profit ₹ 10,00,000	
Tax on ₹ 10,00,000 @ 15%	1,50,000
Add: Surcharge	Nil
1,50,000	
Add: Education cess	6,000
<b>Tax on Book Profit (b)</b>	<b>1,56,000</b>
<b>Tax Payable (a) or (b) whichever is more</b>	<b>1,56,000</b>

**Illustration 28**

XYZ Ltd has provided the following information for the year ended 31.3.2020

- Income computed as per the provision of income tax act ₹20,00,000
- Profit as per statement of profit and loss account ₹50,00,000
- Items deducted in statement of profit and loss
  - Provision for income tax ₹6,50,000
  - Dividend distribution tax ₹ 40,000
  - Provision for deferred tax ₹ 60,000
  - Securities transaction tax ₹1,00,000
  - Provision for gratuity actuarial valuation ₹1,50,000
  - Dividend declared ₹2,50,000
  - Expenditure to earn agriculture income ₹1,00,000
  - Depreciation ₹4,50,000, this includes depreciation of ₹ 2,00,000 on revaluation of asset.
- Items added to the statement of profit and loss
  - Transfer from special reserve ₹2,00,000
  - Agricultural income ₹ 4,00,000
  - Long term capital gain exempted u/s 10(38) ₹ 2,00,000
- Brought forwarded business loss as per books of account -8,00,000



6. Brought forward depreciation as per books of account -7,00,000

You are required to calculate tax payable by the company and tax credit to be carried forward

## Notes

**Solution:****Computation of book profit u/s 115JB for the AY 2021-22**

Net profit as per the profit and loss A/c	50,00,000	
Add:	6,50,000	15,50,000
Provision for income tax	40,000	
Dividend distribution tax	60,000	
Provision for deferred tax	2,50,000	
Dividend declared	1,00,000	
Expenditure to earn agriculture income	4,50,000	
Depreciation		
Less	2,00,000	15,50,000
Transfer of special reserve	4,00,000	
Agricultural income (exempted)	2,50,000	
Depreciation (4,50,000 – 2,00,000)	7,00,000	
b/f business loss or depreciation as per books of account Whichever is less		

**Book profit under MAT provisions** 50,00,000

**Computation of tax liability u/s 115JB for the AY 2021-22**

Tax on book profit of ₹ 50,00,000 @ 15%	7,50,000
Add @4% health and education cess	30,000
<b>Tax liability under MAT</b>	<b>7,80,000</b>

**Computation of tax at normal provision for the AY 2021-22**

Tax on total income of ₹ 20,00,000 @ 25%	5,00,000
Add: education and health cess @ 4%	20,000
<b>Tax liability under normal provision</b>	<b>5,20,000</b>

**Final Tax Liability of XYZ Ltd.**

Tax liability as per Normal Provisions	5,20,000
Tax Liability as per MAT rules	7,80,000
<b>Final tax liability (whichever is higher)</b>	<b>7,80,000</b>
MAT credit (7,80,000 – 5,20,000)	2,60,000

**Illustration 29**

From the following information compute the tax payable by Z & Co keeping in view the provisions of MAT u/s 115JB for the Assessment Year 2021-22:

**Statement of Profit & Loss (for the year ended 31st March 2020)**

Particulars	Amount
I Revenue from operations 30,00,000	
II Other income:	
LTCG (exempt under section 10(38) 2,00,000	
Interest on Govt securities 25000 2,25,000	
III Total Revenue (I + II)	32,25,000
IV Expenses:	
Cost of materials consumed	----
Purchase of stock in trade	----
Depreciation and amortization expenses	1,50,000
Other Expenses:	
Expenses related to sales	23,20,000
STT paid relating to LTCG	5,000
Total Expenses	24,75,000
V Profit Before Tax (III - IV)	7,50,000
VI Tax Expenses:	
Income Tax paid	1,00,000
VII Profit for the period (V - VI)	6,50,000

**Surplus Statement**

Profit/Loss as per last Balance sheet (if any)	6,50,000
Current Year's profit	
Less: Proposed dividend	
Balance of profit carried to Balance Sheet	
6,50,000	
2,50,000	
4,00,000	

**Additional Information:**

- The company revalued its assets from ₹ 3,00,000 to ₹ 6,00,000 and provided depreciation on ₹ 6,00,000 @ 25%. The depreciation allowable as per Income Tax Act ₹ 80,000.
- B/F loss as per books of account ₹ 2,00,000

Notes

3. B/F depreciation as per books of account ₹ 50,000

4. B/F unabsorbed depreciation ₹ 1,00,000

**Solution:**

Notes

**Computation of total income and tax payable  
For the AY 2021-22**

Income from business	₹	₹
Profit as per statement of Profit & Loss		4,00,000
Add: Expenses disallowed		
1. STT paid		5,000
2. Depreciation		1,50,000
3. Proposed Dividend		2,50,000
4. Income Tax	1,00,000	5,05,000
9,05,000		
Less: 1. LTCG		2,00,000
Depreciation allowable		80,000
2. interest on government securities	25000	3,05,000
<b>Business Income for the year</b>		<b>6,00,000</b>
Less: B/F unabsorbed depreciation		1,00,000
Taxable Business Income (a)		5,00,000
<b>Capital gain</b>		
LTCG (Exempt u/s 10(38))		Exempt
<b>Income from Other sources</b>		
Interest on Govt securities (b)		25,000
<b>Gross Total Income (a) + (b)</b>		<b>5,25,000</b>
Deduction		Nil
<b>Total Income</b>		<b>5,25,000</b>
<b>Tax on total income</b>		
Tax on 5,25,000 @ 25%		1,31,200
Add: Surcharge		Nil 5,250
Add: Education Cess and SHEC @ 4%		
<b>Tax Payable on Total Income</b>		<b>1,36,450</b>

**Computation of book profit u/s 115JB and tax payable  
(For the AY 2021-22)**

Profit as per statement of Profit & Loss	1,50,000	4,00,000
Add: Expenses disallowed	2,50,000	5,00,000
1. Depreciation	1,00,000	
2. Proposed Dividend		
3. Income Tax	9,00,000	



Less: Depreciation allowable 3,00,000 @25%	75,000	1,25,000	Clubbing of Income
B/F loss or depreciation, whichever is less	50,000		
<b>Book Profit</b>	<b>7,75,000</b>		

#### Tax on book profit

Tax on 7,75,000 @ 15%	1,16,250
Add: Surcharge	Nil
Add: Education Cess and SHEC @ 4%	4,650
<b>Tax Payable on Book Profit</b>	<b>1,20,900</b>

#### Notes

liability as per Normal Provisions	1,36,450
Tax Liability as per MAT rules	1,20,900
<b>Final tax liability (whichever is higher)</b>	<b>1,36,450</b>

### 5.11 Dividend Distribution Tax (DDT)-Sec 115-O

Dividend is the part of the profit that the company shares with the shareholders. When a company issue dividend to shareholders, a tax is levied on it, which is called dividend distribution tax (DDT). Till financial year 2019-20 the company was required to pay dividend distribution tax on the dividend paid or declared or distributed as a provision of section 115-O of income tax act at prescribed rate of 17.472% and the company required to make the payment of DDT within 14 days of the earliest event in declaration of any dividend, or distribution of dividend, or payment of dividend.

Note: Amendments from FY 2021-22. As per finance act 2020 amendments have been made in section 115-O and section 194 of the income tax act 1961. From F.Y 2021-22 onwards, dividend is taxable in the hands of recipient of dividend, and not by the issuing company.

#### DDT for the F.Y 2019-20

A domestic company is liable to pay tax on the amounts distributed or declared or paid as dividend at the following rates-

Income tax @ 15%

Add: Surcharge @ 12%

Add: health & Education cess on income tax + surcharge @ 4%.

Note-

- Removal of cascading effect on dividend distribution: A domestic holding company (holds more than 50% of the nominal equity) receiving dividend from

subsidiary company can reduce the same from dividends declared /distributed/ paid by it.

### Illustration 30

#### Notes

Amount of dividend paid or distributed by a company is 85 lakhs, calculate dividend distribution tax?

#### Solution:

Dividend distributed = 85,00,000

Grossing up  $= (85,00,000 \times 100 / 17.427) = 1,02,99,535$

Calculating DDT on the distributed profit

DDT @ 15% = 15,44,930

Add: surcharge @ 12% = 1,85,392

Tax + surcharge = 17,30,322

Add: cess @ 4% = 69,213

**Amount payable as DDT = 17, 99,535**

Or

DDT = Gross dividend Effective rate

$= 1,02,99,535 \times 17.472\% = 17, 99,535$

### Illustration 31

ABC Ltd. A domestic company has distributed on 1.10.2019, a dividend of ₹ 240 lakhs to its shareholders. On 1.09.2019 ABC Ltd. Has received a dividend of ₹ 70 lakh from its domestic subsidiary company XYZ Ltd. on which they have paid DDT under section 115-O. Compute additional income tax payable by ABC Ltd. Under section 115-O.

#### Solution:

Particulars	₹ in lakhs
Dividend distributed by ABC Ltd	240
Less: Dividend received from XYZ Ltd	70
Net distributed profit	170
Add: grossing up of Dividend 170	30
Gross dividend	200
Additional income tax payable @ 15% u/s 115-O	30
Add: Surcharge @ 12%	3.60
Add: Health and education cess @ 4%	33.60
	1.34
<b>Dividend Distribution Tax</b>	<b>34.94</b>

### Additional income tax on distributed income of a domestic company during buyback of shares- sec 115qa (w.e.f 5.07.2019)

Buy back of share means the company purchases its own share from the existing shareholders at a price decided by the board or management or at market price. Under this situation the company re-purchases its own shares using the surplus fund to buy back the share and tries to increase the value to the company. The surplus fund can be used to distribute dividend, but dividend is chargeable to dividend distribution tax so the companies prefer to go for buy back of shares which will lead lower rate of tax on capital gain.

So, the government introduced a new section 115QA an anti-tax avoidance measure provision of this section was initially applicable only to the unlisted companies but now it is applicable to listed companies also. In case of buyback of shares (listed or unlisted) by domestic companies an additional income tax @ 20% (plus surcharge 12% and cess@4%) is payable by company on the distributed income. Income arising (capital gain) to shareholders through buyback is exempt u/s 10(34a) since company is liable to pay additional income tax.

### Notes

#### Illustration 32

Mr. X purchases 500 shares of Y Ltd at ₹ 300 where ₹ 290 as premium and ₹ 10 as face value on 1-1-2005. The company Y Ltd decided to buy back 50 % of the shares @ ₹ 400/shares on 1.1.2020. Compute tax liability of Y Ltd.

#### Solution:

Amount distributed =

(Amount paid by the company on buy back of shares – Amount received by the company on issue of shares)

Amount paid by the Company on buy back

= 250 shares (50 × 50% of shares)

= 250 × 400

= ₹1,00,000

Amount received by the company on issue

= 250 shares (50% shares)

= 250 × 300 (includes premium)

= 75,000

Amount distributed = 1,00,000 – 75,000

= 25,000



Tax liability on buy back of share =  $25,000 \times 20.8\%$

(20% income tax + 4% health and education cess) = ₹ 5,200.

### Tax on income distributed to unit holders (115R, 115S and 115T)

Any amount of income distributed by:

### Notes

1. A specified company, or
2. A Mutual Fund, to its unit holders shall be chargeable to tax and such specified company or Mutual Fund shall be liable to pay additional income-tax on such distributed income at the following rate:
  - a. Where the income is distributed to any person being an individual or a HUF by a money market mutual fund or a liquid fund 25% + 12% SC + 4% Cess
  - b. Where the income is distributed to any other person by a money market mutual fund or liquid fund 30% + 12% SC + 4% Cess
  - c. Where the income is distributed by a fund other than a money market mutual fund or a liquid fund and such income is distributed to Individual or HUF 10% + 12% SC + 4% Cess
  - d. Any person other than individual or HUF 30%+7%or12%SC+4% Cess.

**Note:** Amendments from FY 2021-22. The taxability of income from units of mutual funds shifted to unit holders and is now liable to TDS. The incidence of tax is now on recipient of income and not the mutual fund.

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### Securities Transaction Tax (STT)

STT is a kind of financial transaction tax which is similar to tax collected at source (TCS). STT is a direct tax levied on every purchase and sale of securities that are listed on the recognized stock exchanges in India. STT is governed by Securities Transaction Tax Act (STT Act) and STT Act has specifically listed down various taxable securities transaction i.e., transaction on which STT is leviable.

Taxable securities include equity, derivatives, unit of equity oriented mutual fund. It also includes unlisted shares sold under an offer for sale to the public included in IPO and where such shares are subsequently listed in stock exchanges. STT is an amount to

be paid over and above transaction value and hence, increases transaction value.

*Clubbing of Income*

STT Act has also provided for value of transaction on which STT is required to be paid and person who is responsible to pay STT i.e., either buyer or seller. However, rate of STT will be decided by Government and modified from time to time if necessary. STT is required to be collected by a recognised stock exchange or by the prescribed person in the case of every Mutual Fund or the lead merchant banker in the case of an initial public offer, as the case may be, and subsequently payable to the Government on or before the 7th of the following month. In case the above persons fail to collect the taxes, they are still obliged to discharge an equivalent amount of tax to the credit of Central Government within 7th of the following month. Further, failure to collect or, remit whatever has been collected will result in levy of interest and penal consequences too.

Notes

### Securities liable for STT

While the term 'securities' is not defined under STT Act, STT Act specifically allows borrowing of definition of such terms not defined in STT Act but defined in Securities Contracts (Regulation) Act, 1956 or Income-tax Act, 1961. The term 'Securities' is defined in Securities Contracts (Regulation) Act and includes the following:

1. Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate.
2. Derivatives.
3. Units or any other instrument issued by any collective investment scheme to the investors in such schemes.
4. Government securities of equity nature.
5. Equity oriented units of mutual fund.
6. Rights or interest in securities.
7. Securitised debt instruments.

Hence, securities include all the above and the purpose of STT is to levy tax on securities that are traded on recognized stock exchange. Off-market transactions are out of the purview of STT.

### STT rates for the FY 2019-20

S. No.	Taxable securities transaction	Rate of STT	Payable by	Value on which STT to be paid
1.	Delivery based purchase of equity shares in a company.	0.1%	Purchaser	Price at which it is purchased



## Notes

2.	Delivery based sale of equity shares in a company	0.1%	Seller	Price at which it is sold.
3.	Delivery based sale of a unit of oriented mutual fund	0.001%	Seller	Price at which unit sold.
4.	Sale of equity share or unit of equity oriented mutual fund in recognized stock exchange otherwise than by actual delivery or transfer and intraday traded shares	0.025%	Seller	Price at which equity share or unit is sold.
5.	Derivative – Sale of an option in securities	0.017%	seller	Option premium
6.	Derivative – Sale of an option in securities where option is exercised	0.125%	purchaser	Settlement price
7.	Derivative – Sale of futures in securities	0.01%	seller	Price at which such futures is traded
8.	Sale of unit of an equity-oriented fund to the Mutual Fund – Exchange traded funds (ETFs)	0.001%	seller	Price at which unit is sold
9.	Sale of unlisted shares under an offer for sale to public included in IPO and where such shares are subsequently listed in stock exchanges	0.2%	seller	Price at which such shares are sold
10.	Purchase of units of equity oriented mutual funds	nil		N.A

**STT and Income Tax**

- 1. Short term capital gain on sale of equity (111A):** Under section 111A, when shares and mutual funds are transferred within one year of its acquisition, any gains arising from such transfer will be considered as short-term capital gain. The short-term capital gains arising out of the transfer of listed shares and mutual funds for which STT (Securities Transaction Tax) has been paid and are taxable at the rate of 15%. However, short term capital gain arising from the sale of non-STT paid shares, bonds, debentures, and other listed securities will be taxed as per the marginal income tax slabs applicable to individuals and HUFs.



2. **Long term capital gain on sale of equity (112A):** The Finance Act, 2018 inserts a new Section 112A with effect from Assessment Year 2019-20. As per the new section capital gains arising from transfer of a long-term capital asset being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust shall be taxed at the rate of 10% of such capital gains exceeding ₹1,00,000. This concessional rate of 10% will be applicable if:

- i. in a case of an equity share in a company, securities transaction tax has been paid on both acquisition and transfer of such capital asset; and
- ii. in a case a unit of an equity-oriented fund or a unit of a business trust, STT has been paid on transfer of such capital asset. Capital gain tax rate on sale of assets other than the STT paid shares listed on recognized stock exchange and mutual funds

## 5.12 Tonnage Tax: Shipping Companies

Tonnage tax is a taxation scheme of presumptive taxation wherein notional income arising from operation of ships is determined on the basis of tonnage of ships. Tonnage tax is calculated not on the profit or loss of a company in a given year, but by applying a notional annual income on net registered tonnage. Chapter xii-G has been inserted in the income tax act from assessment year 2004-05 contain section 115vt to 115vzc which provide special provision relating to taxation of the shipping company.

### Qualifying Company

1. It is an Indian company
2. The place of effective management of the company is in India
3. Its own at least one qualifying ship (115vd).
4. The main objective of the company is to carry on the business of operating ship.

### Qualifying Ship under Section 115vd

For the purpose of tonnage tax, a ship is a qualifying ship if-

1. it is a sea going ship or vessel of fifteen net tonnage or more.
2. it is a ship registered under the Merchant Shipping Act, 1958 (44 of 1958), or a ship registered outside India in respect of which a license has been issued by the Director-General of Shipping under section 406 or section 407 of the Merchant Shipping Act, 1958 (44 of 1958); and
3. a valid certificate in respect of such ship indicating its net tonnage is in force,  
But does not include

## Notes

- (a) a sea going ship or vessel if the main purpose for which it is used is the provision of goods or services of a kind normally provided on land.
- (b) fishing vessels.
- (c) factory ships; the ship providing, processing services in respect of fishing produce
- (d) pleasure crafts: the ship whose primary use is for the purpose of sport and recreation
- (e) harbor and river ferries.
- (f) offshore installations.
- (g) a qualifying ship which is used as a fishing vessel for a period of more than thirty days during a previous year.

**Computation of Tonnage Income (115VG)**

1. The tonnage income of a tonnage tax company for a previous year shall be the aggregate of the tonnage income of each qualifying ship computed in accordance with the provisions of sub-sections (2) and (3).
2. For the purposes of sub-section (1), the tonnage income of each qualifying ship shall be the daily tonnage income of each such ship multiplied by—
  - (a) the number of days in the previous year; or
  - (b) the number of days in part of the previous year in case the ship is operated by the company as a qualifying ship for only part of the previous year, as the case may be.
3. For the purposes of sub-section (2), the daily tonnage income of a qualifying ship having tonnage referred to in column (1) of the Table below shall be the amount specified in the corresponding entry in column (2) of the Table:

Qualifying ship having net tonnage	Amount of daily tonnage income
(1)	(2)
Up to 1,000 tons	₹ 70 for each 100 tons
Exceeding 1,000 but not more than 10,000	₹700 plus ₹ 53 for each 100 tons exceeding 1,000 tons
Exceeding 10,000 but not more than 25,000	₹ 5,470 plus ₹42 for each 100 tons exceeding 10,000 tons
exceeding 25,000	₹ 11,770 plus ₹ 29 for each 100 tonsexceeding 25,000 tons.

4. For the purposes of this Chapter, the tonnage shall mean the tonnage of a ship indicated in the certificate referred to in section 115VX and includes the deemed tonnage computed in the prescribed manner.



Explanation: for the purposes of this sub-section, "deemed tonnage" shall be the tonnage in respect of an arrangement of purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel.

5. The tonnage shall be rounded off to the nearest multiple of hundred tons and for this purpose any tonnage consisting of kilograms shall be ignored and thereafter if such tonnage is not a multiple of hundred, then, if the last figure in that amount is fifty tons or more, the tonnage shall be increased to the next higher tonnage which is a multiple of hundred and if the last figure is less than fifty tons, the tonnage shall be reduced to the next lower tonnage which is a multiple of hundred; and the tonnage so rounded off shall be the tonnage of the ship for the purposes of this section.
6. Notwithstanding anything contained in any other provision of this Act, no deduction or set off shall be allowed in computing the tonnage income under this Chapter.

## Notes

### **Treatment of Common Costs (115VJ)**

1. Where a tonnage tax company also carries on any business or activity other than the tonnage tax business, common costs attributable to the tonnage tax business shall be determined on a reasonable basis.
2. Where any asset, other than a qualifying ship, is not exclusively used for the tonnage tax business by the tonnage tax company, depreciation on such asset shall be allocated between its tonnage tax business and other business on a fair proportion to be determined by the Assessing Officer, having regard to the use of such asset for the purpose of the tonnage tax business and for the other business.

### **Procedure for Opting of Tonnage tax Scheme**

1. A company may opt for the tonnage tax scheme by making an application to the joint commissioner having jurisdiction over the company in the form and manner as may be prescribed
  - (a) The application may be made by a company within three month of the date of incorporation or the date on which it become qualifying company.
  - (b) On receipt of an application for option for tonnage tax scheme, the joint commissioner may call for such information or documents from the company as he thinks necessary in order to satisfy himself about the eligibility of the company and after satisfying himself about such eligibility to make such option for tonnage tax scheme, he – shall pass an order in writing approved the option for tonnage tax scheme; or



## Notes

- (c) Shall, if he is not so satisfied, pass an order in writing refusing to approve the option for tonnage tax scheme.
2. Every order granting or refusing the approval of the option for tonnage tax scheme under clause (i)&(ii), as the case may be, of sub-section. Shall be passed before the expiry of one month from the end of the month in which the application was received.
  3. Where an order granting approval is passed above the provisions of this chapter shall apply from the assessment year relevant to the previous year in which the option for tonnage tax scheme is exercised.

### Condition for Applicability of Tonnage Tax Scheme

#### I. Transfer of profit to tonnage tax reserve account- section 115VT:

1. An amount not less than 20% of the book profit derived from the business of qualifying ships shall be credited to the tonnage tax reserve account.
2. Amount credited to the tonnage tax reserve account shall be utilized by the company before the expiry of a period of eight years next following the previous year in which the amount was credited—
  - (a) For acquiring a new ship for the purposes of the business of the company; and
  - (b) Until the acquisition of a new ship, for the purposes of the business of operating qualifying ships other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India.

#### II. Minimum training requirement for tonnage tax company- section 115VU:

A tonnage tax company shall comply with the minimum training requirement specified by the director general of shipping and notified in the official gazette by the central government.

#### III. Limit for charter in of tonnage: section – 115VV:

1. In the case of every company which has opted for tonnage tax scheme, not more than forty-nine per cent of the net tonnage of the qualifying ships operated by it during any previous year shall be chartered in.
2. The proportion of net tonnage referred in respect of a previous year shall be calculated based on the average of net tonnage during that previous year.
3. The average of net tonnage shall be computed in such manner as may be prescribed in consultation with the director-general of shipping.

4. Where the net tonnage of ships chartered in exceeds the limit during any PY, the total income of such company in relation to that previous year shall be computed as if the option for tonnage tax scheme does not have effect for that PY.
5. Where the limit had exceeded in any two consecutive previous years, the option for tonnage tax scheme shall cease to have effect from the beginning of the previous year following the second consecutive previous year in which the limit had exceeded.

## Notes

**IV. Maintenance and audit of accounts: section – 115VW:**

1. Maintains separate books of account in respect of the business of operating qualifying ships; and
2. Furnishes, along with the return of income for that previous year, the report of an accountant, in the prescribed forms duly signed and verified by such accountant

**Illustration 33**

From the following information compute the tax payable by a tonnage tax company for the assessment year 2021-22.

1. The company has two qualifying ships. The net tonnage of ship 1 is 27,749 ton and 200 kg and ship 2 is 16,750 ton and 400 kg
2. Ship 1 runs for 365 days during the previous year and ship ii for 180 days during the previous year
3. Turnover of core activities ₹ 10 crore
4. Profit from incidental activities ₹ 3 lakh

**Solution:**

Net tonnage of ship 1: 27749 ton & 200 kg = 27,700 ton(round off)

Net tonnage of ship 2: 16,750 ton & 400 kg = 16,800

**Computation of taxable income (for the AY 2021-22 )**

Ship 1		Ship 2
First 1,000 ton $70 \times 10$	700	700
Next 9,000 ton $53 \times 90$	4,770	4,770
Next 15,000 ton $42 \times 150$	6,300	-----
6,800 ton $42 \times 68$	-----	2,856
Next 2,700 ton $29 \times 27$		783
Daily tonnage	12,553	8,326
Deemed income		45,81,845
Ship 1 = $12,553 \times 365$		8,32,600
Ship 2 = $8,326 \times 100$		
Deemed income under tonnage		54,14,445



## Notes

**Income taxable under provision of the act**

Turnover of core activities	₹ 10 crore
Profit from incidental activities is	₹ 3,00,000
Profit from incidental activities up to .25 % of turnover of core activities is part of the deemed income =	₹ 2,50,000
Income taxable under other provision of the act (3,00,000 – 2,50,000) =	₹ 50,000
<b>Taxable income</b> = (54,14,445 + 50,000) =	<b>₹ 54,64,445</b>
Tax on 54,64,450 @ 25%	13,66,113
Add health and education cess 4%	54,645
<b>Tax payable</b>	<b>14,20,758</b>

**5.13 Summary**

Partnership is the form of business, which is owned by two or more general partners. Each of the partners is liable for the debts of the business. Although the partnership must file a separate tax return, each general partner is required to report his pro rata share of the partnership's income on his individual income tax return. A partnership agreement is a practical necessity for this form of business organisation. A deed of partnership must be drafted which set out the terms and conditions of the partnership.

An Indian company, or ii) any body corporate incorporated in a foreign country, or iii) any institution or body, whether incorporated or not, but declared by the order of the Board to be a company for any assessment year. Residence of a company: It is resident in India in any previous year if it is an Indian company or its control and management is situated wholly in India. It is never not ordinarily resident.

It is computed in the same manner as that of an individual. Briefly the procedure is that at first the taxable income is determined under each head of income. All these taxable incomes are aggregated and then any brought forward losses or allowances are deducted. The balance is gross total income. From G.T.I. the deductions under sections 80G, 80GGA, 80GGB, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE, 80JJA, or 80LA are made. The balance left is Total Income.

A company owned by the government or the Reserve Bank of India to the extent of at least 40% of its shares, or b) a company registered under section 25 of the Companies Act, or c) a company without share capital but declared by the Board to be a company in which the public are substantially interested, or d) a mutual benefit finance company, or e) a company whose shares carrying not less than 50 % of the voting power is beneficially held by one or more co-operative societies throughout the relevant previous year, or f) a company which is not a private company and either its equity shares are quoted on stock exchange in India or its equity shares carrying at least 50% voting power were



beneficially held throughout the previous year by Government, a statutory corporation or a widely-held company or its wholly-owned subsidiary company.

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## 5.14 Keywords

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- **Dividend:** A sum of money paid regularly (typically annually) by a company to its shareholders out of its profit (or reserves).
- **Legal entity:** An association, partnership, proprietorship, trusts, or individual that has legal standing in the eyes of law.
- **Domestic Company:** A company that conducts its affairs in its home country. A domestic corporation is often taxed differently than a foreign corporation.
- **Financial Year:** Financial year is the period between 1<sup>st</sup> April and 31<sup>st</sup> March in which we earn income.

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## 5.15 Review Questions

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1. Explain the Aggregation of Income/Deemed Income.
2. What is the Assessment of Firms?
3. Describe the Partnership Firm assessed as an Association of Person (PFAOP)- u/s 185.
4. What is the Tax planning for Partnership Firms?
5. Discuss the Assessment of Association of Persons (AOP) & Body of Individual (BOI).
6. Explain the Alternate Minimum Tax (AMT).
7. What is the Assessment of Companies?
8. Explain the Minimum Alternate Tax (MAT) Sec 115JB.
9. Discuss the Dividend Distribution Tax (DDT)-Sec 115-O.
10. What is Tonnage Tax: Shipping Companies? Explain.

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## 5.16 Further Readings

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- Corporate Tax Planning—E. A. Srinivas.
- Corporate Tax Planning and Management-Ahuja & Gupta.
- Corporate Tax Planning and Management-G. Ahuja & R. Gupta.
- Direct Taxes-Law & Practice—V. K. Sinhgania & K. Sinhgania.

## Notes

BBA-304

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