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BASIC CONCEPTS

Topic Referencer

-  Components of Income Tax Law
-  Concept of Charge of Income Tax, Person, Assessee and Exceptions to Previous Year Rule
-  Concepts of Income, Method of Accounting
-  Mode of Computation of Income and Tax Rates for Assessment Year 2021-22

1. *What do you understand by Body of Income Tax Law?*

Ans: The Central Government has got the power through Entry 82 of the Union List of Schedule VII of the Constitution of India to impose tax on all incomes, except the agricultural income. Entry 46 of the State List of said Schedule VII gives power to the State Government to impose tax on agricultural income.

The various components of Income-tax Law, as framed by the Central Government, are -

(1) *The Income Tax Act, 1961:*

- (a) Charge of income-tax is governed by the Income-tax Act, 1961 which came into force w.e.f. 1st April 1962.
- (b) It extends to whole of India including the state of Jammu & Kashmir.
- (c) It contains the various provisions for determining taxable income, tax liability, procedure for assessment, appeals, penalties and prosecutions.
- (d) It contains 298 Sections and XIV Schedules.

(2) *The Income Tax Rules, 1962:*

- (a) Section 295 of the Act empowers the Central Board of Direct Taxes (CBDT) to make Rules.
- (b) These Rules are notified by Notification in the Official Gazette.
- (c) Prescribed: Wherever in the Act the phrase 'as prescribed' appears, it means that Rules have been framed in this respect.

(3) *Circulars & Notifications:*

- (a) Section 119 of the Act empowers the CBDT to issue orders, instructions and directions for the proper administration of the Act.
- (b) The Income Tax Authorities are bound by these circulars.
- (c) They are not binding on assessee, Income Tax Appellate Tribunal (ITAT) or the Courts. However, the assessee can claim benefit under such circulars.

(4) *Judicial Decisions:*

- (a) Supreme Court's precedent is binding on all the Courts, Appellate Tribunals, Income tax authorities, and on all assessees. Where any two judgments of Supreme Court are contradictory then the decision of the larger bench whether earlier or later in time shall prevail. However, where benches having equal number of judges give contradictory decisions, then, the later decision shall prevail.
- (b) High Court's precedents are binding on the Tribunal, Income tax authorities and on assessees falling under its jurisdiction.

(5) *Annual Finance Act:*

- (a) **Presenting the Finance Bill**: Every year, the Finance Minister of India presents a Finance Bill in the Parliament, which contains various amendments proposed to be made in the direct and indirect taxes levied by the Central Government.
- (b) **Approval and assent of Bill**: As soon as the Bill is passed by both the houses of the Parliament and thereafter receives the assent of the President of India, it becomes the Finance Act.
- (c) **Incorporation of Amendments**: The amendments proposed therein are then incorporated in the Income Tax Act which are applicable from the very first day of the next financial year.
Example: Generally, amendments by Finance Act, 2020 are effective from 1-4-2021.
- (d) **First schedule to Annual Finance Act**: It contains four parts, which, as applicable for the Finance Act, 2020, are as follows -

Part I	It specifies the rates at which income tax is to be levied on income chargeable to tax for the assessment year 2020-21.
Part II	It lays down the rate at which tax is to be deducted at source during the financial year 2020-21 i.e. assessment year 2021-22.
Part III	It 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 2020-21 i.e. assessment year 2021-22.
Part IV	It lays down the rules for computation of net agricultural income.

CONCEPT OF CHARGE OF INCOME TAX, PERSON ASSESSEE AND EXCEPTIONS TO PREVIOUS YEAR RULE

2. **Write short note on 'Basis of Charge'.** (6 Marks, PE-II May 1999) OR
 Explain the concept of Charge...of Income Tax as given under section 4 of the Act?.

Ans: **Charge of Income-tax [Section 4]:**

- (i) Income tax is charged for every assessment year.
- (ii) It is charged on every person as specified under section 2(31) of the Act.
- (iii) It is charged on the total income earned by the person during the previous year.
- (iv) Total income is computed in accordance with the provisions of the Act.
- (v) The tax is levied at the rates prescribed by the Finance Act.
- (vi) Income-tax shall be deducted at source or paid in advance, where it is so deductible or payable under any provision of the Act.
- (vii) Income Tax Act, as amended on 1st April of any financial year shall apply for assessment of that year.
 Example: The law amended on 1-4-2021 shall be applicable for assessment year 2021-22.

3. **Explain the scope of "Person" in accordance with the Act.**

Ans: The scope of person is explained as under -

(1) **Person [Section 2(31)]:** "Person" includes,-

- (a) Individual (natural persons, minors and persons of unsound mind).
- (b) Hindu Undivided Family (HUF).
- (c) Partnership firm (including a "Limited Liability Partnership" firm).
- (d) Company.
- (e) Association of persons (AOP) or Body of Individuals (BOI), whether incorporated or not. (E)
- (f) Local authority.
- (g) Every artificial juridical person not falling in any of the above categories.

Example: Deities, Idols, Corporation, Bar council, Guru Granth Sahib, Universities etc.

- (2) **Profit motive not essential to constitute person [Explanation]:** An association of persons or a body of individuals or a local authority or an artificial judicial person shall be deemed to be a person, whether or not such person or body or authority or judicial person was formed or established or incorporated with the object of deriving income, profits or gains.

4. Define the term "Local Authority"

Ans: **Local authority [Explanation to Section 10(20)]:** "Local Authority" means,-

- (i) Panchayat;
- (ii) Municipality;
- (iii) Municipal Committee and District Board;
- (iv) Cantonment Board; or
- (v) Any other authority legally entitled to or entrusted by the Government with the control or management of a municipal or local fund.

5. Define Assessee. (4 'Marks, Nov, 2023) (2 Marks, May 2016)

Ans: **Assessee [Section 2(7)] :** "Assessee" means any person by whom any tax or any other sum of money is payable under this Act and includes—

- (1) **Every person in respect of whom any proceedings under this Act has been taken -**
- (a) for the assessment of his income or of the income of any other person in respect of which he is assessable; or
 - (b) to determine the loss sustained by him or by such other person; or
 - (c) the amount of refund due to him or to such other person;
- (2) **Every person who is deemed to be an assessee under any provision of this Act.**
Example: A trustee of a trust is a representative assessee and is deemed to be an assessee.
- (3) **Assessee in Default:** Every person who is deemed to be an assessee in default under any provision of this Act i.e. an assessee who has failed to comply with any of the duties imposed upon him by the Income-tax Act.
Example : As per Section 140A(3), if an assessee fails to pay the self-assessment tax in accordance with Section 140(1), then he shall be considered as 'assessee in default'.

Illustration 1 - Person when regarded as an 'Assessee' : A single letter of enquiry was issued by the income tax department to Mr. Shoumik of Pune. In this letter there was no specific mention of any provision of the Income-tax Act, 1961. Can Mr. Shoumik be treated as 'assessee' under the Income Tax Act, 1961? (Nov. 1998)

Solution: A person is treated as an 'assessee' only when any proceeding is initiated in his respect under the Income Tax Act, 1961. In the given case, the letter was issued to Mr. Shoumik only for an enquiry and not for any assessment. Further, such an issuance of letter cannot be regarded as proceeding without any specific reference to the provisions of the Act.
 Therefore, Mr. Shoumik is not an 'assessee' under the Act.

6. Define the term "Assessment Year". .

Ans: **Assessment Year [Section 2(9)]:** "Assessment year" means the period of 12 months beginning with the 1st day of April and ending on 31st March of the next year. Income earned in previous year is taxed in the assessment year. Example: The assessment year 2021-22 is a period of 12 months starting from the 1st April 2021 and ending on the 31st March 2021.

7. Define the term "Previous. Year".

Ans: **Previous Year [Section 3]:** As per Section 2(34) read with Section 3 of the Act, the term "Previous year" means the financial year immediately preceding the assessment year.

Example: For the assessment year 2021-22, the previous year shall be the period from 1st April, 2020 to 31st March, 2021 and the total income of an assessee earned in the previous year 2020-21 is assessed in the assessment year 2021-22.

8. What will be the previous year in case of newly set-up business or profession?

Ans: In case, a business or profession is newly set-up, the previous year shall commence from the date of setting up of the business or profession and end with the said financial year.

9. What will be the previous year in case where a new source of income comes into existence?

Ans: In case, where a new source of income comes into existence, the previous year shall commence from the date on which the said source comes into existence and end with the said financial year.

Illustration 2 - Ascertainment of previous year: Ascertain the previous year in the following situations -

- (a) Mr. X set up his new business on 27-08-2020.
- (b) Mr. Y's new source of income came into existence on 25-02-2021.

Solution: (a) The previous year for Mr. X shall be 27-08-2020 to 31-03-2021. (b) The previous year for Mr. Y shall be 25-02-2021 to 31-03-2021.

10. What will be the previous year in case of undisclosed sources of income?. (4 Marks, PCC June, 2009)

Ans: The following undisclosed incomes shall be deemed to be the income of the F.Y. in which they are found-

- (1) **Unexplained Cash Credits [Section 68]:** Where the assessee offers no explanation to the Assessing Officer for any sum credited in the books of accounts or the explanation so offered is not satisfactory, then the sum shall be charged as income in the previous year in which it is credited in the books of accounts.
- (2) **Unexplained investments [Section 69]:** Where the assessee fails to record the investments made by him and thereafter offers no explanation or the explanation so offered is not satisfactory, then the value of such investments are taxed as income in the financial year in which such investment is made.
- (3) **Unexplained Money [Section 69A] :** Where the assessee owns any money, bullion, jewellery, etc. and does not record the same in his books of accounts, then the same shall be regarded as his income of the financial year in which it is found, if the assessee fails to offer any explanation regarding such money or the explanation offered by him seems to be unsatisfactory to the Assessing Officer.

- (4) **Investment not fully disclosed [Section 69B]:** In case, it is found that the real value of any investments, money, bullion, etc. is more than the amount recorded in the books and no explanation is offered by the assessee or the explanation so offered is not satisfactory, then such excess amount shall be treated as his income in the financial year in which such investment, etc. is made.
- (5) **Unexplained Expenditure [Section 69C]:** When the assessee incurs any expenditure for which he offers no explanation about its source or offers an explanation which is not satisfactory, then the same shall be considered as his income in the financial year in which such expenditure is incurred.
- (6) **Amount borrowed or repaid on hundi [Section 69D]:** If any amount is borrowed or repaid on hundi through any mode other than the account-payee cheque, then the same shall be regarded as the income in the financial year in which such amount is so borrowed or repaid.

Thus, the taxability of such undisclosed income shall be -

Section	Title	Year of taxability:
68	Unexplained Cash Credit	Previous year in which credited in the books of account.
69	Unexplained investment	Financial year in which investment is made.
69A	Unexplained Money	Financial year in which found.
69B	Investment partly disclosed	Financial year in which investment is made.
69C	Unexplained Expenditure	Financial year in which such expenditure is incurred.
69D	Amount borrowed or repaid on hundi	Financial year of borrowing or repayment.

11. Explain briefly the "Previous year Rule" and discuss its exceptions. (5 Marks: Nov. 2004, Nov. 2006)

Ans: As per Section 4 of the Income-tax Act, the income earned in a year is taxable in the next year. This is known as Previous Year Rule. However, there are certain exceptions in which income earned in a year is taxable in the same year.

The exceptions to the above rule are as follows -

- (1) **Shipping business by Non-residents [Section 172]:**
- (a) This section applies to a non-resident engaged in shipping business and deriving income there from by carrying passengers, livestock, mail or goods from a port in India.
- (b) 7.5% of the freight paid or payable to the owner or charterer or any person on his behalf, whether in or outside India, shall be deemed to be his total income and shall be taxed at the rate applicable for foreign company i.e. @ 40% (plus surcharge and Health and Education cess). Such tax shall be paid before the departure of the vessel. Thus, income is taxable in the same year in which carriage is collected and not in the immediately following assessment year.
- (2) **Persons leaving India [Section 174]:**
- (a) This section applies when it appears to Assessing Officer that an individual may leave India during the current assessment year or shortly after its expiry and he has no intention of returning back to India.
- (b) In case of such person, the total income from 1st April of that assessment year up to the probable date of his departure from India shall be taxable in that year itself at the rates applicable to that assessment year.

(3) Association of persons/ Body of Individuals or artificial juridical person formed for a particular event or purpose [Section 174A]:

- (a) This section applies where the Assessing Officer is of the opinion that any association of persons or body of individuals or an artificial juridical person, formed for a particular event or purpose, may be dissolved in the assessment year in which it is formed or shortly thereafter.
- (b) The total income from 1st April of that assessment year up to the date of its dissolution shall be chargeable to tax in that assessment year itself at the rates applicable to that assessment year.

(4) Persons likely to transfer property to avoid tax [Section 175]:

- (a) It applies when it appears to the Assessing Officer that a person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets so as to avoid his tax liability.
- (b) The total income from 1st April of that assessment year to the date when the Assessing Officer commences proceedings under this section shall be chargeable to tax in that assessment year itself at the rates applicable to that assessment year. (5) Discontinued business [Section 176]:
 - (a) This section applies where any business or profession is discontinued in any assessment year.
 - (b) The total income from 1st April of that assessment year upto the date of discontinuance shall be taxable in the year of discontinuance at the discretion of Assessing Officer.

Note : In above 4 cases it is mandatory for the Assessing Officer to assess the income in the year in which it is earned. However, in 5th case it is at discretion of the Assessing Officer to assess the income in the year in which it is earned or in the next year.

CONCEPTS OF INCOME, METHOD OF ACCOUNTING

12. Define "Income".

Ans: **Income [Section 2(24)]:** According to Section 2(24), "Income" includes,-

- (1) Profits and gains.
- (2) Dividend.
- (3) Voluntary contributions received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes or by a scientific research association or games association referred under section 10(21) or by any other notified fund or institution established for charitable or religious purposes referred under section 10(23), or, by any university or other educational institution or hospital or other medical institution referred under section 10(23C), other than those wholly or substantially financed by the Government, or, by an electoral trust approved by the Board in this behalf.
- (4) The value of any perquisite or profit in lieu of salary taxable under section 17.
- (5) Any special allowance or benefit, other than the perquisite included under above clause, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of duties of an office or employment of profit.
- (6) Any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.

- (7) *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.*
- (8) *The value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee (referred as 'beneficiary') and any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary.*
- (9) *Compensation for termination or modification of terms or conditions of agency or management.*
- (10) *Income of trade, professional or similar association from specific services to its members.*
- (11) *Deemed profits under Section 41 or under Section 59.*
- (12) *Profits on sale of an import licence as referred under section 28(iia).*
- (13) *Cash assistance received or receivable by any person against exports under any scheme of the Government of India, as referred under section 28(iib).*
- (14) *Any duty of customs or excise repaid or repayable as drawback, as referred under section 28(iic).*
- (15) *Value of any benefit or perquisite, whether convertible into money or not, arising from business or exercise of profession, as referred under section 28(iv).*
- (16) *Any interest, salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from such firm.*
- (17) *Any capital gains chargeable under section 45.*
- (18) *Profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with Section 44 or any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule.*
- (19) *The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members.*
- (20) *Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.*

Explanation: (i) "Lottery " includes winnings from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called, (ii) "Card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game.

- (21) *Any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the Employees' State Insurance Act, 1948 or any other fund for the welfare of such employees.*
- (22) *Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.*
- (23) *Any sum received on account of non-competing fees and exclusivity rights as covered under section 28(va).*
- (24) *The fair market value of inventory referred to in Section 28(via) [i.e. Fair market value of inventory which is converted into, or treated as a capital asset.]*
- (25) *Any sum of money/immovable property/any property other than immovable property received by an individual/ HUF, the value of which exceeds fifty thousand rupees as referred under section 56(2) (vii).*
- (26) *Shares of a company (not being a company in which the public is substantially interested) received by a private company or a firm either without or at less consideration, as referred under section 56(2) (viiia).*
- (27) *Any consideration for issue of shares as exceeds the fair market value of the shares received by a company (not being a company in which the public is substantially interested) as referred to in Section 56(2) (viiib).*
- (28) *Any sum of money received as advance, if such sum is forfeited consequent to failure of negotiation for transfer of a capital asset [Section 56(2) (ix)].*
- (29) *Any sum of money or value of property received without consideration or for inadequate consideration by any person [Section 56(2) (x)].*
- (30) *Any compensation or other payment referred to in Section 56(2)(xi) [i.e. Any compensation or other payment, due to or received by any person, in connection with termination of his employment or the modification of the term and conditions relating thereto.]*
- (31) *Assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee other than, —*
 - (a) *the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to Section 43(1); or*
 - (b) *the subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by the Central Government or a State Government, as the case may be.*

13. Discuss the concept of "Income".**Ans:** *The concept of 'income' is as follows -*

- (a) *Income means a periodic monetary return which accrues or is expected to accrue regularly from definite and identifiable sources.*
- (b) *Income normally refers to revenue receipts and it means net receipts, not gross receipts.*
- (c) *It is taxable either on receipt or due basis.*
- (d) *Income may be received in cash or in kind. In case, it is received in kind, the valuation shall be as per the prescribed rules or fair market value.*
- (e) *Illegal incomes are taxable in the same manner as legal income.*
- (f) *Income must be real and not fictitious.*
- (g) *It must arise from outside sources.*
- (h) *The same income cannot be taxed twice unless otherwise provided in law.*
- (i) *Disputed title to income will not withhold its taxability, it will be taxable in the hands of recipient of income.*

14. What are the various heads of income?. Are they mutually exclusive?.**Ans:** *The relevant provisions are discussed as under -*

- (1) **Heads of Income [Section 14]:** *According to Section 14 of the Act, all the incomes are categorised in the following five heads -*
 - (i) *Salaries [Section 15-17];*
 - (ii) *Income from House Property [Section 22-27];*
 - (iii) *Profits and Gains of Business or Profession [Section 28-44DB];*
 - (iv) *Capital Gains [Section 45-55A]; and*
 - (v) *Income from Other Sources [Section 56-59],*
- (2) **Nature of heads of income :** *The heads of income are mutually exclusive i.e. an income, which falls under one head cannot be brought to tax under any other head of income. The Income-tax Act contains provisions describing the incomes to be included in each of the heads of income listed above.*

Correct classification of income under the proper head is mandatory. Incorrect classification to obtain undue incentives in the law may lead to penalties and prosecution.

15. Briefly discuss about the provisions relating to deductibility of expenditure incurred in relation to income not includible in assessee's total income. (4 Marks, PCC May 2007)**Ans:** *Expenditure incurred in relation to income not includible in total income [Section 14A] : As per Section 14A, while computing the total income of an assessee -*

- (1) *No deduction shall be allowed to the assessee in respect of expenditure incurred in relation to income which does not form the part of the total income under the Act.*
- (2) *The Assessing Officer shall determine the amount of expenditure incurred in relation to such income, if having regard to the accounts of the assessee, he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure made by the assessee.*
- (3) *The Assessing Officer has the power to determine the amount of such expenditure even if where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act.*

16. List the differences between Capital Receipts and Revenue Receipts.

Ans: The differences between Capital Receipts and Revenue Receipts are as follows -

	Capital Receipts	Revenue Receipts
(1)	Receipts relating to fixed capital are capital receipts. E.g.: Receipt on sale of asset is a capital receipt.	Receipts relating to circulating capital are revenue receipts. E.g.: Receipt on sale of stock-in-trade is a revenue receipt.
(2)	Compensation received for extinction of a profit earning source (in whole or in part) is a capital receipt.	Compensation received for loss of profits or earnings is a revenue receipt.
(3)	Receipt in substitution of source of income is a capital receipt. E.g.: Compensation for loss of employment is a capital receipt.	A receipt in substitution of income is revenue receipt.
(4)	Capital receipts are exempt from tax unless expressly taxable. E.g.: Capital gains.	Revenue receipts are taxable unless expressly exempt from tax. E.g.: Income exempt under section 10 to 13A.
(5)	Compensation received for relinquishing interest (in whole or in part) in a capital asset is a capital receipt.	Compensation received for relinquishing interest in stock-in-trade of the business is a revenue receipt.
(6)	Profits from transactions outside the purview of regular trading activities of the assessee are capital receipts.	Profits from transactions entered into the course of business regularly carried on by the assessee or are incidental to or are associated with business, are revenue receipts.
(7)	Subsidy is treated as capital receipt if it is given to set-up a new business or to complete a project or to acquire an asset.	Subsidy is treated as revenue receipt if it is given for an existing business or to meet any specific revenue expenditure or by way of reimbursement of such expenditure.
(8)	Profits from sale of shares or securities, which were purchased as an investor, are capital receipts.	Profits from sale of shares, which were acquired in the ordinary course of business as a dealer in shares, are revenue receipts.

17. Describe the "Keyman Insurance Policy" and its taxability.

Ans: The tax treatment of Keyman Insurance Policy is as under -

- (1) **Keyman Insurance Policy** : As per Explanation to Section 10(10D), "Keyman insurance policy" means a life insurance policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected in any manner whatsoever with the business of the first mentioned person and includes such policy which has been assigned to a person, at any time during the term of the policy, with or without any consideration.
- (2) **Sum received including bonus - is income** : According to Section 2(24) of the Act - Sum received under Keyman insurance policy including the sum allocated by way of bonus on such policy, is considered as an income.
- (3) **Taxability of sums received** :
 - (a) If it is taken in name of an employee, then the sum received on its maturity (including the bonus on such policy) is taxable as "profits in lieu of salary" under Section 17(3).

- (b) In case the policy matures in the hands of the person carrying on business or profession, then the sum received (including bonus) shall be treated as "Profits and Gains of Business or Profession".
- (c) In case the policy is taken in name of any other person (other than employer or employee), then the sum received on its maturity by such person is chargeable to tax as "Income from other sources".
- (d) In case the policy is assigned to any other person before its maturity, the sum received from such policy shall not be exempt from tax.

18. Discuss average rate of tax and maximum marginal rate under section 2(10) and 2(29C) of the Income-Tax Act, 1961. (Marks 4, PCC Nov. 2009)

Ans: The relevant concepts are discussed as under -

(1) Average Rate of Tax [Section 2(10)]:

$$\text{Average Rate of tax} = \frac{\text{Amount of income tax calculated on the total income} \times 100}{\text{Total Income}}$$

Wherein -

- (a) Total income = Income as defined by Section 2(45), hence also including the income on which special rates of income tax are applicable. E.g.: Long-term capital gains.
- (b) Amount of Income Tax = Amount of tax computed on such total income considering various rebates and reliefs available under the provisions of the Act.
- (c) Significance : Average Rate of Tax is significant in relation to rebate under section 110 in the assessment of members of an AOP.

(2) Maximum Marginal Rate (MMR) [Section 2(29C)] : MMR is the rate of income-tax (including surcharge, if any) applicable in relation to the highest slab of income, specified in the Finance Act for the relevant year, in the case of the following persons,-

- (a) an individual; or
 - (b) an AOP or Body of Individuals.
- MMR for A.Y. 2021-22 is 42.744% (being tax @ 30% + 37% surcharge + 4% Health and Education Cess (HEC) on Income-tax).

19. Briefly explain the purpose for which the words "PROVISO" and "EXPLANATION" are incorporated under various sections of the Income-tax Act, 1961. (2x2 = 4 Marks, May 2018-NS)

Ans: The purpose for which the words "PROVISO" and "EXPLANATION" are incorporated under various sections of the Income-tax Act, 1961 are as under :

- (i) The Proviso(s) to a section/sub-section/clause spells out the exception(s) to the provision contained in the respective section/ subsection/ clause.
- (ii) The Explanation to a section/ sub-section/ clause gives a clarification relating to the provision contained in the respective section/ subsection/ clause.

20. In computing income under certain heads of income, method of accounting is irrelevant while in some it is relevant. Comment. (4 Marks, Nov. 2005)

Ans: Method of Accounting [Section 145]: As per Section '145 -

- (1) Cash / Mercantile system :** Income chargeable under the head "Profits and Gains of Business and Profession" or "Income from other sources" is to be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

- (2) **Income computation and disclosure standards** : The Central Government may, from time to time, notify in the Official Gazette the income computation and disclosure standards to be followed by the assessee adopting mercantile system of accounting. Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified 10 income computation and disclosure standards (ICDSs) to be followed by all assessee, following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or "Income from other sources". The following standards have been notified :
- ICDS I:** Accounting Policies
ICDS II: Valuation of Inventories
ICDS III: Construction Contracts
ICDS IV: Revenue Recognition
ICDS V: Tangible Fixed Assets
ICDS VI: The Effects of changes in foreign exchange rates
ICDS VII: Government Grants
ICDS VIII: Securities
ICDS IX: Borrowing Costs
ICDS X: Provisions, Contingent Liabilities and Contingent Assets
- (3) **Best Judgment Assessment:** The Assessing Officer can reject the books of accounts maintained by the assessee and make an assessment in the manner provided in Section 144, if,-
- he is not satisfied about the correctness or completeness of the accounts; or
 - the assessee has not regularly followed the proper method of accounting; or
 - the assessee has not regularly followed the notified income computation and disclosure standards.
- (4) **Effect of method of accounting adopted** : The method of accounting adopted determines the amount of income chargeable to tax. If cash basis of accounting is adopted, then, all incomes not received in cash will not be chargeable to tax and all unpaid expenses will not be allowed as deduction. However, if accrual basis of accounting is adopted, then, the outstanding incomes and expenses will be taken into account while determining the amount of income chargeable to tax.
- (5) **Taxability of incomes under other heads** : The method of accounting is not relevant for incomes chargeable under other heads of income, as the Act provides for specific mode of their chargeability. The incomes under other heads are chargeable to tax as follows -

Head of income	Mode of chargeability
 Salaries	 Chargeable on due or receipt basis, whichever is earlier
 Income from House Property	 Chargeable on accrual basis
 Capital Gains	 Chargeable in the year in which the capital asset is transferred

21. **When is an individual said to have a substantial interest in a concern?**

Ans: **Person who has a substantial interest in the company [Section 2(32)]:** According to the said section an individual is said to have substantial interest in a concern if he or she, along with his or her relatives, is, at any time during the previous year, -

- beneficial owner of equity shares carrying 20% or more of the voting power in a company; or
- entitled to 20% or more of the profits of such concern.

22. Define - (i) Chief Commissioner (ii) Commissioner (iii) Director General or Director.**Ans:** The relevant definitions are as under—

- (i) "Chief Commissioner" means a person appointed to be a Chief Commissioner of Income-tax or a Principal Chief Commissioner of Income-tax under section 117(1). [Section 2(15A)]
- (ii) "Commissioner" means a person appointed to be a Commissioner of Income-tax or a Director of Income-tax or a Principal Commissioner of Income-tax or a Principal Director of Income-tax under section 117(1). [Section 2(16)]
- (iii) "Director General or Director" means a person appointed to be a Director General of Income-tax or a Principal Director General of Income-tax or, as the case may be, a Director of Income-tax or a Principal Director of Income-tax u/s 117(1), and includes a person appointed under that section to be an Additional Director of Income-tax or a Joint Director of Income-tax or an Assistant Director or Deputy Director of Income-tax. [Section 2(21)]

**MODE OF COMPUTATION OF INCOME AND TAX RATES FOR
ASSESSMENT YEAR 2021-22**
23. What are the steps for computation of total income.**Ans:** 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.

- (1) Determine Residential Status of the individual assessee as per section 6 and determine scope of his total income as per section 5.
- (2) Compute Income under each head as per sections 15 to 59. [Incomes exempt under section 10 do not form part of total income.]
 - (1) Clubbing provisions u/s 60 to 65 and undisclosed incomes u/s 68 to 69D are to be taken into account.
 - (4) Allow set off and carry forward of losses as given under sections 70 to 80 and the resultant income shall be the Gross Total Income.
 - (5) From Gross Total Income computed in Step 4 above, allow the deductions under Chapter VI-A.
 - (6) After allowing the deductions in Step 5 above, the resultant figure shall be Total Income. Compute income tax on such total income. There are specific rates of tax in case of long-term capital gains u/s 112 and Section 112A, short-term capital gains in case of securities u/s 111A, winnings from lottery etc. u/s 115BB etc.
- (7) Allow rebate under section 87A from the amount of income tax calculated in step 6 above at the rate of 100% of such income tax subject to maximum of Rs. 12,500 if total income does not exceed Rs. 5,00,000.
- (8) Add Surcharge at applicable rates if total income exceeds Rs. 50 lakhs. Provide marginal relief if the same is available. Tax plus surcharge is to be increased by Health and Education cess @ 4%.
- (9) Allow rebate under section 86 read with section 110 in case such individual is a member of an Association of Persons, if applicable, and also allow relief under section 89. The balance shall be the tax liability of such individual for that assessment year.
- (10) From such tax liability deduct TDS, TCS, advance tax and self-assessment tax paid by him. The balance shall be the tax payable by such individual.

24. Discuss the mode of computation of total income of an individual and tax liability thereon.

Ans: The mode of computation of total income of an individual and tax liability thereon is as under -

Name of assessee: Status:	Assessment Year:	Previous Year:
1. Income from Salaries [Section 15-17]	xxxx	
2. Incomes from House Property [Section 22 - 27]	xxxx	
2. Profits and gains of business or Profession [Section 28 - 44DB]	xxxx	
Capital Gains [Section 45 - 55A]	xxxx	
Income from Other Sources [Section 56 - 59]	xxxx	
Total [(1) + (2) + (3) + (4) + (5)]		xxxx
Add: Income of other persons included in assessee's total income (i.e. Deemed incomes to be aggregated with appropriate heads of income) [Section 60- 69D]		xxxx
Less: Adjustment on account of set off or carry forward of losses [Section 70 - 80]		xxxx
Gross Total Income		xxxx
Less: Deductions under Sections 80C to 80U		xxxx
Total Income [rounded off to Rs.10]		xxxx
Computation of tax liability :		
Tax on total income	xxxx	
Less: Tax rebate u/s 87A	xxxx	
Balance tax after rebate	xxxx	
Add: Surcharge	xxxx	
Tax including Surcharge	xxxx	
Add: Health and Education Cess @ 4%	xxxx	
Tax including HEC	xxxx	
Less: Relief under sections 86,89, 90,90A and 91	xxxx	
Tax		xxxx
Less: Pre-paid Taxes	xxxx	
Tax paid on self assessment	xxxx	
Tax deducted or collected at source	xxxx	
Tax paid in advance	xxxx	xxxx
Tax payable/Tax Refundable		xxxx
Add: Interests under sections 234A, 234B and 234C, if any		xxxx
Total amount payable (rounded off to nearest Rs.10)		xxxx

25. List the general rates of income-tax for individual for Assessment Year 2021-22.

Ans: The general rates of income-tax for individual for Assessment Year 2021-22 are as under -

(I) In case of every individual [other than those covered by (II) to (III)], HUF, AOP, BOI, and every artificial juridical person		(II) In case of resident individual of age 60 years or more but less than 80 years at any time during the previous year		(III) In case of resident individual of age 80 years or more at any time during the previous year	
Income	Rate	Income	Rate	Income	Rate
Upto Rs. 2,50,000*	Nil	Upto Rs. 3,00,000*	Nil	Upto Rs. 5,00,000*	Nil
Next Rs. 2,50,000	5%	Next Rs. 2,00,000	5%	-	-

Next Rs. 5,00,000	20%	Next Rs. 5,00,000	20%	Next Rs. 5,00,000	20%
Balance	30%	Balance	30%	Balance	30%

(1) Rate of Surcharge applicable to Individuals/HUF/AOPs/BOIs for assessment year 2021-22:

	Particulars	Rate of surcharge on income-tax	Example	
			Components of total income	Applicable rate of surcharge
(i)	Where the total income (including income u/s 111A and 112A) exceeds Rs. 50 lakhs but does not exceed Rs. 1 crore	10%	□ STCG u/s 111A Rs. 30 lakhs; □ LTCG u/s 112A Rs. 25 lakhs; and □ Other income Rs. 40 lakhs	Surcharge would be levied @ 10% on income-tax computed on total income of Rs. 95 lakhs.
(ii)	Where total income (including income under section 111A and 112A) exceeds Rs. 1 crore but does not exceed Rs. 2 crore	15%	□ STCG u/s 111A Rs. 60 lakhs; □ LTCG u/s 112A Rs. 65 lakhs; and □ Other income Rs. 50 lakhs	Surcharge would be levied @ 15% on income-tax computed on total income of Rs. 1.25 crores.
(iii)	Where total income (excluding income u/s 111A and 112A) exceeds Rs. 2 crore but does not exceed Rs. 5 crore The rate of surcharge on the income-tax payable on the portion of income chargeable to tax u/s 111A and 112A	25% Not exceeding 15%	□ STCG u/s 111A Rs. 54 lakhs; □ LTCG u/s 112A Rs. 55 lakhs; and □ Other income Rs. 3 crores	Surcharge would be levied @ 15% on income-tax on: □ STCG of Rs. 54 lakhs chargeable to tax u/s 111A; and □ LTCG of Rs. 55 lakhs chargeable to tax u/s 112A. Surcharge @ 25% would be leviable on income-tax computed on other income of Rs. 3 crores included in total income
(iv)	Where total income (excluding income u/s 111A and 112A) exceeds Rs. 5 crore Rate of surcharge on the income-tax payable on the portion of income chargeable u/s 111A and 112A	37% Not exceeding 15%	□ STCG u/s 111A Rs. 50 lakhs; □ LTCG u/s 112A Rs. 65 lakhs; and □ Other income Rs. 6 crore	Surcharge @ 15% is leviable on income-tax on: □ STCG of Rs. 50 lakhs chargeable to tax u/s 111A; and □ LTCG of Rs. 65 lakhs chargeable to tax u/s 112A. Surcharge @ 37% is leviable on the income-tax computed on other income of Rs. 6 crores included in total income.
(v)	Where total income (including income u/s 111A and 112A) exceeds Rs. 2 crore in cases not covered under (iii) and (iv)	15%	□ STCG u/s 111A Rs. 60 lakhs; □ LTCG u/s 112A 155 lakhs; and	Surcharge would be levied @ 15% on income tax computed on total income of Rs. 2.25 crore.

	above		☐ Other income Rs. 1.10 crore	

(2) Marginal Relief:

- (i) Marginal relief is available in case total income exceeds Rs. 50 lakhs. The additional amount of income-tax payable (together with surcharge) on the excess of income over Rs. 50 lakhs should not be more than the amount of income exceeding Rs. 50 lakhs.
- (ii) Where total income exceeds Rs. 1 crore, the total amount payable as income-tax and surcharge on such income shall not exceed the total amount payable as income-tax and surcharge on a total income of Rs. 1 crores by more than the amount of income that exceeds Rs. 1 crores.
- (iii) Where total income exceeds Rs. 2 crore, the total amount payable as income-tax and surcharge on such income shall not exceed the total amount payable as income-tax and surcharge on a total income of Rs. 2 crores by more than the amount of income that exceeds Rs. 2 crores.
- (iv) Where total income exceeds Rs. 5 crore, the total amount payable as income-tax and surcharge on such income shall not exceed the total amount payable as income-tax and surcharge on a total income of Rs. 5 crores by more than the amount of income that exceeds Rs. 5 crores.
- (3) Basic Exemption limit* : The amount of Rs. 2,50,000 or Rs. 3,00,000 or Rs. 5,00,000 is called "maximum amount not chargeable to tax" or "basic exemption limit" applicable to the assessee.
- (4) Rebate u/s 87A : In case of resident individual whose total income does not exceed Rs. 5,00,000, rebate shall be allowed from Income tax @ 100% of such tax or Rs. 12,500 whichever is less.

Clarification regarding attaining prescribed age of 60 years/ 80 years on 31st March itself, in case of senior/very senior citizens whose date of birth falls on 1st April [Circular No. 28/2016, dated 27-07-2016]:

- An individual who is resident in India and of the age of 60 years or more (senior citizen) and 80 years or more (very senior citizen) is eligible for a higher basic exemption limit of Rs. 3,00,000 and Rs. 5,00,000, respectively.
- The CBDT has, vide this Circular, clarified that a person born on 1st April would be considered to have attained a particular age on 31st March, the day preceding the anniversary of his birthday. In particular, the question of attainment of age of eligibility for being considered a senior/very senior citizen would be decided on the basis of above criteria.
- Therefore, a resident individual whose 60th birthday falls on 1st April, 2020, would be treated as having attained the age of 60 years in the P.Y. 2020-21, and would be eligible for higher basic exemption limit of Rs. 3 lakh in computing his tax liability for A.Y. 2021-22. Likewise, a resident individual whose 80th birthday falls on 1st April, 2021, would be treated as having attained the age of 80 years in the P.Y. 2020-21, and would be eligible for higher basic exemption limit of Rs. 5 lakh in computing his tax liability for A.Y. 2021-22.

26. List the special rates of Income-tax for the Assessment Year 2021-22.

Ans: The various categories of incomes chargeable to tax at the special rates of income-tax are as follows -

Section	Nature of Income	Rate of tax
111A	Short-term capital gains from transfer of Equity shares in a company, Unit of an equity oriented fund and Unit of business trust on which SIT has been charged	15%
112	Long-term capital gains (other than LTCG taxable as per section 112A)	20%
112A	Long term capital gains on transfer of –  Equity share in a company  Unit of an equity oriented fund	10%

	 Unit of business trust Condition for availing the benefit of this concessional rate is Securities Transaction tax should have been paid- <table><tr><td>in case of- (Capital Asset)</td><td>Time of payment of STT</td></tr><tr><td>Equity shares in a company</td><td>both at the time of acquisition and transfer</td></tr><tr><td>Unit of equity oriented fund or unit of business trust</td><td>at the time of transfer</td></tr></table> Note: LTCG upto Rs. 1 lakh is exempt. LTCG exceeding Rs. 1 lakh is taxable @ 10%.	in case of- (Capital Asset)	Time of payment of STT	Equity shares in a company	both at the time of acquisition and transfer	Unit of equity oriented fund or unit of business trust	at the time of transfer	
in case of- (Capital Asset)	Time of payment of STT							
Equity shares in a company	both at the time of acquisition and transfer							
Unit of equity oriented fund or unit of business trust	at the time of transfer							
115BB	Winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.	30%						
115BBE	Income referred to in section 68 (Unexplained Cash Credits) or section 69 (Unexplained investments) or section 69A (Unexplained Money) or section 69B (Investment not fully disclosed) or section 69C (Unexplained Expenditure) or section 69D (Amount borrowed or repaid on hundi). Tax is to be increased by surcharge @ 25% of such tax and Health and Education cess @ 4% of such tax and surcharge. The effective rate of tax u/s 115BBE would, therefore, be 78% of such undisclosed income etc., if declared in the return of income. In case the same is not shown in the return of income, there would be a further levy of penalty under new section 271AAC @ 10% of tax payable u/s 115BBE	60%						
115BBF	Income by way of royalty in respect of a patent developed and registered in India in respect of person who is resident in India.	10%						
115BBG	Income from transfer of carbon credits	10%						

27. Give the tax rates in case of assessee other than individuals.

Ans: The applicable tax rates are as under - (1) In the case of co-operative society -

Upto Rs. 10,000	10%
Next Rs. 10,000	20%
Balance	30%

- (i) **Surcharge on Income-tax:** The amount of income-tax computed above, shall be increased by surcharge of 12% if the Total Income exceeds Rs. 1 crore.
- (ii) **Marginal Relief:** Marginal relief is available in case total income exceeds Rs. 1 crore. The additional amount of income-tax payable (together with surcharge) on the excess of income over Rs. 1 crore should not be more than the amount of income exceeding Rs. 1 crore.
- (2) In case of Local authority and Partnership firm (including LLP):

	Local Authority	Partnership firm (including Limited Liability Partnership)
Rate of income tax	30%	30%
Surcharge on Income tax if total income exceeds Rs. 1 crore	12%	12%

Marginal Relief: Marginal relief is available in case total income exceeds Rs. 1 crore. The additional amount of income-tax payable (together with surcharge) on the excess of income over Rs. 1 crore should not be more than the amount of income exceeding Rs. 1 crore.

(3) In case of domestic company and foreign company :

	Domestic Company [Where its total turnover or the gross receipt in the PY 2018-19 does not exceed Rs. 400 crore]	Domestic Company	Foreign Company
Rate of income tax	25%	30%	40%
Surcharge on Income tax			
➤ If total income exceeds Rs. 1 crore but does not exceed Rs. 10 crores	7%*	7%*	2%*
➤ If total Income exceeds Rs. 10 crores	12%**	12%**	5%**

- (i) **Marginal Relief:** Marginal relief is available in case total income exceeds Rs. 1 crore. The additional amount of income-tax payable (together with surcharge) on the excess of income over Rs. 1 crore should not be more than the amount of income exceeding Rs. 1 crore.
- (ii) ****Marginal Relief:** In the case of every company having a total income exceeding Rs. 10 crore, the total amount payable as income-tax and surcharge on such income shall not exceed the total amount payable as income-tax and surcharge on a total income of Rs. 10 crores by more than the amount of income that exceeds Rs. 10 crores.

Illustration 3 - Marginal relief and tax liability - Individual assessee : Compute the tax liability of Mr. X resident individual 40 years of age wherein his total income is Rs. 51,00,000 assuming that there is no income in the nature which is chargeable to special rate of tax.

Solution: Tax on total income of Rs. 51,00,000 (including surcharge @ 10%) = Rs. 1476750
 Tax on Rs. 50,00,000 = Rs. 1312500
 Marginal Relief = Rs. 14,76,750 - (Rs. 13,12,500 + Rs. 1,00,000) = Rs. 64250
 Tax liability = (Rs. 14,76,750 - Rs. 64,250) + 4% of Rs. 14,12,500 = Rs. 1469000

Illustration 4 - Marginal relief and tax liability - Individual assessee : Compute the tax liability of Mr. X a resident individual 40 years of age wherein his total income is Rs. 1,00,50,000 assuming that there is no income in the nature of is chargeable to special rate of tax.

Solution: Tax on total income of Rs. 1,00,50,000 (including surcharge @ 15%) = Rs. 3251625
 Tax on Rs. 1,00,00,000 (including surcharge @ 10%) = 3093750
 Marginal Relief = Rs. 32,51,625 - (Rs. 30,93,750 + Rs. 50,000) = Rs. 107875
 Tax liability = (Rs. 32,51,625 - Rs. 1,07,875) + 4% of Rs. 3143750 = Rs. 3269500

Illustration 5 – Marginal relief and tax liability - Individual assessee : Compute the tax liability of Mr. X a resident individual 40 years of age wherein his total income is Rs. 2,00,50,000 assuming that there is no income in the nature of capital gains.

Solution: Tax on total income of Rs. 2,00,50,000 (including surcharge @ 25%) = Rs. 7284375
 Tax on Rs. 2,00,00,000 (including surcharge @ 15%) - 6684375
 Marginal Relief = Rs. 72,84,375 - (Rs. 66,84,375 + Rs. 50,000) = Rs. 550000

$$\text{Tax liability} = (\text{Rs. } 72,84,375 - \text{Rs. } 5,50,000) + 4\% \text{ of Rs. } 67,34,375 = \text{Rs. } 7,00,37,50$$

Illustration 6 - Marginal relief and tax liability - Individual assessee : Compute the tax liability of Mr. X a resident individual 40 years of age wherein his total income is Rs. 5,00,50,000 assuming that there is no income in the nature of capital gains.

Solution: Tax on total income of Rs. 5,00,50,000 (including surcharge @ 37%) = Rs. 20,31,36,75

Tax on Rs. 5,00,00,000 (including surcharge @ 25 %) = 18,51,56,25

Marginal Relief = 12,03,13,675 - (Rs. 1,85,15,625 + Rs. 50,000) = Rs. 17,48,050

Tax liability = (Rs. 2,03,13,675 - Rs. 17,48,050) + 4% of Rs. 18,56,56,25 = Rs. 19,30,82,50

28. Explain the concept of rebate of Income tax in case of certain individuals.

Ans: Rebate of income-tax in case of certain individuals [Section 87A] :

(1) **Eligible Assessee :** Resident Individual, whose total income does not exceed Rs. 5,00,000.

(2) Amount of Rebate : Lower of -

(a) 100% of Income tax; or

(b) Rs. 12,500.

Note: Rebate under section 87A is, however, not available in respect of tax payable @ 10% on long term capital gains taxable under section 112A.

29. What is the rates of various cess?

Ans: In case of every assessee, the amount of tax plus surcharge if any shall be increased by Health and Education Cess (HEC) @ 4% of Income tax and surcharge.

It is leviable to fulfill the commitment of the Government to provide and finance quality health services and universalised quality basic education and secondary and higher education. Note:

(a) Total income will be rounded off to nearest multiple of Rs. 10. [Section 288A]

(b) Tax (including tax deductible at source or advance tax), interest, penalty, fine or any other sum payable, and the refund due under the act shall be rounded off to the nearest multiple of Rs. 10. [Section 288B]

Illustration 7 - Tax liability : Compute the tax liability in the following cases if the assessee has not opted for the provisions of Section 115BAC-

	Assessee-	Status	Total income (in Rs.)
(a)	Mr. Mohan	Resident Individual of 40 years	4,90,000
(b)	Mrs. Swati	Non-resident Individual of 65 years	2,75,000
(c)	Mr. Bansal	Resident Individual of 25 years	5,50,000
(d)	Mrs. Priyanka	Resident Individual of 21 years	15,10,000
(e)	Mrs. Resham	Resident individual of 60 years	12,00,000
(f)	Mrs. Radhika	Resident Individual of 80 years	18,00,000
(g)	Mr. Ganshyam	Resident Individual of 40 years	50,00,000
(h)	Ms Madhuri	Resident Individual of 21 years	2,50,000

Solution: The computation of tax liability is given below -

Assessee	Total income (Rs.)	Income-tax	Rebate u/s 87A	Income tax after rebate	HEC @ 4%	Total Tax	Total Tax (rounded)

							off)
(a) Mr. Mohan	4,90,000	12,000	12,000	-	-	-	-
(b) Mrs. Swati	2,75,000	1,250	-	1,250	50	1,300	1,300
(c) Mr. Bansal	5,50,000	22,500	-	22,500	900	23,400	23,400
(d) Mrs. Priyanka	15,10,000	2,65,500	-	2,65,500	10,620	2,76,120	2,76,120
(e) Mrs. Resham	12,00,000	1,70,000	-	1,70,000	6,800	1,76,800	1,76,800
(f) Mrs. Radhika	18,00,000	3,40,000	-	3,40,000	13,600	3,53,600	3,53,600
(g) Mr. Ganshyam	50,00,000	13,12,500	-	13,12,500	52,500	13,65,000	13,65,000
(h) Ms Madhuri	2,50,000	-	-	-	-	-	-

Illustration 8 - Compute the tax liability in the following cases if the assessee has not opted for the provisions of Section 115BAC-

	Assessee	Status	Total income (in Rs.)
(a)	Mr. X	Resident Individual of 40 years	1,01,00,000
(b)	Mr. Y	Resident Individual of 50 years	1,10,00,000
(c)	Mr. Z	Resident Individual of 55 years	1,00,00,000
(d)	Mr. A	Resident Individual of 55 years	51,00,000
(e)	Mr. B	Resident Individual of 55 years	2,00,00,000
(f)	Mr. C	Resident Individual of 25 years	2,01,00,000
(g)	Mr. D	Resident Individual of 30 years	5,00,00,000
(h)	Mr. E	Resident Individual of 40 years	5,01,00,000

Solution: The computation of tax liability is given below -

Assessee	Total income (Rs.)	Tax	Surcharge @ 37%/25%/15%/10%	Tax incl surcharge	Marginal relief	Balance tax	H&EC® 4%	Total tax (rounded off)
(a) Mr. X	1,01,00,000	28,42,500	4,26,375	32,68,875	75,125	31,93,750	1,27,750	33,21,500
(b) Mr. Y	1,10,00,000	31,12,500	4,66,875	35,79,375	-	35,79,375	1,43,175	37,22,550
(c) Mr. Z	1,00,00,000	28,12,500	2,81,250	30,93,750	-	30,93,750	1,23,750	32,17,500
(d) Mr. A	51,00,000	13,42,500	1,34,250	14,76,750	64,250	14,12,500	56,500	14,69,000
(e) Mr. B	2,00,00,000	58,12,500	8,71,875	66,84,375	-	66,84,375	2,67,375	69,51,750
(f) Mr. C	2,01,00,000	58,42,500	14,60,625	73,03,125	5,18,750	67,84,375	2,71,375	70,55,750
(g) Mr. D	5,00,00,000	1,48,12,500	37,03,125	1,85,15,625	-	1,85,15,625	7,40,625	1,92,56,250
(h) Mr. E	5,01,00,000	1,48,42,500	54,91,725	2,03,34,225	17,18,600	1,86,15,625	7,44,625	1,93,60,250

2 RESIDENTIAL STATUS

Topic Referencer

-  Determination of Residential Status
-  Scope of Total Income
-  Income Deemed to Accrue or Arise in India

DETERMINATION OF RESIDENTIAL STATUS

1. What are the three different categories of residential status of an individual?

Ans: The individuals are classified into 3 categories based on their residential status-

- (1) Resident
- (2) Not ordinarily resident
- (3) Non-resident

2. When can an individual said to be a resident in India?. Give the exceptions to the rule, if any.

Ans: The residential status of an individual will be determined as under -

Assessee	Basic Condition	Additional Conditions
Resident	He must satisfy at least one of the basic conditions (as given below).	Not required.
Not Ordinarily Resident	He must satisfy at least one of the basic conditions (as given below). He is deemed to resident under section 6(1A)	He must satisfy any of the additional conditions given under section 6(6).
Non-Resident	Should not satisfy any of the basic conditions.	Not required.

Residential status of an individual [Section 6(1)]: An individual is said to be a Resident in India in any previous year if he satisfies one or both of the basic conditions as given under section 6(1).

➤ **Basic conditions:**

- (1) He must be in India for a period of 182 days or more during the previous year; or
- (2) He must be in India for a period of 60 days or more during the previous year and 365 days or more during the four years preceding the previous year.

Exceptions: As per Explanation to Section 6(1),

- (1) the period of 60 days [given in (2) above] is substituted by 182 days in case of an individual -
 - (i) being an Indian citizen, leaves India during the previous year for employment outside India;
 - (ii) being an Indian citizen, leaves India during the previous year as a member of the crew of an Indian Ship;
 - (iii) being an Indian citizen or a person of Indian origin, who being outside India, comes on a visit to India in the previous year.
- (2) the period of 60 days [given in (2) above] is substituted by 120 days in case of an individual being an Indian citizen or a person of Indian origin, who being outside India, comes on a visit to India in the previous year, having total income, other than the income from foreign sources, exceeding Rs. 15 lakh during the previous year.

"Income from foreign sources" means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India) and which is not deemed to accrue or arise in India. [Amended by Finance Act, 2020 & Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020, w.e.f. 01-04-2021 i.e. AY 2021-22]

- **Person is deemed to be of Indian origin** : According to Explanation to Section 115C(e), a person is deemed to be of Indian origin, if he, or either of his parents, or any of his grand parents was born in undivided India.
- **Period of stay in case Indian citizen being crew member of foreign bound ship - To be determined in prescribed manner [Explanation 2]** : In the case of an individual, being a citizen of India and a member of the crew of a foreign bound ship leaving India, the period or periods of stay in India shall, in respect of such voyage, be determined in the manner and subject to such conditions as may be prescribed. Computation of period of stay in India in certain cases [Rule 126 of Income Tax Rules, 1962]:
 - (1) For the purposes of Section 6(1), in case of an individual, being a citizen of India and a member of the crew of a ship, the period or periods of stay in India shall, in respect of an eligible voyage, not include the period computed in accordance with sub-rule (2).
 - (2) The period referred to in sub-rule (1) shall be the period beginning on the date entered into the Continuous Discharge Certificate in respect of joining the ship by the said individual for the eligible voyage and ending on the date entered into the Continuous Discharge Certificate in respect of signing off by that individual from the ship in respect of such voyage.

Explanation: For the purposes of this rule,-

- (a) "Continuous Discharge Certificate" shall have the meaning assigned to it in the Merchant Shipping (Continuous Discharge Certificate-cum Seafarer's Identity Document) Rules, 2001 made under the Merchant Shipping Act, 1958;
- (b) "Eligible voyage" shall mean a voyage undertaken by a ship engaged in the carriage of passengers or freight in international traffic where-
 - (i) for the voyage having originated from any port in India, has as its destination any port outside India; and
 - (ii) for the voyage having originated from any port outside India, has as its destination any port in India.

Note:

- (a) As per Section 2(25A), "India" means the territory of India, its territorial waters, seabed and subsoil underlying such waters, continental shelf, exclusive economic zone or any other maritime zone. The term "stay in India" includes stay in the territorial waters of India (i.e. 12 nautical miles into the sea from the Indian coastline). Even the stay in a ship or boat moored in the territorial waters of India would be sufficient to make the individual resident in India.
- (b) The period of stay in India is not compulsorily required to be active or continuous.
- (c) It is not necessary for an individual to stay at his usual place of residence, business or employment.
- (d) While counting the number of days of stay in India, the day of arrival as well as departure are included for stay in India.
- (e) Where an individual is in India for a part of a day, then the total number of hours for which he stayed in India shall be calculated and a total of 24 hours shall be considered equivalent to one day.
- (f) The residence has no relation with citizenship, place of birth or domicile, hence a person can be resident in India even if he is not an Indian citizen.

3. *When an individual will be deemed to be resident in India.*

Ans: Deemed Resident in India [Section 6(1A)] [Inserted by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY 2021-22]: An individual shall be deemed to be resident in India if he fulfills the following conditions :

- (1) He must be citizen of India;
- (2) His total income, other than the income from foreign sources, must exceed Rs. 15 lakh during the previous year; and
- (3) He is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.

If these conditions are satisfied he is deemed to be Not Ordinarily resident in India as per section 6(1)(d). Not Applicability [Explanation] : The above provisions shall not apply in case of an individual who is said to be resident in India in the previous year under Section 6(1). [Inserted by Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020, w.e.f. 1-4-2021 i.e. AY 2021-22]

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

[Amended by Finance Act, 2020 & Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020, w.e.f 1-4-2021 i.e. AY2021-22]

4. *When is an individual regarded as 'Not ordinarily Resident' ?*

Ans: The relevant provision regarding Not ordinarily Resident (NOR) are discussed as under -

- (1) Not Ordinarily Resident: Only individuals and Hindu undivided family can be 'not ordinarily resident'. (Others are resident or non-resident). The residential status of an individual is considered as 'not ordinarily resident' if it fulfills -
 - (a) at least one of the conditions as specified under section 6(1) i.e. basic conditions and any of the additional conditions as specified under section 6(6)(a).
 - (b) He is deemed resident under section 6(1 A) read with section 6(6) (d).
- (2) Additional conditions u/s 6(6): A person is said to be "not ordinarily resident" in India in any previous year if such person has been,-
 - (a) a non-resident in India in any 9 years out of the total 10 years preceding the previous year; or
 - (b) in India for a period of 729 days or less during the 7 years preceding the previous year; or
 - (c) a citizen of India, or a person of Indian origin, having total income, other than the income from foreign sources, exceeding Rs. 15 lakh during the previous year, and he comes to India for the purpose of visit to India during the relevant previous year and he has been in India for a period or periods amounting in all to 120 days or more but less than 182 days; or
 - (d) A citizen of India who is deemed to be resident in India under section 6(1 A).

"Income from foreign sources" means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India) and which is not deemed to accrue or arise in India]. [Amended by Finance Act, 2020 & Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020, w.e.f. 1-4-2021 i.e. AY2021-22]

5. *When will a person be considered as 'Non-resident' ?*

Ans: When an individual does not satisfy any of the basic conditions mentioned under section 6(1), he becomes non-resident. For him additional conditions are irrelevant.

Illustration 1 - Determination of Residential status : Mr. X, an Indian citizen, is employed in XYZ Ltd. He was sent on deputation in US on 15-07-2020.

Determine his residential status for assessment year 2021-22.

Solution: In the given case, - Mr. X was sent on deputation to US during the previous year 2020-21 i.e. he is leaving India for employment outside India. It is irrelevant that he is employed in India before leaving India for employment outside India. For him basic condition number 2 is not applicable. His total stay in India during the previous year = $30 + 31 + 30 + 15 = 106$ days.

Since Mr. X does not satisfy the first basic condition applicable to him, therefore he is a non-resident for the Assessment Year 2021-22.

Illustration 2 - Determination of residential status : In the year 2020-21, a sailor has remained on a ship for a private company owning ocean-going ships as follows :

➤ Outside the territorial waters of India for 182 days;

➤ Inside the territorial waters of India for 183 days;

Is he considered to be a resident for the assessment year 2021-22 Rs. (Nov. 2002)

Solution: An individual is an Indian resident if he is in India for period of 182 days or more during the previous year. India includes territorial waters of India. Since the sailor remained inside the territorial waters of India for 183 days, he is regarded as resident in India for the assessment year 2021-22.

Illustration 3 - Determination of residential status : Mr. Ram an Indian citizen left India on 22-9-2020 for the first time to work as an officer of a company in Germany. Determine the residential status of Ram for the assessment year 2021-22 and explain the conditions to be fulfilled for the same under the Income-tax Act, 1961. (5 Marks, PCC Nov. 2010)

Solution: Mr. Ram is an Indian Citizen who left India during the previous year for employment outside India. For him basic condition no. 2 is not applicable. Hence, for being resident in India, he should be in India for 182 days or more during the previous year. In this case, Mr. Ram was in India only for 175 days during the previous year (01-04-2020 to 22-9-2020 = $30 + 31 + 30 + 31 + 31 + 22 = 175$ days). Since he does not satisfy the minimum criteria of residence of 182 days during the previous year, hence, he is a non-resident for assessment year 2021-22.

Illustration 4 - Determination of residential status : Teji, a citizen of India, is an export manager of Arjun Overseas Ltd., an Indian company since 1st May, 2016. He has been regularly visiting USA for export promotion. He spent the following days in USA during the last 5 years :

Previous year ended	Number of days spent in USA
31-03-2017	320 days
31-03-2018	150 days
31-03-2019	270 days
31-03-2020 (Leap year)	310 days
31-03-2021	295 days

Determine his residential status for assessment year 2021-22 assuming that prior to 1st May, 2016 he had never travelled abroad. (5 Marks, Executive CS Dec. 2004)

Solution: During the previous year 2020-21, Teji was in India for 70 days (365 days - 295 days in USA) and during the immediately preceding previous year, he was in India for 411 days as shown below,-

Year	2016-17	2017-18	2018-19	2019-20 (leap year)	Total
No. of days spent in USA	320	150	270	310	1050
No. of days stayed in India	45	215	95	56	411

Thus, he satisfies one basic condition and thus, he is a resident in India for the previous year 2020-21. He does not satisfy any of the additional conditions, hence Mr. Teji is a resident & ordinarily resident.

Illustration 5 - Determination of residential status : A, a British national, comes to India for first time during 2016-17. During financial years 2016-17, 2017-18, 2018-19, 2019-20 and 2020-21, he was in India for 65 days, 60 days, 80 days, 160 days and 70 days respectively. Determine his residential status for assessment year 2021-22.

Solution: During the previous year 2020-21, A was in India for 70 days and during 4 years immediately preceding the previous year, he was in India for 365 days as shown below,-

Year	2016-17	2017-18	2018-19	2019-20	Total
No. of days stayed in India	65	60	80	160	365

Thus, he satisfies the second basic condition and is, therefore, resident in India for the previous year 2019-20. Further, he satisfies additional conditions as follows,-

- He was non resident in India in all of the last 10 preceding years;
- He resided in India only for 365 days during the 7 preceding previous years.- Accordingly, he is 'Not Ordinarily Resident in India' for the previous year 2020-21.

Illustration 6 - Determination of residential status : Mrs. Karuna Kapoor, is a Hollywood actress. Her passport reveals the following information about her stay in India.

2020-21	From April 3rd	to	July 11th
2019-20	From June 22nd	to	July 11th
2018-19	From February 10th	to	March 26th
2017-18	From September 7th	to	March 26th
2016-17	From May 17th	to	September 30th
2015-16	From April 3rd	to	July 11th
2014-15	From April 3rd	to	July 11th
2013-14	From April 3rd	to	July 11th
2012-13	From April 3rd	to	July 11th

Find out her residential status for the assessment year 2021-22. (5 Marks, May 2018)

Solution: An individual is said to be a Resident in India in any previous year if he satisfies one or both of the basic conditions as given under section 6(1).

- Basic conditions:**
 - He must be in India for a period of 182 days or more during the previous year; or
 - He must be in India for a period of 60 days or more during the previous year and 365 days or more during the four years preceding the previous year.
- If he does not satisfy either of these conditions, he would be a non resident.

During the previous year 2020-21, Mrs. Karuna Kapoor was in India for 100 days (April: 28 + May: 31 + June: 30 + July: 11) and during the immediately preceding 4 previous years, she was in India for 404 days as shown below,-

Year	2016-17	2017-18	2018-19	2019-20 (Leap Year)	Total
No. of days stayed in India	137	202	45	20	404

Thus, she satisfies one basic condition and thus, she is a resident in India for the previous year 2020-21.

As per Section 6(6), a person will be "Not ordinarily Resident" in India in any previous year, if such person:

- (i) has been a non-resident in 9 out of 10 previous years preceding the relevant previous year; or
- (ii) has during the 7 previous years immediately preceding the relevant previous year been in India for 729 days or less.
- (iii) a citizen of India, or a person of Indian origin, having total income, other than the income from foreign sources, exceeding Rs. 15 lakh during the previous year, and he comes to India for the purpose of visit to India during the relevant previous year and he has been in India for a period or periods amounting in all to 120 days or more but less than 182 days; or
- (iv) a citizen of India who is deemed to be resident in India under section 6(1A).

Year	2013-14	2014-15	2015-16 (Leap Year)	2016-17	2017-18	2018-19 (Leap Year)	2019-20	Total
No. of days stayed in India	100	100	100	137	202	45	20	704

She also satisfies the second additional condition, hence she is resident but not ordinarily resident.

Illustration 7 - Determination of residential status : Ms. Bindu, a non-resident, residing in New York since 1991, came back to India on 19-02-2019 for permanent settlement in India. Explain her residential status of Ms. Bindu for the Assessment Year 2021-22 in accordance with the various provision of Indian Income-tax Act. (4 Marks, May 2015)

Solution: Ms. Bindu is a resident in assessment year 2021-22 since she has stayed in India for a period of 365 days (more than 182 days) during the Previous Year 2020-21, respectively.

As per section 6(6), a person will be "Not ordinarily Resident" in India in any previous year, if such person:

- (i) has been a non-resident in 9 out of 10 previous years preceding the relevant previous year; or
- (ii) has during the 7 previous years immediately preceding the relevant previous year been in India for 729 days or less.
- (iii) a citizen of India, or a person of Indian origin, having total income, other than the income from foreign sources, exceeding Rs. 15 lakh during the previous year, and he comes to India for the purpose of visit to India during the relevant previous year and he has been in India for a period or periods amounting in all to 120 days or more but less than 182 days; or
- (iv) a citizen of India who is deemed to be resident in India under section 6(1A).

If he does not satisfy any of these conditions, he would be a resident and ordinarily resident.

In the instant case, applying the above provision, the status of Ms. Bindu for the previous year 2020-21 (A.Y. 2021-22) would be Resident but not ordinarily resident since she was non-resident in 9 out of 10 previous years immediately preceding the previous year and also had stayed for less than 729 days in 7 previous years immediately preceding the previous year.

Therefore her status for A.Y. 2021-22 - "Resident but not ordinarily resident".

Illustration 8 - Determination of residential status of crew member of ship : Mr. Rohan is an Indian citizen and a member of the crew of a London bound Indian ship engaged in carriage of passengers in international traffic departing from Mumbai port on 10th August, 2020. From the following details for the P.Y. 2020-21, determine the residential status of Mr. Rohan for A.Y. 2021-22, assuming that his stay in India in the last 4 previous years (preceding P.Y. 2020-21) is 380 days and last seven previous years (preceding P.Y. 2020-21) is 780 days: (Similar: 4 Marks, May 2017)

Particulars	Date
Date entered into the Continuous Discharge Certificate in respect of joining the ship by Mr. Rohan	10th August, 2020
Date entered into the Continuous Discharge Certificate in respect of signing off the ship by Mr. Rohan	13th February, 2021

Solution: As per Section 6, where an Indian citizen leaves India as a member of crew of an Indian ship or for the purpose of employment outside India, he will be resident only if he stayed for 182 days during the previous year. In this case, the voyage is undertaken by an Indian ship engaged in the carriage of passengers in international traffic, originating from a port in India (i.e., the Mumbai port) and having its destination at a port outside India (i.e., the London port) is an eligible voyage and therefore the period beginning on the date entered into the Continuous Discharge Certificate in respect of joining the ship by the said individual for the eligible voyage and ending on the date entered into the Continuous Discharge Certificate in respect of signing off by that individual from the ship in respect of such voyage shall not be counted for stay in India.

Therefore, the period beginning from 10th August, 2020 and ending on 13th February, 2021, being the dates entered into the Continuous Discharge Certificate in respect of joining the ship and signing off from the ship by Mr. Rohan, has to be excluded for computing the period of his stay in India. Accordingly, 188 days [22 (August) + 30 (September) + 31 (October) + 30 (November) + 31 (December) + 31 (January) + 13 (February)] have to be excluded from the period of his stay in India.

Consequently, Mr. Rohan's period of stay in India during the P.Y. 2020-21 would be 177 days [i.e., 365 days - 188 days]. Since his period of stay in India during the P.Y. 2020-21 is less than 182 days, he is a non-resident for A.Y. 2021-22. Note : Since the residential status of Mr. Rohan is "non-resident" for A.Y. 2021-22 consequent to his number of days of stay in P.Y. 2020-21 being less than 182 days, his period of stay in the earlier previous years become irrelevant.

Illustration 9 - Determination of residential status : Mrs. X, is an Indian citizen. Currently she is in employment with an overseas company located in Dubai. Her passport reveals the following information about her stay in India.

2020-21	From April 3th	to	May 11th
2019-20	From June 22nd	to	July 11th
2018-19	From February 10th	to	March 26th
2017-18	From September 7th	to	March 26th
2016-17	From May 17th	to	September 30th
2015-16	From April 3rd	to	July 11th
2014-15	From April 3rd	to	July 11th
2013-14	From April 3rd	to	July 11th
2012-13	From April 3rd	to	July 11th

Find out her residential status for the assessment year 2021-22 if Mrs. X is not taxable in Dubai or any other country or territory by reason of her domicile or residence. Income of Mrs. X in India for previous year 2020-21 (other than income from foreign sources) is ₹. 20,00,000.

Solution: An individual is said to be a Resident in India in any previous year if he satisfies one or both of the basic conditions as given under section 6(1).

(i) Basic conditions:

- He must be in India for a period of 182 days or more during the previous year; or
- He must be in India for a period of 60 days or more during the previous year and 365 days or more during the four years preceding the previous year.

(ii) If he does not satisfy either of these conditions, he would be a non resident unless his case falls u/s 6(1A). According to section 6(1A) of the Act, an individual shall be deemed to be resident in India if he fulfills the following conditions:

- (1) He must be citizen of India.
- (2) His total income, other than the income from foreign sources, must exceed ₹. 15 lakh during the previous year; and
- (3) He is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.

If these conditions are satisfied he is deemed to be Not Ordinarily resident in India as per Section 6(6)(d). During the previous year 2020-21, Mrs. X was in India for 39 days (April: 28 + May: 11). Thus, she does not satisfy any of the basic condition as per Section 6(1) of the Act. However, she satisfies the conditions of Section 6(1A) read with Section 6(6) (d), hence she is resident but not ordinarily resident in India.

6. Discuss the provisions relating to determination of residential status of HUF, Partnership firm and Company. OR How is the residential status of a company determined for the purposes of Income-tax Act, 1961? (4 Marks, May 2016)

Ans: The provisions relating to determination of residential status are as under -

(1) **Hindu Undivided Family (HUF):**

- (a) **Resident HUF [Section 6(2)] :** HUF is resident in India if the control and management of its affairs is situated wholly or partly in India.
- (b) **Non-Resident HUF :** HUF is non-resident in India if the control and management of its affairs is situated wholly outside India.
- (c) **Not-Ordinarily Resident HUF [Section 6(6)] :** A resident HUF becomes not-ordinarily resident, if karta or manager satisfies one or both of the following additional conditions :
 - He has been non-resident in India in 9 out of the 10 years immediately preceding the relevant previous year; or
 - He has been in India for 729 days or less during the 7 years immediately preceding the previous year.

Meaning of the term "control and management":

- The expression 'control and management' referred to under section 6 refers to the central control and management and not to the carrying on of day-to-day business by servants, employees or agents.
- The business may be done from outside India and yet its control and management may be wholly within India. Therefore, control and management of a business is said to be situated at a place where the head and brain of the adventure is situated.

- The place of control may be different from the usual place of running the business and sometimes even the registered office of the assessee. This is because the control and management of a business need not necessarily be done from the place of business or from the registered office of the assessee.
- But control and management do imply the functioning of the controlling and directing power at a particular place with some degree of permanence.

(2) Partnership Firm (or AOP or any other person):

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

(3) Company [Section 6(3)]: A company is said to be resident in India in any previous year, if—

- (a) it is an Indian company; or
- (b) 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.

Illustration 10 - Determination of Residential status : Mr. X, Karta of HUF, claims that the HUF is non-resident as the business of HUF is transacted from UK and all the policy decisions are taken there. (2 Marks, PCC June, 2009) **Solution:** True since the business of the HUF is transacted from UK and policy decisions are taken there, therefore, the 'Control and Management' of its affairs is wholly situated outside India.

Illustration 11 - Determination of Residential status : XYZ Inc is incorporated in Cayman Island. Its key management and commercial decisions are taken in Board meetings held in Mumbai during financial year 2020-21. Determine its residential status for assessment year 2021-22.

Solution: As per section 6(3), A company is said to be resident in India in any previous year, if its place of effective management, in that year, is in India. In this case though the company is incorporated outside India, it will be regarded as resident in India as its place of effective management during the relevant financial year is in India since its key management and commercial decisions are taken in its board meetings held in Mumbai.

Illustration 12 - Determination of Residential status : Lotus Inc., a US company headquartered at New York, not having a permanent establishment in India, has set up a liaison office in Delhi in April, 2020 in compliance with RBI guidelines to look after its day to day business operations in India, spread awareness about the company's products and explore further opportunities. The liaison office takes decisions relating to day to day routine operations and performs support functions that are preparatory and auxiliary in nature. The significant management and commercial decisions are, however, in substance made by the Board of Directors at New York. Determine the residential status of Lotus Inc. for A.Y. 2021-22.

Solution: In the case of Lotus Inc., its place of effective management for P.Y. 2020-21 is not in India, since the significant management and commercial decisions are, in substance, made by the Board of Directors outside India in New York. Lotus Inc. has only a liaison office in India through which it looks after its routine day to day business operations in India. The place where decisions relating to day to day routine operations are taken and support functions that are preparatory or auxiliary in nature are performed are not relevant in determining the place of effective management. Hence, Lotus Inc., being a foreign company is a non-resident for A.Y. 2021-22, since its place of effective management is outside India in the P.Y. 2020-21.

SCOPE OF TOTAL INCOME

7. Discuss the impact of residential status on tax incidence. (5 Marks, CS Dec. 2007, May 2005) OR
State the scope of total income in the case of an individual, whose residential status is 'non-resident' with reference to Section 5(2) of the Act. (2 Marks, PCC May 2010)

Ans: Scope of total income [Section 5]: The tax incidence in case of different residential status is as follows

Particulars	Tax Incidence		
	R	NOR	NR
(1) Income received in India by him or on his behalf (whether accrued in India or outside India).	Yes	Yes	Yes
(2) Income deemed to be received in India by him or on his behalf (whether accrued in India or outside India).	Yes	Yes	Yes
(3) Income accruing or arising in India (whether received in India or outside India).	Yes	Yes	Yes
(4) Income deemed to accrue or arise in India (whether received in India or outside India).	Yes	Yes	Yes
(5) Income which accrues or arises outside India (other than that covered in cases (1) to (4) above)	Yes	No**	No

****Exception :** Out of the total income, which accrues or arises outside India, that part of income shall be taxable in India which is derived from any business controlled in or profession set up in India.

Note:

- **Foreign income not taxable even if included in Balance Sheet [Explanation 1] :** Foreign income accruing or arising outside India shall not be deemed to be received in India merely because of the reason that it is included in the Balance Sheet prepared in India.
- **Income taxed on accrual basis not taxable again on receipt basis [Explanation 2] :** Income once taxed in the previous year on accrual basis shall not be again chargeable to tax on receipt basis.
- **Receipt of income is important:** Only that income will be taxed in India which is received in India, not remitted to India.

For example : Mr. A, a non-resident, receives some income in USA and remits the same to India thereafter. The income so received in India is not taxable here as it is received in USA, not in India and also it does not accrue in India, only remitted to India.

- **If resident for one source of income, then resident for all the other sources [Section 6(5)] :** If a person is assessed as a resident in India for one of his sources of income, then he shall be deemed to be a resident for all of his other sources of income too.
- **Income should specifically relate to previous year :** Only that income shall be taxed in India which pertains to previous year.

For example: Mr. X, a non-resident earned and received certain income outside India in previous year 2018-19 and hence it was not taxable in India at that time. Thereafter he becomes resident in India in previous year 2020-21, then the income earned in previous year 2018-19 shall not be taxable in previous year 2020-21 when

it is subsequently brought to India merely because of the fact that Mr. X was a non-resident at the time of accrual and receipt of such income.

Circular No. 13/2017, dated 11-04-2017 Circular No. 17/2017, dated 26-04-2017	Clarification regarding liability to income-tax in India of a non-resident seafarer receiving and remuneration in NRE (Non-resident External) account maintained with an Indian Bank : Income by way of salary, received by non-resident seafarers, for services rendered outside India on a foreign going ship (with Indian flag or foreign flag) and received into the NRE bank account maintained with an Indian bank, shall not be included in the total income.

8. List the differences between Receipt and Remittance of income.

Ans: The difference between receipt and remittance is as under,-

	Receipt	Remittance
(1)	It refers to the first occasion when an recipient gets money under his control.	It means subsequent transmission of the money to another place after it is received.
(2)	Receipt of income is chargeable to tax.	Remittance of income is not chargeable to tax.
(3)	If the person bringing the money from outside India acts as agent of the payer, then the income is said to have been received in India.	If the person bringing the money from outside India acts as an agent of the payee, then the income is said to have been received outside India and subsequently remitted to India.

9. When is income deemed to be received?.

Ans: **Income deemed to be received [Section 7]:** The following income shall be deemed to be received in India -

- (1) The annual accretion in the previous year to the balance at the credit of an employee participating in a recognised provident fund to the extent of the following -
 - (a) Employer's contribution in excess of 12% of salary; and
 - (b) Interest credited to the Recognised Provident Fund account in excess of 9.5% p.a.
- (2) The transferred balance from a Unrecognised Provident Fund to a Recognised Provident Fund, to the extent taxable as provided in Rule 11(4) of Part A of the Fourth Schedule, i.e. to the extent of employer's contribution and interest thereon.
- (3) 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 in Section 80CCD.
- (4) Cash Credit, Unexplained investment, Unexplained Money, Investment not fully disclosed, Unexplained Expenditure, Amount borrowed or repaid on Hundi.
- (5) Tax deducted at source in the hands of payee.
- (6) Deemed profits chargeable to tax under the Act.

10. Write short notes on "Income accruing" and "Income due". Can an income which has been taxed on accrual basis be assessed again on receipt basis?. (6 Marks, May 2005)

Ans: Accrual refers to the right to receive income, whereas due refers to the right to enforce the 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. Further, the income which has been taxed on accrual basis cannot be assessed again on receipt basis as it will lead to double taxation.

INCOME DEEMED TO ACCRUE OR ARISE IN INDIA

11. When is income deemed to accrue or arise in India?

Ans: Income deemed to accrue or arise in India [Section 9]: The following incomes shall be deemed to accrue or arise in India -

Section	Income
9(1)(i)	All income accruing or arising, whether directly or indirectly, through or from - - any business connection in India; or any property in India, or - any asset or source of income in India; or - through the transfer of capital asset situated in India Meaning of 'Business Connection': A 'business connection' involves a relation between a business carried on by a non-resident, which yields profits or gains and some activity in India, which contributes directly or indirectly to the earning of those profits or gains. It predicates an element of continuity between the business of the non-resident and the activity in India. The expression 'business connection' postulates a real and intimate relation between trading activity carried on outside India and trading activity within India, the relation between the two contributing to the earning of income by the non-resident in his trading activity. - CIT v. R.D. Aggarwal & Co. [1965] 561TR 20 (SC) Business connection includes professional connection. - Barendra Prasad Roy v. ITO [1981] 129ITR 295 (SC) Incomes not deemed to accrue or arise in India [Explanation 1]: The following incomes are not deemed to accrue or arise in India - (a) In the case of a business, in respect of which all the operations are not carried out in India : 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. (b) Purchase of goods in India for export : Income earned by a non-resident engaged in purchase of goods in India for the purpose of export. (c) Collection of news and views in India for transmission out of India : Income earned by a nonresident engaged in the business of running a news agency/publishing newspapers, magazines, journals, from the activities confined to collection of news and views in India for their transmission out of India. (d) Shooting of cinematograph films in India : Income earned from operations of shooting cinematograph films in India, by a non-resident being- (i) an individual who is not an Indian citizen; (ii) a firm not having a partner who is either a citizen of India or resident in India; and (iii) a company not having any shareholder who is either citizen of India or resident in India. (e) Activities confined to display of rough diamonds in SNZs : Income earned by a foreign company engaged in the business of mining of diamonds through or from the activities which are confined to the display of uncut and unassorted diamond in any special zone notified by the Central Government in the Official Gazette in this behalf. Apportionment of profit where operations not fully carried on in India [Rule 10] : In case the

	income from Indian operations cannot be definitely ascertained, the same may be computed by apportionment - (i) At such percentage of Indian turnover as determined by the Assessing Officer; (ii) Taxable profits = Total Profits $\times$ Receipts accruing/ arising in India + Total Receipts of Business; or (iii) In any other manner as considered suitable by Assessing Officer.
	"Business Connection" shall include any business activity carried out through - (a) Concluding agent - he has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident and the contracts are - (i) in the name of the non-resident; or (ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or (iii) for the provision of services by the non-resident. (b) Stocking agent - he has no authority, but maintains in India a stock of goods/merchandise from which he regularly delivers goods/ merchandise on behalf of the non-resident; or (c) Indenting agent - he secures orders in India, mainly/wholly for the non-resident or for that nonresident and other non-residents controlling, controlled by, or subject to the same common control. [Explanation 2 to Section 9(1)(i)] Exceptions: (i) Business activity carried out through a broker, general commission agent or any other agent who is having an independent status acting in ordinary course of business, is not regarded as a business connection. (ii) As per Explanation 3 - Where a business is carried on in India through a person specified in (a), (b) and (c) 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.
	Explanation 3 : Where a business is carried on in India through a person referred to in clause (a) or clause (b) or clause (c) of Explanation 2, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India.
	Extension of source Rule [Explanation 3A] : The income attributable to the operations carried out in India, as referred to in Explanation 1, shall include income from- (i) such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India; (ii) sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and (iii) sale of goods or services using data collected from a person who resides in India or from a person who uses internet protocol address located in India. 1 Inserted by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY 2021-22] Objective of amendment: As per the discussion going on in international forum, countries generally agree that income from advertisement that targets Indian customers or income from sale of data collected from India or income from sale of goods and services using such data collected from India, needs to be accounted for in Indian revenue. Hence, the source rule has been amended to clarify this position. This amendment will take effect from 1st April, 2021 and will, accordingly, apply in relation to the assessment year 2021-22 and subsequent assessment years.
	Explanation 4 : The expression "through" shall mean and include and shall be deemed to have

	<i>always meant and included "by means of", "in consequence of" or "by reason of".</i> Explanation 5 : <i>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 situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.</i> <i>Indirect transfer provisions not applicable to FPI's: Nothing contained in this Explanation shall apply to an asset or a capital asset, which is held by a nonresident by way of investment, directly or indirectly, in Category-I foreign portfolio investor under the SEBI (Foreign Portfolio Investors) Regulations, 2019, made under the SEBI Act, 1992. [Inserted by Finance Act, 2020 w.e.f. 01-04-2020 i.e. AY 2020-21]</i>
9(1)(ii)	<i>Income which falls under the head "Salaries", if it is earned in India.</i> Explanation: <i>Salary shall be regarded as earned in India if it is payable for -</i> <i>service rendered in India; or</i> <i>the rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment.</i>
9(1)(iii)	<i>Income chargeable under the head "Salaries" payable by the Government to a citizen of India for service rendered outside India</i>
9(1)(iv)	<i>A dividend paid by an Indian company outside India.</i>
9(1)(v)	<i>Income by way of interest payable by -</i> <i>the Government; or</i> <i>a person who is resident, except where the interest is payable in respect of any debt incurred, or moneys borrowed and used 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</i> <i>a person who is non-resident, where the interest is payable in respect of any debt incurred, or moneys borrowed and used for the purposes of a business or profession carried on by such person in India.</i>
9(1)(vi)	<i>Income by way of royalty payable by -</i> <i>the Government; or</i> <i>a person who is resident, except where the royalty is payable in respect of any right, property or information used or services utilised 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</i> <i>a person who is non-resident, where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.</i> Royalty [Explanation 2]: <i>'Royalty' means consideration including any lump sum consideration for -</i> <i>Transfer of all or any rights (including granting of a licence) in respect of any patent, invention, model, design, secret formula or process, trademark or similar property;</i> <i>Use or right to use any industrial, commercial or scientific equipment but not including the amount referred to in section 44BB;</i> <i>Imparting of any information concerning the working of or the use of a patent, invention, model, design, secret formula or process, trade mark or similar property;</i> <i>Imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill.</i> <i>Use of any patent, invention, model, design, secret formula or process, trademark or similar</i>

	property. (vi) Rendering of any service in connection with activities referred in (i) to (v) above. (vii) Transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or videotapes for use in connection with radio broadcasting but not including consideration for the sale, distribution or exhibition of cinematographic films. [Omitted by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY 2021-22] Objective of amendment : Due to exclusion of consideration for the sale, distribution or exhibition of cinematographic films from the definition of royalty, such royalty is not taxable in India even if the DTAA gives India the right to tax such royalty. Such a situation is discriminatory against Indian residents, since India is foregoing its right to tax royalty in case of a non-resident from another country without that other country offering similar concession to Indian resident. Hence, the definition of royalty has been amended so as not to exclude consideration for the sale, distribution or exhibition of cinematographic films from its meaning. Exclusions: Any consideration, which would be chargeable as income of recipient under head 'Capital Gains' shall not be treated as royalty. Consideration for use or right to use of computer software is royalty [Explanation 4]: "The consideration for use or right to use of computer software" is royalty as the 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. Consideration in respect of any right, property or information is royalty [Explanation 5] : 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. Scope of term Process [Explanation 6] : The expression "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, optic fibre or by any other similar technology, whether or not such process is secret.
9(1)(vii)	Income by way of fees for technical services payable by - (a) the Government; or (b) a person who is resident, except where the fees are payable in respect of services utilised in 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 (c) a person who is non-resident, where the fees are payable in respect of any services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India. 'Fees for technical services' means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel). [Explanation 2] Exclusions : 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", shall not be treated as 'fees for technical services'.
9(1)(viii)	Income arising outside India, being any sum of money referred to in Section 2(24)(xviii) i.e. gift of money, paid on or after 05-07-2019 by a person resident in India to a non-resident, not being a company, or to a foreign company.

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] : The income of a non-resident shall be deemed to accrue or arise in India under section 9(1)(v)/(vi)/ (vii) and 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.*

Circular No. 4/2015, dated 26-03-2015]	The dividends declared and paid by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India would NOT be deemed to be income accruing or arising in India by virtue of the provisions of Explanation 5 to section 9(1)(i).

Illustration 13 - Taxability of interest income : Mr. A, a citizen of India, left for USA for the purposes of employment on 01-5-2020. He has not visited India thereafter. Mr. A borrows money from his friend Mr. B, who left India one week before Mr. A's departure, to the extent of Rs.10 lakhs and buys shares in X Ltd., an Indian company. Discuss the taxability of the interest charged @ 10% in B's hands where the same has been received in New York. (4 Marks, PCC May 2006)

Solution: In this case,—

- (a) Mr. A and Mr. B are non-resident in India during the previous year 2020-21;
- (b) the purpose of borrowal by Mr. A is not 'carrying on of any business of profession in India' but for the purpose of investment in India i.e. earning any source of income in India.

Hence, the provisions of section 9(1)(v) relating to deeming fiction of accrual is not applicable in this case. Accordingly the interest does not accrue or arise in India and is, therefore, not taxable in India.

Illustration 14 - Taxability of fees for technical services : Miss Vivitha paid a sum of 5000 USD to Mr. Kulasekhara, a management consultant practising in Colombo, specializing in project financing. The payment was made in Colombo. Mr. Kulasekhara is a non-resident. The consultancy related to a project in India with possible Ceylonese collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kulasekhara, since the services were used in India?. (4 Marks, IPCC May 2011)

Solution: A non-resident is chargeable to tax in respect of income received outside India only if such income accrues or arises or is deemed to accrue or arise to him in India. The income deemed to accrue or arise in India under section 9 comprises, inter alia, income by way of fees for technical services, which includes any consideration for rendering of any managerial, technical or consultancy services. Therefore, payment to a management consultant relating to project financing is covered within the scope of "fees for technical services".

According to explanation to section 9, income by way of, fees for technical services, from services utilized 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.

In the instant case, since the services were utilized in India, the payment received by Mr. Kulasekhara, a non-resident, in Colombo is chargeable to tax in his hands in India, as it is deemed to accrue or arise in India.

Illustration 15 - Residential Status and its effect on tax incidence : Mr. Soham, an Indian Citizen left India on 20-04-2018 for the first time to setup a software firm in Singapore. On 10-04-2020, he entered into an agreement with LK Limited, an Indian Company for the transfer of technical documents and designs to setup an automobile factory in Faridabad. He reached India along with his team to render the requisite services on 15-05-2020 and was able to complete his assignment on 20-08-2020. He left for Singapore on 21-08-2020. He charged Rs. 50 lakhs for his services from LK Limited. Determine the residential status of Mr. Soham for the Assessment Year 2021-22 and explain as to the taxability of the fees charged from LK limited as per the Income-tax Act, 1961. (6 Marks, Nov. 2015)

Solution: As per Section 6 an Indian citizen or a person of Indian origin, who being outside India, comes on a visit to India shall be resident in India if he is in India for a period of 182 days or more during the previous year or he comes on a visit to India in the previous year for a period of more than 120 days and was in India for a period of 365 days or more during 4 years preceding the previous year and having total income, other than the income from foreign sources, exceeding Rs. 15 lakh rupees during the previous year.

In this case Mr. Soham came to India on 15-05-2020 and left for Singapore on 21-08-2020, hence he was in India for a period of 99 days during previous year 2020-21. Hence, he is non resident in India.

According to Section 9(1) (vi), Income by way of royalty shall be deemed to accrue or arise in India in hands of recipient (Mr. Soham) if it is payable by a person who is resident (LK Limited), except where the royalty are payable in respect of services utilised in 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. Hence, the income of Rs. 50,00,000 shall be deemed to accrue in India. The income of a non-resident shall be deemed to accrue or arise in India under section 9(1) (vi) and 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.

Hence, sum of Rs. 50,00,000 will be taxable in hands of Mr. Soham.

Illustration 16 - Scope of total Income : Following incomes are derived by Mr. Krishna Kumar during the year ended 31-3-2021:

Particulars	Amount (Rs.)
Pension received from the US Government	3,20,000
Agricultural income from lands in Malaysia	2,70,000
Rent received from let out property in Colombo, Sri Lanka	4,20,000

Discuss the taxability of the above items where the assessee is (i) Resident, (ii) Non-resident. (6 Marks, Nov. 2018-NS)

Solution: Computation of Gross total income

(amount in Rs.):

Particulars	Resident	Non Resident
Pension received from the US Government [Net of standard deduction of Rs. 50,000]	2,70,000	-
Income from agriculture land situated in Malaysia	2,70,000	-
Rent received from let out property in Colombo, Sri Lanka [WN]	2,94,000	-
Gross Total Income	8,34,000	Nil

It has been assumed that the above incomes has been received outside India. If the same is received in India, then the said amounts will also be taxable even if Krishna Kumar is non resident.

Working Note : *It has been assumed that the rental income is the gross annual value of the property. Therefore, deduction @ 30% under section 24, has been provided and the net income so computed is taken into account for determining the total income of a resident and ordinarily resident.*

	(amount in ₹.)
Rent received (assumed as gross annual value)	4,20,000
Less: Deduction under section 24 (30% of ₹. 4,20,000)	1,26,000
Income from house property	2,94,000

Illustration 17 - Scope of total Income: *Explain with reasons whether the following transactions attract income-tax in India in the hands of recipients?.*

- Salary (Computed) paid to Mr. David, a citizen of India ₹. 15,00,000 by the Central Government for the services rendered in Canada.
- Legal charges of ₹. 7,50,000 paid to Mr. Johnson, a lawyer of London, who visited India to represent a case at the Supreme Court.
- Royalty paid to Rajeev, a non-resident by Mr. Kulkesh, a resident for a business carried on in Sri Lanka.
- Interest received of ₹. 1,00,000, on money borrowed from France, by Ms. Dyana, a non-resident for the business at Bangalore.

(4 Marks, May 2015)

Solution:

	Taxable / Not Taxable	Amount liable to tax (₹.)	Reason
(i)	Taxable	15,00,000	As per Section 9(1) (iii), salaries payable by the Government to a citizen of India for service rendered outside India shall be deemed to accrue or arise in India. Therefore, salary paid by Central Government to Mr. David for services rendered outside India would be deemed to accrue or arise in India since he is a citizen of India.
(ii)	Taxable	7,50,000	Legal charges paid to Mr. Johnson, a lawyer of London, who visited India to represent a case at the Supreme Court, since it accrues or arises in India.
(iii)	Not taxable		Royalty paid by a resident to a non-resident in respect of a business carried outside India would not be taxable in the hands of the non-resident provided the same is not received in India. This has been provided as an exception to deemed accrual mentioned in Section 9(1) (vi) (b).
(iv)	Taxable	1,00,000	As per Section 9(1)(v)(c), interest payable by a non-resident on moneys borrowed and used for the purposes of business carried on by such person in India shall be deemed to accrue or arise in India in the hands of the recipient.

Illustration 18 - Computation of total income : *Determine the taxability of income of US based company Heli Ltd., in India on entering following transactions during the financial year 2020-21:*

- ₹. 5 lacs received from an Indian domestic company for providing technical know how in India.

- (ii) Rs. 6 lacs from an Indian firm for conducting the feasibility study for the new project in Finland.
 (iii) 4 lacs from a non-resident for use of patent for a business in India.
 (iv) Rs. 8 lacs from a non-resident Indian for use of know how for a business in Singapore.
 (v) Rs. 10 lacs for supply of manuals and designs for the business to be established in Singapore. Explain the rate of tax applicable on taxable income for US based company, Heli Ltd., in India.
 (7 Marks, PCC Nov. 2009) (Similar: 4 Marks, May 2017)

Solution: A non resident is chargeable to tax in India in respect of following incomes :

- (i) Income received or deemed to be received in India.
 (ii) Income accruing or arising or deemed to accrue or arise in India.

In view of the above provisions, taxability of income is determined in following manner :

S.No.	Particulars	Rs.
(i)	Amount received from an Indian domestic company for providing technical know how in India is from Business Connection in India, therefore taxable in India.	5,00,000
(ii)	Conducting the feasibility study for the new project in Finland for the Indian firm is not taxable in India as done for the business outside India.	Nil
(iii)	The income from business set up in India is taxable in India. Therefore, money received from a non resident for use of patent for a business in India is taxable in India.	4,00,000
(iv)	Money received from a non resident India for use of know-how for a business in Singapore is for the business outside India, therefore non taxable in India.	Nil
(v)	Payment made for supply of manuals and designs for the business to be established in Singapore is not taxable in India.	Nil
	Total Income taxable in India	9,00,000

Tax rate applicable to Heli Ltd.: In respect of foreign companies, certain specified income such as Royalty and fees for technical service is taxable @ 10% + Surcharge + Health and education cess. The rates are also depends on Double Taxation Avoidance Agreement, if any, entered into between India and the respective country of the foreign company, whichever is more beneficial to the assessee. The basic normal rate applicable for the US based company who is a foreign company is 40%. In case the taxable income is more than Rs. 1 crore but upto Rs. 10 crores in the previous year, the surcharge @ 2% is applicable. If Total income exceeds Rs. 10 crores surcharge of 5% is applicable. The Health and education cess is payable @ 4%. The effective rate of tax in case of foreign companies in India is 42.432%/ 43.68% respectively.

Illustration 19 - Computation of total income : From the following particulars of Income furnished by Mr. Anirudh pertaining to the year ended 31-03-2021, compute the total income for the assessment year 2021-22, if he is :

- (i) Resident and ordinary resident;
 (ii) Resident but not ordinarily resident;
 (iii) Non-resident: (10 Marks, IPCC May 2010)

	Particulars	Amount (Rs.)
(a)	Profit on sale of shares in Indian Company received in Germany	15,000

(b)	Dividend from a Japanese Company received in Japan	10,000
(c)	Rent from property in London deposited in a bank in London, later on remitted to India through approved banking channels	75,000
(d)	Dividend from RP Ltd., an Indian Company	6,000
(e)	Agricultural income from lands in Gujarat	25,000

Solution: The total income, in each case, is computed herein below (amounts in Rs.) -

Particulars	Resident & ordinarily resident	Resident but not ordinarily resident	Non-resident
Profit on sale of shares in Indian company received in Germany	15,000	15,000	15,000
Dividend from Japanese company, received in Japan	10,000	-	-
Rent from property in London deposited in a bank in London [WN-1]	52,500	-	-
Dividend from RP Ltd. an Indian company [WN-2]	-	-	-
Agricultural income from lands in Gujarat [WN-3]	-	-	-
Total Income	77,500	15,000	15,000

Working Notes:

- (1) It has been assumed that the rental income is the gross annual value of the property. Therefore, deduction @ 30% under section 24, has been provided and the net income so computed is taken into account for determining the total income of a resident and ordinarily resident.

(amount in Rs.)

Rent received (assumed as gross annual value)	75,000
Less: Deduction under section 24 (30% of Rs. 75,000)	22,500
Income from house property	52,500

- (2) Dividend from Indian company is exempt under section 10(34).
 (3) Agricultural income is exempt under section 10(1).

Illustration 20 - Computation of total income : Mrs. Geetha and Mrs. Leena are sisters and, they earned the following income during the Financial Year 2020-21. Mrs. Geetha is settled in Malaysia since 1988 and visits India for a month every year. Mrs. Leena is settled in fndore since her marriage in 1996. Compute the total income of Mrs. Geetha and Mrs. Leena for the assessment year 202.1-22 : (amount in Rs.)

	Particulars	Mrs. Geetha	Mrs. Leena
1.	Income from Profession in Malaysia, (set up in India) received there	15,000	-
2.	Profit from business in Delhi, but managed directly from Malaysia	40,000	-
3.	Rent (computed) from property in Malaysia deposited in a Bank at Malaysia, later on remitted to India through approved banking channels.	1,20,000	
4.	Dividend from I'QR Ltd. an Indian Company	5,000	9,000
5.	Dividend from a Malaysian, company received in Malaysia	15,000	8,000
6.	Cash gift received from a friend on Mrs. Leena's 50th birthday	-	51,000
7.	Agricultural income from land in Maharashtra	7,500	4,000
8.	Past foreign untaxed income brought to India	5,000	-
9.	Fees for technical services rendered in India received in Malaysia	25,000	-
10.	Income from a business in Pune (Mrs. Geetha receives 50% of the income in India)	12,000	15,000
11.	Interest on debentures in an Indian company (Mrs. Geetha received the same in Malaysia)	18,500	14,000
12.	Short-term capital gain on sale of shares of an Indian company	15,000	25,500
13.	Interest on savings account with SBI	12,000	8,000
14.	Life insurance premium paid to LIC	-	30,000

(Similar PCC May 2012, 12 Marks) (Similar IPCC May 2013, 8 Marks) (8 Marks, Nov. 2014)

Solution: Computation of total income of Mrs. Geetha and Mrs. Leena (amount in Rs.):

	Particulars	Geetha	Leena
1.	Income from Profession in Malaysia, (set up in India) received there [WN-3]	-	-
2.	Profit from a business in Delhi, but managed directly from Malaysia	40,000	-
3.	Rent (computed) from property in Malaysia deposited in a Bank at Malaysia, later on remitted to India through approved banking channels. (Remittance in India is not taxable)	-	-
4.	Dividend from PQR Ltd. an Indian Company [Taxable in hands of shareholder]	5,000	9,000
5.	Dividend from a Malaysian company received in Malaysia	-	8,000
6.	Cash gift received from a friend on Mrs. Leena's 50th birthday	-	51,000
7.	Agricultural income from land in Maharashtra [WN-4]	-	-
8.	Past foreign untaxed income brought to India [It is not taxable]	-	-
9.	Fees for technical services rendered in India, but received in Malaysia [WN-2]	25,000	-
10.	Income from a business in Pune (Mrs. Geetha receives 50% of the income in India)	12,000	15,000
11.	Interest on debentures in an Indian company (Mrs. Geetha received the same in Malaysia)	18,500	14,000
12.	Short-term capital gain on sale of shares of an Indian company	15,000	25,500
13.	Interest on savings account with SBI	12,000	8,000
	Gross Total Income	1,27,500	1,30,500
	Less: Deduction u/s 80C in respect of Life insurance premium paid	-	-30,000

Less: Deduction u/s 80TTA in respect of Interest on deposits in saving A/c [WN-5]	-10,000	-8,000
Total Income	1,17,500	92,500

Working Notes:

- (1) Mrs. Geetha is a non-resident since she has been living in Malaysia since 1988. Mrs. Leena, who is settled in Indore, is a resident.
- (2) In case of a resident, his global income is taxable as per section 5(1). However, as per section 5(2), in case of a nonresident, only the following income are chargeable to tax:
 - (a) Income received or deemed to be received in India; and
 - (b) Income accruing or arising or deemed to accrue or arise in India.
 Therefore, fees for technical services rendered in India would be taxable in the hands of Mrs. Geetha, even though she is a non-resident. The income referred to in SI. No. 10, 11, 12 and 13 are taxable in the hands of both Mrs. Geetha and Mrs. Leena since they accrue or arise in India.
- (3) Income from Profession in Malaysia, (set up in India) received there by Mrs. Geetha is not taxable since it accrues and received outside India.
- (4) Agricultural income from a land situated in India is exempt under section 10(1) in the case of both non-residents and residents.
- (5) Interest on savings bank deposit is eligible for deduction u/s 80TTA subject to maximum limit of Rs. 10,000.

Illustration 21 - Computation of GTI: Mr. Rajnesh, a citizen of India, serving in the Ministry of Finance in India and transferred to High Commission of Australia on 15th March 2020. He did not come to India during the financial year 2020-21. His income during the financial year 2020-21 is given here under :

Particulars	Rs.
Salary from Government of India	7,20,000
Foreign Allowances from Government of India	6,00,000
Rent from a house situated at London, received in London	3,60,000
Interest accrued on National Saving Certificate during the year 2020-21	45,000

Compute the Gross Total Income of Mr. Rajnesh for the Assessment Year 2021-22.

(4 Marks, Nov. 2016)

Solution: Mr. Rajnesh did not visited India during Financial Year 2020-21, hence he is non resident in India. Since Mr. Rajnesh is an Indian citizen being government employee his salary income is deemed to accrue or arise in India and is taxable in India. Thus even if he is non resident in India, the salary income will be taxable in India. Computation of Gross Total Income (amounts in Rs.):

Income under the head Salaries		
Salary	7,20,000	
Foreign Allowances from Government of India [Such allowance is exempt u/s 10(7)]	Nil	
Gross Salary	7,20,000	
Less: Standard deduction u/s 16(ia)	50,000	6,70,000
Income from House property		
Rent from house property situated in London, received in India [It will not be taxable, since he is non resident]		Nil
Income from other sources		

Interest accrued on National Saving Certificate during the year 2020-21		45,000
Gross Total Income		7,15,000

Illustration 22 - Determination of residential status and scope of total income : DAISY Ltd., a foreign company, incorporated in USA and engaged in the manufacturing and distribution of diamonds, set up a branch office in India in June 2020. The branch office was required to purchase uncut and un-assorted diamonds from dealers of Mumbai and export them to USA. During the Previous Year 2020-21, profit from such export amounted to Rs. 75 lakhs. Out of 20 shareholders of DAISY Ltd., 12 shareholders are non-resident in India. All the major decisions were taken through Board Meetings held at USA.

- (i) Determine the residential status of DAISY Ltd. for the Assessment Year 2021-22.
- (ii) Discuss the tax treatment of profit from export business. (5 Marks, Nov. 2017)

Ans:

- (i) **Residential Status of Daisy Ltd.:** According to Section 6(3) of the Income tax Act, 1961, a foreign company is said to be resident in India in any previous year, 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.
 Since in case of Daisy Ltd., all the major decisions were taken through Board Meetings held at USA, hence it will be non resident in India.
- (ii) According to 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. Thus, export profits of Rs. 75 lakhs shall not be taxable in India in hands of DAISY Ltd.

Illustration 23 - Computation of GTI: Compute the Gross Total Income in the hands of an individual, if he is

- (a) a resident and ordinary resident; and
- (b) a non-resident for the A.Y. 2021-22.

S.No.	Particulars	Amount (Rs.)
(i)	Interest from German Derivatives Bonds (l/3rd received in India)	21,000
(ii)	Income from agriculture land situated in Malaysia, remitted to India	51,000
(iii)	Income earned from business in Dubai, controlled from India (Rs. 20,000 received in India)	75,000
(iv)	Profit from business in Mumbai, controlled from Australia	1,75,000
(v)	Interest received from Mr. Ashok (NRI) on loan provided to him for business in India	35,000
(vi)	Dividend from Brown Ltd., an Indian Co.	30,000
(vii)	Profit from business in Canada controlled from Mumbai (60% of profits deposited in a bank in Canada and 40% remitted to India)	60,000
(viii)	Amount received from an NRI for the use of know-how for his business in Singapore	8,00,000
(ix)	Dividend received from foreign company in India	25,000
(x)	Past years untaxed foreign income brought to India	50,000

Solution: Computation of Gross total income (amount in Rs.):

S.No.	Particulars	Resident	Non Resident
(i)	Interest from German Derivatives Bonds (1/3rd received in India) [WN-1]	21,000	7,000
(ii)	Income from agriculture land situated in Malaysia, remitted to India [WN-1 & 3]	51,000	-
(iii)	Income earned from business in Dubai, controlled from India (Rs.20,000 received in India) [WN-1]	75,000	20,000
(iv)	Profit from business in Mumbai, controlled from Australia [WN-1]	1,75,000	1,75,000
(v)	Interest received from Mr. Ashok (NRI) on loan provided to him for business in India [WN-1]	35,000	35,000
(vi)	Dividend from Brown Ltd., an Indian Co. [Taxable in hands of shareholder]	30,000	30,000
(vii)	Profit from business in Canada controlled from Mumbai (60% of profits deposited in a bank in Canada and 40% remitted to India) [WN-3]	60,000	-
(viii)	Amount received from an NRI for the use of know-how for his business in Singapore [WN-4]	8,00,000	-
(ix)	Dividend received from foreign company in India [WN-2]	25,000	25,000
(x)	Past years untaxed foreign income brought to India	-	-
	Gross Total Income	12,72,000	2,92,000

Working Notes :

- (1) In case of a resident, his global income is taxable as per Section 5(1). However, as per Section 5(2), in case of a nonresident, only the following income are chargeable to tax:
 - (i) Income received or deemed to be received in India; and
 - (ii) Income accruing or arising or deemed to accrue or arise in India

The income referred to in SI. No. (iv), and (v) are taxable in India whether assessee is resident or non resident since they accrue or arise in India.

Interest on German derivatives Bonds would be fully taxable in case of resident, whereas only 1/3rd which is received in India is taxable in the hands of Non resident.

- (2) Dividend received from foreign company in India will be taxable in both cases since it is received in India.
- (3) In case of non resident, Receipt in India is chargeable to tax and not remittance. Hence, Profit from business in Canada controlled from Mumbai and Agricultural Income from land situated in Malaysia will not be taxable in case of non resident. No exemption will be available in respect of agricultural income from Malaysia, since agricultural income from land situated in India is exempt from tax under Section 10(1).
- (4) In case use of know how is outside India, Income from it does not accrue or arise in India. Hence, it will not be taxable in case of non resident.

Illustration 24 - Computation of GTI: The following are the incomes of Shri Subhash Chandra, a citizen of India for the previous year 2020-21:

- (i) Income from business in India ₹. 2,00,000. The business is controlled from London and ₹. 60,000 were remitted to London.
- (ii) Profits from business earned in Japan ₹. 70,000 of which ₹. 20,000 were received in India. This business is controlled from India.
- (iii) Untaxed income of ₹. 1,30,000 for the year 2018-19 of a business in England which was brought in India on 3rd March, 2021.
- (iv) Royalty of ₹. 4,00,000 received from Shri Ramesh, a resident for technical service provided to run a business outside India.
- (v) Agricultural income of ₹. 90,000 in Bhutan.
- (vi) Income of ₹. 73,000 from house property in Dubai, which was deposited in bank at Dubai. Compute Gross total income of Shri Subhash Chandra for the A.Y. 2021-22, if he is —
 - (a) A Resident and Ordinary Resident, and
 - (b) A Resident and Not Ordinarily Resident (7 Marks, May 2019-NS)

Solution: Computation of Gross total income of Shri Subhash Chandra (amount in ₹.):

	Particulars	Resident	NOR
(i)	Income from business in India	2,00,000	2,00,000
(ii)	Profits from business earned in Japan controlled from India	70,000	70,000
(iii)	Untaxed income from business in England	-	-
(iv)	Royalty received from resident for technical services provided to run a business outside India (Income is deemed to accrue or arise outside India)	4,00,000	-
(v)	Agricultural income in Bhutan	90,000	-
(vi)	Income from house property in Dubai which was deposited in Dubai Bank [₹. 73,000 less standard deduction 30% of ₹. 73,000]	51,100	-
	Gross total income	8,11,100	2,70,000

3 SALARIES

Topic Referencer

-  Basic Concept of Salaries
-  Taxability of Allowances
-  Taxability of Perquisites
-  Profits in lieu of salary, Gratuity, Earned leave salary, Pension, Leave travel concession and VRS compensation
-  Tax Treatment of Provident Funds and Tax Relief
-  Miscellaneous Illustrations

BASIC CONCEPT OF SALARIES

Component	Amount	Section
 Taxable salary payments and allowances	xxxx	15,17 (1)
 Taxable perquisites	xxxx	17(2)
 Profits in lieu of salary	xxxx	17(3)
Gross Salary	xxxx	
Less: (i) Standard deduction	xxxx	16(ia)
(ii) Deduction for entertainment allowance	xxxx	16(ii)
(iii) Deduction for tax on employment	xxxx	16(iii)
Income under the head 'Salaries'	xxxx	

1. **The charge under the head "Salaries" presumes the relationship of an employer and employee. Explain the broad propositions of employer-employee relationship.**

Ans: An income earned is chargeable to tax under the head "salaries" if and only if there exists an employer-employee relationship between the payer and the payee. The important features to be considered are -

- (1) **Contract of service :** The employer and employee must enter into a "Contract of Service" and not the "Contract for Service".
"Contract of service" bounds the employee to work for the employer whereas in "contract for service" the payee is not bound but he offers the payer to avail his services and pay the fees as a consideration.
- (2) **Relationship of master & servant:** The relationship between employer and employee must be like master and servant wherein the employer has the direct supervision and control over the work of the employee. Also, the employer gives the instructions to employee and the manner to carry out such instructions.
- (3) **Not a principal-agent relationship :** The employer-employee relationship is not a principal-agent relationship because in case of principal-agent relationship, the agent is free to carry out the instructions given by the principal in his own manner.
- (4) **Illustrations of employer and employee relationship :**
 - (a) **Employee v. Independent professional:** Miss Y, an actress, is employed in Chopra Films wherein she gets the monthly salary of X 1 lakh. She acts in various films and all the

producers pay directly to Chopra Films. Here, the remuneration received by Miss Y from Chopra Films constitutes her "Salary".

In case Miss Y does not get monthly remuneration from Chopra Films but receives from different producers, then it does not constitute the 'Income from Salaries' and shall be treated as 'Profits & Gains of Business or Profession'.

- (b) **Paper-setter / invigilator not an employee** : If an individual is working in a school as a teacher and gets the remuneration for the same, then such remuneration shall come in the ambit of 'Salaries'.
However, if he sets any examination paper or acts as an invigilator in any examination and gets the fees for the same, then the fees so received shall not constitute salaries and is taxable under the head 'Income from other sources'.
- (c) **Salary received by MLA's/ MP's** : MLA's and MP's are elected representatives and not the government employees, hence the salary received by them will be taxable under the head 'Income from other sources'. However, if they are assigned any charge of ministry, then the remuneration received by them shall be taxable under the head 'Salaries'.
- (d) **Remuneration received by Judges** : Salary received by judges of court is chargeable to tax as 'Salaries' as their employment is created by the Indian Constitution. - Justice Deoki Nandan Agarwala v. UOI [1999] 237 ITR 872 (SC)
- (e) **Retainership fees received by Advocate General** : The retainership fees received by an Advocate-General who gives advices to the Government is not 'Salaries' as the same is done by him in his professional capacity. - CITv. Govindaswaminathan [1998] 233 ITR 264 (Mad)
- (f) **Pay and allowances to Chief Minister is 'salary'** : In view of Article 164(5) of the Constitution of India, which provides for payment of salary to the Ministers, the pay and allowances received by the Chief Minister from the State Government is chargeable to tax as 'Income from Salaries'. - Lalit Prasad v. CIT [2009] 316 ITR 186 (Patna).

2. **Explain the Basis of charge of salaries.**

Ans: **The concept of charge of salaries is discussed as under -**

- (1) **Salaries [Section 15]**: The following income shall be chargeable to income tax under the head "Salaries"-
- (a) **Salary taxable on due basis** : Any salary due from an employer or a former employer to an assessee in the previous year, whether paid or not.
- (b) **Advance salary taxable on receipt basis** : Any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him.
- (c) **Arrears of Salary taxable on receipt basis** : Any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.
Thus, salary is taxed on due basis or receipt basis whichever is earlier.
- (2) **Advance salary not to be taxed again on due basis [Explanation 1]**: Where any salary paid in advance is included in the total income of any person for any previous year it shall not be included again in the total income of the person when the salary becomes due.

- (3) **Salary received by partner of firm to be taxed under profit and gains of business or profession**
[Explanation 2]: Any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from the firm shall not be regarded as "salary" for the purposes of this section.

3. Define "Salary".

Ans: According to Section 17(1), Salary includes -

- (1) Wages;
- (2) Any annuity or pension;
- (3) Any gratuity;
- (4) Any fees, commissions, perquisites or profits in lieu of salary or in addition to any salary or wages;
- (5) Any advance of salary;
- (6) Any payment received by an employee in respect of any period of leave not availed of by him;
- (7) The annual accretion to the balance at the credit of an employee participating in a Recognised Provident Fund to the extent it is chargeable to tax;
- (8) The aggregate of all sums that are comprised in the transferred balance of an employee participating in a Recognised Provident Fund to the extent it is chargeable to tax;
- (9) 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 in Section 80CCD.

4. Explain the following terms -

- (1) Fixed pay scale and graded pay scale.
- (2) Tax-free salary.
- (3) Advance salary v/s Loan/advance against salary. (4 Marks, May 2008)
- (4) Foregoing of salary v/s Surrender of salary. (Nov. 2003)
- (5) Annuity.
- (6) Place of accrual of salary income

Ans: The following terms are explained as under -

- (1) **Fixed pay scale and graded pay scale :** In fixed pay scale, the employee receives a certain fixed amount of salary for a specified period whereas in case of graded pay scale, the employee gets an annual increment in his salary on the basis of the grade in which he is placed.

Example: Mr. A joins a job in the grade of Rs. 20,000-500-25,000-1,000-40,000 1,500-60,000 on 1-7-2008. This means-

- (a) His salary will be Rs. 20,000 p.m. from July 2009 onwards.
- (b) He will get the annual increment of Rs. 500 w.e.f. 01-7-2010 for 10 years till his salary becomes Rs. 25,000
- (c) Thereafter he will get the annual increment of Rs. 1,000 w.e.f. 01-7-2020 till his salary becomes Rs. 40,000.

Therefore, his basic salary for the financial year 2020-21 (assessment year 2021-22) shall be -

(amount in Rs.)

For the month of April, May and June 2020 (Rs. 25,000 x 3)	75,000
From July 2020 to March 2021 (Rs. 26,000 x 9)	2,34,000
Total	3,09,000

- (2) **Tax-free salary** : It means that the employer takes the burden of the tax which is to be paid on the salary of the employee.
Therefore, in such a case the taxable salary of the employee shall include the tax paid by the employer on his behalf.

Example : Tax-free salary of employee = Rs. 4,00,000 and tax paid by the employer Rs. 5,485 then the taxable salary of employee = Rs. 4,00,000 + Rs. 5,485 = Rs. 4,05,485.

- (3) **Advance Salary v/s Loan or advance against salary** : Advance salary means that the employee receives the salary before it becomes due to him and hence it is taxable on receipt basis in the year in which it is received.

Loan against salary	Advance against salary
It means that the employee takes loan from his employer and agrees to pay the same in specified number of instalments and such instalments may be deducted out of salary of the employee due to him in subsequent months.	It means the employee takes advance against his salary and agrees to get the same adjusted from his salary subsequently. Thus, while advance salary is taxable; loan or advance against salary is not taxable.

- (4) **Foregoing of salary v/s Surrender of salary:**

Foregoing of salary	Surrender of salary
It means that the employee waives his salary after it becomes due or accrues to him. It is taxable in the hands of employee.	It means that the employee surrenders his salary to the Central Government under section 2 of the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961. The salary so surrendered shall be exempt from tax.

- (5) **Annuity** : Annuity means the yearly sums payable to a person. It may be received from the present employer or past employer or a person other than employer.
- If received from present employer - taxable as 'salary' irrespective of the fact whether it is voluntary payment or in pursuance of any contractual obligation.
 - If received from past employer - taxable as 'profits in lieu of salary'.
 - If received from a person other than employer - taxable as 'income from other sources'.
- (6) **Place of accrual of salary income** : Income under the head salary is deemed to accrue or arise in India if the same is payable for services rendered in India. Further, salary paid by Government to an Indian citizen for services rendered outside India is also deemed to accrue or arise in India. The provisions of Section 9(1) (ii) & (iii) are summarized below -
(It has been assumed that the salary is paid at the place where service is rendered)

Employee -	Employer -	Where service is rendered	Whether taxable in India	
			Salary	Perquisite/allowance
Case 1: Indian citizen (resident or non-resident)	Government of India	Outside India	YES	NO (exempt u/s 10(7))

Case 2: Non-resident or Not ordinarily resident (other than case 1)	Any	Outside India	NO	NO
		In India	YES	YES
Case 3: Resident (other than case 1 and 2)	Any	Anywhere	YES	YES

5. Discuss the concept of 'Salaries'.

Ans: The concept of 'Salaries' is as follows -

- (1) Commission on a fixed percentage of sales comes in the ambit of salary.
- (2) For taxing an income under the head 'Salaries', it is irrelevant whether the assessee is in part-time employment or full-time employment with his employer.
- (3) If an employee receives salary from more than one employer during any previous year, then the salary from each employer is taxable under the head "Salaries".
- (4) Any deductions made by the employer from the employee's salary like PF deduction, Tax-deduction at source etc. shall also be included in the salary.
- (5) Salary is taxed on "due" or "receipt" basis, whichever is earlier; therefore, the date when salary becomes due decides whether it is taxable in the previous year or not.
In some cases, salary becomes due on 1st day of the next month. Therefore, when salary becomes due on 1st day of next month in such a case, salary from March 2020 to February, 2021 shall be taxable for the AY 2021-22.

For example, X is an employee whose salary has been increased from Rs. 20,000 p.m. to Rs. 25,000 p.m. w.e.f. 1st July 2020. The salary becomes due on the first day of next month. Therefore, taxable salary of Mr. X for assessment year 2021-22 will be -

	(amount in Rs.)
For the months of March 2020 to June 2020 (Rs. 20,000 x 4)	80,000
From July 2020 to February 2021 25,000 x 8)	2,00,000
Gross salary	2,80,000

If in the above e.g. salary/ becomes due on the last day of the month - In such a case, salary from April 2020 to March 2021 shall be taxable i.e. Rs. 20,000 x 3 + Rs. 25,000 x 9 = Rs. 2,85,000, will be taxable in the hands of Mr. X.

- (6) Place of accrual of salary : Income which falls under the head "Salaries", shall be deemed to accrue or arise in India if it is earned in India, i.e. service rendered in India. "Salaries" payable by the Government to a citizen of India for service rendered outside India shall also be deemed to accrue or arise in India. Allowances and perquisites to Government Employee's being Indian Citizen for services rendered out side India is exempt from tax.
- (7) Salary received from UNO - Exempt: Salary, emoluments and pension received from the UNO is exempt from tax under section 2 of the United Nations (Privileges and Immunities) Act, 1947.

6. *What are the deductions available to an assessee while computing his income under the head 'Salaries'?*

Ans: **Deductions from salaries [Section 16]** : The income chargeable under head "Salaries" shall be computed after making the following deductions -

(1) **Standard Deduction [Section 16(i)]**: A deduction of Rs. 50,000 or the amount of the salary, whichever is less.

(2) **Entertainment allowance [Section 16(II)]** : Only Government employees are entitled to avail deduction on account of entertainment allowance. Entertainment allowance is first included in the gross salary and thereafter deduction is given.

The deduction is allowed to the extent of least of the following -

(a) Actual amount received; or

(b) Rs. 5,000; or

(c) 20% of basic salary (salary exclusive of any allowance, benefit or other perquisite)

(3) **Employment Tax [Section 16(iii)]**: An assessee is allowed deduction of any sum paid by him on account of a tax on employment within the meaning of Article 276(2). Under the said article employment tax cannot exceed Rs. 2,500 per month.

Illustration 1 - Accrual of salary: Rajesh Kumar, an Indian citizen, is posted in the Indian High commission at London during the previous year 2020-21. His emoluments consist of basic pay of Rs. 1,40,000 per month and overseas allowance of Rs. 40,000 per month. Besides, he is entitled to airfare for going from and coming to India and also to free use of Government's car at London. He has no taxable income except salary income stated above. His employer did not deduct tax at source. Rajesh Kumar argues that -

- (i) he is not liable to pay tax on salary earned and received outside India since he is a non-resident during the previous year 2020-21, and
- (ii) even if any tax is due, it is the duty of his employer to deduct tax at source and as such he has no responsibility to pay the tax.

Discuss whether his contention is correct.

Will it make any difference if Rajesh Kumar is a Foreign citizen?. Give reasons. (Nov. 1998)

Solution:

- (i) **If Rajesh is an Indian Citizen :** The argument of Rajesh Kumar is not correct. Since he is an Indian citizen being government employee his salary income is deemed to accrue or arise in India and is taxable in India. In case if employer does not deduct tax at source, the tax is to be paid directly by employee. The computation of Taxable Salary is as under (amounts in Rs):

Salary (Rs. 1,40,000 x 12)	16,80,000
Overseas Allowance (Rs. 40,000 x 12) & Perquisites shall be exempt u/s 10(7)	Nil
Gross Salary	16,80,000
Less: Standard deduction u/ s 16(i)	50,000
Income under the head Salaries	16,30,000

- (ii) **If Mr. Rajesh is a foreign citizen :** In case Rajesh Kumar is foreign citizen, then salary income shall not be deemed to accrue or arise in India, and hence not taxable in India.

TAXABILITY OF ALLOWANCES

7. Write a note on House Rent allowance (HRA).

Ans: The taxability of house rent allowance is discussed as under -

(1) House Rent Allowance [Section 10(13A)]: HRA is an allowance granted to an employee for the payment of rent of his residence. Section 10(13A) provides exemption to the assessee who is in receipt of HRA from his employer.

Least of the following shall be exempt -

S.No.	In other cities	In Mumbai, Delhi, Chennai and Kolkata
1.	Actual HRA received	Actual HRA received
2.	Rent paid Less 10% of salary	Rent paid Less 10% of salary
3.	40% of salary	50% of salary

(2) Exemption not applicable: This exemption shall not apply in a case where -

- the residential accommodation occupied by the assessee is owned by him; or
- the assessee has not actually incurred expenditure on payment of rent in respect of the residential accommodation occupied by him.

(3) Notes:

- Salary = Basic pay + Dearness Allowance (if it enters into retirement benefits) + Percentage-wise fixed commission on turnover.
- Salary is taken on due basis for the period for which HRA is granted.
- Computation of exempted HRA depends on— (i) HRA actually received, (ii) Amount of rent paid, (iii) 'Salary' of employee and (iv) Place of situation of rented house.

If there is change in any of the factors during the previous year, the exemption should be worked out on 'monthly basis'.

Illustration 2 - Computation of exempted House rent allowance : Arun, a resident of Meerut, receives Rs. 38,000 per annum as basic salary. In addition, he gets Rs. 12,000 p.a. as dearness allowance, which does not form part of basic salary, 5% commission on turnover achieved by him (turnover achieved by him during the relevant previous year is Rs. 6,00,000) and Rs. 7,000 per annum as house rent allowance. He, however, pays Rs. 8,000 per annum as house rent. Determine the quantum of house rent allowance exempt from tax. (CS June 2.007)

Solution: HRA is exempt to the extent least of the following (amount in Rs.)-

(1)	Actual HRA received	7,000
(2)	Rent paid - 10% of salary (Rs. 8,000 - 10% of Rs. 68,000)	1,200
(3)	40% of the salary (40% of Rs. 68,000)	27,200
	Exempted HRA	1,200

Note : Salary = Rs. 38,000 + 5% of Rs. 6,00,000 = Rs. 68,000 for the year.

Illustration 3 - Computation of Taxable HRA and Gross salary: Mr. Mohit is employed with XY Ltd. on a basic salary of Rs. 10,000 p.m. He is also entitled to Dearness allowance @ 100% of basic salary, 50% of which is included in salary as per terms of employment. The company gives him house rent allowance of Rs. 6,000 p.m., which was increased to Rs. 7,000 p.m. with effect from 01-01-2021. He also got an increment of Rs. 1,000 p.m. in his basic salary with effect from 01-02-2021. Rent paid by him during the previous year 2020-21 is as under :

April and May, 2020 — Nil, as he stayed with his parents.
 June to October, 2020 — Rs. 6,000 p.m for an accommodation in Ghaziabad.
 November, 2020 to March, 2021 — Rs. 8,000 p.m for an accommodation in Delhi.
 Compute his gross salary for assessment year 2021-22. (3 Marks, IPCC May 2012)

Solution: Computation of HRA exempt (amount in Rs.):

Period	01-04-2020 to 31-05-2020	01-06-2020 to 31-10-2020	01-11-2020 to 31-12-2020	01-01-2021 to 31-01-2021	01-02-2021 to 31-03-2021
Number of months	2	5	2	1	2
Basic Salary per month	10,000	10,000	10,000	10,000	11,000
Dearness allowance, to the extent it forms part of salary (@ 100% of basic salary, 50% of which is included in salary as per terms of employment)	5,000	5,000	5,000	5,000	5,500
Salary for the purpose of HRA exemption	15,000	15,000	15,000	15,000	16,500
Rent paid per month	-	6,000	8,000	8,000	8,000
HRA received	6,000	6,000	6,000	7,000	7,000
HRA is exempt per month upto least of following -					
(a) HRA received	6,000	6,000	6,000	7,000	7,000
(b) Rent paid - 10% of salary	-	4,500	6,500	6,500	6,350
(c) 40% of salary (50% of salary, for Delhi w.e.f. 1-11-2020)	6,000	6,000	7,500	7,500	8,250
HRA exempt p.m. = Least of the above three (a), (b) or (c)	-	4,500	6,000	6,500	6,350
Taxable HRA p.m.	6,000	1,500	-	500	650
Total taxable HRA	12,000	7,500	-	500	1,300
Total taxable HRA			21,300		

Computation of gross salary (Rs.)

Basic Salary [Rs. 10,000 x 10 + Rs. 11,000 x 2]	1,22,000
Dearness Allowance @ 100% of basic pay	1,22,000
House Rent Allowance	21,300
Gross Salary	2,65,300

8. List the different allowances and discuss their taxability.

Ans: There are many allowances some of which are fully taxable, some are partially taxable and some are wholly exempt from tax.

(1) Fully Taxable Allowances :

- Dearness allowance;
- City Compensatory allowance;
- Medical allowance;
- Tiffin allowance;
- Servant allowance;
- Project allowance;
- Interim Allowance;
- Non-practicing Allowance;
- Family allowance;
- Overtime allowance;
- Warden allowance;
- Transport allowance to employee other than blind/ deaf and dumb/ orthopedically handicapped employee;
- Any other cash allowance etc.

(2) Partly Taxable Allowances :

(a) Allowances exempt from tax to the extent of amount expended for the purpose for which they are given [Section 10(14)(i)]: Allowances granted to meet expenses wholly, necessarily and exclusively incurred in the performance of the duties of an office or employment of profit, to the extent such expenses are actually incurred for that purpose :

- (i) Travelling Allowance to meet cost of travel on tour or on transfer (including any sum paid in connection with transfer, packing and transportation of personal effects on such transfer).
- (ii) Conveyance Allowance to meet expenditure incurred on conveyance in performance of official duties if free conveyance is not provided by the employer.
- (iii) Uniform Allowance to meet expenditure incurred on purchase or maintenance of uniform or wears during the performance of the duties of an office or employment of profit.
- (iv) Daily Allowance granted on tour or for the period of journey in connection with transfer, to meet ordinary daily charges incurred on account of absence from his normal place of duty.
- (v) Research Allowance for encouraging the academic, research and training pursuits in educational and research institutions.
- (vi) Helper Allowance to meet expenditure incurred on a helper where such helper is engaged for performance of official duties or employment of profit.

(b) Allowances exempt from tax to the extent of amount notified in the Rules [Section 10(14)(ii)]: Allowances granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at the place where he ordinarily resides, or to compensate him for the increased cost of living, to the extent as may be prescribed -

	<i>Allowances</i>	<i>Amount Exempt</i>
(1)	<i>Any Special Compensatory Allowance in the nature of Special Compensatory (Hilly Areas) Allowance or High Altitude Allowance or Uncongenial Climate Allowance or Snow Bound Area Allowance or Avalanche Allowance</i>	<i>Rs. 800 or Rs. 7,000 or Rs. 300 per month depending upon the specified locations</i>
(2)	<i>Any Special Compensatory Allowance in the nature of border area allowance or remote locality allowance or difficult area allowance or disturbed area allowance</i>	<i>Rs. 1,300 or Rs. 1,100 or Rs. 1,050 or Rs. 750 or Rs. 300 or Rs. 200 per month depending upon the specified locations.</i>
(3)	<i>Transport Allowance to employees of transport system : Allowance granted to an employee working in transport system to meet his personal expenditure incurred in course of his official duty of running the transport from one place to another, provided he is not in receipt of daily allowance.</i>	<i>(i) 70% of such allowance; or (ii) Rs. 10,000 p.m., whichever is lower.</i>
(4)	<i>Tribal Area Allowance : [in states of MP, Tamil Nadu, UP, Karnataka, Tripura, Assam, West Bengal, Bihar, Orissa]</i>	<i>Rs.200 p.m.</i>
(5)	<i>Transport Allowance : Transport allowance granted to an employee, who is blind or deaf and dumb or orthopaedically handicapped for commuting between the place of residence and the place of duty</i>	<i>Rs. 3,200 p.m.</i>
(6)	<i>Underground Allowance : It is granted to the employees working in unnatural climate in underground mines</i>	<i>Rs. 800 p.m.</i>
(7)	<i>Children Education Allowance</i>	<i>Rs. 100 p.m. per child for maximum 2 children.</i>
(8)	<i>Hostel Expenditure Allowance</i>	<i>Rs. 300 p.m. per child for maximum 2 children.</i>
(9)	<i>Compensatory Field Area Allowance</i>	<i>Rs. 2,600 per month in specified areas.</i>
(10)	<i>Compensatory Modified Field Area Allowance</i>	<i>Rs. 1,000 per month in specified areas.</i>
(11)	<i>Any special allowance in the nature of counter insurgency allowance granted to the members of the armed forces operating in areas away from their permanent locations. Any assessee claiming exemption in respect of allowances mentioned at serial numbers 9,10 and 11 shall not be entitled to exemption in respect of the allowance referred to at serial number 2.</i>	<i>Rs. 3,900 per month</i>

(3) Wholly Exempt Allowances :

- (a) Allowances to Indian citizen who is a government employee and rendering services outside India [Sec. 10(7)].
- (b) Allowances to High Court judges.
- (c) Sumptuary Allowance to judges of High Court and Supreme Court.
- (d) Allowances to employees of UNO.

Illustration 4 - Transport Allowance to employee of transport system : Examine with brief reasons, whether the following is chargeable to income-tax and the amount liable to tax with reference to the provisions of the Income-tax Act, 1961: Allowance received by an employee Mr. Ram working in a transport system at Rs. 12,000 p.m. which has been granted to meet his personal expenditure while on duty. He is not in receipt of any daily allowance from his employer. (2 Marks, Nov. 2018-NS)

Solution: Under section 10(14), any allowance granted to an employee working in a transport system to meet his personal expenditure during his duty is exempt provided he is not in receipt of daily allowance. The exemption is 70% of such allowance (i.e., Rs. 8,400 per month, being 70% of Rs. 12,000) or Rs. 10,000 per month, whichever is less. Hence, Rs. 8,400 p.m. is allowable as exemption u/s 10(14); and the balance Rs. 3,600 p.m. shall be taxable. Hence taxable allowance will be Rs. $3,600 \times 12 = \text{Rs. } 43,200$.

TAXABILITY OF PERQUISITES

9. Define "Perquisites" as per Section 17(2).

Ans: The term "perquisites" means any extra benefit granted to the employee in addition to his salary. It may be given in cash or kind.
Perquisites [Section 17(2)] [Amended by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY 2021-22]: It includes -

(1)	Rent free accommodation	The value of rent-free accommodation provided to the assessee by his employer.
(2)	Accommodation provided at concessional rate	The value of any concession in the matter of rent in respect of any accommodation provided to the assessee by his employer.
(3)	Perquisites taxable in case of specified employee	The value of any benefit or amenity granted or provided free of cost or at concessional rate to specified employees.
(4)	Employee's obligation met by employer	Any sum paid by the employer in respect of any obligation, for which such payment would have been payable by the assessee [other than tax exempt under section 10(10CC)].
(5)	Life insurance/annuity contract payments	Any sum payable by the employer, whether directly or through a fund other than a RPF or an approved Superannuation fund (or a Deposit-linked Insurance Fund), to effect an assurance on the life of the assessee or to effect a contract for an annuity.
(6)	ESOP/ Sweat equity shares	The value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee.
(7)	Contribution to RPF/ NPS/ Approved superannuation fund	The amount or the aggregate of amounts of any contribution made to the account of the assessee by the employer— (a) in a recognised provident fund; (b) in the scheme referred to in Section 80CCD(1); and (c) in an approved superannuation fund, to the extent it exceeds Rs. 7,50,000 in a previous year.
(8)	Interest/Dividend etc. on taxable contributions under RPF/ NPS/ Approved Superannuation Fund	The annual accretion by way of interest, dividend or any other amount of similar nature during the previous year to the balance at the credit of the fund or scheme referred above to the extent it relates to the contribution which is included in total income in any previous year computed in such manner as may be prescribed.

(9)	Other fringe benefits	The value of any other fringe benefit or amenity as may be prescribed. The following perquisites have been specified ➤ Interest-free or concessional loan; ➤ Travelling, touring for holiday; ➤ Food and beverage facility; ➤ Gifts; ➤ Credit card facility; ➤ Club facility; ➤ Use of movable asset; ➤ Sale of movable assets at concessional rates; and ➤ Other facilities.
Objective of amendment: Under the existing provisions of the Act, the contribution by the employer to the account of an employee in a recognized provident fund exceeding 12% of salary is taxable. Further, the amount of any contribution to an approved superannuation fund by the employer exceeding Rs. 1,50,000 is treated as perquisite in the hands of the employee. Similarly, the assessee is allowed a deduction under National Pension Scheme (NPS) for the 14% of the salary contributed by the Central Government and 10% of the salary contributed by any other employer. However, there is no combined upper limit for the purpose of deduction on the amount of contribution made by the employer. This is giving undue benefit to employees earning high salary income. While an employee with low salary income is not able to let employer contribute a large part of his salary to all these three funds, employees with high salary income are able to design their salary package in a manner where a large part of their salary is paid by the employer in these three funds. Thus, this portion of salary does not suffer taxation at any point of time, since Exempt-Exempt-Exempt (EEE) regime is followed for these three funds. Thus, not having a combined upper cap is iniquitous and hence, not desirable.		

Therefore, a combined upper limit of Rs. 7,50,000 is provided in respect of employer's contribution in a year to NPS, superannuation fund and recognised provident fund and any excess contribution is made taxable. Consequently, it is also provided that any annual accretion by way of interest, dividend or any other amount of similar nature during the previous year to the balance at the credit of the fund or scheme may be treated as perquisite to the extent it relates to the employer's contribution which is included in total income. This amendment will take effect from 1st April, 2021 and will, accordingly, apply in relation to the assessment year 2021-22 and subsequent assessment years.

10. What do you mean by 'Specified Employee'? What perquisites are taxable in case of specified employees. (Nov. 2002)

Ans: The provisions relating to specified employee are discussed as under -

(1) Specified Employee [Section 17(2)(iii)]: "Specified Employee" means -

- (a) An employee who is a director of the company; or
- (b) An employee being a person who has a substantial interest in the company i.e. who is the beneficial owner of equity shares carrying 20% or more of the voting rights in the company; or
- (c) Any other employee whose income chargeable under the head "Salaries" (whether due from, or paid or allowed by, one or more employers), exclusive of the value of all benefits or amenities not provided for by way of monetary payment, exceeds Rs. 50,000.

In other words, while computing limit of Rs. 50,000, following shall be deducted/excluded :

- (i) All non-monetary benefits;
- (ii) All monetary payments exempt under section 10;
- (iii) Deductions under section 16 [i.e. Standard deduction, Entertainment allowance and professional tax],

- (2) **Perquisites taxable in case of specified employees only** : Car Facility, Provision for sweeper, domestic servant, Facility for gas, electricity, or water; Education facility; and Transport facility are taxable only in the case of specified employees.

Illustration 5 - Computation of Gross Salary: Mr. M is an area manager of M/s. N. Steels Co. Ltd. During the previous year 2021-21 he gets following emoluments from his employer:

Basic salary	Rs. 40,00,000
Dearness Allowance [50% of basic salary forming part of retirement benefits]	Rs. 20,00,000
Contribution to recognized provident fund	12% of basic salary and D.A.
Contribution to superannuation fund	Rs. 2,00,000

Determine his gross salary for the Assessment Year 2021-22.

Solution: Computation of income from salary of Mr. M (amount in Rs.):

Basic salary		40,00,000
Dearness Allowance		20,00,000
Employer's contribution to RPF [12% of salary (i.e., 12% of Rs. 60,00,000)]	7,20,000	
Contribution to approved superannuation fund	2,00,000	
Aggregate contribution to RPF and Approved superannuation fund	9,20,000	
Less: Exempt	7,50,000	1,70,000
Gross salary		60,00,000

11. How is value of Rent Free Accommodation (RFA) determined while computing the gross salary ?

Ans: Meaning of Accommodation [Explanations to Section 17(2) read with Rule 3] : As per Rule 3, "accommodation" includes a house, flat, farmhouse or part thereof, or accommodation in a hotel, motel, service apartment, guesthouse, caravan, mobile home, ship or other floating structure.

Valuation of Rent Free Accommodation : The value of residential accommodation provided by the employer directly or indirectly to the assessee or to any member of his household by reason of his employment, shall be determined in the following manner:

	Circumstances	When accommodation is unfurnished	When accommodation is furnished
(1)	(2)	(3)	(4)
1.	When accommodation is provided by the Government to its employees holding office/ post in connection with Government affairs	License fee determined by the Government as reduced by the rent actually paid by the employee.	Value calculated under column (3) as increased by - 10% p.a. of the cost of furniture if owned by employer or actual hire charges payable in case the furniture is taken on hire. Any charges recovered from the employee shall be deducted.
2.	(a) When the accommodation is provided by any other employer and such accommodation is owned by the employer	Any charges recovered from the employee shall be deducted.	Value calculated under column (3) as increased by - 10% p.a. of the cost of furniture if owned by employer or actual hire charges payable in case the furniture is taken on hire. Any charges

			<i>recovered from the employee shall be deducted.</i>
	<i>(b) Such accommodation is taken on lease or rent by the employer -</i>	<i>Lower of – (i) actual rent paid by the employer; or (ii) 15% of salary; Any amount recovered from the employee shall be reduced.</i>	<i>Value calculated under column (3) as increased by - 10% p.a. of the cost of furniture if owned by employer or actual hire charges payable in case the furniture is taken on hire. Any charges recovered from the employee shall be deducted.</i>
3.	<i>When the accommodation is provided by the above employers in a hotel -</i>	<i>Not applicable.</i>	<i>Lower of - (i) the actual charges paid/ payable to such hotel; or (ii) 24% of salary; Any amount recovered from the employee shall be reduced.</i>

Notes:

- (1) **Salary** = Basic pay + Dearness allowance/pay (if forms part of superannuation or retirement benefits) + Bonus + Commission + Fees + All taxable allowances + All monetary payments chargeable to tax; from one or more employers,
Salary does not include -
- dearness allowance or dearness pay unless it enters into the computation of superannuation or retirement benefits of the employee concerned;
 - employer's contribution to the provident fund account of the employee;
 - allowances which are exempted from payment of tax;
 - the value of perquisites specified under section 17(2);
 - any payment or expenditure specifically excluded under proviso to Section 17(2)(iii) or proviso to Sec. 17(2);
 - lump sum payments received at the time of termination of service or superannuation or voluntary retirement, like gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and similar payments.

Exemption: The perquisite shall be exempt in the following cases-

- Hotel accommodation not exceeding 15 days: When the employee is provided accommodation in a hotel for a period not exceeding 15 days on account of his transfer from one place to another, then the value of such perquisite shall be Nil.
- Accommodation of temporary nature/ remote area : Accommodation provided to employee working at mining site or an onshore oil exploration site, or a project execution site or a dam site or a power generation site or an offshore site -
 - which, being of a temporary nature and having plinth area not exceeding 800 sq. feet, is located not less than 8 kms. away from the local limits of any municipality or a cantonment board; or
 - which is located in a remote area. ['Remote area' means an area that is located at least 40 kilometres away from a town having a population not exceeding 20,000 based on latest published all-India census.]

- (3) **Double accommodation on account of transfer :** Where on account of his transfer from one place to another, the employee is provided with accommodation at the new place of posting while retaining the accommodation at the other place, the value of perquisite shall be determined as follows -

(i)	For First 90 days	The value of perquisite shall be the value of such accommodation whose value is lower when computed as per the above rules.
(ii)	After 90 days	The value of perquisite shall be aggregate of the value of both such accommodations as per the above rules.

- (4) Government Employees sent on deputation - Valuation : Where the accommodation is provided by the Central Government or any State Government to an employee who is serving on deputation with any body or undertaking under the control of such Government,-
- the employer of such an employee shall be deemed to be that body or undertaking where the employee is serving on deputation; and
 - the value of perquisite of such an accommodation shall be the amount calculated as if the accommodation is owned by the employer.

Illustration 6 - Valuation of rent free accommodation in hotel: Calculate the value of perquisite, if any, chargeable to tax in respect of free accommodation provided by the employer in a hotel to an employee,-

- for 10 days when he was transferred from Delhi to Mumbai.
- throughout the year as per contract of employment. (May 2003)

Solution:

- When the employee is provided accommodation in a hotel for a period not exceeding 15 days on account of his transfer from one place to another, then the value of such perquisite shall be nil. In this case, since the period of hotel accommodation doesn't exceed 15 days and the same has been provided on the transfer of employee from Delhi to Mumbai, the same shall be exempt.
- When hotel accommodation is provided throughout the year as per contract of employment – The taxable value shall be Lower of -
 - the actual charges paid/payable to such hotel; or
 - 24% of salary;
 Any amount recovered from the employee shall be reduced.

Illustration 7 - Rent free accommodation : Compute the value of perquisite in respect of rent-free furnished house, if Ashok stays in a city with a population of-

- not exceeding 10 lakh;
- exceeding 10 lakh but not exceeding 25 lakh; and
- exceeding 25 lakh. Ashok is in receipt of the following amounts from his employer during the previous year —
 - Basic pay : Rs. 1,80,000;
 - Dearness allowance : 25% of basic pay;
 - Commission: 5% of basic pay; and
 - Bonus : Rs. 8,000.

His employer has paid income tax of Rs. 5,000 and professional tax of Rs. 1,500 on his behalf.

Besides, his employer provided refrigerator and television costing Rs. 24,000 and paid Rs. 500 per month towards rent of other furniture provided. (CS Dec. 2006)

Solution: Taxable value of Rent Free furnished Accommodation (amount in Rs.):

Particulars	Cities having population		
	Not exceeding 10 lakh	Exceeding 10 lakhs but not exceeding 25 lakh	Exceeding 25 lakh
Valuation of rent free accommodation	7.5% of salary	10% of salary	15% of salary
Perquisite value of RFA [WN]	18,150	24,200	36,300
Add: Furniture (10% p.a. of original cost of furniture)	2,400	2,400	2,400
Rent of furniture (Rs. 500 x 12)	6,000	6,000	6,000
Taxable value of furnished accommodation	26,550	32,600	44,700

Working Notes: Salary for rent free accommodation (amount in Rs.):

Basic Pay	1,80,000
DA (assuming DA form part of retirement benefits)	45,000
Commission (5% of basic pay)	9,000
Bonus	8,000
Income tax & professional tax paid by employer (not includible in salary, as they are 'perquisites')	Nil
Salary for rent free accommodation	2,42,000

Illustration 8 - Computation of salary income: Mrs. Padma (age : 25 years) is offered an employment by Pritam Ltd. at a basic salary of Rs. 24,000 per month; other allowances according to rules of the company are - Dearness allowance : 18% of basic pay (not forming part of salary for calculating retirement benefits); Bonus : 1 month basic pay; and Project allowance : 6% of basic pay.

The company gives Mrs. Padma an option either to take a rent-free unfurnished accommodation at Mumbai for which the company would directly bear the rent of Rs. 1.5,000 per month or to accept a house rent allowance of Rs. 15,000 per month and find out her own accommodation. If Mrs. Padma opts for house rent allowance, she will have to pay Rs. 15,000 per month for an unfurnished house. Which one of the two options should be opted by Mrs. Padma in order to minimize her tax liability?. (Marks 5, CS June 2008)

Solution: Computation of total taxable income of Mrs. Padma (amount in Rs.):

Particulars	Receipt of HRA	Rent-free accommodation
Basic Salary (Rs. 24,000 x 12)	2,88,000	2,88,000
Dearness Allowance (18% of basic salary i.e. 18% of Rs. 2,88,000)	51,840	51,840
Bonus (1 month basic pay)	24,000	24,000
Project Allowances (6% of basic salary i.e. 6% of Rs. 2,88,000)	17,280	17,280
House Rent Allowance [WN-1]	36,000	
Rent Free Accommodation [WN-2]	-	49,392
Salary Income	4,17,120	4,30,512

Hence, Mrs. Padma should opt for HRA so as to minimize her tax liability.

Working Notes:

(1) Computation of taxable HRA:

(amount in ₹s.)

HRA received		1,80,000
Least of following amount is exempt		
(a) Actual amount received	1,80,000	
(b) Rent paid less 10% of salary i.e. ₹s. 1,80,000 - ₹s. 28,800	1,51,200	
(c) 50% of salary	1,44,000	1,44,000
Taxable HRA		36,000

(2) Value of rent free accommodation shall be least of the following –

(amount in ₹s)

(a) Actual rent paid or payable or	1,80,000
(b) 15% of salary i.e. 15% of ₹s. 3,29,280	49,392

(3) Salary for rent free accommodation:

(amount in ₹s.)

Basic Salary	2,88,000
Bonus	24,000
Project Allowance	17,280
Total	3,29,280

12. What are the various perquisites taxable in the hands of specified employees only ?. Discuss their valuation.

Ans: **Perquisites taxable in the hands of specified employees :** The following perquisites shall be taxable in the hands of specified employees only. However, if bills are in the name of employee or obligation to make payment is on the employee, then the reimbursement of expenses shall be taxable in case of all employees under section 17(2)(iv).

(1) Motor car or other conveyance facility : The rules for valuation of perquisite in respect of use of conveyance provided to an employee or any member of his household are as follows -

<i>Circumstances (Col. 1)</i>	<i>Used wholly for private purposes (Col. 2)</i>	<i>Partly for official and partly for private purposes (Col. 3)</i>	
<i>I. When motor car is owned or hired by the employer -</i>			
<i>(A) When maintenance and running expenses are met or reimbursed by employer.</i>	<i>Amount incurred or reimbursed by employer + Chauffeur's salary + Normal wear & tear @ 10% p.a. of actual cost of car or hire charges - Amount recovered from employee</i>	<i>If cubic capacity does not exceed 1.6 litres : Rs. 1,800 p.m. (plus Rs. 900 p.m. if chauffeur is provided) [Note 4]</i>	<i>If cubic capacity exceeds 1.6 litres : Rs. 2,400 p.m. (plus Rs. 900 p.m. if chauffeur is provided) [Note 4]</i>
<i>(B) When maintenance and running expenses are met by employee. [See Note 1]</i>	<i>Normal wear and tear @ 10% p.a. of the actual cost of the car or hire charges.</i>	<i>If cubic capacity does not exceed 1.6 litres: Rs. 600 p.m. (plus Rs. 900 p.m. if chauffeur is provided) [Note 4]</i>	<i>If cubic capacity exceeds 1.6 litres: Rs. 900 p.m. (plus Rs.900 p.m. if chauffeur is provided) [Note 4]</i>

II. Where motor car is owned by employee and maintenance and running expenses including remuneration of the chauffeur are met or reimbursed by the employer.	Actual expenditure incurred by employer Less: Amount, if any, paid or recovered from the employee.	Actual expenses incurred by employer Less : If cubic capacity of engine does not exceed 1.6 litres: Rs. 1,800 p.m. (plus Rs. 900 if chauffeur is also provided) [Note 3]	Actual expenses incurred by employer Less: If cubic capacity of engine exceeds 1.6 litres: Rs. 2,400 p.m. (plus Rs. 900 if chauffeur is also provided). [Note 3]
III. Conveyance other than motorcar (Scooter, motorcycle etc.), is owned by the employee and the employer meets its running expenses.	Amount actually incurred by employer for maintenance and running less Amount recovered from employee	Actual expenditure incurred by the employer less Rs. 900 p.m. [Note 3]	

Notes -

- (1) If conveyance is used wholly and exclusively for the purpose of business, then it will be fully exempt as the same is not a perquisite.
- (2) In case more than one car is provided to the employee (not wholly for official purpose), then one car is to be considered as partly official and partly for personal purpose; and the other to be considered as wholly for private purposes.
- (3) Where the assessee claims that -
 - (a) the conveyance is used wholly and exclusively for official purposes; or
 - (b) expenses incurred on running and maintenance of the conveyance owned by him is higher than the amounts deducted in items (II) and (III), then—
 he may claim for such higher amount provided —
 - (i) the employer has maintained full details of journey undertaken for official purpose including date of journey, destination, mileage, and expenditure incurred thereon; and
 - (ii) the employer gives a certificate to the effect that the claimed expenditure was spent wholly and exclusively for official purposes.
- (4) In these cases, no deduction shall be allowed to the employee for the amount recovered from him.
- (5) Month : The perquisite is valued for each calendar month. Calendar month is the month starting from any particular date of a month but ending on a date immediately preceding the corresponding date of next month. Eg. 15th July to 14th August constitute a calendar month.
- (6) In case if car is used for commuting between office and residence, then it shall be considered as official use.
- (2) Sweeper, gardener, watchman or personal attendant: If any sweeper, gardener, watchman or personal attendant is provided to an employee or any of his household member, then the value shall be - Salary paid or payable to such person less amount recovered from the employee, if any.
- (3) Gas, electricity or water facility: The value of perquisites shall be –
 - (i) If supplied by employer from his own sources : Manufacturing cost per unit $\times$ Number of units consumed by employee
 - (ii) If taken by employer from outside agencies: Hire charges paid to such agencies.

Note: If any amount is recovered from the employee the same shall be reduced to arrive at taxable value, if any.

(4) Free or Concessional educational facility:

Circumstance	Valuation of perquisite
(a) Employer incurs cost of education.	
(b) (i) Educational institution is owned and maintained by the employer; or (ii) Free educational facility is provided in any other institution by reason of his employment with that employer.	Actual expenditure incurred by the employer. Cost of such education in a similar institution in or near the locality. [The perquisite is exempt if – (a) free education facility is provided to children of the employee and (b) cost of education is upto Rs. 1,000 p.m. per child, otherwise it is fully taxable.]
Note: Any amount paid or recovered from the employee shall be reduced from value of perquisite.	

- (5) Transport facility to the employees of transport undertaking :** If any transport facility is provided by an employer carrying transport business (of carrying passengers/ goods) to his employee in a conveyance owned, leased or made available by some arrangement, then—
Taxable Value = Amount charged from general public for such facility less amount recovered from the employee, if any.
Exemption: This rule shall not apply to employees of an airline or the railways.

Illustration 9 - Car facility: Mr. A is provided with two cars, to be used for official and personal work by his employer ABC Ltd. The following information is available from the company records-

	Car 1 Rs..	Car 2 Rs.
Cost of the Car	6,00,000	4,00,000
Running and maintenance (Borne by the company)	40,800	28,000
Salary of driver (Borne by the company)	24,000	24,000

The taxable monetary emoluments of Mr. A are Rs. 90,000. Compute the taxable 'Perk' in respect of Cars on the assumption car 2, is exclusively used by 'A' for personal purpose. (4 Marks, Nov. 2004)

Solution: The perquisite in respect of motor car will be taxable in the hands of Mr. A, as he is a 'specified employee'. Since in question it is specifically mentioned that Car 2 is used for private purposes therefore Car 1 shall be taken as used for partly official and partly personal purpose: (amount in Rs.)

Car 1 (Partly official and partly personal, assumed to be above 1.6 litres cc) [(Rs. 2,400 + Rs. 900) × 12]	39,600
Car 2 (Private use only) [Expenses actually incurred Rs. 28,000 and Rs. 24,000 + 10% of cost of car]	92,000
Total value of perquisite	1,31,600

Illustration 10 - Education facility : Vidya Bhawan is owned by ABC Ltd. Shri Ramesh is an employee of ABC Ltd drawing salary of Rs. 2,00,000 and his following family members are studying in the said school. Find out the taxable value of perquisite-

	Rahul, son of Ramesh	Kajri, daughter of Ramesh
Cost of education in a similar institution	Rs. 3,500 p.m.	Rs. 1,800 p.m.
Amount charged from Ramesh	Rs. 2,500 p.m.	-

Solution: It was held in *CIT v. Delhi Public School* [2009] 318 ITR 234 (Del.) that perquisite in respect of education facility is exempt if its value is upto Rs. 1,000 p.m. If the value exceeds Rs. 1,000 p.m. then the entire amount will be taxable. Further, if value of concessional facility is upto Rs. 1,000 p.m., it will also be exempt.

In case of Rahul, the value of perquisite shall be (Rs. 3,500 - Rs. 2,500) = Rs. 1,000 p.m. As the value of perquisite doesn't exceed Rs. 1,000 p.m., hence, the perquisite shall not be taxable.

Taxable value of perquisite in case of Kajri = Rs. 1,800 $\times$ 12 = Rs. 21,600. (Since the value of the perquisite exceeds Rs. 1,000 p.m., entire amount is taxable.)

13. How is the value determined of Employee Stock Option Plan / Scheme (ESOP) or Sweat Equity granted by an employer to his employee ?

Ans: Employee Stock Option Plan / Scheme (ESOP) or Sweat Equity shares : The taxable value of ESOP or any Specified Security granted by an employer to his employee shall be determined as under -

Fair market value (determined as per prescribed method) of the security or sweat equity shares - on the date on which the option is exercised by the assessee/employee	xxx
Less: Amount actually paid by, or recovered from, assessee in respect of such security or shares	xxx
Value of such security or sweat equity shares	xxx

Notes:

- (1) "Sweat Equity Shares" means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.
- (2) "Option" means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price.
- (3) The taxability of Employee Stock Option Plan/ Scheme (ESOP) or Sweat Equity shall arise when the same is allotted or transferred, directly or indirectly, by the employer, or former employer.
- (4) Deferment of Taxability in case of ESOP allotted to employee of eligible start-up [Inserted by Finance Act, 2020 w.e.f. 01-04-2020]: Where the income of the assessee of any assessment year, beginning on or after 01-04-2021, includes perquisite income of specified security or sweat equity shares and such specified security or sweat equity shares are allotted or transferred directly or indirectly by the current employer, being an eligible start-up referred to in section 80-IAC, the tax or interest on such income included in the notice of demand u/s 156(1) shall be payable by the assessee within 14 days —
 - (i) after the expiry of 48 months from the end of the relevant assessment year; or
 - (ii) from the date of the sale of such specified security or sweat equity share by the assessee; or
 - (iii) from the date of the assessee ceasing to be the employee of the employer who allotted or transferred him such specified security or sweat equity share,
 whichever is the earliest.

Thus, the tax burden on such employees getting ESOP has been reduced by deferring the payment of tax by 5 years or till they leave the company or when they sell their shares, whichever is earliest.

FMV of the Employee Stock Option Plan/Scheme (ESOP) or Sweat Equity shares allotted or transferred shall be determined on the date of exercising the option as under -

Case	Fair market value shall be -	
(1)	Listed equity shares : If, on the date of exercising of the option, the shares of the company are listed - (a) on only one recognised stock exchange and shares are traded on that date on that exchange (b) on only one recognised stock exchange but shares are not traded on that date on that exchange	(Opening price on that date on that stock exchange + Corresponding Closing Price) ÷ 2. Closing price of the share on that recognised stock exchange on a immediately preceding date closest to the date of exercising of the option.
	(a) on more than one recognized stock exchanges and shares are traded on that date on any of the exchanges	(Opening price on that date on stock exchange, which records the highest volume of trading in the share + Corresponding Closing Price) ÷ 2.
	(b) on more than one recognized stock exchanges but shares are not traded on that date on any of the exchanges	Closing price of the share on any recognised stock exchange, which records the highest volume of trading in such share, as on immediately preceding date closest to the date of exercising of the option.
(2)	Unlisted equity shares : If, on the date of exercising of option, shares of the company are not listed on any recognised exchange.	Such value of the share in company as determined by a 'Category I Merchant Banker registered with the SEBI' on the specified date.
(3)	Specified security not being an equity share	Such value as determined by a merchant banker on the specified date.

Note:

- (i) Closing price of a share on a recognised stock exchange on a date means the price of the last settlement on such date on such stock exchange. However, where the stock exchange quotes both buy and sell prices, the 'sell price' shall be the closing price.
- (ii) Opening price of a share on a recognised stock exchange on a date means the price of the first settlement on such date on such stock exchange. However, where the stock exchange quotes both buy and sell prices, the 'sell price' shall be the opening price.
- (iii) "Specified date" means-
 - (a) date on which the option is exercised; or
 - (b) any date earlier than the date of exercising the option provided such date is not more than 180 days earlier than the date of exercising the option.

Illustration 11-ESOP: Mr. M is working with MNO Limited for the last 10 years. He was granted an option on 01-7-2019 by the company to purchase 800 equity shares at a price of Rs. 250 per share. The period during which the option can be exercised to purchase 800 shares at a pre-determined price of Rs. 250 per share commencing on 01-7-2019 and ending on 31-3-2021. Mr. M exercised the option on 15-3-2020 to purchase 500 shares. Fair market value on the said date was Rs. 6,490 on the Bombay Stock Exchange and Rs. 6,500 on the National Stock Exchange. The NSE has recorded the higher volume of trading in that share.

The company has allotted him 500 shares on 24th April, 2020. The fair market value on the date of allotment was Rs. 7/100 per share on NSE and Rs. 7,110 on the BSE, that has recorded the higher volume of trading in that share. The option was granted for making available rights in the nature of intellectual property rights. Determine the taxability of perquisite.

Does it make any difference if the option was granted for providing technical know-how?

Solution: The value of perquisite shall be computed as follows -

- (i) In this question shares of M/s. MNO Ltd. are traded on more than one stock exchange (both, BSE and NSE) on the date of exercise of the option i.e. on 15-3-2020, hence, as per Valuation Rules, the average of the opening and closing prices on the recognised stock exchange, which records highest trading volume shall be taken to be the fair market value of each option.
- (ii) Since NSE recorded the higher trading volume, hence, FMV on that date on NSE = Rs. 6,500 shall be taken to be the FMV for the purpose of valuation of perquisite.
- (iii) Value of perquisite = (FMV - Exercise Price) $\times$ No. of shares = (Rs. 6,500 - Rs. 250) $\times$ 500 shares = Rs. 31,25,000.
- (iv) The taxability of perquisite will arise in the year in which shares are allotted or transferred to employee i.e. in the previous year 2020-21.
Even if the option is granted for providing know-how, the same will fall within the meaning of 'sweat equity shares' and, therefore, section 17(2)(vi) shall apply in the same manner as given above.

14. Discuss the valuation of medical facilities provided by employer.

Ans: **Valuation of medical facilities :** The medical facilities provided by an employer to his employee shall be valued as under [Proviso to Section 17(2)] —

- (1) Treatment in hospital maintained by employer - Exempt: The medical treatment of an employee or any of his family member in a hospital maintained by the employer is exempt from tax.
- (2) Treatment in government hospital - Exempt: Any sum paid by an employer in respect of an expenditure incurred by the employee on his medical treatment or treatment of any of his family member, in a hospital maintained by the Government/local authority or any other hospital approved by Government, is exempt from tax.
- (3) Treatment of prescribed disease in a hospital approved by the Principal Chief Commissioner or Chief Commissioner - Exempt: Any sum paid by an employer in respect of expenditure incurred on medical treatment of employee or any of his family member in respect of diseases or ailments prescribed in Rule 3A in an approved hospital is exempt from tax.
- (4) Health insurance premium paid by the employer - Exempt: Any premium paid by an employer in order to effect an insurance on the health of his employee, under any scheme approved by the Central Government or Insurance Regulatory and Development Authority (IRDA) for the purposes of Section 36(1)(ib), is exempt from tax.
- (5) Health insurance premium reimbursed by the employer - Exempt: Any sum paid by the employer in order to reimburse the health insurance premium paid by employee on his health or on health of any of his family member, under a scheme approved by Central Government or IRDA under section 80D, is exempt from tax.
- (6) Medical treatment abroad: Expenditure incurred or reimbursed by the employer for,
 - (a) Medical treatment of employee or his family member outside India and stay abroad of such employee or his family member for medical treatment and one attendant shall be exempt to the extent permitted by RBI; and
 - (b) Cost of travel of employee or his family member and one attendant who accompanies the patient in connection with such treatment is exempt only if gross total income of such employee, as computed before including this expenditure, does not exceed Rs. 2 lakh.
➤ Hospital: Hospital includes a dispensary or a clinic or a nursing home;

- *Meaning of family: "Family" means - (i) spouse and children of that individual; and (ii) the parents, brothers and sisters of the individual or any of them wholly or mainly dependent on the individual.*

Illustration 12 - Medical Facility: Ms. Rakhi is an employee in a private company. She receives the following medical benefits from the company during the previous year 2020-21:

	Rs.
(1) Reimbursement of following Medical Expenses incurred by Ms. Rakhi —	
(a) On treatment of her self employed daughter in a private clinic .	4,000
(b) On treatment of herself by Family doctor	8,000
(c) On treatment of her Mother-in-law dependent on her, in a Nursing Home	5,000
(2) Payment of premium on Mediclaim Policy taken on her health.	7,500
(3) Medical Allowance.	2,000 p.m.
(4) Medical Expenses Reimbursed on her Son's treatment in a Government Hospital.	5,000
(5) Expenses incurred by company on the treatment of her minor son abroad.	1,05,000
(6) Expenses in relation to Foreign Travel and stay of Rakhi and her son abroad for Medical Treatment. (Limit prescribed by RBI for this is Rs. 2,00,000)	1,20,000

Discuss about the taxability of above benefits and allowances in the hands of Rakhi.

(8 Marks, May 2014)

Solution: Computation of taxable value of perquisite in the hands of Ms. Rakhi

	(amount in Rs.)	
Reimbursement of following Medical Expenses incurred by Ms. Rakhi.		
(a) On treatment of her self employed daughter in a private clinic (The same shall be taxable)	4,000	
(b) On treatment of herself by Family doctor (The same shall be taxable)	8,000	
Total expenditure	12,000	
Less: Exempt	Nil	12,000
(c) On treatment of her Mother-in-law dependent on her, in a Nursing Home (Since mother in law is not his family member hence the same shall be taxable)		5,000
Payment of premium on Mediclaim Policy taken on her health. (The same shall be exempt from tax)		Exempt
Medical Allowance (Fully taxable)		
Medical Expenses Reimbursed on her Son's treatment in a Government Hospital		24,000
Expenses incurred by company on the treatment of her minor son abroad. [WN]		Exempt
Expenses in relation to Foreign Travel and stay of Rakhi and her son abroad for Medical Treatment. [WN]		Exempt
Taxable Value of Perquisites		41,000

Working Note : As per clause (vi) of the first proviso to section 17(2), the following expenditure incurred by the employer would be excluded from perquisite subject to certain conditions -

- The expenditure on medical treatment and stay abroad would be excluded from perquisite to the extent permitted by Reserve Bank of India;
- The expenditure on travel would be excluded from perquisite only in the case of an employee whose gross total income, as computed before including the said expenditure, does not exceed Rs. 2 lakh. Assuming that the limit of Rs. 2 lakh prescribed by RBI pertains to both expenditure on medical treatment of minor son as well as expenditure on stay abroad of Ms. Rakhi and her minor son, such

expenditure would be excluded from perquisite subject to a maximum of Rs. 2 lakh. If such expenditure is less than Rs. 2 lakh, it would be fully excluded. The foreign travel expenditure of Ms. Rakhi and her minor son borne by the employer would be excluded from perquisite only if the gross total income of Ms. Rakhi, as computed before including the said expenditure, does not exceed Rs. 2 lakh.

Illustration 13 - Medical facility: Himalaya Ltd. reimburses the following expenditure on medical treatment of the son of an employee Karan. The treatment was done at UK:

- (i) Travelling expenses Rs. 1,15,000.
- (ii) Stay expenses at UK permitted by RBI Rs. 45,000 (Actual expenses Rs. 70,000).
- (iii) Medical expenses permitted by RBI Rs. 50,000 (Actual expenses Rs. 70,000).

Compute the taxable perquisites in the hands of Karan, if his annual income from salary (after standard deduction) was - (i) Rs. 1,55,000; (ii) Rs. 1,56,000. (CS June 2005)

Solution: Computation of taxable value of medical perquisite (amount in Rs.) -

In case salary is Rs. 1,55,000, taxable value of medical perquisite will be -	
Stay expenses [Rs. 70,000 - Rs. 45,000 (exempt)]	25,000
Medical expenses [Rs. 70,000 - Rs. 50,000 (exempt)]	20,000
Travelling expenses (See note)	Nil
Taxable value of Medical perquisite	45,000

Note : The gross total income before including travel expenses = Rs. 1,55,000 + Rs. 25,000 + Rs. 20,000 = Rs. 2,00,000, i.e. does not exceed Rs. 2 lakh. Hence, the travel expenses will be exempt in this case.

In case salary is Rs. 1,56,000, taxable value of medical perquisite will be —

Stay expenses [Rs. 70,000 - Rs. 45,000 (exempt)] Medical expenses 70,000 – Rs. 50,000 (exempt)] Travelling expenses (See Note) 25,000 20,000 1,15,000
Taxable value of Medical perquisite 1,60,000

Note : The gross total income before including travel expenses = Rs. 1,56,000 + Rs. 25,000 + Rs. 20,000 = Rs. 2,01,000, i.e. greater than Rs. 2 lakh. Hence, the travel expenses will be taxable in this case.

15. What are the various fringe benefits taxable in case of all employees ?

Ans: Valuation of prescribed Fringe Benefits : Section 17(2) (vii) specifies that any fringe benefit or amenity provided to an employee shall be considered as 'perquisite'. The following benefits provided by the employer or by any other person on his behalf to the employee or any member of his household shall be valued as follows - (1) Interest free or concessional loans : The value of benefit resulting from the loans made available to the employee or any member of their household shall be - (amount in Rs.)

Maximum outstanding monthly balance* x Rate charged p.a. by SBI for similar purpose, as on 1st day of relevant previous year (i.e. as on 1-4-2020 for assessment year 2021-22)	xxx
Less: Interest, if any, actually paid by him or any such member of his household.	xxx
Maximum outstanding monthly balance means the aggregate outstanding balance for each loan as on the last day of each month.	

- **Exemption:** The perquisite in respect of interest is exempt -
 - (a) Where the amount of loans are petty not exceeding in the aggregate Rs. 20,000; or
 - (b) If such loans are made available for medical treatment in respect of diseases specified in Rule 3A.
- No exemption: In case of loan provided for medical treatment in respect of diseases specified in Rule 3A, the exemption shall not apply to so much of the loan as has been reimbursed to the employee under any medical insurance scheme.
- (2) Travelling, touring, accommodation and any other expenses paid for or borne or reimbursed by the employer for any holiday, other than leave travel concession assistance, availed of by an employee or any member of his household: The perquisite shall be valued as the sum equal to the amount of the expenditure incurred by the employer in that behalf.

Notes:

- (i) Valuation when facility is maintained by employer and is not available uniformly to all employees: Value of benefit = Value at which such facilities are offered by other agencies to the public.
- (ii) If employee is on official tour and expenses are incurred for any member of his household accompanying him, the amount of expenditure so incurred shall also be a fringe benefit or amenity.
- (iii) Where any official tour is extended as a vacation, the value of such fringe benefit will be limited to the expenses incurred in relation to such extended period of stay or vacation. The amount so determined shall be reduced by the amount, if any paid or recovered from the employee for such benefit or amenity.
- (3) Free food & non-alcoholic beverages provided by employer: Value of benefit = Amount of expenditure incurred by employer - Amount paid or recovered from the employee for such benefit or amenity.

Exemption: The following will not be treated as perquisites -

- (i) Free food and non-alcoholic beverages provided by employer during working hours at office or business premises or through paid vouchers which are not transferable and usable only at eating joints, to the extent the value thereof either case does not exceed Rs. 50 per meal. If the value exceeds Rs. 50 per meal, the excess amount shall be taxable.
- (ii) Tea or snacks provided during working hours.
- (iii) Free food and non-alcoholic beverages provided during working hours in a remote area or an off-shore installation.

However, the exemption provided in respect of free food and non-alcoholic beverage provided by such employer through paid voucher shall not apply to an employee, being an assessee, who has exercised option under Section 115BAC. [Amended w.e.f. 01-04-2021 i.e. AY2021-22]

- (4) Gift including gift vouchers and tokens received by the employee or any member of his household on ceremonial occasions or otherwise: Value of benefit - Sum equal to amount of such gift.

Exemption: If the value of such gift or voucher or token is less than Rs. 5,000 in aggregate during the previous year, the value of perquisite shall be taken as 'nil'; otherwise it is fully taxable.

- (5) **Credit card or Add on card provided to employee or any member of his household:** Value of perquisite = Amount of such expenses (including the membership fees and annual fees) charged to such credit card or reimbursed by the employer - Amount paid or recovered from the employee.
Exemption: Perquisite is exempt if expenses are incurred wholly & exclusively for official purposes*

- (6) **Club facility provided to employee or any member of his household :** Value of benefit = Actual expenditure (including the amount of annual or periodical fee) paid or reimbursed by the employer - Amount paid or recovered from the employee.

Exemption: The perquisite shall be exempt in the following cases -

- (i) Where the employer has obtained corporate membership of the club and the facility is enjoyed by the employee or any member of his household, the initial fee paid for acquiring such membership shall be exempt.
- (ii) If expenditure is incurred wholly & exclusively for business purposes it shall not be a perquisite.*
- (iii) Use of health club, sports and similar facilities provided uniformly to all employees by the employer shall not be taxable as perquisites.

***Note for (5) and (6) :** Where the expenses are claimed to be incurred wholly and exclusively for official purposes, the perquisite in (5) & (6) above shall be exempt only if the following conditions are fulfilled -

- complete details in respect of such expenditure is maintained by the employer which may include the date of expenditure, the nature of expenditure and its business expediency; and
- the employer gives a certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties.

- (7) **Use, by the employee or any member of his household, of movable assets (other than assets elsewhere specified in Rule 3) belonging to the employer or hired by him :** The value of perquisite shall be 10% p.a. of the actual cost of such asset, or, amount of rent or hire charges paid or payable by the employer less amount paid or recovered from the employee.

Exemption: Use of Laptops and computers belonging to or hired by the employer is exempt.

- (8) Transfer of any movable asset which was belonging to the employer, directly or indirectly to employee or any member of his household: The value of benefit shall be calculated as follows :-

Computers & electronic gadgets*	Motor cars	Others
Actual cost	Actual cost	Actual cost
Less: Depreciation @ 50% under Reducing Balance Method Less: Amount, if any, paid or recovered from the employee	Less: Depreciation @ 20% under Reducing Balance Method Less: Amount, if any, paid or recovered from the employee	Less: Depreciation @ 10% under Straight Line Method Less: Amount, if any, paid or recovered from employee
Note : (1) The deduction on account of depreciation (normal wear and tear) is allowed for each completed year during which such asset was put to use by the employer. (2) Electronic gadgets in this case means data storage and handling devices like computer, digital diaries and printers. They do not include household appliance (i.e. white goods) like washing machines, microwave ovens, mixers, hot plates, ovens etc.		

- (9) **Any other benefit or amenity :** Value of any other benefit or amenity, service, right or privilege provided by the employer = Cost of the same to the employer under an arm's length transaction -

Employee's contribution. Exemption: If an employer pays/reimburses the telephone bills or mobile phone charges, then there will be no tax liability.

Note : Member of household shall include - (i) Spouse(s); (ii) Children and their spouses; (iii) Parents; and (iv) Servants and dependants.

Illustration 14 - Interest free loan : Ram is working as a General Manager of A Ltd. on a monthly salary of Rs. 20,000. In the previous year ending 31-3-2021, the Company provided him the following—

- (i) Interest free loan (on 01-10-2020)
- (a) For purchase of residential flat (repayable in 8 years) (SBI Rate 12.25%) Rs. 5,00,000
- (b) Education loan (for son) (SBI Rate 11.5 %) Rs. 15,000
- (ii) Loan for purchase of computer on 01-10-2020 (8% interest p.a.) (SBI Rate 15.25%) Rs. 30,000
- You are required to state the basis for calculation and compute the chargeable perquisite. (Nov. 2002)

Solution: Computation of taxable perquisite in respect of interest-free or concessional loans (amount in Rs.) -

Interest on Housing Loan (Rs. 5,00,000 $\times$ 12.25% $\times$ 6/12) [1-10-2020 to 31-3-2021]	30,625.00
Education Loan for Son (Rs. 15,000 $\times$ 11.50% $\times$ 6/12) [1-10-2020 to 31-3-2021]	862.50
Loan for purchase of Computer [Rs. 30,000 $\times$ (15.25% - 8%) $\times$ 6/12] [1-10-2020 to 31-3-2021]	1,087.50
Taxable value of Perquisite	32,575.00

Note : Since the aggregate value of all the loans during the previous year exceeds Rs. 20,000, hence, the education loan though less than Rs. 20,000 shall also be considered for valuation of perquisite.

Illustration 15 - Transfer of movable assets : Find out the taxable value of perquisites from the following particulars in case of an employee to whom the following assets held by the company were sold on 13th September, 2020 (amt. in Rs.):

	Car	Laptop	Furniture
Cost of purchase (in May 2018)	8,72,000	1,22,500	35,000
Sale price	5,15,000	25,000	10,000

The assets were put to use by the company from the day these were purchased.

Solution: Computation of taxable value of perquisite (amounts in Rs.) -

	Car (20% WDV)	Laptop (50% WDV)	Furniture (10% SLM)
Cost of the asset	8,72,000	1,22,500	35,000
Less: Depreciation for each completed year of use - => 1st year ending May 2019	1,74,400	61,250	3,500
Balance as on 1st June 2019	6,97,600	61,250	31,500
=> 2nd year ending May 2020	1,39,520	30,625	3,500
Balance as on 1st June 2020	5,58,080	30,625	28,000
Less: Sale Price	5,15,000	25,000	10,000
Taxable value of perquisites	43,080	5,625	18,000

Illustration 16 - Interest free loan and transfer of movable asset : Following benefits have been granted by Ved Software Ltd. to one of its employees Mr. Badri:

- (i) Housing loan @ 6% per annum. Amount outstanding on 01-4-2020 is ₹ 6,00,000. Mr. Badri pays ₹. 12,000 per month, on 5th of each month.
- (ii) Air conditioners purchased 4 years back for ₹. 2,00,000 have been given to Mr. Badri for ₹. 90,000. Compute the chargeable perquisite in the hands of Mr. Badri for the assessment year 2021-22. The lending rate of SBI as on 1-4-2020 for housing loan may be taken as 10%. (6 Marks, PCC May 2008)

Solution: Computation of Taxable Perquisite in the hands of Mr. Badri (amounts in ₹) -

(1)	Concessional loan (See Note)		20,880
(2)	Transfer of movable asset: Actual cost of the air conditioner	2,00,000	
	Less: (i) 10% depreciation on SLM basis for 4 years	80,000	
	(ii) Amount paid by Mr. Badri	90,000	30,000
	Total value of taxable perquisite		50,880

Note : Total maximum monthly outstanding balance means the amount outstanding on the last day of the concerned month.

Month	Maximum outstanding monthly balance (amount in ₹)	Perquisite value
April 2020	5,88,000	1,960
May 2020	5,76,000	1,920
June, 2020	5,64,000	1,880
July, 2020	5,52,000	1,840
August, 2020	5,40,000	1,800
September, 2020	5,28,000	1,760
October, 2020	5,16,000	1,720
November, 2020	5,04,000	1,680
December, 2020	4,92,000	1,640
January, 2021	4,80,000	1,600
February, 2021	4,68,000	1,560
March, 2021	4,56,000	1,520
Total		20,880

Illustration 17 - Computation of taxable value of perquisites: Shri Bala employed in ABC Co. Ltd. as Finance Manager gives you the list of perquisites provided by the company to him for the entire FY 2020-21: (8 Marks, PCC May 2011)

- (i) Medical facility given to his family in a hospital maintained by the company. The estimated value of benefit because of such facility is ₹. 40,000.
- (ii) Domestic servant was provided at the residence of Bala. Salary of domestic servant is ₹. 1,500 per month. The servant was engaged by him and the salary is reimbursed by the company (employer). In case, the company has employed the domestic servant, what is the value of perquisite?
- (iii) Free education was provided to his two children Arthy and Ashok in a school maintained and owned by the company. The cost of such education for Arthy is computed at ₹. 900 per month and for Ashok at ₹. 1,200 per month. No amount was recovered by the company for such education facility from Bala.

- (iv) The employer has provided movable assets such as television, refrigerator and air-conditioner at the residence of Bala. The actual cost of such assets provided to the employee is Rs. 1,10,000.
- (v) A gift voucher worth Rs. 10,000 was given on the occasion of his marriage anniversary. It is given by the company to all employees above certain grade.
- State the taxability or otherwise of the above said perquisites and compute the total value of taxable perquisites. Solution: Computation of total value of taxable perquisites (amount in Rs.) -

(i)	Medical facility to family in a hospital maintained by the company	[WN-1]	Exempt
(ii)	Salary of domestic servant of Bala reimbursed by the company (Rs. 1,500 $\times$ 12)	[WN-2]	18,000
(iii)	Free education provided to children of Bala in a school maintained by the company	[WN-3]	14,400
(iv)	Movable assets provided by the ABC Co. Ltd	[WN-4]	11,000
(v)	Gift voucher given by the company to Bala on his marriage anniversary	[WN-5]	10,000
Total value of taxable perquisites			53,400

Working Notes:

- The medical facility provided to an employee in a hospital maintained by the employer is exempt from tax under proviso to section 17(2).
- Here, the servant is engaged by Bala i.e. reimbursement by the employer-company would be employee's obligation met by employer, hence, taxable under section 17(2)(iv). In case, the company has employed the domestic servant, then the same shall be taxable if Bala is specified employee.
- Free education provided in a school maintained and owned by the employer is exempt if the cost of such education does not exceed Rs. 1,000 per month per child, otherwise it is fully taxable. In this case, free education for Arthy shall be exempt since it does not exceed Rs. 1,000 p.m.; but the free education for Ashok, which exceeds Rs. 1,000 per month shall be fully liable to tax [Rs. 1,200 $\times$ 12].
- In case employer allows use of movable asset, the value of perquisite shall be -10% p.a. of the actual cost. Hence, taxable value = 10% of Rs. 1,10,000 = Rs. 11,000.
- Gifts, the value of which is below Rs. 5,000, are exempt from tax. Here, the value of the gift voucher is Rs. 10,000, hence it is fully taxable.

16. List out the perquisites which are exempt from tax.

Ans: The following perquisites are exempt from tax in the hands of all employees.

Particulars	Explanation
1. Telephone	Telephone provided by an employer to an employee at his residence.
2. Transport Facility	Transport facility provided by an employer engaged in the business of carrying of passengers or goods to his employees either free of charge or at concessional rate.
3. Privilege passes and privilege ticket	Privilege passes and privilege ticket orders granted by Indian Railways to its employees.
4. Perquisites allowed outside India by the Government	Perquisites allowed outside India by the Government to a citizen of India for rendering services outside India.
5. Employer's contribution to staff group insurance scheme	Employer's contribution to staff group insurance scheme
6. Annual premium by employer on personal accident policy	Payment of annual premium by employer on personal accident policy effected by him on the life of the employee.
7. Refreshment	Refreshment provided to all employees during working hours in office

		<i>premises.</i>
8.	<i>Subsidized lunch</i>	<i>Subsidized lunch or dinner provided to an employee.</i>
9.	<i>Recreational facilities</i>	<i>Recreational facilities, including club facilities, extended to employees in general i.e., not restricted to a few select employees.</i>
10.	<i>Amount spent on training of employees</i>	<i>Amount spent by the employer on training of employees or amount paid for refresher management course including expenses on boarding and lodging.</i>
11.	<i>Sum payable by employer to a RPF</i>	<i>Sum payable by an employer to a RPF or deposit-linked insurance fund established under the Coal Mines Provident Fund or the 'Employees' Provident Fund Act.</i>
12.	<i>Leave travel concession</i>	<i>Leave travel concession, subject to the conditions specified under section 10.</i>
13.	<i>Medical facilities</i>	<i>Medical facilities subject to certain prescribed limits.</i>
14.	<i>Rent-free official residence</i>	<i>Rent-free official residence provided to a Judge of a High Court or the Supreme Court.</i>
15.	<i>Rent-free furnished residence</i>	<i>Rent-free furnished residence including maintenance provided to an Officer of Parliament, Union Minister and a Leader of Opposition in Parliament.</i>
16.	<i>Conveyance facility</i>	<i>Conveyance facility provided to High Court Judges under section 22B of the High Court Judges (Conditions of Service) Act, 1954 and Supreme Court Judges under section 23A of the Supreme Court Judges (Conditions of Service) Act, 1958.</i>

PROFITS IN LIEU OF SALARY, GRATUITY, EARNED LEAVE SALARY PENSION, LEAVE TRAVEL CONCESSION AND VRS COMPENSATION

17. Define Profits in lieu of Salary as explained in Section 17(3). (4 Marks, Nov. 2002; May 2006)

Ans: **Profits in lieu of salary [Section 17(3)]:** "Profits in lieu of salary" includes -

- (1) The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment or the modification of the terms and conditions relating thereto.
- (2) Any payment due to or received by an assessee from an employer or from a provident fund or other fund, to the extent it does not consist of contributions by the assessee or interest on such contributions.
- (3) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy,
- (4) Any amount due to or received, whether in lump sum or otherwise, by any assessee from any person -
 - (a) before his joining any employment with that person; or
 - (b) after cessation of his employment with that person.

For example: Dearness allowance, house rent allowance, city compensatory allowance, etc. are taxable as profits in lieu of salary.

18. Discuss the exemption available in respect of "Gratuity".

Ans: **Gratuity [Section 10(10)]:** The exemption to the assessee who are in receipt of gratuity from their employers at the time of death or retirement from employment is as under —

Section	Particulars of Employee	Amount of exemption
10(10)(i)	Central Government employees/ Members of civil services/ Local authority employees etc.	Fully Exempt
10(10)(ii)	Other Employees : Employees covered under Payment of Gratuity Act, 1972	Least of the following is exempt - (i) Rs. 20 lakh; or (ii) Actual gratuity received; or (iii) $(15 \div 26) \times \text{Salary last drawn} \times \text{No. of completed years of service or part thereof in excess of 6 months.}$ Salary = Basic pay + Dearness allowance (always included). In case of seasonal establishment, 15 days shall be substituted by 7 days. Part of a year exceeding 6 months is taken as a full year.
10(10)(iii)	Employees not covered by the payment of Gratuity Act, 1972	Least of the following is exempt — (i) Rs. 20 lakh, being the specified limit; or (ii) Actual gratuity received; or (iii) $\frac{1}{2} \times \text{Average Salary} \times \text{Completed years of service (fraction of a year not to be considered)}$ Average salary = Average of salary in last 10 months preceding the month of retirement. For example: Retirement is on 15th February 2021, then average salary will be average of salary from 1st April 2020 to 31st January 2021. Salary = Basic pay + Dearness allowance (to the extent it forms part of retirement benefits) + % wise fixed commission on turnover.

Notes:

- (1) Gratuity received by an employee while in employment is fully taxable.
- (2) If an individual receives gratuity from more than one employer in the same previous year, then the total amount of exemption claimed in that previous year shall not exceed Rs. 20 lakhs.
- (3) If an assessee has already availed exemption in respect of any gratuity received from previous employer in earlier years, then while computing the exemption in the current year, the maximum exemption limit of Rs. 20 lakhs shall be reduced by the amount of exemption already availed.
- (4) In case if the employee has rendered services to any other employer in the earlier years and did not receive any gratuity from him, then such period of services rendered to his former employer shall also be included while calculating 'completed years of service'. - CIT v. P.N. Mehra [1993] 201 ITR 930 (Bom.)

Illustration 18 - Computation of taxable Gratuity : Mr. Raj is an employee of XYZ Ltd. He received Rs. 25,00,000 as gratuity. He retired on 16th February 2021 after rendering 25 years and 7 months of service. His basic salary w.e.f. 01-10-2020 was Rs. 60,000 per month (prior to that Rs. 50,000 p.m.). His dearness allowance was Rs. 30,800 p.m. Calculate the amount of gratuity exempt from tax if -

- Mr. Raj is a government employee.
- Mr. Raj is covered by the Payment of Gratuity Act, 1972;
- Mr. Raj is not covered by the Payment of Gratuity Act, 1972; (40% of dearness allowance forms part of salary for retirement benefits)

Solution: Computation of taxable gratuity shall be as under -

- If Mr. Raj is a Government Employee : The whole of the gratuity shall be exempt from tax.
- If Mr. Raj is covered by Payment of Gratuity Act: The amount of exemption shall be (amounts in Rs.)

Completed years of service (Part thereof in excess of 6 months shall be rounded off to higher side)	26
Exemption u/s 10(10): Least of the following is exempt -	
(a) Gratuity received	25,00,000
(b) $15/26 \times \text{Salary last drawn} \times \text{Completed years of service (Salary Last Drawn = Basic + DA (fully included) = Rs. 60,000 + Rs. 30,800 = Rs. 90,800)}$	13,62,000
(c) Specified limit	20,00,000
Taxable Gratuity = Gratuity Received - Exemption	11,38,000

- If Mr. Raj is not covered by the Payment of Gratuity Act: The amount of exemption shall be (amounts in Rs.)—

Gratuity received		25,00,000
Exemption u/s 10(10): Least of the following is exempt -		
(a) Gratuity received	25,00,000	
(b) $\frac{1}{2} \times \text{Average Salary (Rs. 66,320)} \times \text{Completed Years (25)} [WN]$	8,29,000	
(c) Specified limit	20,00,000	8,29,000
Taxable Gratuity = Gratuity Received - Exemption		16,71,000

Working Note:

Ten months immediately preceding the month of retirement	01-04-2020 to 31-01-2021
Basic Salary for the said ten months [Rs. 50,000 $\times$ 6 + Rs. 60,000 $\times$ 4]	5,40,000
DA (to the extent it forms part of retirement benefits), 40% of Rs. 30,800 $\times$ 10	1,23,200
Total Salary during the said ten months	6,63,200
Average salary for the said ten months	66,320
Completed years of service ignoring any fraction	25

Illustration 19 - Compute taxable gratuity : Mr. Shah, an Accounts Manager, has retired from JK Ltd. On 15-1-2021 after rendering services for 30 years 7 months. His salary is Rs. 25,000 p.m. upto 30-09-2020 and Rs. 27,000 thereafter. He also gets Rs. 2,000 p.m. as dearness allowance (55% of it is a part of salary for computing retirement benefits). He is not covered by the Payments of Gratuity Act, 1972. He has received Rs. 8 lacs as gratuity from the employer company. Compute taxable gratuity. (4 Marks, IPCC Nov. 2010)

Solution: Computation of taxable gratuity: The relevant computations are as follows

(amount in ₹) -

Gratuity received		8,00,000
Exemption u/s 10(10): The least of the following is exempt -		
(a) Gratuity received	4,00,500	
(b) $\frac{1}{2} \times \text{Average Salary (₹. 26,700)} \times \text{Completed years (30)} [WN]$	20,00,000	
(c) Specified limit	8,00,000	4,00,500
Taxable Gratuity = Gratuity Received - Exemption		3,99,500

Working Notes:

Ten months immediately preceding the month of retirement	01-03-2020 to 31-12-2020
Basic Salary for the said ten months [₹. 25,000 $\times$ 7 + ₹. 27,000 $\times$ 3]	2,56,000
DA (to the extent it forms part of retirement benefits), 55% of ₹. 2,000 $\times$ 10	11,000
Total Salary during the said ten months	2,67,000
Average salary for the said ten months	26,700
Completed years of service ignoring any fraction	30

19. Elaborate briefly the exemption available to assesseees in respect of leave encashment received by them from their employer. (4 Marks: PCC May 2003, PCC Nov. 2004)

Ans: Exemption of Earned leave salary [Section 10(10AA)]: Exemption for leave encashment received by an individual from his employer, on retirement, superannuation or otherwise is as under —

- (i) In case of Government employees: Wholly exempt.
- (ii) In case of any other Employees (including the employees of a local authority/ a statutory corporation): Least of the following is exempt -
 - (a) Actual amount received; or
 - (b) ₹. 3,00,000; or
 - (c) 10 months' average salary; or
 - (d) Average salary $\times$ leaves at the credit of an employee taking 30 days in a year for completed years of service (fraction of year is to be ignored while computing completed years of service)

Where -

- Salary = Basic pay + Dearness Allowance (if it forms part of retirement benefits) + Percentage-wise fixed commission on turnover.
- Average Salary = Average of salary drawn in the last 10 months immediately preceding the date of retirement. (E.g. - If a person retires on 16th March, 2021, then 10 months average salary shall be computed from 16th May, 2020 to 15th March, 2021)
- Leaves standing at the credit of employee = [Annual Leave Entitlement (taking 30 days in a year) $\times$ Completed years of actual service rendered] - Leaves actually availed in service.

Other Notes:

- 1) Exemption is also available for leave encashment received on resignation as it is covered under the expression 'otherwise'.

- 2) No exemption is available in respect of leave encashment received during continuity of employment. However, relief u/s 89 can be availed.
- 3) When leave encashment is received by an employee from more than one employer in the same previous year, then the aggregate quantum of exemption must not exceed the limit of Rs. 3,00,000 in that year.
- 4) If the employee has already availed an exemption under section 10(10AA) in any earlier year, then the limit of Rs. 3,00,000 shall be reduced by the amount of the exemption already claimed for computing the exemption in the current year.
- 5) Leave salary paid to widow/legal heirs of the assessee, who dies during the employment, will not be taxable.
- 6) Leave salary received by the family of government employee or legal heirs of deceased employee is also not taxable in their hands.

Illustration 20 - Computation of taxable earned leave salary : Mr. Bansal was employed in M/s. ABC & Associates. After completing 40 years and 7 months of service he retired on 31st October 2020. From the following information, compute the amount of taxable leave salary –

Salary at the time of retirement 10,000 p.m.

Average monthly salary for 10 months ending on 31st October 2020 - Rs. 9,500 p.m.

Leave entitlement - 1½ months for each completed year of service.

Leave encashment received on the basis of salary at the time of retirement 5,00,000

Solution: The relevant computations are (amount in Rs.) -

Leave salary received		5,00,000
Exemption: Least of the following is exempt -		
➤ Actual earned leave salary received	5,00,000	
➤ 10 months' Average salary	95,000	
➤ Earned leave to the credit $\times$ Average Salary (30 $\times$ Rs. 9,500)	2,85,000	
➤ Amount notified by the Central Government	3,00,000	95,000
Taxable Leave Encashment = Sum Received - Exemption		4,05,000

Working Note: Computation of leave at the credit of an employee:

Particulars	As per Company Rules	As per Income-tax Rules
Leave entitlement for completed year	1.5 months	1 month
Completed years of service	40	40
Total leave entitlement (months)	60	40
Leave availed while in service (months)	10	10
Balance leave at his credit (months)	50	30

20. Write a short note on exemption in respect of Commuted Pension.

Ans: **Commuted Pension [Section 10(10A)]:** The exemption in respect of commuted pension received by an employee during a previous year is as under—

Particulars of employee	Amount of exemption
(1) Employees of the Central Government local authorities/ Statutory Corporation/ Members of the Defence Services	Wholly Exempt

(2) Other employees -	Exemption = 1/3rd of Commuted value of pension
(a) In receipt of gratuity	Exemption = 1/2 of Commuted value of pension
(b) Not in receipt of gratuity	

Notes:

- (1) Commuted value of pension = Pension received ÷ % of pension commuted.
- (2) Uncommuted pension is fully taxable for all kinds of employees, (i.e. whether government employee or non-government employee)
- (3) Pension received from UNO is exempt.
- (4) Commuted Pension received from pension fund established by LIC or any other approved insurer under section 10(23AAB) is exempt from tax for all employees.
- (5) Family pension received by legal heirs is not income from salaries, it shall be taxed as 'Income from other sources'.

Illustration 21 - Computation of taxable pension : Rani is entitled to get a pension of Rs. 1,500 p.m. from Raja Ltd. She gets three-fifth of the pension commuted and receives Rs. 90,000. Compute the taxable portion of commuted value of pension when-

- (i) she does not receive gratuity;
- (ii) receives Rs. 50,000 as gratuity. (CS June 2004) Solution: Computation of taxable pension -
 - (i) When Rani doesn't receive gratuity :
 - (a) % of pension commuted = $3/5 = 60\%$.
 - (b) Commuted value of pension (Pension received ÷ % commuted) = Rs. 90,000 ÷ 60% = Rs. 1,50,000.
 - (c) Exemption = 1/3rd of commuted value of pension (Rs. 1,50,000) = Rs. 75,000
 - (d) Taxable portion of commuted pension = Rs. 90,000 - Rs. 75,000 = Rs. 15,000.
 - (ii) When Rani receives gratuity :
 - (a) Exemption = 1/3rd of commuted value of pension (Rs. 1,50,000) = Rs. 50,000
 - (b) Taxable portion of commuted pension = Rs. 90,000 - Rs. 50,000 = Rs. 40,000.

Illustration 22 - Computation of Gross salary: Mr. Jain retires from a Private service on 1st August 2020. At the time of his retirement after 28 years and 8 months of service, he was getting the salary of Rs. 34,000 per month. He gets pension of Rs. 10,000 per month upto 31st December 2020. With effect from 1st January 2021 he gets 4/5th of his pension commuted for Rs. 12,00,000. Determine his gross salary.

Solution: Computation of gross salary (amounts in Rs.) -

Salary @ Rs. 34,000 per month (April 2020 to July 2020)	1,36,000
Uncommuted pension [Rs. 10,000 x 5 months (August 2020 to December 2020) + (Rs. 2,000 x 3 (January 2021 to March 2021)] [WN-1]	56,000
Taxable portion of commuted value of pension [WN-2]	4,50,000
Gross salary	6,42,000

Working Notes:

- (1) **Uncommuted Pension :** Since Mr. Jain commuted 4/5th pension in December, 2020. His uncommuted pension from January, 2021 onward shall be [Rs. 10,000 x 1/5] = Rs. 2,000 p.m.
- (2) Commuted pension:
 - (a) % of pension commuted = $4/5 = 80\%$.

- (b) Commuted value of pension (Pension received - % commuted) = 12,00,000 * 80% = Rs. 15,00,000.
- (c) Exemption = 1/2 of commuted value of pension (Rs. 15,00,000) = Rs. 7,50,000.
- (d) Taxable portion of commuted pension = Rs. 12,00,000 - Rs. 7,50,000 = Rs. 4,50,000.

21. Explain briefly the treatment of Leave Travel Concession (LTC) granted by an employer to his employee.

Ans: The exemption in respect of Leave Travel Concession is discussed as under -

- (1) **Leave Travel Concession [Section 10(5)] :** Section 10(5) gives the exemption to an assessee in respect of Leave Travel Concession (LTC) received by or due to him, from his current or former employer, for himself and his family, in connection with his proceedings on leave to any place in India either during his employment or after the retirement/ termination of his employment.

"Family" means,—

- (a) the spouse and children of the individual; and
- (b) the parents, brothers and sisters of the individual or any of them, wholly or mainly dependent on the individual. In case of children born after 1-10-1998, the exemption is available for only two surviving children and in case of birth of multiple children after one child, the multiple children shall be regarded as one child.

(2) Amount of Exemption [Rule 2B]:

Situations -	Exemption upto the amount not exceeding** —
Journey by air	Economy fare of national carrier by shortest route.
In case places are connected by rail and journey is performed other than by air	1st Class AC rail fare by the shortest route.
If places are not connected by rail and -	1st/ deluxe class fare on such transport by shortest route.
(a) recognised transport system exists	
(b) no recognised transport carrier exists	1st Class AC rail fare by the shortest route (as if the journey had been performed by rail).
**The amount of exemption shall not exceed the amount actually incurred for such travel.	

(3) Claim of Exemption:

- (a) The assessee can claim exemption for any two journeys in a block of 4 calendar years.
- (b) The current blocks are: Ninth block 2018-2021.
- (c) Carry-over of Concession: In case no concession or only one concession is availed in the previous block, then the assessee can claim one additional exemption in the first year of next block.

Illustration 23 - Exemption in respect of leave travel concession u/s 10(5): Mr. Amit avails the benefit of LTC and went by air (economy class) on a holiday in India on 25-01-2021. along with his wife and three children consisting of son aged 6 years and twin daughters of 2 years age. Total cost of tickets reimbursed by his employer was Rs. 1,00,000 (Rs. 55,000 for 2 adults and Rs. 45,000 for the three children). State with reasons the amount which is exempt in the hands of Mr. Amit out of the reimbursement received by him. (Similar 4 Marks, IPCC May 2013) (Similar: 4 Marks, Nov. 2016) What will be your answer in case among his three children, the twins were 6 years old and the age of the son was 2 years ?

Solution: Exemption is available under section 10(5) to an employee in respect of value of LTC for himself and his family, in connection with his proceedings on leave to any place in India.

"Family" includes the spouse and children of the individual. In case of children born after 1-10-1998 exemption is available for 2 surviving children. However, exemption shall be available in respect of children born before 1-10-1998 and also in respect of multiple births after one child.

Further, as per Rule 2B, if journey is performed by air, the exemption will be available only upto the extent of economy air fare of national carrier by shortest route.

Case I: Son aged 6 years & Twin daughters of 2 years age : This is a case of multiple birth (twin daughters) after one child, hence, all the three children will be eligible for exemption. Accordingly, the whole of the LTC of ₹ 1,00,000 will be exempt as the travel is economy class of air.

Case II: Twin daughters of 6 years age & son aged 2 years : In this case the number of children is three and one son was born after the multiple birth. Hence, the exemption will be available only in respect of two children and the economy air fare of one child will be taxable. Therefore, taxable value = ₹ 45,000 $\times 3$ = ₹. 15,000; and the balance of ₹. 85,000 will be exempt.

22. Upto what extent Retrenchment Compensation can be exempted from tax (6 Marks, Nov.2006) (CS June 2007)

Ans: Exemption in respect of Retrenchment Compensation [Section 10(10B)] : Retrenchment Compensation received by an assessee shall be exempt to the extent of least of the following -

- 1) Actual amount received; or
- 2) ₹. 5,00,000; or
- 3) An amount calculated in accordance with Section 25F(b) of the Industrial Disputes Act, 1947 i.e. 15 days' average pay $\times$ Every completed year of service or part thereof in excess of 6 months.

Illustration 24 - Retrenchment Compensation: Mr. Gobind received retrenchment compensation of ₹. 10,00,000 after 30 years 4 months of service. At the time of retrenchment, he was receiving basic salary of ₹. 20,000 p.m.; dearness allowance of ₹. 5,000 p.m. Compute his taxable retrenchment compensation. (4 Marks, 1PCC May 2013)

Solution: Computation of taxable retrenchment compensation (amount in ₹.)-

Retrenchment compensation received	10,00,000
Less: Exemption under section 10(10B) [WN]	4,32,692
Taxable retrenchment compensation	<u>5,67,308</u>

Working Note : Exemption is to the extent of least of the following -

- (i) Compensation actually received: ₹. 10,00,000
- (ii) Statutory Limit: ₹. 5,00,000
- (iii) Amount calculated in accordance with provisions of the Industrial Disputes Act, 1947

i.e. $= \frac{15}{26} \times \text{Avg salary of last 3 months} \times \text{Completed year of service and part thereof in excess of 6 months}$

$$\frac{15}{26} \times \frac{(\text{Rs.} 20,000 \times 3) + (\text{Rs.} 5,000 \times 3)}{3} \times 30 \text{ years} = \text{Rs.} 4,32,692$$

23. Write a note on exemption in respect of compensation received on voluntary retirement/ separation.

Ans: **Exemption in respect of compensation received on voluntary retirement or separation [Section 10(10C)]:** Section 10(10C) grants exemption to the employees who are in receipt of voluntary retirement receipts, subject to some conditions -

(1) **Eligible Employees:** Only the employees of following undertakings are eligible -

- (a) A public sector company;
- (b) Any other company;
- (c) An authority established under a Central/State or Provincial Act;
- (d) A local authority;
- (e) A co-operative society;
- (f) A University established or incorporated under a Central/State or Provincial Act and an institute declared to be a University by University Grants Commission;
- (g) An Indian Institute of Technology;
- (h) Institute of management as the Central Government may specify in this behalf through a notification in the Official Gazette;
- (i) Central or State Government; or
- (j) An institution having importance throughout India or in any state as the Central Government may specify by notification in the Official Gazette.

(2) **Limit of Exemption : Least of the following is exempt -**

- (a) Actual amount received;
- (b) Rs. 5,00,000.

The exemption shall be given even if the compensation is receivable in instalments.

(3) **Guidelines for claiming exemption [Rule 2BA]:**

- (a) the scheme applies to an employee who has completed 10 years of service or completed 40 years of age except in case of employees of public sector company;
- (b) it applies to all employees including workers and executives except directors of a company or co-operative society;
- (c) scheme has been drawn to result in overall reduction in the existing strength of the employees;
- (d) the vacancy caused by the voluntary retirement or voluntary separation is not to be filled up;
- (e) retiring employee is not employed in another company/concern belonging to same management;
- (f) Amount of compensation does not exceed -
 - (i) 3 months $\times$ salary last drawn $\times$ completed year of service; or
 - (ii) Salary last drawn $\times$ Balance of months left before retirement or superannuation.

Salary = Basic pay + DA (forming part of retirement benefits) + %-wise fixed commission on turnover.

(4) **Exemption only once :** If exemption has been allowed to an employee under this section in any assessment year, no exemption shall be allowed to him in relation to any other assessment year.

(5) **No exemption if relief availed u/s 89 :** Where any relief has been allowed to an assessee under section 89 for any assessment year in respect of any amount received or receivable on his voluntary retirement or termination of service or voluntary separation, no exemption under this section shall be allowed to him in relation to such, or any other, assessment year.

Thus, relief under section 89 and exemption under this section cannot be availed of simultaneously. Further, once relief is claimed under section 89, the right to claim exemption in respect of VRS compensation is lost forever.

Illustration 25 - VRS compensation : R is employed in a public company and is paid a sum of Rs. 6,00,000 on Voluntary Retirement from service. The normal age of retirement in the company is 60 years and R who was 45 years at the time of retirement had completed 20 years of service. His monthly salary at the time of retirement was as follows -

	Rs.
Basic Pay	10,000
Dearness Allowance (50% is includible for pension)	6,000
HRA	3,000
Conveyance Allowance	800

What is the amount of compensation taxable under the Income-tax Act?

Solution; As per section 10(10C) read with rule 2BA the exemption is available of Rs. 5,00,000 only if the amount received as compensation does not exceed higher of the following limits -

- (a) 3 months $\times$ salary last drawn $\times$ completed years of service i.e., $(3 \times \text{Rs. } 13,000 \times 20)$ (amount in Rs.)
 [WN] 7,80,000
- (b) Salary last drawn $\times$ No. of months of service left for retirement i.e., $13,000 \times 15 \times 12$ 23,40,000
 Rs. 5,00,000 will be exempt, since the amount received is less than the aforesaid limits, Consequently, Rs. 1,00,000 will be taxable.

Working Notes: Salary means = $110,000 + \text{Rs. } 3,000$ (50% of DA of Rs. 6,000) = Rs. 13,000.

Illustration 26 - Computation of taxable compensation : What will be the amount of taxable compensation in the illustration above, if instead of compensation of Rs. 6,00,000, R receives a compensation at the time of his retirement of -

- (i) Rs. 10,00,000; or
 (ii) Rs. 29,80,000.

Solution : (i) Here, the amount received is within the limit of Rs. 23,40,000. Therefore, the exemption under section 10(10C) will be available. The amount taxable at the time of retirement = Rs. 10,00,000 - Rs. 5,00,000 = Rs. 5,00,000. (ii) Since the compensation received exceeds Rs. 23,40,000, the payment is not in accordance with Rule 2BA and therefore no exemption will be available under section 10(10C). Therefore, entire compensation will be taxable i.e. Rs. 29,80,000.

24. Discuss the exemption available in respect of tax on non-monetary perquisites borne by the employer on behalf of employee. (PCE Nov. 2007)

Ans: Exemption in respect of tax on non-monetary perquisites borne by the employer on behalf of employee [Section 10(10CC)]: This section provides the exemption to an employee in respect of the tax paid by his employer on his behalf on the non-monetary perquisites [within the scope of Section 17(2)] received by such employee. Hence, such tax paid shall not form part of the employee's gross salary.

Tax implication in hands of employer : Section 40(a)(v) disallows such expenditure in the hands of the employer. Therefore, the tax so paid by the employer will not be deductible expenditure in his hands.

TAX TREATMENT OF PROVIDENT FUNDS AND TAX RELIEF

25. Discuss the tax implications in respect of various Provident Funds.

Ans: The tax implications of various provident funds is as under -

(1) Provident fund scheme : In a Provident Fund Scheme, employer deducts a certain amount from the salary of employee for the purpose of contribution towards a fund and the employer also contributes to the same. Both the contributions are invested in securities and interest earned thereon is credited to the fund.

Hence, Provident Fund consists of-

- (c) employer's contribution and interest thereon; and
- (d) employee's contribution and interest thereon.

(2) The various provident funds are -

- (a) **Statutory Provident Fund (SPF) :** Statutory provident fund is set up under the provisions of the Provident Funds Act, 1925. This fund is maintained by Government and semi-Government organizations, local authorities, railways, universities and recognised educational institutions.
- (b) **Recognised Provident Fund (RPF) :** A provident fund scheme to which the Employee's Provident Fund and Miscellaneous Provisions Act, 1952 applies is Recognised Provident Fund. Besides, these funds are recognized by the Principal CIT or CIT or Principal CCIT or CCIT under the provisions of the Income Tax Act, 1961. The Principal CIT or CIT recognizes only those funds which follow the rules given in the Fourth Schedule of Income-tax Act.
- (c) **Unrecognised Provident Fund (URPF) :** If a provident fund is not recognized by the Principal CIT or CIT of Income tax, it is known as unrecognized provident fund.

(3) Tax treatment of various Provident Funds :

Tax incidence of -	SPF	RPF	URPF
(1) Employer's contribution	Exempt	Exempt upto 12% of salary [Note-1 & 2]	Not taxable when the contribution is made.
(2) Employee's contribution	Taxable	Taxable	Taxable
(3) Deduction u/s 80C on employee's contribution	Available	Available	Not available
(4) Interest credited to PF	Exempt	Exempt upto interest calculated @ 9.5% p.a. [Note-3]	Not taxable when interest is credited

(5) Lump sum payment at the time of retirement or termination of service	Exempt u/s 10(11)	Exempt from tax in some cases. When not exempt provident fund will be treated as an unrecognised fund from the beginning. [Note-2]	➤ Employer's contribution & interest thereon: Taxable as salary. Relief can be claimed u/s 89. ➤ Employee's own contribution: Exempt, as taxed earlier. ➤ Interest on employee's contribution : Taxable as 'Income from Other Sources'.

Note:

- (1) Salary = Basic + Dearness allowance, if the terms of employment so provide + percentage-wise fixed commission on turnover.
- (2) The amount or the aggregate of amounts of any contribution made to the account of the assessee by the employer—
 - (a) in a recognised provident fund;
 - (b) in the scheme referred to in Section 80CCD(1); and
 - (c) in an approved superannuation fund, to the extent it does not exceed Rs. 7,50,000 in a previous year is exempt from tax.
- (3) The annual accretion by way of interest, dividend or any other amount of similar nature during the previous year to the balance at the credit of the fund or scheme referred above to the extent it relates to the contribution which is included in total income in any previous year computed in such manner as may be prescribed. [Amended by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY 2021-22]
- (4) Lump sum payment at the time of retirement or termination of service is exempt from tax if:
 - (a) the employee has rendered continuous service with his employer for a period of 5 years or more.
 - (b) Service is terminated due to ill health of employee or discontinuance of employer's business or any other reason beyond his control; or
 - (c) On cessation of employment, he takes employment with another employer, exemption is allowed to the extent such accumulated balance transferred to his RPF account maintained by other employer; or
 - (d) The entire balance standing to the credit of the employee is transferred to his account under a pension scheme referred to in section 80CCD and notified by the Central Government.
- (5) In case if the employee has transferred his PF balance with the previous employer to the PF a/c maintained with the current employer, then for determining the period of 5 years, services rendered to the previous employer shall also be considered.
- (6) **Tax liability on transfer from URPF to RPF :** In case if URPF is converted into RPF, then the amount to be taxed shall be the amount which is arrived by treating the fund as RPF from its inception i.e. from the year of creation of fund.

26. Discuss the tax incidence of approved superannuation funds.

Ans: The tax treatment of approved superannuation funds is as follows -

- (1) Employer's contribution to the fund - Exempt if the amount or the aggregate of amounts of any contribution made to the account of the assessee by the employer in a RPF, NPS scheme and in an approved superannuation fund, to the extent it does not exceed Rs. 7,50,000 in a previous year.
- (2) Employee's contribution - qualifies for deduction under section 80C.
- (3) Interest credited to the employee's account - Exempt. However, the annual accretion by way of interest, dividend or any other amount of similar nature during the previous year to the balance at the credit of the fund or scheme referred above to the extent it relates to the contribution which is included in total income in any previous year computed in such manner as may be prescribed. [Amended by Finance Act, 2020 w.e.f. 01-04-2021 e. AY 2021-22]
- (4) **Exemption of payment from the fund [Section 10(13)] :** Section 10(13) gives exemption in respect of payments from approved superannuation fund if they are made,-
 - a) to legal heirs on the death of the beneficiary; or
 - b) to an employee in substitution of or in commutation of an annuity on his retirement at or after a specified age or if he becomes incapable prior to his retirement; or
 - c) in form of refund of contribution on death of beneficiary; or
 - d) in the form of refund of contribution to an employee leaving the service in circumstances other than those mentioned in (c) above, to the extent the payment does not exceed contribution made prior to commencement of this Act and interest thereon; or
 - e) by way of transfer to the account of the employee under a pension scheme referred to in section 80CCD and notified by the Central Government.

Illustration 27 - Computation of taxable salary : Mr. M is an area manager of M/s. N. Steels Co. Ltd. During the previous year 2021-21 he gets following emoluments from his employer :

Basic salary : upto 31-08-2020	Rs. 20,000 p.m.
from 01-09-2020	Rs. 25,000 p.m.
Transport Allowance	Rs. 2,000 p.m.
Contribution to recognized provident fund	15% of basic salary and D.A.
Children education allowance City	Rs. 500 p.m. for two children
Compensatory Allowance	Rs. 300 p.m.
Hostel expenses allowance	Rs. 380 p.m. for two children
Tiffin allowance (actual expenses Rs. 3,700)	Rs. 5,000 p.a.
Tax paid on employment	Rs. 2,500

Compute taxable salary of Mr. M. (6 Marks, PCC Nov. 2008)

Solution: Computation of income from salary of Mr. M (amount in Rs.):

Basic salary (Rs. 20,000 $\times$ 5 + Rs. 25,000 $\times$ 7)		2,75,000
Transport Allowance (Rs. 2,000 p.m. $\times$ 12)	24,000	
Less: Exempt	Nil	24,000
Children education allowance (Rs. 500 p.m. $\times$ 12)	6,000	
Less: Exempt (Rs. 100 $\times$ 2 $\times$ 12)	2,400	3,600
City Compensatory Allowance		3,600
Hostel expenses allowance (Rs. 380 $\times$ 12)	4,560	
Less: Exempt (Rs. 300 $\times$ 2 $\times$ 12) = X 7,200 but restricted to the actual allowance of Rs. 4,560	4,560	Exempt

Tiffin allowance (Fully taxable)		5,000
Tax paid on employment (Employee's obligation met by employer) [WN-2]		2,500
Employer's contribution to R.P.F. In excess of 12% of salary (i.e., 3% of Rs. 2,75,000) [WN-1]		8,250
Gross salary		3,21,950
Less: Standard Deduction u/s 16(ia) [WN-3]		50,000
Employment tax u/s Section 16(iii)		2,500
Taxable Salary		2,69,450

Working Notes:

- (1) The question states that contribution to recognised provident fund is at 15% of Basic salary + D.A. However, since the amount or rate of D.A. is not given in the question, contribution to recognised provident fund has been taken as 15% of basic salary.
- (2) Employment tax paid by employer should be included in the salary of Mr. M as a perquisite since it is discharge of monetary obligation of the employee by the employer. Thereafter, deduction of employment tax paid is allowed to the employee from his gross salary.
- (3) As per Section 16(ia), standard deduction will be allowed from gross salary amounting Rs. 50,000 or the amount of salary, whichever is less.

27. How is relief computed when salary is paid in arrears or in advance ?

Ans: The provisions relating to tax relief under Section 89 are as under:

(A) Relief when available : Section 89 read with Rule 21A grants relief to the assessee who receives -

- (a) salary, being paid in arrears or in advance; or
- (b) salary for more than 12 months in any one financial year; or
- (c) profits in lieu of salary under section 17(3); or
- (d) family pension as referred to in Section 57(ia) being paid in arrears, due to which his total income is assessed at a rate higher than that at which it should have been assessed.

(B) Calculation of relief: The admissible relief will be calculated as per the following steps -

- (1) Calculate the tax payable on the total income, including the additional salary, of the previous year in which the same is received.
- (2) Calculate the tax payable on the total income, excluding the additional salary of the previous year in which the same is received.
- (3) Find out the difference between the tax at (1) and (2).
- (4) Compute tax on total income after including the additional salary in the previous year to which such salary relates.
- (5) Compute tax on total income after excluding the additional salary in the previous year to which such salary relates.
- (6) Find out the difference between tax at (4) and (5).
- (7) Relief under section 89 = Tax computed at (3) - Tax computed at (6).

(C) No relief, if exemption claimed u/s 10(10C) in respect of VRS compensation : No relief shall be granted under this section in respect of any amount received or receivable by an assessee on his voluntary retirement or termination of his service under Voluntary Retirement or Separation Scheme if an exemption u/s 10(10C) has been claimed in respect of such or any other assessment year.

Effect: The cumulative effect of sections 10(10C) and 89 is -

- (a) The assessee cannot avail of exemption u/s 10(10C) and simultaneously claim relief u/s 89 in respect of the un-exempt portion in the same assessment year;
- (b) Once exemption is claimed u/s 10(10C), no exemption u/s 10(10C) and no relief u/s 89 can be claimed for any other assessment year in respect of VRS compensation;
- (c) Once relief is claimed u/s 89 in respect of VRS compensation received, no exemption u/s 10(10C) can be claimed for any other assessment year. However, if any VRS compensation is received subsequently from any other employer, relief u/s 89 can be claimed. Therefore, relief u/s 89 can be claimed more than once.

Illustration 28 - Tax relief: Mr. Ashok Kumar, an employee of a PSU, furnishes the following particulars for the previous year ending 31-3-2021:

	Particulars	Rs.
(a)	Salary income (computed) for the year	8,25,000
(b)	Salary for financial year 2008-09 received during the year	40,000
(c)	Assessed income for the financial year 2008-09	1,40,000

You are requested to compute relief under Section 89 of the Income-tax Act, 1961, in terms of tax payable. The rates of Income-tax for the Assessment Year 2009-10 are -

On first Rs. 1,00,000 : Nil

On Rs. 1,00,000 - Rs. 1,50,000 : 10%

On Rs. 1,50,000 - Rs. 2,50,000 : 20%

Above Rs. 2,50,000: 30%. Education cess @ 2% of tax payable. (7Marks, Modified PCC June, 2009)

Solution: Computation of Relief under section 89 -

Particulars	Tax liability for AY 2021-22		Tax liability for AY 2009-10	
	Salary inclusive of arrears	Salary without arrears	Salary inclusive of arrears	Salary without arrears
	(1)	(2)	(3)	(4)
Actual Salary	8,65,000	8,25,000	1,80,000	1,40,000
Income Tax thereon	85,500	77,500	11,000	4,000
H/E C @ 4%/E C @ 2%	3,420	3,100	220	80
Total Tax liability	88,920	80,600	11,220	4,080
Step 1: Tax at (1) - Tax at (2)	8,320			
Step 2: Tax at (3) - Tax at (4)			7,140	
Relief u/s 89 : Step 1 - Step 2			1,180	
Tax payable [Tax at (1) - Relief] (Rounded off)			87,740	

Assumption: Arrears of salary of financial year 2008-09 are not included in salary income of current year.

MISCELLANEOUS ILLUSTRATIONS

Illustration 29 - Computation of taxable income: Mr. Narendra, who retired from the services of Hotel Samode Ltd., on 31-1-2021 after putting on service for 5 years, received the following amounts from the employer for the year ending on 31-3-2021:

- (i) Salary @ Rs. 16,000 p.m. comprising of basic salary of Rs. 10,000, Dearness allowance of Rs. 3,000, City compensatory allowance of Rs. 2,000 and Night duty allowance of Rs. 1,000.
- (ii) Pension @ 30% of basic salary from 1-2-2021.
- (iii) Leave salary of Rs. 75,000 for 225 days of leave accumulated during 5 year @ 45 days leave per year.
- (iv) Gratuity of Rs. 50,000. Compute the total income of Mr. Narendra. (6 Marks, PCC May 2008)

Solution: Computation of total income of Mr. Narendra (amount in Rs.) -

Basic Salary (Rs. 10,000 $\times$ 10)	1,00,000
Dearness Allowance 3,000 $\times$ 10)	30,000
City Compensatory Allowances 2,000 $\times$ 10) - Fully taxable	20,000
Night Duty Allowance (Rs. 1,000 $\times$ 10) - Fully taxable	10,000
Pension (30% of Rs. 10,000 $\times$ 2) [February, 2021 to March, 2021]	6,000
Taxable leave encashment [WN-1]	25,000
Gratuity [WN-2]	25,000
Gross Salary	2,16,000
Less: Standard Deduction u/s 16(ia)	50,000
Salary Income/ Total Income	1,66,000

Working Notes:

(1) Computation of taxable leave encashment (amount in Rs.):

Leave salary received		75,000
Exemption: Least of the following is exempt -		
➤ Actual earned leave salary received	75,000	
➤ 10 months' Average salary	1,00,000	
➤ Earned leave to the credit $\times$ Average Salary (5 $\times$ Rs. 10,000)	50,000	
➤ Amount notified by the Central Government	3,00,000	50,000
Taxable Leave Encashment = Sum Received - Exemption		25,000

Computation of leave of at the credit of an employee:

Particulars	Company	Income-tax
Leave entitlement for completed year	45 days	30 days
Completed years of service	5	5
Total leave entitlement (days)	225	150
Leave availed while in service (days)	0	0
Balance leave at his credit (days)	225	150

(2) Computation of taxable gratuity (amount in Rs.) -

Gratuity received		50,000
Exemption v/s 10(10): The least of the following is exempt -		
(a) Gratuity received	50,000	
(b) $1/2 \times$ Average Salary (Rs. 10,000) $\times$ Completed Years (5)	25,000	
(c) Specified limit	20,00,000	25,000

Taxable Gratuity = Gratuity Received - Exemption		25,000

Illustration 30 - Computation of taxable salary : Babu joined a Company on 01-06-2020 and was paid the following emoluments and allowed perquisites as under -

Emoluments: Basic pay Rs. 25,000 per month; DA Rs. 10,000 per month; Bonus Rs. 50,000 per month.
Perquisites:

- Furnished accommodation owned by the employer and provided free of cost. Value of furniture therein Rs. 3,00,000.
 - Motorcar owned by the Company (with engine cubic capacity less than 1.6 litres) along with chauffeur for official and personal use.
 - Sweeper salary paid by Company Rs. 1,500 per month.
 - Watchman salary paid by Company Rs. 1,500 per month.
 - Educational facility for 2 children provided free of cost. School is owned and maintained by company.
 - Interest free loan of Rs. 5,00,000 given on 1-10-2020 for purchase of a house. No repayment was made during the year. (SBI Rate 12.25%)
 - Interest free loan for purchase of computer Rs. 50,000 given on 1-1-2021 No repayment was made during the year. (SBI Rate 15.25%)
 - Corporate membership of a club. The initial fee of Rs. 1,00,000 was paid by the Company. Babu paid the bills for his use of club facilities.
- You are required to compute the income of Babu under the Head "Salaries". Suitable assumptions may be made, wherever necessary. (May 2002)

Solution: Computation of Income of Babu under the Head "Salaries" (amounts in Rs.)

Basic Salary (Rs. 25,000 $\times$ 10)		2,50,000
Dearness allowance (Rs. 10,000 $\times$ 10)	[WN-1]	1,00,000
Bonus (Rs. 50,000 $\times$ 10 months)		5,00,000
Value of Accommodation	[WN-2 & 3]	1,52,500
Sweeper Salary paid by employer (Rs. 1,500 $\times$ 10)		15,000
Watchman Salary paid by employer (Rs. 1,500 $\times$ 10)		15,000
Car facility	[WN-4]	27,000
Club facility	[WN-5]	Nil
Education facility to children	[WN-6]	Nil
Interest free housing Loan (Rs. 5,00,000 $\times$ 12.25% $\times$ 6 $\div$ 12)		30,625
Interest free Computer Loan 50,000 $\times$ 15.25% p.a. $\times$ 3 $\div$ 12)		1,906
Gross Salary		10,92,031
Less: Standard Deduction u/s 16(ia)		50,000
Income under the head salaries		10,42,031

Working Notes:

- It is assumed that DA forms the part of salary for retirement benefits.
- It is assumed that the place of accommodation has population exceeding 25 lakhs.
- Taxable value of Rent Free furnished Accommodation:

Valuation of rent free accommodation	15% of salary
Value of rent free accommodation 8,50,000 $\times$ 15%	1,27,500
Add: Furniture (10% p.a. of original cost of furniture) 3,00,000 $\times$ 10% $\times$ 10/12)	25,000
Taxable value of furnished accommodation	1,52,500

Salary for rent free accommodation:	
➤ Basic Pay	2,50,000
➤ DA	1,00,000
➤ Bonus	5,00,000
	8,50,000

- (4) The car is used partly for personal and partly for official use. Assuming that the maintenance and running expenses are met by the owner-company, value of car facility = (Rs. 1,800 + Rs. 900) $\times$ 10 = Rs. 27,000.
- (5) The initial fee for corporate membership is exempt from tax.
- (6) It is assumed that the cost of education per child does not exceed Rs. 1,000 p.m.

Illustration 31 - Computation of gross salary : Sehwag is employed with Sure Shots Ltd. on a salary of Rs. 25,000 per month. The company provides him with the following benefits

- (a) A company owned accommodation at Delhi.
- (b) A housing loan of Rs. 5,00,000 on 1st July 2020 on which it charges interest @ 6% per annum. The entire loan is still outstanding. The rate of SBI is 8% p.a.
- (c) The company gave him a watch worth Rs. 4,900 as gift on his 50th birthday on 21st October, 2020.
- (d) He made purchases of Rs. 12,000 on his credit card. This amount, along with the annual fee of Rs. 2,000, was paid by the company.
- (e) He is allowed to use the video camera belonging to the company. The company had purchased this camera for Rs. 60,000 on 1st May 2016. This camera was sold to him on 1st August 2020 for Rs. 30,000.
- (f) The company had purchased a car on 16th July 2016 for Rs. 2,50,000. This car was sold to Sehwag on 14th July 2020 for Rs. 80,000.
- (g) The company pays telephone bills of Rs. 24,000 for the telephone installed at the residence of Sehwag. Compute the gross income from salary of Sehwag. (CS Dec. 2002)

Solution: Computation of Taxable Salary of Sehwag (amounts in Rs.) -

Basic salary @ Rs. 25,000 p.m. 25,000 $\times$ 12)		3,00,000
Rent free accommodation (15% of salary)		45,000
Concessional housing loan	[WN-1]	7,500
Free gift of watch	[WN-2]	Exempt
Credit card facility (Rs. 12,000 + Rs. 2,000)		14,000
Telephone facility	[WN-3]	Exempt
Use of Video camera	[WN-4]	2,000
Sale of video camera	[WN-5]	12,000
Sale of car	[WN-6]	80,000
Gross Salary		4,60,500
Less: Standard Deduction u/s 16(ia)		50,000
Income under the head salaries		4,10,500

Working Notes:

- (1) Value of concessional housing loan = Rs. 5,00,000 $\times$ 2% $\times$ 9/12 = Rs. 7,500.
- (2) The value of gift received is exempt from tax as the amount is below Rs. 5,000.
- (3) Telephone facility provided is an exempt perquisite, hence not liable to tax.
- (4) Taxable value for use of video camera = Rs. 60,000 $\times$ 10% $\times$ 4/12 = Rs. 2,000.

- (5) Taxable value for use of video camera = WDV - Sale price = (Rs. 60,000 - Depreciation @ 10% for 3 years Rs. 18,000) - Rs. 30,000 = Rs. 42,000 - Rs. 30,000 = Rs. 12,000.
- (6) Total depreciation for two completed years on motor car = Rs. 90,000, computed as follows -

Depreciation for the 1 st year @ 20% of cost	50,000
WDV at the end of 1st year	2,00,000
Depreciation for 2nd year @ 20%	40,000

Hence, taxable value for sale of car = Rs. 2,50,000 - Rs. 90,000 - Rs. 80,000 = Rs. 80,000.

Illustration 32 - Computation of taxable salary: Naresh, who is neither a director nor he has substantial interest in any company, is offered an employment by Freewheel Ltd., Mumbai with following alternatives :

	Alternative I Rs.	Alternative II Rs.
Basic pay	1,66,000	1,66,000
Bonus	9,000	9,000
Education allowance for 2 children/ Education facility for 2 children in a school maintained by employer	30,200	30,200
Sweeper allowance/Sweeper facility	10,000	10,000
Entertainment Allowance/Club facility	6,000	6,000
Transport allowance/Free car (1200 cc) facility for personal use (Car owned by the employer)	21,600	21,600
Medical allowance/Medical facility for Naresh and his family members in a hospital maintained by employer	18,000	18,000
Allowance for gas, electricity and water supply/ Free gas, electricity and water supply (bills will be in the name of the employer)	4,500	4,500
Holiday home allowance/Holiday home facility	8,000	8,000
Lunch allowance/ Free lunch (Rs. 70 x 200 days + Rs. 80 x 50 days)	18,000	18,000
Diwali gift allowance/ Gift on Diwali	7,500	7,500
A rent-free unfurnished home — lease rent	30,000	30,000

Which of the two alternatives Naresh should opt for on the assumption that both employer and employee will contribute 10% of salary towards unrecognised provident fund?

Interest-free loan of Rs. 20,000 will be given to him for purchasing household items. (CS June 2004)

Solution: Computation of Taxable Salary of Naresh under two Alternatives

(amounts in Rs.)-

	Alternative I	Alternative II
Basic pay	1,66,000	1,66,000
Bonus	9,000	9,000
Education allowance/Education facility [WN-1]	27,800	30,200
Sweeper allowance/Sweeper facility	10,000	10,000
Entertainment Allowance/Club facility	6,000	6,000
Transport allowance/ Free car (1200 cc) facility for personal use [WN-2]	21,600	21,600
Medical allowance/Medical facility for Naresh and his family members in a hospital maintained by employer	18,000	Exempt
Allowance for gas, electricity and water supply/Free gas, electricity and water supply (bills will be in the name of the employer)	4,500	4,500
Holiday home allowance/Holiday home facility	8,000	8,000
Lunch allowance/Free lunch [WN-3]	18,000	5,500
Diwali gift allowance/Gift on Diwali [WN-4]	7,500	7,500
Rent-free unfurnished home [WN-5]	30,000	26,250
Gross Salary	3,26,400	2,94,550
Less: Standard Deduction u/s 16(ia)	50,000	50,000
Total taxable salary	2,76,400	2,44,550

Hence, Naresh should opt for Alternative II, as taxable income is less in that case, thus his tax liability will be less.

Working Notes:

(1) **Alternative I:** Taxable value of Education allowance = Rs. 30,200 - [Rs. 100 × 12 × 2] = Rs. 27,800.

Alternative II: Taxable value of Education facility for 2 children is fully taxable as the value exceeds Rs. 1,000 p.m. per child.

(2) **Alternative I:** Taxable value of Transport Allowance = Rs. 21,600

Alternative II: Assuming that Rs. 21,600 includes all expenses incurred including normal wear & tear, taxable value of Car Facility = Rs. 21,600.

(3) **Alternative II:** Free lunch is exempt upto Rs. 50 per meal, hence, taxable amount = (Rs. 80 - Rs. 50) × 50 days + 70 - Rs. 50 × 200 days = Rs. 5,500.

(4) **Alternative II:** The gift received on Diwali is fully taxable as the value exceeds Rs. 5,000.

(5) Value of rent free house shall be lower of the following -

		Alternative I	Alternative II
(a)	15% of Monetary Salary (15% of Rs. 2,96,400 and 15% of Rs. 75,000)	44,460	26,250
(b)	Lease rent paid	30,000	30,000

Illustration 33 - Computation of taxable salary: From the following details find out the salary chargeable to tax: Mr. X is a regular employee of Rama & Co. in Gurgaon. He was appointed on 01-01-2020 in the scale of Rs. 20,000 – Rs. 1,000 – Rs. 30,000. He is paid 10% D.A. & Bonus equivalent to one month pay. He contributes 15% of his pay and D.A. towards his recognized provident fund and the company contributes the same amount. He is provided free housing facility which has been taken on rent by the company at Rs. 10,000 per month. He is also provided with following facilities :

- (i) Facility of laptop costing Rs. 50,000
- (ii) Company reimbursed medical treatment bill of his brother of Rs. 25,000, who is dependent on him.
- (iii) The monthly salary of Rs. 1,000 of a house keeper is reimbursed by the company.
- (iv) A gift voucher of Rs. 1,0,000 on the occasion of his marriage anniversary.
- (v) Conveyance allowance of Rs. 1,000 p.m. is given by the company towards actual reimbursement.
- (vi) He is provided personal accident policy for which premium of Rs. 5,000 is paid by the company.
- (vii) He is getting telephone allowance @ Rs. 500 per month.
- (viii) Company pays medical insurance premium of his family of Rs. 10,000.

(8 Marks, IPCC Nov. 2010)

Solution: Computation of taxable salary of Mr. X (amounts in Rs.) -

Basic pay [(Rs. 20,000 x 9) + (Rs. 21,000 x 3)]		2,43,000
Dearness allowance [10% of basic pay]		24,300
Bonus	[WN-1]	21,000
Telephone allowance [Rs. 500 x 12]		6,000
Conveyance allowance	[WN-2]	Exempt
Employer's contribution to RPF in excess of 12%	[WN-3]	8,019
Rent-free accommodation	[WN-4]	44,145
Medical reimbursement	[WN-5]	25,000
Reimbursement of salary of housekeeper - Taxable u/s 17(2)(iv)		12,000
Facility of laptop - Exempt under Rule 3 of the Income-tax Rules		Exempt
Medical insurance premium paid by employer on self or family member- Exempt under proviso to Section 17(2) of the Act		Exempt
Premium of Rs. 5,000 paid by the company for personal accident policy	[WN-6]	Exempt
Gift voucher	[WN-7]	10,000
Gross Salary		3,93,464
Less: Standard Deduction u/s 16(ia)		50,000
Salary income chargeable to tax	3,43,464	

Working Notes:

- (1) Bonus has been taken as 1 month's basic pay as at the end of year i.e. Rs. 21,000. Alternatively, it may be taken Rs. 20,000, being 1 month's basic pay upto 31-12-2020.
- (2) Conveyance Allowance is exempt as it is fully used for official purposes.
- (3) Taxable part of employer's contribution to RPF = 3% of (Basic pay + D.A.) = 3% of (Rs. 2,43,000 + Rs. 24,300) = Rs. 8,019. Since employer contributes to RPF on basic pay plus D.A, hence, even the D.A forms the part of salary for computing retirement benefits.
- (4) Value of taxable RFA = Lower of the two - (a) 15% of salary i.e. Rs. 44,145 (b) Lease rent Rs. 10,000 x 12 = Rs. 1,20,000.

Salary for rent free accommodation (amount in Rs.):

Basic pay	2,43,000
Dearness allowance	24,300
Bonus	21,000
Telephone allowance	6,000
Conveyance allowance	Exempt
Total	2,94,300

(5) Reimbursed medical treatment bill of his brother of Rs. 25,000 who is dependent on him is fully taxable.

(6) Premium of Rs. 5,000 paid by company for personal accident policy is not liable to tax.

(7) Gifts below Rs. 5,000 are not taxable; otherwise it is fully taxable.

Illustration 34 - Computation of taxable salary : Mr. Balaji, employed as Production Manager in Beta Ltd., furnishes you the following information for the year ended 31-03-2021:

- (i) Basic Salary upto 31-10-2020 Rs. 50,000 p.m.
Basic salary from 01-11-2020 Rs. 60,000 p.m.
Note: Salary is due and paid on the last day of every month.
- (ii) Dearness allowance @ 40% of basic salary.
- (iii) Bonus equal to one month salary. Paid in October 2020 on basic salary plus dearness allowance applicable for that month.
- (iv) Contribution of employer to recognized provident fund account of the employee @ 16% of basic salary.
- (v) Profession tax paid Rs. 3,000 of which Rs. 2,000 was paid by the employer.
- (vi) Facility of laptop and computer was provided to Balaji for both official and personal use. Cost of laptop Rs. 45,000 and computer Rs. 35,000 were acquired by the company on 01-12-2020.
- (vii) Motor car owned by the employer (cubic capacity of engine exceeds 1.60 litres) provided to the employee from 01-11-2020 meant for both official and personal use. Repair and running expenses of Rs. 45,000 from 01-11-2020 to 31-03-2021, were fully met by the employer. The motor car was self-driven by the employee.
- (viii) Leave travel concession given to employee, his wife and three children (one daughter aged 7 and twin sons - aged 3). Cost of air tickets (economy class) reimbursed by the employer Rs. 30,000 for adults and Rs. 45,000 for three children. Balaji is eligible for availing exemption this year to the extent it is permissible in law.

Compute the salary income chargeable to tax in the hands of Mr. Balaji.

(8 Marks, IPCC Nov. 2011)

Solution: Computation of taxable salary of Mr. Balaji

(amounts in Rs.) -

Basic salary [(Rs. 50,000 × 7) + (Rs. 60,000 × 5)]	6,50,000
Dearness allowance [40% of basic salary]	2,60,000
Bonus (Rs. 50,000 + 40% of Rs. 50,000)	[WN-1] 70,000
Employer's contribution to RPF in excess of 12% [4% of Rs. 6,50,000]	[WN-4] 26,000
Professional tax paid by the employer	[WN-6] 2,000
Facility of laptop and Computers	[WN-2] Exempt
Motor Car Facility used for both official and personal purpose	[WN-5] 12,000
Leave Travel Facility - Exemption u/s 10(5)	[WN-3] Exempt
Gross Salary	10,20,000
Less: Professional tax paid	3,000
Less: Standard Deduction u/s 16(ia)	50,000
Income chargeable to tax under 'Salaries'	9,67,000

Working Notes:

- (1) Since bonus was paid in the month of October, the basic salary of Rs. 50,000 for the month of October is considered for its calculation.
- (2) As per Rule 3(7)(vii), facility of use of laptop and computer is an exempt perquisite, whether used for official or personal purpose or both.
- (3) Mr. Balaji can avail exemption u/s 10(5) on the entire amount of Rs. 75,000 reimbursed by the employer towards Leave Travel Concession since the same was availed for himself, his wife and three children and the journey was undertaken by economy class airfare. The restriction imposed for two children is not applicable in case of multiple births which take place after the first child. It is assumed that the Leave Travel Concession was availed for journey within India.
- (4) It is assumed that dearness allowance does not form part of salary for computing retirement benefits.
- (5) As per the provisions of Rule 3(2), in case a motor car (engine cubic capacity exceeding 1.60 liters) owned by the employer is provided to the employee without chauffeur for personal as well as office use the value of perquisite shall be Rs. 2,400 per month. The car was provided to the employee from 01-11-2020 therefore, the perquisite value has been calculated for 5 months.
- (6) As per Section 17(2) (iv), a "perquisite" includes any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee. Therefore, professional tax of Rs. 2,000 paid by the employer is taxable as a perquisite in the hands of Mr. Balaji. As per Section 16(iii), a deduction from the salary is provided on account of tax on employment i.e. professional tax paid during the year.

Therefore, in the present case, the professional tax paid by the employer on behalf of the employee Rs. 2,000 is first included in the salary and deduction of the entire professional tax of Rs. 3,000 is provided from salary.

Illustration 35 - Computation of taxable salary: From the following details, find out the salary chargeable to tax of Mr. Anand for the assessment year 2021-22 : Mr. Anand is a regular employee of Malpani Ltd. in Mumbai. He was appointed on 01-03-2020 in the scale of 25,000 - 2,500 - 35,000. He is paid dearness allowance (which forms part of salary for retirement benefits) @ 15% of basic pay and bonus equivalent to one and a half month's basic pay as at the end of the year. He contributes 18% of his salary (basic pay plus dearness allowance) towards recognized provident fund and the Company contributes the same amount.

He is provided free housing facility which has been taken on rent by the Company at Rs. 15,000 per month. He is also provided with following facilities.

- (i) The company reimbursed the medical treatment bill of Rs. 40,000 of his daughter, who is dependent on him.
- (ii) The monthly salary of 12,000 of a house keeper is reimbursed by the Company.
- (iii) He is getting telephone allowance @ < 1,000 per month.
- (iv) A gift voucher of Rs. 4,700 was given on the occasion of his marriage anniversary.
- (v) The Company pays medical insurance premium to effect an insurance on the health of Mr. Anand Rs. 12,000.
- (vi) Motor car running and maintenance charges fully paid by employer of Rs. 36,600. (The motor car is owned and driven by Mr. Anand. The engine cubic capacity is below 1.60 litres. The motor car is used for both official and personal purpose by the employee.)
- (vii) Value of free lunch provided during office hours is Rs. 2,200. (8 Marks, Nov. 2013)

Solution: Computation of Salary chargeable to tax of Mr. Anand (amount in Rs.) -

Basic pay [(Rs. 25,000 × 11) + 27,500 × 1]		3,02,500
Dearness allowance (15% of basic pay)		45,375
Bonus (Rs. 27,500 × 1.5)	[WN-1]	41,250
Telephone allowance (Rs. 1000 × 12)		12,000
Car facility (Rs. 36,600 - Rs. 1,800 × 12)	[WN-2]	15,000
Employer's contribution to RPF in excess of 12%	[WN-3]	20,873
Rent-free accommodation	[WN-4]	60,169
Medical reimbursement [Fully Taxable]		40,000
Reimbursement of salary of housekeeper - Taxable u/s 17(2)(iv)		24,000
Medical insurance premium paid by employer on health of Mr. Anand	[WN-5]	Exempt
Gift voucher	[WN-6]	Exempt
Free lunch provided during office hours shall be exempt from tax (assuming value per meal doesn't exceed Rs. 50)		Exempt
Gross Salary		5,61,167
Less: Standard Deduction u/s 16(ia)		50,000
Salary income chargeable to tax		5,11,167

Working Notes:

- (1) Bonus has been taken as 1.5 month's basic pay as at the end of year i.e. Rs. 27,500.
- (2) In case motor car is owned by the employee and repair and maintenance expenses are met by employer, then perquisite value shall be actual expenses incurred by employer as reduced by Rs. 1,800 p.m., since cubic capacity of engine does not exceed 1.6 litres.
- (3) Taxable part of employer's contribution to RPF = 6% of (Basic pay + DA) = 6% of (Rs. 3,02,500 + Rs. 45,375) = Rs. 20,873. Since employer contributes to RPF on basic pay plus DA, hence, even the DA forms the part of salary for computing retirement benefits.
- (4) Value of taxable RFA = Lower of the two -
 - (a) 15% of salary (Rs. 4,01,125) i.e. 160,169
 - (b) Lease rent Rs. 15,000 × 12 = Rs. 1,80,000.

Salary for rent free accommodation (amount in Rs.):

Basic pay	3,02,500
Dearness allowance	45,375
Bonus	41,250
Telephone allowance	12,000
Total	4,01,125

- (5) Premium of Rs. 12,000 paid by company for medical insurance premium on health of Anand is not liable to tax.
- (6) Gifts below Rs. 5,000 are not taxable.

Illustration 36 - Computation of taxable salary : Mr. Anand an employee of XYZ Co. Ltd. at Mumbai and covered by Payment of Gratuity Act, retires at the age of 64 years on 31-12-2020 after completing 33 years and 7 months of service. At the time of retirement, his employer pays Rs. 20,51,640 as Gratuity and Rs. 6,00,000 as

accumulated balance of Recognised Provident fund. He is also entitled for monthly pension of Rs. 8,000. He gets 75% of pension Commuted for Rs. 4,50,000 on 1st February, 2021.

Determine the salary chargeable to tax for Mr. Anand for the AY 2021-22 with the help of following information:

	Rs.
Basic Salary (Rs. 80,000 x 9)	7,20,000
Bonus	36,000
House Rent Allowance (Rs. 15,000 x 9)	1,35,000
Rent paid by Mr. Anand (Rs. 10,000 x 12)	1,20,000
Employer contribution towards Recognized Provident Fund	1,10,000
Professional Tax paid by Mr. Anand	2,000

Note : Salary and Pension falls due on the last day of each month. (8 Marks, Nov. 2014)

Solution: Computation of Income from salary (amount in Rs.):

Basic Salary (Rs. 80,000 x 9)	7,20,000
Bonus	36,000
Taxable House Rent Allowance [WN-1]	1,17,000
Employer contribution towards Recognized Provident Fund 1,10,000 -12% of Rs. 7,20,000] [WN-5]	23,600
Taxable Gratuity [WN-2]	4,82,409
Uncommuted pension [Rs.8,000 x 1 month (January, 2021) + (Rs. 2,000 x 2 (February 2021 to March 2021))] [WN-3]	12,000
Taxable portion of commuted value of pension [WN-4]	2,50,000
Gross Salary	16,41,009
Less: Standard Deduction u/s 16(ia)	50,000
Less: Professional Tax paid by Mr. Anand	2,000
Income from salary	15,89,009

Working Notes:

(1) HRA is exempt to the extent least of the following (amount in Rs.) -

(1) Actual HRA received	1,35,000
(2) Rent paid -10% of salary (Rs. 90,000 -10% of Rs. 7,20,000)	18,000
(3) 50% of the salary (50% of Rs. 7,20,000)	3,60,000
Exempted HRA	18,000
Taxable HRA	1,17,000

(2) Computation of taxable gratuity (amount in Rs.):

Completed years of service (Part thereof in excess of 6 months shall be rounded off to higher side) Exemption u/s 10(10): Least of the following is exempt -	34
(a) Gratuity received	20,51,640
(b) 15/26 x Salary last drawn x Completed years of service	15,69,231
(c) Specified limit	20,00,000
Taxable Gratuity = Gratuity Received - Exemption	4,82,409

(3) **Uncommuted Pension :** Since Mr. Anand commuted 75% pension in February, 2021. His uncommuted pension from February, 2021 onward shall be (Rs. 8,000 $\times$ 25%) = Rs. 2,000 p.m.

(4) **Commuted pension:**

(a) % of pension commuted = 75%.

(b) Commuted value of pension (Pension received $\div$ % commuted) = Rs. 4,50,000 $\div$ 75% = Rs. 6,00,000.

(c) Exemption = 1/3rd of commuted value of pension (Rs. 6,00,000) = Rs. 2,00,000.

(d) Taxable portion of commuted pension = Rs. 4,50,000 - Rs. 2,00,000 = Rs. 2,50,000.

(5) Employer's contribution is exempt upto 12% of salary.

Illustration 37 - Computation of taxable salary : Mr. Nambi, a salaried employee, furnishes the following details for the financial year 2020-21:

Particulars	Rs.
Basic salary	6,00,000
Dearness allowance	3,20,000
Commission	50,000
Entertainment allowance	7,500
Medical expenses reimbursed by the employer	21,000
Profession Tax (of this, 50% paid by employer)	7,000
Health insurance premium paid by employer	9,000
Gift voucher given by employer on his birthday	12,000
Life insurance premium of Nambi paid by employer	34,000
Laptop provided for use at home. Actual cost of Laptop to employer [Children of the assessee are also using the Laptop at home]	30,000
Employer-Company owns a Tata Nano car, which was provided to the assessee, both for official and personal use. No driver was provided. (Engine cubic capacity less than 1.6 litres)	
Annual credit card fees paid by employer [Credit card is not exclusively used for official purposes; details of usage are not available]	2,000

You are required to compute the income chargeable under the head "Salaries" for the AY 2021-22. (8 Marks, May 2017)

Solution: Computation of Taxable Salary of Nambi (amounts in Rs.) -

Basic salary	6,00,000
Dearness allowance	3,20,000
Commission	50,000
Entertainment allowance	7,500
Medical expenses reimbursed by the employer [Fully Taxable]	21,000
Profession Tax (50% paid by employer shall be treated as perquisite)	3,500
Health insurance premium paid by employer [Exempt from tax]	-
Gift voucher given by employer on his birthday (taxable, as it is not below Rs. 5,000)	12,000
Life insurance premium of Nambi paid by employer [Employees obligation met by employer, hence fully taxable]	34,000

Laptop facility [Use of Laptops and computers belonging to or hired by the employer is exempt]	-
Car facility for official and personal use [Rs. 1,800 p.m. is taxable, since engine cubic capacity less than 1.6 litres] [Rs. 1800 x 12]	21,600
Annual credit card fees paid by employer	2,000
Gross Salary	10,71,600
Less: Standard Deduction u/s 16(ia)	50,000
Less: Professional Tax paid	7,000
Income chargeable to tax under 'Salaries'	10,14,600

Illustration 38 - Computation of taxable salary : Ms. Jaya is the marketing manager in XYZ limited. She gives you the following particulars:

Basic Salary	:	Rs. 65,000 p.m.
Dearness Allowance	:	Rs. 22,000 p.m. (30% is for retirement benefits)
Bonus	:	Rs. 17,000 p.m.

Her employer has provided her with an accommodation on 1st April, 2020 at a concessional rent. The house was taken on lease by XYZ Ltd. for Rs. 12,000 p.m. Ms. Jaya occupied the house from 1st November, 2020. Rs. 4,800 p.m. is recovered from the salary of Ms. Jaya.

The employer gave her a gift voucher of Rs. 8,000 on her birthday. She contributes 18% of her salary (Basic Pay + DA) towards recognised provident fund and the company contributes the same amount.

The company pays medical insurance premium to effect insurance on the health of Ms. Jaya Rs. 18,000.

Motor car owned by the employer (cubic capacity of engine exceeds 1.6 liters) provided to Ms. Jaya from 1st November, 2020 which is used for both official and personal purposes. Repair and running expenses of Rs. 50,000 were fully met by the company. The motor car was self-driven by the employee.

Compute the income chargeable to tax under the head "Salaries" in the hands of Ms. Jaya for the A.Y. 2021-22. (10 Marks, Nov. 2017)

Solution: Computation of Salary chargeable to tax of Ms. Jaya (amount in Rs.) -

Basic salary [(Rs. 65,000 x 12)]		7,80,000
Dearness allowance [Rs. 22,000 p.m. (30% is for retirement benefits)] [Rs. 22,000 x 12]		2,64,000
Bonus 17,000 x 12)		2,04,000
Car facility (Rs. 2,400 x 5)	[WN-1]	12,000
Employer's contribution to RPF in excess of 12%	[WN-2]	84,816
Rent-free accommodation	[WN-3]	36,000
Medical insurance premium paid by employer on health of Ms Jaya	[WN-4]	Exempt
Gift voucher	[WN-5]	8,000
Gross Salary		13,88,816
Less: Standard Deduction u/s 16(ia)		50,000
Salary income chargeable to tax		13,38,816

Working Notes:

- (1) In case motor car is owned by the employer and repair and maintenance expenses are met by employer, then perquisite value shall be Rs. 2,400 p.m., since cubic capacity of engine exceeds 1.6 litres. Since it is provided from 1st November, 2020, it will be taxable for 5 months.

- (2) Employer's contribution to recognized provident fund in excess of 12% of salary is taxable as per section 17(1)(vi). $18\% \times [(\text{Rs. } 65,000 + \text{Rs. } 22,000) \times 12] - 12\% \times [(\text{Rs. } 65,000 + \text{Rs. } 6,600 \text{ (being 30\% of Rs. } 22,000)}) \times 12] = \text{Rs. } 1,87,920 - \text{Rs. } 1,03,104 [\text{Salary} = \text{Basic Salary} + \text{Dearness allowance, to the extent it forms part of pay for retirement benefits}]$
- (3) In case of accommodation taken on lease by the employer, there would be deemed concession in the matter of rent i.e. the rent paid by the employer or 15% of salary, whichever is lower, exceeds rent recoverable from the employee.
Hence, Value of concessional Accommodation = Lower of the two -
(a) 15% of salary (Rs. 4,43,000) i.e. Rs. 66,450
(b) Lease rent Rs. 12,000 $\times$ 5 = Rs. 60,000
as reduced by rent recovered from Ms. Jaya i.e. [Rs. 60,000 - 4,800 $\times$ 5] = 36,000
Salary for rent free accommodation (amount in Rs.):

Basic pay (Rs. 65,000 $\times$ 5)	3,25,000
Dearness allowance (Rs. 22,000 $\times$ 30% $\times$ 5)	33,000
Bonus 17,000 $\times$ 5)	85,000
Total	4,43,000

Note : Since Ms. Jaya has occupied the house only from 1-11-2020, salary would be considered only in respect of the months during which she has occupied the accommodation. Hence, salary for 5 months (i.e. from 1-11-2020 to 31-3-2021) would be considered.

- (4) Premium of Rs. 18,000 paid by company for medical insurance premium on health of Jaya is not liable to tax.
- (5) Gift voucher of Rs. 8,000 will be fully taxable, since it is not below Rs. 5,000.

Illustration 39 - Computation of taxable salary: Mr. Honey is working with a domestic company having a production unit in the U.S.A. for last 15 years. He has been regularly visiting India for export promotion of company's product. He has been staying in India for at least 184 days every year.

He submits the following information:

Salary received outside India (For 6 months) Rs. 50,000 p.m.

Salary received in India (For 6 months) Rs. 50,000 p.m.

He has been given rent free accommodation in U.S.A. for which company pays Rs. 15,000 per month as rent, but when he comes to India, he stays in the guest house of the company. During this period he is given free lunch facility. During the previous year company incurred an expenditure of Rs. 48,000 on this facility.

He has been provided a car of 2000 cc capacity in U.S.A. which is used by him for both office and private purposes. The actual cost of the car is Rs. 8,00,000. But when he is in India, the car is used by him and the members of his family only for personal purpose. The monthly expenditure of car is Rs. 5,000. His elder son is studying in India for which his employer spends Rs. 12,000 per year where as his younger son is studying in U.S.A. and stays in a hostel for which Mr. Honey gets Rs. 3,000 per month as combined allowance.

The company has taken an accident insurance policy and a life insurance policy. During the previous year the company paid premium of Rs. 5,000 and Rs. 10,000 respectively.

Compute Mr. Honey's taxable income from salary for the Assessment Year 2021-22. (10 Marks, May 2018-NS)

Solution: Since Honey was in India for more than 182 days during the previous year, he is a resident in India for assessment year 2021-22. Hence, his worldwide income will be taxable in India.

Basic Salary [(Rs. 50,000 × 6) + (Rs. 50,000 × 6)]		6,00,000
Hostel and education allowance [Rs. 3000 × 12]	[WN-1]	36,000
Education facility for elder child	[WN-2]	12,000
Car facility for official and personal use in U.S.A. 2,400 × 6)	[WN-3]	14,400
Car facility for personal use	[WN-4]	70,000
Guest House	[WN-5]	Nil
Lunch facility	[WN-5]	48,000
Rent-free accommodation (lease rent paid or 15% of salary whichever is less	[WN-6]	95,400
Premium of Rs. 5,000 paid by the company for personal accident policy	[WN-7]	Exempt
Life Insurance premium paid		10,000
Gross Salary		8,85,800
Less: Standard deduction u/s 16(ia)		50,000
Salary Income chargeable to Tax		8,35,800

Working Notes:

- (1) No exemption is available in respect of allowance received for any education or hostel facility of children outside India.
- (2) If employer incurs expenditure on providing education facility to member of household, it is fully taxable.
- (3) Since car (2000cc) is used for official and personal purpose when Mr. Honey is in USA Rs. 2,400 p.m. will be taxable.
- (4) When Mr. Honey is in India, Car is used for personal purpose by his family members. Hence amount to be taxable is arrived as under: (amount in Rs.)

Depreciation of car @ 10% p.a. of original cost of car 8,00,000 × 10% × 6/12]	40,000
Monthly expenditure incurred by employer [Rs. 5,000 × 6]	30,000
Total	70,000

- (5) Guest house facility is not taxable, since it is provided for stay when he visits India wholly for official purposes. Expenditure incurred on providing lunch facility is taxable.
- (6) **Value of taxable RFA = Lower of the two -**
 - (a) 15% of salary i.e. Rs. 95,400
 - (b) Lease rent Rs. 15,000 × 12 = Rs. 1,80,000

Salary for rent free accommodation:

(amount in Rs.)

Basic pay	6,00,000
Hostel and education allowance	36,000
Total	6,36,000
15% of salary	95,400

- (7) Premium of Rs. 5,000 paid by company for personal accident policy is not liable to tax.

Illustration 40 - Computation of taxable salary : Mr. Janakraj, employed as General Manager in Rajus Refractories Pvt.

Ltd., furnishes you the under-mentioned information for the year ended 31-03-2021 :

- (i) Basic salary upto 30-11-2020 Rs. 70,000 p.m.
Basic salary from 01-12-2020 Rs. 80,000 p.m.
Note: Salary is due and paid on the last day of every month.
- (ii) Dearness allowance @ 50% of basic salary (not forming part of salary for retirement benefits).
- (iii) Bonus equal to one month salary. This was paid in November, 2020 on basic salary plus dearness allowance applicable for that month.
- (iv) Contribution of employer to recognized provident fund account of the employee @ 1.8% of basic salary, employee also contributing an equivalent amount.
- (v) Profession tax paid Rs. 6,000 of which Rs. 3,000 was paid by the employer.
- (vi) Facility of laptop was provided to Janakraj for both official and personal use. Cost of laptop Rs. 65,000 and was purchased by the company on 11-10-2020.
- (vii) Leave travel concession given to Janakraj, his wife and three children (one daughter aged 6 and twin sons aged 4). Cost of air tickets (economy class) reimbursed by the employer Rs. 20,000 for adults and lump sum of Rs. 25,000 for three children. Janakraj is eligible for availing exemption this year to the extent it is permissible under the Income-tax Act, 1961.

Compute the taxable salary of Mr. Janakraj. (6 Marks, Nov. 2018-NS)

Solution: Computation of income from salary of Mr. Janakraj (amount in Rs.):

Basic salary (Rs. 70,000 $\times$ 8 + Rs. 80,000 $\times$ 4)		8,80,000
Dearness allowance (Fully taxable) [50% of basic salary]		4,40,000
Bonus on basis of salary for month of November [Rs. 70,000 + Rs. 35,000]		1,05,000
Facility of laptop	[WN-1]	Exempt
Leave travel concession -Exempt under Section 10(5)	[WN-3]	Exempt
Tax paid on employment (Employee's obligation met by employer)		3,000
Employer's contribution to R.P.F. in excess of 12% of basic salary (i.e., 6% of Rs. 8,80,000)	[WN-2]	52,800
Gross salary		14,80,800
Less: Standard Deduction u/s 16(ia)	[WN-4]	50,000
Professional tax u/s Section 16(iii)	[WN-2]	6,000
Taxable Salary		14,24,800

Working Notes:

- (1) As per Rule 3(7)(vii), facility of use of laptop and computer is an exempt perquisite, whether used for official or personal purpose or both.
- (2) As per Section 17(2)(iv), a "perquisite" includes any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee. Therefore, professional tax of Rs. 3,000 paid by the employer is taxable as a perquisite in the hands of Mr. Janakraj. As per Section 16(iii), a deduction from the salary is provided on account of tax on employment i.e. professional tax paid during the year.
Therefore, in the present case, the professional tax paid by the employer on behalf of the employee Rs. 3,000 is first included in the salary and deduction of the entire professional tax of Rs. 6,000 is provided from salary.

- (3) *Mr. Janakraj can avail exemption u/ s 10(5) on the entire amount of Rs. 45,000 reimbursed by the employer towards Leave Travel Concession since the same was availed for himself, his wife and three children and the journey was undertaken by economy class airfare. The restriction imposed for two children is not applicable in case of multiple births which take place after the first child.*
- (4) *As per Section 16(ia), standard deduction will be allowed from gross salary amounting Rs. 50,000 or the amount of salary, whichever is less.*

4

INCOME FROM HOUSE PROPERTY

Topic Referencer

- ✚ Basic Concepts of Taxability of Income from House Property
- ✚ Computation of Annual Value - Section 23
- ✚ Deductions from Annual Value - Section 24
- ✚ Special Provision for Arrears of Rent and Unrealised Rent Received Subsequently - Section 25A.
- ✚ Co-ownership and Deemed Ownership - Section 26 & 27

BASIC CONCEPTS OF TAXABILITY OF INCOME FROM HOUSE PROPERTY

1. *Chart of computation of Income from House Property:*

Particulars	Let out/ Deemed Let out/ Self occupied for a part of year and let out for another part.	Self-occupied property (One/Two) whose annual value is/are assessed at Nil u/s 23(2)
Gross Annual Value [Section 23(1)]	xxxx	Nil
Less: Municipal Taxes actually paid by the assessee during the previous year	xxxx	Nil
Net Annual Value (NAV)	xxxx	Nil
Less: Deductions under section 24		
(a) 30% of NAV	xxxx	Nil
(b) Interest on borrowed capital	xxxx	xxxx
Income from house property	(Actual interest payable without any limit)	(Actual interest upto maximum of Rs. 30,000 or Rs. 2,00,000)
	xxxx	xxxx

2. *Discuss the chargeability of Income from House Property under section 22.*

Ans: *Income from House Property [Section 22]:* The annual value of property consisting of any buildings or land appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to tax, shall be chargeable to income-tax under the head "Income from house-property".

Conditions to be fulfilled for the purpose of charging any income under this head:

- (1) Property must consist of any building or land appurtenant thereto -
 - (a) Scope of buildings : Buildings includes residential buildings, factory buildings, offices, shops, etc. Building constructed on leasehold/rented land is also covered here.
 - (b) Rent of vacant land - taxable under 'Income from Other Sources': Income from letting out any vacant land is not taxable as 'income from house property', but taxable as 'income from other sources', since vacant land cannot be taken as land appurtenant to a building.

(2) *Assessee must be the owner of such property -*

- (a) Ownership covers free-hold as well as leasehold rights and deemed ownership under section 27.
- (b) Ownership must exist in the previous year (not necessary to be in assessment year) of which assessment is to be done.

(3) *The property can be used for any purpose except for the purpose of business or profession of the assessee -*

- (a) *The property can be used for any purpose by the assessee, however it should not be used by him for the business or profession, whose profits are chargeable to tax.*

The income earned by an assessee engaged in the business of letting out of properties on rent would be taxable as business income. - Rayala Corporation (P) Ltd. v. Asstt. CIT [2016] 386ITR 500 (SC)

- (b) *In case property is used by the assessee for his own business, then neither the notional rent of property used shall be allowed as deduction while calculating business income nor the notional income shall be taxed under section 22. (Purpose incidental to business shall be considered as business purpose).*

(4) *Property held as stock-in-trade etc. :* Annual value of house property will be charged under the head "Income from house property", where it is held by the assessee as stock-in-trade of a business also.

However, the annual value of property being held as stock in trade would be treated as NIL for a period of two years from the end of the financial year in which certificate of completion of construction of the property is obtained from the competent authority, if such property is not let-out during such period. [Section 23(5)]

Exceptions:

- (a) ***Sublet receipts - Taxable under 'Income from Other Sources':*** In case of sub-letting, since the assessee is not the owner of the building sublet, hence the income derived therefrom shall not be taxable as income from house property, but shall be taxable as 'income from other sources'.

- (b) ***Principle of Mutuality:*** When the assessee is governed by principle of mutuality, then the income from property will also be governed by the said principle and hence, not taxable under the head 'Income from House Property'. E.g. - Annual value of property of a social club will be outside the scope of the levy of income tax.

- (c) ***Letting is incidental to main business :*** In case the letting out of property is incidental to the main business, then income from such property shall be taxable as 'Profits and gains of business or profession'. E.g. - An assessee lets out his house property to his employees/directors for efficient conduct of his business, then such property will be considered as being used for the business purpose and hence, taxable as 'Profits and gains of business or profession'.

- (d) ***Assessee's property used for his partnership firm :*** In case any property is owned by an assessee and the same is given by him to the partnership firm, in which he is a partner, for carrying on the business of such firm, then it will be treated as if the property is used by the assessee for his own business and thus, the income from such property will not be taxable under this head.

However, if property owned by HUF is given on rent to a firm in which members of HUF are partners in their personal capacity, then the rental income from such property shall be taxed as 'income from house-property' in the hands of HUF.

3. State the head of income in the following cases under which the receipt is to be assessed and comment.
- A uses his property for his own business. Can he claim depreciation?
 - B lets out his property to X. X sublets it. How is sub-letting to be assessed in the hands of X?
 - C has built a house on a leasehold land. He has let out the property and claims the rent as income from house property and deducted expenses on repairs, security charges, insurance and collection charges totalling to 40% of receipts. (4 Marks, IPCC May 2013)

Ans: The taxability of income under various heads is as under -

- Yes, even if property is used for assessee's own business depreciation is allowed u/s 32 of Income-tax Act, 1961.
- Income from sub-letting is taxable under the head income from other sources.
- Even if property is built on a leasehold land the assessee will be regarded as owner of such house property and rental income will be taxed under Income from house property. However, standard deduction of 30% of net annual value is allowed while computing income from house property. Hence, he will not be entitled deduction on repairs, security charges, insurance and collection charges totalling to 40% of receipts.

4. Explain briefly the applicability of Section 22 for chargeability of income-tax for house-property with disputed ownerships Marks, IPCC Nov. 2010)

Ans: **Disputed Ownership :** If the title of ownership of the house property is under dispute in a court of law, the decision about who is the owner lies with the Income tax Department. The assessment cannot be held up for such dispute. Generally, a person who receives the income or who enjoys the possession of the house property as owner, though his claim is under dispute, is assessable to tax under section 22.

5. What do you understand by "Composite Rent"? What is the tax treatment of Composite Rent under the Income- tax Act, 1961 Rs. (6 Marks, May 2008)

Ans: Composite Rent: The rent received by the owner of a property in respect of building as well as other assets like furniture, plant & machinery etc.; or for different services in the building like lifts, security, etc., is known as Composite Rent.

Tax Treatment of Composite Rent:

- Composite Rent including rent for letting out of property as well as rendering of services -
 - Where letting out of property and rendering of services are two different line of activities or two different sources : To be apportioned as 'property income' and 'business income or income from other sources'.
 - Where the two activities are related to the extent that they form a single activity for all purposes, then -
 - if the main intention is letting out the property: It will be taxable under Income from House-Property.
 - if the main intention is to exploit the immovable property by way of complex commercial activities : It will be taxable under Profits & gains of business or profession.

- (2) **Composite Rent including rent for letting out of building as well as other assets like plant, machinery, furniture:** According to Section 56(2) (iii) -
- If letting of property is inseparable from letting of other assets : Entire income is taxable as 'Business income or Income from other sources'.
 - If letting of property is separable from letting of other assets : Rent for house is taxable as 'House property income' and rent for other assets is taxable as 'Business income or income from other sources'.

COMPUTATION OF ANNUAL VALUE - SECTION 23

6. How is the annual value of a House Property computed ?

Ans: The annual value of a House Property is computed in the following two steps -

- Computation of Gross Annual Value (GAV) as per section 23(1).
 - Computation of Net Annual Value (NAV).
- Computation of Gross Annual Value (GAV) [Section 23(1)] :** For the purpose of Section 22, the gross annual value shall be deemed to be -

 - Expected Rent [Section 23(1) (a)] :** Expected rent is the sum for which the property might reasonably be expected to be let out from year to year. It is the sum higher of Fair Rent and Municipal Rent (Valuation) but it cannot exceed Standard Rent fixed by any Rent Control Act.
Expected Rent (ER) = Municipal Valuation or Fair Rent, whichever is higher, subject to maximum of Standard Rent.
 - If Actual Rent Received or Receivable (ARR) exceeds Expected Rent (ER) - ARR to be GAV [Section 23(1) (b)]:** Where the property or any part of property is let out and the actual rent received or receivable by the owner is in excess of the sum referred to in (a) above, amount so received or receivable shall be GAV. Gross Annual Value (GAV) = Actual Rent Received or Receivable (ARR), if ARR exceeds ER.
 - Actual rent received/ receivable (ARR) is less than Expected Rent (ER) [Section 23(1)(c)] :** Where the property or any part of the property is let out and was vacant during the whole or any part of the previous year and owing to such vacancy, the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in (a) above, amount so received or receivable shall be GAV.

Gross Annual Value (GAV) = Actual Rent Received or Receivable (ARR).
- Computation of Net Annual Value (NAV) :** Net Annual Value is the sum arrived at after deducting the taxes levied by any local authority on such property paid by owner, from the Gross Annual Value.
NAV = Gross annual value - Municipal Taxes paid by the owner during the previous year.

Notes:

(A) Treatment of Unrealised Rent: Unrealised Rent shall be deducted from actual rent received or receivable if it is proved to be lost and irrecoverable.
As per Rule 4, the amount of rent which the owner cannot realise (Unrealised Amount) shall be equal to the amount of rent payable but not paid by a tenant of the assessee and so proved to be lost and irrecoverable, where -

 - the tenancy is bona fide;

- (ii) the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;
- (iii) the defaulting tenant is not in occupation of any other property of the assessee; and
- (iv) 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.

- (B) **Determining whether Actual rent received/receivable is less than Expected rent, due to vacancy or not** : Expected rent shall be made proportionate for the period for which property is let out i.e. Proportionate Expected Rent (PER) shall be calculated as follows :

$$ARR = \frac{ER \text{ for 12 months} \times \text{Months for which property was let out}}{12}$$

If ARR exceeds PER , it means that the ARR is less than ER due to vacancy and hence, $GAV =$

If ARR is less than PER , it means that the ARR is less than ER not due to vacancy but on account of other factors and hence, $GAV = ER$ for 12 months.

- (C) **Deduction of Municipal Taxes**: Municipal taxes are allowed as deduction only if they have been actually paid by the assessee himself during the previous year, irrespective of the year to which such taxes relate.

As per Section 27(vi), taxes levied by a local authority in respect of any property shall be deemed to include service taxes levied by local authority in respect of the property.

Taxes must be paid by assessee; if they have been paid by tenant, no deduction will be allowed.

- (D) **Vacancy for the whole year** : If the property was vacant during the whole of the previous year, then the annual value of such property shall be NIL because in that case ARR shall be NIL and it is less than the ER owing to such vacancy.

Illustration 1 - Computation of Gross Annual Value : Mr. Vaibhav owns five houses at Cochin. Compute the gross annual value of each house from the information given below :

(5 Marks, PCC May 2012)

Particulars	House-I	House-II	House-III	House-IV	House-V
Municipal Value	1,20,000	2,40,000	1,10,000	90,000	75,000
Fair Rent	1,50,000	2,40,000	1,14,000	84,000	80,000
Standard Rent	1,08,000	N.A.	1,44,000	N.A.	78,000
Actual Rent Received / Receivable	1,80,000	2,10,000	1,20,000	1,08,000	72,000

Solution: Computation of Gross Annual Value (amount in Rs.)-

Particulars	House-I	House-II	House-III	House-IV	House-V
Expected Rent [WN]	1,08,000	2,40,000	1,14,000	90,000	78,000
Actual rent receivable	1,80,000	2,10,000	1,20,000	1,08,000	72,000
Gross Annual value (Higher of the above two)	1,80,000	2,40,000	1,20,000	1,08,000	78,000

Working Note : ER = Municipal Value or Fair Rent, whichever is higher subject to maximum of Standard Rent.

Illustration 2 - Computation of Gross Annual Value : Vinod is the owner of the three houses, which are all let out and covered by the Rent Control Act. From the following particulars, find out the gross annual value in each case : (Rs.)

Particulars	House - I	House - II	House - III
Municipal value	30,000	26,000	35,000
Annual rent	42,000	36,000	30,000
Fair rent	36,000	28,000	30,000
Standard rent	30,000	35,000	36,000
Unrealised rent	7,000	9,000	2,500
Period of vacancy	1 month	2 months	3 months

Solution: Computation of Gross Annual Value (amount in Rs.) - (CS Dec. 2003)

Particulars		House I	House II	House III
Expected rent	[WN-1]	30,000	28,000	35,000
Let out period (in months)		11	10	9
Proportionate Expected Rent for the let out period (PER)	[WN-2]	27,500	23,333	26,250
Actual rent for let out period		38,500	30,000	22,500
Actual rent received (ARR)	[WN-3]	31,500	21,000	20,000
Gross Annual Value (GAV)	[WN-4]	31,500	28,000	35,000

Working Notes:

- (1) ER = Municipal Value or Fair Rent, whichever is higher subject to maximum of Standard Rent.
- (2) $PER = ER \times \text{Let-out period} \div 12$.
- (3) ARR = Actual rent - Unrealised rent.
- (4) If ARR is greater than or equal to PER , then $GAV = ARR$, otherwise $GAV = ER$.

7. Explain the mode of computation of annual value in case of a self-occupied house property.

Ans: **Self-Occupied Property [Section 23(2)]:** Where the property consists of a house or part of a house which -

- (a) is in the occupation of the owner for the purposes of his own residence; or
- (b) cannot actually be occupied by the owner by reason of the fact that owing to his employment, business or profession carried on at any other place, he has to reside at that other place in a building not belonging to him i.e. (unoccupied property), the annual value of such house or part of the house shall be taken to be Nil.

The benefit of "Nil" Annual Value is available for two self-occupied or unoccupied house properties i.e. for either one house property or two house properties.

Notes:

- (i) Since here annual value will be NIL, hence municipal taxes paid have no relevance.
- (ii) The annual value will be NIL only if self-occupied by the owner himself, hence no such benefit of self occupation is available if occupied by the relatives of the owner.
- (iii) If the assessee has let out his house property to his employer and the employer has allotted the same to the assessee as rent-free quarters, then such house property allotted cannot be considered as self-occupied by the assessee under section 23(2), and hence no benefit shall be available to the assessee.

- (iv) The benefit of "Nil" Annual Value in respect of upto two self-occupied house properties is available only to an individual/HUF.

8. What will be the tax treatment of House Property if it is -

- (i) Let out for certain period and self-occupied for the remaining period; or
- (ii) Let out for certain portion and self-occupied for the remaining portion.

Ans: The tax treatment is as under -

- (1) House property let out for certain period and self-occupied for the remaining period :** As per Section 23(3), the annual value will not be taken as Nil if -

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

Hence, in such case annual value shall be computed as per Section 23(1) i.e. actual rent for let-out period shall be compared with expected rent of 12 months to determine the gross annual value.

- (2) House property let out for certain portion and self-occupied for the remaining portion:**

- (a) The annual value of let out portion will be computed as per the provisions of Section 23(1) and the value of self-occupied portion as per the provisions of Section 23(2) (a) i.e. the value will be Nil of such self-occupied portion.
- (b) If municipal value or fair rent are not given separately, then they are to be apportioned between the let out portion and self-occupied portion on some reasonable basis, E.g.- plinth area, built-up floor space, etc.

9. How is the Income from House Property determined in case the assessee owns two or more houses and all are self-occupied ?

Ans: Deemed to be let-out property [Section 23(4)] : Where more than two houses are self occupied by the assessee then —

- (i) the provisions of section 23(2) shall apply only in respect of two of such houses, which the assessee may, at his option, specify in this behalf i.e. two houses at option of assessee shall be treated as self-occupied;
- (ii) the annual value of the other house(s) shall be determined u/s 23(1) as if such house(s) had been let-out.

10. Mr. Rohan a resident individual, owns 3 houses in Chennai. Two houses are self occupied by him and the third house is vacant during the year. You are required to highlight the steps involved to compute Income From House Property for Mr. Rohan under deemed to be let out concept. (5 Marks, May 2018)

Ans: The relevant provisions are discussed as under :

- (1)** Since Mr. Rohan has two properties for self-occupation in respect of which he does not derive any benefit, the income from both of such properties shall be computed under the self-occupied property category and its annual value will be Nil. No deduction towards municipal tax paid is allowable on such self occupied property. However, interest on moneys borrowed is allowable subject to conditions specified in section 24. (i.e. one-fifth of pre-construction interest, if any, and interest accrued during the year together subject to monetary limit of Rs.2,00,000 or Rs. 30,000, as the case may be).

- (2) *The annual value of vacant property would also be treated as 'Nil' if the property was not occupied by the owner by reason of his employment, business or profession at a different place and he resides at such other place in a building not belonging to him.*
- (3) *As Mr. Rohan does not satisfy the condition mentioned above, the vacant property would be treated as deemed let out property.*
- (4) ***In case of deemed let-out property :***
- *The expected rent (higher of municipal value and fair rent, but restricted to standard rent) shall be taken as the Gross Annual Value.*
 - *Municipal taxes paid by Mr. Rohan during the year would be allowed as deduction from gross annual value to arrive at the net annual value.*
 - *In computing the income from such deemed let out house properties, deduction @ 30% of net annual value and actual interest payable (plus one-fifth of pre-construction period interest, if any) would be allowable as deduction from net annual value.*
- (5) *The question of considering actual rent received/receivable does not arise in case of deemed let out property. Consequently, no adjustment is necessary on account of property remaining vacant for part of the year or unrealized rent.*

11. *Explain the provisions of computation of Income from house property which is held by the assessee as stock in trade.*

Ans: ***House property held as stock in trade - Notional income not to be taxable upto two years [Section 23(5)] :*** *The annual value of property or part of the property shall be taken as Nil if the following conditions are to be satisfied—*

- (i) *The property must consist of any building or land appurtenant thereto is held as stock-in-trade by the owner of the property.*
- (ii) *The property or any part of the property is not let during the whole or any part of the previous year. However, the annual value of such property or part of the property shall be taken as NIL only for the period up to two years from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority.*

Illustration 3 - Computation of Income from House Property : *XYZ Ltd. is engaged in construction of residential flats. One building consisting of 25 residential apartments was constructed and completion certificate was obtained on 15-07-2018. Out of 25 residential apartments 5 apartments remained unsold upto 31-03-2022. The expected rent of each apartment is Rs. 30,000 per month. You are required to determine Income from House property for Assessment Year 2021-22 and Assessment Year 2022-23.*

Solution: *As per provisions of Section 23(5), where the house property consisting of any building and land appurtenant thereto is held as stock-in-trade and the property or any part of the property is not let during the whole or any part of the previous year, the annual value of such property or part of the property, for the period upto two years from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority, shall be taken to be nil.*

Thus, the income from house property upto 31-03-2021 i.e., two years from end of Financial Year 2018-19 shall be taken as NIL. Thus, income from house property for AY 2021-22 shall be taken as NIL.

Computation of Income from House property for Assessment Year 2022-23:

	(amount in ₹.)
Expected Rent being Gross annual value (₹. 30,000 × 12 × 5)	18,00,000
Less: Municipal taxes paid	Nil
Net Annual Value	18,00,000
Less: Deductions under section 24 (Statutory deduction @ 30% of NAV)	5,40,000
Income from House Property	12,60,000

DEDUCTIONS FROM ANNUAL VALUE - SECTION 24:

12. Discuss the various deductions allowed while computing Income from House Property.

Ans: **Deductions under section 24 :** Income chargeable under the head "Income from house property" shall be computed after making the following deductions, namely -

(a) **Statutory deduction :** A sum equal to 30% of annual value;

(b) **Interest on borrowed capital :** Where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital.

Pre-construction/ acquisition period : Where the property has been acquired or constructed with borrowed capital, then the interest payable on such borrowed capital, relating to pre-acquisition or pre-construction period, shall be allowed in 5 equal installments beginning with the previous year in which house is completed and 4 succeeding years. Where -

(A) **Pre-acquisition/ pre-construction period shall -**

(i) start from the date of borrowing; and

(ii) end on -

(a) 31st March preceding the year of completion of construction or acquisition; or

(b) on the date of actual repayment of loan, whichever is earlier.

(B) Interest of pre-acquisition or pre-construction period = Loan taken for acquisition and construction of a house property × Rate of Interest × Pre-acquisition or pre-construction period.

Maximum deduction for interest allowable when the one/two houses are Self-occupied/unoccupied :

The maximum limit is ₹. 2,00,000 (for one or two houses in aggregate) with following break-up -

Case	Amount of deduction
(1) Interest on capital borrowed on or after 1-4-1999 for acquisition or construction of house/ s. (A) Conditions: This case is applicable only if - (i) such acquisition or construction is completed within 5 years from the end of the financial year in which capital was borrowed; and (ii) the assessee furnishes a certificate, from the person to whom any interest is payable on the capital borrowed, specifying the amount of interest payable by the assessee. (B) New loan also covered : Deduction is admissible even if the interest pertains to a new loan taken by the assessee for repayment of whole or any part of capital borrowed earlier.	Actual interest payable in aggregate for one or two self-occupied properties, subject to maximum of ₹. 2,00,000
(2) In any other case i.e. If the interest relates to — (A) Capital borrowed before 1-4-1999 for acquisition, construction, repair renewal or reconstruction of house property; or (B) Capital borrowed on or after 1-4-1999 for repair, renewal or reconstruction	Actual interest payable in aggregate for one or two self-occupied properties, subject to a maximum of ₹. 30,000.

of house; or (C) Capital borrowed as per (1) above but any condition mentioned therein is not satisfied.	
Objective of amendment : Section 24 has been amended to provide that the monetary limit of deduction on account of interest payable on borrowed capital shall continue to apply to the aggregate of the amounts of deduction in case of more than one self-occupied houses.	

Notes:

- (1) **Scope of 'interest':** Interest includes service fee or other charges in respect of money borrowed. Hence, brokerage or commission to arrange the loan is deductible as interest on capital borrowed.
- (2) Interest on unpaid interest is not deductible as this interest is not on funds borrowed. - *Shew Kissen Matter v. CIT* [1973] 89 ITR 61 (SC).
- (3) **Interest on unpaid purchase price :** If instead of borrowing, buyer opts to pay to the seller in instalments, then interest on unpaid amount is deductible. - *CIT v. Sunil Kumar Sharma* [2002] 254 ITR 103 (P&H).
- (4) **No standard deduction in case of self occupied property :** In case of self-occupied property, statutory deduction of 30% under section 24(a) is not allowed as the NAV is NIL.
- (5) In case certain portion of a house property is let out and the remaining portion is self-occupied, then deduction in respect of let out portion is without any limit whereas interest relating to the self-occupied portion shall be subject to Rs. 30,000 or Rs. 2,00,000 as the case may be.

- **Illustration 4 - Self occupied properties :** Mr. Naman owns two house properties one at Mumbai, wherein his family resides and the other at Delhi, which is unoccupied. He lives in Chandigarh for his employment purposes in a rented house. For acquisition of house property at Mumbai, he has taken a loan of Rs. 25 lakh @ 12% p.a. on 01-04-2019. He has not repaid any amount so far. In respect of house property at Delhi, he has taken a loan of Rs. 6 lakh @ 11% p.a. on 01-10-2019 towards repairs. Compute the deduction which would be available to him under section 24(b) for A.Y. 2021-22 in respect of interest payable on such loan.

Solution: Mr. Naman can claim benefit of Nil Annual Value in respect of his house property at Mumbai and Delhi, since no benefit is derived by him from such properties, and he cannot occupy such properties due to reason of his employment at Chandigarh, where he lives in a rented house.
Computation of deduction u/s 24(b) for A.Y. 2021-22 (amount in Rs.):

Interest on loan taken for acquisition of residential house property at Mumbai [Rs. 25,00,000 $\times$ 12% = Rs. 3,00,000 (restricted to Rs. 2,00,000)]	2,00,000
Interest on loan taken for repair of residential house property at Delhi [Rs. 6,00,000 $\times$ 11% = Rs. 66,000 (restricted to Rs. 30,000)]	30,000
Total Interest	2,30,000
Deduction u/s 24(b) in respect of (I) and (II) above to be restricted to -	2,00,000

Illustration 5 - Self occupied properties: Nisha has two houses, both of which are self occupied. The particulars of these are given below:

Particulars	(Value in Rs.)	
	House - I	House - II
Municipal Valuation per annum	1,20,000	1,15,000
Fair Rent per annum	1,50,000	1,75,000

Standard rent per annum	1,00,000	1,65,000
Date of completion	31-03-2018	31-03-2019
Municipal taxes payable during the year (paid for House II only)	12%	8%
Interest on money borrowed for acquisition of house properties	1,80,000	80,000

Compute Nisha's income from the House Property for the Assessment Year 2021-22.

Solution: Section 23 of the Income-tax Act provides relief to the taxpayer by allowing him an option to claim nil annual value in respect of any two houses, declared as self-occupied. Besides this section 24 of the Income-tax Act provides that the monetary limit of deduction on account of interest payable on borrowed capital i.e. Rs. 30,000/Rs. 2,00,000 shall continue to apply to the aggregate of the amounts of deduction in case of more than one self-occupied houses. Hence, the Income from house property shall be computed as under :

Computation of income from houses when they are treated as self-occupied (amount in Rs.)

Particulars	House I and II
Annual Value [Since both the houses are self occupied]	Nil
Less: Interest on loans [House -I: Rs. 1,80,000 and House - II: Rs. 80,000 (Restricted to 2,00,000)]	2,00,000
Income from house property	-2,00,000

Illustration 6 - Self occupied properties: Mr. X has three houses, all of which are self occupied . The particulars of these are given below:

Particulars	(Value in Rs.)		
	House - I	House - II	House - III
Municipal Valuation per annum	1,20,000	1,15,000	2,00,000
Fair Rent per annum	1,50,000	1,75,000	2,50,000
Standard rent per annum	1,00,000	1,65,000	2,40,000
Date of completion	31-03-2018	31-03-2019	31-03-2019
Municipal taxes payable during the year (paid for House II and III only)	12%	8%	10%
Interest on money borrowed for acquisition of house properties	1,80,000	80,000	75,000

Compute Mr. X income from the House Property for the Assessment Year 2021-22.

Solution: Section 23 of the Income-tax Act provides relief to the taxpayer by allowing him an option to claim nil annual value in respect of any two houses, declared as self-occupied, instead of one such house as provided earlier. Besides this section 24 of the Income-tax Act provides that the monetary limit of deduction on account of interest payable on borrowed capital i.e. Rs. 30,000/ Rs. 2,00,000 shall continue to apply to the aggregate of the amounts of deduction in case of more than one self-occupied houses. Thus, assessee has the following options:

Option I : House I and II self occupied and House III - deemed to be let out.

Option II : House I and III self occupied and House II - deemed to be let out.

Option III : House II and III self occupied and House I - deemed to be let out.

The lowest value of house property amongst the above options shall be offered for taxation.

Hence, the Income from house property shall be computed as under:

(1) Computation of income from houses when they are deemed to be let out

(amount in ₹.) -

Particulars	House-I	House-II	House-III
Gross Annual Value [Note-A]	1,00,000	1,65,000	2,40,000
Less: Municipal taxes paid [Note-B]	Nil	9,200	20,000
Net Annual Value	1,00,000	1,55,800	2,20,000
Less: Deductions under section 24 -			
(a) Statutory Deduction @ 30% of NAV	30,000	46,740	66,000
(b) Interest on loans	1,80,000	80,000	75,000
Income from house	-1,10,000	29,060	79,000

Notes:

- (A) GAV = Municipal Value or Fair Rent, whichever is higher subject to maximum of Standard Rent.
- (B) Municipal taxes actually paid shall only be allowed as deduction.

(2) Computation of income from houses when they are treated as self-occupied (amount in ₹.) -

Particulars	House I & II	House I & III	House II & III
Annual Value [Since both the houses are self occupied]	Nil	Nil	Nil
Less: Interest on loans (Restricted to 2,00,000)	2,00,000	2,00,000	1,55,000
Income from house property	-2,00,000	-2,00,000	-1,55,000

(3) Hence, the taxable value shall be arrived as under:

Option	Total
Option I: House I and II self occupied and House III - deemed to be let out	-1,21,000
Option II: House I and III self occupied and House II - deemed to be let out	-1,70,940
Option III: House II and III self occupied and House I - deemed to be let out.	-2,65,000

Since the lowest value is in option III, hence the Income from house property will be ₹. (- 2,65,000.)

13. List the circumstances as per Section 25 in which interest payable outside India is not deductible.

Ans: Amounts not deductible [Section 25]: Notwithstanding anything contained in Section 24, any interest chargeable under this Act -

- which is payable outside India;
 - on which tax has not been paid or deducted; and
 - in respect of which there is no person in India who may be treated as an agent under section 163;
- shall not be allowed as deduction in computing the income chargeable under the head "Income from house property".

Illustration 7 - Interest on borrowed capital: Arvind commenced construction of a residential house, intended exclusively for his residence, on 01-11-2019. He raised a loan of ₹. 10,00,000 at 12% interest for the purpose of construction on 01-11-2019. Finding that there was an over-run in the cost of construction, he raised a further loan of ₹. 12,00,000 at the same rate of interest on 1-10-2020. What is the interest allowable under section 24, assuming that the construction was completed by 31-3-2021? (May 2000)

Solution: According to Section 23(2), the annual value shall be taken as NIL since the house is self-occupied by the assessee.

Thus, the interest allowable (including interest relating to pre-construction period) will be subject to maximum limit of Rs. 2,00,000. Pre-construction period shall start from 01-11-2019 and end on 31-03-2020 i.e. (31st March preceding the date of completion of construction). Computation of interest allowable under section 24(b) (amounts in Rs.) -

Total pre-construction interest	[WN-1]	50,000
Pre-construction interest allowable in assessment year 2021-22 (1/5th of above)		10,000
Current year interest	[WN-2]	1,92,000
Total interest		2,02,000

Hence, total amount deductible under section 24(b) = Rs. 2,00,000.

Working Notes:

- (1) Pre-construction interest = Rs. 10,00,000 $\times$ 12% $\times$ 5 $\div$ 12 (from 1-11-2019 to 31-3-2020) = Rs. 50,000.
- (2) Current year interest (FY 2020-21) = Loan-I: Rs. 10 lakhs $\times$ 12% $\times$ 1 + Loan-II: Rs. 12 lakhs $\times$ 12% $\times$ 6 $\div$ 12 = Rs. 1,92,000.

Illustration 8 - Determination of heads of income for taxability: In the following cases, state the head of income under which the receipt is to be assessed and comment-

- (a) X Ltd. lets out its property to Y. Y sublets the same.
- (b) X has built a house on a leasehold land. He has let out the above property and claims income from House Property under other Sources and deducted expenses on repair, security charges, insurance and collection charges in all amounting to 40% of receipts. (Nov. 2002)

Solution: (a) Rent paid by Y will be taxed in hands of X Ltd. as "Income from House Property". However, income from subletting (Subletting receipts Less rent paid to X Ltd.) shall be taxed as "Income from Other Sources" in hands of Y.

- (b) House constructed on leasehold land is assessable under head "Income from house property", hence the rent therefrom shall be taxable as Income from house property. Further, the standard deduction under section 24 @ 30% of NAV and interest on capital borrowed will only be allowable to him.

Illustration 9 - Self-occupied and let out property period wise : Ram owned a house property at Madras which was occupied by him for the purpose of his residence. He was transferred to Bombay in June, 2020 and therefore he let out the property with effect from 1-7-2020 on a monthly rent of Rs. 3,000. The corporation tax payable in respect of the property was Rs. 6,000 of which 50% was paid by him before 31-3-2021. Interest on money borrowed for the construction of the property amounted to Rs. 20,000. Compute the income from house property. (May 1997)

Solution: Computation of Income from House Property (amount in Rs.)

Annual value	[WN-1]	36,000
Less: Municipal taxes paid (Rs. 6,000 $\times$ 50%)	[WN-2]	3,000
Net Annual Value (NAV)		33,000
Less: Deductions under section 24 -		
(a) Standard deduction @ 30% of NAV		9,900

(b) Interest on borrowed capital	20,000
Income from House Property	3,100

Working Notes:

- (1) Where the property is let for a part of a year and self-occupied for remaining period, the benefit of self-occupation shall not be available and the annual value shall be determined as per Section 23(1)(a).
Thus, annual value =
- (a) Expected Rent i.e. $\text{Rs. } 3,000 \times 12 = \text{Rs. } 36,000$; or
- (b) Actual Rent i.e. $\text{Rs. } 3,000 \times 9 = \text{Rs. } 27,000$; whichever is higher.
- (2) Municipal taxes paid by Ram shall only be allowed as deduction.

14. Explain briefly the applicability of Section 22 for chargeability of income-tax for house-property situated in foreign country. (May 2003) (2 Marks, IPCC Nov. 2010)

Ans: **House property situated in foreign country :** The income from house-property situated in foreign country shall be taxable in India as per the provisions of Sections 22 to Section 27 if, -

(i) the owner is resident in India; or

(ii) the owner is non-resident or not ordinarily resident and the income is received by him in India. The municipal taxes paid by the owner outside India shall be allowed as deduction only if they have been actually paid by him in the previous year.

Illustration 10 - Let-out property : Rajeev owns a house, which is self-occupied upto 31-5-2020. W.e.f. 1-6-2020, the property is let to Rafi at Rs. 20,000 p.m. On 1-12-2020, Rafi vacated the house and the property after remaining vacant for one month, was let to Rachna w.e.f. 1-1-2021 at Rs. 25,000 p.m. Determine the Gross Annual Value of the house if the expected rent of the property is - (a) Rs. 2,00,000 or (b) Rs. 3,00,000.

Solution: In this case, the property is -

- self-occupied for 2 months;
- let-out for 9 months; and
- vacant for 1 month. Hence, no benefit of self-occupation will be available.

The Actual Rent Receivable (ARR) for 9 months will be compared with Proportionate Expected Rent (PER) for 11 months to determine the Gross Annual Value.

- (a) Case I - If expected rent is Rs. 2,00,000 : In this case -
 $ARR = \text{Rs. } 20,000 \times 6 + \text{Rs. } 25,000 \times 3 = \text{Rs. } 1,95,000$;
 $PER = \text{Rs. } 2,00,000 \times 11/12 = \text{Rs. } 1,83,333$.
 This implies that since ARR is greater than PER, hence ARR is less than ER on account of vacancy.
 Therefore, $GAV = ARR = \text{Rs. } 1,95,000$.
- (b) Case 2 - If expected rent is Rs. 3,00,000: In this case -
 $ARR = \text{Rs. } 20,000 \times 6 + \text{Rs. } 25,000 \times 3 = \text{Rs. } 1,95,000$;
 $PER = \text{Rs. } 3,00,000 \times 11/12 = \text{Rs. } 2,75,000$.

This implies that since ARR is less than PER, hence ARR is less than ER not on account of vacancy but due to other reasons.

Therefore, $GAV = ER = \text{Rs. } 3,00,000$.

Illustration 11 - Deemed to be let out property - Computation of Income from House Property: Mr. X owns one residential house in Mumbai. The house is having two units. First unit of the house is self-occupied by Mr. X and another unit is rented for 8,000 p.m. The rented unit was vacant for 2 months during the year. The particulars of house are:

Standard rent	Rs. 1,62,000 p.a.
Municipal valuation	Rs. 1,90,000 p.a.
Fair rent	Rs. 1,85,000 p.a.
Municipal tax	15% of municipal value
Light and water charges	Rs. 500 p.m.
Interest on borrowed capital	Rs. 1,500 p.m.
Lease money	Rs. 1,200 p.a.
Insurance charges	Rs. 3,000 p.a.
Repairs.	Rs. 12,000 p.a.

Compute the income from house property of Mr. X. (9 Marks, PCC Nov. 2008) Solution: Computation of Income from House Property of Mr. X (amount in Rs.)—

(1) In case of Unit-I (self-occupied):

Net Annual Value	Nil
Less: Interest on the borrowed capital u/s 24(b) (Rs. 1,500 $\times$ 12 $\times$ 1/2)	9,000
Net Income from Unit - I	-9,000

(2) In case of Unit-II (let-out):

Expected Rent	[WN-1]	81,000
Actual rent received (Rs. 8,000 $\times$ 10)		80,000
Proportionate Expected Rent (PER)	[WN-2]	67,500
Gross Annual Value	[WN-3]	80,000
Less: Municipal taxes paid (15% of Rs. 1,90,000 $\times$ 1/2)		14,250
Net Annual Value		65,750
Less: Deductions under section 24 -		
(a) Statutory deduction @ 30 % of NAV		19,725
(b) Interest on the borrowed capital (Rs. 1,500 $\times$ 12 $\times$ 1/2)		9,000
Net Income from Unit - II	37,025	

Thus, total Income from House Property = (Rs.) - 9,000 + 37,025 = Rs. 28,025. Working Notes:

- (1) $ER = \text{Fair Rent Rs. 92,500 or Municipal Value Rs. 95,000, whichever is higher; subject to maximum of Standard Rent Rs. 81,000.}$
- (2) $PER = \text{Expected Rent } \times 10 \div 12 = \text{Rs. } 81,000 \times 10 \div 12 = \text{Rs. } 67,500.$
- (3) Since ARR is greater than PER , therefore, ARR is less than ER on account of vacancy hence ARR is GAV .

Illustration 12 - Computation of Income from House Property : Mr. Krishna owns a residential house in Delhi. The house is having two identical units. First unit of the house is self-occupied by Mr. Krishna and another unit is rented for Rs. 12,000 p.m. The rented unit was vacant for three months during the year. The particulars of the house for the previous year 2020-21. are as under:

Standard Rent	Rs. 2,20,000 p.a.

Municipal Valuation	Rs. 2,44,000 p.a.
Fair Rent	Rs. 2,35,000 p.a.
Municipal tax paid by Mr. Krishna	12% of the Municipal Valuation
Light and water charges	Rs. 800 p.m.
Interest on borrowed capital	Rs. 2,000 p.m.
Insurance charges	Rs. 3,500 p.a.
Painting expenses	Rs. 16,000 p.a.
Compute income from house property of Mr. Krishna. (8 Marks, Nov. 2013)	

Solution: Computation of Income from House Property of Mr. Krishna (amount in Rs.) –

(i) In case of Unit-I (Self-occupied):

Net Annual Value	Nil
Less: Interest on the borrowed capital u/s 24(b) ($2,000 \times 12 \times 1/2$)	12,000
Net Income from Unit -I	-12,000

(ii) In case of Unit-II (Let-out):

Expected Rent	[WN-1]	1,10,000
Actual rent received (Rs. 12,000 $\times$ 9)		1,08,000
Proportionate Expected Rent (PER)	[WN-2]	82,500
Gross Annual Value	[WN-3]	1,08,000
Less: Municipal taxes paid (12% of Rs. 2,44,000 $\times$ 1/2)		14,640
Net Annual Value		93,360
Less: Deductions under section 24 -		
(a) Statutory deduction @ 30 % of NAV		28,008
(b) Interest on the borrowed capital $2,000 \times 12 \times 1/2$		12,000
Net Income from Unit - II		53,352

Thus, total Income from House Property = Rs. -12,000 + Rs. 53,352 = Rs. 41,352.

Working Notes:

- (1) $ER = \text{Fair Rent Rs. 1,17,500 or Municipal Value Rs. 1,22,000 whichever is higher; subject to maximum of Standard Rent Rs. 1,10,000.}$
- (2) $PER = \text{Expected Rent } \times 9 \div 12 = \text{Rs. 1,10,000 } \times 9 \div 12 = \text{Rs. 82,500.}$
- (3) Since ARR is greater than PER , therefore, ARR is less than ER on account of vacancy hence ARR is NAV .

Illustration 13 - Computation of Income from House Property : A and B construct their houses on a piece of land purchased by them at New Delhi. The built up area of each house is 1,000 sq. ft. (ground floor and an equal area in the first floor). A starts construction on April 1, 2019 and completes it on March 31, 2020. B starts the construction on April 1, 2019 and completes on June 30, 2020 and lets out the first floor for a rent of Rs. 15,000 per month. The tenant vacates the house on December 31, 2020 and B occupies the entire house during the period January 1, 2021 to March 31, 2021. The following are the other informations (amount in Rs.):

Fair rental value of each unit (ground floor/first floor) (per annum)	72,000
Municipal value of each unit (ground floor/first floor) (per annum)	1,00,000
Municipal taxes paid by — A	8,000

-B	8,000
Repair and maintenance charges paid by — A	28,000
- B	30,000

A has availed a housing loan of Rs. 20 lakhs @ 12% on April 1, 2019. B has availed a housing loan of Rs. 12 lakh @ 10% on July 1, 2019. No repayment is made by either of them till March 31, 2021. Compute the Income from house property. (Nov. 2003)

Solution: Computation of Income from House Property of A and B (amounts in Rs.) –

(1) In case of Mr. A:

Net Annual Value (self-occupied)	Nil
Less: Interest on borrowed capital [WN]	2,00,000
Income from House Property	-2,00,000

Working Note : 'A' started construction on 01-04-2019, which ended on 31-03-2020. Since A had taken loan on 01-04-2019 and the construction was completed on 31-03-2020, there is no pre-construction period. Thus, interest from 01-4-2020 to 31-03-2021 i.e. Rs. 2,40,000 shall be deductible, subject to maximum of Rs. 2,00,000.

(2) In case of Mr. B :

Particulars	Unit 1 - Self occupied	Unit 2 - Partly SOP and partly let out
Expected Rent [WN-1]	-	75,000
ARR (Rs. 15,000 x 6)	-	90,000
Gross Annual Value [WN-2]	-	90,000
Less: Municipal taxes (50% of 8,000)	-	4,000
Net Annual Value	Nil	86,000
Less: Deductions under section 24 —		
(a) Statutory deduction @ 30% of NAV	-	25,800
(b) Interest on borrowed capital [WN-3]	69,000	69,000
Income from House Property	-69,000	-8,800

Working Notes:

- (1) ER = Municipal value (of 9 months) or Fair rent (of 9 months), whichever is higher = higher of Rs. 75,000 or Rs. 54,000 = Rs. 75,000. B has occupied the ground floor for self-occupation from 01-07-2020. Its annual value will be computed as per Section 23(2). The first floor is let for a part of the year and then it is self-occupied. Its annual value will also be computed as per Section 23(1). However, since the house has come into existence on 01-07-2020, the annual fair value and annual municipal value for the period when the property was in existence (9 months) shall be considered for computing GAV.
- (2) Since ARR is greater than ER, hence GAV = ARR.
- (3) The pre-construction period starts from 01-07-2019 (date of loan) and ends on 31-03-2020. The interest for the said period i.e. for 9 months shall be - Rs. 12,00,000 x 10% x (9 ÷ 12) = Rs. 90,000; Rs. 45,000 for ground floor and Rs. 45,000 for 1st floor. Such interest is deductible in 5 equal annual instalments starting with previous year 2020-21, each installment being Rs. 9,000 (i.e., Rs. 45,000 ÷ 5).

5). Interest of Rs. 1,20,000 for current year will be apportioned between the 2 units at Rs. 60,000 each. Therefore, total interest deductible = Rs. 69,000 (i.e., Rs. 60,000 + Rs. 9,000) in each case.

Illustration 14 - Computation of Income from House Property : Mrs. Indu, a resident individual, owns a house in U.S.A. She receives rent @ \$ 2,000 per month. She paid municipal taxes of \$ 1,500 during the financial year 2020-21. She also owns a two storied house in Mumbai, ground floor is used for her residence and first floor is let out at a monthly rent of Rs. 10,000. Standard rent for each floor is Rs. 11,000 per month. Municipal taxes paid for the house amounts to Rs. 7,500. Mrs. Indu had constructed the house by taking a loan from a nationalised bank on 20-6-2018. She repaid the loan of Rs. 54,000 including interest of Rs. 24,000. The value of one dollar is to be taken as Rs. 75. Compute total income from house property of Mrs. Indu. (7Marks, PCC Nov. 2009)

Solution : Computation total Income from House Property of Mrs. Indu (amounts in Rs.) - (1)
Mumbai House - Ground Floor:

Net Annual Value	Nil
Less: Interest on borrowed capital [See Note]	12,000
Net Income from Ground Floor	-12,000

Note : Interest on capital borrowed for construction = Rs. 24,000 $\times$ 1/2 = Rs. 12,000, remaining half is for 1st floor.

(2) **Mumbai House - First Floor :**

Gross Annual Value being actual rent	[WN-1]	1,20,000
Less: Municipal Taxes paid	[WN-2]	3,750
Net Annual Value		1,16,250
Less: Deductions under section 24 -		
(a) Standard Deduction @ 30% of NAV		34,875
(b) Interest on capital borrowed	[WN-3]	12,000
Income from First Floor of Mumbai House		69,375

Working Notes:

(1) $GAV = Rs. 10,000 \times 12 = Rs. 1,20,000$.

(2) Municipal taxes paid in respect of first floor =

(3) Interest on capital borrowed for construction (3) U.S.A. House:

Gross Annual Value [WN-1] Less: Municipal Taxes paid [WN-2]

Net Annual Value Less: Standard Deduction u/s 24 @ 30% of NAV 18,00,000 1,12,500

16,87,500

5,06,250

Income from U.S.A. House 11,81,250

Working Notes:

(1) $GAV = \$ 2,000 \times 12 \times f 75 \text{ per dollar} = Rs. 1800000$.

(2) Municipal Taxes paid = \$ 1,500 $\times$ 75 = Rs. 112500.

Therefore, total Income from House Property of Mrs. Indu = Rs. (-12,000) + Rs. 69,375 + Rs. 11,81,250 = Rs. 1,238,625.

**SPECIAL PROVISION FOR ARREARS OF RENT AND
UNREALISED RENT RECEIVED SUBSEQUENTLY - SECTION 25A**

15. Discuss special provision for arrears of rent and unrealised rent received subsequently?

Ans: *Special provision for arrears of rent and unrealised rent received subsequently [Section 25A]:*

(1) *Arrears of rent received and unrealised rent received - Taxable as income from house property:*

(a) *The amount of arrears of rent received from a tenant; or*

(b) *The unrealised rent realised subsequently from a tenant,*

as the case may be, by an assessee shall be deemed to be the income from house property in respect of the financial year in which such rent is received or realised, and shall be included in the total income of the assessee under the head "Income from house property", whether the assessee is the owner of the property or not in that financial year.

(2) **Ad hoc deduction of 30% is admissible :** *A sum equal to 30% of the arrears of rent or the unrealised rent shall be allowed as deduction.*

Taxable Amount:

Amount received as arrears of rent or unrealised rent	xxx
Less: Standard Deduction @ 30% of such amount	xxx
Income from house property	xxx

Illustration 15 - Tax Treatment of unrealised rent and arrears of rent received : Mr. Krishna sold his residential house property in March, 2020. In June, 2020, he recovered rent of Rs. 35,000 from Mr. Ravindra, to whom he had let out his house for two years from April 2014 to March 2016. He could not realise two months rent of Rs. 40,000 from him and to that extent his actual rent was reduced while computing Income from house property for A.Y. 2016-17.

Further, he had let out his property from April, 2016 to February, 2020 to Mr. Kamlesh. In April, 2019, he had increased the rent from Rs. 20,000 to Rs. 25,000 per month and the same was a subject matter of dispute. In September, 2020, the matter was finally settled and Mr. Krishna received Rs. 1,15,000 as arrears of rent for the period April 2018 to February, 2020.

Would the recovery of unrealised rent and arrears of rent be taxable in the hands of Mr. Krishna, and if so in which year?

= Rs. 7,500 $\times$ 1/2 = 13,750, as balance half is for ground floor. = Rs. 24,000 $\times$ 1/2 = Rs. 12,000.

Solution: Since the unrealised rent was recovered in the P.Y. 2020-21, the same would be taxable in the A.Y. 2021-22 under section 25A, irrespective of the fact that Mr. Krishna was not the owner of the house in that year. Further, the arrears of rent was also received in the P.Y. 2020-21, and hence the same would be taxable in the A.Y. 2021-22 under section 25A, even though Mr. Krishna was not the owner of the house in that year.

A deduction of 30% of unrealised rent recovered and arrears of rent would be allowed while computing income from house property of Mr. Krishna for A.Y. 2021-22.

Computation of income from house property of Mr. Krishna for A.Y. 2021-22

(amount in Rs.):

(i) Unrealised rent recovered	35,000
(ii) Arrears of rent received	1,15,000
	1,50,000
Less: Deduction @ 30%	45,000
Income from house property	1,05,000

Illustration 16 - Tax treatment of unrealised rent: An owner of a house property is allowed a deduction of Rs. 12,000 by way of unrealised rent for assessment year 2017-18. He sold the house on 15-4-2020 and ceases to be the owner thereof. A decree for the unrealised rent was given in his favour on 1-12-2020 and he receives the full amount on 1-2-2021. Examine the tax consequence. (May 2006)

Solution : According to Section 25A, recovery of unrealised rent is taxable as "Income from House Property" whether the assessee is owner of the house or not. Hence, in the given case, the amount of Rs. 12,000 received by A by way of unrealised rent after giving deduction of 30%, shall be taxable as his income for the previous year 2020-21 even if he ceases to be the owner of the house property during the previous year. Taxable

(amount in Rs.):

The amount received as unrealised rent	12,000
Less: Standard Deduction @ 30% of such amount	3,600
Income from house property	8,400

Illustration 17 - Computation of income from house property : X is the owner of a commercial property let out at Rs. 20,000 p.m. The municipal tax on the property is Rs. 25,000 annually, 50% of which is payable by the tenant. This tax was actually paid on 15-4-2021. He had borrowed a sum of Rs. 10 lacs from his cousin, resident in USA (In Dollars) for the construction of the property on which interest at 10% is payable. He has also received arrears of rent of Rs. 20,000 during the year, which was not charged to tax in the earlier years. What is the property income of X Rs. (Nov. 2002)

Solution: Computation of Income From House Property of Mr. X (amount in Rs.)-

Gross Annual Value (Rs. 20,000 $\times$ 12)		2,40,000
Less: Municipal taxes paid	[WN-1]	Nil
Net Annual Value		2,40,000
Less: Deductions under section 24 -		
(a) Standard deduction @ 30% of NAV		72,000
(b) Interest on Housing Loan (Rs. 10,00,000 $\times$ 10%)	[WN-2]	1,00,000
		68,000
Add: Arrears of rent received	[WN-3]	14,000
Income from House Property		82,000

Working Notes:

- (1) No deduction shall be allowed for municipal taxes as the same were not actually paid during the previous year.
- (2) It is assumed that the tax has been deducted at source on the amount of interest paid outside India.
- (3) Taxable value of arrears of rent under section 25A = Rs. 20,000 - 30% of Rs. 20,000 = Rs. 14,000.

Illustration 18 - Computation of taxable income : Ramesh (58 years) retired as General Manager of XYZ Co. Ltd. On 30-11-2020 after rendering service for 20 years and 10 months. He received Rs. 3,00,000 as gratuity from the employer. (He is not covered by Gratuity Act, 1972). His salary particulars are given below :

Basic Pay	Rs. 10,000 p.m. upto 30-06-2020
Basic Pay	Rs. 12,000 p.m. from 01-07-2020
Dearness allowance (Eligible for retirement benefits)	50% of basic pay
Transport Allowance	Rs. 2,300 p.m.

He resides in his own house. Interest on monies borrowed for the self-occupied house is Rs. 24,000 for the year-ended 31-3-2021. From a fixed deposit with a bank he earned interest income of Rs. 18,000 for the year ending 31-3-2021. Compute taxable income of Ramesh. (May 2004)

Solution: Computation of taxable income of Ramesh (amount in Rs.) -

Income from Salaries			
Basic Pay (Rs. 10,000 $\times$ 3 + Rs. 12,000 $\times$ 5)		90,000	
Dearness Allowance (50% of basic pay)		45,000	
Transport Allowance (Rs. 2,300 $\times$ 8) [WN-1]		18,400	
Gratuity Received	3,00,000		
Less: Exempt [WN-2]	1,62,000	1,38,000	
Gross Salary		2,91,400	
Less: Standard deduction u/s 16(ia)		50,000	2,41,400
Income from House Property			
Annual Value [WN-3]		Nil	
Less: Interest on borrowed capital		24,000	-24,000
Income from other sources (Bank Interest)			18,000
Total Income			2,35,400

Working Notes:

- (1) Transport allowance is fully taxable.
- (2) Gratuity received shall be exempt to the extent of least of the following (Payment of Gratuity Act is not applicable) -
 - (a) Actual amount received 3,00,000
 - (b) Notified Amount 20,00,000
 - (c) $\frac{1}{2} \times \text{Average Salary} \times \text{No. of completed years of service} = \frac{1}{2} \times \text{Rs. 16,200} \times 20 \text{ years}$
 $1,62,000 \text{ Average Salary} = \text{Basic and DA for 10 months preceding the month of retirement i.e. January to October} + 10 = [(\text{Rs. 10,000} \times 6 + \text{Rs. 12,000} \times 4) + 50\% \text{ of } (\text{Rs. 10,000} \times 6 + \text{Rs. 12,000} \times 4)] = \text{Rs. 16,200}.$
- (3) Since the house is self-occupied, hence its annual value shall be Nil.

CO-OWNERSHIP AND DEEMED OWNERSHIP - SECTION 26 & 27

- 16.** Under Section 4, an association of persons is also one of the entities on which tax shall be charged in respect of the previous year on the income accruing or arising or received or deemed to be received. There is an exception to this rule. What is the? (May 1995) OR
 Explain the tax treatment in case of property owned by co-owners ?

Ans: An Association of Persons is also one of the entities on which tax shall be charged, in respect of the previous year on the income accruing or arising or received or deemed to be received. There is an exception to this rule which is provided in Section 26. As per this section -

- (1) Property owned by co-owners [Section 26] :** Where property consisting of buildings or buildings and lands appurtenant thereto is owned by two or more persons (i.e. the co-owners) and their respective shares are definite and ascertainable, then such persons in respect of such property shall not be assessed as an Association of Persons, but the share of each such person in the income from the property will be computed in accordance with sections 22 to 25 and included in his total income.

Explanation to Section 26 : In case of self-occupied property under section 23(2), the annual value of the property for each such co-owner shall be NIL and each of the co-owner shall be entitled to the deduction of interest on borrowed capital.

- (2) Unascertainable shares - Assessed as AOP :** If the respective shares are not definite and ascertainable, the co-owners shall be assessed as Association of Persons in respect of such property.
- (3) Co-owned property [Section 26]:** The relevant provision can be summarized as under :

Self-occupied property	Let-out property
The annual value of the property of each co-owner will be Nil and each co-owner shall be entitled to a deduction of Rs. 30,000/Rs. 2,00,000, as the case may be, on account of interest on borrowed capital. However, if the co-owner owns another self-occupied/unoccupied property, the aggregate interest from the co-owned property and the other self-occupied property cannot exceed Rs. 30,000/Rs. 2,00,000, as the case may be.	The income from such property shall be computed as if the property is owned by one owner and thereafter the income so computed shall be apportioned amongst each co-owner as per their specific share.

Illustration 19 - Income from House Property in case of co-ownership : Mr. Raman is a co-owner of a house property along with his brother.

Municipal value of the Property	Rs. 1,60,000
Fair Rent	Rs. 1,50,000
Standard Rent Under the Rent Control Act	Rs. 1,70,000
Rent received	Rs. 15,000 p.m.

The loan for the construction of this property is jointly taken and the interest charged by the bank is Rs. 25,000 out of which Rs. 21,000 have been paid. Interest on the unpaid interest is Rs. 450.

To repay this loan, Raman and his brother have taken a fresh loan and interest charged on this loan is Rs. 5,000. The Municipal taxes of Rs. 5,100 have been paid by the tenant.

Compute the income from this property chargeable in the hands of Mr. Raman. (6 Marks, IPCC Nov. 2009)

Solution: Computation of Income from House Property chargeable in the hands of Mr. Raman (amount in Rs.)

Expected Rent	[WN-1]	1,60,000
Actual Rent Received or Receivable (Rs. 15,000 x 12)		1,80,000
Gross Annual Value (GAV) (higher of above two)		1,80,000
Less: Municipal Taxes	[WN-2]	-
Net Annual Value (NAV)		1,80,000
Less: Standard Deduction u/s 24 @ 30% of NAV		54,000
Joint interest on loan taken for the property (allowed on accrual basis)		25,000
Interest on unpaid interest	[WN-3]	-
Interest on fresh loan taken to repay the original loan (allowed as deduction)		5,000
Income from house property		96,000
Income taxable in Raman's hands (Income from house x 50%)		48,000

Working Notes:

- (1) ER = Municipal value or fair rent, whichever is higher subject to maximum of Standard rent.
- (2) Municipal taxes have been paid by the tenant and not by the owner, hence no deduction shall be allowed in respect of the same.
- (3) Interest on unpaid interest cannot be regarded as interest on capital borrowed, hence not deductible.
- (4) Raman is a co-owner. Hence, as per Section 26, he will be liable to income tax only in respect of his share in the property. It is assumed that such share is definite and ascertainable and is 50%.

Illustration 20 - Computation of Income from House Property: Two brothers Arun and Bimal are co-owners of a house property with equal share. The property was constructed during the financial year 1997-98. The property consists of eight identical units and is situated at Cochin. During the current year, each co-owner occupied one unit for residence and the balance of six units were let out at a rent of Rs. 12,000 per month per unit. The municipal value of the house property is Rs. 9,00,000 and the municipal taxes are 20% of municipal value, which were paid during the year. The other expenses were as follows :

(i)	Repairs	40,000
(ii)	Insurance premium (paid)	15,000
(iii)	Interest payable on loan taken for construction of house	3,00,000

One of the let out units remained vacant for four months during the year. Arun could not occupy his unit for six months as he was transferred to Chennai. He does not own any other house. The other income of Mr. Arun and Mr. Bimal are Rs. 2,90,000 and Rs. 1,80,000 respectively for the year. Compute the income under the head 'Income from House Property' and the total income of two brothers. (12 Marks, PCC Nov. 2010)

Solution: Computation of total income (amount in Rs.) –

Particulars	Arun	Bimal
Income from house property		
(1) Self-occupied portion (25%): Annual value	Nil	Nil
Less: Deduction u/s 24(b) [WN-1]	30,000	30,000
Income from self-occupied portion	-30,000	-30,000
(2) Let-out portion (75%) [WN-2]	1,25,850	1,25,850
Income from house property	95,850	95,850
Other Income	2,90,000	1,80,000
Total Income	3,85,850	2,75,850

Working Notes:

- (1) Interest on loan taken for construction = 25% of Rs. 3 lakhs = Rs. 75,000 - restricted to maximum of Rs. 30,000 for each co-owner.
- (2) Computation of income from let-out portion (75%) of house property (amount in Rs)
Since 6 units have been let out out of 8 units, hence let out portion = $6/8 \times 100 = 75\%$.

All expenses will be made proportionate (i.e. 75%) for calculating income from house property.

Municipal value (75% of Rs. 9 lakhs) (being expected rent)	6,75,000	
Actual rent [(Rs. 12,000 $\times$ 6 $\times$ 12) - (Rs. 12,000 $\times$ 1 $\times$ 4)] = Rs. 8,64,000 - Rs. 48,000	8,16,000	
Gross Annual Value, being the higher of: Municipal Value or Actual Rent		8,16,000
Less: Municipal taxes paid [75% of 20% of Rs. 9 lakhs]		1,35,000
Net Annual Value (NAV)		6,81,000
Less: Deduction under section 24 -		
(a) Standard deduction @ 30% of NAV	2,04,300	
(b) Interest on loan taken for the house (75% of Rs. 3 lakhs)	2,25,000	4,29,300
Income from let-out portion of house property		2,51,700
Share of each co-owner (50%)		1,25,850

17. **Ownership is the criterion for assessment of Income from property under section 22. However, there are instances in which the income from property is assessable in the hands of an assessee, who is not the legal owner thereof. Enumerate these cases. (4 Marks, May 1995) (Nov. 2004)**

Ans: **Deemed Ownership [Section 27]:** For the purposes of Sections 22 to 26, the following persons shall be deemed to be the owner of house property -

- (1) **Transfer to spouse or minor child otherwise than for adequate consideration:** An individual who transfers otherwise than for adequate consideration his house property to -
 - (a) His or her spouse, not being a transfer in connection with an agreement to live apart; or
 - (b) Minor child, not being married daughter;
 shall be deemed to be the owner of the house property so transferred.
- (2) **Holder of an Impartible Estate:** The holder of impartible estate shall be deemed to be the individual owner of all the properties comprised in the estate.

- (3) **Property allotted under 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 owner of that building or part thereof.
- (4) **Possession on part performance of contract:** A person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882, shall be deemed to be the owner of that building or part thereof.
- (5) **Holder of substantial lease or other rights for not less than 12 years:** A person who acquires any rights (excluding any rights 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, by virtue of any transaction as is referred to under section 269VA(f), shall be deemed to be the owner of that building or part thereof.
- [Note: According to Section 269VA(f) - Transfer means,-
- transfer of property by way of sale or exchange or lease for a term of not less than 12 years, and includes allowing the possession of such 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;
 - doing of anything (whether by way of admitting as a member of or by way of transfer of shares in a co-operative society or company or other association of persons or by way of any agreement or arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, such property.]

Only deemed owner liable to tax: Since the above mentioned persons are the deemed owners of the property, hence the income therefrom will be assessable in their hands and not in the hands of the legal owner.

Illustration 21 - Deemed owner: Answer the following -

- Mr. Rajesh transfers a property of market value Rs. 38,00,000 to his wife out of natural love and affection. The income from such property is Rs. 2,00,000. How will the property income be taxed?
- Mr. Amit gifts a property valuing 10,00,000 to his minor child. The annual income from such property is Rs. 2,00,000. How will the property income be taxed?
- What will your answer be, if in the above case Mr. Amit has gifted the house property to his minor married daughter?
- Mr. Anuj gives his house property to Mr. Dinesh on lease for 20 years. However, the lease is to be renewed by Mr. Dinesh every year. How will the property income be taxed?
- What will your answer be if in the above case Mr. Anuj gives his house property on lease to Mr. Dinesh for 2 years and Mr. Dinesh can get the lease renewed for another 2. years on payment of a specified sum and so on for indefinite period?

Solution: The above mentioned cases have been discussed as follows -

- In this case, Mr. Rajesh has transferred his house property to his wife in natural love and affection i.e. otherwise than for adequate consideration. Therefore, he will be the deemed owner of such property and hence income of Rs. 2,00,000 will be assessed in the hands of Mr. Rajesh as 'Income from House Property'.
- Here, Mr. Amit has gifted the property to his minor child i.e. without any adequate consideration. Thus, Mr. Amit shall be the deemed owner of such property and the income of Rs. 2,00,000 from the said property shall be taxable in his hands.

- (3) In case, an individual transfers the property without adequate consideration to his minor married daughter, then he shall not be treated as deemed owner in respect of such property as per Section 27. Hence, the income from such property will be taxed in the hands of the minor married daughter.
- (4) In this case, the lease is for 20 years i.e. for more than 12 years, but the same is to be renewed every year by Mr. Dinesh i.e. for a period of not more than one year. Thus, Mr. Dinesh is not treated as the deemed owner of such property and the income from such property will be taxable for Mr. Anuj.
- (5) Here, the lease is for 2 years but Mr. Dinesh can renew it after every 2 years for indefinite period, which implies that the lease can be for more than 12 years. Thus, Mr. Dinesh will be the deemed owner of such property and income therefrom will be taxable in his hands.

Illustration 22 - Computation of Total Income: From the following particulars furnished by Kiran for the previous year ending 31-3-2021, compute the taxable income : (Nov. 2001)

- (i) He owns a house property at Metro City. The fair rental value per annum is Rs. 27,000 and the Municipal value is Rs. 24,000.
- (ii) The house was let out from 1-4-2020 to 31-8-2020 at a monthly rent of Rs. 2,100. From 1-9-2020 Kiran occupies for his residence (self).
- (iii) Expenditure incurred on property and paid :

(a) Municipal tax	4,000
(b) Fire Insurance	2,500
(c) Land Revenue	4,600
(d) Repairs	1,000
- (iv) Interest paid on borrowing for construction:

(a) For the yea.	21,600
(b) Proportionate pre-construction interest	12,960
- (v) Income from Firm (PF A/ c) as partner: Salary Rs. 25,000; Interest on Capital Rs. 20,000; and Share Income Rs. 35,000.

Solution: Computation of Total Income of Kiran (amounts in Rs.)-

Gross Annual Value	[WN-1]	27,000
Less: Municipal Taxes paid		4,000
Net Annual Value		23,000
Less: Deduction under section 24 -		
(a) Standard deduction 30% of NAV		6,900
(b) Interest on Borrowed Capital (Rs. 21,600 + Rs. 12,960)		34,560
Income from House Property		-18,460
Profits and Gains of Business or Profession	[WN-2]	45,000
Gross Total Income/Total Income		26,540

Working Notes:

- (1) $GAV = (a)$ Expected Rent Rs. 27,000 (being higher of Municipal Value or Fair Rent); or (b) ARR Rs. 10,500 $(Rs. 2,100 \times 5 \text{ months}) = Rs. 27,000$, whichever is higher.
- (2) Salary and interest from partnership firm is taxable under the head profits and gains of business or profession, however share income from firm is exempt under section 10(2A).

Illustration 23 - Computation of Income from house property: Rohit is the owner of a house property, its municipal valuation is Rs. 80,000. It has been let-out for Rs. 1,20,000 per annum. The local taxes payable by the owner amount to Rs. 16,000, but as per agreement between the tenant and the landlord, the tenant has paid the amount directly to the municipality. The landlord, however, bears the following expenses on tenant's amenities:

	Rs.
Extension of water connection	3,000
Water charges	1,500
Lift maintenance	1,500
Salary of gardener	1,800
Lighting of stairs	1,200
Maintenance of swimming pool	750
The landlord claims the following deductions :	
Repairs and collection charges	7,500
Land revenue paid	1,500
Compute the taxable income of Rohit from the house property. (10 Marks, CS Executive Dec. 2009)	

Solution: Computation of income from the property (amount in Rs.):

Total sum received from the tenant		1,20,000
Less: Sum incurred towards tenant's amenities -	[WN-1]	
Extension of water connection		-3,000
Water charges		-1,500
Lift maintenance		-1,500
Salary of gardener		-1,800
Lighting of stairs		-1,200
Maintenance of swimming pool		-750
Total Rent received for the property		1,10,250
Less: Municipal taxes	[WN-2]	Nil
Net annual value		1,10,250
Less: Standard Deduction u/s 24 @ 30%	[WN-3]	33,075
Income from house property		77,175

Working Notes:

- (1) The expenses borne by the landlord towards amenities of the tenant is included in the rent of Rs. 1,20,000, hence the same is to be excluded for calculating actual rent as the same have been incurred on behalf of the tenant, for his personal amenities.
- (2) No deduction shall be allowed for municipal taxes as the same have been paid by the tenant.
- (3) No deduction is allowed for repair and collection charges and land revenue paid by the landlord, only a standard deduction under section 24 @ 30% of the NAV shall be allowed.

Illustration 24 - Computation of Income from house property : Mr. Raphael constructed a shopping complex. He had taken a loan of Rs. 25 lakhs for construction of the said property on 01-08-2018 from SBI @ 10% for 5 years. The construction was completed on 30-06-2019. Rental income received from shopping complex Rs. 30,000 per month-let out for the whole year. Municipal Taxes paid for shopping complex Rs. 8,000. Arrears of rent received from shopping complex Rs. 1,20,000.

Interest paid on loan taken from SBI for purchase of house for use as own residence for the period 2020-21, Rs. 3 lakhs. You are required to compute Income from House property of Mr. Raphael for A.Y. 2021-22.

(8 Marks, Nov. 2015) (Similar: 4 Marks, May 2017)

Solution: Computation of Income From House Property of Mr. Raphael (amount in Rs.)

Let out property [Shopping Complex]

Gross Annual Value (Rs. 30,000 × 12)		3,60,000
Less: Municipal taxes paid		8,000
Net Annual Value		3,52,000
Less: Deductions under section 24 -		1,05,600
(a) Standard deduction @ 30% of NAV		
(b) Interest on Housing Loan	[WN-2]	2,83,333
		-36,933
Add: Arrears of rent received	[WN-3]	84,000
Income from let out property	[A]	47,067
Self occupied house:		
Net Annual Value		Nil
Less: Interest on borrowed capital	[WN-1]	-2,00,000
Income From Self occupied property	[B]	-2,00,000
Income from House property [A] + [B]		-1,52,933

Working Notes:

- (1) The maximum amount of interest on borrowed capital to be allowed as deduction in case of self occupied house is Rs. 2,00,000.
- (2) The pre-construction period starts from 01-08-2018 (date of loan) and ends on 31-03-2019. The interest for the said period i.e. for 8 months shall be - Rs. 25,00,000 × 10% × (8 × 12) = Rs. 166,667. Such interest is deductible in 5 equal annual instalments starting with previous year 2019-20, each installment being Rs. 33,333 (i.e., Rs. 1,66,667 ÷ 5). Interest of Rs. 2,50,000 for current year will be deductible. Therefore, total interest deductible = Rs. 283,333 (i.e., Rs. 33,333 + Rs. 2,50,000).
- (3) Taxable value of arrears of rent under section 25A = ₹ 1,20,000 - 30% of ₹ 1,20,000 = ₹ 84,000.

Illustration 25 - Computation of Income from house property: Mr. Aditya, a resident but not ordinarily resident in India during the Assessment Year 2021-22. He owns two house, one in Dubai and the other in Mumbai. The house in Dubai is let out there at a rent of DHS 20,000 p.m. (1 DHS = INR 18). The entire rent is received in India. He paid Property tax of DHS 2,500 and Sewerage Tax DHS 1,500 there, for the Financial Year 2020-21. The house in Mumbai is self-occupied. He had taken a loan of Rs. 25,00,000 to construct the house on 1st June, 2017 @ 12%. The construction was completed on 31st May, 2019 and he occupied the house on 15th June, 2019. The entire loan is outstanding as on 31st March, 2021. Property tax paid in respect of the second house is Rs. 2,400 for the Financial Year 2020-21. Compute the income chargeable under the head "Income from House Property" in the hands of Mr. Aditya for the Assessment Year 2021-22. (5 Marks, Nov. 2017)

Solution: Though Mr. Aditya is a resident but not ordinarily resident in India but the income from property in Dubai will be taxable in India since the rent is received in India. (amount in Rs.)

Let out property [Dubai House]		
Gross Annual Value (DHS 20,000 $\times$ Rs. 18 $\times$ 12)		43,20,000
Less: Municipal taxes paid (DHS (2,500 + 1,500) $\times$ Rs. 18)		72,000
Net Annual Value		42,48,000
Less: Deductions under section 24 -		
(a) Standard deduction @ 30% of NAV		12,74,400
(b) Interest on Housing Loan		-
Income from let out property	[A]	29,73,600
Self occupied house :		
Net Annual Value		Nil
Less: Interest on borrowed capital	[WN]	-2,00,000
Income From Self occupied property	[B]	-2,00,000
Income from House property [A] + [B]		27,73,600

Working Note: The pre-construction period starts from 01-06-2017 (date of loan) and ends on 31-03-2019. The interest for the said period i.e. for 22 months shall be - Rs. 25,00,000 $\times$ 12% $\times$ (22 - 12) = Rs. 550,000. Such interest is deductible in 5 equal annual instalments starting with previous year 2019-20, each installment being Rs. 1,10,000 (i.e., Rs. 5,50,000 / 5). Interest for current year is Rs. 3,00,000 (Rs. 25,00,000 $\times$ 12% $\times$ 1). Therefore, total interest = Rs. 410,000 (i.e., Rs. 1,10,000 + Rs. 3,00,000). Since the house is

Illustration 26 - Computation of Income from house property: Mrs. Disha Khanria, a resident of India, owns a house property at Bhiwani in Haryana. The Municipal value of the property is Rs. 7,50,000, Fair Rent of the property is Rs. 6,30,000 and Standard Rent is Rs. 7,20,000 per annum. The property was let out for Rs. 75,000 per month for the period April 2020 to December 2020.

Thereafter, the tenant vacated the property and Mrs. Disha Khanna used the house for self-occupation. Rent for the months of November and December 2020 could not be realized from the tenant. The tenancy was bonafide but the defaulting tenant was in occupation of another property of the assessee, paying rent regularly.

She paid municipal taxes @ 12% during the year and paid interest of Rs. 35,000 during the year for amount borrowed towards repairs of the house property.

You are required to compute her income from "House Property" for the A.Y. 2021-22. (7Marks, Nov. 2018-NS)

Solution: Computation of Income from House Property (amount in Rs.) –

Annual value	[WN-1]	7,20,000
Less: Municipal taxes paid (Rs. 7,50,000 $\times$ 12%)		90,000
Net Annual Value (NAV)		6,30,000
Less: Deductions u/s 24 -		
(a) Standard deduction @ 30% of NAV		1,89,000
(b) Interest on borrowed capital		35,000
Income from House Property		4,06,000

Working Notes:

- (1) *Where the property is let for a part of a year and self-occupied for remaining period, the benefit of self-occupation shall not be available and the annual value shall be determined as per Section 23(1)(a).*

Thus, annual value =

- (a) *Expected Rent i.e. Municipal Value 7,50,000) or Fair Rent (f 6,30,000) whichever is higher subject to maximum of Standard Rent (Rs. 7,20,000) i.e. Rs. 7,20,000; or*
- (b) *Actual Rent i.e. Rs. 75,000 $\times$ 9 = Rs. 675000; whichever is higher.*
- (2) *Unrealised Rent cannot be deducted from actual rent since the conditions of Rule 4 have not been satisfied.*

5

PROFITS AND GAINS OF BUSINESS OR PROFESSION

<i>Topic Referencer</i>
❖ <i>Basic Concepts</i>
❖ <i>Deduction in Respect of Rent, Rates & Taxes, etc. of Building Machinery and Furniture - Section 30 & 31</i>
❖ <i>Depreciation, WDV and Actual Cost</i>
❖ <i>Apportionment of Depreciation, Additional Depreciation & Unabsorbed Depreciation</i>
❖ <i>Depreciation in case of Power Generating Units</i>
❖ <i>Certain Special Deductions Section 35 to 35DDA</i>
❖ <i>Other Specified Deductions & General Deduction - Section 36 & 37</i>
❖ <i>Specific Disallowances - Section 40 & 40A</i>
❖ <i>Deemed Profits - Section 41</i>
❖ <i>Special Provisions / Deductions</i>
❖ <i>Accounts and Audit - Section 44AA & 44AB</i>
❖ <i>Deemed Profits in case of Certain Businesses - Section 44AD, 44ADA & 44AE</i>
❖ <i>Miscellaneous Illustrations on Computing Business Income/Total Income</i>
❖ <i>Agricultural Income</i>

BASIC CONCEPTS

1. **Explain broadly the concept of 'Business' and 'Profession'!**

Ans: **The concept of 'Business' and 'Profession' is as under -**

- (1) Business [Section 2(13)]:** 'Business' includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.
- Trade means purchase and sale of goods carried on in order to earn profits;
 - Commerce means large scale trade;
 - Manufacture, with its grammatical variations, means a change in a non-living physical object or article or thing,-
 - (i) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or
 - (ii) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.
 - Any adventure or concern in the nature of trade, commerce or manufacture means the transaction which cannot be properly considered as trade or business. A single isolated transaction outside the assessee's line of business may constitute an adventure in nature of trade and commerce. The cumulative effect of the facts and circumstances is to be considered while deciding whether an activity is an adventure or concern in the nature of trade, commerce or manufacture.

For example: In case of investment - the intention is to earn capital appreciation whereas in case of adventure or concern - intention is to derive immediate profits.

In case the assessee purchases a plot of land and builds a complex on it and divides the same into office spaces and sells each of these, thereby making a profit from the entire activity - the same shall be regarded as such adventure or concern.

Essentials of business:

- (a) Carrying of transactions or activities on regular basis.
- (b) Profit motive.
- (c) Application of labour and skill.

(2) Profession [Section 2(36)]: 'Profession' includes vocation.

Thus, Profession means an occupation which requires intellectual or manual skill, based on regular learning & experience, exercised for earning livelihood. E.g. - Legal consultancy is a profession.

"Vocation" means a work (whether systematic and organised or not) which is done on the basis of one's natural ability. It does not aim to earn any livelihood. E.g. - Dancing, Singing etc. is vocation.

2. What are the incomes taxable under the head "Profits and Gains of Business or Profession" as per Section 28;

Ans: As per Section 28, the following income shall be chargeable to income-tax under the head "Profits and gains of business or profession" -

- (i) **Profits and Gains of any business or profession :** Profits and gains of any business or profession which was carried on by the assessee at any time during the previous year;
- (ii) **Compensations:** Any compensation or other payment due to or received by -
 - (a) any person managing the whole or substantially the whole of the affairs of an Indian company, at or in connection with the termination of his management or the modification of the terms and conditions relating thereto;
 - (b) any person managing the whole or substantially the whole of the affairs in India of any other company, at or in connection with the termination of his office or the modification of the terms and conditions relating thereto;
 - (c) any person holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of the terms and conditions relating thereto;
 - (d) any person, for or in connection with the vesting in the government, or in any corporation owned or controlled by the Government, under any law for the time being in force, of the management of any property or business;
 - (e) any person, by whatever name called, at or in connection with the termination or the modification of the terms and conditions, of any contract relating to his business.
- (iii) Income derived by a trade, professional or similar association from specific services performed for its members. (This clause is an exception to Principle of Mutuality);
- (iv) **Incentives received or receivable by assessee carrying on export business:**
 - (a) **Profit on sale of import entitlements:** Profits on sale of a licence granted under the Imports (Control) Order, 1955, made under the Imports and Exports (Control) Act, 1947;
 - (b) **Cash assistance against exports under any scheme of Govt:** Cash assistance received or receivable by any person against exports under any scheme of the Government of India;

- (c) **Duty Drawback:** Any duty of customs or excise repaid or repayable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971;
- (d) **Profit on the transfer of DEPB:** Any profit on the transfer of the Duty Entitlement Pass Book Scheme (DEPB), being the Duty Remission Scheme under the EXIM policy;
- (e) **Profit on the transfer of DFRC:** Any profit on the transfer of Duty Free Replenishment Certificate (DFRC), being the Duty Remission Scheme under the EXIM policy;
- (v) **Benefit or perquisite arising from business or profession:** The value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;
- (vi) **Partners remuneration:** Any interest, salary, bonus, commission or remuneration, by whatever name called, due to or received by, a partner of a firm from such firm. However, where such income is not deductible in the hands of the firm u/s 40(b), the same shall not be taxable in the hands of partners to the extent deduction is not allowed;
- (va) **Non competing fees and exclusivity receipts:** Any sum, whether received or receivable, in cash or in kind, under an agreement for —
- (a) Not carrying out any activity in relation to any business or profession i.e. for non-competing; or
- (b) Not sharing any know-how, patent, copyright, trademark, license, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision of services i.e. exclusivity;
- Exceptions:** The clause (a) shall not apply in respect of sum received,—
- (i) on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business or profession, which is chargeable as 'Capital Gains' under section 45; or
- (ii) as compensation from the multilateral fund of the Montreal Protocol on Substances that deplete the Ozone Layer under the United Nations Environment Programme.
- (vii) **Key man insurance policy receipts:** Any sum received under a Keyman Insurance Policy including the sum allocated by way of bonus on such policy;
- (viii) **FMV of inventory on its conversion as capital asset:** The fair market value of inventory as on the date on which it is converted into, or treated as, a capital asset determined in the prescribed manner, (ix) Sale proceeds of assets of specified business : Any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD.

Speculation business distinct from general business [Explanation 2]: Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business shall be deemed to be distinct and separate from any other business.

3. **Explain the mode of computation of income under the head 'Profits and Gains of Business or Profession'**

Ans: **Mode of computation of income under the head 'Profits and Gains of Business or Profession' [Section 29]:**

Net Profit as per Profit and Loss Account	XXX
Add: Expenses debited to Profit and Loss A/c but not allowable under this head. [Section 37(2B), 38, 40, 40A, 43B; expenses allowable under any other head or capital expenditure]	XXX
Less: Allowable Expenses under this head but not debited to Profit & Loss A/c [Section 30 to 37(1)]	XXX
Less: Incomes not taxable under this head but credited to Profit and Loss A/c [Section 15, 22, 45 and 56 or incomes exempt under section 10]	XXX
Add: Incomes not credited to Profit and Loss A/c but taxable under this head [Section 28, 41]	
Profits and Gains of Business or Profession	XXX

4. What are the basic requirements for charging any income under the head 'Profits and Gains of Business or Profession'?

Ans: The basic requirements for charging any income under the head 'Profits and Gains of Business or Profession' are as under -

- (1) **There should be profits & gains:** Only real profits and gains are liable to tax and not mere gross receipts. However, there is an exception; stock-in-trade is valued at lower of cost or market price.
- (2) **Profits and gains may be of any business or profession:** Profits and gains from an illegal business are also chargeable to tax under this head.
- (3) **Business or profession must be carried on by assessee:** The profits and gains from business or profession are taxable in the hands of the person who has the right to carry on the business. A company becomes a legal entity in the eye of law only when it is incorporated. Therefore, the pre-incorporation profits cannot be included in the assessment of the assessee-company. For such profits only the promoters can be held liable.
- (4) **Business or profession should be carried on at any time during previous year:** The business or profession must have been carried on for some time during the previous year. However, a temporary suspension of activities of the business does not necessarily amount to discontinuance of the business.
- (5) **Income from letting of business assets:** In case of temporary letting out of business assets while assessee is carrying out his other business activities, the letting income is taxable as business profits. But if the business never started or has started but ceased with no intention to be resumed, then letting income will be taxable as income from other sources. - *Universal Plast Ltd. v. CIT* [1999] 237ITR 454 (SC)

5. List the circumstances under which the receipts are taxable even if no business was carried out during the previous year. (May 2001)

Ans: The circumstances in which the receipts are taxable even if the assessee/recipient carried out no business or profession during the previous year, are as follows -

- (i) Amount unutilised or misutilised from Tea/ Coffee/ Rubber Development A/c [Section 33AB]
- (ii) Amount unutilised or misutilised from Site Restoration Fund [Section 33ABA]
- (iii) Sale of telecommunication license [Section 35ABB]
- (iv) Amounts taxable under section 41(1), 41(2), 41(3), 41(4) and 41(4A);
- (v) Sale of mineral oil business [Section 42]
- (vi) Any sum received after discontinuance of a business or profession. [Section 176(3A)/176(4)]

6. What are the methods of accounting that can be followed for computing the business income?

Ans: **Method of accounting [Section 145]:** Income chargeable under the head 'Profits and gains of business or profession' shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

- (i) If cash system of accounting is followed, then only the incomes actually received and expenses actually paid in cash during the previous year will be considered.
- (ii) If mercantile system of accounting is followed, then the income will be computed on accrual basis, adjusting the outstanding incomes/expenses, prepaid expenses and unearned incomes.

7. What do you mean by Speculative Transactions Rs. List the transactions which are not deemed to be speculative transactions? (Nov. 2000)

Ans: **Speculative Transactions [Section 43(5)]:** "Speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips.

The transactions which are not regarded as speculative transactions are as follows -

- (1) **Hedging contract in respect of raw materials or merchandise :** A contract in respect of raw materials or merchandise entered into by a person in the normal course of his manufacturing or merchandising business to guard against loss due to future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him.
- (2) **Hedging contract in respect of stocks and shares:** A contract in respect of stocks and shares entered into by a dealer or investor to guard against loss in his holdings of stocks and shares through price fluctuations.
- (3) **Forward contract:** A contract entered into by a member of forward market or a stock exchange in the course of transaction including jobbing or arbitrage to guard against loss arising in the ordinary course of business as a member.
- (4) **Trading in derivatives:** An eligible transaction carried out in respect of trading in derivatives in a recognised stock exchange. Such transaction must be done electronically, through a registered intermediary and supported by a time stamped contract note having unique client identity number and PAN number.
- (5) **Trading in commodity derivatives:** An eligible transaction in respect of trading in commodity derivatives carried out in a recognised stock exchange, which is chargeable to commodities transaction tax carried out electronically in a recognised stock exchange through a registered member or intermediary and supported by a time stamped contract note having unique client identity number, unique trade number and PAN number. [Amended by Finance Act, 2020 w.e.f. 01-04-2020 i.e. AY 2020-21]
However, in respect of trading in agricultural commodity derivatives, the requirement of chargeability of commodity transaction tax under Chapter VII of the Finance Act, 2013 shall not apply.

8. Define Deemed Speculation Business.

Ans: **Deemed Speculation Business [Explanation to Section 73]:** Where any part of the business of a company consists of purchase and sale of shares of other companies, then such company shall be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

Exceptions: The said business shall not be deemed to be speculation business in the case of following companies -

- (a) A Company whose gross total income consists mainly of income under the heads "Income from house property", "Capital gains" and "Income from other sources";
- (b) A Company the principal business of which is the business of trading in shares or banking or the granting of loans and advances.

9. Discuss the taxability of Speculation Business.

Ans: **Taxability of Speculation Business [Explanation 2 to Section 28]:** Where the speculative transactions carried on by an assessee are of such a nature as to constitute a business, such business shall be deemed to be distinct and separate from any other business. Thus, in such case -

- Profits and gains of such business are to be shown separately;
- The loss of a speculation business can only be set off only against speculation income.
- This loss can be carried forward for 4 years.

10. What are the conditions to be fulfilled for claiming deduction of 'Losses incidental to business'?

Ans: The trading losses (other than the capital losses), incidental to business, shall be allowed as deduction while computing business income, on fulfillment of the following conditions -

- (a) Loss should be real in nature and not notional or fictitious.
- (b) The loss should be revenue loss and not capital loss.
- (c) Losses should have actually occurred during the previous year.
- (d) Loss should be incidental to business i.e. arising directly from carrying of business activities.
- (e) There should not be any direct or indirect provision in the Act prohibiting the deduction of such loss.

For example: Loss on account of embezzlement by employee or loss of goods in transit, etc. is allowed as deduction.

11. Discuss briefly the basic principles governing the admissibility of deduction under section 30 to 44DB.

Ans: The basic principles governing the admissibility of deduction under section 30 to 44DB are as follows -

- (i) The effect of allowances specified under Section 30 to 37 is cumulative and not alternative.
- (ii) Expenditure should relate the business of the assessee.
- (iii) Expenditure should relate to the previous year in which business has been carried out.
- (iv) Burden to prove the admissibility of expenditure lies on the assessee.
- (v) In case of newly set up business or profession, no deduction shall be allowed of any expenditure incurred before the setting up of business or profession.

**DEDUCTION IN RESPECT OF RENT
RATES & TAXES ETC. OF BUILDING**

12. Discuss briefly the deduction available under section 30 in respect of rent, rates, etc., on buildings.

Ans: The relevant provisions are discussed as under -

- (1) **Rent, rates, taxes, repairs and insurance of building [Section 30] :** In respect of rent, rates, taxes, repairs and insurance for premises, used for the purposes of the business or profession, the following deductions shall be allowed -
 - (a) Rent and repairs of premises: Where the premises are occupied by the assessee -

- (i) **as a tenant** - rent paid for such premises; and further if he has undertaken to bear the cost of repairs to the premises, the amount paid for such repairs;
- (ii) **otherwise than as a tenant** - the amount paid by him for current repairs of the premises.
- (b) **Taxes:** Any sums paid on account of land revenue, local rates or municipal taxes paid, subject to the provisions of Section 43B.
- (c) **Insurance premium:** The amount of any premium paid in respect of insurance against risk of damage or destruction of the premises.
- (2) **Cost of repairs and current repairs of capital nature not deductible [Explanation]:** The amount paid on account of the cost of repairs referred to in (i) and (ii) above, shall not include any expenditure in the nature of capital expenditure.
- (3) **Capital Expenditure on leased building - Lessee deemed owner - Entitled for depreciation:** As per Explanation 1 to Section 32, where any capital expenditure on construction, renovation, extension or improvement is incurred by an assessee, in respect of a building not owned by him but occupied by way of lease or other right of occupancy, then the assessee shall be regarded as deemed owner in respect of such capital expenditure and shall be entitled for the depreciation on the same.

13. **What are the various deductions allowed in respect of repairs and insurance of machinery, plant or furniture?**

Ans: **Repairs and insurance of machinery, plant or furniture [Section 31]:** In respect of repairs and insurance of machinery, plant or furniture used for the purposes of the business or profession, the following deductions shall be allowed —

- (i) the amount paid on account of current repairs thereto;
- (ii) the amount of any premium paid in respect of insurance against risk of damage or destruction of such machinery, plant or furniture.
- **Usage of the asset:** In order to claim this deduction the assets must have been used for purposes of the assessee's own business the profits of which are being taxed. Even if an asset is used for a part of the previous year, the assessee is entitled to the deduction of the full amount of expenses on repair and insurance charges and not merely an amount proportionate to the period of use. The word 'used' has to be read in a wide sense so as to include a passive as well as an active user. Thus, insurance and repair charges of assets which have been discarded (though owned by the assessee) or have not been used for the business during the previous year would not be allowed as a deduction.
- **Current repairs of capital nature not deductible [Explanation]:** The amount paid on account of the current repairs shall not include any expenditure in the nature of capital expenditure.
- **Repairs exclude replacement or reconstruction:** The term 'repairs' will include renewal or renovation of an asset but not its replacement or reconstruction. Also, the deduction allowable under this section is only of current repairs but not arrears of repairs for earlier years even though they may still rank for a deduction u/s 37(1).

14. **How will the amount of deduction be computed in case the building, plant, etc. are partly used for business or profession and partly for other purpose?**

Ans: **Building, plant, etc. partly used for business or profession [Section 38(2)]:** Where any building, plant or furniture is not exclusively used for the purposes of business or profession, then the deductions under section 30 and 31 shall be restricted to a fair proportionate part thereof. Hence, amount of deduction will be—

- (a) In case of rent of premises = $\text{Rent paid} \times \frac{\text{Annual value of part of premises used for business}}{\text{Annual value of entire premises}}$,
- (b) In any other case = $\text{Expenditure incurred} \times \text{Proportion of part of asset (or expenditure) used for business}$.

DEPRECIATION WDV AND ACTUAL COST
15. What are the conditions to be satisfied for claiming depreciation under section 32?

Ans: Depreciation [Section 32]: The conditions to be satisfied for claiming depreciation u/s 32 are as follows-

(1) **Depreciation is available on 'assets' and 'block of assets':** As per Explanation 3 to Section 32, the expression "assets" shall mean -

- (a) tangible assets, being buildings, machinery, plant or furniture;
- (b) intangible assets, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature.

"Block of assets" means a group of assets falling within a class of assets comprising of -

- (a) tangible assets, being buildings, machinery, plant or furniture;
- (b) intangible assets, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature; in respect of which the same percentage of depreciation is prescribed. [Section 2(11)]

(2) **Asset must be owned wholly or partly by assessee :** Depreciation is allowed only to the owner of asset, however, registered ownership is not necessary, as held in *Mysore Minerals Ltd. v. CIT* [1999] 239 ITR 775 (SC). Depreciation is allowed in respect of fractional ownership and co-ownership also.

Exceptions:

- (a) **In case of leased building:** In case of lease, lessee is entitled to claim depreciation on any superstructure constructed by him on land taken on lease; or on renovation/extension/improvement of building.
- (b) **In case of hire purchase :** In case of hire-purchase, the depreciation on the asset is claimed by the hire-purchaser, as it was held in *CIT v. Nagpur Golden Transport Co.* [1998] 233 ITR 389 (Del), that the depreciation is to be allowed to the user (i.e. hire-purchaser) in the case of a hire purchase agreement.
- (c) **In case of lease transactions :** In the lease agreement, the asset shall remain sole and exclusive property of the lessor and lessor can inspect and take possession of asset in case of default. Thus, lessor is entitled for depreciation on such leased asset - *I.C.D.S. Ltd. v. CIT* [2013] 350 ITR 527 (SC).
- (3) **Asset must be used for the purpose of business or profession of the assessee:** Depreciation can be claimed in respect of any asset, only if it is used for the purpose of business or profession. In case only a part of the asset is used for business or profession, depreciation shall be allowed only for that part which is used for the purpose of business or profession of the assessee.
- (4) **Asset should be used during the relevant previous year:** In order to claim depreciation, it is mandatory that the asset must be in use during the previous year, irrespective of the degree of utilisation.

Amount of depreciation:

- (a) **Use for less than 180 days:** If an asset is acquired by the assessee during the previous year and the same is put to use for less than 180 days during that previous year, then the depreciation will be limited to 50% of the depreciation allowable on such asset as per the rate prescribed in Rule 5(1).
- (b) **Use for 180 days or more:** There shall be no such restriction, depreciation will be allowed in full i.e. 100% of the amount calculated as per the prescribed rate.

Note: If the asset is used for less than 180 days in any subsequent previous year (i.e. year subsequent to the year of acquisition), then the depreciation is fully allowable.

16. Is it mandatory for an assessee to claim depreciation under section 32 of Income-tax Act? (Nov. 2004)

Ans: **Claim for depreciation is mandatory:** Yes, it is mandatory for an assessee to claim depreciation under section 32. As per Explanation 5 to Section 32(1), the provisions of section 32(1) relating to claim of depreciation shall apply whether or not the assessee has claimed the deduction in respect of depreciation in computing his total income.

17. What are intangible assets? Give four examples. What is the rate of depreciation on a block of intangible assets? (4 Marks, PCC May 2005)

Ans: **"Intangible assets"** means the assets which are not corporeal i.e. can neither be seen nor be touched. Such assets are represented by the rights of the person through them.

As per Explanation 3(b) to Section 32(1), the intangible assets are: Know-how, patents, copyrights, trademarks, licences, franchises, or any other business or commercial rights of similar nature. They are depreciated at the rate of 25%.

18. List the various 'Rates of Depreciation' as prescribed in respect of Block of Assets.

Ans: The various 'Rates of Depreciation' as prescribed in respect of Block of Assets are as follows:- (1) Rates of depreciation [Rule 5(1)]: All assets have been divided into four main categories and rates of depreciation as prescribed by Rule 5(1) are given below:

PART A: Tangible Assets -

Assets		Rates
(I) BUILDING:		
Block 1.	Buildings which are used mainly for residential purposes except hotels and boarding houses	5%
Block 2.	Buildings which are not used mainly for residential purposes and not covered by Block (1) above and (3) below	10%
Block 3.	Buildings acquired on or after 1st September, 2002 for installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities	40%
Block 4.	Purely temporary erections such as wooden structures	40%
(II) FURNITURE AND FITTINGS		
Block 1.	Furniture and fittings including electrical fittings	10%
(III) PLANT & MACHINERY		
Block 1.	(a) Motor buses, motor lorries and motor taxis used in a business of running them on hire other than those covered under entry (b).	30%
	(b) Motor buses, motor lorries and motor taxis used in a business of running them on hire, acquired on or after 23-08-2019 but before 01-04-2020 and is put to use before the 01-04-2020.	45%
Block 3.	Aeroplanes, Aeroengines	40%

Block 2.	Specified air, water pollution control equipments, solid waste control equipment and solidwaste recycling and resource recovery systems	40%
Block 4.	Energy Saving Devices (as specified)	40%
Block 5.	(i) Motor cars, other than those used in a business of running them on hire, acquired or put to use on or after 01-04-1990 except those covered under entry (ii);	15%
	(ii) Motor cars, other than those used in a business of running them on hire, acquired on or after 23-08-2019 but before 01-04-2020 and is put to use before 01-04-2020.	30%
Block 6.	Computers including computer software	40%
Block 7.	Annual publications owned by assessee carrying on a profession	40%
Block 8.	Books owned by assessee carrying on business in running lending libraries	40%
Block 9.	Books, other than annual publications, owned by assessee carrying on a profession	40%
Block 10.	Life saving medical equipments	40%
Block 11.	Plant & machinery (General rate)	15%
(IV) SHIPS		
Block 1.	Ocean-going ships	20%
Block 2.	Vessels ordinarily operating on inland waters not covered by Block (3) below	20%
Block 3.	Speed boats operating on inland water	20%

PART B: Intangible Assets -

Assets	Rates
Know-how, patents, copyrights, trademarks, licences, franchises, or any other business or commercial rights of similar nature	25%

Notes:

- (i) Windmills and any specially designed devices which run on windmills installed on or after 1-4-2014 would be eligible for depreciation @ 40%. Likewise, any special devices including electric generators and pumps running on wind energy installed on or after 1-4-2014 would be eligible for depreciation @ 40%. In respect of windmills and any specially designed devices running on windmills installed on or before 31-3-2014 and any special devices including electric generators and pumps running on wind energy installed on or before 31-3-2014, the rate of depreciation is 15%.
- (ii) Oil wells included in New Appendix I under Mineral Oil concerns under "III. Plant and Machinery" to be eligible for depreciation @ 15% [Notification No. 13/2016 dated 03-03-2016] Oil wells has been included as entry (c) under sub-item (xi) "Mineral Oil concerns" under item (8) of sub-heading III "Plant and Machinery" in new Appendix I. The rate of depreciation for oil-wells included as entry (c) is 15%.
- (2) **Increased rate of depreciation for certain assets [Rule 5(2)] :** Any new machinery or plant installed to manufacture or produce any article or thing by using any technology or other know-how developed in a laboratory owned or financed by the Government or a laboratory owned by a public sector company or a University or an institution recognized by the Secretary, Department of Scientific and Industrial Research, Government of India shall be treated as a part of the block of assets qualifying for depreciation @ 40%.

Conditions to be fulfilled:

- (i) The right to use such technology to manufacture such article has been acquired from the owner of such laboratory or any person deriving title from such owner.
- (ii) The return filed by the assessee for any previous year in which the said machinery is acquired, should be accompanied by a certificate from the Secretary, Department of Scientific and Industrial Research, Government of India to the effect that such article is manufactured by using such technology developed in such laboratory or such article has been invented in that laboratory.
The machinery or plant is not used for the purpose of business of manufacture or production of any article or thing specified in the Eleventh schedule.

The depreciation ordinarily allowable to an assessee in respect of any block of assets shall be calculated at the above specified rates on the WDV of such block of assets as are used for the purposes of the business or profession of the assessee at any time during the previous year.

19. What is 'Actual Cost' Rs. Discuss the manner of its computation?

Ans: **Actual cost [Section 43(1)] :** "Actual cost" means the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

However, where the assessee incurs any expenditure for acquisition of any asset or part thereof in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed, exceeds Rs. 10,000, such expenditure shall be ignored for the purposes of determination of actual cost, [(a) Credit Card; (b) Debit Card; (c) Net Banking; (d) IMPS (Immediate Payment Service); (e) UPI (Unified Payment Interface); (f) RTGS (Real Time Gross Settlement); (g) NEFT (National Electronic Funds Transfer), and (h) BHIM (Bharat Interface for Money) Aadhar Pay have been prescribed as mode of electronic payment]

Manner of computation of Actual Cost:

Purchase price of the asset	XXX
Add: Direct costs attributable to bring asset to its present location and working condition for its intended use (i.e. expenses incurred for acquiring the asset E.g.- freight, insurance, loading and handling etc. and expenses incurred in connection with the installation of the asset.)	XXX
Add: Interest on capital borrowed in connection with the acquisition of asset before the asset is first put to use. [Explanation 8]	XXX
Less: Amount of duty of excise or additional duties of customs levied on it and included in its cost, in respect of which claim of CENVAT credit has been made and allowed under the CENVAT Credit Rules, 2004. [Explanation 9]	XXX
Less: Portion of cost of asset which has been met directly or indirectly by the Central Government or a State Government or any authority under any law or any other person, in the form of a subsidy or grant or reimbursement. However, if such subsidy or grant or reimbursement is not directly relatable to the acquisition of the asset, then the amount to be reduced from the cost of the asset shall be - Amount to be deducted = $\frac{\text{Total amount of subsidy/grant/reimbursement} \times \text{Cost of that Asset}}{\text{Total cost of the assets for which subsidy/grant/reimbursement is given}}$	
[Explanation 10]	
Add/Less: Increase or decrease in cost due to exchange rate fluctuation [Section 43A]	XXX

Actual Cost of the asset for purpose of Section 43(1)	XXX

20. What are the various situations when the actual cost of an asset is taken at notional figures?

Ans: As per the Explanations to Section 43(1), the various cases when the actual cost is taken at notional figures are:

Exp.	Circumstances	Actual Cost
(1)	Scientific research asset used for business: Asset is used in the business after it ceases to be used for scientific research related to that business.	Actual Cost as reduced by deduction allowed under section 35(1)(iv) (z.e. NIL).
(1A)	Inventory converted into capital asset and used for business or profession : Where inventory is converted or treated as a capital asset and is used for the purpose of business or profession,	The fair market value of such inventory as on the date of its conversion into capital asset determined in the prescribed manner, shall be the actual cost of such capital asset to the assessee.
(2)	Asset acquired by way of gift or inheritance.	Actual Cost to the previous owner as reduced by the amount of depreciation allowed to him (i.e. WDV).
(3)	Second hand asset: Where the assets constitute the business assets earlier used by any other person (i.e. second hand assets), and the Assessing Officer is satisfied that the main purpose of the transfer of such assets was the reduction of tax liability by claiming depreciation on enhanced cost.	Actual cost as determined by Assessing Officer with the previous approval of the Joint Commissioner, having regard to all the circumstances of the case.
(4)	Reacquisition of asset: Where assessee had transferred asset (which had once been owned and used by him for his business and profession) and now, the same is reacquired by him.	Lower of: (a) WDV at the time of the original transfer; or (b) Price paid for reacquiring it.
(4A)	Safe & lease back: Assessee X purchases an asset belonging to Y, who had earlier claimed depreciation on such asset, and subsequently leases/hires the same to Y.	Cost to X shall be the WDV of the assets to Y at the time of transfer. Explanation 4A overrides Explanation 3 : In the Explanation 4A, a non-obstante clause has been included to the effect that Explanation 4A will have an overriding effect over Explanation 3, The result of this is that there is no necessity of finding out whether the main purpose of the transaction is reduction of tax liability. Explanation 4A is activated in every situation described above without inquiring about the main purpose.
(5)	Building converted to be used for business: Building previously the property of the assessee, is now brought into use for the purpose of business of the assessee. Note: Rate of depreciation applicable	Actual cost of the building as reduced by the depreciation that would have been allowed, had the asset been used for business purpose since the date of its acquisition.

	<i>in previous year of bringing the asset into business use is applied.</i>	
(6)	Capital asset acquired from holding/subsidiary company: Capital asset transferred by holding co. to its subsidiary co. or vice-versa, satisfying the conditions prescribed under section 47(iv)/47(v).	Cost to transferee company shall be the cost to the transferor company had it continued to hold the asset for its business purpose.
(7)	Amalgamation: Capital asset transferred by amalgamating company to the amalgamated company and the amalgamated company is an Indian company.	Cost to amalgamated company shall be the cost to the amalgamating company had it continued to hold the asset for its business purpose.
(7A)	Demerger: Transfer of capital asset in a scheme of demerger, by a demerged company to the resulting company and resulting company is an Indian company.	Cost to resulting company shall be the cost to the demerged company had it continued to hold the asset for its business purpose.
(11)	Asset brought by nonresident: An asset acquired outside India by a non-resident, and subsequently brought to India and used for the purpose of his business and profession in India. Note: Depreciation is computed at rates that would have been allowable had the asset been used in India for his business/profession since the date of its acquisition.	Actual cost as reduced by the depreciation that would have been allowed, had the asset been used in India for the said purpose since the date of its acquisition.
(12)	Capital asset acquired under a scheme for corporatisation of Recognised Stock Exchange in India, approved by SEBI.	Cost of asset to such stock exchange had there been no such corporatisation.
(13)	Capital asset on which deduction has been allowed or is allowable under section 35AD.	Nil, - (a) in the case of such assessee; or (b) if the asset is acquired or received,- (i) by way of gift or will or an irrevocable trust; (ii) on any distribution on liquidation of the company; and (iii) by mode of transfer referred u/s 47(i)/(iv)/(v) / (vi) / (viB) / (xiii) / (xiiib) / (xiv). However, where any capital asset in respect of which deduction or part of deduction allowed u/s 35AD is deemed to be the income of the assessee in accordance with the provisions of Section 35AD(7B), the actual cost of the asset to the assessee shall be the actual cost to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used for the purpose of business since the date of its acquisition.

Illustration 1 - Computation of depreciation - Impact of cash payment on actual cost: From the following data, calculate the depreciation admissible to an individual carrying on trading business :

	Amount in Rs.
Plant and Machinery (Block Rate 15%) (WDV of Plant A and Plant B on 01-04-2020)	25,00,000
Additions - Plant C on 30-06-2020 (Rs. 5,00,000 is paid in cash and balance Rs. 10,00,000 is paid through account payee cheque)	15,00,000
Plant D on 31-12-2020 (< 4,80,000 is paid in cash and balance Rs. 7,20,000 through RTGS transfer)	12,00,000
Sales - Plant A on 01-12-2020	6,00,000

Solution: Where the assessee incurs any expenditure for acquisition of any asset or part thereof in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account, exceeds Rs. 10,000, such expenditure shall be ignored for the purposes of determination of actual cost. Thus, Actual cost of Plant C will be Rs. 10,00,000 i.e. [Rs. 15,00,000 - Rs. 5,00,000] and Plant D will be Rs. [12,00,000 - 4,80,000] = Rs. 7,20,000

Computation of the amount of depreciation allowable (amounts in Rs.) -

WDV as on 01-04-2020	25,00,000
Add: Actual cost of asset acquired during the year -	
30-06-2020	10,00,000
31-12-2020	7,20,000
	42,20,000
Less: Sale proceeds of Plant A on 1-12-2020	6,00,000
WDV	36,20,000
Less: Depreciation (7.5% of Rs. 7,20,000 and 15% of Rs. 29,00,000)	4,89,000
Depreciated value as on 31-03-2021	31,31,000

Working Note: Depreciation is allowed to the extent of 50% as the asset is used for less than 180 days during the previous year. Thus, depreciation on Plant D acquired on 31-12-2020 shall be allowed @ 7.5% of Rs. 7,20,000.

Illustration 2 - Conversion of use of building - depreciation: Compute the amount of depreciation allowable in the following cases - Dr. Jolly purchased a house property on 1-12-2018 for Rs. 10,00,000. Till 1-12-2020, the same was self-occupied as a residence. On this date, the building was brought into use for his medical profession. Rate of depreciation on buildings at the time of purchase of house property was 15%. (CS June 2001)

Solution: As per Explanation 5 to section 43(1), building previously the property of the assessee, is now brought into use for the purpose of business of the assessee, the actual cost shall be the actual cost of the building as reduced by the depreciation that would have been allowed, had the asset been used for business purpose since the date of its acquisition. The rate of depreciation to be applied is the rate in force in the year in which building is brought into business use i.e. 10%.

Computation of the amount of depreciation allowable (amounts in ₹s.) –

WDV as on 31-3-2019	10,00,000
Less: Depreciation @ 5% of ₹s. 10,00,000 [WN]	50,000
WDV as on 01-04-2019	9,50,000
Less: Depreciation (10% of ₹s. 9,50,000)	95,000
WDV as on 1-4-2020 (Actual cost of building)	8,55,000
Depreciation for the current year (10% of ₹s. 8,55,000)	85,500

Working Note: Depreciation is allowed to the extent of 50% as the asset is used for less than 180 days during the previous year.

Illustration 3 - Computation of depreciation : A car purchased by S on 10-08-2016 for ₹s. 3,25,000 for personal use is brought into the business of the assessee on 01-12-2020, when its market value is ₹s. 1,50,000. Compute the actual cost of the car and the amount of depreciation for the assessment year 2021-22 assuming the rate of depreciation to be 15%. (4 Marks, Nov. 2004)

Solution: As per Explanation 5 to section 43(1), building previously the property of the assessee, is now brought into use for the purpose of business of the assessee, the actual cost shall be the actual cost of the building as reduced by the depreciation that would have been allowed, had the asset been used for business purpose since the date of its acquisition. However, it does not provide any mode for a motorcar which is brought into business use after being initially used for personal purposes.

Therefore, Actual cost of motorcar brought into business use = actual cost to assessee = ₹s. 3,25,000. (The market value of motorcar as on date of bringing it into business use is irrelevant)

Thus, actual cost of car = ₹s. 3,25,000 & depreciation = 7.5% of 3,25,000 = ₹s. 24,375 (since the car was used for less than 180 days in the previous year).

21. What do you mean by Written down value (WDV)?

Ans: **Written down value [Section 43(6)]:** Written down value (WDV) means -

- (i) **In case of assets acquired in the previous year:** Actual cost to the assessee.
- (ii) **In case of assets acquired before the previous year:** Actual cost to the assessee less depreciation actually allowed to him (including unabsorbed depreciation, if any).

22. How shall the WDV be determined in case of Block of Assets?

Ans: **WDV in case of block of assets:** As per Section 43(6) (c), WDV of block of assets shall be computed as follows:-

Aggregate of Written Down Value of all the assets falling within that block of assets as at the beginning of the previous year	XXX
Add: Actual cost of any asset falling within that block, acquired during the previous year	XXX
Less: Moneys payable (including scrap) in respect of any asset falling within that block which is sold, discarded, demolished or destroyed during the previous year, to the extent it does not exceed the sum of the above two.	XXX
WDV at the end of the year	XXX

<i>Less: Depreciation at block rate</i>	<i>XXX</i>
<i>Depreciated value of the block at the end of year</i>	<i>XXX</i>

23. What shall be the WDV in case of 'Slump Sale'?

Ans: WDV in case of 'Slump Sale' : Slump sale means the transfer of undertaking(s) for a lump sum consideration without assigning values to individual assets and liabilities. The WDV shall be calculated as follows -

WDV of Block of assets	<i>XXX</i>
<i>Less: Deduction on account of slump sale to the extent of amount computed as under (See Note)</i>	<i>XXX</i>
<i>WDV of block of assets eligible for depreciation</i>	<i>XXX</i>

Note: Deduction on account of slump sale is computed as follows -

<i>Actual cost of assets falling in the Block, which is transferred by slump sale</i>	<i>XXX</i>
<i>Less: Depreciation that would have been allowed if that asset was the only one in the block</i>	<i>XXX</i>
<i>Deduction on account of slump sale</i>	<i>XXX</i>

24. What shall be the actual cost to be taken for computation of depreciation, in case an assessee was covered by exemption from income-tax in any preceding previous year?

Ans: WDV in case assessee was covered by exemption in any previous year: In case an assessee has availed an exemption from income-tax in any previous year(s) preceding the current year i.e. he was not required to compute his total income during that previous year(s), then, the actual cost of any 'asset', for the purposes of computing depreciation, shall be determined as follows –

<i>Actual cost of an asset as per the books of accounts</i>	<i>XXX</i>
<i>Less: Amount attributable to the upward revaluation of such asset in the books of accounts</i>	<i>XXX</i>
<i>Add: Amount attributable to the downward revaluation of such asset in the books of accounts</i>	<i>XXX</i>
<i>Less: Depreciation on adjusted cost of the asset (i.e., Total depreciation on such asset, provided in the books of account of assessee in respect of such preceding previous year(s) - Depreciation attributable to upward revaluation + Depreciation attributable to downward revaluation).</i>	<i>XXX</i>
<i>WDV of the asset for the purpose of claiming depreciation</i>	<i>XXX</i>

25. How will the depreciation admissible be computed in case the assessee's total income comprises partly of agricultural income and partly business income?

Ans: WDV in case of assessee having partly agricultural and partly business income : If the assessee's income consists partly of agricultural income and partly business income which is taxable under the head "Profits and gains of business or profession", then, for computing the written down value of assets acquired before the previous year, the amount of depreciation admissible shall be calculated as if the entire income is derived from the business of the assessee and depreciation so computed shall be deemed to be 'depreciation actually allowed' under the Act.

26. How will the WDV be determined of the block of assets in case the block is transferred in succession of business or profession?

Ans: In case a block is transferred in succession of business or profession, WDV shall be -

No.	Cases		WDV
(1)	WDV in hands of successor under section 170	=	WDV in hands of the predecessor.
(2)	WDV in hands of transferee company [being holding/ subsidiary company, where transfer made fulfills the conditions under section 47(iv)/(v)]		WDV in hands of transferor company.
(3)	WDV in hands of amalgamated Indian company	=	WDV in hands of amalgamating company.
(4)	WDV of assets transferred to resulting company Note: The WDV of the assets so transferred to resulting company shall be reduced from the WDV of demerged company on the 1st day of the previous year.		WDV in hands of demerged company.
(5)	WDV in hands of company formed by corporatisation of recognised stock exchange	=	WDV in the hands of such recognised stock exchange immediately before such corporatisation.
(6)	Actual cost of block of assets transferred to the limited liability partnership [in case transfer made fulfills the conditions under section 47(xiii)]		WDV of the block of assets in the hands of the transferor private/unlisted company on the date on which the company got converted into LLP.

27. Discuss the admissibility of depreciation if— (1) Block exists but WDV ceases to exist; or (2) WDV exists but the Block ceases to exist.

Ans: Since, existence of the block of assets as well as positive WDV are the two basic requirements for claiming depreciation, hence, no depreciation shall be allowed in case either of them ceases to exist.

(1) Block exists but WDV ceases to exist: In case written down value of a block of assets ceases to exist i.e. becomes zero, but the block still exists, then there will be no allowance of any depreciation. Further, the amount of sale price over and above the written down value of block of assets, shall be treated as short-term capital gains.

(2) WDV exists but the block ceases to exist: In case WDV exists but the block of assets ceases to exist i.e. no asset exists in such block, then also there will be no allowance of any depreciation. Further, the balance amount of WDV, shall be treated as short-term capital loss under the law.

Illustration 4 - WDV exists but there is no asset in the block: WDV of the block as on April 1, 2020 is Rs. 15,00,000; rate of depreciation = 15%.

- Assets, falling within the block, are purchased during the year for Rs. 5,00,000.
- Sale of entire block = Rs. 8,80,000. Determine the tax consequences.

Solution: WDV of the block as on 31st March 2021

(amounts in Rs.)—

Opening WDV	15,00,000
	5,00,000
Add: Actual cost of the asset acquired during the year	20,00,000
Less: Moneys payable in respect of entire block sold during the year	8,80,000
WDV as on 31-3-2021 (as block ceases to exist)	-
Depreciation admissible	-
Short term capital Loss (Rs. 20,00,000 - Rs. 8,80,000)	11,20,000

Illustration 5 - Block exists but there is no WDV: Mr. Prakash has the following assets which are eligible for depreciation at 15% on Written Down Value (WDV) basis:

01-04-2017	WDV of plant 'X' and Plant 'Y'	Rs. 2,00,000
10-12-2020	Acquired a new plant 'Z' for	Rs. 2,00,000
22-01-2021	Sold Plant 'T' for	Rs. 4,00,000

Expenditure incurred in connection with transfer Rs. 10,000

Compute eligible depreciation claim/chargeable capital gain if any.

(7 Marks, PCC May 2010)

Solution: Computation of capital gain/depreciation claim of Mr. Prakash (amount in Rs.)—

Sale proceeds of Plant 'Y'				4,00,000
Less: Deduction under section 50(1)				
Purchase of new Plant 'Z'	2,00,000			
WDV as on 1-4-2020 of Block comprising of Plants 'X' and 'Y' [WN-1]	1,22,825			
Expenditure incurred in connection with such transfer	10,000			3,32,825
Short-term capital gains for 2020-21 (Assessment Year 2021-22)				67,175

Working Notes:

(1) Computation of WDV:

(amount in Rs.)

WDV as on 1-4-2017 of Block comprising of Plants 'X' and 'Y'	2,00,000
Less: Depreciation for previous year 2017-18 @ 15%	30,000
WDV as on 1-4-2018	1,70,000
Less: Depreciation for previous year 2018-19 @ 15%	25,500
WDV as on 1-4-2019	1,44,500
Less: Depreciation for previous year 2019-20 @ 15%	21,675
WDV as on 1-4-2020	1,22,825

(2) Since the block is reduced to Nil, hence, no depreciation shall be admissible for assessment year 2021-22.

Illustration 6 - Computation of depreciation: From the following data, calculate the depreciation admissible to an individual carrying on trading business : (amounts in Rs.)

Factory Building (WDV)	5,00,000
Plant and Machinery (WDV):	8,00,000

Additions - 30-06-2020	1,00,000
31-12-2020	1,00,000
Sales - 01-12-2020	6,00,000
Computer Addition 1-1-2021. (Rs. 60,000 is paid through A/ c payee cheque and balance in cash)	80,000
Furniture and Fixtures (WDV)	1,00,000
Motor-car (WDV)	60,000
	(Nov. 2000)

Solution: The admissibility of depreciation shall be computed as follows (amount in Rs.)-

Particulars	Block 1 – Plant & Machinery (15%)	Block 2 – Furniture & Fittings (10%)	Block 3 – Factory Building (10%)	Block 4 – Motor Car (15%)	Block Computer (40%)
WDV as on 1-4-2020	8,00,000	1,00,000	5,00,000	60,000	Nil
Add: Actual cost of asset acquired during the year - 30-06-2020	1,00,000	Nil	Nil	Nil	Nil
31-12-2020 & 1-1-2021	1,00,000	Nil	Nil	Nil	60,000
	10,00,000	1,00,000	5,00,000	60,000	60,000
Less: Sales (1-12-2020)	6,00,000	Nil	Nil	Nil	Nil
WDV as on 31-3-2021	4,00,000	1,00,000	5,00,000	60,000	60,000
Less: Depreciation at block rate	52,500	10,000	50,000	9,000	12,000
WDV as on 1-4-2021	3,47,500	90,000	4,50,000	51,000	48,000

Working Notes:

- (1) Since assessee is carrying on trading business, no additional depreciation is admissible.
- (2) Since the new plant acquired during the previous year is put to use for less than 180 days depreciation on such plant is calculated at half of the block rate. Hence, depreciation on Plant & Machinery = 15% of Rs. 3 lakh + 50% of 15% of Rs. 1 lakh (since used for less than 180 days) = 52,500.
- (3) Though purchase price of computer is Rs. 80,000 but Rs. 20,000 is paid in cash, hence its actual cost will be Rs. 80,000 - Rs. 20,000 = Rs. 60,000. Since the new computer acquired during the previous year is put to use for less than 180 days, hence depreciation on such computer is calculated at half of the block rate. Depreciation on computer = 50% of 40% of Rs. 60,000 = Rs. 12,000.

Illustration 7 - Computation of depreciation: A newly qualified Chartered Accountant Mr. Dhaval, commenced practice and has acquired the following assets in his office at the cost shown against each item. Calculate the amount of depreciation that can be claimed from his professional income:

No.	Description	Date of Acquisition	Date when put to use	Amount (Rs.)
(a)	Computer	27 Sept. 2020	2 Oct., 2020	35,000
(b)	Computer software	2 Oct., 2020	4 Oct., 2020	8,500
(c)	Computer printer	2 Oct., 2020	3 Oct., 2020	12,500
(d)	Books (of which books being annual			

	Publications			
	are of ₹12,000)	1 Apr., 2020	1 Apr., 2020	13,000
(e)	Office furniture (Acquired from practicing CA.)	1 Apr., 2020	1 Apr., 2020	3,00,000
(f)	Laptop	26 Sept., 2020	4 Oct., 2020	43,000
(g)	Fire extinguisher	1 Apr., 2020	No instance arose to use during F.Y. 2020-21	2,500
(h)	Purchased practicing CA's office in April 2020 who had run it for 4 years, for Rs. 5 lakhs which includes Rs. 2 lakhs for goodwill and Rs. 3 lakhs for cost of furniture (included in (e) above)			

Note: Depreciation is to be provided at the applicable rates. (Take 365 days in a year) (8 Marks, May 2007)

Solution: Computation of depreciation allowable (amounts in ₹.)-

Particulars	Block 1 (Computer, Computer software. Laptop & Books being non-annual publications, Books being Annual publications) - 40%	Block 2 (Furniture) - 10%	Block 3 (Intangible Assets - Goodwill) - 25%	Block 4 (Fire Extinguisher & Computer Printer) - 15%
Assets put to use for 180 days or more	48,000	3,00,000	2,00,000	15,000
Assets put to use for less than 180 days	51,500	Nil	Nil	Nil
Allowable Depreciation	29,500	30,000	50,000	2,250

Working Notes:

- (1) Goodwill is an intangible asset and falls within the scope of "any other business or commercial rights of similar nature" and the same is eligible for depreciation as has been judicially decided by Supreme Court in CIT v. Smifs Securities Ltd. [2012]348 ITR 302 (SC).
- (2) Depreciation on fire extinguisher will be available even if it is not actually put to use because of its nature.

Illustration 8 - Computation of depreciation : Mr. Rangamannar resides in Delhi. As per new rule in the city, private cars can be plied in the city only on alternate days.

He has purchased a car on 21-09-2020, for the purpose of his business as per following details:

	₹.
Cost of car (excluding GST)	12,00,000
Add: Delhi GST at 14%	<u>1,68,000</u>
Add: Central GST at 14%	<u>1,68,000</u>

Total price of car 15,36,000 He estimates the usage of the car for personal purposes will be 25%. He is advised that since the car has run only on alternate days, half the depreciation, which is otherwise allowable, will be actually allowed. He has started using the car immediately after purchase.

Determine the depreciation allowable on car for the assessment year 2021-22, if this is the only asset in the block. If this car were to be used in the subsequent assessment year 2022-23 on the same terms and conditions above, what will be the depreciation allowable Rs. Assume that there is no change in the legal position under the Income-tax Act, 1961. (4 Marks, Nov. 2018-NS)

Solution: According to Section 32, if an asset is acquired by the assessee during the previous year and the same is put to use for less than 180 days during that previous year, then the depreciation will be limited to 50% of the depreciation allowable on such asset as per the rate prescribed in Rule 5(1). Since the car was ready for use for more than 180 days, the date of purchase being 21-09-2020 (the date when car was put to use), hence depreciation will be allowed on such car at full rate.

Since, no input tax credit is admissible of CGST and SGST paid in respect of motor vehicles (subject to certain exceptions), the actual cost of car shall be Rs. 15,36,000.

Where any motor car is not exclusively used for the purposes of business or profession, then the deduction u/s 32 shall be restricted to a fair proportionate part thereof which is used for the purpose of business. The amount of depreciation actually allowed shall be reduced from the written down value to find out depreciated value of the block of asset.

Thus, taking into account the above observations depreciation shall be computed as under

(amount in Rs.):

Assessment Year 2021-22 :		
Actual cost of car		15,36,000
Less: Depreciation @ 15% of Rs. 15,36,000	2,30,400	
Less: Disallowed as per Section 38(2) for personal use [25%]	57,600	1,72,800
Depreciated value of the block at the end of year Assessment Year 2022-23:		13,63,200
Depreciated value of the block at the beginning of year		13,63,200
Less: Depreciation @ 15% of Rs. 13,63,200	2,04,480	
Less: Disallowed as per Section 38(2) for personal use [25%]	51,120	1,53,360
Depreciated value of the block at the end of year		12,09,840
Thus, depreciation allowable for A.Y. 2021-22 is Rs. 1,72,800 and for A.Y. 2022-23 is Rs. 1,53,360.		

28. Explain briefly the treatment of Exchange Rate Fluctuations arising in case of purchase of an asset from outside India.

Ans: Special provisions consequential to changes in rate of exchange of currency [Section 43A]: The provisions of this section are as follows –

(1) Applicability: The provisions of this section apply in case the assessee fulfills the following conditions –

- (a) An asset is acquired from outside India for his business and profession.
- (b) Subsequently, after the date of acquisition, there is change in the rate of exchange during any previous year.
- (c) Such exchange rate fluctuation results in increase or reduction in the liability of the assessee (as expressed in Indian currency) at the time of making the payment –
 - (i) Towards the whole or part of the cost of the asset; or

- (ii) Towards the repayment (along with interest) of whole or part of the moneys borrowed by him from any person in any foreign currency specifically for acquiring the asset.

(2) **Treatment** : The amount by which the liability is so increased or decreased (along with increase/decrease in interest) at the time of making payment, shall be added to or reduced from the following -

- (a) Actual cost of the asset; or
- (b) Capital expenditure incurred on scientific research as referred to under Section 35(1) (iv); or
- (c) Capital expenditure on family planning incurred by a co. as referred to under Section 36(1)(ix); or
- (d) Cost of acquisition of a capital asset (other than depreciable assets referred to in Section 50), while computing capital gains under Section 48.

The amount so arrived at after such addition or deduction shall be taken to be the actual cost of the asset or the amount of capital expenditure.

(3) **Other relevant points:**

- (a) These adjustments are to be made only on actual payment by the assessee towards the cost of asset or repayment of the loan/interest irrespective of the method of accounting adopted by the assessee.
- (b) Where whole or part the liability is not met by assessee but is met by any other person, no adjustments of exchange rate fluctuations shall be made with respect to the liability so met.
- (c) Where assessee has entered into forward exchange contract with "authorized dealer" for purchase of foreign currency to discharge the liability as referred above, the increase or decrease in liability is computed with reference to rate of exchange specified in the contract.
- (d) Increase/decrease in liability of interest payment on account of exchange rate fluctuations will form part of cost of asset.

APPORTIONMENT OF DEPRECIATION, ADDITIONAL DEPRECIATION & UNABSORBED DEPRECIATION

29. **How shall the depreciation is apportioned in case of succession of business or amalgamation/ demerger of a company?**

Ans: **Apportionment of depreciation in case of amalgamation/ demerger/ business reorganisation** : In case of succession of firm or proprietary concern by a company as referred to in Section 47(xiii)/(xiv); or succession under section 170; or amalgamation or demerger of a company; or conversion of a private/unlisted company into a limited liability partnership under section 47(xiii b), the provisions for allowability of depreciation shall be as under -

- (1) The amount of depreciation in any previous year, on tangible and intangible assets, allowable to predecessor and successor; or to amalgamating company and amalgamated company; or to demerged company and resulting company, shall not exceed the depreciation calculated at prescribed rates, had been such succession or amalgamation or demerger not taken place.
- (2) Such depreciation determined shall be apportioned between predecessor and successor, or amalgamating company and amalgamated company, or demerged company and resulting company, in the ratio of the number of days of use of assets by them during that previous year.

Illustration 9 -Apportionment of Depreciation: Mr. Gopi carrying on business as proprietor converted the same into a limited company by name Gopi Pipes (P) Ltd. from 01-07-2020. The details of the assets are given below:

Block -I WDV of plant & machinery (rate of depreciation @ 15%)	12,00,000
Block -II WDV of building (rate of depreciation @ 10%)	25,00,000

The Company Gopi Pipes (P) Ltd. acquired plant and machinery in December 2020 for 110,00,000. It has been doing the business from 01-07-2020.

Compute the quantum of depreciation to be claimed by Mr. Gopi and successor Gopi Pipes (P) Ltd. for the A.Y. 2021-22.

Note : Ignore additional depreciation. (4 Marks, Nov. 2014)

Solution: The amount of depreciation in any previous year, on tangible and intangible assets, allowable to Sole Proprietor and Private limited company shall be maximum upto the depreciation calculated at prescribed rates, had such conversion not taken place. Such depreciation shall be apportioned between predecessor and successor, in the ratio of the number of days of use of assets by them during that previous year.

Apportionment of Depreciation: No. of days in the year = 365; Date of conversion = 01-07-2020

Asset	Total Depreciation (WDV on 1-4-2020 x Dep. Rate)	Total Days used	Days used by Gopi Proprietor	Days used by Gopi Pipes (P) Ltd.	Allowable Depreciation to Gopi Proprietor	Allowable depreciation Gopi Pipes (P) Ltd
Buildings	2,50,000	365	91	274	62,329	1,87,671
Plant & Machinery	1,80,000	365	91	274	44,877	1,35,123
New Plant and machinery	75,000	-	-	Less than 180 days	-	75,000
Total	5,05,000				1,07,206	3,97,794

Illustration 10 - Apportionment of Depreciation: Sai Ltd. has a block of assets carrying 1.5% rate of depreciation, whose written down value on 01-04-2020 was Rs. 40 lacs. It purchased another asset of the same block on 01-11-2020 for Rs. 14.40 lacs and put to use on the same day. Sai Ltd. was amalgamated with Shirdi Ltd. with effect from 01-01-2021. Compute the depreciation allowable to Sai Ltd. & Shirdi Ltd. for the previous year ended on 31-03-2021 assuming the assets transferred of Shirdi Ltd. at Rs. 60 lacs. (8 Marks, IPCC Nov. 2010)

Solution: The amount of depreciation in any previous year, on tangible and intangible assets, allowable to amalgamating company and amalgamated company shall not exceed the depreciation calculated at prescribed rates, had such amalgamation not taken place. Such depreciation determined shall be apportioned between amalgamating company and amalgamated company, in the ratio of the number of days of use of assets by them during that previous year.

Apportionment of Depreciation: Number of days in the year = 365; Date of amalgamation = 01-01-2021.

Asset	Total Depreciation	Total Days used	Days used by Sai	Days used by Shirdi	Sai Ltd.	Shirdi Ltd.
(a) On opening balance [WN-1]	6,00,000	365	275	90	4,52,055	1,47,945
(b) Additions made by Sai Ltd. [WN-2]	1,08,000	151	61	90	43,629	64,371
	Total	7,08,000			4,95,684	2,12,316

Working Notes:

(1) **Statement showing computation of depreciation:**

WDV as on 1-04-2020	40,00,000
Add: Actual cost of asset acquired during the year (used for less than 180 Days)	14,40,000
Depreciation on Rs. 40,00,000 @ 15%	6,00,000
Depreciation on Rs. 14,40,000 @ 7.5%	1,08,000

(2) The price at which the assets were transferred, i.e., Rs. 60 lacs, has no effect on depreciation.

30. Write a short note on Additional Depreciation. (6 Marks, PCC May 2005)

Ans: Additional depreciation [Section 32(1) (ia)]: The provisions relating to additional depreciation are as under -

(1) **Applicability:** Additional depreciation is available on new machinery or plant (other than ships and aircraft), which has been acquired and installed after 31-3-2005.

- This provision is applicable only in case of an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation, transmission or distribution of power.
- It is applicable to only those assessees who claim depreciation on block of assets under section 32(1)(ii).

(2) **Deduction:** A further deduction of 20% of actual cost of such plant and machinery is allowed. However, in case the asset acquired during previous year is put to use for a period of less than 180 days then additional depreciation on such asset will be calculated @ 10% of actual cost.

Allowance of balance 50% additional depreciation : Where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business for a period of less than 180 days in that previous year, and the additional depreciation in respect of such asset is restricted to 10% of the actual cost for that previous year, then, the deduction for the balance additional depreciation i.e. 10% of the actual cost of such asset shall be allowed in the immediately succeeding previous year in respect of such asset.

(3) **No Deduction:** Additional depreciation is not allowed in respect of the following -

- Plant and machinery which, before its installation by assessee, was used whether in India or outside India by any other person;
- Any office appliances or road transport vehicles.
- Plant or machinery installed in the office premises or the residential accommodation (including the guest houses).
- Plant and machinery whose whole of the actual cost is deductible (by way of depreciation or otherwise) in computing income under this head of any one previous year.

Illustration 11 - Computation of depreciation and additional depreciation: GP Ltd. was incorporated on 31-12-2019 for manufacture of tyres and tubes for motor vehicles in Rajasthan. The manufacturing unit was set up on 30-4-2020. The company commenced its operations on 01-05-2020. The total cost of the plant and machinery installed in the unit is Rs. 10 crores. The said plant and machinery included second-hand plant and machinery bought for Rs. 1 crores and new plant and machinery for scientific research relating to the business of the assessee acquired at a cost of Rs. 1 crores. Out of the said plant and machinery, new plant and machinery acquired at cost of Rs. 2 crores was put to use on 14-12-2020. Compute the amount of depreciation allowable u/s 32 of the Income-tax Act, 1961 in respect of the assessment year 2021-22 and assessment year 2022-23. Furnish explanations in support of your computation. (4 Marks, May 2007)

Solution: Computation of depreciation allowable for the assessment year 2021-22 to GP Ltd. (Rs. crores):

Total cost of plant and machinery	10	
Less: Used for Scientific Research [WN-1]	1	
Cost eligible for normal depreciation	9	
Normal depreciation at 15% of Rs. 7 crores (since put to use for not less than 180 days):	1.05	
Normal depreciation at 7.5% of Rs. 2 crores (since put to use for less than 180 days)	0.15	1.20
Additional Depreciation		
Cost of plant and machinery	10	
Less: Second hand plant and machinery [WN-2]	1	
Plant and machinery used for scientific research [WN-2]	1	
Cost eligible for additional depreciation	8	
Additional Depreciation at 20% of actual cost of Rs. 6 crores (put to use not less than 180 days)	1.2	
Additional Depreciation at 10% of actual cost of Rs. 2 crores (put to use for less than 180 days)	0.2	1.40
Depreciation allowable for AY 2021-22 under section 32		2.60
Depreciated value of plant and machinery [Rs. 9 crores – Rs. 2.6 crores]		6.40

Computation of depreciation allowable for the assessment year 2022-23 to GP Ltd. (Rs. crores):

Depreciated value of Plant and machinery as on 01-04-2021		6.40
Normal depreciation at 15% of Rs. 6.4 crores	0.96	
Additional Depreciation : Cost of plant and machinery 2 crores x 10% [WN-3]	0.20	1.16
Depreciated value of plant and machinery 6.4 crores - Rs. 1.16 crores]		5.24

Working Notes:

- (1) As per section 35(2) (iv), no depreciation shall be allowed in respect of plant and machinery purchased for scientific research relating to assessee's business, since the entire expenditure is deductible under section 35.
- (2) No additional depreciation will be allowed on second hand plant and machinery as well as plant and machinery used for scientific research.
- (3) Where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business for a period of less than 180 days in that previous year, and the additional depreciation in

respect of such asset is restricted to 10% of the actual cost for that previous year, then, the deduction for the balance additional depreciation i.e. 10% of the actual cost of such asset shall be allowed in the immediately succeeding previous year in respect of such asset.

Illustration 12 - Computation of depreciation and additional depreciation: Venus Ltd., engaged in manufacture of pesticides, furnishes the following particulars relating to its manufacturing unit at Chermai (for the year ending 31-03-2021): (Rs. in lacs)

Opening WDV of Plant and Machinery	20
New machinery purchased on 1-9-2020	10
New car purchased on 1-12-2020	8
Computer purchased on 3-1-2021	4

Additional information:

- All assets were put to use immediately.
- Computer has been installed in the office.
- During the year ended 31-3-2020, a new machinery had been purchased on 31-10-2019, for Rs. 10 lacs. Additional depreciation, besides normal depreciation, had been claimed thereon.
- Depreciation rate of machinery may be taken as 15%.

Compute the depreciation available to the assessee as per the provisions of the Income-tax Act, 1961 and the WDV of different blocks of assets as on 31-3-2021. (8 Marks, May 2016)

Solution: Computation of depreciation and the WDV of different blocks of asset as on 31-03-2021
(amount in Rs.)

Particulars	Block I (Plant & Machinery) & (Car) Block Rate 15%	Block II (Computer) Block Rate 40%
Opening WDV [Opening WDV in case of car is Nil]	20,00,000	Nil
Add: Assets acquired during the previous year 10,00,000 + Rs. 8,00,000 (Computer = Rs. 4,00,000)	18,00,000	4,00,000
Less: Moneys payable in respect of assets sold during the year	Nil	Nil
WDV as on 31-3-2021 eligible for depreciation	38,00,000	4,00,000
Less: (a) Normal Depreciation - On car (Rs. 8,00,000 $\times$ 7.5%, since used for less than 180 days and balance WDV i.e. Rs. 30,00,000 $\times$ 15%) - On Computer (Rs. 4,00,000 $\times$ 40% $\times$ 50%, since used for less than 180 days)	5,10,000	80,000
(b) Additional Depreciation - On plant (Rs. 10,00,000 $\times$ 20%, since used for more than 180 days) [WN]	2,00,000	-
(c) Additional Depreciation - On plant (Rs. 10,00,000 $\times$ 10%, since purchased in FY 2019-20 and put to use for less than 180 days) [WN]	1,00,000	-
WDV as on 1-4-2021	29,90,000	3,20,000

Working Notes:

- (1) In case of new machinery of Rs. 20,00,000, additional depreciation is calculated @ 20% of actual cost since the asset is acquired during the previous year and put to use for a period of not less than 180 days.
- (2) Since the computer is installed in office building, the same shall not be eligible for additional depreciation.
- (3) Where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business for a period of less than 180 days in that previous year, and the additional depreciation in respect of such asset is restricted to 10% of the actual cost for that previous year, then, the deduction for the balance additional depreciation i.e. 10% of the actual cost of such asset shall be allowed in the immediately succeeding previous year in respect of such asset. Hence, on plant of Rs. 10,00,000 which was purchased in FY 2019-20 and put to use for less than 180 days in that year, the remaining additional depreciation @ 10% is allowed in FY 2020-21.

Illustration. 13 Computation of depreciation and additional depreciation: An industrial undertaking which has commenced the manufacturing activity has acquired the following assets during the previous year (amount in Rs.):

Assets	Date of acquisition	Date when put to use	Cost of acquisition
Factory buildings	4-4-2020	1-9-2020	50,00,000
Plant and Machinery:			
Air pollution control equipment	4-5-2020	1-9-2020	4,00,000
Machinery A	5-5-2020	1-9-2020	2,00,000
Machinery B	7-6-2020	1-9-2020	5,00,000
Machinery C	30-8-2020	1-9-2020	10,00,000
Machinery D	1-9-2020	31-10-2020	4,00,000
Machinery E	1-1-2021	28-2-2021	3,00,000
Machinery F (second hand)	11-1-2021	13-1-2021	2,00,000
Motor car	1-2-2021	1-2-2021	5,00,000
Air conditioner (installed in the office)	1-2-2021	2-2-2021	1,00,000

Compute depreciation allowable and the WDV. (CS Dec. 2005)

Solution: Computation of depreciation and WDV (amount in Rs.)-

Nature of Asset	Actual Cost	Rate of Depreciation	Normal Depreciation	Additional Depreciation	WDV as on 1-4-2021
Factory buildings	50,00,000	10%	5,00,000	-	45,00,000
Plant & machinery:					
Air pollution control equipment	4,00,000	40%	1,60,000	80,000	1,60,000
Machinery A, B & C	17,00,000	15%	2,55,000	3,40,000	11,05,000
Machinery D & E (used for less than 180 days)	7,00,000	15%	52,500	70,000	5,77,500
Machinery F & AC (used for less than 180 days)	3,00,000	15%	22,500	Not Eligible	2,77,500
Motor car (used for less than 180 days)	5,00,000	15%	37,500	Not Eligible	4,62,500

Working Notes:

- (1) No Additional depreciation shall be allowed in respect of -
 - (a) Machinery F (second hand) which before its installation by the assessee, was used by any other person;
 - (b) Air conditioner since the same is installed in any office premises;
 - (c) Motor Car since it is road transport vehicles; or
- (2) In case of Machinery D and E additional depreciation is calculated @ 10% of actual cost since the asset is acquired during the previous year and put to use for a period of less than 180 days.

Illustration 14 - Computation of depreciation and additional depreciation: Gopichand Industries furnishes you the following information: (amount in Rs.)

On 1-4-2020 -		
Block I: Plant and machinery (consisting of 10 looms) Rate of depreciation 15%	WDV	5,00,000
Block II: Buildings (consisting of 3 buildings) Rate of depreciation 10%	WDV	12,50,000
Acquired on 5-7-2020 - 5 looms for		4,00,000
Sold on 7-12-2020 -15 looms for		10,00,000
Acquired on 10-1-2021 - 2 looms for		3,00,000
Compute depreciation claim.		

Solution: Computation of depreciation claim (amount in Rs.) –

Particulars	Block I (Plant)	Block II (Buildings)
Opening WDV	5,00,000	12,50,000
Add: Assets acquired during the previous year (Rs. 4,00,000 + Rs. 3,00,000)	7,00,000	-
	12,00,000	12,50,000
Less: Moneys payable in respect of assets sold during the year	10,00,000	-
WDV as on 31-3-2021 eligible for depreciation	2,00,000	12,50,000
Less: (a) Normal Depreciation (Rs.2,00,000 $\times$ 7.5%, since used for less than 180 days)	15,000	1,25,000
(b) Additional Depreciation (Rs.3,00,000 $\times$ 10%, since used for less than 180 days) [WN]	30,000	-
WDV as on 1-4-2021	1,55,000	11,25,000

Working Note: In case if plant is acquired during the year and is sold in the same year then no additional depreciation on the same shall be admissible. Hence, no additional depreciation can be claimed on 5 looms which were sold in the year of acquisition. The balance additional depreciation amounting Rs. 30,000 will be allowed in the immediately succeeding previous year.
No additional depreciation is admissible on building.

Illustration 15 - Computation of depreciation and additional depreciation: Mr. Abhimanyu is engaged in the business of generation and distribution of electric power. He always opts to claim depreciation on written down value for income-tax purposes. From the following details, compute the depreciation allowable as per the provisions of the Income-tax Act, 1961 for the assessment year 2021 -22 : (4 Marks, Nov. 2013)
(Rs. in lacs)

(i) Opening WDV of block (15% rate)	42
(ii) New machinery purchased on 12-10-2020	10
(iii) Machinery imported from Colombo on 12-04-2020 This machine had been used only in Colombo earlier and the assessee is the first user in India.	9
(iv) New computer installed in generation wing of the unit on 15-07-2020.	2

Solution: Computation of depreciation (amount in Rs.):

Particulars	Block I (Plant) Block Rate 15%	Block II (Computer) Block Rate 40%
Opening WDV	42,00,000	Nil
Add: Assets acquired during the previous year (Rs. 10,00,000 + Rs. 9,00,000)	19,00,000	2,00,000
Less: Moneys payable in respect of assets sold during the year	Nil	Nil
WDV as on 31-3-2021 eligible for depreciation	61,00,000	2,00,000
Less: (a) Normal Depreciation - On plant (Rs. 10,00,000 $\times$ 7.5%, since used for less than 180 days and balance WDV i.e. Rs. 51,00,000 $\times$ 15%) - On Computer (Rs. 2,00,000 $\times$ 40%)	8,40,000	80,000
(b) Additional Depreciation - On plant (Rs. 10,00,000 $\times$ 10%, since used for less than 180 days) - On computers (Rs. 2,00,000 $\times$ 20%) [WN]	1,00,000	40,000
WDV as on 1-4-2021	51,60,000	80,000

Working Notes:

- (1) No Additional depreciation shall be allowed in respect of Machinery imported from Colombo which before its installation by the assessee, was used by any other person.
- (2) In case of new machinery of Rs. 10,00,000, additional depreciation is calculated @ 10% of actual cost since the asset is acquired during the previous year and put to use for a period of less than 180 days. The balance additional depreciation amounting Rs. 1,00,000 will be allowed in the immediately succeeding previous year.
- (3) Since the computer is installed in generation wing of the unit, the same shall be eligible for additional depreciation @ 20% i.e. Rs. 2,00,000 $\times$ 20% = Rs. 40,000.

31. Write a short note on carry forward and set-off of unabsorbed depreciation. (Nov.00, Nov.01, Nov.06 - 6 Marks)

Ans: Unabsorbed depreciation [Section 32(2)]: The provisions relating to unabsorbed depreciation is as under

- (1) Unabsorbed depreciation shall be allowed to be carried forward. It shall be treated as part of current year depreciation.
- (2) It can be carried forward whether or not the business or asset to which it relates is in existence.
- (3) Return of loss is not required to be submitted to carry forward unabsorbed depreciation.
- (4) Brought forward business losses (speculative or non-speculative) under Section 72(2) and 73(3) shall be given priority of set off over unabsorbed depreciation.

- (5) Such unabsorbed depreciation can be carried forward for an indefinite period and set-off against any head of income (except Salaries). - CIT v. Mother India Refrigeration Industries Pvt. Ltd. [1985] 155 ITR 711 (SC).

DEPRECIATION IN CASE OF POWER GENERATING UNITS

32. Discuss the claim for depreciation in case of Power Generating Units.

Ans: **Depreciation in case of Power Generating Unit [Section 32(1) (i)]:** The provisions relating to it are as follows -

- (1) **Applicability:** Section 32(1) (i) applies to an undertaking engaged in generation or generation and distribution of power i.e. it does not apply to an undertaking engaged in only distribution of power.
- (2) **Claim of depreciation on SLM basis instead of WDV:** These undertakings are given an option that, instead of Written Down Value method (WDV), they can claim the depreciation as per the Straight Line Method (SLM) on their individual assets. This option is to be exercised by the undertakings before due date of furnishing Return of Income under section 139(1) for the assessment year relevant to previous year in which they start generating power. Once exercised, the option shall be final and shall apply to subsequent assessment years.
- (3) **Treatment in case of sale of assets :** In case the tangible asset on which depreciation as per SLM is claimed, is sold, discarded, demolished or destroyed in any previous year (other than the year in which it is first put to use), then there can arise two situations which are as follows :
- (a) **Monies payable is less than WDV - Terminal depreciation [Section 32(1)(iii)]:** In case the Monies payable (including scrap) is less than the WDV of the asset, then such shortfall of monies payable over WDV shall be treated as 'Terminal Depreciation' under section 32(1)(iii), in the year in which such asset is so sold, discarded, demolished or destroyed.
- (b) **Monies payable exceeds WDV - Balancing Charge [Section 41(2)]:** If the Monies payable together with the scrap exceeds the WDV of the asset, then so much of the excess, as does not exceed the difference between the actual cost and the WDV, shall be treated as 'Balancing Charge' in the form of deemed business profits under section 41(2), in the year in which monies payable become due. Further, the excess of surplus over the actual cost is taxable as capital gains.
Balancing Charge = Lower of: (1) Actual cost - WDV of asset; or (2) Monies Payable - WDV of asset. Capital Gains = Monies Payable - Actual Cost of the asset, if positive.
As per Explanation to Section 41(2): Where the monies payable become due in the previous year in which the business is no longer in existence, the provisions shall apply as if the business is in existence in that previous year.

Illustration 16 – Balancing charge and terminal depreciation in case of power generating undertakings: Determine the tax consequences in following cases for assessment year 2021-22

- (a) XYZ Co., an undertaking established in 2011 for generation and distribution of power, has opted for SLM method of depreciation. The written down value of its machinery as on 1-4-2020 was Rs. 6,60,000. The machinery is sold for Rs. 4,60,000 on 1-5-2020.
- (b) ABC Co., a power-generating unit (opted for SLM), has purchased machinery on 1-5-2020 for Rs. 10,00,000 which is destroyed by fire on 15-10-2020 and an insurance claim of Rs. 8,80,000 is received on 31-1-2021.

- (c) *XA Co., an undertaking established in 2017 for generation of power, has opted for SLM method of depreciation. The company purchased a machinery for Rs. 5,00,000. The written down value of its machinery as on 1-4-2020 is Rs. 3,50,000. The machinery is sold for Rs. 7,65,000 on 1-12-2020.*

Solution: *The tax consequences in aforesaid cases shall be as follows -*

- (a) *Here, monies payable is less than WDV, hence there shall be allowed deduction for terminal depreciation. Therefore, terminal Depreciation u/s 32(1)(iii) = Rs. 6,60,000 - Rs. 4,60,000 = Rs. 2,00,000.*
- (b) *Here, since machine is destroyed in the same previous year in which it is first put to use, hence there is no terminal depreciation. The amount of loss, to the extent not reimbursed by insurance company, shall be treated as Short-Term Capital Loss. Therefore, STCL = Rs. 10,00,000 - Rs. 8,80,000 = Rs. 1,20,000.*
- (c) *Here, monies payable is greater than WDV.*
Therefore, Balancing Charge u/s 41(2) = [(Lower of Rs. 5,00,000 or Rs. 7,65,000) - Rs. 3,50,000] = Rs. 1,50,000; and Short-Term Capital Gains = Rs. 7,65,000 - Rs. 5,00,000 = Rs. 2,65,000.

CERTAIN SPECIAL DEDUCTIONS -SECTION 35 TO 35DDA

33. Discuss the various deductions available in respect of expenditure incurred on 'Scientific Research'.

Ans: **Deductions available in respect of expenditure incurred on 'Scientific Research' [Section 35]:** (1) *Meaning of Scientific research: As per Section 43(4), 'Scientific research' means any activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries.*

(2) Deduction in relation to expenditure incurred on scientific research [Section 35] :

Section 35	Expenditure incurred	Amt. of deduction	Conditions / Remarks
(1)(i)	⇒ Revenue expenditure on scientific research related to business. Expenditure on scientific research before commencement of business by way of - (a) Purchase of materials; or (b) Salary (other than perquisite) of employees	Amount of expenditure incurred	Expenditure incurred within 3 years immediately preceding commencement of business is allowed as deduction in the year of commencement of business to the extent certified by the prescribed authority.
(1)(ii)	Sum paid to a research association, university, college or institution whose object is undertaking of scientific research**	Sum so paid	Such association, university college or institution must be approved as per prescribed guidelines and must be notified by the Central Government. Deduction is allowed even if research is not related to business.
(1)(iia)	Sum paid to a company having as its main object 'scientific research and development' to be used by it for scientific research	Sum so paid	Such company is registered in India, is approved by prescribed authority and fulfils other prescribed conditions.
(1)(iii)	Sum paid for social science or statistical research to a research association which has as its object the undertaking of research in	Sum so paid	**Such association, university college or institution must be approved as per prescribed guidelines and must be notified by

	social science or statistical research or to a university, college, or institution** [See Note 1]		the Central Government. ** Deduction is allowed even if research is not related to business.
(1)(iv)/(2)	Capital expenditure (except expenditure on the purchase of land) on scientific research related to business. Capital expenditure (except expenditure on the purchase of land) incurred before the commencement of business.	Amount of expenditure incurred	Expenditure incurred within 3 years immediately preceding the commencement of business is allowed in the year of the commencement of the business. ⇒ No depreciation is allowable.
(2AA)	Sum paid to - (a) a National Laboratory; or (b) a University; or (c) an Indian Institute of technology; or (d) a specified person [See Note 1]	Sum so paid	⇒ Sum is paid with a specific direction that it shall be used for scientific research undertaken under a programme approved in this behalf by prescribed authority. ⇒ No deduction shall be allowed in respect of such sum under any other provision of the Act. ⇒ The prescribed authority shall, before granting approval, satisfy itself about the feasibility of carrying out the scientific research and shall submit its report to the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General in such form as may be prescribed.
(2AB)	Expenditure (not being in nature of cost of any land or buildings) incurred on in-house research and development facility incurred by a company engaged in the business of bio-technology, or, any business of manufacture or production of any article or thing, not being an article or thing specified in the list of the Eleventh Schedule. ⇒ Expenditure on scientific research in relation to drugs and pharmaceuticals includes expenditure on clinical drug trial, obtaining approval from any regulatory authority and filing an application for patent.	Amount of expenditure incurred	Such Research and development facility is approved by prescribed authority. ⇒ Such assessee should enter into an agreement with prescribed authority for co-operation in such Research and development facility and fulfils such conditions with regard to maintenance of accounts and audit thereof and furnishing of reports in such manner as may be prescribed. ⇒ The prescribed authority shall submit its report in relation to the approval of the said facility to the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General in such form and within such time as may be prescribed. ⇒ No deduction shall be allowed in respect of such sum under any other provision of the Act. ⇒ No deduction shall be allowed in this sub-section to a company approved under section 35(1)(iia).

Notes:

- (1) **Deduction not to be denied even if approval withdrawn subsequently [Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 w.e.f. 01-04-2021] :** The deduction allowable under this section shall not be denied merely on the ground that subsequent to the payment of such sum by the assessee, -
- the approval granted to association, university, college, other institution referred to u/s 35(1)(ii)/(iii), or the company referred u/s 35(1)(ia) or the Laboratory or specified person referred to under section 35 (2 A A) has been withdrawn; or
 - the approval granted to the programme undertaken by the National Laboratory, University, Indian Institute of Technology or specified person, has been withdrawn.
- (2) **Intimation to prescribed income tax authority within 3 months :** Every notification for approval under Section 35(1)(ii)/(ia)/(iii) in respect of the research association, university, college or other institution or the company issued on or before 01-04-2021, shall be deemed to have been withdrawn unless such research association, university, college or other institution or company makes an intimation in prescribed form and manner to the prescribed income-tax authority within 3 months from 01-04-2021, and subject to such intimation the notification shall be valid for a period of 5 consecutive assessment years beginning with the assessment year commencing on or after 01-04-2022.
- Notification to be effective for a period not exceeding 5 years :** Any notification issued by the Central Government any one time, have effect for such assessment year or years, not exceeding 5 assessment years as may be specified in the notification.
- (3) **Conditions for claiming deduction :** The research association, university, college or other institution or company referred to in Section 35(1)(ii)/(ia)/(iii) shall not be entitled to deduction , unless such research association, university, college or other institution or company-
- Prescribed statement to be furnished:** Prepares prescribed statement for prescribed period in prescribed form and delivers the said statement to prescribed income-tax authority or authorised person by such authority:
Correction statement to be furnished : Such research association, university, college or other institution or the company may also deliver to the prescribed authority a correction statement for rectification of any mistake or to add, delete or update the information furnished in the statement delivered in such form and verified in such manner as may be prescribed; and
 - certificate to be furnished to the donor:** Furnishes to the donor, a certificate specifying the amount of donation in such manner, containing such particulars and within such time from the date of receipt of sum, as may be prescribed.
- (4) Expenditure incurred on scientific research includes all expenditure incurred for the prosecution, or the provision of facilities for the prosecution, of scientific research, but do not include any expenditure incurred in the acquisition of rights in, or arising out of, scientific research.
- (5) **Research related to business or class of business includes -**
- Any scientific research which may lead to or facilitate an extension of that business or, as the case may be, all business of that class.
 - Any scientific research of a medical nature, which has a special relation to the welfare of workers, employed in that business/ all businesses of that class.
- (6) According to Section 35(4) unabsorbed scientific research capital expenditure is carried forward and set-off in the same manner as unabsorbed depreciation.

- (3) **Actual use for scientific research during the previous year - Not necessary :** Deduction under section 35(1)(iv) is available only if the asset was acquired during the previous year for the purposes of scientific research. There is no further requirement that asset must be put to use in the relevant previous year.

34. **What shall be the tax treatment in case the asset acquired for scientific research is sold during the year.**

Ans. Tax treatment in case of sale of scientific research assets is as under -

- (1) **When the asset is sold without being used for other purposes :** In such a case, there shall be deemed profits in the year in which sale takes place.

- (i) The taxable amount under section 41(3) shall be = So much of the sale proceeds which do not exceed the amount of deduction allowed under section 35.
- (ii) Capital gains under section 45 = Excess of sale proceeds over the cost of acquisition and expenditure incurred on transfer.

- (2) **When the asset is sold after being used for business purposes :** In such a case, treatment will be as follows -

- (i) **At the time of use for business purposes :** The cost of such asset will be added to the WDV of relevant block. As per Section 43(1), the cost of such asset will be = Actual cost of the asset less Deduction allowed under section 35(2) i.e. cost will be NIL as 100% deduction was allowed under section 35(2).
- (ii) **At the time of sale :** When the asset is sold, the treatment is done as if an asset forming part of block is sold. Capital gains arising are to be computed under Section 50.

Illustration 17 - Expenditure on Scientific research : Mr. Praveen Kumar has furnished the following particulars relating to payments made towards scientific research for the year ended 31-3-2021:

	(Rs. in lacs)
(i) Payments made to K Research Ltd.	20
(ii) Payment made to LMN College	15
(iii) Payment made to OPQ College	10

Note: K Research Ltd. and LMN College are approved research institutions and these payments are to be used for the purposes of scientific research.

(iv) Payment made to National Laboratory	8
(v) Machinery purchased for in-house scientific research	25
(vi) Salaries to research staff engaged in in-house scientific research	12

Compute the amount of deduction available under section 35. (4 Marks, IPCC May 2011)

Solution: Computation of deduction under section 35 of the Act (amount in Rs.)—

Particulars	Section	Qualifying Sum	Deduction
(i) Payments made to K Research Ltd. [WN-1] (approved company)	35(1)(ia)	20,00,000	20,00,000
(ii) Payment made to LMN College - approved institution	35(1) (ii)	15,00,000	15,00,000
(iii) Payment made to OPQ College [WN-2]	-	-	-
(iv) Payment to National Laboratory [WN-3]	35(2AA)	8,00,000	8,00,000

(v)	Machinery purchased for in-house scientific research	[WN-4]	35(1)(iv)	25,00,000	25,00,000
(vi)	Salaries to research staff engaged in in-house scientific research		35(1)(i)	12,00,000	12,00,000
	Total Deduction	[WN-5]			80,00,000

Working Notes:

- (1) Payments made to K research Ltd. an Indian company shall be eligible for deduction of 100% u/s 35(1)(ia).
- (2) Since in the question it has been specifically provided that K Research Ltd. and LMN College are approved, hence it can be concluded that OPQ college is not an approved research institution. Therefore payment made to OPQ college shall not be eligible for deduction.
- (3) Payment to National Laboratory is eligible for deduction under section 35(2AA) @ 100% of the sum so paid.
- (4) Mr. Praveen Kumar is an individual shall not be eligible for deduction of 100% for in house research under section 35(2AB) since the same is available only to a company assessee.
- (5) Salaries to research staff engaged in in-house scientific research is not eligible for deduction under section 35(2AB) as the said deduction is available only to a company assessee.

Illustration 18 - Expenditure on Scientific research: Vivitha Bio-medicals Ltd. is engaged in the business of manufacture of bio-medical items. The following expenses were incurred in respect of activities connected with scientific research :

Year ended	Item	Rs.
30-12-2018	Land	10,00,000
(incurred after 1-9-2017)	Building	25,00,000
31-03-2019	Plant and machinery	5,00,000
31-03-2020	Raw materials	2,20,000
31-03-2021	Raw materials and salaries	1,80,000

The business was commenced on 01-09-2020. In view of availability of better model plant and machinery, the existing plant and machinery were sold for Rs. 8,00,000 on 01-03-2021.

Discuss the implications of the above for assessment year 2021-22 along with brief computation of deduction permissible under section 35, assuming that necessary conditions have been fulfilled. (7 Marks, PCE Nov. 2007)

Solution: Expenditure incurred (other than cost of land or building) on in-house research and development facility as approved by the prescribed authority, by a company engaged in the business of bio-technology shall be allowed as deduction to the extent of 100% of such expenditure under section 35(2AB).

Expenditure incurred within the 3 years preceding the date in which the business commences, on salary paid to an employee engaged in such scientific research or on the purchase of materials used in such scientific research, or capital expenditure (other than cost of land), shall be allowed as deduction, to the extent of 100% of such expenditure (allowed in the previous year i.e. year of commencement of business). The relevant computation is as under –

➤ *Computation of amount of deduction under section 35 (amounts in ₹.)—*

Particulars	Expenditure allowable u/s 35(1)(i) and (iv) at 100%	Expenditure allowable u/s 35(2A) at 100%
Land	—	—
Building	25,00,000	—
Plant and Machinery	5,00,000	—
Raw material	2,20,000	—
Raw material and salaries	—	1,80,000
Eligible expenditure	32,20,000	1,80,000
Deduction allowable	32,20,000	1,80,000
Total deduction allowable u/s 35	34,00,000	

- When the asset is sold without being used for other purposes : In such a case, there shall be deemed profits in the year in which sale took place.

(a) The taxable amount under section 41(3) shall be = So much of the sale proceeds which do not exceed the amount of deduction allowed under section 35 i.e. ₹. 5 lakhs.

(b) Capital gains under section 45 = Excess of sale proceeds over the cost of acquisition and expenditure incurred on transfer. Short-term capital gains = Moneys payable - Cost = ₹. 8 lakhs - ₹. 5 lakhs = ₹. 3 lakhs.

35. What are the provisions relating to deduction in respect of expenditure incurred on Specified Business Rs. OR Name any four specified businesses covered under section 35AD and state the fiscal incentives available to such businesses. (4 Marks, Nov. 2014)

Ans: Deduction in respect of expenditure on Specified Business [Section 35AD]:

(1) **Optional deduction :** An assessee shall be allowed deduction under this section if he opts for the provisions of this section. [Amended by Finance Act, 2020 w.e.f. 01-04-2020 i.e. AY 2020-21]

(2)

Objective of amendment: Section 35AD of the Act, relating to deduction in respect of expenditure on specified business, provides for 100% deduction on capital expenditure (other than expenditure on land, goodwill and financial assets) incurred by the assessee on certain specified businesses. Under section 35AD(1), the said deduction of 100% of the capital expenditure is allowable during the previous year in which such expenditure has been incurred.

Further, 35AD(4) provides that no deduction is allowable under any other section in respect to the expenditure referred to in 35AD(1).

At present, an assessee does not have any option of not availing the incentive under said section. Due to this, a legal interpretation can be made that a domestic company opting for concessional tax rate u/s 115BAA or section 115BAB of the Act, which does not claim deduction u/s 35AD, would also be denied normal depreciation u/s 32 due to operation of section 35AD(4). This has not been the intention of the statute. Therefore, section 35AD(1) has been amended to make the deduction

thereunder optional. Section 35AD (4) is amended to provide that no deduction will be allowed in respect of expenditure incurred u/s 35AD(1) in any other section in any previous year or under this section in any other previous year, if the deduction has been claimed by the assessee and allowed to him under this section.

This amendment will take effect from 1st April, 2020 and will, accordingly, apply in relation to the assessment year 2020-21 and subsequent assessment years.

- (2) **Meaning of Specified business :** Specified business means any one or more of the following business namely:-
- (a) **Cold chain facilities :** Setting up and operating cold chain facilities for specified products, if its operations are commenced on or after 1-4-2009;
 - (b) **Warehousing facilities-Agricultural produce :** Setting up and operating warehousing facilities for storing agricultural produce, if its operations are commenced on or after 1-4-2009;
 - (c) **Hospitals :** Building and operating, anywhere in India, a hospital with at least one hundred beds for patients, if its operations are commenced on or after 1-4-2010;
 - (d) **Housing Projects :** Developing and building a housing project under a notified scheme for affordable housing framed by the Central Government or a State Government, as the case may be, and notified by the CBDT in this behalf in accordance with the guidelines as may be prescribed, if its operations are commenced on or after 1-4-2011;
 - (e) **Fertilizer plant:** Production of fertilizer in India in a new plant or in a newly installed capacity in an existing plant, if its operations are commenced on or after 1-4-2011;
 - (f) **Cross-country natural gas pipeline network :** Laying & operating a cross-country natural gas pipeline network for distribution, including storage facilities being an integral part of such network, if its operations are commenced on or after 1-4-2007;
 - (g) **Cross-country crude or petroleum oil pipeline network :** Laying and operating a cross-country crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network, if its operations are commenced on or after 1-4-2009;
 - (h) **Hotel :** Building and operating, anywhere in India, a hotel of two star or above category as classified by Central government, if its operations are commenced on or after the 1-4-2010;
 - (i) **Slum redevelopment housing project:** Developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and notified by the CBDT in accordance with the prescribed guidelines, if its operations are commenced on or after 1-4-2010;
 - (j) **ICD/CFS :** Setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962, if its operations are commenced on or after 1-4-2012;
 - (k) **Bee-keeping and production of honey and beeswax :** Bee-keeping and production of honey and beeswax, if its operations are commenced on or after 1-4-2012;
 - (l) **Warehousing facilities-Sugar :** Setting up and operating a warehousing facility for storage of sugar, if its operations are commenced on or after 1-4-2012.
 - (m) **Slurry pipe line :** Laying and operating a slurry pipeline for transportation of iron ore on or after 1-4-2014.
 - (n) **Semi-conductor wafer fabrication manufacturing unit :** Setting up and operating a semi-conductor wafer fabrication manufacturing unit on or after 1-4-2014.
 - (o) **Infrastructure facility :** Developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility on or after 01-04-2017.

- (3) **Eligible deduction :** 100% of the capital expenditure incurred, wholly and exclusively, for the purposes of any specified business carried on by the assessee shall be allowed as deduction during the previous year in which such expenditure is incurred by him.

Deduction in respect of expenditure incurred prior to commencement : Further, the expenditure incurred, wholly and exclusively, for any specified business, shall be allowed as deduction during the previous year in which he commences operations of his specified business, if -

- (a) the expenditure is incurred prior to the commencement of its operations; and
- (b) the amount is capitalised in the books of account of the assessee on the date of commencement of its operations.

Cash expenditure exceeding Rs. 10,000 or expenditure on land, goodwill and financial instrument not eligible :

Any expenditure of capital nature shall not include any expenditure in respect of which the payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account, or through such other electronic mode as may be prescribed, exceeds Rs. 10,000 or any expenditure incurred on the acquisition of any land or goodwill or financial instrument, [(a) Credit Card; (b) Debit Card; (c) Net Banking; (d) IMPS (Immediate Payment Service); (e) UPI (Unified Payment Interface); (f) RTGS (Real Time Gross Settlement); (g) NEFT (National Electronic Funds Transfer), and (h) BHIM (Bharat Interface for Money) Aadhar Pay have been prescribed as mode of electronic payment]

- (4) **Conditions to be fulfilled in respect of specified business in order to claim deduction :** The specified business must fulfill the following conditions namely -

- (a) it is not set up by splitting up, or the reconstruction, of a business already in existence; or
- (b) it is not set up by the transfer of plant or machinery previously used for any purpose.
However, where -
 - (i) the value of second hand plant and machinery doesn't exceed 20% of total value of plant or machinery used in that business, or
 - (ii) such second hand machinery is the one imported by the assessee on which no depreciation was allowed or allowable under this Act in any other earlier year,
then, this condition is not violated.

- (5) **Minimum use of capital asset for specified business - 8 years :** Any asset in respect of which a deduction is claimed and allowed under this section shall be used only for the specified business, for a period of eight years beginning with the previous year in which such asset is acquired or constructed.

- (6) **Assets used for purposes other than specified business - Consequences thereof :**

Where any asset, in respect of which a deduction is claimed and allowed under this section, is used for a purpose other than the specified business during the period of 8 years, otherwise than by way of a mode referred to in section 28(vii), the total amount of deduction so claimed and allowed in one or more previous years, as reduced by the amount of depreciation allowable in accordance with the provisions of section 32, as if no deduction under this section was allowed, shall be deemed to be the income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which the asset is so used.

However, above provision shall not apply to a company which has become a sick industrial company u/s 17(1) of the Sick Industrial Companies (Special Provisions) Act, 1985, during the period of 8 years as specified above.

(7) Additional conditions for Cross-country natural gas pipeline network: Where the business is of the nature specified in 1(Rs.) above, such business -

- (a) is owned by a company formed and registered in India under the Companies Act, 1956 or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central or State Act;
- (b) has been approved by the Petroleum and Natural Gas Regulatory Board and notified by the Central Government in the Official Gazette in this behalf;
- (c) has made not less than such proportion of its total pipeline capacity as specified by regulations made by the Petroleum and Natural Gas Regulatory Board established under section 3(1) of the Petroleum and Natural Gas Regulatory Board Act, 2006 available for use on common carrier basis by any person other than the assessee or an associated person; and
- (d) fulfils any other condition as may be prescribed.

Meaning of Associated person: An "associated person" in relation to the assessee means a person —

- (i) who participates directly or indirectly or through one or more intermediaries in the management or control or capital of the assessee;
- (ii) who holds, directly or indirectly, shares carrying 26% or more voting power in the assessee;
- (iii) who appoints more than half of the Board of directors or members of the governing board, or one or more executive directors or executive members of governing board of assessee; or
- (iv) who guarantees 10% or more of the total borrowings of the assessee.

(8) Additional conditions for Infrastructure facility: Where the business is of the nature specified in 1(o) above, such business -

- (a) is owned by a company registered in India or by a consortium of such companies or by an authority or a board or corporation or any other body established or constituted under any Central or State Act;
- (b) entity referred to in (a) above has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for developing or operating and maintaining or developing, operating and maintaining, a new infrastructure facility.

"Infrastructure facility" means —

- (i) a road including toll road, a bridge or a rail system;
- (ii) a highway project including housing or other activities being an integral part of the highway project;
- (iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system;
- (iv) a port, airport, inland waterway, inland port or navigational channel in the sea.

(9) Owner of a hotel eligible for deduction even if he transfers the operation of the hotel to another person : The assessee shall be deemed to be carrying on the specified business of building and operating hotel if—

- (a) the assessee builds a hotel of two-star or above category;
- (b) thereafter, he transfers the operation of the hotel to another person; >
- (c) he, however, should continue to own the hotel.

(10) Deduction allowed under this section, not to be claimed under any other provision:

- (a) Where a deduction under this section is claimed and allowed in respect of the specified business for any assessment year, no deduction shall be allowed under the provisions of Chapter VI-A i.e. section 80-IA to 80-RRB or Section 10AA in relation to such specified business for the same or any other assessment year.
- (b) No deduction in respect of the expenditure shall be allowed to the assessee under any other section in any previous year or under this section in any other previous year, if the deduction has been claimed or opted by the assessee and allowed to him under this section. [Amended by Finance Act, 2020 w.e.f. 01-06-2020]
- (11) **Certain provisions to apply :** The provisions contained in Section 80A(6), 80-IA(7) and 80-IA(10) shall, so far as may be, apply to this section in respect of goods or services or assets held for the purposes of the specified business.
- (12) **Carry forward and set-off loss from specified business :** As per Section 73A, loss from specified business can be carried forward and set off only from profits of specified business. Further, it can be carried forward for indefinite period.
- (13) **Meaning of Cold chain facility :** It means a chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for preservation of such produce.

Illustration 19 - Deduction of expenditure on Specified Business u/s 35AD: Win Limited commenced the business of operating a three star hotel in Tirupati on 1-4-2020.

(i)	Cost of land (acquired in June 2018)	Rs. 60 lakhs
(ii)	Cost of construction of hotel building :	
	Financial year 2019-20	Rs. 30 lakhs
	Financial year 2020-21	Rs. 150 lakhs
	[Out of expenditure of Rs. 150 lakhs, 11,50,000 is paid in cash to contractor on 10-09-2020 and Rs. 50,000 is paid in cash of 15-01-2021 and balance through account payee cheque.]	
(iii)	Plant and Machinery (all new) acquired during financial year 2020-21	Rs. 30 lakhs
	[All the above expenditures were capitalized in the books of the company]	
	Net profit before depreciation for the financial year 2020-21	Rs. 80 lakhs

Determine the amount eligible for deduction u/s 35AD of the Income tax Act for AY 2021-22. (4 Marks, PCC May 2011)

Solution: Computation of amount eligible for deduction u/s 35AD: As per Section 35AD in case an assessee is engaged in the business of operating a hotel of 2-star or above category (i.e., 3-star category) on or after 1-4-2010, it is eligible for deduction under section 35AD. Since Win Ltd. is engaged in the business of operating a hotel of 3-star category, hence, it is eligible for deduction under section 35AD. Deduction shall be allowed in respect of the capital expenditure incurred in the earlier years (i.e. years earlier than the previous year 2020-21, as the expenditure has been capitalized in the books of accounts in the current financial year; and the expenditure incurred in the previous year Any expenditure of capital nature shall not include any expenditure

in respect of which the payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed, exceeds Rs. 10,000 or any expenditure incurred on the acquisition of any land or goodwill or financial instrument.

The relevant computations are (Rs.in lakhs) -

Net profit before depreciation for the financial year 2020-21		80
Cost of construction of hotel building (Rs. 148 + Rs. 30) (Rs. 1.5 and Rs. 0.5 lakhs shall not be eligible Less: Deduction u/s 35AD for deduction since the same is paid in cash)	-178	
Plant and Machinery (all new) acquired during financial year 2020-21	-30	-208
Loss to be carried forward under section 73A for indefinite period (to be set-off only against business specified in section 35AD)		-128

Illustration 20 - Consequences of misutilisation of asset whose deduction is claimed u/s 35AD : XYZ Ltd. commenced business of production of fertilizer on 1-4-2018. The company purchased plant and machinery for manufacture of the fertilizer amounting Rs. 100 lakhs for which deduction was claimed under Section 35AD. In financial year 2020-21 the said asset was used for non specified business. You are required to determine the tax implications of the said transaction in hands of XYZ Ltd.

Solution : According to Section 35AD(7B), if any asset is used for any purpose other than the specified business, the total amount of deduction so claimed and allowed in any previous year in respect of such asset, as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction had been allowed under section 35AD, shall be deemed to be income of the assessee chargeable under the head "**Profits and gains of business or profession**" of the previous year in which the asset is so used. Hence, the relevant computation will be as under:

(Rs.in lakhs)

Total amount of deduction claimed and allowed in respect of such asset u/s 35AD	100
Less: Depreciation eligible under Section 32 in respect of such asset [WN]	44.75
Deemed profits u/s 35AD	55.25

Actual Cost of asset	100
Less: Depreciation eligible under Section 32 (including additional depreciation) for FY 2018-19	35
WDV	65
Less: Depreciation eligible under Section 32 for FY 2019-20	9.75
WDV as on 01-04-2020	55.25
Deduction admissible on account of depreciation for FY 2018-19 and 2019-20	44.75

36. Write a short note on deduction available in respect of payment made to association and institutions for carrying out Rural Development Programme. (6 Marks, PCC Nov. 2005)

Ans: Expenditure by way of payment to associations and institutions for carrying out Rural Development Programmes [Section 35CCA]:

(1) Eligible payments : Where an assessee incurs any expenditure by way of payment of any sum -

(a) to a rural development fund set up and notified by the Central Government in this behalf; or

(b) to the National Urban Poverty Eradication Fund set up and notified by the Central Government in this behalf,

the assessee shall, subject to the provisions of this section, be allowed a deduction of the amount of such expenditure incurred during the previous year.

- (2) **No double deduction** : Where a deduction under this section has been claimed and allowed in respect of any expenditure, no deduction shall be allowed in respect of such expenditure under any other provision of the Act for the same or any other assessment year.

37. What are the deductions-admissible in respect of expenditure incurred on notified Agricultural Extension Project?

Ans: **Expenditure incurred on notified Agricultural Extension Project [Section 35CCC] :** The provisions relating to this section are -

- (1) **Nature of expenditure** : Any expenditure on notified agricultural extension project in accordance with the prescribed guidelines.
- (2) **Amount of deduction**: 100% of such expenditure.
- (3) **No double deduction** : Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure, deduction shall not be allowed in respect of such expenditure under any other provisions of this Act for the same or any other assessment year.

38. Discuss the provisions relating to the expenditure incurred by companies on notified Skill-Development Project

Ans: **Expenditure incurred by companies on notified Skill Development Project [Section 35CCD] :** The provisions relating to this section are -

- (1) **Eligible Assessee** : Company Assessee.
- (2) **Nature of expenditure** : Any expenditure (not being expenditure in the nature of cost of any land or building) on any notified Skill Development Project in accordance with prescribed guidelines.
- (3) **Amount of deduction** : 100% of such expenditure.
- (4) **No double deduction** : Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure, deduction shall not be allowed in respect of such expenditure under any other provisions of this Act for the same or any other assessment year.

Illustration 21 - Computation of "Profits and gains of business or profession" : Isac limited is a company engaged in the business of biotechnology. The net profit of the company for the financial year ended 31-03-2021 is ₹. 15,25,890 after debiting the following items :

	Particulars	Rs.
(1)	Purchase price of raw material used for the purpose of in-house research and development	1,80,000
(2)	Purchase price of asset used for in-house research and development wrongly debited to profit and loss account :	
	(a) Land	5,00,000
	(b) Building	3,00,000
(3)	Expenditure incurred on notified agricultural extension project	1,50,000
(4)	Expenditure on notified skill development project:	
	(a) Purchase of land	2,00,000
	(b) Expenditure on training for skill development	2,50,000
(5)	Expenditure incurred on advertisement in the souvenir published by a political party	75,000

Compute the income under the head "Profits and gains of business or profession" for the A.Y. 2021*22 of Isac Ltd.

Solution: Computation of income under the head "Profits and gains of business or profession" for the A.Y. 2021-22 :

Particulars	Rs.	Rs.
Net profit as per Profit and Loss A/c		15,25,890
Add: Items debited to P&L A/c, but to be disallowed -		
Purchase price of raw material used for in-house research and development [WN-1]	-	
Purchase price of land used in in-house research and development [WN-2]	5,00,000	
Purchase price of building used in in-house research and development [WN-3]	-	
Expenditure incurred on notified agricultural extension project [WN-4]	-	
Expenditure incurred on purchase of land for notified skill development project [WN-5]	2,00,000	
Expenditure incurred on training for skill development for notified skill development project [WN-6]	-	
Expenditure incurred on advertisement in the souvenir published by a political party [WN-7]	75,000	7,75,000
Profit and gains from business		23,00,890

Working Notes:

- (1) Purchase price of raw material used for the purpose of in-house research and development - 100% deduction is admissible. Since the same is already debited to P&L A/c hence no adjustment is required.
- (2) Purchase price of land is not allowable as deduction under section 35(2A)(B).
- (3) Cost of building, being capital expenditure, 100% deduction shall be allowed u/s 35(1)(iv) read with section 35(2). Since the same is already debited to P&L A/c hence no adjustment is required.
- (4) This expenditure qualifies for 100% deduction under section 35CCC. Since the same is already debited to P&L A/c hence no adjustment is required.
- (5) Purchase of land does not qualify for deduction under section 35CCD.
- (6) This expenditure qualifies for 100% deduction under section 35CCD. Since the same is already debited to P&L A/c hence no adjustment is required.
- (7) The expenditure incurred on advertisement in the souvenir published by a political party is disallowed as per section 37(2B) while computing income under the head "Profit and Gains of Business or Profession" but the same would be allowed as deduction under section 80GGB from the gross total income of the company.

39. State briefly the provisions in respect of deduction relating to preliminary expenses.

Ans: Amortization of certain Preliminary Expenses [Section 35D]: The provisions relating to this section are -

- (1) **Eligible Assessee :** Indian Company or a person (other than a company) resident in India.
- (2) **Deduction to be allowed in 5 equal installment :** Where an eligible assessee incurs any expenditure on preliminary expenses,-

- (a) before the commencement of his business; or
- (b) after the commencement of his business, in connection with the extension of his undertaking or in connection with his setting up a new unit; he shall be allowed a deduction of an amount equal to 1/5th of such expenditure for each of the 5 successive previous years beginning with the previous year in which the business commences, or the previous year in which the extension of the undertaking is completed or the new unit commences production or operation.

(3) Expenditure eligible for deduction: Expenditure eligible for deduction shall be -

- (a) Expenditure in connection with -
 - (i) preparation of feasibility report;
 - (ii) preparation of project report;
 - (iii) conducting market or any other survey necessary for business of the assessee; or
 - (iv) engineering services relating to the business of the assessee.
- (b) Legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee.
- (c) Where the assessee is a company, also expenditure of -
 - (i) Legal charges for drafting its Memorandum and Articles of Association; or
 - (ii) Printing charges of its Memorandum and Articles of Association; or
 - (iii) Registration fees for its registration under the provisions of the Companies Act, 1956; or
 - (iv) Underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus, in connection with the issue of shares or debentures of the company for public subscription;
- (d) Such other expenditure, not being eligible for any allowance or deduction under any other provisions of the Act, as may be prescribed.

(4) Amount qualifying for deduction: Lower of the following qualifies for deduction -

- (a) Aggregate amount of eligible expenditure; or
- (b) Higher of (i) or (ii) ~
 - (i) 5% of Cost of the project; or
 - (ii) 5% of Capital employed (Only in the case of an Indian company).

□ **"Cost of project"** means actual cost of fixed assets acquired or developed in relation to such commencement, extension or set up, and which are shown as on 31st March of relevant previous year.

□ **"Capital employed in the business of company"** means - [Issued share capital + Debentures + Long-Term borrowings] in relation to such commencement, extension or set up and which are shown as on 31st March of the relevant previous year.

Note: "Relevant previous year" means the year in which the business is commenced; or the extension of such industrial undertaking is completed; or the new industrial unit commences production or operation.

(5) Audit of accounts : Where the assessee is a person other than a company or a co-operative society, no deduction shall be admissible unless the accounts of the assessee for the year or years in which the expenditure is incurred have been audited by a Chartered accountant before the specified date referred to in section 44AB and the assessee furnishes for the first year in which the deduction under this section is claimed, the report of such audit by that date in the prescribed form duly signed and verified

by such accountant and setting forth such particulars as may be prescribed. [Amended by Finance Act, 2020 w.e.f. 01-04-2020 i.e. AY 2020-21]

- (6) **Transfer of undertaking in scheme of amalgamation/ demerger** : Where the undertaking of an Indian company entitled to deduction under this section is transferred, before the expiry of the period of 5 years, to another Indian company in a scheme of amalgamation/ demerger, then -
- no deduction shall be admissible in the case of the amalgamating/ demerged company for the previous year in which the amalgamation/ demerger takes place; and
 - the provisions of this section shall apply to the amalgamated/resulting company, as they would have applied to the amalgamating/demerged company, if the amalgamation/demerger had not taken place.
- (7) **No double deduction** : Where a deduction under this section is claimed and allowed in respect of any expenditure, the expenditure in respect of which deduction is so allowed shall not qualify for deduction under any other provision of this Act for the same or any other assessment year.
- (8) **Service units eligible** : Deduction under this section is available to all undertakings including service sector units as well.

Illustration 22 - Amortisation of preliminary expenses : Jardine Ltd., is an existing Indian Company, which sets up a new industrial unit. It incurs the following expenditure in connection with the new unit (amounts in Rs.):

Preparation of project report	4,00,000
Market Survey	5,00,000
Legal and other charges for issue of additional capital required for the new unit	2,00,000
Total	11,00,000
The following further data is given :	
Cost of project	30,00,000
Capital employed in the new unit	40,00,000

What is the deduction admissible to the company under section 35D?

What will be your answer if the above facts relate to Mr. Jardine, a resident in India Rs. (May 2000)

Solution: In case of Jardine Ltd.: In case of an Indian company, the preliminary expenditure qualifying for deduction cannot exceed higher of the following two limits,-

- 5% of cost of project i.e. 5% of 30,00,000 i.e. Rs. 1,50,000, or
- 5% of capital employed i.e. 5% of 40,00,000 i.e. Rs. 2,00,000.

Therefore, the qualifying amount for deduction = Rs. 2,00,000, which shall be allowed in five equal annual instalments of Rs. 40,000 each beginning with previous year in which new industrial unit is set up.

In case of Mr. Jardine : It must be noted that the option of 5% of capital employed is available only in case of Indian company. Therefore, in case of Mr. Jardine, the qualifying amount of deduction = 5% of 30,00,000 i.e. Rs. 1,50,000, which shall be allowed in five equal annual installments of Rs. 30,000 each.

40. Elaborate briefly the provisions in respect of deduction for expenditure on Voluntary Retirement. (May 2002) (6 Marks, Nov. 2007)

Ans: *Amortisation of expenditure incurred under Voluntary Retirement Scheme [Section 35DDA] : The provisions relating to this section are -*

- (1) **Eligible Assessee :** Any person.
- (2) **Eligible expenditure :** 100% of expenditure incurred by an assessee in any previous year by way of payment of any sum to an employee in connection with his voluntary retirement in accordance with any scheme(s).
- (3) **Deduction and Period :** 1/5th of such expenditure is deductible for each of 5 successive previous years starting with the previous year in which such expenditure is incurred.
- (4) **Transfer of undertaking in scheme of amalgamation/ demerger :** Where the assessee, being an Indian company, is entitled to the deduction under the said section and the undertaking of such company is transferred, before the expiry of the period as specified, to another Indian company in a scheme of amalgamation/ demerger, then no deduction shall be allowed to the amalgamating/demergered company and the provisions shall apply to the amalgamated/demergered company, as they would have applied to the amalgamating/ demergered company, if the amalgamation/ demerger had not taken place.
- (5) **Transfer of undertaking in scheme of business reorganisation :** Where there has been reorganisation of business, whereby a firm is succeeded by a company fulfilling the conditions as specified in Section 47(xiii), or a proprietary concern is succeeded by a company fulfilling the conditions as specified in Section 47(xiv), then the provisions of this section shall apply to the successor company, as they would have applied to the firm or the proprietary concern, if reorganisation of business had not taken place.
- (6) **No double deduction :** No deduction shall be allowed in respect of such expenditure incurred under any other provision of this Act.

Illustration 23 - VRS Compensation ; X Co. Ltd. paid Rs. 120 lakhs as compensation as per approved Voluntary Retirement Scheme (VRS) during the financial year 2020-21. How much is deductible under section 35DDA for the assessment year 2021-22? **(1 Mark, PCC May 2011)**

Solution: Deduction admissible under section 35DDA = 1/5th of Rs. 120 lakhs = Rs. 24 lakhs, deductible for the current year as well as four subsequent assessment years.

**OTHER SPECIFIED DEDUCTIONS & GENERAL
DEDUCTION r SECTION 36&37;**

41. List the various deductions allowable under Section 36(1);

Ans: **Other Deductions [Section 36]:** In the computing the income referred to in section 2,8, the deductions provided for in the following clauses of section 36(1) shall be allowed in respect of the matters dealt with therein -

S. 36(1)	Deductible Expenditure	Conditions / Remarks
(i)	⇒ Insurance premium of stock or stores against damage or destruction thereof.	⇒ Such stock or stores are used for Business or Profession.
(ia)	⇒ Insurance premium paid by Federal Milk Co-operative Society on life of cattle owned by a	⇒ Such primary society should be engaged in supplying milk raised by its members to such

	<i>member of a Primary co-operative society.</i>	<i>federal milk co-operative society.</i>
(ib)	⇒ Health Insurance premium paid by any mode of payment other than cash by an employer on health of his employees under a scheme.	⇒ Such scheme must be - (a) framed by GIC and approved by Central Government, or (b) framed by any other insurer and approved by IRDA
(ii)	⇒ Bonus or commission paid to an employee for services rendered (not otherwise have been payable to him as profit or dividend). ⇒ Deduction is subject to the provisions of Section 43B and Section 40A(2).	⇒ Voluntary payments are deductible if it is for services rendered. ⇒ Any bonus exceeding the statutory amount is allowed if such excess payment has been made on account of commercial expediency
(iii)	⇒ Interest on capital borrowed for the purposes of business or profession. ⇒ However, the interest paid on capital borrowed, for acquisition of an asset (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction. Thus, interest paid in respect of capital borrowed for acquisition of an asset, for the period upto the date on which the asset is first put to use to be capitalized, even if the acquisition of the asset is not for extension of existing business or profession.	⇒ Capital means 'money'; not any other asset. ⇒ Deduction subject to Section 43B & 40(a)(i). ⇒ Interest on own capital is not deductible. ⇒ The need of assessee to borrow cannot be examined/evaluated by the Assessing Officer. ⇒ Interest on money borrowed for payment of tax or interest on late payment of advance tax or for late filing of return is not deductible. ⇒ Periodical Subscriptions paid by shareholders, or subscribers in Mutual Benefit Societies shall be deemed to be capital borrowed.
(iiia)	⇒ Discount on zero coupon bond calculated in pro rata manner over the life of such bond. ⇒ Discount = Amount payable by issuer on maturity/ redemption of such bond Less Amount received or receivable on issue of bond ⇒ Zero coupon bond means a notified bond issued by any infrastructure capital company/fund or public sector company or scheduled bank, in respect of which no payment and benefit is received or receivable before maturity or redemption.	⇒ Life of bond = Period starting from the date of issue of the bond and ending on the date of maturity or redemption of such bond. ⇒ For computing life of the bond, if the month in which bond is issued or is redeemed/ matured is a part of the month, then, such month shall be rounded off to the nearest one i.e. if such part is 15 days or more, it will be taken as one month, otherwise it will be ignored.
(iv)	⇒ Contribution made by employer to recognised provident fund/approved superannuation fund	⇒ Deduction is subject to the provisions of Section 43B.
(iva)	⇒ Deduction of - ⇒ Contribution made by an employer towards a pension scheme, as referred to u/s 80CCD, on account of an employee; or ⇒ (b) 10% of salary of the employee in the previous year, whichever is less.	⇒ 'Salary' includes clearness allowance, if the terms of employment so provide, but excludes all other allowances & perquisites.
(v)	⇒ Sum paid by employer towards an approved	⇒ Deduction is subject to the provisions of

	gratuity fund set up for benefit of his employees.	Section 43B.
(va)	⇒ Sum received by assessee from his employees as contributions to Provident Fund or Employee State Insurance Fund or Superannuation fund or any other employee-welfare fund ⇒ Such sum received by the assessee is first treated as income under Section 2(24) (x) and thereafter, deduction is allowed in respect of such sum if the relevant conditions are satisfied.	⇒ Such sum should be credited by the assessee to the employee's account in the relevant fund(s) on or before the due date. Due date means date by which the assessee is required as an employer to credit an employee's contribution to his account in the relevant fund(s) under any law, standing order, award, contract of service or otherwise. ⇒ As per the Employees Provident Funds Scheme, 1952, the amounts under consideration in respect of wages of the employees for any particular month shall be paid within 15 days of the close of every month.
(vi)	⇒ Loss in respect of animals, used for business or profession (otherwise than as stock-in trade), which have died or become permanently useless.	⇒ Deduction allowed = [Actual cost of the animal - Sale proceeds of carcasses or animals]
(vii)	⇒ Bad debts	⇒ Discussed later.
(ix)	⇒ Expenditure incurred by a company for promoting family planning amongst its employees. ⇒ Extent of deduction: ⇒ Where expenditure is of revenue nature: 100% in the previous year in which it is incurred. (2) Where expenditure is capital in nature: 1/5th of such expenditure is deductible in each of the consecutive previous years beginning with the previous year in which expenditure is incurred.	⇒ Any unabsorbed family planning expenditure is carried forward and set off in the same manner as unabsorbed depreciation ⇒ No depreciation allowable under Section 32 if deduction has been claimed here. ⇒ Tax treatment in case of sale of such asset: Same as in Section 35.
(xv)	Securities Transaction Tax (STT) paid by the assessee in respect of the taxable securities transactions entered into in the course of his business during the previous year.	
(xvi)	Commodities transaction tax (CTT) paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year, if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".	

42. Explain the provisions in relation to bad debts.

Ans: Deductions in relation to bad debts under section 36(1)(vii) read with 36(2):

(1) Deduction in respect of bad debts [Section 36(1) (vii) and 36(2)] : Bad debts written off as irrecoverable in the accounts (P&L A/c) of the assessee are deductible. However, no deduction is allowed for any provision for bad and doubtful debts.

Where the amount of such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof becomes irrecoverable or of an earlier previous year on the basis of income computation and disclosure standards notified under Section 145(2) without recording the same in the accounts, then, such debt or part

thereof shall be allowed in the previous year in which such debt or part thereof becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purposes of Section 36(1)(vii).

This deduction is allowed subject to the following conditions -

- (a) There must be a debt and the debt must be incidental to the business or profession of the assessee. Thus, loan advanced by a firm of solicitors to a company, in whose formation it acted as legal advisor, is not deductible on its becoming irrecoverable because that is not a part of the profession of a solicitor and such debt is not revenue in nature.
- (b) Such debt must have been taken into account in computing the income of the assessee of previous year in which it is written off or of an earlier previous year; or it represents money lent in ordinary course of banking or money lending business carried on by assessee.
- (3) In the case of an assessee to which Section 36(1)(viii) applies, if the amount of the actual bad-debts is greater than the provision made, then such bad-debts in excess of the provision shall be allowed as deduction under this section.
- (4) **In case of bad debt recovery [Section 41(4)]:** In case any amount allowed as bad debt is ultimately recovered, the following sum shall be chargeable to tax whether or not the business is in existence in that previous year - Amount recovered on such debt - [Actual Amount of bad debt - Amount deducted u/s 36(1)(vii)]
If the aforesaid sum is negative, the same shall be allowed as deduction as bad debts.
- (5) **Successor of business - Bad debts allowable business-wise, not assessee-wise :** The successor to the business is entitled to deduction in respect of the debts incurred by the predecessor if the business is not dissolved and the identity of the business after succession remains the same. Deduction for bad debts is allowed business-wise and not assessee-wise. - CIT v. Veerbhadra Rao, K, Koteswara Rao and Co. [1985] 155 ITR 152 (SC)
- (6) **No requirement to prove bad debts :** The only requirement for availing deduction under this section is that the bad debt is written off as irrecoverable in the accounts of the assessee and there is no necessity to establish that the debt has really become irrecoverable. - T. R. F. Ltd. v. CIT [2010] 323 ITR 397 (SC)

Illustration 24 - Recovery of bad debt: Bad debt written off and allowed in the financial year 2017-18 of Rs. 50,000 recovered in the financial year 2020-21. Discuss its taxability. (2 Marks, PCC Nov. 2010)

Solution: The bad-debts recovered in the financial year 2020-21 shall be taxable since as per section 41(4), any amount recovered by the assessee against bad debt earlier allowed as deduction shall be taxed as income in the year in which it is received. Therefore, in this case, Rs. 50,000 would be taxable in the financial year 2020-21 (A.Y. 2021-22).

43. **What are the conditions to be satisfied for the allowability of expenditure under section 37 of the Income-tax Act, 1961? (Nov. 2002) (4 Marks, PCC May 2011)**

Ans: The relevant provisions are discussed as under -

- (1) **General Deduction [Section 37] :** The conditions to be satisfied for the allowability of expenditure under Section 37 are as follows -
 - (a) The expenditure should not be of the nature described in Sections 30 to 36.
 - (b) It should have been incurred by the assessee in the accounting year.

- (c) *It should be in respect of a business carried on by the assessee the profits of which are being computed and assessed.*
 - (d) *It must have been incurred after the business was set up.*
 - (e) *It should not be in the nature of personal expenses of the assessee.*
 - (f) *It should not be in the nature of capital expenditure.*
 - (g) *It should be laid out or expended wholly and exclusively for the purposes of the business or profession carried on by the assessee.*
- (2) **Expenditure for any offence or prohibited purpose - Not allowable [Explanation 1 to Section 37(1)] :**
Any expenditure incurred by an assessee for any purpose, which is an offence, or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.
- (3) **CSR expenditure - Not deductible [Explanation 2 to Section 37(1)]:** *Any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.*
- (3) **Advertisement expenditure in magazine published by political party - Not deductible [Section 37(2B)]**
: No allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party.

Dr. T. A. Quereshi v. CIT [2006] 287 ITR 547 (SC)	<i>There is a difference between the illegal business and illegal expenditure. The losses suffered during illegal business shall be allowed as deduction while computing income from illegal business. Hence, in case a doctor is engaged in heroin business (illegal business), then the value of seized heroin (forming part of stock-in-trade) is allowable as deduction while computing his income from such business.</i>
Circular No. 38/2016 dated 22-11-2016	Expenditure incurred by a firm on Keyman insurance policy of partner is admissible as deduction : <i>Keyman insurance policy when obtained to secure the life of a partner to safeguard the firm against a disruption of the business is equally for the benefit of the partnership business which may be effected as a result of premature death of a partner. Thus, the premium on the Keyman Insurance Policy of partner of the firm is wholly and exclusively for the purpose of business and is an admissible expenditure under section 37 of the Act.</i>
Circular No. 5/2012 dated 1-8-2012	Inadmissibility of expenses incurred in providing freebies to medical practitioner by pharmaceutical and allied health sector industry : <i>The CBDT, considering the fact that the claim of any expense incurred in providing freebies to medical practitioner is in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 has clarified that the expenditure so incurred shall be inadmissible under section 37(1) of the Income-tax Act, 1961, being an expense prohibited by the law. The disallowance shall be made in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebies and claimed it as a deductible expense in its accounts against income. This circular has also clarified that a sum equivalent to value of freebies enjoyed by the aforesaid medical practitioner or professional associations is also taxable as business income or income from other sources, as the case may be, depending on the facts of each case.</i>

SPECIFIC DISALLOWANCES - SECTION 40 & 40A

44. Discuss briefly the various disallowances as provided under section 40(a) while computing income under the head Profits and gains of business or profession.

Ans: **Amounts not deductible/specific disallowances [Section 40]** : As per Section 40(a), notwithstanding anything to the contrary in Sections 30 - 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession" —

Sec. 40(a)	Expenditure disallowed -
(i)	Payments outside India or to non-residents on which tax has not been deducted/paid; ➤ Any interest, royalty, fees for technical services or other sum chargeable in the hands of recipient under this Act and payable - (a) outside India; or (b) in India to a non-resident, not being a company or to a foreign company, on which tax is deductible at source and such tax has not been deducted or, after such deduction, has not been paid on or before the due date of furnishing return of income specified under section 139(1). However, where in respect of any sum - (a) tax has been deducted in any subsequent year; or (b) has been deducted during the P.Y. but paid after the due date specified in section 139(1), then, such sum shall be allowed as a deduction in computing the income of the subsequent previous year in which the TDS has been so paid. y Where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to Section 200(1), by reason that such payee - (a) has furnished his return of income under section 139; (b) has taken into account such sum for computing income in such return of income; and (c) has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as maybe prescribed, it would be deemed that the assessee has deducted and paid the tax on such sum on the date on which return of income has been furnished by the payee. Since the date of furnishing the return of income by the payee is taken to be the date on which the payer has deducted tax at source and paid the same, such expenditure/ payment in respect of which the payer has failed to deduct tax at source shall be disallowed under section 40(a)(i) in the year in which the said expenditure is incurred. However, such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the payee, since tax is deemed to have been deducted and paid by the payer in that year. For example: If TDS on interest payable outside India during financial year 2020-21 is not paid in 2.020-21, but is paid on or before 31.-10-2021 (being due date of furnishing return of Income), then, such interest shall be allowed as deduction in assessment year 2021-22 (i.e. previous year 2020-21) only. However, if such TDS is paid on 01-11-2021 i.e. after the expiry of the due date of filing return of income, then the deduction for such payment shall be allowed during assessment year 2.022-23 (previous year 2021-22).
(ia)	Payments to residents on which tax has not been deducted/ paid - 30% of such sum shall not be allowed as deduction: ➤ 30% of any sum payable to a resident on which -

	(a) tax is deductible at source and such tax has not been deducted; or (b) after such deduction, has not been paid on or before the due date of furnishing return of income specified under section 139(1). ➤ However, where in respect of any sum - (a) tax has been deducted in any subsequent year; or (b) 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 subsequent previous year in which the TDS has been so paid. ➤ Where an assessee fails to deduct the whole or any part of the tax on any such sum but is not deemed to be an assessee in default under the first proviso to Section 201(1) (i.e. payee has deposited self assessment tax directly), then, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the payee. For example: The tax amounting to Rs.10,000 was deductible in previous year 2020-21 in respect of interest of Rs. 1 lakh payable to a resident. Such interest of Rs. 1,00,000 will be allowed as deduction during the previous year 2020-21 only if the tax of Rs. 10,000 is deducted in 2020-21 and is paid on or before due date specified under section 139(1). However, if such tax is deducted in 2020-21 and is paid in 2021-22 after due date specified u/s 139(1), then, 30% of such interest (i.e. Rs. 30,000) will not be allowed as deduction in the previous year 2020-21 but the same will be allowed as deduction in previous year 2021-22. Further, if the tax relating to such interest payment is deducted on or after 1-4-2021, then, 30% of such interest shall not be allowed only in the year 2020-21, even if the same is paid on or before due date specified in section 139(1) for furnishing return of Income for assessment year 2021-22.
(ii)	Income-tax: Any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains (i.e. income-tax). Any income tax paid outside India and eligible for relief of tax under section 90 or 90A or 91 shall also not be deductible.
(iia)	Wealth-tax: Any sum paid on account of wealth-tax.
(iib)	Certain fees, Royalty, Service charges etc. payable by State Government undertaking to the State Government: Any amount— (A) paid by way of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called, which is levied exclusively on; or (B) which is appropriated, directly or indirectly, from, a State Government undertaking by the State Government. State government undertaking [Explanation]: A State Government undertaking includes — (i) a corporation established by or under any Act of the State Government; (ii) a company in which more than 50% of the paid-up equity share capital is held by the State Government; (iii) a company in which more than 50% of the paid-up equity share capital is held by the entity referred to in clause (i) or clause (ii) (whether singly or taken together); (iv) a company or corporation in which the State Government has the right to appoint the majority of the directors or to control the management or policy decisions, directly or

	indirectly, including by virtue of its shareholding or management rights or shareholders agreements or voting agreements or in any other manner; (v) an authority, a board or an institution or a body established or constituted by or under any Act of the State Government or owned or controlled by the State Government.
(iii)	Payment of Salaries outside India or to non-residents on which tax has not been deducted and paid : Any payment which is chargeable under the head "Salaries", if it is payable - (a) outside India; or (b) to a non-resident, and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B. [Note : Even if tax is deducted on such salary in subsequent previous year, such salary shall not be allowed as deduction in that previous year.]
(iv)	Contribution towards Employees welfare fund : Any payment by the employer to provident fund or other fund established for the benefit of the employees of the assessee, unless he has made effective arrangements to secure that tax shall be deducted at source from any payments made from the fund which are taxable under the head "Salaries".
(v)	Tax paid by employer on non-monetary perquisites : Any tax actually paid by an employer on non-monetary perquisites, as referred to in Section 10(10CC).

Illustration 25 - Section 40(a)(i): X Ltd. pays a sum of Rs. 10,00,000 as commission to Y Inc. (a US company) on October 15, 2020. Tax is deductible under section 195 (read with Indo-US tax treaty) but it is not deducted by X Ltd. Y Inc. pays advance tax on the due dates on its income (including Rs. 10,00,000). Entire tax liability is paid by Y Inc. during the financial year 2020-21 by way of advance tax. Return of income of Y Inc. for the assessment year 2021-22 is submitted on September 20, 2021. X Ltd. has a certificate of this effect from a chartered accountant in the prescribed form. Discuss tax consequences in respect of the said transaction in hands of X Ltd.

Solution: In this case, X Ltd. has not deducted tax at source in the financial year 2020-21. By virtue of section 40(a)(i), the payment of Rs. 10,00,000 will be disallowed in computing the income for the assessment year 2021-22. However, X Ltd. cannot be treated as an assessee-in-default under the amended provisions of first proviso to section 201(1), as the following conditions are satisfied —

- Y Inc. has furnished its return of income under section 139;
- Y Inc. has taken into account the above income in such return of income;
- Y Inc. has paid the tax due on the income declared in such return of income, and
- X Ltd. has a certificate to this effect from a chartered accountant in a prescribed form.

Under the amended provisions, it will be assumed that X Ltd. has deducted and paid tax on September 20, 2021. As a consequence, Rs. 10,00,000 will be allowed as deduction in the hands of X Ltd. for the financial year 2021-22 (i.e. assessment year 2022-23).

Illustration 26 - TDS not paid: Tax deducted at source on salary paid to employees not remitted till 'due date' of filing the return prescribed u/s 139. Is the expenditure to be disallowed u/s 40(a)(ia) Rs. (1 Marks, PCC May 2011)

Solution: Yes, 30% of the said expenditure shall not be allowed since Section 40(a)(ia) cover all the payments to residents including salary payments on which tax is liable to be deducted at source. Hence, non-payment of the TDS on salaries within the due date attracts disallowance u/s 40(a)(ia) and 30% of such salary shall be disallowed.

Illustration 27 - Deductibility of various expenses: State with reasons, the allowability of the following expenses incurred by MN Limited, a wholesale dealer of commodities, under the Income-tax Act, 1961 while computing Profit & Gains from business or profession for the Assessment Year 2021-22.

- (a) Construction of school building in compliance with CSR activities amounting to Rs. 5,60,000.
- (b) Purchase of building for setting up a warehousing facility for storage of food grains amounting to Rs. 4,50,000.
- (c) Interest on loan paid to Mr. X (a resident) Rs. 50,000 on which tax has not been deducted.
- (d) Commodity transaction tax paid Rs. 20,000 on sale of bullion. **(8 Marks, Nov. 2015)**

Ans.

- (a) According to Explanation 2 to Section 37(1), Any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession. Hence, expenditure incurred on construction of school building in compliance with CSR activities amounting to Rs. 5,60,000 will not be allowed as deduction.
- (b) 100% of the expenditure incurred on purchase of building for setting up a warehousing facility for storage of food grains is eligible for deduction under Section 35AD. Hence, the company will be eligible for deduction of 100% of Rs. 4,50,000 in accordance with the provisions of Section 35AD.
- (c) According to Section 40(a)(ia) - 30% of any sum payable to a resident on which tax is deductible at source and such tax has not been deducted; or after such deduction, has not been paid on or before the due date of furnishing return of income specified under section 139(1) shall not be allowed as deduction. Hence, 30% of Rs. 50,000 = Rs. 15,000 shall not be allowed as deduction while computing Profits and Gains of Business or Profession.
- (d) According to Section 36(1)(xvi) Commodities transaction tax paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year, if the income arising from such taxable commodities transactions is included in the income computed under the head 'Profits and gains of business or profession' shall be allowed as deduction. Hence, commodity transaction tax paid Rs. 20,000 on sale of bullion shall be admissible as deduction.

45. Explain the provisions relating to assessment of income of partnership firm under the IT Act 1961 OR Are there any restrictions on deduction allowable to the partnership firm in respect of salary and interest to its partners under section 40(b) of the Income-tax Act, 1961?

Ans: **Provisions relating to computation of Profits and Gains of Business or Profession of Firm :** In computing the income under the head Profits and Gains of Business or Profession of a firm which is assessed as such, the following amounts shall be disallowed in accordance with the provisions of Section 40(b),-

- (i) any payment of salary, bonus, commission or remuneration, to any partner who is not a working partner i.e. non working partner; or
- (ii) any payment of remuneration to any partner who is a working partner, or of interest to any partner, which is not authorised by, or which is not in accordance with, the terms of the partnership deed; or
- (iii) any payment of remuneration to any partner who is a working partner, or of interest to any partner which is authorised by and is in accordance with, the terms of the partnership deed, but which relates to any period prior to the date of such partnership deed unless authorised by earlier partnership deed; or
- (iv) any interest paid to any partner in excess of 12% simple interest p.a.;

- (v) *Remuneration to working partners: Remuneration paid to working partners during the previous year shall not be allowed to the extent it exceeds, in aggregate the following limits-*

Book profits	Allowable Remuneration
On first Rs. 3,00,000 of book profits, or, in case of a loss.	Rs. 1,50,000, or 90% of book profits, whichever is more.
On balance of the book profits	60% of the book profits.

- **Explanation 1:** Where an individual is a partner in a firm on behalf, or for the benefit, of any other person (such partner and the other person being hereinafter referred to as "partner in a representative capacity" and "person so represented", respectively),-
- (a) interest paid by the firm to such individual, otherwise than as partner in a representative capacity, shall not be taken into account for the purposes of this section;
- (b) interest paid by the firm to such individual as partner in a representative capacity and interest paid by the firm to the person so represented shall be taken into account for the purposes of this section.

For example: Mr. X (HUF) is a partner in XYZ firm, where Mr. X is representing his HUF. If personal funds of Mr. X are invested in the firm, then such interest shall not be disallowed even if it exceeds 12% p.a. However, interest paid to X for HUF or to the HUF shall be disallowed in excess of 12% p.a.

- **Explanation 2:** Where an individual is a partner in a firm otherwise than as a partner in a representative capacity, interest paid by the firm to such individual shall not be taken into account for the purposes of this section, if such interest is received by him on behalf, or for the benefit, of any other person.

For example: Mr. X is a partner in a firm in his personal capacity. His minor son has invested funds in the firm. In this case, interest paid to Mr. X for funds of his minor son shall not be disallowed under section 40(b).

- **Explanation 3:** "Book-profit" means the net profit, as shown in the P&L A/c for the relevant previous year, computed in the manner laid down in Chapter 1V-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit.
- **Explanation 4:** "Working partner" means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner.

OTHER PROVISIONS:

- (1) **Exemption to partners in respect of their share in firm's income [Section 10(2A)] :** In case of a person being a partner of a firm which is separately assessed as such, his share in the total income of the firm shall not be included in his total income.

$$\text{Share of partner in the total income of firm} = \frac{\text{Total income of the firm} \times \text{amount of partner's share in the profits of the firm in accordance with the partnership deed}}{\text{Total profits of the firm}}$$

Circular No. 8 dated 31st March, 2014	Clarification of interpretation of provision of section 10(2A) of the Income-tax Act, 1961 in regard to cases where income of the firm is exempt. ➤ It is clarified that 'total income' of the firm for section 10(2A) of the Act, includes income which is exempt or deductible under various provisions of the Act. Income of a firm is to be taxed in the hands of the firm only and the same can under no circumstances be taxed in the hands of its partners. ➤ Therefore, it is further clarified that the entire profit credited to the partners' accounts in the firm would be exempt from tax in the hands of such partners, even if the income chargeable to tax becomes NIL in the hands of the firm on account of any exemption or deduction as per the provisions of the Act.

- (2) **Interest, salary, etc. received by a partner to be assessed as his business income [Section 28(v)] :** Any interest, salary, bonus, commission or remuneration due to or received by a partner from a firm shall be chargeable to income-tax under the head Profits and Gains of Business or Profession. However, where such payment has not been allowed to be deducted under section 40(b) in the hands of the firm, then it shall be exempt in the hands of the partner.

Illustration 28 - Computation of book profits and allowable remuneration: Rao & Jain, a partnership firm consisting of two partners, reports a net profit of Rs. 7,00,000 before deduction of the following items:

- (1) Salary of Rs. 20,000 each per month payable to two working partners of the firm (as authorized by the deed of partnership).
- (2) Depreciation on plant and machinery under section 32 (computed) Rs. 1,50,000.
- (3) Interest on capital at 15% p.a. (as per deed of partnership). The amount of capital eligible for interest Rs. 5,00,000.

Compute:

- (i) Book-profit of the firm under section 40(b) of the Income-tax Act, 1961.
- (ii) Allowable working partner salary as per section 40(b) of the Income-tax Act, 1961. (5 Marks, IPCC Nov. 2011)

Solution: Computation of book profits and allowable working partner salary (amounts in Rs.):

Net profit as per Profit & Loss account		7,00,000
Less: (a) Depreciation u/s 32	1,50,000	
(b) Interest on capital to the extent of 12% p.a. on Rs. 5,00,000	60,000	2,10,000
Book profits		4,90,000

Computation of allowable remuneration (amount in Rs.):

Actual Remuneration (Rs. 20,000 p.m. × 12 months × 2 partners)		4,80,000
Remuneration allowable u/s 40(b)		
On the first Rs. 3,00,000 of book profit [(Rs. 1,50,000 or 90 % of Rs. 3,00,000) whichever is more]	2,70,000	
On the balance of book profit [60% of (Rs. 4,90,000 – Rs. 3,00,000)]	1,14,000	3,84,000
Maximum allowable remuneration (lower of actual remuneration or remuneration as per section 40(b))		3,84,000

Illustration 29 - Remuneration allowable u/s 40(b): Nikhil, Gagan and Suman are partners in a firm with equal shares. The profit and loss account for the year ending 31st March, 2021 shows a net profit of Rs.42,300 after debiting the following items:

- (i) Salary of Rs. 74,000 each to Nikhil and Gagan.
- (ii) Bonus to Suman Rs. 68,000.
- (iii) Commission of Rs. 19,000, Rs.20,000 and Rs.45,000 to Nikhil, Gagan and Suman respectively.
- (iv) Interest on capital @ 15% amounting to Rs. 4,500, Rs.6,000 and 15,000 was paid to Nikhil, Gagan and Suman respectively.

Assuming that all partners are working partners and the firm fulfils the conditions of Section 184, compute the total income of the firm and taxable income of the partners in the firm. (8 Marks, CS Exe. Dec. 2008)

Solution: Calculation of total income of the firm (amount in Rs.):

Net profit as per Profit and Loss A/c		42,300
Add: Disallowed items:		
Salary to Partners (Nikhil Rs.74,000 + Gagan Rs.74,000)	1,48,000	
Bonus to Suman	68,000	
Commission to Partners (Nikhil Rs.19,000 + Gagan Rs.20,000 + Suman Rs.45,000)	84,000	3,00,000
Interest to partners in excess of 12% p.a. -		
Nikhil = (Rs.4,500 x 3) + 15	900	
Gagan = (Rs.6,000 x 3) + 15	1,200	
Suman = (Rs.15,000 x 3) - 15	3,000	5,100
Book profits		3,47,400
Less: Allowable remuneration allowable under section 40(b), being lower of the following -		
(a) Actual remuneration; or	3,00,000	
(b) Allowable u/s 40(b) [Rs.3,00,000 x 90% + Rs. 47,400 x 60%]	2,98,440	2,98,440
Total income		48,960

Calculation of total income of each partner of the firm (amount in Rs.):

Particulars	Nikhil	Gagan	Suman
Interest on capital @ 12% (to the extent allowed in hands of the firm)	3,600	92,516	4,800
Salary, Bonus & Commission (taxable only upto Rs. 2,98,440 since the same is allowed in hands of firm)	93,511	12,000	1,12,412
Total income	96,116	98,311	1,24,412

46. Explain the provisions for computing business income of an AOP/BOI.

Ans: Provisions for computing business income of any AOP/BOI [Section 40(ba)]: In computing the income of an AOP/BOI under the head, 'Profits and gains of business or profession', the following shall be disallowed -

- (1) **Interest to members - Not allowable:** Any payment of interest, made by such association or body to a member of such association or body.

Note:

- (a) Where interest is paid by an association or body to any member thereof who has also paid interest to the association or body, then net amount of interest shall be disallowed.
- (b) Where an individual is a member of an association or body on behalf, or for the benefit, of any other person (such member and the other person hereinafter referred to as "member in a representative capacity" and "person so represented", respectively), —
- interest paid by the association or body to such individual or by such individual to the association or body otherwise than as member in a representative capacity, shall not be disallowed.
 - interest paid by the association or body to such individual or by such individual to the association or body as member in a representative capacity and interest paid by the association or body to the person so represented or by the person so represented to the association or body, shall be disallowed.
- (c) Where an individual is a member of an association or body otherwise than as member in a representative capacity, interest paid by the association or body to such individual shall not be disallowed, if such interest is received by him on behalf, or for the benefit, of any other person.
- (2) **Remuneration to members - Not allowable:** Any payment of salary, bonus, commission or remuneration, by whatever name called, made by such association Or body to a member of such association or body.

Illustration 30 - Computation of total income of AOP: M/s. XYZ, an association of person, consisting of members X, Y & Z sharing profits in the ratio of 2: 2:1, furnishes you with the following information:

Net profit as per P&L A/c is Rs. 6 lakhs after following debits:

Salaries paid to members: Mr. X Rs. 1,60,000, Mr. Y Rs. 2,40,000 and Mr. Z Rs. 1,20,000. Interest on capital to members @ 15% p.a.: Mr. X Rs. 45,000, Mr. Y Rs. 60,000 and Mr. Z Rs. 15,000.

Determine the income of association of person.

Solution: Computation of total income of AOP (amounts in Rs.):

Net profit as per Profit and Loss Account		6,00,000
Add: Salaries to members -		
Mr. X	1,60,000	
Mr. Y	2,40,000	
Mr. Z	1,20,000	5,20,000
Add: Interest on capital -		
Mr. X	45,000	
Mr. Y	60,000	
Mr. Z	15,000	1,20,000
Total income of the AOP		12,40,000

47. Discuss the deductibility of payment made to relatives in excess of fair market value under section 40A(2) for computing Profits and gains of business or profession.

Ans: Disallowance of Payment made to specified persons/relatives in excess of fair market value [Section 40A(2)]:

(1) **Payment to relatives in excess of fair value - Not deductible :** If the -

- (a) assessee incurs any expenditure in respect of which payment has been or is to be made to 'specified persons'; and
- (b) the Assessing Officer is of opinion that such expenditure is excessive or unreasonable having regard to-
- (i) the fair market value of goods, services or facilities for which the payment is made; or
 - (ii) the legitimate needs of the business or profession of the assessee; or
 - (iii) the benefit derived by or accruing to assessee therefrom;
- then, so much of the expenditure as is so considered by the Assessing Officer to be excessive or unreasonable shall not be allowed as deduction.

Thus, amount to be disallowed = Expenditure incurred - FMV of goods/ services/ facilities/benefit etc. received by the assessee.

(2) **Meaning of Specified persons:** The Specified Persons are the following, namely -

(i)	Where the assessee is an individual	Any relative of the assessee;
(ii)	Where the assessee is a company, firm, association of persons or Hindu undivided family	Any director of the company, partner of the firm, or member of the association or family, or any relative of such director, partner or member;
(iii)	Any individual who has a substantial interest in the business or profession of the assessee, or any relative of such individual;	
(iv)	A company, firm, association of persons or Hindu undivided family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member, or any other company carrying on business or profession in which the first mentioned company has substantial interest;	
(v)	A company, firm, association of persons or Hindu undivided family of which a director, partner or member, as the case may be, has a substantial interest in the business or profession of the assessee; or any director, partner or member of such company, firm, association or family or any relative of such director, partner or member;	
(vi)	Any person who carries on a business or profession,- (A) where the assessee being an individual, or any relative of such assessee, has a substantial interest in the business or profession of that person; or (B) where the assessee being a company, firm, association of persons or Hindu undivided family, or any director of such company, partner of such firm or member of the association or family, or any relative of such director, partner or member, has a substantial interest in the business or profession of that person.	

48. Briefly explain the term "Substantial Interest". State any two situations in which the same assumes importance. (4 Marks, PCC May 2008)

Ans: As per Explanation to Section 40A (2), a person shall be deemed to have a substantial interest in a business or profession, if -

- (a) in a case where the business or profession is carried on by a company, such person, at any time during the previous year, is the beneficial owner of equity shares carrying not less than 20% of the voting power; and
- (b) in any other case, such person, at any time during the previous year, is beneficially entitled to not less than 20% of the profits of such business or profession.

The situations where the substantial interest assumes importance are,-

- (i) Taxability of deemed dividend under section 2(22) (e);
- (ii) Disallowance of excessive or unreasonable expenditure under section 40A(2) to an individual who has substantial interest in the business or profession of the assessee;
- (iii) Clubbing of salary income of spouse under section 64(1) (ii) in respect of remuneration received by the spouse from a concern in which the individual has a substantial interest.

49. State briefly the provisions relating to disallowance in respect of payment of expenditure in excess of Rs. 10,000 otherwise than by an account payee cheque drawn on a bank or account payee bank draft while computing Profits and gains of business or profession.

Ans: *The relevant provisions are discussed as under -*

- (1) **Expenditure paid in aggregate exceeding Rs. 10,000 in a day, otherwise than by account payee cheque or account payee bank draft [Section 40A(3)] :** *Where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed, exceeds Rs. 10,000, no deduction shall be allowed in respect of such expenditure, [(a) Credit Card; (b) Debit Card; (c) Net Banking; (d) IMPS (Immediate Payment Service); (e) UPI (Unified Payment Interface); (f) RTGS (Real Time Gross Settlement); (g) NEFT (National Electronic Funds Transfer), and (h) BHIM (Bharat Interface for Money) Aadhar Pay have been prescribed as mode of electronic payment]*
- (2) **Disallowance to be made in the year of payment for expenditure incurred in earlier years [Section 40A(3A)] :** *Where -*
 - (a) *an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure; and*
 - (b) *subsequently, during any subsequent year, the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed, and*
 - (c) *the payment or aggregate of payments so made to a person in a day exceeds Rs. 10,000; then, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year, [(a) Credit Card; (b) Debit Card; (c) Net Banking; (d) IMPS (Immediate Payment Service); (e) UPI (Unified Payment Interface); (f) RTGS (Real Time Gross Settlement); (g) NEFT (National Electronic Funds Transfer), and (It) BHIM (Bharat Interface for Money) Aadhar Pay have been prescribed as mode of electronic payment]*
- (3) *No disallowance shall be made and no payment shall be deemed to be the profits and gains of business or profession, in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.*
- (4) **Enhanced limit of Rs. 35,000 in case of goods transport agencies:** *In the case of payment made for plying, hiring or leasing goods carriages, the aforesaid limit shall be Rs. 35,000 instead of Rs. 10,000.*
- (5) **No person to enforce that payment exceeding Rs. 10,000 / Rs. 35,000 to be made in cash [Section 40A(4)]:** *Where any payment in respect of any expenditure has to be made by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank,*

account or through such other electronic mode as may be prescribed in order that such expenditure may not be disallowed as a deduction under this section, then the payment may be made by such cheque or draft or electronic clearing system or through such other electronic mode as may be prescribed and where the payment is so made or tendered, no person shall be allowed to raise, in any suit or other proceeding, a plea based on the ground that the payment was not made or tendered in cash or in any other manner, [(a) Credit Card; (b) Debit Card; (c) Net Banking; (d) IMPS (Immediate Payment Service); (e) UPI (Unified Payment Interface); (f) RTGS (Real Time Gross Settlement); (g) NEFT (National Electronic Funds Transfer), and (It) BHIM (Bharat Interface for Money) Aadhar Pay have been prescribed as mode of electronic payment]

(6) Cases where disallowances would not be attracted:

(i) **Loan transactions:** It does not apply to loan transactions because advancing of loans or repayments of the principal amount of loan does not constitute an expenditure deductible in computing the taxable income. However, interest payments of amounts exceeding Rs. 10,000 at a time are required to be made by account payee cheques or drafts or electronic clearing system or through such other prescribed electronic modes as interest is a deductible expenditure.

(ii) **Payment made by commission agents :** This requirement does not apply to payment made by commission agents for goods received by them for sale on commission or consignment basis because such a payment is not an expenditure deductible in computing the taxable income of the commission agent.

For the same reason, this requirement does not apply to advance payment made by the commission agent to the party concerned against supply of goods.

However, where commission agent purchases goods on his own account but not on commission basis, the requirement will apply. The provisions regarding payments by account payee cheque or draft or electronic clearing system or through such other prescribed electronic modes apply equally to payments made for goods purchased on credit.

50. Write a short note on: The circumstances where the provisions of Section 40A(3) regarding cash payments in excess of Rs. 10,000 does not apply. (Nov. 1998) (6 Marks, PE-II Nov. 2008)

Ans: Provisions of Section 40A (3) not to apply in certain cases: The exceptions to Section 40A(3) are given in Rule 6DD, which are as follows -

- (1) Where the payment is made to RBI, any banking company, State Bank of India or its subsidiary banks, any co-operative bank or land mortgage bank, any primary agricultural credit society or any primary credit society or the Life Insurance Corporation of India;
- (2) Where the payment is made to the Government and under the rules framed by it, such payment is required to be made in legal tender;
- (3) Where the payment is made through any bank, including foreign bank, by any of these modes -
 - (a) any letter of credit arrangements;
 - (b) a mail or telegraphic transfer;
 - (c) a book adjustment between banks;
 - (d) a bill of exchange made payable only to a bank;
 - (e) Electronic clearing system;
 - (f) a credit card;

- (g) a debit card;
- (4) Where payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;
- (5) Where payment is made to the cultivator, grower or producer of the following for purchase thereof -
- agricultural or forest produce; or
 - produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming;
 - fish or fish products;
 - the products of horticulture or apiculture;
- (6) Where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;
- (7) Where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;
- (8) Where any payment is made to an employee of assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to employee or his heir does not exceed Rs. 50,000;
- (9) Where the payment is made by an assessee by way of salary to his employee after deducting the income-tax at source, when such employee is temporarily posted for a continuous period of 15 days or more in a place other than his normal place of duty or on a ship, and does not maintain any account in any bank at such place or ship;
holiday or strike; [Omitted w.e.f. 29-01-2020]
- (11) Where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;
- (12) Where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.
No disallowance in case of calculation of profit at net profit rate: Where the Assessing Officer has applied net profit rate in computing the business income, no disallowance can be made under section 40A(3) because no deduction of any expenditure was allowed in computing such income.

51. Whether deduction is allowed for provision made in respect of gratuity?

Ans: **Provision made for Gratuity [Section 40A(7)]:**

- (1) **Provision made for unapproved gratuity fund - Not allowable:** No deduction shall be allowed in respect of any provision made by the assessee for the payment of gratuity to his employees on their retirement or on termination of their employment for any reason.
However, any provision made by the assessee for the purpose of contribution towards an approved gratuity fund, or for the purpose of payment of any gratuity, that has become payable during the previous year, shall be allowed as deduction.

- (2) **Payment of gratuity to retiring employee - Allowable :** Where any provision, made by the assessee for the payment of gratuity to his employees on their retirement or termination of their employment, has been allowed as a deduction in computing the income of the assessee for any assessment year, then any sum paid out of such provision by way of contribution towards an approved gratuity fund or by way of gratuity to any employee, shall not be allowed as a deduction in computing the income of the assessee of the P.Y. in which the sum is so paid.

Note: The deduction allowed shall be subject to the provisions of Section 43B.

52. Discuss the deductibility of payments made to Non-Statutory Funds.

Ans: **Payment made to Non-Statutory Funds - Not deductible [Section 40A(9)] :** No deduction shall be allowed in respect of any sum paid by an employer towards the setting up or formation of, or as contribution to, any fund, trust, company, association of persons, body of individuals, registered society, or other institution for any purpose. However, deduction shall be allowed in case such sum is paid as per provisions under section 36(1)(iv)/(iva)/(v) or under any other law for time being in force.

Illustration 31 - Payments to relatives u/s 40A(2) and Cash payments u/s 40A(3) : M/s. XYZ, a firm constituting partners X, Y and Z, is engaged in wholesale business of electronics and made following payments towards some purchases on 01-12-2020:

Party	Mode of payment	Amount (Rs.)	Fair Value (Rs.)
Raj Ltd.	Cash	80,000	10,000
PQR and Co.	Account payee cheque	65,000	65,000
Mr. Bansal (Bill No. 100)	Crossed cheque	15,000	8,000
Mr. Bansal (Bill No. 101)	Cash	5,000	8,000
Freight paid to Shiv Transporters	Cash	30,000	30,000

X holds 2.5% equity shares of Raj Ltd. Y's son Ram is 60% partner in PQR and Co. Mr. Bansal is father of Z. What amount will be disallowed as per Income-tax Act, 1961?

Solution: Here, X and Y have substantial interest in Raj Ltd. and PQR and Co. respectively; and Mr. Bansal is a relative of Z. Thus, all the three parties are specified persons as per Section 40A(2). So, firstly, disallowance will be made as per Section 40A(2); and Section 40A(3) will apply to amount available after disallowance under section 40A(2).

The amount of disallowance will be computed as follows (amounts in Rs.) -

Purchases from -	Disallowance u/s 40A(2) [Expenditure - Fair Value]	Disallowance u/s 40A(3) for cash payment exceeding Rs.10,000 [WN-1]
Raj Ltd.	Rs. 70,000 [Rs.80,000 - Rs. 10,000]	NIL
PQR and Co.	Nil	NIL [Since payment is made through account payee cheque]
Mr. Bansal	Rs. 7,000 [Rs. 15,000 - Rs. 8,000, for 1st purchase] Nil [for 2nd purchase, as FMV is higher]	Rs. 13,000 [WN-2]
Shiv Transporters	Nil	Nil [WN-3]
Total	Rs. 13,000	Rs. 77,000

Working Notes:

- (1) Since after disallowance under section 40A(2) of Rs. 70,000, remaining allowable expenditure is Rs. 10,000 since, the amount does not exceed Rs. 10,000 i.e. within the prescribed limit of Section 40A(3), disallowance under section 40A(3) is not attracted.
- (2) While individual bills do not exceed Rs. 10,000, but since cash payment made to Mr. Bansal on the day exceeds Rs. 10,000, hence, it will be disallowed.
- (3) Payment to goods transport agency in cash shall be allowed as deduction since maximum limit for cash payment in such case is Rs. 35,000.

Illustration 32 - Allowable expenditure: Discuss the tax implications of the following in the case of a doctor running a nursing home (amount in Rs.). (CA May 2001)

- (1) Amount paid to a scientific research association approved by the Central Government and run by 20,000 a drug manufacturing company
- (2) Payments made in cash towards purchases of medicines 50,000
- (3) Amounts received from the employees of the nursing home as contributions towards Provident Fund for the month of March 2021, paid to the P.F. Commissioner on 25-4-2021.

Solution: Tax implications of the following in the case of a doctor running a nursing home (amounts in Rs.) -

Cases	Deduction
(1) Amount paid to a scientific research association approved by the Central Government and run by a drug manufacturing company [WN-1]	20,000
(2) Payments made in cash towards purchases of medicines [WN-2]	Nil
(3) Amounts received from the employees of the nursing home as contributions towards Provident Fund [WN-3]	Nil

Working Notes:

- (1) 100% of such expenditure is allowable as deduction under section 35(1)(ii) i.e. 100% of Rs. 20,000 = Rs. 20,000.
- (2) Such cash payments are not allowable under section 40A(3) since the same exceeds Rs. 10,000.
- (3) The amount received will be first included in income of the assessee and then deduction shall be allowed under section 36(1)(va) if payment is made on or before due date of relevant fund i.e. 15-04-2021 + 5 days. In this case since payment was made on 25-04-2021 therefore no deduction shall be allowed under section 36(1)(va).

DEEMED PROFITS - SECTION 41

53. Give a brief note on Deemed Profits chargeable to tax under Section 41. (Nov. 2000, May 2001)

Ans: Profits chargeable to tax [Section 41]: The deemed profits chargeable to tax under section 41 are -

Section	Deemed Profits
41(1)	Recovery against a deduction allowed in any previous year: Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee and subsequently during any previous year - (i) the assessee has obtained, whether in cash or in any other manner whatsoever; (ii) any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of its remission or cessation thereof; then, the amount obtained by such person or the value of benefit accruing to him shall be deemed to be profits and gains of business or

	profession and accordingly, taxable as the income of that previous year, whether the business or profession is in existence in that year or not. The same provisions shall apply in case of succession of business, in which the amount received shall be taxable in the hands of the successor. Unilateral Act covered [Explanation 1]: The expression "loss or expenditure or some benefit in respect of any such trading liability by way of remission or cessation thereof" shall include the remission or cessation of any liability by a unilateral act by the assessee or successor by way of writing off such liability in his accounts. Successor in Business [Explanation 2]: "Successor in business" means - (a) In case of amalgamation or demerger, the amalgamated or resulting company; and (b) In case assessee/firm carrying on business or profession is succeeded by any other person/firm in that business or profession, the other person/firm. Note: The amount so obtained shall be taxable only when it is actually received, even if the assessee follows accrual system of accounting.
41(2)	Taxability of Balancing Charge in case of Power Generating Undertakings. (Already discussed)
41(3)	Sale of an asset used for scientific research without having been used for the purposes of business or profession. (Already discussed)
41(4)	Recovery of bad debts. (Already discussed)
41(5)	Set off of loss against incomes taxable under section 41 (1)/41 (3)/41 (4): Where - ➤ the business or profession is no longer in existence; and ➤ there is income chargeable to tax under section 41(1) or 41(3) or 41(4) in respect of that business or profession; ➤ any loss, not being a loss sustained in speculation business, which arose in that business or profession during the previous year in which it ceased to exist and which could not be set off against any other income of that previous year; ➤ shall be set off against such deemed profits to the extent of such profits.

54. *List 8 items of expenses which otherwise are deductible shall be disallowed, unless payments are actually made within the due date for furnishing the return of income under Section 139(1). When can the deduction be claimed, if paid after the said date? (6 Marks: May 1998, May 2000, May 2002, May 2003, May 2007) (4 Marks, PCC May 2008)*

Ans: *Certain deductions to be allowed only on actual payment [Section 43B]: Notwithstanding anything contained in any other provision of the Act, a deduction of the following sums paid by the assessee, otherwise allowable under this Act, shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred according to the method of accounting regularly employed) in that previous year in which such sum is actually paid by him,-*

(a) Any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force; or

(b) Any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees; or

(c) Any bonus or commission to employees for services rendered as referred under section 36(1)(ii); or

(d) Any sum payable by the assessee as interest on any loan or borrowing from -

(i) Any Public Financial Institution (e.g. ICICI, IFCI, IDBI, LIC, UTI etc.); or

- (ii) State Financial Corporation, or State Industrial Investment Corporation, in accordance with the terms and conditions of the agreement governing such loan or borrowing; or;
- (e) Any sum payable by the assessee as interest on any loan or borrowing from a deposit taking non-banking financial company or systemically important non-deposit taking non-banking financial company, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or

Explanation:**(i) Non-banking financial company means —**

- a financial institution which is a company;
- a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
- such other non-banking institution or class of such institutions, as the bank may, specify with the previous approval of the Central Government and by notification in the Official Gazette.

(ii) "Deposit taking non-banking financial company" means a non-banking financial company which is accepting or holding public deposits and is registered with the Reserve Bank of India under the provisions of the Reserve Bank of India Act, 1934.**(iii) "Systemically important non-deposit taking non-banking financial company" means a non-banking financial company which is not accepting or holding public deposits and having total assets of not less than Rs. 500 crore as per the last audited balance sheet and is registered with the Reserve Bank of India under the provisions of the Reserve Bank of India Act, 1934.**

- (f) Any sum payable by the assessee as interest on any loan or advances from a scheduled bank or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank in accordance with the terms and conditions of the agreement governing such loan or advance;
- (g) Any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee; or (Leave Encashment)
- (h) Any sum payable by the assessee to the Indian Railways for the use of railway assets. Manner of deduction: The expenditure shall be allowed as deduction in the following manner -

Case	Year of allowance
If the sum relates to any previous year for which payment has been made on or before the due date of furnishing the Return of Income of that year	In the previous year to which it relates
In any other case	In the year of payment.

In case of conversion of interest into loan/ borrowing/ advance: In case if any interest is payable covered under (d), (e) and (f) above and such interest is converted into loan or borrowing or advance, then the same shall not be allowed as deduction in the year of conversion, but shall be allowed in the year in which such converted loan is as actually paid. For example : A had taken loan on 31-3-2015, on which interest unpaid @ 12% upto 31-3-2020 is Rs. 60 lakhs. In restructuring arrangement, the unpaid interest of Rs. 60 lakhs is converted into interest-free Funded Interest Term Loan (FITL) and is payable in 15 annual installments of Rs. 4 lakhs each, starting from the financial year 2020-21. In this case, installments of FITL of Rs. 4 lakhs will, be allowed in

the assessment year 2021-22 and subsequent years on the basis of actual payment. However, the interest on the original principal, if any, actually paid will be independently allowable under section 43B.

Note: If the sales tax laws of the state provide that deferred sales tax is to be treated as actually paid, it will be treated as such under this Section. Further, in case unpaid sales tax is deemed as actually paid and disbursed as loan by the State Government, then, deduction will be allowed in the previous year in which such conversion is permitted. [Circulars No. 496 dated 25-9-1987, and 674 dated 29-12-1993]

Illustration 33 - Deduction on payment basis: X Ltd. follows mercantile system of accounting. After negotiations with the bank, interest of Rs. 4 lakhs (including interest of 11.2 lakhs) pertaining to year ended 31-03-2021 has been converted into loan. Can the interest of Rs. 1.2 lakhs so capitalized be claimed as business expenditure? (2 Marks, PCE Nov. 2007)

Solution: No, the said interest of 1.2 lakhs cannot be claimed as expenditure, since Section 43B specifically disallows the interest converted into loan, as it is not actually paid.

Illustration 34 - Deduction on payment basis: An analysis of the profit and loss account and the balance sheet of Kapil as at 31st March, 2021 reveals that the following expenses which were due, were though debited to the profit and loss account, but have been paid after 31st March, 2021:

- (i) **Goods and Services Tax:** Rs. 50,000 (Rs. 20,000 paid on 14th September, 2021; and Rs. 30,000 paid on 15th December, 2021;
- (ii) **Customs duty :** Rs. 1,20,000 (Rs. 40,000 paid on 14th September, 2021; Rs. 40,000 paid on 15th December, 2021; and Rs.40,000 paid on 24th December, 2021).
- (iii) **Bonus to staff:** Rs. 60,000 (Rs. 58,000 paid on 10th September, 2021; & Rs.2,000 paid on 15th December, 2021).
- (iv) **Employer's contribution to provident fund:** Rs. 55,000 (Rs. 25,000 paid on 15th July, 2021; Rs. 10,000 paid on 30th September, 2021; and Rs. 20,000 paid on 15th December, 2021).
- (v) **Interest on term loan from cooperative bank:** Rs. 1,50,000 (Rs. 1,20,000 paid on 14th July, 2021; and Rs. 30,000 paid on 15th December, 2021).

The due date for filing of return is 31th October, 2021. In which previous years can the above payments be claimed as a deduction? (Modified CS Dec. 2004)

Solution: The aforesaid amounts shall be deductible as follows -

Expenses	Amount of Expenditure	Date of payment	Amount of payment	Previous year in which deductible
Goods and Services Tax	50,000	14-09-2021	20,000	2020-21
Customs duty	1,20,000	15-12-2021	30,000	2021-22
		14-09-2021	40,000	2020-21
		15-12-2021	40,000	2021-22
		24-12-2021	40,000	2021-22
Bonus to staff	60,000	10-09-2021	58,000	2020-21
		15-12-2021	2,000	2021-22
Employer's contribution to PF	55,000	15-07-2021	25,000	2020-21
		30-09-2021	10,000	2020-21
		15-12-2021	20,000	2021-22
Interest on term loan from	1,50,000	14-07-2021	1,20,000	2020-21

cooperative bank		15-12-2021	30,000	2021-22

SPECIAL PROVISIONS/DEDUCTIONS;

55. Explain Special provision for full value of consideration for transfer of assets other than capital assets in certain cases.

Ans: Special provision for full value of consideration for transfer of assets other than capital assets in certain cases [Section 43CA]: The said provisions are as under -

- (1) **Stamp duty value deemed to be Full Value of consideration :** Where the consideration received or accruing as a result of the transfer by an assessee of an asset (other than a capital asset), being land or building or both, is less than the value adopted or assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall, for the purposes of computing profits and gains from transfer of such asset, be deemed to be the full value of the consideration received or accruing as a result of such transfer.

However, where the value adopted or assessed or assessable by the authority for the purpose of payment of stamp duty does not exceed 110% of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of computing profits and gains from transfer of such asset, be deemed to be the full value of the consideration. [Amended by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY 2021-22]

- (2) **Stamp duty value on the date of agreement to be considered:** Where the date of agreement fixing the value of consideration for transfer of the asset and the date of registration of such transfer of asset are not the same, the full value of consideration may be taken to be the stamp duty value on the date of the agreement for such transfer and not on the date of registration of such transfer.

However, this provision shall apply only in a case where the amount of consideration or a part thereof has been received by way of an account payee cheque or an account payee bank draft or by use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed, on or before the date of agreement for transfer of the asset, [(a) Credit Card; (b) Debit Card; (c) Net Banking; (d) IMPS (Immediate Payment Service); (e) UPI (Unified Payment Interface); (f) RTGS (Real Time Gross Settlement); (g) NEFT (National Electronic Funds Transfer), and (h) BHIM (Bharat Interface for Money) Aadhaar Pay have been prescribed as mode of electronic payment]

- (3) **Other provisions of Section 50C applicable:** The other provisions of Section 50C shall be applicable for operation of Section 43CA.

Illustration 35 - Section- 43CA: Find out "full value of consideration" for the purpose of Section 43CA in the cases given below--

Different cases	Stamp duty value (date of agreement)		Stamp duty value (date of registration)		Amount of consideration as per agreement	Date when first payment is received by seller by account-payee cheque/draft, etc.
	(f)	Date	(f)	Date		
Case 1	26,40,000	15-04-2020	35,00,000	30-04-2020	24,00,000	10-04-2020
Case 2	27,00,000	04-2020	35,00,000	30-04-2020	24,00,000	10-05-2020

Case 3	25,00,000	2020 10-05-	35,00,000	30-05-2020	24,00,000	
Case 4	30,00,000	2020	31,50,000	30-05-2020	30,00,000	

Solution: Computation of Full value of consideration (amount in Rs.):

Different cases	Amount of consideration as per agreement	Stamp duty value relevant for Section 43CA		110% of amount of consideration as per agreement	Full value of consideration u/s 43CA [if Column 4 is more than Column 5, Column 4 value will be taken, otherwise section 43CA is not applicable]
		Date of agreement/ registration	Stamp duty value		
(1)	(2)	(3)	(4)	(5)	(6)
Case 1	24,00,000	Date of agreement	26,40,000	26,40,000	24,00,000
Case 2	24,00,000	Date of agreement	27,00,000	26,40,000	27,00,000
Case 3	24,00,000	Date of registration	35,00,000	26,40,000	35,00,000
Case 4	30,00,000	Date of registration	31,50,000	33,00,000	30,00,000

Illustration 36 - Applicability of Section 43CA: Mr. Ramesh, a property dealer, purchased a building on 15 July 2020 for a sum of Rs. 65 lakh. The said building was sold by him during the course of his business to his friend Mahesh, who is a dealer in cosmetic goods, for Rs. 90 lakh on 1-1-2021, when the stamp duty value was Rs. 185 lakh. The agreement was entered on the same day and the property was registered on the same day. Discuss tax implications in hands of Ramesh.

What would be your answer if the agreement was entered into on 1-7-2020 when the stamp duty value was Rs. 120 lakh. Mr. Ramesh had received a down payment of Rs. 15 lakh by cheque from Mahesh on the date of agreement. Will your answer change if the said sum of Rs. 15 lakhs has been received by cash instead of cheque.

Solution: The tax implications in hands of Ramesh shall be as under -

Case I: *In case the agreement has been entered on the date of sale and property has been registered on the same day:* The provisions of section 43CA would be attracted, since the building represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value on the date of registration of property and the stamp duty value exceeds 110% of the consideration.

Therefore, Rs. 120 lakh, being the difference between the stamp duty value on the date of registration (i.e., Rs. 185 lakh) and the purchase price (i.e. Rs. 65 lakh), would be chargeable as business income in the hands of Mr. Ramesh.

Case II: *In case the agreement has been entered on 1-7-2020:* In this case the stamp duty value on the date of agreement will be considered to compute business profits since, Mr. Ramesh had received a down payment of Rs. 15 lakh by cheque from Mahesh on the date of agreement and stamp duty does exceeds 110% of the consideration received or accruing as a result of the transfer. Therefore, Rs. 55 lakh, being the difference between the stamp duty value on the date of agreement (i.e. Rs. 120 lakh) and the purchase price (i.e. Rs. 65 lakh), would be chargeable as business income in the hands of Mr. Ramesh.

Yes, the answer will change in case if on the date of agreement cash has been received instead of cheque. In such case stamp duty value on the date of agreement shall not be considered but the stamp duty value on the date of registration of property shall be considered and the business profits shall be Rs. 120 lakhs.

ACCOUNTS AND AUDIT - SECTION 44AA & 44AE

56. Who are the persons and what are the circumstances which require maintaining books of accounts compulsorily Rs. State the period for which such books are required to be kept and maintained.

Ans: Maintenance of books of accounts by certain persons carrying on business or profession [Section 44AA]:

- 1) Persons carrying on specified professions :** Every person carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorised representative or film artist or any other profession as is notified by the Board in the Official Gazette shall keep and maintain specified books of account and other documents,-
- (a) if his gross receipts exceeds Rs. 1,50,000 in all of the three immediately preceding previous years or;
 - (b) where the profession is newly setup, the gross receipts are likely to exceed Rs. 1,50,000 during current previous year.

Books of account to be maintained:

- (i) Cash book;
- (ii) Journal, in case of mercantile system of accounting;
- (iii) Ledger;
- (iv) Carbon copies or counterfoils of bills or receipts issued by him exceeding Rs. 25;
- (v) Original bills issued to him and receipts in respect of expenditure incurred by him. In absence of bills, and where the payment does not exceed Rs. 50, payment vouchers.

Additional books in case of medical profession: In case of medical profession following additional books are required to be maintained -

- (i) A daily case register in Form No. 3C;
- (ii) An inventory [under broad heads] as on the first and the last day of previous year, of the stock of drugs, medicines and other consumable accessories used for the purpose of his profession.

- (2) Other assessee's:** The assessee's, other than those covered by (1) above, shall keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of this Act, -

In case of existing business or profession	If- (a) his income from business or profession exceeds Rs. 1,20,000; (Rs.2,50,000 in case of Individual or Hindu Undivided Family); or (b) Total sales/ turnover/ gross receipts thereof exceeds Rs. 10,00,000 (Rs.25,00,000 in case of Individual or Hindu Undivided Family, in any of the three previous years immediately preceding the previous year.
In case of newly set up business or profession	If (a) his income from business or profession is likely to exceed Rs. 1,20,000 (Rs.2,50,000 in case of Individual or Hindu Undivided Family) during such previous year. (b) Total sales, turnover or gross receipts thereof is likely to exceed Rs. 10,00,000 (Rs.25,00,000 in case of Individual or Hindu Undivided Family) during such

	<i>previous year.</i>
<i>In case of deemed profits u/s 44AE, 44BB or 44BDB</i>	<i>If the assessee has claimed his income lower than the profits and gains so deemed, during such previous year.</i>
<i>Where the provisions of Section 44AD (4) are applicable</i>	<i>If his income exceeds the maximum amount which is not chargeable to income-tax in any previous year.</i>

Notes:

- (i) **Place at which books to be kept:** If the business is carried on at more than one place, then the books are to be kept at the principal place of profession. However, if separate books of accounts are maintained for each place of business, then the same are to be kept at the respective places, where profession is carried on.
- (ii) **Period for maintenance of books:** The books of accounts are to be kept and maintained for a period of six years from the end of the relevant assessment year.

Illustration 37 - Maintenance of books of Accounts : Vinod is a person carrying on profession as film artist. His gross receipt from profession are as under:

Financial Year 2018-19 Rs. 1,15,000

Financial Year 2019-20 Rs. 1,80,000

Financial Year 2020-21 Rs. 2,10,000

What is his obligation regarding maintenance of books of accounts for each assessment year under Section 44AA of Income-tax Act, 1961 Rs. (5 Marks, May 2001, May 2008)

Solution: Every person carrying on the profession of film artist shall keep and maintain specified books of account and other documents, if his gross receipts exceeds Rs. 1,50,000 in all of the three immediately preceding previous years, since Mr. Vinod is a film artist he is required to maintain books of account only if his gross receipts exceeds f 1,50,000 in all of the 3 immediately preceding previous years. Accordingly -

Financial year 2018-19 He is not required to maintain any books of accounts.

Financial year 2019-20 He is not required to maintain any books of accounts.

Financial year 2020-21 He is not required to maintain any books of accounts.

57. Discuss the provisions of tax audit under section 44AB of the Income-tax Act, 1961. (Nov. 2002)

Ans: **Audit of accounts of certain persons carrying on business or profession [Section 44AB] [Amended by Finance Act, 2020 w.e.f. 01-04-2020 i.e. AY 2020-21] :**

- (1) **Tax Audit:** Every person shall get his accounts of any previous year audited by a Chartered Accountant before the specified date and furnish by that date the audit report in form 3CB along with prescribed particulars (Form 3CD), -

In case of Business	his total sales, turnover or gross receipts, as the case may be, exceeds Rs. 1 crore in any previous year; However, in the case of a person whose - (a) aggregate of all amounts received including amount received for sales, turnover or gross receipts during the previous year, in cash, does not exceed 5% of the said amount; and (b) aggregate of all payments made including amount incurred for expenditure, in cash, during the previous year does not exceed 5% of the said payment, he will have to get his accounts audited if his

	<i>total sales, turnover or gross receipts, as the case may be, exceeds Rs. 5 crore in any previous year; or</i>
<i>In case of Profession</i>	<i>his gross receipts exceeds Rs. 50 lakhs in any previous year; or</i>
<i>In case the profits and gains from the business are deemed profits u/s 44AE, 44BB or 44B&B</i>	<i>he has claimed his income to be lower than the profits or gains so deemed in any previous year; or</i>
<i>In case the profits and gains from the profession are deemed profits u/s 44ADA</i>	<i>he has claimed his income to be lower than the profits and gains so deemed and his income exceeds the maximum amount not chargeable to tax in any previous year; or</i>
<i>In case of business if the provisions of section 44AD (4) are applicable in his case</i>	<i>his income exceeds the maximum amount which is not chargeable to income- tax in any previous year.</i>
<i>"Specified date", in relation to the accounts of the assessee of the previous year relevant to an assessment year, means date one month prior to the due date for furnishing the return of income under Section 139(1).</i>	
Objective of amendment: In order to reduce compliance burden on small and medium enterprises, the threshold limit for a person carrying on business from X1 crore to Rs. 5 crore in cases where,- (i) aggregate of all receipts in cash during the previous year does not exceed 5% of such receipt; and (ii) aggregate of all payments in cash during the previous year does not exceed 5% of such payment. Further, to enable pre-filing of returns in case of persons having income from business or profession, it is required that the tax audit report may be furnished by the said assessee at least one month prior to the due date of filing of return of income. This requires amendments in all the sections of the Act which mandates filing of audit report along with the return of income or by the due date of filing of return of income. Thus, provisions of section 10, 10A, 12A, 32AB, 33AB, 33ABA, 35D, 35E, 44AB, 44DA, SOB, 80-IA, 80-IB, 80JJAA, 92F, 115JB, 115JC and 115VW of the Act are amended accordingly.	

- (2) **Non applicability:** This section shall not apply to the person, who declares profits and gains for the previous year in accordance with the provisions of Section 44AD(1) and his total sales, turnover or gross receipts, as the case may be, in business does not exceed Rs. 2 crore in such previous year.
- (3) **Audit under other law:** In case where such person is required under any other law to get his accounts audited, it shall be sufficient compliance with the provisions of this section, if such person gets the accounts of such business or profession audited under such law before the due date for furnishing the return of income under section 139(1) and furnishes the audit report by that date in Form 3CA along with prescribed particulars (Form 3CD).

DEEMED PROFITS IN CASE OF CERTAIN BUSINESSES

58. Write a note on special provisions for computing profits and gains of business on presumptive basis as per Section 44AD. (6 Marks, Nov. 2001, Nov. 2007, CS June 2007)(6 Marks, CA PE-II June 2009)

Ans: Special provision for computing profits and gains of business on presumptive basis [Section 44AD]:

- (1) **"Eligible assessee" means,-**
 - (i) an individual, Hindu undivided family or a partnership firm, who is a resident, but not a limited liability partnership firm; and
 - (ii) who has not claimed deduction under any of the sections 10A, 10AA, 10B, 10BA or deduction under any provisions of sections 80-IA to 80-RRB in the relevant assessment year.
- (2) **"Eligible business" means,-**
 - (i) any business except the business of plying, hiring or leasing goods carriages referred to in section 44AE; and
 - (ii) whose total turnover or gross receipts in the previous year does not exceed an amount of Rs. 2 crore.
- (3) **Non applicability:** The provisions of this section shall not apply to -
 - (i) a person carrying on specified profession as referred to section 44AA i.e. legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board (film artists, company secretaries, etc.);
 - (ii) a person earning income in the nature of commission or brokerage; or
 - (iii) a person carrying on any agency business.
- (4) **Presumptive Income:** Notwithstanding anything to the contrary contained in sections 28 to 43C, in case of an eligible assessee engaged in an eligible business -
 - (i) a sum equal to 8% of the total turnover or gross receipts of the assessee in the previous year on account of such business (6% of the amount of total turnover or gross receipts which is received by an account payee cheque or an account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed during the previous year or before the due date specified in Section 139(1) in respect of that previous year); [(a) Credit Card; (b) Debit Card; (c) Net Banking; (d) IMPS (Immediate Payment Service); (e) UPI (Unified Payment Interface); (f) RTGS (Real Time Gross Settlement); (g) NEFT (National Electronic Funds Transfer), and (h) BHIM (Bharat Interface for Money) Aadhar Pay have been prescribed as mode of electronic payment] or
 - (ii) a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee; shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of Business or Profession".
- (5) **No deductions under section 30 to 38:** Any deduction allowable under the provisions of Sections 30 to 38 (including unabsorbed depreciation, unabsorbed capital expenditure on scientific research/family planning) shall be deemed to have been already deducted and no further deduction under those sections shall be allowed.

- (6) **Determination of WDV of assets:** The WDV of any asset of an eligible business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.
- (7) **Consequences of declaring lower income [Section 44AD(4)] :** Where an eligible assessee declares profit for any previous year in accordance with the provisions of this section and he declares profit for any of the 5 subsequent assessment years i.e. subsequent to the assessment year relevant to the previous year in which profit has not been declared at rate of 8%, then he shall not be eligible to claim the benefit of the provisions of this section for 5 assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared at rate of 8%.

For example, an eligible assessee claims to be taxed on presumptive basis under section 44AD for assessment year 2021-22 and offers income of Rs. 8 lakh on the turnover of Rs.1 crore.

For assessment year 2022-23 and assessment year 2023-24 also he offers income in accordance with the provisions of section 44AD. However, for assessment year 2024-25, he offers income of Rs.6 lakh on turnover of Rs.1.5 crore. In this case since he has not offered income in accordance with the provisions of section 44AD for five consecutive assessment years, after assessment year 2021-22, he will not be eligible to claim the benefit of section 44AD for next 5 assessment years i.e. from assessment year 2025-26 to 2029-30.

- (8) **In case profits claimed to be lower than the deemed profits - Maintenance of accounts and audit:** An eligible assessee -
- to whom the provisions of Section 44AD (4) as discussed above are applicable; and
 - whose total income exceeds the maximum amount which is not chargeable to income-tax, shall be required to keep and maintain such books of account and other documents as required under section 44AA(2) and get them audited and furnish a report of such audit as required under section 44AB.
- (9) **Advance tax to be deposited upto 151, 1 March of the relevant year:** An eligible assessee in respect of an eligible business referred to in section 44AD, to the extent of the whole amount of such advance tax during each financial year on or before the 15th March.
- (10) **In case of supply of materials by contractee/purchaser-No profit is earned thereon by contractor/manufacturer, hence not includible in turnover / gross receipts [Brij Bhushan Lai Praduman Kumar v. CIT [1978] 115 ITR 524 (SC)]:** If the material is supplied by the purchaser/contractee to the contractor/ manufacturer-seller, then such materials supplied always remain the property of the purchaser/contractee. Hence, it is impossible that there is any element of profit being involved in the turnover represented by the cost of such materials.
Thus, where materials are supplied to the contractor solely to use, fix or incorporate in the works, value of the entire contract = Value - Cost of materials so supplied.
Accordingly, the profits from such contracts are to be determined on the basis of the value of the contract represented by the cash payments received by the contractor as excluding the cost of the materials so supplied by the purchaser/ contractee.

Illustration 38 - Presumptive basis taxation Section 44AD: Mr. Praveen engaged in retail trade, reports a turnover of Rs. 1,58,50,000 (out of which Rs. 1,00,00,000 is received through account payee cheque) for the financial year 2020-21. His income from the said business as per books of account is computed at Rs. 6,90,000. Retail trade is the only source of income for Mr. Praveen.

- (i) Is Mr. Praveen eligible to opt for presumptive determination of his income chargeable to tax?
- (ii) If so, determine his income from retail trade as per the applicable presumptive provision.
- (iii) In case, Mr. Praveen does not opt for presumptive taxation of income from retail trade, what are his obligations under the Income-tax Act, 1961?
- (iv) What is the 'due date' for filing his return of income, under both the options Rs. (5 Marks, PCC May 2011)

Solution: Thus, the relevant answers are as follows -

- (i) Yes. Mr. Praveen is an individual and the turnover of his business is not more than Rs. 200 lakhs. Hence, Section 44AD applies to him and his income shall be computed as per section 44AD.
- (11) His Income from retail trade under section 44AD = 6% of turnover of Rs. 1,00,00,000 + 8% of turnover of Rs. 58,50,000 = Rs. 1068000.
- (iii) In case he opts out of section 44AD and claim that his profits are only Rs. 6,90,000 (which is lower than presumptive income of 10,68,000), then he has to maintain requisite books of account as required in section 44AA and gets them audited under section 44AB.
- (iv) If he accepts presumptive income under section 44AD, then, the due date of return of income is 31-7-2021, for the assessment year 2021-22. However, if he decides that provision of said section is not made applicable then he will have to get his accounts audited, then, the due date shall be 31-10-2021.

Illustration 39 - Presumptive basis taxation Section 44AD: Mr. Querashi is a business man. During the year ended 31-03-2021 he was engaged in the business of Hypermarket and Super Market. He maintains proper books of accounts for both businesses in mercantile system. Sales from Hypermarket achieved a turnover of Rs. 75 lakhs and all receipts were in cash. However, Supermarket business is through online and entire receipts of Rs. 50 lakhs during the year were received though online in his bank account. The expenses were incurred in the ratio 65:35. Following additional information is furnished:

To Salary	10,00,000
To Repairs on building	1,81,000
To Interest	1,10,000
To Travelling	1,30,550
To Depreciation	8,12,000
Net profit	3,93,950

- (a) In addition to the above, repairs of Rs. 1,00,000 was incurred for building a new room which was debited to P&L a/c.
- (b) Depreciation as per Income-tax Act is Rs. 7,17,000.
- (c) Rs. 75,000 was paid in cash on 30-09-2020 to Mrs. Ann, accountant for preparation of the accounts for the year ended 31-03-2020 and adjusted under the head "expenses payable" account.
- (d) He was forced to shutdown his furniture business in the year 2018 as his accountant absconded with cash of Rs. 5 lakhs and fully allowed in that year. Unabsorbed business loss of furniture business is Rs. 3 lakhs. Rs. 4 lakhs was received as insurance compensation on 31-03-2021 for the cash theft.
- (e) Mr. Querashi wants to declare income under "Presumptive income" basis. Compute the income chargeable under the head profits and gains of business or profession of Mr. Querashi under Presumptive Income scheme u/s 44AD and his Total Income for the year ended 31-03-2021. (10 Marks, May 2018)

Solution:

(1) *As per Section 44AD, in case of an eligible assessee engaged in an eligible business -*

- (a) *a sum equal to 8% of the total turnover or gross receipts of the assessee in the previous year on account of such business (6% of the amount of total turnover or gross receipts which is received by an account payee cheque or an account payee bank draft or use of electronic clearing system through a bank account during the previous year or before the due date specified in Section 139(1) in respect of that previous year); or*
- (b) *a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee, shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of Business or Profession".*

(2) *Any deduction allowable under the provisions of Sections 30 to 38 (including unabsorbed depreciation, unabsorbed capital expenditure on scientific research/ family planning) shall be deemed to have been already deducted and no further deduction under those sections shall be allowed.*

Thus, His Presumptive Income under section 44AD is as under = 8% of turnover of Rs. 75,00,000 + 6% of turnover of Rs. 50,00,000 = Rs. 900,000.

Particulars	Rs.	Rs.
Presumptive Income under Section 44AD	9,00,000	
Furniture business Recovery against deduction taxable as business profits [WN-1]	4,00,000	
Less: Unabsorbed business loss as per Section 41(5) [WN-2]	3,00,000	1,00,000
Profits and Gains of Business and Profession /Total Income		10,00,000

In the question it is stated that Mr. Querashi "maintains proper books of accounts for both businesses in mercantile system". The income as per regular books of account has to be computed and if such income is more than the presumptive income computed under section 44AD, the higher income can be declared under section 44AD. Hence, income of Mr. Querashi for the assessment year 2021-22 as per books of account is computed below:

(amount in Rs.)

Income under the head Profits & Gains of Business and Profession		
Net profit as per Profit and Loss Account	3,93,950	
Add: Expenses not allowable -		
Depreciation debited in Profit and loss Account	8,12,000	
Cash payment in excess of Rs. 10,000 made in a day in the current year in respect of expenditure allowed on mercantile basis in the previous year, would be deemed as income in the current year	75,000	
Building construction expenditure debited to P & L A/c	1,00,000	13,80,950
Less: Expenses allowable under this head -		
Depreciation as per Income-tax Act, 1961	7,17,000	
Depreciation on building extension of a room @ 10%	10,000	7,27,000
Profits and gains of business computed as per books of account		6,53,950

Note: *The assessee's total income from hypermarket and supermarket business computed as per books of account is less than the income computed under section 44AD. The question states that the assessee wants to*

declare income under presumptive provision i.e. section 44AD. Hence, the total income computation would include only the presumptive income computed under section 44AD for both hypermarket and supermarket businesses.

Computation of Total Income

(amount in Rs.):

Presumptive Income under Section 44AD		9,00,000
Furniture business Recovery against deduction taxable as business profits [WN-1]	4,00,000	
Less: Unabsorbed business loss as per Section 41(5) [WN-2]	3,00,000	1,00,000
Profits and Gains of Business and Profession /Total Income		10,00,000

Working Note:

- (1) As per provisions of Section 41(1), recovery of any amount in respect of any loss which was earlier claimed as deduction is chargeable to tax under the head Profits and gains of business whether the business is in existence or not. Hence, Rs. 4,00,000 shall be treated as taxable profits.
- (2) As per Section 41(5), where the business or profession is no longer in existence; and there is income chargeable to tax under section 41(1) in respect of that business or profession any loss, not being a loss sustained in speculation business, which arose in that business or profession during the previous year in which it ceased to exist and which could not be set off against any other income of that previous year shall be set off against such deemed profits to the extent of such profits. Thus, loss of Rs. 3,00,000 shall be set-off from such recovery of Rs. 4,00,000 and balance amount will be taxable.

59. Explain the special provision for computing profits and gains of profession on presumptive basis as per Section 44ADA.

Ans: Special provision for computing profits and gains of profession on presumptive basis [Section 44ADA]:

- (1) **Eligible Assessee:** The eligible assessee is an assessee,-
 - (a) being a resident in India,
 - (b) who is engaged in a profession referred to in Section 44AA(1); and
 - (c) whose total gross receipts do not exceed Rs. 50 lakh in a previous year.
- (2) **Presumptive Income:** The deemed profits and gains of such profession chargeable to tax under the head "Profits and gains of business or profession" shall be -
 - (a) A sum equal to 50% of the total gross receipts of the assessee in the previous year on account of such profession; or
 - (b) a sum higher than the aforesaid sum claimed to have been earned by the assessee.
- (3) **No further deduction:** Any deduction allowable under the provisions of sections 30 to 38 shall be deemed to have been already given full effect to and no further deduction under those sections shall be allowed from such deemed income.
- (4) **WDV of Assets:** The written down value of any asset used for the purposes of profession shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.
- (5) **Accounts and audit if profits claimed to lower than deemed profits:** Notwithstanding anything contained in the foregoing provisions of this section,-

- (a) an assessee who claims that his profits and gains from the profession are lower than the deemed profits and gains specified above, and
- (b) whose total income exceeds the maximum amount which is not chargeable to income-tax, shall be required to keep and maintain such books of account and other documents as required under section 44AA(1) and get them audited and furnish a report of such audit as required under section 44AB.
- (6) **Advance Tax:** Further, since the presumptive taxation regime has been extended for professionals also, the eligible assessee is now required to pay advance tax by 15th March of the financial year.

Illustration 40 - Section 44ADA : A partnership firm consisting of three partners X, Y, and Z is engaged in the profession of accountancy. Gross Receipts of the profession for the year ended 31st March, 2021 amounts to Rs. 48 lakh. Bad debts written off in the books are Rs. 75,000. Interest at 12% p.a. is provided to partner, Z on his capital of Rs. 6 lakh as authorized by the partnership deed.

The firm had business loss of Rs. 50,000 and unabsorbed depreciation of Rs. 1,50,000 carried forward from assessment year 2020-21. The firm opts for presumptive taxation under section 44ADA for assessment year 2021-22. Compute the Total income of the firm for assessment year 2021-22.

Solution: Computation of income of the firm chargeable under the head "Profits and Gains of business or profession" (amount in Rs.):

Presumptive income under section 44ADA (50% of Rs. 48 lakh)	[WN-1]	24,00,000
Less: Interest @ 12% to Z (12% of Rs. 6 lakh)	[WN-2]	Nil
Less: Brought forward loss under section 72	[WN-3]	50,000
PGBP/Total Income		23,50,000

Working Notes:

- (1) A partnership firm falls within the definition of "eligible assessee" under section 44ADA. In this case, since the gross receipts of the profession of the firm does not exceed Rs. 50 lakhs, and therefore, the firm is eligible to opt for presumptive taxation under section 44ADA. Hence, 50% of the gross receipts would be deemed to be the Profits and Gains of Business or Profession of the firm.
- (2) As per Section 44ADA(2), all deductions allowable under sections 30 to 38 shall be deemed to have been allowed. Accordingly no deduction shall be allowed for bad debts since the same is deductible under section 36(1) (viii) and unabsorbed depreciation since the same is deductible under section 32(2). No deduction shall be allowed for interest on capital paid to partners.
- (3) Further, business loss of P.Y. 2019-20 can be set-off against current year professional income as per Section 72.

Illustration 41 - Presumptive basis u/s 44ADA : Ms. Kriti is a Chartered Accountant in practice. She maintains her accounts on cash basis. Her Income and Expenditure account for the year ended 31st March, 2021 reads as follows :

Expenditure	Rs.	Income		Rs.
Salary to staff	5,50,000	Fees earned:		

Stipend to articled assistants	37,000	Audit	17,88,000	
Incentive to articled assistants	3,000	Taxation services	5,40,300	
Office rent	24,000	Consultancy	2,70,000	25,98,300
Printing and stationery	22,000	Dividend on shares of Indian companies (Gross)		10,524
Meeting, seminar and conference	31,600	Income from units of mutual fund (Gross)		7,600
Purchase of car	80,000	Honorarium received from various institutions for valuation of answer papers		15,800
Repair, maintenance and petrol of car	4,000	Rent received from residential flat let out		85,600
Travelling expenses	35,000			
• Municipal tax paid in respect of house property	3,000			
Net Profit	19,28,224			
	27,17,824			27,17,824

Other Information:

- Allowable rate of depreciation on motor car is 15%.
- Incentives to articled assistants represent amount paid to two articled assistants for passing IPCC Examination at first attempt.
- Salary include Rs. 15,000 to a computer specialist in cash on 15-07-2020 for assisting Ms. Kriti in one professional assignment.

On the basis of above information, determine whether Ms. Kriti should opt for presumptive basis taxation for computation of her Gross Total Income for assessment year 2021-22.

Solution: Computation of the Gross Total Income for the assessment year 2021-22.

- **CASE I:** When Ms. Kriti opt for the provisions of Section 44ADA:
Computation of gross total income (amounts in Rs.):

Income from house property:		
Actual Rent Received [Being Gross Annual Value u/s 23(1)]	85,600	
Less: Municipal taxes paid	3,000	
Net Annual Value (NAV)	82,600	
Less: Standard deduction u/s 24 @ 30% of NAV	24,780	57,820
Income under the head Profits & Gains of Business and Profession		
50% of the Gross receipts i.e. 50% of Rs.25,98,300 is deemed profits from profession under Section 44ADA	12,99,150	
Income from other sources:		
Dividends from Indian companies [Taxable in hands of shareholder]	10,524	
Income from Unit Trust of India. [Taxable in hands of unit holder]	7,600	

Honorarium for valuation of answer papers	15,800	33,924
Gross Total Income		13,90,894

➤ **CASE II:** When income is computed as per normal provisions of the Act.

Computation of gross total income (amounts in Rs.):

Income from house property:		
Actual Rent Received [Being Gross Annual Value u/s 23(1)]	85,600	
Less: Municipal taxes paid	3,000	
Net Annual Value NAV	82,600	
Less: Standard deduction u/s 24 @ 30% of NAV	24,780	57,820
Income under the head Profits & Gains of Business and Profession		
Net profit as per Income and Expenditure Account	19,28,224	
Add: Expenses debited but not allowable -		
Municipal Taxes of house property in respect of residential flat let out	3,000	
Salary paid to computer specialist in cash disallowed u/s 40A(3), since such cash payment is in excess of Rs. 10,000	15,000	
Amount paid for purchase of car is not allowable u/s 37(1) since it is a capital expenditure	80,000	
Less: Income credited but not taxable under this head -		
Dividend on shares of Indian Companies [The same taxable under the head Income From Other Sources]	10,524	
Income from Unit Trust of India [The same taxable under the head Income From Other Sources]	7,600	
Honorarium for valuation of answer papers [The same is taxable under the head 'Income from other sources']	15,800	
Rent received from residential flat let out [The same is taxable under the 'Income from house property']	85,600	
Depreciation on Motor Car @ 15% [WN]	12,000	18,94,700
Income from other sources :		
Dividends from Indian companies [Taxable in hands of shareholder]	10,524	
Income from Unit Trust of India. [Taxable in hands of shareholder]	7,600	
Honorarium for valuation of answer papers	15,800	33,924
Gross Total Income		19,86,444

Working Note: It has been assumed that the motor car was put to use for more than 180 days during the previous year and hence, full depreciation @ 15% has been provided for under section 32(1) (ii).

Conclusion : The assessee should opt for the provisions of Section 44ADA since her income from profession as per the said section is Rs. 12,99,150 which is less than actual income of Rs. 18,94,700.

60. Discuss the special provision relating to computation of profits and gains in case of business of plying, hiring or leasing goods carriages. (Nov. 2000)

Ans: Special provision for computing profits and gains of business of plying, hiring or leasing goods carriages [Section 44AE]:

(1) Eligible assessee : Notwithstanding anything to the contrary contained in Sections 28 to 43C, in the case of an assessee who -

- (i) owns not more than 10 goods carriages at any time during the previous year; and
 (ii) is engaged in the business of plying, hiring or leasing such goods carriages; the income of such business, chargeable to tax under the head "Profits and gains of business or profession", shall be deemed to be the aggregate of profits, from all the goods carriages owned by him in the previous year.

Hire purchaser deemed to be the owner of goods carriage: An assessee, who is in possession of a goods carriage, whether taken on hire purchase or on installments and for which the whole or part of the amount payable is still due, shall be deemed to be the owner of such goods carriage.

Note: Even if on a single day, the number of goods carriages (whether heavy goods vehicle or not) exceeds 10, then, this section shall not apply to that assessee for that previous year.

Deemed Profits: The income chargeable to tax under the head "Profits and gains of business or profession" from such business shall be computed as follows -

	Particulars	Rs.
I.	In case of goods carriage being a heavy goods vehicle : Higher of -	XX
	(a) Rs. 1,000 per ton of gross vehicle weight or unladen weight, as the case may be, per month per vehicle $\times$ No. of month(s) or part of a month in the previous year during which the heavy vehicle is owned by the assessee $\times$ No. of heavy goods Vehicle	
	(b) An amount claimed to have been actually earned from such vehicle(s)	
II.	In case of goods carriage other than a heavy goods vehicle : Higher of-	XX
	(a) Rs. 7,500 per month per vehicle $\times$ No. of month(s) or part of a month in the previous year during which the vehicle is owned by the assessee $\times$ No. of other goods carriages	
	(b) An amount claimed to have been actually earned from such vehicle(s)	
Profits & Gains of Business or Profession from this business (I + II)		
"Heavy goods vehicle" means any goods carriage, the gross vehicle weight of which exceeds 12000 kilograms.		
"Gross vehicle weight" means total weight of the vehicle and load certified and registered by the registering authority as permissible for that vehicle.		
"Unladen weight" means the weight of a vehicle or trailer including all equipment ordinarily used with the vehicle or trailer when working but excluding the weight of driver or attendant and where alternative parts or bodies are used the unladen weight of the vehicle means the weight of the vehicle with the heaviest such alternative body or part.		

- (3) **All other deduction deemed to be allowed:** The assessee will be deemed to have been allowed the deductions under sections 30 to 38. Accordingly, the written down value of any asset used for the purpose of the business of the assessee will be deemed to have been calculated as if the assessee had claimed and had actually been allowed the deduction in respect of depreciation for each of the relevant assessment years.
- (4) **Salary and interest to partners is allowed:** Where the assessee is a firm, the salary and interest paid to its partner are allowed to be deducted subject to the conditions and limit specified under section 40(b).
- (5) **Not requirement to maintain books of accounts and get the accounts audited:** The assessee joining the scheme will not be required to maintain books of account under section 44AA and get the accounts audited under section 44AB in respect of such income.

- (6) **Option to claim lower profits:** An assessee may claim lower profits and gains than the deemed profits and gains specified in Section 44AE (1) of that section subject to the condition that the books of account and other documents are kept and maintained as required under section 44AA (2) and the assessee gets his accounts audited and furnishes a report of such audit as required under section 44AB.

Illustration 42 - Income from plying goods carriages: Mr. X commenced the business of operating goods vehicles on 1-4-2020. He purchased the following vehicles during the previous year 2020-21. Compute his income under section 44AE for assessment year 2021-22.

	Number	Date of purchase	Gross Vehicle Weight (in kilograms)
(1)	7,000	2	10-04-2020
(2)	6,500	1	15-03-2021
(3)	10,000	3	16-07-2020
(4)	11,000	1	02-01-2021
(5)	15,000	2	29-08-2020
(6)	15,000	1	23-02-2020

Would your answer change if the goods vehicles purchased in April, 2020 were put to use only in July, 2020? Rs.

Solution: Since Mr. X does not own more than 10 vehicles at any time during the previous year 2020-21, he is eligible to opt for presumptive taxation scheme under section 44AE. Rs. 1,000 per ton of gross vehicle weight or unladen weight per month or part of the month for each heavy goods vehicle and Rs. 7,500 per month or part of month for each goods carriage other than heavy goods vehicle, owned by him would be deemed as his profits and gains from such goods carriage.

Heavy goods vehicle means any goods carriage, the gross vehicle weight of which exceeds 12,000 kg.

Type of Carriage	Number of Vehicles	Date of purchase	No. of months for which vehicle is owned	No. of months $\times$ No. of vehicles	Deemed income per month	Amount (Rs.)
For Heavy goods vehicle	2	29-08-2020	8	16	15,000	2,40,000
	1	23-02-2021	2	2	15,000	30,000
For goods vehicle other than heavy goods vehicle	2	10-04-2020	12	24	7,500	1,80,000
	1	15-03-2021	1	1	7,500	7,500
	3	16-07-2020	9	27	7,500	2,02,500
	1	02-01-2021	3	3	7,500	22,500
Profits from the business referred to u/s 44AE						6,82,500

The answer would remain the same even if the two vehicles purchased in April, 2020 were put to use only in July, 2020, since the presumptive income has to be calculated per month or part of the month for which the vehicle is owned by Mr. X.

Illustration 43 - Income from plying goods carriages: Mr. Sukhvinder is engaged in the business of plying goods carriages. On 1st April 2020, he owns 10 trucks (out of which 6 are heavy goods vehicles (gross unladen weight 31,000 kgs). On 2nd May 2020, he sold one of the heavy goods vehicles and purchased a light goods vehicle on 6th May 2020. This new vehicle could however be put to use only on 15th June 2020. Compute the total

income of Mr. Sukhvinder for the assessment year 2021-22 taking note of the following data (amount in Rs.):
(6 Marks; May 2005)

Freight charges collected		75,00,000
Less: Operational expenses	45,00,000	
Depreciation as per section 32	5,56,000	
Other office expenses	2,15,000	52,71,000
Net Profit		22,29,000
Other business and non-business income		70,000

Solution: In this case, provisions of Section 44AE apply since assessee does not own more than 10 goods carriages at any time during the previous year.

Computation of total income of Mr. Sukhvinder (amounts in Rs.) -

Particulars	Presumptive income	Where books are maintained
Income from plying goods carriages [WN]	23,64,500	22,29,000
Other income	70,000	70,000
Total income	24,34,500	22,99,000

Since income as per books of accounts is lower than presumptive income computed under section 44AE, hence, Mr. Sukhvinder should keep and maintain books and get his accounts audited and his total income shall be Rs. 22,99,000.

Working Note: Calculation of presumptive income as per section 44AE (amounts in Rs.) –

Type of Carriage	No. of goods	Period during which trucks	Months	Deemed income	Amount
	carriages	owned		p.m.	(Rs.)
	4	01-04-2020 to 31-03-2021	12	7,500	3,60,000
Light Goods Vehicles					
	1	06-05-2020 to 31-03-2021	11	7,500	82,500
	5	01-04-2020 to 31-03-2021	12	Rs. 1,000 x 31	18,60,000
Heavy Goods Vehicle					
	1	01-04-2020 to 02-05-2021	2	Rs. 1,000 x 31	62,000
Total					23,64,500

Illustration 44 - Income from plying goods carriages: Ramamurthy had 4 light goods vehicles as on 1-4-2020. He acquired 7 light goods vehicles on 27-6-2020. He sold 2 light goods vehicles on 31-5-2020. He has brought forward business loss, of Rs. 50,000 relating to A.Y. 2017-18 of a discontinued business. Assuming that he

opts for presumptive taxation of income as per section 44AE, compute his total income chargeable to tax. (4 Marks, PCC May 2011)

Solution: In this case, section 44AE shall apply because Ramamurthy didn't have more than 10 vehicles at any time during the previous year.

The relevant computations are –

No. of light Goods Vehicle	Period during which owned	No. of months	Rate p.m.	(Rs.)
2	01-04-2020 to 31-03-2021	12	7,500	1,80,000
2	01-04-2020 to 31-05-2020	2	7,500	30,000
7	27-06-2020 to 31-03-2021	10	7,500	5,25,000
Profits from the business referred to u/s 44AE				7,35,000
Less: Set-off of the brought forward business loss				50,000
Total Income				6,85,000

As per provision of Section 44AE, the computed income is profits and gains of business or profession. Hence, the assessee will be entitled to set off other business loss from such presumptive income.

Illustration 45 - Presumptive incomes under section 44AD & 44AE: Mr. R furnishes you the following information for the year-ended 31-3-2021 (amounts in Rs.):

- (i) Income from plying of vehicles (computed as per books) (He owned 5 light goods vehicle throughout the year) 5,10,000
- (ii) Income from retail trade of garments (computed as per books) (Sales turnover Rs.41,70,000) 2,00,000
- (iii) Brought forward depreciation relating to assessment year 2020-21 1,20,000
- (iv) Amount deposited into PPF Account on 06-04-2021 1,00,000

Compute taxable income of Mr. R and his tax liability if sale proceeds of garments is received through account payee cheque. (May 2004)

Solution: If Mr. R opts for presumptive taxation under section 44AD and 44AE, then, any deduction allowable under the provisions of Sections 30 to 38 (including unabsorbed depreciation, unabsorbed capital expenditure on scientific research/ family planning) shall be deemed to have been already deducted and no further deduction under those sections shall be allowed. The relevant computation is as under:

Computation of taxable income of R and his tax liability (amounts in Rs.) -

Particulars	Presumptive taxation	Income as per books
Income from plying of vehicles (Rs. 7,500 x 12 x 5)	4,50,000	5,10,000
Income from retail trade business (6% of Rs. 41,70,000) (Since sale proceeds are received through account payee cheque)	2,50,200	2,00,000
	7,00,200	7,10,000
Less: Unabsorbed depreciation	-	1,20,000
Gross total income	7,00,200	5,90,000
Gross total income		5,90,000

[W/N-1]

Less: Deduction u/s 80C in respect of PPF [WN-2]	Nil
Taxable income	5,90,000
Income tax on total income	30,500
Add: HEC @ 4%	1,220
Tax liability (rounded off)	31,720

Working Notes:

- (1) Since total income as per books of accounts is lower than presumptive income under section 44AD and Section 44AE, therefore, Mr. R. should claim his income as per books and get his such books of accounts audited.
- (2) Deduction in respect of PPF is not allowable as it is not paid upto 31-3-2021.

Illustration 46 - Presumptive incomes under section 44AE: Mr. Prakash is in the business of operating goods vehicles. As on 1st April, 2020, he had the following vehicles:

Vehicle	Gross Vehicle Weight (in Kgs.)	Date of Purchase	Put to use during F.Y. 2020-21
A	8,500	02-04-2019	Yes
B	13,000	15-05-2019	Yes
C	12,000	04-08-2019	No (as under repairs)

During F.Y. 2020-21, he purchased the following vehicles:

Vehicle	Gross Vehicle Weight (in Kgs.)	Date of Purchase	Date on which put to use
D	11,000	30-04-2020	10-05-2020
E	15,000	15-05-2020	18-05-2020

Compute his income under section 44AE of the Income-tax Act, 1961 for A.Y. 2021-22. (4 Marks, Nov. 2019)

Solution: Since Mr. Prakash does not own more than 10 vehicles at any time during the previous year 2019-20, he is eligible to opt for presumptive taxation scheme under section 44AE. Rs. 1,000 per ton of gross vehicle weight or unladen weight per month or part of the month for each heavy goods vehicle and Rs. 7,500 per month or part of month for each goods carriage other than heavy goods vehicle, owned by him would be deemed as his profits and gains from such goods carriage. Heavy goods vehicle means any goods carriage, the gross vehicle weight of which exceeds 12,000 kg.

Computation of income u/s 44AE:

Type of Carriage	Number of Vehicles	Date of purchase	No. of months for which vehicle is owned	Deemed income per month	Amount (Rs.)
For Heavy goods vehicle	B	15-07-2019 15-	12	13,000 15,000	1,56,000
	E	05-2020	11		1,65,000
For goods vehicle other than heavy goods vehicle	A	02-04-2019	12	7,500	90,000
	B	04-08-2019	12	7,500	90,000
	C	30-04-2020	12	7,500	90,000
Profits from the business referred to u/s 44AE					5,91,000

Note: The 'put to use' date of the vehicle is not relevant for the purpose of computation of presumptive income under section 44AE, since the presumptive income has to be calculated per month or part of the month for which the vehicle is owned by Mr. Praakash.

Illustration 47 - Computation of Business profit s.' Following is the Profit and Loss account of Mr. A (amounts in Rs.) –

To	Repairs on building	1,30,000	By	Gross profit	6,01,000
To	Advertisement	51,000	By	IT Refund	4,500
To	Amount paid to Scientific Research Association approved u/s 35	1,00,000	By	Interest from company deposits	6,400
To	Interest	1,10,000	By	Dividends	3,600
To	Traveling	1,30,000			
To	Miscellaneous Expenditure	550			
To	Net Profit	93,950			
		6,15,500			6,15,500

Following additional information is furnished:

- Repairs on building includes Rs. 95,000 being cost of raising a compound wall for the own business premises.
- Interest payments include interest of Rs. 12,000 payable to a resident Indian on which tax has not been deducted and penalty of 124,000 for contravention of Central Goods and Services Tax Act. Compute the income chargeable under the head 'Profits and gains of business or profession' of Mr. A ignoring depreciation.

(7Marks, May 2006) (Similar IPCC May 2012, 10 Marks)

Solution: Profits and gains of business or profession of Mr. A (amounts in Rs.) –

Net profit as per Profit and Loss Account		93,950
Add: Expenses not allowable -		
Expenses on raising a compound wall [WN-1]	95,000	
Penalty for contravention of CGST Act [WN-2]	24,000	
Interest payable to a resident, as tax has not been deducted on the same Rs. 12,000 $\times$ 30% [WN-5]	3,600	
Contribution for scientific research (considered separately)	1,00,000	2,22,600
		3,16,550
Less: Income not forming part of business income -		
Interest from company deposits [WN-3]	6,400	
I.T. Refund [WN-4]	4,500	
Dividend [WN-6]	3,600	14,500
		3,02,050
Less: Deduction under section 35(1)(ii) for scientific research [100% $\times$ 1,00,000]		1,00,000
Profit and Gains of Business or Profession		2,02,050

Working Notes:

- (1) Expenses on raising a compound wall shall not be deductible as it is a capital expenditure.
- (2) Penalty paid for violation or infringement of any law is not allowable as deduction under section 37(1).
- (3) Interest from company deposits shall not form part of business income as it is taxable as Income from other sources.
- (4) I.T. Refund is not taxable, as it is not 'income'.
- (5) 30% of interest payable to a resident, as tax has not been deducted on the same shall not be allowed as deduction under section 40(a).
- (6) Dividend from shares of Indian Company is taxable in hands of shareholder under the head Income from other sources.

Illustration 48 - Computation of Business profits: Ram, who is 28 years of age, is a businessman in Delhi. On the basis of the following profit and loss account for the financial year 2020-21, compute his taxable income:

Particulars	Rs.	Particulars	Rs.
Opening stock	20,700	Sales	15,00,000
Purchases	10,00,000	Closing stock	25,200
Household expenses	10,000		
Income-tax for the financial year 2019-20	30,000		
Interest on capital	8,400		
Depreciation on furniture	12,000		
Reserve for bad debts	1,200		
Salaries and wages	60,000		
Rent and rates	25,000		
Net profit	3,57,900		
	15,25,200		15,25,200

Other relevant particulars are as follows:

- (i) Opening stock and closing stock have consistently been valued at 10% below cost price.
- (ii) Household expenses include a contribution of Rs. 1,500 towards public provident fund.
- (iii) Amount of depreciation on furniture as per income-tax provisions is Rs. 10,000.

(6 Marks, CS Executive Dec, 2008)
(amounts in Rs.) –

Solution: Computation of taxable income of Mr. Ram

Net profit as per Profit and Loss A/c		3,57,900
Add: Expenses not allowable		
Household expenses	10,000	
Income-tax for the financial year 2019-20	30,000	
Interest on capital	8,400	
Depreciation on furniture	12,000	
Reserve for bad debts	1,200	61,600
Add: Undervaluation of closing stock (Rs. 25,200 x 1/9)		2,800
Less: Undervaluation of opening stock (Rs. 20,700 x 1/9)		-2,300
Less: Allowable depreciation		-10,000
		4,10,000
Less: Deduction u/s 80C for contribution to PPF		1,500

Total income	4,08,500

Illustration 49— Computation of Business Income: Mr. Rameshwar is registered Medical practitioner. He keeps his book on cash basis and his summarised cash account for year ended 31st March 2021 is as under (amounts in ₹):

To Balance b/d	2,700	By Costs of medicines	20,000
To Loan from Bank	6,000	By Surgical equipment	6,000
To Sale of medicines	30,500	By Motor car purchased	12,000
To Consultation fees	50,10,000	By Car expenses	1,800
To Visiting fees	8,000	By Salaries	48,01,200
To Interest on investments	9,000	By Rent on dispensary	1,200
To Dividend on shares	7,200	By General expenses	600
To Sale of building	15,000	By Personal expenses	3,600
To Sale of furniture	5,000	By Life insurance premium	2,000
		By Interest on bank loan for investment	360
		By Insurance of personal property	400
		By Fixed Deposit in Bank	30,000
		By Balance c/d	2,14,240
	50,93,400		50,93,400

Compute his Income from profession taking into account the following further information:

- (1) 1/3rd of the motorcar expenses are in respect of his personal use.
- (2) The original cost of the building was ₹. 20,000 and written down value of furniture as on 1st April 2020 was ₹. 4,000. There was no other asset in this block.
- (3) The rate of depreciation on motorcar and on surgical equipments is 15%. An old car was purchased in May 2020 while the surgical equipments were purchased in December 2020.
- (4) Outstanding consultancy fees and outstanding salaries are ₹. 20,000 and ₹. 1,000 respectively. Further, medicines valuing ₹. 5,000 were sold to Mr. Babu on credit.

Solution: Computation of taxable income from profession (amounts in ₹.) -

Gross Receipts: Sale of medicines	30,500	
Consultation fees	50,10,000	
Visiting fees	8,000	50,48,500
Less: Allowable expenses viz. cost of medicines	20,000	
Car expenses (₹. 1,800 $\times$ 2 $\div$ 3)	1,200	
Salaries	48,01,200	
Rent of dispensary	1,200	
General Expenses	600	
Allowable Depreciation Motor car (₹. 12,000 $\times$ 15%) $\times$ 2/3	1,200	
Surgical equipment (7.5% $\times$ ₹. 6,000)	450	48,25,850
Income from profession		2,22,650

Note: Since the assessee maintains accounts as per cash basis, therefore, outstanding consultancy fees, outstanding salaries and sale of medicines on credit will not be considered.

Illustration 50 - Computation of Business Income: Mr. X, a retail trader of Cochin gives the following Trading & Profit and Loss A/c for the year ended 31-3-2021

(amounts in Rs.):				
To	Opening Stock	90,000	By Sales	12,11,500
To	Purchases	10,04,000	By Income from UTI	2,400
To	Gross Profits	3,06,000	By Other Business receipts	6,100
			By Closing Stock	1,80,000
		14,00,000		14,00,000
To	Salary	60,000	Gross Profit B/d	3,06,000
To	Rent and Rates	36,000		
To	Interest on loan	15,000		
To	Depreciation	1,05,000		
To	Printing and Stationery	13,200		
To	Postage and Telegram	1,640		
To	Loss on Sale of Shares (short-term)	8,100		
To	Other General Expenses	7,060		
To	Net Profit	60,000		
		3,06,000		3,06,000

Additional Information:

- It was found, some stocks were omitted to be included in both the Opening and Closing stock, the values of which were : Opening stock - Rs. 9,000, and Closing stock - Rs. 18,000.
 - Salary includes Rs. 10,000 paid to his brother, which is unreasonable to the extent of Rs. 2,000.
 - The whole amount of Printing and Stationery was paid in cash.
 - The Depreciation provided in Profit & Loss A/c Rs. 1,05,000 was based on following information:
 - The WDV of Plant & Machinery is Rs. 4,20,000. A new Plant falling under same Block of depreciation of 15% was bought on 1-7-2020 for Rs. 70,000. Two old plants were sold on 1-10-2020 for Rs. 50,000.
 - Rent and Rates includes Goods and Services Tax liability of Rs. 3,400 paid on 7-4-2021.
 - Other Business receipts include Rs. 2,200 received as refund of Goods and Services Tax relating to 2019-20.
 - Other General Expenses include Rs. 2,000 paid as Donation to a Public Charitable Trust.
 - Sale proceeds are received through account payee cheque.
- Advise Mr. X whether he can offer his business income under section 44AD i.e. presumptive taxation. (May 2003)

Solution:

- (A) Business income if Mr. X does not opt for presumptive income scheme

			(amounts in Rs.) -
Net profit	as per Profit and Loss account		60,000
Add: (a)	Closing stock not included	18,000	
(b)	Excess salary paid to brother [WN1]	2,000	
(c)	Whole of printing and stationery expenses paid in cash [WN2]	13,200	

(d)	Depreciation		1,05,000	
(e)	Donations		2,000	
(f)	Loss on shares		8,100	1,48,300
				2,08,300
Less: (a)	Opening stock not included		9,000	
(b)	Allowable depreciation	[WN-3]	66,000	
(c)	Income from UTI	[WN4]	2,400	77,400
Income from business				1,30,900

Working Note:

- (1) Salary paid to his brother, which is unreasonable to the extent of Rs. 2,000 shall not be allowed as deduction in accordance with Section 40A(2).
- (2) Since the whole amount of Printing and Stationery was paid in cash which exceeds Rs. 10,000 whole of such expenditure shall be disallowed in accordance with Section 40A(3).
- (3) Computation of allowable depreciation **(amount in Rs.):**

Opening WDV of plant and machinery	4,20,000
Add: Actual cost of plant acquired on 01-07-2020	70,000
Less: Sale proceeds of plant	-50,000
WDV as on 31-03-2021	4,40,000
Depreciation @ 15%	66,000

- (4) Income from units of UTI is taxable in hands of unit holder under the head Income from other sources.
- (5) Goods and Services Tax refund is taxable, as it would have been allowed as deduction earlier.

- (B) **Business income if he opts for presumptive income scheme u/s 44AD:** Deemed income as per Section 44AD = 6% of Turnover (since sale proceeds are received through account payee cheque) i.e. 6% of Rs. 12,11,500 = Rs. 72,690.

Conclusion: Since income as per Section 44AD works out to be lower than income as per normal provisions, the assessee should opt for presumptive taxation under Section 44AD.

Illustration 51 - Computation of Business Income: Alpha Ltd. a manufacturing company, which maintains accounts under mercantile system, has disclosed a net profit of Rs. 12.50 lakhs. You are required to compute the taxable income of the company after considering the following information, duly explaining the reasons for each item of adjustment -

- (a) Advertisement expenditure includes the sum of Rs. 60,000 paid in cash to the sister concern of a director, the market value of which is Rs. 52,000.
- (b) Corporate social responsibility expenditure in accordance with Section 135 of Companies Act, 2013 : Rs. 1,00,000.
- (c) Repairs of plant and machinery include Rs. 1.80 lakhs towards replacement of worn out parts.
- (d) A sum of Rs. 6,000 on account of liability foregone by a creditor has been taken to general reserve. The same was charged to the Revenue Account in the assessment year 2009-10.
- (e) Rs. 1,00,000 is paid on account of directors fees to a resident director on which tax has not been deducted at source under Section 194J.
- (f) Sale proceeds of import entitlements amounting to Rs. 1 lakh has been credited to Profit and Loss A/c, which company claims as capital receipt not chargeable to Income tax.

- (g) Being also engaged in the biotechnology business, the company incurred the following expenditure on in-house research and development as approved by prescribed authority,-
- (i) Research equipments purchased Rs. 1,50,000
 - (ii) Remuneration paid to scientists Rs. 50,000
- The total amount of Rs. 2,00,000 is debited to Profit and Loss A/c.

Solution: Computation of Taxable Income of Alpha Ltd. (amounts in Rs.) -

Net Profit as per Profit and Loss Account		12,50,000
Add: Expenses disallowed or considered separately —		
Excessive payment to relatives 60,000 - Rs. 52,000]	[WN-1]	8,000
Cash payment of advertisement expenditure	[WN-2]	52,000
Corporate Social Responsibility Expenditure	[WN-5]	1,00,000
Director fees	[WN-6]	30,000
Scientific research expenses (100% of such expenditure is deductible, since already debited to P&L A/c, hence no adjustment required)		-
		1,90,000
		14,40,000
Add: Amount foregone by the creditor - Taxable u/s 41(1)		6,000
Taxable Income		14,46,000

Working Notes:

- (1) Excessive Advertisement expenditure of Rs. 8,000 paid to the sister concern of a director shall be disallowed under section 40A(2).
- (2) Remaining advertisement expenses paid in cash exceeds Rs. 10,000 whole of such expenditure shall be disallowed.
- (3) Expenditure on replacement of worn out part of machinery is revenue expenses. Since the same is included in Repairs, no adjustment is required.
- (4) Sale of import entitlements being export incentives is chargeable as business income under section 28(iia). Since the same is already credited to profit and loss account, no adjustment is required.
- (5) According to Explanation 2 to Section 37(1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.
- (6) According to Section 40(a)(ia), in case tax has not been deducted at source in respect of any expenditure for which payment is made to resident, 30% of such expenditure shall be disallowed.

Illustration 52 - Computation of Business Income: Mr. Raju, a manufacturer at Chennai, gives the following Manufacturing, Trading and Profit & Loss Account for the year ended 31-03-2021.

Manufacturing, Trading and Profit & Loss Account for the year ended 31-03-2021

Particulars	Rs.	Particulars	Rs.
To Opening Stock	71,000	By Sales	32,00,000
To Purchases of Raw materials	16,99,000	By Closing stock	2,00,000
To Manufacturing Wages & Expenses	5,70,000		
To Gross Profit	10,60,000		34,00,000
	34,00,000	By Gross Profit	10,60,000
To Administrative Charges	3,26,000	By Dividend from domestic companies	
To GST penalty paid			

To GST paid	5,000 1,10,000	(Gross) By Income from agriculture (net)	15,000 1,80,000
To General Expenses	54,000		
To Interest to Bank (On machinery term loan)	60,000		
To Depreciation	2,00,000		
To Net Profit	5,00,000		
	12,55,000		12,55,000

Following are the further information relating to the financial year 2020-21:

- Administrative charges include Rs. 46,000 paid as commission to brother of the assessee. The commission amount at the market rate is Rs. 36,000.
- The assessee paid Rs. 33,000 in cash to a transport carrier on 29-12-2020. This amount is included in manufacturing expenses. (Assume that the provisions relating to TDS are not applicable to this payment.)
- A sum of Rs. 4,000 per month was paid as salary to a staff throughout the year and this has not been recorded in the books of account.
- Bank term loan interest actually paid upto 31-03-2021 was Rs. 20,000 and the balance was paid in Nov. 2021.
- Housing loan principal repaid during the year was Rs. 50,000 and it relates to residential property occupied by him. Interest on housing loan was Rs. 23,000. Housing loan was taken from Canara Bank. These amounts were not dealt with in the Profit and Loss Account given above.
- Depreciation allowable under the Act is to be computed on the basis of following information (amount in Rs.):

Plant & Machinery (Depreciation rate @15%)	
Opening WDV (as on 01-04-2020)	12,00,000
Additions during the year (used for more than 180 days)	2,00,000
Total additions during the year	4,00,000
Note : Ignore additional depreciation u/s 32(1) (iii)	

Compute the total income of Mr. Raju for the assessment year 2021-22. (12 Marks, PCC Nov. 2010)

Note: Ignore application of Section 14A for disallowance of expenditures in respect of any exempt income.

Solution: Computation of Total Income of Mr. Raju (amount in Rs.):

Income from house property:		Nil	
Annual value of self-occupied property		23000	-23000
Less: Deduction under section 24(b) - Interest on housing loan			
Profits and gains of business or profession:			
Net profits as per P&L A/c		500000	
Add: Excess commission paid to brother disallowed under section 40A(2)		10000	
Salary paid to staff not recorded in the books	[WN-1]	48000	
Bank term loan interest paid in October 2021	[WN-2]	40000	
GST penalty paid disallowed	[WN-3]	5000	
Depreciation debited to profit and loss account		200000	
		803000	

Less: Dividend from domestic companies [Taxable in hands of shareholder]	-15000	
Income from agriculture [Exempt u/s 10(1)]	180000	
Depreciation under the Income-tax Act, 1961 [WN-4]	-225000	383000
Income from Other Sources :		
Dividend from domestic companies [Taxable in hands of shareholder]		15000
Gross Total Income		375000
Less: Deduction u/s 80C in respect of Principal repayment of housing loan		50000
Total Income		325000

Working Notes:

- (1) Assuming that the salary paid to staff is in the nature of unexplained expenditure and hence, is deemed to be income as per section 69C. Further, no deduction shall be allowable in respect of such expenditure.

Alternate view: It is also possible to take a view that the salary not recorded in the books of account was an erroneous omission and that the assessee has offered satisfactory explanation for the same. In such a case, the same should not be added back as unexplained expenditure under section 69C of the Act, but would be allowable as deduction while computing profits and gains of business and profession.

- (2) Bank term loan interest paid after the due date of filing of return under section 139(1) shall be disallowed as per Section 43B. It is assumed that the interest doesn't relate to the period before the machinery is first put to use, hence, the same is a revenue expenditure. Thus, amount to be disallowed = Rs. 60,000 - 20,000 = Rs. 40,000.

- (3) Where the imposition of penalty is not for delay in payment of Goods and Services Tax but for contravention of provisions of the Goods and Services Tax Act, the levy is not compensatory and therefore, not deductible. However, if the levy is compensatory in nature, it would be fully allowable. Where it is a composite levy, the portion which is compensatory is allowable and that portion which is penal is to be disallowed.

Since the question only mentions "GST penalty paid" and the reason for levy of penalty is not given, it has been assumed that the levy is not compensatory and therefore, not deductible. However, it may also be assumed that such levy is compensatory in nature and hence, allowable as deduction, in which case the answer would change.

- (4) Depreciation as per Income-tax Act, 1961 (amount in Rs.) -

Plant & Machinery (Depreciation rate @ 15%)	
Opening WDV (as on 01-04-2020)	12,00,000
Add: Additions during the year (used for more than 180 days)	2,00,000
Add: Additions during the year (used for less than 180 days)	2,00,000
WDV (as on 31-03-2021)	16,00,000
Depreciation @ 15% (Rs. 12,00,000 + Rs. 2,00,000)	2,10,000
Depreciation @ 7.5 % (Rs. 2,00,000)	15,000
Total allowable depreciation	2,25,000

- (5) Payment made to transporter is not disallowed under section 40A(3) since the limit for cash payment in case of transporters is Rs. 35,000. Hence, it is fully allowable as deduction.

Illustration 53 - Taxability/ Deductibility of various items: Ramji Ltd., engaged in manufacture of medicines (pharmaceuticals) furnishes the following information for the year ended 31-03-2021:

- (i) Municipal tax relating to office building Rs. 51,000 not paid till 31-10-2021.
- (ii) Patent acquired for Rs. 20,00,000 on 01-09-2020 and used from the same month.
- (iii) Capital expenditure on scientific research Rs. 10,00,000 which includes cost of land Rs. 2,00,000.
- (iv) Amount due from customer X outstanding for more than 3 years written off as bad debt in the books Rs. 5,00,000.
- (v) Income tax paid Rs. 90,000 by the company in respect of non-monetary perquisites provided to its employees.
- (vi) Provident fund contribution of employees Rs. 5,50,000 remitted in July 2021.
- (vii) Expenditure towards advertisement in souvenir of a political party Rs. 1,50,000.
- (viii) Refund of Goods and Services Tax Rs. 75,000 received during the year, which was claimed as expenditure in an earlier year.

State with reasons the taxability or deductibility of the items given above under Income-tax Act, 1961.

Note: Computation of total income is not required. (8 Marks, CA IPCC Nov. 2011)

Solution: The treatment is as under -

- (i) As per Section 43B, municipal tax is not deductible for assessment year 2021-22 since it is not paid on or before 31-10-2021, being the due date of filing the return for assessment year 2021-22.
- (ii) Patent is an intangible asset eligible for depreciation @ 25%. Since, it has been acquired and put to use for more than 180 days during the previous year 2020-21, full depreciation of 15,00,000 (i.e. 25% of Rs. 20,00,000) is allowable as deduction under section 32.
- (iii) Deduction @ 100% is available under section 35(2AB) in respect of expenditure incurred by a company on scientific research on in-house research and development facility as approved by the prescribed authority. However, cost of land is not eligible for deduction.
Deduction under section 35(2AB) = 100% of lakhs = Rs. 8,00,000.
- (iv) Bad debts i.e. Rs. 5,00,000 written off in the books of account as irrecoverable is deductible under section 36(1) (vii), provided the debt has been taken into account in computing the income of the company in the current previous year or any of the earlier previous years.
- (v) As per Section 40(a) (v), income-tax of Rs. 90,000 paid by the company in respect of non-monetary perquisites provided to its employees, exempt in the employee's hands under section 10(10CC), is not deductible while computing business income of the employer-company.
- (vi) The employees' contribution to provident fund is taxable in the hands of the company since it is included in the definition of income under section 2(24) (x). As per section 36(1) (va), provident fund contribution of employees is deductible only if such sum is credited to the employee's provident fund account on or before the due date under the 'Employees' Provident Fund and Miscellaneous Provisions Act, 1952. In this case, since it is remitted after the due date under the said Act, it is not deductible.
- (vii) Expenditure towards advertisement in souvenir of a political party is disallowed under section 37(2B) while computing business income. However, the same is deductible under section 80GG from gross total income.
- (viii) Refund of a trading liability is taxable under section 41(1), if a deduction was allowed in respect of the same to the taxpayer in an earlier year. Since Goods and Services Tax was claimed as expenditure in an earlier year, refund of the same during the year would attract the provisions of Section 41(1).

AGRICULTURAL INCOME

61. Define Agricultural income?

Ans: Section 10(1) exempts 'agricultural income' from income tax chargeable under this Act. However, it is chargeable to income-tax at state-level as per state laws. As per section 2(1A), agricultural income means -

(1) Rent or Revenue derived from land [Section 2(1A)(a)] : Any rent or revenue should be derived from land, which is situated in India and is used for agricultural purposes.

The amount received in money or in kind, by one person from another for right to use land is termed as Rent. The rent can either be received by the owner of the land or by the original tenant from the sub-tenant. It implies that ownership of land is not necessary. Thus, the rent received by the original tenant from sub-tenant would also be agricultural income subject the other conditions mentioned above.

The scope of the term "Revenue" is much broader than rent. It includes income other than rent. For example, fees received for renewal for grant of land on lease would be revenue derived from land.

The Supreme Court in CIT v. Raja Benoy Kumar Sahas Roy, has held that, agricultural activity is divided into two parts:

(i) Basic operations: It means application of human skill & labour upon the land, prior to germination E.g. Tilling, sowing, planting and similar operations.

(ii) Subsequent operations : It means operations which fosters the growth and preserves the produce, for rendering the produce fit for sale in market, and which are performed after the produce sprouts from the land, like weeding, digging the soil, removal of undesirable undergrowths, prevention of crop from insects and pests, depredation from outside, cutting, pruning etc.

Both basic and subsequent operations are to be performed to constitute agriculturist activities. One cannot disassociate the basic operations from the subsequent operations.

(2) Income derived from agricultural land by agricultural operations [Section 2(1A)(b)]: This includes -

(i) Income derived from such land by agriculture.

(ii) Income derived by cultivator or receiver of rent in kind, for any process ordinarily employed to render the produce raised, fit to be taken to the market.

(iii) Income derived from sale of agricultural produce is also agricultural income.

(3) Income from farm building [Section 2(1A)(c)]: If a building satisfies the following conditions, then income from such building shall be treated as agricultural income -

(i) Building must be occupied by the cultivator or receiver of rent in kind;

(ii) It is on or in the immediate vicinity of land situated in India and used for agricultural purposes;

(iii) The building is occupied as a dwelling house, storehouse or other out-building; and

(iv) Land is either assessed to land revenue or local rate, or it is situated in a rural area**.

****Note :** "Rural area" means any area which is outside the jurisdiction of a municipality or a cantonment board and which has a population of 10,000 or more and which does not fall within distance (to be measured aerially) given below -

➤ 2 kilometres, from the local limits of any municipality or cantonment board	➤ If the population of municipality or cantonment board is more than 10,000 but not exceeding 1,00,000; or
➤ 6 kilometres, from the local limits of any municipality or cantonment board	➤ If the population of municipality or cantonment board is more than 1,00,000 but not exceeding 10,00,000; or
➤ 8 kilometres, from the local limits of any municipality or cantonment board	➤ If the population of municipality or cantonment board is more than 10,00,000.

"Population" means the population according to the last preceding census of which the relevant figures have been published before the first day of the previous year. [Explanation]

- (4) **Surplus from transfer of urban agricultural land [Explanation 1] :** Any surplus arising from transfer of "urban agricultural land" is not treated as revenue derived from land.
- (5) **Income from non-agricultural use of farm-building - Not agricultural income [Explanation 2]:** However, income derived from any such building or land from its use for non-agricultural purposes (including letting for residential purpose or for the purpose of any business or profession) shall not be agricultural income.
- (6) **Income from plant nursery - Deemed agricultural income [Explanation 3]:** Any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income.

62. Give instances of agricultural income and non-agricultural income.

Ans: Instances of agricultural Income:

- (1) Income from growing trade or commercial products like jute, cotton, etc. is an agricultural income.
- (2) Income from growing flowers is an agricultural income.
- (3) Plants sold in pots are an agricultural income provided basis operations are performed.
- (4) Remuneration and interest to partner: Any remuneration (salary, commission, etc.) received by partner from a firm engaged in agricultural operation is an agricultural income.
Interest on capital received by a partner from a firm engaged in agricultural operation is an agricultural income.

Instances of Non-agricultural Income:

- (1) Salary received by an employee from any business (having agricultural income).
- (2) Dividend received from a company engaged in agricultural operation.
- (3) Income from fisheries.
- (4) Income from poultry farming.
- (5) Income from dairy farming, butter & cheese making, etc..
- (6) Breeding & rearing of livestock.
- (7) Income earned by a cultivator from conversion of sugarcane (raised on own land) to jaggery is non-agricultural income to the extent to which income is related to such conversion only. This is because sugarcane itself is marketable.
- (8) Income from a land situated outside India is non-agricultural income and taxable under the head "Income from other sources".
- (9) Income from sale of trees and grasses grown spontaneously (without any human effort).

- (10) Proceeds from sale of cocoons are not agricultural income. Here, assessee grows mulberry leaves and rears silkworms, and then sells the silk cocoons in the market. Therefore agricultural produce of the cultivator will be mulberry leaves and the silkworms cannot be regarded as the agricultural produce of the cultivator. –

K. Lakshmanan & Co. v. CIT [2000] 239 ITR 597 (SC).

63. Give the disintegration of income in case of - (A) Rubber, coffee and tea business. (B) Any other business.

Ans: Disintegration of income is as follows - (A) In case of rubber, coffee and tea business -

Particulars	Rubber [Rule 7A]	Coffee [Rule 7B]		Tea [Rule 8]
Income derived from the sale of -	Latex/ cenex/ block rubbers manufactured or processed from rubber plants grown by seller in India	Coffee grown & cured by seller in India	Coffee grown, cured, roasted and grounded by seller in India	Tea grown & manufactured by seller in India
Business income	35%	25%	40%	40%
Agricultural income	65%	75%	60%	60%

- (B) In case of any other business [Rule 7]: The following mode will be adopted –

- (a) Agricultural Income = (Market value of agricultural produce used as raw material for business + Sale proceeds from direct sale of agricultural produce) - Cost of Cultivation.
- (b) Business Income = Sale proceeds of the processed goods - Market value of agricultural produce used as raw material for business - Expenses for processing.

64. Under the Constitution, the power of levy tax on agricultural income vests in the States. However, Parliament has also levied tax on such income. Explain how this has been achieved. OR Briefly explain about aggregation of agricultural income for rate purposes. How will income-tax be computed where an individual derives agricultural as well as non-agricultural income? (5 Marks: May 1996, May 2005)

Ans: The relevant provisions are discussed as under -

- (A) **Partial integration of agricultural income for rate purposes:** Under constitution, the power of levy tax on agricultural income vests in states. However, Parliament has provided for integration of agricultural income for determining income-tax rate on total income.

- (B) **Conditions for applicability of partial integration:** This partial integration is applicable only if -

- (a) The taxpayer is a HUF, an Individual, BOI or an AOP or artificial juridical person;
- (b) The non-agricultural income exceeds the maximum amount not chargeable to tax; and
- (c) Agricultural income exceeds ₹ 5,000.

- (C) **Computation of tax:**

Step 1: Net agricultural income is to be computed as if it were income chargeable to income tax.

Step 2: Compute tax on (Agricultural + Non-agricultural income)

Step 3: Compute tax on (Net agricultural income + Maximum amount not chargeable to tax).

- Step 4:** Compute [Amount calculated in (Step 2) - Amount calculated in (Step 3)]
Step 5: Total income tax payable = Tax as computed under Step 4 - Tax rebate.

Illustration 54 - Computation of Business and agricultural Income: Mr. Anil earned Rs. 5,00,000 from sale of Coffee grown and cured (processed) by him. He claims the entire income as agricultural income, hence exempt from tax. Is he correct?

(2 Marks, PCC May 2010)

Solution: No. Out of the total income of Rs. 5,00,000 - Agricultural income = 75% of Rs. 5,00,000 = Rs. 3,75,000; Business income = 25% of Rs. 5,00,000 = Rs. 1,25,000.

Illustration 55 - Computation of Business and agricultural Income: Mr. Tony had estates in Rubber, Tea and Coffee. He derives income from them. He has also a nursery wherein he grows plants and sells. For the previous year ending 31-3-2021, he furnishes the following particulars of his sources of income from estates and sale of plants

(amounts in Rs.)-

(a)	Manufacture of Rubber	5,00,000
(b)	Manufacture of Coffee grown and cured	3,50,000
(c)	Manufacture of Tea	7,00,000
(d)	Sale of plants from nursery	1,00,000

You are requested to compute the taxable income. (5 Marks, CA PE-II Nov. 2004)

Solution: Computation of taxable income of Tony (amount in Rs.)-

Particulars	Business income	Agricultural income
Income from growing and manufacturing rubber (Rule 7A) - 35% : 65%	1,75,000	3,25,000
Income from growing and curing coffee (Rule 7B) - 25% : 75%	87,500	2,62,500
Income from growing and manufacturing tea (Rule 8) - 40% : 60%	2,80,000	4,20,000
Sale of plants from nursery (It is an agricultural income)	Nil	1,00,000
Total	5,42,500	11,07,500

Hence, total income of Mr. Tony = Rs. 5,42,500.

Illustration 56 - Computation of Business and agricultural Income: Miss. Kavita, a resident and ordinarily resident in India, has derived the following income for the year ended 31-3-2021:

Rs.

(i)	Income from sale of centrifuged latex processed from rubber plants grown in Darjeeling	1,00,000
(ii)	Income from sale of coffee grown and cured in Yercaud, Tamil Nadu	2,00,000
(iii)	Income from sale of coffee grown, cured, roasted and grounded in Colombo. Sale consideration was received in Chennai.	5,00,000
(iv)	Income from sale of tea grown and manufactured in Shimla	10,00,000
(v)	Income from sapling and seedling grown in a nursery at Cochin. Basic operations were not carried out by her on land.	2,00,000

You are required to compute the business income and agricultural income of Miss. Kavita for the Assessment Year 2021-22. (5 Marks, May 2018) (Similar: 6 Marks, CA PE-II June, 2009)

Solution: Computation of taxable income of Miss Kavita (amounts in Rs.) -

Particulars	Business Income	Agricultural Income
Income from growing & manufacturing rubber in India (Rule 7A) - 35% : 65%	35,000	65,000
Income from growing and curing coffee in India (Rule 7B) - 25% : 75%	50,000	1,50,000
Income from growing/curing/roasting etc. coffee out of India in Colombo (Sri Lanka) [WN-1]	5,00,000	-
Income from growing and manufacturing tea in India (Rule 8) - 40% : 60%	4,00,000	6,00,000
Income from sapling and seedling grown in a nursery [WN-2]	-	2,00,000
Total	9,85,000	10,15,000

Working Note:

- (1) Income from a land situated outside India is Non-Agricultural Income. Since the operations have taken place outside India, hence, no part of such income can be regarded as agricultural income (Rule 7B will not apply). Since Miss Kavita is resident in India, hence, this income will be taxed in India.
- (2) Income from sapling and seedling grown in a nursery is deemed agricultural income even if no basic operations have been carried out.

Illustration 57 - Computation of Business and agricultural Income: Mr. Tenzingh is engaged in composite business of growing and curing (further processing) Coffee in Coorg, Karnataka. The whole of coffee grown in his plantation is cured. Relevant information pertaining to the year ended 31-3-2021 are given below:

	Rs.
WDV of Car as on 01-04-2020	3,00,000
WDV of machinery as on 31-03-2020 (15% rate)	15,00,000
Expenses incurred for growing coffee	3,10,000
Expenditure for curing Coffee	3,00,000
Sale value of cured Coffee	22,00,000

Besides being used for agricultural operations, the car is also used for personal use; disallowance for personal use may be taken at 20%. The expenses incurred for car running and maintenance are Rs. 50,000. The machines were used in coffee curing business operations. Compute the income arising from the above activities for the assessment year 2021-22. Show the WDV of the assets as on 31-03-2021. (6 Marks, IPCC May 2010)

Solution: Computation of income from partly agricultural and partly business activities : Where an assessee is engaged in the composite business of growing and curing of coffee, the income will be segregated between agricultural income and business income, as per Rule 7B of the Income-tax Rules, 1962.

As per the above Rule, income derived from sale of coffee grown and cured by the seller in India shall be computed as if it were income derived from business, and 25% of such income shall be deemed to be income liable to tax. The balance 75% will be treated as agricultural income (amount in Rs.) -

Sale value of cured coffee		22,00,000
Less: Expenditure incurred for growing coffee	3,10,000	
Expenditure incurred for curing coffee	3,00,000	
Expenditure on running and maintenance of car (Rs. 50,000 x 80%) - Balance 20%		

pertaining to personal use, not allowed as deduction	40,000	
Depreciation on machinery	2,25,000	
Depreciation on car	36,000	9,11,000
Income from coffee business (before disintegration)		12,89,000
Agricultural Income @ 75%		9,66,750
Business Income @ 25%		3,22,250
Computation of WDV of assets as on 31-3-2021:		
WDV as on 01-04-2020	Car 3,00,000	Machine 15,00,000
Less: Depreciation @ 15% (In case of car, only 80% will be deducted) (See Note)	-36,000	-2,25,000
Depreciated WDV as on 31-3-2021	2,64,000	12,75,000

Note:

- (1) Explanation 7 has been inserted in section 43(6) to provide that in cases of 'composite income', for the purpose of computing written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee (and not just 25%) is chargeable under the head "Profits and gains of business or profession". The depreciation so computed shall be deemed to have been "actually allowed" to the assessee.
- (2) It has been assumed that the written down value of machinery as on 31-3-2020 i.e., Rs. 15 lakhs given in the question represents the closing balance after providing depreciation for the previous year 2019-20. It is also possible to assume that the written down value of Rs. 15 lakhs as on 31-3-2020 represents the written down value on which depreciation has to be charged for the previous year 2019-20 and answer will be modified accordingly.

Illustration 58 - Computation of tax liability in case of Business income & other income: Mr. X, a resident, has provided the following particulars of his income for the P.Y. 2020-21. Compute his tax liability.

- (4) Income from salary (Computed) - Rs. 3,80,000
- (5) Income from house property (computed) - Rs. 2,00,000
- (6) Agricultural income from a land in Jaipur - Rs. 2,80,000
- (7) Expenses incurred for earning agricultural income - Rs. 1,70,000

Solution: Computation of total income of Mr. X for the A.Y. 2021-22 (amount in Rs.):

Income from salary (Computed)		3,80,000
Income from house property		2,00,000
Net agricultural income [Rs. 2,80,000 - Rs. 1,70,000]	1,10,000	
Less: Exempt under section 10(1)	-1,10,000	-
Gross Total Income		5,80,000
Less: Deductions under Chapter VI-A		-
Total Income		5,80,000

Computation of tax payable by Mr. X (amounts in Rs.):

Tax on business income including agricultural income (Rs. 5,80,000 + Rs. 1,10,000)	50,500
Less: Tax on agricultural income + basic exemption (Rs. 1,10,000 + Rs. 2,50,000)	5,500
Tax payable	45,000
Add: HEC @ 4%	1,800
Tax liability (rounded off)	46,800

Illustration 59 - Computation of Business and agricultural Income: Mr. Kamal grows paddy and uses the same for the purpose of manufacturing of rice in his own Rice Mill. The cost of cultivation of 40% of paddy produce is Rs. 7,00,000 which is sold for Rs. 15,00,000; and the cost of cultivation of balance 60% of paddy is Rs. 12,00,000 and the market value of such paddy is Rs. 24,00,000. To manufacture the rice, he incurred Rs. 2,00,000 in the manufacturing process on the balance (60%) paddy. The rice was sold for Rs. 30,00,000. Compute the Business income and Agriculture Income of Mr. Kamal. (4 Marks, Nov. 2016)

Solution: Computation of Business income and Agriculture Income of Mr. Kamal

(amount in Rs.):

Agricultural Income:		
Sale value of paddy	15,00,000	
Less: Cost of Cultivation	7,00,000	8,00,000
Market value of paddy used for production of rice	24,00,000	
Less: Cost of Cultivation	12,00,000	12,00,000
Business Income:		
Sale Value of Rice	30,00,000	
Less: Cost of Paddy [Market Valued Paddy is taken for computing Business Income as u/r 7]	24,00,000	
Less: Further Processing Cost [Note: These are processing Costs, not Agri. Operations]	2,00,000	4,00,000

Illustration 60 - Computation of tax liability in case of Business income & Other income: Mr. Avani, a resident aged 25 years, manufactures tea leaves from the tea plants grown by him in India. These are then sold in the Indian market for Rs. 40 lakhs. The cost of growing tea plants was Rs. 15 lakhs and the cost of manufacturing tea leaves was Rs. 10 lakhs. Compute his tax liability for the Assessment Year 2021-22. (7 Marks, May 2018-NS)

Solution: Computation of tax liability of Mr. Avani (amount in Rs.):

Sale value of manufactured Tea		40,00,000
Less: Expenditure incurred for growing tea plants	15,00,000	
Expenditure incurred for manufacturing tea leaves	10,00,000	25,00,000
Composite income from growing and manufacturing tea		15,00,000
Agricultural Income @ 60%		9,00,000
Business Income @ 40%		6,00,000

Computation of tax payable by Mr. Avani (amounts in Rs.):

Tax on business income including agricultural income (Rs. 6,00,000 + Rs. 9,00,000)	2,62,500
Less: Tax on agricultural income + basic exemption (Rs. 9,00,000 + Rs. 2,50,000)	1,57,500
Tax payable	1,05,000
Add: HEC @ 4%	4,200
Tax liability (rounded off)	1,09,200

6 CAPITAL GAINS

Topic Referencer

- ❖ Basis of Charge, Capital Asset, Transfer, Transaction not regarded as transfer
- ❖ Computation of Capital Gains
- ❖ Capital Gains in Special Cases
- ❖ Exemptions from Capital Gains
- ❖ Taxability of Capital Gains
- ❖ Miscellaneous Questions

BASIS OF CHARGE, CAPITAL ASSET/ TRANSFER, TRANSACTION NOT REGARDED TRANSFER

1. Discuss the basis of charge of 'Capital Gains' under Section 45.

Ans: The basis of charge of Capital Gains is discussed as under -

(1) **Capital gains [Section 45]:** Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, unless exempt under sections 54, 54B, 54D, 54EC, 54EE, 54F, 54G, 54GA, 54GB and 54H, 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.

(2) **Conditions for taxability under Capital Gains:** An income shall be taxable as 'Capital Gains' on the fulfilment of the following conditions -

- (a) There must be a capital asset;
- (b) The capital asset must have been transferred;
- (c) Such transfer must have taken place during the previous year;
- (d) The transfer of such capital asset must give rise to profits or gains (includes loss also);
- (e) Such capital gains should not be exempt from tax u/s 54, 54B, 54D, 54EC, 54EE, 54F, 54G, 54GA, 54GB & 54H.

2. Define Capital asset.

Ans: The relevant provisions are discussed as under - (1) **Capital Asset [Section 2(14)]:** "Capital asset" means—

- (a) property of any kind held by an assessee, whether or not connected with his business or profession;
- (b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992,

but does not include.

- (a) any stock-in-trade [other than the securities referred above in point (b)], consumable stores or raw materials held for the purposes of his business or profession.
- (b) Personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him, but excludes -
 - (i) jewellery;

- (ii) archaeological collections;
- (iii) drawings;
- (iv) paintings;
- (v) sculptures; or
- (vi) any work of art.

[Thus, jewellery, archaeological collections, drawings, paintings, sculptures, and any work of art comes in the ambit of capital asset.]

Explanation: "Jewellery" includes -

- (i) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stone, and whether or not worked or sewn into any wearing apparel;
- (ii) precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

(c) **Rural Agricultural Lands:** Only rural agricultural lands in India are excluded from the purview of the term "capital asset". Hence, urban agricultural lands constitute capital assets.

Accordingly, the agricultural land described in (i) and (ii) below, being land situated within the specified urban limits, would fall within the definition of "capital asset", and transfer of such land would attract capital gains tax -

- (i) agricultural land situated in any area within the jurisdiction of a municipality or cantonment board having population of not less than 10000 according to last preceding census, or
- (ii) agricultural land situated in any area within such distance, measured aially, in relation to the range of population according to the last preceding census as shown hereunder -

	Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (i)	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.
(1)	≤ 2 kilometers	> 10,000 ≤ 1,00,000
(2)	≤ 6 kilometers	> 1,00,000 ≤ 10,00,000
(3)	≤ 8 kilometers	> 10,00,000

- (d) **Specified Gold Bonds :** 6.5% Gold Bonds, 1977 or 7% Gold Bonds, 1980 or National Defence Gold Bonds, 1980 issued by the Central Government.
- (e) Special Bearer Bonds, 1991, issued by the Central Government.
- (f) Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government or Deposit certificates issued under the Gold Monetisation Scheme, 2015.

(2) **Rights in or in relation to an Indian company - Included in property [Explanation]:** "Property" includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever. .

(3) **Other Aspects:** Silver utensils belonging to assessee, which are used in kitchen or dining room, are for his personal use; hence they are personal effects and not capital assets. However, silver bars, sovereigns and rupee coins used for puja, festivals etc. come in the ambit of 'capital asset'. Similarly, gold articles are capital assets.

3. Define (i) short-term capital asset as per Section 2(42A) (ii) Long term capital asset as per Section 2(29A) of the Income-tax Act, 1961.

Ans: The relevant definitions are as under -

- (1) **Short-term capital asset [Section 2(42A)]:** "Short-term capital asset" means a capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer. However, in case of -
- (a) Security (other than a unit) listed in a recognised stock exchange in India
 - (b) Unit of UTI or Unit of an equity oriented fund
 - (c) Zero Coupon Bond
- These assets shall be treated as short-term capital asset if they are held for not more than 12 months immediately preceding the date of transfer.
- (a) Share of a company (not being a share listed in a recognised stock exchange in India)
 - (b) An immovable property, being land or building or both
- these assets shall be treated as short-term capital asset if it is held for not more than 24 months immediately preceding the date of transfer.

Term	Meaning
Equity oriented fund	A fund set up under a scheme of a mutual fund; and (i) in a case where the fund invested in the units of another fund which is traded on a recognised stock exchange - (I) a minimum of 90% of the total proceeds of such fund is invested in the units of such other fund; and (II) such other fund also invests a minimum of 90% of its total proceeds in the equity shares of domestic companies listed on a recognised stock exchange; and (ii) in any other case, a minimum of 65% of the total proceeds of such fund is invested in the equity shares of domestic companies listed on a recognised stock exchange. However, the percentage of equity shareholding or unit held in respect of the fund, as the case may be, shall be computed with reference to the annual average of the monthly averages of the opening and closing figures.
Zero Coupon Bond	A bond - ➤ issued by any infrastructure capital company or infrastructure capital fund or a public sector company or a scheduled bank on or after 1st June, 2005, ➤ in respect of which no payment and benefit is received or receivable before maturity or redemption from such issuing entity and ➤ which the Central Government may notify in this behalf. [Section 2(48)]

- (2) **Long term capital asset [Section 2(29A)]:** "Long-term capital asset" means a capital asset which is not a short-term capital asset. In other words, a capital asset held for more than 36 months/12 months/24 months in case of specified assets given in table above shall be a long-term capital asset.
- (3) **Determination of period of holding [Clause (i) of Explanation 1 to section 2(42A)] :** In determining period of holding of any capital asset by the assessee in the circumstances stated in column (1), the period shall be determined by considering the period specified in Column (2).

Determination of period of holding:

Circumstances(Column 1)	Period of holding (Column 2)

1.	Shares of company in liquidation : Where shares held in a company in liquidation	The period subsequent to the date of liquidation of company shall be excluded.
2.	Capital asset acquired u/s 49(1) modes : Where asset becomes the property of an assessee by virtue of section 49(1)	The period for which the capital asset was held by the previous owner shall be included.
3.	Conversion of inventory into capital asset : Where inventory of business is converted into or treated as a capital asset by the assessee	Period from the date of conversion or treatment as a capital asset shall be considered.
4.	Shares held in amalgamated company : Where share/s in the Indian company (amalgamated company), becomes the property of an assessee in lieu of share/s held by him in the amalgamating company at the time of transfer referred under section 47(vii).	The period for which the share(s) was held by the assessee in the amalgamating company shall be included.
5.	Right shares : Where the share or any other security is subscribed by the assessee on the basis of right to subscribe to any share or security or by the person in whose favour such right is renounced by the assessee	Period from the date of allotment of such share or security shall be reckoned.
6.	Offer of Rights : Where the right to subscribe to any share or security is renounced in favour of any other person	Period from the date of offer of such right by the company or institution shall be reckoned.
7.	Bonus shares : Where any financial asset is allotted without any payment and on the basis of holding of any other financial asset	Period from the date of allotment of such financial asset shall be reckoned.
8.	Shares held in resulting company : Where share/s in the Indian company being a resulting company becomes the property of an assessee in consideration of demerger	The period for which the share/s were held by the assessee in demerged company shall be included.
9.	Units of mutual fund acquired under consolidating scheme of mutual fund : Where unit/s becomes the property of the assessee in consideration of transfer of unit/s in the consolidated scheme of the mutual fund referred to in section 47(xviii)	The period for which the unit/s in the consolidating scheme of the mutual fund were held by the assessee shall be included.
10.	Equity shares acquired on conversion of preference shares : Where equity share in a company becomes the property of the assessee by way of conversion of preference shares into equity shares referred under section 47(xb)	The period for which the preference shares were held by the assessee shall be included.
11.	Units of mutual fund acquired under consolidating plan of mutual fund scheme : Where unit/s becomes the property of the assessee in consideration of transfer of unit/s in the consolidated plan of a mutual fund scheme as referred to in section 47(xix)	The period for which the unit/s in the consolidating plan of a mutual fund scheme were held by the assessee shall be included.
12.	Sweat Equity Shares/ ESOP : Where any specified security or sweat equity shares is allotted or transferred, directly or indirectly, by the employer free of cost or at concessional rate to his employees (including former employees)	Period from the date of allotment or transfer of such specified security or sweat equity shares shall be reckoned.
13.	Units in segregated portfolio: In the case of a capital asset, being a unit or units in a segregated portfolio	Period for which the original unit or units in the main portfolio were held by the

	referred u/s 49(2AG) becomes the property of the assessee	assessee shall be included. [Inserted by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY 2021-22]

Notes:

- (1) An asset which is held exactly for 36 months or 12 months or 24 months, as the case may be, will be considered as short-term capital asset.
- (2) **Property constructed on a land purchased earlier:** In case, a land is held by the assessee for more than 24 months but the building constructed over it is held for not more than 24 months, then there will be long-term capital gains on sale of the land and short-term capital gains on sale of building. - *CIT v. Citibank N.A. [2003] 261 ITR 570 (Bom.)*

Notification No. 18/2016 dated 17-3-2016	Method of determination of period of holding of capital assets in certain cases [Rule 8AA] : In the case of a capital asset, being a share or debenture of a company, which becomes the property of the assessee in the circumstances mentioned in section 47(x) of the Act, there shall be included the period for which the bond, debenture, debenture-stock or deposit certificate, as the case may be, was held by the assessee prior to the conversion.

4. What do you mean by "Transfer" in relation to capital asset? (4 Marks: Nov 2002)

Ans: **Transfer [Section 2(47)]:** Transfer, in relation to a capital asset, includes -

- (a) sale, exchange or relinquishment of the asset;
- (b) compulsory acquisition thereof under any law;
- (c) extinguishment of any rights therein;
- (d) maturity or redemption of zero coupon bond;
- (e) in case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment;
- (f) any transaction involving allowing of possession of an immovable property to be taken or retained in part performance of a contract of the nature referred under section 53A of Transfer of Property Act, 1882;
- (g) any transaction (whether by way of acquiring shares in, or by way of becoming a member of, a co-operative society, company or other AOP or by way of any arrangement or agreement or in any other manner) that has the effect of transferring, or enabling the enjoyment of, any immovable property.

5. List the transactions that are not regarded as "Transfer". (Nov. 2003)

Ans: **Transactions not regarded as "Transfer" [Section 47]:** The following transactions are not regarded as "Transfer"-

Sec. 47	Transactions
(i)	Any distribution of capital assets on the total or partial partition of a Hindu Undivided Family.
(iii)	Any transfer of a capital asset under a gift or will or an irrevocable trust. However, this section shall not apply to transfer under a gift or an irrevocable trust of a capital asset being shares, debentures or warrants allotted by a company directly to its employees under any Employees' Stock Option Plan or Scheme, in accordance with the guidelines issued by the Central Government in this behalf. In such a case, its fair market value on date of such gift/irrevocable trust shall be treated as full value of consideration.
(iv)	Any transfer of a capital asset by a company to its subsidiary company, if—

	(a) the parent company or its nominees hold the whole of the share capital of the subsidiary company, and
	(b) the subsidiary company is an Indian company. [Note-1]
(v)	Any transfer of a capital asset by a subsidiary company to the holding company, if—
	(a) the whole of the share capital of the subsidiary company is held by the holding company, and
	(b) the holding company is an Indian company. [Note-1]
(vi)	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.
(viib)	Any transfer, in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.
(viid)	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.
(vii)	Any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or 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 except where the shareholder itself is the amalgamated company; and
	(b) the amalgamated company is an Indian company.
	However, if besides share(s) in amalgamated company, the shareholder is allotted something more, say bonds or debentures, in consideration of such transfer; the transfer will not be exempt. Composite consideration is not covered by section 47(vii). - CIT v. Gautam Sarabhai Trust [1988] 173 ITR 216 (Guj.)
(viiia)	Any transfer, made outside India, of a capital asset being rupee denominated bond of an Indian company issued outside India, by a non-resident to another non-resident.
(viiib)	Transfer of specified capital asset by a non-resident on a recognized stock exchange in any IFSC : Any transfer of a capital asset, being— (a) bond or Global Depository Receipt referred to in Section 115AC(1); or (b) rupee denominated bond of an Indian company; or (c) derivative; or (d) such other securities as may be notified by the Central Government in this behalf, made by a non-resident on a recognised stock exchange located in any International Financial Services Centre (IFSC) and where the consideration for such transaction is paid or payable in foreign currency.
(viiib)	Any transfer of a capital asset, being a Government Security carrying a periodic payment of interest, made outside India through an intermediary dealing in settlement of securities, by a non-resident to another non-resident.
(viiic)	Any transfer of Sovereign Gold Bond issued by the Reserve Bank of India under the Sovereign Gold Bond Scheme, 2015, by way of redemption, by an assessee being an individual.
(ix)	Any transfer of a capital asset, being any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print, to the Government or a University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution as may be notified by the Central Government in the Official Gazette to be of national importance or to be of renown throughout any State(s).
(x)	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.
(xb)	Any transfer by way of conversion of preference shares of a company into equity shares of that

	company.								
(xvi)	Any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government.								
(xviii)	Any transfer by a unit holder of a capital asset, being a unit or units, held by him in the consolidating scheme of a mutual fund, made in consideration of the allotment to him of a capital asset, being a unit or units, in the consolidated scheme of the mutual fund:								
	However, the consolidation is of two or more schemes of equity oriented fund or of two or more schemes of a fund other than equity oriented fund. Explanation : For the purposes of this clause,-								
	<table> <tr> <th>Term</th><th>Meaning</th></tr> <tr> <td>Consolidated scheme</td><td>The scheme with which the consolidating scheme merges or which is formed as a result of such merger.</td></tr> <tr> <td>Consolidating scheme</td><td>The scheme of a mutual fund which merges under the process of consolidation of the schemes of mutual fund in accordance with the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 made under the SEBI Act, 1992.</td></tr> </table>	Term	Meaning	Consolidated scheme	The scheme with which the consolidating scheme merges or which is formed as a result of such merger.	Consolidating scheme	The scheme of a mutual fund which merges under the process of consolidation of the schemes of mutual fund in accordance with the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 made under the SEBI Act, 1992.		
Term	Meaning								
Consolidated scheme	The scheme with which the consolidating scheme merges or which is formed as a result of such merger.								
Consolidating scheme	The scheme of a mutual fund which merges under the process of consolidation of the schemes of mutual fund in accordance with the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 made under the SEBI Act, 1992.								
(xix)	Any transfer by a unit holder of a capital asset, being a unit or units, held by him in the consolidating plan of a mutual fund scheme, made in consideration of the allotment to him of a capital asset, being a unit or units, in the consolidated plan of that scheme of the mutual fund. Explanation:								
	<table> <tr> <th>Term</th><th>Meaning</th></tr> <tr> <td>Consolidating plan</td><td>The plan within a scheme of a mutual fund which merges under the process of consolidation of the plans within a scheme of mutual fund in accordance with the SEBI (Mutual Funds) Regulations, 1996 made under the SEBI Act, 1992.</td></tr> <tr> <td>Consolidated plan</td><td>The plan with which the consolidating plan merges or which is formed as a result of such merger.</td></tr> <tr> <td>Mutual fund</td><td>A mutual fund specified under Section 10(23D), i.e., (i) a Mutual Fund registered under the SEBI Act, 1992 or regulations made thereunder; (ii) such other Mutual Fund set up by a public sector bank or a public financial institution or authorised by the RBI and subject to conditions notified by the Central Government.</td></tr> </table>	Term	Meaning	Consolidating plan	The plan within a scheme of a mutual fund which merges under the process of consolidation of the plans within a scheme of mutual fund in accordance with the SEBI (Mutual Funds) Regulations, 1996 made under the SEBI Act, 1992.	Consolidated plan	The plan with which the consolidating plan merges or which is formed as a result of such merger.	Mutual fund	A mutual fund specified under Section 10(23D), i.e., (i) a Mutual Fund registered under the SEBI Act, 1992 or regulations made thereunder; (ii) such other Mutual Fund set up by a public sector bank or a public financial institution or authorised by the RBI and subject to conditions notified by the Central Government.
Term	Meaning								
Consolidating plan	The plan within a scheme of a mutual fund which merges under the process of consolidation of the plans within a scheme of mutual fund in accordance with the SEBI (Mutual Funds) Regulations, 1996 made under the SEBI Act, 1992.								
Consolidated plan	The plan with which the consolidating plan merges or which is formed as a result of such merger.								
Mutual fund	A mutual fund specified under Section 10(23D), i.e., (i) a Mutual Fund registered under the SEBI Act, 1992 or regulations made thereunder; (ii) such other Mutual Fund set up by a public sector bank or a public financial institution or authorised by the RBI and subject to conditions notified by the Central Government.								

Circular No. 6/2015, dated 09-04-2015]	The roll over of units of Mutual Funds under the Fixed Maturity Plans in accordance with the SEBI (Mutual Funds) Regulation, 1996 will not amount to transfer as the scheme remains the same. Accordingly, no capital gains will arise at the time of exercise of the option by the investor to continue in the same scheme. The capital gains will, however, arise at the time of redemption of the units or opting out of the scheme, as the case may be.

COMPUTATION OF CAPITAL GAINS

6. Define long-term capital gains and short-term capital gains and discuss their computation.

Ans: The relevant provisions are discussed as under –

- (1) **Short term capital gains [Section 2(42B)] :** Short term capital gain means capital gains arising from the transfer of a short-term capital asset.
- (2) **Long term capital gains [Section 2(29B)] :** Long-term capital gain means capital gains arising from transfer of a long-term capital asset.
- (3) **Mode of computation [Section 48]:** Capital gains shall be computed as under –

Short term Capital Gains	Rs.	Long term Capital Gains	Rs.
Full Value of Consideration	xx	Full Value of Consideration	xx
Less: Expenses incurred wholly and exclusively in connection with such transfer	xx	Less: Expenses incurred wholly and exclusively in connection with such transfer	xx
Net Consideration	xx	Net Consideration	xx
Less: Cost of acquisition	xx	Less: Indexed Cost of acquisition	xx
Cost of improvement	xx	Indexed Cost of improvement	xx
Short term Capital Gains	xx	Long term Capital Gains	xx
Less: Exemption u/s 54B, 54D, 54G, 54GA	xx	Less: Exemption u/s 54, 54B, 54D, 54EC, 54EE, 54F, 54G, 54GA, 54GB	xx
Taxable Short term Capital Gains	xx	Taxable Long term Capital Gains	xx

Notes:

- (1) Computation of Indexed cost of acquisition or improvement –

$$\text{Indexed Cost of Acquisition} = \frac{\text{Cost of acquisition} \times \text{Cost Inflation Index of the year of transfer}}{\text{Cost Inflation Index (CII) for –}}$$

- (i) the first year in which the asset was held by the assessee; or
- (ii) for the year beginning on 1-4-2001, whichever is later.

$$\text{Indexed Cost of improvement} = \frac{\text{Cost of improvement} \times \text{Cost Inflation Index of the year of transfer}}{\text{Cost Inflation Index (CII) for the year in which improvement took place}}$$

- (2) Securities transaction tax paid is not allowed as deduction while computing capital gains.
- (3) The benefit of indexation (second proviso to Section 48) and currency fluctuation (first proviso to Section 48) would not be applicable to the long-term capital gains arising from the transfer of the following assets referred to in section 112A –
 - (a) equity share in a company on which STT is paid both at the time of acquisition and transfer
 - (b) unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer.
- (4) Indexation benefit will not be available in computing the long-term capital gain arising from the transfer of a long-term capital asset, being a bond or debenture other than —

- (a) Capital indexed bonds issued by the Government; or
- (b) Sovereign Gold Bond issued by the Reserve Bank of India under the Sovereign Gold Bond Scheme, 2015.
- (5) In case of an assessee being a non-resident, any gains arising on account of appreciation of rupee against a foreign currency at the time of redemption of rupee denominated bond of an Indian company held by him, shall be ignored for the purposes of computation of full value of consideration under this section.
- (6) "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 the Consumer Price Index for urban non-manual employees for the immediately preceding previous year to such previous year, by notification in the Official Gazette, specify, in this behalf.
7. Describe the procedure for computation of capital gains on transfer of shares of an Indian company by non-residents. (CS Inter Dec. 2003)

Ans: Special provision for non-residents - First proviso to Section 48 and Rule 115A: The capital gains on transfer of shares or debentures of an Indian company acquired by non-resident in convertible foreign exchange shall be computed in accordance with 1st Proviso to Section 48 and Rule 115A as under -

Particulars	Amount (Rs.)
Full Value of consideration is converted into foreign currency by applying average exchange rate as on date of transfer.	XXX
Less: Expenses incurred wholly and exclusively on transfer is converted into foreign currency by applying average exchange rate as on date of transfer.	XXX
Less: Cost of acquisition is converted into foreign currency by applying average exchange rate as on date of acquisition. (No indexation benefit is available)	XXX
Resultant Capital Gains in foreign currency to be reconverted into Indian Currency by applying telegraphic transfer buying rate on date of transfer.	XXX
Note: (1) Average exchange rate = [Telegraphic transfer buying rate + Telegraphic transfer selling rate (as per SBI)] (2) This manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every reinvestment thereafter in, and sale of, shares/debentures of an Indian company.	

8. What shall be the cost of acquisition (COA) and cost of improvement (COI) in case the asset is acquired before 1-4-2001?

Ans: In case if the asset is acquired before 1-4-2001 the cost of acquisition & cost of improvement shall be as under [Section 55]:

- (1) **Cost of acquisition:** FMV on 1-4-2001 or cost of property/cost to the previous owner (if property acquired under 49(1) modes), whichever is higher.
 In case of a capital asset, being land or building or both, the fair market value of such asset on 01-04-2001 shall not exceed the stamp duty value, wherever available, of such asset as on 01-04-2001.

"Stamp duty value" means the value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of an immovable property. [Amended by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY 2021-22]

Where the cost for which previous owner acquired the property cannot be ascertained, the cost of acquisition to the previous owner means the fair market value on the date on which the capital asset became the property of the previous owner. [Section 55(3)]

Further, if, on the facts of a particular case, computation under section 48 is not possible, then capital gains shall not be charged to tax. Thus, if no cost can be ascertained in acquisition of an asset, capital gains cannot be charged.

- (2) **Cost of improvement:** Capital expenditure incurred by the previous owner or the assessee in making any additions/ alterations to the capital asset on or after 1-4-2001. However, cost of improvement does not include any expenditure which is deductible in computing the income chargeable under the head "Income from house property", "Profits and gains of business or profession", or "Income from other sources".

Illustration 1 - Capital gains - Basics: Compute the capital gains for assessment year 2021-22 in following independent cases -

- (i) Mr. Ramesh, a property dealer, sells a commercial plot of land on 1-3-2021 for Rs. 100 lakhs which was acquired by him on 1-8-2018 for Rs. 25,00,000 for selling of offices constructed therein. He had incurred land development charges of Rs. 10,00,000 on 1-10-2018. He incurred Rs. 50,000 for selling the plot of land.
- (ii) Mr. Roy sells his personal motorcar on 11-4-2020 for Rs. 2,55,000, which was acquired on 31-1-2018 for Rs. 6,50,000. The expenses on transfer are 2% of selling price.
- (iii) Mr. Pawan sells his personal residential house on 1-4-2021 for Rs. 86,70,000, which was acquired by him on 1-10-2008 for 130,00,000. The expenses on transfer were Rs. 70,000.
- (iv) Mr. Yash sells an agricultural land situated in rural area on 1-1-2021 for Rs. 10,50,000. The population of municipality under which the village is covered is 9,800. The land was acquired on 1-3-2002 for Rs. 1,00,000.
- (v) Mrs. Priya sells her gold bracelet on 1-5-2020 for Rs. 5,00,000, which was acquired for Rs. 40,000 on 1-3-2005. A diamond was fitted onto that bracelet on 1-4-2007 for Rs. 10,000.
- (vi) Mr. Kalicharan, a businessman, had acquired a sculpture for Rs. 8,36,600 and a drawing for Rs. 20,000 in the year 2004-05. He sold the sculpture for Rs. 9,00,000 to a university and the drawing for Rs. 15,000 to a National Museum on 25-12-2020.

Solution: Capital gains for A.Y. 2021-22 in respect of above cases shall be computed as follows,-

- (i) Commercial plot of land acquired by property dealer 'Ramesh' for his business purpose is in the nature of stock-in-trade for him. Therefore, it is not a capital asset and hence, no capital gains will arise.
- (ii) Personal motorcar sold by Mr. Roy is a personal effect. Therefore, it is not a capital asset and hence, no capital gains will arise.
- (iii) The transfer of the residential house by Mr. Pawan was effected on 01-04-2021, which doesn't fall within the previous year 2020-21. Hence, this transaction is not liable to capital gains in the assessment year 2021-22, but will be taxable in the assessment year 2022-23.
- (iv) In this case, agricultural land is situated in an area, the population of whose municipality is less than 10,000. Hence, the land is a rural agricultural land, thus not a capital asset.
- (v) Bracelet for personal use is 'jewellery' and is specifically excluded from the term personal effect. Therefore, it is a capital asset liable to capital gains tax, as follows:

(amounts in Rs.)	
Full value of consideration	5,00,000
Less: Indexed cost of acquisition (Rs. 40,000 $\times$ 301 $\div$ 113)	1,06,549

Less: Indexed cost of improvement being fitting of diamond ($\text{Rs. } 10,000 \times 301 \div 129$)	23,333
Long-term capital gains	3,70,118

- (vi) While sculpture/ drawings are capital assets, but their transfer to a University/National Museum is exempt under section 47(ix). Hence, no capital gains shall arise.

Illustration 2 - Computation of Capital Gains: A owns a capital asset which was purchased by him on 1-5-1999 for Rs. 4,00,000. The market value of the said asset as on 1-4-2001. was Rs. 3,00,000. The said asset was sold for Rs. 18,00,000 on 30-01-2021. Expense incurred on transfer amounted to Rs. 5,000. Compute the capital gain for the A.Y. 2021-22. (Cost inflation index for F.Y. 2001-02 = 100 and 2020-21 = 301)

Solution: Computation of capital gains chargeable to tax (amount in Rs.) -

Full value of consideration	18,00,000
Less: Expenses on transfer	5,000
Net Consideration	17,95,000
Less: Indexed cost of acquisition ($\text{Rs. } 4,00,000 \times 301 \div 100$)	12,04,000
Long-term Capital Gains	5,91,000

Illustration 3 - Computation of Capital Gains- Short term: A owns shares of unlisted company which was purchased by him on 15-10-2019 for Rs. 4,00,000. The said asset was sold for Rs. 4,80,000 on 30-01-2021. Expense incurred on transfer amounted to Rs. 5,000. Compute the capital gain for the assessment year 2021-22.

Solution: Computation of capital gains chargeable to tax (amount in Rs.) -

Full value of consideration	4,80,000
Less: Expenses on transfer	5,000
Net Consideration	4,75,000
Less: Cost of acquisition [WN]	4,00,000
Short-term Capital Gains	75,000

Working Note: Since the shares of unlisted company are not held for more than 24 months immediately preceding the date of transfer the said capital asset is short term capital asset.

Illustration 4 - Computation of Capital Gains - Long Term: A owns shares of unlisted company which was purchased by him on 15-10-2016 for 14,00,000. The said asset was sold for Rs. 5,75,000 on 30-01-2021. Expense incurred on transfer amounted to Rs. 5,000. Compute the capital gain for the assessment year 2021-22. (Cost inflation index for F.Y. 2016-17 = 264 and 2020-21 = 301)

Solution: Computation of capital gains chargeable to tax (amount in Rs.) -

Full value of consideration	5,75,000
Less: Expenses on transfer	5,000
Net Consideration	5,70,000
Less: Cost of acquisition $4,00,000 \times 301 \div 264$ [WN]	4,56,061
Long-term Capital Gains	1,13,939

Working Note: Since the shares of unlisted company are held for more than 24 months immediately preceding the date of transfer the said capital asset is long term capital asset.

Illustration 5 - Computation of Capital Gains - Long Term: A owns a commercial property which was purchased by him on 15-10-2016 for Rs. 8,00,000. The said asset was sold for Rs. 15,75,000 on 30-01-2021. Expense incurred on transfer amounted to ₹ 5,000. Compute the capital gain for the assessment year 2021-22. (Cost inflation index for F.Y. 2016-17 = 264 and 2020-21 = 301)

Solution: Computation of capital gains chargeable to tax (amount in Rs.) -

Full value of consideration	15,75,000
Less: Expenses on transfer	5,000
Net Consideration	15,70,000
Less: Cost of acquisition (Rs. 8,00,000 $\times$ 301 $\div$ 264) [WN]	9,12,121
Long-term Capital Gains	6,57,879

Working Note: Since the commercial property is held for more than 24 months immediately preceding the date of transfer the said capital asset is long term capital asset.

Illustration 6 - Computation of Capital Gains: A owns a capital asset which was purchased by him on 01-5-1989 for Rs. 4,00,000. The fair market value as on 01-04-2001 is Rs. 15,00,000. The said asset was sold for Rs. 48,00,000 during financial year 2020-21. Expense incurred on transfer amounted to Rs. 15,000. Compute the capital gain for the assessment year 2021-22. (Cost inflation index for F.Y. 2001-02 = 100 and 2020-21 = 302)

Solution: Computation of capital gains chargeable to tax (amount in Rs.) -

Full value of consideration	48,00,000
Less: Expenses on transfer	15,000
Net Consideration	47,85,000
Less: Indexed cost of acquisition 15,00,000 $\times$ 302 $\div$ 100)	45,15,000
Long-term Capital Gains	2,70,000

Illustration 7 - Computation of Capital gains: Ram purchases a house property for Rs. 15,00,000 on 30th June, 1994. The following expenses were incurred by him for making addition/ alteration to the house property:

	Rs.
Cost of construction of first floor in 1995-1996	5,00,000
Cost of construction of second floor in 2002-03	7,50,000
Alteration/reconstruction of the property in 2006-07	6,25,000
Fair market value of the property on 1st April, 2001	21,00,000
Stamp duty value of the property as on 1st April, 2001	20,00,000

The house property is sold by him on 15th June, 2020 for Rs. 1,00,00,000 (expenses incurred on transfer Rs. 1,15,000). Compute the amount of capital gains chargeable to tax for the assessment year 2021-22. Cost inflation indices: FY 2001-02:100; FY 2002-03 :105; FY 2006-07:122 and 2020-21:301.

Solution: Computation of capital gains/ loss chargeable to tax (amount in Rs.)—

Full value of consideration	1,00,00,000
Less: Expenses on transfer	1,15,000
Net Consideration	98,85,000
Less: Indexed cost of acquisition (Rs. 21,00,000 $\times$ 301 $\div$ 100) [Stamp duty value will be considered as cost of acquisition since it exceeds the fair market value of the property]	60,20,000
Less: Indexed cost of improvement (second floor) 7,50,000 $\times$ 301 $\div$ 105)	21,50,000
Less: Indexed cost of improvement (Rs. 6,25,000 $\times$ 301 $\div$ 122)	15,42,008
Long-term Capital Gains	1,72,992

9. Write a short note on cost of acquisition in the circumstances as specified under section 49.

Ans: Cost with reference to certain modes of acquisition [Section 49]:

Sec. 49	Mode of acquisition	Cost
(1)	Where the capital asset became the property of the assessee under modes specified in Section 49(1). [Note-1]	Cost for which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee. [Note-2]
(2)	Where the share(s) of an amalgamated Indian company became the property of the assessee in consideration of a transfer in scheme of amalgamation.	Cost of acquisition to the assessee of the share(s) in the amalgamating company.
(2A)	Where the shares or debentures of a company became the property of the assessee by way of conversion of bonds or debentures, debenture-stock or deposit certificates, referred to in Section 47(x)/(xa).	Cost of that part of debenture, debenture-stock, bond or deposit certificate in relation to which such asset is acquired by the assessee.
(2AA)	Transfer of specified security/stock options or sweat equity shares, referred to in Section 17(2)(vi).	Fair market value which has been taken into account while computing the value of perquisite.
(2AD)	Where the capital asset, being a unit or units in a consolidated scheme of a mutual fund, became the property of the assessee in consideration of a transfer referred to in Section 47(xviii).	The cost of acquisition of the asset shall be deemed to be the cost of acquisition to him of the unit or units in the consolidating scheme of the mutual fund.
(2AE)	Where the capital asset, being equity share of a company, became the property of the assessee in consideration of a transfer referred to in Section 47 (xb).	Cost of acquisition of the asset shall be deemed to be that part of the cost of the preference share in relation to which such asset is acquired by the assessee.
(2AF)	Where the capital asset, being a unit or units in a consolidated plan of a mutual fund scheme, became the property of the assessee in consideration of a transfer referred to in Section 47(xix).	Cost of acquisition of the asset shall be deemed to be the cost of acquisition to him of the unit or units in the consolidating plan of the scheme of the mutual fund.

(2AG)	Unit or units in the segregated portfolio	Cost of unit/units in segregated portfolio = Cost of acquisition of a unit or units held by the assessee in the total portfolio $\times$ Net Assets Value of assets transferred to segregated portfolio / Net asset value of the total portfolio immediately before the segregation of portfolios.
(2AH)	Original units held by the unit holder in the main portfolio	Cost of the acquisition of the original units held by the unit holder in the main portfolio = Total Cost of units before segregation - the amount as so arrived at under section 49(2AG).
	"Main portfolio", "segregated portfolio" and "total portfolio" shall have the meanings respectively assigned to them in the Circular No. SEBI/HO/IMD/DF2/CIR/P/2018/160, dated 28-12-2018, issued by the Securities and Exchange Board of India under section 11 of the Securities and Exchange Board of India Act, 1992. [Inserted by Finance Act, 2020 w.e.f. 01-04-2020 i.e AY 2020-21]	
(2C)/ (2D)	Where the share(s) of resulting company became the property of the assessee in scheme of demerger.	Cost of shares in resulting co. = Cost of shares in demerged company $\times$ Net Book Value of assets transferred to resulting company + Net worth of the demerged company before demerger. Cost of shares in demerged company = Total cost of shares - Cost of shares in resulting company computed above.
(4)	Transfer of a property, the value of which has been subject to tax under section 56(2)(vii)/(viii)/(x) (i.e. taxable gifts of movable/immovable property).	Value which has been taken into account for the purposes of computing taxable gifts under section 56(2)(vii)/(viii)/(x).
(5)	Where the capital gain arises from the transfer of a capital asset, being share in the project, in the form of land or building or both, referred to in section 45 (5A) which is chargeable to tax in the previous year in which the completion of certificate for the whole or part of the project is issued by the competent authority,	Cost of acquisition of such asset, shall be the amount which is deemed as full value of consideration in that sub-section i.e., stamp duty value on the date of issue of certificate of completion plus cash consideration. However, this does not apply to a capital asset, being share in the project which is transferred on or before the date of issue of said completion certificate [Section 49(7)].
(9)	Where the capital gain arises from the transfer of a capital asset referred to in Section 28(via),	Cost of acquisition of such asset shall be deemed to be the fair market value which has been taken into account for the purposes of Section 28(via).

Notes:

- (1) The various modes specified under section 49(1) are - Where the capital asset became the property of the assessee -
- (i) On any distribution of assets on the total or partial partition of a Hindu undivided family;
 - (ii) Under a gift or will;
 - (iii) (a) by succession, inheritance or devolution, or
- (b) on any distribution of assets on the liquidation of a company, or
- (c) under a transfer to a revocable or an irrevocable trust, or

- (d) under any transfer of capital asset by a holding company to its wholly owned subsidiary Indian company or by a subsidiary company to its 100% holding Indian company, referred to in section 47(iv) and 47(v) respectively;
 - (e) under any transfer referred to in section 47(vi) of a capital asset by amalgamating company to the amalgamated Indian company, in a scheme of amalgamation;
 - (f) under any transfer referred to in section 47(vib), of a capital asset by the demerged company to the resulting Indian company, in a scheme of demerger;
 - (iv) In case of HUF-assessee, by conversion of member's individual property into HUF property. Indexation benefit in respect of the gifted asset to apply from the year in which the asset was first acquired by the previous owner.
- (2) **'Previous owner'** means the last previous owner of the asset who acquired it by a mode of acquisition other than that referred to under section 49(1).

Facts:

→ The assessee acquired a capital asset by way of gift. He treated the income arising on its transfer as long term capital gains after taking into consideration the period of holding of the previous owner as well (as given under explanation 1 to section 2(42A) read with section 49(1). The assessee computed the long term capital gains considering the CII of the year in which the asset was first held by the previous owner, i.e.

$$\frac{\text{CII of the year of transfer} \times \text{capital gains}}{\text{CII of the year in which asset was acquired by the previous owner}}$$

→ The AO raised an objection contending that the year in which the asset was first held by the assessee i.e. the year in which the gift was received by the assessee must be considered for indexation as per the meaning assigned to 'indexed cost of acquisition' (given in explanation (iii) to section 48).

[**Note:** While period of holding is not disputed, the dispute is with respect to computation of the indexed cost of acquisition.]

Decision:

→ Where the asset is acquired by the assessee in any of the modes mentioned in Section 49(1), then as per Explanation 1 to Section 2(42A) read with section 49(1), the period of holding of the previous owner is to be included while determining the period of holding of the asset and the cost to the previous owner is taken as 'cost of acquisition' of the assessee.

→ Therefore, it is logical to provide for indexation of the year in which the asset was first acquired by the previous owner. There is nothing to indicate that for determining the indexed cost of acquisition under section 48, the provisions of Section 2(42A) and 49(1) should not be followed.

Therefore, for determining the indexed cost of acquisition under section 48, the assessee must be treated to have held the asset from the year the asset was first held by the previous owner and accordingly, the CII for the year in which the asset was first acquired by the previous owner and not the year in which the asset was transferred to the assessee should be considered.

Author's Note : Answer has been solved by following the Ruling of Mumbai High Court in CIT v. Manjula J Shah [2011] 16 Taxman.com 42 (Bom.)

Illustration 8 - Computation of Capital Gains. Mrs. X, an individual resident woman, wanted to know whether income tax is attracted on the sale of gold and jewellery gifted to her by her parents at the occasion of her marriage in the year 1999 which was purchased at a total cost of Rs. 2,00,000. (4 Marks, PCC Nov. 2008)

Solution: Yes, the said transfer shall attract tax liability on capital gains arising from such transfer. Since the period of holding is more than 36 months, hence, long-term capital gains resulting from such sale = Full Value of consideration - Expenses on Transfer - Indexed cost of acquisition (viz. Cost of acquisition in hands of the parents or FMV as on 1-4-2001, whichever is higher $\times 301 \div 100$).

Illustration 9 - Computation of capital gains when transferred asset acquired u/s 49(1) modes: Mrs. R sells a plot of land on 21-11-2020 for Rs. 50,00,000. She inherited the plot from her grandfather on 01-04-2013. Her grandfather had acquired the plot on 01-03-2001 for Rs. 5,00,000. Her grandfather incurred land development charges of Rs. 2,90,000 on 31-3-2001 and Rs. 6,60,000 on 01-05-2013. Mrs. R also incurred land development charges of Rs. 1,00,000 on 01-09-2015. The expenses incurred on transfer amounted to 1.5% of the sale price. The FMV of the plot as on 01-04-2001 was Rs. 8,00,000. Compute the capital gains.

Cost Inflation Index: FY 2001-02 = 100; FY 2013-14 = 220; FY 2015-16 = 254 and FY 2020-21 = 301.

Solution: Here, the property (plot of land) was acquired by Mrs. R from her grandfather under inheritance i.e. Section 49(1) modes. Hence, the period of holding of Mrs. R's grandfather will be included, as a result of which, the plot of land becomes long-term capital asset for Mrs. R.

Cost of acquisition for Mrs. R = Cost to the previous owner or FMV as on 1-4-2001, whichever is higher = Rs. 8,00,000.

Cost of improvement incurred after 1-4-2001 by previous owner or the assessee is deductible.

(amounts in Rs.)

Full value of consideration	50,00,000
Less: Expenses on transfer @ 1.5% of 50,00,000	75,000
Net consideration	49,25,000
Less: Indexed cost of acquisition (Rs. 8,00,000 $\times 301 \div 100$)	24,08,000
Less: Cost of improvement incurred after 1-4-2001	
Mrs. R's grandfather (Rs. 6,60,000 $\times 301 - 220$) + Mrs. R (Rs. 1,00,000 $\times 301 \div 254$)	10,21,504
Long-term capital gains	14,95,496

Illustration 10 - Computation of capital gains in case of conversion of preference shares into equity shares: Mr. A is the holder of 1,000 preference shares of XYZ Ltd. having a face value of Rs. 100 each. The preference shares were acquired by him on 10-07-2014 for Rs. 1,50,000. The company converted the preference shares into equity shares in ratio of 1:1 on 15-07-2020. The market value of the equity shares on the date of conversion was Rs. 250 per share. He sold all the equity shares on 10-03-2021 for Rs. 325 per share. Expenses on transfer amounted to Rs. 10,000. The shares are not listed in recognized stock exchange. Determine taxable capital gains.

Solution: As per provisions of section 47(xb), conversion of preference share of a company into its equity share shall not be regarded as transfer. As per Section 49(2AE), where the capital asset, being equity share of a company, became the property of the assessee in consideration of such conversion, the cost of acquisition of the equity share shall be deemed to be that part of the cost of the preference share in relation to which such equity share is acquired by the assessee. In computing the period of holding of equity shares, there shall be included the

period for which the preference shares were held by the assessee. The capital gains shall be computed as under
(amount in Rs.):

Full value of consideration	3,25,000
Less: Expenses on transfer	10,000
Net consideration	3,15,000
Less: Indexed cost of acquisition (Rs. 1,50,000 $\times$ 301 $\div$ 240)	1,88,125
Long-term capital gains	1,26,875

Illustration 11 - Perquisite and Capital gains of ESOP: AB Co. Ltd. allotted 1,000 sweat equity shares to Sri Chand in June 2020. The shares were allotted at Rs. 200 per share as against the fair market value of Rs. 300 per share on the date of exercise of option by the allottee viz., Sri Chand. The fair market value was computed in accordance with the method prescribed under the Act.

- (i) What is the perquisite value of sweat equity shares allotted to Sri Chand?
- (ii) In the case of subsequent sale of those shares by Sri Chand, what would be the cost of acquisition of those sweat equity shares Rs. (4 Marks, PCC Nov. 2010)

Solution:

- (i) As per Section 17(2) (vi), the value of sweat equity shares chargeable to tax as perquisite shall be the fair market value of such shares on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from, the assessee in respect of such shares.
(amounts in Rs.)

Fair market value of 1,000 sweat equity shares @ Rs. 300 each	3,00,000
Less: Amount recovered from Sri Chand 1,000 shares @ Rs. 200 each	2,00,000
Value of perquisite of sweat equity shares allotted to Sri Chand	1,00,000

- (ii) As per section 49(2AA), where capital gain arises from transfer of sweat equity shares, the cost of acquisition of such shares shall be the fair market value which has been taken into account for perquisite valuation under section 17(2)(vi). Therefore, in case of subsequent sale of sweat equity shares by Sri Chand, the cost of acquisition would be Rs. 3,00,000.

Illustration 12 - Conversion of stock in trade into Capital Asset: Mr. X, a trader in gold and silver jewellery furnishes you with the following information —

- (1) On 14th May, 2019, X purchases 100 grams of gold bullion the rate of Rs. 30,000 per 10 gram as his stock-in-trade
- (2) This stock-in-trade is not sold till 31st March, 2020. FMV of gold bullion on 31st March, 2020 is Rs. 31,500 per 10 grams.
- (3) The above inventory of 100 grams gold bullion is converted into capital asset on 10th July, 2020. FMV of Gold bullion on 10th July, 2020 is Rs. 31,750 per ten grams.
- (4) X transfers 50 grams of gold bullion on 25th March, 2021 at the rate of Rs. 32,500 per 10 gram.

Find out tax consequences of these transactions (assume that X has not undertaken any other transaction during the previous years 2019-20 and 2020-21).

Solution:

- (1) For the previous year 2019-20, business income from the above transaction will be determined as follows (Rs.) —

Opening stock on 1st April, 2019	Nil	
Purchase of inventory during 2019-20 [Rs. 30,000 ÷ 10 × 100]	3,00,000	
Sales during 2019-20		Nil
Closing value of inventory (cost or market price, whichever is lower) Net profit	Nil	3,00,000
Total	3,00,000	3,00,000

- (2) Business income of X for the previous year 2020-21 will be computed as follows (amount in Rs.) —

Opening stock on 1st April, 2020	3,00,000	
Purchase of inventory during 2020-21	Nil	
Sales during 2020-21		Nil
Fair market value on the date of conversion as per Section 28(via) [Rs. 31,750 ÷ 10 × 100]		3,17,500
Closing value of inventory		Nil
Net profit	17,500	
Total	3,17,500	3,17,500

- (3) Income under the head "Capital gains" will be as follows (amount in Rs.) —

Full value of consideration (Rs. 32,500 × 50/10)	1,62,500
Less: Cost of acquisition (being fair market value on the date of conversion) (Rs. 31,750 × 50 - 10) [W.N.]	1,58,750
Short-term capital gain	3,750

Working Note: Where the capital gain arises from the transfer of a capital asset referred to in Section 28(via) i.e. inventory converted into capital asset, the cost of acquisition of such asset shall be deemed to be the fair market value which has been taken into account for the purposes of Section 28(via) and the period of holding of such capital asset shall be reckoned from the date of conversion or treatment.

Illustration 13 - Conversion of convertible debentures into shares: Mr. B purchased convertible debentures for Rs. 5,00,000 during August 2002. The debentures were converted into equity shares in September 2012. These shares were sold for Rs. 15,00,000 in August, 2020. The brokerage expenses are Rs.50,000. You are required to compute the capital gains in case of Mr. B for the assessment year 2021-22.

Cost Inflation Index: FY 2002-03 = 105; FY 2012-13 = 200 and FY 2020-21 = 301.

Solution: Computation of Capital Gains of Mr. B for the A.Y. 2021-22:

Sale consideration	15,00,000
Less: Expenses on transfer i.e. Brokerage paid	50,000
Net consideration	14,50,000
Less: Indexed cost of acquisition (Rs. 5,00,000 × 301/105)	14,33,333
Long term capital gain	16,667

Note: For determining the period of holding of a capital asset, being a share of a company, which becomes the property of the assessee by way of conversion of debentures of that company, the period for which the debenture was held by the assessee before conversion shall also be considered.

10. Write a short note on Cost of acquisition and improvement of intangible assets, in the context of capital gains, with reference to the provisions of the Income-tax Act, 1961.

Ans: The cost of acquisition and improvement of intangible assets is arrived as under –

Capital asset	COA	COI
Goodwill of business or right to manufacture/produce/process any article/ thing, or right to carry on any business or profession.	If self-generated: NIL; If purchased from previous owner: Purchase Price	NIL
Trademark/brand name associated with business or tenancy rights or stage carriage permits/loom hours.	If self-generated: NIL; If purchased from previous owner: Purchase Price	Expenses incurred by assessee or previous owner after 31-3-2001

Illustration 14 - Computation of capital gains in case of self generated asset: Mr. Sunil sells the goodwill on 20-01-2021 for Rs. 38,00,000. It was self-generated by him on 02-01-2001 and he incurred cost of improvement thereof for Rs.5,55,000 on 1-4-2016. Compute his taxable gains.

Also compute the capital gains in case the goodwill was purchased by Mr. Sunil on 2-1-2001 for Rs. 5,46,000.

Solution: Computation of capital gains of Mr. Sunil (amounts in Rs.)-

Particulars	Self-Generated Goodwill	Purchased Goodwill
Full value of consideration	38,00,000	38,00,000
Less: Indexed cost of acquisition [WN-1]	Nil	16,43,460
Less: Indexed cost of improvement [WN-2]	Nil	Nil
Long-term capital gains	38,00,000	21,56,540

Working Notes:

- (1) Indexed cost of acquisition in case of purchased goodwill = Rs. 5,46,000 $\times$ 301/100 = Rs.1643460.
- (2) Indexed cost of improvement shall be always NIL in case of goodwill.

11. What shall be the cost of acquisition of bonus shares allotted to an assessee?

Ans: As per Section 55, In a case where, by virtue of holding a capital asset, being a share or any other security, the assessee becomes entitled to subscribe to any additional financial asset (bonus shares), then in relation to the financial asset allotted to the assessee without any payment and on the basis of holding of any other financial asset, the cost of acquisition of such shares is to be taken as NIL. However, if such shares are allotted before 01-04-2001, then the cost is to be taken as fair market value as on 1-4-2001.

12. How shall the cost of acquisition be determined in case of ~

- (a) Right shares;
- (b) Offer for right shares.

Ans: The aforesaid points have been discussed below,-

- (a) **Right shares [Section 55]:** In a case where, by virtue of holding a capital asset, being a share or any other security, the assessee becomes entitled to right shares, then its cost of acquisition shall be taken as the purchase price actually paid by the assessee to the company for acquisition of right shares.

However, in case the right shares are purchased by person in whose favour right was renounced, and then cost shall be the aggregate of purchase price paid to company and amount paid by him for renouncement in his favour.

(6) **Offer for right shares [Section 55]:** In case of offer for rights, the cost shall be taken as NIL.

Illustration 15 - Capital gains in case of offer of rights: A is a shareholder of X & Co. Ltd., holding 1,000 shares of the face value of Rs. 10 each, allotted at the time of the company's incorporation in May, 2001. The company made a right issue in the ratio of 1:1 on 15-7-2020 at a premium of Rs. 40 per share. Instead of taking up the right, he renounced it in favour of 'B' at a price of Rs. 10 per share. What is the capital gain chargeable in the hands of 'A'? What will be the cost of the shares in the hands of B? (Nov. 1995, May 2000)

Solution: Capital Gain chargeable in the hands of A:

- (1) Short-term capital gains in hands of A = Sale proceeds of the right entitlements - Cost thereof = Rs. 10 $\times$ 1,000 - Nil = Rs. 10,000.
- (2) Cost of acquisition for B = Amount paid to A + Amount paid to X Ltd. = 1,000 (Rs. 10 + Rs. 50) = Rs. 60,000.

13. Discuss the determination of cost of acquisition of Share/ stock of company acquired on consolidation & division of share capital into shares of larger or smaller amount/ conversion of share into stock or vice-versa/ conversion of one kind of shares in other.

Ans: The cost of acquisition shall be determined as under -

Share/ stock of company acquired on consolidation & division of share capital into shares of larger or smaller amount/ conversion of share into stock or vice-versa/ conversion of one kind of shares in other: Cost of acquisition of such share or stock = Cost calculated with reference to the cost of acquisition of the shares or stock from which such share or stock is derived.

Illustration 16 - Computation of Capital Gains in case of sub-division of shares: In April, 2001, S subscribed to the first issue of equity capital of a public limited company (face value of each share was Rs. 100) to the extent of Rs. 25,000. In 2005, the company converted the face value of its shares from Rs. 100 to Rs. 10 each. Half of the holdings of the shares held by S was sold by him in October, 2020 for Rs. 50,000. S had to pay a brokerage of 2% on sale. What is the nature of gains realised and compute the same. The shares are transferred otherwise than through recognized stock exchange. (May 1998)

Solution: Computation of Capital Gain (amounts in Rs.) –

Full value of consideration [WN]	50,000
Less: Expenses on transfer i.e. brokerage @ 2%	1,000
Net consideration	49,000
Less: Indexed cost of acquisition (Rs. 12,500 $\times$ 301 $\div$ 100)	37,625
Long-term capital gains	11,375

Working Note: No. of original shares = 250 shares of Rs. 100 each. On sub-division of share capital from face value of Rs. 100 to Rs. 10, the total number of shares = 2,500 shares of Rs. 10 each.

14. List the cases where benefit of indexation is not available even in case of long-term capital assets.

Ans: The cases where benefit of indexation is not available even in case of long-term capital assets are as follows -

- (1) Transfer of a bond or a debenture other than capital indexed bonds issued by the Government or Sovereign Gold Bond issued by the Reserve Bank of India under the Sovereign Gold Bond Scheme, 2015.
- (2) Transfer of undertaking or division in a slump sale under section 50B.
- (3) Transfer of shares/debentures of an Indian company purchased by a non-resident in foreign currency.
- (4) Transfer of units purchased in foreign currency by an assessee covered under section 115AB.
- (5) Transfer of bonds or shares purchased in foreign currency by an assessee covered under section 115AC.
- (6) Transfer of global depository receipts by a resident employee of an Indian company under section 115ACA.
- (7) Transfer of securities by foreign institutional investors under section 115AD.
- (8) Transfer of a foreign exchange asset by a non-resident Indian under section 115D.
- (9) Transfer of equity shares or equity-oriented mutual fund units or units of business trust as provided in Section 112A.

CAPITAL GAINS IN SPECIAL CASES**15. A person receives money from an insurer on account of damage to a capital asset resulting from accidental fire. Whether such money shall be taxable as capital gains Rs. (3 Marks, CS Dec. 2008)**

Ans: The relevant provisions are discussed as under -

- (1) **Capital gains in case of damage or destruction of capital asset [Section 45(1A)]:** Where any person receives, at any time during any previous year, any money or other assets under an insurance from an insurer on account of damage to, or destruction of, any capital asset, as a result of -
 - (a) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or
 - (b) riot or civil disturbance; or
 - (c) accidental fire or explosion; or
 - (d) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war), then, any profits or gains arising from receipt of such money or other assets shall be taxable as capital gains, where-
 - (a) Full value of consideration: Value of money plus fair market value of assets on the date of such receipt.
 - (b) Year of taxability: Previous year in which such money or other asset was received.
- (2) **No taxability in other cases:** However, where damage/destruction is not attributable to any of the reasons aforesaid, there will be no charge of capital gains, as there can be no 'transfer' without existence of capital asset at the time of transfer. - *Vania Silk Mills P Ltd. v. CIT* [1991] 191 ITR 647 (SC)
- (3) **Computation of capital gains in respect of such assets:** As per board's circular, capital gains would be worked out in respect of assets which get destroyed, etc., as per the provisions of Sections 48 and 50, as the case may be, by taking the insurance money or the market value of the asset received from the insurer as the "full value of consideration". Further, adjustment for cost inflation index will be made for non-depreciable assets and for depreciable assets, the written down value of such assets will be reduced from the block of assets as provided for in Section 43(6).

Illustration 17 - Insurance compensation on damage/ destruction of capital asset: Mr. A is an individual carrying on business. His stock and machinery were damaged and destroyed in a fire accident. The value of stock lost (total damaged) was Rs. 6,50,000. Certain portion of the machinery could be salvaged. The opening WDV of the block as on 1-4-2020 was Rs. 10,80,000. During the process of safeguarding machinery and in the fire fighting operations, Mr. A lost his gold chain and a diamond ring, which he had purchased in April, 2005 for Rs. 1,20,000. The market value of these two items as on the date of fire accident was Rs. 1,80,000. Mr. A received the following amounts from the insurance company:

- (i) Towards loss of stock = 4,80,000
- (ii) Towards damage of machinery = Rs. 6,00,000
- (iii) Towards gold chain and diamond ring = Rs. 4,00,000

Briefly comment on the tax treatment of the above three items. (7 Marks, Nov. 2006)

Solution: The taxability of the aforesaid items has been discussed herein below -

- (i) **Treatment of compensation in respect of stock-in-trade:** Stock-in-trade is not a capital asset, hence its loss is a trading loss which will be allowed as deduction in computing income under the head Profits and gains of business or profession.

The whole of the value of stock can be claimed as deduction; and the insurance compensation received can be assessed as taxable business receipt. Alternatively net loss of stock-in-trade = Value of stock - Insurance compensation received = Rs. 6,50,000 - Rs. 4,80,000 = Rs. 1,70,000 can be claimed as deduction.

- (ii) **Treatment of compensation in respect of machinery:** Since the machinery has been directly destroyed by fire, therefore, the compensation has been received under circumstances referred to in section 45(1 A). Accordingly, the capital gains shall be computed as follows -

(amounts in Rs.)

Particulars	Machinery
Full value of consideration (being insurance compensation received) Less: Cost of acquisition being : WDV of the block of machinery	6,00,000 10,80,000
Short-term Capital Loss	-4,80,000

- (iii) **Treatment of compensation in respect of gold chain and ring :** Since the gold chain and diamond ring has been destroyed during fire fighting operation (the immediate cause thereof being the fire). Therefore, the compensation has been received under circumstances referred to in Section 45(1 A). Accordingly, the capital gains shall be computed as follows -

(amounts in Rs.)

Particulars	Gold Chain & Ring
Full value of consideration (being insurance compensation received)	4,00,000
Less: Indexed cost of acquisition diamond ring and Gold chain (Rs. 1,20,000 $\times$ 301 -117)	3,08,718
Long-term Capital Gains	91,282

Note : It is assumed that both the breaking out of the fire and receipt of insurance compensation took place during the previous year 2020-21 and whole of the insurance compensation has been received in cash.

16. Discuss the tax implications arising consequent to conversion of a capital asset into, stock-in-trade of business and its subsequent sale. (6 Marks: May 2000, CS Inter Dec. 2004, May 2007)

Ans: The tax implications are as under -

- (1) **Capital gains in case of conversion of a capital asset into stock-in-trade [Section 45(2)] :** As per Section 45(2), In case of conversion of a capital asset into, or its treatment, by the owner, as stock-in-trade of a business carried on by him, the profits or gains arising shall be chargeable to tax as Capital gains, where -

- (a) Full value of consideration = Fair market value of the asset on the date of such conversion or treatment.
- (b) Year of taxability = Previous year in which such stock-in-trade is sold or otherwise transferred by him.

- (2) **Business Profits :** Further, there will be business income in the year of transfer chargeable to tax under the head "Profits and Gains of Business or Profession", which shall be computed as = Sale price of stock less FMV of stock on the date of conversion.

Note: In this case, transfer takes place in the year of conversion, so CII of the year of conversion is used for computation of capital gains.

Illustration 18 - Computation of capital gains in case of conversion of a capital asset into stock-in-trade: Aarnav converts his plot of land purchased in July, 2003 for Rs. 80,000 into stock-in-trade on 31st March, 2020. The fair market value as on 31st March, 2020 was 2,50,000. The stock-in-trade was sold Rs. 2,75,000 in the month of January 2021. Find out the taxable income, if any, and, if so, under which 'head of income' and for which Assessment Year Rs. (5 Marks, May 2008)

Cost Inflation Index: FY 2003-04 = 109; FY 2019-20 = 289 and FY 2020-21 = 301.

Solution: Conversion of capital asset into stock-in-trade is transfer exigible to capital gains tax, but the capital gains are charged to tax in the year of sale of stock-in-trade. The tax implications are

(amounts in Rs.) -

Full value of consideration (FMV on the date of conversion)	2,50,000
Less: Indexed cost of acquisition (Rs. 80,000 $\times$ 280 $\div$ 109) [WN]	2,12,110
Long-term capital gains taxable in assessment year 2021-22	37,890
Sale price of stock	2,75,000
Less: Cost of stock being FMV as on the date of conversion	2,50,000
Business income taxable in assessment year 2021-22	25,000

Working Note: Since plot of land is converted into stock in trade therefore transfer takes place in the year of conversion, hence cost inflation index of the year of conversion (i.e., F.Y. 2019-20) shall be taken.

17. Discuss the chargeability of capital gains in case of transfer of shares held by the assessee in Demat form.

Ans: Capital gains in case of transfer of shares held by depository [Section 45(2A)] : Where any person has, at any time during the previous year, any beneficial interest in any securities, then -

- (i) profits or gains arising from transfer made by the depository or participant of such beneficial interest in respect of securities shall be chargeable to tax as the income of the beneficial owner of the previous year in which such transfer took place; and
- (ii) shall not be regarded as income of the depository who is deemed to be the registered owner of securities. Further, the cost of acquisition and the period of holding of securities shall be determined on the basis of the first-in- first-out (FIFO) method.

18. Explain in brief the tax liability in the hands of partner/member transferring the capital asset to firm /AOP/BOI.

Ans: Capital Gains in case of transfer of capital asset by a partner or member to a firm or AOP or BOI [Section 45(3)]: According to Section 45(3), the profits or gains arising from the transfer of a capital asset by a partner or member to a firm or other association of persons or body of individuals (not being a company or a co-operative society), by way of capital contribution or otherwise, shall be taxable as capital gains, where -

- (a) Full value of consideration = Amount recorded in the books of account of the firm, association or body as the value of the capital asset.
- (b) Year of taxability = Previous year in which such transfer takes place.
- (c) Taxability in the hands of = Partner/member.

Illustration 19 - Capital Gains on transfer of capital asset by a partner to firm: X and Y formed a partnership firm. Just after formation of the partnership, X brought the following assets into the firm on 13th October 2020 as his capital contribution - (amounts in Rs.)

Particulars	House property	Gold ornaments
Market value of the property on the date of transfer	8,20,000	50,000
Amount recorded in the books of firm	9,50,000	60,000
Actual cost	2,62,500	36,600
Year of acquisition	2001-02	2018-19

What tax consequences will X have to face in respect of the above transaction? What will your answer be if X brings the above assets otherwise than by way of his capital contribution?

Solution : Transfer of capital asset by a partner to his firm, by way of his capital contribution or otherwise, is eligible to capital gains tax under section 45(3) in the hands of the partner in the year in which transfer takes place.

Computation of Capital Gains of X (amounts in Rs.) –

Particulars	House property	Gold ornaments
Full value of consideration (amount recorded in books of the firm)	9,50,000	60,000
Less: Cost of acquisition (Indexed cost of house = Rs. 2,62,500 $\times$ 301 $\div$ 100)	7,90,125	36,600
LTCG on House/ STCG on Gold Ornaments	1,59,875	23,400

If X brings the assets otherwise than by way of capital contribution, then also, the same taxability shall arise in his hands.

19. Explain in brief the tax consequences in case of transfer of the capital asset by firm /AOP/ BOI u/s 45(4).

Ans: **Capital Gains in case of distribution of capital asset by firm or AOP or BOI to partners or members [Section 45(4)]:** The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or a co-operative society) or otherwise, shall be taxable as capital gains, where -

- (a) Full value of consideration = Fair market value of the asset on the date of such transfer.
- (b) Year of taxability = Previous year in which such transfer takes place.
- (c) Taxable in the hands of = firm, association or body.

- It was held in *P. P. Menon v. CIT* [2010] 325 ITR 122 (Ker) that the distribution of capital asset on dissolution of firm/ AOP/BOI is a transfer under section 45(4), thus, the period of holding in the hands of partner/member shall be taken from the date of such distribution and the cost of acquisition for such partner/member shall be taken at the value specified under section 45(4).
- Distribution of assets on retirement of partners is also covered under section 45(4).
- Since the tax treatment accorded to a LLP and a general partnership is the same, the conversion from a general partnership firm to an LLP will have no tax implications if the rights and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. However, if there is a change in rights and obligations of partners or there is a transfer of asset or liability after conversion, then the provisions of section 45 would get attracted.

Illustration 20 - Capital Gains on distribution of capital asset by AOP to members on dissolution: Mr. Roy and S Ltd. are members of 'Ram & Associates', an AOP. Ram & Associates was dissolved on 14th February, 2021 and the following assets were distributed to the members

Particulars	(amounts in Rs.)	
	House property (given to Mr. Roy)	Listed Govt, securities (given to S Ltd.)
FMV as on 14th February, 2021	17,00,000	10,00,000
Amount recorded in agreement of sale	12,00,000	11,00,000
Cost of acquisition	4,20,000	7,70,000
Date of acquisition	01-04-2000	15-09-2020
FMV of the asset as on 1-4-2001	4,50,000	

What are the tax consequences of these transactions?

What will be your answer if 'Ram & Associates' is a co-operative society?

Solution: Any distribution of capital asset by a firm/AOP/BOI (other than company or co-operative society) on dissolution or otherwise is eligible to capital gains in the hands of such firm/AOP/BOI. Computation of capital gains of Ram & Associates (amounts in Rs.):

Particulars	House property	Listed Govt, securities
Full value of consideration (FMV as on the date of transfer)	17,00,000	10,00,000
Less: Cost of acquisition (Rs. 4,50,000 $\times$ 301/100)	13,54,500	7,70,000
LTCG on House/STCG on Listed Securities	3,45,500	2,30,000

Note: If Ram & Associates is a co-operative society, then Section 45(4) would not have applied to it.

20. *What shall be the tax implications of capital gains arising on compulsory acquisition of any capital asset under any law.*

Ans: The tax implications are discussed as under -

- (1) **Compulsory acquisition of any capital asset under any law [Section 45(5)]:** Where the capital gain arises from the transfer of a capital asset, being a transfer by way of compulsory acquisition under any law, or a transfer consideration for which was determined or approved by the Central Government or the RBI, and the compensation or the consideration for such transfer is enhanced or further enhanced by any court, Tribunal or other authority, there shall be the following consequences -

- (a) **Full value of consideration:** Amount of compensation/consideration so determined to be payable to the assessee.
- (b) **Year of taxability:** Previous year in which such compensation or part thereof, or such consideration or part thereof, is first received by the assessee.
- (c) **In case compensation is enhanced:** The amount by which the compensation/consideration is enhanced or further enhanced by the court, Tribunal or other authority shall be taxable as capital gains in the previous year in which such enhanced amount is received by the assessee, where full value of consideration shall be taken as the amount of enhanced compensation and the cost of acquisition and cost of improvement shall be taken as NIL.

Compensation received by interim order - Taxable in the year when final order is received: If any amount of compensation received in pursuance of an interim order of a court, Tribunal or other authority shall be deemed to be income chargeable under the head "Capital gains" of the previous year in which the final order of such court, Tribunal or other authority is made.

- (d) **In case compensation is reduced :** Where the capital gains have already been assessed in any previous year and subsequently in any previous year, such compensation/consideration is reduced by any court, Tribunal or other authority, then such assessed capital gains of that year shall be recomputed by taking the reduced compensation/ consideration as the full value of the consideration.
 - (e) **Compensation taxable in hands of legal heirs:** In case the enhanced compensation is received by any other person due to the death of the transferor or any other reason, the amount will be deemed to be capital gain of the recipient.
- (2) **Interest received on compensation or enhanced compensation - Taxable as Income from other sources :** The interest, if any, received on enhanced compensation shall be taxable in the previous year in which it is received, as income under the head 'Income from Other Sources', where taxable amount = 50% of such interest.
- (3) **Compulsory acquisition of urban agricultural land - Exempt [Section 10(37)]:** In the case of an assessee, being an Individual or a Hindu Undivided Family, any income chargeable under the head "Capital gains" arising from the transfer of agricultural land shall be exempt, where -
- (a) such land is situated in any urban area;
 - (b) such land, during the period of 2 years immediately preceding the date of transfer, was being used for agricultural purposes by such Hindu undivided family or individual or his parents;
 - (c) such transfer is by way of compulsory acquisition under any law, or a transfer consideration for which is determined or approved by the Central Government or the Reserve Bank of India;

- (d) such income has arisen from the compensation or consideration for such transfer received by such assessee on or after 01-04-2004.

Illustration 21 - Capital gains on compulsory acquisition under any law: The house property of Abhinav is compulsorily acquired by the Government for Rs. 20,00,000 vide Notification issued on 12th March 2020. Abhinav has purchased the house in 2007-08 for Rs. 8,00,000. The compensation is received on 15th April 2020. The compensation is further enhanced by an order of the court on 5th April 2021 and a sum of Rs. 2,00,000 is received as enhanced compensation on 25th May 2021. Abhinav wants to claim full exemption of the capital gains. Advise Abhinav in this regard. Compute the capital gains and determine the year in which it is taxable. (CS June 2007)

Solution: Mr. Abhinav's house property is compulsorily acquired by the Government on 12th March 2019 hence, the year of transfer is the financial year 2019-20. However, as specified in Section 45(5), the capital gains arising due to such acquisition shall be taxable as capital gains in the previous year in which the compensation or part thereof is first received. Thus, the liability for capital gains shall arise in previous year 2020-21 (assessment year 2021-22).

Computation of long term capital gains for the assessment year 2021-22: (amount in Rs.)

Full value of consideration	20,00,000
Less: Indexed cost of acquisition (Rs. 8,00,000 $\times$ 289 $\div$ 129)	17,92,248
Long term capital gains	2,07,752

Treatment of enhanced compensation: LTCG due to enhanced compensation = Rs. 2,00,000, which will be chargeable to tax in the year in which it is received i.e. previous year 2021-22 (assessment year 2022-23).

Exemption from capital gain [Section 54 read with Section 54H]: In order to claim full exemption, Mr. Abhinav should invest the amount of capital gains in acquiring/ constructing another house property. The investment must be made within 2 years (in case of acquisition) or 3 years (in case of construction) from dates of receipt of compensation i.e. 15-4-2020 (for capital gains of Rs. 2,07,752) and 25-5-2021 (for capital gains of Rs. 2,00,000). (Discussed later in this chapter).

Illustration 22 - Compensation by Interim order: Mr. X purchased an urban land on 25-04-2006 for Rs. 6,00,000. His property was acquired in land acquisition proceedings on 15-07-2012 and award of Rs. 15,00,000 was determined and the same was paid on 18-07-2012. The assessee filed an appeal against the award so determined. The land acquisition court, by order dated 01-05-2013, enhanced the compensation amount by Rs. 10,00,000, which was not paid to the assessee on account of the contest by the State through an appeal. The High Court by interim order allowed the assessee to withdraw 50% of the enhanced compensation on 15-07-2020 and the assessee received the amount in the relevant financial year. The court by final order dated 01-10-2021 held the enhancement of compensation as valid and assessee received the balance award on 17-12-2021. Discuss the taxability of the said compensation.

Solution: The original compensation will be taxable in the year of receipt. However, the amount of compensation received in pursuance of an interim order of the court, Tribunal or other authority shall be deemed to be income chargeable under the head 'Capital gains' in the previous year in which the final order of such court, Tribunal or other authority is made. Hence, the relevant computation will be as under:

Computation of long term capital gains on receipt of original compensation

	(amount in Rs.):
Full value of consideration	15,00,000
Less: Indexed cost of acquisition (Rs. 6,00,000 $\times$ 200 $\div$ 122)	9,83,607
Long term capital gains taxable in AY 2013-14	5,16,393

Computation of long term capital gains on receipt of enhanced compensation (amount in Rs.):	
Full value of consideration	10,00,000
Less: Indexed cost of acquisition	NIL
Long term capital gains taxable in AY 2022-23	10,00,000

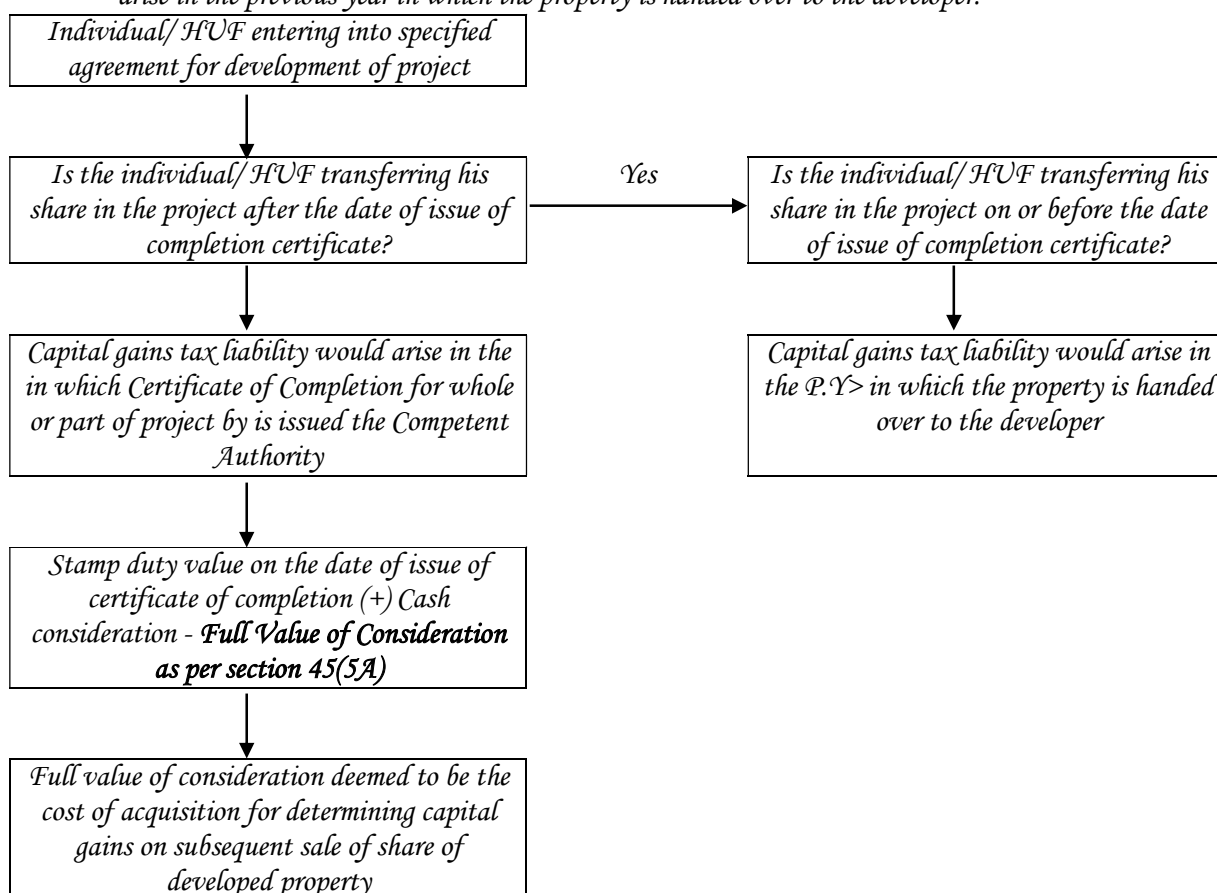
Note : The interim compensation of Rs. 5,00,000 will not be taxable in AY 2021-22 but will be taxable when the final award is received i.e. AY 2022-23.

21. Explain special provisions for computation of capital gains in case of joint development agreement as per Section 45(5A) of the Income-tax Act, 1961.

Ans: Special provisions for computation of capital gains in case of joint development agreement [Section 45(5A): The special provisions for computation of capital gains in case of joint development agreement as per Section 45(5A) of the Act are as under —

- (1) **Applicability:** Individual or Hindu undivided family.
- (2) **Capital Asset transferred:** Land or building or both, under a specified agreement.
"Specified agreement" means a registered agreement in which a person owning land or building or both, agrees to allow another person to develop a real estate project on such land or building or both, in consideration of a share, being land or building or both in such project, whether with or without payment of part of the consideration in cash.
- (3) **Year of taxability:** Capital gains shall be chargeable to income-tax as income of the previous year in which the certificate of completion for the whole or part of the project is issued by the competent authority. "Competent authority" means the authority empowered to approve the building plan by or under any law for the time being in force.
- (4) **Full value of consideration:** The stamp duty value, on the date of issue of the said certificate, of his share, being land or building or both in the project, as increased by the consideration received in cash, if any, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset. "Stamp duty value" means the value adopted or assessed or assessable by any authority of the Government for the purpose of payment of stamp duty in respect of an immovable property being land or building or both.

- (5) **Consequences if the assessee transfers his share in the project on or before the date of issue of the completion certificate :** Where the assessee transfers his share in the project on or before the date of issue of the said certificate of completion, and the capital gains shall be deemed to be the income of the previous year in which such transfer takes place and the provisions of this Act, other than the provisions of Section 45(5A), shall apply for the purpose of determination of full value of consideration received or accruing as a result of such transfer. Thus, Capital gains tax liability would arise in the previous year in which the property is handed over to the developer.



22. **State the provisions relating to the computation of capital gains in the hands of shareholder of a company on distribution of assets upon liquidation. (May 2002, Nov. 2002)**

Ans: **Capital gains on distribution of assets by company in liquidation [Section 46]:** As per the provisions of the said section, where the assets of a company are distributed to its shareholders on its liquidation, the following tax implications shall arise -

- (1) **Taxability in the hands of company and shareholder:** Such distribution shall not be regarded as a transfer in the hands of the company; and any money or other assets received by a shareholder from the company shall be chargeable to income-tax in his hands under the head "Capital gains".
- (2) **Computation of capital gains:** The capital gains in the hands of shareholder shall be computed as follows -

Money so received or market value of other assets received on liquidation on the date of distribution	XX
Less: Amount assessed as deemed dividend under section 2(22)(c) to the extent of accumulated profits as on the date of liquidation	XX
Full value of consideration for the purposes of section 48	XX
Less: Indexed cost of acquisition (or cost of acquisition) of the shares held in that company	XX
Long-term Capital Gains or Short-term Capital Gains	XX

- (3) **Cost of acquisition of assets received on liquidation in hands of shareholders [Section 55(2)]:** In case of transfer of any capital asset received by the shareholder on liquidation of a company, which had been assessed under section 46, then the cost of acquisition will be the fair market value as on the date of distribution.

Illustration 23 - Computation of capital gains on distribution of assets by companies in liquidation: Mr. Raghu purchased 10,000 equity shares of AB Avenues Private Limited on 25-03-2005 for Rs. 1,20,000. The company went into liquidation on 31-07-2020. The following is the summarized financial position of the company as on 31-07-2020.

Liabilities	Rs.	Assets	Rs.
60,000 equity shares of Rs. 10 each	6,00,000	Agricultural lands in urban area	22,00,000
General reserve	40,00,000	Cash at bank	32,22,212
Provision for taxation	8,22,212		
Total	54,22,212	Total	54,22,212

The assets remaining after discharging liability for income tax were distributed to the shareholders in the proportion of their shareholding. The market value of agricultural land as on 31-07-2019 is Rs. 60,00,000.

The agricultural land received as above was sold by Mr. Raghu on 28-02-2020 for Rs. 15,00,000. Discuss the tax implications in the hand of the company and Mr. Raghu.

The cost inflation indices are F.Y. 2004-05:113 and F.Y. 2019-20 : 289.

(Modified PCC May 2008, 8 Marks)

Solution:

(1) Tax implications in the hands of the company :

- (i) According to Section 46(1) of the Act, distribution of capital assets amongst the shareholders on liquidation of the company is not regarded as "transfer" in the hands of the company. Consequently, there will be no capital gains in the hands of the company.
- (ii) According to Section 2(22) (c), any distribution made to the shareholders of a company on its liquidation, to the extent to which distribution is attributable to the accumulated profits of the company immediately before its liquidation would be deemed as dividend. Therefore, Rs. 40,00,000, being the amount of general reserves on the date of liquidation would be deemed as dividend. THE Company will be liable to deduct tax at source under section 194@7.5%.

(2) **Tax implications in the hands of Mr. Raghu (shareholder):**

- (i) On liquidation (31-07-2019): Where a shareholder on the liquidation of a company receives any money or other assets from the company, he shall be chargeable to income-tax under the head "capital gains" in respect of the money so received or the market value of the other assets on the date of the distribution, as reduced by the amount assessed as dividend and the sum so arrived at shall be deemed to be the full value of consideration.

(amount in ₹.)

Mr. Raghu holds 1/6th of the shareholding of the company	
Market value of agricultural land received (₹. 60 lakhs $\times$ 1/6th) + Cash at bank [1/6th of 32,22,212 - ₹. 8,22,212]	14,00,000
Less: Deemed dividend u/s 2(22)(c) i.e., 1/6th of ₹. 40,00,000	6,66,667
Full value of consideration	7,33,333
Less: Indexed cost of acquisition of Shares (₹. 1,20,000 $\times$ 301/113)	3,19,646
Long term capital gains	4,13,687

- (ii) **On sale of agriculture land :** Hence, the short-term capital gains in the hands of Mr. Raghu (shareholder) at the time of sale of urban agricultural land should be computed as follows :

(amount in ₹.)

Full value of consideration	15,00,000
Less: Fair market value of the agricultural land on the date of distribution [W ^N]	10,00,000
Short term capital gain	5,00,000

Working Note : Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to capital gains in respect of that asset, the cost of acquisition means the fair market value of the asset on the date of distribution. Dividend under section 2(22)(c) amounting to ₹. 6,66,667 will be exempt under section 10(34).

23. **Discuss the tax consequences of capital gains under section 46A on buy-back of own shares or other specified securities by a company. (May 2001)**

Ans: **Capital gains on purchase by company of its own shares or other specified securities [Section 46A] :** Where a holder of specified securities (other than shares) receives any consideration from any company for purchase of its own shares or other specified securities held by him, then there shall be the capital gains with the following tax implications -

(1) **Taxability in the hands of the holder of specified securities :**

- (a) **Capital gains :** Difference between the cost of acquisition and the value of consideration received by the holder of other specified securities.
- (b) **Year of taxability :** Previous year in which such specified securities are purchased by the company.

Note: As far as shares are concerned, this provision would be attracted in the hands of the shareholder only if the shares are bought back by a company, other than a domestic company.

- (2) **Buy back in case of Listed /Unlisted Company - Company liable to pay tax @ 23.296% - Not taxable in hands of shareholders:** In case of listed /unlisted company, such company is liable to pay tax on such buy back of shares under section 115QA @ 23.296%. In such case the amount received by the shareholders on buy back of shares is exempt from tax under section 10(34A).

- (3) **Summary:** Taxability in case of buyback of shares and other specified securities can be summarized as under:

Taxability in the hands of the	Buyback of shares by domestic companies	Buyback of shares by a company, other than a domestic company	Buyback of specified securities by any company
Company	Subject to additional income-tax @ 23.296%.	Not subject to tax in the hands of the company.	Not subject to tax in the hands of the company.
Shareholders	Income arising to shareholders of listed/unlisted companies is exempt under section 10(34A)	Income arising to shareholder taxable as capital gains u/s 46A.	Income arising to holder of specified securities taxable as capital gains u/s 46A

24. **Explain computation of capital gain in case of depreciable asset u/s 50. (6 Marks, May 2000, May 2008)**

Ans: In case of depreciable assets, the capital gains shall be computed as per the provisions of Section 50 and 50A, which are as follows -

- (1) Where capital asset transferred is forming part of a block of assets in respect of which depreciation has been allowed under section 32(1) (ii) [Section 50]: The capital gains shall be computed as follows -

- (a) **Block of assets does not cease to exist but WDV of block is reduced to zero [Section 50(1)]:**

Full value of consideration	XX
Less: (1) Expenditure incurred wholly and exclusively in connection with such transfer	XX
(2) WDV of the block of assets at the beginning of the previous year	XX
(3) Actual cost of asset, falling within the block of assets, acquired during the previous year	XX
Short term Capital Gains	XXX

- (b) **Block of assets ceases to exist due to the sale of all assets falling in that block [Section 50(2)]:**

Full value of consideration	XX
Less: (1) Expenditure incurred wholly and exclusively in connection with such transfer	XX
(2) WDV of the block of assets at the beginning of the previous year	XX
(3) Actual cost of asset, falling within the block of assets, acquired during the previous year	XX
Short term Capital Gains/Loss	XXX

- (2) *Where capital asset is an asset of power generating units on which depreciation allowed under section 32(1)(i) [Section 50A]:*
- (a) *If moneys payable is less than WDV:* There will be terminal depreciation under section 32(1)(iii) which is equal to WDV less Moneys Payable.
- (b) *If moneys payable exceeds WDV:*
- (i) *Moneys payable does not exceed actual cost:* Balancing Charge u/s 41(2) = Moneys Payable - WDV
- (ii) *Moneys payable exceeds actual cost:* Balancing Charge u/s 41(2) = Actual Cost - WDV; and Short-term/Long-term capital gains = Moneys Payable - Actual Cost.

Illustration 24 - Computation of capital gain in case of depreciable Asset: The written down value of the block of assets of Rosy Ltd. as on 1st April, 2020 was Rs. 5 lakhs. An asset of the same block was acquired on 11th May, 2020 for Rs. 3 lakhs. There was a fire on 18th September, 2020 and the assets were destroyed by fire and the assessee received a sum of Rs. 11 lakhs from the insurance company. Compute the capital gain assuming -

- (i) All the assets were destroyed by fire; and
- (ii) Part of the block of assets was destroyed by fire.
- What will be the answer if assessee received Rs. 6 lakhs from insurance company instead of Rs. 11 lakhs? (CS Dec. 2006)

Solution:

- (1) *If compensation is received for Rs. 11 lakhs:* Here, moneys payable exceeds WDV, thus there will be short-term capital gains which shall be computed as follows (amount in Rs.) -

Written down value of the block on 01-04-2020	5,00,000
Add: Asset acquired during the year	3,00,000
	8,00,000
Less: Sum received from the insurance company	11,00,000
Short term capital Gains	3,00,000

Note : In case (i) and (ii), both, i.e. whether the block is fully destroyed or partly destroyed by fire, there will be STCG of Rs. 3,00,000, since the sum received is more than the WDV of the block. (2) If compensation is received for Rs. 6 lakhs:

- (i) *If the block is fully destroyed:* Short-term capital loss = WDV - moneys payable = Rs. 8 lakhs - Rs. 6 lakhs = Rs. 2 lakhs.
- (ii) *If the block is partly destroyed:* There will be no capital gains. Since the block and WDV both exists, therefore, the balance WDV of Rs. 2 lakhs will be eligible for depreciation.

25. *Does any capital gains arise on the sale of an undertaking as a going concern? OR What is Slump sale? How is capital gain computed in case of a slump sale? (May 2003, May 2006, Nov. 2008)*

Ans: *The capital gains in case of slump sale shall be computed as under -*

- (1) *Slump Sale [Section 2(42C)]:* It means transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.

- (2) **Special provision for computation of capital gains in case of slump sale [Section 50B]** : Any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains in the previous year in which such transfer took place.
Where the capital asset, being one or more undertakings, was owned and held by an assessee for not more than 36 months immediately preceding the date of its transfer, the capital gains will be 'short term capital gains'; otherwise the same shall be long-term capital gains.

- (3) **Computation of capital gains:** The capital gains shall be computed as follows -

Full Value of consideration being lump sum consideration	XXX
Less: Expenditure incurred wholly and exclusively in connection with such transfer	XXX
Less: Net worth of the undertaking being the cost of acquisition and improvement	XXX
Short term/Long term Capital gains	XXX

Computation of net-worth:

Aggregate value of total assets of the undertaking or division (ignoring any change in the value of assets on account of revaluation of assets) i.e. -		
In case of depreciable assets, the WDV of the block as per section 43(6)	xx	
In case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD	Nil	
In case of other assets, the book value	xx	XXX
Less: Value of liabilities of such undertaking or division as appearing in its books		XXX
Net worth of the undertaking or division		XXX

Notes:

- (1) No indexation benefit shall be available even in case of long-term capital asset.
- (2) **Certificate by a Chartered Accountant:** Every assessee, in case of slump sale, shall furnish in the prescribed form a report of an Chartered Accountant before the specified date referred to in section 44AB indicating the computation of net worth and certifying that the net worth of the undertaking or division has been correctly arrived at. [Amended by Finance Act, 2020 w.e.f. 01-04-2020 i.e. AY 2020-21]

Illustration 25 - Computation of Capital Gains in case of slump sale: Mr. A is a proprietor of Akash Enterprises having 2 units. He transferred on 1-4-2020 his unit 1 by way of slump sale for a total consideration of Rs. 25 lakhs. The expenses incurred for this transfer were Rs.28,000. His Balance Sheet as on 31-3-2020 is as under (amount in Rs.):

Liabilities	Total	Assets	Unit-1	Unit-2	Total
Own Capital	15,00,000	Building	12,00,000	2,00,000	14,00,000
Revaluation Reserve (for Building of unit 1)	3,00,000	Machinery	3,00,000	1,00,000	4,00,000
Bank loan (70% for unit 1)	2,00,000	Debtors	1,00,000	40,000	1,40,000
Trade creditors (25% for unit 1)	1,50,000	Other assets	1,50,000	60,000	2,10,000
Total	21,50,000	Total	17,50,000	4,00,000	21,50,000

Other information:

- (i) Revaluation reserve is created by revising upward the value of the building of unit 1.
 - (ii) No individual value of any asset is considered in the transfer deed.
 - (iii) Other assets of unit 1 include patents acquired on 01-07-2018 for Rs. 50,000 on which no depreciation has been charged.
- Compute the capital gain for the assessment year 2021-22. (5 Marks, IPCC Nov. 2010)

Solution: Computation of capital gains on slump sale of Unit 1 as per section 50B

(amounts in Rs.):	
Full value consideration	25,00,000
Less: Expenses on sale	28,000
Net Consideration	24,72,000
Less: Net worth [WN]	12,50,625
Long term capital gain (Assuming Unit 1 was held for more than 36 months)	

Working Note: Computation of net worth of Unit 1 of Akash Enterprises (amount in Rs.):

Building (f 12 lakhs - Rs. 3 lakhs on account of revaluation) [Note-2]	9,00,000
Machinery [assumed that this value represents WDV as per section 43(6)]	3,00,000
Debtors	1,00,000
Other assets (Rs. 1,50,000 - Rs. 50,000 for patents considered separately)	1,00,000
WDV of patents as on 01-04-2020 (Rs. 50,000 - Depreciation @ 25% on WDV for 2 years)	28,125
Aggregate value of total assets	14,28,125
Less: Creditors (Rs. 1,50,000 x 25% + Bank Loan Rs. 2,00,000 x 70%)	1,77,500
Net worth	12,50,625

Notes:

- (1) It is assumed that the value of assets shown in the books is WDV as per the Income-tax Act, 1961.
- (2) Revaluation reserve is to be ignored while computing the net worth of the company.

Illustration 26 - Computation of Capital Gains in case of slump sale: Star Enterprises has transferred its unit R to A Ltd. by way of Slump Sale on January 23, 2021. The summarized Balance Sheet of Star Enterprises as on that date is given below:

Liabilities	(Rs. in lacs)	Assets	(Rs. in lacs)
Own Capital	1,750	Fixed Assets:	
Accumulated P&L balance	670	Unit P	200
Liabilities:		Unit Q	150
Unit P	90	Unit R	600
Unit Q	160	Other Assets:	
Unit R	140	Unit P	570
		Unit Q	850
		Unit R	440
Total	2,810	Total	2,810

Using the further information below, compute the Capital Gains arising from slump sale of Unit R for A.Y. 2021-22.

- (i) Slump sale consideration on transfer of Unit R was Rs. 930 lacs.
- (ii) Fixed Assets of Unit R includes land which was purchased at Rs. 110 lacs in the year 2008 and was revalued at Rs. 140 lacs.
- (iii) Other fixed assets are reflected at Rs. 460 lacs. (i.e. Rs. 600 lacs less value of land) which represents written down value of those assets as per books. The written down value of these asset is 1430 lacs.
- (iv) Unit R was set up by Star Enterprises in October, 2006.

Note: Cost of Inflation Indices for the FY 2006-07 and FY 2020-21 are 122 and 301 respectively. (10 Marks, May 2018-NS) Solution: Computation of capital gain on slump sale of Unit R under section SOB:

(Rs. in lakhs)

Sale consideration for the slump sale of Unit R	930
Less: Net worth of Unit R (being cost of acquisition) [WN]	840
Long term capital gain arising on slump sale	90

Working Notes:

(1) Computation of net worth of Unit R;

(Rs. in lakhs)

(A) Value of Fixed assets :	
(i) Land (excluding revaluation)	110
(ii) Other assets [WDV]	430
(B) Other Assets [Book value]	440
Aggregate value of total assets	980
Less: Aggregate value of liabilities	140
Net worth of Unit N	840

- (2) Since Unit R is held for more than 36 months, the capital gains of Rs. 90 lakhs arising on transfer of such unit would be a long term capital gain taxable u/s 112. However indexation benefit is not available in the case of a slump sale.

26. Write short note on special provision for full value of consideration in certain cases, in the context of capital gains liability. (Nov. 2004)

Ans: Full value of consideration in certain cases [Section 50C]: The provisions are as under -

- (1) **Stamp duty value deemed to be full value of consideration in case it exceeds actual consideration :** Where the consideration received/accruing as a result of the transfer by an assessee of a capital asset, being land or building or both, is less than the value adopted/assessed/ assessable by the Stamp Valuation Authority for the payment of stamp duty in respect of such transfer, the value so adopted/assessed/assessable shall be deemed to be the full value of the consideration for the purpose of Section 48.
- (2) **Stamp duty value on the date of agreement to be considered:** Where the date of the agreement fixing the amount of consideration and the date of registration for the transfer of the capital asset are not the same, the value adopted or assessed or assessable by the stamp valuation authority on the date of agreement may be taken for the purposes of computing full value of consideration for such transfer.

However, the above provisions shall apply only in a case where the amount of consideration, or a part thereof, has been received by way of an account payee cheque or account payee bank draft or by use of

electronic clearing system through a bank account or through such other electronic mode as may be prescribed, on or before the date of the agreement for transfer, ((a) Credit Card; (b) Debit Card; (c) Net Banking; (d) IMPS (Immediate Payment Service); (e) UPI (Unified Payment Interface); (f) RTGS (Real Time Gross Settlement); (g) NEFT (National Electronic Funds Transfer), and (h) BHIM (Bharat Interface for Money) Aadhar Pay have been prescribed as mode of electronic payment].

- (3) **Stamp duty value not to be full value of consideration:** Where the value adopted or assessed or assessable by the stamp valuation authority does not exceed 110% of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of Section 48, be deemed to be the full value of the consideration. [Amended by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY 2021-22]
- (4) **Reference to Valuation officer:** The Assessing Officer may refer the valuation of the capital asset to Valuation Officer where -
 - (a) the assessee claims before any Assessing Officer that the value adopted/ assessed/ assessable by the Stamp Valuation Authority exceeds fair market value of the property as on the date of transfer, and
 - (b) the value adopted or assessed or assessable by the Stamp Valuation Authority has not been disputed in appeal or revision or no reference has been made before any other authority, court or High Court.
- (5) **Where the value ascertained by Valuation Officer exceeds the value assessed by the Stamp Valuation Authority:** Where the value ascertained by Valuation Officer exceeds the value adopted/assessed/assessable by the stamp valuation authority, then the value so adopted/assessed/assessable by such authority shall be taken as the full value of the consideration. Thus, in case reference is made to Valuation Officer, the full value of consideration shall be lower of -
 - (a) Value as determined by the Valuation Officer; or
 - (b) Value assessed or adopted or assessable by the Stamp Valuation Authority.
- (6) **Meaning of "assessable":** Assessable means the price which the stamp valuation authority would have adopted or assessed, if it were referred to such authority for the purposes of payment of stamp duty. Accordingly, even if the sale deed has not been registered with the stamp valuation authority and no actual value has been assessed for the payment of stamp duty, the stamp value under this section shall be the value that would have been assessed by the stamp valuation authority.
- (7) **FMV as on 01-04-2001 not to exceed SDV as on that date:** In case of a capital asset, being land or building or both, the fair market value of such asset on 01-04-2001 shall not exceed the stamp duty value, wherever available, of such asset as on the 1-04-2001.

"Stamp duty value" means the value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of an immovable property. [Amended by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY 2021-22]

Illustration 27 - Stamp value - Full value of consideration - Section 50C: From the following information compute taxable Capital gains in hands of X —

- (1) X purchases a plot of land on 10th August, 2008 for Rs. 4,11,000.
- (2) He enters into an agreement with B to transfer the plot of land on 1st May, 2020 for Rs. 80,00,000 (stamp duty value being Rs. 86,00,000).

- (3) On 1st May, 2020, X gets an advance of Rs. 1,00,000 by an account-payee cheque.
 (4) Conveyance deed is registered on 5th June, 2020 (stamp duty value on the date of registration: Rs. 89,00,000).

What would your answer be in case Rs. 1,00,000 is received on 2nd May 2020, instead of 1st May, 2020.

Solution:

- (i) **When X has received an advance on the date of agreement:** In this case, stamp duty value on the date of agreement is different from stamp duty value on the date of registration. X has received an advance of Rs. 1,00,000 by an account-payee cheque on or before the date of agreement. Consequently, stamp duty value on the date of agreement will be taken into consideration. Capital gain will be calculated as follows—

(amount in Rs.)	
Full value of consideration [110% of actual consideration of Rs. 80,00,000 is Rs. 88,00,000. Stamp duty value is Rs. 86,00,000. As stamp duty value does not exceed 110%, of actual consideration, stamp duty value is not considered.]	80,00,000
Less: Indexed cost of acquisition [Rs. 4,11,000 $\times$ 301 $\div$ 137]	9,03,000
Long-term capital gain	70,97,000

- (ii) **When X has received an advance after the date of agreement:** X has received an advance of Rs. 1,00,000 after the date of agreement. Consequently, stamp duty value on the date of registration will be taken into consideration. Capital gain will be calculated as follows —

(amount in Rs.)	
Full value of consideration [220% of actual consideration of Rs. 80,00,000 is Rs. 88,00,000. Stamp duty value on date of registration is Rs. 89,00,000. As stamp duty value exceeds 105% of actual consideration, stamp duty value is taken as full value of consideration.]	89,00,000
Less: Indexed cost of acquisition [Rs. 4,11,000 $\times$ 301 $\div$ 137]	9,03,000
Long-term capital gain	79,97,000

Illustration 28 - Capital gains on Land - Stamp Value to be full value of consideration - Section 50C: Mr. Ramesh purchased a building on 10-04-2001 for a sum of Rs. 35 lakh. The said building was sold by him to Mahesh, for Rs. 90 lakh on 1-1-2021, when the stamp duty value was Rs. 185 lakh. The agreement was entered on the same day and the property was registered on the same day. Discuss tax implications in hands of Ramesh.

What would be your answer if the agreement was entered into on 1-7-2020 when the stamp duty value was Rs. 12.0 lakh. Mr. Ramesh had received a down payment of Rs. 15 lakh by cheque from Mahesh on the date of agreement. Will your answer change if the said sum of Rs. 15 lakhs has been received by cash instead of cheque.

Solution:

- (1) The tax implications in hands of Ramesh shall be as under -
CASE I: In case the agreement has been entered on the date of sale and property has been registered on the same day: Full Value of Consideration = Value fixed by stamp valuation authority, as per the provisions of Section 50C i.e. Rs. 1,85,00,000 on the date of registration will be taken as full value of consideration since the stamp duty value exceeds 110% of the actual consideration and capital gains shall be computed as under: (amount in Rs.)

Full value of consideration [Section 50C]	1,85,00,000
Less: Indexed cost of acquisition ($\text{Rs. } 35,00,000 \times 301 \div 100$)	1,05,35,000
Long-term capital gains	79,65,000

CASE II : In case the agreement has been entered on 1-7-2020 : In this case the stamp duty value on the date of agreement will be considered to compute capital gains since on the date of agreement, sum of Rs. 15 lakh has been received by an account payee cheque and the value adopted or assessed or assessable by the stamp valuation authority exceed 110% of the consideration received as a result of transfer of capital asset. The capital gains shall be computed as under : (amount in Rs.)

Full value of consideration [Section 50C]	1,20,00,000
Less: Indexed cost of acquisition ($\text{Rs. } 35,00,000 \times 301 \div 100$)	1,05,35,000
Long-term capital gains	14,65,000

- (2) Yes, the answer will change in case if on the date of agreement cash has been received instead of an account payee cheque. In such case stamp duty value on the date of agreement shall not be considered but the stamp duty value on the date of registration of property shall be considered and capital gains shall be Rs. 79,65,000.

Illustration 29 - Capital gains on Land- Stamp Value to be full value of consideration : Bala sold his vacant site on 30-09-2020 for Rs. 12,00,000. It was acquired by him on 01-10-1998 for Rs. 1,50,000. The fair market value on 01-04-2001 is Rs. 2,00,000 and the stamp duty value as on 01-04-2001 is Rs. 1,80,000. The State stamp valuation authority fixed the value of the site at the time of transfer at Rs. 13,20,000. Compute income under the head capital gains in the hands of Bala and give your reasons for computation.

Solution: Computation of capital gains of Bala (amounts in Rs.) -

Full value of consideration	[WN-1]	12,00,000
Less: Indexed cost of acquisition $1,80,000 \times 301 \div 100$	[WN-2]	5,41,800
Long-term capital gains		6,58,200

Working Note:

- (1) Since the value adopted or assessed or assessable by the stamp valuation authority i.e. Rs. 13,20,000 does not exceed 110% of the consideration received i.e. Rs. 12,00,000, the consideration so received or accruing as a result of the transfer shall be deemed to be the full value of the consideration.
- (2) In case of a capital asset, being land or building or both, the fair market value of such asset on 01-04-2001 shall not exceed the stamp duty value, wherever available, of such asset as on 01-04-2001. Hence, in this case the SDV as on 01-04-2001 i.e. Rs. 1,80,000 shall be taken as cost of acquisition.

Illustration 30 - Computation of Capital gains - Implications of Section 50C :

Mr. Vaibhav sold a house, held as a capital asset, to his friend Mr. Dhanush on 1st December, 2020 for a consideration of Rs. 25,00,000. The Sub-Registrar refused to register the document for the said value, as according to him, stamp duty valuation based on State Government guidelines was Rs. 45,00,000. Mr. Vaibhav preferred an appeal to the Revenue Divisional Officer, who fixed the value of the house as Rs. 35,00,000 (Rs. 22,00,000 for land and the balance for building portion). The differential stamp duty was paid, accepting the said value

determined. Mr. Vaibhav had purchased the land on 1st June, 2007 for Rs. 6,10,000 and completed the construction of the house on 21st December, 2019 for Rs. 14,00,000.

Briefly discuss the tax implications in the hands of Mr. Vaibhav and compute the capital gains chargeable to tax. (4 Marks, Nov. 2013)

Solution: Computation of capital gains chargeable to tax of Mr. Vaibhav (amount in Rs.):

Particulars	Land	Building
Full value of consideration (Section 50C) [WN]	22,00,000	13,00,000
Less: Indexed cost/cost of acquisition (Rs. 6,10,000 $\times$ 301 $\div$ 129)	14,23,333	14,00,000
Long-term capital gain	7,76,667	
Short-term capital gain/loss		-1,00,000
Taxable Capital Gains		6,76,667

Working Notes:

- (1) In case, a land is held by the assessee for more than 24 months but the building constructed over it is held for not more than 24 months, then there will be long-term capital gains on sale of the land and short-term capital gains on sale of building - *CIT v. Citibank N.A.* [2003] 261 ITR 570 (Bom.). Hence, the capital gains have been computed accordingly.
- (2) As per provisions of Section 50C, if the stamp duty value adopted by stamp valuation authority is disputed in appeal and the same is reduced by the appellate authority, the reduced value shall be taken to be full value of consideration for computing the capital gains chargeable to tax.
Since the value adopted or assessed or assessable by the stamp valuation authority as revised by Revenue Divisional Officer i.e. Rs. 35,00,000 exceed 110% of the consideration received i.e. Rs. 25,00,000, Value fixed by stamp valuation authority, as per the provisions of Section 50C shall be deemed to be the full value of the consideration i.e. 35,00,000.
- (3) Short term capital loss can be set off from long term capital gains in accordance with provisions of Section 74 of the Income-tax Act, 1961.

Illustration 31 - Computation of Capital gains - Implications of Section 50C: Mr. T inherited a house in Jaipur under will of his father in May, 2002. The house was purchased by his father in January, 1980 for Rs. 2,50,000. He invested an amount of Rs. 7,00,000 in construction of one more floor in this house in June, 2006. The house was sold by him in November, 2020 for Rs. 37,50,000. The valuation adopted by the registration authorities for charge of stamp duty was Rs. 47,25,000 which was not contested by the buyer, but as per assessee's request/the Assessing Officer made a reference to Valuation Officer. The value determined by Valuation Officer was Rs. 47,50,000. Brokerage @ 1% of sale consideration was paid by Mr. T to Mr. S. The market value of house as on 1-4-2001 was Rs. 2,70,000. Compute the capital gain chargeable to tax. (9 Marks, PCE Nov. 2007)

Solution: Computation of capital gains chargeable to tax of Mr. T (amount in Rs.):

Full value of consideration	[WN-1]	47,25,000	
Less: Expenses of transfer i.e. brokerage @ 1% of Rs. 37,50,000		37,500	
Net sale consideration			46,87,500
Less: Indexed cost of acquisition (Rs. 2,70,000 $\times$ 301 $\div$ 100)	[WN-2]	8,12,700	
Indexed cost of improvement (Rs. 7,00,000 $\times$ 301 $\div$ 122)		17,27,049	25,39,749
Long-term capital gains			21,47,751

Working Notes:

- (1) As per Section 50C, where the value adopted or assessed or assessable by the stamp valuation authority exceeds 105% of the consideration received, the stamp duty value shall be deemed to be the full value of the consideration. Hence, in the given case — Sales consideration — Rs. 37,50,000, 110% of Sale Consideration — Rs. 41,25,000, Stamp duty value = Rs. 47,25,000, Valuation made by Valuation officer = Rs. 47,50,000, Therefore, full value of consideration = Higher of Rs. 41,25,000 and Rs. 47,50,000; subject to maximum of Rs. 47,25,000 = Rs. 47,25,000.
- (2) Since the house has been obtained under inheritance i.e. one of the modes specified under section 49(1), therefore, its cost shall be the cost to the previous owner (father) i.e. FMV as on 1-4-2001 i.e. Rs. 2,70,000. The CII of acquisition will be of 2001-02 since his father has acquired the property prior to 01-04-2001.
27. Explain the special provision for full value of consideration for transfer of share other than quoted share.

Ans: **Special provision for full value of consideration for transfer of share other than quoted share [Section 50CA]:** Where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such manner as may be prescribed, the value so determined shall, for the purposes of section 48, be deemed to be the full value of consideration received or accruing as a result of such transfer.

However, the provisions of this section shall not apply to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.

"Quoted share" means the share quoted on any recognised stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business. [Explanation]

28. What shall be the full value of consideration in case sale consideration cannot be ascertained?

Ans: **Fair market value deemed to be full value of consideration in certain cases [Section 50D]:** Where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of the consideration received or accruing as a result of such transfer.

29. What shall be the treatment of advance money received and forfeited while computing capital gains?

Ans: **The relevant provisions are as under -**

- (1) **Advance money received [Section 51]:** Where any capital asset was on any previous occasion the subject of negotiations for its transfer, any advance or other money received and retained by the assessee in respect of such negotiation shall be deducted from the cost for which the asset was acquired, or the WDV of the asset or the FMV in computing the cost of acquisition of the capital asset. Such sum of money must be received and forfeited before 01-04-2014.

Advance money forfeited not to be reduced if the same is taxable as Income from other Sources : However, any sum of money, received on or after 01-04-2014, as an advance or otherwise in the course

of negotiations for transfer of a capital asset, has been included in the total income of the assessee for any previous year in accordance with the provisions of Section 56(2) (ix), then, such sum shall not be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.

Amount forfeited by previous owner not deductible: The amount forfeited by the previous owner shall not be deducted for computing cost of acquisition. Further, indexation applies to the cost arrived at after deducting such advance money received.

- (2) **Earnest money forfeited to be deducted from cost :** It was held in *Travancore Rubber & Tea Co. Ltd. v. CIT* [2000] 243 ITR158 (SC) that the phrase 'other money' would cover deposits made by purchaser for guaranteeing due performance of contracts. Therefore, the earnest money so received and forfeited and the compensation received for breach of contract by the prospective purchaser will be deducted from the cost of acquisition.

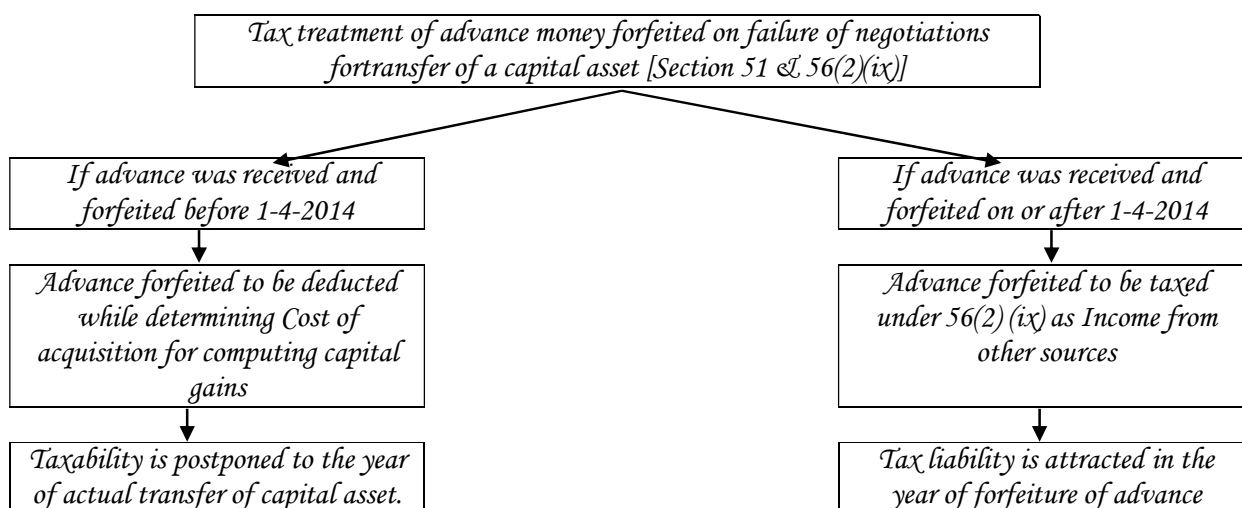


Illustration 32 - Advance money - Forfeited: Mr. Paresh purchased a house property on 14th Nov., 2015 for Rs. 10,00,000. He entered into an agreement with Mr. B for the sale of house on 15th September, 2020 and received an advance of Rs. 25,000. However, since Mr. B did not remit the balance amount, Mr. Paresh forfeited the advance. Finally, the house was sold by Mr. Paresh to Mr. Sanjay on 15-03-2021 for a consideration of Rs. 21,00,000. Discuss tax implications of such transaction in hands of Paresh.

Solution: Section 56(2)(ix) provides for the taxability of any sum of money, received as an advance or otherwise on or after 01-04-2014 in the course of negotiations for transfer of a capital asset shall be chargeable to income-tax under the head 'income from other sources' if such sum is forfeited and the negotiations do not result in transfer of such capital asset. The sum so taxable will not be reduced from cost of acquisition to compute capital gains on transfer of such asset. Hence, the sum of Rs. 25,000 received as advance & forfeited by Mr. Paresh shall be taxable as his Income from other Sources in assessment year 2021-22.

Since the house property is held for more than 24 months immediately preceding the date of transfer, it will be regarded as long term capital asset. The capital gains shall be computed as under:

Computation of capital gains of Mr. Paresh for AY 2021-22 (amounts in Rs.)

Full value of consideration	21,00,000
Less: Indexed Cost of acquisition [$\text{Rs. } 10,00,000 \times 301 \div 254$] [WN]	11,85,039
Long-term capital gains	9,14,961

Working Note: The advance money forfeited by Paresh shall not be reduced since the same is taken into account while computing Income from other sources under Section 56(2)(ix).

Illustration 33 - Advance money received-forfeited by the assessee: Mr. Rakesh purchased a house property on 14th April, 1999 for Rs. 9,05,000. He entered into an agreement with Mr. B for the sale of house on 15th September, 2002 and received an advance of Rs. 25,000. However, since Mr. B did not remit the balance amount, Mr. Rakesh forfeited the advance. Later on, he gifted the house property to his brother Mr. A on 15th June, 2006. Following renovations were carried out by Mr. Rakesh and Mr. A to the house property:

Particulars	Amounts
By Mr. Rakesh during FY 1999-2000	10,000
By Mr. Rakesh during FY 2003-04	50,000
By Mr. A during FY 2007-08	1,90,000

The fair market value of the property as on 01-04-2001 is Rs. 11,00,000

Mr. A entered into an agreement with Mr. C for sale of the house on 1st June, 2012 and received an advance of Rs. 80,000.

The said amount was forfeited by Mr. A, since Mr. C could not fulfil the terms of the agreement. Finally, the house was sold by Mr. A to Mr. Sanjay on 2nd January, 2021 for a consideration of Rs. 42,00,000.

Compute the capital gains chargeable to tax in the hands of Mr. A for the assessment year 2021-22.

Cost inflation indices are as under:

Financial Year	Cost inflation index
2001-02 to 2003-04	109
2006-07	122
2007-08	129
2021-22	301

(8 Marks, IPCC Modified, May 2011)

Solution: Computation of capital gains taxable in the hands of Mr. A: Here, the house property so transferred shall be the long term capital asset for Mr. A as he has acquired the property from Mr. Rakesh by way of gift [one of the modes specified in Section 49(1)], hence, his period of holding = 14-4-1999 to 2-1-2020 i.e. more than 2 years, (amount in Rs.)

Full value of consideration	42,00,000
Less: Indexed cost of acquisition ($\text{Rs. } 10,20,000 \times 301 \div 100$) [WN-1]	30,70,200
Less: Indexed cost of improvement by Mr. Rakesh ($\text{Rs. } 50,000 \times 301 \div 109$) [WN-2]	1,38,073
Less: Indexed cost of improvement by Mr. A ($\text{Rs. } 1,90,000 \times 301 \div 129$)	4,43,333
Long-term Capital Gains	5,48,394

Working Notes:

- (1) Cost of acquisition = FMV as on 01-04-2001 Less Advance forfeited by Mr. A = Rs. 11,00,000 – Rs. 80,000 = Rs. 10,20,000. Forfeiture made by Mr. Rakesh (previous owner) shall be ignored.
- (2) Cost of improvement by Mr. Rakesh shall not include the improvements made before 1-04-2001.

EXEMPTIONS FROM CAPITAL GAINS

30. Discuss the exemption available on capital gains arising from transfer of Residential House Property.

Ans: Profit on sale of property used for residence [Section 54]:

(1) **Eligible Assessee:** Individual or a Hindu undivided family.

(2) **Capital asset transferred:** Long-term capital asset, being buildings or lands appurtenant thereto, and being a residential house, the income of which is chargeable under the head "Income from house property".

(3) **Basic condition subject to which exemption available:**

(i) **Where the amount of capital gains exceeds Rs. 2 crores :** The assessee has purchased within a period of 1 year before or 2 years after, or has constructed within a period of 3 years, one residential house in India after the date on which the transfer took place.

(ii) **Where the amount of capital gains does not exceed Rs. 2 crore :** Where the amount of capital gains does not exceed Rs. 2 crore, the assessee may at his option,—

- (a) purchase two residential houses in India within 1 year before or 2 years after the date of transfer (or)
- (b) construct two residential houses in India within a period of 3 years after the date of transfer.

If the assessee has exercised the option to make investment in two residential houses, he shall not be subsequently entitled to exercise the said option for the same assessment year or any subsequent assessment year. Thus, the aforesaid option can be exercised once in life time. However, he can continue to claim exemption under section 54 by investing in purchase or construction of one residential house property.

This implies that if an assessee has availed the option of claiming benefit of section 54 in respect of purchase of two residential houses in Alwar and Jodhpur, say, in respect of capital gains of Rs. 1.50 crores arising from transfer of residential house at Mumbai in the P.Y. 2020-21 then, he will not be entitled to avail the benefit of section 54 again in respect of purchase of two residential houses in, say, Surat and Nagpur, in respect of capital gains of Rs. 1.20 crores arising from transfer of residential house in Alwar in the P.Y. 2023-24, even though the capital gains arising on transfer of the residential house at Alwar does not exceed Rs. 2 crore.

(4) **Amount of Exemption:**

(i) If the amount of the capital gain is greater than the cost of the residential house or houses as the case may be so purchased or constructed, then capital gains to the extent of the cost of the new residential house(s) shall be exempt.

(ii) If the amount of the capital gain is equal to or less than the cost of the new residential house(s), then whole of the capital gains shall be exempt.

- (5) **Lock-in-period:** 3 years.
Hence, in case if the new asset is transferred within 3 years of its purchase or construction, then its cost of acquisition shall be reduced by the amount of the capital gains exempted earlier for the purpose of computing capital gains on such transfer.
- (6) **Capital Gains Accounts Scheme, 1988:** The assessee availing exemption under this section has to comply with the provisions of this scheme, which are as follows -
- (i) **Exemption available only if amount deposited in the Deposit A/c before due date of return:**
The exemption is available if the investment in new asset is made within the time allowed. In case, the amount of capital gains could not be appropriated for the specified purposes before the due date of furnishing return of income, then, the same is to be deposited by him, before the due date of furnishing such return, in deposit account in any such bank or institution as may be specified. Such return shall be accompanied by proof of such deposit.
- (ii) **Withdrawal out of deposit account:** If the amount withdrawn from the Deposit A/c for specified purposes is not so utilised either wholly or partly, then the amount not so utilised shall be chargeable to tax as 'Capital gains' of previous year in which specified period expires.
- (iii) **In case of death of individual :** If an individual dies before the expiry of stipulated period, then the unutilised amount cannot be taxed in the hands of the deceased or legal heirs, as the unutilised portion is not income but only a part of the estate devolving upon them. [Circular 743, dated 06-05-1996]

Illustration 34 - Advance money received and Exemption u/s 54 : Compute the net taxable capital gains of Smt. Megha on the basis of the following information :

(6 Marks, 1PCC Nov. 2.009)

A house was purchased on 01-05-2007 for Rs. 4,50,000 and was used as a residence by the owner. The owner had contracted to sell this property in June, 2012 for Rs. 10,00,000 and had received an advance of Rs. 70,000 towards sale. The intending purchaser did not proceed with the transaction and the advance was forfeited by the owner. The property was sold in April, 2020 for Rs. 18,00,000. The owner, from out of sale proceeds, invested Rs. 4 lakhs in a new residential house in India in January, 2021.

What would your answer be if the new residential house property is purchased in Dubai instead of India.

Solution:

(1) **Computation of taxable capital gains in the hands of Megha (amounts in Rs.) -**

Full Value of consideration	18,00,000
Less: Indexed cost of acquisition [Rs. 3,80,000 $\times$ 301 $\div$ 129] [WN-1]	8,86,667
Long-term capital gains	9,13,333
Less: Exemption u/s 54 [WN-2]	4,00,000
Taxable long-term capital gains	5,13,333

Working Notes:

- (1) For computing cost of acquisition, advance money received and forfeited shall be deducted. Hence, cost of acquisition = Rs. 4,50,000 - Rs. 70,000 = 3,80,000. [Section 51]

- (2) Exemption under section 54 shall be available in respect of one/ two new house(s) purchased within 2 years from the date of transfer of existing residential house. (2) In case the residential house property is purchased in Dubai, the benefit of exemption under Section 54 shall not be available since the house property must be located in India for getting the exemption under Section 54. Hence, the taxable Capital Gains will be Rs. 9,13,333.

Illustration 35 - Exemption under section 54: Mr. Surinder furnishes the following particulars for the previous year ending 31-3-2021, and requests you to compute the taxable capital gain:

- (i) He had a residential house inherited from father in 2006, the fair market value of which as on 1-4-2001 is Rs. 5 lakhs.
- (ii) In the year 2007-08, further construction and improvements costed Rs. 6 lakhs.
- (iii) On 10-5-2020, the house was sold for Rs. 90 lakhs. Expenditure in connection with transfer = 150,000.
- (iv) On 20-12-2020, he purchased a residential house for Rs.10 lakhs. (May 2002)

Solution: Computation of Capital Gains (amounts in Rs.)-

Full value of consideration		90,00,000
Less: Expenditure in connection with transfer		50,000
Net Sale Consideration		89,50,000
Less: Indexed Cost of Acquisition (Rs. 5,00,000 $\times$ 301 $\div$ 100) [WN 1]	15,05,000	
Less: Indexed Cost of Improvement (Rs. 6,00,000 $\times$ 301 $\div$ 129)	14,00,000	29,05,000
Long Term Capital Gains		60,45,000
Less: Exemption u/s 54 [WN 2]		10,00,000
Taxable Long Term Capital Gains		50,45,000

Working Note:

- (1) In this question it is assumed that his father has acquired the property before 01-04-2001. Hence, cost inflation index of the year 2001-02 is taken for determining indexed cost of acquisition.
- (2) Exemption under section 54 shall be the cost of new house acquired i.e. Rs. 10,00,000 as the amount of capital gain is more than the cost of new house.

Illustration 36 - Section 50C and Exemption u/s 54: Mr. Sunil entered into an agreement with Mr. Dhaval to sell his residential house located at Navi Mumbai on 16-08-2020 for Rs. 80,00,000. The sale proceeds was to be paid in the following manner:

- (i) 20% through account payee bank draft on the date of agreement.
- (ii) 60% on the date of the possession of the property.
- (iii) Balance after the completion of the registration of the title of the property.

Mr. Dhaval was handed over the possession of the property on 15-12-2020 and the registration process was completed on 14-01-2021. He paid the sale proceeds as per the sale agreement.

The value determined by the Stamp Duty Authority on 16-08-2020 was Rs. 98,00,000 whereas, on 14-01-2021 it was Rs. 1,01,50,000.

Mr. Sunil had acquired the property on 01-04-2001 for Rs. 20,00,000. After recovering the sale proceeds from Dhaval, he purchased another residential house property for Rs. 32,00,000.

Compute the income under the head "Capital Gains" for the Assessment Year 2021-22.

Cost Inflation Index for Financial Year(s): 2001-02 - 100; 2002-03 - 105 and 2020-21 - 301. (5 Marks, Nov. 2017)

Solution: Computation of taxable capital gains (amount in Rs.):

Full value of consideration [Section 50C] [WN-1]	98,00,000
Less: Indexed cost of acquisition (Rs. 20,00,000 $\times$ 301 $\div$ 100) [WN-2]	60,20,000
Long-term capital gains	37,80,000
Less: Exemption u/s 54 [WN-3]	32,00,000
Taxable long-term capital gains	5,80,000

Working Notes:

- (1) As per provisions of Section 50C, since the value adopted or assessed or assessable by the stamp valuation authority i.e. Rs. 98,00,000 exceeds 110% of the consideration received i.e. Rs. 80,00,000, stamp duty value will be taken as full value of consideration. In this case the stamp duty value on the date of agreement will be considered to compute capital gains since on the date of agreement, 20% of sales consideration i.e. Rs. 16 lakh has been received by an account payee bank draft.
- (2) Since the residential house property was held by Mr. Sunil for more than 24 months immediately preceding the date of its transfer, the resultant capital gains will be long term capital gains.
- (3) Exemption under section 54 shall be available in respect of one/ two new house(s) purchased within 2 years from the date of transfer of existing residential house.

Illustration 37 - Exemption u/s 54: The following information is given by X and Y for the previous year 2020-21:

	X(Rs.)	Y(Rs.)
Sales consideration of a residential house property situated in Mumbai	2,30,00,000	9,40,00,000
Stamp duty value on the date of transfer	2,55,00,000	9,50,00,000
Cost of acquisition in 1996-97	8,00,000	1,60,00,000
Fair market value on 1 April, 2001.	9,00,000	2,30,00,000
Cost of improvement incurred in 2002-03	40,000	50,00,000
Expenditure on transfer borne by transferor	40,000	50,000
Purchase of residential house property in Cochin on 1 December, 2020	60,70,000	20,10,000
Purchase of another residential house property in Mumbai on 10 July, 2021	2,02,00,000	1,20,00,000

Determine taxable capital gains for assessment year 2021-22.

Cost Inflation Index for Financial Year(s): 2001-02:1.00; 2002-03:105 and 2020-21:301.

Solution: Computation of capital gains —

	X(Rs.)	Y(Rs.)
Full value of consideration (In case of Mr. X stamp duty value is taken as it exceeds 110% of sale consideration)	2,55,00,000	9,40,00,000
Less: Expenses on transfer	40,000	50,000
Net Consideration	2,54,60,000	9,39,50,000
Less: Indexed cost of acquisition: - In the case of X (Rs. 9,00,000 $\times$ 301 $\div$ 100)	27,09,000	

- In the case of Y (Rs. 2,30,00,000 $\times$ 301 $\div$ 100)	-	6,92,30,000
Indexed cost of improvement:		
- In the case of X (Rs. 40,000 $\times$ 301 $\div$ 105)	1,14,667	
- In the case of Y (Rs. 50,00,000 $\times$ 301 $\div$ 105)	-	1,43,33,333
Long-term capital gain before exemption		
Less: Exemption u/s 54	2,26,36,333	1,03,86,667
In the case of X (as long-term capital gain exceeds Rs.2 crore, X can avail section 54 exemption only for investment in one residential house property)	2,02,00,000	-
In the case of Y (as long-term capital gain does not exceed Rs. 2 crore, Y can claim section 54 exemption for investment in two residential house properties) Rs. 20,10,000 + Rs. 1,20,00,000, subject to maximum of long-term capital gain of Rs. 1,03,86,667)	-	1,03,86,667
Income under the head "Capital gains"	24,36,333	Nil

Illustration 38 - Exemption u/s 54: Mr. Roy owned a residential house in Noida. It was acquired on 09-09-2009 for Rs. 30,00,000. He sold it for Rs. 1,57,00,000 on 07-01-2017.

Mr. Roy utilized the sale proceeds of the above property to acquire a residential house in Panchkula for Rs. 2,05,00,000 on 20-07-2017. The said house property was sold on 31-05-2020 and he purchased another residential house in Delhi for Rs. 2,57,00,000 on 02-03-2021. The property at Panchkula was sold for Rs. 3,25,00,000.

Calculate capital gains chargeable to tax for the A.Y. 2017-18 and 2021-22. All workings should form part of your answer. (6 Marks, May 2019-NS)

Cost inflation index for various financial year are as under: 2009-10:148, 2016-17 : 264, 2017-18 : 272 and 2020-21:301

Solution:

(i) Computation of capital gains for A.Y. 2017-18 (amount in Rs.):

Sale of Residential House in Noida		
Full value of consideration		1,57,00,000
Less: Indexed Cost of Acquisition (Rs. 30,00,000 $\times$ 264/148)		53,51,351
Long-term capital gains		1,03,48,649
Less: Exemption u/s 54 (Since investment in new residential house in Panchkula exceeds the capital gains, entire capital gains shall be exempt from tax)		1,03,48,649
Taxable Long-term capital gains		Nil

(ii) Computation of capital gains for A.Y. 2021-22 (amount in Rs.):

Sale of Residential House in Panchkula		
Full value of consideration		3,25,00,000
Less: Indexed cost of acquisition		
Cost of Acquisition	2,05,00,000	
Less: Exemption claimed u/s 54 [See Note]	1,03,48,649	
(Rs. 1,01,51,351 $\times$ 301/272)	1,01,51,351	1,12,33,665
Long term capital gains		2,12,66,335
Less: Exemption u/s 54 (on purchase of new house at Delhi)		2,12,66,335
Taxable Long-term capital gains		Nil

Note: The house purchased in Panchkula has been transferred before 3 years from the date of its acquisition, hence cost of the asset will be reduced by capital gains exempted earlier for computing capital gains.

31. *Explain briefly the exemption available under section 54B in respect of capital gains arising on transfer of agricultural land.*

Ans: Capital gain on transfer of land used for agricultural purposes not to be charged in certain cases [Section 54B]:

- (1) **Assessee eligible for exemption:** Individual or Hindu Undivided Family.
- (2) **Capital asset transferred:** Short term or long term capital asset being land which, in the 2 years immediately preceding the date on which the transfer took place, was being used by the HUF or individual or his parents for agricultural purposes.
- (3) **Basic condition subject to which exemption available:** The assessee has, within a period of 2 years after the date of transfer, purchased any other land for being used for agricultural purposes.
- (4) **Amount of Exemption:**
 - (i) If the amount of the capital gain is greater than the cost of the land so purchased, then capital gains to the extent of the cost of new land shall be exempt.
 - (ii) If the amount of the capital gain is equal to or less than the cost of the new asset, then whole of the capital gains shall be exempt.
- (5) **Lock-in-period:** 3 years.
Hence, in case if the new asset is transferred within 3 years of its purchase, then its cost of acquisition shall be reduced by the amount of the capital gains exempted earlier for the purpose of computing capital gains on such transfer.
- (6) **Capital Gains Accounts Scheme, 1988:** Same provisions as in Section 54.

32. *Discuss the exemption available on capital gains in relation to compulsory acquisition of land and building.*

Ans: Capital gain on compulsory acquisition of land and buildings not to be charged in certain cases [Section 54D]:

- (1) **Assessee eligible for exemption:** Any person.
- (2) **Capital asset transferred:** Short term or long term capital asset being land or building or any right in land or building, forming part of an industrial undertaking belonging to the assessee which, in 2 years immediately preceding the date on which the transfer took place, was being used by the assessee for the purposes of the business of the said undertaking.
- (3) **Basic condition subject to which exemption available :** The assessee has, within a period of 3 years after that date, purchased any other land or building or any right in any other land or building or constructed any other building for the purposes of shifting or re-establishing the said undertaking or setting up another industrial undertaking.
- (4) **Amount of Exemption:**
 - (i) If the amount of the capital gain is greater than the cost of the new asset, then capital gains to the extent of the cost of the new asset shall be exempt.

- (ii) *If the amount of the capital gain is equal to or less than the cost of the new asset, then whole of the capital gains shall be exempt.*

(5) Lock-in-period: 3 years.

Hence, in case if the new asset is transferred within 3 years of its purchase or construction, then its cost of acquisition shall be reduced by the amount of the capital gains exempted earlier while computing capital gains on such transfer.

(6) Capital Gains Accounts Scheme, 1988: Same provisions as in Section 54.

33. State the exemption available u/s 54EC in respect of capital gains which are invested in certain bonds.

Ans: *Capital gain not to be charged on investment in certain bonds [Section 54EC]:*

(1) Assessee eligible for exemption: Any person.

(2) Capital asset transferred: Long-term capital asset being land or building or both. Such asset can be depreciable asset held for more than 36 months.

(3) Basic condition subject to which exemption available: The assessee has, at any time within a period of 6 months after the date of such transfer, invested the whole or any part of capital gains in the long-term specified asset. However, the investment made by the assessee in the long-term specified asset during any financial year must not exceed Rs. 50 lakhs.

Maximum investment in bonds for capital gains exemption arising from transfer of one or more capital assets during a financial year, must not exceed Rs. 50 lakhs : The investment made by an assessee in the long-term specified asset, from capital gains arising from transfer of one or more original assets, during the financial year in which the original asset or assets are transferred and in the subsequent financial year does not exceed Rs. 50 lakh.

(4) Long-term specified asset means any bond, redeemable after 3 years (for bonds issued prior to 01-04-2018)/ 5 years (for bonds issued on or after 01-04-2018) —

- (i) *issued by National Highways Authority of India; or*
- (ii) *issued by Rural Electrification Corporation Limited; or*
- (iii) *notified by the Central Government in this behalf. [The Central Government has notified any bond redeemable after three years and issued by the Power Finance Corporation Limited on or after 15-06-2017 or by the Indian Railway Finance Corporation Limited on or after 08-08-17 as 'long-term specified asset']*

(5) Amount of Exemption:

- (i) *If the cost of the long-term specified asset is not less than the capital gain arising from the transfer of the original asset, then whole of such capital gain shall be exempt.*
- (ii) *If the cost of the long-term specified asset is less than the capital gain, then capital gains to the extent of the cost of such asset shall be exempt.*

(6) Lock-in-period: 3 years for bonds issued prior to 01-04-2018 / 5 years for bonds issued on or after 01-04-2018. Hence, where the long-term specified asset is transferred or converted into money at any time within 3 years/ 5 years from the date of its acquisition, the amount of capital gains exempt earlier shall be deemed to be the income chargeable under the head "Capital gain" of the previous year in which the said asset is so transferred or converted.

Loan or advance taken on security of specified asset—deemed conversion into money [Explanation to Section 54EC]: Where the original asset is transferred and the assessee invests the whole or any part of the capital gain received or accrued as a result of transfer of the original asset in any long-term specified asset and such assessee takes any loan or advance on the security of such specified asset, he shall be deemed to have converted such specified asset into money on the date on which such loan or advance is taken.

- (7) **No deduction u/s 80C:** If exemption is claimed u/s 54EC in respect of investment in a new asset, then no deduction shall be allowed u/s 80C for the amount of investment for which exemption has been claimed.

Illustration 39 - Exemption under Section 54EC: Mr. Chandru transferred a vacant site on 28-10-2020 for Rs. 100 lakhs. The site was acquired for Rs. 9,99,300 on 30-6-2001. He deposited Rs. 40 lakhs in eligible bonds issued by Rural Electrification Corporation Ltd. (REC) on 20-3-2021. Again, he deposited Rs. 30 lakhs in eligible bonds issued by National Highways Authority of India (NHAI) on 16-4-2021.

Compute the chargeable capital gain in the hands of Chandru for the assessment year 2021-22.

Financial Year	Cost Inflation Index
2001-02	100
2020-21	301

(5 Marks, PCC May 2011)

Solution: Computation of capital gains (amounts in Rs.) -

Full value of consideration	1,00,00,000
Less: Indexed Cost of Acquisition [Rs. 9,99,300 $\times$ 301 $\div$ 100]	30,07,893
Long-term Capital Gains	69,92,107
Less: Exemption u/s 54EC [WN]	50,00,000
Taxable Capital Gains	19,92,107

Working Note: Exemption u/s 54EC = Investment in REC Bonds (acquired within 6 months from the date of transfer) + NHAI Bonds (acquired within 6 months from the date of transfer) = Rs. 40,00,000 + Rs. 30,00,000 = Rs. 70,00,000.

Section 54EC provides that the maximum limit of investment during the financial year in which asset is transferred and in subsequent financial year shall be Rs. 50 lakhs. Thus, the limit of Rs. 50 lakhs applies in aggregate for more than one financial year taken together. In this case, REC Bonds were acquired during the financial year 2020-21; while NHAI bonds were acquired during the financial year 2021-22. Hence, both the investments shall be eligible for exemption under section 54EC as the same have been made in different financial years but subject to maximum of Rs. 50 lakhs.

Illustration 40 Exemption under Section 54EC: X transfers the following long-term capital assets -

Capital asset	Date of transfer	Full Value of Consideration	Indexed cost of acquisition	Investment in NHAI/REC bonds (date of investment)
Land	03-04-2020	Rs. 95 lakhs	Rs. 40 lakhs	Rs. 40 lakh (01-09-2020)
Commercial House	05-11-2020	Rs. 65 lakhs	Rs. 20 lakhs	Rs. 40 lakh (01-04-2021)

Find out exemption under section 54EC and taxable capital gain for AY 2021-22.

Solution: Computation of Taxable Capital Gains Assessment year 2021-22 (Rs. in lakh):

Long-term capital gain on transfer of Land and Commercial House (Rs. 55 lakh + Rs. 45 lakh)	100
Less: Exemption u/s 54EC (Investment in NHAI/RFC bonds: Rs. 40 lakh + Rs. 40 lakh, limited to Rs. 50 lakh)	50
Long-term capital gain chargeable to tax	50

Illustration 41 - Exemption under section 54 and its withdrawal: Mr. Selvan acquired a residential house in January, 2002 for Rs. 10,00,000 and made some improvements by way of additional construction to the house, incurring expenditure of Rs. 2,00,000 in October, 2004. He sold the house property in October, 2020 for Rs. 75,00,000. The value of property was adopted as Rs. 88,00,000 by the State stamp valuation authority for registration purpose. He acquired a residential house in January, 2020 for Rs. 25,00,000. He deposited Rs. 20,00,000 in capital gains bonds issued by National Highways Authority of India (NHAI) in June, 2021. Compute the capital gain chargeable to tax for the A.Y. 2021-22. What would be the tax consequence and in which assessment year it would be taxable, if the house property acquired in January, 2020 is sold for Rs. 40,00,000 in December, 2021?

(8 Marks, IPCC Nov. 2011)

Solution:

(1) **Computation of Capital Gains (amounts in Rs.)-**

Full Value of Consideration (i.e. Stamp Duty Value) [WN-1]		88,00,000
Less: Cost being: Indexed Cost of Acquisition (Rs. 10,00,000 $\times$ 301 $\div$ 100)	30,10,000	
Indexed Cost of Improvement (Rs. 2,00,000 $\times$ 301 $\div$ 113)	5,32,743	35,42,743
Long Term Capital Gains		52,57,257
Less: Exemption u/s 54 [WN-2]		25,00,000
Exemption u/s 54EC in respect of bonds of NHAI [WN-3]		NIL
Taxable Long Term Capital Gains		27,57,257

Working Notes:

- (1) As per the provisions of Section 50C, in this case the value assessed by the stamp valuation authority exceed 110% of the consideration received therefore, the stamp duty value shall be deemed as the full value of consideration.
- (2) Exemption under section 54 is available if a one /two residential house(s) is/are purchased within 1 year before or 2 years after the date of transfer. Here the new house is purchased within the said time limit, further the cost of new residential house is less than the capital gain, capital gain to the extent of cost of new asset is exempt under section 54.
- (3) Exemption under section 54EC is available in respect of investment in bonds of National Highways Authority of India only if the investment is made within a period of 6 months after the date of such transfer. In this case, since the investment is made after 6 months, exemption under section 54EC would not be available.

- (2) Short Term Capital Gains for the assessment year 2022-23 sale of house = Full value of consideration - Cost of acquisition = Rs. 40,00,000 - NIL = Rs. 40,00,000.

Since exemption was claimed under section 54 in respect of the house and the same has been sold within 3 years from the date of its acquisition, therefore, the exemption will be withdrawn. Accordingly, cost of acquisition of house = Original Cost of purchase - Exemption claimed under section 54 = Rs. 25 lakhs - Rs. 25 lakhs = NIL.

Illustration 42 - Section 50C and Investment to be made in bonds of NHAI/REC: Mr. A who transfers land and building on 02-01-2021, furnishes the following information:

- (i) Net consideration received Rs. 16 lakhs.
- (ii) Value adopted by stamp valuation authority, which was not contested by Mr. A Rs. 2.1 lakhs.
- (iii) Value ascertained by Valuation Officer on reference by the Assessing Officer Rs. 25 lakhs.
- (iv) This land was distributed to Mr. A on the partial partition of his HUF on 1-4-2001. Fair market value of the land as on 1-4-2001 was Rs. 1,00,000.
- (v) A residential building was constructed on the above land by Mr. A at a cost of Rs. 3,00,000 (construction completed on 1-12-2004) during the financial year 2004-05.
- (vi) Short-term capital loss incurred on sale of shares during the financial year 2018-19 Rs. 2,05,000. Mr. A seeks your advice as to the amount to be invested in NHAI bonds so as to be exempt from clutches of capital gain tax,

(8 Marks, Modified May 2006) (8 Marks, IPCC May 2012)

Solution: Computation of Capital Gains of Mr. A (amounts in Rs.) –

Full value of consideration	[WN-1]		21,00,000
Less: Indexed cost of land (Rs. 1,00,000 $\times$ 301 $\div$ 100)	[WN-2]	3,01,000	
Indexed cost of building (Rs. 3,00,000 $\times$ 301 $\div$ 113)		7,99,115	11,00,115
Long-term capital gains			9,99,885
Less: Brought forward short-term capital loss set off			2,05,000
Amount to be invested in NHAI/REC bonds to claim exemption u/s 54EC			7,94,885

Working Notes:

- (1) As per Section 50C, where the value assessed by the stamp valuation authority exceeds 110% of the consideration received then the stamp duty value shall be deemed to be the full value of the consideration. Hence, in the given case - Sales consideration = Rs.16,00,000, 110% of Sale Consideration = Rs. 17,60,000, Stamp duty value = Rs. 21,00,000, Valuation made by Valuation officer = Rs. 25,00,000. Therefore, full value of consideration = Higher of Rs. 16,00,000 and Rs. 25,00,000; subject to maximum of Rs. 21,00,000. (4) Since acquisition of capital asset on partition of HUF is one of the modes specified in Section 49(1), hence, cost thereof shall be the cost to the previous owner. Hence, FMV as on 1-4-2001 shall be the cost of acquisition and shall be eligible for indexation.

34. State the exemption available under section 54EE in respect of capital gains which are invested in certain units.

Ans: Capital gain not to be charged on investment in units of a specified fund [Section 54EE]:

- (1) **Eligible Assessee:** Any person.

- (2) **Capital asset transferred:** Any long-term capital asset.
- (3) **Basic condition subject to which exemption available :** The assessee has, at any time within a period of 6 months after the date of such transfer, invested the whole or any part of capital gains in the long-term specified asset (i.e. unit or units as notified by Central Government).

However, the investment made on or after 01-04-2016 in the long-term specified asset by the assessee during any financial year must not exceed Rs. 50 lakhs.

Maximum investment in units for capital gains exemption arising from transfer of one or more capital assets during a financial year, must not exceed Rs. 50 lakhs : The investment made by an assessee in the long-term specified asset, from capital gains arising from transfer of one or more original assets, during the financial year in which the original asset or assets are transferred and in the subsequent financial year does not exceed Rs. 50 lakh.

- (4) **Long-term specified asset:** "Long-term specified asset" means a unit or units, issued before 01-04-2019, of such fund as may be notified by the Central Government in this behalf.
- (5) **Amount of Exemption:**
- (i) If the cost of the long-term specified asset is not less than the capital gain arising from the transfer of the original asset, then whole of such capital gain shall be exempt.
- (ii) If the cost of the long-term specified asset is less than the capital gain, then capital gains to the extent of the cost of such asset shall be exempt.
- (6) **Lock-in-period:** 3 years.
- Hence, where the long-term specified asset is transferred or converted into money at any time within 3 years from the date of its acquisition, the amount of capital gains exempt earlier shall be deemed to be the income chargeable under the head "Capital gains" of the previous year in which the said asset is so transferred or converted.

Loan or advance taken on security of specified asset-deemed conversion into money [Explanation 1 to Section 54EE]: In a case where the original asset is transferred and the assessee invests the whole or any part of the capital gain received or accrued as a result of transfer of the original asset in any long-term specified asset and such assessee takes any loan or advance on the security of such specified asset, he shall be deemed to have transferred such specified asset on the date on which such loan or advance is taken.

35. **Explain the exemption provided as per Section 54F in case capital gains arising on certain capital assets are invested in residential house.**

Ans: Capital gain on transfer of certain capital assets not to be charged in case of investment in residential house [Section 54F]:

- (1) **Assessee eligible for exemption:** Individual or HUF.
- (2) **Capital asset transferred:** Any long-term capital asset, not being a residential house.
- (3) **Basic condition subject to which exemption available :** The assessee has, within a period of 1 year before or 2 years after the date on which the transfer took place, purchased, or within a period of 3 years after that date, constructed, one residential house in India.

(4) Amount of Exemption:

- (i) If the cost of the new house is not less than the net consideration in respect of the original asset, the whole of such capital gain shall be exempt.
- (ii) If the cost of the new house is less than the net consideration in respect of the original asset, then -

$$\text{Amount of exemption} = \frac{\text{Capital Gains} \times \text{Cost of the new asset}}{\text{Net consideration}}$$

Where -

Net Consideration = Full value of the consideration — Expenditure incurred wholly and exclusively in connection with such transfer.

(5) Specified circumstances in which exemption not available: Nothing contained in this section shall apply where -

- (i) the assessee -
 - (a) owns more than 1 residential house, other than the new house, on the date of transfer of the original asset; or
 - (b) purchases any residential house, other than the new house, within a period of 1 year after the date of transfer of the original asset; or
 - (c) constructs any residential house, other than the new house, within a period of 3 years after the date of transfer of the original asset; and

- (ii) the income from such residential house, other than the one residential house owned on the date of transfer of the original asset, is chargeable under the head "Income from house property".

- (6) Where the assessee purchases within a period of 2 years, or constructs within a period of 3 years, after the date of the transfer of the original asset, any residential house, other than the new asset, then the capital gain exempted earlier shall be deemed to be income chargeable under the head "Capital gains" of the previous year in which such residential house is purchased or constructed.

(7) Lock-in-period: 3 years.

Where the new asset is transferred within a period of 3 years from the date of its purchase/construction, the amount of capital gains exempt earlier shall be deemed to be income chargeable under the head "Capital gains" of the previous year in which such new asset is transferred.

- (8) **Capital Gains Accounts Scheme, 1988 :** In case, the amount of net consideration could not be appropriated for the specified purposes before the due date of furnishing return of income, then, the same is to be deposited by him, before the due date of furnishing such return, in deposit account in any such bank or institution as may be specified. Such return shall be accompanied by proof of such deposit.

- (9) **Withdrawal out of deposit account:** If the amount withdrawn from the Deposit A/c for specified purposes is not so utilised either wholly or partly, then the amount not so utilised shall be chargeable to tax as 'Capital gains' of previous year in which specified period expires as under:

$$\text{Taxable Capital Gains} = \frac{\text{Amount not so utilised} \times \text{Original Capital Gains (before claiming exemption)}}{\text{Net sale consideration in respect of transfer of original asset}}$$

Illustration 43 - Exemption u/s 54F: Mr. 'X' furnishes the following data for the previous year ending 31-3-2021:

- (a) Equity Shares of AB Ltd., 10,000 in number were sold on 31-5-2020, at Rs. 550 for each share.
- (b) The above shares of 10,000, were acquired by 'X' in the following manner:
 - (i) Received as gift from his father on 1-6-2000 (5,000 shares) the market price on 1-4-2001 Rs. 50 per share.
 - (ii) Bonus shares received from AB Ltd. on 21-7-2004 (2,000 shares).
 - (iii) Purchased on 1-2-2013 at the price of Rs. 125 per share (3,000 shares).
- (c) Purchased one residential house at Rs. 25 lakhs, on 1-9-2021 from the sale proceeds of shares.
- (d) 'X' is already owning a residential house, even before the purchase of above house.
You are required to compute the taxable capital gain. He has no other source of income chargeable to tax. (6 Marks, Modified Nov. 2004)

Solution: Computation of taxable capital gains of Mr. 'X' (amounts in Rs.)

Sale consideration @ Rs. 550 per share on 10,000 shares	[A]	55,00,000
Less: (1) Shares received as gift on 1-6-2000 (Indexed cost = 5,000 $\times$ Rs. 50 $\times$ 301 - 100)	[WN-1]	7,52,500
(2) Shares received as bonus on 21-7-2004	[WN-2]	Nil
(3) Shares purchased on 1-2-2013 (Indexed cost = 3,000 $\times$ Rs. 125 $\times$ 301 $\div$ 200)		5,64,375
Long Term Capital Gain	[B]	41,83,125
Exemption u/s 54F = [Rs. 42,75,000 $\times$ Rs. 25,00,000 $\times$ Rs. 55,00,000]	[C]	19,01,420
[WN-3]		
Taxable Long-term Capital Gains = B - C		22,81,705

Working Notes:

- (1) Cost of shares gifted by the father would be FMV as on 1-4-2001 i.e. Rs. 50 per share.
- (2) The cost of bonus shares allotted on or after 1-04-2001 is always taken as NIL.
- (3) Mr. X is eligible for exemption under section 54F since he owns only one house at the time of the transfer of the shares and the purchase of the new house takes place within 2 years from the date of transfer of the shares.
- (4) It is assumed that Mr. X has complied with all the procedures like deposit of money under the capital gains account scheme by the due date, as may be applicable to him.

Illustration 44 - Exemption under Section 54 and 54F: Mr. X owns a residential house, which is self-occupied, and also a plot of land (he owns no other house). He sells the house on January 2, 2021 and the plot on February 11, 2021 for Rs. 15,00,000 and Rs. 12,00,000 respectively. The house was purchased on June, 2001 for Rs. 4,50,000 and the plot on March 31, 2002 for Rs. 3,00,000. X has purchased a new residential house on April 25, 2021 for Rs. 7,00,000 and claims exemption in respect of such house. On 1-1-2022, he transfers the said residential house for Rs. 8,25,000 and purchases a new house on 31-3-2023. for Rs. 12,00,000. Compute the capital gains for relevant years.

Solution: X can claim exemption under section 54 in respect of capital gains on sale of residential house and exemption under section 54F in respect of capital gains on sale of plot. Since the exemption under section 54 is available on investment of capital gains, therefore, first of all, exemption under section 54 will be claimed. Thereafter, exemption under section 54F, which is available on investment of net consideration, shall be claimed. The exemption under section 54F will be available only in respect of balance cost of new house i.e. Original cost of new house - Exemption u/s 54.

- *Computation of Capital Gains for assessment year 2021-22 (amounts in Rs.) -*

Particulars	Residential house	Plot
Full Value of consideration	15,00,000	12,00,000
Less: Indexed cost [(4,50,000 × 301 ÷ 100); (3,00,000 × 301 ÷ 100)]	13,54,500	9,03,000
Long term capital gains	1,45,500	2,97,000
Less: Exemption u/s 54	1,45,500	
Exemption u/s 54F [WN]		1,37,239
Taxable long term capital gains	Nil	1,59,760

Working Note: Exemption under section 54F -

$$\frac{\text{Capital gains} \times (\text{cost of new house} - \text{exemption u/s 54})}{\text{Net consideration of plot}} + \frac{\text{Rs. 3,33,000} \times (\text{Rs. 7,00,000} - \text{Rs. 1,45,500})}{\text{Rs. 12,00,000}} = \text{Rs. 1,37,239 ...}$$

- *Computation of capital gains on sale of residential house for assessment year 2022-23 (amounts in Rs.)*

Sale price of the residential house (acquired on 25-4-2021)	8,25,000
Less: Cost of Acquisition (Rs. 7,00,000 – Rs. 1,45,500 i.e. exemption claimed u/s 54)	5,54,500
Short-term capital gains for assessment year 2022-23	2,70,500
Long-term capital gains (Exemption claimed u/s 54F shall be chargeable as long-term capital gains of the year in which the house is transferred i.e. assessment year 2022-23)	1,37,239

Note: No exemption u/s 54 or 54F will be available in respect of second new house acquired on 31-3-2023 since the house transferred on 1-1-2022 is a short-term capital asset.

36. **Explain the provisions of Section 54H relating to extension of period in case of compulsory acquisition by law.**

Ans: **Extension of time for acquiring new asset or depositing or investing amount of capital gain [Section 54H] :** Where the transfer of the original assets referred to in sections 54, 54B, 54D, 54EC and 54F is by way of compulsory acquisition under any law and the amount of compensation awarded for such acquisition is not received by the assessee on the date of such transfer, then the period for acquiring the new asset by the assessee referred to in those sections or, as the case may be, the period available to the assessee under those sections for depositing or investing the amount of capital gain in relation to such compensation as is not received on the date of the transfer, shall be reckoned from the date of receipt of such compensation.

37. **What are the circumstances under which the Assessing Officer can make a reference to the Valuation Officer under section 55A of the Income-tax Act, 1961?** (6 Marks, May 2008) (4 Marks, IPCC Nov. 2009)

Ans: **Reference to Valuation Officer [Section 55A]:** With a view to ascertaining the fair market value of a capital asset, the Assessing Officer may refer the valuation of a capital asset to a Valuation Officer in following cases -

- (1) in a case where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the Assessing Officer is of opinion that the value so claimed is at variance with its fair market value.
- (2) in any other case, if the Assessing Officer is of opinion -
 - (i) that the fair market value of the asset exceeds the value of the asset as claimed by the assessee by -
 - (a) Rs. 25,000; or
 - (b) 15% of the value claimed by the assessee;
 - (ii) that having regard to the nature of the asset and other relevant circumstances, it is necessary so to do.

38. Explain the concept of reverse mortgage & discuss its tax implications. (4 Marks, IPCC Nov. 2009)

Ans: The concept of reverse mortgages and its tax implications are as under -

- (1) **Applicability:** It applies only to a capital asset being a residential house property located in India, which is owned by an eligible person and is free from any encumbrances.
- (2) **Eligible persons:** The persons eligible to avail of this scheme are -
 - (i) an individual who is of age 60 years or more; or
 - (ii) a married couple, where either of the husband or wife is of age 60 years or more.
- (3) **Reverse Mortgage:** It means a mortgage of a capital asset by an eligible person against a loan obtained by him from an approved lending institution (being National Housing Bank or any housing finance company registered with it or any scheduled bank). However, it does not include a transaction of sale, or disposal, of the property for settlement of the loan.
- (4) **Procedure:** The loan may be disbursed either by way of periodic payments or upto 50% in lumpsum and balance by way of periodic payments. The loan period may be upto 20 years. At the time of foreclosure of the loan agreement, the reverse mortgagor or his legal heir or estate, shall be liable for repayment of the principal amount of loan along with the interest.
- (5) **Tax consideration:** A transaction of reverse mortgage is not regarded as 'transfer' u/s 47(xvi) of the Act. Further, any sum received as loan under reverse mortgage transaction is exempt u/s 10(43). Therefore, a borrower, under a reverse mortgage scheme, will be liable to income tax (in the nature of tax on capital gains) only at the point of alienation of the mortgaged property by the mortgagee for the purposes of recovering the loan.

Illustration 45 - Reverse Mortgage: Mr. Abhik's father, who is a senior citizen, had pledged his residential house to a bank under a notified reverse mortgage scheme. He was getting loan from bank in monthly instalments. Mr. Abhik's father did not repay the loan on maturity and given possession of the house to the bank to discharge his loan. How will the treatment of the long-term capital gain be made on such reverse mortgage transaction? (3 Marks, PCC June, 2009)

Solution: As per Section 47(xvi), mortgage of residential house under a notified reverse mortgage scheme doesn't constitute 'transfer'. Also, the loan received under such scheme is exempt under section 10(43). However, when the bank alienates the property for the purpose of recovery of the loan on non-payment of the loan, then the same will constitute 'transfer' and the capital gains so computed will be taxed accordingly.

Illustration 46 - Reverse Mortgage: Sachin received 15,00,000 on 23-01-2021 on transfer of his residential building in a transaction of reverse mortgage under a scheme notified by the Central Government. The building was acquired in March 1991 for Rs. 8,00,000. Is the amount received on reverse mortgage chargeable to tax in the hands of Sachin under the head 'Capital Gains'? (4 Marks, PCC Nov. 2010)

Solution: As per section 47(xvi), any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government will not be regarded as a transfer. Therefore, capital gains tax liability is not attracted. Section 10(43) provides that the amount received by a senior citizen as a loan, either in lump sum or in installments, in a transaction of reverse mortgage would be exempt from income-tax. Therefore, the amount received by Sachin in a transaction of reverse mortgage of his residential building is exempt under section 10(43).

TAXABILITY OF CAPITAL GAINS

39. Discuss the computation of tax on short term capital gains as per Section 111A.

Ans: The computation of tax on short term capital gains is as under -

- (1) **Short-term capital gains (STCG) on transfer of an equity share of a company or a unit of an equity-oriented fund or a unit of a business trust on which securities transaction tax has been charged [Section 111A] :** Tax is computed on STCG on transfer of an equity share of a company or a unit of an equity-oriented fund or a unit of a business trust on which securities transaction tax has been charged capital gains at a flat rate of 15%. The above concessional rate of tax shall apply to a transaction undertaken on a recognised stock exchange located in any International Financial Services Centre and where the consideration for such transaction is paid or payable in foreign currency even if securities transaction tax is not applicable.

However, in case of resident individual or resident HUF, if -

- other income is less than 'basic exemption limit',
 - then, such STCG shall be reduced by such shortfall, and
 - tax on balance of STCG shall be computed @ 15%.
 - Accordingly, tax on such STCG = $15\% \times [\text{Such STCG} - (\text{basic exemption limit} - \text{Other Income})]$.
- Further, where Gross total income of an assessee includes any such short-term capital gains, the deduction under Chapter VI-A shall be allowed from the Gross total income as reduced by such gains.

- (2) **Other Short-term capital gains :** They are taxed at the normal rates applicable to the assessee.

40. Discuss the computation of tax on long-term capital gains.

Ans: Computation of tax on long term capital gains [Section 112]:

- (1) **Individual/HUF :** In the case of an individual or a Hindu undivided family, being a resident, tax on long-term capital gains is payable @ 20%.

However, in case of resident individual or resident HUF, if -

- other income is less than 'basic exemption limit',
- then, such LTCG shall be reduced by such shortfall, and
- tax on balance of LTCG shall be computed @ 20%.
- Accordingly, tax on such LTCG = $20\% \times [\text{Such LTCG} - (\text{basic exemption limit} - \text{Other Income})]$.

- (2) **Domestic Company:** Long-term capital gains shall be taxed @ 20%.

- (3) **Non-resident (not being a company) or a foreign company:**
- (a) **Unlisted Securities:** The amount of tax on long-term capital gains arising from the transfer of a capital asset, being unlisted securities or shares of a company not being a company in which the public are substantially interested, shall be calculated at the rate of 10% without giving effect to the 1st proviso (Converting capital gains into foreign currency and reconverting it into Indian currency) and 2nd proviso to Section 48 (Indexation Benefit).
- (b) In case of other capital assets, the tax shall be computed @ 20%.
- (4) **In any other case:** Long-term capital gains shall be taxed @ 20%.
- Notes:**
- (a) **Tax on listed securities not to exceed 10% [Proviso to section 112] :** Where the tax payable in respect of any income arising from the transfer of long term capital asset being listed securities (other than a unit) or zero coupon bonds, exceeds 10% of the amount of capital gains before indexation, then such excess shall be ignored while computing the tax payable by the assessee. Thus, tax payable in case of listed securities (other than a unit) or zero coupon bonds, shall be lower of:
- (i) 10% of gross capital gains i.e. (Net consideration - Cost of acquisition without indexation)
- (ii) 20% of Long term capital gains i.e. (Net Consideration - Indexed cost of acquisition)
- (b) **No deduction under Chapter VI-A on LTCG:** The deductions under chapter VI-A cannot be availed in respect of the long-term capital gains included in the total income of the assessee.
41. **Explain the provisions relating to taxation of long term capital gains arising from transfer of listed equity shares or units of equity oriented fund or units of business trust.**

Ans: Tax on long-term capital gains in certain cases [Section 112A]:

- (1) **Conditions for invoking Section 112A:** This section is applicable only if the following conditions are satisfied:
- (i) the total income includes any income chargeable under the head "Capital gains";
- (ii) the capital gains arise from the transfer of a long-term capital asset being
- (a) an equity share in a company or
- (b) a unit of an equity oriented fund or
- (c) a unit of a business trust;
- (iii) securities transaction tax has, —
- (a) in a case where the long-term capital asset is in the nature of an equity share in a company, been paid on acquisition and transfer of such capital asset; or
- (b) in a case where the long-term capital asset is in the nature of a unit of an equity oriented fund or a unit of a business trust, been paid on transfer of such capital asset.

Non applicability: This condition shall not apply to a transfer undertaken on a recognised stock exchange located in any International Financial Services Centre and where the consideration for such transfer is received or receivable in foreign currency.

Non applicability of condition (iii) (a) in notified cases: The Central Government may, by notification in the Official Gazette, specify the nature of acquisition in respect of which condition no. (iii)(a) shall not apply.

- (2) **Tax computation under Section 112A :** If the above conditions are fulfilled the tax on long term capital gains shall be calculated on the basis of following parameters :
- (i) **LTCG in excess of ₹ 1,00,000 shall be chargeable @ 10% :** Such long-term capital gains exceeding ₹. 1,00,000 shall be chargeable to tax @ 10% plus surcharge as applicable plus Health Education Cess.
Thus, if LTCG does not exceed ₹. 1,00,000 it shall not be chargeable to tax.
- (ii) **Benefit of exemption limit in certain cases:** In the case of Resident individual or a Hindu undivided family, where the other income is below the maximum amount which is not chargeable to income-tax i.e. basic exemption limit, then, the long-term capital gains shall be reduced by the amount of such short fall and on balance LTCG tax shall be payable @ 10%.
- (iii) **First proviso and second proviso to Section 48 not applicable:**
- (a) Mode of computation of capital Gains in foreign currency in case of non residents as specified under First proviso to Section 48 shall not be applicable when tax is payable as per provisions of this section.
- (b) Indexation benefit (Second proviso to Section 48) is not applicable while computing capital gains when tax is payable as per provisions of this section.
- (iv) **Tax rebate not admissible:** The rebate under section 87A shall be allowed from the income-tax on the total income as reduced by tax payable on such capital gains. Thus, no tax rebate under Section 87A shall be allowed from tax payable under Section 112A.
- (v) **No deduction under Chapter VI-A from such LTCG:** The deductions under chapter VI-A cannot be availed in respect of the long-term capital gains included in the total income of the assessee.
- (3) **Computation of Cost of Acquisition [Section 55(2) (ac)]:** If tax is payable under this Section, the cost of acquisition of equity share in a company or a unit of an equity oriented fund or a unit of a business trust, acquired before 01-02-2018 shall be computed as under —

Step 1: Find out cost of acquisition of such equity shares/ units Step 2: Find out

- (a) the fair market value of such asset as on 31-01-2018; or
- (b) the full value of consideration received or accruing as a result of the transfer of the capital asset whichever is less.

Step 3: Cost of acquisition shall be deemed to be the amount computed at Step 1 or Step 2 whichever is higher.

Meaning of Fair Market value:

	Circumstance	Fair Market Value
(i)	In a case where the capital asset is listed on any recognized stock exchange as on 31-01-2018	If there is trading in such asset on such exchange on 31-01-2018 The highest price of the capital asset quoted on such exchange on the said date If there is no trading in such asset on such exchange on 31-01-2018 The highest price of such asset on such exchange on a date immediately preceding 31-01-2018 when such

		<i>asset was traded on such exchange.</i>
(ii)	<i>In a case where the capital asset is a unit which is not listed on any recognized stock exchange as on 31-01-2018</i>	<i>The net asset value of such unit as on the said date</i>
(iii)	<i>In a case where the capital asset is an equity share in a company which is</i> ➤ <i>not listed on a recognized stock exchange as on 31-01-2018 but listed on such exchange on the date of transfer</i> ➤ <i>listed on a recognized stock exchange on the date of transfer and which became the property of the assessee in consideration of share which is not listed on such exchange as on 31-01-2018 by way of transaction not regarded as transfer under section 47</i>	$FMV = \frac{\text{Cost of Acquisition} \times CII \text{ of } 2017 - 18 \text{ i.e. } 272}{CII \text{ for the first year in which the asset was held by the assessee or } 2001 - 02 \text{ whichever is later}}$

Subsequent to insertion of Section 112A, the CBDT has issued clarification F. No. 370149/20/ 2018-TPL dated 04-02-2018 in the form of a Question and Answer format to clarify certain issues raised in different for a on various issues relating to the new tax regime for taxation of long-term capital gains. The relevant questions raised and answers to such questions as per the said Circular are given hereunder:

	Question	Answer
1.	<i>What is the meaning of long term capital gains under the new tax regime for long term capital gains?</i>	<i>Long term capital gains mean gains arising from the transfer of long-term capital asset.</i> <i>It provides for a new long-term capital gains tax regime for the following assets-</i> (i) <i>Equity Shares in a company listed on a recognised stock exchange;</i> (ii) <i>Unit of an equity oriented fund; and</i> (iii) <i>Unit of a business trust.</i> <i>The new tax regime applies to the above assets, if-</i> (a) <i>the assets are held for a minimum period of twelve months from the date of acquisition; and</i> (b) <i>the Securities Transaction Tax (STT) is paid at the time of transfer. However, in the case of equity shares acquired after 1-10-2004, STT is required to be paid even at the time of acquisition (subject to notified exemptions).</i>
2.	<i>What is the point of chargeability of the tax?</i>	<i>The tax will be levied only upon transfer of the long-term capital asset on or after 1st April, 2018, as defined in clause (47) of section 2 of the Act.</i>
3.	<i>What is the method for calculation of long-term capital gains?</i>	<i>The long-term capital gains will be computed by deducting the cost of acquisition from the full value of consideration on transfer of the long-term capital asset.</i>
4.	<i>How do we determine the</i>	<i>The cost of acquisition for the long-term capital asset acquired on or</i>

	cost of acquisition for assets acquired on or before 31st January, 2018?	before 31st of January, 2018 will be the actual cost. However, if the actual cost is less than the fair market value of such asset as on 31st of January, 2018, the fair market value will be deemed to be the cost of acquisition. Further, if the full value of consideration on transfer is less than the fair market value, then such full value of consideration or the actual cost, whichever is higher, will be deemed to be the cost of acquisition.
5.	Please provide illustrations for computing long-term capital gains in different scenarios, in the light of answers to questions 4.	The computation of long-term capital gains in different scenarios is illustrated as under Scenario 1 - An equity share is acquired on 1st of January, 2017 at Rs. 100, its fair market value is Rs. 200 on 31st of January, 2018 and it is sold on 1st of April, 2018 at Rs. 250. As the actual cost of acquisition is less than the fair market value as on 31st of January, 2018, the fair market value of Rs. 200 will be taken as the cost of acquisition and the long-term capital gain will be Rs.50 (Rs. 250 - Rs. 200). Scenario 2 - An equity share is acquired on 1st of January, 2017 at Rs. 100, its fair market value is Rs. 200 on 31st of January, 2018 and it is sold on 1st of April, 2018 at Rs. 150. In this case, the actual cost of acquisition is less than the fair market value as on 31st of January, 2018. However, the sale value is also less than the fair market value as on 31st of January, 2018. Accordingly, the sale value of Rs. 150 will be taken as the cost of acquisition and the long-term capital gain will be NIL 150 - Rs.150). Scenario 3 - An equity share is acquired on 1st of January, 2017 at Rs. 100, its fair market value is Rs. 50 on 31st of January, 2018 and it is sold on 1st of April, 2018 at Rs. 150. In this case, the fair market value as on 31st of January, 2018 is less than the actual cost of acquisition, and therefore, the actual cost of Rs. 100 will be taken as actual cost of acquisition and the long-term capital gain will be Rs. 50 150 - Rs. 100). Scenario 4 - An equity share is acquired on 1st of January, 2017 at Rs. 100, its fair market value is Rs. 200 on 31st of January, 2018 and it is sold on 1st of April, 2018 at Rs. 50. In this case, the actual cost of acquisition is less than the fair market value as on 31st of January, 2018. The sale value is less than the fair market value as on 31st of January, 2018 and also the actual cost of acquisition. Therefore, the actual cost of Rs. 100 will be taken as the cost of acquisition in this case. Hence, the long-term capital loss will be Rs. 50 50 - Rs. 100) in this case.
6.	Whether the cost of acquisition will be inflation indexed?	Third proviso to Section 48, provides that the long-term capital gain will be computed without giving effect to the provisions of the second provisos of section 48. Accordingly, it is clarified that the benefit of inflation indexation of the cost of acquisition would not be available for computing long-term capital gains under the new tax regime.
7.	What will be the tax treatment of transfer made on or after 1st April	The long-term capital gains exceeding Rs.1 lakh arising from transfer of these assets made on or after 1st April, 2018 will be taxed at 10%. However, there will be no tax on gains accrued upto 31st January,

	2018?	2018.
8.	What is the date from which the holding period will be counted?	The holding period will be counted from the date of acquisition.
9.	Whether tax will be deducted at source in case of gains by resident tax payer?	No. There will be no deduction of tax at source from the payment of long-term capital gains to a resident tax payer.
10.	What will be the cost of acquisition in the case of bonus shares acquired before 1st February 2018?	The cost of acquisition of bonus shares acquired before 31st January, 2018 will be determined as per Section 55(2)(ac). Therefore, the fair market value of the bonus shares as on 31st January, 2018 will be taken as cost of acquisition (except in some typical situations explained in Ans 5), and hence, the gains accrued upto 31st January, 2018 will continue to be exempt.
11.	What will be the cost of acquisition in the case of right share acquired before 1st February 2018?	The cost of acquisition of right share acquired before 31st January, 2018 will be determined as per section 55(2) (ac). Therefore, the fair market value of right share as on 31st January, 2018 will be taken as cost of acquisition (except in some typical situations explained in Ans 5), and hence, the gains accrued upto 31st January, 2018 will continue to be exempt.
12.	Long-term capital loss arising from transfer made on or after 1st April, 2018	will be allowed to be set-off and carried forward in accordance with existing provisions of the Act. Therefore, it can be set-off against any other long-term capital gains and unabsorbed loss can be carried forward to subsequent eight years for set-off against long-term capital gains.

Illustration 47 - Computation of LTCG on sale of Equity shares: From the following information determine taxable capital gains. Mr. X has acquired 1,000 equity shares on 01-04-2017 for Rs. 15,00,000 (STT paid @ 0.1%). The fair-market value of shares as on 31-01-2018 was Rs. 15,25,000. He sold the shares on 25-08-2020 for Rs. 16,75,000 (STT paid @ 0.1%). Brokerage Expenses incurred on transfer: 0.5% of the Sales consideration. Solution:

Computation of taxable capital gains (amount in Rs.):

Full value of consideration	16,75,000
Less: Expenses on transfer (0.5% of the gross consideration)	8,375
Net consideration	16,66,625
Less: Cost of acquisition [WN]	15,25,000
Long-term capital gains	1,41,625

Working Note: The cost of acquisition of equity shares shall be determined as under—

- **Step 1:** Cost of acquisition of such equity shares i.e. Rs. 15,00,000
- **Step 2 :** Lower of - (a) the fair market value of such asset as on 31-01-2018 i.e. 15,25,000; or (b) the full value of consideration received or accruing as a result of the transfer of the capital asset i.e. Rs. 16,75,000 = Rs. 15,25,000.
- **Step 3:** Cost of acquisition shall be deemed to the amount computed at Step 1 or Step 2 whichever is higher i.e. Rs. 15,25,000.

Illustration 48 - Computation of LTCG on sale of Equity shares: From the following information determine taxable capital gains. Mr. X has acquired 1,000 equity shares on 1-04-2017 for Rs. 15,25,000 (STT paid @ 0.1%). The fair market value of Shares as on 31-01-2018 was Rs. 15,00,000. He sold the shares on 25-08-2020 for Rs. 14,75,000 (STT paid @ 0.1%). Brokerage Expenses incurred on transfer: 0.5% of the Sales consideration.

Solution: Computation of taxable capital gains (amount in Rs.):

Full value of consideration	14,75,000
Less: Expenses on transfer (0.5% of the gross consideration)	7,375
Net consideration	14,67,625
Less: Cost of acquisition [WN]	15,25,000
Long-term capital gains	-57,375

Working Note: The cost of acquisition of equity shares shall be determined as under—

- **Step 1:** Cost of acquisition of such equity shares i.e. Rs. 15,25,000.
- **Step 2 :** Lower of - (a) the fair market value of such asset as on 31-01-2018 i.e. 15,00,000; or (b) the full value of consideration received or accruing as a result of the transfer of the capital asset i.e. Rs. 14,75,000 = Rs. 14,75,000.
- **Step 3 :** Cost of acquisition shall be deemed to the amount computed at Step 1 or Step 2 whichever is higher i.e. Rs. 15,25,000

Illustration 49 - Computation of LTCG on sale of Equity shares: From the following information determine taxable capital gains. Mr. X has acquired 1,000 equity shares on 1-04-2017 for Rs. 15,25,000 (STT paid @ 0.1%). The fair market value of shares as on 31-01-2018 was Rs. 16,50,000. He sold the shares on 25-08-2020 for Rs. 16,00,000 (STT paid @ 0.1%).

Solution: Computation of taxable capital gains (amount in Rs.):

Full value of consideration	16,00,000
Less: Expenses on transfer	Nil
Net consideration	16,00,000
Less: Cost of acquisition [WN]	16,00,000
Long-term capital gains	Nil

Working Note: The cost of acquisition of equity shares shall be determined as under—

- **Step 1:** Cost of acquisition of such equity shares i.e. Rs. 15,25,000
- **Step 2 :** Lower of — (a) the fair market value of such asset as on 31-01-2018 i.e. 16,50,000; or (b) the full value of consideration received or accruing as a result of the transfer of the capital asset i.e. Rs. 16,00,000 = Rs. 16,00,000.
- **Step 3:** Cost of acquisition shall be deemed to the amount computed at Step 1 or Step 2 whichever is higher i.e. Rs. 16,00,000.

Illustration 50 - Computation of tax liability: Mr. X (64 years) is a resident individual. For the A.Y. 2021-22, he has following income-

Long-term capital gain on transfer of equity shares as computed as per provisions of section 112A)	1,80,000
Other income	2,75,000
Compute his tax liability for A.Y. 2021-22.	

Solution: Computation of tax liability (amount in Rs.):

Tax on long-term capital gain u/s 112A [10% of (long-term capital gain exceeding Rs. 1,00,000)]	5,500
Add: Health and education cess @4%	220
Tax liability	5,720

Working Note : In this case, the other income falls short of maximum amount not chargeable to tax by Rs. 25,000 [Rs. 3,00,000 - Rs. 2,75,000], hence long term capital gains will be reduced by such shortfall. Taxable LTCG under Section 112A = Rs. 1,55,000. No rebate under Section 87A shall be admissible from tax on long term capital gains computed as per the provisions of Section 112A of the Income tax Act, 1961.

Illustration 51 - Computation of Capital Gains and Tax liability: Mr. Rajan provides you the following details with regard to sale of certain securities by him during F.Y. 2020-21:

- (i) **Sold 10000 shares of A Ltd. on 05-04-2020 @ Rs. 650 per share:** A Ltd. is a listed company. These shares were acquired by Mr. Rajan on 05-04-2017 @ Rs. 100 per share. STT was paid both at the time of acquisition as well as at the time of transfer of such shares which was affected through a recognized stock exchange. On 31-01-2018, the shares of A Ltd. were traded on a recognized stock exchange as under:
Highest price 300 per share Average price – Rs. 290 per share Lowest price Rs. 280 per share
- (ii) **Sold 1000 units of B Mutual Fund on 20-04-2020 @ Rs. 50 per unit:** B Mutual Fund is an equity oriented fund. These units were acquired by Mr. Rajan on 15-04-2017 @ Rs. 10 per unit. STT was paid only at the time of transfer of such units. On 31-01-2018, the Net Asset Value of the units of B Mutual Fund was Rs. 55 per unit.
- (iii) **Sold 100 shares of C Ltd. on 25-04-2020 @ Rs. 200 per share :** C Ltd. is an un-listed company. These shares were issued by the company as bonus shares on 30-09-1997. The Fair Market Value of these shares as on 01-04-2001 was Rs. 50 per share.

Calculate the amount chargeable to tax under the head 'Capital Gains' and also calculate tax on such gains for assessment year 2021-22 assuming that the other incomes of Mr. Rajan exceeds the maximum amount not chargeable to tax. (Ignore surcharge and cess).

Cost Inflation Index for various financial years are as under: 2001-02: 100, 2016-17: 264, 2017-18: 272, 2019-20: 289 and 2020-21: 301. (6 Marks, Nov. 2019)

Solution: Computation of taxable capital gains and tax thereon (amount in Rs.):

Long Term Capital gains on sale of Shares of A Ltd. (listed in RSE)		
Full value of consideration	65,00,000	
Less: Expenses on transfer	Nil	

Net consideration	65,00,000	
Less: Cost of acquisition (No benefit of indexation is available) [WN-1]	30,00,000	35,00,000
Long-term capital gains on sale of units of B Mutual Fund		
Full value of consideration	50,000	
Less: Expenses on transfer	Nil	
Net consideration	50,000	
Less: Cost of acquisition (No benefit of indexation is available) [WN-2]	50,000	Nil
Long Term Capital gains on sale of Shares of C Ltd. (unlisted company)		
Full value of consideration	20,000	
Less: Expenses on transfer	Nil	
Net consideration	20,000	
Less: Indexed Cost of acquisition $50 \times 100 \times 301 - 100$	15,050	4,950
Total Taxable LTCG		35,04,950
Computation of tax on capital gains		
Tax on Long Term Capital gains on sale of Shares of A Ltd. (listed in RSE) taxable under		3,40,000
Section 112A @ 10% in excess of Rs. 1,00,000		
Tax on Long Term Capital gains on sale of Shares of C Ltd. (unlisted company) @ 20%		990

Working Notes:

- (1) The cost of acquisition of equity shares shall be determined as under —
Step 1: Cost of acquisition of such equity shares (Rs. $100 \times 10,000$) i.e. Rs. 10,00,000
Step 2: Lower of - (a) the fair market value of such asset as on 31-01-2018 (being highest price i.e. Rs. 300 per shares) i.e. Rs. $300 \times 10,000$; or (b) the full value of consideration received or accruing as a result of the transfer of the capital asset i.e. Rs. 65,00,000 = Rs. 30,00,000.
Step 3: Cost of acquisition shall be deemed to the amount computed at Step 1 or Step 2 whichever is higher i.e. Rs. 30,00,000.
- (2) The cost of acquisition of mutual fund units shall be determined as under —
Step 1: Cost of acquisition of such units (Rs. $10 \times 1,000$) i.e. Rs. 10,000
Step 2: Lower of - (a) the fair market value of such asset as on 31-01-2018 (Rs. 55 per unit) i.e. Rs. $55 \times 1,000$; or (b) the full value of consideration received or accruing as a result of the transfer of the capital asset i.e. Rs. 50,000 = Rs. 50,000
Step 3: Cost of acquisition shall be deemed to the amount computed at Step 1 or Step 2 whichever is higher i.e. Rs. 50,000.

MISCELLANEOUS QUESTIONS

Illustration 52 - Computation of capital gains: Mr. Malik owns a factory building on which he had been claiming depreciation for the past few years. It is the only asset in the block. The factory building and land appurtenant thereto were sold during the year. The following details are available

(amounts in Rs.):

Building completed in September, 2004 for	10,00,000
Land appurtenant thereto purchased in April, 2003 for	11,00,000
Advance received from a prospective buyer for land in May, 2004, forfeited in favour of assessee, as negotiations failed	50,000
WDV of the building block as on 1-4-2020	8,74,800

Sale value of factory building in November, 2020	8,00,000
Sale value of appurtenant land	40,00,000

The assessee is ready to invest in long-term specified assets under section 54EC within specified time.

Compute the amount of taxable capital gain for the assessment year 2021-22 and the amount to be invested under section 54EC for availing the maximum exemption. (10 Marks, Nov. 2006)

Solution: Computation of Capital Gain (amount in Rs.) -

Sale consideration of the block	8,00,000
Less: Cost of acquisition i.e. WDV of block	8,74,800
Short-term capital loss	-74,800
Full value of consideration of land	40,00,000
Less: Indexed cost of land $10,50,000 \times 301 \div 109$ [WN]	28,99,541
Long-term capital gains	11,00,459
Taxable long-term capital gains (after set-off of short-term capital loss)	10,25,659

Working Note: Rs. 50,000 advance forfeited by Mr. Malik shall be deducted from cost of acquisition.

Exemption under section 54EC: The aforesaid amount of taxable net long-term capital gains Rs. 11,00,459 should be invested within 6 months under section 54EC for availing the maximum exemption.

Illustration 53 - Computation of Capital Gains and tax liability: Abhay purchased 1,000 listed equity shares of Rs. 10 each at Rs. 100 per share from a broker on 4th May, 2014. He paid Rs. 3,000 as brokerage. On 15th March, 2020, he was given bonus shares by the company on the basis of one share for every two shares held. On the same date, he was also given a right to acquire 1,000 rights shares @ Rs. 90 per share. He acquired 50% of the right shares offered and sold the balance 50% of the rights entitlement for a sum of Rs. 67,500 on 7th April 2020. The right shares were allotted to him on 30th April, 2020. All the shares held by him were sold on 24th September 2020 @ Rs. 280 per share through a recognised stock exchange.

Compute capital gain and tax assuming his income from other sources is Rs. 5,40,000. FMV as on 31-01-2018 is Rs. 150 per share. (CS Inter June 2005)

Solution: Computation of capital gains on remaining shares (amounts in Rs.) -

Particulars	Original Shares	Right Entitlement	Right shares	Bonus shares
No. of shares	1,000	500	500	500
Full value of consideration (@ Rs. 280 per share)	2,80,000	67,500	1,40,000	1,40,000
Less: Cost of acquisition	1,50,000	NIL	45,000	NIL
Long term capital gains / Short-term capital gains	1,30,000	67,500	95,000	1,40,000
Total short-term capital gains falling u/s 111A (from sale of right and bonus shares)				2,35,000
Other short-term capital gains				67,500
Long term capital gains in excess of 11,00,000 as per Section 112A				30,000
Income from other sources				5,40,000
Total Income				8,72,500
Tax on LTCG under Section 112A [10% of Rs. 30,000]				3,000
Tax on STCG under Section 111A [15% of Rs. 2,35,000]				35,250

Tax on balance Income [Taxable at slab rates]	34,000
Total Tax	72,250
Less: Tax rebate u/s 87A [Since total income exceeds Rs. 5,00,000]	Nil
Balance tax	72,250
Add: Health and Education Cess @ 4%	2,890
Tax liability (rounded off)	75,140

Illustration 54 – Computation of total income: Mr. Y submits the following information pertaining to the year ended 31st March, 2021:

- (1) On 30-11-2020, when he attained the age of 60, his friends in India gave a flat at Surat as a gift, each contributing a sum of Rs. 20,000 in cash. The cost of flat purchased using various gifts was Rs. 3.4 lakhs.
 - (2) His close friend abroad sent him a cash gift of Rs. 75,000 through his relative, for the above occasion.
 - (3) Mr. Y sold the above flat on 30-1-2021 for Rs. 3.6 lakhs. The Registrar's valuation for stamp duty purposes was Rs. 3.9 lakhs. Neither Mr. Y nor the buyer, questioned the value fixed by the Registrar.
 - (4) He had purchased some equity shares in X Pvt. Ltd. on 5-2-2020 for Rs. 3.5 lakhs. These shares were sold on 15-3-2021 for Rs. 2.8 lakhs.
- You are requested to calculate the total income of Mr. Y for the assessment year 2021-22. (6 Marks, May 2005)

Solution: Computation of total income of Mr. Y (amounts in Rs.) -

Particulars	Flat*	Equity shares
Full value of consideration [Since stamp duty value exceeds 105% of actual consideration]	3,90,000	2,80,000
Less: Cost of acquisition	3,40,000	3,50,000
Short-term capital gains/loss	50,000	-70,000
Short term capital Loss to be carried forward		-20,000
Income from other sources (cash gift of Rs. 75,000 + Flat of Rs. 3.4 lakh)		4,15,000
Total Income		4,15,000

Working Notes:

- (1) Gift of flat in excess of Rs. 50,000 is taxable under section 56(2)(x). The cost of such gifted asset will be Rs. 3,40,000, being the fair market value taken for the purpose of taxability under section 56(2)(x).
- (2) Cash gift exceeding Rs. 50,000 from an unrelated person is taxable as Income from other sources.
- (3) Equity shares of unlisted company held for more than 24 months from the date of purchase are long-term capital asset. Hence, the same shall be regarded as short term capital asset.

Illustration 55 - Computation of capital gains in case of conversion of debentures into shares: Amin is the holder of 1,000 debentures of Amin Ltd. having a face value of Rs. 1,000 each. The company has offered an option to the debenture- holders either to redeem the debentures at Rs. 1,200 each or to convert the debentures into equity shares of equivalent value. The market value of the shares on the date of exercising the option is Rs. 1,200 per share (face value Rs. 1,000). What will be the tax consequences of the two options in the hands of debenture-holder Amin? (May 1997)

Solution: Option-I: Redemption: In case Amin opts for the redemption of debentures, then capital gains shall arise in his hands which shall be computed as follows = Rs. $(1,200-1,000) \times 1,000$ debentures = Rs. 2 lakhs (indexation benefit is not allowed).

Option-II: Conversion : In case Amin opts for the conversion of debentures, then no capital gains shall arise as the conversion of debenture into shares is not regarded as 'transfer' according to Section 47(x).

Illustration 56 - Taxability of capital gains: Ms. Smriti purchased 40 capital indexed bonds issued by Government listed in RSE for Rs. 10,000 each on 01-04-2008. She sold all the bonds @ Rs. 40,500 per bond on 28th September 2020. She invested Rs. 80,000 in bonds of NABARD on 01-11-2020 and Rs. 70,000 in the bonds National Highway Authority of India on 31-03-2021. Compute the tax liability of Ms. Smriti assuming that she has no other income chargeable to tax.

Solution: Computation of tax liability of Ms. Smriti (amounts in Rs.) -

Full value of consideration (Rs. $29,500 \times 40$)	16,20,000
Less: Indexed Cost of acquisition ($40 \times \text{Rs. } 10,000 \times 301 \div 137$)	8,78,832
Long-term capital gains	7,41,168
Less: Exemption u/s 54EC [WN-1]	Nil
Taxable long-term capital gains	7,41,168
Total Income (rounded off)	7,41,170
Tax on LTCG (No rebate u/s 87A is admissible since, total income exceeds Rs. 5,00,000) [WN-2]	98,234
Add: Health & Education cess @ 4%	3,929
Tax Liability (rounded off to nearest Rs.10)	1,02,160

Working Notes:

- (1) Benefit of Section 54EC is not available on LTCG arising from transfer of bonds.
- (2) **Tax on LTCG shall be lower of the following:**
 - (a) 20% of (LTCG - basic exemption limit of Rs. 2,50,000) = 20% of (Rs. 7,41,170 - Rs. 2,50,000) = Rs. 98,234
 - (b) 10% of LTCG without indexation & basic exemption = 10% of [(Rs. 40,500 - Rs. 10,000) $\times$ 40] = Rs. 122,000.

Illustration 57 - Computation of Capital gains and Tax liability Mukesh (aged 55 years) owned a residential house at Nagpur. It was acquired by Mukesh on 1.0-10-2004 for Rs. 14,50,000. It was sold for Rs. 55,00,000 on 04-11-2020. The State stamp valuation authority fixed the value of the property at Rs. 75,00,000. The assessee paid 2% of the sale consideration as brokerage for the sale of said property.

Mukesh acquired a residential house at Chennai on 10-12-2020 for Rs. 10,00,000 and deposited Rs. 1,00,000 on 10-04-2021 in the capital gain bond of Rural Electrification Corporation Ltd (REC). He deposited Rs. 5,00,000 on 06-07-2021 in the Capital Gain Deposit Scheme in a nationalised bank for construction of additional floor on the residential house property acquired at Chennai.

Compute the capital gain chargeable to tax in the hands of Mr. Mukesh.

Calculate the income-tax payable on the assumption that he has no other income chargeable to tax. (7 Marks, PCC Nov. 2010)

Solution: Computation of capital gains and tax thereon in the hands of Mukesh (amounts in Rs.) -

Full value of consideration	[WN-1]	75,00,000
Less: Brokerage @ 2% of actual sale consideration of Rs. 55,00,000		1,10,000
Net sale consideration		73,90,000
Less: Indexed cost of acquisition (Rs. 14,50,000 $\times$ 301 $\div$ 113)		38,62,389
Capital Gains		35,27,611
Less: Exemption under section 54	[WN-2]	15,00,000
Exemption under section 54EC	[WN-3]	10,00,000
Income by way of Long-term capital gain		10,27,611
Less: Basic Exemption Limit of Rs. 2,50,000	[WN-4]	2,50,000
LTCG on which tax imposable		7,77,610
Income Tax @ 20%		1,55,522
Add: Health & Education cess @ 4%		6,221
Total Tax (round off)		1,61,740

Working Notes:

- (1) As per the provisions of Section 50C, in this case the value assessed by the stamp valuation authority exceed 110% of the consideration received therefore, the stamp duty value shall be deemed as the full value of consideration.
- (2) Exemption under section 54 = Cost of residential house acquired at Chennai on 10-12-2020 + amount deposited in Capital Gains Accounts Scheme on 6-7-2021 (before the due date of filing of return of income) for construction of additional floor on residential house property acquired at Chennai = Rs. 10 lakhs + 5 lakhs = Rs. 15 lakhs.
- (3) Exemption under section 54EC = amount deposited in RECL bonds on 10-04-2021 (within 6 months from the date of transfer) = Rs. 10 lakhs.
- (4) Since Mukesh is a resident individual having no other income, hence, he will be entitled to basic exemption limit in respect of the income from LTCG - Section 112.

Illustration 58 - Computation of Tax liability: The total income of Mrs. Z is Rs. 3,50,000, which includes the following:

Particulars	Rs.
Long-term capital gains	30,000
Winnings from lotteries	20,000
Short-term capital gains covered by Section 111A	10,000
	60,000

Agricultural income earned by her was Rs. 50,000. Compute the tax payable by Mrs. Z.

(6 Marks, May 2006)

Solution: Computation of tax payable by Mrs. Z (amounts in Rs.) -

Tax on incomes taxable at special rates:	
Tax on STCG u/s 111A @ 15% [Rs. 10,000 $\times$ 15%]	1,500
Tax on LTCG u/s 112 @ 20% 30,000 $\times$ 20%	6,000
Tax on Lottery income @ 30% [Rs. 20,000 $\times$ 30%]	6,000
Tax on balance income : Balance income including agricultural income (Rs. 50,000 + Rs. 2,90,000)	4,500
Less: Tax on agricultural income + basic exemption (Rs. 2,50,000 + Rs. 50,000)	-2,500

Tax payable	15,500
Less: Tax rebate u/s 87A [100% of tax or Rs. 12,500 which ever is less]	12,500
Balance tax	3,000
Add: Health & Education cess @ 4%	120
Tax payable by Mrs. Z (rounded off)	3,120

Illustration 59 - Computation of Total Income and Tax liability: Rajesh, a director at Young Pvt. Ltd., Mumbai, carrying on transport business has submitted the following particulars of his income for the assessment year 2021-22. Compute his taxable income and tax payable:

(1) Director's remuneration and perquisites:

- Remuneration: Rs. 3,46,000.
- Free use of car of engine capacity of 1,500 cc provided by the company.
- The company has provided rent-free accommodation (unfurnished) to Rajesh at Mumbai. It is ascertained that for this purpose the company has obtained a flat on lease from Prem Ltd. for which the company pays a rent of Rs. 23,400 p.a., which is also the fair rental value.
- Medical expenses met by the company on an ordinary treatment of Rajesh and the members of his family 'Rs. 4,500.

(2) Rajesh was occupying a bungalow on rent at New Delhi since November 1986. He agreed to transfer his tenancy right in the said bungalow in favour of Bala Ltd. for a sum of Rs. 2,00,000 payable as follows:

- Rs. 50,000 in cash.
- A flat valued at Rs. 1,50,000 (at cost) in the new building to be put up by Bala Ltd to be allotted free of cost. The cash payment was made on 5th April, 2020 and the flat was allotted to him on 5th October, 2020 which was kept for his own residence from that date. (CS Inter Dec. 2003)

Solution: Computation of taxable income (amount in Rs.)-

Income from salaries:

Remuneration		3,46,000	
Use of car	[WN-1]	32,400	
Value of residential accommodation	[WN-2]	23,400	
Medical expenses	[WN-3]	4,500	
Gross Salary		4,06,300	
Less: Standard deduction 16(ia)		50,000	3,56,300
Income under the head "Capital Gains":			
Long-term capital gains from transfer of tenancy rights	[WN-4]	2,00,000	
Less: Exemption u/s 54F	[WN-5]	1,50,000	50,000
Total income			4,06,300
Tax on LTCG at special rates : Rs. 50,000 x 20%			10,000
Tax on normal income at normal rates			5,315
Total Income-tax			15,315
Less: Tax rebate under section 87A [100% of tax or Rs. 12,500 which ever is less]			12,500
Balance tax			2,815
Add: Health & Education cess @ 4%			113
Tax payable (rounded off)			2,930

Working Notes:

- (1) It is assumed that the car is used partly for official and partly for personal purposes and chauffeur is provided, hence the taxable value shall be = (Rs. 1,800 + Rs. 900) $\times$ 12 = Rs. 32,400.
- (2) Value of RFA = Lower of -
 - (a) 15% of salary = 15% of Rs. 3,46,000 = Rs. 51,900;
 - (b) Lease rent = 23,400.
- (3) No exemption is available for any sum paid by the employer in respect of expenditure incurred by an employee on his medical treatment.
- (4) Tenancy right is a long-term capital asset. Its cost of acquisition is NIL. Thus, the amount of long-term capital gains shall be equal to the net consideration i.e. Rs. 2 lakhs.
- (5) Since Rajesh has transferred long term capital asset being tenancy rights and invested the net consideration in purchase of flat, he will be entitled exemption under section 54F as under :
(Cost of flat $\times$ LTCG Net consideration from the transfer). Thus, the exemption will be Rs. 1.5 lakhs.

Illustration 60 - Computation of Capital gains and tax liability: Mr. C inherited from his father 8 plots of land in 1980. His father had purchased the plots in 1960 for Rs. 5 lakhs. The fair market value of the plots as on 1-4-2001 was Rs. 8 lakhs. (Rs. 1 lakh for each plot)

On 1st June 2001, C started a business of dealer in plots and converted the 8 plots as stock-in-trade of his business. He recorded the plots in his books at Rs. 45 lakhs being the fair market value on that date. In June 2005, C sold the 8 plots for Rs. 50 lakhs.

In the same year, he acquired a residential house property for Rs. 45 lakhs. He invested an amount of Rs. 5 lakhs in construction of one more floor in his house in June 2006. The house was sold by him in June 2020 for Rs. 90,00,000. The valuation adopted by the registration authorities for charge of stamp duty was Rs. 1,36,50,000. As per the assessee's request, the Assessing Officer made a reference to a Valuation Officer. The value determined by the Valuation Officer was Rs. 1,39,20,000.

Brokerage of 1% of sale consideration was paid by C. Give the tax computation for the relevant assessment years with reasoning. (Modified 8 Marks: Nov. 2012 & Similar Nov. 2016)

Solution: Computation of total income and tax liability of Mr. C (amount in Rs.):

Capital Gains on sale of residential house property		
Full value of consideration [WN-1]	1,36,50,000	
Less: Brokerage @ 1% of sale consideration (1% of Rs. 90,00,000)		90,000
Net consideration		1,35,60,000
Less: Indexed cost of acquisition (Rs. 45,00,000 $\times$ 301/117)	15,76,923	
Less: Indexed cost of improvement (Rs. 5,00,000 $\times$ 301/122)	12,33,607	1,28,10,530
Long-term capital gains (Total Income) (rounded off)		7,49,470
Tax on total income [WN-2]		
Long-term capital gain taxable @ 20% (Rs. 7,49,470 - Rs. 2,50,000)		99,894
Add: Health & Education cess @ 4%		3,996
Total tax liability		1,03,890

Working Notes:

- (1) As per the provisions of Section 50C, in this case the value assessed by the stamp valuation authority exceed 110% of the consideration received therefore, the stamp duty value shall be deemed as the full value of consideration.
- (2) As per Section 112, the unexhausted basic exemption limit can be exhausted against the long-term capital gains. Since Mr. C does not have any other income in the current year, the whole of the basic exemption limit of Rs. 2,50,000 is exhausted against the long-term capital gains of Rs. 7,49,470 and the balance long-term capital gains shall be taxable @ 20%. It is assumed that Mr. C is a resident individual below the age of 60 years.

Illustration 61 - Computation of Capital gain: Ms. Neelima had purchased 500 equity shares in A Ltd. at a cost of Rs. 30 per share (brokerage 1%) in February 1995. She got 50 bonus shares in September 1999. She again got 550 bonus shares by virtue of her holding on March, 2,005. Fair market value of the shares of A Ltd. on April, 2001 is Rs. 45. In January 2021, she transferred all her shares @ Rs. 280 per share (brokerage 2%). The FMV of shares as on 31-01-2018 is Rs. 150 per share. Compute the capital gains taxable in the hands of Ms. Neelima assuming -

- (i) A Ltd. is an unlisted company and securities transaction tax was not applicable at the time of sale.
- (ii) A Ltd. is a listed company and the shares are sold in a recognised stock exchange and securities transaction tax was paid at the time of purchase and sale.

(8 Marks, IPCC May 2013)

Solution:

(i) Computation of capital gains [unlisted shares]

(amount in Rs.) -

Particulars	Original shares [A]	Ist Bonus shares [B]	IIInd Bonus shares [C]
No. of shares	500	50	550
Full value of consideration (@ Rs. 280 per share)	1,40,000	14,000	1,54,000
Less: Brokerage paid	2,800	280	3,080
Net sale consideration	1,37,200	13,720	1,50,920
Less: Indexed cost of acquisition (Rs. 45 x 500 x 301/100)	67,725	6,773	Nil
Long term capital gain	69,475	6,948	1,50,920
Long term capital gains [A + B + C]			2,27,340

Notes: Cost of acquisition of bonus shares shall be NIL.

Computation of capital gains [Listed shares] (amount in Rs.) -

Particulars	Original shares [A]	Ist Bonus shares [B]	IIInd Bonus shares [C]
No. of shares	500	50	550
Full value of consideration (@ Rs. 280 per share)	1,40,000	14,000	1,54,000
Less: Brokerage paid	2,800	280	3,080
Net sale consideration	1,37,200	13,720	1,50,920
Less: Cost of acquisition [No benefit of indexation will be available as per Section 112A]	75,000	7,500	82,500
Long term capital gain	62,200	6,220	68,420
Long term capital gains [A + B + C]			1,36,840

Illustration 62 - Computation of Capital Gains and Tax Liability: Mr. Roy, aged 55 years owned a Residential House in Ghaziabad. It was acquired by Mr. Roy on 10-10-1986 for Rs. 6,00,000. The fair market value as on

01-04-2001 was Rs. 1,80,00,000. He sold it for Rs. 53,00,000 on 4-11-2020. The stamp valuation authority of the state fixed value of the property at Rs. 85,00,000. The Assessee paid 2% of the sale consideration as brokerage on the sale of the said property. Mr. Roy Acquired a Residential House property at Kolkata on 10-12-2020 for Rs. 10,00,000 and deposited Rs. 7,00,000 on 10-04-2021 and Rs. 5,00,000 on 15-06-2021 in the capital gains bonds of Rural Electrification Corporation Ltd. He deposited Rs. 4,00,000 on 06-07-2021 and Rs. 3,00,000 on 01-11-2021 the capital gain deposit scheme in a Nationalized Bank for construction of an additional floor on the residential house property in Kolkata.

Compute the Capital Gain chargeable to Tax for the Assessment Year 2021-22 and Income Tax chargeable thereon assuming Mr. Roy has no other income. (8 Marks, May 2014) (Similar: 8 Marks, May 2017)

Solution: Computation of Capital Gains (amounts in Rs.) -

Full Value of Consideration (i.e. Stamp Duty Value)	[WN-1]	85,00,000
Less: Expenses on transfer (2% expenses on transfer of Rs. 53,00,000)		1,06,000
Net consideration		83,94,000
Less: Cost being: Indexed Cost of Acquisition (Rs. 18,00,000 $\times$ 301 $\div$ 100)		54,18,000
Long Term Capital Gains		29,76,000
Less: Exemption u/s 54 (Rs. 10,00,000 + Rs. 4,00,000)	[WN-2]	14,00,000
Exemption u/s 54EC in respect of bonds of REC	[WN-3]	7,00,000
Taxable Long Term Capital Gains		8,76,000
Total Income (rounded off)		8,76,000
Tax on long-term capital gains	[WN-4]	1,25,200
Add: HEC @ 4%		5,008
Tax payable (rounded off)		1,30,210

Working Notes:

- (1) In case the stamp duty value fixed by the stamp valuation authority exceeds 110% of actual sale consideration, the stamp duty value shall be deemed as the full value of consideration.
- (2) Exemption u/s 54 is available if one/two new residential house(s) is/are purchased within 1 year before or 2 years after the date of transfer. Here the new house is purchased within the said time limit, further the cost of new residential house is less than the capital gain, capital gain to the extent of cost of new asset is exempt u/s 54. Besides this the amount deposited in capital gains account scheme on or before the due date of furnishing the return of income shall also qualify for deduction even if it is deposited for construction of additional floor of the house.
- (3) Exemption under section 54EC is available in respect of investment in bonds of Rural Electrification Corporation only if the investment is made within a period of 6 months after the date of such transfer. In this case the investment made after 6 months amounting Rs. 5,00,000 shall not qualify for exemption under section 54EC.
- (4) Tax on LTCG = 20% of (Rs. 8,76,000 - basic exemption limit of Rs. 2,50,000 (assuming that the assessee is resident in India) = 20% of Rs. 6,26,000 = Rs. 1,25,200.
- (5) Since the total income of Mr. Roy exceeds Rs. 5,00,000, he is not entitled for tax rebate under Section 87A.

Illustration 63 - Computation of capital gains and tax liability: Mr. Martin sold his residential house property on 08-06-2020 for Rs. 70 lakhs which was purchased by him for Rs. 20 lakhs on 05-05-2006.

- (1) He paid Rs. 50,000 as brokerage for the sale of said property. The stamp duty valuation assessed by sub registrar was Rs. 89.5 lakhs.
- (2) He bought another house property on 25-12-2020 for Rs. 15 lakhs.
- (3) He deposited Rs. 10 lakhs on 10-11-2020 in the capital gain bond of National Highway Authority of India (NHAI).
- (4) He deposited another Rs. 10 lakhs on 10-07-2021 in the capital gain deposit scheme with SBI for construction of additional floor of house property.
Compute income under the head "Capital Gains" for A.Y. 2021-22 as per Income-tax Act, 1961 and also Income tax payable on the assumption that he has no other income chargeable to tax. (8 Marks, Nov. 2015)

Solution: Computation of capital gains and tax thereon in the hands of Mr. Martin

(amounts in Rs.) -

Full value of consideration	[WN-1]	89,50,000
Less: Brokerage		50,000
Net sale consideration		89,00,000
Less: Indexed cost of acquisition (Rs. 20,00,000 x 301/122)		49,34,426
Capital Gains		39,65,574
Less: Exemption under section 54	[WN-2]	25,00,000
Exemption under section 54EC	[WN-3]	10,00,000
Income by way of Long-term capital gain Total Income (rounded off)		4,65,570
Less: Basic Exemption Limit of Rs. 2,50,000	[WN-4]	2,50,000
LTCG on which tax imposable		2,15,570
Income Tax @ 20%		43,114
Less: Tax rebate u/s 87A [100% of tax or Rs. 12,500 whichever is less]		12,500
Balance Income tax		30,614
Add: Health & Education cess @ 4%		1,225
Tax payable (rounded off)		31,840

- (3) Exemption under section 54EC = amount deposited in NHAI bonds on 10-11-2020 (within 6 months from the date of transfer) = Rs. 10 lakhs.
- (4) Since Mr. Martin is a resident individual having no other income, hence, he will be entitled to basic exemption limit in respect of the income from LTCG - Section 112.

Illustration 64 - Conversion of Capital Asset into stock in trade: Ms. Gunjan purchased a land at a cost of 150 lakh in the financial year 2001-02 and held the same as her capital asset till 31st August, 2013. She started her real estate business on 1st September, 2013 and converted the said land into stock-in-trade of her business on the said date, when the fair market value of the land was Rs. 320 lakh.

She constructed 8 flats of equal size, quality and dimension. Cost of construction of each flat is Rs. 36 lakh. Construction was completed in January, 2021. She sold 5 flats at Rs. 90 lakh per flat in February, 2021. She invested Rs. 70 lakh in bonds issued by National Highways Authority of India on 31st March, 2021.

Compute the capital gains and business income arising from the above transactions in the hands of Ms. Gunjan for Assessment Year 2021-22 indicating clearly the reasons for treatment for each item.

Solution: Computation of capital gains and business income of Ms. Gunjan for A.Y. 2021-22

(amount in Rs.):

Capital Gains:	
Fair market value of land on the date of conversion deemed as the full value of consideration for the purposes of section 45(2)	3,20,00,000
Less: Indexed cost of acquisition [Rs. 50,00,000 $\times$ 220/100]	1,10,00,000
	2,10,00,000
Proportionate capital gains arising during the A.Y. 2021-22 (Rs. 2,10,00,000 $\times$ 5/8)	1,31,25,000
Less: Exemption under section 54EC (restricted to Rs. 50 lakh)	50,00,000
Capital gains chargeable to tax for A.Y. 2021-22	81,25,000
Business Income	
Sale price of flats [5 $\times$ Rs. 90 lakh]	4,50,00,000
Less: Cost of flats -	
Fair market value of land on the date of conversion (Rs. 3,20,00,000 $\times$ 5/8)	2,00,00,000
Cost of construction of flats [5 $\times$ Rs. 36 lakh]	1,80,00,000
Profits and Gains of Business or Profession	70,00,000

Working Notes:

- (1) The conversion of a capital asset into stock-in-trade is treated as a transfer under section 2(47). It would be treated as a transfer in the year in which the capital asset is converted into stock-in-trade.
- (2) However, as per section 45(2), the capital gains arising from the transfer by way of conversion of capital assets into stock-in-trade will be chargeable to tax only in the year in which the stock-in-trade is sold.
- (3) The indexation benefit for computing indexed cost of acquisition would be available only up to the year of conversion of capital asset to stock-in-trade and not up to the year of sale of stock-in-trade.
- (4) For the purpose of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted into stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.
In this case, since only 5/8th of stock-in-trade (5 flats out of 8 flats) is sold in the P.Y. 2020-21 only proportionate capital gains (i.e. 5/8th) would be chargeable to tax in the A.Y. 2021-22.
- (5) On sale of such stock-in-trade (i.e., flats, in this case), business income would arise. The business income chargeable to tax would be the price at which the flats are sold as reduced by the fair market value on the date of conversion of the capital asset (i.e., land) into stock-in-trade and the cost of construction of flats.
- (6) In case of conversion of capital asset into stock-in-trade and subsequent sale of stock-in-trade, the period of 6 months, for the purpose of exemption under section 54EC, is to be reckoned from the date of sale of stock-in-trade [CBDT Circular No. 791 dated 02-6-2000]. In this case, since the investment in bonds of NHAI has been made within 6 months of sale of flats, the same qualifies for exemption under section 54EC, subject to a maximum of Rs. 50 lakh.

Illustration 65 - Capital gains in case of Reverse Mortgage and Tax liability : Mrs. Mahalakshmi an individual, aged 68 years, mortgaged her Residential Property, purchased for Rs. 3 lakhs on 01-10-2002, with a bank, under a notified reverse mortgage scheme and was sanctioned a loan of Rs. 20 lakhs. As per the said

scheme she was receiving the loan amount in equal monthly installments of Rs. 30,000 per month from the bank. Mrs. Mahalakshmi was not able to repay the loan on maturity and in lieu of settlement of the loan surrenders the residential property to the bank. Bank sold the property for 125 lakhs on 22-02-2021. She had no other income during the year.

Discuss the Tax consequences and compute tax for the Assessment Year 2021-22.

Cost Inflation Index: 2002-03 = 1.05 and 2020-21 = 301. (5 Marks, May 2018)

Solution: The tax consequences in hands of Mrs. Mahalakshmi are as under:

(1) **At the time of mortgage:**

- As per section 47(xvi), any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government will not be regarded as a transfer. Therefore, capital gains tax liability is not attracted.
- Section 10(43) provides that the amount received by a senior citizen as a loan, either in lump sum or in installments, in a transaction of reverse mortgage would be exempt from income-tax. Therefore, the amount received by Mrs. Mahalakshmi in a transaction of reverse mortgage of her residential building is exempt under section 10(43).

(2) **At the time of alienation of house property:** When the bank alienates the property for the purpose of recovery of the loan on non-payment of the loan, then the same will constitute 'transfer' and the capital gains so computed will be taxed accordingly.

Thus, Capital Gains in hands of Mrs. Mahalakshmi are as under:

Full value of consideration	25,00,000
Less: Indexed cost of acquisition (Rs. 3,00,000 $\times$ 301 $\div$ 105)	8,60,000
Long-term capital gains/ Gross Total Income	16,40,000
Less: Deduction under Chapter VI-A	Nil
Total Income (rounded off)	16,40,000
Tax on long-term capital gains [Tax on LTCG = 20% of (Rs. 16,40,000 - Basic exemption limit of Rs. 3,00,000 (assuming that the assessee is resident in India))]	2,68,000
Less: Tax rebate u/s 87A (Nil, since her Total Income exceeds Rs. 5,00,000)	Nil
Balance tax	2,68,000
Add: HEC@4%	10,720
Tax payable (rounded off)	2,78,720

7

INCOME FROM OTHER SOURCES

Topic Referencer

- ❖ Incomes taxable under Income from Other Sources
- ❖ Deemed Dividend and its Taxability
- ❖ Taxability of Gifts
- ❖ Deductions in Computing Income from Other Sources

INCOMES TAXABLE UNDER INCOME FROM OTHER SOURCES

1. Discuss the basis of charge of 'Income from Other Sources' as per Section 56.

Ans: The basis of charge of 'Income from Other Sources' as per Section 56 is as under -

- (1) **Income from Other Sources [Section 56]:** 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 other four heads. Thus, this head is the residuary head of income and brings within its scope all the taxable incomes which are outside the scope of any other head.
- (2) **Conditions to be satisfied to tax any income under this head:** The following conditions must be satisfied to tax any receipt under this head -
- (a) such receipt must be income;
 - (b) such income must not be exempt by virtue of any provisions of the Act;
 - (c) such income must not be charged as an income under any other heads of income.

2. What are the various incomes specifically chargeable under the head 'Income from Other Sources'?

Ans: According to Section 56(2), the following incomes shall be chargeable to income-tax under the head "Income from other sources", namely -

Sec. 56(2)	Income taxable under the head 'Income from Other Sources'
(i)	Dividends.
(ib)	Lottery winnings: Winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever. As per Explanation: ➤ 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.
(ic)	Employees contribution towards staff welfare schemes : Any sum received by the assessee from his employees as contributions to any Provident Fund or Superannuation Fund or any fund set up under the provisions of the 'Employees' State Insurance Act or any other fund for the welfare of such employees, if such income is not chargeable to tax under the head 'Profits and Gains of Business or Profession'.

(id)	Interest on securities: Income by way of interest on securities, if it is not chargeable to tax under the head 'Profits and Gains of Business or Profession'.
(ii)	Hire Income of Plant, Machinery and Furniture: Income from machinery, plant or furniture belonging to the assessee and let on hire, if the income is not chargeable to tax under the head "Profits and gains of business or profession".
(iii)	Hire Income of Plant, Machinery and Furniture along with building: Income from letting on hire machinery, plant or furniture belonging to the assessee along with building and the letting of the building is inseparable from the letting of the said machinery, plant or furniture, if such income is not chargeable to income-tax under the head "Profits and gains of business or Profession".
(iv)	Keyman insurance policy receipts: Any sum received under a Keyman insurance policy including any sum allocated by way of 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".
(viib)	Shares issued by Private limited Company - Issue price exceeds FMV of shares: Where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares. However, this clause 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 specified fund; or (ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf. Explanation: (a) The fair market value of the shares shall be the value - (i) as may be determined in accordance with such method as may be prescribed; or (ii) as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares, of its assets, including intangible assets being goodwill, knowhow, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, whichever is higher, (b) "Venture capital company", "venture capital fund" and "venture capital undertaking" shall have the meanings respectively assigned to them in Section 10(23FB). (c) "Specified fund" means a fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or a Category II Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012 made under the Securities and Exchange Board of India Act, 1992; (d) "Trust" means a trust established under the Indian Trusts Act, 1882 or under any other law for the time being in force.
(viii)	Interest on compensation: Income by way of interest received on compensation/ enhanced compensation under Section 145B(1).
(ix)	Advance money forfeited : Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if,— (a) such sum is forfeited; and (b) the negotiations do not result in transfer of such capital asset.
(x)	Any sum of money or value of property received without consideration or for inadequate consideration in the hands of the recipient.

(xi)	Any compensation or other payment, due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto.

Other incomes taxable under this head:

- Income from sub-letting
- Interest on bank deposits and loans
- Director's fee
- Interest on foreign Government securities
- Agricultural income received from outside India
- Income of race establishment
- Commission received by the director on giving bank guarantee for the company.

Illustration 1 - Taxability of Income under various heads: State under which heads the following incomes are taxable:

- (1) Rental income in case of dealer in property;
 - (2) Dividend on shares in case of a dealer in shares;
 - (3) Salary by a partner from his partnership firm;
 - (4) Rental income of machinery;
 - (5) Winnings from lotteries by a person having the same as business activity;
 - (6) Salaries payable to a Member of Parliament;
 - (7) Receipts without consideration;
 - (8) In case of retirement, interest on employee's contribution if provident fund is unrecognised.
- (4 Marks, IPCC Nov. 2010)

Solution: The taxability of the given incomes is discussed in the following table -

	Particulars	Head of Income
1.	Rental income in case of dealer in property	Income from house property.
2.	Dividend on shares in case of a dealer in shares	Income from other sources.
3.	Salary by partner from his partnership firm	Profit and gains of business or profession.
4.	Rental income of machinery	Profits and gains of business or profession. However, if the same is not taxable as business income, it is taxable as Income from Other Sources under section 56(2)(ii).
5.	Winnings from lotteries by a person having the same as business activity	Income from other sources.
6.	Salaries payable to a Member of Parliament	Income from other sources.
7.	Receipts without consideration	Income from other sources under section 56(2)(x).
8.	In case of retirement, interest on employee's contribution if provident fund is unrecognized	Income from other sources.

Illustration 2 - Issue price exceeds FMV of shares - Taxability : The following are the details of the shares issued by VSC Pvt. Ltd. during financial year 2020-21. Discuss the applicability of provisions of section 56(2)(vii) in the hands of the company :

(Rs. in lakhs)

S. No,	Face value of shares (Rs.)	FMV of shares (Rs.)	Issue price of shares (Rs.)

(i)	200	220	230
(ii)	200	230	220
(iii)	200	190	198
(iv)	200	190	210

Solution: The applicability of provisions of Section 56(2)(viib) in the hands of the VSC Pvt. Ltd. is as under -

S. No.	Face value of shares (Rs.)	FMV of shares (Rs.)	Issue price of shares (Rs.)	Applicability of section 56(2)(viib)
(i)	200	220	230	The provisions of Section 56(2)(viib) are attracted in this case since the shares are issued at a premium (i.e., issue price exceeds the face value of shares). The excess of the issue price of the shares over the FMV would be taxable under section 56(2)(viib). Hence, Rs. 10 lakhs (Rs. 230 lakhs - Rs. 220 lakhs) shall be treated as income in the hands of VSC Pvt. Ltd.
(ii)	200	230	220	The provisions of Section 56(2)(viib) are attracted since the shares are issued at a premium. However, no sum shall be chargeable to tax under the said section as the shares are issued at a price less than the FMV of shares.
(iii)	200	190	198	Section 56(2)(viib) is not attracted since the shares are issued at a discount, though the issue price is greater than the FMV.
(iv)	200	210	190	The provisions of section 56(2)(viib) are attracted in this case since the shares are issued at a premium. The excess of the issue price of the shares over the FMV would be taxable under section 56(2)(viib). Therefore, Rs. 20 lakhs (Rs. 210 lakhs - Rs. 190 lakhs) shall be treated as income in the hands of VSC Pvt. Ltd.

DEEMED DIVIDEND AND ITS TAXABILITY

3. Discuss the scope of dividend taxable under the head 'Income from Other Sources'.

Ans: The scope of dividend taxable under the head Income from other sources is as under —

(1) **Meaning of Dividend :** In ordinary sense, dividend means sum of money paid to or received by a shareholder proportionate to his shareholding in a company out of the total sum distributed.

(2) **Scope of Dividend:** Dividend includes deemed dividend as given in Section 2(22). As per the said section, "dividend" includes -

(a) **Distribution of accumulated profits, entailing release of assets :** Any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company.

Bonus shares : The bonus shares issued by a company to its equity shareholders is not treated as dividend since it does not involve any release of assets. However, if the bonus shares are redeemed (if such bonus shares are preference shares), then it will be treated as dividend at the time of such redemption since there involves release of assets.

- (b) **Distribution of debentures/ deposit-certificates to shareholders or bonus shares to preference shareholders :** Any distribution by a company of -
- (i) Debentures, debenture-stock, or deposit certificates in any form, whether with or without interest, to its shareholders; and
 - (ii) Bonus shares to its preference shareholders, to the extent to which the company possesses accumulated profits, whether capitalised or not.
- (c) **Distribution to shareholders on liquidation :** Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not.
- (d) **Distribution to shareholders on reduction of share capital :** Any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits, whether capitalised or not.
- (e) **Loan/ advances by a private company to its substantial shareholder/ concern :** Any payment made by a company, not being a company in which the public are substantially interested, of any sum by way of advance or loan, to the extent of accumulated profits (capitalised accumulated profits not included here)-
- (i) to a shareholder who is the beneficial owner of equity shares holding not less than 10% of the voting power.
 - (ii) to any concern (HUF/Firm/AOP/BOI/Company) in which the shareholder referred to in (i) above is a member or a partner and in which he has a substantial interest.
Substantial interest: A person is deemed to have a substantial interest if he holds 20% of the voting power (equity shares) in the company; or is beneficially entitled to 20% or more of the income of such concern.
 - (iii) to any person on behalf, or for the individual benefit, of shareholder referred to in (i) above.
- (3) **Exclusions :** Dividend does not include -
- (a) Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of Section 68 of the Companies Act, 2013.
 - (b) Any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).
 - (c) Any dividend paid by a company which is set-off by it against whole or any part of deemed dividend under section 2(22)(e), to the extent it is so set-off.
 - (d) Any advance or loan made to shareholder or such concern by a company in ordinary course of its business, where lending of money is substantial part of business of company.
 - (e) Any distribution made in accordance with Section 2(22)(c)/(d) in respect of any share issued for full cash consideration, where the holder of the share is not entitled in the event of liquidation to participate in the surplus assets.
- (4) **Accumulated profits in case of amalgamation [Explanation 2A] :** In the case of an amalgamated company, the accumulated profits, whether capitalised or not, or loss, as the case may be, shall be

increased by the accumulated profits, whether capitalised or not, of the amalgamating company on the date of amalgamation.

4. When does the dividend income accrue or arise?

Ans: The provisions relating to the year of taxability of dividend are contained in Section 8 of the Act, which are as follows -

- (1) Any dividend declared or distributed or paid by a company under section 2(22) of the Act shall be deemed to be the income of the previous year in which it is so declared, distributed or paid;
- (2) Any interim dividend shall be deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the member who is entitled to it.

5. Discuss the taxability of deemed dividend/ Income from units of mutual fund.

Ans: Taxability of deemed dividend/Income from units of mutual fund [Amended by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY 2021-22]: Deemed dividend under section 2(22)(a) to 2(22)(e) and income from units of mutual fund shall be taxed as follows -

(1) In hands of Shareholders/ Unit-holder:

- (a) **Taxable:** It shall be chargeable to tax since exemption available u/s 10(34)/10(35) has been withdrawn from assessment year 2021-22.
- (b) **Deduction :** No deduction shall be allowed from the dividend income, or income in respect of units of a Mutual Fund specified under section 10(23D) or income in respect of units from a specified company defined in the explanation to section 10(35), other than deduction on account of interest expense, and in any previous year such deduction shall not exceed 20% of the dividend income, or income in respect of such units, included in the total income for that year, without deduction under this section.
- (c) **Grossing up :** Since dividend income/income from units of mutual fund is subject to TDS u/s 194/194K @ 10%, hence such income is to be grossed up before being included in the total income of the assessee.
The net income shall be grossed up as follows -

$$\text{Gross Dividend} = \frac{\text{Net Dividend} \times 100}{[100 - (\text{Rate of TDS i. e. } 10)] \text{ i. e. } 90}$$

- (2) **In hands of Company/Mutual Fund:** The company/mutual fund will be not be liable to pay tax on distributed profits under section 115-Q/115R. However, company/mutual fund shall be liable to deduct tax at source @ 10% under section 194/194K. However, no such deduction shall be made u/s 194 in the case of a shareholder, being an individual, if—

- (a) the dividend is paid by the company by any mode other than cash; and
- (b) the amount of such dividend or, as the case may be, the aggregate of the amounts of such dividend distributed or paid or likely to be distributed or paid during the financial year by the company to the shareholder, does not exceed Rs. 5,000.

Similarly in case of mutual fund, TDS provisions will not be applicable where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year by the person responsible for making the payment to the account of, or to, the payee does not exceed Rs. 5,000.

Objective of amendment: Prior to amendment, the incidence of tax is, thus, on the payer company/Mutual Fund and not on the recipient, where it should normally be. The dividend is income in the hands of the shareholders and not in the hands of the company. The incidence of the tax should therefore, be on the recipient.

Moreover, the present provisions levy tax at a flat rate on the distributed profits, across the board irrespective of the marginal rate at which the recipient is otherwise taxed. The provisions are hence, considered, iniquitous and regressive. The present system of taxation of dividend in the hands of company/ mutual funds was reintroduced by the Finance Act, 2003 (with effect from the assessment year 2004-05) since it was easier to collect tax at a single point and the new system was leading to increase in compliance burden. However, with the advent of technology and easy tracking system available, the justification for current system of taxation of dividend has outlived itself. In view of above, necessary amendments have been carried out so that dividend or income from units are taxable in the hands of shareholders or unit holders at the applicable rate and the domestic company or specified company or mutual funds are not required to pay any DDT. It is also provided that the deduction for expense under section 57 of the Act shall be maximum 20% of the dividend or income from units.

Illustration 3 - Taxation of dividends received from domestic companies: XYZ Ltd. a domestic company, declared dividend of Rs. 150 lakh for the Financial Year 2020-21 and distributed the same on 31-07-2020. Mr. A holding 10% share in XYZ Ltd. received net dividend of 113.5 lakh in July, 2020. Mr. B holding 5% share in XYZ Ltd. received net dividend of Rs. 6.75 lakh in July, 2020.

Discuss the tax liabilities in the hands of Mr. A and Mr. B assuming that Mr. A and Mr. B have not received dividend from any other domestic company during the year. (3 Marks, May 2018)

Solution: In both the cases dividend received from shares of Indian company shall be chargeable to tax in hands of the shareholder. Gross dividend will be taxable in hands of shareholders. Thus, gross dividend of Rs. 15 lakh (Rs. 13.5 lakh $\div 90 \times 100$) received by Mr. A and gross dividend Rs. 7.5 lakh (Rs. 6.75 lakh 90×100) received by Mr. B will be chargeable to tax in their hands.

Illustration 4 - Taxation of dividends received from domestic companies: Mr. X resident individual 45 years of age gives the following information pertaining to the assessment year 2021-22 :

Particulars	Rs.
Business Income	15,00,000
Dividend from shares of Indian company (net)	9,00,000
Interest Expenses incurred on making investment in shares	2,50,000
Long term capital gains on sale of building	18,60,000

Determine the amount of Total Income and tax liability for the assessment year 2021-22.

Solution: Computation of amount of total income and tax liability for AY 2021-22

(amount in Rs.):

Business Income		15,00,000
Long term capital gains on sale of building		18,60,000
Income from other sources :		
Dividend from shares of Indian company [Gross Amount (Rs. 9,00,000 $\times$ 100 90)]	10,00,000	
Interest Expenses incurred for making investment in shares (Subject to maximum of 20% of dividend income)	2,00,000	8,00,000

Total Income (rounded off)		41,60,000

Tax liability: (amount in Rs.)

Long term capital gains taxable under Section 112 @ 20% (Rs. 18,60,000 x 20%)	3,72,000
Balance Income taxable at normal rates (Rs. 23,00,000)	5,02,500
Total Tax	8,74,500
Add: HEC @ 4%	34,980
Total tax liability (rounded off)	9,09,480
Less: TDS u/s 194 on dividends	1,00,000
Tax payable	8,09,480

Illustration 5 - Taxability of deemed dividend u/s 2(22)(e): Rahul, holding 28% of equity shares in a company, took a loan of Rs. 5,00,000 from the same company. On the date of granting the loan, the company had accumulated profits of Rs. 4,00,000. The company is engaged in some manufacturing activity.

- Is the amount of loan taxable as deemed dividend in the hands of Rahul, if the company is a company in which the public are substantially interested?
- What would be your answer, if the lending company is a private limited company (i.e.) a company in which the public are not substantially interested?

(5 Marks, PCC May 2011) (Similar 4 Marks, Nov. 2016)

Ans: The given case requires application of Section 2(22)(e) as follows -

- The provisions of section 2(22)(e) will not apply where the loan is given by a company in which public are substantially interested. In the given case, the loan would not be taxable as deemed dividend in the hands of Rahul as the company which has extended loan is a company in which public are substantially interested.
- If the loan is taken from a private limited company (i.e. a company in which the public are not substantially interested), which is a manufacturing company and not a company where lending of money is a substantial part of the business of the company, then, the provisions of section 2(22)(e) would be attracted.

Since Rahul is holding more than 10% of the equity shares in the company, thus loan granted by the company to him is treated as deemed dividend to the extent of accumulated profits.

Hence, the loan of Rs. 5 lakhs shall be deemed to be dividend in the hands of Mr. Rahul only upto the extent of accumulated profits of Rs. 4 lakhs. Accordingly, Rs. 4 lakhs shall be taxable in the hands of Mr. Rahul under section 2(22)(e) as deemed dividend.

- Examine with brief reasons, whether the following is chargeable to income-tax and the amount liable to tax with reference to the provisions of the Income-tax Act, 1961 : During the previous year 2020-21, Mrs. Aishwarya, resident, received a sum of Rs. 8,50,000 as dividend from Indian companies and Rs. 4,00,000 as dividend from Indian equity oriented mutual fund units. (2 Marks, Nov. 2018-NS)

Ans: Dividend from shares of Indian company and Dividend from units of Indian Equity oriented mutual fund is taxable in hands of Mrs. Aishwarya, Hence, taxable income in her hands is Rs. (8,50,000 + 4,00,000) = Rs. 12,50,000.

7. Explain briefly the chargeability of winnings from lotteries, crossword puzzles, horse races & card games.

Ans: Tax on Winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or gambling or betting of any form or nature whatsoever [Section 115BB] : Winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or gambling or betting of any form or nature whatsoever, shall be taxable @ 30% (plus surcharge, as applicable and HEC).

- **Grossing up of income :** Income in form of winnings from lotteries, crossword puzzles, card games or other games of any sort is subject to TDS under section 194B if it exceeds Rs. 10,000; and income from horse races is subject to TDS under section 194BB if it exceeds Rs. 10,000. Thus, such income is to be grossed up before being included in the total income of the assessee. The net income shall be grossed up as follows -

$$\text{Gross Winnings} = \frac{\text{Net Winnings} \times 100}{[100 - (\text{Rate of TDS i. e. } 30)] \text{ i. e. } 70}$$

Note: Winnings from races other than horse races are not subject to TDS.

- **No deduction in respect of expenditure to earn lottery winnings, etc.:** According to Section 58(4), no deduction in respect of any expenditure or allowance in connection with such income shall be allowed under any provision of this Act in computing the income by way of any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature.

8. Discuss the chargeability of income by way of interest on securities. .

Ans: The taxability of interest on securities is discussed as under -

- (1) **Interest on securities [Section 2(28B)]:** "Interest on securities" means -
- Interest on any security of the Central or State Government;
 - Interest on debentures or other securities for money issued by or on behalf of a local authority or a company or a corporation established by a Central, State or Provincial Act.
- (2) **Grossing up of interest:** Income in form of interest on securities is subject to TDS under section 193 @ 10% if it exceeds Rs. 5,000. However, no TDS is deducted from Government securities except from 7.75% Savings (Taxable) Bonds, 2018 if the interest exceeds Rs. 10,000.

Therefore, Gross Interest = [Net Interest $\times$ 100 $\times$ (100 - Rate of TDS)] i.e. Net Interest $\div$ 90%.

TAXABILITY OF GIFTS

9. Discuss the taxability of gift received by various persons in accordance with provisions of Section 56(2)(x).

Ans: The taxability of gifts received by any person -

- (1) **Cash Gifts, or Gifts of Movable Property, or Gifts of immovable property [Section 56(2) (x)]:** Where any person receives, in any previous year, from any person or persons on or after 01-04-2017 —

	Case	Amount Taxable
(a)	Cash gifts : Any sum of money, without consideration, the aggregate value of which exceeds Rs. 50,000,	the whole of the aggregate value of such

		sum.
(b)	<i>Immovable property without consideration or for inadequate consideration [Amended by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY 2021-22]:</i> <i>Any immovable property -</i> (i) <i>without consideration, the stamp duty value of which exceeds Rs. 50,000,</i> (ii) <i>for a consideration, the stamp duty value of such property as exceeds such consideration, if the amount of such excess is more than the higher of the following amounts, namely: —</i> (a) <i>the amount of Rs. 50,000; and</i> (b) <i>the amount equal to 10% of the consideration.</i> <i>[Analysis: Thus, the taxability will arise when stamp duty value exceeds 110% of the consideration or Rs. 50,000, whichever is more.]</i> <i>Stamp duty value on the date of agreement to be considered : Where the date of the agreement fixing the amount of consideration for the transfer of immovable property and the date of registration are not the same, the stamp duty value on the date of the agreement may be taken for this Section.</i> <i>However, this provision shall apply only in a case where the amount of consideration or a part thereof, has been paid by way of an account payee cheque or an account payee bank draft or by use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed, on or before the date of agreement for transfer of such immovable property, [(a) Credit Card; (b) Debit Card; (c) Net Banking; (d) IMPS (Immediate Payment Service); (e) IIP (Unified Payment Interface); (1) RTGS (Real Time Gross Settlement); (g) NEFT (National Electronic Funds Transfer), and (h) BHIM (Bharat Interface for Money) Aadhar Pay have been prescribed as mode of electronic payment]</i> <i>Where the stamp duty value of immovable property is disputed by the assessee on grounds mentioned in Section 50C(2), the Assessing Officer may refer the valuation of such property to a Valuation Officer, and the provisions of Section 50C and Section 155(15) shall, as far as may be, apply in relation to the stamp duty value of such property for the purpose of this sub-clause as they apply for valuation of capital asset under those sections.</i>	<i>the stamp duty value of such property.</i> <i>the aggregate fair market value of such property - Such consideration.</i>
(c)	<i>Movable property without consideration or for inadequate consideration: Any property, other than immovable property -</i> (i) <i>without consideration, the aggregate fair market value of which exceeds Rs. 50,000,</i> (ii) <i>for a consideration which is less than the aggregate fair market value of the property by an amount exceeding Rs. 50,000,</i>	<i>the whole of the aggregate fair market value of such property.</i> <i>the stamp duty value of such property - Such consideration.</i>

- (2) **Exceptions [Amended by Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 w.e.f. 01-04-2021]:** This clause shall not apply to any sum of money or any property received-
- (i) from any relative; or
 - (ii) on the occasion of the marriage of the individual; or
 - (iii) under a will or by way of inheritance; or
 - (iv) in contemplation of death of the payer or donor; or
 - (v) from any local authority as defined in Explanation to Section 10(20); or
 - (vi) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in section 10(23C); or
 - (vii) from any trust or institution registered under section 12A or Section 12AA or 12AB; or
 - (viii) by any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in Section 10(23C)(iv)/(v)/(vi)/(via); or
 - (ix) by way of transaction not regarded as transfer under section 47(i)/(iv)/(v)/(vi)/(viaa)/(vib)/(vic)/(vica)/(vicb)/(vid)/(vii); or
 - (x) from an individual by a trust created or established solely for the benefit of relative of the individual; or
 - (xi) from such class of persons and subject to such conditions, as may be prescribed.
- (3) **Meaning of Relative :** "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 persons referred to in items (ii) to (vi); and
- (b) **In case of a Hindu undivided family -** any member thereof.
- (4) **Meaning of various terms :**
- (a) "Property" means the following capital asset of the assessee, namely -
- (i) immovable property being land or building or both;
 - (ii) shares and securities;
 - (iii) jewellery;
 - (iv) archaeological collections;
 - (v) drawings;
 - (vi) paintings;
 - (vii) sculptures;
 - (viii) any work of art; or
 - (ix) bullion.
- (b) "Stamp duty value" means the value adopted or assessed or assessable by any stamp valuation authority for the purpose of payment of stamp duty in respect of an immovable property;
- (c) "Fair market value" of a property, other than an immovable property, means the value determined in accordance with the method as may be prescribed;
- (d) "Jewellery" shall have meaning assigned to it in Section 2(14). (Refer Chapter on Capital gains). Notes:

- (A) Sum of money includes not only cash but also cheque, drafts, fixed deposit receipts or a NSC since it represents a sum of money though not in cash.
- (B) The sum of money is taxable if aggregate value of gifts received by assessee from any person or persons exceeds Rs. 50,000. E.g.: If A receives Rs. 31,000 from B and Rs. 20,000 from C, then, since aggregate value of gifts received by A exceeds Rs. 50,000, thus whole of Rs. 51,000 is taxable.
- (C) The definition of property is exhaustive and no other asset can be included in the same.
- (D) According to Section 9(1) (viii), Income arising outside India, being any sum of money referred to in Section 2(24) (xviii) i.e. gift of money, paid by a person resident in India to a non-resident, not being a company, or to a foreign company shall be deemed to accrue or arise in India.

Illustration 6 - Taxability of the gifts : Check the taxability of the following gifts received by Mrs. Rashmi during the previous year and compute the taxable income from gifts :

- (i) On the occasion of her marriage on 14-8-2020, she has received Rs. 90,000 as gift out of which Rs. 70,000 are from relatives and balance from friends.
- (ii) On 12-9-2020, she has received gift of Rs. 18,000 from cousin of her mother.
- (iii) A cell phone of Rs. 21,000 is gifted by her employer on 15-08-2020.
- (iv) She gets gift of Rs. 25,000 from elder brother of her husband's grandfather on 25-09-2020.
- (v) She has received gift from her friend of Rs. 2,000 on 14-04-2020. (6 Marks, PE-II Nov. 2008)

Ans: The answer is as follows -

- (i) Not taxable since the same has been received by her on the occasion of marriage.
- (ii) Taxable since her mother's cousin does not fall in the category of relative.
- (iii) Gift from employer shall be chargeable to tax under the head 'Salaries' as the same exceeds Rs. 5,000.
- (iv) Taxable since brother of grandfather does not fall in the category of relative.
- (v) Taxable.

Therefore, the total taxable sum under income from other sources under section 56 = Rs. 18,000 + Rs. 25,000 + Rs. 2,000 = Rs. 45,000. Since the aggregate value of taxable gifts doesn't exceed Rs. 50,000, therefore, the same are not 'income' as per section 56(2)(x). Hence, none of the gifts shall be taxable in the hands of Mrs. Rashmi.

Illustration 7 - Taxability of gifts : Discuss the taxability of the following receipts in the hands of Mr. Sanjay Kamboj under the Income-tax Act, 1961. for A.Y. 2021-22 :

- (i) Rs. 51,000 received from his sister living in US on 1-6-2020.
- (ii) Received a car from his friend on payment of Rs. 2,50,000, the FMV of which was Rs. 5,50,000. Provisions of taxability or Non-taxability must be discussed. (3 Marks, May 2018-NS)

Ans:

- (i) **Not taxable :** Gift from sister i.e. 'relative' is not liable to tax under section 56(2) (x).
- (ii) **Not taxable:** Car is not included in the definition of property for the purpose of Section 56(2)(x), therefore, the same shall not be taxable.

Illustration 8 - Taxability under various heads of Income : Decide the following transactions in the context of Income-tax Act, 1961: (6 Marks, PCC May 2011)

- (i) Mr. B transferred 500 shares of Reliance Industries Ltd. to M/s. B Co. (P) Ltd. on 10-10-2020 for Rs. 3,00,000 when the market price was Rs. 5,00,000. The indexed cost of acquisition of shares for Mr. B was computed at Rs. 4,45,000. The transfer was not subjected to securities transaction, tax. Determine the income chargeable to tax in hands of Mr. B and M/s. B Co (P) Ltd. because of the above said transaction.

- (ii) Ms. Chhaya transferred a vacant site to Ms. Dayama for Rs. 4,25,000. The stamp valuation authority fixed the value of vacant site for stamp duty purpose at Rs. 6,00,000. The total income of Chhaya and Dayama before considering the transfer of vacant site are 50,000 and Rs. 2,05,000 respectively. The indexed cost of acquisition for Ms. Chhaya in respect of vacant site is Rs. 4,00,000 (computed). Determine the total income of both Ms. Chhaya and Ms. Dayama taking into account the abovesaid transaction.
- (iii) Mr. Cheqian is employed in a company with taxable salary income of Rs. 5,00,000. He received a cash gift of Rs. 1,00,000 from Atma Charitable Trust (registered under section 12 A A) in December 2020 for meeting his medical expenses. Is the cash gift so received from the trust chargeable to tax in the hands of Mr. Cheqian?

Solution: The answer is as follows -

- (i) Any movable property received for inadequate consideration by any person is chargeable to tax under section 56(2)(x), if the difference between aggregate Fair Market Value of the property and consideration exceeds Rs. 50,000. Thus, share received by M/s B. Co. (P) Ltd. from Mr. B for inadequate consideration is chargeable to tax under section 56(2)(x) to the extent of Rs. 2,00,000.

The indexed cost of acquisition (Rs. 4,45,000) less the actual sale consideration (Rs. 3,00,000) would result in a long term capital loss of Rs. 1,45,000 in the hands of Mr. B, which is eligible for set off against any other long term capital gain.

- (ii) Total Income of Chhaya = Rs. 50,000 + LTCG (Rs. 6 lakhs, being stamp value u/s 50C - Rs. 4 lakhs) = Rs. 2,50,000.

Total Income of Dayama = Rs. 2,05,000 + Rs. 1,75,000 = Rs. 3,80,000. [Difference between the stamp duty value of Rs. 6,00,000 and the actual consideration of Rs. 4,25,000 paid is taxable under section 56(2)(x) since the difference exceeds Rs. 50,000 being, the higher of Rs. 50,000 and 10% of consideration i.e. Rs. 42,500.]

- (iii) No, the cash gift so received by Mr. Cheqian shall not be taxable in his hands as any sum received without consideration i.e., as cash gift from a charitable trust registered u/s 12AA is specifically excluded u/s 56(2)(x).

Illustration 9 - Taxability of the gifts: The following details have been furnished by Mrs. Hemali, pertaining to the year ended 31-3-2021:

- (i) Cash gift of Rs. 51,000 received from her friend on the occasion of her "Shastipatha Poorthi", a wedding function celebrated on her husband completing 60 years of age. This was also her 25th wedding anniversary.
- (ii) On the above occasion, a diamond necklace worth Rs. 2 lakhs was presented by her sister living in Dubai.
- (iii) When she celebrated her daughter's wedding on 21-2-2021, her friend assigned in Mrs. Hemali's favour, a fixed deposit held by the said friend in a scheduled bank; the value of the fixed deposit and the accrued interest on the said date was Rs. 51,000.
- Compute the income, if any, assessable as income from other sources. (4 Marks, IPCC May 2011)

Solution: Computation of income assessable as income from other sources (amounts in Rs.):

Cash gift from friend on the occasion of a wedding function/ anniversary	[WN-1]	51,000
Diamond necklace received from sister	[WN-2]	Not Taxable

Gift from friend on the occasion of marriage of her daughter [W5N-3]	51,000
Income from Other Sources	1,02,000

Working Notes:

- (1) Any sum received by an individual on the occasion of the marriage of the individual is not liable to tax under section 56(2) (x). However, in this case, the gift is received on wedding anniversary or birthday of her husband, hence the same shall be taxable.
- (2) Gift from sister i.e. 'relative' is not liable to tax under section 56(2)(x). "
- (3) Gifts received on the occasion of the marriage of "the individual" i.e. on the marriage of the recipient of the gift, is outside the scope of tax. In the given case, the gift has been received on the occasion of the marriage of "daughter", hence, the same is not exempt. Section 56(2) (x) refers to any sum of money, which includes fixed deposits.

Illustration 10 - Taxability of the gifts : Mr. Sharma asks you to compute his taxable income from the following transactions which took place with his friends during January 2021-

- (i) Cash gifts received by him from Mr. A and Mr. Z : Rs. 32,000 each ;
- (ii) Two plot of lands gifted to him by Mr. B and Mr. C whose stamp values are Rs. 3,50,000 and Rs. 50,000 respectively;
- (iii) He purchased a residential house at Rs. 6,00,000 from Mr. D, which was not registered, but the prevalent stamp value of which was Rs. 7,50,000;
- (iv) A sculpture and jewellery worth 150,000 and Rs. 35,000 respectively were gifted by Mr. E and Mr. F;
- (v) A silver coin purchased by him at Rs. 10 lakhs from Mr. G, when prevalent market value is Rs. 10.5 lakhs and shares purchased by him at Rs. 3 lakhs from Mr. H, when fair market value thereof was Rs. 3.3 lakhs.
- (vi) A diamond ring purchased at Rs. 50 lakhs from M/s. Pearl Jewels (a jewellery shop of his close friend) when the fair market value was Rs. 55 lakhs for the purpose of Sharma Gem and Jewellery Mart (a jewellery shop owned by Mr. Sharma).

Solution: Mr. Sharma has received cash and various items of property, which are covered by Section 56(2)(x). Hence, the taxability of these amounts in view of said section is as follows -

Cash gifts received from Mr. A and Mr. Z	[W5N-1]	64,000
Gift of plot of land from Mr. B (fully taxable, as stamp value exceeds Rs. 50,000)		3,50,000
Gift of plot of land from Mr. C (not taxable, as stamp value doesn't exceed Rs. 50,000)		Nil
Residential house acquired for inadequate consideration	[W5N-2]	1,50,000
Sculpture and jewellery gifted by Mr. E and Mr. F	[W5N-3]	85,000
Silver coin and shares purchased by him from Mr. G and Mr. H	[W5N-4]	80,000
Diamond ring purchased from M/s. Pearl Jewels	[W5N-5]	Nil
Total Income		7,29,000

Working Notes:

Working Notes:

- (1) Aggregate of cash gifts received by Mr. Sharma = Rs. 32,000 $\times$ 2 = Rs. 64,000 i.e. exceeding Rs. 50,000, hence fully taxable.

- (2) Difference between the stamp duty value of Rs. 7,50,000 and the actual consideration of Rs. 6,00,000 paid is taxable under section 56(2)(x) since the difference exceeds Rs. 50,000 being, the higher of Rs. 50,000 and 10% of consideration i.e. Rs. 60,000.
- (3) Aggregate value of gift in form of movable properties = Rs. 50,000 + Rs. 35,000 = Rs. 85,000 i.e. exceeding Rs. 50,000, hence fully taxable.
- (4) Aggregate value of inadequate consideration of movable properties = (Rs. 10.5 lakhs - Rs. 10 lakhs) + (Rs. 3.3 lakhs - Rs. 3 lakhs) = Rs. 80,000 i.e. exceeding Rs. 50,000, hence, whole of the difference will be taxable.
- (5) Purchase of diamond ring for business purposes at less than fair market value cannot be treated as gift in hands of Mr. Sharma since the said ring is held as stock-in-trade by Mr. Sharma, hence cannot be regarded as property in the hands of Mr. Sharma, as the same is specifically excluded from the definition of capital asset. Accordingly, inadequacy of consideration is not taxable.

Illustration 11 - Taxability of gifts : Discuss the taxability or otherwise of the following in the hands of the recipient under section 56(2)(x) the Income-tax Act, 1961-

- (i) Ankit HUF received Rs. 1,75,000 in cash from niece of Ankit (i.e., daughter of Ankit's sister). Ankit is the Karta of the HUF.
- (ii) Nikita, a member of her father's HUF, transferred a house property to the HUF without consideration. The stamp duty value of the house property is Rs. 19,00,000.
- (iii) Mr. Rakshit received 100 shares of A Ltd. from his friend as a gift on occasion of his 25th marriage anniversary. The fair market value on that date was Rs. 120 per share. He also received jewellery worth Rs. 45,000 (FMV) from his nephew on the same day.
- (iv) Rakesh HUF gifted a car to son of Karta for achieving good marks in XII board examination. The fair market value of the car is Rs. 3,00,000.
- (v) Ms. Kareena purchased a land from PMC Co. a partnership concern for Rs. 7,15,000. The stamp duty value of the same was Rs. 12,00,000.

Solution: The taxability in the hands of the recipient under section 56(2)(x) is as under -

S. No.	Taxable/ Non-taxable	Amount liable to tax (Rs.)	Reason
(i)	Taxable	1,75,000	Sum of money exceeding Rs. 50,000 received without consideration from a non relative is taxable under section 56(2)(x). Daughter of Mr. Ankit's sister is not a relative of Ankit HUF, since she is not a member of Ankit HUF.
(ii)	Non-taxable	Nil	Immovable property received without consideration by a HUF from its relative is not taxable under section 56(2)(x). Since Nikita is a member of the HUF, she is a relative of the HUF. However, income from such asset would be included in the hands of Nikita under section 64(2).
(iii)	Taxable	57,000	As per provisions of section 56(2)(x), in case the aggregate fair market value of property, other than immovable property, received without consideration exceeds Rs. 50,000, the whole of the aggregate value shall be taxable. In this case, the aggregate fair market value of shares (Rs. 12,000) and jewellery (Rs. 45,000) exceeds Rs. 50,000. Hence, the entire amount of Rs. 57,000 shall be taxable.
(iv)	Non-taxable	Nil	Car is not included in the definition of property for the purpose

			of section 56(2)(x), therefore, the same shall not be taxable.
(v)	Taxable	4,85,000	Difference between the stamp duty value of Rs. 12,00,000 and the actual consideration of Rs. 7,15,000 paid is taxable under section 56(2) (x) since the difference exceeds Rs. 50,000 being, the higher of Rs. 50,000 and 10% of consideration i.e. Rs. 71,500.

Illustration 12 - Taxability of various receipts: Discuss the taxability or otherwise in the hands of the recipients, as per the provisions of the Income-tax Act, 1961:

(2 x 4 = 8 Marks, May 2016)

- ABC Private Limited, a closely held company, issued 10,000 share at Rs. 130 per share. (The face value of the share is Rs. 100 per share and the fair market value of the share is Rs. 120 per share).
- Mr. A received an advance of Rs. 50,000 on 1-9-2020 against the sale of his house. However, due to non-payment of instalment in time, the contract has cancelled and the amount of Rs. 50,000 was forfeited.
- Mr. N, a member of his father's HUF, transferred a house property to the HUF without consideration. The value of the house is Rs. 10 lacs as per the registrar of stamp duty.
- Mr. Kumar gifted a car to his sister's son (Sunil) for achieving goods marks in CA Final exam. The fair market value of the car is Rs. 5,00,000.

Ans:

- The provisions of Section 56(2) (viib) are attracted in this case since the shares of a closely held company are issued at a premium (i.e., the issue price of Rs.130 per share exceeds the face value of Rs. 100 per share) and the issue price exceeds the fair market value of such shares.
The consideration received by the company in excess of the fair market value of the shares would be taxable under section 56(2)(viib).
Therefore, Rs. 1,00,000 [i.e., (Rs. 130 - Rs. 120) x 10,000 shares] shall be the income chargeable u/s 56(2)(viib) in the hands of ABC Private Limited.
- Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if such sum is forfeited and the negotiations do not result in transfer of such capital asset. Hence, amount of Rs. 50,000 received by Mr. A will be taxable as income from other sources.
- Any property received without consideration by a HUF from its relative is not taxable u/s 56(2)(x). Since "N" is a member of his father's HUF, he is a "relative" of the HUF. Therefore, if HUF receives any property (house, in this case) from its member, i.e., "N", without consideration, then, the stamp duty value of such property will not be chargeable to tax in the hands of the HUF, since gift received from a "relative" is excluded from the scope of section 56(2)(x).
- Car is not included in the definition of property for the purpose of section 56(2)(x), therefore, the same shall not be taxable.

Illustration 13 - Capital gains & Gift in case of inadequate consideration: Mr. Raj Kumar sold a house to his friend Mr. Dhruv on 1st November, 2020 for a consideration of Rs. 25,00,000. The Sub-Registrar refused to register the document for the said value, as according to him, stamp duty had to be paid on Rs.45,00,000, which was the Government guideline value. Mr. Raj Kumar preferred an appeal to the Revenue Divisional Officer, who fixed the value of the house as 32,00,000 (Rs. 22,00,000 for land; balance for building portion). The differential stamp duty was paid, accepting the said value determined. Assuming that the fair market value is Rs. 32,00,000, what are the tax implications in the hands of Mr. Raj Kumar and Mr. Dhruv for the

assessment year 2021-22 Rs. Mr. Raj Kumar had purchased the land on 1st June, 2006 for Rs. 5,19,000 and completed the construction of house on 1st December, 2019 for Rs. 14,00,000. (6 Marks, IPCC May 2010)

Solution: Computation of capital gains in the hands of Mr. Rajkumar: In case a land is held by the assessee for more than 24 months but the building constructed over it is held for not more than 24 months, then there will be long-term capital gains on sale of the land and short-term capital gains on sale of building. - *CIT v. Citibank N.A.* [2003] 261 ITR 570 (Bom.)

In the given case, the land was purchased on 1-6-2006 and sold on 1-11-2020, hence, it is a long-term capital asset; while the building thereon was constructed on 1-12-2019, hence it is a short-term capital asset.

As per provisions of Section 50C, if the stamp duty value adopted by stamp valuation authority is disputed in appeal and the same is reduced by the appellate authority, the reduced value shall be taken to be full value of consideration for computing the capital gains chargeable to tax since the difference between the stamp duty value (as reduced) and the actual consideration exceeds 10% of the actual consideration. Hence, in this case the full value of consideration for the purpose of computing capital gains shall be Rs. 32 lakhs (Rs. 22 lakhs for the land and Rs. 10 lakhs).

The relevant computations are as follows (amounts in Rs.):

Particulars	Land	Building
Full value of consideration	22,00,000	10,00,000
Less: Expenditure in connection with transfer (Not given)	Nil	Nil
Net consideration	22,00,000	10,00,000
Less: Indexed cost of acquisition of land [Rs. 5,19,000 $\times$ 301 $\div$ 122]	12,80,484	
Cost of acquisition of building		14,00,000
Long-term Capital Gains	9,19,516	
Short-term Capital Loss		-4,00,000
Taxable Capital Gains		5,19,516

Tax consequences in the hands of Dhruv: Mr. Rajkumar sold the house property to Mr. Dhruv for Rs. 25 lakhs, while its stamp value/fair value is Rs. 32 lakhs. Hence, there is an inadequate consideration of Rs. 7 lakhs (Rs. 32 lakhs - Rs. 25 lakhs), i.e. difference between the stamp duty value of Rs. 32 lakhs and the actual consideration of Rs. 25 lakhs paid is taxable under section 56(2)(x) since the difference exceeds Rs. 1,25,000 being, the higher of Rs. 50,000 and 10% of consideration (Rs. 25,00,000) i.e. Rs. 2,50,000.]

Illustration 14 - Computation of Total Income : Ms. Mohini transferred a house to her friend Ms. Ragini for Rs. 35,00,000 on 01-10-2020. The Sub Registrar valued the land at Rs. 50,00,000. Ms. Mohini contested the valuation and the matter was referred to Divisional Revenue Officer, who valued the house at Rs. 48,50,000. Accepting the said value, differential stamp duty was also paid and the transfer was completed.

The total income of Mohini and Ragini for the assessment year 2021-22, before considering the transfer of said house are Rs. 2,80,000 and Rs. 3,45,000, respectively. Ms. Mohini had purchased the house on 15th May 2010 for Rs. 25,00,000 and registration expenses were Rs. 1,50,000.

You are required to explain provisions of Income-tax Act, 1961 applicable to present case and also determine the total income of both Ms. Mohini and Ms. Ragini taking into account the above said transactions. (8 Marks, May 2015)

Solution: Computation of Total Income chargeable to tax of Ms. Mohini (amount in Rs.):

Capital Gains		
Full value of consideration (Section 50C) [WN]	48,50,000	
Less: Indexed cost/cost of acquisition (Rs. 26,50,000 x 301 -167)	47,76,347	73,653
Other Income		2,80,000
Total Income (rounded off)		3,53,650

Working Notes: As per provisions of Section 50C, if the stamp duty value adopted by stamp valuation authority is disputed in appeal and the same is reduced by the appellate authority, the reduced value shall be taken to be full value of consideration for computing the capital gains chargeable to tax since the difference between the stamp duty value (as reduced) and the actual consideration exceeds 10% of the actual consideration. Hence, in this case the full value of consideration for the purpose of computing capital gains shall be Rs. 48.50 lakhs.

Computation of Total Income chargeable to tax of Ms. Ragini (amount in Rs.):

Income from other sources :	
Purchase of Immovable property for inadequate consideration [Note]	13,50,000
Other Income	3,45,000
Total Income	16,95,000

Note : Since Ms. Ragini purchased immovable property for inadequate consideration, as per Section 56(2)(x) (Rs. 48,50,000 - Rs. 35,00,000) = Rs. 13,50,000 i.e. difference between the stamp duty value of Rs. 48.50 lakhs and the actual consideration of Rs. 35 lakhs paid is taxable under section 56(2) (x) as Income from other sources, since the difference exceeds Rs. 3,50,000 being, the higher of Rs. 50,000 and 10% of consideration (Rs. 35,00,000) i.e. Rs.3,50,000.]

Illustration 15 - Capital gains & Gift in case of inadequate consideration: Mr. Subramani sold a house plot to Mrs. Vimala for 45 lakhs on 12-05-2020. The valuation determined by the stamp valuation authority was Rs. 53 lakhs. Discuss the tax consequences of above, in the hands of each one of them, viz, Mr. Subramani & Mrs. Vimala. Mrs. Vimala has sold this plot to Ms. Padmaja on 21-03-2021 for Rs. 55 lakhs. The valuation as per stamp valuation authority remains the same at Rs. 53 lakhs. Compute the capital gains arising on sale of the house plot by Mrs. Vimala.

Note : None of the parties viz Mr. Subramani, Mrs. Vimala & Ms. Padmaja are related to each other; the transactions are between outsiders. (6 Marks, Nov. 2018-NS)

Solution: Tax implications in hands of Mr. Subramani: As per Section 50C, where the value adopted or assessed or assessable by the stamp valuation authority exceeds 110% of the consideration received, the stamp duty value shall be deemed to be the full value of the consideration. Hence, in the given case - Sales consideration = Rs. 45,00,000, 110% of Sale Consideration Rs. 49,50,000, Stamp duty value = Rs. 53,00,000. Hence, Rs. 53,00,000 will be taken as Full Value of consideration in hands of Mr. Subramani for computing his capital gains.

Tax implications in hands of Mrs. Vimala on purchase of immovable property : Difference between the stamp duty value of Rs. 53,00,000 and the actual consideration of Rs. 45,00,000 paid is taxable under section 56(2)(x) since the difference exceeds Rs. 4,50,000 being, the higher of Rs. 50,000 and 10% of consideration i.e.

Rs. 450000. Thus, Income from other sources taxable in hands of Mrs. Vimala = Rs. 8,00,000 [Rs. 53,00,000 - Rs. 45,00,000].

Sale of immovable property to Ms. Padmaja : Capital Gains will arise in hands of Vimala on sale of immovable property to Padmaja. Since immovable property is not held for more than 24 months, the resultant capital gains shall be short term capital gains. The stamp duty value so taken into account for computing Income from other sources shall become cost of acquisition in hands of Vimala as per provisions of Section 49(4). Short term capital gains : [Rs. 55,00,000 - Rs. 53,00,000] = Rs. 2,00,000.

Illustration 16 - Tax implications on issue of shares at premium : MLX Investments (P) Ltd. was incorporated during previous year 2018-19 having a paid up capital of Rs. 10 lakhs. In order to increase its capital, the company further issues, 1,00,000 shares (having face value of Rs. 100 each) during the year at par as on 01-08-2020. The FMV of such share as on 01-08-2020 was Rs. 85.

- (i) Determine the tax implications of the above transaction in the hands of company, assuming it is the only transaction made during the year.
- (ii) Will your answer change, if shares were issued at Rs. 105 each?
- (iii) What will be your answer, if shares were issued at Rs. 105 and FMV of the share was Rs. 120 as on 01-08-2020?

(4 Marks, Nov. 2019)

Solution: According to Section 56(2)(viib), where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be taxable as Income from other sources in hands of company.

- (i) In this case, since MLX Investments (P) Ltd., a closely held company issued 1,00,000 shares (having face value of Rs. 100 each) at par i.e., Rs. 100 each, though issue price is greater than FMV, no amount would be chargeable to tax as income from other sources.
- (ii) In case shares are issued at premium of Rs. 5 per share, the difference between issue price and FMV of shares i.e. (Rs. 105 - Rs. 85) $\times$ 1,00,000 = Rs. 20,00,000 shall be taxable as Income from other sources.
- (iii) If shares are issued at Rs.105 each and FMV of share is Rs. 120 each, no amount would be chargeable to tax even though the shares were issued at a premium, since shares are issued at a price which is less than the fair market value but for shareholder, the same may be taxable in his hands under section 56(2)(x), since the shares are purchased for inadequate consideration and the difference exceeds Rs. 50,000.

10. Discuss the taxability of interest on compensation enhanced compensation.

Ans: Interest on compensation/ enhanced compensation : The taxability of interest on compensation/enhanced compensation is as under -

- (1) **Head of income [Section 56]:** Such interest shall be chargeable to tax as income from other sources.
- (2) **Year of taxability [Section 145B(1)] :** Such interest shall be deemed to be the income of the year in which it is received.
- (3) **Deduction in respect of such income [Section 57(iv)]:** A deduction of a sum equal to 50% of such interest income shall be allowed and no deduction shall be allowed under other provision of section 57. Thus, the taxable interest income = 50% of interest income received.

Illustration 17 - Interest on enhanced compensation : On 10-10-2020, Mr. Govind (a bank employee) received Rs. 5,00,000 towards interest on enhanced compensation from State Government in respect of compulsory acquisition of his land effected during the financial year 2011-12. Out of this interest, Rs. 1,50,000 relates to the financial year 2015-16; Rs. 1,65,000 to the financial year 2016-17; Rs. 1,85,000 to the financial year 2017-18. He incurred Rs. 50,000 by way of legal expenses to receive the interest on such enhanced compensation. How much of interest on enhanced compensation would be chargeable to tax for assessment year 2021-22? (4 Marks, IPCC Nov. 2011)

Solution: Section 145B provides that interest received by the assessee on enhanced compensation shall be deemed to be the income of the assessee of the year in which it is received, irrespective of the method of accounting followed by the assessee and irrespective of the financial year to which it relates. Section 56(2)(viii) states that such income shall be taxable as 'Income from other sources'. 50% of such income shall be allowed as deduction by virtue of section 57(iv) and no other deduction shall be permissible from such Income. Therefore, legal expenses incurred to receive the interest on enhanced compensation would not be allowed as deduction from such income.

Computation of interest on enhanced compensation taxable as "Income from other sources" for the A.Y. 2021-22 (Rs.):

Interest on enhanced compensation	5,00,000
Less: Deduction under section 57 (50% of Rs. 5,00,000)	2,50,000
Taxable interest on enhanced compensation	2,50,000

DEDUCTIONS IN COMPUTING INCOME FROM OTHER SOURCES

11. What are the deductions allowable under section 57 of the Income-tax Act, 1961 in respect of "Income from other sources"? (May 2003)

Ans: **Deductions [Section 57]:** The income chargeable under the head "Income from other sources" shall be computed after making the following deductions -

- (1) In the case of dividends or interest on securities : In the case of dividends or interest on securities, any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such dividend or interest on behalf of the assessee.

However, no deduction shall be allowed from the dividend income, or income in respect of units of a Mutual Fund specified under section 10(23D) or income in respect of units from a specified company defined in the Explanation to section 10(35), other than deduction on account of interest expense, and in any previous year such deduction shall not exceed 20% of the dividend income, or income in respect of such units, included in the total income for that year, without deduction under this section. [Amended by Finance Act, 2020 w.e.f. 01-04-2021 i.e. AY2021-22]

- (2) Where any sum is received by an employer from employees as contribution to any provident fund, superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act - a deduction will be allowed in accordance with the provisions of section 36(1)(va) i.e. to the extent the contribution is remitted to the employees account before the due date under the respective Acts.
- (3) Where the income is from letting on hire of machinery, plant and furniture, with or without building, the following deductions as provided in section 30, 31, 32 read with section 38 shall be allowed :

- (a) the amount paid on account of any current repairs to the machinery, plant or furniture.
 - (b) the amount of any premium paid in respect of insurance against risk of damage or destruction of the machinery or plant or furniture.
 - (c) the normal depreciation allowance in respect of the machinery, plant or furniture, due thereon.
- (4) In the case of family pension - a deduction of a sum equal to one-third of such income or Rs. 15,000, whichever is less, is allowable.
- (5) Any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income is deductible.
- (6) A deduction of 50% of income by way of interest on compensation/ enhanced compensation received chargeable to tax under section 56(2)(viii).

12. What are the deductions not allowed while computing income under the head 'Income from Other Sources'?

Ans: **Amounts not deductible [Section 58] :** The following amounts shall not be deductible in computing the income chargeable under the head 'Income from other source' :

- (i) Any personal expense of the assessee;
- (ii) Any interest chargeable to tax under the Act which is payable outside India on which tax has not been paid or deducted at source;
- (iii) Any payment which is chargeable under the head 'Salaries', if it is payable outside India unless tax has been paid thereon or deducted at source;
- (iv) Disallowances specified u/s 40(a) (ia) of the Act;
- (v) Any sum paid on account of wealth tax;
- (vi) All disallowances under section 40A;
- (vii) No deduction in respect of any expenditure or allowance in connection with such income shall be allowed under any provision of this Act in computing the income by way of any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature.

However, this provision shall not apply in computing 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. Thus, no deduction whether in respect of any expenditure or set-off of losses/allowances or deduction under Chapter VI-A or otherwise is allowable in computing income from lottery winnings, etc. Such income after grossing up is taxed at flat rate of 30% without allowing basic exemption limit.

Illustration 18 - Computation of gross total income : J furnishes the following particulars relating to his house properties and other incomes and expenditure for the year 2020-21:

- (1) **First House :** This house is taken by him on lease for 10 years which is let to a tenant, for his residence, at a monthly rent of Rs. 2,400. He has incurred the following expenses during this year:
- | | |
|--|---------------------|
| Lease rent | Rs. 1,000 per month |
| Salary of Durban | Rs. 200 per month |
| Interest on loan taken to pay for the acquisition of the lease | Rs. 200 per month |
- (2) **Second House :** This house was constructed by him in 1988, but was transferred to his wife in 1992 out of love and affection. He, however, continues to stay in this house with his wife till date. He has taken a loan for the construction of this house for which interest of Rs. 6,000 becomes due for the year, but had not been paid by him. He has paid repair expenses of Rs. 1,000 during the year.

- (3) Taxable income from business for this year amounts to Rs. 64,000.
Compute gross total income of J for the assessment year 2021-22. (CA Nov. 1998)

Solution: Computation of Gross Total Income of J (amounts in Rs.) -

Income from House Property			
Net Annual Value of Self-occupied House II	[WN-1]	Nil	
Less: Interest on borrowed capital		6,000	
Profits and Gains from Business or Profession			
Income from other sources			
Rent of House I (Rs. 2,400 x 12)	[WN-2]	28,800	
Less: Lease rent (Rs. 1,000 x 12)		12,000	
Salary of Durban (Rs. 200 x 12)		2,400	
Interest on loan taken to pay for the acquisition of the lease (Rs. 200 x 12)		2,400	
Gross Total Income		70,000	

Working Notes:

- (1) Since Second House has been transferred by J to his wife without adequate consideration, hence he shall be to be the deemed owner of such house. Thus, the same is taxable in his hands.
- (2) Since First House is taken by J on lease of 10 years i.e. less than 12 years, hence he is not the deemed owner of this house. Thus, income from this house shall be taxable in the hands of J under the head 'Income from Other Sources'.

Illustration 19 - Computation of income from other sources : From the following particulars of Pankaj for the previous year ended 31st March, 2021 compute the Income under the head "Income from other Sources".

S.No.	Particulars	Rs.
(i)	Directors Fee from a Company	10,000
(ii)	Interest on Bank Deposits	3,000
(iii)	Income from undisclosed source	12,000
(iv)	Winnings from Lotteries (Net)	33,936
(v)	Royalty on a book written by him	9,000
(vi)	Lectures in Seminars	5,000
(vii)	Interest on loan given to a relative	7,000
(viii)	Interest on Debentures of a Company (listed in a Recognized Stock Exchange) Net of Taxes	7,200
(ix)	Interest on Post Office Savings Bank Account	500
(x)	Interest on Government Securities	2,200
(xi)	Interest on Monthly Income Scheme of Post office	33,000

He paid Rs. 1,000 for typing the manuscript of book written by him.

(6 Marks, IPCC Nov. 2009)

Solution: Computation of the Income under the head "Income from other Sources" (amounts in Rs.) -

(i)	Directors Fee from a Company	10,000
(ii)	Interest on Bank Deposits	3,000
(iii)	Income from undisclosed source	12,000
(iv)	Winnings from Lotteries [WN-1]	48,480
(v)	Royalty on a book written by him [WN-2]	8,000
(vi)	Lectures in Seminars	5,000
(vii)	Interest on loan given to a relative	7,000
(viii)	Interest on Debentures of a Company (listed in a Recognized Stock Exchange) Net of Taxes [WN-3]	8,000
(ix)	Interest on Post Office Savings Bank Account [WN-4]	Exempt
(X)	Interest on Government Securities	2,200
(Xi)	Interest on Monthly Income Scheme of Post office	33,000
	Income from other sources	1,36,680

Working Notes:

- Gross winnings from lotteries = Income (net of TDS) $\times 100 - (100 - \text{TDS rate}) = \text{Rs. } 33,936 \times 100 - 70 = \text{Rs. } 48,480$.
- Royalty income is taxed under the head 'Profits and gains of Business or Profession' only if the assessee is an author by profession. In the given case, it is assumed that the royalty income doesn't fall under PGBP head, hence the same shall be taxable under the head 'Income from Other Sources'.
Taxable Amount = Royalty Less Expenses on typing manuscript = Rs. 9,000 - Rs. 1,000 = Rs. 8,000.
- Gross interest on debentures = Rs. 7,200 $\times 100 - 90 = \text{Rs. } 8,000$.
- Interest on Post Office Savings Bank Account is exempt under section 10(15) upto Rs. 3,500.

Illustration 20 - Taxability of various receipts: State with brief reasoning whether the following receipts are chargeable to income-tax or are exempt (if chargeable, the amount taxable is to be mentioned) for the assessment year 2021-22 :

Nature of receipt	Amount (Rs.)
Interest on enhanced compensation received on 12-03-2021 for acquisition of urban land, of which 40% relates to the earlier year.	96,000
Rent received for letting out agricultural land for a movie shooting.	72,000

Computation is NOT required. (4 Marks, Nov. 2013)

Solution:

- Section 145B(1) provides that interest received by the assessee on enhanced compensation shall be deemed to be the income of the assessee of the year in which it is received, irrespective of the method of accounting followed by the assessee and irrespective of the financial year to which it relates. Section 56(2) (viii) states that such income shall be taxable as 'Income from other sources'. 50% of such income shall be allowed as deduction by virtue of section 57(iv) and no other deduction shall be permissible from such Income. Hence, taxable interest under the head Income from other sources is Rs. 48,000.
- Income derived from any farm building or land from its use for non-agricultural purposes (including letting for residential purpose or for the purpose of any business or profession) shall not be agricultural income. Hence, Rent received for letting out agricultural land for a movie shooting shall be chargeable to tax.

Illustration 21 - Taxability of various receipts: Discuss the tax implications under section 56(2) in respect of each of the following transactions —

- (1) Mr. Tejpal received a painting by M. F. Hussain worth Rs. 2 lakh from his nephew on his 10th wedding anniversary.
- (2) Verma's son transferred shares of D Ltd. to Verma HUF without any consideration. The fair market value of the shares is Rs. 2.5 lakh.
- (3) Sunshine (P) Ltd. purchased 9,500 equity shares of Saturn (P) Ltd. at Rs. 86 per share. The fair market value of the share on the date of transaction is Rs. 105.
- (4) Bijali (P) Ltd. issued 28,000 equity shares of Rs. 10 each at a premium of Rs. 8. The fair market value of each share on the date of issue is Rs. 15.
- (5) Mr. Sharan's land was acquired by the Government in August 2011. He received interest of Rs. 5,40,000 on enhanced compensation in January, 2021, out of which Rs. 1,20,000 related to the year 2017-18, Rs. 1,60,000 related to the year 2018-19, Rs. 2,00,000 related to the year 2019-20 and 60,000 related to the year 2020-21.
- (6) Mr. Rajan decided to sell capital asset to Mr. Mahajan and received an advance of Rs. 1,00,000 on 1st October, 2020. Mr. Mahajan could not pay the balance sum and advance money was forfeited by Mr. Rajan on 15th January, 2021. (Similar: 2 Marks, Nov. 2016)

Solution: Tax implications under section 56(2):

- (1) Since paintings are included in the definition of "property", therefore, when paintings are received without consideration, the same is taxable under section 56(2)(x), as the aggregate fair market value of paintings exceed Rs. 50,000. Therefore, Rs. 2,00,000, being the value of painting gifted by his nephew, would be taxable under section 56(2)(x) in the hands of Mr. Tejpal, since "nephew" is not included in the definition of "relative" thereunder.
- (2) Any property received without consideration by a HUF from its relative is not taxable under section 56(2)(x). Since Verma's son is a member of Verma HUF, he is a "relative" of the HUF. Therefore, if Verma HUF receives any property (shares, in this case) from its member, i.e., Verma's son, without consideration, then, the fair market value of such shares will not be chargeable to tax in the hands of the HUF, since gift received from a "relative" is excluded from the scope of section 56(2)(x).
- (3) The difference between the aggregate fair market value of shares of a closely held company and the consideration paid for purchase of such shares is deemed as income in the hands of the purchasing company u/s 56(2)(x), if the difference exceeds Rs. 50,000. Accordingly, in this case, the difference of Rs. 1,80,500 [i.e., (Rs. 105 - Rs. 86) × 9,500] is taxable u/s 56(2)(x) in the hands of Sunshine (P) Ltd.
- (4) The provisions of Section 56(2)(viib) are attracted in this case since the shares of a closely held company are issued at a premium (i.e., the issue price of Rs. 18 per share exceeds the face value of Rs. 10 per share) and the issue price exceeds the fair market value of such shares.

The consideration received by the company in excess of the fair market value of the shares would be taxable under section 56(2)(viib).

Therefore, Rs. 84,000 [i.e., (Rs. 18 - Rs. 15) × 28,000 shares] shall be the income chargeable under section 56(2)(viib) in the hands of Bijali (P) Ltd.

- (5) As per section 145B(1), interest received on enhanced compensation shall be deemed to be the income of the previous year in which it is received, irrespective of the method of accounting followed by the

assessee. Therefore, in this case, interest on enhanced compensation received by Mr. Sharan in January, 2021 shall be deemed to be the income of P.Y. 2020-21, i.e., the year of receipt, irrespective of the method of accounting followed by him. Such interest is taxable under section 56(2)(viii).

(Rs. 1,20,000 + Rs. 1,60,000 + Rs. 2,00,000 + Rs. 60,000)	5,40,000
Less: Deduction under section 57(iv) @ 50% of Rs. 5,40,000	2,70,000

- (6) Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if such sum is forfeited and the negotiations do not result in transfer of such capital asset. Hence, amount of Rs. 1,00,000 received by Mr. Rajan will be taxable as income from other sources.

Illustration 22 - Taxability of gifts - Section 9(1)(viii) and Section 56(2)(x) : Mr. Y a non resident has received the following gifts from his friend R. who is resident in India during the half year ending 31-03-2021. Determine his Income from other sources.

- (1) Gift of Rs. 25 lakh by NEFT transfer from X's bank account (PNB, Mumbai) to Y's bank account in New York, US.
- (2) Gift of Rs. 15 lakh to Y (X has a bank account in Citibank, New York. Permission of RBI has taken for this purpose. This gift is transferred from Citibank, New York account of X to the account of Y in Deutsche Bank, New York).
- (3) Gift of house property situated in New Jersey (market value: Rs. 2.70 crore).
- (4) Diamond Jewellery (market value Rs. 50 lakh) given in New York from X's locker in New York.

Solution: According to Section 9(1)(viii), Income arising outside India, being any sum of money referred to in Section 2(24)(xviii) i.e. gifts, paid on or after 05-07-2019 by a person resident in India to a non-resident, not being a company, or to a foreign company shall be deemed to accrue or arise in India. In light of the above provisions the taxability in hands of Mr. Y is as under (amount in Rs.):

(1) Gift by way of NEFT to foreign bank [The same shall be taxable in India as the Income is deemed to accrue or arise in India as per the provisions of Section 9(1)(viii)]	25,00,000
(2) Gift by bank transfer in New York [The same shall be taxable in India as the Income is deemed to accrue or arise in India as per the provisions of Section 9(1)(viii)]	15,00,000
(3) Gift of house property situated in New Jersey [The same shall not be taxable in India as the provisions of Section 9(1)(viii) applies only in respect of money and not in respect of other property]	Nil
(4) Gift of diamond Jewellery outside India [The same shall not be taxable in India as the provisions of Section 9(1)(viii) applies only in respect of money and not in respect of other property]	Nil
Income from Other Sources	40,00,000

