VG STUDY HUB

TAXATION EXAM TRAP

THE MASTERBOOK

308 Exam Traps Explained Simply



Understand the Question.
Spot the Mistake.
Get the Answer Right.

By CA Vivek Gaba

Your Gaba (VG) Sir

Relevant for - December 2026 & Jan 2027 Exams

Taxation Exam TRAP

DETAILED STUDENT EDITION | 308 TRAPS

Book Prepared by CA Vivek Gaba
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39 theory traps + 269 practical question traps. All 255 traps from the earlier book are retained, with 53 additional practical cases.

Within each chapter, read the theory traps and then the practical traps. The numbering continues within that chapter and restarts at Trap 1 in the next chapter. Read each question point, identify the mistake, then check the explanation and worked example.

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★★★★★ **Revise first.** Stars indicate teaching priority; they do not promise a repeated or future exam question. Normal/old scheme means the same scheme. Default scheme means section 115BAC.

Law basis: financial year 2025-26 / assessment year 2026-27, under the 1961 Act as amended by Finance Act, 2025. Use the assessment year and institute applicability stated for your question. Worked cases are teaching examples; source references are on the final page.

Chapter 1: Basic Concepts

THEORY TRAPS

Trap 1 | Person, assessee and individual are different

Sections 2(7) and 2(31); Finance Act rate schedule

Question trap: A partnership firm has taxable income below ₹5 lakh. The question asks whether it can use individual tax slabs and claim the section 87A rebate.

Student mistake: A student treats every taxpayer as an individual and gives the firm a basic exemption and rebate.

Final result: First identify the taxpayer. A person can be an individual, Hindu undivided family, firm, limited liability partnership, company, association of persons, body of individuals or another statutory category. An assessee can also be a person whose loss or refund is assessed. A firm or limited liability partnership generally pays 30% tax. It pays 12% surcharge if income exceeds ₹1 crore, subject to marginal relief, and 4% cess. Individual basic exemptions and the section 87A rebate do not apply to it.

Trap 2 | First previous year and same-year assessment

Section 3; Sections 172, 174, 174A, 175 and 176

Question trap: A business was ready to operate before its first sale. Another statement says that income can never be assessed in the same year in which it is earned.

Student mistake: A student starts the first previous year from the first sale and accepts the statement without checking exceptions.

Final result: The first previous year of a new business runs from its setting-up date to 31 March. Its first sale may happen later. An assessment year always has 12 months. The Act has special same-year assessment rules for non-resident shipping, permanent departure from India, temporary associations, disposal of assets to avoid tax and discontinued businesses. For a discontinued business, the tax officer may choose same-year assessment. Therefore, check the case before writing that assessment must happen in the next year.

Chapter 1: Basic Concepts (continued)

THEORY TRAPS

Trap 3 | Who can use the default scheme?

Section 115BAC(1A)

Question trap: A non-resident individual and an association of persons whose members are all companies want to use section 115BAC. The question asks whether either is excluded.

Student mistake: A student assumes that the default scheme is available only to resident individuals.

Final result: Section 115BAC covers individuals, Hindu undivided families, eligible associations of persons, bodies of individuals and specified artificial juridical persons. A non-resident individual can also use it. Firms, limited liability partnerships, companies and co-operative societies cannot use this scheme. An association of persons is not excluded merely because all its members are companies. Its separate maximum surcharge of 15% is a different condition. The default scheme gives the same basic slab limits regardless of an individual's age.

Trap 4 | Choosing the old scheme ★★★★★

Section 115BAC(6); Form 10-IEA

Question trap: A taxpayer with business income chose the old scheme, later returned to the default scheme, and now wants to choose the old scheme again.

Student mistake: A student allows a fresh choice every year without checking whether business or professional income continues.

Final result: A person without business or professional income can choose the old scheme each year through a return filed on time under section 139(1). A person with such income must submit Form 10-IEA by the prescribed due date. That choice continues in later years and can be withdrawn once. After withdrawal, the old scheme generally cannot be chosen again while business or professional income continues. Check the income category before allowing a change of scheme.

Chapter 1: Basic Concepts (continued)

PRACTICAL QUESTION TRAPS

Trap 5 | Old scheme: age and the ₹5 lakh rebate ★★★★★

Finance Act rate schedule; Section 87A main provision

Question trap: The question gives a senior citizen's age and residential status. It may also place taxable income just above ₹5 lakh or give a 60th or 80th birthday on 1 April 2026.

Student mistake: A student gives age-based relief to a non-resident or allows rebate even when income is just above ₹5 lakh.

Final result: Under the old scheme, a resident individual gets a basic exemption of ₹2.5 lakh below age 60, ₹3 lakh at ages 60 to 79, and ₹5 lakh from age 80. A person's 60th or 80th birthday on 1 April 2026 is treated as attained on 31 March 2026. A non-resident gets ₹2.5 lakh regardless of age. Section 87A gives a resident individual a rebate of up to ₹12,500 only when total income does not exceed ₹5 lakh. There is no corresponding rebate marginal relief just above this limit. Tax under section 112A cannot be reduced by this rebate.

Worked example: A resident below age 60 has ordinary taxable income of ₹5,00,010. Tax before cess is ₹12,502. The rebate is nil because income exceeds ₹5 lakh.

Chapter 1: Basic Concepts (continued)

PRACTICAL QUESTION TRAPS

Trap 6 | Default scheme: ₹4 lakh is not ₹12 lakh ★★★★★

Sections 115BAC and 87A; Section 87A; Sections 16(ia), 87A and 115BAC

Question trap: A Hindu undivided family and a resident individual each have ₹8 lakh of ordinary taxable income under the default scheme. The question asks whether both have no tax to pay.

Student mistake: A student treats ₹12 lakh as a basic exemption available to every taxpayer.

Final result: The nil-rate slab ends at ₹4 lakh. Each next ₹4 lakh band is taxed at 5%, 10%, 15%, 20% and 25%, respectively. Income above ₹24 lakh is taxed at 30%. The separate rebate of up to ₹60,000 is available only to a resident individual, including a resident but not ordinarily resident, whose total income does not exceed ₹12 lakh. A Hindu undivided family or non-resident gets no rebate. The zero-tax illustration for gross salary of ₹12.75 lakh assumes a ₹75,000 standard deduction, no additional taxable income and no special-rate tax left outside the rebate.

Worked example: The Hindu undivided family pays ₹20,000 tax plus ₹800 cess. The eligible resident individual gets a full rebate on the slab tax on the same ordinary income.

Trap 7 | Special-rate income and rebate ★★★★★

Section 87A, second proviso

Question trap: A resident individual under the default scheme has ₹10 lakh of ordinary taxable income and ₹2 lakh of capital gains taxable under section 111A. The shares are sold during financial year 2025-26.

Student mistake: A student removes the capital gain from the ₹12 lakh income test or uses the rebate to cancel capital-gains tax.

Final result: Use total income for the ₹12 lakh test, including income taxed at special rates. However, the rebate can reduce only tax calculated at section 115BAC slab rates. Tax charged at a special rate remains payable. Keep these two checks separate: what enters total income, and which tax can be reduced by rebate. An ordinary taxable dividend normally attracts slab rates.

Worked example: Total income is ₹12 lakh. The rebate removes the ₹40,000 slab tax on ordinary income. The ₹40,000 capital-gains tax remains payable. Add ₹1,600 cess, giving total tax of ₹41,600.

Quick help: Income threshold mein include; special-rate tax par rebate nahi.

Chapter 1: Basic Concepts (continued)

PRACTICAL QUESTION TRAPS

Trap 8 | Marginal relief just above ₹12 lakh ★★★★★

Section 87A first proviso (b)

Question trap: A resident individual under the default scheme has only ordinary taxable income of ₹12,10,000. This is just ₹10,000 above the rebate limit.

Student mistake: A student immediately charges the full slab tax because total income exceeds ₹12 lakh.

Final result: Check section 87A marginal relief. For an eligible resident individual, compare income-tax before cess with the amount by which total income exceeds ₹12 lakh. If tax is higher, the relief may reduce it. If special-rate income is present, also apply the restriction on which tax can receive rebate. Do not apply the ordinary-income shortcut without that check.

Worked example: Slab tax is ₹61,500, but income exceeds ₹12 lakh by only ₹10,000. Relief of ₹51,500 leaves tax of ₹10,000. Add ₹400 cess, so the total is ₹10,400.

Trap 9 | Surcharge: income bands and the 15% cap ★★★★★

Finance Act rate schedule; Finance Act rate schedule: mixed income

Question trap: An individual has ordinary income of ₹1.8 crore and capital gains under section 112 of ₹40 lakh. Only the capital gains take total income above ₹2 crore.

Student mistake: A student applies 25% surcharge to every part of the tax, or calculates surcharge on income itself.

Final result: Calculate surcharge on tax. For individuals, the rate is 10% above ₹50 lakh, 15% above ₹1 crore and 25% above ₹2 crore. Under the old scheme, it becomes 37% above ₹5 crore; the default-scheme maximum is 25%. Surcharge on dividend tax and tax under sections 111A, 112 and 112A is capped at 15%. Where only these specified incomes push total income above ₹2 crore and the remaining income does not exceed ₹2 crore, the applicable surcharge rate is generally 15%. Also check marginal relief.

Worked example: Total income is ₹2.2 crore, but the remaining ordinary income is only ₹1.8 crore. Do not apply 25% surcharge to its tax merely because the combined income exceeds ₹2 crore.

Chapter 1: Basic Concepts (continued)

PRACTICAL QUESTION TRAPS

Trap 10 | Surcharge marginal relief: use the full base ★★★★★

Finance Act rate schedule

Question trap: Total income is slightly above a surcharge threshold, such as ₹1 crore or ₹2 crore. The question asks for tax after marginal relief.

Student mistake: A student compares with basic tax at the threshold and forgets the surcharge already payable at that threshold.

Final result: First calculate actual tax plus surcharge. Compare it with tax plus the applicable surcharge at the threshold, then add the income exceeding that threshold. Where marginal relief applies, use the lower amount and add cess afterwards. The comparison must include any lower-band surcharge already applicable at the threshold. This relief is different from the section 87A relief around ₹12 lakh.

Worked example: At the ₹1 crore threshold, the comparison tax includes 10% surcharge. At the ₹2 crore threshold, it includes 15% surcharge. Leaving out this surcharge gives incorrect relief.

Trap 11 | Calculation order and rounding

Sections 10, 80A and 87A; Sections 288A and 288B

Question trap: The question gives deductions, rebate, tax already deducted and income ending in ₹5. It asks for the final amount payable after cess and rounding.

Student mistake: A student subtracts rebate from income, calculates cess on income, or rounds every intermediate amount.

Final result: An exemption keeps qualifying income outside tax. A deduction reduces eligible gross total income. A rebate reduces tax. Round total income to the nearest ₹10 under section 288A. Then calculate tax, rebate, surcharge and any applicable relief, followed by 4% cess. Tax deducted at source and advance tax are credits for tax already paid. Round the final tax payable or refund to the nearest ₹10 under section 288B. A last digit of 5 is rounded upwards.

Worked example: Total income of ₹8,25,005 becomes ₹8,25,010. If tax plus surcharge after relief is ₹25,000, cess is 4% of ₹25,000, which is ₹1,000.

Chapter 1: Basic Concepts (continued)

PRACTICAL QUESTION TRAPS

Trap 12 | Unexplained income: 60% is not the final rate ★★★★★

Sections 68-69D and 115BBE

Question trap: Unexplained income of ₹1 lakh is taxable under section 115BBE. The taxpayer also has expenses or a loss and wants to adjust them against this income.

Student mistake: A student allows the adjustment and then treats 60% as the complete tax rate.

Final result: Income covered by sections 68 to 69D attracts 60% tax under section 115BBE. Add surcharge equal to 25% of that tax, then add 4% cess. The combined burden is 78%, before any separate penalty. No expense deduction, allowance deduction or adjustment of loss is allowed against this income.

Worked example: On unexplained income of ₹1 lakh, tax is ₹60,000 and surcharge is ₹15,000. Cess on ₹75,000 is ₹3,000. Total tax is therefore ₹78,000.

Trap 13 | Domestic company: which year's turnover?

Finance Act rate schedule; sections 115BAA and 115BAB

Question trap: A domestic company's turnover was ₹390 crore in 2023-24 and ₹600 crore in 2025-26. The question asks for its normal tax rate for assessment year 2026-27.

Student mistake: A student uses the latest turnover figure and applies the 30% normal rate.

Final result: For assessment year 2026-27, test the normal 25% domestic-company rate using turnover or gross receipts of financial year 2023-24. That amount must not exceed ₹400 crore. Otherwise, the general rate is 30%. Keep optional schemes separate. A valid section 115BAA option gives 22% tax, 10% surcharge and 4% cess, giving an effective rate of 25.168%. Eligible manufacturing income under section 115BAB attracts 15% tax, with an effective rate of 17.16%. Check all conditions of the option before applying it.

Worked example: The relevant turnover is ₹390 crore. The later ₹600 crore turnover does not, by itself, increase the normal rate from 25% to 30%.

Chapter 1: Basic Concepts (continued)

PRACTICAL QUESTION TRAPS

Trap 14 | Agriculture: location and processing

Sections 2(1A) and 10(1); Section 2(1A); Rule 7

Question trap: A farmer uses his own sugarcane in a factory. Its growing cost is ₹1 lakh, but its market value when used by the factory is ₹1.6 lakh.

Student mistake: A student treats the entire factory profit as agricultural income or uses growing cost as the factory's input cost.

Final result: Qualifying agricultural income under section 10(1) relates to land in India. Test foreign farming income under residential-scope rules. Dairy, poultry and fisheries are not automatically agricultural activities. Income from growing nursery saplings or seedlings is deemed agricultural. Ordinary processing needed to make one's produce marketable can remain agricultural; further manufacturing creates a business component. Under Rule 7, use the agricultural produce's market value in the business calculation.

Worked example: The factory takes ₹1.6 lakh as the sugarcane input cost in its business calculation. It does not use the farmer's ₹1 lakh growing cost for that step.

Trap 15 | Tea, rubber and coffee: split income, not sales ★★★★★

Rules 7A, 7B and 8

Question trap: A question gives either sales or composite income from growing and manufacturing tea in India. It asks for the agricultural and business portions.

Student mistake: A student applies the business percentage directly to sales without first finding the income.

Final result: First calculate income from the qualifying growing and manufacturing activity in India. The business portion is 40% for tea, 35% for rubber, and 25% for coffee grown and cured. It is 40% for coffee grown, cured, roasted and ground. The balance is agricultural income. A trader who merely buys and sells these products cannot use this split.

Worked example: Composite tea income of ₹10 lakh is divided into ₹4 lakh of business income and ₹6 lakh of agricultural income. If ₹10 lakh represents only sales, first calculate the income.

Chapter 1: Basic Concepts (continued)

PRACTICAL QUESTION TRAPS

Trap 16 | Agriculture and partial integration ★★★★★

Finance Act, First Schedule

Question trap: A resident below age 60 uses the old scheme. He has ordinary taxable non-agricultural income of ₹6 lakh and net agricultural income of ₹1 lakh.

Student mistake: A student ignores the agricultural income completely because it is exempt.

Final result: For an eligible taxpayer using slab rates, check partial integration when net agricultural income exceeds ₹5,000 and non-agricultural income exceeds the basic exemption. Calculate slab tax on the combined income. From this, subtract slab tax on agricultural income plus the basic exemption. Then apply any eligible rebate, surcharge and cess. Agricultural income remains exempt, but it helps determine the rate on the other income.

Worked example: Tax on ₹7 lakh is ₹52,500. Agricultural income of ₹1 lakh plus the ₹2.5 lakh basic exemption gives ₹3.5 lakh; tax on this amount is ₹5,000. The difference is ₹47,500. Add cess of ₹1,900.

Trap 17 | Paying someone directly does not always divert your income

Sections 4 and 5; diversion by overriding title

Question trap: A consultant earns ₹6 lakh of fees. At his request, the client pays ₹1.2 lakh directly to his family and pays him the balance.

Student mistake: The student includes only ₹4.8 lakh because the consultant did not personally receive the family payment.

Final result: The full fee belongs to the consultant. Paying part of it to discharge a personal obligation is application of income, not diversion. Include ₹6 lakh as gross professional receipts and consider eligible business deductions separately. A true overriding title diverts income before it becomes the taxpayer's own income. The timing of the bank transfer alone does not establish such a title.

Worked example: The family payment does not reduce the receipts to ₹4.8 lakh. It is not a professional expense merely because the client made the payment directly.

Chapter 1: Basic Concepts (continued)

PRACTICAL QUESTION TRAPS

Trap 18 | A member-club surplus and bank interest have different treatment

Principle of mutuality; section 56

Question trap: A members' recreation club has a ₹4 lakh surplus from qualifying mutual activities and ₹50,000 interest from a commercial bank deposit.

Student mistake: The student exempts both amounts simply because the recipient is a members' club.

Final result: Mutuality requires the relevant contributors and participants to form the same class, with the common funds used for that mutual purpose. Assume these conditions are met for the ₹4 lakh member surplus. The bank deposit is a separate commercial transaction outside that mutual activity. Its interest is taxable, ordinarily under Other Sources. Even the bank's membership of the club does not automatically protect the deposit interest.

Worked example: Keep the qualifying ₹4 lakh mutual surplus outside taxable income. Include the ₹50,000 bank interest, subject to any separately allowable deduction. Check each activity; the club's name does not give blanket exemption.

Trap 19 | An agricultural loss cannot reduce taxable salary

Finance Act rules for net agricultural income; section 10(1)

Question trap: An individual has ₹8 lakh taxable salary, ₹3 lakh profit from one Indian farm, ₹1.2 lakh loss from another and ₹80,000 eligible earlier agricultural loss.

Student mistake: The student subtracts the farm losses from salary, or uses ₹3 lakh as the agricultural income for rate purposes.

Final result: Compute net agricultural income separately under the applicable rules. Here it is ₹3 lakh - ₹1.2 lakh - ₹80,000 = ₹1 lakh. Agricultural losses cannot reduce the taxable salary. If partial integration applies, use the ₹1 lakh net agricultural income to calculate the rate on the ₹8 lakh taxable income. Check the permitted earlier-loss period and identity of the person entitled to it.

Worked example: Total taxable income remains ₹8 lakh, not ₹9 lakh and not ₹6 lakh. If the net agricultural calculation instead gives a loss, use nil agricultural income for the rate calculation.

Chapter 2: Residential Status and Scope of Total Income

THEORY TRAPS

Trap 1 | Citizenship does not decide residence

Section 6

Question trap: The question calls a person an Indian citizen but says that the person lives abroad. It asks for India residential status for the current previous year.

Student mistake: A student marks the person as resident merely because the passport is Indian.

Final result: Determine residential status under section 6 separately for each person and each previous year. An Indian citizen can be non-resident, and a foreign citizen can be resident. Citizenship matters only for the specific exceptions in the residence rules. Within one previous year, a person cannot have one India residential status for salary and another for a different income source.

Trap 2 | Residence of a Hindu undivided family, firm or company

Section 6(2) and 6(6)(b); Section 6(2)-(4); Section 6(3); CBDT Circular 8/2017

Question trap: A question gives the place where a firm is managed, the travel history of a Hindu undivided family's Karta and the location of a foreign company's board meeting.

Student mistake: A student applies the individual day-count test to every taxpayer or treats a board-meeting address as conclusive.

Final result: A Hindu undivided family, firm, limited liability partnership, association of persons or body of individuals is resident unless its control and management are wholly outside India. Only individuals and Hindu undivided families can be resident but not ordinarily resident. For a resident Hindu undivided family, use the Karta's history for that check. An Indian company is always resident. For a foreign company, the place of effective management is where key business decisions are actually made. Check applicable Central Board of Direct Taxes relief where turnover or gross receipts do not exceed ₹50 crore. A board-meeting address alone does not decide place of effective management.

Chapter 2: Residential Status and Scope of Total Income (continued)

THEORY TRAPS

Trap 3 | Foreign-source income in the ₹15 lakh test ★★★★★

Explanation to section 6

Question trap: Income is earned abroad from a profession set up in India, and the money goes to a foreign bank. The question asks whether it enters the section 6 ₹15 lakh test.

Student mistake: A student excludes the income just because it was earned or received abroad.

Final result: For section 6, foreign-source income generally means income that accrues or arises outside India. It does not include income from a business controlled in India or a profession set up in India. It also excludes income deemed to accrue in India. Therefore, these excluded amounts may enter the relevant ₹15 lakh calculation even if earned abroad. First calculate each income under its proper head. Do not compare gross receipts directly with the limit.

Worked example: Profit earned abroad from a profession set up in India enters the relevant ₹15 lakh calculation. Its receipt in a foreign bank does not change this treatment.

Trap 4 | Business connection and significant economic presence: only relevant income

Section 9(1)(i), Explanation 2A; Rule 11UD; Section 9(1)(i), Explanations 1-3

Question trap: A foreign enterprise has an Indian business connection. Its worldwide profit is ₹1 crore, but only ₹12 lakh is attributable to its Indian operations.

Student mistake: A student taxes the entire worldwide profit once an Indian connection is established.

Final result: Generally, include only the profit attributable to the Indian operations or connection. Significant economic presence may arise from prescribed India-linked payments exceeding ₹2 crore, or systematic and continuous business interaction or solicitation involving at least 3 lakh users in India. Finance Act 2025 excludes activities confined to purchasing goods in India for export from significant economic presence. A dependent agent may also create a business connection. Establishing a connection and measuring the taxable Indian profit are separate steps.

Worked example: The Indian connection does not, by itself, make the whole ₹1 crore Indian-source income. On the stated facts, ₹12 lakh is attributable to India.

Chapter 2: Residential Status and Scope of Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 5 | 182 OR 60 + 365 ★★★★★

Section 6(1); Section 6; ordinary day-count convention

Question trap: A foreign citizen who is not a person of Indian origin stayed in India for 70 days in the current previous year and 400 days in the preceding four previous years.

Student mistake: A student checks only the 182-day test or treats either 60 days or 365 days alone as sufficient.

Final result: Under the general rule, a person is resident after at least 182 current-year days. Alternatively, both conditions must be met: at least 60 current-year days and at least 365 days in the preceding four previous years. Replace the 60-day limit where a specific exception applies. Add all visits. In ordinary examination day counts, include arrival and departure dates. The preceding four, seven or ten years exclude the current previous year.

Worked example: The person is resident because 70 current-year days meet the 60-day condition and 400 earlier days meet the 365-day condition. If earlier stay were only 300 days, the general tests would give non-resident status.

Quick help: 60 aur 365 dono chahiye; sirf ek se resident nahi.

Trap 6 | Leaving for foreign employment or ship duty

Explanation 1(a) to section 6(1); Explanation 1(a) and (2) to section 6(1); Rule 126

Question trap: An Indian citizen leaves India for foreign employment after spending 175 days here. The question also gives a long stay in India during earlier years.

Student mistake: A student applies the usual 60-day condition and concludes that the person is resident.

Final result: For an Indian citizen leaving for foreign employment or as crew of an Indian ship, replace 60 days with 182 days. A holiday or business trip is not automatically covered. Separately, Rule 126 allows the prescribed joining-to-signing-off period in the Continuous Discharge Certificate to be excluded for an Indian-citizen crew member on an eligible foreign-bound voyage. Do not exclude every day described as ship duty.

Worked example: The employment-leaver with 175 days in India is non-resident under the physical-stay tests. Check deemed residence separately if the facts make that rule relevant.

Chapter 2: Residential Status and Scope of Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 7 | Visitor: ₹15 lakh, 120 days and 365 days ★★★★★

Explanation 1(b) to section 6(1); Section 6(6)(c)

Question trap: An Indian citizen or person of Indian origin living abroad visits India for 130 days. Relevant income is ₹18 lakh, and earlier four-year stay is 400 days.

Student mistake: A student uses 120 days without checking earlier stay, or applies that limit even when relevant income is exactly ₹15 lakh.

Final result: For a qualifying visitor with relevant income up to ₹15 lakh, replace 60 days with 182 days. Above ₹15 lakh, use 120 days but still require at least 365 days in the preceding four previous years. A visitor who becomes resident under this modified test with 120 to 181 days is specially treated as resident but not ordinarily resident. At 182 days or more, use the usual residence-history tests. A permanent return is not a visit, so the ordinary tests may apply.

Worked example: With ₹18 lakh of relevant income, 130 current-year days and 400 earlier days, the visitor is resident but not ordinarily resident. If earlier stay were 300 days, the physical tests would give non-resident status. For an Indian citizen, also check deemed residence.

Chapter 2: Residential Status and Scope of Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 8 | Deemed residence: nil tax is not no liability ★★★★★

Sections 6(1A) and 6(6)(d); Sections 2(29A) and 6(1A)

Question trap: An Indian citizen has relevant income of ₹20 lakh and is non-resident under the physical-stay tests. The question says that no tax was actually paid abroad.

Student mistake: A student assumes that paying no foreign tax automatically means deemed residence in India.

Final result: Check whether the person is legally liable to tax elsewhere because of residence, domicile or a similar criterion. Section 6(1A) needs Indian citizenship, total income other than foreign-source income exceeding ₹15 lakh, and absence of that foreign tax liability. It does not apply to someone already resident under section 6(1). A deemed resident is resident but not ordinarily resident. A foreign-citizen person of Indian origin is outside this rule. Tax reduced to nil by deductions or exemption does not automatically mean that legal tax liability is absent.

Worked example: If the citizen with relevant income of ₹20 lakh has no residence-based tax liability anywhere and is non-resident under section 6(1), the person is deemed resident but not ordinarily resident. Merely stating that no foreign tax was paid is insufficient.

Trap 9 | Resident and ordinarily resident needs both history tests ★★★★★

Section 6(6)

Question trap: A person is already resident this year. The person was resident in three of the preceding ten years but stayed in India for only 700 days in the preceding seven years.

Student mistake: A student stops after the ten-year test and labels the person ordinarily resident.

Final result: First establish current-year residence. Under the usual route to resident and ordinarily resident, both history conditions must be met: residence in at least two of the preceding ten previous years and at least 730 days in India during the preceding seven previous years. Failure of either condition gives resident but not ordinarily resident status. Apply any special visitor or deemed-resident resident but not ordinarily resident rule before using these ordinary history tests.

Worked example: The person passes the two-out-of-ten-year condition but fails the 730-day condition because the stay was only 700 days. The result is resident but not ordinarily resident.

Chapter 2: Residential Status and Scope of Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 10 | First receipt versus later remittance ★★★★★

Section 5 and its Explanations; Section 5; relevant section 10 exemptions

Question trap: A non-resident first receives salary for foreign services in a foreign bank and later transfers ₹5 lakh from that account to India.

Student mistake: A student treats the transfer to India as a fresh receipt of taxable income.

Final result: Separate the first receipt of income from a later transfer of the same money. First receipt in India can bring income within scope for every residential category. A later transfer of money already received abroad is not another income receipt. Genuine old savings do not become current income merely because they are brought to India. A resident and ordinarily resident's global-income rule is a separate matter: current foreign income may be taxable even without a transfer to India. A specific clarification for non-resident seafarers is explained in the later trap on foreign-going ship salary.

Worked example: The later ₹5 lakh transfer does not itself create fresh taxable income. First examine where the salary was earned and first received.

Quick help: Pehli receipt dekho; baad ka bank transfer nayi income nahi.

Trap 11 | Foreign payment can still be Indian-source

Sections 5 and 9(1)(i)-(ii)

Question trap: A non-resident earns rent from a house in Delhi, but the tenant pays it directly into the owner's London bank account.

Student mistake: A student calls the rent foreign income and excludes it because the bank account is outside India.

Final result: Check where the income arises, not just where the money is received. Indian accrual or deemed Indian accrual generally enters even a non-resident's income scope. For rent, examine the property's location. For salary, examine where employment services are performed. A foreign payer or bank account does not automatically change the source. Consider a specific exemption or treaty separately if the question provides supporting facts.

Worked example: Rent of ₹2 lakh from the Delhi house must be considered under Indian-source rental-income rules even though it goes directly to London.

Chapter 2: Residential Status and Scope of Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 12 | Resident but not ordinarily resident and foreign income ★★★★★

Proviso to section 5(1)

Question trap: A resident but not ordinarily resident earns foreign business profit from a business controlled in India and also earns interest from an unrelated foreign bank account. Both amounts are first received abroad.

Student mistake: A student excludes every foreign income merely because the taxpayer is resident but not ordinarily resident.

Final result: A resident but not ordinarily resident includes income received in India, income arising in India and income deemed to arise in India. Also include foreign profit from a business controlled in India or a profession set up in India. Pure foreign property rent or investment income earned and first received abroad is generally excluded. A resident and ordinarily resident has wider, global-income scope. Identify the kind of foreign income before deciding whether to include it.

Worked example: Include ₹3 lakh of foreign profit from the India-controlled business. Generally exclude ₹1 lakh of pure foreign-bank interest earned and first received abroad.

Trap 13 | Government posting abroad: salary and allowance

Sections 9(1)(iii) and 10(7)

Question trap: An Indian citizen employed by the Central Government works abroad and receives salary plus a qualifying foreign-posting allowance.

Student mistake: A student gives the same exemption to both the salary and the allowance because the work is outside India.

Final result: Government salary paid to an Indian citizen for services abroad is deemed Indian income. However, qualifying allowances and perquisites for those services, paid or allowed abroad by the Government, are exempt under section 10(7). Treat salary and the qualifying allowance separately. A public-sector company is not automatically the Government for this rule.

Worked example: Salary of ₹8 lakh enters the employee's income scope. A qualifying allowance of ₹2 lakh is exempt under section 10(7).

Chapter 2: Residential Status and Scope of Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 14 | Interest, royalty and technical fees: payer and use

Section 9(1)(v)-(vii); Section 9(2)

Question trap: An Indian resident pays technical fees to a non-resident consultant for its Indian business, but all work is performed abroad. Another payment relates solely to the resident's foreign business.

Student mistake: A student excludes every payment for work done abroad without checking the payer and the use of the service.

Final result: Government payments come within the relevant deeming rules. Interest, royalty and technical fees paid by a resident generally qualify, subject to the specified exceptions for foreign business or a foreign income source. For interest paid by a non-resident, check whether the borrowing is used in an Indian business or profession. For royalty or technical fees paid by a non-resident, check use in an Indian business or profession, or for an Indian income source. Once the relevant rule applies, foreign performance or absence of an Indian office does not by itself remove the income from scope.

Worked example: Royalty paid by an India resident solely for its foreign business may qualify for the exception. Technical fees for its Indian business do not escape merely because the consultant worked abroad.

Chapter 2: Residential Status and Scope of Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 15 | A short foreign-employee visit needs all exemption conditions

Section 10(6)(vi)

Question trap: A non-Indian citizen employed by a foreign enterprise works in India for 85 days and receives ₹5 lakh for that work. The employer has no trade or business in India.

Student mistake: The student taxes the salary automatically because the services were in India, or grants exemption from the 85-day fact alone.

Final result: Section 10(6)(vi) can exempt the remuneration only when all conditions apply: the individual is not an Indian citizen; the foreign enterprise has no Indian trade or business; total stay does not exceed 90 days in the financial year; and the remuneration is not deductible from the employer's income chargeable in India. Combine all visits when counting the 90 days.

Worked example: If the final deduction condition is also satisfied, the ₹5 lakh qualifies. Exactly 90 days can qualify; 91 days fails this exemption. Consider any separately applicable treaty only if the question supplies its facts.

Chapter 2: Residential Status and Scope of Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 16 | Foreign-going ship salary has a specific bank-credit clarification ★★★★★

Section 5; Central Board of Direct Taxes Circulars 13/2017 and 17/2017

Question trap: A seafarer is non-resident under Indian tax law. Salary of ₹12 lakh for services outside India on a foreign-going ship is paid into his Indian Non-Resident External bank account.

Student mistake: The student taxes it solely because the first bank credit occurred in India, or insists that only foreign-flag ships qualify.

Final result: The Board's clarification excludes this qualifying salary from total income even when credited to the Indian Non-Resident External account. A foreign-going ship may carry an Indian or foreign flag. First establish non-resident status and services outside India. The account label alone cannot exempt salary of a resident or salary for Indian services.

Worked example: On these stated facts, the ₹12 lakh salary is excluded. This is a specific seafarer clarification; do not extend it to every overseas employee receiving money in an Indian account.

Trap 17 | Shipping receipts: 7.5% is deemed income, not final tax

Section 172(2), (4) and (8)

Question trap: A covered non-resident ship carries goods loaded at an Indian port. Freight is ₹20 lakh, paid abroad, and related demurrage is ₹2 lakh.

Student mistake: The student excludes the foreign payment, deducts actual operating expenses or treats 7.5% of receipts as the final tax.

Final result: For section 172, include covered carriage receipts for goods loaded in India whether paid in India or abroad. Include the specified related demurrage and handling-type charges. Deemed income is 7.5% of the ₹22 lakh covered amount: ₹1.65 lakh. Apply the special company-rate rule in section 172(4) separately. This is the special shipping collection and assessment provision, not a 7.5% final tax rate.

Worked example: The income base is ₹1.65 lakh without a further deduction of actual voyage costs. Calculate tax using section 172(4)'s prescribed company-rate rule, then check applicable surcharge, cess and any treaty relief. Do not use individual slabs.

Chapter 3: Salaries

THEORY TRAPS

Trap 1 | Salary or professional income?

Sections 15 and 17; section 28(v)

Question trap: A firm pays its partner an amount described as monthly salary. Another person receives consultancy fees without being an employee. The question asks for the correct income head and deductions.

Student mistake: The student treats both amounts as salary because the payments are regular, and claims the salary standard deduction.

Final result: Salary requires an employer-employee relationship. A partner's remuneration from the firm is business income, so the salary standard deduction is unavailable. Independent consultancy fees are normally professional income. A director is not automatically an employee; check the relationship. Genuine reimbursement of official expenses need not be a personal salary benefit. Identify the income head before applying deductions.

Worked example: A partner receiving ₹30,000 monthly has ₹3.6 lakh of business receipts from remuneration before applicable adjustments. The payment does not create a salary standard deduction.

Trap 2 | Recognised provident fund withdrawal before five years

Section 10(12); Fourth Schedule, Part A, Rule 8

Question trap: An employee joins a new employer after three years and transfers the recognised provident fund balance properly. The question also mentions early retirement caused by ill-health.

Student mistake: The student treats every withdrawal before five years with the latest employer as taxable.

Final result: The usual exemption requires five years of continuous service. If the earlier recognised provident fund balance is properly transferred to the next employer's recognised fund, include the earlier service. Specified involuntary termination, including ill-health or closure of the employer's business, can qualify even before five years. A voluntary early cash withdrawal needs separate examination. The amount below which tax deducted at source is not deducted is not an income-exemption limit.

Worked example: Three years with employer A plus two years with employer B can satisfy five years where the recognised fund balance was properly transferred. A fresh two-year-only calculation would wrongly deny the exemption.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 3 | Salary due dates and increments

Sections 15 and 17(1)

Question trap: An existing employee earns ₹30,000 monthly from April 2025. Salary rises to ₹30,500 from January 2026 and becomes due at each month-end. The question may also mention advances or earlier arrears.

Student mistake: The student multiplies the latest monthly salary by twelve and ignores the due dates or amounts already taxed.

Final result: Tax salary when it becomes due or is received, whichever happens first. Split the calculation for joining dates, increments and contractual due dates. An advance already taxed must not be taxed again when due. Tax arrears only if they were not taxed earlier. March salary due next April, and not received by March-end, is outside the current year.

Worked example: Here, salary is due at each month-end. April-December salary is ₹30,000 × 9, and January-March salary is ₹30,500 × 3. Total salary is ₹3,61,500. The increment applies for only three months.

Trap 4 | One annual standard deduction

Section 16(ia)

Question trap: An employee changes jobs during the year and receives ₹4 lakh from employer A and ₹3 lakh from employer B. The question asks for salary under the default regime.

Student mistake: The student gives a separate ₹75,000 standard deduction against salary from each employer.

Final result: Combine taxable salary from all employers and allow one annual standard deduction. Under the normal regime, deduct the lower of total salary and ₹50,000. Under the default regime, use the lower of total salary and ₹75,000. Pension from a former employer is salary and shares this limit. Family pension is Other Sources income with a different deduction. Changing jobs does not renew the limit.

Worked example: Total salary of ₹7 lakh allows only ₹75,000 under the default regime. If total salary before deduction were ₹60,000, deduct only ₹60,000. The standard deduction cannot create a salary loss.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 5 | Entertainment allowance and professional tax

Section 16(ii); Section 16(iii); section 17(2)(iv)

Question trap: A government employee receives entertainment allowance. The employer pays ₹2,400 of professional tax, while another ₹600 remains unpaid. The question asks for deductions under both tax regimes.

Student mistake: The student deducts actual entertainment expenses and the full professional tax liability, including the unpaid amount.

Final result: Under the normal regime, first include entertainment allowance in salary. A government employee deducts the least of the allowance received, ₹5,000 and 20% of basic salary. Employment in a government company alone does not qualify. Deduct professional tax only when paid. If the employer pays it, first add it to salary, then allow the eligible deduction. Both deductions are unavailable under the default regime.

Worked example: Entertainment allowance of ₹18,000 and basic salary of ₹3 lakh give a ₹5,000 deduction. Employer-paid professional tax of ₹2,400 is added and deducted under the normal regime. Under the default regime, only add it. The unpaid ₹600 is not deductible.

Trap 6 | Allowances: spending or fixed ceiling?

Section 10(14)(i); Rule 2BB; Section 10(14)(ii)

Question trap: An employee receives separate conveyance and uniform allowances. The question gives actual official spending and specifies the default regime. It may also mention children's allowances or travel from home to work.

Student mistake: The student exempts every allowance with an official-sounding name, or ignores the regime and actual spending.

Final result: Under the normal regime, duty allowances are exempt only up to eligible spending. The default regime retains travel and daily allowances on tour or transfer, and official conveyance where free conveyance is not provided. It denies uniform, helper and academic exemptions. Normal-regime education and hostel limits are ₹100 and ₹300 per child monthly, for two children. Ordinary commuting is taxable; prescribed disability commuting allows ₹3,200 monthly in both regimes. Under the normal regime, transport-system running-duty allowance allows the lower of 70% of the allowance and ₹10,000 monthly, only if no daily allowance is received.

Worked example: Conveyance allowance of ₹36,000 with eligible official spending of ₹29,000 leaves ₹7,000 taxable. A ₹36,000 uniform allowance is fully taxable under the default regime.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 7 | House rent allowance: salary, rent and city ★★★★★

Section 10(13A); Rule 2A

Question trap: An employee lives in Ghaziabad, which the question describes as part of the National Capital Region. Salary includes bonus and commission, and rent changes during the year.

Student mistake: The student uses Delhi's 50% limit for Ghaziabad, includes all gross salary, and makes one calculation for the entire year.

Final result: Under the normal regime, exemption is the least of house rent allowance, rent minus 10% of salary, and 50% or 40% of salary for the eligible rented period. Salary includes basic pay, retirement-benefit dearness allowance and commission fixed as a percentage of the employee's turnover; exclude bonus. Only Delhi, Mumbai, Kolkata and Chennai use 50%. Recalculate when salary, rent, house rent allowance or residence changes. There is no exemption without qualifying rent, for own housing, or under the default regime.

Worked example: Monthly eligible salary is ₹80,000, house rent allowance is ₹40,000 and rent is ₹50,000. Delhi exemption is the least of ₹40,000, ₹42,000 and ₹40,000: ₹40,000. In Ghaziabad, the 40% salary limit reduces exemption to ₹32,000.

Trap 8 | Leave encashment and earlier exemption ★★★★★

Section 10(10AA); Sections 10(10) and 10(10AA)

Question trap: A private employee retires after twenty years. The employer permits forty days of earned leave annually, 420 days were used, and the employee claimed leave-encashment exemption on an earlier retirement.

Student mistake: The student uses all leave allowed by the employer and treats ₹25 lakh as a fresh exemption limit.

Final result: Leave encashment during service is taxable. Central or State Government retirement receipts are fully exempt. For others, exempt the least of the receipt, ₹25 lakh less earlier exemption, ten months' average salary and eligible unused-leave value. Count earned leave at no more than thirty days per service year, then deduct leave used. Average the preceding ten months' basic pay, qualifying dearness allowance and turnover commission. These retirement exemptions apply in both regimes. Earlier gratuity exemption similarly reduces the ₹20 lakh gratuity ceiling.

Worked example: For twenty years of service and 420 days of leave used, eligible balance is 20 × 30 - 420 = 180 days, or six months. Average salary of ₹60,000 gives a leave-value limit of ₹3,60,000. Compare it with the other three limits.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 9 | Gratuity: salary and completed service ★★★★★

Section 10(10)

Question trap: An employee covered by the Payment of Gratuity Act retires after eighteen years and seven months. The question gives last-drawn salary and average salary for the earlier ten months.

Student mistake: The student uses the ten-month average or rounds the service period incorrectly without checking Gratuity Act coverage.

Final result: For a covered employee, use 15/26 × (last basic pay + full dearness allowance) × eligible service years. Count an extra year only when the fraction exceeds six months. Without coverage, use half the average monthly salary for the ten months before the retirement month × completed years. That salary includes qualifying dearness allowance and turnover commission. Exempt the least of the formula amount, receipt and available ₹20 lakh ceiling. Qualifying government gratuity is fully exempt.

Worked example: For covered salary of ₹52,000 and service of eighteen years and seven months, use nineteen years. The formula gives 15/26 × ₹52,000 × 19 = ₹5,70,000. Exactly eighteen years and six months counts as eighteen years.

Trap 10 | Pension: first find the full value ★★★★★

Section 10(10A)

Question trap: A private employee receives ₹4,80,000 by converting 40% of the pension into a lump sum. The employee also receives gratuity. The question asks how much pension is exempt.

Student mistake: The student exempts one-third of ₹4,80,000 without first finding the value of the full pension.

Final result: Regular monthly pension is normally taxable salary. Commuted pension means the lump sum received instead of part or all of the pension. Eligible government, local-authority and statutory-corporation employees receive full exemption. For others, exempt one-third of the full commuted value if gratuity is received, or one-half if it is not. Exemption cannot exceed the actual receipt. Adjust the remaining monthly pension from the effective commutation date.

Worked example: The full commuted value is ₹4,80,000 ÷ 40% = ₹12 lakh. One-third is ₹4 lakh, so taxable commuted pension is ₹80,000.

Quick help: Pehle 100% pension value, phir exemption fraction.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 11 | Voluntary retirement requires an eligible scheme

Section 10(10C); Rule 2BA

Question trap: An employee receives ₹7 lakh under a voluntary retirement scheme. The scheme uses a service-based compensation formula, and the question mentions whether the employee received voluntary retirement exemption before.

Student mistake: The student grants ₹5 lakh exemption automatically from the voluntary retirement label or repeats the exemption on a second retirement.

Final result: The employer and scheme must qualify under Rule 2BA. Generally, the employee needs ten years' service or age forty; company and co-operative directors are excluded. Check workforce reduction, no vacancy refilling and no re-employment under the same management. The prescribed public-sector separation exception applies. The scheme may use three months' salary per completed year or salary for remaining service; taking the lower is not compulsory. Exemption is limited to ₹5 lakh once. Section 89 relief cannot accompany exemption for the same voluntary retirement payment.

Worked example: A first qualifying receipt of ₹7 lakh gives exemption of ₹5 lakh and taxable income of ₹2 lakh. A second voluntary retirement receipt does not get a fresh exemption.

Trap 12 | Retrenchment is not gratuity

Section 10(10B)

Question trap: A worker receives ₹6,20,000 as retrenchment compensation. The question separately gives ₹4,70,000 as the statutory compensation amount and states that no specially approved scheme applies.

Student mistake: The student applies the ₹20 lakh gratuity limit or uses voluntary retirement eligibility conditions because employment has ended.

Final result: First identify the payment as retrenchment compensation. The usual exemption is the least of the receipt, the amount under section 25F(b) of the Industrial Disputes Act and ₹5 lakh. The statutory amount generally uses fifteen days' average pay per completed year, including a service fraction exceeding six months. A scheme specifically approved by the Central Government may escape the normal ceiling restriction. Gratuity and voluntary retirement have separate rules.

Worked example: The least of ₹6,20,000, ₹4,70,000 and ₹5 lakh is ₹4,70,000. Taxable compensation is ₹6,20,000 - ₹4,70,000 = ₹1,50,000.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 13 | Recognised provident fund contributions and interest

Sections 17(1), 80C; Fourth Schedule, Part A; Sections 10(11), 10(12); Rule 9D

Question trap: A salary slip deducts the employee's provident fund contribution. The employer also contributes to the recognised fund, and the question separately gives interest on the employee's large contribution.

Student mistake: The student reduces salary by the employee's contribution and taxes the same excess contribution again instead of taxing its interest.

Final result: Use salary before the employee's provident fund deduction. Eligible section 80C relief is separate and available only under the normal regime. Employer recognised provident fund contribution above 12% of defined salary is taxable salary; also check the separate ₹7.5 lakh combined-fund rule. Interest attributable to employee contributions above ₹2.5 lakh is Other Sources income. The threshold is ₹5 lakh where no employer contributes. Recognised provident fund interest above 9.5% follows a separate salary rule. Avoid taxing the same amount twice.

Worked example: Defined salary of ₹8 lakh gives a 12% limit of ₹96,000. Employer contribution of ₹1,20,000 leaves ₹24,000 taxable. Own contribution of ₹3,40,000 creates a ₹90,000 excess for calculating taxable interest; that principal is not taxed again.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 14 | Unrecognised provident fund withdrawal has four components

Sections 17(3), 56 and 80C

Question trap: An employee withdraws an unrecognised provident fund balance. The question splits it into the employee's contribution, employer's contribution and the interest earned on each contribution.

Student mistake: The student taxes the whole withdrawal as salary or applies the exemption available to a recognised provident fund.

Final result: The employee's own contribution is a return of capital and is not taxed again. Interest on that contribution is Other Sources income. The employer's contribution and interest on it are profits in lieu of salary. Contributions to an unrecognised fund do not qualify under section 80C merely because the employer deducted them from pay. Keep all four components separate.

Worked example: The withdrawal includes own contribution of ₹2 lakh, its interest of ₹40,000, employer contribution of ₹2 lakh and its interest of ₹40,000. Salary income is ₹2,40,000 and Other Sources income is ₹40,000. The original own contribution of ₹2 lakh remains untaxed.

Trap 15 | Gift and school thresholds

Section 17(2); Rule 3(7)(iv); Section 17(2)(iii)/(iv); Rule 3(5)

Question trap: An employee-director receives noncash employer gifts of ₹3,000 and ₹4,000 during the year. The employer also provides qualifying free schooling for one child worth ₹1,300 monthly, without recovering any amount.

Student mistake: The student checks each gift separately and taxes only the schooling amount above ₹1,000 per month.

Final result: Under the rule-based whole-value view, total annual noncash gifts or vouchers below ₹5,000 have nil value. At ₹5,000 or more, the whole value is taxable. Cash gifts are fully taxable. Qualifying free school facilities have nil value up to ₹1,000 per child monthly; above that, a taxable employee includes the whole value less recovery. Personal fee reimbursement is different. ICAI also discusses excess-only alternatives for both items. State the view used; these examples use whole-value treatment.

Worked example: Gifts of ₹3,000 and ₹4,000 total ₹7,000, which is taxable. Free schooling at ₹1,300 monthly for a specified employee gives a yearly value of ₹15,600, not ₹3,600.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 16 | Employee stock options: exercise value and later sale

Section 17(2)(vi); Rule 3(8); section 49(2AA)

Question trap: An employee buys shares under an employee stock option plan. The question gives the offer price, fair market value on exercise and a different selling price when the shares are later sold.

Student mistake: The student uses the later sale price to calculate the salary benefit, or taxes the entire sale proceeds as capital gain.

Final result: The salary benefit equals the prescribed fair market value on the exercise date minus the employee's payment. Listed shares follow the prescribed stock-exchange and opening-closing-price rules. Unlisted shares follow prescribed merchant-banker valuation. The exercise-date value then becomes the cost for capital gains on later sale. An eligible start-up's special tax-collection timing does not change the benefit's value.

Worked example: For 100 shares, the employee pays ₹120 each, exercise-date value is ₹350 and sale price is ₹410. Salary benefit is 100 × ₹230 = ₹23,000. Later capital gain is 100 × ₹60 = ₹6,000 before other adjustments, not the ₹41,000 sale receipt.

Trap 17 | Office meals and paid vouchers

Rule 3(7)(iii)

Question trap: An employee under the default regime receives twenty-two office lunches costing ₹80 each. Another employee receives paid meal vouchers of the same amount instead of meals at the office.

Student mistake: The student gives the ₹50 exemption to paid vouchers under the default regime or assumes twenty-five meals every month.

Final result: Eligible food at the office or business premises during working hours allows a ₹50-per-meal exclusion in both regimes. Eligible non-transferable vouchers for eating joints can qualify under the normal regime, but the default regime denies the paid-voucher exclusion. Tea, snacks and prescribed remote-area or offshore meals have separate exclusions. Use the actual number of eligible meals. There is no fixed twenty-five-working-day rule.

Worked example: The office lunches give a taxable benefit of (₹80 - ₹50) × 22 = ₹660 in either regime. Under the default regime, the same paid vouchers give a taxable benefit of ₹80 × 22 = ₹1,760.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 18 | Asset use and later transfer

Rule 3(7)(vii) and (viii)

Question trap: An employer first lets an employee use its laptop, then transfers ownership for ₹10,000 after two completed years of employer use. The laptop originally cost ₹80,000. The question may include an additional incomplete year.

Student mistake: The student assumes the later transfer is also tax-free because laptop use was free, or allows depreciation for an incomplete year.

Final result: Use of an employer's laptop or computer has nil value. Use of other movable assets generally costs 10% of original cost yearly, or actual hire charges, less recovery. Transfer is a separate benefit. Reduce original cost for completed years of employer use: computers and electronic items use 50% reducing balance, cars use 20% reducing balance, and other assets use 10% of original cost yearly. Then subtract the employee's payment. Ignore incomplete years for this depreciation.

Worked example: A laptop cost ₹80,000 and is transferred after two completed years for ₹10,000. Its reduced value is ₹80,000 × 50% × 50% = ₹20,000. The taxable transfer benefit is ₹20,000 - ₹10,000 = ₹10,000.

Trap 19 | Employer loans use month-end balances

Rule 3(7)(i)

Question trap: An employer gives an interest-free loan of ₹1,20,000. The balance remains outstanding at six month-ends. The question provides the relevant State Bank of India rate and mentions the ₹20,000 small-loan exception.

Student mistake: The student deducts ₹20,000 from the loan or calculates interest using only the year-end balance.

Final result: Use State Bank of India's rate for a similar-purpose loan on 1 April of the relevant year. Apply it to each month-end outstanding balance and subtract interest actually paid by the employee. Aggregate loans up to ₹20,000 qualify for the small-loan exception; it is not a deduction from a larger loan. A loan for a prescribed disease has an exclusion, but the portion reimbursed by medical insurance loses that exclusion.

Worked example: At a State Bank of India rate of 10%, the taxable benefit is ₹1,20,000 × 10% × 6/12 = ₹6,000. The calculation uses the full ₹1,20,000 balance, not ₹1 lakh.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 20 | Leave travel concession: fare, calendar block and family

Section 10(5); Rule 2B

Question trap: An employee travels within India in January 2026, using an unused journey from the 2022-25 calendar block. The reimbursement includes eligible fare, hotel costs and travel for family members.

Student mistake: The student includes hotel costs, counts financial years instead of calendar years, or carries the unused journey into 2027.

Final result: Leave travel concession exemption is available only under the normal regime for eligible travel within India. Allow actual fare within the shortest-route ceiling: economy air fare, air-conditioned first-class rail fare for rail-connected non-air travel, or the prescribed fare for other routes. Exclude food and hotels. Allow two journeys per four-calendar-year block; one unused journey carries only into the next block's first year. Spouse and children need not be dependent; parents and siblings must be wholly or mainly dependent. The two-child restriction after 1 October 1998 has older-child and multiple-birth exceptions. The employee must travel; cash encashment alone is taxable.

Worked example: The carried 2022-25 journey must be used in 2026, not 2027. It does not use either of the two regular journeys allowed for 2026-29.

Trap 21 | Specified employee and personal bills ★★★★★

Section 17(2)(iii)/(iv); Rule 3C

Question trap: An employee who is neither a director nor substantially interested in the company has ₹4.5 lakh taxable monetary salary before the default-regime standard deduction. The employer reimburses a servant bill personally incurred by the employee.

Student mistake: The student treats gross salary above ₹4 lakh as sufficient, or exempts every benefit when the specified-employee salary test fails.

Final result: For the salary test, combine taxable monetary salary from all employers after eligible section 16 deductions. It must exceed ₹4 lakh. Directors and employees with substantial interest may qualify independently. This classification applies only to section 17(2)(iii) benefits. Employer payment of an employee's personal obligation under section 17(2)(iv) can be taxable for every employee. Provided servants are valued at employer cost less recovery. Purchased utilities use cost; self-produced utilities use manufacturing cost, both less recovery.

Worked example: ₹4.5 lakh - ₹75,000 = ₹3.75 lakh, so the salary test fails. Reimbursement for the employee's personally hired servant is still taxable because it pays the employee's own bill.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 22 | Medical allowance, treatment and travel ★★★★★

Proviso to section 17(2); Rule 3D

Question trap: An employer pays for treatment and stay abroad and also pays the travel cost. The employee's gross total income before adding the travel benefit is ₹8.2 lakh.

Student mistake: The student exempts all foreign medical costs together or assumes every medical reimbursement has a general ₹15,000 exemption.

Final result: There is no general ₹15,000 exemption for a fixed medical allowance or ordinary reimbursement. Check specific exclusions for prescribed employer, government or approved-hospital treatment and eligible health-insurance premiums. Not every hospital qualifies. Foreign treatment and stay for the patient and one attendant are excluded within Reserve Bank of India-permitted limits. Travel has a separate condition: gross total income before that travel cost must not exceed ₹8 lakh. Spouse and children need not be dependent; parents and siblings must be dependent.

Worked example: Gross total income before travel is ₹8.2 lakh. Eligible treatment and stay of ₹4 lakh remain excluded, but employer-paid travel of ₹1 lakh is taxable.

Trap 23 | Accommodation: owned or leased? ★★★★★

Rule 3(1)

Question trap: A private employer takes an unfurnished house on lease for ₹18,000 monthly and provides it to an employee. The question gives salary for the occupation period and any rent recovered.

Student mistake: The student uses the owned-house population percentage for leased housing or uses salary for months before occupation.

Final result: Qualifying Central or State Government housing uses licence fee less employee rent. Other employer-owned housing uses 2011 population: above 40 lakh, use 10% of occupation-period salary; above 15 lakh up to 40 lakh, use 7.5%; otherwise use 5%. For leased housing, take the lower of lease rent and 10% of occupation-period salary. Deduct housing rent recovered. Add furniture at 10% of its original cost per year or actual hire charges, less furniture recovery. Government deputation has a specific deemed-employer rule.

Worked example: For a full year, lease rent is ₹18,000 × 12 = ₹2,16,000 and relevant salary is ₹10 lakh. The lower of ₹2,16,000 and ₹1 lakh is ₹1 lakh, before deducting rent recovered from the employee.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 24 | Accommodation salary and the inflation ceiling ★★★★★

Rule 3(1), third proviso and Explanation

Question trap: The same employee continues in the same employer-provided house. Salary has increased, and the question gives the earlier housing value, Cost Inflation Index figures, furniture cost and employee recovery.

Student mistake: The student caps the value before deducting housing rent recovered, or includes furniture in the indexed housing ceiling.

Final result: Accommodation salary includes pay, qualifying dearness allowance, bonus, commission and taxable allowances. Exclude exempt allowances, employer provident fund, perquisites and specified retirement lump sums. For continuously providing the same house to the same employee, first calculate the unfurnished value under the employer-owned or employer-leased housing rules, after housing-rent recovery. The ceiling is first-year value × current-year Cost Inflation Index ÷ first-year Cost Inflation Index. The first year is 2023-24 or the first provision year, whichever is later. Add net furniture value afterwards.

Worked example: The unfurnished value after recovery is ₹1,40,000, while its indexed ceiling is ₹1,18,000. Add net furniture value of ₹12,000. The final taxable value is ₹1,30,000.

Quick help: Pehle housing rent, phir Cost Inflation Index cap, phir furniture.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 25 | Transfer: fifteen days or ninety days?

Rule 3(1)

Question trap: On transfer, an employee keeps the old and new employer-provided flats for 110 days. Another transfer-related benefit is a twenty-day hotel stay. The question asks how long the concessions apply.

Student mistake: The student gives both houses ninety tax-free days or exempts the first fifteen days of every hotel stay.

Final result: Transfer-related hotel accommodation is excluded only if the total stay does not exceed fifteen days. Otherwise, use the lower of hotel cost and 24% of relevant salary, less recovery. Where old and new housing overlap because of transfer, value only the lower-valued accommodation for up to ninety days. Value both after that. The fifteen-day hotel rule and ninety-day housing rule apply to different benefits.

Worked example: For 110 days of overlapping flats, use the lower value for ninety days and both values for twenty days. A twenty-day hotel stay does not get a separate first-fifteen-day exemption.

Trap 26 | Car ownership and running costs ★★★★★

Section 17(2); Rule 3(2), (3), (4) and (7)

Question trap: An employee-director receives two alternative car-benefit calculations: one car belongs to the employer and another belongs to the employee. Both have official and personal use. The question gives engine size, running-cost payer and driver availability.

Student mistake: The student uses the same fixed monthly value for both cars and ignores who owns the car or pays running costs.

Final result: For a specified employee, an employer-owned or hired mixed-use car with employer-paid running costs is valued at ₹1,800 monthly up to 1.6 litres, or ₹2,400 above it. Add ₹900 for a chauffeur. If the employee fully pays personal running costs, use ₹600 or ₹900 respectively, plus ₹900 for a chauffeur. For an employee-owned mixed-use car, deduct the prescribed official-use amount from reimbursement; a larger official claim needs proof. Wholly official use requires records and certification. Wholly personal employer-car use follows actual running cost plus 10% annual wear on original cost, less recovery. A private card or club bill remains personal despite its label.

Worked example: An employer-funded 1.5-litre car with driver for six months gives ₹2,700 × 6 = ₹16,200. An employee-owned 1.5-litre mixed-use car without driver gives ₹60,000 annual reimbursement - ₹21,600 = ₹38,400.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 27 | Employer funds and taxable accretion ★★★★★

Section 17(2)(vii)/(viia); Rule 3B

Question trap: An employer contributes to recognised provident fund, National Pension System and approved superannuation fund. The question also gives earlier taxable excess contributions, their accumulated returns and the current fund return.

Student mistake: The student applies ₹7.5 lakh separately to each fund or taxes only the new excess contribution and ignores its growth.

Final result: Add employer contributions to all three funds. The total above ₹7.5 lakh is taxable. Growth on taxable excess contributions is a separate benefit. Under Rule 3B, multiply half the current excess by the return rate. Add (cumulative earlier excess contributions + earlier taxable growth) × the same rate. Earlier amounts cover relevant years from 1 April 2020 and cannot exceed the relevant opening balance. The return equals fund income divided by the average opening and closing balance.

Worked example: Current excess is ₹1 lakh; earlier excess plus taxable growth is ₹2.2 lakh; return is 8%. Taxable growth is ₹50,000 × 8% + ₹2.2 lakh × 8% = ₹21,600. The current ₹1 lakh excess contribution is taxed separately.

Trap 28 | Arrears relief reduces tax, not salary

Section 89; Rule 21A

Question trap: An employee receives salary arrears relating to earlier years. The question gives the extra current-year tax and the extra tax that would have arisen if those arrears had been taxed in their respective years.

Student mistake: The student removes the arrears from salary or subtracts the relief amount from income instead of from tax.

Final result: Include taxable arrears in salary. Compare the additional current-year tax caused by them with the additional tax for the earlier years to which they relate. Use each year's income, rates and regime. Section 89 relief is only the positive difference between these amounts and requires Form 10E. Section 10(10C) exemption and section 89 relief cannot both apply to the same voluntary retirement payment.

Worked example: Additional current-year tax is ₹48,000. The total additional tax recomputed for earlier years is ₹31,000. Relief is ₹48,000 - ₹31,000 = ₹17,000. The arrears stay in salary, while relief reduces tax.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 29 | Telephone allowance or actual bill reimbursement?

Section 17(1); Rule 3(7)(ix)

Question trap: Employee A receives a fixed telephone allowance of ₹2,000 monthly, whether or not any bill is submitted. Employee B receives reimbursement of actual mobile bills totalling ₹24,000. Both use the default regime.

Student mistake: The student exempts both payments because they relate to a telephone, or taxes both because some calls are personal.

Final result: A fixed cash telephone allowance is taxable salary. Actual telephone or mobile expenses paid or reimbursed by the employer have a specific exclusion under Rule 3. The label on the salary slip is not enough: identify a cash allowance versus payment of actual bills. This exclusion remains available under the default regime. Do not subtract the employee's private telephone expenses from taxable salary.

Worked example: Employee A includes ₹2,000 × 12 = ₹24,000 as allowance. Employee B has nil taxable telephone benefit on the ₹24,000 actual reimbursement. The same rupee amount therefore produces different salary results.

Trap 30 | Salary waived after it becomes due is still income

Section 15; Section 17(1)

Question trap: An employee earns ₹60,000 salary that becomes due on 31 March 2026. After it becomes due, the employee asks the employer to donate it to a charity. Separately, the employer gives a genuine repayable loan of ₹1 lakh.

Student mistake: The student excludes the donated salary because no cash reached the employee, but includes the loan principal because cash was received.

Final result: Salary already due remains taxable even if the employee later waives it or directs someone else to receive it. A possible donation deduction is a separate question under the normal regime. A genuine loan creates a repayment obligation and is not salary principal. Check any concessional-interest benefit separately. The special statutory surrender of salary to the Central Government is different from an ordinary waiver.

Worked example: Include ₹60,000 as salary. Do not include the ₹1 lakh loan principal. Repayment through future salary deductions does not turn the original borrowing into advance salary.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 31 | Stock options: choose the exchange by trading volume

Section 17(2)(vi); Rule 3(8)

Question trap: An employee exercises options for 100 shares at ₹200 each. Both exchanges are recognised. On that date, Exchange A opens at ₹400 and closes at ₹460; Exchange B opens at ₹410 and closes at ₹430. Trading volume is higher on Exchange B.

Student mistake: The student uses the highest quoted price, averages both exchanges, or selects the exchange with the highest opening price.

Final result: For shares traded on more than one recognised exchange, first choose the exchange with the highest trading volume. Use the average of its opening and closing prices on the exercise date. Where no recognised exchange trades the share that day, the prescribed nearest preceding closing-price rule applies. Unlisted shares require prescribed merchant-banker valuation instead. After choosing the correct value, subtract the employee's payment.

Worked example: Exchange B gives (₹410 + ₹430) ÷ 2 = ₹420 per share. Taxable salary benefit is (₹420 - ₹200) × 100 = ₹22,000.

Trap 32 | Two employer cars do not both get the fixed value

Section 17(2)(iii); Rule 3(2)

Question trap: An employee-director can use two identical employer-owned 1.5-litre cars for official and personal travel throughout the year. Each car originally cost ₹8 lakh; each has employer-paid running costs of ₹60,000. There is no driver or employee recovery.

Student mistake: The student values both cars at ₹1,800 monthly and ignores the extra-car rule.

Final result: When more than one employer-owned or hired car is available for mixed or personal use, value one under the prescribed mixed-use rule. Treat the additional car as wholly personal for valuation: include employer-paid running costs and 10% annual wear on original cost, less recovery. A car proved to be used exclusively for official duties is examined separately. The question's employee-director status establishes that the provided-car benefit is taxable.

Worked example: One car gives ₹1,800 × 12 = ₹21,600. The second gives ₹60,000 + 10% of ₹8 lakh = ₹1,40,000. Total benefit is ₹1,61,600, not ₹43,200.

Chapter 3: Salaries (continued)

PRACTICAL QUESTION TRAPS

Trap 33 | An official tour can contain a taxable holiday

Rule 3(7)(ii)

Question trap: The employer pays ₹50,000 for an employee's documented official tour. It separately pays ₹20,000 for the spouse accompanying the employee and ₹15,000 for the employee's private holiday extension. The employee repays ₹5,000 against the private costs.

Student mistake: The student exempts the entire trip because it began as an official tour, or taxes all travel expenses because the trip included a holiday.

Final result: Keep genuine official-duty costs separate from personal benefits. Employer-paid expenses for an accompanying household member are taxable. When an official tour is extended for a vacation, include expenses relating to that extension. Deduct the amount recovered from the employee against these benefits. Do not apply the leave travel concession exemption automatically; this question concerns separate employer-paid holiday and family expenses.

Worked example: Exclude the ₹50,000 official cost. The taxable benefit is ₹20,000 + ₹15,000 - ₹5,000 = ₹30,000. Do not add the recovered ₹5,000 again.

Trap 34 | Employer-paid tax does not exempt the actual benefit

Section 10(10CC); Section 192(1A)

Question trap: The employee has a taxable noncash accommodation benefit of ₹1 lakh. The employer exercises its statutory option and actually pays ₹20,000, stated to be the correctly calculated tax attributable to this benefit, without recovering it from the employee.

Student mistake: The student either removes the ₹1 lakh accommodation benefit from salary or adds the employer-paid tax as another taxable benefit.

Final result: Section 10(10CC) exempts the tax actually paid by the employer on an eligible nonmonetary perquisite. It does not exempt the underlying perquisite. Keep the accommodation benefit in salary, but do not create another salary addition for this qualifying tax payment. Ordinary employer-paid tax on cash salary does not enjoy the same exclusion. Also distinguish tax borne by the employer from ordinary tax deducted out of the employee's own salary.

Worked example: Include ₹1 lakh as accommodation benefit. The employer-paid ₹20,000 tax is exempt under section 10(10CC), so the salary addition remains ₹1 lakh, not ₹1.2 lakh.

Chapter 4: Income from House Property

THEORY TRAPS

Trap 1 | Rent: identify the owner and asset

Section 22; section 28; section 56(2)(iii); Sections 22 and 27

Question trap: A person receives rent from an owned residential building, rent from bare land and money from subletting a rented property. Another building is let together with machinery under an inseparable agreement.

Student mistake: The student puts every receipt described as rent under Income from House Property.

Final result: Ordinary rent from an owned building generally belongs under House Property. Bare-land rent and a tenant's subletting income normally do not. Property used for the owner's taxable business is excluded. An inseparable letting of a building with machinery or furniture is business income if it forms a business; otherwise it is Other Sources income. Classify separable charges separately. Examine commercial-letting business facts. Section 28's clarification places an owner's residential-house letting under House Property.

Worked example: If an ordinary tenant pays ₹20,000 monthly and sublets for ₹27,000, the ₹7,000 monthly surplus is ordinarily examined under Other Sources. The tenant cannot claim the 30% house-property deduction.

Trap 2 | Deemed ownership overrides legal title

Section 27(i); Sections 27(iii)-(iiib)

Question trap: A person gifts a house to a spouse without adequate consideration, outside any agreement to live apart. The spouse receives the rent. The question asks whose house-property income it is.

Student mistake: The student taxes the spouse as legal owner or applies the ₹1,500 minor-child clubbing exemption to a similar transfer.

Final result: The transferor is treated as owner when a house is transferred without adequate consideration to a spouse, except under a living-apart agreement, or to a minor other than a married daughter. Compute house-property income directly for that deemed owner; no ₹1,500 clubbing exemption arises. Also check specified allotments, possession under qualifying part-performance arrangements and qualifying leases of at least twelve years, including relevant renewals. Merely possessing a house as an ordinary tenant does not make someone its owner.

Worked example: A parent gifts a house to an unmarried minor child. If net annual value is ₹1 lakh and there is no interest, ₹70,000 is computed directly as the parent's house-property income. Do not subtract ₹1,500.

Chapter 4: Income from House Property (continued)

PRACTICAL QUESTION TRAPS

Trap 3 | Expected rent and vacancy ★★★★★

Section 23(1); Section 23(1)(b)/(c)

Question trap: A let house has municipal value, fair rent and standard rent that differ. The question also gives actual rent and explains whether any shortfall arose from vacancy or simply from a low agreed rent.

Student mistake: The student always uses actual rent, or treats low rent as vacancy even when the property was occupied throughout.

Final result: Expected rent is the higher of municipal value and fair rent, limited to standard rent where applicable. Usually, gross annual value is the higher of expected rent and adjusted actual rent. If qualifying vacancy of a let property causes actual rent to fall below expected rent, that actual rent can become gross annual value. A low negotiated rent or the owner's personal occupation does not create vacancy relief.

Worked example: Municipal value is ₹2.4 lakh, fair rent ₹2.7 lakh and standard rent ₹2.5 lakh. Expected rent is ₹2.5 lakh; actual rent of ₹3 lakh gives gross annual value of ₹3 lakh. Separately, expected rent of ₹2.4 lakh with four vacant months at ₹20,000 monthly can give gross annual value of ₹1.6 lakh.

Trap 4 | Unrealised rent: deduct it once

Explanation to section 23(1); Rule 4

Question trap: A tenant fails to pay ₹30,000 out of annual contractual rent of ₹3.6 lakh. The question states whether the tenant has left, occupies another property of the owner, and whether recovery action was taken.

Student mistake: The student deducts all unpaid rent automatically, or subtracts the same amount twice while calculating house-property income.

Final result: Rule 4 requires genuine tenancy, the tenant's vacation or eviction steps, and no occupation of the owner's other property by that tenant. Reasonable recovery proceedings must be taken, or shown to be useless. Reduce actual rent by qualifying unrealised rent before comparing it with expected rent. Follow the question's stated computation approach consistently. If the amount is recovered later, apply section 25A separately.

Worked example: Annual contractual rent of ₹3.6 lakh less qualifying unrealised rent of ₹30,000 gives adjusted actual rent of ₹3.3 lakh. Compare that amount with expected rent. Do not subtract the same ₹30,000 again after deciding gross annual value.

Chapter 4: Income from House Property (continued)

PRACTICAL QUESTION TRAPS

Trap 5 | Municipal tax first, then thirty per cent ★★★★★

Proviso to section 23(1); Section 24(a)

Question trap: A let-property question gives municipal tax paid by the owner, unpaid tax and actual repair expenses. Some tax may relate to an earlier year, while another payment occurs after 31 March.

Student mistake: The student deducts all tax due and actual repairs, then calculates the 30% deduction on gross rent.

Final result: Deduct municipal taxes borne by the owner and actually paid during the previous year. Earlier years' tax paid now can qualify, but a payment after 31 March does not belong to the earlier year. Subtract eligible municipal taxes from gross annual value to get net annual value. Allow 30% of net annual value under section 24(a). Repairs, insurance and collection costs are not separate deductions. This let-property standard deduction is also available under the default regime.

Worked example: Gross annual value of ₹3 lakh less paid municipal tax of ₹20,000 gives net annual value of ₹2.8 lakh. Deduct 30%, or ₹84,000. Income before interest is ₹1,96,000. Do not also deduct ₹50,000 spent on repairs.

Trap 6 | Self-occupation: any reason, only two houses ★★★★★

Section 23(2)-(4)

Question trap: An owner keeps three houses for personal use and lets none. One house cannot be occupied for a personal reason. The question asks whether all three houses can have nil annual value.

Student mistake: The student gives nil annual value to every unused house, or insists that non-occupation must be caused by employment elsewhere.

Final result: After Finance Act 2025, nil annual value can apply where the owner occupies the house as a residence or cannot actually occupy it for any reason. Choose no more than two eligible houses. If a house was actually let during the year or another benefit was obtained from it, do not simply apply this nil-value rule. Additional personal-use houses require deemed-let-out computation. Employment elsewhere is no longer the only allowed reason for non-occupation.

Worked example: For three houses kept for personal use, select two for nil annual value. Calculate the third as deemed let out, even though the owner received no rent from it.

Chapter 4: Income from House Property (continued)

PRACTICAL QUESTION TRAPS

Trap 7 | Part-year self-use or separate portions?

Section 23(3)

Question trap: An owner lets the whole house for six months and lives in it for the next six months. A different question gives one self-occupied floor and another floor let throughout the year.

Student mistake: The student treats self-use months as vacancy or applies one combined calculation to separately identifiable floors with different uses.

Final result: If the whole house is let for part of the year and personally used for the rest, apply let-property rules. Expected rent covers the relevant full ownership period, while actual rent covers the letting period. Personal-use months do not qualify as vacancy. Where separately identifiable floors or portions have different uses, calculate them separately and divide common costs reasonably.

Worked example: Expected annual rent is ₹2.4 lakh. The whole house is let for six months at ₹25,000 and self-used for six months. Actual rent is ₹1.5 lakh, but gross annual value is ordinarily ₹2.4 lakh.

Trap 8 | Builder's stock: count from year-end

Section 23(5)

Question trap: A builder holds an unsold, unlet flat as stock-in-trade. Its completion certificate is dated 12 September 2023. The question asks when the two-year nil-annual-value period ends.

Student mistake: The student counts twenty-four months from the certificate date or continues nil annual value for as long as the flat remains unsold.

Final result: For qualifying property held as stock-in-trade and not let during the relevant period, annual value can be nil for up to two years from the end of the financial year of the competent authority's completion certificate. After that period, calculate the applicable notional annual value. Actual letting does not make the rent exempt under this rule. The booking or purchase date does not start the period.

Worked example: The certificate falls in the year ending 31 March 2024. The two-year period ends on 31 March 2026. It does not end on 11 September 2025.

Chapter 4: Income from House Property (continued)

PRACTICAL QUESTION TRAPS

Trap 9 | Interest: accrual and overseas conditions

Sections 24(b), 25 and 163

Question trap: A landlord owes ₹80,000 interest on an eligible housing loan but pays only ₹60,000. The lender also charges interest on unpaid interest. Another loan involves interest payable outside India.

Student mistake: The student deducts only interest paid, includes interest on unpaid interest, or overlooks the combined conditions for overseas interest.

Final result: Eligible interest for acquisition, construction, repair, renewal or reconstruction is deductible as it accrues; the lender need not be a bank. Proven refinancing of an eligible loan can qualify. Interest on unpaid interest does not. Section 25 denies chargeable overseas interest when tax is neither paid nor deducted and there is no Indian agent under section 163. Qualifying public-subscription loans issued before 1 April 1938 are excepted. Check loan purpose, certificate and regime limits.

Worked example: Deduct the eligible ₹80,000 interest on the let property even though only ₹60,000 was paid. Exclude an additional ₹2,000 charged as interest on unpaid interest. Unlike municipal tax, eligible loan interest does not require actual payment.

Trap 10 | Self-occupied interest: ₹2 lakh or ₹30,000? ★★★★★

Section 24(b)

Question trap: The owner takes a construction loan in August 2019 and completes the house in May 2025. It is then self-occupied. The question may instead describe a repair loan or two self-occupied houses.

Student mistake: The student grants ₹2 lakh for every housing loan or gives a separate ₹2 lakh limit for each house.

Final result: Under the normal regime, the ₹2 lakh limit requires acquisition or construction borrowing on or after 1 April 1999, completion within five years from the borrowing year's end, and the prescribed interest certificate. Repair, reconstruction and other non-qualifying cases normally have a ₹30,000 limit. Selected self-occupied houses share the taxpayer's overall ceiling. The default regime does not allow section 24(b) interest on self-occupied houses.

Worked example: The borrowing financial year ends on 31 March 2020, so completion was required by 31 March 2025. Completion in May 2025 is late: the normal-regime ceiling is ₹30,000. Separately, eligible interest of ₹2.4 lakh gives ₹2 lakh when every higher-limit condition is met.

Chapter 4: Income from House Property (continued)

PRACTICAL QUESTION TRAPS

Trap 11 | Pre-construction interest stops before the completion year ★★★★★

Explanation to section 24(b)

Question trap: A house is completed in December 2025. Interest up to 31 March 2025 is ₹2 lakh; full-year interest for 2025-26 is ₹90,000. The loan remains outstanding and no interest was deducted elsewhere.

Student mistake: The student treats April-December 2025 interest as pre-construction interest and spreads that amount over five years.

Final result: The pre-construction period ends before the previous year of acquisition or completion, or at the applicable earlier repayment date. Subtract any amount already deducted elsewhere, then claim the remaining interest in five equal instalments starting with the completion year. Add the whole completion-year current interest separately. For a self-occupied house, the instalment forms part of the overall interest ceiling; it is not an extra deduction above that ceiling.

Worked example: Interest up to 31 March 2025 is ₹2 lakh, and current interest for 2025-26 is ₹90,000. With completion in December 2025, the first deduction is ₹2 lakh ÷ 5 + ₹90,000 = ₹1,30,000, before applying any ceiling.

Chapter 4: Income from House Property (continued)

PRACTICAL QUESTION TRAPS

Trap 12 | Let-out loss: deduction and set-off differ ★★★★★

Sections 24(b), 71(3A), 71B and 115BAC; Sections 70, 71B and 115BAC

Question trap: A let house earns ₹2.1 lakh before eligible interest of ₹5.1 lakh. Taxable salary exceeds ₹2 lakh. Compare the regimes; the question may also give a valid earlier normal-regime house-property loss.

Student mistake: The student limits let-property interest to ₹2 lakh or assumes the rules for current and earlier losses are identical.

Final result: Eligible let-property interest has no ₹2 lakh property-level limit. Under the normal regime, net house-property loss can reduce other-head income up to ₹2 lakh; carry the balance forward for up to eight assessment years against house-property income. Under the default regime, current loss can reduce income from another house property, but the remaining current loss cannot reduce another head or be carried forward. A valid earlier normal-regime let-property loss may reduce house-property income within the permitted period if it does not relate to a prohibited deduction.

Worked example: ₹2.1 lakh - ₹5.1 lakh gives a ₹3 lakh loss. Under the normal regime, set off ₹2 lakh against salary and carry ₹1 lakh forward. Under the default regime, the remaining current loss gets neither treatment.

Quick help: Interest deduction aur loss set-off alag steps hain.

Chapter 4: Income from House Property (continued)

PRACTICAL QUESTION TRAPS

Trap 13 | Co-owners: actual share before ceiling

Section 26; section 24(b)

Question trap: Spouses own and occupy a house equally, are equal co-borrowers, and bear total eligible interest of ₹3 lakh equally. All conditions for the higher self-occupied interest ceiling are met under the normal regime.

Student mistake: The student gives ₹2 lakh to each spouse simply because both names appear on the property title.

Final result: Where ownership shares are definite, assess each co-owner separately. An eligible co-owner who is also a borrower can claim only their own qualifying interest, within the individual ceiling and regime rules. Ownership alone does not create an interest expense. For a let property, divide income by definite ownership shares while respecting each borrower's actual interest entitlement.

Worked example: Equal ownership and borrowing make each spouse's qualifying interest ₹1.5 lakh. Each deducts ₹1.5 lakh under the normal regime. Allowing ₹2 lakh each would create a total ₹4 lakh deduction against an actual expense of only ₹3 lakh.

Trap 14 | Old rent recovered after sale

Section 25A

Question trap: A person sells a house in February 2024 but receives ₹90,000 of previously untaxed rent arrears in October 2025. The question asks the income head and deduction for that receipt.

Student mistake: The student exempts the receipt because the person no longer owns the house, or taxes it under Other Sources.

Final result: Previously untaxed rent arrears or unrealised rent recovered are taxable under House Property in the year of receipt. Section 25A can apply even after ownership ends. Deduct 30% of the relevant receipt. Do not again deduct municipal tax or actual repair costs separately. Also ensure that the same receipt is not included again as current contractual rent.

Worked example: From arrears of ₹90,000 received in October 2025, deduct 30%, or ₹27,000. Taxable house-property income is ₹63,000 for financial year 2025-26, even though the house was sold earlier.

Chapter 4: Income from House Property (continued)

PRACTICAL QUESTION TRAPS

Trap 15 | Choose the two houses that give the best result

Sections 23(4) and 24

Question trap: An owner keeps three eligible houses for personal use throughout 2025-26. Their annual expected rents are ₹1.2 lakh, ₹2.4 lakh and ₹3.6 lakh. No house is actually let, and there are no municipal taxes or housing loans.

Student mistake: The student automatically selects the first two houses listed in the question as self-occupied, leaving the highest annual value taxable.

Final result: The owner may choose up to two eligible houses for nil annual value. Compute the remaining house as deemed let out. Compare the available choices instead of following the order in the question. With no taxes or loans, selecting the two higher-annual-value houses minimises taxable house-property income. Where interest or municipal taxes exist, compare the complete calculations because the largest expected-rent figures alone may not identify the best pair.

Worked example: Select the ₹2.4 lakh and ₹3.6 lakh houses. The remaining house gives ₹1.2 lakh × 70% = ₹84,000 income. Selecting the first two instead would leave ₹2.52 lakh taxable.

Chapter 4: Income from House Property (continued)

PRACTICAL QUESTION TRAPS

Trap 16 | A repaid construction loan can still give five instalments

Explanation to section 24(b)

Question trap: The owner repays an eligible construction loan on 30 September 2024. Construction is completed in December 2025, and the property is then let. Interest up to repayment was ₹1.5 lakh; it was not deducted under any other provision.

Student mistake: The student denies all interest because no loan remains outstanding in the completion year, or calculates imaginary interest up to the completion date.

Final result: Repayment does not erase eligible interest incurred before construction was completed. Stop the interest total when the borrowing was actually repaid. Claim eligible pre-construction interest in five equal annual instalments, beginning with the completion year. Since this loan has been fully repaid, there is no current-year interest on it to add. For self-occupied property, the combined interest ceiling and tax-regime restrictions would still need checking.

Worked example: Deduct ₹1.5 lakh ÷ 5 = ₹30,000 for 2025-26 and each of the next four years under the stated letting facts.

Trap 17 | Ownership for six months does not mean twelve months of rent

Sections 22 and 23

Question trap: A person becomes the owner of a completed, tenanted house on 1 October 2025 and is entitled to rent from that date. Expected annual rent is ₹2.4 lakh; actual rent is ₹25,000 monthly. There are no unpaid rents, vacancy, municipal taxes or interest.

Student mistake: The student taxes twelve months' rent in the buyer's hands or compares six months' actual rent with twelve months' expected rent.

Final result: Compute the buyer's house-property income for the period of ownership. Use consistent periods when comparing expected rent and actual rent. The seller's earlier ownership period does not become the buyer's income merely because the question supplies annual figures. This is different from personally occupying an already-owned house for part of the year; personal-use months cannot simply be removed from the annual-value comparison.

Worked example: For October-March, expected rent is ₹1.2 lakh and actual rent is ₹1.5 lakh. Gross annual value is ₹1.5 lakh; after 30%, taxable income is ₹1.05 lakh.

Chapter 5: Profits and Gains of Business or Profession

THEORY TRAPS

Trap 1 | Business benefits are not personal gifts

Section 28(ii), (iv), (va), (vi)

Question trap: A supplier gives a trader a business benefit worth ₹40,000. Another receipt compensates the trader for cancellation of a business contract. The question asks whether these receipts are taxable.

Student mistake: The student treats the benefit as a personal gift below ₹50,000 and ignores the contract compensation.

Final result: A benefit arising from business may be taxable whether received in cash, in goods or in both. The ₹50,000 personal-gift threshold does not apply. Compensation for termination or modification of a business contract is also covered. Non-compete receipts are generally business income, but an amount for transferring a business right may instead fall under capital gains. For Keyman insurance receipts, check who receives the money and in what capacity before choosing the income head.

Worked example: The ₹40,000 supplier benefit is considered business income without applying the personal-gift threshold. Assess the cancellation compensation under the applicable business-receipt provision as well.

Trap 2 | Distinguish repairs from capital improvements

Section 30, 31; 32 Explanation 1

Question trap: A tenant pays for routine repairs and also adds a permanent room to a rented business building. The accounts record both amounts under "repairs".

Student mistake: The student deducts both amounts immediately, or refuses depreciation on the room because the tenant does not own the building.

Final result: Look at the work done, not just the name in the accounts. Routine current repairs may be deductible immediately. A permanent extension or capital improvement is capital expenditure. A business tenant may claim depreciation on qualifying construction or renovation under the special rule that treats it as the tenant's building. Check the nature of each expense and whether the relevant depreciation conditions are met.

Worked example: For example, ₹30,000 spent on an allowable current repair may be deducted now. A ₹3 lakh permanent business extension follows the capital/depreciation route; its full cost is not a repair deduction.

Chapter 5: Profits and Gains of Business or Profession (continued)

THEORY TRAPS

Trap 3 | Intraday shares and derivatives can differ

Section 43(5)

Question trap: A trader reports losses from ordinary intraday equity trades and eligible exchange-traded derivatives. Neither transaction involves physical delivery. The question asks how to set off the losses.

Student mistake: The student treats both losses as speculative merely because there was no physical delivery.

Final result: Ordinary intraday equity trades are generally speculative. Eligible derivatives on a recognised stock exchange may be non-speculative when the required conditions are met. For commodity derivatives, check the separate exchange and transaction-tax conditions, including the exception for agricultural commodities. A hedging contract also needs to satisfy its own conditions. Classify the transaction first: speculative losses have different set-off and carry-forward rules from ordinary business losses.

Worked example: For example, a ₹40,000 intraday equity loss is generally speculative, while a ₹60,000 loss on eligible recognised-exchange derivatives is ordinarily non-speculative. Put them in separate loss categories before set-off.

Trap 4 | Check eligibility before using section 44AD

Section 44AD(6) and Explanation

Question trap: A resident commission agent and a resident limited liability partnership each have low turnover. Both want to calculate income under section 44AD because their turnover is below its limit.

Student mistake: The student checks only turnover and allows both taxpayers to use section 44AD.

Final result: First check the taxpayer and the activity. Section 44AD can cover a resident individual, resident Hindu undivided family or resident partnership firm other than a limited liability partnership. It excludes specified professions, agency business, commission or brokerage income, and goods-carriage business covered by section 44AE. Claiming the listed tax holidays or Chapter VI-A deductions linked to income also prevents eligibility. However, this does not mean that every Chapter VI-A deduction based on a payment is prohibited.

Worked example: Neither the commission agent nor the limited liability partnership can use section 44AD on these facts. Low turnover does not remove the activity or taxpayer restriction.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 5 | Adjust the profit and loss account only once

Section 28-38; 40(a)(ii), (v)

Question trap: The question starts with profit of ₹8 lakh after tax depreciation. Income tax of ₹1 lakh and cess of ₹4,000 have also been debited to that profit.

Student mistake: The student deducts depreciation again or allows income tax and cess as business expenses.

Final result: Read what the starting profit already includes. Add back a disallowed expense only if it was debited. Deduct an allowable item separately only if it has not already been deducted. Where book depreciation was debited, replace it with tax depreciation. Income tax, surcharge, cess, interest for income-tax defaults and covered employer-paid tax on non-monetary perks are disallowed. Remove income taxable under another head and assess it under that head.

Worked example: The adjusted profit is ₹8 lakh + ₹1 lakh + ₹4,000 = ₹9.04 lakh. Tax depreciation was already deducted, so do not deduct it again.

Trap 6 | Apply the 180-day restriction correctly ★★★★★

Section 32; Rule 5, Appendix I

Question trap: A general business machine costing ₹4 lakh was acquired in March 2025 but was first used in December 2025. It was used only for business and for fewer than 180 days during previous year 2025-26. No depreciation was allowed earlier.

Student mistake: The student allows only half depreciation by counting use days, without checking the acquisition year.

Final result: The half-rate restriction applies only when the asset is acquired in the current previous year and used for fewer than 180 days in that year. Exactly 180 days gets the full rate. Ownership and business use are still required. Usual rates are 5% for mainly residential buildings, 10% for other buildings and furniture, 15% for general plant, 40% for computers and software, and 25% for eligible intangibles. Check special rates and personal use. Land and goodwill do not qualify. Depreciation is mandatory.

Worked example: The ₹4 lakh machine was acquired in the preceding year. Eligible normal depreciation for previous year 2025-26 is ₹4 lakh × 15% = ₹60,000, even though use was below 180 days.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 7 | Additional depreciation depends on the activity and regime ★★★★★

Section 32(1)(iia); 115BAC(2)

Question trap: A manufacturer buys a new machine and uses it for 120 days. The question also states whether the manufacturer follows the normal regime or the default regime.

Student mistake: The student claims the full 20% immediately, or allows additional depreciation under the default regime.

Final result: Eligible manufacturing or production, and power generation, transmission or distribution, generally qualify for 20% additional depreciation under the written-down-value route on new plant and machinery. Trading alone does not qualify. Exclusions include used machinery, ships, aircraft, office or residential installations, office appliances, road vehicles and assets whose full cost was already deducted. Use below 180 days in the acquisition year gives 10% in that year and the remaining 10% next year, subject to the conditions. The default regime does not allow this incentive.

Worked example: For an eligible normal-regime manufacturer, a ₹10 lakh machine used for 120 days gives additional depreciation of ₹1 lakh now and ₹1 lakh next year. Calculate normal depreciation separately.

Trap 8 | Check whether the block continues ★★★★★

Section 43(6), 50

Question trap: A business sells a machine from a block of assets. The question gives the block's opening written-down value, additions and sale proceeds, and states whether any asset remains.

Student mistake: The student calculates a separate loss on the sold machine without checking the entire block.

Final result: From the opening tax written-down value plus eligible additions, subtract net sale consideration. If an asset remains and the balance is positive, there is no separate loss on the individual machine. If every asset has left the block, the positive shortfall becomes a short-term capital loss. Sale consideration exceeding opening value plus additions creates a short-term capital gain, even if an asset remains. No depreciation is allowed on a nil balance or an extinguished block.

Worked example: Opening value of ₹6 lakh + additions of ₹2 lakh - sale proceeds of ₹5 lakh leaves ₹3 lakh. If an asset remains, this is the block balance. If all assets were sold, it is a ₹3 lakh short-term capital loss.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 9 | Share depreciation after a covered succession

Section 32(1): succession proviso

Question trap: In a covered business succession, the predecessor uses the machinery for 100 days and the successor uses it for 265 days. Each claims a full year's depreciation.

Student mistake: The student allows two full deductions because two different taxpayers used the machinery during the year.

Final result: For a covered succession, amalgamation or demerger, calculate total depreciation as if the transfer had not occurred. Divide that amount according to the days each party used the assets. The ownership change does not create another full deduction. First check that the transaction falls within this special rule. Do not apply the sharing rule automatically to every ordinary purchase of a used machine.

Worked example: Total eligible depreciation is ₹73,000. The predecessor gets ₹73,000 × 100/365 = ₹20,000. The successor gets the remaining ₹53,000.

Trap 10 | Separate the power unit's balancing charge

Section 32(1)(i), (iii); 41(2), 50A

Question trap: An eligible power unit uses straight-line depreciation. It sells an asset for ₹12 lakh, although its original cost was ₹10 lakh and its written-down value was ₹6 lakh.

Student mistake: The student treats the entire ₹6 lakh excess over written-down value as a short-term capital gain.

Final result: An eligible power-generation or generation-and-distribution unit can use the prescribed straight-line method or choose the prescribed written-down-value method by the commencement-year return due date. The choice continues. Under the individual-asset straight-line method, sale below written-down value may give terminal depreciation if the loss is written off. Recovery above that value, limited to past depreciation, is a business balancing charge. Examine only the excess above original cost as capital gains. Section 50's short-term rule does not automatically apply to these straight-line assets.

Worked example: Past depreciation is ₹10 lakh - ₹6 lakh = ₹4 lakh, so the business balancing charge is ₹4 lakh. The separate capital gain is ₹12 lakh - ₹10 lakh = ₹2 lakh.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 11 | Calculate actual cost after the required adjustments ★★★★★

Section 43(1), 36(1)(iii), 43A

Question trap: A machine costs ₹2 lakh plus recoverable goods and services tax of ₹36,000. The buyer pays ₹50,000 of its price in cash to the seller on one day.

Student mistake: The student includes recoverable goods and services tax and the entire cash payment in the cost used for depreciation.

Final result: Actual cost includes eligible freight, installation and borrowing interest up to first use. Exclude recoverable goods and services tax and asset-linked subsidies. If acquisition payments through prohibited modes exceed ₹10,000 to one person in one day, exclude the whole affected payment, not just the excess. Loan principal is not deductible. Later business interest follows the normal revenue-expense and lender-payment rules. Section 43A adjusts qualifying foreign-currency differences on imported assets when actual payment is made.

Worked example: Exclude the recoverable goods and services tax and the prohibited cash payment of ₹50,000. With no other adjustments, the eligible cost is ₹2 lakh - ₹50,000 = ₹1.5 lakh.

Trap 12 | Use unabsorbed depreciation in the correct order

Section 32(2), 71, 72

Question trap: Profit after current depreciation is ₹3 lakh. The taxpayer also has ₹2 lakh of brought-forward business loss and ₹2 lakh of unabsorbed depreciation.

Student mistake: The student uses unabsorbed depreciation first, leaving a business loss that has a limited carry-forward period.

Final result: Apply current depreciation first, eligible brought-forward business loss next, and unabsorbed depreciation after that. Unabsorbed depreciation generally has no eight-year limit. A late return alone does not attract the loss-return restriction, and the same business need not continue. It cannot be set off against salary or expressly restricted income, such as specified winnings and unexplained income. Separately check depreciation linked to incentives that are denied under the default regime.

Worked example: From the ₹3 lakh profit, use the ₹2 lakh business loss first. Then use ₹1 lakh of unabsorbed depreciation. Carry forward the remaining ₹1 lakh of unabsorbed depreciation.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 13 | Check the Special Economic Zone period, exports and reserve

Section 10AA(1), (2), (4), (4A), (7)

Question trap: An eligible Special Economic Zone unit is in its twelfth deduction year. Its business profit is ₹20 lakh, export turnover is ₹60 lakh and total turnover is ₹1 crore. Only ₹4 lakh is transferred to the qualifying reinvestment reserve. The normal regime applies, all export-receipt and return deadlines are met, and pre-deduction total income is sufficient.

Student mistake: The student claims 50% of export profit without checking the reserve, eligibility period, export-realisation deadline or return filing.

Final result: The ordinary commencement cutoff was 31 March 2020. Check the extension to 31 March 2021 for units approved by 31 March 2020. Eligible units get 100% for five years, 50% for five years, then up to 50% linked to the reinvestment reserve for five years. Export profit = unit profit × export turnover/total turnover. Receive qualifying foreign exchange within six months of year-end or an authorised extension, and file the return on time. Use the last-phase reserve for eligible new plant within the prescribed three years. Deduction cannot exceed pre-deduction total income. It is denied under the default regime.

Worked example: In year 12, ₹20 lakh × ₹60 lakh/₹1 crore gives export profit of ₹12 lakh. Half is ₹6 lakh, but a reserve of only ₹4 lakh limits the deduction to ₹4 lakh.

Trap 14 | Do not claim research cost twice

Section 35(1), 35(2), 35(2AA), 35(2AB)

Question trap: A business claims the full cost of its qualifying research machine as a research deduction. It also asks for depreciation and deduction of research costs incurred before business commencement.

Student mistake: The student deducts the machine's cost and depreciation, and treats every pre-commencement overhead as eligible research expenditure.

Final result: Eligible own research related to the business gets a 100% deduction; land is excluded. Qualifying capital costs from the preceding three years are considered at commencement. For pre-start revenue costs, relief covers certified research salary and materials, not every overhead. Approved research payments generally get 100%, subject to approval and reporting conditions; later withdrawal of approval alone does not defeat an earlier valid donation. The company in-house rule excludes land and buildings; check a building separately under the own-research rule. The default regime denies specified donations and incentives but generally preserves section 35(1)(i) and (iv). Do not claim depreciation again.

Worked example: A qualifying research machine costs ₹2 lakh, and certified pre-start materials cost ₹40,000. The deduction is ₹2.4 lakh. No further depreciation is allowed on that machine.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 15 | Distinguish direct sale of a research asset

Section 41(3); 43(1) Explanation 1; 50

Question trap: A research machine cost ₹5 lakh, and its full cost was deducted. It is sold directly for ₹6 lakh without first being used in the ordinary business.

Student mistake: The student treats all sale proceeds as capital gains or applies the normal depreciation-block rule immediately.

Final result: Where the asset is sold without intervening use for another purpose, apply section 41(3). After a full cost deduction, the business recovery is broadly the lower of sale proceeds and original cost. Examine any excess above cost separately as capital gains. The result differs if the asset first enters ordinary business use: reduce its depreciation cost by the research deduction already allowed, usually to nil, and then consider the block rules.

Worked example: The direct sale gives business recovery of ₹5 lakh. Examine the remaining ₹1 lakh separately as capital gains.

Trap 16 | Check the specified business and eligible capital cost ★★★★★

Section 35AD(1), (2), (5), (8)

Question trap: A qualifying cold-chain business spends ₹40 lakh on buildings and machinery and ₹10 lakh on land. The question also gives details of used machinery and cash payments.

Student mistake: The student deducts all capital expenditure under section 35AD without checking the asset, payment mode or business conditions.

Final result: Only listed businesses qualify, subject to commencement and approval conditions. Examples include cold chains, agricultural or sugar warehouses, hotels rated at least two stars, and hospitals with at least 100 beds. The optional 100% capital deduction excludes land, goodwill, financial instruments and prohibited cash payments above ₹10,000 per person per day. Capitalise qualifying pre-start costs at commencement. Check restrictions on splitting or reconstruction. Used machinery cannot exceed 20% of total machinery value. Imported used machinery may qualify if never used in India and no Indian depreciation was previously allowed or allowable. Do not claim depreciation again. The default regime denies section 35AD.

Worked example: If the other conditions are met, deduction is ₹40 lakh for the eligible buildings and machinery. The ₹10 lakh spent on land is excluded.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 17 | Separate diversion, sale and specified-business loss

Section 28(vii); 35AD(7A)-(7C); 73A

Question trap: An asset whose full cost was deducted under section 35AD is moved to an ordinary business before eight years end. The question may instead say that the asset was sold.

Student mistake: The student uses the same recovery calculation for diversion and sale, or sets off the specified-business loss against ordinary profit.

Final result: The asset must serve the specified business for eight years starting with its acquisition or construction year. Earlier diversion generally brings back the deduction minus depreciation that would otherwise have been allowed. Section 35AD(7C) exempts a company that becomes a qualifying sick industrial company within these eight years from this diversion charge. Sale, demolition, destruction or discard follows section 28(vii)'s separate recovery rule. Specified-business loss can offset only specified-business profit, even where the profitable business did not claim section 35AD. A timely loss return permits indefinite carry-forward.

Worked example: The fully deducted asset cost ₹10 lakh. If hypothetical depreciation before diversion is ₹3 lakh, the normal diversion charge is ₹10 lakh - ₹3 lakh = ₹7 lakh.

Trap 18 | Apply the preliminary-expense ceiling first

Section 35D

Question trap: An Indian company incurs ₹8 lakh of qualifying preliminary expenditure for a new unit. Its chosen statutory 5% ceiling is ₹6 lakh. The unit starts production in previous year 2025-26. The question asks for the deduction in this first eligible year.

Student mistake: The student divides the full ₹8 lakh by five before applying the statutory ceiling.

Final result: Section 35D covers specified preliminary expenses of an Indian company or a resident non-company taxpayer before commencement or for a qualifying extension or new unit. Check the eligible reports, legal agreements and specified formation or issue costs; not every start-up overhead qualifies. First restrict the expenditure to 5% of project cost. An Indian company may instead choose 5% of capital employed. Deduct one-fifth of the restricted amount in each of five years.

Worked example: The restricted expenditure is ₹6 lakh. Annual deduction is ₹6 lakh ÷ 5 = ₹1.2 lakh, not ₹8 lakh ÷ 5 = ₹1.6 lakh.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 19 | Keep employer deductions separate from employee exemptions

Section 35DD, 35DDA, 36(1)(ix)

Question trap: A company pays ₹10 lakh under a qualifying voluntary retirement scheme. It also incurs family-planning expenses of ₹1 lakh on revenue items and ₹5 lakh on capital items.

Student mistake: The student uses the employee's exemption rule for the employer, or deducts every employee-welfare payment fully in the payment year.

Final result: The employer deducts qualifying voluntary-retirement expenditure over five years: one-fifth in the payment year and one-fifth in each of the following four years. The employee's exemption is a separate matter. An Indian company's qualifying amalgamation or demerger expenditure also follows five instalments. A company's qualifying family-planning revenue expenditure may be fully deductible, while capital expenditure follows five instalments. Identify the expense before choosing its deduction rule.

Worked example: The ₹10 lakh retirement payment gives a first-year deduction of ₹2 lakh. The separate family-planning deduction is ₹1 lakh + ₹5 lakh ÷ 5 = ₹2 lakh.

Trap 20 | Distinguish the 40% and 20% deposit ceilings

Section 33AB, 33ABA

Question trap: A qualifying tea grower and manufacturer makes an approved deposit of ₹9 lakh within the section 33AB deadline. Relevant composite business profit before this deduction and brought-forward loss is ₹20 lakh. A separate eligible petroleum business has the same profit and deposit figures, with the restoration-account deposit made within the previous year. The normal regime applies.

Student mistake: The student applies the same percentage and deposit deadline to both businesses, or reduces profit by brought-forward loss first.

Final result: For eligible tea, coffee or rubber growers and manufacturers, section 33AB allows the lower of the approved deposit and 40% of relevant profit before this deduction and brought-forward loss. Deposit by the earlier of six months after year-end or return filing. Section 33ABA's petroleum or natural-gas restoration account uses a 20% ceiling and requires deposit within the previous year. An ordinary deposit is insufficient. Apply agricultural apportionment in the correct order. The default regime denies both incentives.

Worked example: The section 33AB deduction from composite tea-business profit is ₹8 lakh, being 40% of ₹20 lakh. The balance is ₹12 lakh; where Rule 8 applies, its 40% taxable business portion is ₹4.8 lakh. In the separate petroleum case, section 33ABA deduction is ₹4 lakh, being 20% of ₹20 lakh.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 21 | Separate employee and employer provident fund deadlines ★★★★★

Section 36(1)(va); 43B(b)

Question trap: An employer deposits both shares of provident fund after the provident fund law's deadline but before the income-tax return due date. Both amounts appear in the same challan.

Student mistake: The student allows both shares because the combined payment was made before the income-tax return due date.

Final result: Keep the employee's share and employer's share separate. Contributions collected from employees must reach the fund by the due date under the relevant provident fund or Employees' State Insurance law. The income-tax return due date does not cure a late employee contribution. The employer's own contribution follows section 43B and ordinarily qualifies if actually paid by the return due date. A common challan does not give both shares the same tax treatment.

Worked example: Employee provident fund of ₹25,000 and employer provident fund of ₹25,000 are paid after the welfare-law deadline but before the return due date. Disallow the employee share. The employer share is ordinarily deductible.

Trap 22 | Check bad-debt write-off and later recovery

Section 36(1)(vii), 36(2), 41(1), 41(4)

Question trap: A debt of ₹1 lakh was written off, but only ₹70,000 was allowed as a deduction. The business later recovers ₹50,000 from the debtor.

Student mistake: The student taxes the entire recovery, without first allowing for the portion of the debt that never received a deduction.

Final result: An ordinary business normally needs an actual bad-debt write-off; a provision is insufficient. The debt must have entered taxable income or be an ordinary banking or money-lending loan. The Income Computation and Disclosure Standards exception covers an irrecoverable debt previously taxed without book recognition. On later recovery, first cover the original debt's unallowed portion and tax only the excess. Separately, remission or cessation of a previously allowed trading liability may attract section 41(1), including a unilateral write-off. An old unpaid balance alone does not prove that the liability has ended.

Worked example: The unallowed portion is ₹1 lakh - ₹70,000 = ₹30,000. From the ₹50,000 recovery, cover this ₹30,000 first. Taxable recovery is ₹20,000.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 23 | A gratuity provision is not automatic deduction

Section 36(1)(v); 40A(7), (9); 43B

Question trap: A company debits a ₹4 lakh provision for future gratuity, supported by an actuarial certificate. No gratuity became payable and no qualifying contribution was made to an approved fund.

Student mistake: The student allows the provision merely because an actuary calculated it and the accounts recognise a liability.

Final result: A mere provision for future gratuity is normally disallowed. Check the exceptions for gratuity that became payable during the year and qualifying approved-fund contributions. Approved-fund contributions also need to pass section 43B's actual-payment test. A contribution to a self-created employee fund needs a recognised statutory route or legal requirement. It differs from actual expenditure on an employee benefit. Check the liability, fund approval and payment separately.

Worked example: Add back the ₹4 lakh provision on these facts. An actuarial certificate alone does not create a tax deduction.

Trap 24 | Check securities transaction tax and specific employee expenses

Section 36(1)(ib), (ii), (iiia), (xv), (xvi)

Question trap: A share trader and a share investor each pay securities transaction tax of ₹12,000. The question asks whether the amount can be deducted from their respective incomes.

Student mistake: The student gives both taxpayers the same deduction merely because both paid the same transaction tax.

Final result: Securities or commodities transaction tax may qualify where the related taxable income is business income. Securities transaction tax is not deductible in an ordinary capital-gains calculation. Also check specific employee expenses: qualifying medical-insurance premiums must be paid by the employer through a non-cash mode. Bonus or commission must reward services, not replace profit distribution or dividends, and section 43B timing matters. A zero-coupon bond's discount is spread over its life in the prescribed proportion; it is not fully deducted on issue.

Worked example: The share trader may deduct eligible securities transaction tax of ₹12,000 against business income. The investor cannot deduct that ₹12,000 when computing capital gains.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 25 | Business purpose does not override express prohibitions

Section 37(1), Explanations 1-3; 37(2B)

Question trap: A business debits an offence penalty, political-party brochure advertising and compensation paid to a customer for delay. It argues that all three payments helped its business.

Student mistake: The student allows every payment because it has a business connection, without checking the express prohibitions.

Final result: Offence fines and compounding payments are disallowed. The bar can also cover foreign-law offences and benefits that violate rules governing the recipient. Settlements of notified contraventions under the Securities and Exchange Board of India Act, Securities Contracts (Regulation) Act, Depositories Act and Competition Act are barred. Examine genuine contractual compensation separately. Statutory corporate social responsibility spending is denied under the general section 37 rule; check independently qualifying expenses under sections 30-36 on their own conditions. Political-party souvenir or brochure advertising is expressly disallowed. Do not automatically relabel it as a donation.

Worked example: An offence penalty of ₹70,000 plus political brochure advertising of ₹50,000 requires an add-back of ₹1.2 lakh. Separately examine a ₹70,000 customer-delay payment according to its contractual nature.

Trap 26 | Distinguish 30% and 100% tax deduction at source disallowance ★★★★★

Section 40(a)(ia), 40(a)(i), 40(a)(iii)

Question trap: A business pays professional fees of ₹1 lakh without deducting required tax. The question identifies the payee as resident in one case and non-resident in another.

Student mistake: The student disallows 100% in both cases, or applies the 30% resident rule to a covered non-resident payment.

Final result: First check whether tax deduction was required. Covered resident expenses face 30% disallowance; specified non-resident payments face 100%. Tax deducted during the previous year and deposited by the return due date can preserve deduction. Otherwise, the disallowed amount is normally deductible in the tax-payment year. Relief based on the payee's return requires the relevant conditions and certification. India-taxable salary payable abroad or to a non-resident follows section 40(a)(iii): required tax must be paid or deducted. Do not automatically apply the other clauses' express later-payment relief to this salary rule.

Worked example: For resident fees of ₹1 lakh, omitted required tax deduction at source with no relief causes a ₹30,000 add-back. A covered non-resident payment of ₹1 lakh may cause a ₹1 lakh disallowance.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 27 | Disallow only excessive related-party expenditure

Section 40A(2)

Question trap: A business pays a specified related person ₹1.8 lakh for services reasonably worth ₹1.3 lakh. The services were actually provided for the business.

Student mistake: The student disallows the full payment because the recipient is related, or uses the gift-tax definition of "relative".

Final result: Use section 40A(2)'s own list of specified persons; the personal-gift relative definition is different. Disallow only the excessive or unreasonable portion after considering market value, legitimate business needs and the benefit obtained. The substantial-interest test generally needs at least 20% voting power or profit entitlement. A reasonable business payment does not become wholly disallowed merely because the recipient is related.

Worked example: On these facts, the excessive portion is ₹1.8 lakh - ₹1.3 lakh = ₹50,000. Disallow ₹50,000 and allow ₹1.3 lakh.

Trap 28 | Aggregate cash payments by person and day ★★★★★

Section 40A(3), 40A(3A); Rule 6DD

Question trap: A business pays one supplier ₹6,000 in cash in the morning and ₹5,000 in cash that evening. It argues that each payment is below ₹10,000.

Student mistake: The student checks each payment separately and allows both, or disallows only the ₹1,000 excess over the daily limit.

Final result: Combine prohibited-mode payments to one person in one day. Above ₹10,000, disallow the whole affected expense. Exactly ₹10,000 is within the limit. Payments for plying, hiring or leasing goods carriages have a ₹35,000 limit. Account-payee and prescribed electronic modes qualify. If an already deducted liability is later settled in prohibited cash, section 40A(3A) treats it as current income. Rule 6DD exceptions have conditions: direct purchases from a cultivator, grower or producer differ from purchases from a trader. Government payments must meet the specified legal-tender condition.

Worked example: The same-day total is ₹6,000 + ₹5,000 = ₹11,000, so disallow ₹11,000. Separately, an already allowed ₹24,000 bill later settled in prohibited cash creates ₹24,000 current income, unless an exception applies.

Quick help: Person aur din jodo; sirf extra amount disallow mat karo.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 29 | Section 43B covers listed liabilities

Section 43B(a)-(g)

Question trap: A bank converts unpaid interest of ₹90,000 into a new funded-interest loan. The business claims that the original interest is now paid because it appears under a new loan account.

Student mistake: The student treats conversion of unpaid interest into a fresh loan as actual payment under section 43B.

Final result: Section 43B covers listed liabilities, not every unpaid supplier bill. These include taxes, duties, cess and fees; employer welfare contributions; employee bonus or commission; interest to specified institutions, notified non-banking financial companies and covered banks; leave encashment; and Indian Railways asset-use payments. For these clauses, actual payment by the return due date ordinarily gives a deduction for the liability year. A later payment gives a deduction in the payment year. Converting interest into another loan, debenture or deferred instrument is not actual payment.

Worked example: The funded-interest loan does not, by itself, permit deduction of the ₹90,000 interest. Check when an actual qualifying payment is made.

Trap 30 | The micro or small enterprise rule does not use the return due date ★★★★★

Section 43B(h); MSMED Act 15, 23

Question trap: A January bill from a qualifying small enterprise is payable under a written 30-day agreement. It remains unpaid on 31 March and is paid in June, before the return due date.

Student mistake: The student claims the expense in the earlier year by using section 43B's usual return-due-date relief.

Final result: For a qualifying micro or small enterprise, payment beyond the Micro, Small and Medium Enterprises Development time limit is deductible in the actual-payment year. A written agreement cannot allow more than 45 days. Without one, the period is 15 days from acceptance or deemed acceptance. Medium enterprises are excluded. Clause (h) does not get return-due-date relief. However, a payment made after 31 March but within the Micro, Small and Medium Enterprises Development period does not trigger this delayed-payment restriction. Interest under the Micro, Small and Medium Enterprises Development law is separately non-deductible.

Worked example: The January bill is ₹50,000, and its 30-day payment period expired before year-end. Since payment occurs in June, deduct ₹50,000 in the next previous year, even though June is before the return due date.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 31 | Check partner status, deed and revised ceiling ★★★★★

Section 40(b); 28(v); 10(2A)

Question trap: A firm's book profit is ₹10 lakh, and it pays eligible remuneration of ₹7 lakh to working partners. The question also gives the deed date and interest paid to partners.

Student mistake: The student deducts the statutory maximum even when actual remuneration is lower, or ignores partner status and deed authority.

Final result: Remuneration needs an individual working partner and deed authority for the relevant period. Authorised interest may go to working or non-working partners, but is capped at 12% simple interest per annum. A later deed does not authorise an earlier period. Make tax adjustments to book profit and add back debited partner remuneration. For the first ₹6 lakh of positive book profit, take the higher of ₹3 lakh or 90% of that first-slab amount. Add 60% of any book profit above ₹6 lakh. For a loss, use the ₹3 lakh limit. Deduct the lower actual eligible remuneration. Partner receipts are business income after section 40(b) adjustment; the profit share is exempt.

Worked example: For book profit of ₹10 lakh, the ceiling is ₹5.4 lakh + ₹2.4 lakh = ₹7.8 lakh. Actual eligible remuneration is only ₹7 lakh, so deduct ₹7 lakh.

Trap 32 | Use the builder's 110% tolerance correctly ★★★★★

Section 43CA

Question trap: A builder sells a property held as trading stock for ₹50 lakh. Its stamp value is ₹55 lakh. The question may give a different agreement date and a cash advance.

Student mistake: The student substitutes stamp value at exactly 110%, or uses the agreement-date value even though the advance was entirely in cash.

Final result: For land or a building held as stock, examine substitution only when the relevant stamp value exceeds 110% of consideration. Exactly 110% is within the tolerance. Where agreement and registration dates differ, the agreement-date value may apply only if some consideration was received through permitted modes on or before the agreement date. A wholly cash advance is insufficient. Apply the statutory safeguards for a valuation reference. The excess over the tolerance is not itself the deemed sale consideration.

Worked example: For price of ₹50 lakh and stamp value of ₹55 lakh, use ₹50 lakh. If stamp value is ₹56 lakh, use ₹56 lakh, subject to the statutory valuation safeguards. Do not use merely the ₹1 lakh excess over the tolerance as sale consideration.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 33 | Distinguish prescribed books from basic records

Section 44AA; Rule 6F

Question trap: An individual trader's current turnover is low, but turnover was ₹28 lakh in one of the preceding three years. A separate professional question gives receipts for all three earlier years.

Student mistake: The student checks only the current year, or applies the professional prescribed-books test to every business.

Final result: Specified professionals need sufficient records to compute income, subject to valid presumptive relief. For prescribed books under Rule 6F, the test generally requires receipts above ₹1.5 lakh in all three preceding years, or likely above it for a new profession. Other businesses and non-specified professions test any of the preceding three years. Individuals and Hindu undivided families use income above ₹2.5 lakh or turnover above ₹25 lakh. Others generally use ₹1.2 lakh and ₹10 lakh respectively. A new business uses expected figures.

Worked example: The individual trader crossed ₹25 lakh turnover in one preceding year. The records requirement may therefore apply despite lower current turnover.

Trap 34 | Both cash tests control the ₹10 crore audit limit ★★★★★

Section 44AB; 271B, 271A, 273B

Question trap: A business has turnover of ₹4 crore. Cash receipts are 3% of total receipts, but cash payments are 7% of total payments. It claims the ₹10 crore audit threshold.

Student mistake: The student checks only cash receipts and allows the higher threshold, ignoring the separate cash-payment condition.

Final result: Business audit ordinarily starts above ₹1 crore turnover. For the ₹10 crore threshold, both cash receipts and cash payments must independently stay within 5%. Test aggregate receipts and payments, not just sales and purchases. Non-account-payee instruments count as cash. Professional audit normally starts above ₹50 lakh, with specific relief for valid section 44ADA cases up to ₹75 lakh. Check separate lower-profit triggers. The audit report is ordinarily due one month before the return due date. Section 271B penalty is the lower of 0.5% of relevant turnover or gross receipts and ₹1.5 lakh, subject to reasonable-cause relief. The separate section 271A books penalty is ₹25,000.

Worked example: The business fails the higher threshold because cash payments are 7%. In a separate case with ₹80 lakh receipts where audit was required, 0.5% gives ₹40,000 for the penalty calculation.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 35 | Separate section 44AD's ₹3 crore and 6% tests ★★★★★

Section 44AD(1) and Explanation

Question trap: An eligible business has ₹50 lakh turnover. It receives ₹30 lakh digitally by the return due date, but ₹20 lakh is still unpaid on that date.

Student mistake: The student applies 6% to the entire turnover because the customer promises to pay the remaining amount electronically later.

Final result: The turnover ceiling is ₹2 crore. It rises to ₹3 crore if cash receipts during the previous year are within 5% of turnover or gross receipts. Non-account-payee instruments count as cash. This ceiling test looks only at receipts. Separately, the 6% rate covers turnover received through permitted modes during the previous year or by the section 139(1) due date. Other turnover uses 8%, including amounts still unpaid at that deadline. Later electronic collection does not change that result for the earlier year.

Worked example: Income is ₹30 lakh × 6% + ₹20 lakh × 8% = ₹1.8 lakh + ₹1.6 lakh = ₹3.4 lakh.

Trap 36 | Presumptive income already includes ordinary deductions

Section 44AD(2)-(3), 44ADA(2)-(3), 44AE(3)-(4)

Question trap: A taxpayer calculates presumptive income of ₹4 lakh under section 44AD and then claims depreciation of ₹60,000 as another deduction. The question also asks for the asset's closing written-down value.

Student mistake: The student deducts depreciation again, or leaves the asset's written-down value unchanged because no separate depreciation deduction was given.

Final result: Sections 44AD and 44ADA already cover ordinary expenses. Do not deduct rent, salary, interest or depreciation again, and do not add routine disallowances under sections 28-43C to the presumptive figure. Still reduce the asset's written-down value as if normal depreciation had been allowed. A firm under section 44AE has a special deduction for eligible partner remuneration and interest, subject to section 40(b). Consider income under other heads and eligible loss adjustments separately.

Worked example: Business income stays ₹4 lakh; it does not fall to ₹3.4 lakh. The asset's written-down value still reduces by the applicable depreciation of ₹60,000.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 37 | An exit from section 44AD is not a lifetime ban

Section 44AD(4)-(5); 44AB(e)

Question trap: For a historical illustration, a taxpayer uses section 44AD for assessment year 2017-18 but departs from the required presumptive amount in assessment year 2019-20. The question asks for the five assessment years during which the taxpayer is excluded.

Student mistake: The student imposes a lifetime ban, counts five years from the first use, or applies the exit rule without earlier-year facts.

Final result: After section 44AD is used, declaring business income below its required presumptive amount in one of the next five assessment years causes exclusion for the five assessment years following that departure year. The linked books and audit requirements apply when section 44AD(4) applies and total income exceeds the basic exemption. Also check other section 44AB triggers independently. A first-time non-presumptive case is not automatically an exit: read the earlier-year facts first.

Worked example: The departure year is assessment year 2019-20. The five-year exclusion runs from assessment year 2020-21 through assessment year 2024-25. It is not a permanent ban. The separate books-and-audit condition also needs total income above the applicable basic exemption.

Trap 38 | Section 44ADA excludes Hindu undivided families and limited liability partnerships ★★★★★

Section 44ADA

Question trap: A resident architect has receipts of ₹60 lakh, of which 2% are in cash, and declares profit of ₹30 lakh. The question may instead describe the practice as a limited liability partnership.

Student mistake: The student applies the old ₹50 lakh ceiling automatically, or allows a limited liability partnership or Hindu undivided family to use section 44ADA.

Final result: A resident individual or resident partnership firm other than a limited liability partnership carrying on a specified profession can qualify. A Hindu undivided family cannot. The ₹50 lakh receipts ceiling rises to ₹75 lakh if cash receipts during the previous year stay within 5% of total receipts. Non-account-payee instruments count as cash. Declare 50% or the higher amount claimed to have been earned. Lower profit with total income above the basic exemption requires books and audit. There is no five-year exclusion like section 44AD.

Worked example: The architect's ₹60 lakh receipts and 2% cash receipts can satisfy the higher ceiling. Declared profit is ₹30 lakh, or 50%. A limited liability partnership running the same practice cannot use section 44ADA.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 39 | Count goods-carriage ownership, including idle months ★★★★★

Section 44AE; 44AB(c); 211

Question trap: A taxpayer carrying on a goods-carriage business never owns more than ten goods carriages. One vehicle has a gross vehicle weight of 13 tons and is owned from 20 January to 31 March, but is operated only briefly. Actual earnings claimed from it are below the statutory amount. Calculate its presumptive income.

Student mistake: The student counts only operating days or full months, and ignores periods when the vehicle was owned but idle.

Final result: A qualifying taxpayer can use section 44AE if ownership never exceeds ten goods carriages at any time. Possession under hire-purchase can count as ownership. A heavy vehicle exceeds 12,000 kg gross weight; exactly 12,000 kg is not heavy. Heavy vehicles use ₹1,000 per ton of gross vehicle weight or unladen weight, as applicable, per ownership month or part. Other vehicles use ₹7,500 per ownership month or part. Include idle months and use higher actual earnings if claimed. Lower profit requires books and audit without a basic-exemption condition. The single March advance-tax instalment for sections 44AD and 44ADA does not apply here. Valid presumptive turnover is excluded from ordinary books and audit monetary tests.

Worked example: Ownership covers part of January, all of February and all of March: three months. Presumptive income is ₹13,000 × 3 = ₹39,000, even if the vehicle was operated only briefly.

Trap 40 | Count financial years for a telecom licence, not exact months

Section 35ABB; 35ABA

Question trap: A telecom operator pays ₹11 lakh in July 2022 for an eligible ten-year licence that remains valid until July 2032. The business is already running. All conditions for section 35ABB are met. What is the annual deduction for previous year 2025-26?

Student mistake: The student divides by ten because the licence lasts ten calendar years, or starts deduction when the liability is recorded although payment is still outstanding.

Final result: Capital licence expenditure is spread over the relevant previous years after actual payment. Count the payment year and every later financial year during which the licence remains in force; even the final part-year counts. If payment precedes business commencement, start with the commencement year instead. Spectrum fees have a similar separate rule under section 35ABA. The same expenditure cannot also receive depreciation.

Worked example: The licence covers eleven financial years, from 2022-23 through 2032-33. The annual deduction under the stated rule is ₹11 lakh ÷ 11 = ₹1 lakh. No monthly apportionment is needed.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 41 | Mineral prospecting: the annual instalment cannot create a loss

Section 35E

Question trap: An eligible Indian mining company starts commercial production during previous year 2025-26. Its verified qualifying prospecting expenditure is ₹10 lakh. Income from the relevant commercial mineral exploitation, before section 35E, is only ₹60,000. All prescribed conditions are satisfied.

Student mistake: The student deducts the complete one-tenth instalment of ₹1 lakh and creates a ₹40,000 loss, or treats the balance as an unlimited carry-forward.

Final result: Qualifying expenditure is spread over ten years beginning with the commercial-production year. The claim for a year cannot exceed the relevant mineral-exploitation income before this deduction. An unallowed instalment joins the next year's claim, but only within the original ten-year period. Expenditure must fall within the permitted production-year and preceding-four-year window. Exclude land, mineral rights and depreciable buildings, machinery, plant and furniture; also adjust qualifying recoveries or reimbursements.

Worked example: The normal instalment is ₹10 lakh ÷ 10 = ₹1 lakh. Deduct ₹60,000 now and carry ₹40,000 of this instalment into the next claim, subject to the remaining ten-year window.

Trap 42 | Carbon credits: apply the special rate to gross income ★★★★★

Section 115BBG

Question trap: A company transfers qualifying carbon credits for ₹10 lakh during previous year 2025-26 and incurs ₹2 lakh of related expenditure. The credits satisfy the statutory definition. The question asks for tax attributable to this receipt; assume no surcharge applies.

Student mistake: The student taxes only the ₹8 lakh net profit at the normal business rate, or deducts the related expenditure before applying the special rate.

Final result: Section 115BBG applies a 10% income-tax rate to qualifying carbon-credit transfer income. It disallows expenditure and allowances in computing that income. Keep this amount separate from ordinary business profit. The statutory definition concerns certified credits representing permitted carbon-emission reduction; every general environmental incentive is not automatically a carbon credit. Apply applicable surcharge and then 4% Health and Education Cess to the computed tax.

Worked example: The special-rate base is ₹10 lakh, not ₹8 lakh. Income tax is ₹1 lakh and cess is ₹4,000, giving ₹1.04 lakh attributable tax on these assumptions. Compute tax on other income separately.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 43 | A trade association can earn taxable income from members

Section 28(iii)

Question trap: A trade association, with no separate statutory exemption, charges its members ₹8 lakh for individual product-testing services. It incurs ₹5 lakh of wholly allowable expenditure on those services. General membership subscriptions are accounted for separately.

Student mistake: The student says every receipt from a member is exempt under mutuality, or taxes all ₹8 lakh without deducting the related allowable costs.

Final result: Section 28(iii) specifically covers income derived by a trade, professional or similar association from particular services performed for its members. Identify the paid service and compute the business income from it. A general claim that members contributed the money does not remove this express rule. Keep common subscriptions and any genuinely mutual activity separate; test their facts independently. If the question gives a separate statutory exemption, examine its conditions before concluding taxability.

Worked example: The testing activity produces taxable business income of ₹8 lakh - ₹5 lakh = ₹3 lakh. This answer concerns the specific service; it does not automatically decide every other association receipt.

Trap 44 | A closed business can still have a taxable recovery

Section 41(1), (5)

Question trap: A trader closed an ordinary business in previous year 2014-15. A genuine ₹70,000 loss arising in that closure year could not be set off against any income of that year and remains unabsorbed through the recovery year. In previous year 2025-26, a ₹1 lakh trading liability, deducted before closure, is finally waived.

Student mistake: The student ignores the waiver because the business has closed, or rejects the closure-year loss simply because more than eight years have passed.

Final result: Section 41(1) can tax remission of a previously deducted trading liability even after the business has ended. Section 41(5) then permits the unabsorbed non-speculation loss of the cessation year against the specified section 41 recoveries. This is a narrow exception, not a revival of every old business loss. It covers the listed recoveries under subsections (1), (3), (4) and (4A), but not a balancing charge under subsection (2).

Worked example: Tax the ₹1 lakh recovery and set off the eligible closure-year loss of ₹70,000. Net taxable income from this adjustment is ₹30,000.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 45 | Closing stock: compare cost with net realisable value correctly

Section 145A; notified inventory standard

Question trap: A trader values all closing goods at their ₹5 lakh total cost. One independent product has cost ₹3 lakh and net realisable value ₹2.4 lakh. Another has cost ₹2 lakh and net realisable value ₹2.5 lakh. All figures already include the required tax adjustments.

Student mistake: The student uses total market value, recognises an unrealised gain on the second product, or ignores the fall in the first product's value.

Final result: For ordinary goods, use the lower of cost and net realisable value, under the notified item or permitted-group rules. Net realisable value means expected selling price less necessary completion and selling costs. Apply the inclusive-tax rule consistently to purchases, sales and inventories; do not add tax only to closing stock. Securities held as stock have separate statutory rules, including cost valuation for unlisted or irregularly quoted securities and category-wise comparison for other securities.

Worked example: Correct stock is ₹2.4 lakh + ₹2 lakh = ₹4.4 lakh. Compared with the ₹5 lakh book figure, reduce the stated profit by ₹60,000.

Trap 46 | A short service contract has a separate completion rule

Section 43CB

Question trap: A company follows mercantile accounting and undertakes a 70-day service project from 20 February to 30 April 2026. It is incomplete at 31 March. Contract revenue is ₹6 lakh and its total attributable cost is ₹4 lakh. There is no separate completed service component.

Student mistake: The student automatically recognises a percentage of the expected ₹2 lakh profit at 31 March, without checking the contract's duration and nature.

Final result: Section 43CB generally uses percentage of completion for construction and service contracts. However, a service contract lasting not more than 90 days follows the project-completion method. A service involving an indeterminate number of acts over a specified time follows the straight-line method. Check the contract category; the short-service exception does not cover every short construction job. Revenue recognition and the matching cost treatment must use the same method.

Worked example: For previous year 2025-26, this incomplete short service project does not recognise the ₹2 lakh profit merely by percentage completion. Its profit is recognised when the completion condition is met.

Chapter 5: Profits and Gains of Business or Profession (continued)

PRACTICAL QUESTION TRAPS

Trap 47 | Partner interest: identify whose money the partner represents ★★★★★

Section 40(b), Explanations 1 and 2; 40A(2)

Question trap: Arun is a partner representing his Hindu undivided family. The firm pays authorised 15% simple interest on ₹10 lakh belonging to that family. It also pays 15% on Arun's separate ₹4 lakh personal business loan. Both balances remain for the full year; the personal-loan rate is reasonable.

Student mistake: The student applies the 12% partner-interest ceiling to both balances merely because both payments are made through Arun.

Final result: For a representative partner, interest on money belonging to the represented person is considered under section 40(b). Interest paid to that individual in his separate personal capacity is left outside this specific partner-interest restriction. The personal borrowing still needs a genuine business purpose and must satisfy the other deduction conditions, including reasonableness. Read ownership of funds and capacity of receipt together; the bank-account name alone cannot decide the treatment.

Worked example: Family-capital interest is limited to ₹1.2 lakh; disallow ₹30,000. The separate ₹60,000 personal-loan interest is allowable on these stated facts. Total interest deduction is ₹1.8 lakh.

Trap 48 | Exempt investment income does not support an expense deduction

Section 14A; 10(15)

Question trap: A trader's adjusted profit is ₹5 lakh after exempt bond interest has already been removed. This figure still includes ₹30,000 interest on a loan used solely to buy qualifying tax-free bonds. The bond income is exempt under section 10(15).

Student mistake: The student removes the exempt receipt but keeps the related borrowing expense as a deduction against taxable business income.

Final result: Expenditure incurred in relation to income excluded from total income is disallowed under section 14A. Where the question directly identifies the related expense, use that fact; do not invent an arbitrary percentage of all expenses. The section can apply even if the related exempt income has not accrued, arisen or been received in that particular year. A taxable dividend is different: identify whether the income is actually exempt before applying this rule.

Worked example: Add back the directly identified ₹30,000. Starting from the stated profit after separate removal of exempt income, taxable profit becomes ₹5.3 lakh, before other adjustments. The expense cannot shelter unrelated taxable income.

Chapter 6: Capital Gains

THEORY TRAPS

Trap 1 | Personal use and taxable transfers

Section 2(14), 2(47)

Question trap: A person exchanges jewellery used by the family for another asset. No cash is received. The question asks whether personal use and the absence of cash prevent capital gains.

Student mistake: The student treats the jewellery like a personal car and assumes that capital gains require a cash sale.

Final result: A personal car is generally outside the definition of a capital asset. However, jewellery, paintings and sculptures remain capital assets even when used personally. A transfer can include an exchange, giving up a right or ending a right. Cash payment is not essential. Merely allowing someone to inspect property is insufficient. Possession given under a contract in part performance must satisfy the relevant legal and registration conditions. For an ordinary sale, capital gains arise in the year of transfer.

Trap 2 | Securities held by specified funds

Section 2(14)(b), 115UB

Question trap: An eligible investment fund holds securities under the prescribed regulations but shows them as trading stock in its accounts. The question asks whether the sale profit is business income.

Student mistake: The student follows the accounting label and classifies the securities as stock without checking the special statutory rule.

Final result: Securities held by specified Foreign Institutional Investors under the prescribed regulations are capital assets. Finance Act 2025 extends this express rule to eligible section 115UB investment funds holding securities under the relevant Securities and Exchange Board of India or International Financial Services Centres Authority regulations. Therefore, an accounting description alone does not decide the income head for a covered fund. This rule does not cover every fund, company or individual trader. For ordinary investors and traders, examine whether the securities are actually held as investments or as trading stock.

Chapter 6: Capital Gains (continued)

THEORY TRAPS

Trap 3 | Gifts and other exempt transfers

Section 47(i), 47(iii)-(vii), 47A; 47(viib)

Question trap: A company transfers an investment asset to its 99%-owned subsidiary without consideration. The question describes this as a gift within the same group and asks whether the transfer is exempt.

Student mistake: The student assumes that every gift or group transfer is exempt for both the transferor and the recipient.

Final result: Section 47(iii) protects a qualifying gift, will or irrevocable-trust transfer by an individual or Hindu undivided family. The recipient must separately satisfy section 56(2)(x). Hindu undivided family partition follows a different rule. Parent-subsidiary relief requires 100% ownership and an Indian receiving company; it excludes stock-in-trade. A 99% holding therefore fails. Check the separate conditions for amalgamation and demerger, and withdrawal under section 47A. Relevant parent-subsidiary breaches have an eight-year test. Section 47(viib) separately protects a Government Security carrying periodic interest when one non-resident transfers it to another outside India through a securities-settlement intermediary.

Trap 4 | Sovereign Gold Bond: redemption differs from sale

Section 47(viic), 47(viid), 47(xvi), 10(43)

Question trap: An individual sells a Sovereign Gold Bond on a stock exchange and also receives interest. The question refers to the exemption available when such a bond is redeemed.

Student mistake: The student treats an exchange sale like redemption and exempts both the sale gain and the interest.

Final result: Under this book's applicable law, redemption of a Sovereign Gold Bond by an individual receives protection. A stock-exchange sale does not receive that exemption, and interest is taxable. Qualifying conversion of gold into an Electronic Gold Receipt, or conversion of that receipt back into gold, is not a transfer. The original cost and holding period continue. A notified reverse mortgage and eligible loan receipts have separate protection. These rules do not make every later sale of the underlying asset exempt.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 5 | Agricultural land: use aerial distance ★★★★★

Section 2(14)(iii)

Question trap: Agricultural land lies outside a municipality with a population of 70,000. It is 5 km away by road but only 1.8 km away by air. Is the sale outside capital gains?

Student mistake: The student uses the longer road distance and treats the land as rural agricultural land outside capital gains.

Final result: For Indian agricultural land, use aerial distance from municipal or cantonment limits. For a population above 10,000 and up to 1 lakh, the covered distance is up to 2 km. Above 1 lakh and up to 10 lakh, it is up to 6 km; above 10 lakh, it is up to 8 km. The stated distance boundary is included. Land inside the municipality or cantonment itself is covered when its population is at least 10,000. Use the applicable published census figures. Foreign agricultural land does not receive the rural-India exclusion.

Worked example: The population is 70,000 and aerial distance is 1.8 km. The land falls within the 2 km limit and is a capital asset, despite the 5 km road distance.

Trap 6 | Non-exempt unit-linked insurance policies: income head and rate ★★★★★

Section 2(14)(c), 45(1B), 112A; Rule 8AD

Question trap: A unit-linked insurance policy receipt fails the conditions for exemption under section 10(10D), although the premium is below ₹2.5 lakh. The question asks for the income head and tax rate.

Student mistake: The student assumes that only high-premium unit-linked insurance policies enter capital gains, or automatically applies the equity-oriented fund rate.

Final result: From assessment year 2026-27, the capital-gains framework covers unit-linked insurance policies that fail section 10(10D), including failures unrelated to the high-premium limit. Calculate the gain under Rule 8AD. Do not deduct premiums already used against earlier receipts. Applying section 112A is a separate step: the unit-linked insurance policy must satisfy the equity-oriented conditions, including the prescribed investment percentage throughout the policy term. A non-equity unit-linked insurance policy does not qualify merely because its receipt is taxable as capital gains.

Worked example: The relevant receipt is ₹6 lakh and eligible premiums under Rule 8AD are ₹4 lakh. The gain is ₹2 lakh. Check the separate conditions before applying section 112A.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 7 | Holding periods: 12, 24 or 36 months

Section 2(42A), 50, 50AA, 50B

Question trap: During financial year 2025-26, a person sells gold held for 30 months and unlisted shares held for exactly 24 months. A separate question gives a slump sale of a 30-month-old undertaking.

Student mistake: The student applies one holding period to every asset or treats exactly 24 months as more than 24 months.

Final result: For ordinary financial year 2025-26 transfers, the general short-term limit is 24 months. Securities listed on a recognised Indian exchange, Unit Trust of India units, equity-oriented fund units and zero-coupon bonds use 12 months. Holding an asset for exactly the applicable limit still gives a short-term result. Unlisted shares and land or buildings normally use 24 months. Sections 50 and 50AA can override the ordinary holding-period result. For a slump-sale undertaking, the special limit remains 36 months.

Worked example: Gold held for 30 months normally gives long-term capital gain. Unlisted shares held for exactly 24 months give short-term capital gain. A 30-month undertaking gives short-term capital gain under section 50B.

Trap 8 | Section 50AA: fund tests and dates ★★★★★

Section 50AA

Question trap: Debt-fund units bought in 2022 are sold in financial year 2025-26 after more than 24 months. An unlisted bond bought in 2022 is redeemed in the same financial year. Are both gains automatically short-term?

Student mistake: The student applies the debt-fund acquisition cutoff to the bond, or applies section 50AA to every old debt-fund unit.

Final result: For fund units, section 50AA requires acquisition on or after 1 April 2023. A specified fund invests more than 65% in debt or money-market instruments, or at least 65% in units of such debt funds. Use annual averages of daily closing figures. Market-linked debentures have no such acquisition cutoff. Unlisted bonds and debentures transferred, redeemed or matured on or after 23 July 2024 give deemed short-term capital gain regardless of their holding period.

Worked example: The 2022 debt-fund units fall outside section 50AA and give long-term capital gain under the stated ordinary holding-period test. The unlisted bond redeemed in financial year 2025-26 gives deemed short-term capital gain under section 50AA.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 9 | Cost after gifts, inheritance and conversion

Section 49, 2(42A), 47(x)/(xb)

Question trap: A daughter sells jewellery in financial year 2025-26 that her father bought in 2020 and gifted to her in 2024. The question gives his original cost and the jewellery's gift-date market value. She paid nothing.

Student mistake: The student uses nil cost or the gift-date market value and counts the holding period only from the gift.

Final result: For qualifying gifts and inheritance, carry forward the relevant previous owner's cost and holding period. However, if the receipt value was actually taxed under section 56(2)(x), section 49(4) uses that taxed value as the cost. Qualifying conversions of debentures or preference shares also preserve the prescribed cost and holding period. For a demerger, allocate cost using the prescribed ratio of net book value to net worth. Current market value does not automatically become the new cost.

Worked example: The father's jewellery cost ₹3 lakh. His daughter receives it as a gift and sells it for ₹5 lakh, with no transfer expenses. Her long-term capital gain is ₹2 lakh. Include his ownership period; use his cost, not the gift-date market value.

Trap 10 | Compensation: choose the correct tax year

Section 45(1A), 45(5), 10(37)

Question trap: Original compulsory-acquisition compensation is ₹30 lakh, but only ₹5 lakh is received initially. A separate insurance case gives fire damage in March 2025 and compensation received in August 2025.

Student mistake: The student taxes only the first compensation instalment or taxes an insurance gain in the year of damage.

Final result: First check exemption under section 10(37) or the applicable land-acquisition law, Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013. Otherwise, use the full original compensation in the year any part is first received. Enhanced compensation is generally taxed on receipt with nil acquisition and improvement cost; enhancement under an interim order waits for the final order. Interest is considered separately. Insurance gains from the specified casualties follow the receipt year, but the holding period ends on damage or destruction. Ordinary theft is not a listed cause.

Worked example: Use the full ₹30 lakh when the first ₹5 lakh is received. The fire compensation received in August 2025 is charged in financial year 2025-26, although the damage occurred in March 2025.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 11 | Conversion between stock and capital assets ★★★★★

Section 45(2), 28(via), 49(9), 2(42A)

Question trap: An investment asset is converted into trading stock and sold later. Another case reverses the process: trading stock becomes an investment. Both questions give market value on the conversion date.

Student mistake: The student taxes both conversions immediately, or postpones both until sale, and uses the same cost rule in each case.

Final result: When a capital asset becomes stock, capital gain is taxed when that stock is sold or transferred. Conversion-date fair market value separates capital gain from business profit. Test holding period and indexation at conversion. A partial sale releases proportionate capital gain. When stock becomes a capital asset, the prescribed fair market value enters business income in the conversion year, with normal deduction for stock cost. That market value becomes the cost for the later capital gain. The capital holding period starts at conversion.

Worked example: Capital to stock: cost ₹10 lakh, conversion value ₹25 lakh and sale ₹32 lakh give sale-year capital gain ₹15 lakh and business profit ₹7 lakh, assuming conversion on or after 23 July 2024. Reverse conversion: cost ₹2 lakh and value ₹3 lakh give immediate business profit ₹1 lakh. A later sale for ₹4 lakh gives capital gain ₹1 lakh.

Quick help: Dono directions ka tax-year alag hai.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 12 | Joint development agreement and contribution to a firm

Section 45(5A), 45(3)

Question trap: A landowner receives flats and cash under a registered joint development agreement. Another person contributes jewellery to a firm as capital. Neither transaction is described as an ordinary cash sale.

Student mistake: The student takes consideration as nil or taxes a qualifying development agreement before the completion-certificate year.

Final result: For an individual or Hindu undivided family's qualifying registered joint development agreement, tax is deferred to the year a completion certificate is issued for the whole or part of the project. Consideration is the certificate-date stamp value of the owner's share plus money received. Transfer of that share on or before the certificate ends this special deferral. For an asset contributed to a firm, association of persons or body of individuals, section 45(3) uses the value recorded in its books. Later distributions require separate examination under sections 9B and 45(4).

Worked example: Flats with the relevant stamp value of ₹70 lakh plus ₹10 lakh cash give ₹80 lakh consideration. Contributed jewellery costing ₹4 lakh and recorded at ₹9 lakh gives ₹5 lakh gain before other adjustments.

Trap 13 | The 2001 cost option still matters

Section 55(1)(b), 55(2)(a)/(b), 48

Question trap: Land bought in 1996 has a higher market value and a lower stamp value on 1 April 2001. The question also asks whether self-created goodwill can use a similar market-value cost.

Student mistake: The student discards the 2001 cost option because indexation changed, or applies that option to self-created goodwill.

Final result: Eligible assets acquired before 1 April 2001 can still use the prescribed cost or market-value option. For land or buildings, the 2001 market value cannot exceed the stamp value available for that date. Do not deduct pre-2001 improvements separately; eligible later improvements remain relevant. Specified self-generated goodwill and rights have statutory nil cost and cannot use the general 2001 market-value option. For purchased goodwill, adjust the cost where earlier depreciation was allowed.

Worked example: Land cost ₹5 lakh in 1996. Its 2001 market value is ₹14 lakh and stamp value is ₹11 lakh, so the substituted cost is ₹11 lakh. Self-created goodwill sold for ₹12 lakh, with ₹0.5 lakh transfer expense, gives ₹11.5 lakh gain.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 14 | Bonus shares and rights have different costs

Section 55(2)(aa), 2(42A)

Question trap: An existing shareholder gives up a rights entitlement for ₹20. The buyer pays that ₹20 to the shareholder and another ₹80 to the company to obtain the share.

Student mistake: The student gives both parties the same cost, or ignores the buyer's payment to the person who gave up the right.

Final result: The original shareholder's renounced right normally has nil cost. A buyer who subscribes adds both payments: the amount paid for the right and the amount paid to the company. Direct rights subscription uses the payment to the company as cost. Bonus shares allotted on or after 1 April 2001 normally have nil cost and their own holding period from allotment. The original shares retain their cost. Check any applicable 2001 or 2018 grandfathering separately.

Worked example: The buyer's share cost is ₹20 + ₹80 = ₹100. For the original shareholder, the ₹20 received for giving up the right normally gives ₹20 capital gain.

Trap 15 | Securities Transaction Tax and previously taxed advances

Section 48, 51, 56(2)(ix)

Question trap: A share-sale statement includes brokerage and Securities Transaction Tax. A property question also gives loan interest already deducted and an advance forfeited in 2025 after sale negotiations failed.

Student mistake: The student deducts every payment from capital gains and reduces property cost again for an advance already taxed separately.

Final result: Eligible transfer brokerage is deductible. Securities Transaction Tax cannot be deducted or added to capital-gains cost. Housing interest already deducted under section 24(b) or Chapter VI-A cannot be claimed again as cost. An advance forfeited on or after 1 April 2014 after failed capital-asset negotiations is taxable under Other Sources. An amount so taxed does not reduce the future asset cost again. Earlier forfeitures follow the separate section 51 rule.

Worked example: Sale proceeds ₹3 lakh less cost ₹2 lakh and brokerage ₹2,000 give ₹98,000 gain. Do not deduct Securities Transaction Tax of ₹300. A ₹2 lakh advance forfeited in 2025 is Other Sources income, without another cost reduction.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 16 | Section 50C: tolerance, date and valuation ★★★★★

Section 50C

Question trap: Land held as a capital asset sells for ₹50 lakh, while its stamp duty value is ₹55.10 lakh. The question also gives an earlier agreement date, the advance-payment method and a possible valuation officer's report.

Student mistake: The student deducts a 10% allowance from stamp value or uses the agreement-date value without checking the advance payment.

Final result: If stamp value is no more than 110% of actual price, use actual consideration. Above that limit, use the full stamp value, subject to available relief. Agreement-date value requires fixed consideration and eligible payment on or before the agreement by account-payee cheque or draft, electronic clearing system or a prescribed electronic mode. Cash or later payment fails. If an eligible reference is made to the Departmental Valuation Officer, the actual price is the minimum and the applicable stamp value is the maximum.

Worked example: At price ₹50 lakh, stamp value ₹55 lakh permits ₹50 lakh; stamp value ₹55.10 lakh requires ₹55.10 lakh. If price is ₹50 lakh and stamp value ₹65 lakh, a valuation of ₹58 lakh is used. A valuation of ₹70 lakh is capped at ₹65 lakh.

Trap 17 | Unquoted shares have no 10% tolerance

Section 50CA, 50D

Question trap: Covered unquoted shares are sold for ₹9.5 lakh although their prescribed fair market value is ₹10 lakh. The question asks whether the small 5% difference can be ignored.

Student mistake: The student imports the 10% property tolerance into share valuation or applies market value to every cheap sale.

Final result: For covered shares other than quoted shares, section 50CA substitutes the prescribed fair market value when the sale price is lower. There is no general 10% tolerance. Apply the statutory definition of a quoted share and the prescribed exceptions; the word 'unlisted' is only shorthand. Section 50D is different: it uses transfer-date fair market value when consideration cannot be determined. A low but clearly known price does not by itself trigger section 50D.

Worked example: The covered shares sell for ₹9.5 lakh and their prescribed fair market value is ₹10 lakh. Use ₹10 lakh, even though the price is only 5% lower.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 18 | Depreciable assets: test the whole block

Section 50, 43(6)

Question trap: A depreciable block has an opening written-down value of ₹8 lakh and no additions. Assets are sold for net proceeds of ₹6 lakh. The question states whether any assets remain in the block.

Student mistake: The student calculates a ₹2 lakh capital loss immediately without checking whether the whole block has ceased to exist.

Final result: Compare net disposal proceeds with the opening written-down value of the whole block plus relevant additions. Excess proceeds give deemed short-term capital gain. Lower proceeds give short-term capital loss only if the entire block ceases to exist. If assets remain, the balance normally continues for depreciation. Section 50 and section 50AA are different rules. Where the asset is a genuinely long-held building, separately examine whether eligible relief under section 54EC is available.

Worked example: If the whole block ceases, ₹8 lakh less ₹6 lakh gives ₹2 lakh short-term capital loss. If assets remain, the remaining block value is normally ₹2 lakh.

Trap 19 | Slump sale: net worth and two prescribed values ★★★★★

Section 50B, 2(42C); Rule 11UAE

Question trap: An undertaking is sold for a lump sum. The question gives revalued accounts, tax written-down values, two prescribed fair market values and separate asset values used only for stamp duty.

Student mistake: The student uses accounting net worth or the stated price, and assumes that stamp-duty values prevent a slump sale.

Final result: The short-term holding limit for a slump-sale undertaking remains 36 months. Its prescribed net worth is cost, without indexation. Ignore revaluation. Use tax written-down value for depreciable assets, nil for relevant section 35AD assets and self-generated goodwill, and the required book values for other assets; then deduct liabilities. Consideration is the higher of the asset-based prescribed value and the consideration-based prescribed value. Allocating values only for stamp duty does not automatically prevent slump-sale treatment. An accountant's report is required.

Worked example: Net worth is ₹30 lakh, the asset-based prescribed value is ₹58 lakh, the consideration-based prescribed value is ₹62 lakh, and transfer expenses are ₹2 lakh. Gain is ₹62 lakh - ₹30 lakh - ₹2 lakh = ₹30 lakh. A 30-month undertaking gives short-term capital gain.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 20 | Liquidation and buy-back are different ★★★★★

Section 46, 46A, 2(22)(c)/(f), 57

Question trap: One shareholder receives money on liquidation. Another receives a covered domestic company's buy-back payment on or after 1 October 2024. The question gives share cost in both cases.

Student mistake: The student deducts share cost directly from the buy-back dividend or applies the liquidation calculation to the buy-back.

Final result: On liquidation, first subtract deemed dividend from the shareholder's receipt, then deduct share cost to calculate capital gain. The company's distribution is protected by section 46(1). For a covered domestic-company buy-back on or after 1 October 2024, the full receipt is dividend without expense deduction. Section 46A separately uses nil consideration, producing a capital loss equal to eligible cost. Classify that loss by holding period; it cannot reduce dividend income. Foreign-company share buy-backs and other specified-security buy-backs instead follow the ordinary section 46A capital-gains calculation.

Worked example: Liquidation receipt ₹12 lakh less dividend ₹3 lakh and share cost ₹4 lakh gives ₹5 lakh capital gain. Buy-back receipt ₹3 lakh with cost ₹2 lakh gives ₹3 lakh dividend and a separate ₹2 lakh capital loss.

Trap 21 | Capital-gains rates, basic exemption and rebate ★★★★★

Section 111A, 112, 112A, 87A

Question trap: A resident individual under the default regime has ordinary income of ₹3 lakh and eligible section 111A gain of ₹2 lakh. The question asks for tax after basic exemption and rebate.

Student mistake: The student taxes the full gain at 20%, or assumes that section 87A removes the remaining special-rate tax.

Final result: Eligible section 111A gains on equity shares, equity-fund units or business-trust units are taxed at 20%, subject to the Securities Transaction Tax conditions and specified International Financial Services Centre exception. Other short-term gains normally use ordinary rates. Ordinary long-term gains generally use section 112 at 12.5%, subject to special rules. Resident individuals and Hindu undivided families may adjust unused basic exemption as prescribed; non-residents cannot. Default-regime section 87A does not remove special-rate capital-gains tax. For transfers before 23 July 2024, section 111A generally used 15% and section 112 generally used 20% with indexation, subject to then-applicable exceptions. Check the transfer date even when taxation is deferred.

Worked example: The resident individual has ₹1 lakh of unused basic exemption. Adjust it against the ₹2 lakh section 111A gain. Tax is ₹1 lakh × 20% = ₹20,000, plus cess.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 22 | Section 112A: one annual threshold ★★★★★

Section 112A

Question trap: A person earns eligible section 112A long-term gains of ₹90,000 from one investment and ₹80,000 from another during the same year. The question lists the transactions separately.

Student mistake: The student gives each transaction its own ₹1.25 lakh threshold or excludes that threshold amount from total income.

Final result: Add all eligible section 112A long-term gains for the year. Tax the amount exceeding ₹1.25 lakh at 12.5%. This is one annual tax threshold; it is neither an exclusion from total income nor a Chapter VI-A deduction. Equity shares generally require Securities Transaction Tax on both acquisition and transfer, subject to notified acquisition exceptions. Eligible fund and business-trust units have the transfer-side Securities Transaction Tax test. The restrictions on Chapter VI-A deductions and section 87A rebate also apply.

Worked example: Total gain is ₹90,000 + ₹80,000 = ₹1.70 lakh. The excess over ₹1.25 lakh is ₹45,000. Base tax is ₹45,000 × 12.5% = ₹5,625, assuming no unused-basic-exemption adjustment. Add applicable cess.

Trap 23 | The 31 January 2018 cost formula

Section 55(2)(ac)

Question trap: Eligible section 112A shares were acquired before 1 February 2018 for ₹100. Their 31 January 2018 market value is ₹180, but they are later sold for only ₹150.

Student mistake: The student directly adopts ₹180 as cost and creates an artificial loss, without first comparing market value with sale price.

Final result: For eligible assets acquired before 1 February 2018, first take the lower of the 31 January 2018 fair market value and sale consideration. Then compare that result with actual cost and take the higher amount. This formula prevents the historical market value from creating an artificial loss. However, a genuine loss below original cost can remain. Later acquisitions cannot use this formula. Apply the statutory fair-market-value definition for the particular asset.

Worked example: The lower of ₹180 and ₹150 is ₹150. The higher of actual cost ₹100 and ₹150 is ₹150, so gain is nil. If sale price is ₹90, cost remains ₹100 and the genuine loss is ₹10.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 24 | Old property: a tax cap, not a gain choice ★★★★★

Section 112(1)(a), 48

Question trap: A resident individual sells long-term land acquired before 23 July 2024. The current non-indexed gain is ₹20 lakh, but the old-law indexed calculation gives a gain of only ₹8 lakh.

Student mistake: The student replaces the current gain with the lower indexed gain or carries forward a loss arising only in the comparison.

Final result: For a resident individual or Hindu undivided family's eligible long-term land or building acquired before 23 July 2024, compare the current 12.5% non-indexed tax with the old-law indexed tax. The old calculation caps the tax; it does not replace the current gain. Companies and non-residents do not receive this protection. A loss arising only in the indexed comparison cannot be carried forward. The Cost Inflation Index for financial year 2025-26 is 376. Include applicable exemptions and unused basic exemption correctly in both complete tax calculations.

Worked example: Without exemption or basic-limit adjustments, ₹20 lakh at 12.5% gives ₹2.5 lakh tax. Old indexed gain ₹8 lakh at 20% gives ₹1.6 lakh. The protected base tax is ₹1.6 lakh, but the current gain remains ₹20 lakh.

Quick help: Tax compare karo; gain select mat karo.

Trap 25 | Section 54 versus section 54F ★★★★★

Section 54, 54F

Question trap: An eligible individual sells a long-term investment plot for net consideration of ₹60 lakh, earns a gain of ₹20 lakh and buys an eligible Indian house for ₹30 lakh within the prescribed time. All other section 54F conditions are satisfied.

Student mistake: The student exempts the full ₹20 lakh because the house costs more than the gain, using section 54 logic for section 54F.

Final result: For eligible individuals and Hindu undivided families, section 54 covers a long-term residential-house sale; section 54F covers other long-term assets. Buy an eligible Indian house within one year before or two years after transfer, or construct within three years after transfer. Section 54 broadly exempts the lower of gain and eligible cost. Under section 54F, full relief requires capped eligible cost at least equal to net consideration. Otherwise, relief is long-term gain × eligible cost ÷ net consideration. The ₹10 crore cost cap does not cap the denominator. Both exemptions remain available under the default regime.

Worked example: Section 54F relief is ₹20 lakh × ₹30 lakh ÷ ₹60 lakh = ₹10 lakh. The remaining ₹10 lakh gain is taxable.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 26 | Section 54: the ₹2 crore and ₹10 crore tests

Section 54(1)

Question trap: An eligible individual claims section 54. One question gives sale proceeds, capital gain and investment in two houses. Another gives eligible long-term residential-house gain of ₹12 crore and eligible new-house investment of ₹11 crore.

Student mistake: The student tests the ₹2 crore limit against sale proceeds or denies all relief when the gain exceeds ₹10 crore.

Final result: Section 54 normally permits one eligible house in India. Where the capital gain does not exceed ₹2 crore, the two-house option may be used only once in a lifetime. Test the gain, not the sale proceeds. Separately, the ₹10 crore ceiling limits the new-house cost recognised for relief. It does not cancel the entire exemption when the gain is larger. Section 54F does not provide this two-house option.

Worked example: For eligible gain of ₹12 crore and house investment of ₹11 crore, recognised cost and exemption are capped at ₹10 crore. Taxable gain is ₹2 crore, not ₹12 crore.

Trap 27 | House count and early withdrawal of relief

Section 54F(1)-(3), 54, 54B, 54D

Question trap: A person claims section 54F after buying a new house. The question also mentions another house already owned, a later house purchase, or sale of the replacement house in its second year.

Student mistake: The student checks only the new investment and ignores the other-house conditions or the later withdrawal of relief.

Final result: For section 54F, the taxpayer must own no more than one other house on the original transfer date. Purchasing another house within one year after the original transfer, or constructing one within three years after that transfer, affects initial eligibility. A separate withdrawal rule covers another-house purchase within two years or construction within three years after that transfer. These restrictions concern houses whose income is chargeable under House Property. Selling the replacement house within three years of its purchase or construction also withdraws relief. Section 54F taxes the earlier exempt long-term gain separately. Sections 54, 54B and 54D generally reduce replacement-asset cost on a qualifying early sale. That cost reduction does not make rural replacement land taxable if it remains outside capital assets.

Worked example: Earlier section 54F relief was ₹6 lakh. A prohibited sale in the second year after buying the new house revives ₹6 lakh long-term capital gain. Calculate the new house's own gain separately.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 28 | Capital Gains Accounts Scheme: deposit and final use

Section 54(2), 54B(2), 54D(2), 54F(4)

Question trap: A taxpayer deposits ₹48 lakh for section 54F relief but finally uses only ₹36 lakh. The question gives the original asset-transfer date, return due date and the later account-opening date.

Student mistake: The student starts the three-year period from the deposit date or taxes all unspent cash instead of recalculating the exemption.

Final result: Deposit eligible unspent money in the Capital Gains Accounts Scheme before filing the return and no later than the section 139(1) due date. An ordinary fixed deposit is insufficient. Section 54 concerns the gain; section 54F concerns net consideration, subject to its separate ₹10 crore deposit restriction. When three years from the original transfer expire, section 54 taxes unspent gain. Section 54F recalculates relief using actual investment and taxes the excess relief previously allowed. Section 54B uses a two-year period. Interest earned on the deposit is separate income.

Worked example: Section 54F gain is ₹12 lakh, net proceeds and deposit are ₹48 lakh, and final use is ₹36 lakh. Final relief is ₹12 lakh × ₹36 lakh ÷ ₹48 lakh = ₹9 lakh. Tax the ₹3 lakh excess relief, not the ₹12 lakh unspent cash.

Trap 29 | Section 54B can cover short-term capital gain

Section 54B, 10(37)

Question trap: An individual sells taxable urban agricultural land that the father farmed during the immediately preceding two years. The gain is short-term, and eligible replacement agricultural land is purchased within two years after sale.

Student mistake: The student rejects section 54B because the gain is short-term or because the parent, rather than the owner, farmed the land.

Final result: Section 54B can cover an individual or Hindu undivided family's qualifying short-term or long-term agricultural-land gain. The individual or parent, or the Hindu undivided family, must have used the land for agriculture during the preceding two years. Buy agricultural land within two years after transfer; the new land may be urban or rural. Relief is the lower of gain and eligible cost. First check the rural-land exclusion and compulsory-acquisition exemption under section 10(37). Do not claim another deduction from a gain that is already exempt.

Worked example: The father farmed the land for the required period. Taxable gain is ₹7 lakh and timely replacement-land cost is ₹5 lakh. Relief is ₹5 lakh, leaving ₹2 lakh taxable.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 30 | Industrial relief: choose the correct route

Section 54D, 54G, 54GA, 54H

Question trap: A qualifying industrial undertaking moves from an urban area to a Special Economic Zone that is also urban. The question gives relocation spending before and after the original asset transfer.

Student mistake: The student rejects relief because the new location is urban or applies the compulsory-acquisition rules to a relocation.

Final result: Section 54G covers movement from an urban to a non-urban area. Section 54GA covers movement from an urban area to a Special Economic Zone, even an urban one. Eligible spending under these two sections runs from one year before to three years after transfer. Section 54D instead requires compulsory acquisition and industrial-business use during the preceding two years, followed by eligible industrial land or building investment within three years. Any assessee's short-term or long-term gain may qualify, limited by gain and eligible spending. Check Capital Gains Accounts Scheme and lock-in conditions. For delayed section 54D compensation, section 54H can start the relevant deadlines from receipt.

Worked example: A qualifying factory moves from an urban area to an urban Special Economic Zone. Gain of ₹8 lakh and eligible spending of ₹6 lakh give ₹6 lakh relief under section 54GA.

Trap 31 | Section 54EC: April does not reset the limit

Section 54EC

Question trap: After earning an eligible land gain of ₹80 lakh, a taxpayer invests ₹50 lakh in notified bonds in February and ₹30 lakh in April. Both investments fall within six months of transfer.

Student mistake: The student treats April as a fresh ₹50 lakh exemption limit or assumes that a Capital Gains Accounts Scheme deposit extends the six-month deadline.

Final result: Any assessee may invest qualifying long-term land or building gain in notified bonds within six months. Relief is limited by the gain, eligible investment and ₹50 lakh. Aggregate the relevant investments across the transfer financial year and the following financial year; April does not restart the limit. An ordinary fixed deposit is ineligible, and Capital Gains Accounts Scheme does not extend six months. Qualifying Housing and Urban Development Corporation bonds issued on or after 1 April 2025 are notified. Transfer or conversion of the bonds, or a loan or advance against them, within five years of acquisition can revive the exempt long-term gain.

Worked example: Although ₹80 lakh is invested within six months, relief remains ₹50 lakh. A loan against the bonds in year three can also trigger withdrawal of the exemption.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 32 | Dematerialised shares: identify the sale within its account

Section 45(2A); Circular 768

Question trap: An investor sells 100 shares from dematerialised Account B. Account A contains an older lot of the same company. Account B's first credited lot contains 100 shares costing ₹200 each; a later credited lot costs ₹250 per share.

Student mistake: The student selects the oldest lot across both accounts or chooses the ₹250 lot because it produces a smaller taxable gain.

Final result: Apply the first-in-first-out method separately within the account from which the shares are sold. Shares remaining in another account, or held physically, are not treated as sold. Identify the lot that first entered the selling account. Its actual acquisition date determines the holding period; later conversion of physical shares into electronic form does not restart ownership.

Worked example: The 100 shares sold for ₹300 each come from the first ₹200 lot in Account B. Cost is ₹20,000 and gain is ₹10,000 before transfer expenses. Account A stays untouched.

Trap 33 | Dividend stripping: first check whether the dividend is exempt

Section 94(7)

Question trap: An investor buys ordinary shares for ₹1 lakh shortly before the record date, receives taxable dividend of ₹8,000 and sells those shares for ₹90,000 shortly afterwards. The question asks whether the ₹10,000 capital loss is disallowed.

Student mistake: The student automatically deducts the dividend from the loss because the purchase and sale occurred close to the record date.

Final result: Section 94(7) requires exempt dividend or income. Taxable ordinary dividend does not satisfy that condition. Where the rule does apply, the purchase must be within three months before the record date; sale must be within three months afterwards for securities, or nine months for units. Ignore loss only up to the exempt income received.

Worked example: Here, dividend of ₹8,000 is taxable separately and the ₹10,000 capital loss is not denied under section 94(7). Apply the normal capital-loss set-off rules to that loss.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 34 | Bonus stripping: the ignored loss becomes bonus cost

Section 94(8)

Question trap: An investor buys 1,000 shares for ₹1 lakh two months before the record date, receives 1,000 bonus shares free and sells all original shares for ₹60,000 two months after that date. All bonus shares are still held.

Student mistake: The student claims a ₹40,000 capital loss and also keeps the bonus shares at nil cost for their later sale.

Final result: The rule covers securities as well as units. If the originals were acquired within three months before the record date and sold within nine months afterwards while any bonus holding remains, ignore the covered loss. Add that ignored loss to the cost of the bonus securities or units still held on the sale date. It is not lost forever.

Worked example: The ₹40,000 loss is ignored now. The retained 1,000 bonus shares obtain total cost of ₹40,000, or ₹40 each. Do not also claim the same ₹40,000 as a current capital loss.

Trap 35 | Non-resident shares: compute the gain in the original currency

Section 48, first proviso; Rule 115A

Question trap: A non-resident bought Indian-company shares using US dollars. The shares are sold after eight months. The prescribed conversion gives purchase cost of US$10,000, sale proceeds of US$12,000 and transfer expenses of US$100. The applicable buying rate on sale is ₹83 per dollar.

Student mistake: The student subtracts historical rupee cost from rupee sale proceeds or uses one exchange rate for every step.

Final result: For covered Indian-company shares or debentures acquired in foreign currency, compute cost, transfer expenses and sale consideration in that original currency using the prescribed rates. Convert the resulting gain back into rupees. Rule 115A uses the prescribed average rates for the inputs and the transfer-date telegraphic transfer buying rate for the final reconversion. Special exclusions, including section 112A, must be checked separately.

Worked example: Foreign-currency gain is US$12,000 - US$10,000 - US$100 = US$1,900. Rupee short-term gain is US$1,900 × ₹83 = ₹1,57,700; then apply the relevant tax rate.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 36 | Amalgamation shares: carry forward total cost, not face value

Section 47(vii), 49(2), 2(42A)

Question trap: A shareholder bought 100 shares in Company A in 2020 for ₹2 lakh. In a qualifying amalgamation with an Indian Company B, those shares are exchanged for 50 B shares in June 2025. All B shares are sold for ₹3 lakh in December 2025.

Student mistake: The student treats the new shares as free, uses their face value as cost or counts ownership only from June 2025.

Final result: A qualifying share-for-share amalgamation does not tax the shareholder at the exchange stage. The aggregate cost of the original shares becomes the aggregate cost of the replacement shares. Include the original shares' holding period when testing the later sale. The exchange ratio changes cost per replacement share, not the total historical cost. The statutory amalgamation and Indian-company conditions must be met.

Worked example: Each of the 50 replacement shares carries cost of ₹4,000. Their total cost remains ₹2 lakh. The later ₹3 lakh sale gives ₹1 lakh long-term capital gain before transfer expenses.

Trap 37 | Reduction of share capital: separate dividend and capital gain

Section 2(22)(d), 2(47), 45, 48

Question trap: In financial year 2025-26, an equity shareholder receives ₹8 lakh on a valid reduction of share capital. The question identifies ₹3 lakh as the covered accumulated-profit component and ₹2 lakh as the acquisition cost attributable to the rights extinguished. There are no transfer expenses.

Student mistake: The student treats the whole receipt as a tax-free capital repayment, taxes all of it as dividend, or deducts the cost of every share still held.

Final result: Reduction can extinguish part of a shareholder's rights and therefore amount to a transfer. First identify the amount treated as deemed dividend under section 2(22)(d). Use the balance as the capital receipt and deduct only the cost attributable to the extinguished rights. This is a capital-reduction calculation; do not automatically import the separate domestic share-buy-back rule.

Worked example: Taxable dividend is ₹3 lakh. Capital gain is ₹8 lakh - ₹3 lakh - ₹2 lakh = ₹3 lakh. Classify that gain using the relevant holding period.

Chapter 6: Capital Gains (continued)

PRACTICAL QUESTION TRAPS

Trap 38 | A retiring partner receives cash: remove revaluation uplift

Section 45(4)

Question trap: A partner retires from a continuing firm and receives only ₹18 lakh cash in financial year 2025-26. The capital account shows ₹20 lakh, including ₹8 lakh credited solely from asset revaluation. All other genuine profit and capital adjustments are already included.

Student mistake: The student compares the cash with the inflated ₹20 lakh account and concludes that the firm has no taxable capital gain.

Final result: On a covered reconstitution, the firm computes section 45(4) gain from money plus the fair market value of capital assets received by the partner, less the qualifying capital-account balance. Exclude increases from asset revaluation, self-generated goodwill and other self-generated assets. A negative result becomes nil. The charge is on the firm. A cash-only payout does not itself create a deemed asset transfer under section 9B.

Worked example: Qualifying capital is ₹20 lakh - ₹8 lakh = ₹12 lakh. The firm's section 45(4) capital gain is ₹18 lakh - ₹12 lakh = ₹6 lakh.

Trap 39 | Stock given to a retiring partner: the firm recognises business income

Section 9B, 45(4)

Question trap: On retirement from a continuing firm, a partner receives only trading goods that cost the firm ₹6 lakh and have fair market value of ₹9 lakh on receipt. No money or investment asset is distributed. The firm makes only a capital-account entry.

Student mistake: The student records the goods at cost without taxable profit, or labels the ₹3 lakh increase as capital gain because a partner is retiring.

Final result: Section 9B treats the firm as transferring capital assets or trading stock received by a partner on covered dissolution or reconstitution. Use receipt-date fair market value as consideration. The income head follows the distributed asset: trading stock produces business income. Section 45(4) separately covers money or capital assets received on reconstitution; the stock-only receipt described here is outside that separate charging formula.

Worked example: The firm recognises deemed trading proceeds of ₹9 lakh and deducts the ₹6 lakh stock cost, giving ₹3 lakh business profit. A journal entry does not remove the tax charge.

Chapter 7: Income from Other Sources

THEORY TRAPS

Trap 1 | Choose the income head first.

Sections 56(1), 56(2)(ii)/(iii)

Question trap: An owner rents a building together with machinery under one agreement. The question also gives rent from a vacant plot and regular professional fees.

Student mistake: A student puts every unusual receipt under Other Sources, or treats every receipt called rent as House Property income.

Final result: Check the other four income heads before using Other Sources. Regular professional fees may belong to business income. Rent from vacant land does not belong to House Property. If the building and machinery cannot be hired separately, the combined income belongs wholly to business income or wholly to Other Sources, depending on the facts. A single agreement does not, by itself, prove that the two lettings are inseparable.

Trap 2 | Check the specified-property list.

Section 56(2)(x)

Question trap: A person receives a car, a painting and jewellery as gifts. The question asks whether every valuable gift attracts the property-gift rule.

Student mistake: A student applies the same gift rule to all three items merely because each item has a market value.

Final result: Section 56(2)(x) covers only the listed types of property held as capital assets. The list includes land or buildings, shares or securities, jewellery, bullion, archaeological collections, drawings, paintings, sculptures, other artwork and virtual digital assets. A personal-use car, laptop or ordinary furniture is outside this list. However, a benefit received through employment or business may be taxable under separate provisions. Being outside this gift list does not make every such receipt exempt.

Chapter 7: Income from Other Sources (continued)

THEORY TRAPS

Trap 3 | Identify the contract being terminated.

Sections 17(3), 28(ii)(e), 56(2)(xi)

Question trap: One person receives compensation when employment ends. Another receives compensation when a business supply contract is cancelled. Both receipts are described as termination payments.

Student mistake: A student taxes both payments under section 56(2)(xi) because the question uses the word termination.

Final result: Identify the contract that ended. Section 56(2)(xi) covers termination of employment or changes in employment terms, but first check whether section 17(3) already taxes the receipt as Salary. Compensation for ending or changing a business contract is examined under section 28(ii)(e). Do not assume that compensation is exempt merely because the receipt is unusual or paid only once. Any exemption has its own conditions.

PRACTICAL QUESTION TRAPS

Trap 4 | Aggregate gifts in separate categories. ★★★★★

Section 56(2)(x)(a)/(c)

Question trap: Two friends give a person cash gifts of ₹28,000 and ₹24,000 during the year. Another question gives both cash gifts and free jewellery.

Student mistake: A student applies ₹50,000 separately to each donor, taxes only the excess, or combines cash and movable-property gifts.

Final result: First remove exempt gifts. Then maintain three separate yearly totals: money gifts, the fair market value of specified movable property received free, and the shortfall between fair market value and price for specified movables bought cheaply. If a category exceeds ₹50,000, its whole total or whole shortfall is taxable. A total of exactly ₹50,000 does not trigger this rule.

Worked example: The two cash gifts total ₹52,000, so all ₹52,000 is taxable. Separately, cash of ₹35,000 and free jewellery worth ₹40,000 cross neither limit. Adding a free painting worth ₹20,000 makes the full ₹60,000 movable-property gift total taxable.

Chapter 7: Income from Other Sources (continued)

PRACTICAL QUESTION TRAPS

Trap 5 | Test the relationship from the recipient's side.

Section 56(2)(x), Explanation

Question trap: An uncle gives his nephew ₹1 lakh. In a separate case, the nephew gives his uncle the same amount. The question calls both donors family members.

Student mistake: A student exempts both gifts because the relationship appears to be the same in both directions.

Final result: Check the relationship from the person receiving the gift. The recipient's parent's brother or sister is a listed relative. The recipient's brother's or sister's child is not specifically included. First cousins and a grandfather's sister are also outside the list. Everyday labels such as family member or close relative cannot replace the relationship list in the Act.

Worked example: The uncle's ₹1 lakh gift to his nephew is exempt because the donor is the recipient's parent's brother. The nephew's ₹1 lakh gift to his uncle is wholly taxable unless another exemption applies.

Trap 6 | The marriage exemption belongs to the recipient.

Section 56(2)(x), first proviso

Question trap: At Nisha's wedding, friends give money to Nisha and to her father. The question also includes money inherited from a neighbour under a will.

Student mistake: A student exempts every gift received at the wedding but taxes the inheritance because the deceased was not a relative.

Final result: The marriage exemption applies to gifts received on the individual recipient's own marriage. A birthday, anniversary, engagement or child's marriage does not automatically qualify. A receipt under a will or by inheritance can be exempt even when the deceased was a stranger. However, future income earned from the inherited asset follows the normal tax rules.

Worked example: Nisha's ₹3 lakh wedding gift from friends is exempt. Her father's ₹80,000 gift from his friend is taxable because it is not his marriage. The ₹2 lakh received under a neighbour's will is exempt.

Chapter 7: Income from Other Sources (continued)

PRACTICAL QUESTION TRAPS

Trap 7 | Distinguish a free property from a cheap purchase. ★★★★★

Section 56(2)(x)(b)

Question trap: A person receives one non-agricultural investment plot free and buys another below its stamp-duty value. The question gives a 10% difference as a possible exemption in both cases.

Student mistake: A student applies the 10% tolerance to the free plot, or taxes only the amount above the permitted difference.

Final result: For immovable property received free, the whole stamp-duty value is taxable if that property's value exceeds ₹50,000. For a cheap purchase, compare the value-minus-price difference with the higher of ₹50,000 and 10% of the price. Tax the whole difference only if it exceeds that limit. Equality does not trigger an addition. In both cases, check whether a separate exemption applies.

Worked example: A free plot with a stamp-duty value of ₹4 lakh gives taxable income of ₹4 lakh. For a ₹30 lakh purchase, a value of ₹33 lakh causes no addition. A value of ₹33.20 lakh makes the full ₹3.20 lakh difference taxable.

Quick help: Pehle free ya paid dekho; phir limit lagao.

Trap 8 | Check the advance before using agreement-date value.

Section 56(2)(x)(b), provisos

Question trap: A non-agricultural investment property's stamp-duty value rises between the agreement and registration dates. The buyer paid a token amount before the agreement, but the question specifies its payment mode.

Student mistake: A student always uses the lower agreement-date value and ignores whether the advance was paid in cash.

Final result: The agreement must fix the price. Some consideration must be paid on or before that agreement date through an account-payee cheque or draft, electronic clearing system, or another prescribed electronic mode. Only then can the agreement-date stamp-duty value be used. Then compare the value-minus-price difference with the higher of ₹50,000 and 10% of the price.

Worked example: The price is ₹40 lakh, the agreement-date value is ₹42 lakh and the registration-date value is ₹46 lakh. A ₹1 lakh Unified Payments Interface advance before the agreement permits ₹42 lakh, so the ₹2 lakh difference is within the limit. With only a cash token, the ₹6 lakh difference is taxable.

Chapter 7: Income from Other Sources (continued)

PRACTICAL QUESTION TRAPS

Trap 9 | Treat 20% as the interest ceiling. ★★★★★

Section 57, first proviso

Question trap: A shareholder receives ₹1 lakh of ordinary dividend and pays interest of ₹28,000 plus collection charges of ₹2,000. A second case gives interest of only ₹8,000.

Student mistake: A student deducts every expense or gives a flat 20% deduction even when the actual interest is lower.

Final result: For ordinary dividend, allow the lower of eligible actual interest and 20% of the gross dividend. The 20% amount is a ceiling, not an automatic deduction. Collection charges, brokerage and other expenses are not deductible. Check the same restriction for covered mutual-fund unit income. A covered buy-back dividend follows a separate rule that allows no deduction under section 57.

Worked example: On the ₹1 lakh dividend, the deduction is ₹20,000 and taxable income is ₹80,000. If eligible interest is only ₹8,000, taxable income is ₹92,000. If there is no interest expense, there is no automatic deduction.

Trap 10 | Check shareholder percentages and accumulated profits. ★★★★★

Section 2(22)(e)

Question trap: A closely held company gives a personal loan to a shareholder with 10% voting power. The shareholder repays it before year-end, and the loan exceeds accumulated profits.

Student mistake: A student treats repayment as an exemption, or taxes the whole loan without checking the accumulated-profits limit.

Final result: A covered loan can be deemed dividend even after repayment. The beneficial shareholder must have at least 10% voting power. For a loan to a concern, that shareholder must also be its member or partner, generally with at least 20% voting power in a company concern or 20% income entitlement otherwise. Tax cannot exceed accumulated profits. Genuine trade advances differ. The ordinary-course money-lending exception requires lending to be a substantial business activity.

Worked example: A qualifying shareholder receives a ₹6 lakh personal loan when accumulated profits are ₹4 lakh. The deemed dividend is ₹4 lakh, despite repayment.

Chapter 7: Income from Other Sources (continued)

PRACTICAL QUESTION TRAPS

Trap 11 | Compute buy-back dividend and capital loss separately. ★★★★★

Sections 2(22)(f), 46A, 57

Question trap: A domestic company buys back shares in December 2025. The question gives both the original share cost of ₹2 lakh and the payout of ₹3.20 lakh.

Student mistake: A student subtracts the share cost from the payout and reports only ₹1.20 lakh as dividend income.

Final result: For a covered domestic-company buy-back on or after 1 October 2024, the full payout is dividend. Neither share cost nor interest reduces that dividend. Separately, section 46A treats the sale consideration as nil, creating a capital loss based on the eligible share cost. Use the holding period to decide whether the loss is short-term or long-term, and then apply capital-loss restrictions.

Worked example: The dividend is ₹3.20 lakh. The separate capital loss is ₹2 lakh. That capital loss cannot be adjusted against the ordinary dividend to reduce it to ₹1.20 lakh.

Trap 12 | Use gross lottery winnings and statutory net game winnings.

Sections 115BB, 115BBJ, 58(4); Rule 133

Question trap: A winner receives lottery money after tax deduction and has ticket costs. An online-game account separately shows own deposits, withdrawals and a closing balance.

Student mistake: A student taxes only the lottery cash received, or uses the same gross-winnings calculation for online games.

Final result: Lottery winnings are taxed on the gross amount. Ticket costs, losing bets, unused basic exemption and Chapter VI-A deductions cannot reduce them. Online games use net winnings calculated under Rule 133; eligible deposits from the player's own money differ from promotional bonuses. Both categories attract 30% tax plus applicable surcharge and cess.

Worked example: Lottery cash of ₹70,000 plus ₹30,000 tax deducted means taxable winnings of ₹1 lakh; ignore the ₹5,000 ticket cost. With nil opening balance, online-game deposits of ₹20,000, withdrawals of ₹35,000 and closing balance of ₹5,000 give net winnings of ₹35,000 + ₹5,000 - ₹20,000 = ₹20,000.

Chapter 7: Income from Other Sources (continued)

PRACTICAL QUESTION TRAPS

Trap 13 | Use the family-pension deduction for the chosen regime. ★★★★★

Section 57(iia)

Question trap: After an employee's death, the spouse receives annual family pension of ₹90,000. The question asks for taxable income under both the normal and default regimes.

Student mistake: A student calls it Salary and applies the salary standard deduction instead of the family-pension deduction.

Final result: Family pension paid after an employee's death generally belongs to Other Sources. Under the normal regime, deduct the lower of one-third of the pension and ₹15,000. Under the default regime, deduct the lower of one-third and ₹25,000. These are annual limits. First check any specific exemption, such as a qualifying death during operational duties.

Worked example: One-third of ₹90,000 is ₹30,000. Taxable family pension is ₹75,000 under the normal regime and ₹65,000 under the default regime. The salary standard deductions of ₹50,000 and ₹75,000 do not apply.

Trap 14 | Tax compensation-interest in the receipt year.

Sections 56(2)(viii), 57(iv), 145B(1)

Question trap: Taxable interest on delayed compensation is received in February 2026, although it relates to four earlier years. The question also gives legal fees incurred to recover it.

Student mistake: A student spreads the interest over four years or deducts legal fees in addition to the 50% deduction.

Final result: Covered interest on compensation or enhanced compensation is Other Sources income in the year of receipt. Allow the fixed 50% deduction; no further deduction under section 57 is allowed against that interest. Examine the main compensation amount separately. This interest rule does not decide whether the compensation itself is exempt or gives rise to capital gains.

Worked example: Interest of ₹2.40 lakh received in February 2026 gives taxable income of ₹1.20 lakh for assessment year 2026-27. Do not deduct the ₹15,000 legal fees again or spread this income across four assessment years.

Chapter 7: Income from Other Sources (continued)

PRACTICAL QUESTION TRAPS

Trap 15 | Avoid a second adjustment for forfeited advances.

Sections 56(2)(ix), 51

Question trap: A buyer abandons a capital-asset purchase, and the seller keeps the advance in September 2025. The same asset is sold to another buyer later.

Student mistake: A student taxes the forfeited advance now and also reduces the asset's cost by the same amount on sale.

Final result: A covered advance becomes Other Sources income when negotiations to transfer a capital asset fail and the seller forfeits the advance. An amount that remains refundable is not yet forfeited. Once the advance is taxed under section 56(2)(ix), it cannot also reduce the asset's cost on a later sale. Forfeitures governed by the earlier law need separate treatment.

Worked example: The owner forfeits ₹3 lakh in September 2025 after the buyer abandons the deal. Tax ₹3 lakh in assessment year 2026-27. When the asset is eventually sold, do not reduce its cost by this ₹3 lakh again.

Trap 16 | Do not deduct the same policy premium twice.

Section 56(2)(xiii); Rule 11UACA

Question trap: A non-exempt ordinary life-insurance policy pays ₹9 lakh on maturity. The question says some of its premiums were already claimed as deductions under section 80C.

Student mistake: A student deducts all premiums again, including the amount that already gave a deduction in earlier years.

Final result: For a covered ordinary policy other than a unit-linked insurance policy that is not exempt, deduct eligible premiums from the receipts, including bonus. A premium already deducted under another provision cannot be deducted again. If there are several receipts, apply Rule 11UACA so that the same premium is not recovered twice. Non-exempt unit-linked insurance policies and Keyman policies have separate rules.

Worked example: For a single final receipt of ₹9 lakh, total premiums are ₹6 lakh, including ₹2 lakh already deducted under section 80C. With no earlier receipt, eligible premiums are ₹4 lakh. Taxable income is ₹9 lakh - ₹4 lakh = ₹5 lakh.

Chapter 7: Income from Other Sources (continued)

PRACTICAL QUESTION TRAPS

Trap 17 | Check the particular interest exemption.

Sections 10(4)(ii), 10(15)

Question trap: The income list includes interest from a post-office savings account and Sovereign Gold Bonds. It also distinguishes Non-Resident External and Non-Resident Ordinary bank accounts held by a non-resident.

Student mistake: A student treats all government-backed deposits, gold investments or non-resident bank accounts as exempt.

Final result: Non-Resident External account interest requires the prescribed account and the Foreign Exchange Management Act or Reserve Bank of India status conditions. Non-Resident Ordinary account interest does not share that exemption. Post-office savings interest is exempt up to ₹3,500 for an individual account and ₹7,000 for a joint account; other deposits are not automatically exempt. Qualifying Gold Deposit or Gold Monetisation interest differs from taxable Sovereign Gold Bond interest.

Worked example: An individual earns post-office savings interest of ₹5,000 and Sovereign Gold Bond interest of ₹12,000. After the specific exemption, income to include is ₹1,500 + ₹12,000 = ₹13,500. Examine any eligible Chapter VI-A deduction separately.

Trap 18 | Use the correct year for final and interim dividends.

Section 8

Question trap: A company declares a final dividend on 25 March 2026 and pays it in April. Another company declares an interim dividend in March but makes it available only in April.

Student mistake: A student taxes both dividends only when cash reaches the shareholder, or taxes both merely from the declaration date.

Final result: A final dividend is normally included in the year of declaration. An interim dividend belongs to the year when the company makes it unconditionally available to the entitled shareholder. Read that availability date; a board announcement alone does not establish availability. Later collection of an already available amount does not postpone the income.

Worked example: A ₹40,000 final dividend declared in March belongs to assessment year 2026-27 despite April payment. A ₹30,000 interim dividend first made unconditionally available on 5 April is outside that assessment year. If it was available on 30 March but collected in April, include it in assessment year 2026-27.

Chapter 7: Income from Other Sources (continued)

PRACTICAL QUESTION TRAPS

Trap 19 | Use actual allowed deductions for hired machinery.

Sections 56(2)(ii)/(iii), 57(ii), 32

Question trap: An owner earns hire charges from machinery outside a business. The question separately gives current repairs, insurance, tax depreciation and the purchase price of a replacement machine.

Student mistake: A student claims the 30% house-property deduction against hire charges or deducts the full replacement-machine purchase price as a running expense.

Final result: Where this letting is taxable under Other Sources, eligible current repairs, insurance and depreciation follow the specific provisions imported by section 57(ii). A capital purchase is not a revenue deduction; apply the relevant depreciation rules instead. Inseparable letting of a building with machinery uses this treatment when the composite income is under Other Sources. Verify the head first.

Worked example: Hire charges are ₹2 lakh, eligible current repairs ₹20,000, insurance ₹5,000 and allowable tax depreciation ₹30,000. Taxable income is ₹1,45,000. This assumes the stated depreciation already covers all eligible assets. Do not deduct a further 30% or the replacement machine's full cost.

Trap 20 | Bring back an expense recovered after an earlier deduction.

Section 59 read with section 41(1)

Question trap: A taxpayer received a deduction for machinery repairs against Other Sources income in an earlier year. The supplier later refunds part of that amount, but there is no current hire income.

Student mistake: A student ignores the refund because it relates to an old bill, or assumes that recovery is taxable only when the original deduction was under business income.

Final result: Section 59 applies the recovery rule of section 41(1) to Other Sources. Where the relevant expense or loss was actually allowed earlier, a later qualifying recovery or benefit is taxable in the year obtained. Trace the earlier allowed deduction and the amount recovered. Lack of a fresh hire receipt does not itself make the recovered amount exempt.

Worked example: Current repairs of ₹60,000 were allowed in an earlier assessment. A supplier refunds ₹18,000 during 2025-26. Include ₹18,000 as Other Sources income in assessment year 2026-27; do not reopen the old computation simply to reduce that earlier deduction.

Chapter 8: Clubbing of Income

THEORY TRAPS

Trap 1 | Read revocation powers rather than the deed's title.

Sections 61-63

Question trap: A trust deed is titled irrevocable, but another clause lets the transferor recover part of its income after a specified date. The transferor has not exercised that right.

Student mistake: A student accepts the deed's title or waits until the transferor actually takes the income back.

Final result: Read the powers given by the deed. A right to recover or control any part of the asset or income can make the transfer revocable. Section 62 requires irrevocability during the beneficiary's lifetime for a trust, or the transferee's lifetime otherwise, with no direct or indirect income benefit to the transferor. If the section 62 lifetime exception applies, clubbing starts when the revocation power arises, even if unused. Otherwise, a revocable transfer is covered from the start. Other clubbing provisions must still be checked.

Trap 2 | Preserve the income head and include eligible losses.

Section 64, Explanation 2

Question trap: An asset's income must be included in another family member's total income. The asset gives a tax loss, and the recipient also claims a personal deduction.

Student mistake: A student clubs only positive income, changes its income head, or automatically transfers every personal deduction with it.

Final result: First calculate the income or eligible loss under its correct head after permitted deductions. Include that result with the appropriate person under the same income head. Section 64 treats loss as income for clubbing, but normal loss-adjustment restrictions still apply. Chapter VI-A deductions do not transfer automatically. Check who paid the amount, who the beneficiary is and whether the chosen tax regime allows the deduction.

Chapter 8: Clubbing of Income (continued)

PRACTICAL QUESTION TRAPS

Trap 3 | Check whether the asset itself was transferred.

Section 60

Question trap: Ravi keeps ownership of his fixed deposit but permanently directs the bank to pay its interest to his adult sister. The direction cannot be cancelled.

Student mistake: A student taxes the sister because she receives the money and the payment direction is permanent.

Final result: Section 60 applies when the owner transfers only the income while retaining the asset that earns it. The income is taxed to that owner. Making the payment direction irrevocable does not change this result. The recipient need not be a spouse or minor child; a transfer of income to an adult relative or friend can also be covered.

Worked example: Ravi retains his ₹10 lakh deposit and directs its annual interest of ₹70,000 to his adult sister. Include the full ₹70,000 in Ravi's computation because he transferred the interest, not the deposit.

Trap 4 | Check spouse-transfer timing and consideration. ★★★★★

Sections 64(1)(iv), 27(i), 56(2)(x)

Question trap: A man transfers a deposit to his wife after marriage. A comparison case gives a completed transfer before marriage, or describes the payment as a genuine repayable loan.

Student mistake: A student clubs every receipt between spouses without checking the transfer date, consideration or nature of payment.

Final result: Income from an asset transferred to a spouse without adequate consideration is generally included with the transferor. The marriage must exist both when the transfer occurs and when income accrues. A completed pre-marriage transfer is outside this clause. Adequate consideration and agreements to live apart are exceptions. A genuine repayable loan is not automatically a gift. Check gift taxability separately and, for houses, also check deemed ownership.

Worked example: A husband gifts a ₹4 lakh deposit after marriage. Its ₹28,000 interest is clubbed with him. A genuine completed transfer before marriage would not attract this spouse-transfer clause.

Chapter 8: Clubbing of Income (continued)

PRACTICAL QUESTION TRAPS

Trap 5 | Trace benefits to a spouse or son's wife.
Section 64(1)(vi)-(viii)

Question trap: A mother-in-law gifts a deposit to her son's wife. Separately, a person transfers an asset to a trust that gives only part of its income to the transferor's wife.

Student mistake: A student applies the rule only to fathers-in-law or clubs the trust's entire income without checking the wife's share.

Final result: Transfers without adequate consideration to a son's wife can be covered whether made by the father-in-law or mother-in-law. The rule also covers such transfers to another person or association of persons for a spouse's or son's wife's immediate or future benefit. Include only the relevant beneficial share with the transferor. A genuine gift to an adult son or daughter does not automatically fall within this clause.

Worked example: Interest of ₹21,000 on the mother-in-law's gifted ₹3 lakh deposit is clubbed with her. In the trust case, if 60% of ₹1 lakh income benefits the transferor's wife, club only ₹60,000.

Trap 6 | Check substantial interest and the correct spouse. ★★★★★
Section 64(1)(ii), Explanations 1/2

Question trap: Dev holds 12% voting power in the company paying only his wife; his father holds 9%. A separate first-year case gives both spouses substantial interest and covered remuneration. Neither case qualifies for the professional exception.

Student mistake: A student checks only Dev's personal percentage or automatically adds the wife's remuneration to the husband's income.

Final result: The at-least-20% voting-power or profit-interest test includes section 2(41) relatives and applies anytime during the year. A family stake held through its manager is not automatically his personal stake. Ordinarily, include the spouse's covered remuneration with the individual having substantial interest. Where both spouses have substantial interest and both receive covered remuneration, use the spouse with higher other income. A later switch needs the Assessing Officer's statutory process. The exception requires technical or professional qualifications and pay solely attributable to applying that knowledge and experience.

Worked example: Dev's 12% plus his father's 9% meets the test, so his wife's covered pay is clubbed with Dev. In the separate case, taxable remuneration after head-wise deductions is ₹4 lakh for the wife and ₹3 lakh for the husband. Their other incomes are ₹10 lakh and ₹7 lakh. Include both remuneration amounts with the wife: ₹17 lakh in all.

Chapter 8: Clubbing of Income (continued)

PRACTICAL QUESTION TRAPS

Trap 7 | Select the parent before applying the child exemption. ★★★★★
Sections 64(1A), 10(32), 115BAC

Question trap: In the first year of clubbing, a mother earns more than the father; their marriage subsists. Their three minor children, none with a specified disability, earn deposit interest. The question asks for both regimes.

Student mistake: A student chooses the father automatically, gives ₹1,500 even against lower income, or limits the exemption to two children.

Final result: Choose the parent with higher income before adding the minor's income. The rule includes adopted children, stepchildren and a minor married daughter. If the parents' marriage does not subsist, use the maintaining parent. Later switching needs the statutory Assessing Officer process. Under the normal regime, exempt the lower of ₹1,500 and included income for each child, with no two-child limit. The default regime gives no such exemption.

Worked example: The mother earns ₹9 lakh and father ₹7 lakh. Interest of ₹900, ₹4,000 and ₹6,000 is clubbed with the mother. Normal-regime exemption is ₹900 + ₹1,500 + ₹1,500 = ₹3,900, leaving ₹7,000. Default-regime inclusion is ₹10,900.

Trap 8 | Separate a minor's talent income from investment income. ★★★★★
Section 64(1A), proviso

Question trap: A 15-year-old singer earns performance fees and then earns interest by investing those fees. A separate case states that the child has a disability specified in section 80U.

Student mistake: A student exempts the investment interest from clubbing merely because the original money came from the child's talent.

Final result: A minor's income from manual work, skill, talent, specialised knowledge or experience is assessed to the child. Ordinary interest earned by investing that income is generally clubbed with the appropriate parent. The section 80U disability exception is wider: all income of a minor with the specified disability is outside section 64(1A), not just income earned through personal effort.

Worked example: The singer's ₹2 lakh fees are not clubbed. Interest of ₹12,000 from investing those fees is clubbed, with the normal-regime ₹1,500 exemption checked separately. If the child has a qualifying disability, that interest is also outside minor-income clubbing.

Chapter 8: Clubbing of Income (continued)

PRACTICAL QUESTION TRAPS

Trap 9 | Use the actual date of majority and income accrual.

Section 64(1A)

Question trap: A child becomes an adult on 1 October 2025, but the bank pays the full year's deposit interest in March. The question gives monthly interest accrual.

Student mistake: A student clubs all interest because it was earned on an old deposit, or allocates income only by the payment date.

Final result: Check when the income accrues. Income accruing during minority needs clubbing analysis; income accruing after the child becomes an adult belongs in the child's computation. Do not automatically divide annual receipts equally unless the accrual facts support it. If both parents have died, grandparents do not become clubbing parents merely because they maintain the child. The guardian handles the assessment and return obligations.

Worked example: Interest accrues at ₹1,000 monthly. April-September interest of ₹6,000 needs clubbing analysis. October-March interest of ₹6,000 belongs to the child, who becomes an adult on 1 October. The later payment date does not change this allocation.

Trap 10 | Distinguish a substituted asset from reinvested income.

Section 64(1)(iv)/(vi)

Question trap: A wife earns interest on a deposit gifted by her husband. She invests only that interest separately. A comparison case merely renews the original gifted deposit.

Student mistake: A student clubs every later earning, or treats renewal of the original deposit as income earned on income.

Final result: Trace the original gifted asset and any asset bought in its place. Relevant clubbing can continue for income and capital gains from these assets. However, further income from separately investing income already earned is generally outside the spouse-transfer rule. The minor-child rule is wider, so this exception cannot automatically be applied to a minor's reinvested income.

Worked example: Interest of ₹20,000 from the husband-gifted deposit is clubbed with him. If the wife separately invests only that earned ₹20,000 and earns ₹1,400, the ₹1,400 ordinarily belongs to her. Renewing the original deposit is a different situation.

Quick help: Asset badla toh clubbing; income ki income alag check karo.

Chapter 8: Clubbing of Income (continued)

PRACTICAL QUESTION TRAPS

Trap 11 | Use the opening business-investment ratio.

Section 64(1), Explanation 3

Question trap: A wife's continuing business uses her own money and money gifted by her husband. The question gives the investment balances on 1 April and the year's profit.

Student mistake: A student clubs all business profit or applies an average or year-end capital ratio instead of the opening ratio.

Final result: For this business rule, divide the transferred assets invested in the business by its total investment, using both amounts on the first day of the previous year. Apply that ratio to business income. For capital invested as a partner, the corresponding rule apportions interest. Do not automatically treat an exempt profit share or remuneration for personal work as interest earned on gifted capital.

Worked example: On 1 April, the wife's business investment is ₹5 lakh, including ₹2 lakh gifted by her husband. On profit of ₹1.50 lakh, the amount clubbed is ₹1.50 lakh × ₹2 lakh ÷ ₹5 lakh = ₹60,000.

Trap 12 | Match the amounts in connected cross transfers.

Section 64; indirect-transfer principle

Question trap: Under one arrangement, A gives money to B's wife and B gives money to A's wife. The gifts are unequal, and both wives invest them at the same interest rate.

Student mistake: A student sees no direct spouse gift and skips clubbing, or clubs the whole income from the larger gift.

Final result: Connected reciprocal gifts can amount to indirect transfers to the donors' own spouses. Where the amounts differ, trace the matching amount and the income it earns. Separate, unrelated family gifts are not automatically reciprocal transfers. If the transferred asset is a house, also check the deemed-ownership rules. Test the gifts themselves separately under section 56(2)(x).

Worked example: A gives B's wife ₹6 lakh and B gives A's wife ₹4 lakh under one arrangement. At 7%, the matched ₹4 lakh gives ₹28,000 to be clubbed with each respective husband. Interest of ₹14,000 on B's wife's unmatched ₹2 lakh remains hers unless another rule applies.

Chapter 8: Clubbing of Income (continued)

PRACTICAL QUESTION TRAPS

Trap 13 | Apply Hindu undivided family conversion rules to separate property. ★★★★★

Sections 64(2), 56(2)(x), 10(2)

Question trap: A member gifts a personally owned deposit to the Hindu undivided family. The question states that the gift itself is exempt and asks who should report its interest.

Student mistake: A student assumes that an exempt gift also makes its future interest taxable only to the family.

Final result: When a member transfers separate movable or immovable property to the Hindu undivided family without adequate consideration, its income is clubbed with that member. Replacement property and sale proceeds are also covered. After partition, check indirect-spouse rules for converted property allotted to the spouse. A member is a relative when the family receives a gift, but the reverse gift is not automatically exempt. Section 10(2) separately covers qualifying distributions of family income.

Worked example: A member gifts a ₹5 lakh deposit to the family. The gift is exempt, but its ₹35,000 interest is clubbed with that member. Section 64(2) covers deposits as well as houses.

Trap 14 | Give tax-deduction credit to the person assessed on clubbed income. ★★★★★

Sections 64(1A), 199; Rule 37BA(2)/(3)

Question trap: A minor's deposit earns gross interest of ₹60,000. The bank deducts and deposits ₹6,000 tax and pays ₹54,000. The question states that the income must be clubbed with the mother.

Student mistake: A student clubs only the net ₹54,000, or adds gross income to the mother while leaving all tax-deduction credit with the child.

Final result: Income and tax credit are separate entries. Include the assessable gross income with the correct parent. For credit to that parent, Rule 37BA requires a declaration to the deductor and reporting of the deduction in the parent's name, with the prescribed particulars and certificate. Credit belongs to the assessment year in which that income is assessed. Both persons cannot claim the same credit.

Worked example: Under the default regime, include ₹60,000 in the mother's Other Sources income. Assuming the declaration and reporting conditions are met, allow ₹6,000 tax credit in her tax computation. The bank's net payment of ₹54,000 is not the taxable-income figure.

Chapter 8: Clubbing of Income (continued)

PRACTICAL QUESTION TRAPS

Trap 15 | Separate a minor's partnership profit share from interest.

Sections 2(23), 10(2A), 28(v), 64(1A), 10(32)

Question trap: A minor admitted to the benefits of a separately assessed firm receives an exempt profit share and interest on capital. The parents are married, and this is the first year of clubbing.

Student mistake: A student clubs every amount paid by the firm, or treats the interest as exempt merely because the profit share is exempt.

Final result: First remove the share of profit exempt under section 10(2A). Interest on capital is a separate taxable receipt; assume the stated amount is fully allowable to the firm. For a minor without a specified disability, ordinary investment interest follows minor-income clubbing. Admission to partnership benefits does not make that interest income from the child's skill. Preserve the relevant business-income head when clubbing it.

Worked example: The exempt profit share is ₹80,000 and taxable interest is ₹20,000. The mother has higher other income. Add ₹18,500 under the normal regime after the ₹1,500 child exemption, or ₹20,000 under the default regime. Do not add the ₹80,000 exempt share.

Chapter 9: Set-off and Carry-forward of Losses

THEORY TRAPS

Trap 1 | Distinguish exempt-source loss from ordinary Other Sources loss.

Sections 10, 70, 71

Question trap: A computation includes a loss from an exempt activity and an ordinary Other Sources loss. It also lists personal spending as an expense against taxable income.

Student mistake: A student treats every negative amount as an adjustable tax loss and carries forward all unused Other Sources losses.

Final result: A loss from an exempt source generally cannot reduce taxable income. An allowable ordinary Other Sources loss follows the current-year adjustment rules, but this head has no general rule allowing unused losses to move to future years. Owning and maintaining racehorses is a specific exception. First check whether the expense itself is deductible; personal spending does not become a tax loss merely because the taxpayer claims it.

PRACTICAL QUESTION TRAPS

Trap 2 | Apply the different short-term capital loss and long-term capital loss restrictions. ★★★★★

Sections 70, 71(3), 74

Question trap: One computation contains a short-term capital loss with both short-term and long-term gains. Another replaces it with a long-term loss and gives only a short-term gain.

Student mistake: A student adjusts either type of capital loss against any capital gain, or against income under another head.

Final result: A short-term capital loss can reduce eligible short-term or long-term capital gains. A long-term capital loss can reduce only long-term gains. Neither can reduce income under another head. Valid losses brought forward from earlier years follow the same direction. Make permitted adjustments within the capital-gains head first. Where a choice is allowed, compare the beneficial allocation; short-term loss need not always be used against short-term gain first.

Worked example: A ₹70,000 short-term loss against short-term gain of ₹20,000 and long-term gain of ₹80,000 leaves total capital gains of ₹30,000. If the ₹70,000 loss is long-term and the only gain is ₹20,000 short-term, that gain remains taxable.

Chapter 9: Set-off and Carry-forward of Losses (continued)

PRACTICAL QUESTION TRAPS

Trap 3 | Distinguish current and brought-forward business losses.

Sections 71(2A), 72, 78(2)

Question trap: A taxpayer has bank interest and an ordinary business loss. The question changes the loss from current-year to brought-forward, or says the taxpayer has started a different business.

Student mistake: A student applies the same adjustment rule to current and old losses, or insists that the original business must continue.

Final result: A current ordinary business loss may reduce eligible income under other heads, except Salary. An ordinary business loss brought forward from an earlier year reduces only that taxpayer's business or professional profit. The original business need not continue. The identity of the taxpayer matters: a buyer does not automatically inherit the seller's loss. Check inheritance and statutory business-reorganisation exceptions separately.

Worked example: A current business loss of ₹80,000 can absorb bank interest of ₹50,000, leaving ₹30,000. A brought-forward business loss cannot absorb that interest. However, the same taxpayer's eligible old garment-business loss can reduce profit from a new stationery business.

Trap 4 | Read speculation restrictions in the correct direction.

Sections 43(5), 73

Question trap: One case gives an ordinary business loss and speculation profit. The next case reverses the categories. The question may also call every exchange-traded derivative transaction speculative.

Student mistake: A student assumes that an adjustment allowed in one direction must also be allowed in the reverse direction.

Final result: Speculation loss can reduce only speculation-business profit. Ordinary business loss may reduce speculation profit under its normal rules. Eligible speculation loss can be carried forward for at most four assessment years, subject to filing the loss return on time. First classify the transaction under section 43(5); eligible exchange-traded derivatives are not automatically speculative transactions.

Worked example: An ordinary business loss of ₹60,000 reduces speculation profit of ₹90,000 to ₹30,000. In the reverse case, speculation loss of ₹60,000 cannot reduce ordinary business profit of ₹90,000. The ₹90,000 ordinary profit remains taxable, and the speculation loss stays restricted.

Chapter 9: Set-off and Carry-forward of Losses (continued)

PRACTICAL QUESTION TRAPS

Trap 5 | Keep specified-business loss within eligible specified businesses.

Sections 35AD, 73A, 115BAC

Question trap: A specified cold-chain business makes a loss. The taxpayer also earns profits from an ordinary shop and another specified business that did not itself claim section 35AD deduction.

Student mistake: A student adjusts the loss against the ordinary shop, or rejects the other specified business because it did not claim 35AD.

Final result: A section 35AD specified-business loss can reduce only specified-business income. The profitable specified business need not itself have claimed the section 35AD deduction. An eligible balance has no fixed carry-forward period, but the loss return must be filed on time. Under the default regime, section 35AD deduction is unavailable, as is brought-forward loss attributable to that disallowed deduction.

Worked example: Under the normal regime, the cold-chain loss is ₹4 lakh, shop profit is ₹5 lakh and another specified business earns ₹1.50 lakh. Adjust only ₹1.50 lakh. The remaining ₹2.50 lakh cannot reduce the shop profit and remains restricted.

Trap 6 | Separate racehorse ownership from betting.

Sections 74A(3), 58(4), 115BB

Question trap: An owner earns income from maintaining racehorses and has an old loss from that activity. A separate item describes money lost on horse-race betting tickets.

Student mistake: A student treats betting losses and losses from owning racehorses as the same type of loss.

Final result: An eligible loss from owning and maintaining racehorses can reduce only income from that activity. It can be carried forward for up to four assessment years, subject to a timely return and the other statutory conditions. For these provisions, the activity belongs to Other Sources. Losing betting tickets do not qualify for either loss adjustment or carry-forward.

Worked example: Current racehorse-activity income is ₹70,000 and a valid old activity loss is ₹90,000. Adjust ₹70,000 and track the eligible ₹20,000 within the original four-year period. A ₹90,000 betting loss would not qualify for this treatment.

Chapter 9: Set-off and Carry-forward of Losses (continued)

PRACTICAL QUESTION TRAPS

Trap 7 | Adjust houses first, then apply the regime. ★★★★★

Sections 70, 71(3A), 71B, 115BAC

Question trap: A taxpayer has income from one house, a loss from another and taxable salary exceeding ₹2 lakh. The question asks how much loss reduces salary and moves to future years under each regime.

Student mistake: A student applies ₹2 lakh separately to each house, or carries forward a fresh residual loss under the default regime.

Final result: Under the normal regime, first adjust eligible losses against income from other houses without a ₹2 lakh cap. The net house-property loss can reduce other heads by up to ₹2 lakh; an eligible balance carries forward eight years for house-property income only. Under the default regime, eligible let-out properties can still be adjusted against each other, but a residual current loss cannot reduce other heads or be freshly carried forward. Disallowed self-occupied interest cannot create a loss.

Worked example: Under the normal regime, ₹4 lakh house loss less ₹1 lakh house income leaves ₹3 lakh: adjust ₹2 lakh against Salary and carry ₹1 lakh. Under the default regime, ₹2.40 lakh let-out loss less ₹80,000 income leaves ₹1.60 lakh with neither facility.

Trap 8 | Distinguish old let-out loss from current default-regime loss.

Sections 71B, 115BAC(2)(ii)(a)

Question trap: A taxpayer switches to the default regime with a valid old loss from a let-out house. After adjusting current houses, there is positive house-property income.

Student mistake: A student rejects every old house loss because the taxpayer now uses the default regime.

Final result: An eligible let-out loss brought forward from a normal-regime year may reduce current House Property income. This is different from creating a fresh carry-forward of residual current loss under the default regime. Reject loss attributable to a disallowed deduction, such as self-occupied interest. For an eligible old loss, the original carry-forward period continues; changing the regime does not restart it.

Worked example: An eligible old let-out loss is ₹1 lakh, and current house-property income after adjustments is ₹70,000. Adjust ₹70,000 of the old loss. Track the remaining ₹30,000 within its original permitted period, without giving eight fresh years.

Chapter 9: Set-off and Carry-forward of Losses (continued)

PRACTICAL QUESTION TRAPS

Trap 9 | Separate late-filing rules from current set-off. ★★★★★

Sections 139(3), 80, 71B, 32(2)

Question trap: A taxpayer files the return late. It shows both a capital loss and a normal-regime house-property loss, with part of the current loss already adjusted against eligible income.

Student mistake: A student cancels every current adjustment and every carry-forward merely because the return was filed late.

Final result: To carry forward ordinary business, speculation, specified-business, capital and racehorse losses, file the loss return on time. House-property loss and unabsorbed depreciation generally do not face this timely-return condition. An otherwise permitted current-year adjustment is not lost merely because filing is late. Separate restrictions under the default regime still apply.

Worked example: A late return shows remaining capital loss of ₹50,000 and normal-regime house-property loss of ₹80,000. Ordinarily, the capital loss cannot be carried forward, but the eligible house loss can. This exception does not allow a fresh house-loss carry-forward under the default regime.

Trap 10 | Keep the original loss-expiry clock after reorganisation. ★★★★★

Sections 71B, 72, 73, 74, 74A; 72A(6B), 72AA

Question trap: A company takes over an eligible predecessor's business loss in a covered June 2025 merger. The question gives the assessment year in which that loss originally arose.

Student mistake: A student starts a new eight-year period from the merger, instead of counting from the original loss year.

Final result: Ordinary business, eligible house-property and capital losses get eight assessment years after the year in which they arise. Speculation and racehorse losses get four. Specified-business loss and eligible unabsorbed depreciation have no fixed time cap. For covered amalgamations or reorganisations on or after 1 April 2025, Finance Act 2025 preserves the original predecessor's business-loss period.

Worked example: An assessment year 2018-19 business loss expires after assessment year 2026-27. An assessment year 2022-23 loss transferred in a covered June 2025 merger still expires after assessment year 2030-31. The successor gets no fresh eight-year period. This cap does not apply to eligible unabsorbed depreciation.

Chapter 9: Set-off and Carry-forward of Losses (continued)

PRACTICAL QUESTION TRAPS

Trap 11 | Use business loss before old depreciation. ★★★★★

Sections 32(2), 71(2A), 72(2)

Question trap: A business has profit before current depreciation, an old business loss nearing expiry and unabsorbed depreciation from an earlier year. The question asks for the order of adjustment.

Student mistake: A student uses old depreciation first and leaves an expiring business loss unused.

Final result: Normally, deduct current expenses and current depreciation first. Then adjust eligible brought-forward business loss, followed by unabsorbed depreciation. Eligible old depreciation has no fixed carry-forward limit or timely-return condition. It can generally reduce eligible income other than Salary, subject to special-income and tax-regime restrictions. Ordinary business loss under section 72 has different limits and cannot be treated like depreciation.

Worked example: Profit before current depreciation is ₹3 lakh. Current depreciation of ₹50,000 leaves ₹2.50 lakh. Old business loss of ₹2 lakh leaves ₹50,000. Adjust ₹50,000 from old depreciation of ₹1 lakh, and carry forward the remaining ₹50,000 depreciation.

Quick help: Current depreciation, phir old business loss, phir old depreciation.

Chapter 9: Set-off and Carry-forward of Losses (continued)

PRACTICAL QUESTION TRAPS

Trap 12 | Apply special-income restrictions before the general loss chart.

Sections 115BB, 115BBE, 115BBH, 115BBJ, 79A

Question trap: A computation shows a business loss, bank interest and lottery winnings. Another shows a gain on one virtual digital asset and a loss on another.

Student mistake: A student combines every gain and loss into one net figure without checking the special-income restrictions.

Final result: Apply each special-income prohibition before the ordinary loss chart. A virtual digital asset transfer loss cannot reduce another such asset's profit or other income, and cannot be carried forward. Section 79A restricts brought-forward losses and unabsorbed depreciation against covered undisclosed income found through search, requisition or survey. The statutory net-winnings calculation for online games is not a general permission to adjust unrelated losses.

Worked example: Business loss of ₹80,000 absorbs bank interest of ₹50,000, but lottery winnings of ₹1 lakh remain unchanged. Separately, a virtual digital asset gain of ₹40,000 and another asset's loss of ₹25,000 do not give taxable net gain of ₹15,000.

Trap 13 | Reduce firm losses correctly when a partner retires or dies.

Section 78(1)

Question trap: A firm has an eligible brought-forward business loss. A partner retires during the year. The question gives that partner's share in the old loss and share of current-year profit.

Student mistake: A student removes the entire old loss, ignores retirement, or removes the retiring partner's full loss share without reducing it by that partner's current profit share.

Final result: On a change in the firm's constitution, section 78(1) restricts the loss corresponding to the retired or deceased partner. The restricted amount is that partner's proportionate old loss minus the partner's share of current-year profit, if any, with no negative restriction. Keep the other loss eligible under its ordinary conditions. Do not apply this rule mechanically to unabsorbed depreciation.

Worked example: The old business loss is ₹4 lakh and the retired partner's loss share is 30%, or ₹1.20 lakh. His current profit share is ₹20,000. The restriction is ₹1 lakh. Therefore ₹3 lakh remains eligible before applying the available current profit and normal carry-forward rules.

Chapter 9: Set-off and Carry-forward of Losses (continued)

PRACTICAL QUESTION TRAPS

Trap 14 | Check continuing voting control before using a company's old losses.

Section 79; section 32(2)

Question trap: A closely held company's old shareholders held all voting rights in the loss year but retain only 45% at this year-end. It has both an old business loss and unabsorbed depreciation.

Student mistake: A student allows the old loss because the company itself is unchanged, or rejects depreciation together with the business loss without applying their different rules.

Final result: Under the ordinary section 79 test, the required common beneficial shareholders must hold at least 51% voting power at the relevant year-ends. Check each loss year. Statutory exceptions and the special eligible-start-up rule need separate checking; this example assumes none applies. Section 79's loss restriction does not itself cancel eligible unabsorbed depreciation. Other applicable tax-regime restrictions still matter.

Worked example: Current business profit after current depreciation is ₹3 lakh. Old business loss is ₹3 lakh and eligible unabsorbed depreciation is ₹1 lakh. On these facts the business loss is blocked, but depreciation reduces taxable business income to ₹2 lakh. Merely retaining 45% fails the ordinary 51% test.

Trap 15 | Distinguish an inherited business from a purchased business.

Sections 72, 78(2)

Question trap: A daughter inherits and continues her father's business on death. It has an eligible unexpired business loss. Another case says she bought the business while he was alive.

Student mistake: A student refuses every inherited loss because the taxpayer has changed, or transfers the seller's old loss to every purchaser of a business.

Final result: Section 78(2) distinguishes succession by inheritance from an ordinary transfer to another person. An heir continuing an inherited business may use its eligible old business loss, subject to the ordinary conditions. A purchaser does not obtain that facility merely by buying the undertaking. Keep the predecessor's original loss year and remaining time limit. The inheritance must be of the business, not merely a receipt of unrelated family money.

Worked example: An eligible ₹2 lakh loss originally arose in assessment year 2024-25. The daughter inherits the business in 2025-26 and earns ₹1.50 lakh eligible profit. Set off ₹1.50 lakh and track ₹50,000 within the original period, ending with assessment year 2032-33; inheritance gives no new eight-year clock.

Chapter 10: Deductions from Gross Total Income

THEORY TRAPS

Trap 1 | Check income and regime first

Section 80A; 115BAC

Question trap: A person has made eligible investments, but the question also gives capital gains, a brought-forward loss and the chosen tax regime. It asks for the deductions while calculating total income.

Student mistake: The student deducts every investment directly from the total receipts without checking the income or tax regime.

Final result: First calculate gross total income after clubbing income and setting off permitted losses. Allow deductions only against eligible income and within the overall limit. Certain special-rate incomes cannot be reduced by these deductions. The default regime disallows most personal deductions. Its main exceptions include employer National Pension System contributions under 80CCD(2), Government Agniveer contributions under 80CCH(2) and 80JJAA. Qualifying International Financial Services Centre units have an exception for 80LA. Unless stated otherwise, this chapter's personal-deduction examples assume the normal regime and enough eligible income.

Trap 2 | Income-linked deductions require a timely return

Section 80A(5), 80AB, 80AC

Question trap: An author or eligible business satisfies the conditions for an income-linked deduction. However, the question says that the return was filed after the section 139(1) due date.

Student mistake: The student allows the deduction because the activity qualifies and ignores the late return.

Final result: Deductions under heading C of Chapter VI-A require a return filed by the section 139(1) due date and a deduction claimed in that return. Examples include 80-IAC, 80JJAA, 80QQB and 80RRB. Also check any separate report or certificate requirement. Calculate the deduction using eligible net income after related expenses, not gross receipts. Do not apply this particular heading C filing condition automatically to payment-based deductions such as 80C.

Chapter 10: Deductions from Gross Total Income (continued)

THEORY TRAPS

Trap 3 | Research and political donations differ

Section 80GGA; 80GGB; 80GGC

Question trap: A taxpayer with business income makes an approved research donation. The same question gives a political donation made in cash and asks whether both payments are deductible.

Student mistake: The student applies the same donation rules to both payments and overlooks business income and the cash restriction.

Final result: Section 80GGA allows 100% of eligible research or rural-development donations only if gross total income contains no business or professional income. A cash donation above ₹2,000 is disallowed. Political donations fall under 80GGB for Indian companies and 80GGC for other eligible persons; cash payments are disallowed under both. Local authorities and Government-funded artificial juridical persons cannot claim 80GGC. Check that the political party or electoral trust qualifies. Never claim the same donation twice.

Trap 4 | Agniveer: separate own and Government contributions

Section 80CCH(1), 80CCH(2)

Question trap: An eligible Agniveer's fund statement shows personal contributions and matching Central Government contributions. The question asks for deductions under both the normal and default tax regimes.

Student mistake: The student deducts both contributions under both regimes, or puts them within the ₹1.50 lakh investment ceiling.

Final result: The Agniveer's own contribution falls under 80CCH(1), and the Central Government contribution falls under 80CCH(2). Both qualify in full under the normal regime. Under the default regime, only the Government contribution qualifies. First include the Government contribution in salary, then claim its deduction. Neither deduction uses the ₹1.50 lakh combined ceiling under 80CCE.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 5 | 80C and own National Pension System share a ceiling ★★★★★

Section 80C; 80CCC; 80CCD(1)/(1B); 80CCE

Question trap: An employee has already paid ₹1.50 lakh towards eligible 80C investments. The question separately gives an own National Pension System contribution of ₹40,000 and asks for the maximum deduction.

Student mistake: The student gives separate ₹1.50 lakh limits to each section, or rejects the extra National Pension System contribution entirely.

Final result: Sections 80C, 80CCC and 80CCD(1) share one ₹1.50 lakh ceiling. Under 80CCD(1), an employee's own National Pension System deduction cannot exceed 10% of statutory salary; for another individual, the limit is 20% of gross total income. Actual contribution is also a limit. Statutory salary here includes basic pay and qualifying dearness allowance. Section 80CCD(1B) gives a separate limit of ₹50,000 outside the common ceiling. Allocate the contribution between the provisions without deducting the same amount twice.

Worked example: Eligible 80C payments are ₹1.50 lakh, and a separate own National Pension System contribution is ₹40,000. Claiming that National Pension System amount under 80CCD(1B) gives a total deduction of ₹1.90 lakh.

Quick help: Common limit pehle; extra NPS limit alag.

Trap 6 | Life insurance: check the insured person and percentage

Section 80C(3), (3A), (4)

Question trap: A parent pays ₹55,000 for a life policy on an adult daughter. The policy was issued in 2020, and its actual capital sum assured is only ₹4 lakh.

Student mistake: The student deducts the full premium, or rejects the policy merely because the daughter is an adult.

Final result: An individual can claim for a policy on self, spouse or any child, including an adult or earning child. A parent's policy does not qualify. A Hindu undivided family can cover a member. The premium cap is 20% of actual capital sum assured for policies issued by 31 March 2012, and normally 10% for later policies. The cap is 15% for qualifying disability or specified-disease policies issued on or after 1 April 2013. Take the lower of the eligible premium and the percentage cap, then apply the overall 80C ceiling.

Worked example: For the daughter's ordinary 2020 policy, 10% of ₹4 lakh is ₹40,000. Only ₹40,000 of the ₹55,000 premium qualifies. A premium for the taxpayer's parent would not qualify.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 7 | Tuition fees can cover any two children

Section 80C(2)(xvii), (4)(c)

Question trap: A mother pays school fees for her second and third children. The bill includes tuition, development fees and bus charges. Both children study full-time at an institution in India.

Student mistake: The student rejects the third child's fees or treats every item in the school bill as tuition.

Final result: An individual can claim actual tuition fees for the full-time education of any two children at an institution in India. The children need not be the first two children. Development fees, donations and bus charges do not qualify as tuition. Fees for the taxpayer's own education or the spouse's education do not qualify under this clause. The India-only condition belongs to this tuition deduction; do not apply it to education-loan interest under 80E.

Worked example: Tuition for the two children is ₹45,000 and ₹35,000. Development fees are ₹10,000, and bus charges are ₹12,000. Eligible tuition is ₹80,000, subject to the overall 80C ceiling.

Trap 8 | Housing principal and interest are different deductions

Section 80C(2)(xviii); 24(b)

Question trap: A housing-loan instalment includes principal and interest. The taxpayer also repays money borrowed from a friend for the house. The question asks for the deduction under 80C.

Student mistake: The student includes the entire instalment and the repayment to the friend in the 80C claim.

Final result: Eligible principal repaid for purchasing or constructing a residential house can qualify under 80C. The loan must come from a specified lender, such as a bank; an ordinary friend is not a qualifying lender. Eligible stamp duty and registration charges can also qualify. Examine interest separately under 24(b) or an additional-interest provision. Principal for later repairs or renovation of an already completed or occupied house is not eligible purchase or construction principal.

Worked example: The bank instalment contains ₹70,000 principal and ₹1 lakh interest. Only ₹70,000 enters the 80C calculation. A separate ₹25,000 principal repayment to a friend does not qualify.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 9 | Earlier 80C deductions can become taxable

Section 80C(5), (6A)

Question trap: A taxpayer claimed 80C in an earlier year and now withdraws the deposit prematurely. The taxpayer uses the default regime this year, and some deposit interest was taxed earlier.

Student mistake: The student assumes that the default regime prevents a reversal, or taxes the previously taxed interest again.

Final result: A taxable reversal can arise even in a year when the default regime applies. Check 80C(6A) for premature withdrawal of eligible post-office time deposits or Senior Citizens' Savings Scheme deposits. Exclude interest already taxed. Selling a house before five years from the end of the financial year of possession can reverse earlier deductions. Life policies and specified unit-linked insurance plans have separate two-year and five-year early-exit tests.

Worked example: A previously deducted ₹80,000 post-office deposit is withdrawn prematurely with ₹8,000 interest. Of this interest, ₹5,000 was already taxed. The taxable amount is ₹80,000 + ₹3,000 = ₹83,000, rather than ₹88,000.

Trap 10 | Employer National Pension System: 10% or 14%? ★★★★★

Section 80CCD(2)

Question trap: A private employer contributes 14% of an employee's statutory salary to National Pension System. The question asks for total income under both the normal regime and the default regime.

Student mistake: The student allows the full 14% deduction under both regimes or forgets to include the contribution in salary.

Final result: Central and State Government contributions qualify up to 14% of statutory salary. For other employers, the limit is 10% under the normal regime and 14% under the default regime. The deduction cannot exceed the actual contribution. Include the employer contribution in salary before claiming 80CCD(2). This deduction is outside the ₹1.50 lakh ceiling under 80CCE. Separately apply the salary-perquisite rule for the combined employer contributions to specified retirement funds.

Worked example: Statutory salary is ₹10 lakh, and the private employer contributes ₹1.40 lakh to National Pension System. The deduction is ₹1 lakh under the normal regime and ₹1.40 lakh under the default regime.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 11 | National Pension System Vatsalya shares the ₹50,000 limit

Section 80CCD(1B); 10(12BA)

Question trap: A parent contributes ₹30,000 to their own National Pension System account and ₹40,000 to a minor child's National Pension System Vatsalya account. Both contributions are claimed under 80CCD(1B).

Student mistake: The student gives a separate ₹50,000 limit to the parent's account and to each minor's account.

Final result: From assessment year 2026-27, eligible contributions by a parent or guardian to a minor's pension account can qualify under 80CCD(1B). Claims for the parent's own account and the minor's account share its ₹50,000 ceiling. The deduction is unavailable under the default regime. Eligible partial withdrawals are exempt up to 25% of the parent's or guardian's contributions, subject to notified conditions. Closure because of the minor's death has a separate rule for non-taxability.

Worked example: The two contributions total ₹70,000. When both are claimed under 80CCD(1B), the deduction is limited to ₹50,000.

Trap 12 | Unified Pension Scheme withdrawals and service payments have separate rules

Section 80CCD(3A)/(6); 10(12AA)/(12AB)

Question trap: A retiring Unified Pension Scheme subscriber receives a withdrawal from the individual corpus, a separate service-linked lump sum and a monthly pension. The question describes all three as retirement receipts.

Student mistake: The student applies one exemption percentage to all three receipts, or treats the monthly pension as fully exempt.

Final result: Apply the Unified Pension Scheme changes under the Taxation Laws (Amendment) Act, 2025. A qualifying retirement payment from National Pension System Trust is exempt under 10(12AA) up to 60% of the individual corpus. The separate service-linked lump sum is exempt under 10(12AB). To calculate it, take 10% of (last basic pay + dearness allowance), then multiply by the number of completed six-month periods of qualifying service. A transfer from the individual corpus to the pool corpus is not a receipt under 80CCD(6). These rules do not exempt every monthly pension.

Worked example: The individual corpus is ₹20 lakh, and the qualifying retirement withdrawal is ₹8 lakh. The exemption ceiling is 60% × ₹20 lakh = ₹12 lakh, so the ₹8 lakh withdrawal is covered. Examine the service-linked lump sum separately.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 13 | 80D gives group limits, not one limit per person

Section 80D

Question trap: A taxpayer aged 42 and spouse aged 40 are covered by health insurance. The taxpayer also pays health premiums for both resident parents, each aged over 60. Each family member's premium is listed separately.

Student mistake: The student gives a fresh ₹25,000 or ₹50,000 limit to every person named in the question.

Final result: Self, spouse and dependent children share one group limit. Parents share a second group limit. Each limit is normally ₹25,000 and rises to ₹50,000 when the senior-citizen conditions apply. For this purpose, a senior citizen must be resident and aged 60 or more at any time during the previous year. Parents need not be dependent, but children must be dependent. Parents-in-law are not the taxpayer's parents. Eligible payments to Central Government Health Scheme or a notified health scheme also qualify.

Worked example: The taxpayer electronically pays ₹28,000 for self and spouse, both below 60, and ₹54,000 for the resident senior parents. The deduction is ₹25,000 + ₹50,000 = ₹75,000. Each parent does not receive a separate ₹50,000 limit.

Trap 14 | 80D: cash check-ups and uninsured seniors ★★★★★

Section 80D(2A)/(2B), (2)(c)/(d)

Question trap: A taxpayer pays a preventive check-up bill in cash, a health premium online and medical bills for an uninsured resident senior parent. The question asks for one combined 80D calculation.

Student mistake: The student rejects the cash check-up or adds its ₹5,000 limit over and above the normal group ceiling.

Final result: Payments must come from taxable income and must be non-cash, except preventive check-ups. Their combined ₹5,000 limit remains inside the relevant group ceiling. A resident senior's medical expenses qualify only if no payment was made to keep that person's health insurance in force. Premium for one parent and medical expenses for the other uninsured senior parent can share the parents' ₹50,000 limit. A Hindu undivided family cannot deduct preventive check-up expenditure.

Worked example: A non-senior pays ₹23,000 premium online and ₹6,000 for a check-up in cash; the deduction is ₹25,000. Separately, non-cash payments of ₹18,000 for a senior mother's premium and ₹45,000 for an uninsured senior father's eligible treatment give ₹50,000.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 15 | Spread a single premium over financial years

Section 80D(4A)

Question trap: A person pays one health-insurance premium on 1 October 2025 for cover ending on 30 September 2028. The insurer calls it a three-year policy.

Student mistake: The student divides the premium by three because the cover lasts 36 months, without counting the financial years.

Final result: When one premium covers more than one year, divide it equally between the relevant financial years. Count the year of payment and the later financial years during which the cover remains effective. The number of policy years or months does not decide the fraction. After allocating the premium, apply the relevant 80D limit separately for each year.

Worked example: A ₹72,000 premium covers 1 October 2025 to 30 September 2028. The cover touches four financial years, from 2025-26 to 2028-29. Each year's share is ₹72,000 ÷ 4 = ₹18,000, subject to the group ceiling. It is not ₹24,000.

Quick help: Policy years nahi, financial years gino.

Trap 16 | 80DD and 80U cover different claimants ★★★★★

Section 80DD; 80U

Question trap: A resident mother spends only ₹18,000 on treatment for her dependent son. His certified disability is 85%, and he does not claim a deduction under 80U.

Student mistake: The student limits the mother's deduction to the actual ₹18,000 expenditure, or allows both family members to claim.

Final result: Section 80DD covers an eligible resident individual or Hindu undivided family supporting a wholly or mainly dependent relative or member. Qualifying expenditure or payment to an approved scheme is required. Section 80U covers a resident individual's own disability and does not require treatment expenditure. With the prescribed certificate, disability of at least 40% gives a fixed ₹75,000 deduction; severe disability of at least 80% gives ₹1.25 lakh. If the dependent claims 80U, the supporter cannot claim 80DD for that dependent.

Worked example: The mother's qualifying expenditure is ₹18,000, but the certified disability is 85%. Her eligible 80DD deduction is the fixed ₹1.25 lakh, since her son does not claim 80U.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 17 | 80DDB: apply the cap before reimbursement ★★★★★

Section 80DDB; Rule 11DD

Question trap: A resident individual pays ₹1.60 lakh for treatment of a prescribed disease of a wholly dependent resident father aged 65. The insurance company reimburses ₹30,000. Calculate the deduction under section 80DDB.

Student mistake: The student subtracts reimbursement before applying the statutory cap, which overstates the deduction.

Final result: A resident individual or Hindu undivided family must pay for eligible treatment of a prescribed disease and obtain the required specialist prescription. First take the lower of actual payment and ₹40,000. Use a ₹1 lakh cap when the patient is a resident senior citizen. Then subtract reimbursement from insurance or the employer. The deduction cannot be negative. For an individual's claim, the eligible relative must be wholly or mainly dependent. A high medical bill alone does not prove that the disease qualifies.

Worked example: First restrict ₹1.60 lakh to the ₹1 lakh senior-citizen cap. Then subtract ₹30,000 reimbursement. The deduction is ₹1 lakh - ₹30,000 = ₹70,000.

Quick help: Pehle cap, phir reimbursement.

Trap 18 | 80E can cover higher education abroad ★★★★★

Section 80E

Question trap: A father borrows from a qualifying Indian bank for his daughter's overseas postgraduate education. His instalment contains both principal and interest, and the repayment period is also given.

Student mistake: The student rejects foreign education or deducts the whole instalment without separating interest and checking the eligible years.

Final result: An individual's qualifying higher-education loan can fund self, spouse, a child or a student under legal guardianship. The lender must be a qualifying financial institution or approved charitable institution; an ordinary relative does not qualify. Deduct only interest actually paid from taxable income. Foreign education can qualify. The deduction runs for eight assessment years starting with the assessment year for the first interest-payment year, or until the interest is fully paid, whichever ends earlier.

Worked example: In an eligible year, the father pays ₹90,000 principal and ₹75,000 interest on the qualifying loan. His deduction is ₹75,000. The overseas location of the course does not by itself disqualify the claim.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 19 | Extra housing interest: distinguish 80EE and 80EEA ★★★★★

Section 80EE; 80EEA; 24(b)

Question trap: A first-time home buyer's question gives the loan-sanction date, loan amount, house value and stamp-duty value. Some interest has already been deducted under 24(b). It asks for additional relief.

Student mistake: The student mixes the eligibility limits of 80EE and 80EEA or deducts the same interest for a second time.

Final result: Both sections require an individual, a qualifying institutional loan and no residential house owned on the sanction date. Under 80EE, sanction must fall between 1 April 2016 and 31 March 2017, the loan must not exceed ₹35 lakh and house value must not exceed ₹50 lakh. Its deduction cap is ₹50,000. Under 80EEA, sanction must fall between 1 April 2019 and 31 March 2022, and stamp-duty value must not exceed ₹45 lakh. Its cap is ₹1.50 lakh, with no separate ₹35 lakh loan limit. A person eligible for 80EE cannot use 80EEA. Deduct each rupee of interest only once.

Worked example: Eligible 80EEA interest is ₹3.20 lakh. After a ₹2 lakh deduction under 24(b), the remaining ₹1.20 lakh can qualify. A house with ₹47 lakh stamp-duty value would fail the 80EEA limit.

Trap 20 | 80EEB can cover interest on an older electric-vehicle loan

Section 80EEB

Question trap: An individual pays electric-vehicle loan interest during previous year 2025-26. The bank sanctioned the loan in February 2023. The question highlights that the statutory sanction window has already ended.

Student mistake: The student rejects the interest merely because it was paid after 31 March 2023.

Final result: Section 80EEB applies only to individuals, whether resident or non-resident. Eligible electric-vehicle loan interest is deductible up to ₹1.50 lakh. A qualifying financial institution must have sanctioned the loan between 1 April 2019 and 31 March 2023. Specified banks and non-banking financial companies can qualify. Interest paid later on an eligible old loan can still be deductible. A new loan sanctioned in 2025 cannot qualify. Never deduct the same interest under another provision.

Worked example: The individual pays ₹95,000 interest in previous year 2025-26 on the qualifying February 2023 loan. The normal-regime deduction can be ₹95,000. A limited liability partnership cannot claim this deduction.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 21 | 80G: choose the category, then apply the limit ★★★★★

Section 80G

Question trap: A taxpayer makes a qualifying family-planning donation and a donation to an ordinary approved charity. The question also gives adjusted gross total income and the payment method.

Student mistake: The student applies one deduction percentage to all donations or ignores the shared qualifying-income ceiling.

Final result: First identify the donation category. The Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund qualifies at 100% and the Prime Minister's Drought Relief Fund at 50%, without the income restriction. Eligible family-planning donations qualify at 100% and ordinary approved charities generally at 50%, subject to that restriction. Cap restricted donations at 10% of adjusted gross total income, calculated after other deductions and statutory income exclusions. Allocate this ceiling to the qualifying 100% donations first. Cash donations above ₹2,000 and donations in kind fail. Check approval and certificates. Clean Ganga needs a resident donor; the Indian Olympic category needs a company. Section 135(5) corporate social responsibility payments to Swachh Bharat Kosh or Clean Ganga are excluded.

Worked example: Adjusted gross total income is ₹6 lakh. Restricted donations are ₹20,000 for family planning and ₹80,000 to charity. The ₹60,000 ceiling allows ₹20,000 at 100% and ₹40,000 at 50%. The deduction is ₹40,000.

Trap 22 | 80GG: house location can change eligibility

Section 80GG

Question trap: A person without house rent allowance pays residential rent and also pays office rent. The question says that the person owns a let-out house in another city.

Student mistake: The student includes office rent or rejects the claim merely because the person owns any house anywhere.

Final result: For an eligible individual without house rent allowance, compare three amounts: residential rent minus 10% of adjusted income, 25% of adjusted income, and ₹5,000 per month. Deduct the lowest. Calculate adjusted income before 80GG but after other deductions and relevant special-income exclusions. A residential house at the place of residence, work or business, owned by self, spouse, minor child or the Hindu undivided family of which the person is a member, can disqualify the claim. The person's own self-occupied house elsewhere also disqualifies it. An elsewhere let-out house does not automatically do so. Form 10BA is required.

Worked example: Adjusted income is ₹4 lakh, and residential rent for 12 months is ₹1.20 lakh. Compare ₹1.20 lakh - ₹40,000 = ₹80,000; 25% × ₹4 lakh = ₹1 lakh; and ₹5,000 × 12 = ₹60,000. The deduction is ₹60,000.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 23 | 80JJAA: test the employee before applying 30% ★★★★★

Section 80JJAA

Question trap: A business hires new workers, but their monthly pay and days worked differ. One worker falls short of the required days in the first year and completes them in the next year.

Student mistake: The student applies 30% to every new worker's salary without testing eligibility, or permanently rejects the short-service worker.

Final result: An eligible business subject to tax audit, not formed by a disqualifying split, reconstruction or acquisition, gets 30% of qualifying additional employee cost for three assessment years. Check the net increase in staff, payment through permitted banking or electronic methods, and participation in a recognised provident fund. Monthly emoluments above ₹25,000 fail; exactly ₹25,000 can qualify. Exclude workers whose entire specified Employees' Pension Scheme contribution is Government-paid. Normally, 240 days of employment are needed; apparel, footwear and leather-product manufacturers use 150 days. A worker who falls short initially can qualify from the immediately next year if that year meets the day requirement. Exclude employer fund contributions and termination lump sums from emoluments. The required report and timely return must be furnished.

Worked example: Qualifying employee cost of ₹6 lakh gives a ₹1.80 lakh deduction for each of three years. Under the normal 240-day test, a worker serving 180 days and then 300 days starts qualifying in the second year.

Trap 24 | 80TTA, 80TTB and post-office exemption are different

Section 80TTA; 80TTB; 10(15)(i)

Question trap: A resident aged 67 receives interest from a bank savings account and a fixed deposit. The question also asks whether the taxpayer can claim both 80TTA and 80TTB.

Student mistake: The student gives the senior citizen ₹10,000 under 80TTA as well as ₹50,000 under 80TTB.

Final result: Section 80TTA covers eligible individuals and Hindu undivided families for specified savings interest up to ₹10,000; time-deposit interest is excluded. Section 80TTB covers resident senior citizens for eligible deposit interest, including fixed deposits, up to ₹50,000. The deposits must be with specified banks, banking co-operatives or post offices. Corporate bonds and private loans are not automatically covered. Do not claim both sections. First exempt eligible post-office savings interest of ₹3,500 for an individual account or ₹7,000 for a joint account, then examine the taxable balance.

Worked example: The resident senior receives ₹12,000 bank savings interest and ₹46,000 fixed-deposit interest. Taxable interest before deduction is ₹58,000. The normal-regime deduction under 80TTB is ₹50,000.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 25 | Author and patent deductions use eligible income

Section 80QQB; 80RRB

Question trap: A resident novelist receives ₹2.80 lakh as eligible lump-sum royalty and spends ₹40,000 to earn it. The question asks for the royalty deduction from gross total income.

Student mistake: The student uses the gross royalty for the deduction and ignores the expenses incurred to earn it.

Final result: Sections 80QQB and 80RRB apply to resident individuals. Each deduction is the lower of eligible income and ₹3 lakh. Section 80QQB excludes guides, commentaries, journals and school textbooks. For royalty that is not a lump sum, first restrict gross royalty to 15% of the books' sale value, then deduct related expenses. Section 80RRB requires the true first inventor to be the registered patentee, with the patent registered on or after 1 April 2003. Product-sale receipts and capital gains are not royalty. Eligible foreign royalty must reach India in convertible foreign exchange within six months of year-end, unless extended. Check certificates and timely filing.

Worked example: The novelist's eligible net royalty is ₹2.80 lakh - ₹40,000 = ₹2.40 lakh. The 80QQB deduction is ₹2.40 lakh, subject to the other conditions.

Trap 26 | 80M requires distribution by an earlier deadline

Section 80M

Question trap: A domestic company receives dividend income and declares a dividend to its shareholders. It distributes part before the special 80M deadline and pays the balance after that deadline.

Student mistake: The student treats declaration as distribution or includes the amount distributed after the special deadline.

Final result: A domestic company can deduct eligible dividend income, after permitted related expenses, received from another domestic company, foreign company or business trust. The deduction cannot exceed its own dividend actually distributed by the special deadline. That deadline is one month before the section 139(1) return due date. Declaration alone is insufficient. The same distributed amount cannot support another year's deduction. Individual shareholders cannot claim 80M.

Worked example: Eligible dividend income is ₹9 lakh. The company distributes ₹6 lakh by the special deadline and ₹2 lakh afterwards. Its deduction is ₹6 lakh, rather than ₹8 lakh or ₹9 lakh.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 27 | Start-up relief covers three consecutive years

Section 80-IAC

Question trap: An otherwise eligible start-up limited liability partnership was incorporated in July 2025. The question asks whether it missed the incorporation deadline and whether all its first ten years are tax-free.

Student mistake: The student uses the old March 2025 cutoff or allows the deduction for all ten years.

Final result: Finance Act 2025 allows incorporation on or after 1 April 2016 but before 1 April 2030. The company or limited liability partnership must meet the eligible-business conditions, obtain Inter-Ministerial Board certification and satisfy the other conditions. It can deduct 100% of eligible profit for any three consecutive assessment years within the ten-year period from incorporation. Turnover in the previous year of the claim must not exceed ₹100 crore. Also check the chosen regime and timely filing.

Worked example: An otherwise eligible limited liability partnership incorporated in July 2025 is within the extended incorporation window. It can choose three consecutive assessment years within the permitted ten-year period. It does not get ten tax-free years.

Trap 28 | Savings-certificate interest needs two separate entries ★★★★★

Section 56; 80C

Question trap: An individual using the normal regime reports ₹8,000 of third-year interest and ₹9,000 of final-year interest on two five-year National Savings Certificates. Other eligible section 80C payments are ₹1.42 lakh. Interest is accounted for annually.

Student mistake: The student treats all certificate interest as exempt, or includes final-year interest as a fresh investment.

Final result: Show both interest amounts under Income from Other Sources. Interest accrued during the first four certificate years is deemed reinvested and can qualify under section 80C. Final-year interest is paid at maturity and is not deemed reinvested. The reinvestment deduction still uses the shared ₹1.50 lakh ceiling; taxable interest does not disappear merely because that ceiling is already exhausted.

Worked example: Include ₹17,000 as interest income. Eligible section 80C payments become ₹1.42 lakh + ₹8,000 = ₹1.50 lakh. The ₹9,000 final-year interest creates no additional deduction.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 29 | An annuity-plan surrender can make the whole receipt taxable

Section 80CCC(1)-(3)

Question trap: An individual surrenders a qualifying insurer's annuity plan. The receipt is ₹2.60 lakh, comprising ₹2 lakh of contributions allowed as deductions in earlier years and ₹60,000 of accumulated interest and bonus. Calculate the taxable receipt.

Student mistake: The student taxes only the bonus or assumes every receipt from a life insurer is exempt.

Final result: For an annuity-plan balance covered by section 80CCC, the surrender receipt, including interest and bonus, is taxable when received by the individual or nominee. Pension from the plan also falls within this rule. At the contribution stage, interest or bonus merely credited to the account is not a fresh deductible contribution. Eligible actual contributions share the section 80CCE ceiling and cannot also be deducted under section 80C.

Worked example: On these facts, ₹2.60 lakh is taxable in the year of surrender, not merely ₹60,000. The entire contribution component was previously deducted, so it is covered by the stated reversal rule.

Trap 30 | Disability-scheme refund: use the receipt year and deposited amount

Section 80DD(2), (3), (3A)

Question trap: A resident father deposited ₹30,000 in an approved scheme for his dependent child with severe disability and claimed ₹1.25 lakh under section 80DD. The child dies first. The father receives the ₹30,000 deposit back in the following financial year.

Student mistake: The student taxes ₹1.25 lakh because that was the deduction, or taxes the refund in the year of death before receipt.

Final result: Where the dependent dies before the subscriber, section 80DD(3) treats an amount equal to the scheme payments or deposits as income in the year the subscriber receives it. This is different from the fixed annual deduction. A separate exception protects annuity or lump-sum amounts already received by the dependent before death under the qualifying age-60 payout arrangement, after contributions stop.

Worked example: The father includes ₹30,000 in the year of refund. The ₹1.25 lakh fixed deduction is not substituted for the ₹30,000 deposited amount when applying this rule.

Chapter 10: Deductions from Gross Total Income (continued)

PRACTICAL QUESTION TRAPS

Trap 31 | Waste-processing relief starts when the business starts

Section 80JJA; 80AC

Question trap: A normal-regime taxpayer starts an eligible business converting biodegradable waste into organic manure. It earns ₹4 lakh of eligible net profit and ₹1 lakh from a separate plastic-scrap trading activity. The return is filed on time.

Student mistake: The student deducts both profits, applies 30% of employee cost, or delays the five-year clock until a more profitable year.

Final result: Section 80JJA allows 100% of eligible profit for five consecutive assessment years beginning with the assessment year for the commencement year. It covers collecting and processing or treating biodegradable waste for listed outputs such as power, biogas, bio-fertilisers, bio-pesticides, other biological agents, fuel pellets or briquettes, and organic manure. Ordinary trading in non-biodegradable scrap does not qualify.

Worked example: Deduct ₹4 lakh under section 80JJA; the ₹1 lakh separate trading profit remains outside this deduction. The first eligible assessment year starts the five-year period even if another year may give a larger tax saving.

Trap 32 | Financial-services-centre relief has one fifteen-year window

Section 80LA(1A)-(3)

Question trap: A qualifying International Financial Services Centre unit has ₹8 lakh of eligible business income. It proposes to choose years 7 to 16 of its statutory window as ten deduction years, because commercial operations started after regulatory permission.

Student mistake: The student restarts the fifteen-year clock from commercial operations or allows ten selected years that are not consecutive.

Final result: Under section 80LA(1A), the unit can choose a 100% deduction for ten consecutive assessment years within fifteen years. The window begins with the assessment year corresponding to the year of the relevant regulatory permission or registration. Do not restart it when profit or operations begin. Only qualifying income is covered; check the required accountant's report and permission documents.

Worked example: Years 6 to 15 form a valid ten-year block; years 7 to 16 do not fit. In a valid elected year, the stated eligible income can give an ₹8 lakh deduction, subject to all other conditions.

Chapter 11: Alternate Minimum Tax

THEORY TRAPS

Trap 1 | Alternate minimum tax needs a trigger; the ₹20 lakh exception is limited

Section 115JEE; 115JC

Question trap: An individual and a limited liability partnership each claim a deduction that can trigger alternate minimum tax. Their adjusted total income is exactly ₹20 lakh. Another individual has high income but claims only 80C.

Student mistake: The student treats ₹20 lakh as a common exemption for everyone, or assumes that high income alone triggers alternate minimum tax.

Final result: For non-companies, alternate minimum tax can be triggered by deductions under 35AD, 10AA or heading C of Chapter VI-A, except 80P. Individuals, Hindu undivided families, associations of persons, bodies of individuals and artificial juridical persons are exempt when adjusted total income does not exceed ₹20 lakh. Exactly ₹20 lakh qualifies. Firms and limited liability partnerships have no such threshold exemption. The default regime is excluded. Also check the statutory exclusions for specified co-operative regimes and funds. Company minimum alternate tax is a different tax. An 80C deduction alone does not trigger alternate minimum tax.

PRACTICAL QUESTION TRAPS

Trap 2 | Alternate minimum tax adds back only specified deductions ★★★★★

Section 115JC(2)

Question trap: A question gives normal total income after deductions under 80C, 80QQB and 35AD. It also gives the depreciation that would have been allowed on the assets covered by 35AD.

Student mistake: The student adds back every deduction or adds the full 35AD amount without reducing the relevant hypothetical depreciation.

Final result: Start with total income calculated under the normal provisions. Add back deductions under heading C of Chapter VI-A, except 80P, and the 10AA deduction. For 35AD, add the deduction but subtract the section 32 depreciation that would have been allowed on those same assets if 35AD had not been claimed. Depreciation on unrelated assets cannot reduce this adjustment. Use the resulting adjusted total income to test the alternate minimum tax threshold.

Worked example: Normal total income is ₹16 lakh after deductions of ₹1.50 lakh under 80C, ₹2 lakh under 80QQB and ₹8 lakh under 35AD. Hypothetical depreciation on the 35AD assets is ₹1 lakh. Adjusted total income is ₹16 lakh + ₹2 lakh + ₹8 lakh - ₹1 lakh = ₹25 lakh. Do not add back 80C.

Quick help: Sirf listed deductions add back karo.

Chapter 11: Alternate Minimum Tax (continued)

PRACTICAL QUESTION TRAPS

Trap 3 | Pay the higher of alternate minimum tax and regular tax

Section 115JC; 115JF

Question trap: A non-company taxpayer has adjusted total income of ₹25 lakh. The question separately gives regular tax and asks for the final liability after considering alternate minimum tax.

Student mistake: The student adds alternate minimum tax to regular tax, or calculates alternate minimum tax on the book-profit figure used for company minimum alternate tax.

Final result: Calculate ordinary alternate minimum tax at 18.5% of adjusted total income. A qualifying International Financial Services Centre unit earning solely in convertible foreign exchange uses 9%, and an applicable co-operative society uses 15%. Add the applicable surcharge and 4% cess. Compare the complete alternate minimum tax liability with the complete regular-tax liability and pay the higher amount. Do not add them together. Company minimum alternate tax uses a separate book-profit calculation.

Worked example: With adjusted income of ₹25 lakh, the ordinary rate and no surcharge, alternate minimum tax is ₹25 lakh × 18.5% × 104% = ₹4,81,000. If regular tax including cess is ₹4,20,000, the tax payable is ₹4,81,000.

Chapter 11: Alternate Minimum Tax (continued)

PRACTICAL QUESTION TRAPS

Trap 4 | Alternate minimum tax credit is limited by the current tax gap

Section 115JD; 115JEE(3)

Question trap: A taxpayer has ₹80,000 of brought-forward alternate minimum tax credit. This year's regular tax is higher than alternate minimum tax, but the difference between them is only ₹40,000.

Student mistake: The student uses the whole ₹80,000 credit immediately, without checking the current year's permitted set-off.

Final result: Alternate minimum tax credit normally equals alternate minimum tax paid minus regular tax, subject to any separate foreign-tax-credit adjustment. It can be carried forward for fifteen succeeding assessment years and earns no interest. In a later year, use the available credit only up to the amount by which current regular tax exceeds current alternate minimum tax. Income falling below ₹20 lakh later does not automatically cancel existing credit. Restrictions under the default or other concessional regimes still apply.

Worked example: Brought-forward credit is ₹80,000, current regular tax is ₹5,40,000 and current alternate minimum tax is ₹5 lakh. Use ₹40,000 credit. Carry the remaining ₹40,000 forward only within its original expiry period.

Chapter 11: Alternate Minimum Tax (continued)

PRACTICAL QUESTION TRAPS

Trap 5 | Extra foreign-tax relief reduces the minimum-tax credit carried forward

Section 115JD(2); Rule 128(6)-(7)

Question trap: A resident non-company taxpayer pays alternate minimum tax. Before foreign-tax relief, complete alternate minimum tax is ₹10 lakh and regular tax is ₹8 lakh. Allowable foreign-tax credits are ₹1.50 lakh and ₹1 lakh respectively.

Student mistake: The student carries forward the entire ₹2 lakh gross tax difference and ignores the extra foreign-tax relief already used.

Final result: When foreign-tax credit against alternate minimum tax exceeds the credit against regular tax, exclude that excess from the alternate minimum tax credit carried forward. Otherwise, the same extra relief would benefit the taxpayer again. Start with the gross difference between the two complete tax liabilities, then subtract only the excess foreign-tax credit. Do not subtract the full foreign-tax credit again.

Worked example: Gross difference is ₹2 lakh. Excess foreign-tax credit is ₹50,000. Carry-forward alternate minimum tax credit is ₹1.50 lakh. The net liabilities, ₹8.50 lakh and ₹7 lakh, also differ by ₹1.50 lakh.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source

THEORY TRAPS

Trap 1 | Tax deduction and final income-tax liability

Section 192-196D

Question trap: A resident receives income without any tax deduction at source. Another resident receives professional fees after tax deduction at source at 10%. The question asks for their final income-tax liability.

Student mistake: A student treats the first receipt as exempt and the 10% deduction on the second receipt as the final tax.

Final result: Tax deduction at source collects tax in advance; it does not decide whether income is taxable or how much final tax is payable. Calculate the recipient's taxable income and final tax under the applicable rules. Normally, do not add surcharge or cess to tax deduction at source on non-salary payments to residents. Salary tax calculations include applicable surcharge and cess. Payments to non-residents have separate rate rules.

Trap 2 | Tax deduction without a tax audit

Section 194A, 194C, 194H, 194-I, 194J, 194R

Question trap: An individual had business turnover above ₹1 crore last year but did not require a tax audit because cash transactions were low. This year, the individual pays professional fees.

Student mistake: A student assumes that no tax audit means no obligation to deduct tax at source.

Final result: For individual or Hindu undivided family payers, these sections generally test the preceding year's business turnover above ₹1 crore or professional receipts above ₹50 lakh. The higher tax-audit limit for businesses with low cash transactions does not replace these tax deduction at source limits. Then check the conditions of the relevant payment section. Personal-purpose exceptions differ between sections; section 194J specifically excludes professional fees paid for personal purposes. Even a smaller payer may have to deduct under section 194-IB for rent or section 194M for specified large payments.

Trap 3 | Forms 15G, 15H and lower-deduction certificates ★★★★★

Section 197, 197A

Question trap: A resident below 60 has nil estimated tax after rebate, but the income covered by Form 15G exceeds the basic exemption limit. The person submits Form 15G to avoid tax deduction at source.

Student mistake: A student accepts Form 15G merely because the final estimated tax is nil.

Final result: Form 15G has two tests: estimated tax must be nil, and the specified income must not exceed the applicable basic exemption limit. Companies and firms cannot use it. Form 15H is for a resident individual aged 60 or more whose estimated tax is nil; it does not have that separate income ceiling. Both forms cover only specified income of eligible residents, and permanent account number is required. A certificate allowing a lower tax deduction under section 197 works only for the payment, period, amount and rate authorised in that certificate.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

THEORY TRAPS

Trap 4 | Salary tax deduction and relief at age 75

Section 192, 194P

Question trap: A resident aged 76 receives a pension from Bank A and interest from Banks A and B. The question asks whether the pension-paying bank's deduction removes the return-filing requirement.

Student mistake: A student grants the section 194P relief only because the person is older than 75.

Final result: Section 194P requires a resident aged 75 or more whose only income is pension and interest from the same specified bank that pays the pension. The required declaration and the bank's computation and deduction must also be completed. Interest from Bank B prevents this particular relief. For ordinary salary tax deduction at source, use the average rate of estimated annual tax and deduct on payment. Consider the regime, rebate and relief. Generally, do not adjust losses under other heads, except a house-property loss allowed by the applicable regime.

Trap 5 | Transporters and customer-supplied materials

Section 194C

Question trap: A goods transporter gives permanent account number but no declaration about vehicle ownership. Another contractor manufactures goods using materials supplied by the customer, with the material value shown separately in the bill.

Student mistake: A student allows the transporter's exemption on permanent account number alone and deducts tax at source on the manufacturer's entire bill.

Final result: The transporter must give both permanent account number and the declaration, and must not own more than 10 goods carriages at any time during the year. Passenger transport does not receive this relief. For custom manufacturing, materials supplied by the customer or a specified associate can make the arrangement covered "work". Exclude the material value if it is separately stated in the bill. If materials come from an unrelated supplier, examine whether the arrangement is a sale or covered work. The customer's design alone does not settle that question.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 6 | Goods purchases: deduct only on the excess ★★★★★

Section 194Q; 206C(1H)

Question trap: A buyer with preceding-year business turnover above ₹10 crore credits the same resident seller with purchases of ₹35 lakh and later ₹25 lakh during financial year 2025-26. Payment follows next year. The seller has a small turnover.

Student mistake: A student checks the seller's turnover, waits for payment, or deducts on the entire ₹60 lakh.

Final result: Check the buyer's preceding-year business turnover: it must exceed ₹10 crore. Annual purchases from that resident seller must exceed ₹50 lakh. Deduct 0.1% only on the excess over ₹50 lakh, when the amount is credited or paid, whichever happens first. An advance or a credit to a suspense account can also trigger deduction. The seller's turnover does not decide section 194Q. Section 206C(1H) does not apply from 1 April 2025, but check whether another tax deduction at source or tax collection at source provision applies.

Worked example: Total purchases are ₹60 lakh. The excess is ₹10 lakh, so tax deduction at source is ₹10 lakh × 0.1% = ₹1,000. Deduct when the second amount is credited; do not wait for payment.

Trap 7 | Missing account number and non-filing are different ★★★★★

Section 206AA, 206CC; omitted 206AB/206CCA

Question trap: A resident professional does not give permanent account number. The question also says that the higher-rate provisions for certain non-filers were removed from 1 April 2025.

Student mistake: A student applies the ordinary 10% rate because the non-filer provisions have been removed.

Final result: The rules for a missing permanent account number still apply. Sections 206AB and 206CCA were removed from 1 April 2025, but sections 206AA and 206CC continue. Without permanent account number, tax deduction at source is normally the highest of the relevant section rate, the rates in force and 20%. For sections 194-O and 194Q, use 5% instead of that 20% figure. For tax collection at source, normally use twice the specified rate or 5%, whichever is higher, subject to a 20% ceiling. Section 194N also retains its own separate test for specified non-filers.

Worked example: Covered professional fees of ₹1 lakh paid to a resident without permanent account number normally require ₹20,000 tax deduction at source. If the covered excess under section 194Q is ₹1 lakh, the normal deduction without a permanent account number is ₹5,000.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 8 | Deposit, statement and certificate deadlines

Section 200, 203, 234E, 271H; Rules 30-31A

Question trap: A non-government payer deducts and collects tax under the ordinary source-tax provisions in March. A separate question gives a late quarterly tax deduction at source statement and asks for the fee and certificate deadline.

Student mistake: A student applies 30 April to every March deposit and uses the deposit date as the statement or certificate deadline.

Final result: Ordinary non-government tax deduction at source is deposited by the next month's 7th, except March tax deduction at source, which is due by 30 April. Ordinary tax collection at source is due by the next month's 7th even for March. The special challans under sections 194-IA, 194-IB, 194M and specified-person 194S are due within 30 days of month-end. Ordinary quarterly tax deduction at source statements are due on 31 July, 31 October, 31 January and 31 May. Form 16 is due on 15 June; Form 16A is due 15 days after the statement deadline. Section 234E charges ₹200 per day, capped at the tax deduction at source or tax collection at source amount. Section 271H late-statement relief requires filing and payment of tax, fee and interest within one month of the statement deadline.

Worked example: If a statement involving ₹5,000 tax deduction at source is 10 days late, the section 234E fee is ₹2,000. Form 16A for the December quarter is ordinarily due on 15 February.

Trap 9 | Late deduction and late deposit ★★★★★

Section 201(1A)

Question trap: Tax of ₹10,000 should have been deducted on 20 June. It is actually deducted on 10 July and deposited late on 20 August. Both defaults occur in the same transaction.

Student mistake: A student charges 1% for the whole delay or counts deposit interest only after the statutory deposit deadline.

Final result: Calculate the two defaults separately. Late deduction attracts 1% per month or part of a month, from the date tax was deductible until actual deduction. Late deposit attracts 1.5% per month or part, from actual deduction until deposit. Count a part of a calendar month as a full month. Relief from recovery of the principal tax requires the payee's return, inclusion of income, payment of tax and the prescribed certificate. That relief does not automatically remove interest.

Worked example: Late deduction covers June and July: ₹10,000 × 1% × 2 = ₹200. Late deposit covers July and August: ₹10,000 × 1.5% × 2 = ₹300. Total interest is ₹500.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 10 | Provident-fund withdrawal: five years and ₹50,000

Section 192A

Question trap: An employee withdraws provident-fund money after two years with the present employer, following three years with the previous employer. The earlier balance was properly transferred. Another taxable withdrawal is exactly ₹50,000.

Student mistake: A student counts only present-employer service and treats exactly ₹50,000 as below the tax deduction at source threshold.

Final result: First decide whether the provident-fund withdrawal is taxable. After a proper transfer, previous-employer service counts towards the five-year condition. Also check prescribed exceptions, such as ill health or closure of the employer's business. If the withdrawal is taxable and covered payments total ₹50,000 or more, the normal tax deduction at source rate is 10%. A taxable withdrawal below ₹50,000 may escape tax deduction at source, but that does not make the income exempt.

Worked example: The properly transferred service of 3 + 2 years meets the five-year condition, so a qualifying withdrawal can be exempt. Separately, a taxable withdrawal of exactly ₹50,000 normally requires ₹5,000 tax deduction at source.

Trap 11 | Interest: select the correct threshold

Section 193, 194A, 194T

Question trap: A resident aged 67 receives ₹90,000 deposit interest from a bank. A separate resident receives ₹12,000 interest on a loan to a company. The question asks for tax deduction at source and the income deduction.

Student mistake: A student uses the bank's threshold for the company too, or treats the no-tax deduction at source threshold as a deduction from taxable income.

Final result: For bank, co-operative-bank and notified post-office deposits, section 194A uses an annual ₹50,000 threshold, increased to ₹1 lakh for resident senior citizens. Other payers, and covered securities interest under section 193, use ₹10,000. Once the relevant threshold is exceeded, normally deduct 10% on all covered interest. Combine branches of a bank using core banking. A qualifying co-operative society with preceding-year turnover above ₹50 crore loses its member or deposit exemption when interest exceeds ₹50,000, or ₹1 lakh for resident seniors. Savings-account interest is excluded. Motor Accident Claims Tribunal interest has no tax deduction at source on credit; payment has an annual ₹50,000 test. Apply section 194T separately to partner interest.

Worked example: The senior's ₹90,000 bank interest ordinarily has no tax deduction at source, but section 80TTB in the normal regime still allows only up to ₹50,000. The covered company-loan interest of ₹12,000 requires ₹1,200 tax deduction at source.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 12 | Dividend: individual and non-cash conditions

Section 194

Question trap: A company pays a ₹9,000 dividend to a resident individual in cash. Another resident individual receives the same annual amount by bank transfer. Both amounts are below ₹10,000.

Student mistake: A student gives the ₹10,000 no-tax deduction at source concession to both shareholders without checking the payment mode.

Final result: The annual ₹10,000 concession requires both an individual shareholder and non-cash payment. A small cash dividend does not qualify for this concession. Nor does another resident shareholder, such as a company, qualify merely because the amount is small. The normal resident rate is 10% on the whole covered dividend, deducted before payment or distribution. Check the special exemptions for qualifying insurer-held shares and notified recipients. Income from mutual-fund units follows the separate section 194K rule.

Worked example: The ₹9,000 bank-transfer dividend can qualify for the concession. The same ₹9,000 dividend paid in cash normally requires ₹900 tax deduction at source.

Trap 13 | Lottery versus online gaming ★★★★★

Section 194B, 194BB, 194BA; Rule 133

Question trap: A person wins two independent lottery prizes of ₹8,000 each. Another person has ₹2,000 net winnings from an online game. The question asks whether the ₹10,000 tax deduction at source threshold protects both.

Student mistake: A student adds unrelated lottery wins together and also gives online gaming the lottery threshold.

Final result: From 1 April 2025, lottery and horse-race winnings normally attract 30% tax deduction at source when a single winning transaction exceeds ₹10,000. Paying one prize in instalments does not split that transaction. Online gaming has no general ₹10,000 threshold. Apply 30% to net winnings calculated under Rule 133 at withdrawal or year-end. Exclude the player's own deposits and avoid taxing previously taxed winnings again. Where a prize is in kind, ensure that the required tax is paid before releasing it.

Worked example: Neither independent ₹8,000 lottery win crosses the threshold. For a fresh online account with ₹10,000 own deposits, a ₹12,000 closing balance and no withdrawals, net winnings are ₹2,000. Tax deduction at source is ₹600.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 14 | Contractor bills and large personal payments

Section 194C, 194M

Question trap: A company pays an individual contractor four bills of ₹28,000 each. Separately, a salaried individual makes a qualifying ₹60 lakh payment for a personal contract to a resident.

Student mistake: A student checks each contractor bill alone and assumes that a personal payment can never attract tax deduction at source.

Final result: Under section 194C, tax deduction at source applies if one payment exceeds ₹30,000 or annual payments to one contractor exceed ₹1 lakh. Deduct on the whole covered amount: 1% for an individual or Hindu undivided family contractor and 2% for others. Check whether the payer is covered. Section 194M can apply to an individual or Hindu undivided family not deducting under the relevant section 194C, 194H or 194J. It charges 2% when covered contract, commission, brokerage or professional payments to one resident exceed ₹50 lakh annually, including personal payments. Insurance commission is excluded. Section 194M does not require Tax Deduction and Collection Account Number.

Worked example: The four bills total ₹1,12,000, so the company deducts ₹1,120 under section 194C. The separate qualifying ₹60 lakh personal contract requires ₹1,20,000 under section 194M.

Trap 15 | Commission: threshold and recipient rate

Section 194D, 194G, 194H

Question trap: An insurer pays ₹30,000 commission to a domestic company acting as its agent. The question also gives a resident individual agent who receives the same annual commission.

Student mistake: A student applies 2% to both recipients without checking whether the insurance agent is a company.

Final result: For financial year 2025-26, sections 194D, 194G and 194H use an annual threshold of ₹20,000. Once it is exceeded, deduct on the whole covered commission. Insurance commission normally attracts 2% for a resident recipient other than a company, but 10% for a domestic company. Lottery-ticket selling commission and ordinary resident commission or brokerage generally attract 2%. Check professional services separately under section 194J. A trade discount is not automatically commission; examine the payer's eligibility and whether an agency relationship exists.

Worked example: Insurance commission of ₹30,000 requires ₹3,000 tax deduction at source if the agent is a domestic company. The same commission paid to a resident individual agent requires ₹600.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 16 | Policy receipts: gross threshold, income base ★★★★★

Section 194DA

Question trap: A resident receives ₹1,20,000 from a life-insurance policy. The receipt is not exempt under section 10(10D), but only ₹20,000 of it is income. The question asks for tax deduction at source.

Student mistake: A student calculates tax deduction at source on the full receipt, or tests the ₹1 lakh threshold using only the ₹20,000 income.

Final result: First check whether section 10(10D) exempts the policy receipt. An exempt receipt does not attract section 194DA. For a non-exempt policy payment to a resident, test whether annual gross payments are ₹1 lakh or more. If covered, normally deduct 2% only on the income component. The threshold therefore uses gross receipts, while the tax deduction at source calculation uses the income portion. Only gross payments below ₹1 lakh receive this no-deduction concession. That concession does not exempt the income.

Worked example: The gross receipt of ₹1,20,000 crosses the threshold. Tax deduction at source is ₹20,000 × 2% = ₹400. It is not ₹2,400 on the full receipt.

Trap 17 | Rent: choose section 194-I or section 194-IB ★★★★★

Section 194-I, 194-IB

Question trap: A salaried individual rents a house from a resident for ₹60,000 per month for the full year. A company separately pays ₹80,000 for one month's office rent.

Student mistake: A student applies the same section and rate to both tenants, or deducts on only one month of the individual's rent.

Final result: Both provisions test rent above ₹50,000 for a month or part of a month. Under section 194-I, the rate is 2% for equipment and 10% for land, buildings, furniture or fittings; deduct at credit or payment, whichever is earlier. An individual or Hindu undivided family outside section 194-I pays 2% under section 194-IB on covered land or building rent to a resident. Apply its special timing rule linked to the last month of the year or tenancy. Deduct on the whole applicable rent; no Tax Deduction and Collection Account Number is required. Without permanent account number, section 194-IB deduction cannot exceed the last month's rent.

Worked example: The company deducts ₹8,000 on its ₹80,000 office rent. The salaried tenant's annual rent is ₹7,20,000, so tax deduction at source under section 194-IB is ₹14,400, not ₹1,200.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 18 | Property: exactly ₹50 lakh is covered

★★★★★

Section 194-IA

Question trap: Two buyers purchase the same covered property from a resident seller and pay ₹25 lakh each. The total consideration and stamp duty value are both exactly ₹50 lakh.

Student mistake: A student tests each buyer's ₹25 lakh share separately or thinks that exactly ₹50 lakh escapes tax deduction at source.

Final result: For a covered property bought from a resident seller, tax deduction at source applies if the consideration or stamp duty value is ₹50 lakh or more. Deduct 1% on the higher amount, not just on the excess over ₹50 lakh. Include connected parking, club and maintenance charges. Combine consideration involving multiple buyers or sellers of the same property. Deduct when the amount is credited or paid, whichever happens first. If the seller is a non-resident, examine section 195 instead of automatically applying the 1% rate.

Worked example: The buyers' payments total ₹50 lakh, equal to the stamp duty value. Aggregate tax deduction at source is ₹50,000. Dividing the property between two buyers does not remove this obligation.

Trap 19 | Agricultural land and development-agreement cash

Section 194-IA, 194LA, 194-IC

Question trap: One question describes urban agricultural land acquired compulsorily. Another gives a resident landowner ₹4 lakh cash plus flats under a specified development agreement. Both ask for tax deduction at source.

Student mistake: A student applies one agricultural-land exclusion everywhere and includes the flats in the development agreement's cash-tax deduction at source base.

Final result: Section 194-IA excludes rural agricultural land; urban agricultural land can be covered. Section 194LA excludes both rural and urban agricultural land. Covered compensation for compulsory acquisition of non-agricultural property normally attracts 10% tax deduction on payment if annual compensation exceeds ₹5 lakh. Also check the exemption for qualifying awards under the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013. For a specified development agreement under section 45(5A), section 194-IC charges 10% on monetary consideration paid to a resident, without a minimum amount. The value of allotted flats is not part of this monetary base.

Worked example: Covered acquisition compensation of exactly ₹5 lakh does not cross its threshold. A separate qualifying development-agreement cash payment of ₹4 lakh requires ₹40,000 tax deduction at source.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 20 | Professional fees and director payments

★★★★★

Section 194J

Question trap: A company pays a non-employee director ₹35,000 as sitting fees. It also pays ₹60,000 for covered technical services. The question gives the ₹50,000 section 194J threshold.

Student mistake: A student uses the threshold for the director's fees and applies 10% to every kind of technical service.

Final result: Test the annual ₹50,000 threshold separately for professional fees, technical fees, royalty and non-compete payments. Covered non-salary fees, remuneration and commission to a director have no threshold. Professional fees and ordinary royalty generally attract 10%. Technical services that are not professional services, specified film royalty and payments to a recipient engaged only in operating a call centre attract 2%. An employee-director's salary falls under section 192. Identify the service and the director's employment status before choosing the section, threshold and rate.

Worked example: The ₹35,000 sitting fee requires ₹3,500 tax deduction at source despite being below ₹50,000. Covered technical-service fees of ₹60,000 at 2% require ₹1,200. Professional audit fees normally use 10%.

Trap 21 | Unit income and securitisation trusts

Section 194K, 194LBC

Question trap: A resident receives ₹12,000 covered income from mutual-fund units. Another resident receives ₹8,000 covered income as an investor in a securitisation trust. The question asks whether both get the ₹10,000 concession.

Student mistake: A student transfers the section 194K threshold to securitisation-trust income, or uses the old section 194LBC resident rates.

Final result: Section 194K normally charges 10% on covered resident unit income when the annual amount exceeds ₹10,000. Capital-gain income is excluded. Section 194LBC has a different rule: from 1 April 2025, covered securitisation-trust income paid to a resident investor attracts 10% without a minimum amount. Non-resident and foreign-company recipients follow the separate rates-in-force rule. Under both provisions, deduct when the amount is credited or paid, whichever happens first.

Worked example: The ₹12,000 covered unit income requires ₹1,200 tax deduction at source under section 194K. The ₹8,000 covered resident securitisation-trust income requires ₹800 under section 194LBC.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 22 | Cash withdrawals: filer versus non-filer

Section 194N

Question trap: An ordinary recipient withdraws ₹1.20 crore in cash from one bank during the year. The question changes one fact: the recipient is either a normal return-filer or a specified three-year non-filer.

Student mistake: A student applies the ₹1 crore starting threshold to the non-filer too, or treats the withdrawal itself as taxable income.

Final result: For a normal filer, deduct 2% on aggregate withdrawals above ₹1 crore from the same bank, co-operative bank or post office. If the recipient is a co-operative society, the upper limit is ₹3 crore. For a specified three-year non-filer, deduct 2% on the amount above ₹20 lakh up to the relevant upper limit, then 5% on the excess above that limit. Do not combine unrelated banks as one payer. Tax deduction at source on a cash withdrawal does not mean the withdrawal itself is income.

Worked example: For the ordinary normal filer, tax deduction at source is ₹20 lakh × 2% = ₹40,000. For the ordinary specified non-filer, it is ₹80 lakh × 2% + ₹20 lakh × 5% = ₹2,60,000.

Trap 23 | E-commerce and virtual digital assets

Section 194-O, 194S

Question trap: A resident company makes ₹4 lakh sales through an online platform, including direct customer payments. Separately, a specified individual payer buys a virtual digital asset for ₹80,000 from a resident who makes a loss.

Student mistake: A student gives every seller the ₹5 lakh platform concession and deducts tax on a virtual asset only if the seller earns profit.

Final result: Section 194-O charges 0.1% on a resident participant's gross facilitated sales or services, including direct customer payments. Its ₹5 lakh concession requires an eligible individual or Hindu undivided family with permanent account number or Aadhaar. Section 194S charges 1% on resident virtual-digital-asset consideration, not profit. Annual limits are ₹50,000 for specified individual or Hindu undivided family payers and ₹10,000 for others. Specified payers have no business or professional income, or preceding-year business turnover not above ₹1 crore or professional receipts not above ₹50 lakh, as applicable. Deduct at earlier credit or payment, and ensure payment of tax for non-cash exchanges. Section 194S takes priority over section 194-O.

Worked example: The resident company's ₹4 lakh platform sales require ₹400 tax deduction at source. The specified payer's ₹80,000 virtual-asset purchase requires ₹800 tax deduction at source even though the seller makes a loss.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 24 | Business benefits in kind

Section 194R

Question trap: A company rewards a resident dealer with a television worth ₹40,000 for business performance. No cash is paid with the gift. The question asks whether tax must be arranged before delivery.

Student mistake: A student ignores tax deduction at source because there is no cash payment from which the company can deduct it.

Final result: Section 194R normally charges 10% on covered benefits arising from a resident's business or profession. Once the annual value exceeds ₹20,000, deduct on the whole covered value. The benefit may be in cash, in kind or partly in both. If the cash component is insufficient, ensure that the required tax is paid before releasing the benefit. Check the turnover exception for small individual or Hindu undivided family providers. Salary perquisites follow section 192. Ordinary discounts and rebates have separate Central Board of Direct Taxes treatment and should not automatically be treated like this reward.

Worked example: The covered television benefit is worth ₹40,000, so the normal tax deduction at source requirement is ₹4,000. The company must ensure that the tax is arranged before it delivers the television.

Trap 25 | Partner payments include capital-account credits ★★★★★

Section 194T

Question trap: On or after 1 April 2025, a firm credits ₹18,000 interest and ₹12,000 remuneration to the same partner's capital account during the year. Neither item separately exceeds ₹20,000. The partner withdraws no cash.

Student mistake: A student tests each payment separately or waits until the partner withdraws cash from the capital account.

Final result: From 1 April 2025, a firm or limited liability partnership deducts 10% when annual salary, remuneration, commission, bonus and interest to the same partner together exceed ₹20,000. Deduct on the whole covered sum when it is credited or paid, whichever happens first. A credit to the partner's capital account also counts. There is no separate ₹20,000 limit for each type of payment. Exempt profit shares and genuine repayments of capital are different. Partner remuneration is not employee salary for section 192.

Worked example: The covered credits total ₹18,000 + ₹12,000 = ₹30,000. Tax deduction at source is ₹3,000 when credited, even though the partner has withdrawn nothing.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 26 | Specified goods and mining leases

Section 206C(1), (1A), (1C)

Question trap: A business pays for a coal-mining lease, while another business buys coal for resale. The question also changes the buyer to a public-sector undertaking or a retail personal consumer.

Student mistake: A student uses the coal-sale rate for the mining lease and applies the same buyer exclusions to every tax collection at source provision.

Final result: For specified goods, tax collection at source rates are 1% for liquor; 5% for tendu leaves; 1% for scrap, coal, lignite and iron ore; and 2% for covered timber and forest produce. The other-forest-produce entry requires a forest lease and excludes tendu. A resident buyer's qualifying manufacturing-use declaration can provide relief; resale does not qualify. Section 206C(1) excludes retail purchases for personal consumption, unlike covered motor vehicles under section 206C(1F). Mining, parking and toll business leases generally attract 2%; public-sector lessees and mineral-oil mining are excluded. A coal sale to a public-sector undertaking can escape specified-goods tax collection at source, but an eligible buyer must still check section 194Q.

Worked example: A covered ₹2 crore coal-mine lease to a non-public-sector entity requires ₹4 lakh tax collection at source. A covered ₹10 lakh coal sale to an ordinary trader requires ₹10,000 tax collection at source.

Trap 27 | Expensive cars and notified goods

Section 206C(1F); Notification 36/2025

Question trap: A seller receives ₹12 lakh for a covered watch sold on 1 June 2025. Another buyer purchases a covered ₹12 lakh car solely for personal use. The question asks for tax collection at source.

Student mistake: A student collects tax only on the amount above ₹10 lakh or exempts the car because it is for personal use.

Final result: A covered motor vehicle or notified item valued above ₹10 lakh attracts 1% tax collection at source on the full consideration when received. Personal use does not automatically exempt the car. The notified-goods rule applies from 22 April 2025. Its categories include specified watches, art, collectibles, boats, helicopters, sunglasses, bags, shoes, sportswear, sports equipment, home-theatre systems and race or polo horses. Check whether the item falls within the notified description; a high price alone does not make every article covered.

Worked example: The covered ₹12 lakh watch requires ₹12,000 tax collection at source, not ₹2,000 on the excess. The covered ₹12 lakh personal-use car also normally requires ₹12,000 tax collection at source.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 28 | Foreign remittances and overseas tour packages ★★★★★

Section 206C(1G)

Question trap: One person remits ₹12 lakh abroad for medical treatment under Liberalised Remittance Scheme. Another pays ₹12 lakh for an overseas tour package. The question mentions a ₹10 lakh amount in both rules.

Student mistake: A student treats the first ₹10 lakh of an overseas tour package as exempt, just like the Liberalised Remittance Scheme remittance threshold.

Final result: Under the Liberalised Remittance Scheme, education or medical remittances normally attract 5% tax collection at source only on the annual excess over ₹10 lakh. Other Liberalised Remittance Scheme purposes attract 20% on that excess. From 1 April 2025, education remittances funded by a qualifying section 80E financial-institution loan have no tax collection at source. Overseas tour packages follow a different rule: collect 5% on the first ₹10 lakh and 20% on the excess. The first ₹10 lakh is a lower-rate slab, not an exemption. Check the authorised dealer's relief from duplicate collection when the tour seller has already collected tax at source.

Worked example: Medical Liberalised Remittance Scheme of ₹12 lakh requires ₹2 lakh × 5% = ₹10,000 tax collection at source. The ₹12 lakh tour requires ₹10 lakh × 5% + ₹2 lakh × 20% = ₹90,000.

Trap 29 | Advance-tax liability and instalments

Section 207-211

Question trap: A resident aged 65 has business income and ₹1 lakh advance-tax liability after adjustments. Another business computes income under section 44AE. The question asks whether either gets a special instalment exemption.

Student mistake: A student exempts every senior citizen or allows every presumptive taxpayer to pay only one instalment in March.

Final result: Advance tax becomes payable when liability after permitted adjustments is ₹10,000 or more. The senior-citizen exemption requires a resident individual aged 60 or more with no business or professional income. Section 209 normally reduces deductible or collectible tax, but not where payment or credit has occurred without required deduction, or receipt or debit has occurred without required collection. Normal cumulative instalments are 15% by 15 June, 45% by 15 September, 75% by 15 December and 100% by 15 March. Sections 44AD and 44ADA allow 100% by 15 March; section 44AE does not.

Worked example: For ₹1 lakh annual liability, pay fresh timely instalments of ₹15,000, ₹30,000, ₹30,000 and ₹25,000. Payment by 31 March still counts as advance tax, but interest for missed instalments may remain.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 30 | Section 234B: the 90% test and full shortfall ★★★★★

Section 234B

Question trap: A taxpayer liable to pay advance tax has assessed tax of ₹1 lakh after relevant credits and has paid ₹80,000 advance tax. Calculate one month's interest under section 234B from 1 April of the assessment year.

Student mistake: A student charges interest only on the ₹10,000 needed to reach 90%, instead of the whole unpaid balance.

Final result: First check that the taxpayer was liable to pay advance tax. The 90% figure decides whether section 234B generally applies; it is not the interest base. If advance tax is below 90% of assessed tax, charge interest on assessed tax minus advance tax. Reduce the relevant credits when finding assessed tax. Interest is 1% per month or part, generally from 1 April of the assessment year, with adjustments for later payments. Paying at least 90% may avoid section 234B, but instalment interest under section 234C may still apply.

Worked example: Advance tax of ₹80,000 is below 90% of ₹1 lakh. The interest base is ₹1 lakh - ₹80,000 = ₹20,000. One month's interest is ₹200, not ₹100.

Trap 31 | Section 234C: the 12% and 36% tolerance tests ★★★★★

Section 234C

Question trap: In a normal advance-tax instalment case, tax on returned income after the relevant credits is ₹1 lakh. The taxpayer pays ₹11,000 by 15 June. The question says that payment of at least 12% can avoid June interest.

Student mistake: A student calculates interest only on the ₹1,000 gap up to 12%, rather than the shortfall from the normal 15% instalment.

Final result: In normal instalment cases, June payment of at least 12% and September payment of at least 36% avoid the respective interest. If these tests fail, calculate the shortfall from 15% and 45%, respectively, at 1% for three months. For December, use the shortfall from 75% at 1% for three months. For March, use the shortfall from 100% at 1% for one month. Relief for earlier shortfalls caused by capital gains, specified casual income, first-time business or professional income, and dividends other than section 2(22)(e) requires payment in the remaining instalments, or by 31 March if none remain.

Worked example: June interest is (₹15,000 - ₹11,000) × 1% × 3 = ₹120. If ₹12,000 had been paid by 15 June, that instalment would attract no interest.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 32 | An amount agreed after tax must be increased first ★★★★★

Section 195A; 194J

Question trap: A company promises a resident professional ₹90,000 after tax. The agreement says that the company will bear the tax. The applicable deduction rate is 10%, the professional gives a valid permanent account number, and no other tax component applies.

Student mistake: A student deducts ₹9,000 from the promised ₹90,000, or pays ₹90,000 plus only ₹9,000 tax.

Final result: Section 195A increases an amount agreed after tax into its equivalent before tax. Divide the promised net amount by one minus the applicable deduction rate. Calculate tax on that increased amount. The professional must still receive the full agreed net amount. This calculation concerns a tax-bearing agreement; an ordinary fee quoted before tax does not need this increase. The employer's separate option to pay tax on non-monetary salary benefits has its own exception.

Worked example: The amount before tax is ₹90,000 ÷ 90% = ₹1,00,000. Deduct ₹10,000 and pay the professional ₹90,000. The company's total payment is ₹1,00,000.

Trap 33 | Goods and Services Tax: invoice credit versus advance ★★★★★

Section 194Q; Circular 13/2021

Question trap: An eligible buyer has already crossed ₹50 lakh purchases from a resident seller. It now credits an invoice for ₹10 lakh goods plus separately stated Goods and Services Tax of ₹1.80 lakh. Compare a separate case in which ₹11.80 lakh is paid as an advance before invoicing.

Student mistake: A student excludes the tax component from every advance, or includes separately stated tax even when deduction happens on invoice credit.

Final result: When deduction under section 194Q happens on credit and the agreement separately identifies the Goods and Services Tax component, exclude that component from the deduction base. If payment occurs before invoice credit, deduct on the whole advance because it cannot yet be identified with the tax component of a future invoice. The example assumes the annual purchase threshold is already crossed.

Worked example: On invoice credit, deduct ₹10 lakh × 0.1% = ₹1,000. On the separate advance, deduct ₹11.80 lakh × 0.1% = ₹1,180.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 34 | Cooling charges do not automatically become rent

Section 194C; 194-I; Circular 1/2008

Question trap: A company pays ₹2 lakh to a resident cold-storage company for preserving perishable goods. The customer gets no right to occupy a particular room or to use the machinery. The bill describes the amount as cooling charges.

Student mistake: A student sees a building and machinery and applies the 10% rent deduction rate.

Final result: Identify the actual arrangement. Where the service is preserving goods through cooling and storage is incidental, with no tenancy or right to use a defined space or machinery, the Central Board of Direct Taxes treats the charges as a contract under section 194C. A company contractor attracts 2%, subject to the ordinary conditions. A genuine agreement giving the customer a right to use premises must be examined separately as rent. The bill's description alone does not decide the section.

Worked example: Tax deduction is ₹2 lakh × 2% = ₹4,000 under section 194C. The student's ₹20,000 rent-based answer is incorrect for these facts.

Trap 35 | Medical treatment can be paid for by an insurer

Section 194J; Circular 8/2009

Question trap: A company administering medical-insurance claims pays ₹3 lakh directly to a resident hospital for treating insured patients. It acts for an insurance company. The hospital has a valid permanent account number and no lower-deduction certificate.

Student mistake: A student says that the administrator received no medical treatment, so the payment is merely a reimbursement with no professional-fee deduction.

Final result: Medical treatment is a professional service. For section 194J, the service need not be supplied personally to the payer. The Central Board of Direct Taxes specifically applies this section to insurance administrators paying hospitals to settle medical claims. First check the covered annual amount and recipient status. Here, the ₹50,000 annual professional-fee threshold is crossed. Use the 10% professional-service rate; hospital equipment does not turn medical treatment into a technical service taxable at 2%.

Worked example: The covered ₹3 lakh hospital payment requires ₹30,000 tax deduction. Treatment given to the patients rather than the administrator does not remove this obligation.

Chapter 12: Advance Tax, Tax Deducted at Source and Tax Collected at Source (continued)

PRACTICAL QUESTION TRAPS

Trap 36 | A business conference may include a personal benefit

Section 194R; Circulars 12/2022 and 18/2022

Question trap: A manufacturing company spends ₹25,000 on genuine product training for a resident dealer. It separately provides a ₹30,000 benefit for the dealer's spouse and a leisure outing. Values exclude Goods and Services Tax. Costs are clearly allocated, and the event is not a reward for achieving sales targets.

Student mistake: A student excludes the entire ₹55,000 because the invoice describes a business conference.

Final result: A genuine conference primarily held for dealer education, product discussion or similar business purposes is ordinarily outside section 194R. Separately identify leisure expenses, accompanying family costs and an extended personal stay. Those parts can be business-related benefits to the dealer. The day immediately before and the day immediately after the conference are not treated as an extended stay for this rule. Deduct 10% when the dealer's covered annual benefits exceed ₹20,000, and arrange the tax before releasing a benefit in kind.

Worked example: The covered personal benefit is ₹30,000. The normal tax requirement is ₹3,000. The genuine ₹25,000 training cost is excluded on these facts.

Trap 37 | Foreign sports fees use the special gross-income rule

Section 194E; 115BBA

Question trap: A foreign citizen who is non-resident receives ₹10 lakh for playing a sport in India during financial year 2025-26. The athlete spends ₹2 lakh on travel and coaching. Assume no surcharge, no treaty issue and a valid permanent account number.

Student mistake: A student deducts the expenses first and applies the 10% professional-fee deduction rate to the remaining ₹8 lakh.

Final result: Section 194E applies to covered income of a non-resident sportsman who is not an Indian citizen. The special deduction rate is 20%, with applicable surcharge and cess, at credit or payment, whichever happens first. There is no monetary threshold in this section. Under section 115BBA, expenses and allowances do not reduce this covered income. Do not give the resident professional-fee threshold or rate to this foreign sports payment.

Worked example: Use the full ₹10 lakh. Tax is ₹2 lakh plus 4% cess of ₹8,000, giving a deduction of ₹2,08,000. The ₹2 lakh expenses do not reduce the base.

Chapter 13: Returns of Income and Permanent Account Number

THEORY TRAPS

Trap 1 | Foreign assets: check ordinary residence first

Section 139(1)

Question trap: A resident individual has no taxable income but holds a foreign bank account or signing authority abroad. The question changes the residential status from ordinarily resident to not ordinarily resident.

Student mistake: A student applies the special foreign-asset filing rule to every resident, or ignores it because taxable income is nil.

Final result: This special filing rule applies to a resident and ordinarily resident person, not a resident but not ordinarily resident person. A foreign asset, financial interest, signing authority or specified beneficiary interest can require a return even without taxable income. An individual who is only a beneficiary gets the statutory exception where the asset's income is includible, under the Act, in the income of the person holding that asset as owner or otherwise. A person who is not ordinarily resident may escape this rule but still have another filing obligation. Decide residential status first, then test all applicable filing conditions.

Trap 2 | What an updated return cannot do

Section 139(8A)

Question trap: A taxpayer discovers an omitted deduction and wants an updated return to increase the refund. Another taxpayer receives a section 148A show-cause notice more than 36 months after the assessment year ends.

Student mistake: A student treats an updated return as another revised return that can reduce tax or increase a refund.

Final result: An updated return cannot report a loss, reduce tax liability, or create or increase a refund. Only one updated return is allowed for an assessment year. Check restrictions relating to specified proceedings, search or survey, prosecution and information communicated to the taxpayer. A section 148A show-cause notice issued after 36 months from the assessment year's end creates a specific bar. An order under section 148A(3) finding that it is not a fit case can remove that bar. The other conditions and the final time limit still apply.

Chapter 13: Returns of Income and Permanent Account Number (continued)

THEORY TRAPS

Trap 3 | A defective return is not immediately invalid

Section 139(9)

Question trap: The Assessing Officer informs a taxpayer that a return is defective and gives time to correct it. The taxpayer corrects it after that period but before the assessment is completed.

Student mistake: A student treats the return as invalid immediately when the defect notice arrives, with no possibility of correction or condonation.

Final result: A defective return normally gets 15 days from intimation for correction. The Assessing Officer can extend that period. Failure to correct the defect can make the return invalid. If the taxpayer corrects it late but before assessment, the officer may condone the delay. An updated return without proof of the required section 140B payment is also defective. Correcting a defect through this process is different from voluntarily filing a revised return.

PRACTICAL QUESTION TRAPS

Trap 4 | Nil tax can still require a return ★★★★★

Section 139(1); Rule 12AB

Question trap: A resident aged 40 has ₹8 lakh ordinary income under the default regime, and rebate makes tax nil. Another person has low income but large bank deposits or specified spending.

Student mistake: A student decides that a return is unnecessary whenever the final tax is nil or income is below the basic exemption.

Final result: Companies and firms must file even with nil income or losses. For other taxpayers, compare income with the basic exemption limit before reducing the specified exemptions and Chapter VI-A deductions. Separate filing triggers include current-account deposits above ₹1 crore; foreign-travel spending above ₹2 lakh; electricity spending above ₹1 lakh; business turnover above ₹60 lakh; professional receipts above ₹10 lakh; or savings-account deposits of ₹50 lakh or more. Tax deduction at source plus tax collection at source of ₹25,000 or more is another trigger; use ₹50,000 for resident individuals aged 60 or more. Each condition works independently, so a person need not meet all of them.

Worked example: The 40-year-old's ₹8 lakh income exceeds the default regime's ₹4 lakh basic exemption. A return is required even if the rebate makes final tax nil.

Chapter 13: Returns of Income and Permanent Account Number (continued)

PRACTICAL QUESTION TRAPS

Trap 5 | Due dates, revision and late fees

Section 139(1), 139(4)-(5), 234A, 234F

Question trap: A required filer with total income of ₹4.80 lakh pays all tax by the due date but files the return late. The question asks about interest, late fee and the last filing date.

Student mistake: A student assumes timely tax payment removes the filing fee, or gives a revised belated return a fresh time limit.

Final result: Normal statutory due dates are 31 July for other taxpayers; 31 October for companies, audit cases and covered partners of audited firms; and 30 November for section 92E cases and covered partners. For assessment year 2026-27, belated or revised filing ends on 31 December 2026 or completion of assessment, whichever is earlier. A belated return can be revised, but the same deadline applies. Late mandatory filing attracts a ₹5,000 fee, capped at ₹1,000 when total income is not above ₹5 lakh. Section 234A separately charges 1% per month or part on the applicable unpaid-tax amount.

Worked example: Because all tax was paid on time, section 234A interest may be nil. However, the late return still attracts a ₹1,000 fee because total income is ₹4.80 lakh.

Trap 6 | Late loss returns: set-off versus carry-forward ★★★★★

Section 139(3), 80, 71B, 32(2)

Question trap: A taxpayer files the first return late and reports a current short-term capital loss of ₹1 lakh against an otherwise eligible long-term capital gain of ₹1.50 lakh.

Student mistake: A student refuses the current-year set-off because a late loss return can restrict the carry-forward of losses.

Final result: Same-year set-off and carry-forward are separate questions. A timely loss return is required to carry forward ordinary business losses, speculation losses, section 35AD specified-business losses, capital losses and losses from owning and maintaining race horses. Late filing does not by itself deny an otherwise valid current-year set-off. House-property loss and unabsorbed depreciation escape this section 80 timing restriction, though their other conditions still apply. A valid revision of an originally timely return is different from filing the first return late.

Worked example: The permitted current short-term capital loss of ₹1 lakh can reduce the eligible ₹1.50 lakh long-term capital gain to ₹50,000. Separately test whether any remaining loss can be carried forward.

Chapter 13: Returns of Income and Permanent Account Number (continued)

PRACTICAL QUESTION TRAPS

Trap 7 | Updated return: the 48-month clock and extra tax ★★★★★

Section 139(8A), 140B(3)

Question trap: An eligible taxpayer wants to update the return for financial year 2025-26. The return is filed 30 months after the relevant assessment year ends, with a ₹1 lakh tax-plus-interest base.

Student mistake: A student starts the 48-month clock from the financial year's end or adds the filing fee to the additional-tax base.

Final result: The updated return limit is 48 months from the end of the relevant assessment year, subject to eligibility. Additional tax is 25% after the belated or revised deadline up to 12 months after assessment-year end. It is 50% after 12 and up to 24 months, 60% after 24 and up to 36 months, and 70% after 36 and up to 48 months. Apply the percentage to tax plus interest after the section 140B payment and refund adjustments. Pay fees separately; they are not part of this base.

Worked example: Financial year 2025-26 relates to assessment year 2026-27, which ends on 31 March 2027. The outer updated return date is 31 March 2031. At month 30, ₹1 lakh tax plus interest requires ₹60,000 additional tax, plus any fee.

Trap 8 | Insufficient payment: clear fees first

Section 140A, 140B

Question trap: Before filing, a taxpayer owes ₹20,000 tax, ₹3,000 interest and ₹1,000 fee, but pays only ₹10,000. The question asks how much tax remains unpaid.

Student mistake: A student reduces the full ₹10,000 from tax first and leaves the interest and fee unpaid.

Final result: First calculate tax, interest and fees after adjusting relevant advance tax, tax deduction at source, tax collection at source, relief and permitted credits. If a payment under section 140A is insufficient, adjust it against fees first, then interest, and only then tax. This order decides how much principal tax remains unpaid. An updated return also requires the additional tax under section 140B. Do not assume that an alternate minimum tax credit is available under the default regime.

Worked example: The ₹10,000 payment first clears the ₹1,000 fee and ₹3,000 interest. Only ₹6,000 remains for tax, so unpaid tax is ₹20,000 - ₹6,000 = ₹14,000.

Chapter 13: Returns of Income and Permanent Account Number (continued)

PRACTICAL QUESTION TRAPS

Trap 9 | Permanent account number: amount, mode and status

Section 139A, 139AA; Rules 114B/114BA

Question trap: A taxpayer pays a ₹60,000 hotel bill in cash. Another buys property whose consideration and stamp duty value are both exactly ₹10 lakh. The question asks where permanent account number must be quoted.

Student mistake: A student applies cash-only conditions to every permanent account number transaction or treats exactly ₹10 lakh as crossing the property threshold.

Final result: For specified hotel, restaurant, foreign-travel and foreign-currency payments, the above-₹50,000 permanent account number test applies to cash payments. Life-insurance premiums use an annual above-₹50,000 test. Property requires permanent account number if consideration or stamp duty value exceeds ₹10 lakh. Other goods or services use an above-₹2 lakh test per transaction; these two rules are not limited to cash. Annual cash deposits or withdrawals of ₹20 lakh or more have a separate Rule 114BA test. Follow the conditions for substituting Aadhaar for permanent account number; an enrolment ID is unavailable from 1 October 2024. Failure to complete mandatory linking can make permanent account number inoperative and affect refunds, tax deduction at source and tax collection at source, subject to specific relief.

Worked example: The ₹60,000 cash hotel bill crosses its permanent account number threshold. Annual life-insurance premium of ₹48,000 does not. Property consideration and stamp duty value both exactly ₹10 lakh do not cross the property threshold.

Chapter 13: Returns of Income and Permanent Account Number (continued)

PRACTICAL QUESTION TRAPS

Trap 10 | An updated return can change a later year too

Section 139(8A)

Question trap: A company timely reported a ₹3 lakh business loss for assessment year 2024-25. It later finds an omitted ₹4 lakh business receipt. The entire loss had reduced the next year's ₹5 lakh business profit. Assume both years meet the updated-return conditions.

Student mistake: A student corrects only the earlier year and leaves the later year's ₹3 lakh loss adjustment untouched.

Final result: A taxpayer who originally filed a timely loss return can file an eligible updated return that reports income. If the update reduces a loss, unabsorbed depreciation or minimum-tax credit carried into a subsequent year, an updated return must also be filed for each affected later year. Check the eligibility and time limit for each year. An updated return cannot itself remain a loss return under the law used in this book.

Worked example: The first year changes from a ₹3 lakh loss to ₹1 lakh income. The next year's income becomes ₹5 lakh instead of ₹2 lakh. Update both affected years.