1.3 MEANING OF TAX PLANNING, TAX AVOIDANCE, TAX EVASION AND TAX MANAGEMENT

Some of the important concepts of taxation are tax planning, tax avoidance, tax evasion and tax management which are explained below –

Tax Planning

Tax planning can be defined as an arrangement of one's financial and economic affairs by taking complete legitimate benefit of all deductions, exemptions, allowances and rebates and relief so that tax liability reduces to minimum. The benefits arising from tax planning are substantial particularly in the long run.

Tax Avoidance

Tax avoidance is reducing or negating tax liability of an assessee in legally permissible ways and has legal sanction. Tax avoidance is sound law and certainly not bad morality for anybody to so arrange his affairs in such a way that the brunt of taxation is the minimum. This can be done within the legal framework even by taking help of loopholes in the law. Tax avoidance is intentional tax planning before the actual tax liability arises. **Property of the assessee cannot be confiscated in tax avoidance as it is legal and not punishable.**

Tax Evasion

All methods by which tax liability is illegally avoided are termed as tax evasion. Tax evasion may involve concealment of any earned income, an untrue statement knowingly, submitting misleading documents, suppression of facts, not maintaining proper accounts of income earned (if required under law), omission of material facts on assessment. Tax evasion is illegal and punishable offence. Property of the assessee can be confiscated.

Tax Management

Tax management refers to the comply with the provision of law and relates to past (i.e., assessment proceedings, rectification, revision, appeals etc.), present (filing of return of income on time on the basis of updated records) and future (corrective action). As a result of effective tax management, penalty, penal interest, prosecutions etc can be avoided.

1.4 DEFINITIONS

Section 2 of the Income-tax Act gives definitions. Some of the relevant definitions are given below –

Income [Sec. 2(24)]

This term has not been defined in the Income-tax Act, except that it states as to what is included in income. Under this *section,* income includes:

- profits and gains;
- dividend;
- the value of any perquisite or profits in lieu of salary taxable under the head 'salaries';

- any special allowance or benefit, other than granted to the assessee to meet his expenses;
- any allowance granted to the assessee either to meet his personal expenses, e.g., City Compensatory Allowance;
- the value of any benefit or perquisite;
- any sum paid by any such company in respect of any obligation;
- any profits on sale of import license;
- cash assistance received or receivable under exports;
- any refundable custom duty or excise the value of any benefit or perquisite arising from business or exercise of profession;
- any capital gains.

Note: Income-tax does not make any distinction between income accrued or arisen from a legal source and income tainted with illegality.

WHAT IS ACCRUAL OF INCOME

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

WHAT IS INCOME DEEMED TO ACCRUE OR ARISE IN INDIA

(i) Income of an individual which falls under the head "Salaries" is deemed to accrue or arise in India if service is rendered in India

(ii) Salary received by Indian nationals from the Indian Government, out of India, is deemed to accrue or arise in India. By virtue of section 10(7), any allowance or perquisite paid abroad is, however, fully exempt from tax.

(iii) Dividend received by a shareholder from an Indian company is always deemed to accrue or arise in India.

(iv) Income by way of interest, royalty and technical fees - These are deemed to accrue or arise in India in the following cases –

Rule 1 - When received from Government - Interest, royalty or technical fees received from the Centralπ Government/any State Government, is deemed to accrue or arise in India.

Rule 2 - When received from a person resident in India - Interest, royalty or technical fees received from a residentπ person, is deemed to accrue or arise in India in the hands of recipient. However, this rule is not applicable in the following cases – a. if borrowed money is utilised by the payer for carrying on a business/profession outside India or for earning any income outside India; or b. payment of royalty/technical fees pertains to a business/profession carried on by the payer outside India or earning any income outside India.

Rule 3 - When received from a non-resident - Interest, royalty or technical fees received from a non-resident, is deemed to accrue or arise in India in the hands of recipient, in the following cases –

a. borrowed money is utilised by the payer for carrying on a business/profession in India; or

b. payment of royalty/technical fees pertains to a business/profession carried on by the payer in India or earning any income in India.

(v) Interest received outside India by a foreign bank from its branch in India - In the hands of recipient, income shall be deemed to accrue or arise in India.

Person [Sec. 2(31)]

The term "person" includes:

- an individual;
- a Hindu undivided family;
- a firm;
- a company;
- an association of persons or a body of individuals, whether incorporated or not;
- a local authority; and
- every artificial juridical person not falling within any of the preceding categories e.g., University of Delhi.

Assessee [Sec. 2(7)]

An assessee means a person:

- who is liable to pay any **tax;** or
- who is liable to pay any other sum of money under this Act (e.g., **interest, penalty,** etc.); or
- in respect of whom any **proceeding** under this Act has been taken for the assessment of his income; or
- in respect of whom any proceeding under this Act has been taken for the **amount of refund** due to him or to such other person; or
- who is **deemed** to be an assessee under any provision of this Act; or
- who is deemed to be an **assessee in default** under any provision of this Act.

Casual Income

Any receipt which is of a casual and non-recurring nature is casual income. It is an income the receipt of which is accidental and without a stipulation. It is in nature of an unexpected windfall.

Examples of casual income:

1. Winnings form lottery, crossword puzzles, card games and other games of any sort or form, gambling or betting of any form or nature;
2. Receipts even from habitual betting are non-recurring receipts and assessable as casual income.
3. Prize awarded for coin collection or stamp collection may be a casual income. This income is due to hobby.

Casual income does not include:

- Capital gains;
- Receipts arising from business or the exercise of a profession or occupation;
- Receipts by way of addition to remuneration of an employee;
- Voluntary payment received in exercise of an occupation, e.g., tips given in the ordinary way to taxi-drivers.

Note –

- Expenses are not deductible from casual incomes.
- Set-off of losses is not permitted against casual income.

Previous Year [Sec. 3]

Previous year is not defined under section 2 of the Income-tax Act. It is defined separately under section 3 of the Income-tax Act. Previous year means the financial year immediately preceding the assessment year. In simple words, it can be said that the year in which income is earned is known as previous year and the next year in which this income is taxable is known as assessment year. It will be the uniform previous year for all the assessees and for all sources of income. For newly set-up business or profession first previous year may be of less than 12 months.

Exceptions to the general rule (i.e., when income of previous year is not taxable in the immediately following assessment year):

The rule says the income of previous year is assessable as the income of the immediately following assessment year or in other words, it can be said that income of previous year is chargeable to tax in the next following assessment year.

The above rule, however, has certain exceptions which are given below:

1. **Income of non-resident from shipping:**
   Conditions to be satisfied:
   - The assessee is a non-resident who owns a ship or ship is chartered by a non-resident.
   - The ship carries passengers, livestock, mail or goods shipped at a port in India.
   - The non-resident may (or may not) have an agent/ representative in India.
2. **Income of persons leaving India either permanently or for a long period of time;**
3. Income of association of persons or a body of individuals or artificial juridical persons formed for short duration;
4. Income of a person trying to alienate his assets with a view to avoiding payment of tax; and
5. **Income of a discontinued business.**

In these cases, income of a previous year may be taxed as the income of the assessment year immediately proceeding the normal assessment year.

These exceptions have been incorporated in order to ensure smooth collection of income-tax from the aforesaid taxpayers who may not be traceable if tax assessment procedure is postponed till the commencement of the normal assessment.

Assessment year [Sec. 2(9)]

“Assessment year" means the period of twelve months commencing on the 1st day of April every year. The income earned during any year is taxable in the next year which starts from April 1. For example, income is earned during the year April 1, 2019 to March

31, 2020. It will be taxable in the next year which starts from April 1, 2020 and ends on March 31, 2021. Thus, the assessment year for the income in which income has been earned during the year previous year i.e., 2019-20 is 2020-21.
Therefore, year 2019-20 is known as previous year and year 2020-21 is known as assessment year for the previous year 2019-20.
In simple words, it can be said that the year in which assessment procedure of income is started and taxable is known as assessment year.

Maximum marginal rate [Sec. 2(29C)]
Maximum marginal rate means the rate of income-tax (including surcharge on income-tax, if any) applicable in relation to the highest slab of income in the case of an individual, association of persons or body of individuals, as specified in the Finance Act of the relevant year. For instance, for the assessment year 2020-21, the maximum marginal rate of tax for an individual assessee is 34.32% (tax rate @ 30% + surcharge @ 10% + cess @ 4%).

1.5 CHARGE OF INCOME TAX

Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate (or rates), income-tax at that rate (or those rates) shall be charged for that year in accordance with, and subject to the provisions of, this Act in respect of the total income of the previous year of every person.

Finance Act gives the tax rates every year and all the amendments in the Income Tax Act. Finance Act becomes an Act from the Finance Bill. Finance bill is a Money bill and is presented in the Lok Sabha on February 1 of every year by the Finance Minister. For some days, discussion on Finance bill takes place in Lok Sabha and Rajya Sabha. After the Finance bill is passed by both Lok Sabha and Rajya Sabha and after the assent of the President, the Finance bill becomes Finance Act.

Every Finance Act shows the proposals for the coming financial year. For instance, Finance Act 2019 shows the proposals for 2019-20 (i.e., April 1, 2019 to March 31, 2020). As far as tax rates are concerned, Part I of The First Schedule of the Finance Act 2019 shows the tax rates for the financial year 2018-19 and Part III of The First Schedule of the Finance Act 2017 shows the tax rates for the financial year 2019-20.

Similarly, Finance Act 2020 shows the proposals for 2020-21 (i.e., April 1, 2020 to March 31, 2021). As far as tax rates are concerned, Part I of The First Schedule of the Finance Act 2019 shows the tax rates for the financial year 2019-20 and Part III of The First Schedule of the Finance Act 2020 shows the tax rates for the financial year 2020-21.

Part III of The First Schedule of current year’s Finance Act becomes Part I of The First Schedule of next year’s Finance Act. For instance, Part III of The First Schedule of the Finance Act 2019 becomes Part I of The First Schedule of the Finance Act 2020.

1.6 BASIC PRINCIPLES OF INCOME-TAX

Following are some basic principles of income-tax:

1. Income tax is an annual tax on Total income.

2. Tax rates are fixed by the annual Finance Act.

3. Tax is charged on the total income of every person computed in accordance with the provisions of this Act.

4. Income tax is to be deducted at source or paid in advance as provided under provisions of the Act.

5. Total income is computed on the basis of residential status of the assessee.

1.7 COMPUTATION OF TOTAL INCOME

Taxable income of any assessee is computed as per the format given below –

Computation of net taxable income/ total income of an assessee for the assessment year 2020-21:

	Particulars	***Amount (Rs.)***
	1. Income under the head "Salaries"	X
	2. Income under the head "House Property"	X
	3. Income under the head "Profits and gains of business or profession"	X
	4. Income under the head "Capital Gains"	X
	5. Income under the head "Income from other sources"	X
	Gross total income (GTI) [sum of 1 to 5]	XXXXX
Less:	Deductions under chapter VIA [Sec. 80]	XX
	Net taxable income or Total income (NTI)	XXX

Rounding off of income [Sec. 288A]

The taxable income shall be rounded off to the nearest multiple of ten rupees and for this purpose any part of a rupee consisting of paise shall be ignored and thereafter, if such amount is not a multiple of ten, then, if the last figure in that amount is five or more, the amount shall be increased to the next higher amount which is a multiple of ten and if the last figure is less than five, the amount shall be reduced to the next lower amount which is a multiple of ten.

1.8 COMPUTATION OF TAX LIABILITY

Tax to be paid by any assessee is computed as per the format given below –

Computation of tax liability of an assessee for the assessment year 2018-19:

	Particulars	*Amount (Rs.)*
A-	Income taxable at Special Rate:	XX
B-	Income taxable at Normal Rate	XX
	Income-tax on net taxable income	XXXX
Less:	Rebate under section 87A (if any)	XX
		XX
Add:	Surcharge (% of income-tax)	XX
	Total (a)	XX
Add:	Education Cess (EC) @ 2% on (a)	XX
Add:	Secondary and Higher Education Cess (SHEC) @ 1% on (a)	XX
Add:	Health cess @1% on (a)	X
	Total	XX
Less:	Relief under section 89	XX
	Tax Liability	XX
Add:	Interest/ Penalty etc.	XX
Less:	Pre-paid taxes [i.e., advance tax, self-assessment tax, TDS, TCS, MAT credit]	XX
	Tax Payable	XXX

1.9 TAX RATES, REBATE, SURCHARGE AND CESS FOR THE ASSESSMENT YEAR 2020-21

Tax Rates for "Individuals"

*Situation 1: For a **resident senior citizen** (who is **60 years or more** at any time during the relevant previous year 2019-20 but **less than 80 years** on the last day of the relevant previous year 2019-20):*

Annual net taxable income	*Tax*
Up to Rs. 3,00,000	Nil
Rs. 3,00,001 – Rs. 5,00,000	5% of income exceeding Rs. 3,00,000
Rs. 5,00,001 – Rs. 10,00,000	Rs. 10,000 + 20% of income exceeding Rs. 5,00,000
Above Rs. 10,00,000	Rs. 1,10,000 + 30% of income exceeding Rs. 10,00,000

*Situation 2: For a **resident super senior citizen** (who is **80 years or more** at any time during the relevant previous year 2019-20):*

Annual net taxable income	*Tax*
Up to Rs. 5,00,000	Nil
Rs. 5,00,001 – Rs. 10,00,000	20% of income exceeding Rs. 5,00,000
Above Rs. 10,00,000	Rs. 1,00,000 + 30% of income exceeding Rs. 10,00,000

*Situation 3: For any **other resident individual** (who is less than 60 years of age at any time during the relevant previous year 2019-20), any **non-resident individual**, every **HUF**/ AOP/ BOI/ artificial juridical person:*

Annual net taxable income	*Tax*
Up to Rs. 2,50,000	Nil
Rs. 2,50,001 – Rs. 5,00,000	5% of income exceeding Rs. 2,50,000
Rs. 5,00,001 – Rs. 10,00,000	Rs. 12,500 + 20% of income exceeding Rs. 5,00,000
Above Rs. 10,00,000	Rs. 1,12,500 + 30% of income exceeding Rs. 10,00,000

FIRM - A partnership firm (including a limited liability partnership firm) is taxable at the rate of 30 per cent (no exemption limit).

COMPANY - A domestic company is taxable at the rate of 30 per cent‡ and a non-domestic company is taxable at the rate of 40 per cent. Dividend distribution is taxable at the rate of 15 per cent.

Rebate of tax in case of certain individuals [Sec. 87A]
A resident individual (whose taxable income does not exceed Rs. 5 lakhs (i.e., GTI *minus* deductions under section 80C to 80U)) can claimπ a rebate under section 87A from income-tax. The amount of rebate is income-tax on total income or Rs. 12,500, whichever is less.
This rebate is available from income tax (before adding surcharge and cess).

Surcharge

	Net income range	**Surcharge (as % of income-tax)**
Individuals /HUF /AOP /BOI /artificial juridical person	**Upto Rs.50 lakh**	**Nil**
	Rs. 50 lakh-Rs. 1 crore	**10%**
	Rs. 1 crore-Rs. 2 crores	**15%**
	Rs.2 crore-Rs.5 crore	**25% [Note: 1]**
	Above Rs.5 crore	**37% [Note: 1]**
Firm /co-operative society /local authority	**Upto Rs.1 crore**	**Nil**
	Above Rs.1 crore	**12%**
Domestic Company	**Upto Rs. 1 crore**	**Nil**
	Rs. 1 crore-Rs. 10 crore	**7%**
	Above Rs.10 crore	**12%**
Foreign Company	**Upto Rs. 1 crore**	**Nil**
	Rs. 1 crore-Rs. 10 crore	**2%**
	Above Rs.10 crore	**5%**

Note: 1

†In the case of a company, tax liability cannot be less than minimum alternate tax. In the case of a non-corporate assessee, tax liability cannot be less than alternate minimum tax [see para 194.2].

‡ If a few conditions are satisfied a domestic company has an option to pay tax at the rate of (a) 25 per cent under section 115BA, (b) 22 per cent under section 115BAA or (c) 15 per cent under section 115BAB. Besides, a domestic company (whose turnover/gross receipt during the previous year 2017-18 does not exceed Rs. 400 crore) is taxable at the rate of 25 per cent for the assessment year 2020-21.

Health and Education Cess:

Amount of income-tax and surcharge shall be increased by health and education cess which is 4 per cent of (income-tax + surcharge) which are as under:

i. Education Cess (EC)
   2% of (income tax after deducting rebate under section 87A and after adding surcharge)
ii. Secondary and Higher Education Cess (SHEC)
   1% of (income tax after deducting rebate under section 87A and after adding surcharge)
iii. Health Cess:
   1% of (income tax after deducting rebate under section 87A and after adding surcharge)

Marginal relief

Surcharge is subject to marginal relief.

- In case of an individual assessee, if net income exceeds Rs. 50 lakhs, the amount payable as income tax and surcharge shall not exceed the total amount payable as income-tax on total income of Rs. 50 lakhs by more than the amount of income that exceeds Rs. 50 lakhs.
- In case of any assessee, if net income exceeds Rs. 1 crore, the amount payable as income tax and surcharge shall not exceed the total amount payable as income-tax on total income of Rs. 1 crore by more than the amount of income that exceeds Rs. 1 crore.
- In case of a company assessee, if net income exceeds Rs. 10 crore, the amount payable as income tax and surcharge shall not exceed the total amount payable as income-tax on total income of Rs. 10 crore by more than the amount of income that exceeds Rs. 10 crore.

1.10 SPECIAL RATES OF TAX ON CERTAIN INCOMES

Some incomes under the Income Tax Act are taxable at special rates. While applying tax on these incomes, exemption slab applicable for an assessee is of no use. It means even if income of an individual assessee is less than Rs. 2,50,000 (i.e., exempted slab of an individual assessee who is less than 60 years of age) or Rs. 3,00,000 (i.e., exempted slab of a resident senior citizen who is less than 80 years of age but more than 60 years of age) or Rs. 5,00,000 (i.e., exempted slab of a resident super senior citizen who is 80 years or more of age), these incomes are taxable at flat rate given below –

1. Long term capital gain is taxable at a flat rate of 20%.
2. Short term capital gain covered under section 111A is taxable at a flat rate of 15%.
3. Casual incomes (viz., gambling, lottery, betting, etc.) is taxable at a flat rate of 30%.

1.11 ROUNDED OFF OF TAX

Rounding of tax (Sec. 288B)-
The amount payable by the assessee and the amount of refund due, under the provisions of the Act shall be rounded off to the nearest ten rupees

1.12 MISCELLANEOUS PROVISIONS

Exemption and Deduction – Difference
If an income is exempt from tax, it is not included in the computation of income. Exemption can never exceed the amount of income. Deduction is generally given from income chargeable to tax. Deduction can be less than or equal to more than the amount of income. If the amount deductible is more than the amount of income, the resulting amount will be taken as loss.

Method of Accounting
Mainly there are two types of accounting methods – mercantile system and cash system. Under the mercantile system, income and expenditure are recorded at the time of occurrence during the previous year. Under the cash system, revenue and expenses are recorded only when received or paid.

Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" is to be computed in accordance with the method of accounting regularly employed by the assessee.

In case of income chargeable under the heads "Salaries", "Income from house property" and "Capital gains", method of accounting adopted by the assessee is not relevant in calculating taxable income. For calculating taxable income under these heads, one has to follow the statutory provisions of the Income-tax Act which expressly provide whether revenue (or expenditure) is taxable (or deductible) on "accrual basis" or "cash basis".

1.13 SUMMARY

In this chapter, we have discussed the basics of tax. These basics will be applicable in studying other chapters.

Books recommended –

1. *Singhania, V.K. and Singhania, Monica [2018], Students' Guide to Income Tax (University Edition), Taxmann Publications (P) Ltd.*

2. *Ahuja, Girish and Gupta, Ravi [2018], Simplified Approach to Income Tax (University Edition), Flair Publications Pvt. Ltd.*

LESSON 2

AGRICULTURAL INCOME

STRUCTURE OF THE CHAPTER

2.1 OBJECTIVES

This chapter explains the provisions of Income Tax Act applicable for agricultural income earned by the assessees.

2.2 DEFINITION OF AGRICULTURAL INCOME

Agricultural Income [Sec. 2(1A)]

"Agricultural income" means:

1. Any rent or revenue derived from land which is situated in India and is used for agricultural purposes;

2. Any income derived from land (which is situated in India and is used for agricultural purposes) by agricultural operations.
   Following are the three instances of this type of agricultural income:
   a. Any income derived by agriculture from land situated in India and used for agricultural purposes;
   b. Any income derived by a cultivator or receiver of rent-in-kind of any process ordinarily employed to render the produce raised or received by him to make it fit to be taken to market; or
   c. Any income derived by such land by the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him in respect of which no process has been performed other than a process of the nature described in (b).

3. Income from farm building

Note –

Capital gain arising from the transfer of agricultural land shall not be treated as agricultural income.

Partly agricultural incomes:

Income[1]	*Non - agricultural income*	*Agricultural income*
Growing and manufacturing tea in India	40%	60%
Sale of centrifuged latex or cenex or latex based crepes	35%	65%
Sale of coffee grown and cured by seller	25%	75%

2.3 SCHEME OF PARTIAL INTEGRATION

Agricultural income in India is not chargeable to tax which mean totally exempt from tax. However, agricultural income is taken into consideration while computing the tax on non-agricultural income of an assessee. This is known as scheme of partial integration.

The scheme of partial integration of non-agricultural income with agricultural income is applicable if the following conditions are satisfied:

1. The taxpayer is an individual, a HUF, a body of individual, an association of persons or an artificial juridical person.
2. The taxpayer has non-agricultural income exceeding the amount of exemption limit [i.e., Rs. 5,00,000 (in the case of a resident super senior citizen who is 80 years or more), Rs. 3,00,000 (in the case of a resident senior citizen who is 60 years or more), and Rs. 2,50,000 (in the case of any other individual or every HUF) for the relevant previous year].
3. The agricultural income of the taxpayer exceeds Rs. 5,000.

If the above conditions are satisfied, then the scheme of partial integration of tax on non-agricultural income with income derived from agriculture is applicable.
It is to be noted that this scheme is NOT applicable in the case of a firm, company, co-operative society etc.

Procedure of computing tax as per the scheme:

Step 1: Net agricultural income is to be computed as if it were income chargeable to income-tax.

Step 2: Agricultural and non-agricultural income of the assessee will then be aggregated and income-tax is calculated on the aggregate income as if such aggregate income were the total income.

Step 3: The net agricultural income will then be increased by the amount of exemption limit (i.e., the first slab of income on which tax is charged at *nil* rate) and income-

[1] Income in respect of the business given above is, in the first instance, computed under the Act as if it were derived from business after making permissible deduction. 40% or 35% or 25% of the income so arrived at is treated as business income and the balance is treated as agricultural income. Salary and interest received by a partner from a firm is taxable only to the extent of 40% or 35% or 25% and the balance is treated as agricultural income.

tax is calculated on net agricultural income, so increased, as if such income was the total income of the assessee.

Step 4: The amount of income-tax determined at step 2 will be reduced by the amount of income-tax determined under step 3.

Step 5: Find out the balance. In the balance so arrived, add surcharge and cess. It is to be noted that for applicability of surcharge, non-agricultural income is considered.

Step 6: This will be the total income-tax payable by the assessee.

2.4 SUMMARY

In this chapter, we have discussed the tax aspect of agricultural income. Though agricultural income earned in India is exempt from tax, it is still included while computing income tax of an assessee for other incomes earned by him. It is to be remembered that agricultural income earned outside India is not treated as an agricultural income earned in India and thus, such incomes are fully taxable in India.

2.5 EXERCISE

The working notes given below in the solutions of unsolved questions are only for clarity purposes and for solving some typical concepts. However, in the final examination, students are expected to be more cautious in preparing working notes. Working notes in the examination must mention the concepts along with numerical calculation.

Problem 1 –
For the assessment year 2020-21, Mrs. X (Date of birth: Sept. 1, 1950) furnishes the following information:

	Amount (Rs.)
Gross agricultural income	*12,21,000*
Expenditure on earning agricultural income	*90,000*
Non-agricultural income (Gross total income)	*4,00,000*

Determine the tax liability of Mrs. X for the assessment year 2020-21 on the assumption that she contributes Rs. 60,000 towards PPF and pays insurance premium of Rs. 90,000 on her life insurance policy (sum assured: Rs. 1,50,000).

Solution:
Mrs. X is a senior Citizen.

Computation of taxable income of Mrs. X for the assessment year 2020-21:

		Amount (Rs.)
	Gross total income	4,00,000
Less:	Deduction under section 80C (60,000 + 30,000)	90,000
	Net taxable income	3,10,000

In the present case, assessee is a senior citizen whose non-agriculture income is more than the exemption limit of Rs. 3,00,000 and net agriculture income i.e., Rs. 11,31,000 which is more than Rs. 5,000. So, tax has to be computed as per the scheme of partial integration which is as follows:

Step 1: Net agricultural income is to be computed as if it were income chargeable to income-tax. Agricultural and non-agricultural income of the assessee will then be aggregated and income-tax is calculated on the aggregate income as if such aggregate income were the total income. Thus, total income including agricultural income is Rs. 14,41,000 (Rs. 3,10,000 + Rs. 11,31,000).
Tax on Rs. 14,41,000 is Rs. 2,42,300 [1,10,000 + 30% (14,41,000 – 10,00,000)]

Step 2: The net agricultural income will then be increased by the amount of exemption limit (i.e., the first slab of income on which tax is charged at *nil* rate) and income-tax is calculated on net agricultural income, so increased, as if such income was the total income of the assessee.

		Amount (Rs.)
	Agriculture income	11,31,000
Add:	Exemption limit in case of resident senior citizen	3,00,000
	Total	14,31,000

Tax on Rs. 14,31,000 is Rs. 2,39,300 [1,10,000 + 30% (14,31,000 – 10,00,000)]

Step 3: The amount of income-tax determined at step 1 will be reduced by the amount of income-tax determined under step 2 and find out the balance.

		Amount (Rs.)
	Tax in step 1	2,42,300
Less:	Tax in step 2	2,39,300
	Balance (Step 1 minus step 2)	3,000

Step 4: From the balance so arrived, give rebate under section 87A (if applicable), add surcharge and cess and deduct prepaid taxes (if any). This will be the total income-tax payable by the assessee. It is to be noted that for applicability of rebate and surcharge, non-agricultural income is considered.

		Amount (Rs.)
	Balance	3,000
Less:	Rebate under section 87A(if Non-agri total income does not exceeds Rs.5,00,000)	2,500
		500
Add:	Cess @ 3%	15
	Tax payable	515
	Rounded off Rs. 520	

Note –

It is assumed that policy is issued on or after April 1, 2012 and thus, maximum limit of deduction for life insurance premium is 20% of sum assured.

Problem 2 –

From the following information, calculate tax liability of X, a resident and ordinarily resident in India, for the assessment year 2020-21:

	Amount (Rs.)
Income from house property	*1,60,000*
Income from growing and manufacturing tea in India	*1,00,000*
Share of profit from a firm carrying agricultural business in India	*1,20,000*
Donation to Prime Minister's National Relief Fund	*40,000*

Solution:

	Particulars	Non-agricultural income (Rs.)	Agricultural income (Rs.)
	Income from house property	1,60,000	----
	Tea business [40%; 60%]	40,000	60,000
	Share of profit from firm [Exempt U/S 10(2A)]	Exempt	Exempt
	Gross total income	2,00,000	60,000
Less:	Deduction U/S 80G	40,000	----
	Net taxable income	1,60,000	60,000

Here, tax liability is nil because scheme of partial integration is not applicable as non-agriculture income (i.e., Rs. 1,60,000) is less than the exemption limit of Rs. 2,50,000.

Notes –

In case of income related to growing and manufacturing tea in India, 40% income is treated as non-agriculture income and 60% is treated as agricultural income.

Problem 3 –

'X' is a non-resident for 2019-20. He earned the following incomes during the previous year in India:

- a. *Net agricultural income: Rs. 5,40,000*
- b. *Income from business: Rs. 3,00,000*
- c. *Income from other sources: Rs. 2,60,000*

He made the following donations during the previous year:

- a. *Donations to Prime Minster Relief Fund: Rs. 20,000*
- b. *Donation to Charitable Trust: Rs. 40,000*
- c. *Donation to Delhi Government for promoting family planning: Rs. 30,000*

Compute the tax liability of 'X' for the assessment year 2020-21.

Solution:

Computation of taxable income of X for the assessment year 2020-21:

	Amount (Rs.)
Business income	3,00,000
Income from other sources	2,60,000

	Gross total income	5,60,000
Less:	Deduction U/S 80G (W.N. – 1)	63,000
	Net taxable income	4,97,000
	Add: Net agricultural income	5,40,000
		10,37,000

In the present case, assessee is an individual whose non-agriculture income is more than the exemption limit of Rs. 2,50,000 and net agriculture income (i.e., Rs. 5,40,000) is more than Rs. 5,000. So, tax has to be computed as per the scheme of partial integration which is as follows –

Step 1: Net agricultural income is to be computed as if it were income chargeable to income-tax. Agricultural and non-agricultural income of the assessee will then be aggregated and income-tax is calculated on the aggregate income as if such aggregate income were the total income. Thus, total income including agricultural income is Rs. 10,37,000 (Rs. 4,97,000 + Rs. 5,40,000).
Tax on Rs. 10,37,000 is Rs. 1,23,600 [1,12,500 + 30% on Rs. 37,000 (10,37,000 – 10,00,000)]

Step 2: The net agricultural income will then be increased by the amount of exemption limit (i.e., the first slab of income on which tax is charged at *nil* rate) and income-tax is calculated on net agricultural income, so increased, as if such income was the total income of the assessee.

		Amount (Rs.)
	Agriculture income	5,40,000
Add:	Exemption limit in case of non-resident	2,50,000
	Total	7,90,000

Tax on Rs. 7,90,000 is Rs. 70,500 i.e., [12,500 + 20% (7,90,000 – 5,00,000)]

Step 3: The amount of income-tax determined at step 1 will be reduced by the amount of income-tax determined under step 2 and find out the balance.

		Amount (Rs.)	
	Tax in step 1		1,23,600
Less:	Tax relief on agriculture income as per step 2	70,500	
	Balance tax amount	53,100	

Step 4: From the balance so arrived, give rebate under section 87A (if applicable), add surcharge and cess and deduct prepaid taxes (if any). This will be the total income-tax payable by the assessee. It is to be noted that for applicability of rebate and surcharge, non-agricultural income is considered.

		Amount (Rs.)
	Balance tax amount	53,100
Less:	Rebate under section 87A	Nil
		53,100
Add:	Cess @ 4% on Rs.53,100	2124

		55,224
	Tax payable (Rounded off)	55,220

Note –W.N-1

Section 80G:

A-No limit (100%):

Relief fund [20,000*100%]		20,000	
B-Limits:			
Limit is 10% of adjusted GTI i.e., 10% of 5,60,000 i.e., 56,000			
Family Planning [100% of 30,000]	30,000		
Other purpose [50% of 26,000*]	13,000	43,000	63,000

Problem 4 –

Mr. A is resident but not ordinarily resident in India, age 62 years, earned a net agricultural income of Rs. 4,00,000 during the previous year 2019-20. Compute his tax liability assuming that he has non-agricultural income of Rs. 8,50,000 and he contributes Rs. 90,000 towards Public Provident Fund.

Solution:

Computation of taxable income of A for the assessment year 2020-21:

		Amount (Rs.)
	Gross total income being non-agri.income	8,50,000
Less:	Deduction U/S 80C	90,000
	Net taxable income	7,60,000
Add:	Net agricultural income	4,00,000

	Total Income	11,60,000

In the present case, assessee is an individual whose non-agriculture net taxable income (i.e., Rs. 7,60,000) is more than the exemption limit of Rs. 3,00,000 (resident senior citizen) and net agriculture income (i.e., Rs. 4,00,000) is more than Rs. 5,000. So, tax has to be computed as per the scheme of partial integration which is as follows:

Step 1: Net agricultural income is to be computed as if it were income chargeable to income-tax. Agricultural and non-agricultural income of the assessee will then be aggregated and income-tax is calculated on the aggregate income as if such

aggregate income were the total income. Thus, total income including agricultural income is Rs. 11,60,000 (Rs. 7,60,000 + Rs. 4,00,000).
Tax on Rs. 11,60,000 is Rs. 1,58,000 or [1,10,000 + 30% (11,60,000 – 10,00,000)]

Step 2: The net agricultural income will then be increased by the amount of exemption limit (i.e., the first slab of income on which tax is charged at *nil* rate) and income-tax is calculated on net agricultural income, so increased, as if such income was the total income of the assessee.

		Amount (Rs.)
	Agriculture income	4,00,000
Add:	Exemption limit in case of non-resident	3,00,000
	Total	7,00,000

Tax on Rs. 7,00,000 is Rs. 50,000 [10,000 + 20% (7,00,000 – 5,00,000)]

Step 3: The amount of income-tax determined at step 1 will be reduced by the amount of income-tax determined under step 2 and find out the balance.

		Amount (Rs.)
	Tax in step 1	1,58,000
Less:	Tax in step 2	50,000
	Balance tax	1,08,000

Step 4: From the balance tax so arrived, give rebate under section 87A (if applicable), add surcharge and cess and deduct prepaid taxes (if any). This will be the total income-tax payable by the assessee. It is to be noted that for applicability of rebate and surcharge, non-agricultural income is considered.

		Amount (Rs.)
	Balance	1,08,000
Less:	Rebate under section 87A	Nil
		1,08,000
Add:	Cess @ 4%	4320
	Tax payable	1,12,320

Books recommended –

1. *Singhania, V.K. and Singhania, Monica [2018], Students' Guide to Income Tax (University Edition), Taxmann Publications (P) Ltd.*

2. *Ahuja, Girish and Gupta, Ravi [2018], Simplified Approach to Income Tax (University Edition), Flair Publications Pvt. Ltd.*

LESSON 3

RESIDENTIAL STATUS

STRUCTURE OF THE CHAPTER

3.1 OBJECTIVES

Taxability of income depends upon the residential status of an assessee. Also, it depends whether the income earned is an Indian income or foreign income. This chapter is, thus, divided into two parts – first part shows determining the residential status of an assessee and second part shows tax incidence.

3.2 RESIDENCE AND CITIZENSHIP

The scope of total income of an assessee is determined with reference to his residential status in India in the previous year (Sec. 5). Tax incidence of an assessee depends upon his residential status rather than on his citizenship.

Residence and citizenship are two different things. The incidence of tax has nothing to do with citizenship. An Indian may be non-resident and a foreigner may be resident for income tax purposes. The residence of a person may change from year to year but citizenship cannot be changed every year.

Part I

3.3 DETERMINATION OF RESIDENTIAL STATUS OF AN ASSESSEE

How to determine the residential status of an INDIVIDUAL [Sec. 6]

An individual may be resident or non-resident. Further, if an individual is resident, he may be resident and ordinarily resident or resident but not ordinarily resident.

Following are the rules to determine the residential status of an individual:

a. ***Resident**: An individual is said to be resident in India during the relevant previous year if he/she satisfies at least basic condition*

b. ***Resident and ordinarily resident (ROR):** An individual is said to be resident and ordinarily resident in India during the relevant previous year if he/she satisfies basic condition and both the additional conditions.*

c. ***Resident but not ordinarily resident (RNOR):*** *An individual is said to be resident but not ordinarily resident in India during the relevant previous year if he/she satisfies basic condition but not additional conditions.*

d. ***Non-resident in India (NR):*** *An individual is said to be non-resident in India during the relevant previous year if he/she does not satisfy basic condition.*

Basic conditions [Sec. 6(1)]

(i) He is in India in the previous year for a period of 182 days or more;

or

(ii) He is in India for a period of 60 days or more during the previous year and 365 days or more during 4 years immediately proceeding the previous year.

Exceptions:

In the following two situations, basic condition (ii) is not applicable:

1. An **Indian citizen** who **leaves** India during the previous year
   - for the purpose of employment outside India; or
   - as a member of crew of an Indian ship.
2. An **Indian citizen** or a **person of Indian origin** who **comes** on a visit to India during the previous year.

Additional conditions [Sec. 6(6)]

a. He has been **resident** in India in at least 2 out of 10 previous years immediately proceeding the relevant previous year.
b. He has been in India for a period of 730 days or more during 7 years immediately proceeding the relevant previous year.

How to determine the residential status of a HUF

A Hindu undivided family (like an individual) is either resident in India or non-resident in India. A resident Hindu undivided family is either ordinarily resident or not ordinarily resident.

Following are the rules to determine the residential status of a Hindu undivided family:

a. **Resident in India**: A Hindu undivided family is said to be resident in India if control and management of its affairs are situated –
   - Wholly in India or
   - Partly in India and partly outside India

   It is to be noted that in order to determine whether a HUF is resident or non-resident, the residential status of the karta of the family during the previous year is not relevant. Residential status of the karta during the preceding years is considered for determining whether a resident HUF is "ordinarily resident" or not.

   A resident Hindu Undivided family is an ordinarily resident in India if karta or manager of the family satisfies the two additional conditions given above.

However, if kata or manager of a resident HUF does not satisfy the two additional conditions, the family is treated as resident but not ordinarily resident in India.

b. **Non-resident in India**: A Hindu undivided family is said to be non-resident in India if control and management of its affairs are situated wholly out of India.

How to determine the residential status of a FIRM AND an ASSOCIATION OF PERSONS

a. **Resident:** A partnership firm and an association of persons are said to be resident in India if control and management of their affairs, during the relevant previous year, are situated –
    - Wholly in India or
    - Partly in India and partly outside India

b. **Non-resident:** A partnership firm and an association of persons are said to be non-resident in India if control and management of their affairs, during the relevant previous year, are situated wholly out of India.

How to determine the residential status of a COMPANY

a. **Resident:** A company is said to be resident in India if:
    (i) it is an India company
    (ii) in case of any other company if its control and management during the previous year is situated wholly in India.
    (iii) Also, if a company is incorporated in India under the companies act, it will be considered as resident though it may be controlled and managed from outside India.

b. **Non-resident:** A company is said to be non-resident in India if it is neither an India company nor it is controlled and managed from India.

How to determine the residential status of every OTHER PERSON

a. **Resident:** Every other person is resident in India if control and management of its affairs, during the previous year, is situated –
    - Wholly in India or
    - Partly in India and partly outside India

b. **Non- resident:** Every other person is non-resident in India if control and management of its affairs, during the previous year, is situated wholly out of India.

3.4 RELATIONSHIP BETWEEN RESIDENTIAL STATUS AND INCIDENCE OF TAX

As per section 5 of the Income Tax Act, incidence of tax on asseessee depends on his residential status and also on the place and time of accrual or receipt of income.

Meaning of "INDIAN INCOME"

Any of the following three is an Indian income:

1. If income is received (or deemed to be received) in India during the previous year and at the same time it accrues or arises (or is deemed to accrue or arise) in India during the previous year.
2. If income is received (or deemed to be received) in India during the previous year but it accrues or arises (or is deemed to accrue or arise) outside India during the previous year.
3. If income is received outside India during the previous year but it accrues or arises (or is deemed to accrue or arise) in India during the previous year.

Meaning of "FOREIGN INCOME"

If the following two conditions are satisfied, then such income is "foreign income":

1. Income is not received (or not deemed to be received) in India and
2. Income does not accrue or arise (or is deemed to accrue or arise) in India.

Conclusions regarding taxability

1. ***Indian Income***

Indian income is always taxable in India irrespective of the residential status of the taxpayer.

2. ***Foreign Income***

Foreign income is taxable in the hands of resident (in case of a firm, an association of persons, a joint stock company and every other person) or resident and ordinarily resident (in case of an individual and a Hindu Undivided Family) in India. But, Foreign income is not taxable in the hands of non-resident in India.

<u>In the hands of **resident but not ordinarily resident** (RNoR) taxpayer, foreign income is **taxable only** in **any of the following two situations** –</u>

a. If it is business income and business is controlled wholly or partly from India, or
b. If it is professional income and profession is set up in India.

In any other case (like salary, rent, interest etc.), foreign income is not taxable in the hands of resident but not ordinarily resident taxpayers.

3.5 SUMMARY

This chapter explained the concept of residence and citizenship from income tax point of view. How to determine the residential status of an assessee is explained in detail in this chapter. Further, the students will be able to determine whether the income is an Indian income or foreign income.

3.6 EXERCISE 1: Long practical questions

The working notes given below in the solutions of unsolved questions are only for clarity purposes and for solving some typical concepts. However, in the final examination, students are expected to be more cautious in preparing working notes. Working notes in the examination must mention the concepts along with numerical calculation.

Problem 1 –
Mr. X, a foreign national (not being a person of Indian origin) came to India for the first time on 16-10-2019 for a visit of 190 days. He furnishes the following particulars of his income earned during the previous year relevant to the assessment year 2020-21:

		Amount (Rs.)
a.	Interest received from Government of India (Received outside India)	2,50,000
b.	Royalty received from a foreign company outside India (Paid for know-how used by payer organization in India)	1,00,000
c.	Income from agriculture in Bhutan remitted to India	3,00,000

Compute total income of Mr. X for the previous year 2019-20 relevant to the assessment year 2020-21.

Solution:
Mr. X is a non-resident for the assessment year 2020-21 as he does not satisfy any of the following basic conditions:

1. He was present in India during the previous year 2019-20 for 167 days [16+30+31+31+28+31] and not for 182 days, as required.
2. He was present in India for a period of 60 days or more during the previous year 2019-20 but not for 365 days or more during 4 years immediately preceding the previous year 2019-20 [i.e., during 2015-16 to 2018-19, he was not present in India as he came to India on 16-10-2019 for the first time].

Computation of total income of Mr. X (a non-resident) for the previous year 2019-20 relevant to the assessment year 2020-21:

Particulars	*Amount (Rs.)*
Indian Income (Interest received from Government of India is deemed to be accrued in India)	2,50,000
Indian Income (Royalty received from a non-resident is deemed to be accrued in India if it is paid for know-how used by the payer in India)	1,00,000
Foreign Income [Agriculture income accrued and received outside India, foreign income is not taxable for a non-resident assessee]	----
Total income	3,50,000

Problem 2 –
From the following information, compute gross total income of Mr. Y for the assessment year 2020-21 assuming Mr. Y is:

(i) Not ordinarily resident, and (ii) Non-resident.

	Amount (Rs.)
- *Pensions for services rendered in India but received in England*	*1,00,000*
- *Remuneration for consultancy service in Canada but half of that received in Mumbai*	*2,00,000*
- *Loss incurred in textile business carried on in Bangladesh but controlled from India*	*(75,000)*
- *Fees for technical services payable by Z, a non-resident (the payable relates to a business carried on in India)*	*3,00,000*

Solution:

Computation of total income of Mr. X (a non-resident) for the previous year 2019-20 relevant to the assessment year 2020-21:

Particulars	*(i)RNoR (Rs.)*	*(ii)NR (Rs.)*
Indian Income (Pension for services rendered in India)	1,00,000	1,00,000
Indian Income (Money received in India) Foreign Income (Remuneration for services accrued and received outside India)	1,00,000 Not taxable	1,00,000 Not taxable
Foreign Income (business income accrued and received outside India, but business is controlled from India)	(-75,000)	----
Indian Income (Fees for technical services payable by a non-resident is deemed to be accrued in India if payment of technical fees pertains to a business carried on in India	3,00,000	3,00,000
Total income	4,25,000	5,00,000

Problem 3 –

"Manan Sethia" is a citizen of India. He has been employed with an Indian company since 2013. On September 1, 2019 Manan left India to join employment in Germany with a foreign company. During the previous year 2019-20 his income included:

a. *Salary from an Indian company: Rs. 2,60,000*
b. *Salary from a foreign company: Rs. 4,70,000*
c. *Interest on bank deposits in India received in Germany: Rs. 1,30,000*

Find out Manan's total income chargeable to tax in India for the assessment year 2020-21.

Solution:

Since Manan left India for the purpose of employment outside India, he is covered under exceptional category of basic condition no. (2) of 60 days or more. It means basic condition of 60 days or more is not applicable for Manan Sethia.

Further, he was present in India for 154 days [April 30+ May 31+ June 30+ July 31+August 31+ Sept.1] during the previous year 2019-20. Thus, he does not satisfy the basic condition of 182 days or more and therefore, he will be **treated as non-resident** for the assessment year 2020-21.

Computation of taxable income:

	Amount (Rs.)
Indian Income (Salary from an Indian company)	2,60,000
Foreign Income (Salary from a foreign company)	Not taxable
Indian Income (Interest on bank deposits in India)	1,30,000
Total Income	3,90,000

Problem 4 –

Renuka Desai is a citizen of USA. She left India during 1989 and got permanently settled in New York. She was born in India in 1974 and her husband was also born in India in 1972. Her parents were born in UK prior to 1949; however, they migrated to India in 1969 and got permanently settled in Delhi. Renuka came to India on January 29, 2019 and stayed for 100 days. Before that also she had been coming to India for 100 days during every previous year since 1993. For the previous year 2019-20, she earned the following income/ loss:

i. *Income from salaries of services rendered in USA, received there: Rs. 7,96,000*
ii. *Income from house property in India received in USA: Rs. 2,84,000*
iii. *Interest on bank deposits in India received in USA: Rs. 3,60,000*
iv. *Loss from a business in India (controlled from USA): Rs. 1,10,000*
v. *Income from a business in Sri Lanka (controlled from India): Rs. 1,90,000*
vi. *Interest on bank deposits in USA subsequently remitted to India: Rs. 2,64,000*

Compute Renuka's total income and tax liability for the assessment year 2020-21, assuming that she is not entitled to deductions under section 80C to 80U.

Solution:

She is **Resident but not ordinarily resident** (RNoR) for the previous year 2019-20 as she satisfies the basic condition no. (ii) of 60 days or more during 2019-20 [3+28+31] and 365 days or more [400] during 4 years immediately preceding the relevant previous year.

Further he satisfies only one out of two additional conditions.

a. The additional condition which is satisfied is:

She is resident in India in at least 2 years out of 10 years immediately proceeding the relevant previous year.

b. The additional condition which is not satisfied is:

She is not present in India for a period of 730 days during 7 years immediately proceeding the relevant previous year.

She is not a person of Indian Origin and thus, not covered in exceptional category.

Computation of taxable income:

		Amount (Rs.)
i.	Foreign income (salary received and accrued outside India) [not taxable for RNoR]	--------
ii.	Indian income (income accrued in India)	2,84,000
iii.	Indian income (income accrued in India)	3,60,000
iv.	Indian income (business in India)	(1,10,000)
v.	Foreign income (accrued outside India; but business is controlled from India, taxable for RNoR)	1,90,000
vi.	Interest on bank deposit Remitted to India	-------
	Total Income	7,24,000

Computation of tax liability:

		Amount (Rs.)
	Tax on Rs. 7,24,000	57,300
Add:	Cess @ 4%	2,222
	Tax payable	59,522
Tax payble (rounded off)		59,520

Problem 5 –

Determine the residential status in the cases given below for the assessment year 2020-21:

i. *X Ltd., a foreign company, operates in India and all decisions regarding the affairs of its business are taken in India. However, a few decisions like fixation of managerial remuneration and appointment of CEO etc. are taken in London where the company is registered.*
ii. *Y (HUF), a Hindu Undivided Family, whose karta Y is a person of Indian origin. Y has been visiting India for 100 days every year since 2008-09. The family's business is controlled by a team of professionals in India under the guidance of Y.*
iii. *Mr. A is a citizen of Bangladesh. His maternal grandfather was born in a village near Dhaka in 1945. He comes to India for the first time since 1997-98 on October 4, for a visit of 200 days.*

Solution:

i. X Ltd. is a non-resident for the assessment year 2020-21. Though all decisions regarding the affairs of its business are taken in India, however, a few decisions like fixation of managerial remuneration and appointment of CEO etc. are taken outside India. It seems that place of effective management of X Ltd. in 2019-20 is outside India and thus, the **foreign company is non-resident.**

ii. Business of Y (HUF) is controlled by a team of professionals in India, thus, Y (HUF) is resident in India. To see whether Y (HUF) is ordinarily resident or not ordinarily resident, Y (Karta) has to satisfy two additional conditions –
   a. Basic condition no. (ii) of 60 days or more is not applicable for a person of Indian Origin who comes on a visit to India during the previous year.

So, to check whether he is resident or not, basic condition no. (i) of 182 days or more is relevant. Y (Karta) is not present for 182 days or more in any year and thus, he is non-resident in all the 10 years immediately preceding the relevant previous year. It means additional condition no. (i) is not satisfied.

b. Further, he was present only for 700 days during 2012-13 to 2018-19 and not 730 days or more, as required.

Y (Karta) does not satisfy any of the additional conditions and thus Y (Karta) is not ordinarily resident.

It implies that Y (HUF) is resident but not ordinarily resident (RNoR) for the assessment year 2020-21.

iii. Mr. A is non-resident for the previous year 2019-20. Mr. A is a person of Indian Origin as his grandparents were born in undivided India. Basic condition no. (ii) of 60 days or more is not applicable for a person of Indian Origin who comes on a visit to India during the previous year.

To become a resident, Mr. A has to satisfy basic condition no. (i) which states that a person must be present in India for a period of 182 days or more during relevant previous year. Mr. A is present only for 179 [28+30+31+31+28+31] days during the previous year 2019-20. He does not satisfy the eligible basic condition and thus, he is non-resident for the assessment year 2020-21.

Problem 6 –

Discuss whether the following incomes are taxable or not in India:

i. *A non-resident owns a residential house in Delhi which is given on rent to a foreign embassy. Rent is however, payable outside India in a foreign currency.*
ii. *Non-resident purchase goods from India and sells these goods abroad at profit.*
iii. *Interest on loan is paid by the govt. of India to a non-resident outside India.*
iv. *A non-resident owns commercial building in Mumbai which is transferred to another non-resident outside India. The consideration is payable in a foreign currency outside India.*
v. *C, a non-resident Indian, is presently appointed by the govt. of India in its embassy at Saudi Arabia; salary for rendering service is paid to him in foreign currency outside India.*

Solution:

i. **Taxable**, as it is accrued in India and thus, becomes an Indian income which is taxable for a non-resident.
ii. **Not taxable**, as profit is earned and received outside India and thus, a foreign income which is not taxable for a non-resident. It does not matter whether the goods have been purchased from India or not.
iii. **Taxable**, as interest paid by Government of India is assumed as an Indian income and thus, taxable for a non-resident.
iv. **Taxable**, as it is accrued in India and thus, Indian income which is taxable for a non-resident.

v. **Taxable,** as salary paid by the Indian Government to an Indian national is deemed to accrue or arise in India, even if service is rendered outside India. This provision is applicable only in respect of salary and not in respect of allowances and perquisites paid or allowed by the Government to Indian nationals working abroad, as such allowances and perquisites are exempt under section 10(7). C, though a non-resident, but an Indian national.

Problem 7 –

Mrs. Y is a foreign citizen. Her grandmother was born in Karachi on August 15, 1940. She came to India for the first time on November 3, 2019 for a period of 200 days. Her income for the previous year 2019-20 is as under:

i. *Income earned in Bangladesh but received in India Rs. 4,40,000.*
ii. *Income earned and received outside India Rs. 5,60,000.*
iii. *Royalty received in Germany from a resident of India for technical services provided for a business carried on in Germany Rs. 1,00,000.*
iv. *Agricultural income in Sri Lanka Rs. 5,00,000.*
v. *Dividend from Indian Company received in Pakistan Rs. 80,000.*
vi. *Profits of a business carried on in Pakistan but controlled from India Rs. 2,00,000 (out of which Rs. 50,000 is received in India).*

Solution:

Mrs. Y is a **Non-Resident** for the previous year 2019-20 as she does not satisfy the basis condition of presence for a period of 182 days or more. She was present in India for a period of 149 days (28+31+31+28+31) only during the previous year 2019-20.

Further, as she is a person of Indian Origin (because her grandmother was born in Undivided India), she is covered under the exception of basic condition no. (ii) Applicability. For a person of Indian Origin who comes on a visit to India during the previous year, basic condition no. (ii) of 60 days is not applicable.

<u>Computation of taxable income of Mrs. Y (a non-resident):</u>

		Amount (Rs.)
i.	Indian income (income received in India)	4,40,000
ii.	Foreign income (income received and accrued outside India)	----
iii.	Foreign income (royalty income received and accrued outside India)	----
iv.	Foreign income (accrued outside India) *[Though, agricultural income outside India is not exempt from tax]*	----
v.	Dividend income from an Indian company [exempt from tax]	----
vi.	Indian income (received in India)	50,000
vii.	Foreign income (received and accrued outside India)	----
	Total Income	4,90,000

Problem 8 –

Mr. Ramesh & Mr. Suresh are brothers and they earned the following income during the financial year 2019-20. Mr. Ramesh settled in Canada in the year 1997 and has not visited India since. Mr. Suresh is settled in Delhi and has never left India. Compute their total income for the assessment year 2020-21.

S. No.	Particulars	Mr. Ramesh (Rs.)	Mr. Suresh (Rs.)
1.	Interest on Canada Development Bonds (only 50% of interest received in India	35,000	40,000
2.	Dividend from British company received in London	28,000	20,000
3.	Profit from a business in Nagpur, but managed directly from London	1,00,000	1,40,000
4.	Income from a business in Chennai	80,000	70,000
5.	Fees for technical services rendered in India, but received in Canada	1,00,000	----
6.	Interest on savings bank deposit in SBI, Delhi	7,000	12,000
7.	Agricultural income from a land situated in Andhra Pradesh	55,000	45,000
8.	Rent received in respect of house property at Bhopal	1,00,000	60,000
9.	Life insurance premium paid	----	30,000

Solution:

For the assessment year 2020-21, Mr. Ramesh is **Non-resident** as he does not satisfy any of the (i) or (ii) basic condition and Mr. Suresh is **Resident and Ordinarily Resident** as he satisfies both, basic condition as well two additional conditions.

Computation of their total income for the assessment year 2020-21:

S. No.	*Particulars*	*Mr. Ramesh (Non-Resident) (Rs.)*	*Mr. Suresh (R&OR) (Rs.)*
1	Interest on Canada Development Bonds i. Indian income being interest received in India [50%] ii. Foreign income being interest received outside India[50%]	 17,500 ---------	 20,000 20,000
2	Foreign income [Dividend from British company received in London]	---	20,000
3	Indian income [Profit from a business in Nagpur, but managed directly from London]	1,00,000	1,40,000
4	Indian income [Income from a business in Chennai]	80,000	70,000
5	Indian income	1,00,000	1,00,000

	[Fees for technical services rendered in India, but received in Canada]		
6	Indian income [Interest on savings bank deposit in SBI, Delhi]	7,000	12,000
7	Indian income [Agricultural income from a land situated in Andhra Pradesh – (exempt u/s 10(1)]	Exempt	Exempt
8	Indian income [Rent received in respect of house property at Bhopal less standard deduction @ 30% (i.e., 1,00,000 – 30,000; 60,000 – 18,000)]	70,000	42,000
	Gross total Income	3,74,500	3,24,000
Less:	Deductions: u/s 80C u/s 80TTA	 ---- 7,000	 30,000 10,000
	Total Income	3,67,500	3,84,000

3.6 Exercise 2: Short theory questions

1. *When is a company to be treated as non-resident in India? Explain.*

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2. *How will you determine the residential status of Hindu undivided family? Explain.*

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3. When an Individual is said to be Resident and Ordinary Resident in India? Explain.

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Books recommended –

1. *Singhania, V.K. and Singhania, Monica [2018], Students' Guide to Income Tax (University Edition), Taxmann Publications (P) Ltd.*

2. *Ahuja, Girish and Gupta, Ravi [2018], Simplified Approach to Income Tax (University Edition), Flair Publications Pvt. Ltd.*

LESSON 4

INCOMES EXEMPT FROM TAX

STRUCTURE OF THE CHAPTER

4.1 OBJECTIVES

After studying this chapter, students will be able to learn the application of section 10 of the Income Tax Act. Section 10 explains the incomes which are exempt from tax. Some incomes are fully exempt and some incomes are partially exempt from tax.

4.2 EXEMPTED INCOMES

Some of the incomes exempt under section 10 (excluding exempt incomes under the head "Salaries") are –

1. Agricultural income
2. Share of income from Hindu Undivided Family [Sec. 10(2)]
3. Share of income/profits of a partner from his firm
4. Payment received by an individual under Bhopal Gas Leak Disaster Act
5. Educational Scholarships received by an individual [Sec. 10(16)]
6. Daily allowances of Members of Parliament [Sec. 10(17)]
7. Amount received on life insurance policy [Sec. 10(10D)]
8. Perquisites/allowances to Chairman/Members of UPSC [Sec. 10(45)]
9. Awards made by the Government in public interest
10. Income of scientific research association
11. Income of news agency
12. Income of Khadi and Village Industries
13. Income of SAARC
14. Income of IRDA
15. Income of mutual fund
16. Income of Swachh Bharat Kosh and Clean Ganga Fund
17. Partial withdrawal from NPS (to the extent it does not exceed 25% of an employee's contribution) is exempt from tax.
18. 40% of the total amount received on account of assessee's opting out of NPS or closing of NPS account.

Incomes exempt under the head "Salaries" are explained in chapter of "Salaries".

4.3 SUMMARY

Some of the examples of section 10 incomes are mentioned in the chapter.

Books recommended –

1. *Singhania, V.K. and Singhania, Monica [2018], Students' Guide to Income Tax (University Edition), Taxmann Publications (P) Ltd.*

2. *Ahuja, Girish and Gupta, Ravi [2018], Simplified Approach to Income Tax (University Edition), Flair Publications Pvt. Ltd.*

LESSON 5

Unit I

SALARIES - I

STRUCTURE OF THE CHAPTER

5.1 LEARNING OBJECTIVES

After studying this chapter, students will be able to compute the taxable amount of salary received by an employee from the employer.

5.2 BASICS

Section 15, 16 and 17 of the Act deals with the computation of income under the head "Salaries".

5.3 UNDERSTANDING SOME RELEVANT CONCEPTS

In order to understand the computation of income under the head "Salaries", the following relevant concepts need to be understood first:

1. Employer-employee relationship:
An income is taxable under the head "Income from Salaries" if there is a relationship between the payer and payee is of employer-employee or master and servant. If this relationship does not exist, then the income will not be taxable as salary income; it will be taxable under other heads of income.

Employer may be an individual, firm, association of persons, company, local authority, Central Government, State Government, etc. Likewise, employer may be operating in India or outside India. The employee may be a full-time employee or a part-time employee.

MPs or MLAs are not treated as employees of the Government. Thus, remuneration received by them is not taxable under the head "Income from Salaries" but taxable under the head as "Income from other sources".

However, pay and allowances received by the Chief Minister of a State are assessable as salary and not as income from other sources, in view of the provisions of article 164(5) of the Constitution.

Note: Any salary, bonus, commission or remuneration, by whatever name called, due to/ received by, a partner of a firm from the firm shall not be taxable under the head "Income from Salaries" because there is no employer-employee relationship between firm and its partners. Such remuneration, however, is taxable under the head "Profits and gains from business or profession" in the hands of partners.

2. No difference between salary and wages –
Conceptually, there is no difference between 'salary' and 'wages', both being a payment for work done or services rendered.

3. Arrears of salary –
Salary due to an assessee in the earlier years, which was neither paid nor was charged to tax in those years, will have to treated as 'arrears of salary' and thus, taxable under the head "Income from Salaries". It is taxable on receipt basis. In this case recipient can claim relief u/s 89.

4. Advance salary – [Sec. 17 (1) (v)]
Salary received in advance is taxable in the year of receipt. It will not be taxable again in the relevant year in which it becomes due. In this case the recipient, however, can claim relief u/s 89.

5. Salary paid by foreign Government –
Salary paid by a foreign Government to its employees serving in India is taxable under the head "Income from Salaries".

6. Salary from more than one employer –
Salary received by an employee from more than one employer during the same previous year, then total salary received from all employers is taxable under the head "Income from Salaries".

7. Salary from former employer, present employer or prospective employer –
Salary received (or due) during the previous year is chargeable to tax under the head "Income from Salaries" irrespective of the fact whether it is received from a former, present or prospective employer.

8. Tax-free salary –
If Tax-free salary is paid by the employer, the employee has to include in his taxable income not only the salary received but also the amount of tax paid by the employer on this tax-free salary income of the employee.

9. Foregoing of salary –
Once salary is earned by the employee, it becomes taxable in his hands though he may subsequently waive the right to receive the same from his employer. Such voluntary waiver or foregoing by an employee of salary due to him is merely an application of income and is chargeable to tax under the head "Income from Salaries".

10. Place of accrual – [Sec.9(1)]
Income under the head "Income from Salaries" is deemed to accrue or arise at the place where the service (in respect of which it accrues) is rendered. If the services are rendered in India and if the salary in respect of such service is received outside India, it will be treated as an income which is deemed to accrue or arise in India.
Similarly, if a person, who after rendering services in India, retires and settles abroad, receives any pension on account of the same, such pension shall be an income which is deemed to accrue or arise in India because the services on account of which pension accrues, were rendered in India.
There is, however, an exception to the above rule. Salary payable by the Government of India to a citizen of India for services outside India is treated as income deemed to accrue or arise in India even though services are rendered outside India.

11. Method of accounting not relevant –
Salary is taxable on receipt or due basis, whichever is earlier regardless of the fact whether books of account, in respect of salary income, are maintained by the assessee on mercantile basis or cash basis.

Problem – 1.
N is an employee of XYZ Private Ltd. getting a salary of Rs. 50,000 per month which becomes due on the last day of each month but is paid on the fifth of next month. Explain the provisions regarding the Computation the salary taxable for the assessment year 2020-21?

Solution:
The provisions of computation of Salary is taxable on receipt basis or due basis, whichever is earlier. In case of Non-Government Sector, Salary is taxable on due basis but in case of government sector, salary is taxable on receipt basis.
For assessment year 2020-21, the relevant previous year is 2019-20. In this case, salary becomes due on the last day of each month and received on the fifth day of next month. Thus, salary of April 2017 will become due on April 30, 2017 and will be paid on May 5, 2017.
So, salary of April 2017 will become taxable on April 30, 2017 irrespective of payment date. On this basis, May 2017 salary will become taxable on May 31, 2017 and so on.
Thus, during the previous year 2019-20, salary from April 2019 to March 2020 will be taxable and amount of taxable salary will be Rs. 6,00,000 [Rs. 50,000 per month*12 months].

Problem – 2.
N is an employee of XYZ Private Ltd. Company. His salary till March 31, 2019 was Rs. 40,000 per month and from April 1, 2019, his salary becomes Rs. 50,000 per month. Salary becomes due on the first day of next month but is paid on the fifth of next month. Compute the salary taxable for the assessment year 2020-21?

Solution:
In this case, salary becomes due on the first day of next month and received on the fifth day of next month. Thus, salary of April 2017 will become due on May 1, 2017 and will be paid on May 5, 2017. So, salary of April 2017 will become taxable on May 1, 2017. On this basis, May 2017 salary will become taxable in June 2017 and so on. However, March 2018 salary will become taxable in April 2018 which is not in our relevant previous year.
But March 2019 salary is taxable in April 2019 which is in our relevant previous year 2019-20.

Thus, during the previous year 2019-20, salary from March 2019 @Rs. 40,000 per month (one month only) and from April 2019 to February 2020 will be taxable @ Rs. 50,000 per month (11 months) and amount of taxable salary will Rs. 5,90,000 [Rs. 40,000*1 + Rs. 50,000*11].

Problem 3- on advance salary-
N is an employee of XYZ Ltd. getting a salary of Rs. 50,000 per month which becomes due on the last day of each month but is paid on the fifth of next month. He is paid the salary of April 2019 in advance in March 2019. Compute the salary taxable for the assessment year 2020-21.

Solution:
In this case, salary of April 2019 will become due on April 30, 2019 but it is received in March 2019. Thus, advance salary of April 2019 will become taxable on receipt basis which is earlier than the due date.
Thus, taxable salary during the previous year 2019-20 will be:

i.	Salary from April 2019 to March 2020 [Rs. 50,000*12]	Rs. 6,00,000
ii.	Advance salary of April 2019 (taxable in March 2017)	Rs. 50,000
	Gross Salary	Rs. 6,50,000

Note:
Since salary received in advance for April 2019 is included in the previous year 2019-20 on receipt basis. So, it will not be included again in the previous year 2020-21 when it becomes due.

Problem – 4. On pay-Scale or calculation of Basic pay.
N joins a private company on September 1, 2013 in the pay scale of Rs. 14,000 – Rs. 1,000 (annual increment) – Rs. 30,000 (salary at the time of joining is fixed at Rs. 18,000). As per the terms of employment salary becomes "due" on the first day of next month, and it is generally paid on the fifth day of the next month. Find out the taxable salary for the assessment year 2020-21.

Solution:

For the assessment year 2020-21, previous year is 2019-20. In this case, N gets an annual increment of Rs. 1,000. The amount of salary for different years will be as follows:

September 1, 2013 to August 31, 2014	:	Rs. 18,000
September 1, 2014 to August 31, 2015	:	Rs. 19,000
September 1, 2015 to August 31, 2016	:	Rs. 20,000
September 1, 2016 to August 31, 2017	:	Rs. 21,000
September 1, 2017 to August 31, 2018	:	Rs. 22,000
September 1, 2018 to August 31, 2019	:	Rs. 23,000
September 1. 2019 to August 31, 2020	:	Rs. 24,000

Note: Rs. 1,000 will be added to the salary every year as annual increment till it reaches the maximum point of Rs. 30,000.

For the previous year 2019-20, salary will be taxable as follows:

Month	*Due date of salary* *[Due date or receipt date, whichever is earlier]*	*Amount (Rs.)*
March 2019	April 1, 2019	23,000
April 2019	May 1, 2019	23,000
May 2019	June 1, 2019	23,000
June 2019	July 1, 2019	23,000
July 2019	August 1, 2019	23,000
August 2019	September 1, 2019	23,000
September 2019	October 1, 2019	24,000
October 2019	November 1, 2019	24,000
November 2019	December 1, 2019	24,000
December 2019	January 1, 2020	24,000
January 2020	February 1, 2020	24,000
February 2020	March 1, 2020	24,000
March 2020	April 1, 2020 (Not applicable)	See note
Total		2,82,000

Note:

Salary of March 2019 will be taxable in April 2019 which falls in the previous year 2019-20. However, salary of March 2019 will be taxable in April 2019 which is in our relevant previous year 2019-20.

Problem – 5. Calculation of Basic pay

N joins in a State Government University as a assistant professor on July 1, 2015 in the pay scale of Rs. 15,600 – Rs. 67,400. The annual increment is 3% of the basic pay. Find out the taxable salary for the assessment year 2020-21.

Solution:
For the assessment year 2020-21, previous year is 2019-20. In this case, N gets an annual increment of Rs. 1,000. The amount of salary for different years will be as follows:

Month		
From	To	Basic pay (Rs.)
July 1. 2015	June 30, 2016	15,600
July 1, 2026	June 30, 2017	16,048
July 1, 2017	June 30, 2018	16,530
July 1, 2018	June 30, 2019	17,026
July 1, 2019	June30, 2020	17,537

Note: 3% annual increment will be added to the every year basic salary as till it reaches the maximum point of Rs. 67,400.

For the previous year 2019-20, assessment year 2020-21 salary will be taxable as follows:

Month Due on last day of the	*Salary received on*	*Amount (Rs.)*
March 2019	April 1, 2019	17,026
April 2019	May 1, 2019	17,026
May 2019	June 1, 2019	17,026
June 2019	July 1, 2019	17,026
July 2019	August 1, 2019	17,537
August 2019	September 1, 2019	17,537
September 2019	October 1, 2019	17,537
October 2019	November 1, 2019	17,537
November 2019	December 1, 2019	17,537
December 2019	January 1, 2020	17,537
January 2020	February 1, 2020	17,537
February 2020	March 1, 2020	17,537
March 2020	April 1, 2020 (Not applicable)	See note
Total		2,08,400

Note: *it is assumed that as per the terms of employment salary becomes "due" on the last day of the month but paid on the 1st day of the next month. Hence, taxable salary is to be calculated on the basis of receipt. Salary of March 2020 will be included in the previous year 2020-21.*

12. Meaning of salary [Section 17(1)]
Salary includes –
a. wages;
b. any annuity or pension;
c. any gratuity;
d. any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages;

e. any advance of salary;
f. any payment received by an employee in respect of any period of leave not availed by him;
g. employer's contribution towards Recognized Provident Fund (RPF) in excess of 12% of employee's salary and interest credited to RPF in excess of 9.5% p.a.;
h. transferred balance in a recognized provident fund to the extent it is taxable; and
i. the contribution made by the Central Government (or any other employer) in the previous year, to the account of an employee under a notified pension scheme referred to in section 80CCD.

13. Profits in lieu of salary [Section 17(3)]

It includes the following –

a. the amount of any compensation due to or received by an assessee from his employer (or former employer) at or in connection with the termination of his employment or the modification of the terms and conditions thereto;

b. any payment due to or received by an assessee from his employer (or former employer) except the following:
    i. Payment of gratuity exempted under section 10(10);
    ii. Payment of commuted pension exempted under section 10(10A);
    iii. Payment of retrenchment compensation exempted under section 10(10B);
    iv. Payment from statutory provident fund (SPF) – Section 10(11);
    v. Payment from recognized provident fund (RPF) to the extent it is exempt under section 10(12);
    vi. Payment from an approved superannuation fund under section 10(13);
    vii. Payment of HRA exempted under section 10(13A).

c. Any payment from unrecognized provident fund (UPF) or such other fund to the extent to which it does not consist of contributions by the assessee or interest on such contributions.

d. Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

e. Any amount due to or received, whether in lump sum or otherwise, by an assessee from any person prior to employment or after cessation of employment.

5.4 BASIS OF CHARGE

Under section 15, the following income shall be chargeable to income-tax under the head "Salaries" –

a. any salary *due* from an employer (or a former employer) to an assessee in the previous year, whether actually *paid or not;*
b. any salary *paid* or allowed to him in the previous year by or on behalf of an employer (or a former employer), though not due or before it became due; and

c. any *arrears* of salary paid or allowed to him in the previous year by or on behalf of an employer (or a former employer), if not charged to income-tax for any earlier previous year.

Computation of salary income –
Income under the head "Salaries" is computed in the following manner:

Particulars	*Amount (Rs.)*
(i) Basic pay (ii) Fees, commission, bonus	XX
(iii) Income by way of allowances	XX
(iv) Taxable value of perquisites	XX
(v) Employers' contribution to RPF in excess of 12%	X
(vi) Employers' contribution to NPS	
(vii) Interest on RPF in excess of 9.5%	X
(viii) Pension (in case of retired employees)	X
(ix) Advance Salary (u/s 89)	X
(x) Arrears of salary (u/s 89)	X
(xi) Profit in lieu of salary	X
(xii) Taxable gratuity/ any annuity	X
Gross salary	Total
Less: Deductions under section 16:	
a. Standard Deductions u/s 16(i)	XX
b. Entertainment allowance u/s 16(ii)	XX
c. Professional tax u/s 16 (iii)	XX
Income from salaries	Taxable Salary

5.5 Retirement benefits

Retirement benefits are considered as those benefits which are generally given to the employees at the time of retirement. Some common retirement benefits are explained below –

(1) Encashment of Earned Leave Salary –
Employees are entitled to different types of leaves while they are in service. The leaves may either be allowed to be availed by them or if not availed, then these leaves may either lapse or encashed every year or accumulated and encashed at the time of retirement/ death/ or leaving the job.

Tax treatment – The tax treatment is given below:

Nature of leave encashment	*Status of employee*	*Taxability*
1. Leave encashment during continuity of employment	Government/ non-Government employee	**It is fully chargeable to tax**. However, relief can be taken under section 89.
2. Leave encashment at	(i) Government	**It is fully exempt from**

Nature of leave encashment	*Status of employee*	*Taxability*
the time of retirement/ leaving job	employee	**tax** *(see the provisions given below).*
	(ii) Non-Government employee	It is **fully or partially exempt from tax**. Here, exemption depends upon the provisions given below *(see the provisions given below).*

Government employees getting leave encashment at the time of retirement – In case of Central/ State Government employees, any amount received as cash equivalent of leave salary in respect of earned leaves standing to their credit at the time of retirement/ leaving the job is **exempt from tax.**

Non-Government employees getting leave encashment at the time of retirement – In case of non-Government employees (including an employee of a local authority or public-sector undertaking), leave salary **is exempt from tax to the extent of least of the following four amounts:**

a. Period of earned leave (in number of months) standing to the credit of employee at the time of retirement/ leaving the job (earned leave entitlements cannot exceed 30 days for every year of actual service)*Average monthly salary
b. 10*Average monthly salary
c. Amount specified by the government (i.e., Rs. 3,00,000 *minus* amount exempted earlier)
d. Leave encashment actually received at the time of retirement

Notes:
1. How to find out the leave standing to the credit of employee at the time of retirement or leaving the job -
Step 1: Find out duration of service in years (ignore any fraction of the year).

Step 2: Find out the rate of earned leave entitlement from the service book of the employees – such entitlement cannot exceed 30 days in a year. For example, if leave entitlement allowed is 20 days per year, then 20 days per year will be taken (because it is less than 30 days in a year). However, if leave entitlement allowed is 40 days per year, then for the purpose of computing leave entitlement, 30 days would be taken and not 40.

Step 3: Find out the leaves actually availed or encashed while in service (in number of days).

Step 4: Multiply step 1 with step 2 and then divide the resulting figure by step 3 and result would be in number of days. For example, if duration of service is 24 years 9 months, step 1 becomes 24. If leave entitlement as per service rules is 35 days per year, step 2 becomes 30. If leaves actually availed while in service is 90 days, then step 3 becomes 90. Thus, step 4 becomes 24*30–90 = 630 days which is to be further divided by 30 to get the result in number of months and the final leaves standing to one's credit in numbers of months comes out to be 21 (630/30).

For the computation of encashment of earned leave salary, here salary means:
*1. **Meaning of salary*** – Salary for this purpose means Basic Salary (+) dearness allowance (if terms of employment so provide) (+) commission based upon fixed percentage of turnover achieved by an employee. It is to be noted that dearness allowance/ pay shall be considered only when it is part of salary for computing *all* retirement benefits (like provident fund, pension, leave encashment, gratuity, etc.). If dearness allowance/ pay is part of salary for computing only some (not all) of the retirement benefits, then it is not taken into consideration for this purpose.

*2. **Average salary*** – Average salary for this purpose is to be calculated on the basis of average salary drawn during the period of 10 months immediately preceding the retirement. For example, if a person retires on 30 Nov. 2019, average salary will be taken from Feb. 1, 2019 to Nov. 30, 2019.

*3. **Actual years of service*** – While computing completed/ actual years of service, any fraction of the year shall be ignored. For example; if total period of service is 34.5 years, then only completed years as 34 will be consider as actual year of service.
4. ***When earned leave encashment is received from two or more employers*** – Where leave salary or leave encashment is received by a non-Government employee from two or more employers (may be in the same year or different years), the maximum amount of exemption cannot exceed Rs. 3,00,000 during the lifetime of the concerned employee.

*5. **Other relevant points*** –

- Relief under section 89 would be admissible in respect of encashment of leave salary by an employee while in service.

- Salary paid to the legal heirs of the deceased employee in respect of privilege leave standing to the credit of such employee at the time of his/ her death is not taxable as salary.

Problem – 6
N, an employee of the State Government, retires on November 30, 2019 and receives Rs. 10,00,000 as leave encashment. How much amount is taxable as Salary?

Solution:
Since N is a Government employee, Rs. 10,00,000 received as cash equivalent of leaves standing to his credit, is fully exempt from tax.

Problem – 7
N was employed by XYZ Ltd. Company upto August 31, 2003. At the time of leaving XYZ Ltd., he was paid Rs. 4,00,000 as leave salary out of which Rs. 80,000 was exempted from tax as per the provisions of Income-tax Act at that time. Thereafter, he joined another private company, ABC Ltd. and from this company, he retired on October 31, 2019 after

receiving leave salary of Rs. 6,16,000. Determine the taxable leave salary from the following information for the assessment year 2020-21:

(i)	*Salary at the time of retirement*	*Rs. 28,000*
(ii)	*Salary till March 31, 2019*	*Rs. 25,000*
(iii)	*Salary after March 31, 2019*	*Rs. 28,000*
(iv)	*Duration of service*	*16 years 11 months*
(v)	*Leave entitlement for every year of service*	*60 days*
(vi)	*Leave availed while in service*	*300 days*
(vii)	*Leave at the credit of employee at the time of retirement [(16*60 - 300÷30]*	*22 months*
(viii)	*Leave salary paid at the time of retirement (22*Rs. 28,000)*	*Rs.6,16,000*

Solution:

The amount of taxable leave salary for the assessment year 2020-21 is computed as follows:

N has retired from ABC Ltd., a private sector company, on October 31, 2019.
Out of Rs. 6,16,000 received as leave salary, least of the following four points is exempt from tax:

a.	Earned leave (in number of months) standing to the credit*Average monthly salary [i.e., 6*Rs. 27,100]	Rs. 1,62,600
b.	10*Average monthly salary [i.e., 10*Rs. 27,100]	Rs. 2,71,000
c.	Amount specified by the government (Rs. 3,00,000 *minus* amount exempted earlier) [i.e., Rs. 3,00,000 – Rs. 80,000]	Rs. 2,20,000
d.	Leave encashment actually received at the time of retirement	Rs. 6,16,000

Rs. 1,62,600, being the least, is exempt from tax and thus, taxable leave salary is Rs. 4,53,400 (Rs. 6,16,000 – Rs. 1,62,600).

Notes:

1. Calculation of leaves (in number of months) standing to the credit:

	Leave entitlement (must not exceed 1 month for actual service)	16 months
Less:	Leave actually availed	<u>10</u> months
	*Leave at the credit	<u>6</u> months

2. Calculation of average monthly salary:

	Basic salary (Rs. 25,000*3 + Rs. 28,000*7)	Rs. 2,71,000
Add:	DA (forming part)	Nil
Add:	Commission based on percentage of turnover	<u>Nil</u>
	Total salary of 10 months	<u>Rs. 2,71,000</u>
	Average monthly salary	Rs. 27,100

3. While completed actual years of service, any fraction of the year is ignored.

4. N can claim relief under section 89 in respect of Rs. 4,53,400.

(2) Gratuity –

Gratuity is generally payable to an employee at the time of cessation (i.e., retirement, death, termination, resignation or on his becoming incapacitated prior to the retirement) of employment in appreciation of the past services rendered by him.

Tax treatment – The tax treatment is given below:

Status of employee		*Taxability*
(a) Government employee		It is fully exempt from tax
(b) Non-Government employee	(i) Covered by the Payment of Gratuity Act, 1972	*See the provisions given below*
	(ii) Not covered by the Payment of Gratuity Act, 1972	*see the provisions given below*

(a) Government employees receiving gratuity at the time of retirement – In case of Government employees (including employees of local authority but not employees of a statutory corporation), amount of death-cum retirement gratuity received is fully exempt from tax.

(b) Non-Government employees:

(i) Non-Government employees Covered by the Payment of Gratuity Act, 1972 – In such cases, least of the following amount is exempt from tax:

a. 15 days salary (7 days salary in the case of employees of a seasonal establishment) based on salary last drawn for every completed year of service or part thereof in excess of 6 months.
   *For example, i*f service is rendered for 20 years and 6 months, then we have to take 20 years.
b. Rs. 20,00,000 being the amount specified by the Government
c. Gratuity actually received

Notes:

1. *Relief under section 89* – Gratuity in excess of the aforesaid limits is taxable in the hands of the assessee. However, the assessee can claim relief under section 89.
2. *Salary for this purpose means* – Salary last drawn by an employee and dearness allowance (whether forming part or not) but does not include any bonus, commission, etc.

3. *Calculation of 15 days' salary* – Salary of 15 days is calculated by dividing salary last drawn by 26 *i.e.,* the maximum number of working days in a month.
*For example, i*f monthly salary at the time of retirement is Rs. 3,000, 15 days salary would come to Rs. 1,730.77 (Rs. 15*3,000/26).

Problem – 8

N, an employee of XYZ Co. Ltd., receives Rs. 9,00,000 as gratuity. He is covered by the Payment of Gratuity Act, 1972. He retires on January 23, 2020 after rendering service of 38 years and 11 months. At the time of retirement his monthly basic salary and dearness allowance was Rs. 50,000 and Rs. 7,000, respectively. What amount of gratuity is exempt from tax?

Solution:

Employee receives gratuity at the time of retirement and he is covered by the Payment of Gratuity Act, 1972.

Therefore, out of Rs. 9,00,000 received as gratuity, least of the following is exempt from tax:

a. Rs. 9,00,000 (Gratuity actually received)
b. Rs. 20,00,000 (amount specified by the Government)
c. Rs. 12,82,500 [Rs. 32,884.62*39] (15 days salary for each completed year of service in excess of 6 months)

Rs. 9,00,000 being the least, is exempt from tax. Hence, Taxable amount of gratuity is Nil as actual amount is gratuity received is equal to the exemption limit of Rs.9,00,00 i.e., (Rs. 9,00,000 - Rs. 9,00,000)

Note:

1. Calculation of salary –

	Basic salary	Rs. 50,000
Add:	Dearness allowance	Rs. 7,000
	Total	Rs. 57,000

2. Calculation of 15 days salary –

Rs. 32,884.62 [Rs. 15*57,000/26]

(ii) Non-Government employees not covered by the Payment of Gratuity Act, 1972 – In such cases, least of the following amount is exempt from tax:

a. Half months average salary for each completed year of service
b. Rs. 20,00,000 *minus* amount exempted earlier
c. Gratuity actually received

Notes:

1. Relief under section 89 – Gratuity in excess of the aforesaid limits is taxable in the hands of the assessee. However, the assessee can claim relief under section 89.

2. Salary for this purpose means – Basic salary (+) dearness allowance (if terms of employment so provide) (+) commission based on fixed percentage on turnover achieved by an employee. It is to be noted that dearness allowance/ pay shall be considered only when it is part of salary for computing all retirement benefits (like provident fund, pension, leave encashment, gratuity, etc.). If dearness allowance/ pay is part of salary for computing only some (not all) of the retirement benefits, then it is not taken into consideration for this purpose.

3. Average monthly salary – is calculated on the basis of average salary for 10 months immediately preceding the month in which the employee has retired. *For example*, if a person retires on February 19, 2020, average salary will be considered on the basis of salary drawn from April 1, 2019 to January 31, 2020.

4. Completed/ actual years of service – While computing completed/ actual years of service, any fraction of the year shall be ignored. The words "each year of completed service" used for the purpose of 'gratuity' in are not confined to completed years of service under one employer and have to be interpreted to mean an employee's total service under two different employers including employer other than one from whose service he has retired, for purposes of calculation of period of years of his completed service, provided he was not paid gratuity by former employer.

5. Employee – Covered under Gratuity Act 1972 or not – If nothing is mentioned whether the employee is covered under the Payment of Gratuity Act, 1972 or not, it would be assumed that the employee is not covered under the Payment of Gratuity Act, 1972.

Gratuity paid while in service is taxable – Any gratuity paid to an employee while he continues to remain in service (whether or not after he has put in a minimum specified period of service) is not exempt from tax. However, here also, assessee can claim relief under section 89.

Gratuity received by family members after the death of the employee – If gratuity is paid after the death of an employee, then following situations may arise:

a. When gratuity becomes due before the death of the assessee but paid after the death of the assessee, it will be taxable (as per the provisions) in the hands of the assessee even if it is received by his legal heirs after his death.
b. When gratuity becomes due and paid after the death of a person, then the gratuity amount will neither be taxable in the hands of that person nor in the hands of legal heirs of that person.

Problem – 9

N, who is not covered by the Payment of Gratuity Act 1972, retires on November 5, 2019 from XYZ Ltd. and receives Rs. 12, 50,000 as gratuity after service of 38 years and 7 months. His salary is Rs. 80,000 per month up to July 31, 2019 and Rs. 90,000 per month from August 1, 2019. Besides, he gets Rs. 11,000 per month as dearness allowance (70 per cent of which is part of salary for computing all retirement benefits but 100% of dearness allowance is considered for computing pension). Compute the exempted amount of gratuity?

Solution:

Employee receives gratuity at the time of retirement and he is not covered by the Payment of Gratuity Act, 1972.

Therefore, out of Rs. 12, 50,000 received as gratuity, least of the following is exempt from tax:

a. Rs. 12,50,000 (gratuity actually received)
b. Rs. 20,00,000 (amount specified by the Government)
c. Rs. 17,23,300 [Rs. 90,700*38/2] (half month's salary for each completed year of service)

Rs. 12, 50,000 being the least, is exempt from tax. Hence, Taxable amount of gratuity (Rs. 12, 50,000 - Rs. 12, 50,000) is Nil.

Notes:

1. Calculation of average monthly salary –

Since the employee is retired in the month of November, salary for 10 months will be taken till October (the preceding month in which the employee has retired).

Basic Salary:

January 2019 to July 2019 @Rs.80,000 for 7 months	Rs. 5,60,000	
August 2019 to October 2019 @Rs. 90,000 for 3 months	Rs. 2,70,000	Rs. 8,30,000
Add: D.A.70% of @Rs. 11,000 for 10 months		Rs. 77,000
Add: Commission based on fixed percentage of sales		Nil
Total		Rs.9,07,000
Average monthly salary (Rs. 9,07,000/10)		Rs.90,700

Problem –10

X is a manager working with B Ltd. He retired from A Ltd. on 30 April, 1980 (salary at the time of retirement was Rs. 26,000) and received Rs. 2, 00,000 as gratuity of which Rs. 80,000 was exempt from tax. Finally, he retired from B Ltd on December 31, 2019 after 32 years and 8 months of service and received Rs. 6, 00,000 as gratuity. His other particulars are as follows:

a. His average basic salary for the preceding 10 months ending on December 31, 2019 is Rs. 50,000 per month.
b. Received Rs.6, 000 per month as DA since 1-1-2019 (80% forms part of salary for retirement benefits).
c. 6% commission on sales turnover of Rs. 2, 00,000 achieved by him during the preceding 10 months ending on December 31, 2019.

Determine the amount of taxable gratuity, assuming that he is not covered by Payment of Gratuity Act 1972 for the assessment year 2020-21.

Solution:

Out of Rs. 8,00,000 received as gratuity, least of the following is exempt from tax:

a. Gratuity actually received i.e., Rs. 8,00,000
b. Exemption limit – Amount exempted earlier i.e., Rs. 20,00,000 – Rs. 80,000 [Rs. 19,20,000]
c. Half month salary based on completed year of service i.e., Rs. 9,12,000 (Rs. 57,200*32/2)

Rs. 8,00,000, being the least is exempt from tax. Hence, Taxable amount of gratuity is nil.

(Amount of gratuity received Rs. 8,00,000 – Exempt amount of gratuity Rs. 8,00,000)

Calculation of salary [February 2019 to November 2019]:

Basic salary per month	Rs.50,000
Add: DA	Rs. 6,000
Add: Commission based on fixed percentage (6% of Rs.2,00,000) of 1 month/10 months	Rs. 1,200
Average salary per month	Rs. 57,200

(3) Pension –

Pension is always given to the employee after retirement. The tax treatment of pension received by the employee from the employer is given below –

Pension	*Status of employee*	*Is it chargeable to tax*
(a) **Uncommuted pension** (Periodical payment)	Both, for Government and Non-Government employee	Full amount of periodical pension received by the employee is fully chargeable to tax.
(b) **Commuted Pension** (Lump sum payment in lieu of periodical payment)	For Government employee (including the employees of local authority and statutory corporation)	(a) Lump-sum amount of commuted pension received is fully exempt from tax. (b) Remaining amount of uncommuted pension received periodically is fully taxable.
	For Non-Government employee	(a) If gratuity received: One-third of the pension which he is normally entitled to receive is exempt from tax (b) If gratuity is not received: One-half of the pension which he is normally entitled to receive is exempt from tax See provisions below:

Commutation of pension for Non-Government Employees:-

Exemption of commuted pension for non-government employees depends upon the receipt of gratuity (i.e., whether employee has received gratuity also or not):

a. ***In case where a non-government employee receives Gratuity*** –
the commuted value of one-third of the such pension which he is normally entitled to receive is exempt from tax.

b. ***In case where a non-government employee does not receive Gratuity –***
the commuted value of one-half of such pension which he is normally entitled to receive is exempt from tax.

Notes:

1. Assessee can claim relief under section 89 in respect of taxable pension.

2. Pension received from UNO by the employees or his family members is not chargeable to tax.

3. Family pension received by the family members of armed forces is exempt from tax under section 10(19) in some cases.

4. Family Pension received by family members (not being the family members of armed forces) after the death of an employee is taxable in the hands of recipients under section 56 under the head "Income from other sources". Standard deduction is available under section 57 which is one-third of such pension or Rs. 15,000, whichever is lower.

5. Judges of the Supreme Court and High Courts are also entitled to the exemption of the commuted pension under section 10(10A)(i) of the Act.

Problem – 11

Determine the amount of pension taxable for the assessment year 2020-21 in the following cases on the assumption that it becomes due on the last day of each month:

1. *Mr. N receives Rs. 1, 00,000 per month as uncommuted pension from the Government of Haryana during the previous year 2019-20.*
2. *Mr. N is entitled to receive Rs. 1, 00,000 per month as pension from the Government of Haryana during the previous year 2019-20. Out of which 20% pension was commuted as a result he received Rs. 20,00,000.*
3. *Mr. G receives Rs. 40,000 per month as uncommuted pension from a private company during the previous year 2019-20.*
4. *Mr G retires from XYZ Co. on June 30, 2019. He gets pension of Rs. 20,000 per month up to January 31, 2020. With effect from February 1, 2020, he gets 60 per cent of pension commuted for Rs. 10,71,000. Does it make any difference if he also gets gratuity of Rs. 2, 50,000 at the time of retirement?*

Solution:	
A-	**No Commutation of Pension:**
1.	**Mr. N is a government employee: No commutation of pension:** Uncommuted pension (i.e., monthly pension) received periodically is fully taxable. So, Rs. 12,00,000 (Rs. 1,00,000*12) is taxable as salary for the assessment year 2020-21
2.	**Mr. G is a employee of a private company: No commutation of pension:** Uncommuted pension (i.e., monthly pension) received periodically is fully taxable. Hence, Rs. 4,80,000 (Rs. 40,000*12 months) is fully taxable.
B-	**Commutation of Pension:**
3.	**Mr. N is a government employee: commutation of pension:** (a) When 20% pension is commuted: The whole amount received as a commutation of 20% pension i.e., Rs. 20,00,000 is fully exempt from tax. (b) 80% of pension not commuted: 80% of Rs.1,00,000 i.e., pension of Rs. 80,000 per month is fully taxable.
4.	**Mr.G is an employee of a private company:**

	(a) Uncommuted pension: (i) From July 2019 to January 2020 @Rs.20,000 for 7 months (ii) From February 2020 to March 2020 40% of @ Rs. 20,000 for 2 months	Rs. 1.40.000 Rs. 16,000
	Total of (a)	**Rs. 1,56,000**
	(b) Commuted pension: received Rs. 10,71,000	
	Situation I: if employee does not receive gratuity:	
	1.Commuted value of full pension:- Rs. 10,71,000/60% 2.Exemption amount is ½ of full value of commutation (i.e., Rs. 17,85,000)	Rs. 17,85,000 Rs. 8,92,500
	Thus, taxable commuted pension (Rs.10,71,000 minus RS. 8,92,500)	**Rs. 1,78,500**
	Thus, Total taxable pension in case of employee does not receive gratuity is (a) Rs. 1,56,000 uncommuted + Rs. 1,78,500 commuted= **Rs. 3,34,500**	
	Situation II: if the employee receives gratuity:	
	1. Commuted value of full pension (Rs. 10,71,000 / 60%)	Rs. 17,85,000
	2. Exempt amount of commuted value of pension 1/3	Rs. 5,95,000
	Thus, taxable commuted pension (Commuted pension- exempt) (Rs.10,71,000 minus Rs. 5,95,000	Rs. 4,76,000
	Hence, In situation II, taxable amount of pension is Rs. 1,56,000 uncommuted+ 4,76,000 commuted= **Rs. 6,32,000**	

(4) National Pension Scheme: (NPS)

<u>Pension scheme in case of an employee joining Central Government or any other employer on or after January 1, 2004:</u>

National Pension Scheme (NPS) is applicable to new entrants to Government service or any other employer. Even a self-employed person can join NPS. As per the scheme, it is mandatory for persons entering the service on or after January 1, 2004, to contribute 10% of salary every month towards NPS. A matching contribution or 14% is required to be made by the employer to the said account. The tax treatment under the new scheme is as follows –

a. Contribution by the employer to NPS is first included under the head "Income of Salaries" in hands of the employee and then deduction is also available under section 80CCD(2) for such contribution *(shown in the table given below).*

b. *Taxability of amount received from NPS –*
   i. Partial withdrawal from NPS (to the extent it does not exceed 25% of an employee's contribution) is exempt from tax.
   ii. When pension is received out of NPS, it will be chargeable to tax in the hands of the recipient.

iii. In case of closure of account or on his opting out of the NPS scheme, 60% of the amount received by the assessee is taxable.
iv. If received amount mentioned in point (i) and (ii) above is utilized for purchasing an annuity plan in the same previous year, then the received amount mentioned in point (i) and (ii) above is exempt from tax. However, pension received out of this annuity plan is chargeable to tax.

c. *Exemption of amount received from NPS –*
The whole amount received by the nominee from NPS on death of the assessee is exempt from tax.

d. No deduction will be allowed under section 80C in respect of amounts on which deduction has been claimed under section 80CCD.

e. "Salary" for the above purpose of NPS means basic salary + dearness allowance (forming part) + commission based on fixed percentage of turnover achieved by the employee.

f. Deduction for contribution towards NPS is available under section 80CCD which is explained below in detail:

Provisions	*Maximum deduction*	*Cumulative maximum deduction*
Section 80C (Investments)	Rs. 1,50,000	Rs. 1,50,000 [Section 80CCE]
Section 80CCC (Pension Fund)	Rs. 1,50,000	
Section 80CCD(1) [i.e., employee's contribution or assessee's contribution towards NPS]	10% of salary (if a salaried individual)/ 20% of GTI (if a non-salaried individual)	
Section 80CCD(1B) [i.e., employees contribution or assessee's contribution towards NPS]	Rs. 50,000	Not Applicable
Section 80CCD(2) [i.e., employer's contribution towards NPS]	14% of salary	Not Applicable

Problem –12
X is employed (since 2010) by the Central Government (or any other employer). During the previous year 2019-20, he gets Rs. 30,000 per month as salary and Rs. 10,000 per month as dearness allowance (60% is considered for retirement benefits). Employer contributes Rs. 45,000 towards NPS. X, however, annually contributes Rs. 55,000. Income from other sources of X is Rs. 9,00,000. X deposits every year Rs. 90,000 in PPF. X is also eligible for a deduction of Rs. 25,000 under section 80CCC. Compute the taxable income of X for the assessment year 2020-21.

Solution:

Computation of taxable income of X for the assessment year 2020-21:

1.	Income from Salary:		Amount (Rs.)	
	Basic salary		3,60,000	
	Dearness allowance		1,20,000	
	Employers contribution towards NPS		45,000	
	Gross salary		5,25,000	
Less:	Deductions U/S 16:			
	Standard Deduction [u/s 16(i)]		50,000	
	Entertainment Allowance [Sec. 16(ii)]		Nil	
	Professional tax [u/s 16(iii)]		Nil	
	Income from salaries			4,75,000
2.	Income from other sources			9,00,000
	Gross total income GTI			13,75,000
Less:	Deductions:			
	1. u/s 80C	90,000		
	u/s80CCC	25,000		
	u/s80CCD(1)	5,000*	1,20,000	
	2. u/s80CCD(1B)		50,000	
	3. u/s80CCD(2)		45,000	2,15,000
	Net taxable income or TI			11,60,000

Working notes:

1. X's contribution towards NPS is Rs. 55,000. Out of this, Rs. 50,000 is allowed under section 80CCD(1B) and remaining Rs. 5,000 can be claimed under section 80CCD(1) but subject to a maximum of 10% of salary of Rs. 4,32,000 i.e., (3,60,000+ 60% of DA i.e., 72,000)

2. Employer's contribution towards NPS is Rs. 45,000 but subject to a maximum of 14% of salary of Rs. 4,32,000 is allowed as deduction under section 80CCD(2).

3. Maximum deduction under section 80C, 80CCC, 80CCD(1) [employees contribution] collectively cannot exceed Rs. 1,50,000.

4. Section 80CCD(2) is regarding employers contribution.

Another way of attempting this question:

Computation of taxable income of X for the assessment year 2018-19:

		Amount (Rs.)
	Basic salary	3,60,000
	Dearness allowance	1,20,000
	Employers contribution towards NPS	45,000
	Gross salary	5,25,000
Less:	Deductions U/S 16:	
	Standard Deduction [u/s 16 (i)]	50,000

	Entertainment Allowance [Sec. 16(ii)]		Nil	
	Professional tax[u/s 16(iii)]		Nil	
	Income from salaries		4,75,000	
	Income from other sources		9,00,000	
	Gross total income GTI			13,75,000
Less:	Deductions U/S 80C	90,000		
	80CCC	25,000		
	80CCD(1)	43,200*	1,50,000(Maximum)	
	80CCD(1B) [55,000 – 43,200]		11,800	
	80CCD(2)		43,200	2,15,000
	Net taxable income or TI			11,60,000

Working notes:

1. X's contribution towards NPS is Rs. 55,000. Out of this, Rs. 43,200 (10% of 4,32,000) should be utilised towards section 80CCD(1) and remaining Rs. 11,800 [55,000 – 43,200] can be utilised towards section 80CCD(1B).

2. Employer's contribution towards NPS is Rs. 45,000 but subject to a maximum of 10% of salary of Rs. 4,32,000 is allowed as deduction under section 80CCD(2).

3. Maximum deduction under section 80C, 80CCC, 80CCD(1) [employees contribution] collectively cannot exceed Rs. 1,50,000.

4. Section 80CCD(2) is regarding employers contribution.

Note:

The question can be attempted in any of the two ways. There is no clarity from Income Tax Department whether amount contributed by the employee towards NPS for the purpose of section 80CCD(1B) is over and above 10% of salary or not. However, the author is of the view that till 10% of salary, employees contribution towards NPS shall be utilised for section 80CCD(1) and the employees contribution towards NPS over and above 10% of salary should be utilised for the purpose of section 80CCD(1B) but subject to a maximum of Rs. 50,000.

(5) Compensation received at the time of voluntary retirement [Sec. 10(10C)] – Compensation received/ receivable at the time of voluntary retirement is exempt from tax upto Rs. 5, 00,000 if few conditions are satisfied. One of the conditions is the amount payable on account of voluntary retirement or voluntary separation of the employees should not exceed:

a. the amount equivalent to 3 months' salary for each completed year of service; or
b. salary at the time of retirement multiplied by the balance months of service left before the date of his retirement on superannuation,
   whichever is more.

In this case, relief under section 89 is not available.

(6) Retrenchment Compensation [Sec. 10(10B)] –

Compensation received by a workman at the time of his retrenchment is exempt from tax to the least of the following amounts –

a. Rs. 5,00,000 (amount specified by the Government);
b. 15 days average pay for every completed year of service or part thereof in excess of 6 months;
c. Amount actually received.

In this case, relief under section 89 is available.

***(7)* Provident Funds –**

Provident fund scheme is a retirement benefit scheme. Under this scheme, a set sum is deducted from the salary of the employee as his contribution towards the fund. The employer also, generally, contributes simultaneously the same amount out of his pocket to the fund. The employee's and employer's contributions are then invested securities and interest earned thereon is also credited to the provident fund account of the employees. The accumulated sum is paid to the employee at the time of his retirement. In the case of death of an employee, accumulated balance is paid to his legal heirs.

Following are the different types of provident funds –

1. Statutory provident fund – This fund is set up under the provisions of the Provident Funds Act, 1925. This fund is maintained by the Government and the Semi-Government organizations, local authorities, railways, universities and recognized educational institutions.

2. Recognized provident fund – A provident fund scheme to which the Employee's Provident Fund and Miscellaneous Provisions Act, 1952 applies is recognized provident fund. As per this Act, any establishment employing 20 or more persons is covered by this Act (establishments employing less than 20 persons can also join the provident fund scheme if the employer and employees want to do so).

3. Unrecognized provident fund – If a provident fund is not recognized by the Commissioner of Income-tax, it is known as unrecognized provident fund.

4. Public provident fund – The Central Government has established the public provident fund for the benefits of general public to mobilize personal savings. Any member of the public (whether a salaried employee or a self-employed person) can participate in the fund by opening a provident fund account at the State Bank of India or its subsidiaries or other nationalized banks. Even a salaried employee can simultaneously become member of employees' provident fund (whether statutory, recognized or unrecognized) and public provident fund. Any amount (subject to a minimum of Rs. 500 and maximum of Rs. 1,50,000 per annum) may be deposited under this account. The accumulated sum is payable after 15 years (it may be extended). Interest on this fund is credited every year but payable at the time of maturity.

Tax treatment of different types of provident funds –

Situations	*Statutory Provident Fund (SPF)*	*Recognized Provident Fund (RPF)*	*Unrecognized Provident Fund (UPF)*	*Public Provident Fund (PPF)*
Employer's contribution to provident fund	Exempt from tax	Exempt up to 12% of salary. Excess of employer's contribution over 12% of salary is taxable.	Exempt from tax	Employer does not contribute
Interest credited to provident fund	Exempt from tax	Exempt from tax if rate of interest does not exceed 9.5%; excess of interest over this rate is taxable.	Exempt from tax	Exempt from tax
Lump sum payment at the time of retirement or termination of service	Exempt from tax	Exempt from taxes in some *cases given below*§. When not exempt, provident fund will be treated as an unrecognized fund from the beginning.	Employer's contribution and interest thereon is taxable under the head "Salary". However, payment received in respect of employee's own contribution is exempt from tax. Interest on employee's contribution is taxable under the head "Income from other sources".	Exempt from tax

Salary for this purpose means – Basic salary (+) dearness allowance/ dearness pay (if terms of employment so provide) (+) commission based on fixed percentage of turnover achieved by an employee.

It is to be noted that dearness allowance/ pay shall be considered only when it is part of salary for computing all retirement benefits (like provident fund, pension, leave encashment, gratuity, etc.). If dearness allowance/ pay is part of salary for computing only some (not all) of the retirement benefits, then it is not taken into consideration for this purpose.

§ Cases in which lump sum payment (RPF) is exempt –

1. If the employee has rendered continuous service with his employer for a period of 5 years or more. If accumulated balance includes any amount transferred from his individual account in any other recognized provident fund(s) maintained by his former employer(s), then, in computing the period of 5 years, the period(s) for which the employee rendered continuous service to his former employer(s) is also to be included;

or

2. If the employee is not able to fulfil the conditions of such continuous service due to his service having being terminated by reason of his ill-health or by reason of the contraction or discontinuance of the employer's business or due to some other reason beyond the control of the employee; **or**

3. If the employee has resigned before completion of 5 years but he joins another employer (who maintains recognized provident fund and provident fund money with the current employer is transferred to the new employer).

4. If the entire balance standing to the credit of the employee is transferred to employee's account under a pension scheme referred to in section 80CCD and notified by the Central Government (i.e., NPS).

Problem – 13

X retires on June 30, 2019. He submits the following information –

Basic salary (since January 2019): Rs. 20,000 per month, dearness allowance: Rs. 6,000 per month (1/3 of which is part of salary for retirement benefits), employer's contribution towards provident fund: Rs. 3,000 per month (X makes a matching contribution); interest credited at the rate of 15 per cent on May 31, 2019: Rs. 7,500; pension after retirement: Rs. 10,000 per month; and payment of provident fund at the time of retirement: Rs. 7,60,000 (out of which employer's contribution: Rs. 3,30,000, interest thereon: Rs. 44,000, X's contribution: Rs. 3,40,000, interest thereon: Rs. 46,000). Salary and pension become due on the last day of each month. X has deposited the entire provident fund payment with a company (rate of interest: 9 per cent per annum).

Find out the income of X for the assessment year 2020-21 on the assumption that the provident fund is (a) statutory provident fund, (b) recognized provident fund, or (c) unrecognized provident fund.

Solution:

Computation of total income of X for the assessment year 2020-21:

	Particulars	SPF (Rs.)	RPF (Rs.)	UPF (Rs.)
1.	**Income from Salary:**			
	Basic salary @Rs. 20,000 p.m. for 3 months)	60,000	60,000	60,000
	Dearness allowance @Rs. 6,000p.m. for3 months)	18,000	18,000	18,000
	Employer's contribution towards PF in excess of 12% (Rs. 9,000 – 12% of Rs. 66,000)	Exempt	1,080	Exempt
	Interest credited in excess of 9.5% (Rs. 7,500*5.5/15)	Exempt	2,750	Exempt
	Uncommuted Pension (Rs. 10,000*9)	90,000	90,000	90,000
	Lump sum payment at the time of retirement(employer's contribution and interest thereon)	Exempt	Exempt[3]	3,74,000
	Gross salary	1,68,000	1,71,830	5,42,000
Less:	Standard Deductions under section 16(i)	50,000	50,000	50,000
	Taxable Income from Salary	1,18,000	1,21,830	4,92,000
2.	**Income from other sources :**			
	Interest on employees' contribution to URPF	--------	--------	46,000
	Interest on company's deposit (Rs. 7,60,000*@9% for 9/12 months)	51,300	51,300	51,300
	Gross total income	1,69,300	1,73,130	5,89,300
Less:	Deduction under section 80C	9,000	9,000	Nil
	Net taxable Total Income	1,60,300	1,64,130	5,89,300

Notes:

1. Calculation of salary for the purpose of fund –

Basic salary	Rs. 60,000
DA (forming part)	Rs. 6,000
Total	Rs. 66,000

2. It is assumed that the employee has been doing the job with his employer of a private sector company for a period of 5 years or more.

(8) Approved Superannuation Fund –

It means a superannuation fund which is approved by the Commissioner of Income-tax. Like Provident Fund, Superannuation fund is also a scheme of retirement benefits for the employee. These are funds, usually established under trusts by an undertaking, for the purpose of providing annuities, etc. to the employees of the undertaking on their retirement at or after a specified age, or on their becoming incapacitated prior to such retirement, or for the widows, children or dependents of the employees in case of any employee's earlier death. The trust invests the money contributed to the fund in the form and mode prescribed. Income earned on these investments shall be exempt, if any such fund is an Approved Superannuation Fund.

Tax treatment –

1. *Employer's contribution* towards an approved superannuation fund will be chargeable to tax to the extent it exceeds Rs. 1, 50,000 per annum.

2. *Employee's contribution* towards such fund is exempt from tax under section 80C.

3. *Interest* on accumulated balance is exempt from tax.

4. *Payment from the fund* is not chargeable to tax in the following cases:
   a. refund of contribution or any payment from fund on the death of employee (i.e., payment to widow); and
   b. lump sum payment by way of commutation of annuity to the employee on his retirement.

5.6 Summary

In this chapter, we have discussed the basis of charge of Salaries. Tax treatment of retirement benefits viz., leave encashment, gratuity, pension, provident fund, etc. have been discussed. Next two chapters of Salaries will discuss other provisions related to Salaries.

LESSON 6

Unit II

SALARIES - II

STRUCTURE OF THE CHAPTER

6.1 OBJECTIVES

This chapter of salaries discusses the tax treatment of different types of allowances and some perquisites received by the employee from the employer.

6.2 ALLOWANCES

Allowances are fixed monetary amount paid by the employer to the employee for meeting some particular expenses. These are generally fully taxable and thus, included to compute gross salary unless a specific exemption has been provided in respect of that particular allowance which is received.

Allowances are divided under three categories for the purpose of taxability:

1. Fully taxable allowances;
2. Fully exempt allowances; or
3. Partially exempt allowances:
   a. Exemption depending upon actual expenditure; or
   b. Fixed exemption depending upon the provisions of the Act.

1. Fully taxable allowances –

There can be hundreds of fully taxable allowances. All those allowances which are not covered under exempt category become fully taxable. Some of the common fully taxable allowances are –

(i) Dearness allowance
(ii) City compensatory allowance (CCA)
(iii) Fixed medical allowance
(iv) Non-practicing allowance
(v) Servant allowance
(vi) Deputation allowance
(vii) Lunch/ meal/ dinner/ refreshment allowance
(viii) Overtime allowance
(ix) Family allowance

(x) Tiffin allowance
(xi) Warden/Dy. Warden allowance
(xii) Planning allowance, etc.

2. Special allowances prescribed as exempt under section 10(14) –

When exemption depends upon actual expenditure by the employee –
In the case of given below six allowances, lower of the following is allowed as deduction:

- the amount of the allowance;

  or
- the amount utilized for the specific purpose for which allowance is given.

These allowances are as follows –

(i) Travelling allowance/ Transfer allowance –
An allowance (by whatever name called) granted to meet the cost of travel on tour or on transfer (including any sum paid in connection with transfer, packing and transportation of personal effects on such transfer).

(ii) ***Conveyance allowance –***
Conveyance allowance is exempt from tax to the extent it is utilized for performance of official duties. It is an allowance which is granted to meet the expenditure on conveyance in performance of duties of an office. It may be noted that any expenditure for covering the journey between office and residence is not treated as expenditure in performance of duties of the office.

(iii)Daily allowance –
An allowance whether granted on tour or for the period of journey in connection with transfer, to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty.

(iv) Helper allowance –
An allowance (by whatever name called) to meet the expenditure on a helper where such helper is engaged for the performance of official duties.

(v) Research/ Academic allowance –
An allowance (by whatever name called) granted for encouraging the academic research and other professional ethics.

(vi) Uniform allowance –
An allowance (by whatever name called) to meet the expenditure on the purchase or maintenance of uniform for wear during the performance of duties of an office.

3. Partially exempt allowances:

(a) When exemption does not depend upon the actual expenditure –
In case of given below allowances, the amount of exemption does not depend upon the expenditure actually incurred by the employee. Amount of exemption is –

- the amount of allowance; or
- the amount specified in rule 2BB,
  whichever is lower.

1. House rent allowance [Section 10(13A) and rule 2A] –

In case of house rent allowance, least of the following amount is exempt from tax –

1. House rent allowance received by the employee in respect of the period during which rental accommodation is occupied by the employee during the previous year.
2. The excess of rent paid over 10% of salary.
3. An amount equal to 50% of salary, where residential house is situated at Mumbai, Kolkata, Delhi and Chennai and an amount equal to 40% of salary where residential house is situated at any other place.

Notes:

1. Salary for this purpose means – Basic salary (+) dearness allowance (if terms of employment so provide) (+) commission based on fixed percentage of turnover achieved by an employee.

It is to be noted that dearness allowance/ pay shall be considered only when it is part of salary for computing all retirement benefits (like provident fund, pension, leave encashment, gratuity, etc.). If dearness allowance/ pay is part of salary for computing only some (not all) of the retirement benefits, then it is not to be taken into consideration for this purpose.

2. Due basis – Salary for this purpose is determined on "due" basis in respect of the period during which rental accommodation is occupied by the employee in the previous year. It, therefore, follows that salary of a period, other than the previous year, is not considered even though such amount is received during the previous year and is taxable on "receipt" basis. Likewise, salary of the period during which rental accommodation is not occupied in the previous year, is left out of the aforesaid computations.

3. Exemption is denied where an employee lives in his own house, or in a house for which he does not pay any rent or pays rent which does not exceed 10% of salary.

Problem – 1

N who resides in Gurgaon gets Rs. 60,000 per month as basic pay. He gets dearness allowance @ 17%. He gets Rs. 9,000 per month as house rent allowance, though he actually pays Rs. 12,000 per month as rent. During the previous year 2019-20, he receives Rs. 60,000 as advance salary of April 2020. Calculate the amount of house rent allowance exempt from tax as well as taxable salary for the assessment year 2020-21?

Solution:

Computation of income under the head "Salaries" for the assessment year 2018-19:

Particulars	Amount (Rs.)
Basic pay	7,20,000
Dearness Allowance @17%	1,22,400
Advance salary	60,000
HRA [received,1,08,000 – Exempt: 59,760]	48,240
Gross salary	9,50,640

Notes –

Out of Rs. 1,08,000 received as HRA, least of the following amount is exempt from tax:

a. *HRA received Rs. 1,08,000*
b. *Excess of rent paid over 10% of salary [Rs.1,44,000- 84,240]=* ***Rs. 59,760***
c. 40% of salary i.e., 40% of Rs. 8,42,400 = Rs. 3,36,960

Rs. 59,760 being the least is exempt per annum and Rs. 48,240 per annum is taxable. Therefore, annual taxable house rent allowance is Rs. 48,240.

2. Entertainment allowance [Sec. 16(ii)] –

It is first included in salary income under the head "allowances" and thereafter a deduction is given on the following basis:

a. In the case of a non-government employee (including employees of local authority and statutory corporation), entertainment allowance is not deductible. It if fully taxable.

b. In case of a Government employee, the least of the following is deductible:
   - Rs. 5,000;
   - 20% of basic salary;
   - Amount of entertainment allowance granted during the previous year.

Basic salary for this purpose excludes any allowance, benefit or other perquisites. Further, amount actually expended towards entertainment (out of entertainment allowance received) is not taken in to consideration.

3. *Allowance for transport employees working in any transport system –*

It is an allowance granted to an employee working in any transport system to meet his personal expenditure during his duty performed in the course of running of such transport from one place to another place provided that such employee is not in receipt of daily allowance.

Amount of exemption is 70% of such allowance or Rs. 10,000 per month whichever is lower.

4. Transport allowance –

It is granted to an employee to meet his expenditure for the purpose of commuting between the place of his residence to place of his duty.

Amount of exemption is limited Rs. 3,200 per month in case of an employee who is blind or orthopaedically handicapped; and in case of any other employee- Nil

It is to be noted that expenditure for covering the journey between office and residence is not treated as expenditure in performance of duties of the office.

5. Children education allowance –

If an employee gets children education allowance from his/her employer, then he is entitled to claim exemption from tax is limited to @Rs. 100 per month per child up to a maximum of two children.

6. Hostel expenditure allowance –

If an employee gets hostel expenditure allowance from his/her employer, then he is entitled to claim exemption from tax is limited to @Rs. 300 per month per child up to maximum of two children.

***7.* Tribal/ scheduled areas allowance –**

Rs. 200 per month if an employee is posted in U.P., M.P., Tamil Nadu, Karnataka, West Bengal, Bihar, Orissa, Assam or Tripura.

8. Underground allowance –

Underground allowance is granted to an employee who is working in uncongenial, unnatural climate in underground mines. Exemption is limited to Rs. 800 per month.

9. Highly active field area allowance –

It is granted to the members of armed forces in the nature of special compensatory highly active field area allowance. It is exempt from tax up to Rs. 4,200 per month.

10. Island duty allowance –

This special allowance is granted to the members of armed forces in the nature of island (duty) allowance in Andaman and Nicobar and Lakshadweep group of islands. It is exempt from tax up to Rs. 3,250 per month.

11. Allowance to Government employees outside India –

Any allowance paid or allowed outside India by the Government to an Indian citizen for rendering service outside India is wholly exempt from tax.

12. Allowance received from UNO –

Not chargeable to tax

13. Allowance to High Court and Supreme Court Judges –

Not chargeable to tax

14. Allowances to Chairman/ members of UPSC –

In the case of serving Chairman and members of UPSC, transport allowance and sumptuary allowance are not chargeable to tax

6.3 PERQUISITES

Perquisite may be defined as any casual emolument or benefit (monetary or non-monetary) attached to an office or position in addition to salary or wages.

Definition of 'Perquisite' as per the Act [Section 17(2)] –

Under the Act, the term "perquisites" includes the following –

a. the value of rent-free accommodation provided to the assessee by his employer;

b. the value of any concession in the matter of rent respecting any accommodation provided to the assessee by his employer;

c. the value of any benefit or amenity granted or provided free of cost or at concessional rate in any of the following cases:
   i. by a company to an employee who is a director thereof;
   ii. by a company to an employee, being a person who has substantial interest in the company;
   iii. by any employer (including a company) to an employee to whom provisions of (i) and (ii) above do not apply and whose income under the head "Salaries" exclusive of the value of all benefits or amenities not provided for by way of monetary benefits, exceeds Rs. 50,000;

d. any sum paid by an employer in respect of any obligation which but for such payment would have been payable by the assessee;

e. any sum payable by the employer, whether directly or through a fund other than a recognized provident fund or approved superannuation fund or a deposit-linked insurance fund, to effect an assurance on the life of the assessee or to effect a contract for an annuity;

f. the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee;

g. the amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds Rs. 1,50,000;

h. the value of any other fringe benefits or amenity as may be provided.

Perquisites are divided under five categories for the purpose of taxability:

1. Perquisites which are taxable for specified as well as non-specified employees;

2. Perquisites which are exempt for specified as well as non-specified employees;

3. Perquisites which are taxable only for specified employees and exempt for non-specified employees;

4. Contribution by the employer to the approved superannuation fund in respect of the assessee to the extent it exceeds Rs. 1,50,000;

5. Specified equity or sweat equity shares allotted or transferred by the employer to the assessee.

I- Perquisites taxable only for Specific Employee:

Specified employee –

The following employees are known as "specified employee":

1. A director-employee – An employee, who is a director (full time or part time) in the employer-company at any time during the previous year, is a specified employee of the company in which he is a director.

2. An employee who has substantial interest in the employer-company – An employee who has a substantial interest in the employer-company at any time during the previous year is a specified employee of the company in which he has substantial interest. A person has substantial interest in the employer-company, if he is a beneficial owner of equity shares carrying 20% or more voting power in the employer-company.

3. An employee drawing in excess of Rs. 50,000 – An employee (not covered by the above two cases), whose income chargeable to tax under the head "Salaries" (exclusive of the value of all benefits or amenities not provided by way of monetary payments) exceeds Rs. 50,000, is a specified employee. For computing the sum of Rs. 50,000, the following are excluded or deducted:

a. all non-monetary benefits;
b. monetary benefits which are not taxable under section 10 (for example, house rent allowance to the extent exempt under section 10(13A) is excluded); and
c. deduction on account of entertainment allowance and professional tax.

Where salary is received from more than one employer, the aggregate salary from these employers will have to be taken into account for the purpose of determining the aforesaid monetary ceiling.

Perquisites taxable only in the hands of a specified employee –
The following perquisites are taxable only in the hands of specified employees on actual basis:

- Service of a sweeper, gardener, watchman or personal attendant
- Supply of gas, electricity or water for household purposes
- Education facility to employee's family members
- Leave travel concession (LTC)
- Medical facility
- Car or any other automotive conveyance
- Transport facility by a transport undertaking

6.4 VALUATION OF DIFFERENT PERQUISITES

II- **Perquisites taxable for all types of assessee including specific employee:**

A- **Accommodation facilities–**

'Accommodation' includes a house, flat, farm house (or part thereof) or accommodation in a hotel, motel, service apartment, guest-house, caravan, mobile home, ship or other floating structure. For the purpose of valuation of this perquisite, employees are divided into two categories:

- Central and State Government employees; and
- Private sector employees or other employees (including employees of local authority or a foreign Government)

1. Rent-free unfurnished accommodation [Rule 3(1)] –

(i) For Central and State Government employees –The value of perquisite in respect of accommodation provided to such employees is equal to the licence fee which would have been determined by the Central or State Government in accordance with the rules framed by the Government for allotment of houses to its officers.
However, rent-free official residence provided to a Judge of a High Court or to a judge of the Supreme Court is exempt from tax. A similar exemption is extended to an official of Parliament, a Union Minister, a Leader of Opposition in Parliament and serving Chairman/ members of UPSC.

(ii) For private sector or other employees (including the employees of a local authority or a foreign Government):

<table>
<tr><th>Population of city as per 2001 census where accommodation is provided</th><th>Where the accommodation is owned by the employer</th><th>Where the accommodation is taken on lease or on rent by the employer</th></tr>
<tr><td>Exceeding 25 lakh</td><td>15% of salary in respect of the period during which the accommodation is occupied by the employee</td><td rowspan="3">Amount of lease rent paid or payable by the employer or 15% of salary, whichever is lower</td></tr>
<tr><td>Exceeding 10 lakh but not exceeding 25 lakh</td><td>10% of salary in respect of the period during which the accommodation is occupied by the employee</td></tr>
<tr><td>Any other</td><td>7.5% of salary in respect of the period during which the accommodation is occupied by the employee</td></tr>
</table>

Notes:
1. Salary for this purpose includes – Basic salary, + dearness allowance/ pay (if terms of employment so provide), +bonus,+ commission,+ fees, + all other taxable allowances (excluding amount not taxable) and any monetary payment which is chargeable to tax (by whatever name called).
It is to be noted that dearness allowance/ pay shall be considered only when it is part of salary for computing all retirement benefits (like provident fund, pension, leave encashment, gratuity, etc.). If dearness allowance/ pay is part of salary for computing only some (not all) of the retirement benefits, then it is not taken into consideration for this purpose.

2. Salary does not include –

- employer's contribution to provident fund account of an employee;
- all allowances which are exempt from tax;
- value of perquisites [under section 17(2)]; and
- lump-sum payment received at the time of termination of service or superannuation or voluntary retirement, like gratuity, severance pay leave

encashment, voluntary retrenchment benefits, commutation of pension and similar payments.

3. Salary shall be determined on "accrual" basis – For example, advance salary of a period other than the previous year is not included even if the same is received in the previous year. Similarly, salary due in the previous year is included, even if it is received after the end of the previous year. In other words, we can say that *salary accrued for the period during which rent-free accommodation is occupied by the employee will be considered whether it is received during the previous year or not*.
In all we can say that advance salary/ bonus for a period other than the previous year will not to be included in salary for the above purpose.

4. Monetary payments which are in the nature of perquisites under section 17(2) shall not be included. Conversely, monetary payments which are not in the nature of perquisites under section 17(2) shall be included. For example, bonus (not being a perquisite, but being a monetary payment) is taken into consideration. However, income tax payment of an employee by the employer, being a monetary payment but also a perquisite is not included for the purpose of computing salary.

5. Salary from two or more employers – Salary from all employers in respect of the period during which an accommodation is provided will be taken into consideration.

6. Accommodation provided on transfer – Where on account of the transfer of an employee from one place to another, he is provided with accommodation at the new place of posting while retaining the accommodation at the other place, the value of perquisite shall be determined with reference to only one such accommodation which has the lower value for a period not exceeding 90 days and thereafter the value of perquisite shall be charged for both such accommodations.

7. Exemption – The above perquisite is not chargeable to tax in respect of any accommodation located in a 'remote area' [i.e., an area located at least 40 kilometres away from a town having a population not exceeding 20,000] provided to an employee working at a mining site or an onshore oil exploration site, or a project execution site or a dam site or power generation site or an offshore site.

2. Rent-free furnished accommodation (not being a hotel) –

First, find out the value of the perquisite assuming that the accommodation is unfurnished and to the figures so arrived, add the value of furniture on the following basis –

a. 10% (p.a.) of the original cost of furniture, if furniture is owned by the employer;
b. actual hire charges (whether paid or payable) if furniture is hired by the employer.

Furniture, here, includes radio sets, televisions sets, refrigerators, air–conditioners and other household appliances.

3. Rent-free furnished accommodation provided in a hotel –

Besides, accommodation in a hotel, it includes licensed accommodation in the nature of motel, service apartment or guest house.
The value of perquisite shall be taken as:

(i) 24% of salary paid or payable for the period during which such accommodation is provided in the previous year; **or**

(ii) actual charges paid/ payable by the employer to such hotel,
whichever is lower.

However, in case of an accommodation provided in a hotel, nothing is chargeable to tax (subject to the fulfilment of given below two conditions) –

1. The hotel accommodation is provided for a period not exceeding in aggregate 15 days in a previous year and
2. Such accommodation is provided on an employee's transfer from one place to another place.

It is to be noted that if in the aforesaid case, the hotel accommodation is provided for more than 15 days, then the perquisite is not taxable for the first 15 days. After that, it is chargeable to tax.

4. Accommodation provided at concessional rent –

Accommodation may be furnished or unfurnished or it is provided in a hotel. However, if it is provided at a concessional rent, the valuation should be made as follows –
Step 1: Find out the value of the perquisite on the assumption that no rent is charged by the employer (as per the above stated rules or rent free accommodation).
Step 2: From the value so arrived at, deduct the rent charged by the employer from the employee.

Problem – 2
A Joint Secretary in Ministry of Mines has been allotted a rent-free unfurnished flat at New Delhi during the previous year 2019-20. Though the license fee of the flat as per Government rules is Rs. 1,600 per month, its fair market rent is not less than Rs. 7,20,000 per annum. Compute the value of the perquisite in respect of rent-free unfurnished flat for the assessment year 2020-21 on the assumption that her/her salary is Rs. 8,80,000 per annum.

Solution:
For a Government employee, licence fee is taken as the value of rent-free unfurnished accommodation. Market rent of the accommodation is of no use to compute the value of this perquisite. Therefore, the taxable value is Rs. 19,200 [Rs. 1,600*12]

Problem –3
A private sector employee based at Ludhiana (population: 45 lakhs), draws Rs. 90,000 per month as basic salary. Other allowances and benefits attached to his office are:

dearness allowance (forming part of salary for all retirement benefits): 17% of basic salary; bonus: 30% of basic salary; commission: Rs. 800 per month, transport allowance: Rs. 1,900 per month for commuting between office and residence (actual expenditure: Rs. 290 per month); and rent-free house (lease rent paid by the employer: Rs. 40,000 per month). Income-tax paid by the company on behalf of N is Rs. 18,000. During the previous year 2019-20., X draws salary of April 2020 in advance. Determine the value of the perquisite in respect of rent-free house and also taxable salary for the assessment year 2020-21.

Solution:

(i)Salary for the purpose of rent-free unfurnished accommodation is:

	Amount (Rs.)
Basic salary (Rs. 90,000*12)	10, 80,000
DA (forming part) (17% of Rs. 10,80,000)	1,83,600
Bonus (30% of Rs. 10,80,000)	3,24,000
Commission (Rs. 800*12)	9,600
Transport allowance [(Rs. 1,900 - Rs. 1,600)*12]	3,600
	16,00,800

(ii)Value of rent-free unfurnished accommodation is:

(a) rent paid by the employer i.e., Rs. 6,00,000 (Rs.50,000*12 months)

(b) 15% of salary i.e., on Rs.16,00,800 = Rs.2,40,120

whichever is lower.

Therefore, lower of above Rs. 2,40,120 is the value of rent-free unfurnished accommodation.

(iii)Computation of Taxable salary for the assessment year 2020-21:

Particulars	Amount (Rs.)
Basic salary	10,80,000
Dearness Allowance@17%	1,83,600
Bonus	3,24,000
Commission	9,600
Transport Allowance [(1,900 – 1,600)*12]	3,600
Value of Rent-Free Unfurnished Accommodation	2,40,120
Income tax paid the employer	18,000
Advance Salary	90,000
Gross Salary/ Net Salary	19,48,920

Problem – 4

N received during the previous year ending March 31, 2020, emoluments consisting of basic pay: Rs. 1,60,000; tiffin allowance: Rs. 19,000 and reimbursement of medical expenditure: Rs. 10,700. His employer has also provided a rent-free furnished flat in Delhi. Lease rent of the unfurnished flat is Rs. 60,000. Some of the household appliances provided to N (with effect from June 1, 2019) are owned by the employer (cost price of which is Rs. 36,000, date of purchase is April 1, 2004 and written down value, as on April 1, 2019 is Rs. 8,400).

Employer pays Rs. 12,000 annually as hire charges for air-conditioners installed throughout the previous year in rent-free flat.
Compute the value of the perquisite if:

a. *N is a Government employee and Rs. 5,000 is the license fee of unfurnished flat as per the Central Government rules;*
b. *N is a private sector employee;*
c. *If N has been provided a hotel accommodation throughout the year (tariff being Rs. 90,000 per annum)?*

Solution:
Calculation of Value of furniture is:

- Owned by the employer [36,000*10%*10/12months] =3,000
- Hire charge of air-condition paid by the employer for 10/12 months of Rs.12,000 10,000

13,000

Value of unfurnished accommodation is:

a. For a Government employee, Rs. 5,000 (being the licence fee).
b. For a non-Government employee (private sector):
   (i) 15% of salary on Rs. 1,79,000 i.e., Rs. 26,850
   (ii) lease rent paid i.e., Rs. 60,000
   whichever is less.
   Thus, Rs. 26,850 is lower, will be the value of unfurnished house
c. For a hotel accommodation, the value is:
   (i) 24% of salary on Rs. 1,79,000 i.e., Rs. 42,960
   (ii) actual charges paid/ payable by the employer to such hotel i.e., Rs90,000.
   whichever is less i.e., Rs. 42,960 will be the value of unfurnished house.

5. Employee's personal obligation met by the employer –
Amount paid by the employer in respect of any obligation which otherwise would have been payable by the employee is taxable in all cases whether the employee is specified or non-specified.

6. Amount payable by the employer to affect an assurance on the life of the employee –
Amount payable by an employer, directly or indirectly, to affect an assurance on the life of the assessee or to affect a contract for an annuity is taxable in the hands of all employees.
This rule is, however, not applicable if the employer makes contribution/ payment towards the following:

a. RPF (up to 12% of salary of the employee);
b. Approved superannuation fund (up to Rs. 1,50,000 per annum);
c. Group insurance schemes;
d. Employee's state insurance schemes; and
e. Fidelity guarantee schemes.

7.Interest-free loan or loan at concessional rate of interest –

If a interest-free loan is given by an employer to the employee (or any member of his household), it is a perquisite chargeable to tax. Value of perquisite is computed at the rate of interest charged by SBI as on the first day of the relevant previous year in respect of loan for the same purpose advanced by it.

Interest is calculated on the maximum outstanding monthly balance for each loan as on the last day of each month.

Given below are the rates of State Bank of India:

Type of loan	*Different limit*	*As on April 1, 2019 (applicable for the assessment year 2020-21)*
Housing loan		8.65% (8.60% for women)
Car loan		9.25% (9.20% for women)
Education loan	Up to Rs. 7.5 lakh	10.00%
	Above Rs. 7.5 lakh	10.75%
Personal loan		14.00% (Approx.)

In the following cases, however, the above perquisite is not chargeable to tax:

1. If a loan is made available for medical treatment in respect of diseases specified in rule 3A (the exemption is, however, not applicable to so much of the loan as has been reimbursed to the employee under any medical insurance scheme; in such a case, perquisite will be chargeable to tax from the date of receipt of insurance compensation).

2. Where the amount of original loan (or loans) does not exceed Rs. 20,000 in aggregate. Where, however, the amount exceeds Rs. 20,000, entire amount is chargeable to tax.

Problem –5

Determine the taxable value of the perquisite in the following cases:

1. N is employed by a private company. On September 1, 2019, the company gives an interest-free housing loan of Rs. 14,00,000. Loan is repayable within 5 years.

2. N is employed by a private sector company. On April 1, 2019, he takes a personal loan of Rs. 12,50,000 from the company. The Company recovered interest @ 8.8% per annum from N.

3. A company gives the following interest-free loan to N, an employee of the company – Rs. 18,000 for child's education and Rs. 2,000 for purchasing a washing machine. No other loan is given by the company.

Solution:

1. Rate of interest of SBI for housing loan is 8.65%.

Therefore, Value of interest-free loan is = Rs. 14,00,000*8.65%*7/12 months

= Rs. 70,641.67

2. Rate of interest of SBI for personal loan is 14.00%.

Therefore, Value of interest-free loan is = Rs. 12,50,000*(14.0% - 8.8%)

= Rs. 65,000

3.Nothing is taxable as amount of loan does not exceed Rs. 20,000.

8.Use of movable assets –

The value of this perquisite is determined @ 10% p.a. on the actual cost of such asset (if the asset is owned by the employer) or the amount of rent paid or payable (if the asset is taken on hire by the employer).

From the value so arrived, deduct the amount received from the employee.

However, no perquisite is chargeable to tax in respect of use of computer/ laptops.

Movable assets sold by employer to its employees (or any member of his household) at a nominal price –

The value of this perquisite is calculated as an actual cost of such asset to the employer *minus* normal wear and tear at the rate given below for each completed year during which such asset was put to use by the employer for his business purposes *minus* amount received from the employee.

Following are the rates for normal wear and tear:

- Computer/ Electronic gadgets : 50% p.a. by reducing balance method (WDV)
- Car : 20% p.a. by reducing balance method (WDV)
- Any other asset : 10% p.a. of the actual cost

[Electronic item means data storage and handling devices like computer, digital diaries and printers but does not include household appliances like mixers, washing machines, ovens, etc.]

Problem –6

Find out the taxable value of the perquisite in the following cases for the assessment year 2020-21:

1. N is given a laptop by the employer-company for using it for office and private purpose (ownership is not transferred). Cost of the laptop to the employer is Rs. 80,000.

2. On December 15, 2019, the company gives its music system to N for domestic use. Ownership is not transferred. Cost of music system (in 1999) to the employer is Rs. 15,000.

3. The employer sells the following assets to the employees on January 1, 2020:

Name of employee	*A*	*B*	*C*
Asset sold	*Car*	*Computer*	*Fridge*
Cost of the asset to employer	*Rs. 6,96,000*	*Rs. 1,17,000*	*Rs. 40,000*
Date of purchase (put to use on the same day)	*May 15, 2017*	*May 15, 2017*	*May15, 2017*
Sale price	*Rs. 2,10,000*	*Rs. 24,270*	*Rs. 1,000*

Before sale on January 15, 2020, these assets were used for business purposes by the employer.

Solution:

1. Use of laptop/ computer is exempt from tax in the hands of the employee.

2. Here, the music system is owned by the employer. Thus, 10% p.a. of actual cost is the taxable value of music system.

Thus, value in respect of movable asset = Rs. 15,000*10%*3.5/12months=Rs. 437.50

or

Rs. 15,000*10%*107/366days' = Rs. 438.52

3.

	Particulars	*Car (Rs.) Dep.@20%*	*Computer(Rs.) Dep.@50%*	*Fridge(Rs.) Dep.@10%SLM*
	Actual cost on May 15, 2017	6,96,000	1,17,000	40,000
Less:	Normal wear and tear (May 15, 2017 to May 14, 2018)	1,39,200	58,500	4,000
	WDV on May 15, 2018	5,56,800	58,500	36,000
Less:	Normal wear and tear (May 15, 2018 to May 14, 2019)	1,11,360	29,250	4,000
	WDV on May 15, 2019	4,45,440	29,250	32,000
Less:	Sale consideration	2,10,000	24,270	1,000
	Taxable value	2,35,440	4,980	31,000

9. Lunch/ Refreshment, etc. –

The value of free food, tea and snacks etc. shall be as under:

Circumstances	*Value of perquisite*
Tea or similar non-alcoholic beverages and snacks (in the form of light refreshments) provided during working hours	NIL
Food and non-alcoholic beverages is provided in working hours in remote area or in an offshore installation	NIL
Food and non-alcoholic beverages is provided in working hours at any other place (other than remote area or in an offshore installation) i.e., either in office or business premises *or* through non-transferable paid vouchers usable only at eating joints provided by an employer	NIL, if the value thereof in either case is up to Rs. 50 per meal. However, expenditure in excess of Rs. 50 per meal should be treated as perquisite. Amount received from the employee is deducted to compute the taxable value of the perquisite.
In any other case	Actual amount of expenditure incurred by the employer *minus* amount paid or recovered from the employee

10.Travelling, Touring and Accommodation –(other than LTC)
Following is the treatment in respect of travelling, touring, accommodation and any other expenses paid by employer for any holiday availed by employee (or any member of household) other than leave travel concession (LTC):

(i)Where such facility is available uniformly to all employees:
Expenditure incurred by the employer *minus* amount recovered from the employee is the taxable value of the perquisite.

(ii)Where such facility is not available uniformly to all employees:
Value at which such facilities are offered by other agencies to the public *minus* amount recovered from the employee is the taxable value of the perquisite.

11.Gift, Voucher or token –
The value of any gift, voucher or token in lieu of which gift may be received by the employee (or by the member of his household) on ceremonial occasions or otherwise shall be determined as the sum equal to the amount of such gift. Such gift is exempt from tax where, the value of such gift, voucher or token, as the case may be, is below Rs. 5,000 in aggregate during the previous year. Beyond Rs. 5,000, gift-in-kind is taxable.
However, gifts made in cash or convertible into money (gift cheques) are not exempt from tax even if their value is less than Rs. 5,000.

12.Credit card –
Any expenditure incurred by the employer in respect of credit card used by the employee or any member of his household after deducting the expenditure on use of this credit card for official purposes is the taxable value of the perquisite. The expenditure incurred by the employer includes the membership fees and annual fees incurred by the employee or any member of his household, which is charged to a credit card (including any add-on-card), provided by the employer (or otherwise paid or reimbursed by the employer).

13.Club expenditure –
This perquisite includes any expenditure on club facility used by the employee or any member of his household which is paid or reimbursed by the employer. It also includes amount of annual or periodical fees paid or payable to a club.

The amount of expenditure incurred by the employer in respect of club facility used by the employee or any member of his household after deducting the expenditure on use of this club facility for official purposes is the taxable value of the perquisite.

(i)Expenditure for official use:
The amount of expenditure incurred on use of club facility for official purposes is deductible, provided following conditions are satisfied:
1. Complete detail in respect of such expenditure is maintained by the employer which may, *inter alia,* include the date of expenditure, the nature of expenditure and its business feasibility.

2. The employer gives a certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties.

(ii)The following expenditure is exempt from tax:
1. Health club, sports facilities etc. provided uniformly to all classes of employees by the employer at employer's premises.

2. The initial one-time deposit or fees for corporate or institutional membership, where benefit does not remain with a particular employee after cessation of employment.

14.Sweat equity shares or Employees stock option plan (ESOP) –
Perquisite in respect of "sweat equity shares" or "ESOP" is chargeable to tax in the hands of employees, provided such shares are allotted or transferred to the concerned employee after March 31, 2009.

For the purpose of valuation of this perquisite, fair market value (FMV) of shares or securities has to be calculated on the date on which the employee exercises the option. Amount actually paid or recovered from the employee in respect of such shares or securities shall be deducted.

This perquisite will be taxable in the hands of employee in the previous year in which shares or securities are allotted or transferred to him. However, fair market value shall be calculated on the date on which the employee exercises the option.

"Sweat equity shares" means shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called. Such shares may be equity shares, any other shares, scrips, debentures, derivatives or units. These may be transferred/ allotted (directly or indirectly) to the employee.

i.Computing fair market value of shares in case of quoted shares:
In a case where, on the date of exercise of the option, the share in the company is listed on a recognized stock exchange in India, the fair market value shall be the average of opening price and closing price of the share on that date on the said stock exchange. Where, however, on the date of exercise of the option, the share is listed on more than one recognized stock exchanges, the fair market value shall be the average of opening price and closing price of the share on the recognized stock exchange which records the highest volume of trading in the share. Where on the date of exercise of the option, there is no trading in the share on any recognized stock exchange in India, the fair market value shall be the closing price of the share on any recognized stock exchange on a date closest to the date of exercise of the option and immediately preceding such date.

ii. Computing fair market value of shares in case of unquoted shares:

In a case where, on the date of exercise of the option, the share in the company is not listed on a recognized stock exchange in India, the fair market value shall be such value of the share in the company as determined by a merchant banker.

15.Domestic servants –
The value of perquisite shall be the actual cost to the employer minus amount paid by the employee for such services.

If an employer provides a rent-free house (owned by the employer) to his employee, expenses (inclusive of salary of a gardener) incurred by the employer on maintenance of garden and ground attached to the house, are not taxable separately.

16.Gas, Electricity or Water supply –
The value of perquisite shall be the cost to the employer as reduced by the amount recovered from the employee.

17.Education –

1. Any amount spent for providing free education facilities to, and training of, the employees is not taxable.

2. Any payment of school fees of the family members of the employee directly to the school or any reimbursement of expenditure incurred for education of the family members of the employee is taxable as a perquisite in all cases.

3. Education facility in employer's institute:
   It means:
   a. an educational institute which is owned and maintained by the employer and educational facility is provided; or
   b. an educational facility is provided in any institute by reason of employee's employment with the employer.

Different situations	*Amount chargeable to tax*
Where educational facility is provided to employee's children: a. If cost of education or value of such benefit does not exceed Rs. 1,000 per month per child (no restriction on number of children) b. Where such amount exceeds Rs. 1,000 per month per child §1	 *Nil* Cost of such education in a similar institution in or near the locality *minus* amount paid or recovered from the employee
Where education facility is provided to member of his household (other than children)	Cost of such education in a similar institution in or near the locality *minus* amount paid or recovered from the employee

§1 A literal meaning of the line indicates that if the cost of education per child exceeds Rs. 1,000 per month, the entire cost will be the value of the perquisite. Also, the Punjab and Haryana High Court in the case of *CIT v. Director, Delhi Public School [2011] 202 Taxmann 318* ruled that nothing is taxable if cost of education in a similar institute is equal to or less than Rs. 1,000 per month. In case, it exceeds Rs. 1,000 per month, the entire amount is chargeable to tax.

18.Leave Travel Concession in India [Section 10(5)] –

Leave travel assistance extended by an employer to an employee for going anywhere in India along with his family is exempt according to the provisions mentioned in the table given below:

Different situations	*Amount of exemption (exemption is available only in respect of fare for going anywhere in India along with the family twice in a block of four years)*
Where journey is performed by air	Amount of economy class fare of the national carrier by the shortest route or the amount spent, whichever is less
Where journey is performed by rail	Amount of air-conditioned first-class rail fare by the shortest route or the amount spent, whichever is less
Where the places of origin of journey and destination are connected by rail and journey is performed by any other mode of transport	Same as (2)
Where the places of origin of journey and destination (or part thereof) are not connected by rail: a. Where a recognized public transport exists b. Where no recognized public transport exists	First class or deluxe class fare by the shortest route or the amount spent whichever is less Air-conditioned first-class rail fare by the shortest route (as if the journey had been performed by rail) or the amount actually spent, whichever is less.

Notes:

1. Family for this purpose includes:

a. spouse and children of the employee; and
b. parents, brothers and sisters of the employee, who are wholly or mainly dependent upon the employee.

2. Only two journeys performed in a block of four years is exempt:

Exemption of this perquisite is available in respect of two journeys performed in a block of four calendar years. The different blocks are:

a. 2010-2013 (i.e., January 1, 2010 to December 31, 2013);
b. 2014-2017 (i.e., January 1, 2014 to December 31, 2017);

c. 2018-2021 (i.e., January 1, 2018 to December 31, 2021)

3. "Carry-over" concession:
If an assessee has not availed travel concession or assistance during any of the specified four-year block periods on one of the two permitted occasions (or on both occasions), exemption can be claimed in the first calendar year of the next block (but in respect of only one journey). This is known as "carry-over" concession. In such case, exemption so availed will not be counted for the purposes of claiming the future exemptions allowable in respect of two journeys in the subsequent block.

4. Exemption is based on actual expenditure.

5. Exemption is available in respect of fare:
Exemption is strictly restricted to expenses on air fare, rail fare, bus fare etc. No other expenditure, like scooter charges, lodging and boarding expenses etc. are qualified for exemption.

6. Exemption is available in respect of shortest route.

19.Medical Facility –
The following expenses whether incurred or reimbursed by the employer are exempt from tax:

Medical facilities in India:
1. Medical facility in employer's hospital (including clinic, dispensary or nursing home).

2. Medical facility in a hospital maintained by Central/ State Government or by a local authority or by any other person approved by the Government for the treatment of its employees.

3. Treatment of prescribed disease given in rule 3A(2) in a hospital approved by the Chief Commissioner.

4. Medical insurance premium for employees on any health insurance policy.

5. Medical facility in a private clinic not exceeding, Rs. 15,000 in aggregate in a year.

Medical facility outside India:
The amount is exempt from tax subject to the conditions given below in the table:

Perquisite not chargeable to tax	*Conditions to be satisfied*
Medical treatment of employee or any member of family of such employee outside India	Expenditure shall be excluded from perquisite only to the extent permitted by RBI
Cost on travel of the employee/ any member of his family and one attendant who accompanies the patient in connection	Expenditure shall be excluded from perquisite only in the case of an employee whose gross total income, as computed

with treatment outside India	before included therein the said expenditure (i.e., travelling) does not exceed Rs. 2,00,000
Cost of stay abroad of the employee or any member of the family for medical treatment and cost of stay of one attendant who accompanies the patient in connection with such treatment	Expenditure shall be excluded from the perquisite only to the extent permitted by RBI

Family for this perquisite means:

1. the spouse and children of the individual; and
2. the parents, brothers and sisters of the individual or any one of them wholly or mainly dependent on the individual.

Problem –7

Find out the taxable value of the perquisite in respect of medical facility in the following cases:

Y, a director in the employer company, gets medical treatment in dispensary maintained by his employer. The expenditure on medical treatment provided to Y and his family members during the previous year 2019-20 is as follows:

	Amount (Rs.)
Y, Mrs. Y and minor child of Y	*9,100*
Major son of Y (not dependent upon Y)	*2,700*
Parents of Y (dependent upon Y)	*3,000*
Parents of Mrs. Y (dependent upon Y)	*12,000*
Brother of Y (dependent on Y)	*6,000*
Sister of Y (not dependent on Y)	*17,000*

Besides, he gets **reimbursement** *of ordinary medical expenses paid to a private medical practitioner:*

	Amount (Rs.)
Treatment of Y, Mrs. Y and their children	*2,000*
Treatment of father of Y	*13,700*
Treatment of father of Mrs. Y	*3,000*

Solution:

1. Medical treatment provided to an employee or his family members in a hospital/ dispensary maintained by the employer is exempt from tax.
Thus, The amount which is exempt from tax [Rs. 9,100 + Rs. 2,700 + Rs. 3,000 + Rs. 6,000] = Rs. 20,800

2. The amount which is not exempt from tax [Rs. 12,000 + Rs. 17,000]
= Rs. 29,000

3. Reimbursement of expenses incurred in a private clinic for the employee and his family members is exempt from tax to the extent of Rs. 15,000.

Thus, taxable amount is Rs. 2,000 + Rs. 13,700 = Rs. 15,700 – Rs. 15,000
= Rs. 700

4. Reimbursement of expenses incurred in a private clinic is fully taxable, if the expenses incurred are not related to the family members of the employee (Father of Mrs. Y)
= Rs. 3,000

6.5 SUMMARY

In this chapter of salary, we have studied the tax treatment of different types of allowances and some perquisites. Some more perquisites are discussed in the next chapter of salary.

LESSON 7

Unit III

SALARIES - III

STRUCTURE OF THE CHAPTER

7.1 VALUATION OF DIFFERENT PERQUISITES

Motor Car facility-

Taxable value of perquisite in respect of car is computed after observing the following three steps:

Step 1: Check who is the owner of car: employer or employee?
Step 2: Check who incurs the running and maintenance expenditure of car
Step 3: Check the use of car: private, office or both

Chart for computing the value of motor car

Ownership	***Owned by Employee***		***Owned by Employer***	
Expenses born by	***Employee***	***Employer***	***Employer***	***Employee***
Official use	Not a perquisite			
Private use	Not a perquisite	Actual expenditure of the employer XXXX Less: Amount recovered from the employee XX Taxable perquisites XX		
Official as well as personal use	Not a perquisite	Actual expenditure of the employer Less: Official expense Rs.1,800/ m [≤ 1.6 ltr.] or Rs.2,400/ m [> 1.6 ltr.] *plus* Rs.900/ m [if driver is provided] OR Higher amount (if log book is maintained) Less: Amount recovered from the employee	Rs.1,800/ m [≤ 1.6 ltr.] Or Rs.2,400/ m [> 1.6 ltr.] *Plus* Rs. 900/ m [if driver is provided] *Note: Amount recovered is not deductible*	Rs.600/ m [≤ 1.6 ltr.] or Rs.900/ m [> 1.6 ltr.] *plus* Rs.900/ m [if driver is provided] *Note: Amount recovered is not deductible*

Note:

1. If car is owned by the employer which is used for official as well as personal use and expenses for personal purpose are incurred by the employee, perquisite value will be done according to the provision given in this column.

Ownership	*Owned by Employee*		*Owned by Employer*	
Expenses born by	***Employee***	***Employer***	***Employer***	***Employee***
Official use	Not a perquisite			
Private use	Not a perquisite	Actual expenditure of the employer XXXX Less: Amount recovered from the employee XX Taxable perquisites XX		
2. Amount recovered from the employee is never deducted in case of car owned by the employer and the car is used for official as well as personal purpose.				

§ Conditions to be satisfied if car is used for official purposes:
Where the employer or the employee claim that the motor-car is used wholly and exclusively in the performance of official duty, the following two conditions should be satisfied –

1. The employer has maintained complete details of journey undertaken for official purpose which may include date of journey, destination, mileage, and the amount of expenditure incurred thereon.
2. The employer gives a certificate to the effect that the expenditure was incurred wholly and exclusively for the performance of official duties.

It is to be noted that the above two conditions should also be satisfied if a car is owned by the employee, expenses are incurred or reimbursed by the employer and the employee claims that the expenses for official purposes is more than Rs. 1,800 per month (or Rs. 2,400 per month if cc of car exceeds 1,600 cc).

Notes –
1. Month: 'Month' means complete month and a part of the month is left out of consideration.

2. The use of motor car by an employee for the purpose of going from his residence to the place where the duties of employment are to be performed or from such place back to his residence, is not chargeable to tax.

3. Car at concessional rate:
If motor car is provided at a concessional rate, the valuation is made according to the basis stated above as if the employee has been provided a free motor car and the amount so computed is reduced by the amount charged by the employer for use of motor car. However, nothing is deductible in respect of amount recovered from the employee in the following situations:

a. Where car is owned or hired by the employer and maintenance and running expenses are also met or reimbursed by the employer and car is used partly for official purposes and partly for private purposes *(already discussed in the table given above)*.
b. Where car is owned or hired by the employer and maintenance and running expenses are also met or reimbursed by the employee and car is used partly for

official purposes and partly for private purposes *(already discussed in the table given above).*

4. Where two or more cars are owned or hired by the employer and maintenance and running expenses are also met or reimbursed by the employer, and the employee (or any member of his household) are allowed the use of such motor-cars (or all or any of such motor-cars) (otherwise than wholly and exclusively in the performance of his duties), in such a situation any one car (as selected by the employee) will be treated as used partly for official and private purposes and others would be assumed as used wholly for private purposes for the purpose of valuation of perquisite of car.

Problem –1

Find out the taxable value of the perquisite in respect of car in the following different situations for the assessment year 2020-21:

1. X is employed by a company. He has been provided a car (1200cc) owned by the employer, cost of the car is Rs. 4,26,000. The expenditure incurred by the company on maintenance of the car is – petrol: Rs. 46,000; driver: Rs. 36,000 and maintenance: Rs. 10,000. The car can be used by X partly for official purposes and partly for private purposes. A sum of Rs. 20,000 is recovered from X.

2. Assume in situation (1) that the car is used only for private purposes.

3. A car (1800cc) is owned by the employer (cost of the car being Rs. 4,80,000). X, an employee, can use it partly for official purposes and partly for private purposes. Expenses for private purposes are, however, incurred by X. During the previous year 2019-20, the total expenditure incurred by X is Rs. 80,000 on car and Rs. 10,000 on driver.

4. Assume in situation (3), the driver's expenses are reimbursed by the employer.

5. Assume in situation (3) that the car can be used only for private purposes.

6. Assume in situation (3) that the car can be used only for private purposes and expenses on driver is also reimbursed by the employer.

7. X owns a car (1400cc). He uses it partly for official purposes and partly for private purposes. During the previous year 2017-18, he incurs a sum of Rs. 40,000 on running and maintenance of car. Besides, he has engaged a driver (salary: Rs. 24,000). The employer reimburses the entire expenditure of Rs. 64,000. Logbook of the car is not maintained.

Solution:

1. Car is owned by the employer, expenses are incurred by the employer and car is used for official as well as personal purposes.

Taxable value is

Car (1,800*12)	=	21,600
Driver (900*12)	=	10,800
		32,400

2. Car is owned by the employer, expenses are incurred by the employer and car is used for personal purposes only.

Taxable value is

	Depreciation (10% of 4,26,000)	=	42,600
	Petrol	=	46,000
	Driver	=	36,000
	Maintenance	=	10,000
	Expenditure incurred by the employer	=	1,34,600
Less:	Amount recovered from X	=	12,000
			1,22,600

3. In this case, car is owned by the employer which is used for official as well as personal use and expenses for personal purpose are incurred by the employee. In such cases, perquisite value will be done as per the provisions which are applicable for cases where car is owned by the employer, expenses are incurred by the employee and car is used for both official as well as personal purposes.

Taxable value is

Car (900*12) = 10,800

4. This situation is same as that of situation (3). In this case, car is owned by the employer which is used for official as well as personal use and expenses for personal purpose are incurred by the employee. In such cases, perquisite value will be done as per the provisions which are applicable for cases where car is owned by the employer, expenses are incurred by the employee and car is used for both official as well as personal purposes.

So, taxable value is

Car (900*12)	=	10,800
Driver (900*12)	=	10,800
		21,600

5. Car is owned by the employer, expenses are incurred by the employee and car is used for personal purposes only.

Taxable value is

Depreciation (10% of 4,80,000) = 48,000

6. Car is owned by the employer, expenses are incurred by the employee (except driver's expenses because driver's expenses are reimbursed by the employer) and car is used for personal purposes only.

Taxable value is

Depreciation (10% of 4,80,000)	=	48,000
Driver Expenses	=	20,000
		68,000

7. Car is owned by the employee, expenses are reimbursed by the employer and car is used for official as well as personal purposes.

	Amount reimbursed by the employer	=	64,000
Less:	Deduction for official use		
	[(1,800*12 + 900*12)]	=	32,400
			31,600

In this case, had logbook been maintained, deduction for official use would have been taken as higher of Rs. 32,400 or expenses as per the log book.

Problem –2

During the previous year 2019-20, 'X' enjoyed the following allowances/ perquisites in addition to basic salary of Rs. 25,000 per month:

i. *Car facility [1.6 litres] for private and official purposes. All expenses which are Rs. 1,68,000 (including salary of the driver) borne by employer. 'X' was made to pay a token amount of Rs. 500 per month for the same.*
ii. *Loan of Rs. 4,00,000 [for personal purposes] @ 11.05% per annum received on 1-6-2019. It was repayable in 5 half yearly instalments of equal amount starting from 31-12-2019. SBI charges 17.80% for similar loans.*

Compute gross salary of 'X' for the assessment year 2020-21.

Solution:

Computation of gross salary of X for the assessment year 2020-21:

	Amount (Rs.)
Basic salary [25,000*12]	3,00,000
Car [1,800+900]*12	32,400
Loan	
[4,00,000*6.75%*7/12] + [3,20,000*6.75%*3/12]	21,150
Gross salary	3,53,550

Free transport provided by a transport undertaking to its employees –

The value of this perquisite is equal to the value at which such benefit is offered by the employer to the public *minus* amount recovered from the employee.

However, nothing is chargeable to tax in the hands of employees of railways/ airlines.

Any other benefit or amenity –

It covers any other benefit or amenity, service, right or privilege provided by the employer and it is applicable to all employees. However, it does not cover the following –

1. Perquisites already discussed above

2. Telephone/ mobile phones

Value of such perquisites shall be determined on the basis of cost to the employer under an arm's length transaction as reduced by the employee's contribution, if any.

7.2 DEDUCTIONS FROM SALARY

Deductions from salary are given in section 16. There are two deductions available from gross salary –

*1. **Standard Deduction [u/s 16 (i)]** Gross Salary or Rs.50,000 , whichever is lower.*

*2.**Entertainment Allowance [u/s 16(ii)]-*** Entertainment allowance is first included in salary income under the head "Salaries" and thereafter a deduction is given on the basis enumerated in the following paragraphs :

In the case of a Government employee (i.e., a Central Government or a State Government employee), the leastπ of the following is deductible:

a. Rs. 5,000;

b. 20 per cent of basic salary; or

c. amount of entertainment allowance granted during the previous year

*2. **Professional tax [u/s 16(iii)]:*** Professional tax or tax on employment, levied by a State under article 276 of the Constitution, is allowed as deduction. Deduction is available only in the year in which professional tax is paid. If the professional tax is paid by the employer on behalf of an employee, it is first included in the salary of the employee as a "perquisite" and then the same is allowed as deduction on account of "professional tax" from gross salary.

It is to be noted that there is no monetary ceiling under the Income-tax Act. Under article 276 of the Constitution, a State Government cannot impose more than Rs. 2,500 per annum as professional tax. However, under the Income-tax Act, whatever professional tax is paid during the previous year is deductible.

Deductions under section 80 –

For deductions under section 80C to 80U, see the chapter "Deductions".

7.3 SUMMARY

This chapter of salary has discussed the valuation of different perquisites and deductions available from gross salary. Further, practical questions have been discussed below in detail. These questions cover the different provisions of salary discussed earlier in detail.

7.4 EXERCISE

Exercise 1 : Long practical questions

The working notes given below in the solutions of unsolved questions are only for clarity purposes and for solving some typical concepts. However, in the final examination, students are expected to be more cautious in preparing working notes. Working notes in the examination must mention the concepts along with numerical calculation.

Problem 1 –

X (age: 50 years) receives the following incomes from Y Ltd. during the year ending March 31, 2020:

a. *Salary @ Rs. 25,000 p.m.*
b. *Tiffin allowance) @ Rs. 1,000 p.m. (Actual expenditure Rs. 8,000)*
c. *Commission @ Rs. 2,000 p.m.*
d. *Reimbursement of ordinary medical expenditure for the treatment of X and his family members: Rs. 30,000*
e. *Transport allowance @ Rs. 1,800 p.m. (Actual expenditure: Rs. 10,800)*

Besides, X enjoys the following perks:

a. *Unfurnished flat provided at Delhi at a nominal rent of Rs. 3,500 p.m. (Rent paid by employer Rs. 12,000 p.m.)*
b. *Interest free loan for purchasing home appliances (Amount: Rs. 1,00,000; Date of taking loan: 1-06-2018; Amount outstanding between April 2019 and Nov. 30, 2019: Rs. 50,000 and after Nov. 30, 2019: Rs. 18,000. The SBI lending rate for similar loan on April 1, 2019 is 18.50%.*
c. *The employer company sells the following assets to X on January 10, 2019:*

Assets Sold	*Car*	*Computer*	*Fridge*
Cost of asset to the employer	*Rs. 4,00,000*	*Rs. 60,000*	*Rs. 20,000*
Sale price	*Rs. 2,00,000*	*Rs. 18,000*	*Rs. 10,000*

Date of purchase of all the assets (Put to use on same day): June 10, 2018

d. *He contributed 20% of his salary to a recognized provident fund account to which his employer made matching contribution.*
e. *Interest @ 13% p.a. amounting to Rs. 52,000 has been credited to his aforesaid provident fund account during the previous year on Dec. 10, 2019.*
f. *He donated Rs. 20,000 to National Defence Fund.*

Determine the net income of Mr. X for the previous year 2019-20 relevant to the assessment year 2020-21.

Solution:

Computation of total income of Mr. X for the assessment year 2020-21:

Particulars	*Amount (Rs.)*
1. Income from Salary: Basic salary@Rs.25,000p.m. for 12 months	3,00,000
Tiffin allowance (fully taxable)	12,000
Transport allowance (1,800 *12 *[W.N. – 2]fully taxable*	21,600
Commission@s.2,000 p.m.	24,000
Medical reimbursement (30,000 – 15,000) *[W.N. – 1]*	15,000
Accommodation at concessional rent [15% of salary i.e.,(3,00,000 + 12,000 + 24,000 + 21,600) i.e., Rs.53,640 or Rs.1,44,000 whichever is lower i.e., 53,640 – rent recovered i.e., 3,500*12 = 42,000]	11,640
Interest free loan (50,000*18.50%*8/12 + 18,000*18.50%*4/12)	7,277
Sale of movable asset (56,000 + Nil + 6,000) *[W.N. – 3]*	62,000
Employer's Contribution towards RPF in excess of 12% (8% of Rs.3,00,000)	24,000
Interest on RPF in excess of 9.5% , (52,000*3.5/13)	14,000

	Gross salary		4,91,517
Less:	Standard Deduction under section 16(i)		50,000
	Net salary		4,41,517
2.	Income from House Property		Nil
3.	Profit and gains from business or profession		Nil
4.	Capital Gain		Nil
5.	Income from other sources		Nil
	Gross total income [sum of 1 to 5]		4,41,517
Less:	Deduction under section 80C (20% of 3,00,000)	Rs.60,000	
	Deduction under section 80G	Rs.20,000	80,000
	Total income		3,61,517
		(Rounded off)	3,61,520

Working notes:

1. Reimbursement of medical expenses in a private clinic is exempt upto Rs. 15,000.

2. Transport allowance is fully taxable (other than physically handicapped/ blind people) from the assessment year 2019-20.

3. Sale of movable assets:

	Particulars	Car (Rs.) Dep.@20%	Computer (Rs.) Dep.@50%	Fridge (Rs.) Dep.@10%SLM
	Actual cost	4,00,000	60,000	20,000
Less:	Normal wear and tear (year 1)	80,000	30,000	2,000
	WDV	3,20,000	30,000	18,000
Less:	Normal wear and tear (year 2)	64,000	15,000	2,000
	WDV	2,56,000	15,000	16,000
Less:	Sale consideration	2,00,000	18,000	10,000
	Taxable value	56,000	Nil	6,000

4. Donation to National Defence Fund is allowed as 100% deduction under section 80G.

Problem 2 –

Mr. X (age 56 years) is a Manager of a company in Delhi. He retires from service on December 31, 2019 after 28 years and 9 months of service. Other details are as follows for the previous year ending 31st March, 2020:

a. Basic salary Rs. 8,000 p.m.
b. House rent allowance Rs. 3,000 p.m. Rent paid by Mr. X Rs. 2,500 p.m.
c. Lunch allowance Rs. 100 per day for 80 days when Mr. X was on field duty.
d. Reimbursement by the company of salary of a watchman and a sweeper Rs. 1,200 p.m. each who are the employees of Mr. X.
e. He receives Rs. 2,00,000 as gratuity. He was drawings a salary of Rs. 8,000 p.m. since January 1, 2019.
f. After retirement he is in receipt of pension @ Rs. 3,500 p.m. On March 1, 2020 he gets one half pension commuted for Rs. 1,50,000.

g. *During the previous year he deposited Rs. 70,000 in public provident fund. He paid the life insurance premium Rs. 4,000 (sum assured Rs. 50,000) on the policy taken on the life of his married son.*

His income from other sources is Rs. 1,50,000. Compute his taxable income and tax liability for the assessment year 2020-21.

Solution:

Computation of total income of X for the assessment year 2020-21:

	Particulars	*Amount (Rs.)*
1.	**Income from Salary:** Basic salary@Rs. 8,000p.m. for 9 months	72,000
	HRA for 9 months (27,000 – 15,300) *[W.N. – 1]*	11,700
	Lunch allowance (100*80)	8,000
	Watchman and sweeper (1,200*2 *9)	21,600
	Gratuity (2,00,000 – 1,12,000) *[W.N. – 2]*	88,000
	Uncommuted pension (Rs.3,500*2 + 1,750)	8,750
	Commuted pension (1,50,000 – 1,00,000) *[W.N. – 3]*	50,000
	Gross salary	2,60,050
Less:	Deduction under section 16(i)	50,000
	Net Taxable salary	2,10,050
2.	**Income from House Property**	Nil
8	**Profit and gains from business or profession**	Nil
9	**Capital gains**	Nil
10	**Income from other sources**	1,50,000
	Gross total income (sum of 1 to 5)	**3,60,050**
Less:	Deduction under section 80C (70,000 + 4,000)	74,000
	Total income	2,86,050

Working notes:

1. HRA exemption:Least of the following:
   a. 36,000 [50% of salary]
   b. 27,000 [HRA actually received]
   c. 22,500 – 7,200 = 15,300 [Rent paid *minus* 10% of salary]

   Rs. 15,300, being the least, is exempt from tax.

2. Gratuity exemption:

   If nothing is mentioned, then we have to assume that the employee is not covered under Payment of Gratuity Act, 1972:
   a. (28*1/2*80,000/10) = 1,12,000 [Half month average salary]
   b. 10,00,000 [Amount specified by the Government]
   c. 2,00,000 [Gratuity actually received]

   Rs. 1,12,000, being the least, is exempt from tax.

3. Commuted pension exemption:

   50% of commuted value = 1,50,000

   Therefore, full value = 3,00,000

Amount exempt is 1/3rd of full value because employee received gratuity also
Therefore, amount exempted is 3,00,000*1/3 = Rs. 1,00,000

Problem 3 –

X was general manager of ABC Ltd. He retired from service on 31-12-2019 after 30 years and 7 months of service. The following information has been provided by him:

a. *Salary Rs. 18,000 p.m. from 1-1-2019.*
b. *House rent allowance Rs. 10,000 p.m. From 1-1-2019, he lived in his own house.*
c. *Medical allowance Rs. 2,400 p.m.*
d. *Rs. 11,200 being the cost of first class rail-ticket for X and his family for their visit to their home town were reimbursed by the employer.*
e. *A car of 1.4 litres engine cubic capacity is provided by the company for official and personal use and all expenses of running and maintenance of car and salary of the driver are borne by the employer.*
f. *X contributes 20% of his salary to a recognized provident fund and the employer contributes 10%.*
g. *He has invested Rs. 10,000 in National Savings Certificate VIII Issue and Rs. 10,000 in PPF account. He paid Rs. 8,000 towards life insurance premium.*
h. *He received Rs. 2,70,000 as gratuity. His salary for the preceding years were as under:*
   - *Year ending 31-12-2014: Rs. 1,68,000*
   - *Year ending 31-12-2015: Rs. 1,80,000*
   - *Year ending 31-12-2016: Rs. 1,88,000*
i. *He received Rs. 2,16,000 for encashment of leave for twelve months unavailed leave. He was entitled to one month's leave for every year of service.*

Compute his taxable income for the assessment year 2020-21.

Solution:

Computation of total income of X for the assessment year 2018-19:

	Particulars	*Amount (Rs.)*
	Basic salary @ Rs. 18,000 p.m. for 9 months	1,62,000
	HRA	90,000
	Medical allowance	21,600
	Car (1,800 + 900)* 9months	24,300
	Reimbursement of rail ticket fare	Exempt
	Gratuity (2,70,000 – 2,70,000) *[W.N. – 1]*	Nil
	Leave salary (2,16,000 – 1,80,000)	36,000
	Gross salary	3,33,900
Less:	Deduction under section 16(i)	50,000
	Net salary	2,83,900
Add:	Other income	Nil
	Gross total income	2,83,900
Less:	Deduction under section 80C (32,400 + 10,000 + 10,000 + 8,000)	60,400
	Total income	2,23,500

Working notes:

1. <u>Gratuity exemption:</u>
   a. (30*1/2*18,000) = 2,70,000 [Half months average salary]
   b. 10,00,000 [Amount specified by the Government]
   c. 2,70,000 [Gratuity actually received]

2. <u>Leave encashment exemption:</u>
   a. 12*18,000 = 2,16,000 [Leave salary based on the leave at the credit of employee]
   b. 10*18,000 = 1,80,000 [10 months salary]
   c. 3,00,000 [Amount specified by the Government]
   d. 2,16,000 [Leave encashment actually received]

Problem 4 –
X (age 54 years), a director of LMN (P) Ltd., receives the following emoluments during the previous year relevant for the assessment year 2020-21:
Basic salary: Rs. 1,80,000; Dearness allowance: Rs. 24,000 (not forming part of basic pay); commission @ 1% of turnover (turnover achieved by X during the previous year 2019-20: Rs. 10,00,000); arrears of the bonus of the previous year 2013-14: Rs. 6,000 (not taxed earlier); employer's contribution towards RPF: Rs. 30,000; interest credited in provident fund account @ 13.5% on April 3, 2019: Rs. 900; conveyance allowance: Rs. 1,200 (60% of which is utilized for official purposes); education allowance for X's three sons @ Rs. 183.33 per month per child: Rs. 6,600; rent-free furnished house in Calcutta (lease rent of unfurnished house paid by the employer: Rs. 90,000; rent of furniture: Rs. 12,000); free services of gardener, cook and watchman (salary: Rs. 3,000, Rs. 4,000, Rs. 5,000 respectively). On March 10, 2020, LMN (P) Ltd. sells imported furniture to X for Rs. 20,000 (the furniture was purchased by the company on June 30, 2014 for Rs. 6,10,000 and since then it was used for business purposes). He runs a business. During the previous year, income from business is Rs. 5,40,000.
He makes the following payments during 2019-20:

a. Own contribution to RPF: Rs. 32,000
b. Deposit in Home Loan Account of National Housing Bank: Rs. 4,000 (including advance deposit of Rs. 1,000)
c. Contribution to NSC VIII issue: Rs. 24,000

Determine the net income and tax liability for the assessment year 2020-21.

Solution:
Computation of Net taxable income of X for the assessment year 2018-19:

Particulars	Amount (Rs.)
1. **Income from Salary**: Basic salary	1,80,000
Dearness allowance (not forming part)	24,000
Commission (Rs. 10,00,000*1%)	10,000
Arrears of bonus of the previous year not taxed earlier	6,000
Employer's contribution to RPF in excess of 12% (Rs. 30,000-12% of Rs. 1,90,000)	7,200

Interest credited to in excess of 9.5%= (Rs. 900/13.5*4)	267
Conveyance allowance (Rs. 1,200 - 60% of Rs. 1,200)	480
Education allowance (Rs. 6,600 - Rs. 100*2*12)	4,200
Rent free furnished house *[W. N.]*	41,202
Salary of Gardener	3,000
Salary of Cook	4,000
Salary of Watchman	5,000
Sale of furniture (Rs. 6,10,000 - dep. for 5 years i.e., Rs. 3,05,000 - Rs. 20,000)	2,85,000
Gross salary/ Net salary	5,70,349
Less: Deduction u/s 16 (i)	50,000
Net Salary	5,20,349
2. **Income from business**	5,40,000
Gross total income	10,60,349
Less: Deduction under section 80C (Rs. 32,000 + Rs. 4,000 + Rs. 24,000)	60,000
Net taxable income (Rounded off)	10,00,350

Computation of tax liability: (for other individual)

Upto Rs. 2,50,000	Nil	
On next Rs. 2,50,000 @5%	Rs. 2,500	
On next Rs. 5,00,000@20%	Rs. 1,00,000	
On balance Rs. 350@30%	Rs. 105	Rs. 1,02,605
Add: EC @ 2%		Rs. 2,052
Add: SHEC @ 1%		Rs. 1,026
Add: Health Cess1%		Rs. 1,026
Total tax liability		Rs. 1,06,709
(Rounded off)	Rs. 1,06,710	

Working note for RFA:
Calculation of salary for RFA:
Rs. 1,80,000 + Rs. 10,000 + Rs. 480 + Rs. 4,200 =Rs. 1,94,680
15% of Rs. 1,94,680 or Rs. 90,000 whichever is less = Rs. 29,202
Add: Rent on Furniture = Rs. 12,000
Rs. 41,202

Problem 5 –

Mr. R (age 48 years) is the manager of a private company at Delhi since March 1, 2016. He is in grade of Rs. 10,000 – 500 – 20,000, plus a dearness allowance @ 20% of his basic pay, half of which enters into retirement benefits. He contributes 15% of his salary to RPF to which his employer contributes an equal amount. During the previous year, he took a loan of Rs. 2,00,000 from his provident fund for his daughter's marriage out of which he repaid Rs. 20,000 during the year by way of deduction from his salary.

He has been provided with a rent-free house for which the company pays rent of Rs. 84,000 p.a. He is getting a transport allowance of Rs. 3,800 p.m. He is also getting a *fixed medical allowance of Rs. 2,000 p.m. and a tiffin allowance of Rs. 2,000 p.m. His club bills of Rs. 20,000 were also paid by the company.*

He received Rs. 11,000 by way of encashment of leave on March 31, 2020. He has been provided with the facility of a gardener and a cook who are paid each Rs. 1,500 p.m. by the employer. He is also provided with a laptop costing Rs. 1,00,000 for use.

Two children of Mr. R are studying in the school run by the employer for which no fees are paid. Expenditure per student is Rs. 1,500 per month.

His salary falls due on the first day of next month.

His other incomes are:

Dividend from Reliance Industries	*Rs. 10,000*
Long-term capital gain	*Rs. 20,000*
Bank interest	*Rs. 41,530*

He contributed Rs. 20,000 for Prime Minister's National Relief Fund. He further paid Rs. 10,000 towards medical treatment of his dependent son who is a person with disability. He also paid LIC premium on the life of his major son Rs. 12,000 on a policy of Rs. 50,000 (policy is taken during 2016-17).

Compute his total income and tax payable for the assessment year 2020-21.

Solution:

Computation of total income of R for the assessment year 2018-19:

Particulars		Amount (Rs.)
1. Income from Salary: Basic salary (11,500*12)		1,38,000
DA (20% of 1,38,000)		27,600
Employer's contribution in RPF in excess of 12% (3% of 1,51,800)		4,554
Rent free accommodation		36,810
Transport allowance @Rs.3,800 p.m. for 12 months		45,600
Medical allowance@Rs.2,000p.m. for 12 months		24,000
Tiffin allowance@ Rs. 2,000 p.m. for 12 months		24,000
Club facility (being personal liability of employee paid by employer)		20,000
Encashment of Leave salary		11,000
Gardener @Rs. 1,500 p.m. for 12 months		18,000
Cook@Rs. 1,500 p.m. for 12 months		18,000
Education facility (1,500 – 1,000)*2*12		12,000
Gross salary		3,79,564
Less: Deduction under section 16(i)		50,000
Net salary		3,29,564
2. Long-term capital gains		20,000
3. Income from other sources:		
(i)Dividend from Reliance Ltd.		Exempt
(ii)Bank interest		41,350
Gross total income		3,90,914
Less: Deduction under section 80C (15% of 1,51,800 + 5,000)	27,770	

Deduction under section 80DD	75,000	
Deduction under section 80G	20,000	1,22,770
Total income		2,68,144
Rounded off = Rs. 2,68,140		

Problem 6 –

Mr. Garg, an employee of PQR Co. Ltd. at Chennai and covered by Payment of Gratuity Act, 1972, retires at the age of 63 years on 31-12-2019 after completing 34 years and 7 months of service. At the time of retirement, he is entitled for monthly pension of Rs. 40,000. He gets 80% of pension commuted for Rs. 9,00,000 on 1st February, 2020. His employer also pays Rs. 20,51,640 as Gratuity and Rs. 6,00,000 as accumulated balance of Recognized Provident fund.

Determine the salary chargeable to tax for Mr. Garg for the assessment year 2020-21 with the help of following information:

Particulars	*Amount (Rs.)*
Basic Salary (Rs. 80,000 × 9)	*7,20,000*
Bonus	*72,000*
Employer contribution towards Recognized Provident Fund	*1,10,000*
Rent paid by Mr. Garg (Rs. 12,000 x 12)	*1,44,000*
House Rent Allowance (Rs. 20,000 x 9)	*1.80,000*
Professional Tax paid by Mr. Garg	*5,000*

Note: Salary and Pension falls due on the last day of each month.

Solution:

Computation of Salary income of Mr. Garg for the assessment year 2018-19:

Particulars	Amount (Rs.)
Basic Salary (Rs. 80,000*9)	7,20,000
Bonus	72,000
Employer contribution towards RPF in excess of 12% [1,10,000 – 86,400 (12% of 7,20,000)]	23,600
Accumulated balance of RPF	Exempt
House Rent Allowance (W. N. – 1)	1,44,000
Gratuity (W.N. – 2)	10,51,640
Pension: Uncommuted [40,000*1 + (40,000*20% = 8,000*2)] Commuted [9,00,000 – 3,75,000 (9,00,000/80%*1/3)]	 56,000 5,25,000
Gross salary	25,92,240
Less: Deductions: (i) Standard deduction u/s 16 (i) (ii) Professional tax u/s 16 (iii)[it cannot be more than Rs.2,500*]	 50,000 2,500
Income from Salary	25,39,740

Working Notes:

1. Calculation of HRA exemption:

Least of the following is exempt:

a. 50% of salary i.e., Rs. 80,000 p.m. for 9 months= Rs.7,20,000
b. HRA received Rs. 20,000p.m. for 9 months = Rs. 1,80,000
c. Excess of Rent paid for 9 months – 10% of salary = [1,08,000 – 72,000 = Rs.36,000

Rs. 36,000, being the least is exempt.

Taxable HRA:

	Received [20,000*9]	1,80,000	
Less:	Exempt	36,000	1,44,000

2. Calculation of Gratuity exemption:

Least of the following is exempt:

a. 16,15,385 [80,000*15/26 = 46,153.85*35] i.e., 15 days salary
b. 10,00,000 i.e., amount notified
c. 20,51,640 i.e., gratuity received

Rs. 10,00,000, being the least is exempt and thus taxable is Rs. 10,51,640 [20,51,640 – 10,00,000].

Problem 7 –

Mahesh is a Finance Executive at X Ltd. His Income details are as follows:

Basic salary (per month)	*Rs. 3,00,000*
Dearness allowance (forming art of salary)	*30% of basic salary*
Transport allowance (for commuting between place of residence per month and office)	*Rs. 3,600 per month*
Motor car running and maintenance charges fully paid by employer (The motor car is owned and driven by Mahesh. The engine cubic capacity of car is below 1.60 litres. The motor car is used both for official and personal purpose by Mahesh)	*Rs. 40,000*
Rent Free Furnished Accommodation provided by the employer in Delhi. - *Cost of furniture* - *Two Air conditioners taken on hire by the employer and installed in the accommodation. Hire Charges of each air conditioner is Rs. 2,000 per annum*	*Rs. 1,00,000*
Expenditure on accommodation in hotels while touring on official duties met the employer	*Rs. 30,000*
Cost of Computer provided by the employer to Mahesh from 1.10.2019	*Rs. 50,000*
Interest on saving bank account with PNB	*Rs. 8,000*
Interest on post office saving bank	*Rs. 5,000*

Mahesh made the following payments:

Tuition fee paid for 2 children studying post-graduation courses at Madras University	*Rs. 1,60,000*
Donation to Government for promoting family planning	*Rs. 50,000*
Medical Insurance premium paid by cash	*Rs. 5,000*
Medical Insurance premium paid by cheque	*Rs. 22,000*

From the above, compute his total income for the assessment year 2020-21.

Solution:

Computation of total income of Mahesh for the assessment year 2018-19:

	Particulars		Amount (Rs.)
1.	Income from Salary:		
	Basic salary (3,00,000*12)		36,00,000
	Dearness allowance (forming part of salary) [30% of 36,00,000]		10,80,000
	Transport allowance [(3,600*12]		43,200
and Less:	Car owned by the employee, expenses incurred by the employer use official as well as personal Expenses Official purpose [1,800*12] *Rs. 1,800 p.m. because engine capacity does not exceed 1.6 litre*	 40,000 21,600	18,400
Add:	Unfurnished accommodation [15% of salary i.e., (36,00,000 + 10,80,000 + 24,000)] =Rs. 7,05,600 Furniture [10% of 1,00,000] Rent of AC [2,000*2]	 10,000 4,000	7,19,600
	Hotel (official tour)		Exempt
	Use of Computer		Exempt
	Gross Salary		54,42,000
Less:	Standard Deduction u/s16 (i)		50,000
		Gross Salary	53,92,000
2.	Income from other sources: Post office saving interest [5,000 – 3,500] PNB interest	 1,500 8,000	9,500
	Gross total income		54,01,500
Less:	Deductions – 80C 80D 80TTA 80G [50,000*100%]	 1,50,000* 22,000 9,500 50,000	2,31,500
	Total income		51,70,000

Calculation of 10% of adjusted GTI for the purpose of section 80G:
Amount donated should not exceed 10% of [54,51,500 – 1,50,000 – 22,000 – 9,500] i.e., 52,700 which is more than the amount donated of Rs. 50,000.

Exercise 2: Short theory questions

1. *Write a short note on exemption in respect of encashment of leave salary.*
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2. *Explain briefly the provisions for the taxability of House Rent Allowance.*
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3. *Explain the provisions with regard to 'Pension' under the head 'Salaries'.*
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4. *Discuss the provisions of Income Tax Act regarding gratuity under section 10(10).*
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5. *Discuss the taxability of perquisite in respect of Employee Stock Option Plan.*
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6. *Explain the provisions related to tax treatment of sale of movable assets at concessional/ nominal price to employee or his/ her member of household.*
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7. *Explain the provisions related to tax treatment of educational facility provided by employer to the family member of employee.*
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8. *Explain the provisions concerned with perquisite in respect of loan at concessional rate of interest.*
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9. *What is included in the definition of salary for the purpose of computing value of perquisite of accommodation?*
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10. Briefly explain the tax provisions concerned with new pension scheme (NPS)?

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Exercise 3: Multiple choice questions

1. An employee availed the exemption of leave encashment of Rs. 75,000 in the past years. He received from the second employer a sum of Rs. 7,00,000 as encashment of leave. He will be entitled to an exemption to the extent of –

a. Rs. 75,000
b. Rs. 7,00,000
c. Rs. 6,25,000
d. Rs. 2,25,000

2. The employee is provided with furniture costing Rs. 2,00,000 along with the house w.e.f. September 1, 2019. The furniture is owned by the employer. The value of the furniture to be included in the valuation of unfurnished house shall be –

a. Rs. 20,000
b. Rs. 24,000
c. Rs. 11,667
d. None of the above

3. An employee is entitled to a hostel expenditure allowance of Rs. 290 per month per child for his 4 children. The taxable amount of hostel expenditure allowance will be –

a. Rs. 6,720
b. Rs. 7,200
c. Rs. 6,960
d. Nil

4. Interest credited towards SPF is –

a. Fully taxable
b. Fully exempt
c. Exempt upto 9.5% p.a.
d. Exempt upto 8.5% p.a.

5. Income tax of Rs. 8,000 paid by the employer directly to the Government of India on behalf of the employee is –

a. Taxable for all categories of employees
b. Exempt for all categories of employees

c. *Exempt only for the specified employee*
d. *Taxable only for the specified employee*

6. Employers contribution towards SPF shall be –
a. *Fully taxable*
b. *Fully exempt*
c. *Taxable up to 9.5% of salary*
d. *Exempt up to 9.5% of salary*

7. X Ltd. pays a salary of Rs. 50,000 per month to Mr. A. The company also undertakes to provide laptop of Rs. 50,000 to him. His gross salary (per annum) will be –
a. *Rs. 6,00,000*
b. *Rs. 6,50,000*
c. *Rs. 1,00,000*
d. *Rs. 12,00,000*

8. Y Ltd. pays a salary of Rs. 1,00,000 per month to Mr. B. The company also paid his income tax liability of Rs. 1,50,000. His gross salary (per annum) will be –
a. *Rs. 2,50,000*
b. *Rs. 12,00,000*
c. *Rs. 13,50,000*
d. *None of the above*

9. Mr. A whose monthly salary is Rs. 40,000 per month took an advance salary of April 2019 in the month of March 2019. His taxable gross salary for the assessment year 2020-21 will be:
a. *Rs. 4,80,000*
b. *Rs. 5,20,000*
c. *Rs. 40,000*
d. *Rs. 80,000*

10. Maximum amount exempt in case of leave encashment received at the time of retirement of a non-Government employee is:
a. *Rs. 3,00,000*
b. *Rs. 3,50,000*
c. *Rs. 10,00,000*
d. *Rs. 12,00,000*

11. Maximum amount exempt in case of leave encashment received at the time of retirement of a Government employee is:
a. *Rs. 3,00,000*
b. *Rs. 3,50,000*
c. *Fully taxable*
d. *Fully exempt*

12. Salary for the purpose of computing exempted amount of leave encashment received at the time of retirement of a non-Government employee includes –

a. *Basic salary*
b. *Commission based on fixed percentage of turnover achieved by the employee*
c. *Both of these*
d. *Only (a)*

13. Leave encashment received during continuity of employment is taxable –

a. *For a Government employee*
b. *For a non-Government employee*
c. *For Government as well as non-Government employee*
d. *None of the above*

14. Uncommuted pension received by a Government employee is –

a. *Fully exempt*
b. *Fully taxable*
c. *Partly exempt*
d. *Partly taxable*

15. Uncommuted pension received by a non-Government employee is –

a. *Fully exempt*
b. *Fully taxable*
c. *Partly exempt*
d. *Partly taxable*

16. Medical allowance is –

a. *Fully exempt*
b. *Fully taxable*
c. *Exempt up to 12% of salary*
d. *Exempt @ Rs. 200 per month*

17. Transport allowance is exempt @ -

a. *Rs. 800 per month*
b. *Rs. 1,000 per month*
c. *Rs. 1,600 per month*
d. *None of the above*

18. Maximum exemption limit in case of retrenchment compensation is –

a. *Rs. 2,50,000*
b. *Rs. 5,00,000*
c. *Rs. 7,50,000*
d. *Rs. 10,00,000*

19. Leave encashment received at the time of death is –

a. *Fully taxable*
b. *Fully exempt*

c. Partly exempt
d. None of the above

20. Pension received by the employees of UNO is –
a. Fully taxable
b. Fully exempt
c. Partly exempt
d. None of the above

21. Maximum exemption limit in case of compensation received at the time of voluntary retirement is –
a. Rs. 2,50,000
b. Rs. 5,00,000
c. Rs. 7,50,000
d. Rs. 10,00,000

22. Lumpsum payment received at the time of retirement in case of SPF is –
a. Exempt from tax
b. Taxable
c. Exempt upto 10% of salary
d. Exempt upto 12% of salary

23. Employer's contribution towards approved superannuation fund is exempt to the extent of –
a. Rs. 1,00,000 per annum
b. Rs. 1,20,000 per annum
c. Rs. 1,50,000 per annum
d. None of the above

24. Which of the following allowance is not fully taxable?
a. Dearness Allowance
b. Servant allowance
c. City Compensatory Allowance
d. Tribal Area Allowance

25. If no rent is paid by the employee, exemption of house rent allowance will always be –
a. The amount of actual HRA received
b. Excess of rent paid over 10% of salary
c. 50% of salary
d. Nil

26. Exemption of HRA is not available to an assessee who–
a. Lives in his own house
b. Lives in his father's house
c. Lives in his mother's house
d. Lives in cousin house

27. Deduction of entertainment allowance u/s 16(ii) is not available to –

- *a. Government employee*
- *b. Non-Government employee*
- *c. Government as well as non-Government employee*
- *d. All of the above*

28. Value of furniture (if owned by the employer) in case of perquisite of furnished accommodation is calculated as –

- *a. 10% p.a. of actual cost*
- *b. 12% p.a. of actual cost*
- *c. 10% p.a. of WDV*
- *d. 12% p.a. of WDV*

29. Perquisite of interest free loan is fully exempt if loan amount does not exceed in aggregate in a year –

- *a. Rs. 10,000*
- *b. Rs. 15,000*
- *c. Rs. 20,000*
- *d. Rs. 25,000*

30. Yearly normal wear and tear while computing perquisite value in respect of car sold to the employee by the employer is calculated as –

- *a. 20% p.a. of actual cost*
- *b. 12% p.a. of actual cost*
- *c. 20% p.a. of WDV*
- *d. 12% p.a. of WDV*

31. Tea provided during office hours is exempt to the extent of –

- *a. Rs. 100 per meal*
- *b. Rs. 50 per meal*
- *c. Fully exempt*
- *d. Fully taxable*

32. Gift in cash received from an employer is –

- *a. Fully taxable*
- *b. Fully exempt*
- *c. Exempt upto Rs. 5,000*
- *d. Exempt upto Rs. 10,000*

33. Perquisite in respect of expenses incurred to give training to employees is –

- *a. Fully exempt*
- *b. Fully taxable*
- *c. Partly exempt*
- *d. None of the above*

34. Medical facility provided in a private clinic is exempt to the extent of –

a. *Rs. 15,000 per year*
b. *Rs. 30,000 per year*
c. *Rs. 50,000 per year*
d. *Rs. 1,50,000 per year*

35. Maximum exemption for professional tax u/s16 (iii)is –

a. *Rs. 1,500*
b. *Rs. 2,500*
c. *Rs. 5,000*
d. *Rs. 10,000*

36. Standard deduction u/s 16(i) is:

a. *Gross Salary*
b. *Rs. 50,000*
c. *Gross Salary or Rs. 50,000, whichever is lower*
d. *All of the above*

37. In case of Government organisation, Employee's contribution to NPS for the assessment year is:

a. *10%*
b. *12%*
c. *14%*
d. *15%*

[Answers to the multiple-choice questions: 1 (d), 2 (c), 3 (c), 4 (b), 5 (a), 6(b), 7(a), 8(c), 9(b), 10(a), 11(d), 12(c), 13(c), 14(b), 15(b), 16(b), 17(d), 18(b), 19(b), 20(b), 21(b), 22(a), 23(c), 24(d), 25(d), 26(a), 27(b), 28(a), 29(c), 30(c), 31(b), 32(a), 33(a), 34(a), 35(b). 36(c), 37(c)]

Exercise 4: Fill in the blanks

1. Monthly pension received by a Government employee is ……………

2. Use of health club, sports and other similar facilities provided uniformly to all employees is ………….

3. An employee was employed on September 1, 2013 in the grade pay of Rs. 15,000 – 400 – 17,000 – 500 – Rs. 22,000. His basic salary for the assessment year 2020-21 shall be ……………

4. Meal provided by the employer to an employee in the office premises is exempt upto a maximum of ………. per meal.

5. When gas or electricity is provided by the employer free of cost to the employee, the taxable value of this perquisite shall be ……………………….

[Answers to the fill in the blanks: 1 (Fully Taxable), 2 (Tax free), 3 (Rs. 2,07,500), 4 (Rs. 50), 5 (Manufacturing cost)]

Exercise 5: True or False

1. If rent is paid for a house situated at Chennai, the maximum exemption for house rent allowance shall be 40% of salary.

2. Salary received by partners from their own partnership firm is taxable under the head "Income from Salary".

3. Computers/ Laptops given by the employer to the employee for use at residence is taxable @ 10% p.a. of actual cost.

4. Facility of Mobile phone is an exempted perquisite.

5. Car facility given to cover the distance from office to residence is exempt from tax.

6. Entertainment allowance can be exempt up to a maximum limit of Rs. 5,000 in case of Government employees.

7. Commuted pension is fully exempt from tax in case of Government employees.

8. Perquisite in respect of interest-free loan is exempt from tax to the extent of Rs. 20,000 if the loan is given to the employee who is suffering from a disease specified in rule 3A.

9. Employer's contribution towards an approved superannuation fund will be chargeable to tax to the extent it exceeds Rs. 1,00,000 per annum.

10. City compensatory allowance is fully taxable.

[Answers to True or False: 1 (False), 2 (False), 3 (False), 4 (True), 5 (True), 6(True), 7(True), 8 (False), 9 (False), 10 (True)]

Books recommended –

1. *Singhania, V.K. and Singhania, Monica [2018], Students' Guide to Income Tax (University Edition), Taxmann Publications (P) Ltd.*

2. *Ahuja, Girish and Gupta, Ravi [2018], Simplified Approach to Income Tax (University Edition), Flair Publications Pvt. Ltd.*

LESSON 8

HOUSE PROPERTY

STRUCTURE OF THE CHAPTER

8.1 BASIS OF CHARGE [SECTION 22]

Income is taxable under the head "Income from house property" if the following three conditions are satisfied:

1. The property should consist of any buildings or lands appurtenant thereto.

2. The assessee should be owner of the property.

3. The property should not be used by the owner for the purpose of business or profession carried on by him, the profits of which are chargeable to income-tax.

8.2 DEEMED OWNER [SECTION 27]

Besides the legal owner, section 27 provides that the following persons are to be treated as deemed owner of house property for the purpose of taxation under the head "Income from house property":

1. *Transfer to spouse or minor child:*
   If the following conditions are satisfied, then the individual who has transferred the property would be deemed as "owner" of the house property:
   a. The taxpayer is an individual.
   b. He or she transfers a house property.
   c. The property is transferred to his/ her spouse (not being a transfer in connection with an arrangement to live apart) or to his/ her minor child (not being a married daughter).
   d. The property is transferred without adequate monetary consideration.

2. Holder of an impartible estate shall be deemed to be the individual owner of all the properties comprised in the estate.

3. A member of a co-operative society, company or other association of persons to whom a building (or part thereof) is allotted or leased under a house building scheme of the society, company or association, as the case may be, shall be deemed to be the owner of that building or part thereof.

4. *Person who has acquired a property under a power of attorney transaction:*
A person who is allowed to take (or retain) possession of any building (or part thereof) in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882, shall be deemed to be the owner of that building (or part thereof).

5. *A person who has acquired a right in a building under section 269UA(f):*
A person who acquires any rights (excluding any rights by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building (or part thereof), by virtue of any such transaction as is referred to in section 269UA(f), shall be deemed to be the owner of that building or part thereof.

8.3 WHEN INCOME IS NOT TAXABLE UNDER THE HEAD "INCOME FROM HOUSE PROPERTY"

In the following cases, income is not taxable under the head "Income from house property":
1. If letting is only **incidental and subservient to the main business** of the assessee, rental income is not taxable under the head "Income from house property" but is chargeable under the head "Profits and gains of business and profession".

2. **Composite Rent:**
If apart from recovering rent of the building, in some cases, the owner gets rent of other assets (like furniture, plant and machinery etc.) or he charges for different services provided in the building (for instance, security, charges for lift, air conditioning, electricity, water etc.), the amount so recovered is known as "composite rent".

Following is the tax treatment of "composite rent":

a. Where composite rent includes rent of building and charges for different services:
In such situations, composite rent is to be split up and amount of services is chargeable under the head "Profits and gains of business or profession" or "Income from other sources" as the case may be and rent of property is chargeable under the head "Income from house property". This rule is applicable even if it is difficult to split up the amount.

b. Where composite rent is rent of letting out of building and letting out of other assets (like furniture, plant etc.) and two letting are not separable i.e., letting of one is not acceptable to the other party without letting of the other):
In such situations, income is taxable either under the head "Profits and gains of business or profession" or "Income from other sources" as the case may be.
This rule is applicable even if sum receivable for the two lettings is fixed separately.

c. Where composite rent is rent of letting out of building and letting out of other assets (like furniture, plant etc.) and the two lettings are separable i.e., letting of one is acceptable to the other party without letting of the other):
In such situations, income from letting out of building is taxable under the head "Income from house property" and income from letting out of other assets is taxable under the head "Profits and gains of business or profession" or "Income from other sources" as the case may be. This rule is applicable even if the assessee receives composite rent from his tenant for two lettings.

8.4 CO-OWNERS [SECTION 26]

If a house property is owned by two or more persons, then such persons are known as co-owners. If respective shares of co-owners are definite and ascertainable, the share of each such person (in the computed income of property) shall be included in his total income. It may be noted that co-owners are not taxable as an association of persons.

8.5 WHEN PROPERTY INCOME IS NOT CHARGEABLE TO TAX

In the following cases, rental income is not chargeable to tax:

1. Income from farm house
2. Annual value of any one palace of an ex-ruler
3. Property income of a local authority
4. Property income of an approved scientific research association
5. Property income of an educational institution and hospital
6. Property income of a trade union
7. House property held for charitable purpose
8. Property income of a political party
9. Property used for own business or profession
10. Income from One self-occupied property

8.6 COMPUTATION OF INCOME UNDER THE HEAD "HOUSE PROPERTY"

There can be three different types of house properties for the purpose of taxation under the head "Income from house property".

1. Let out property [LO]-
2. Self-occupied property [SO]- If two properties are used for own residential purposes, Two residential properties are treated as self-occupied.
3. **Deemed to be let out property [DLO]-** if more than two properties are used for own residential purposes, Only two houses (according to the choice† of the

taxpayer) are treated as self-occupied properties and other house/houses will be treated as "deemed to be let out"

Following format is to be followed for computing the income under the head "House Property":

	Particulars	*1. LO (Rs.) Let Out*	*2.SO (Rs.) Self-Occupied (Upto two houses)*	*3.DLO (Rs.) Deemed to be Let Out*
Step 1:	Expected Rent [Municipal Valuation* or Fair Rent* whichever is higher but subject to a maximum of Standard Rent*]	XX	----	XX
Step 2:	Actual rent received/ receivable after deducting Unrealised Rent	XX	----	NA*
Step 3:	Higher of Step 1 or step 2	XX	----	ER*
Step 4:	Deduct loss due to vacancy	XX	----	NA
Step 5:	Gross Annual Value (GAV) [Step 3 – Step 4]	XX	Nil	ER
Less:	Municipal Taxes paid by owner	XX	Nil	XX
	Net Annual Value (NAV)	XX	Nil	XX
Less:	Deductions under section 24:			
	(i) Standard Deduction [24(a)] (30% of NAV)	XX	Nil	XX
	(ii)Interest on capital borrowed [24(b)] (*limits applicable)	XX	XX*	XX
	Income from house property	XX	(XX)	XX
Add:	Income under section 25A	XX	----	----
	Income taxable under "House Property"	XXX	(XXX)	XXX

* MV refers to Municipal Value, FR refers to Fair Rent, SR refers to Standard Rent, ER refers to Expected Rent and NA refers to Not Applicable.

Meaning of Annual Value

As per section 23(1)(a), the annual value of any property shall be the sum for which the property might reasonably be expected to be let out from year to year. It may neither be the actual rent derived nor the municipal valuation of the property. It is something like notional rent which could have been derived, had the property been let out.

In determining the annual value there are four factors which are normally taken into consideration. These are (a) Actual rent received or receivable, (b) Municipal value, (c) Fair rent of the property, and (d) Standard rent.

Calculation of gross annual value (GAV)

Step 1: Find out reasonable expected rent of the property

[Municipal value or fair rent whichever is higher but subject to a maximum of standard rent]

Expected Rent:
It is deemed to be the sum for which the property might reasonably be expected to be let out from year to year.
Fair rent:
Rent fetched by a similar property in the same or similar locality.
Standard Rent:
It is the maximum rent which a person can legally recover from his tenant under a Rent Control Act.

Step 2: Find out rent actually received or receivable after excluding unrealized rent but before deducting loss due to vacancy

Step 3: Higher of amount computed in Step 1 or Step 2 is taken

Step 4: Find out loss due to vacancy.

Step 5: Step 3 *minus* Step 4 is gross annual value.

Rent actually received/ receivable:
Following points should be noted in this regard:
1. Advance rent cannot be rent received/ receivable of the year of receipt.
2. If the tenant has undertaken to bear the cost of repairs, the amount spent by the tenant cannot be added to rent received or receivable.
3. Occupier's (i.e., tenant's) share of municipal tax realized from the tenant cannot be added to actual rent received/ receivable, as it is the occupier's duty to pay municipal tax.

Unrealized Rent
Unrealized rent is the rent which the owner could not realize. Unrealized rent of earlier years is not deductible, only unrealized rent of current previous year is deductible.
Unrealized rent shall be excluded from rent received/ receivable only if the following conditions are satisfied [Conditions of Rule 4]:
1. The tenancy is bonafide.
2. The defaulting tenant has vacated, or steps have been taken to compel him to vacate the property.
3. The defaulting tenant is not in occupation of any other property of the assessee.
4. The assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.

Municipal Taxes
Municipal taxes (like house tax, service tax, local tax) levied by any local authority in respect of the house property are deductible only if these taxes are borne and actually paid by the owner during the previous year. It doesn't matter whether the municipal taxes paid during the previous year belong to the earlier/past years, current year/previous year or coming years.

Standard Deduction [Sec. 24(a)]
30% of NAV is deductible irrespective of any expenditure incurred or not by the assessee. Thus, no deduction can be claimed in respect of expenses on insurance, ground rent, land revenue, repairs, collection charges, electricity, water supply, salary of liftman, etc.
If the owner of the house occupies more than one house for his residential purposes, except one house on which standard deduction is allowed but on all other houses which is treated as deemed to be let-out houses, no standard deduction is allowed.

Interest on Borrowed Capital [Sec. 24(b)]
Interest on borrowed capital is allowable as deduction on the accrual basis, if capital is borrowed for the purpose of purchase, construction, repair, renewal or reconstruction of the property.

Pre-construction period interest:
Pre-construction period means the period commencing from the date of borrowing and ending on –

a. 31^{st} March immediately prior to the date of completion of construction/ date of acquisition; or
b. Date of repayment of loan,
   whichever is earlier.

Interest payable by an assessee in respect of funds borrowed for the acquisition or construction of a house property and pertaining to a period prior to the previous year in which such property has been acquired or constructed, to the extent it is not allowed as a deduction under any other provision of the Act, is deductible is five equal annual installments and the first installment starts from the previous year in which the property is acquired or constructed.

Post-construction period interest:
It is charged from the year of completion (YOC) to date of repayment (DOR).

Notes –

1. Interest on borrowed capital is calculated by adding pre-construction period interest and current year interest.

2. Interest is borrowed capital is deductible on "accrual basis". It can be claimed as deduction on yearly basis, even if the interest is not actually paid during the year.

3. If interest is calculated on the basis of number of days, the date of borrowing should be included while the date of repayment of loan should be excluded.

4. Income from a self-occupied house property can be negative. Its value always lies between Zero to (-) Rs. 2,00,000.

5. Interest on a fresh loan, taken to repay the original loan raised for the aforesaid purposes, is allowable as deduction. This rule is applicable even if the first loan was interest-free loan.

Steps for computation of Interest on Capital Borrowed:
Step 1: Compute Pre-construction Period
PCP which starts from DOB (Date of borrowing)
and ends on 31st March prior to DOC (Date of completion),
OR
Actual DOR (Date of repayment),
Whichever is earlier
Step 2: Compute Pre-construction Period Interest
Step 3: Total Pre-construction Period Interest is allowed as deduction in 5 equal annual instalments and first instalment will be deductible in the year in which the house is purchased or constructed.
Step 4: Compute Post-construction period interest
It starts from YOC (Year of Completion) and ends on Actual DOR (Date of Repayment).
Step 5: Calculate IOCB (Interest on capital borrowed) which is equal to PCPI (Pre-construction period interest) + PCPI (Post-construction period interest) for different years. For assessment year 2020-21, relevant previous year is 2019-20.
Interest on borrowed capital in case of Let Out/ Deemed to be Let Out property
It is fully deductible (according to the rules given above) without any maximum ceiling.
Interest on borrowed Capital in case of Self-Occupied property
It is deductible (according to the rules given above) subject to a **maximum ceiling** given below:
Case 1: Rs. 2,00,000
If capital is borrowed on or after April 1, 1999 for acquiring or constructing a property and if such acquisition or construction is completed within 5 years from the end of the financial year in which the capital was borrowed.
Further, one more condition to satisfy is that the person extending the loan certifies that such interest is payable in respect of the amount advanced for acquisition or construction of the house or as re-finance of the principal amount outstanding under an earlier loan taken for such acquisition or construction.

Case 2: **Rs. 30,000**

1. If capital is borrowed on or after April 1, 1999 for reconstruction, repairs or renewals of a property.

2. If capital is borrowed before April 1, 1999 for purchase, construction, reconstruction, repairs or renewals of a property.

3. If capital is borrowed on or after April 1, 1999 for acquiring or constructing a property and if such acquisition or construction is **not** completed within 5 years from the end of the financial year in which the capital was borrowed.

8.7 Tax treatment of different cases of self-occupied house property

S. No.	*Self – Occupied Property*	*Tax Treatment*
1	If such property is used by the owner for the purpose of carrying on his business or profession	No income is taxable under the head "Income from house property" but taxable under the head "Profits and gains of business or profession"
2	If such property is used for the residence of the owner and his family members:	
	2.1- if only one/two property is used for such purpose- 2.1-(a) If such property is used throughout the previous year for own residential purposes, it is not let out or put to any other use. Further, no benefit is derived by the owner from such property.	Net Annual Value of one/ second house (as per the choice of tax payer)will be taken as NIL. Nothing is taxable. Only interest on borrowed capital is deductible subject to a maximum ceiling of Rs. 30,000 or Rs. 2,00,000 depending upon the case.
	2.1-(b) If such property could not be occupied throughout the previous year because employment, business or profession of the owner is situated at some other place and he has to reside at that other place in a building not owned by him. Further, no other benefit is derived by the owner from that unoccupied property.	**Same as point (2.1-(a)) above**
	2.1-(c) When a part of the property (being independent residential unit) is self occupied and the other part is let-out	Income from the independent unit, which is self-occupied, will not be taxable. Interest on borrowed capital is deductible up to Rs. 30,000/Rs. 2,00,000. Income from the unit which is let out is to be computed as if the unit is let out
	2.1-(d) When such property is self-occupied for a part of the year and let out for the other part of the year	No concession is available. The house will be taken as let out property.
	2.2 If Two properties are used for own residential purposes	Two residential properties are treated as self-occupied and tax treatment

	2.3 if more than two properties are used for own residential purposes	Only two houses (**according to the choice of the taxpayer**) are treated as self-occupied properties and tax treatment, as given in point 2.1, is applicable. Other remaining property/properties will be treated as "deemed to be let out" property (in the case of a deemed to be let out property, income is calculated as if it is a let out property)

Notes –

1. In the case of "deemed to be let out" properties, the taxable income will be calculated in the same manner as used for let out properties. In case of "deemed to be let out" properties, GAV shall be taken as reasonable expected rent.

2. As far as point (6) mentioned in the above table is concerned, the option should be exercised in such a way that the net income of a taxpayer is reduced to the minimum possible level. Moreover, the option may be changed every year.

How to make selection if more than two properties occupied for own residential purposes –

If a person has occupied more than two properties for his residential purposes, only two properties will be treated as self-occupied properties. Other remaining property/properties will be deemed as let out. Method of calculating taxable income in such case is discussed in the problem given below.

Problem: G owns 5 houses. These houses are used by him for his residential purposes. These houses are not let out during any part of the previous year 2019-20. No other benefit is derived from these houses. The following information is noted from the records of G –

	House 1	House 2	House 3	House 4	House 5
Municipal value or fair rent, whichever is higher (but subject to maximum of standard rent)	12,00,000	12,70,000	27,60,000	4,90,000	15,90,000
Municipal taxes paid by G	40,000	1,20,000	1,90,000	30,000	1,20,000
Interest on capital borrowed to purchase properties (date of borrowing in all cases is after April 1, 1999)	-	11,000	1,70,000	2,00,000	2,30,000
Interest on capital borrowed to finance repair, renewal or reconstruction of house properties	2,10,000	7,89,000	14,00,000		

Compute net income for the assessment year 2020-21.

Solution:

G has occupied FIVE house properties for his own residential purposes. Only TWO houses he can choose which will be treated as self-occupied and other remaining THREE houses will be treated as "deemed to be let-out. Hence, he has the following options:

Different options	Houses to be treated as self-occupied	Houses to be treated a s deemed to be let-out
Option 1	House 1 and 2	House 3,4, and 5
Option 2	House 1 and 3	House 2,4, and 5
Option 3	House 1 and 4	House 2,3 and 5
Option 4	House 1 and 5	House 2,3 and 4
Option 5	House 2 and 3	House 1,4 and 5
Option 6	House 2 and 4	House 1,3 and 5
Option 7	House 2 and 5	House 1,3 and 4
Option 8	House 3 and 1	House 2,4, and 5
Option 9	House 3 and 2	House 1,4 and 5
Option 10	House 3 and 4	House 1,2 and 5
Option 11	House 4 and 5	House 1,2 and 3

While choosing the house property as self-occupied, one must consider to choose that property as self-occupied which minimise taxable income (and maximum loss from house property can be carried forward), one may proceed as follows –
Step 1 - Find out income of 5 houses as if these are treated as "self-occupied property".
Step 2 - Find out income of 5 houses as if these are "deemed to be let out".
Step 3 - Find out the difference between income of each house computed under Step 1 and Step 2.
Step 4 - Two houses (reporting highest difference as per Step 3) may be taken as "self-occupied properties". Other remaining houses will be "deemed to be let out"

	House 1 Rs.	House 2 Rs.	House 3 Rs.	House 4 Rs.	House 5 Rs.
Step 1 - Computation of income if all the FIVE houses are **self-occupied properties –** Net Annual Value Less: Interest on loan	Nil 30,000	Nil 41,000	Ni 2,00,000	Nil 2,00,000	Nil 2,00,00
(a) Income/**(Loss)** from house property **(SO)**	**(30,000)**	**(41,000)**	**(2,00,000)**	**(2,00,000)**	**(2,00,000)**
Step2- Computation of income if all the FIVE houses are **deemed to be let out –** Gross annual value (being municipal value or fair rent, whichever is					

lower but subject to maximum of standard rent)	12,00,000	12,70,000	27,60,000	4,90,000	5,90,000
Less: Municipal Taxes	40,000	1,20,000	1,90,000	30,000	1,20,000
Net Annual Value	11,60,000	11,50,000	25,70,000	4,60,000	14,70,000
Less: Deductions u/s 24: 1. Standard deduction@30% of NAV	(3,48,000)	(3,45,000)	(7,71,000)	(1,38,000)	(4,41,000)
2. Interest on loan	(2,10,000)	(8,00,000)	(15,70,000)	(2,00,000)	(2,30,000)
	(5,58,000)	(11,45,000)	(23,41,000)	(3,38,000)	(6,71,000)
(b)Income from property deemed to be let-out	**6,02,000**	**5,000**	**2,29,000**	**1,22,000**	**7,99,000**
Step3- Step1 minus Step 2 [a-b]	(6,32,000)	(46,000)	(4,29,000)	(3,22,000)	(9,99,000)
Step4- Selection or choice of house					
(i) House 1 and 5 to be **taken as self-occupied:** Net Annual Value	Nil				
Deduction u/s 24:					Nil
Interest on loan on SO house cannot exceed Rs.2,00,000	(30.000)				(1,70,000)
(ii)House 2,3 and 4 taken as deemed to be let-out Income from deemed to be let-out house		5,000	2,29,000	1,22,000	

Note: In this case, if tax payer chooses house 1 and 5 as self-occupied and remaining house 2,3 and 4 as deemed to be let-out, then total income from house property will be minimum.

Computation of Income from house property of G for the assessment year 2020-21:

Income from house property:	Rs.	Rs,
A- Self-occupied House:		
Loss from House 1	(30,000)	
Loss from House 5	(1,70,000)	(2,00,000)
B- Deemed to be Let-out property:		
Income from House 2	5,000	
Income from House 3	2,29,000	
Income from House 4	1,22,000	3,56,000
Income from House property		1,56,000

8.8 SPECIAL PROVISION FOR ARREARS OF RENT AND UNREALISED RENT RECEIVED SUBSEQUENTLY [SECTION 25A]

The amount of rent received in arrear (or unrealised rent realised subsequently) after deducting 30% amount shall be charged to tax in the year in which such rent is received (or realized) by the assessee under the head "Income from house property".

Notes –

- It is taxable even if the house is not owned (or deemed to be owned) by the assessee in the year of recovery.

- In case of recovery of unrealized rent, expenditure on recovery is not taken in to consideration.

- It is to be noted that normally income is taxable under the head "Income from house property" only if the taxpayer is the owner or deemed owner of a house property during the previous year. However, in the case of arrears of rent received or recovery of unrealized rent, property income is taxable even if no house is owned (or deemed to be owned) by the taxpayer.

8.9 MISCELLANEOUS POINTS

1. If rent actually collected is zero and the entire loss is due to vacancy then the gross annual value is NIL.

2. Valuation of any property (like valuation of municipal value, fair rent etc.) starts from the date on which house is purchased. However, difference between the date on which the house is purchased and the date from which the house is let out is treated as vacancy period. For example, a house is purchased on Sept.1, 2019 and let out from Dec. 1, 2019. In such a case, period between 1/9/19 to 31/11/19 is treated as vacancy period. However, municipal value, standard rent etc. would be calculated from Sept. 1, 2019.

3. If any property is self-occupied for some period, then that period cannot be treated as vacancy period.

4. If the municipal tax paid by the landlord is more than gross annual value, then net annual value can be negative.

5. Whenever the houses are deemed to be let out, expected rent computed in step 1 will become Gross Annual Value.

6. Where the property is held as stock-in-trade and the property (or any part of the property) is not let during the whole (or any part of the previous year), the annual value of such property (or part of the property), for the period up to one year from the end of the financial year in which the certificate of completion of

construction of the property is obtained from the competent authority, shall be taken to be nil.

8.10 SUMMARY

This chapter has discussed the computation of income from house property. This head "House property" comes after the head "Salary". There can be three different types of house properties for the purpose of taxation – Let out, Self-occupied and Deemed to be let out. First, gross annual value of a property is computed. From this value, municipal taxes are deducted to arrive at net annual value. From net annual value, deductions under section 24 are given to compute the income from house property. In this value, finally, any recovery of unrealised rent or arrears of rent is added to arrive at the final taxable income under the head "House property".

8.11 EXERCISE 1: LONG PRACTICAL QUESTIONS

The working notes given below in the solutions of unsolved questions are only for clarity purposes and for solving some typical concepts. However, in the final examination, students are expected to be more cautious in preparing working notes. Working notes in the examination must mention the concepts along with numerical calculation.

Problem 1 –

X owns a house at Delhi. From the particulars given below, compute income from house property for the assessment year 2020-21:

	Rs.
Municipal value	*2,50,000*
Fair rent	*2,80,000*
Standard rent	*2,60,000*
*Annual rent (25,000*12)*	*3,00,000*
Vacancy period	*1 month*
Unrealised rent	*1 month*
Municipal taxes paid (half of it was born by tenant)	*25,000*
Expenses on repair	*20,000*
Fire insurance premium paid	*5,000*
Ground rent	*5,000*
Land revenue paid	*6,000*

X had borrowed a sum of Rs. 20,00,000 @ 10% p.a. from LIC Housing Ltd. on 1-8-2015 and the construction of the house was completed on 1-1-2019. Loan is still unpaid.

Solution:

Computation of Income from House Property of X for the assessment year 2020-21:

Particulars	Amount (Rs.)
Calculation of Gross Annual Value: Step 1: Expected Rent (Municipal Value (i.e., Rs.2,50,000) or Fair Rent (i.e., Rs. 2,80,000)whichever is higher but subject to a maximum of Standard Rent i.e., Rs. 2,60,000)	2,60,000

Step 2: Annual Rent – unrealised rent [Rs.3,00,000- Rs.25,000]	2,75,000
Step 3: Higher of Step 1 or Step 2	2,75,000
Step 4: Loss due to vacancy (one month)	25,000
Step 5: Gross Annual Value or GAV	2,50,000
Less: ½ of Municipal Taxes (borne and paid by the owner)	12,500
Net Annual Value (NAV)	2,37,500
Less: Deductions under section 24:	
(i)Standard Deduction (30% of NAV) 71,250 (ii)Interest on borrowed capital (W.N. 2) 3,06,667	3,77,917
Net income from House Property	(1,40,417)

Working notes:

1. Expenses on repairs, fire insurance premium paid, ground rent and land revenue paid are of no consideration and not allowed as deduction.

2. Calculation of interest on borrowed capital:
   DOB is 1/8/2015 and DOC is 1/1/2019
   Pre-construction period is 1/8/2015 to 31/3/2018

Previous Year	Interest	
2015-16 (8 months)	1,33,333	(2,00,000*8/12)
2016-17	2,00,000	
2017-18	2,00,000	
	5,33,333	

   This interest is deductible in 5 equal annual instalments of Rs. 1,06,667 (5,33,333/5) and first instalment starts from the year in which the house is constructed i.e., the previous year 2018-19. So, deduction of pre-construction period interest is available from the previous year 2018-19 to 2022-23.

   Current year/previous year:
   Current year interest starts from year of completion to date of repayment. It starts from the previous year 2018-19 and will go on because loan is still unpaid. So, it will also be available in our relevant previous year 2019-20.

   Total interest on borrowed capital = Pre-construction period interest + Relevant previous year interest i.e., Rs. 3,06,667 [1,06,667 + 2,00,000]

Problem 2 –
R owns a big house. The house has three independent residential units.
Unit 1: *(50 per cent of the floor area) is let out for residential purposes on a monthly rent of Rs. 16,000 (this unit is, however, used by him from January 15, 2019 to March 15, 2019 for his residential purposes). A sum of Rs. 1,000 could not be collected from the tenant.*

Unit 2: *(25 per cent of the floor area) is used by him for the purpose of his residence, while* ***Unit 3*** *:(the remaining 25 per cent) is used by him for the* ***purpose of his business.***
Other particulars of the house are: municipal valuation: Rs. 3,84,000; municipal taxes (paid): Rs. 32,000; repairs: Rs. 40,000; ground rent: Rs. 16,000; land revenue (paid): Rs. 9,800, insurance premium: Rs. 16,000 and interest on capital borrowed for payment of municipal tax: Rs. 14,000.
Income of X from business is Rs. 4,61,200 (without debiting house rent and other incidental expenditure including admissible depreciation of Rs. 1,600 on the one-fourth portion of house used for business).
Determine the taxable income of R for the assessment year 2020-21.

Solution:
Here a property has independent residential units. So, **unit 1** which is let out becomes a letout property, **unit 2** which is self-occupied becomes a self-occupied property and **unit 3** which is used for business or profession is the property where computation will be done as per the provisions of PGBP.

Computation of net taxable income of R for the assessment year 2020-21:

Particulars		Amount (Rs.)
1. Income from house property: (see working notes)		
Unit I (Let out)	1,23,200	
Unit II (self-occupied)	NIL	1,23,200
2. Business Income		4,27,650
Gross Total income or Total Income		5,50,850

Working notes:
1. Bifurcation of different amounts *(only for understanding – no need to show in examination):*

Particulars	Unit I (50%) [LO] (Rs.)	Unit II (25%) [SO] (Rs.)	Unit III (25%) [PGBP] (Rs.)
Municipal value [3,84,000]	1,92,000	96,000	96,000
Municipal taxes [32,000]	16,000	8,000	8,000
Repairs [40,000]	20,000	10,000	10,000
Ground rent [16,000]	8,000	4,000	4,000
Land revenue [9,800]	4,900	2,450	2,450
Insurance premium [16,000]	8,000	4,000	4,000
IOCB for payment of municipal taxes [14,000]	7,000	3,500	3,500

2. Income from house property: (Unit 1 and 2)

Particulars	Unit I (50%) [LO] (Rs.)	Unit II (25%) [SO] (Rs.)
Annual rent for 10 months [April 1, 2019 to January 14, 2020 + March 16, 2020 to March 31, 2020] (16,000*10)	1,60,000	
Step 1: Expected rent	1,92,000	

Step 2: Actual Rent received/ receivable after deducting unrealised rent (i.e., 2 months@16,000 p.m.)	1,59,000	
Step 3: Higher value of step1 and step 2	1,92,000	
Step 4: Loss due to vacancy	NIL	
GAV	1,92,000	
Less: Municipal taxes	16,000	
NAV	1,76,000	NIL
Less: Deduction under section 24:		
(i)Standard deduction (30% of NAV)	52,800	NIL
(ii)Interest on capital borrowed	NIL	NIL
Net income from house property	1,23,200	NIL

3. Unit-3: Computation of PGBP (25%):

			Amount (Rs.)
	Income from business		4,61,200
Less:	Expenses related to business:		
	Municipal taxes	8,000	
	Repairs	10,000	
	Ground rent	4,000	
	Land revenue	2,450	
	Insurance premium	4,000	
	IOBC on MT	3,500	
	Depreciation	1,600	33,550
	Business income		4,27,650

Problem 3 –

A owns a property at Ghaziabad (Municipal value: Rs. 1,90,000, Fair rent: Rs. 2,04,000, Standard rent: Rs. 1,85,000). The house is let out upto Feb. 28, 2019 at a monthly rent of Rs. 18,500. From March l, 2019 the property is self-occupied for own residence.

Expenses incurred by A are as follows:

Municipal Taxes: Rs. 10,000 (half of it was paid by tenant), Repairs: Rs. 20,000 and Fire Insurance premium: Rs. 5,000. Interest on capital borrowed for acquiring the property: Rs. 1,80,000.

Assuming that income of A from other sources is Rs. 4,50,000, find out the net income of A for the assessment year 2020-21. Does it make any difference if the property is let out upto Feb. 28, 2019 @ Rs. 16,500 per month?

Solution:

Computation of net taxable income of A for the assessment year 2020-21:

	Let out at Rs.18,500 p.m.	Let out at Rs. 16,500p.m

Step 1:	ER being higher of MV or FR subject to a maximum of SR	1,85,000	1,85,000
Step 2:	Actual rent received or receivable after deducting unrealized rent (11 months)	2,03,500	1,81,500
Step 3:	Higher of step 1 or step 2	2,03,500	1,85,000
Step 4:	Loss due to vacancy	Nil	Nil
Step 5:	Gross Annual Value (GAV)	2,03,500	1,85,000
Less:	Municipal Taxes paid by owner	5,000	5,000
	Net Annual Value (NAV)	1,98,500	1,80,000
Less:	Deductions u/s 24:		
	(i) Standard deduction @30% of NAV	59,550	54,000
	(ii) Interest on capital borrowed	1,80,000	1,80,000
	1.Income/(Loss) from House Property	(41,050)	(54,000)
	2.Income from other sources	4,50,000	4,50,000
	Gross Total Income	4,08,950	3,96,000

Note –
Loss under the head "House Property" can be adjusted against income of any other head except gambling incomes.

Problem 4 –
Mr. A owns a house at Gurgaon. Particulars of the same are given below:

	Rs.
Municipal valuation	3,20,000
Fair rent	3,40,000
Standard rent	3,00,000
Municipal taxes paid by Mr. A	30,000
Land revenue (payable)	10,000
Fire insurance premium (paid)	10,000

He borrowed Rs. 20,00,000 @ 9% p.a. from LIC Housing Premium Ltd. for the construction of this house on 01-06-2015. Construction on this house was completed on 10-09-2017. The entire loan amount is still outstanding.
Compute his income from the house property for the assessment year 2020-21 assuming:

a. House property is self-occupied throughout the previous year.
b. House property is let out throughout the previous year at a monthly rent of Rs. 28,000.

Solution:
Computation of Income under the head House Property for the assessment year 2018-19:

Particulars	Part (a) [SO] (Rs.)	Part (b) [LO] (Rs.)
Step 1: Expected Rent being higher of MV or FR subject to a maximum of SR		3,00,000
Step 2: Annual Rent received or receivable after deducting Unrealized rent but before vacancy		3,36,000

Step 3: Higher of step 1 or step 2		3,36,000
Step 4: Loss due to vacancy		Nil
Step 5: GAV [Step 3 – Step 4]		3,36,000
Less: Municipal tax paid by owner		30,000
Net Annual Value	Nil	3,06,000
Less: Deductions u/s 24:		
Standard deduction [30% of NAV]	Nil	91,800
Interest on loans or IOBC	2,00,000	2,46,000
	(2,00,000)	(31,800)

Working notes for calculation of IOBC: Loan Rs. 20, 00,000 at 12% p.a.

Calculation of PCP interest:
Date Of Borrowing: 1/6/2015; Date Of Completion: 10/09/2017 and DOR: Outstanding

PCP = 1/06/2015 to 31/03/2017

PCP Interest [20,00,000*9%*1 year 10 months] = 3,33,000/5 = 66,000 is deductible during the previous year 2017-18 to 2021-22

Calculation of Current Year (2019-20) interest:
Current year period = Year of Completion (YOC) to Date of Repayment (DOR)
Loan is not yet paid, so current year interest of 2019-20 is 1,80,000 [20,00,000*9%]

Total interest on borrowed capital:
PCPI + CYI = Rs. 2,46,000 [Rs. 66,000 + Rs. 1,80,000]

Note: (i)In case of let out property, entire interest (Rs.2,46,000) is deductible without any ceiling.

(iii)In case of self-occupied property, however, interest is deductible subject to some limits. In the present case, capital is borrowed on or after April 1, 1999 for construction and such construction is completed within 5 years from the end of the year in which capital is borrowed; so maximum interest deductible is Rs. 2,00,000.

Problem 5 –
For the previous year 2019-20, X (age 67 Years) furnished the following information:

1. Income from Business		Rs. 9,82,000
2.Property Income:	House I (Rs.)	House II (Rs.)
Fair Rent	3,50,000	3,20,000
Municipal Valuation	3,60,000	3,50,000
Standard Rent	3,00,000	5,00,000
Annual Rent	6,00,000	4,20,000
Unrealized Rent of the previous year 2017-18	10,000	80,000
Unrealized Rent of the previous year 2016-17	----	3,00,000

Vacancy period (months)	2	4
Municipal taxes paid	40,000	50,000
Loss on account of vacancy	1,00,000	1,40,000
Repairs	5,000	7,000
Fire Insurance	20,000	30,000
Land revenue	25,000	40,000
Ground rent	66,000	82,000
Interest on capital borrowed by mortgaging House I (Funds used for construction of House II)	1,40,000	----
Nature of Occupation	Let out for Residence	Let out for business

Determine the taxable income and tax liability of X for the assessment year 2020-21 assuming that X paid Rs. 1,40,000 as life insurance premium on the life assured of his wife for Rs. 20,00,000 (policy is taken as 11th August 2011) and purchased NSC for Rs. 50,000.

Solution:

Computation of net taxable income of X for the assessment year 2020-21:

	Particulars	Amount (Rs.)
1.	<u>Income for house property: (see working notes)</u> House I 3,15,000 House II <u>(28,000)</u>	2,87,000
2.	Business income	<u>9,82,000</u>
	Gross total income	12,69,000
Less:	Deduction under section 80C [1,40,000 + 50,000]	<u>1,50,000*</u>
	Net taxable income/ Total income	<u>11,19,000</u>

Computation of tax: being senior citizen:

Upto Rs. 3,00,000 Nil

On next 2,00,000 @5% = Rs. 10,000

On next 5,00,000 @20% = Rs. 1,00,000

On balance Rs, 1,19,000@30% = Rs. 35,7,00 Rs. 1,45,700

Less: Rebate under section 87A <u>Nil</u>

1,45,700

Add: Health & education Cess @ 4% <u>5,828</u>

Tax payable 1,51, 528

Tax payable (Rounded off) Rs. 1,51,530

Working Notes –

1. *Computation of income from house property:*

In this case, both the houses are let out properties. So, income from house property is computed as follows –

	House I [LO] (Rs.)	House II [LO] (Rs.)
Step 1: Expected Rent	3,00,000	3,50,000
Step 2: Annual Rent – Unrealized Rent	5,90,000	3,40,000
Step 3: Higher Value	5,90,000	3,50,000
Step 4: Loss due to vacancy	1,00,000	1,40,000
Step 5: GAV	4,90,000	2,10,000
Less: Municipal taxes paid	40,000	50,000
NAV	4,50,000	1,60,000
Less: Deduction under section 24:		
Standard deduction @30% of N AV	1,35,000	48,000
Interest on borrowed capital	----	1,40,000
Net income from house property	3,15,000	(28,000)

2. Since the policy is taken before April 1, 2012, maximum amount eligible for deduction is 20% of sum assured or actual premium paid, whichever is less.
   Thus, Premium paid Rs. 1,40,000 being lower of Rs. 4,00,000 [20% of Rs. 20,00,000] or Rs. 1,40,000, is eligible.

3. Total amount under section 80C cannot exceed Rs. 1,50,000.

Problem 6 –
Mr. Manick is a Sales-tax officer at Jaipur. He owns two residential houses. ***The first house*** *is in Delhi which was constructed on 31.12.1993. This has been let out on a rent of Rs. 30,000 p.m. to a company for its office.* ***The second house*** *is in Jaipur, which was constructed on 1.3.2019 and has been occupied by him for his own residence since then. He took a loan of Rs. 9,00,000 on 1.8.2017 @ 8% per annum interest for the purpose of construction of this house. The entire loan is outstanding.*

Other Relevant particulars in respect of these houses are given below:

	House I-Delhi (Rs.)	*House II – Jaipur (Rs.)*
Municipal valuation	*2,40,000*	*1,80,000*
Fair Rent	*2,00,000*	*2,40,000*
Municipal taxes	*10% of Municipal value*	*8% of municipal value*
Expenses on repairs	*20,000*	*60,000*
Interest on Loan	----	*72,000*

Municipal Taxes of Jaipur house is unpaid.

Mr. Manick was transferred to Mumbai on 1.12.2019 where he resides in a house at a monthly rent of Rs. 40,000, and his house at Jaipur was let out on the same day on a rent of Rs. 20,000 per month.
Compute the "income from house property" in respect of Mr. Manick for the assessment year 2020-21.

Solution:

Computation of Mr. Manick's Income under the head House Property for the assessment year 2018-19:

Particulars	House I [LO] (Delhi) (Rs.)	House II [LO for 4 months] (Jaipur) (Rs.)
Step 1: Expected Rent	2,40,000	2,40,000
Step 2: Annual Rent received after deducting Unrealized rent but before vacancy	3,60,000	80,000
Step 3: Higher of step 1 or step 2	3,60,000	2,40,000
Step 4: Loss due to vacancy	Nil	Nil
Step 5: GAV [Step 3 – Step 4]	3,60,000	2,40,000
Less: Municipal tax	24,000	Nil
NAV	3,36,000	2,40,000
Less: Deduction u/s 24	1,00,800	72,000
(i)Standard deduction [30% of NAV]		
(ii)IOBC	Nil	81,600
Income from House Property	2,35,200	86,400

Total Income from house property : Rs. 2,35,200 + Rs. 86,400 =Rs. 3,21,600

Working notes for calculation of IOBC:

PCP = 9,00,000 [1/08/2017 to 31/03/2018]
[9,00,000*8%*8/12] = 48,000/5 = Rs. 9,600
Rs. 9,600 is deductible during the previous year 2018-19 to 2022-23

YOC = 2018-19 to DOR (Not yet paid)
Thus, 72,000 as current year interest for 2019-20
Total interest for 2019-20 = Rs.9,600 + Rs.72,000 = Rs.81,600

Exercise 2: Short theory questions

1. *How do you compute annual value of a house property?*
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2. *In what cases, income from house property is not chargeable to tax?*
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3. *What deductions are available under section 24 while computing income from house property?*
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Exercise 3: Multiple Choice Questions

1. Maximum deduction allowed for interest on borrowed capital in case of let out house property is –

a. Rs. 30,000
b. Rs. 1,50,000
c. Rs. 2,00,000
d. None of the above

2. Maximum deduction allowed for interest on borrowed capital in case of deemed to be let out house property is –

a. Rs. 30,000
b. Rs. 1,50,000
c. Rs. 2,00,000
d. None of the above

3. Standard deduction u/s 24 is allowed on:

a. Municipal value
b. Fair value
c. Net Annual value
d. Standard Rent

[Answers: 1 (d), 2 (d), 3 (c)]

Exercise 4: Fill in The Blanks

1. *Maximum amount of deduction under section 24(b) in case of self-occupied house property is ……………*
2. *In case of deemed to be let out house property, Gross annual value is equal to ………….*

3. *Net Annual value of Two self occupied house is ....*

[Answers: 1 (Rs. 2,00,000), 2 (Expected Rent), 3 zero]

Exercise 5: True Or False

1. Net Annual Value can never be negative.
2. Standard deduction under section 24(a) is 30% of Gross annual value.
3. Expected Rent cannot exceed to Standard Rent.
4. If net annual value is negative, standard deduction is not deductible.
5. If net annual value is negative, interest on borrowed capital is deductible.

[Answers: 1 (False), 2 (False), 3 (True), 4 (True), 5 (True)]

Discuss The Following

1. What will be tax treatment if income under the head "Income from house property" is negative.
2. Is it possible to have negative income under the head "Income from house property"?

Books recommended –

1. *Singhania, V.K. and Singhania, Monica [2018], Students' Guide to Income Tax (University Edition), Taxmann Publications (P) Ltd.*
2. *Ahuja, Girish and Gupta, Ravi [2018], Simplified Approach to Income Tax (University Edition), Flair Publications Pvt. Ltd.*

LESSON 9

PROFITS AND GAINS OF BUSINESS OR PROFESSION

STRUCTURE OF THE CHAPTER

9.1 Basis of Charge [Section 28]
9.2 Scheme of business deductions/ allowances
9.3 Expenses allowed as business expenditures [Sections 30 to 35]
9.4 Other Deduction [Section 36]
9.5 General Deductions [Section 37]
9.6 Advertisement expenses [Section 37(2B)]
9.7 Specific Disallowances
9.8 Amount not deductible under section 40(a)
9.9 Amount not deductible under section 40A
9.10 Amount not deductible in respect of unpaid liability [Sec. 43B]
9.11 Time for filing return of income [Sec. 139(1)]
9.12 Deemed Profits [Sec. 41]
9.13 Taxation of Undisclosed Income/ Investments
9.14 Summary
9.15 Exercise

9.1 BASIS OF CHARGE [SECTION 28]

Under section 28, the following income is chargeable to tax under the head "Profits and gains of business or profession":

1. Profits and gains of any business or profession;
2. Any compensation or other payments due to or received by any person specified in section 28(ii);
3. Income derived by a trade, professional or similar association from specific services performed for its members;
4. Export incentive available to exporters;
5. Any profit on transfer of the Duty Entitlement Pass Book Scheme;
6. Any profit on transfer of the Duty Free Replenishment Certificate;
7. The value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;
8. Any interest, salary, bonus, commission or remuneration received by a partner from firm;
9. Any sum received for not carrying out any activity in relation to any business or profession or not to share any know-how, patent, copyright, trademark, etc.;
10. Any sum received under a Keyman insurance policy including bonus;
11. Any sum received (or receivable) in cash or in kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD; and
12. Income from speculative transaction.

9.2 SCHEME OF BUSINESS DEDUCTIONS/ ALLOWANCES

Section 28 defines various income which are chargeable to tax under the head "Profits and gains of business or profession". Section 29 permits deductions and allowances laid down by sections 30 to 43D while computing profits or gains of a business or profession. Sections 40, 40A and 43B give a list of expenses which are not deductible.

9.3 EXPENSES ALLOWED AS BUSINESS EXPENDITURES [SECTIONS 30 TO 35]

(i) Rent, rates, taxes, repairs and insurance for building [Sec. 30]

Deduction is allowed in respect of rent, rates, taxes, repairs and insurance for premises used for the purpose of business or profession.

(ii) Repairs and insurance of machinery, plant and furniture [Sec. 31]

The expenditure incurred on current repairs (not being capital expenditure) and insurance in respect of plant, machinery and furniture used for business purposes is allowable as deduction.

(iii)Depreciation allowance [Sec. 32]

Following conditions should be satisfied by the assessee to avail depreciation:

1. Asset must be owned by the assessee.

2. Asset must be used for the purpose of business or profession.

3. *Asset should be used during the relevant previous year:*
   Normal depreciation (i.e., full year's depreciation) is available if an asset is put to use at least for sometime during the previous year. However, where an asset is acquired during the previous year but put to use for the purpose of business or profession for less than 180 days during that year, in such a case, half of the normal depreciation is allowed.

4. Depreciation is available on tangible assets (Building, machinery, plant or furniture) as well as intangible assets (know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature). However, it must be noted that the intangible assets must be acquired on or after April 1, 1998.

If all the above conditions are satisfied, depreciation is available (it is a must, it is not at the option of the assessee to claim or not to claim, depreciation in such cases).

Basis concepts for computation of depreciation allowance:

1. ***Block of assets:***
   The term "block of assets" means a group of assets falling within a class of assets in respect of which the same percentage of depreciation is prescribed. A taxpayer

may have 9 different blocks of assets (out of which 8 blocks are for tangible assets and 1 block is for intangible asset). These blocks are given below:

Type of Asset	*Blocks*	*Nature of Asset*	*Rate of Depreciation*
Buildings	1	Residential buildings other than hotel and boarding houses	5%
	2	Office, factory, godowns or building which are not mainly used for residential purposes	**10%**
	3	Purely temporary erections such as wooden structures	40%
Furniture	4	Any furniture/fittings including electrical fittings	**10%**
Plant and machinery	5	Any plant and machinery (not covered by block 6, 7 and 8)	**15%**
	6	Ocean-going ships	20%
	7	Buses, lorries and taxis used in the business of running them on hire	30%
	8	Aeroplanes, Containers made of glass or plastic used as re-fills, Computers, Energy saving devices, Air pollution control equipments, water pollution control equipments,	40%
	9	Motor buses, motor lorries and motor taxis (used in a business of running them on hire)	45%
Intangible assets (acquired after March 31, 1998)	10	Know-how, patents, copyrights, trademarks, licenses, franchises and any other business or commercial rights of similar nature	**25%**

2. ***Written down value/ Depreciated value:*** WDV at the year end is equal to:
   WDV of the block on the 1st day of the previous year i.e., on April 1,2019
   Add: Actual cost of the asset (falling in the same block) acquired during the previous year
   Less: Money received/ receivable* (together with scrap value) in respect of that asset (falling within the block of assets) which is sold, discarded, demolished or destroyed during the previous year
   (* It does not mean gross consideration. It is net consideration after excluding expenditure incidental to sale. Further, here actual money received or receivable in cash or by cheque or draft is deductible. In other words, any other things or benefit which can be converted in terms of money cannot be deducted.)

3. ***No depreciation will be charged in the following cases:***
   a. If written down value of the block of asset is reduced to zero, though the block of assets does not cease to exist on the last day of the previous year; or

   b. If block of asset is empty or ceases to exist on the last day of the previous year, though the written down value is not zero (*In such cases, written down value of the block on the first day of the next previous year will be taken as Nil); or

   c. If any imported car is used for the purpose of business or profession in India which is acquired during March 1, 1975 and March 31, 2001. If, however, such imported car is used in the business of running it on hire for tourist or for the purpose of business or profession outside India, then depreciation is admissible at the usual rate.

   d. Whenever depreciable asset is acquired otherwise than by an account payee cheque/ draft or use of electronic clearing system through a bank account (and the payment exceeds Rs. 10,000), such payment shall not be eligible for normal/ additional depreciation.

4. ***Meaning of "Actual Cost":***
   It means the actual cost to the assessee as reduced by the proportion of the cost thereof, if any, as has been met, directly or indirectly, by any other person or authority. Actual cost for any asset includes all expenses directly relatable to acquisition of the asset.
   Interest pertaining to the period till the asset is put to use should be added to the "actual cost" of the asset.
   Expenditure on travelling incurred for acquiring depreciable assets is part of "actual cost".

5. ***Method of depreciation:***
   Method of computation of depreciation is written down value method. However, depreciation is available in the case of tangible assets according to "straight-line" method in the case of an undertaking engaged in generation or generation and distribution of power in some cases.

6. ***The following points should be noted in this regard:***
   a. The concept of half the rate of normal depreciation is applicable only in the year in which an asset is acquired and not in subsequent years.

   b. If an asset is not used at all, no depreciation in respect of that asset is available. This rule is applicable in the first year in which the asset is acquired as well as in the subsequent years.

   c. If an asset is acquired during any previous year but not put to use during that previous year; the actual cost of such asset will become part of the block of assets on day 1 of the next year. For example, if any asset is purchased during the previous year 2018-19 but put to use in the previous year 2019-20; this asset is a part of the block on April 1, 2019. This rule is applicable even if the asset is not put to use in the previous year 2018-19. Here, depreciation is available for the first time in the previous year 2019-20.

d. If nothing is mentioned about the date of use of an asset, then assume that the asset is put to use on the same day the asset is acquired.

Additional depreciation

To claim additional depreciation, the following conditions must be satisfied by the assessee:

1. *Manufacture/ production of any article or thing:*
   The assessee should be engaged in the manufacture or production of any article or thing (may be priority sector item or even non-priority sector item given in the Eleventh Schedule) or generation or generation & distribution of power.

2. *New plant and machinery installed and acquired after March 31, 2005:*
   Additional depreciation is available only in respect of new plant and machinery acquired and installed after March 31, 2005.
   Notes –
   - Additional depreciation is not available in respect of building or furniture even if the other conditions are satisfied.
   - Additional depreciation is not available in respect of old plant and machinery.

3. *Eligible plant and machinery:*
   Any plant and machinery which has been acquired and installed after March 31, 2005 by an assessee is qualified for additional depreciation.
   However, the following assets are not eligible for additional depreciation:
   a. ships and aircrafts; or
   b. any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person; or
   c. any machinery or plant which is installed in any office premises or any residential accommodation, or accommodation in the nature of a guest house; or
   d. any office appliances or road transport vehicles; or
   e. any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any one previous year.

Rate of additional depreciation

Additional depreciation shall be available @ 20 per cent of the actual cost of new plant and machinery acquired and installed after March 31, 2005. If, however, the asset is put to use for less than 180 days in the year in which it is acquired, the rate of additional depreciation will be 10 per cent of the cost of acquisition in the first year and the balance 10% would be available in the immediately succeeding previous year.

Rate of additional depreciation for acquisition and installation of new plant and machinery in notified backward area in A.P., Bihar, Telangana or West Bengal provided the new plant and machinery has been acquired and installed during April 1, 2015 to March 31, 2020:

In this case, additional depreciation is available in respect of new plant and machinery acquired and installed @ **35 per cent of the actual cost (and not 20%).** If, however, the asset is put to use for less than 180 days in the year in which it is acquired, the rate of additional depreciation will be 17.5 per cent (the remaining 17.5 per cent will be allowed as deduction in the next year).

Notes –

1. If because of some reason, normal depreciation is not available, we can still claim additional depreciation provided conditions of additional depreciation are satisfied.

2. Whenever depreciable asset is acquired otherwise than by an account payee cheque/ draft or use of electronic clearing system through a bank account (and the payment exceeds Rs. 10,000), such payment shall not be eligible for normal/ additional depreciation.

Unabsorbed depreciation: setoff and carry forward

Following steps should be applied to claim depreciation:

Step 1: Depreciation allowance of the previous year is first deductible from the income chargeable under the head "Profits and gains of business or profession".

Step 2: Depreciation allowance, if not fully deductible under the head "Profits and gains of business or profession", it is deductible from the income chargeable under other heads of income (except salaries) for the same assessment year.

Step 3: If depreciation allowance is still unabsorbed, it can be carried forward to the subsequent year.

Notes –

1. Unabsorbed depreciation can be carried forward for unlimited number of years.

2. Continuity of business is not relevant for the purpose of adjusting unabsorbed depreciation.

3. In the subsequent year(s), unabsorbed depreciation can be set-off against any income (except income under the head salaries). In the matter of set-off, following order of priority must be followed to adjust unabsorbed depreciation from the "Profits and gains of business or profession" in the subsequent year(s):

a. current depreciation
b. brought forward business loss
c. unabsorbed depreciation

Investment allowance for acquisition and installation of new plant and machinery in notified backward area in A.P., Bihar, Telangana or West Bengal [Sec. 32AD]

Where **an assessee**, engaged in the business of manufacture or production of any article or thing, **acquires and installs "New Asset"** during April 1, 2015 to March 31, 2020, a sum equal to **15%** of the actual cost of new asset acquired and installed during the previous year is allowed as deduction in the year in which the new asset is installed.

For the purposes of this section, "New Asset" means a new plant or machinery but does not include—

a. any plant or machinery which before its installation by the assessee was used either within or outside India by any other person;
b. any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;
c. any office appliances including computers or computer software;
d. any vehicle;
e. ship or aircraft; or
f. any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.

Note –
Whenever any asset is acquired otherwise than by an account payee cheque/ draft or use of electronic clearing system through a bank account (and the payment exceeds Rs. 10,000), such payment shall not be eligible for investment allowance under section 32AD.

Expenditure on scientific research [Sec. 35]
The term "scientific research" means "any activity for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries". To promote scientific research, section 35 provides tax incentives.

Following is the classification of such expenditures which are deductible under section 35:

1. *Revenue expenditure incurred by the assessee himself [Sec. 35(1)(i)]*
   100 per cent deduction is allowed for such expenditure, if such research relates to the business.
   Pre-commencement period expenses:
   Revenue expenses (other than expenditure on providing perquisites to employees) incurred before the commencement of business (but within 3 years immediately before commencement of business) on scientific research related to the business

are deductible in the previous year in which the business in commenced. However, the deduction is limited to the extent it is certified by the prescribed authority.

Such expenses may be the expenditure on purchasing materials used in scientific research, salary paid to employees (not being a perquisite).

2. *Contribution made to outsiders [Sec. 35 (ii)/ (iii)]:*
   Where the assessee does not himself carry on research but makes contributions to other institutions for this purpose, a weighted deduction is allowed, as follows-
   a. Deduction allowed is 150 per cent of any sum paid to an approved research association which has, as its object, undertaking of scientific research related or unrelated to the business of assese [Sec. 35(1)(ii)].
   b. Deduction allowed is 150 per cent of any sum paid to an approved university, college or other institution for the use of scientific research related or unrelated to the business of assese [Sec. 35(1)(ii)].
   c. Deduction allowed is 100 per cent of any sum paid to an approved association which has as its object the undertaking of research in social science or statistical science or an approved university, college or other institution for the use of research in social sciences or statistical research related or unrelated to the business of the assessee [Sec. 35(1)(iii)].

   It is to be noted that approval under section 35(1)(ii)/(iii) is given by the Central Government.

3. *Capital expenditure incurred by an assessee himself [Sec. 35(2)]:*
   100 per cent deduction is allowed for such expenditure, if such research relates to the business.
   However, the following points must be noted in this regard:
   a. Such expense may be on plant or equipment for research or constructing building (*excluding cost of land*) for research or expenses of capital nature connected with research like expenses on purchase of buses to transport research personnel.

   b. Where any capital expenditure has been incurred on scientific research related to business before the commencement of business, the amount of such expenditure incurred within 3 years immediately preceding the commencement of the business, is deductible in the previous year in which the business is commenced.

   c. Deduction is available even if the relevant asset is not put to use for research and development purposes during the previous year in which the expenditure is incurred.

   d. No deduction by way of depreciation is admissible in respect of an asset used in scientific research.

e. If an asset is sold without having been used for other purposes, then surplus (i.e., sale price) or deduction already allowed under section 35, whichever is less, is chargeable to tax as business income of the previous year in which the sale took place [Sec. 41(3)]. The excess of sale price over cost of acquisition (or indexed cost of acquisition) is chargeable to tax under section 45 under the head "Capital Gains".

4. *Contribution to national laboratory [Sec. 35 (2AA)]:*
Deduction allowed is 150 per cent of actual payment made to "National Laboratory" or University or Indian Institute of Technology (IIT) or specified person as approved by the prescribed authority. However, the above payment is made under a specific direction that it should be used by the aforesaid person for undertaking scientific research programme approved by the prescribed authority.

5. *Expenditure on in-house research and development expenses [Sec. 35(2AB)]:*
Deduction allowed is 150 per cent of the expenditure incurred if all the given below conditions are satisfied:
   a. The taxpayer is a company.
   b. The company should be engaged in the business of manufacture or production of any article or thing except those specified in the Eleventh Schedule.
   c. It incurs any expenditure on scientific research and such expenditure is of capital nature or revenue nature (*not being expenditure in the nature of cost of any land or building*)*.
   d. The research and development facility is approved by the prescribed authority.

However, if the aforesaid conditions are not satisfied, then deduction may be claimed as per the rules mentioned in point (1) and point (3) above relating to revenue expenses and capital expenses respectively.
In respect of the aforesaid expenditure, no deduction shall be allowed under any other provisions of the Act.
***** Cost of building (excluding cost of land) is eligible for 100 per cent deduction under section 35(2).

6. *Contribution to a company to be used by such company for scientific research [Sec. 35(1)(iia)]:*
The taxpayer can claim a deduction of 100 per cent of the amount paid to the payee-company if all the given below conditions are satisfied:
   a. The taxpayer is any person (may be an individual, HUF, firm, company or any other person).
   b. The taxpayer has paid any sum to a company (hereinafter referred to as "payee-company") to be used by the payee for scientific research.
   c. The scientific research may or may not be related to the business of the tax payer.
   d. The payee-company is registered in India which has, as its main object, scientific research and development.

e. The payee-company is for the time being approved by the prescribed authority.
f. The payee-company fulfils such other conditions as may be prescribed.

With a view to avoid multiple claims for deduction, it has been provided that the payee-company will not be entitled to claim weighted deduction of 150 per cent under section 35(2AB). However, deduction to the extent of 100 per cent of the sum spent as revenue expenditure or capital expenditure on scientific research, which is available under section 35(1), will continue to be allowed.

7. *Carry forward and set-off of deficiency in subsequent years:*
If on account of inadequacy or absence of profits of the business, deduction on account of capital expenditure on scientific research cannot be allowed, fully or partly, the deficiency so arising is to be carried forward as if it is an unabsorbed depreciation.

Expenditure for obtaining right to use spectrum for telecommunication services [Sec. 35ABA]
Any capital expenditure incurred and actually paid by an assessee for acquiring any right to use spectrum for telecommunication services by paying spectrum fee shall be allowed as deduction in equal instalments over the period for which the right to use spectrum remains in force.

Deduction will be available starting from the year in which the business is commenced or the year in which the spectrum fee is actually paid, whichever is later and ending with the year in which spectrum comes to an end.

Amortization of preliminary expenses [Sec. 35D]
Deduction is available in case of an **Indian company** or a **resident non-corporate assessee**. A foreign company even if it is resident in India, cannot claim any deduction under section 35D.

Types of preliminary expenses:
1. Expenses incurred before commencement of business means for setting up any undertaking or business.
2. Expenses incurred after commencement of business means for extension of an undertaking or for setting up of a new unit.

Amount of deduction:
One-fifth of the qualifying expenditure is allowable as deduction in each of the 5 successive years beginning with the year in which the business commences, or as the case may be, the previous year in which extension of the undertaking is completed or the new unit commences production or operation.

Qualifying expenditure includes:

1. *The work should be carried on by the assessee* ***itself or*** *by a concern* ***approved*** *by the Board:*

   Expenditure in connection with preparation of feasibility report, preparation of project report, conducting a market survey (or any other survey necessary for the business of the assessee), or engineering services relating to the business of the assessee, provided the work is carried on by the assessee himself or by a concern which is for the time being approved in this behalf by the board.

2. *The work can be carried on by the* ***assessee itself*** *or by any* ***concern*** *(approved or not approved):*
   a. Legal charges for drafting any agreement between the assessee and any other person relating to the setting up of the business of the assessee.
   b. Legal charges for drafting the memorandum and articles of association, if the taxpayer is a company.
   c. Printing expenses of the memorandum and articles of association, if the taxpayer is a company.
   d. Registration fee of a company under the provisions of the Companies Act.
   e. Expenses in connection with the public issue of shares or debentures of a company, underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus.
   f. Any other expenditure which is prescribed* (*Nothing is prescribed so far).

Maximum ceiling of qualifying expenditure:

The amount qualified as deduction must never exceed the following limits:

1. *In the case of a corporate assessee:*
   5% of the cost of project or 5% of capital employed, whichever is more.
2. *In the case of a non-corporate assessee: 5% of the cost of project.*

Note:

If expenditure is allowed as deduction under section 35D, the same is not allowed as deduction under any other provision of the Act.

Amortization of expenditure in the case of amalgamation/ demerger [Sec. 35DD]

If an Indian company or co-operative bank incurs any expenditure on or after April 1, 1999 for the purpose of amalgamation or demerger, the expenditure is deductible in 5 equal annual instalments and the first instalment starts from the previous year in which amalgamation or demerger takes place.

Amortization of expenditure under voluntary retirement scheme [Sec. 35DDA]

Any sum paid to an employee in connection with his voluntary retirement under any scheme of voluntary retirement, is deductible in 5 equal annual instalments and the first instalment starts from the year in which such amount is actually paid.

9.4 OTHER DEDUCTION [SECTION 36]

1. *Premia for insurance on health of employees:*
   Health insurance premium of employees paid by employer by any mode other than cash is deductible.

2. *Bonus or commission to employees:*
   Bonus or commission paid to an employee is allowable as deduction subject to certain conditions:
   a. Amount payable to employees as bonus or commission should not otherwise have been payable to them as profit or dividend.
   b. Deduction is allowed on payment basis:
      Bonus or commission is allowed as deduction only where payment is made during the previous year or on or before the due date of furnishing return of income under section 139.

3. *Interest on borrowed capital:*
   Interest on capital borrowed is allowed as deduction if the following conditions are satisfied:
   a. *The assessee must have borrowed money:*
      - Interest on own capital is not deductible.
      - If there is no obligation to refund the capital provided, interest on such capital is not deductible.
      - Interest paid by a firm to partners is deductible according to the provisions of section 40(b) [i.e., @ 12% p.a. simple interest]. However, interest paid by an association of persons to its members is not deductible.

   b. *The money so borrowed must have been used for the purpose of business or profession:*
      - If capital is borrowed for the purpose of acquisition of a business asset it is not necessary that the assessee must have used that business asset for doing business in the relevant accounting year.
      - Interest on money borrowed for payment of dividends is an allowable deduction.
      - Interest on money borrowed to pay income-tax is not allowable as deduction. Interest for late payment/ non-payment of advance tax or for late filling of return is not allowable as deduction, as in such a case there is no borrowing of capital for business purposes. Similarly, where interest is paid for meeting tax liability of partners, such interest is not deductible.

   c. *Interest is paid or payable on such borrowing*

4. *Discount on zero coupon bonds:*
   Discount on notified zero coupon bonds (being the difference between amount received and the amount payable on redemption/ maturity by the issuing company) is allowed as deduction on *pro rata* basis. The *pro rata* deduction is

available having regard to the period of life of such bond. “Period of life of the bond” means the period commencing from the date of issuing of the bond and ending on the date of the maturity or redemption of such bond.

5. *Employer’s contribution to recognized provident fund and approved superannuation fund [Sec. 36(1)(iv)]*
Employer’s contribution towards a recognized provident fund or an approved superannuation fund is allowable as deduction subject to the limits laid down for the purpose of recognizing the provident fund or approving superannuation fund.

6. *Employer’s contribution to national pension scheme [Sec. 36(1)(iva)]*
Employer’s contribution towards employee’s NPS (to the extent of 10 per cent of “salary” of employees) shall be allowed as deduction in computing the income under the head “Profits and gains of business or profession”. “Salary” for this purpose means basic salary, dearness allowance (if terms of employment provide) and commission based on fixed percentage of turnover achieved an employee as per terms of contract of employment.

7. *Employer’s contribution towards an approved gratuity fund [Sec. 36(1)(v)]*
Employer’s contribution towards an approved gratuity fund created by him exclusively for the benefit of his employees under an irrevocable trust is allowed as deduction subject to the provisions of section 43B.

8. *Employees’ contribution towards staff welfare Scheme [Sec. 36(1)(va)]:*
Section 2(24) defines income. Clause (x) of section 2(24) provides that any sum received by any employer from his employees as contribution to provident fund (or any fund for the welfare of such employees) shall be included in the employer’s income.
Moreover, section 36(1)(va) provides that any sum received by the employer as contribution from his employees towards provident fund (or any welfare fund of such employees) shall be allowed as deduction only if such sum is credited by the employer to the employee’s account in the relevant fund on or before the due date. For this purpose, “due date” means the date by which the employer is required to credit such contribution to the employee’s account in the relevant fund under the provisions of any law or term of contract of service or otherwise.

9. *Write off of allowance for animals:*
In respect of animals (including birds and chicken), which are used for the purposes of business or profession (not as stock-in-trade) and have died or become useless, the difference between the actual cost of the animals to the assessee and the amount realized (if any) in respect of carcasses or sale of animals, is allowable as deduction. Here, birds and chicken are also treated as animals.

10. *Bad debts [Sec. 36(1)(vii)]:*
    Amount of any debt or part is allowable as deduction subject to the following conditions:
    a. the debt has been taken into account in computing the income of the assessee of that previous year or of an earlier previous year, or represents money lent in the ordinary course of business of banking or money-lending which is carried on by the assessee; and
    b. it has been written off as irrecoverable in the accounts of the assessee for that previous year.

    Adjustment at the time of recovery –
    Where debt ultimately recovered is less than the difference between the amount of debt and bad debt allowed as deduction, such deficiency is deductible in the previous year in which the ultimate recovery is made. Conversely, where the debt ultimate recovered is more than the difference between the amount of debt and bad debt allowed as deduction, such excess amount will be chargeable to tax in the year of recovery under section 41(4).

11. *Family Planning Expenditure [Sec. 36(1)(ix)]:*
    Any bonafide, expenditure incurred by a company for the purpose of promoting family planning among its employees, is allowable as deduction. If, however, such expenditure is of capital nature, then the amount is **deductible in 5 equal annual instalments** and the first instalment starts from the year in which the expenditure is incurred.

    Note –
    a. No deduction is available under this section in the case of a non-corporate assessee. A non-corporate assessee may claim deduction under sections 32 and 37(1) if the relevant conditions are satisfied.
    b. Any family planning expenditure (capital or revenue) which is not allowed as deduction due to inadequacy of profits, shall be set-off and carry-forward as if it is an unabsorbed depreciation.

12. *Banking cash transaction tax and securities transaction tax and commodities transaction tax:*
    These taxes are deductible under section 36. But securities transaction tax and commodities transaction tax are deductible only if the assessee is a dealer in securities or commodity derivatives.

9.5 GENERAL DEDUCTIONS [SECTION 37]

Section 37(1) is a residuary section. In order to claim deduction under this section, the following conditions should be satisfied:

1. The expenditure should not be of the nature described under sections 30 to 36.
2. It should not be in the nature of capital expenditure.
3. It should not be assessee's personal expenditure.

4. It should have been incurred in the previous year.
5. It should be in respect of business carried on by the assessee.
6. It should have been expended wholly and exclusively for the purpose of such business.
7. It should not have been incurred for any purpose which is an offence or prohibited by any law.

9.6 ADVERTISEMENT EXPENSES [SECTION 37(2B)]

Deduction is not available in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party.

Contribution to a political party is deductible under section 80GGB (if contribution is made by an Indian company) or under section 80GGC (if contribution is made by a person other than an Indian company).

Expenditure by way of advertisement in a magazine owned by a political party is treated as “contribution” to a political party for the purpose of section 80GGB, but not for the purpose of section 80GGC. In other words, advertisement expenditure (in a magazine owned by a political party) is deductible under section 80GGB (if the taxpayer is an Indian company) but the same is not deductible under section 80GGC (if the taxpayer is a person other than an Indian company).

9.7 SPECIFIC DISALLOWANCES

The following expenses given by sections 40, 40A and 43B are expressly disallowed by the Act while computing income chargeable under the head “Profits and gains of business or profession”.

9.8 AMOUNT NOT DEDUCTIBLE UNDER SECTION 40(A)

In the case of any assessee, the following expenses are expressly disallowed ***under section 40 (a):***

Interest, royalty, fees for technical services or any other sum (except salary) payable outside India or payable to a non-resident in India [Sec. 40(a)(i)]
If the following three conditions are satisfied, the assessee (i.e., the payer) is supposed to deduct tax at source (TDS) and deposit the same with the Government:

<u>Condition 1:</u> The amount paid is interest, royalty, fees for technical services or any other sum (not being salary).

<u>Condition 2:</u> The aforesaid amount is chargeable to tax under the Act in the hands of the recipient.

<u>Condition 3:</u> The aforesaid amount is paid/ payable (a) outside India to any person; or (b) in India to a non-resident.

If the assessee fails to deduct tax at source, 100% of such expenditure is disallowed.

Disallowance of expenditure under section 40(a)(i):

TDS default	*Is such expenditure deductible in the current previous year*	*Is such expenditure deductible in any subsequent previous year*
<u>Case 1:</u> Tax is deductible during the current financial/ previous year but not deducted during the current financial/ previous year	100% of such expenditure is disallowed in the current year	If tax is deducted in any subsequent year, the expenditure (which is disallowed in the current year) will be deducted in the year in which TDS will be deposited by the assessee with the Government
<u>Case 2:</u> Tax is deductible (and is so deducted) during the current financial year but it is not deposited on or before the due date of submission of return of income under section 139(1)	100% of such expenditure is disallowed in the current year	If tax is deposited with the Government after the due date of submission of return of income, the expenditure (which is disallowed in the current year) will be deducted in that year in which tax will be deposited

Any sum payable (including salary) to a resident (in India or outside India) [Sec. 40(a)(ia)]

Disallowance of expenditure under section 40(a)(ia):

TDS default	*Is such expenditure deductible in the current previous year*	*Is such expenditure deductible in any subsequent previous year*
<u>Case 1:</u> Tax is deductible during the current financial/ previous year but not deducted during the current financial/ previous year	30% of such expenditure is disallowed in the current year	If tax is deducted in any subsequent year, the expenditure (which is disallowed in the current year) will be deducted in the year in which TDS will be deposited by the assessee with the Government
<u>Case 2:</u> Tax is deductible (and is so deducted) during the current financial year but it is not deposited on or before the due date of submission of return of income under section 139(1)	30% of such expenditure is disallowed in the current year	If tax is deposited with the Government after the due date of submission of return of income, the expenditure (which is disallowed in the current year) will be deducted in that year in which tax will be deposited

Relief applicable in Sec. 40(a)(ia) when recipient has paid tax:
In case of disallowances of section 40(a)(ia), relief is applicable in case 1 default if recipient has paid the tax. In such a case, it shall be deemed that the payer has deducted and paid the tax on such amount and the date of payment shall be assumed as the date when return of income is furnished by the resident recipient.

Amount paid to a non-resident for a service where equalization levy is payable [Sec. 40(a)(ib)]
Where equalization levy (applicable for a specified service) is deductible but not deducted (or deducted but not deposited till due date of filing return of income), any amount paid to a non-resident will be disallowed. However, it will be allowed in the year in which such levy is deposited.

Salary payable outside India (or in India to a non-resident) without tax deduction [Sec. 40(a)(iii)]
This section is applicable if salary is paid paid/ payable outside India to any person or in India to a non-resident and tax has not been paid to the Government nor deducted at source under the Income-tax Act. In such a case, salary payment is not allowed as deduction.

Fringe benefit tax (FBT), income-tax, dividend tax, wealth-tax (including penalty, fine and interest)
These taxes are not deductible while computing income from business or profession.
Note –
Any sum paid on account of income tax (or interest on money borrowed to pay income-tax) is not deductible. Similarly, any interest/ penalty/ fine for non-payment or late payment of income-tax is not deductible. This rule is applicable whether income-tax is payable in India or outside India.

9.9 AMOUNT NOT DEDUCTIBLE UNDER SECTION 40A

In the case of any assessee, the following expenses are expressly disallowed under section 40A:

Amounts not deductible in respect of payment to relatives [Sec. 40A(2)]
Any expenditure incurred by an assessee in respect of which payment has been made to the relatives is liable to be disallowed in computing business profits to the extent such expenditure is considered to be excessive or unreasonable, having regard to the fair market value* of goods or services or facilities, etc.

Relative [Sec. 2(41]):
Relative means the husband, wife, brother or sister or any linear ascendant or descendant of that individual.

Substantial Interest:
A person is deemed to have substantial interest in the business or profession if such person is the beneficial owner of at least 20% of equity capital (in case of a company) or if such person is entitled to 20% profits of a concern (in any other case) at any time during the previous year.

* The aforesaid disallowance shall not be made if such transaction is at arm's length price as defined in section 92F(ii).

Amount not deductible in respect of expenditure exceeding Rs. 10,000 (*Rs. 35,000 in case of payment made for plying, hiring or leasing goods carriages) [Sec. 40A(3)]
No deduction is allowed if the following conditions are satisfied:

a. The assessee incurs any expenditure which is otherwise deductible under other provisions of the Act for computing business/ profession income (i.e., expenditure for purchase of raw material, trading goods, expenditure on salary, etc.) and the amount of expenditure exceeds Rs. 10,000*.
b. A payment (or aggregate of payments made to a person in a day) in respect of the above expenditure exceeds Rs. 10,000*.
c. The above payment is made otherwise than by an account payee cheque/ account payee draft or use of electronic clearing system through a bank account (i.e., it is made in cash or by a bearer cheque or by a crossed cheque or by a crossed demand draft).

Notes –

a. If aggregate payment in a day (otherwise than by an account payee cheque/ draft) to the same person in respect of an expenditure exceeds Rs. 10,000*, it will be disallowed under section 40A(3), even if none of each payment in a day exceeds Rs. 10,000*.

b. If an assessee makes payment of two different bills (none of them exceeds Rs. 10,000*) at the same time in cash (or by bearer cheque or by crossed cheque or by crossed demand draft), section 40A(3) is not applicable even if the aggregate payment is more than Rs. 10,000*. To attract the disallowance under section 40A(3), both the amount of the bill and the amount of payment should exceed Rs. 10,000*.

c. Where the assessee makes payment over Rs. 10,000* at a time, partly by an account payee cheque and partly in cash (or bearer cheque or crossed cheque or by crossed demand draft) to some parties and this payment in cash (or by bearer cheque or crossed cheque or crossed demand draft) alone at one time does not exceed Rs. 10,000*, section 40A(3) is not attracted.

d. Provision of section 40A(3) does not apply in respect of an expenditure which is not to be claimed as deduction under sections 30 to 37.

Some cases where no disallowance will be made even if the expenditure (exceeding Rs. 10,000) is made in cash:*

- Payment to Indian railways;
- Payment of taxes to the government;
- Payment made on a day on which the banks were closed either on account of holiday or strike, etc.

Amount not deductible in respect of provision for unapproved gratuity fund [Sec. 40A(7)]

Provision for gratuity fund (for meeting future liability) is deductible only if such gratuity fund is an approved gratuity fund. In other words, we can say that any provision for unapproved gratuity fund (for meeting future liability) is not deductible.

Notes –

a. An employee retires during the current year. Gratuity is paid to him during the current year. It is deductible during the current year if no deduction was claimed earlier.

b. An employee retires during the current year. Gratuity is payable to him. A part of the amount is paid during the current year and the balance will be paid in the next year. A provision is made towards gratuity in the books of account of the current year for making payment in the next year. The entire amount is deductible during the current year if no deduction was claimed earlier.
   In this case, deduction is available during the current year even if provision is made for gratuity fund, which is unapproved (because, here, the provision is made for already due liability and not for the future liability).

c. A company has 50 employees. To meet future liability to pay them gratuity at the time of retirement, a gratuity fund is created and the employer makes contribution every year. Employers' contribution to this fund is deductible only if the gratuity fund is an approved gratuity fund.

Amount not deductible in respect of contributions to non-statutory funds [Sec. 40A(9)]

Any sum paid by the assessee as an employer by way of contribution towards recognized provident fund, or approved superannuation fund or an approved gratuity fund or NPS is deductible to the extent it is required by any law.

In simple words, if the following conditions are satisfied, then contribution or payment is not deductible by section 40A(9):

a. The contribution/ payment is made by an assessee as an employer.
b. It is paid towards setting up (or formation of) any trust, company, association of persons, body of individuals, society or it is paid by way of contributions to any fund.
c. The contribution or payment is not required by any law.

Notes –

a. Contribution by an assessee (not being in the capacity of an "employer") cannot be disallowed under section 40A(9).

b. All expenses incurred for the benefit of employees by an employer cannot be treated as contribution by the employer towards the various funds enumerated in section 40A(9). What is disallowed under section 40A(9) is employer's contribution/ payment towards a fund (for the benefit of employees) which is otherwise not required by any law (which is paid or contributed by an employer under contractual obligation or otherwise but not under a legal requirement).

Examples –

a. N Ltd. incurs an expenditure of Rs. 50,000 for maintenance of street lights in worker's colony. The expenditure is incurred without any legal or contractual requirement.
In this case, nothing will be disallowed under section 40A(9), as it is not towards setting up or formation of, or as contribution to, any fund, society, etc.

b. A Ltd. has a tea club in its office. Tea club provides tea, coffee, snacks, softdrinks to the employees during tea breaks. The club has been set up by employees (and/ or by A Ltd.) for the benefit of employees without any legal requirement. A Ltd. contributes Rs. 50,000 annually towards tea club.
It will be disallowed under section 40A(9) in the hands of A Ltd. The position will remain the same even if tea club was set up by the employer under the terms of employment but without any legal obligation.

c. Employer's contribution towards unrecognized provident fund or any other staff welfare fund (without any statutory requirement) will be disallowed under section 40A(9).

9.10 AMOUNT NOT DEDUCTIBLE IN RESPECT OF UNPAID LIABILITY [SEC. 43B]

Section 43B is applicable only if the taxpayer maintains books of account on the basis of mercantile system of accounting. The following expenses (which are otherwise deductible under the other provisions of the Income-tax Act) are deductible on payment basis:

1. Any sum payable by way of tax, duty, cess or fee (by whatever name called under any law for the time being in force);
2. Any sum payable by an employer by way of contribution to provident fund or superannuation fund or any other fund for the welfare of employees;
3. Any sum payable as bonus or commission to employees for service rendered;
4. Any sum payable as interest on any loan or borrowing from a public financial institution (i.e., ICICI, IFCI, IDBI, LIC and UTI) or a state financial corporation or a state industrial investment corporation;

5. Interest on any loan or advance taken from a scheduled bank or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank;
6. Any sum payable by an employer in lieu of leave at the credit of his employee; and
7. Any sum payable on account of use of railway assets.

The above expenses are deductible in the year in which payment is actually made.

Exception:
However, if the assessee maintains books of account on merchantile basis and the given below two conditions are satisfied, then the expenditure is deductible on "accrual" basis in the year in which the liability is incurred. The conditions are:

1. Payment in respect of the aforesaid expenses is actually made on or before the due date of submission of return of income; and
2. The evidence of such payment is submitted along with the return of income. But no annexure is possible with the new Income-tax return forms; so such evidence should be kept by the taxpayer himself and it can be produced before the Assessing Officer whenever he is required to produce it.

9.11 TIME FOR FILING RETURN OF INCOME [SEC. 139(1)]

The due date for filling returns of incomes are given below:

Different situations	*Due date of submission of return*
Where the assessee is required to furnish a report under section 92E pertaining to international or specified domestic transaction(s)	November 30 of the assessment year
Where the assessee is a company [not having international or specified domestic transaction(s)]	September 30 of the assessment year
Where the assessee is a person other than a company [i.e., not having international or specified domestic transaction(s)]:	
- In case where accounts of the assessee are required to be audited under any law	September 30 of the assessment year
- Where the assessee is a "working partner" in a firm whose accounts are required to be audited under any law	September 30 of the assessment year
- In any other case	July 31 of the assessment year

9.12 DEEMED PROFITS [SEC. 41]

Recovery against any deduction [Sec. 41(1)]
This section is applicable if the following conditions are satisfied:

a. In any of the earlier, years a deduction was allowed to the taxpayer in respect of loss, expenditure (revenue or capital expenditure) or trading liability incurred by the assessee.
b. During the current previous year, the taxpayer:
    i. has obtained a refund of such trading liability (it may be in cash or any other manner); or
    ii. has obtained some benefit in respect of such trading liability by way of remission or cessation thereof ("remission or cessation" for this purpose includes unilateral act of the assessee by way of writing-off of such liability in his books of account).

If the above two conditions are satisfied, the amount obtained by such person (or the value of benefit accruing to the taxpayer) shall be deemed to be the profits and gains of business or profession and, accordingly, chargeable to tax as the income of that previous year. This rule is applicable even if the business is not in existence in the year of recovery.

Sale of assets used for scientific research [Sec. 41(3)]
Where any capital asset used in scientific research is sold without having been used for other purposes and the sale proceeds, together with the amount of deduction allowed under section 35, exceed the amount of capital expenditure incurred on purchase of such asset, such surplus (i.e., sale price) or the amount of deduction allowed, whichever is less, is chargeable to tax as business income in the year in which the sale took place even if the business is not in existence.

Recovery of bad debts [Sec. 41(4)]
Where any bad debt has been allowed as deduction and the amount subsequently recovered on such debt is greater than the difference between the debt and the deduction so allowed, the excess realization is chargeable to tax as business income of the year in which the debt is recovered even if the business is not in existence.

Recovery after discontinuance of business or profession
Where any business or profession is discontinued by reason of retirement or death of the person carrying on such business or profession, any sum received after the discontinuance of the business or profession is deemed to be the income of the recipient and charged to tax in the year of receipt.

Adjustment of loss [Sec. 41(5)]
Generally, loss of a business cannot be carried forward after 8 years but there is an exception to this rule.
This exception is applicable if the following conditions are satisfied:
a. The business or profession is discontinued.
b. Loss of such business or profession pertaining to the year in which it is discontinued could not be set-off against any other income of that year.
c. Such business is not a speculative business.

d. After discontinuation of such business or profession, there is a receipt which is deemed as business income.

9.13 TAXATION OF DEEMED INCOME/UNDISCLOSED INCOME/ INVESTMENTS

The objective of deeming the amount as income is to check tax evasion, though they are actually not in the nature of income.

Undisclosed incomes/ investments are taxable @ 30% + Surcharge + cess @ 4%.

The following are treated as income from undisclosed sources:

1. ***Cash credit [Sec. 68]:***
   Where any sum is found credited in the books of an assessee maintained for any previous year and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.

2. ***Unexplained investments [Sec. 69]:***
   Where in the financial year immediately preceding the assessment year, the assessee has made investments which are not recorded in the books of account, if any, maintained by him for any source of income and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the value of the investments may be deemed to be the income of the assessee of such financial year.

3. ***Unexplained money, etc. [Sec. 69A]:***
   Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery, or other valuable article and such items are not recorded in the books of account, if any, maintained by him for any source of income and the assess offers no explanation about the nature and scope of acquisition of these items, or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the money and the value of these items may be deemed to be the income of the assessee for such financial year.

4. ***Amount of investments, etc., not fully disclosed in books of account [Sec. 69B]:***
   Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery, or other valuable article, and the Assessing Officer finds that the amount expended on making such investments or in acquiring such items exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of income, and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of Assessing Officer, satisfactory, the excess amount may be deemed to be the income of the assessing, for such financial year.

5. ***Unexplained expenditure, etc. [Sec. 69C]:***
   Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof, or the explanation, if any, offered by him is not, in the opinion of the Assessing Officer, satisfactory, the amount covered by such expenditure or part thereof, as the case may be, deemed to be the income of the assessee for such financial year.
   The proviso to section 69C provides that notwithstanding anything contained in any other provisions of the Act, such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as a deduction under any head of income.

6. ***Amount borrowed or repaid on hundi [Sec. 69D]:***
   Where any amount is borrowed on a hundi from, or any amount due thereon is repaid to, any person otherwise than through an account payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount aforesaid for the previous year in which the amount was borrowed or repaid, as the case may be.
   To avoid the situation of double taxation, it has been provided that if any amount borrowed on a hundi has been deemed under the provisions of this section to be the income of any person, such person should not be liable to be assessed again in respect of such amount under the provisions of this section on repayment of such amount. Moreover, for the purpose of this section, the amount repaid includes the amount of interest paid on the amount borrowed.

9.14 SUMMARY

This chapter has discussed the computation of profit and gains of business or profession. This is the third head of income after salary and house property. The chapter discussed the basis of charge and expenses which are allowed to be shown as valid business expenditures for the purpose of business or profession. This chapter has also discussed the expenses which are not allowed as business expenditures.

9.15 EXERCISE

Exercise 1: Long practical questions

The working notes given below in the solutions of unsolved questions are only for clarity purposes and for solving some typical concepts. However, in the final examination, students are expected to be more cautious in preparing working notes. Working notes in the examination must mention the concepts along with numerical calculation.

Problem 1 –
Mr. X has business income of Rs. 8,00,000 after debiting depreciation of Rs. 80,000 on building in his profit and loss account for the year 2019-20. He bought the following assets during the year:

1. *Building A bought on March 1, 2019 for Rs. 3,00,000 and put to use on March 31, 2020 (Rate of depreciation: 10%).*
2. *Building B bought on August 1, 2019 for Rs. 4,00,000 and put to use on March 10, 2020 (Rate of depreciation: 10%).*
3. *Building C bought on September 10, 2019 for Rs. 5,00,000 and put to use on August 15, 2020 (Rate of depreciation: 10%).*

Compute business income of X for the assessment year 2020-21.

Solution:

			Amount (Rs.)
	Business income after depreciation		8,00,000
Add:	Depreciation already deducted		80,000
	Rectified business income (before depreciation)		8,80,000
Less:	Depreciation under section 32:		
	Building A (3,00,000*10%)	30,000	
	Building B (4,00,000*5%)	20,000	
	Building C	Nil	50,000
	Business income		8,30,000

Note –

1. Where an asset is acquired during the previous year but put to use for the purpose of business or profession for less than 180 days during that year, in such a case, half of the normal depreciation is allowed.

2. If an asset is acquired during any previous year but not put to use during that previous year; the actual cost of such asset will become part of the block of assets on day 1 of the next year. For example, if any asset is purchased during the previous year 2018-19 but put to use in the previous year 2019-20; this asset is a part of the block on April 1, 2019. This rule is applicable even if the asset is not put to use in the previous year 2018-19. Here, depreciation is available for the first time in the previous year 2019-20.

Problem 2 –

X (age: 66 years), a resident individual, furnishes the following particulars for the previous year relevant for the assessment year 2020-21:

Profit and Loss Account for the year ending March 31, 2020

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Salary to staff	*13,000*	*Gross profit*	*4,49,700*
Staff welfare expenditure	*6,000*	*Sundry receipts*	*4,400*
General expenses	*6,500*	*Short-term capital gains*	*3,000*
Bad debts	*3,000*		
Advance tax for the assessment year 2018-19	*400*		
Fire insurance	*4,000*		
Advertisement expenses	*11,000*		

Interest on X's capital and loan	*3,600*		
Expenditure on acquisition of a copyright incurred on March 1, 2020 (it is put to use on the same day)	*2,800*		
Lump sum consideration for acquiring know-how incurred on March 10, 2020 (it is put to use on April 1, 2020)	*12,000*		
Depreciation on other business assets	*6,000*		
Provision for income-tax	*2,000*		
Contribution to a political party	*1,000*		
Net profit	*3,85,800*		
	4,57,100		*4,57,100*

Other information:

1. *Salary to staff includes salary paid to a relative which is unreasonable to the extent of Rs. 3,400.*
2. *Advertisement expenses include Rs. 8,000, being cost of 8 diaries presented to the customers.*
3. *Depreciation on other assets according to income-tax provision comes to Rs. 9,600.*
4. *Provision for income-tax is excessive to the extent of Rs. 600.*
5. *During the year 2019-20, X has purchased National Savings Certificate VIII issue of Rs. 10,000.*
6. *General expenses include an expenditure of Rs. 1,780 for arranging a long-term loan.*
7. *During the previous year 2019-20, the following payments are made:*
   a. *Rs. 7,000 paid on May 5, 2019 on account of outstanding customs duty of the previous year 2018-19; and*
   b. *Rs. 5,000 paid on January 3, 2020 on account of outstanding sales tax of the previous year 2018-19.*

Find out the taxable income and tax liability (net of advance tax) of X for the assessment year 2020-21. Due date of filing return of income is July 31, 2019 (for the assessment year 2019-20) and July 31, 2020 (for the assessment year 2020-21).

Solution:

Computation of net taxable income of X for the assessment year 2020-21:

Particulars			Amount (Rs.)
	Net profit as per profit and loss account		3,85,800
Add:	Expenses disallowed:		
	Salary to a relative (unreasonable)	3,400	
	Provision for income-tax	2,000	
	Advance tax	400	
	Interest on own capital and loan	3,600	

	Copyright [2,800-50% (25% of 2,800)]	2,450	
	Know-how	12,000	
	Contribution to political party	1,000	24,850
			4,10,650
Less:	Depreciation (9,600-6,000)		3,600
Less:	O/S sales tax paid in current previous year [43B]		5,000
			4,02,050
Less:	STCG		3,000
1.	Business income		3,99,050
Add: 2.	Capital gain i.e., STCG		3,000
	Gross total income		4,02,050
Less:	Deduction under section 80C		10,000
	Deduction under section 80GGC		1,000
	Total Income		3,91,050

Computation of tax payable:

			Amount (Rs.)
	Upto Rs.3,00,000		Nil
	On balance Rs. 91,050 @5%		4,552
	Thus, Tax on Total Income	=	4,552
Less:	Rebate under section 87A	=	Nil
		=	4,552
Add:	Cess @ 4%	=	182
		=	4,734
Less:	Advance tax	=	400
	Net tax to be paid (Rounded off)	=	4,334 or Rs 4330

Exercise 2: Short theory questions

1. *Discuss the provision of section 43B regarding certain expenditure allowed on actual payment basis only.*
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2. *When expenses or payments made to certain specified persons are not deductible under section 40A(2)?*
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3. *Explain the concept of expenditure on scientific research (Section 35).*
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Exercise 3 : Multiple choice questions

1. Rate of additional depreciation is _____ of actual cost of new asset.
- *a. 5%*
- *b. 10%*
- *c. 15%*
- *d. 20%*

2. 100% revenue expenditure incurred by the assessee on scientific research is allowed as deduction if such research is ________________ to business of assessee.
- *a. Related*
- *b. Unrelated*
- *c. Related or unrelated*
- *d. None of the above*

3. Payment to relatives is disallowed under section 40A(2) if the payment -
- *a. exceeds Rs. 50,000 per year*
- *b. is unreasonable*
- *c. exceeds Rs. 20,000 per day*
- *d. None of the above*

[Answers: 1 (d), 2 (a), 3(b)]

Exercise 4: Fill in the blanks

1. No depreciation is charged if block of assets is reduced to ……………

[Answers: 1 (Zero)]

Exercise 5: True or False

1. Depreciation is allowed only if the asset is owned by the assessee.

2. No depreciation is charged if block of assets ceases to exist on the last day of the previous year.

[Answers: 1 (True), 2 (True)]

Books recommended –

1. *Singhania, V.K. and Singhania, Monica [2018], Students' Guide to Income Tax (University Edition), Taxmann Publications (P) Ltd.*

2. *Ahuja, Girish and Gupta, Ravi [2018], Simplified Approach to Income Tax (University Edition), Flair Publications Pvt. Ltd.*

LESSON 10

CAPITAL GAINS

STRUCTURE OF THE CHAPTER

10.1 BASIS OF CHARGE [SEC. 45]

Income is taxable under the head "Capital Gains" if the following conditions are satisfied:

1. There should be a capital asset.
2. The capital asset is transferred by the assessee during the previous year.
3. Any profit or gains arises as a result of such transfer.
4. Such profit or gains is not exempt from tax under section 54, 54B, 54D, 54EC, 54EE, 54F, 54G, 54GA and 54GB.

If the aforesaid conditions are satisfied, then capital gain is taxable in the assessment year relevant to the previous year in which the capital asset is transferred.

10.2 CAPITAL ASSET [SEC. 2(14)]

"Capital asset" means –

1. Property of any kind held by an assessee (whether or not connected with his business or profession).
2. Any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the SEBI Act.

However, "capital asset" does not include the following:

1. Any stock-in-trade (other than the securities referred to in point 2 above), consumable stores or raw material held for the purpose of business or profession;

2. All personal belongings of the assessee except Jewellery;

3. Agricultural land in India in a rural area;

   Note:

   Rural area for this purpose means any area which is outside the jurisdiction of a municipality or a cantonment board having a population of 10,000 or more and also which does not fall within distance given below:

   a. 2 kilometres from the local limits of municipality/ cantonment board, if the population of the municipality/ cantonment board is more than 10,000 but not more than 1 lakh; or
   b. 6 kilometres from the local limits of municipality/ cantonment board, if the population of the municipality/ cantonment board is more than 1 lakh but not more than 10 lakh; or
   c. 8 kilometres from the local limits of municipality/ cantonment board, if the population of the municipality/ cantonment board is more than 10 lakh.

4. 6½ per cent Gold Bonds, 1977, or 7 per cent Gold Bonds, 1980, or National Defence Gold Bonds, 1980;

5. Special bearer bonds, 1981;

6. Gold Deposit Bonds issued under Gold Deposit Scheme, 1999; and

7. Deposit certificates issued under the Gold Monetisation Scheme, 2015.

10.3 LONG-TERM CAPITAL ASSET [SECTION 2(29)A]

"Long-term capital asset" means a capital asset held by an assessee for more than 36 months immediately prior to its date of transfer. Thus, capital gain arising from the transfer of long-term capital asset is called Long-Term Capital Gain.

Exceptions:

(i)In case of listed securities or units of UTI or unit of equity oriented fund or zero-coupon bond held by the assessee, the long-term capital asset will mean such assets held by the assessee for more than 12 months.

(ii) If unlisted shares of a company or land or building or both held by the assessee, the long-term capital asset will mean such asset held by the assessee for more than 24 months.

(iii)In case of Land or Building or both:

(a) transferred up to March 31, 2017- 36 months.

(b) If transferred on or after April 1, 2017- 24 months

10.4 SHORT-TERM CAPITAL ASSET [SECTION 2(42)A]

"Short term capital asset" means a capital asset held by an assessee for not more than 36 months (or 24 months in case of unlisted shares and immovable property), immediately prior to its date of transfer.

*In the following cases, however, such period is taken as **12 months**:*

1. Equity or preference shares in a company listed on a recognized stock exchange in India.
2. Securities (like debentures, bonds, Government securities, etc.) listed on a recognized stock exchange in India.
3. Units of UTI (whether quoted or not).
4. Unit of an equity oriented mutual fund (whether quoted or not).
5. Zero coupon bonds (whether quoted or not).

In the aforesaid cases, if the asset is held for more than 12 months immediately prior to its date of transfer, then it is "long-term capital asset".

Note:

In the case of transfer of a depreciable asset (other than an asset used by a power generating unit eligible for depreciation on straight line basis), capital gain (if any) is taken as short-term capital gain, irrespective of period of holding.

10.5 TRANSFER OF CAPITAL ASSET [SEC. 2(47)]

Transfer, in relation to a capital asset, includes sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law.

However, certain transactions are not included in transfers:

1. Distribution of assets in kind by a company to its shareholders on its liquidation;
2. Distribution of capital assets in kind by a HUF to its members at the time of total or partial partition;
3. Any transfer of capital asset under a gift or a will or an irrevocable gift (exception – gift of ESOP[2] shares is chargeable to tax);
4. Any transfer of capital asset by a holding company to its 100% Indian subsidiary company;
5. Transfer of capital asset under a scheme of amalgamation/ demerger, if the transferee company is an Indian company;
6. Transfer of shares in amalgamating company/ demerged company in lieu of allotment of shares in amalgamated company/ resulting company in the above case;
7. Transfer of capital asset in a scheme of amalgamation of a banking company with a banking institution;
8. Any transfer by way of conversion of bonds or debentures, debenture-stock or deposit certificate in any form, of a company into shares or debentures of that company;
9. Any transfer of capital asset in a reverse mortgage;
10. 'Transfer by an individual of Sovereign Gold Bond issued by the RBI under the Sovereign Gold Bond Scheme, 2015, by way of redemption'; and
11. Any transfer by way of conversion of preference shares of a company into equity shares of that company

[2] In case of gift of ESOP shares, fair market value on the date of gift is taken as full value of consideration.

10.6 Computation of Capital Gain/ Loss [Sec. 48]

The income chargeable under the head "Capital Gains" shall be computed as under:

I- Short Term Capital Gain/ Loss – Computation

			Amount (Rs.)
	Full value of sales proceeds/consideration XX		
Less:	Expenses on transfer	XX	
	Cost of acquisition	XX	
	Cost of improvement	XX	XX
	Balance		XX
Less:	Exemption under sections 54B, 54D, 54G and 54GA	XX	
	Balance amount is STCG/ (STCL)		XXX

II- Long Term Capital Gain/ Loss – Computation

			Amount (Rs.)
	Full Value of sales proceeds/Consideration XX		
Less:	Expenses on transfer	XX	
	Indexed cost of acquisition (ICA)	XX	
	Indexed cost of improvement (ICI)	XX	XX
	Balance		XX
Less:	Exemption under sections 54, 54B, 54D, 54EC, 54EE, 54F, 54G, 54GA and 54GB	XX	
	Balance amount is LTCG/ (LTCL)		XX

It is to be noted that no deduction is allowed in respect of securities transaction tax in computing income under the head "Capital gains".

Full value of consideration

Full value of consideration is the consideration received or receivable by the transferor in lieu of assets, which he has transferred. Such consideration may be received in cash or in kind. If it is received in kind, then fair market value (FMV) of such assets is taken as full value of consideration.

However, in few cases, "fair value of consideration" is determined on notional basis according to the different provisions given in the Income-tax Act.

Expenditure on transfer

Expenditure incurred wholly and exclusively in connection with transfer of capital asset is deductible from full value of consideration. The expression "expenditure incurred wholly and exclusively in connection with such transfer" means expenditure incurred which is necessary to effect the transfer.

Examples of such expenses are: brokerage or commission paid for securing a purchase, cost of stamp, registration fees borne by the vendor, traveling expenses incurred in connection with transfer, litigation expenditure for claiming enhancement of compensation awarded in the case of compulsory acquisition of assets.

Cost of Acquisition
Cost of acquisition of an asset is the value for which it was acquired by the assessee. Expenses of capital nature for completing or acquiring the title to the property are includible in the cost of acquisition. Interest on money borrowed to purchase the asset is part of actual cost of asset.

Cost of Improvement
Cost of improvement is capital expenditure incurred by an assessee in making any additions/ improvement to the capital asset. It also includes any expenditure incurred to protect or complete the title to the capital assets or to cure such title. Any expenditure incurred to increase the value of the capital asset is treated as cost of improvement. Cost of improvement includes only expenditure on improvement incurred on or after April 1, 2001 (whether incurred by the previous owner or by the assessee).

Indexed Cost of Acquisition – Computation

Indexed cost of acquisition =

$$\frac{\textit{Cost of acquisition}}{\textit{CII for the year in which the asset was first held by the assessee* or CII for 2001–02, whichever is later}} \times \textit{CII for the year in which the asset is transferred}$$

** or the **previous owner** in cases specified under section 49(1)*

Indexed Cost of Improvement – Computation

Indexed cost of improvement =

$$\frac{\textit{Cost of improvement}}{\textit{CII for the year in which improvement took place}} \times \textit{CII for the year in which the asset is transferred}$$

Cost inflation index (CII) for the previous year 2001-02 (base year) is 100 and for the previous year 2017-18 is 272.

Cost inflation index for different years –

Financial year	*CII*	*Financial year*	*CII*
2001-02	100	2011-12	184
2002-03	105	2012-13	200
2003-04	109	2013-14	220
2004-05	113	2014-15	240
2005-06	117	2015-16	254
2006-07	122	2016-17	264
2007-08	129	2017-18	272

2008-09	137	2018-19	280
2009-10	148	2019-20	289
2010-11	167	2020-21	301

10.7 WHEN THE BENEFIT OF INDEXATION IS NOT AVAILABLE

In the following cases, benefit of indexation is not available even if a long-term capital asset is transferred:

1. Bonds or debentures (other than capital indexed bonds issued by the Government);
2. Shares in or debentures of an Indian company acquired by utilizing convertible foreign exchange as mentioned under first proviso to section 48* (applicable to a non-resident assessee only); and
3. Bonds/ debentures or Sovereign Gold Bond issued by the RBI under the Sovereign Gold Bond Scheme, 2015.

10.8 CAPITAL GAIN EXEMPT FROM TAX UNDER SECTION 10

In the cases given below, capital gains are not chargeable to tax by virtue of section 10. Conversely, in the cases given below, if assets are transferred at a loss, such capital loss is not taken into consideration.

1. *Capital gain on transfer of US 64:*
   Any income arising from the transfer of a capital asset being a unit of US 64 is not chargeable to.

2. *Long-term capital gain on transfer of securities not chargeable to tax in cases covered by transaction tax [Section 10(38)]:*
   Section 10(38) is applicable for all the assesses, if the following conditions are satisfied:
   a. The asset which is transferred is a long-term capital asset.
   b. Such asset is equity share in a company or units of equity oriented mutual fund.
   c. Such transaction takes place on or after October 1, 2004 in a recognized stock exchange in India.
   d. At the time of transfer as well as at the time of acquisition of shares, the transaction is chargeable to securities transaction tax*.

   If the above conditions are satisfied, long-term capital gain is exempt from tax under section 10(38).
   However, in the case given above, if the asset is short-term capital asset, short-term capital gain is taxable under **section 111A** @ 15% + Surcharge (if any) + cess @ 4%.

10.9 COMPUTATION OF CAPITAL GAINS IN CERTAIN SPECIAL CASES

In the following cases the method of computation is different from what we have discussed above:

Cost of asset to the Previous Owner [Sec. 49(1)]
Cost of asset to the previous owner shall be deemed to be the cost of acquisition of assessee in case of inheritance, gift, will, etc.
Further, in order to find out whether the capital asset is short-term or long-term in such cases, the period of holding of the previous owner shall be taken into consideration.

Cost of acquisition being Fair Market Value as on April 1, 2001
In the following cases, the assessee may take at his option, either actual cost or the fair market value of the asset (other than a depreciable asset), as on April 1, 2001 as cost of acquisition:

1. Where the capital asset became the property of the assessee before April 1, 2001; or
2. Where the capital asset became the property of the assessee by any mode referred to in section 49(1) and the capital asset became the property of the previous owner before April 1, 2001.

Notes –

a. The option is available only when an asset was acquired by the assessee [or by the previous owner in case section 49(1) is applicable] before April 1, 2001.

b. The option is not available in the case of depreciable assets.

c. When option is available, the cost of the asset or FMV as on April 1, 2001, whichever is higher, is taken as the cost of acquisition.

d. The option is not available in respect of transfer of a capital asset being goodwill of a business; trademark/ brand name associated with a business; right to manufacture, produce or process any article or thing; right to carry on business; tenancy right; route permits or loom hours (whether self-generated or otherwise).

Cost of acquisition in case of Depreciable Assets [Sec. 50]
Section 50 is applicable in the case of transfer of a depreciable asset but not applicable in the case of transfer of a depreciable asset by a power-generating unit claiming depreciation on the basis of straight-line basis method.

By virtue of section 50, computation of capital gain/ loss can be made in the case of transfer of a depreciable asset only in the following two situations:

a. *When written down value (WDV) of block of assets (BOA) on the last day of the previous year is zero [Section 50(1)]:*

			Amount (Rs.)
	Full value of sale consideration		XX
Less:	Expenses on transfer	XX	
	WDV of the BOA at the beginning of the previous year	XX	
	Actual cost of any asset(s) of same block acquired during the previous year	XX	XX
	Short Term Capital **Gain**		XXX

If the resulting figure is **negative**, then section 50(1) is **not** applicable and capital gain is not chargeable to tax (unless the case comes under situation 2 which is explained below).

b. *When block of asset is empty on the last day of the previous year [Section 50(2)]:*

			Amount (Rs.)
	Full value of sale consideration		XX
Less:	Expenses on transfer	XX	
	WDV of the BOA at the beginning of the previous year	XX	
	Actual cost of any asset(s) of same block acquired during the previous year	XX	XX
	Short Term Capital Gain/ Loss		XXX

Notes –

a. If a depreciable asset (not being the case of power unit as stated above) is transferred and the case does not fall under any of the above two situations, then capital gain is not chargeable to tax.

b. It is not necessary that depreciation is allowed for the year under consideration. If the depreciation is allowed in the current year (or any of the earlier years), the above provisions of section 50 would be applicable.

c. For the purpose of section 50, it is not necessary that the asset should be put to use.

d. In the above two situations, the capital gain/ loss is always short-term.

e. While deducting actual cost from sale consideration to compute capital gain/ loss, any depreciable asset which is acquired otherwise than by an account payee cheque/ draft or use of electronic clearing system through a bank account (and the payment exceeds Rs. 10,000), such payment shall not be eligible for deduction while computing capital gain/ loss.

f. When a single asset like the building is transferred, consideration has to be apportioned between the depreciable portion (i.e., superstructure) and the non-depreciable portion (i.e., land) for implementing section 50.

Advance money forfeited

Advance money forfeited during the previous year **2014-15** (or any subsequent previous year) is taxable in the hands of recipient under the head "Income from other sources" in the year in which advance money is forfeited.

However, advance money forfeited during the previous year 2013-14 (or any earlier previous year) is not taxable as "Income from other sources". Instead, it is deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.

Computation of capital gain in case of Self-generated assets

An asset which does not cost anything to the assessee in terms of money in its creation or acquisition is a self-generated asset.

When a self-generated asset is transferred, *the following special rules are applicable:*

1. *Goodwill of a business (not a profession), right to manufacture/ produce any article/ thing or right to carry on any business or profession:*
   In the case of transfer of these capital assets, cost of acquisition and improvement are taken as *nil*. Expenses on transfer are, however, deductible on the basis of actual expenditure.

2. *Tenancy rights, route permit, loom hours, trade mark or brand name associated with a business:*
   In the case of transfer of these capital assets, cost of acquisition is taken as *nil*. Cost of improvement and expenses on transfer are, however, deductible on the basis of actual expenditure.

3. *Any other self-generated asset:*
   In the case of transfer of any other self-generated capital asset, capital gain is not chargeable to tax.

It is to be noted that even if the above mentioned self-generated assets are acquired before April 1, 2001, the option of adopting the fair market value on the said date is **not available.**

Fair market value of the asset disclosed under Income Declaration Scheme, 2016

For 'asset disclosed under Income Declaration Scheme, 2016, fair market value of the asset declared under the scheme on June 1, 2016 (on the basis of which tax, surcharge and penalty is paid under the scheme) is taken as the cost of acquisition.

Cost of acquisition of Bonus Shares

If bonus shares were allotted prior to 1st April, 2001, the fair market value on 1st April, 2001 is taken as the cost of acquisition. If bonus shares are allotted on or after April 1, 2001, cost of acquisition is taken **as Nil.**

Capital gain on transfer of Right Shares

Following two situations can arise in case of transfer of right shares –

1. *Rights entitlement (which is renounced by the assessee in favour of a person):*
   In such a case, cost of acquisition is Nil.
   However, in such a case, the amount realized by the original shareholder by selling his rights entitlement will be short-term capital gains in his hands (as the cost is taken as nil).
   The period of holding of the rights entitlement will be considered from the date of offer made by the company to subscribe to shares to the date when such right entitlement is renounced by the person.

2. *Right shares purchased by the person in whose favour rights entitlement has been renounced:*
   In such a case, cost of acquisition is equal to the purchase price paid to renouncer of rights entitlement *plus* amount paid to the company which has allotted the rights shares.

Transfer of Land and Buildings [Sec. 50C]
This section is applicable if the following conditions are satisfied:
1. There is a transfer of land or building or both. The asset may be long-term capital asset or short-term capital asset. It may be depreciable or non-depreciable asset.
2. The sale consideration is less than the value adopted (or assessed) by any authority of a State Government for the purpose of payment of stamp duty (hereinafter referred to as "Stamp duty authority") in respect of such transfer.

If the above conditions are satisfied, the value adopted by the Stamp duty authority shall be taken as 'full value of consideration' for the purpose of computing capital gain. However, 'full value of consideration' depends upon the following situations:

Exception:
Where the assessee claims before the Assessing Officer that value adopted by Stamp duty authority is more than the fair market value (but he has not disputed or challenged such valuation under the Stamp Act), then two possibilities arises:
a. Fair market value determined by the Valuation Officer (if it is less than the stamp duty valuation) is taken as full value of consideration.
b. Stamp duty valuation (if the fair market value determined by the Valuation officer is more than the Stamp duty valuation) is taken as full value of consideration.

Computation of capital gain in case of transfer of unlisted shares in a company [Sec. 50CA]
Where consideration for transfer of shares in a company (other than quoted shares) is less than the FMV of such share, the FMV shall be deemed to be the full value of consideration for the purpose of computing "Capital Gains".

10.10 EXEMPTIONS UNDER CAPITAL GAINS

Any gains arising from the transfer of the following assets are exempt from tax.
(1) Transfer of residential house property [Sec. 54]: Any gain is exempt subject to the following conditions:

i. Available to an individual or a HUF
ii. Residential house property (long-term) is transferred
iii. Assessee has **purchased** another residential house within **one year** before or within **two** years after sale of original house or **constructed** another house within **three** years after sale of original house

- Amount of exemption is investment in new asset or LTCG, whichever is lower
- Exemption is available if **1** residential house is purchased or constructed **in India.** A taxpayer may sell two house properties and he may purchase/ construct 1 house property for the purpose of availing the exemption

Deposit Scheme:
In case, the assessee is not interested in purchasing or constructing the house till due date of filing return of income, he has to deposit the amount in Capital Gains Deposit Account Scheme till the due date of filing return of income to get the exemption. On the basis of this deposit, exemption under section 54 can be claimed. But assessee has to actually withdraw the deposited amount and utilize this deposited amount within the prescribed time limit for purchasing or constructing the house.
In case the deposited amount is not fully utilized in purchasing or constructing the house within eligible time limit, then the unutilised amount will be taxable as LTCG in the year in which the maximum time limit for making new investment (i.e., 3 years for construction) expires.

Deposit scheme for exemption under section 54 has been explained below with the help of an example:

a. *Suppose the assessee transfers the residential property on January 14, 2020 i.e., previous year 2019-20*
b. *The assessee has purchased another residential house **within one year** before January 14, 2020 i.e., January14, 2019 to January 13, 2020*

   OR

   *If assessee wants to purchase the house, the house should be purchased **within two years after the transfer** (January 14,2020) i.e., during January 15, 2020 to January 13, 2022*

   OR

   *if assessee wants to construct the house within **three years after date of original transfer** (January 14,2020), the construction should be completed during January 15, 2020 to January 13, 2023 to claim the exemption of section 54.*

c. *If the assessee is not interested in purchasing or constructing the house till July 31, 2020, the assessee has to deposit the amount in "Capital Gains Deposit Account Scheme" till July 31, 2020 (due date of filing return of income for individuals) to claim the exemption.*

d. *By withdrawing from this deposit account, the house should be purchased till January 13, 2022 or constructed till January 13, 2023.*

e. *On January 14, 2023 (Assessment year 2022-23), unutilised amount (if any) will be taxable as LTCG (taxable in the year in which maximum time limit expires). Also, on January 14, 2023 (or at any time thereafter), assessee can withdraw this unutilised amount. However, if the taxpayer dies before the expiry of specified time-limit (for making investment in new asset), then unutilized amount paid to* the legal heirs is not taxable in the hands of recipient.

- *Withdrawal of exemption:*
  If the new asset on which exemption is claimed under section 54 is transferred within 3 years of its acquisition/ construction, exemption given will be taken back. For calculating STCG on transfer of new asset, cost of acquisition will be calculated as original cost of acquisition *minus* exemption availed under section 54.
  Example:1
  Assuming the assessee has purchased the property on May 20, 2020 for Rs. 7,00,000 for the purpose of claiming exemption under section 54. It should not be transferred till May 19, 2023. Suppose, it is transferred on May 18, 2023 for Rs. 9,00,000.
  In this case, since the new capital asset is transferred within 3 years from the date of its acquisition, exemption given earlier would be taken back. Further, capital gain on such transfer is taxable as LTCG in the year of sale.
  So capital gain in assessment year 2023-24 is calculated as follows:

Assessment year 2023-24

		Amount (Rs.)
	Sale	9,00,000
Less:	Indexed cost of acquisition	
	[Cost of acquisition is Nil	
	i.e., 7,00,000 – 7,00,000 (exemption claimed earlier taken back)]	Nil
	LTCG	9,00,000

(2) Sale of land used for agricultural purposes [Sec. 54B]

- Available to an individual or a HUF

- Any short-term or long-term capital asset (being agricultural land) is transferred which was used by assessee (or his/ her parents) or a HUF for agricultural purposes for a period of two years immediately before transfer

- Assessee has purchased other **agricultural lands** (whether in rural area or in urban area) within **two years** from the date of transfer of original asset

- Amount of exemption is investment in new asset or capital gain, whichever is lower

- *Deposit Scheme:*

In case, the assessee is not interested in purchasing the land till due date of filing return of income, he has to deposit the amount in Capital Gains Deposit Account Scheme till the due date of filing return of income to get the exemption. On the basis of this deposit, exemption under section 54B can be claimed. But assessee has to actually withdraw the deposited amount and utilize this deposited amount within the prescribed time limit for purchasing the land.
In case the deposited amount is not fully utilized in purchasing the land within eligible time limit, then the unutilised amount will be taxable as LTCG or STCG (depending upon the original gain) in the year in which the maximum time limit for purchasing land (i.e., 2 years) expires.

- *Withdrawal of exemption:*
  If the new asset on which exemption is claimed under section 54B is transferred within 3 years of its acquisition/ construction, exemption given will be taken back. For calculating STCG on transfer of new asset, cost of acquisition will be calculated as original cost of acquisition *minus* exemption availed under section 54B.

(3) Compulsory acquisition of land and building forming part of industrial undertaking [Sec. 54D]

- Available to all taxpayers

- Such land or building (short-term or long-term) was used by the assessee for the purpose of the industrial undertaking for at least 2 years preceding the date of compulsory acquisition

- Assessee has purchased any other **land or building** (for industrial purposes) within a period of **3 years** from the date of **receipt of compensation** or **constructed** a building within such period

- Amount of exemption is investment in new asset or capital gain, whichever is lower

- *Deposit Scheme:*
  In case, the assessee is not interested in purchasing land or building or constructing a building till due date of filing return of income, he has to deposit the amount in Capital Gains Deposit Account Scheme till the due date of filing return of income to get the exemption. On the basis of this deposit, exemption under section 54D can be claimed. But assessee has to actually withdraw the deposited amount and utilize this deposited amount within the prescribed time limit for purchasing the land or building or constructing the building.
  In case the deposited amount is not fully utilized in purchasing the land or building or constructing the building within eligible time limit, then the unutilised amount will be taxable as LTCG or STCG (depending upon the original capital gain) in the year in which the maximum time limit for making new investment (i.e., 3 years) expires.

- *Withdrawal of exemption:*
  If the new asset on which exemption is claimed under section 54D is transferred within 3 years of its acquisition/ construction, exemption given will be taken back. For calculating STCG on transfer of new asset, cost of acquisition will be calculated as original cost of acquisition *minus* exemption availed under section 54D.

(4) LTCG from any asset but investment should be in bonds of NHAI or REC or notified bonds [Sec. 54EC]

- Available to all taxpayers

- Any long-term capital asset is transferred

- Investment in specified assets [bonds of NHAI or/ and REC] or in any bonds (redeemable after 3 years) issued by any other authority but notified by the Central Government for this purpose, within 6 months from the date of transfer

- Amount of exemption is investment in new asset or LTCG, whichever is lower

- Maximum investment in one financial year is Rs. 50,00,000. Investment made by an assessee in the NHAI/ REC bonds, out of capital gains arising from transfer of one or more original asset, during the financial year in which the original asset or assets are transferred and in the subsequent financial year should not exceed Rs. 50,00,000.
- *Withdrawal of exemption:*
  If the new asset is transferred within 3 years of its acquisition or converted into money, exemption will be taken back and the amount of exemption given earlier under section 54EC will become LTCG of the year in which the assessee commits the default.

(5) LTCG from any asset but investment should be in units of a specified fund [Sec. 54EE]

- Available to all taxpayers
- Any long-term capital asset is transferred
- Investment in units of a specified fund within 6 months from the date of transfer
- Amount of exemption is investment in new asset or LTCG, whichever is lower
- Maximum investment in one financial year is Rs. 50,00,000. Investment made by an assessee in long-term specified assets, out of capital gains arising from transfer of one or more original asset, during the financial year in which the original asset or assets are transferred and in the subsequent financial year should not exceed Rs. 50,00,000.

- *Withdrawal of exemption:*
  If the new asset is transferred within 3 years of its acquisition or converted into money, exemption will be taken back and the amount of exemption given earlier

under section 54EE will become LTCG of the year in which the assessee commits the default.

(6) Sale of any long-term capital asset other than a residential house [Sec. 54F]

- Available to an individual or a HUF

- The taxpayer will have to purchase/ construct **1 residential** house property within the specified period in India.

- The specified period is **1 year before, or within 2 years** after the date of transfer of the original asset in case of purchase option. However, in case of construction option, the construction should be completed **within 3 years** from the date of transfer of original asset.

- Under **section 54F**, exemption is available **only if** on the date of transfer of the original asset, the taxpayer does **not own more than one residential house property** (other than the new house on which exemption under section 54F is claimed).

- *Amount of exemption =*
  $\frac{LTCG}{Net\ sale\ consideration}$ * **Cost of new house**

  Net sale consideration = Sale consideration minus expenses on sale

- *Deposit Scheme:*
  In case, the assessee is not interested in purchasing or constructing the house till due date of filing return of income, he has to deposit the amount in Capital Gains Deposit Account Scheme till the due date of filing return of income to get the exemption. On the basis of this deposit, exemption under section 54F can be claimed. But assessee has to actually withdraw the deposited amount and utilize this deposited amount within the prescribed time limit for purchasing or constructing the house.
  In case the deposited amount is not fully utilized in purchasing or constructing the house within eligible time limit, then the proportionate unutilised amount ($\frac{LTCG}{Net\ sale\ consideration}$ * Unutilised amount) will be taxable as LTCG in the year in which the maximum time limit for making new investment (i.e., 3 years for construction) expires.

- *Withdrawal of exemption:*
  1. If the new house on which exemption is claimed under section 54F is transferred within 3 years of its acquisition/ construction, capital gain which arises on the transfer of new house will be taken as **STCG**. Besides, the capital gain which was exempt under section 54F shall be treated as **LTCG** of the year in which the new house is transferred.

2. If the assessee purchases, within a period of 2 years from the date of transfer of original asset (or constructs within a period of 3 years from the date of transfer of original asset), anther residential house (other than the new house on which exemption under section 54F is claimed), then the capital gain which was exempt under section 54F shall be deemed to be income by way of **LTCG** of the year in which such another residential house is purchased or constructed.

10.11 MISCELLANEOUS POINTS

1. ***Relief*** *is available from LTCG as well as from STCG under section 111A [This relief is available to a resident individual/ a resident HUF]:*
   If net taxable income excluding LTCG and STCG of section 111A is less than the exemption limit (i.e., Rs. 5,00,000; Rs. 3,00,000 or Rs. 2,50,000, depending upon the case) of an assessee, then the difference between net taxable income (after deducting LTCG and STCG of section 111A) and exemption limit is the amount of relief. This difference (i.e. relief) will be deducted from LTCG or STCG of section 111A, as the case may be and on the balance amount, capital gain will be chargeable to tax.

2. STCG (if covered under section 111A) is taxable @ 15% + Surcharge (if any) + Cess @ 4% and normal STCG is taxable as per slab rates of the assessee.

3. No deduction under section 80C to 80U is available from LTCG or from STCG under section 111A.

4. LTCG is taxable @ 20% + Surcharge (if any) + Cess @ 4%. However, in the following 2 cases, LTCG can be taxable @ 10% + Surcharge (if any) + Cess @ 4%.

   In the following 2 cases, LTCG is taxable @ 10%:
   a. If unlisted securities (i.e., unlisted shares, unlisted debentures, etc.) are transferred by a **non-resident/ foreign company**, long-term capital gain is taxable @ 10% + Surcharge (if any) + Cess @ 4%. However, this rule is applicable only if indexation benefit is not claimed and capital gain is calculated without giving effect to the first proviso to section 48 *(under first proviso to section 48, capital gain is calculated in foreign currency if a few conditions are satisfied).*

   b. If listed securities (i.e., shares, bonds, debentures, Government Securities) or zero-coupon bonds are transferred by any **taxpayer** and the taxpayer does not avail the benefit of indexation, LTCG can be taxable @ 10% + Surcharge (if any) + Cess @ 4%. In this case, the taxpayer has an option available. Tax can be paid by the assessee @ 20%, if indexation benefit is claimed or @ 10%, if indexation benefit is not claimed.

However, it is to be noted that in case of transfer of listed debentures or listed bonus shares, option of paying tax @ 10% is always better.

10.12 SUMMARY

This topic discussed the computation of income under the head "Capital gains". There are two types of capital gains – long term capital gains and short term capital gains. From these capital gains, exemptions are also available. Computation of capital gains for special cases has also been discussed in detail in this chapter.

10.13 EXERCISE

Exercise 1: Long practical questions

The working notes given below in the solutions of unsolved questions are only for clarity purposes and for solving some typical concepts. However, in the final examination, students are expected to be more cautious in preparing working notes. Working notes in the examination must mention the concepts along with numerical calculation.

Problem 1 –

Mr. J purchased a house on 01-07-1996 for Rs. 90,000. He had to pay Rs. 2,000 as brokerage to real estate agent and Rs. 8,000 as registration charges. He entered into an agreement for sale of property to X on 10-12-2004 and received Rs. 25,000 as advance. X, could not, however, keep his promise and advance of Rs. 25,000 given by him was forfeited by Mr. J. Later on, he gifted this house to his son K on 15-09-2005. The following expenses were incurred by J and K for the renewal of house:

- *Addition of two rooms by J during 1999-00* — *Rs. 50,000*
- *Addition of first floor by J during 2004-05* — *Rs. 1,00,000*
- *Addition of second floor by K during 2010-11* — *Rs. 1,50,000*
- *Fair market value of house on 01-04-2001 was Rs. 1,25,000*

K entered into an agreement to sell the house for Rs. 9,00,000 to Y on 10-05-2013 after receiving an advance of Rs. 50,000. Y could not pay the balance within the stipulated time of two months and K forfeited the advance of Rs. 50,000 as per agreement with Y. K ultimately found a buyer Mr. Z to whom property was transferred for Rs. 30,00,000 on 15-12-2019. K had to pay brokerage @ 1% for arranging this deal.

Compute the capital gain chargeable to tax in the hands of Mr. K for the assessment year 2020-21.

Can Mr. K get an exemption of tax on capital gain income? If so, how?

The CII for financial year is:

2001-02	100	2005-06	117	2017-18	272	2019-20	289
2004-05	113	2010-11	167	2018-19	280		

Solution:

Computation of LTCG for the Assessment year 2020-21

		Rs.	Rs.
	Sales consideration		30,00,000
Less:	Expenses on sale 1%	30,000	
Less:	Index cost of acquisition 75,000*289/ 100	2,16,750	
Less:	Index cost of improvement: (i) 2004-05: 1,00,000*289/113 (ii)2010-11: 1,50,000*289/167	 2,55,752 2,59,581	 7,62,083
	Long-Term Capital Gain		22,37,917

Yes, Mr. K can claim deduction on the amount of capital gain of Rs. 22, 37,917 in the following manner:

a. **Option I:** If we assume that the house property transferred is a residential house property, then the assessee can claim exemption under section 54 provided conditions of section 54 are satisfied.
b. **Option II**: If we assume that the house property transferred is a commercial house property, then the assessee can claim exemption under section 54F provided conditions of section 54F are satisfied.
c. **Option III:** He may invest the capital gain in bonds specified under section 54EC within 6 months of the date of transfer of the house.

Note:

1. Advance money forfeited by the previous owner J is not to be deducted from the cost of acquisition arrived after applying the concept of FMV on 01-04-2011 but the amount of Rs. 50,000 forfeited by the assessee K shall be deducted for this cost of Rs. 1,25,000.
2. However, with effect from assessment year 2015-16, advance money received and forfeited by the assessee is taxable as "Income from other sources" and it is not to be deducted from the cost of acquisition.

3. Cost of improvement incurred before April 1, 2001 are ignored under the Act.

Problem 2 –

Mr. A purchased a house on July 1, 1998 for Rs. 90,000. He had to pay Rs. 2,000 as brokerage to a real estate agent for arranging the deal and Rs. 8,000 as registration charges. He gifted his house to his son B on September 15, 2005. The following capital expenditures were incurred by A and B in respect of the aforesaid house:

a. Addition of two rooms by A during 1999-00: Rs. 50,000.
b. Addition of first floor by A during 2004-05: Rs. 1,00,000.
c. Addition of Second floor by B during 2010-11: Rs. 1,50,000.

Fair market value of house on April 1, 2001 was Rs. 1,25,000.

B transferred it to Z for Rs. 72,00,000 on November 15, 2019. B had to pay brokerage @ 1% for arranging this deal.

B purchased a residential plot for Rs. 10,00,000 on June 25, 2020 and deposited Rs. 15,00,000 with SBI under 'Capital Gain Deposit Account Scheme'. Compute capital gains for the assessment year 2020-21 and also advise, by which date, he must utilize this *amount by constructing a house on the aforesaid plot in order to avoid withdrawal of exemption claimed under section 54.*

2001-02	100	2005-06	117	2017-18	272	2019-20	289
2004-05	113	2010-11	167	2018-19	280		

Solution:

Computation of capital gains for the assessment year 2020-21:

		Rs.	Rs.
	Sales consideration on Nov.15,2019		72,00,000
Less:	Expenses on sale 1%	72,000	
Less:	Index cost of acquisition 1,25,000*289/ 100	3,61,250	
Less:	Index cost of improvement: (i) 2004-05: 1,00,000*289/113 (ii)2010-11: 1,50,000*289/167	 2,55,752 2,59,581	 7,48,583
	Long-Term Capital Gain before taxation		64,51,417
Less:	Exemption u/s 54: ▪ Purchase of plot on June 25,2020 ▪ Deposited under CG Deposit Account Scheme	 10,00,000 15,00,000	 25,00,000
	Taxable Long-Term Capital Gain or LTCG		38,51,417

Mr. B should utilize the amount of Rs. 15,00,000 for construction purpose on purchased residential plot latest by November 14, 2020; otherwise exemption given earlier will be taken back to the extent of unutilized amount.

Note:

1. Cost of improvement incurred before April 1, 2001 are ignored under the Act.
2. It is assumed that amount has been deposited in Capital Gains Deposit Account Scheme on or before due date of filing return of income.

Problem 3 –

X Ltd. is having two Machines A & B (Depreciation rate: 15%, Depreciated value of the block on 1-4-2019: Rs. 9,00,000). On June 1, 2019, it purchased an old Machine C (depreciation rate: 15%) for Rs. 1,00,000. On Nov 1, 2019, Machine A was transferred for Rs. 30,000. Machine B was transferred for Rs. 20,000 on Dec 1, 2019 and Machine C was transferred for Rs. 25,000 on Jan 1, 2020. Expenditure on transfer on these machines was Rs. 2,000.

Compute the amount of admissible depreciation/ capital gain for the assessment year 2020-21.

Solution: When the block of the assets is empty:

Computation of depreciation for the block of Plant and Machinery having rate of depreciation 15%:

		Rs.	Rs.
	Depreciated value of the block on 01/04/2019	9,00,000	
Add:	Cost of asset acquired during the previous year	1,00,000	

	[01/06/2019]		10,00,000
Less:	Sales considerations :(all machine were sold) (i)Machine A on Nov.1,2019 Rs. 30,000 (ii)Machine B on Dec.1,2019 Rs. 20,000 (iii) Machine C on Jan.1,2020 Rs. 25,000 Less: expenses on sale	75,000 (2,000)	73,000
	Written Down Value of the block on 31/03/2020		9,27,000
	Depreciation in 2019-20		Nil
	WDV of the block of assets on 01/04/2020		Nil

Note: No depreciation will be charged in the present case because block is empty on March 31, 2020, though WDV on March 31, 2020 is not zero.
Since block ceases to exist on March 31, 2018, section 50(2) has to be applied:

Computation of Capital Gain for the assessment year 2020-21

		Rs.	Rs.
	Sales considerations FY 2019-20		75,000
Less:	Expenses on sale	2,000	
Less:	WDV on 01/04/2019	9,00,000	
Less:	Cost of assets acquired FY 2019-20	1,00,000	(10,02,000)
	Short-Term Capital Gain/(loss)u/s 50(2)		(9,27,000)

Problem 4 –

Mr. X (55 years) owns a house property in Ghaziabad. It was acquired by Mr. X on October 10, 2006 for Rs. 6,00,000. He transfers it for Rs. 53,00,000 on November 4, 2019 (Stamp Duty Value Rs. 65,00,000). X pays brokerage @ 2%. He made following investments in order to avail of the exemptions arising out of the aforesaid capital gain transaction.

Mr. X acquires a residential house property at Kolkata on December 10, 2019 for Rs. 10,00,000 and deposited Rs. 4,00,000 on July 16, 2020 and Rs. 1,00,000 on November 1, 2020 in Capital Gain Deposit Scheme in a Nationalised Bank for construction of an additional floor on the residential house property in Kolkata.

Invests Rs. 7,00,000 on April 10, 2020 and Rs. 2,00,000 on June 15, 2020 in REC Capital Gain Bonds.

Compute the chargeable amount of capital gain and tax liability of X for the assessment year 2020-21 on the assumption that Mr. X's salary income (computed) is Rs. 4,90,000.

CII for 2006-07 is 122; 2017-18 is 272; 2018-19 is 280 and 2019-20 is 289.

Solution:

Computation of Total Income for the assessment year 2020-21		
	Rs.	Rs.
1. Income from Salary: **Gross Salary** Less: Standard deduction u/s 16(i)	 4,90,000 50,000	 4,40,000
2. Capital Gain: LTCG (see working notes-1**)**		28,72,689

Gross Total Income (GTI)		33,12,689
Deduction under chapter VI		Nil
Total Income		33,12,689
Rounded off = Rs. 33,12,690		

Computation of Tax Liability:

A- Income Taxable at special rate:

Tax on LTCG @20% on Rs. 28,72,690 = Rs. 5,74,538

B- Income Taxable at Normal Rate: Rs.4,40,000

Upto Rs. 2,50,000 Nil

On balance Rs. 2,90,000@5% Rs. 14,500 Rs. 14,500

Rs. 5,89,038

Add: Cess@4% Rs. 23,562

Tax liability Rs. 6,12, 600

Working notes:

1- Computation of net taxable income for the assessment year 2020-21:

		Rs.	Rs.
	Sales consideration FY 2019-20(as per stamp duty valuation)		65,00,000
Less:	1.Expenses on sale @2% on Rs. 53,00,000 2. Index cost of acquisition (Rs.6,00,000 *289/122)	1,06,000 14,21,311	15,27,311
	LTCG before exemption		49,72,689
Less:	Exemption u/s 54: (i)Purchase of residential property on Dec.10,2019 (ii) Deposited under CGAScheme on July 16,2020	10,00,000 4,00,000	
Less:	Exemption u/s 54EC: Investment in REC Capital Gain Bonds	7,00,000	21,00,000
	LTCG		28,72,689

2. If stamp duty value is more than the actual sale value, stamp duty value is taken as sale value.

3.Amount invested till May 3, 2020 in REC bonds is eligible for exemption under section 54EC.

Exercise 2: Short theory questions

1. *What is the cost of acquisition of bonus shares in the context of capital gains?*
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2. *What is a "Capital asset" under the Income Tax Act, 1961?*
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3. *How would you compute capital gains on depreciable assets under section '50'.*
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4. *Write a short note on exemption under section 54.*
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5. *Briefly explain the provisions relating to exemption of capital gains arising out of transfer of long term capital asset other than a house property (Sec. 54F).*
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Exercise 3: Multiple choice questions

1. Indexation is not available in case of –

- *a. Debentures*
- *b. Listed equity shares*
- *c. Commercial house property*
- *d. None of the above*

2. Deductions under sections 80C to 80U are not available from –

- *a. LTCG*
- *b. STCG under section 111A*
- *c. Both , a. and b.*
- *d. None of the above*

[Answers: 1(a), 2(c)]

Exercise 4: Fill in the blanks

1. STCG under section 111A is taxable @ ……

2. Exemption under section 54EC can be claimed if the asset transferred is a ………… term capital asset.

[Answers: 1(15%), 2(Long)]

Exercise 5: True or False

1. If equity shares are transferred in a recognized stock exchange in India, long term capital gain is exempt from tax.

2. Advance money forfeited during the previous year 2019-20 is taxable as "Income from other sources."

[Answers: 1(True), 2(True)]

Books recommended –

1. *Singhania, V.K. and Singhania, Monica [2018], Students' Guide to Income Tax (University Edition), Taxmann Publications (P) Ltd.*

2. *Ahuja, Girish and Gupta, Ravi [2018], Simplified Approach to Income Tax (University Edition), Flair Publications Pvt. Ltd.*

LESSON 11

INCOME FROM OTHER SOURCES

STRUCTURE OF THE CHAPTER

11.1 INTRODUCTION

"Income from other sources" is the last head of income. While section 56 defines the scope of income chargeable to tax under this head, section 57 and 58 specify the basis of computation of such income.

11.2 BASIS OF CHARGE [SEC. 56]

Any income which is not included in the above discussed four heads of income such as "income from salary", "income from house property" ; " profits and gains from business or profession" and "Capital gain" is by default covered under the head "Income from other sources".
Section 56(1) covers any income which does not fall under any other head of income. However, section 56(2) specifies ten incomes which are always taxable under the head "Income from other sources".

The following ten incomes are always taxable under the head "Income from other sources":

1. Dividend income;
2. Income from winnings from lotteries, crossword puzzles, races including horse races, etc.;
3. Any sum received by the assessee from his employees as contributions to any staff welfare schemes, if the same is not taxed as business income;
4. Income by way of interest on securities, if the same is not taxed as business income;

5. Income from letting out machinery, plant or furniture, if the same is not taxed as business income";
6. Income from letting out of machinery, plant or furniture along with letting out of building and the two lettings are not separable (if the income is not taxed as business income);
7. Any sum received under a Keyman insurance policy (including bonus), if such income is not taxable as salary income or business income;
8. If any sum of money received as *gift* exceeds Rs. 50,000, the whole of the amount is taxable as income from other sources;
9. Income by way of interest on compensation or on enhanced compensation shall be assessed under the head "Income from other sources" in the year in which it is received. However, 50 percent of such interest is deductible and consequently, only 50 percent of such interest is taxable.
10. Where any sum of money, received as an advance or otherwise in the course of the negotiations for transfer of a capital asset, is forfeited and the negotiations do not result in transfer of such capital asset, then, such sum shall be chargeable to tax under the head "Income from other sources". This provision is applicable for those forfeitures of advance money which are forfeited in the assessment year 2015-16 (or onwards).

Some general incomes which are chargeable to tax under the head "Income from other sources":

1. Income from subletting;
2. Income from royalty (if it is not an income from business/ profession);
3. Director's fee;
4. Agricultural income from land situated outside India;
5. Agricultural income from a place outside India;
6. Rent of plot of land;
7. Casual income;
8. Salaries payable to a Member of Parliament;
9. Family pension received by family members of a deceased employee;
10. Income from undisclosed sources;
11. Compensation received for use of business assets;
12. Income from undisclosed sources:
    - Unexplained Cash credits (Sec. 68)
    - Unexplained Investments (Sec. 69)
    - Unexplained Money (Sec. 69A)
    - Unexplained Expenditure (Sec. 69C)
    - Amount borrowed/ repaid on Hundi.

Relevance of method of accounting:

Income chargeable under the head "Income from other sources" is computed in accordance with the method of accounting regularly employed by the assessee.

11.3 TREATMENT OF DIVIDEND

Any dividend, declared, distributed or paid by a company to its shareholders is chargeable to tax under the head "Income from other sources" irrespective of the fact whether shares are held by the assessee as investment or stock-in-trade.
Under section 2(22), some payments may be treated as deemed dividend even though these payments may not be "dividend" under the Companies Act.

Notes –

1. Actual dividend received from domestic companies is exempt in the hands of shareholders under section 10(34) if the dividend income does not exceed Rs. 10 lakh. In case it exceeds Rs. 10 lakh, it is taxable in the hands of shareholders under section 115BBDA.
   However, the company declaring dividend has to pay corporate dividend tax under section 115-O @ 20.555% (17.647% + 12% + 4%) for the assessment year 2020-21. Rate of CDT (Corporate dividend tax) is 15% but computation of effective corporate dividend tax rate makes this rate as 17.647%.

2. *Tax on dividends covered under section 115BBDA –*
   In the case of a resident individual, resident HUF, resident firm and non-domestic companies, aggregate dividend income from domestic companies in excess of Rs. 10 lakh is chargeable to tax @ 10% + Surcharge + Cess @ 4%. Taxation of dividend income in excess of Rs. 10 lakh shall be on gross basis i.e., no deduction is allowed from dividend income.

3. Actual dividend received from a non-domestic company is taxable in the hands of shareholders.

4. If deemed dividend is covered under clause 2(22)(a), (b), (c) or (d), then it is exempt in the hands of shareholders under section 10(34). However, the payer-company has to pay CDT/ DDT (corporate dividend tax/ dividend distribution tax) under section 115-O @ 20.555% for the assessment year 2020-21.

5. However, if dividend is covered under clause 2(22)(e), it is taxable in the hands of shareholders under the head "Income from other sources". On such dividends, company paying dividend has to deduct tax at source under section 192 @ 10% on behalf of the assessee and assessee has to include this income as deemed dividend income under the head "Income from other sources" which will be taxable at the rate depending upon the tax slab applicable for the assessee.

6. Dividend paid by an Indian company is deemed to accrue or arise in India.

7. The aforesaid rules are applicable even if dividend is declared by a company out of income which is not chargeable to tax.

11.4 TREATMENT OF WINNINGS FROM LOTTERIES, CROSSWORD PUZZLES, HORSE RACES AND CARD GAMES, ETC.

1. Gross winnings from lotteries, crossword puzzles, races including horse races (other than income from the activity of owning and maintaining race horses), card games and other games of any sort or from gambling or betting of any nature whatsoever are chargeable to income-tax at a flat rate of 30% + surcharge (if applicable) + cess @ 4% (if applicable) on the amount of gross winnings (without claiming any allowance or expenditure).

2. Under section 194B, tax is deductible @ 30% + surcharge (if applicable) + cess @ 4% on payments in respect of winnings from lotteries or crossword puzzles or card games or other games if amount of payment exceeds Rs. 10,000.

3. Under section 194BB, tax is deductible @ 30% + surcharge (if applicable) + cess @ 4% on payments in respect of winnings from horse races if amount of payment exceeds Rs. 10,000.

4. No tax is required to be deducted in respect of winnings from other races, gambling or betting.

5. No deduction under sections 80C to 80U is allowed from such incomes.

11.5 TREATMENT OF INTEREST ON SECURITIES

Under section 2(28B), interest on securities means:

a. interest on any security of the Central Government or a State Government;
b. interest on debentures or other securities for money issued by or on behalf of a local authority or a company or a corporation established by a Central, State or Provincial Act.

Interest on securities does not accrue daily or according to the period of holding of investment. Under section 193, TDS from interest on securities is 10%. However, no TDS is required to be deducted in case of Central/ State Government securities (except on Relief Bonds).

11.6 INTEREST EXEMPT FROM TAX [SEC. 10(15)]

Interest on the following securities is exempt from tax:

1. National Defence Gold Bonds, 1980;
2. Special Bearer Bonds, 1991;
3. Treasury Saving Deposits Certificates;
4. Post Office Savings Bank Account interest is exempt only to the extent of Rs. 3,500 in case of single account and Rs. 7,000 in case of joint account;
5. National Plan Certificates;
6. 7% Capital Investment Bonds;

7. Notified Relief Bonds;
8. Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999;
9. Scheme of Fixed Deposits governed by the Government Savings Certificates (Fixed Deposits) Rules, 1968;
10. Scheme of Fixed Deposits governed by the Post Office (Fixed Deposits) Rules, 1968;
11. Notified bonds/ debentures of a public sector company;
12. Notified bonds issued by local authority.

11.7 RECEIPTS WITHOUT CONSIDERATION/ INADEQUATE CONSIDERATION TO BE TREATED AS INCOME [SEC. 56(2)]

Under this clause, if any person receives during the previous year 2017-18, a sum of money or property without consideration/ inadequate consideration *(which falls in any of the following five categories)*, it is chargeable to tax in the hands of the recipient under the head "Income from other sources" *except* in the following cases:

1. If money/ property is received from a relative.
2. If money/ property is received on the occasion of the marriage of the individual.
3. If money/ property is received by way of will/ inheritance.
4. If money/ property is received in contemplation of death of the payer.
5. If money/ property is received from a local authority.
6. If money/ property is received from any fund, foundation, university, other educational institution, hospital, medical institution, any trust or institution referred to in section 10(23C).
7. If money/ property is received from a charitable institute registered under section 12A/ 12AA.
8. If money/ property is **received by** any fund/ trust/ university/ other educational institutions/ hospital/ other medical institution referred to in section 10(23C).

Following are the five categories:

Different categories	*Tax treatment*	*For the ceiling of Rs. 50,000 whether a single transaction would be examined or all transactions of the previous year will be considered*
Any sum of money (gift in cash or by cheque or draft)	If aggregate amount of sum of money received without any consideration from one or more persons during a previous year exceeds Rs. 50,000, the whole of such aggregate value will be chargeable to tax.	All transactions

Immovable property without consideration	If any immovable property (without any consideration) is received whose stamp duty value exceeds Rs. 50,000, stamp duty value will be chargeable to tax.	Single transaction
Immovable property for a consideration which is less than the stamp duty value	If any immovable property is received for a consideration which is less than the stamp duty value of the property by an amount exceeding Rs. 50,000, then the difference between stamp duty value and consideration is chargeable to tax.	Single transaction
Movable property** without consideration	If aggregate fair market value of movable properties** received without consideration during a previous year exceeds Rs. 50,000, the whole of aggregate fair market value of movable property or properties** will be chargeable to tax.	All transactions
Movable property** for a consideration which is less than the fair market value	If movable property or properties** is received for a consideration which is less than the aggregate fair market value of the property or properties** by an amount exceeding Rs. 50,000, then the difference between aggregate fair market value and the consideration is chargeable to tax.	All transactions

Notes –

1. **Property:*

   "Property" for this purpose means the following capital assets of the assessee (i.e., recipient):

   i. immovable property being land or building or both;
   ii. shares and securities;
   iii. jewellery;
   iv. archaeological collections;
   v. drawings;
   vi. paintings;
   vii. sculptures;
   viii. any work of art; or
   ix. bullion.

2. ***Movable Property:*

   "Movable Property" for this purpose means the following capital assets of the assessee (i.e., recipient):

   i. Shares and securities;
   ii. jewellery;
   iii. archaeological collections;
   iv. drawings;
   v. paintings;
   vi. sculptures;
   vii. any work of art; or
   viii. bullion.

3. *Relative:*
   Relative means **spouse** of the individual, **brother or sister** of the individual, **brother or sister of the spouse** of the individual, **brother or sister of either of the parents** of the individual, **any linear ascendant or descendant** of the individual, **any linear ascendant or descendant of the spouse** of the individual, and **spouse** of the aforesaid persons discussed above.
   Example –
   If assessee is Mr. X, following people are covered under the definition of relative:
   i. Mrs. X,
   ii. Mr. X's brother and sister,
   iii. Mrs. X's brother and sister,
   iv. Mr. X's parent's brothers and sisters,
   v. Mr. X's father, grandfather, great grandfather, mother, grandmother, great grandmother and so on or Mr. X's son, grandson, great grandson, daughter, granddaughter, great granddaughter and so on,
   vi. Mrs. X's father, grandfather, great grandfather, mother, grandmother, great grandmother and so on or Mrs. X's son, grandson, great grandson, daughter, granddaughter, great granddaughter and so on, and
   vii. in all the cases [from point (ii) to (vi)] spouses also.

11.8 DEDUCTIONS UNDER THE HEAD "INCOME FROM OTHER SOURCES" [SEC. 57]

1. **Interest on loan** taken for the purpose of investment in shares or securities will also be deductible if it is actually used for the aforesaid purpose. But if dividend is exempt under section 10(34), the expenses shall not be allowed as a deduction because expenses incurred to earn the income which is already exempt under section 10 are not allowed as deduction.

2. In the case of income in the nature of **family pension** received by the widows or heirs of deceased employee, a deduction of a sum equal to 1/3rd of such income or Rs. 15,000, whichever is less, is allowed as deduction.

3. Any other expenditure (not being a capital expenditure or personal expenditure of the assessee) incurred wholly and exclusively for the purpose of earning such income.

4. Any expenditure is deductible if the following basic conditions are satisfied:
   a. The expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning the income;
   b. The expenditure must not be in the nature of capital expenditure;
   c. It must not be in the nature of personal expenses of the assessee;
   d. It must be laid out or expended in the relevant previous year and not in any prior or subsequent year.

11.9 AMOUNTS NOT DEDUCTIBLE WHILE COMPUTING "INCOME FROM OTHER SOURCES" [SEC. 58]

1. Any personal expenses of the assessee.

2. Payment to relatives and associates if the Assessing Officer considers it excessive or unreasonable.

3. Expenses or losses in connection with income from lottery, crossword puzzles, races including horse races, card games, gambling or betting of any nature, shall not be deductible in computing the said income.

4. Expenses incurred in relation to exempted incomes are not deductible.

11.10 MISCELLANEOUS POINTS

1. Dividend from UTI/ Mutual fund is exempt from tax under section 10(35).

2. Winnings from lottery or gambling nature incomes are taxable @ 30%.

3. Interest on Government securities and non-Government securities is taxable under the head "Income from other sources". However, in case of non-Government securities (listed on non-listed), TDS rate is 10% but in case of Government securities, TDS is Nil.

4. Anything received by partners from their partnership firm is taxable under the head "Profits and gains of business or profession" in their individual hands. For example, interest on capital, share of profit, remuneration to partners, etc.

5. Share of profit from a partnership firm is exempt from tax in the hands of partners under section 10(2A).

6. Maximum rate of interest which a firm can pay to the partners, as interest on partner's capital contribution cannot exceed 12% p.a. under section 40(b).

7. *Tax-free Government Securities:*
   These securities are those, the interest on which is fully exempt from tax under section 10(15). Interest on such securities is neither included in total income of the assessee, nor it is taxed.

8. *Less-Tax Government Securities:*
   Interest on such securities shall be included in the total income of security holder. Tax shall not be deducted of source on interest of such securities.

11.11 SUMMARY

This topic discussed the computation of income under the head "Income from other sources". Treatment of dividend and gift has been discussed in detail.

11.12 EXERCISE

Exercise 1: Long Practical Questions

The working notes given below in the solutions of unsolved questions are only for clarity purposes and for solving some typical concepts. However, in the final examination, students are expected to be more cautious in preparing working notes. Working notes in the examination must mention the concepts along with numerical calculation.

Problem –1

X (42 years) gives the following information for the previous year 2019-20:

1. *On December 1, 2019, he gets gift of House no.1 from his friend B (stamp duty value is determined at Rs. 6,00,000).*
2. *On December 7, 2019, X purchases a second-hand car for Rs. 70,000 from D (market value is, however, Rs. 3,00,000).*
3. *On December 21, 2019, X purchases a painting for Rs. 4,00,000 from G, who is brother of Mrs. X (fair market value is Rs. 7,00,000).*
4. *On January 25, 2020, X gets a gift cheque of Rs. 1,00,000 from his friend L on his birthday.*
5. *X contributes Rs. 10,000 in the public provident fund account of his dependent mother.*

Determine the amount of net income of X under the head "Income from other sources" for the assessment year 2020-21.

Solution:

Computation of net taxable income of X for the assessment year 2020-21:

		Amount (Rs.)
	Income from other sources/ GTI	7,00,000
Less:	Deduction under section 80C	Nil
	Net taxable income	7,00,000

Point No.	Different categories	Tax treatment	Taxable (Rs.)
1.	Immovable property without consideration	Since stamp duty exceeds Rs. 50,000; stamp duty will be chargeable to tax	6,00,000
2.	Movable property for a consideration which is less than the fair market value	Car is not a movable asset under the definition of gift Gift from relative is exempt from tax	Nil

3.	Painting for consideration which is less than the fair market value	Not an income	Nil
4.	Gifts in cash/cheque	Gift from a friend of Rs. 1,00,000. *Since the amount exceeds* Rs. *50,000, the whole amount is chargeable to tax*	1,00,000

Note: Deduction u/s 80's is not allowed under the head "income from other sources".

Problem –2 [interest on Security]

Mr. Y, a resident individual, furnished the following information relating to his investment for the previous year 2019-20.

a) Rs. 1,20,000, 6% Tax-free Debentures of a Textile Company.
b) Rs. 54,000, 10% Tax-free Debentures issued by Rajasthan Financial Corporation.
c) Rs.25,000, 5% U.P. Govt. Loan
d) Rs. 12,000, 5% Debentures of Delhi Development Authority
e) Rs.60,000, 12% Tax-free Government Securities

   Bank charged 2% commission on the amount of interest collected. Interest is payable in each case on 30th June and 31st December.

Determine the income under the head 'Income from other sources' for the assessment year 2020-21.

Solution:

		Gross Interest Rs.
a)	6% Tax-free Debenture of a Textile Company 7,200 *100/90	8,000
b)	10% Tax-free Debenture of RF corporation 5,400*100/90	6,000
c)	5% U.P.Govt. Loan (Less Tax, No TDS-no gross-up)	1,250
d)	5% Debenture of DDA (Less Tax, No TDS-No gross-up)	600
e)	12% Tax-free Govt. Securities	Exempt
	Total	15,850
	Less: Collection charges 2% on Rs.14,450 or [7,200+5,400+1,250+600]	289
	Income from Interest on Security	15,561

Problem 3-

Mr. G holds the following securities on April 1, 2019:

(a) Rs. 10,00,000 5% UP Government loan (date of payment of interest: January 1).
(b) Rs. 40,000 6% Non-listed debentures of ABC Ltd. (dates of payment of interest: June 11 and December 11 every year).

(c) Rs. 25,000 8% debentures of PQR Ltd. (dates of payment of interest: June 15 and December 15 every year).

On December 1, 2019, G sells Rs. 25,000 8% debentures of PQR Ltd.; Post Office Savings Bank interest is Rs. 4,300, SBI savings bank interest is Rs. 9,500 and he has received a gift of Rs. 1 lakh in foreign currency from a friend on December 1, 2019 on his marriage anniversary.

Calculate the taxable income of G for the assessment year 2020-21.

Solution:

Computation of Income under the head "Income from other sources" for the AY 2020-21

A-Interest on Securities:	Rs.
a) U.P. Government Loan	50,000
b) 6% Non-Listed Debenture of ABC ltd.	2,400
c) 8% Debenture of PQR ltd.	1,000
B-Other income:	
d. Interest on saving account of SBI	9,500
e. Post-Office Saving Bank Interest	800
f. Gift	1,00,000
Gross Total income	1,63,700
Deductions: i. u/s 80TTA (subject to a maximum of Rs.10,000	10,000
Total Income under the head ' Income from other source	1,53,000

Exercise 2: Short theory questions

1. *What are the incomes included under the head "Income from other sources"?*

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2. *Explain the provisions of 'Gift' under Income from other sources?*

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Exercise 3: Multiple choice questions

1. Dividend income from a non-domestic company is __________ *in the hands of shareholders.*

a. *Exempt*
b. *Taxable*
c. *Taxable @ 15%*
d. *None of the above*

2. Which option is odd one?

a. *Gift from a relative*
b. *Gift at the time of marriage anniversary*
c. *Gift by way of will*
d. *Gift from an educational institution*

[Answers: 1 (b), 2 (b)]

Exercise 4: Fill in the blanks

1. Gambling income is taxable @ ……..

2. Maximum exemption in case of family pension is …………

[Answers: 1 (30%), 2 (Rs. 15,000)]

Exercise 5: True or False

1. Gift received from a relative is exempt from tax only if the amount does not exceed Rs. 50,000.

2. Dividend from a domestic company is exempt from tax in the hands of shareholders if it does not exceed Rs. 10 lakh.

[Answers: 1 (False), 2 (True)]

Books recommended –

1. *Singhania, V.K. and Singhania, Monica [2018], Students' Guide to Income Tax (University Edition), Taxmann Publications (P) Ltd.*

2. *Ahuja, Girish and Gupta, Ravi [2018], Simplified Approach to Income Tax (University Edition), Flair Publications Pvt. Ltd.*

LESSON 12

CLUBBING OF INCOME

STRUCTURE OF THE CHAPTER

12.1 INTRODUCTION

Generally, an assessee is taxed in respect of his own income. In some cases, however, the assessee may be taxed in respect of income which legally belongs to some other person. Because an assessee attempts to shift his income to others so that he may keep his tax liability to the minimum. This chapter of clubbing has been incorporated in the Act for those assessees who make an attempt to reduce their tax bill by transferring their income to others.

12.2 TRANSFER OF INCOME WITHOUT TRANSFER OF ASSETS [SEC. 60]

If the following conditions are satisfied, then the income from the asset would be taxable in the hands of the transferor:

1. The taxpayer owns an asset.
2. The income from the asset is transferred to any person but ownership of the assets still remains with the transferor.
3. The above transfer may be revocable or may not be revocable.
4. The above transfer may be effected at any time (maybe before the commencement of the Income-tax Act or otherwise).

Example:
A owns Rs. 50,000, 10% debentures of P Ltd. On 1st April, 2019, he transfers interest income to his friend, B, without transferring the ownership of these debentures. Although, during 2019-20, interest income of Rs. 5,000 is received by B, it is taxable in the hands of A because as per section 60, he has transferred the income without transferring the ownership of the asset.

12.3 REVOCABLE TRANSFER OF ASSETS [SEC. 61]

By virtue of section 61, if an asset is transferred under a "revocable transfer", income from such asset is taxable in the hands of the transferor.

Following are treated as revocable transfers:

1. If the transfer contains any provision to re-transfer the asset (or income therefrom) to the transferor directly or indirectly, wholly or partly.
2. If the transferor has any right to reassume power over the asset (or income therefrom) directly or indirectly, wholly or partly.
3. If an asset is transferred under a trust and it is revocable during the lifetime of the beneficiary.
4. If an asset is transferred to a person and it is revocable during the lifetime of the transferee.
5. If an asset is transferred before April 1, 1961 and it is revocable within six years.

Note –
Income from such assets (covered under section 61) is taxable as and when the power to revoke arises. The above rule is applicable even if the power to revoke has not been exercised so far. For example, X has transferred an asset. Under the terms of transfer, on or after April 1, 1998, he has a right to utilize the income of the asset for his benefit. However, he has not exercised this right as yet. On or after April 1, 1998, income of the asset would be taxable in the hands of X, even if he has not exercised the aforesaid right.

12.4 WHEN AN INDIVIDUAL IS ASSESSABLE IN RESPECT OF REMUNERATION OF SPOUSE [SEC. 64(1)(II)]

This section is applicable if the following conditions are satisfied:

1. The taxpayer is an individual.
2. She/ he has a substantial interest in a concern.
3. Spouse of the taxpayer (i.e., husband/ wife of the taxpayer) is employed in the above-mentioned concern without any technical or professional knowledge or experience.

If the aforesaid conditions are satisfied, then salary income of the spouse will be taxable in the hands of the taxpayer.

Notes –

1. Salary income includes commission, fees or any other form of remuneration whether in cash or in kind.

2. *Substantial Interest:*
   An individual is deemed to have substantial interest, if he (individually or along with his relatives) beneficially holds 20% or more of equity shares in the case of a company or is entitled to 20% or more of the profits in the case of a concern other than a company, at any time during the previous year.

3. *Relative:*
   Relative in relation to an individual means the husband, wife, brother or sister or any linear ascendant or descendant of that individual.

4. *When both the husband and wife have substantial interest in a concern:*
   When both the husband and wife have substantial interest in a concern and both are in receipt of the remuneration from such concern without any technical and professional qualification, then such remuneration will be included in the total income of husband or wife whose total income, excluding such remuneration, is greater.
   It is to be noted that if once clubbing is done in the hands of X, salary of X and Mrs. X will be included in the income of X (in the subsequent years), even if income of X is lower than that of Mrs. X in that year. In such a case, the Assessing Officer can club the income of X and Mrs. X in the hands of Mrs. X only if the Assessing Officer is satisfied that it is necessary to do so. The Assessing Officer can take such action only after giving Mrs. X an opportunity of being heard.

12.5 WHEN AN INDIVIDUAL IS ASSESSABLE IN RESPECT OF INCOME FROM ASSETS (OTHER THAN A HOUSE PROPERTY) TRANSFERRED TO SPOUSE [SEC. 64(1)(IV)]

This section is applicable if the following conditions are satisfied:

1. The taxpayer is an individual.
2. He /she has transferred an asset (other than a house property) to his /her spouse, directly or indirectly.
3. The asset is transferred otherwise than (a) for adequate consideration or (b) in connection with an agreement to live apart.
4. The asset may be held by the transferee – spouse in the same form or in a different form.

If the aforesaid conditions are satisfied, then any income from such asset shall be deemed to be the income of the taxpayer who has transferred the asset.

Example:
X has transferred debentures of IDBI to his wife without adequate consideration. Interest income on these debentures will be included in the income of X.

Note –

1. If a house property is transferred and the above noted conditions are satisfied, then the transferor is "deemed" as owner of the property and income will be treated as income of the transferor under section 27(i).

2. *Indirect transfer:*
   If the two or more transfers are inter-connected and are parts of the same transaction, the aforesaid rule of clubbing is applicable. For instance, if X gifts Rs. 20,000 to Mrs. Y and Y gifts property worth Rs. 20,000 to Mrs. X, the transaction would be indirect transfer without consideration by X to Mrs. X and by Y to Mrs. Y.

12.6 WHEN AN INDIVIDUAL IS ASSESSABLE IN RESPECT OF INCOME FROM ASSETS TRANSFERRED TO SON'S WIFE [SEC. 64(1)(VI)]

This section is applicable if the following conditions are satisfied:

1. The taxpayer is an individual.
2. He/ she has transferred an asset after May 31, 1973 to his/ her son's wife, directly or indirectly.
3. The asset is transferred otherwise than for adequate consideration.
4. The asset may be held by the transferee in the same form or in a different form.

If the aforesaid conditions are satisfied, then any income from such asset shall be deemed to be the income of the taxpayer who has transferred the asset.

Example:
X has transferred a bank deposit of Rs. 20,000 in favour of his son's wife without adequate consideration. Interest income on this deposit will be included in the income of X.

12.7 WHEN AN INDIVIDUAL IS ASSESSABLE IN RESPECT OF INCOME FROM ASSETS TRANSFERRED TO A PERSON FOR THE BENEFIT OF SPOUSE [SEC. 64(1)(VII)]

This section is applicable if the following conditions are satisfied:

1. The taxpayer is an individual.
2. He/ she has transferred an asset to a person or an association of persons, directly or indirectly, for the immediate or deferred benefit of his/ her spouse.
3. The asset is transferred otherwise than for adequate consideration.

If the aforesaid conditions are satisfied, then any income from such asset to the extent of such benefit shall be deemed to be the income of the taxpayer who has transferred the asset.

Example:
X transfers Government bonds without consideration to an association of persons subject to the condition that the interest income from these bonds will be utilized for the benefit of Mrs. X. Interest from bonds shall be included in the income of X.

12.8 WHEN AN INDIVIDUAL IS ASSESSABLE IN RESPECT OF INCOME FROM ASSETS TRANSFERRED TO A PERSON FOR THE BENEFIT OF SON'S WIFE [SEC. 64 (1)(VIII)]

This section is applicable if the following conditions are satisfied:

1. The taxpayer is an individual.
2. He/ she has transferred an asset after May 31, 1973 to any person or an association of persons, directly or indirectly, for the immediate or deferred benefit of his /her son's wife.
3. The asset is transferred otherwise than for adequate consideration.

If the aforesaid conditions are satisfied, then any income from such asset to the extent of such benefit shall be deemed to be the income of the taxpayer who has transferred the asset.

Example:
X transfers an industrial undertaking to an association of persons subject to the condition that out of the annual income of Rs. 5,00,000, a sum of Rs. 1,00,000 shall be utilized for the benefit of daughter-in-law of X. In this case, Rs. 1,00,000 shall be included in the income of X.

12.9 WHEN AN INDIVIDUAL IS ASSESSABLE IN RESPECT OF INCOME OF HIS MINOR CHILD [SEC. 64(1A)]

All income which arises or accrues to the minor child shall be included in the income of his parent. Further, the income of minor will be included in the income of that parent whose total income [excluding the income includible under section 64(1A)] is greater.

Notes –

1. A is minor child of X and Mrs. X. During the previous year 2019-20, income of A is Rs. 2,500 (this is the first income of A during his life time). During the previous year 2019-20, income of X is higher than that of Mrs. X. Consequently, income of A will be included in the income of X for the previous year 2019-20. In the subsequent years (during the minority of A), income of A will be included in the income of X, even if income of Mrs. X is higher than that of X in any of the subsequent years. However, there is one exception. If in the subsequent years, the Assessing Officer wants to include the income of minor child A in the hands of

Mrs. X, it can be done only if it is necessary to do so and that too after giving an opportunity of being heard to Mrs. X.

2. Where the marriage of the parents does not subsist, the income of minor will be includible in the income of that parent who maintains the minor child in the relevant previous year.

3. The minor's income, in case both the parents are not alive, cannot be assessed in the hands of the grand parents or any other relatives or even in the hands of minor.

When clubbing is not attracted under section 64 (1A)

In the following cases, income of minor child cannot be clubbed:

1. Income of minor child (from all sources) suffering from any disability of the nature specified under section 80U.
2. Income of minor child on account of any manual work.
3. Income of minor child an account of any activity involving application of his skill, talent or specialized knowledge or experience.

Exemption under section 10(32)

In case the income of an individual includes the income of his or her minor child in terms of section 64(1A), such individual shall be entitled to the exemption of Rs. 1,500 in respect of each minor child. Where, however, the income of any minor so includible is less than Rs. 1,500, the aforesaid exemption shall be restricted to the income so included in the total income of the individual.

12.10 MISCELLANEOUS POINTS

1. *Income from accretion of property transferred or accumulated income of such property:*
   In the aforesaid cases, income arising to the transferee from the property transferred is taxable in the hands of transferor. Income arising to the transferee from the accretion of such property or from accumulation income of such property is, however, not includible in the total income of the transferor.
   Example:
   X transfers a sum of Rs. 5,00,000 to his wife without any consideration. Mrs. X deposits the money in a bank. Interest received from the bank on such deposit is taxable in the hands of X. If, however, Mrs. X purchases a house from the accumulated interest income, then rental income received by Mrs. X is taxable in her hands and will not be clubbed with the income of X.

2. *Can negative income be clubbed:*
   If income is negative and clubbing provisions are applicable, then negative income would be clubbed.
   Example:
   X transfers Rs. 1,00,000 to Mrs. X. By investing Rs. 1,00,000, Mrs. X sets up a business (total investment only Rs. 1,00,000). For the previous year, income from

business is (-) Rs. 30,000. The loss of Rs. 30,000 will be included in the income of X.

3. *Heads of income under which the clubbed income will be included:*
   In such cases, first, the income has to be computed in the hands of the actual recipient under the relevant heads of income as if the actual recipient of income is liable to pay tax. Thereafter, such income will be clubbed under the same head of income in the hands of other person. This rule is applicable irrespective of the clubbed income being positive or negative.
   After these two steps, gross total income of the person in whose hands the income is clubbed shall be calculated as if it is his own income. Provisions of set off and carry forward of losses are applicable as are applicable in any other case.
   In the last step, deductions under sections 80C to 80U will be given to the person in whose hand income is clubbed within the overall ceiling provided in the sections. No separate deduction is available to the actual recipient of income.

4. Clubbing provisions are applicable even if these are beneficial to the assessee.

12.11 SUMMARY

This topic discussed the provision of clubbing of income i.e., cases when income earned by one person is taxable in the hands of another person. This topic was incorporated in the Act to prevent the practice of tax avoidance. Some assesses do not transfer the assets but only transfers the income earned from these assets which seems illogical and thus, clubbing provisions comes in to picture. The chapter discussed different cases when income earned by the one person is taxable in the hands of another person.

12.12 EXERCISE

Exercise 1: Short theory questions

1. *What are the provisions of clubbing of income in respect of income of minor child?*
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2. *What are the provisions of clubbing of income in respect of remuneration of spouse?*
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Exercise 2: True or False

1. Clubbing is not applicable in respect of minor child if he is suffering from any disability specified under section 80U.

2. Income from an asset is not taxable in the hands of transferor if the asset transferred to spouse is a house property.

[Answers: 1 (True), 2 (False)]

Books recommended –

1. *Singhania, V.K. and Singhania, Monica [2018], Students' Guide to Income Tax (University Edition), Taxmann Publications (P) Ltd.*

2. *Ahuja, Girish and Gupta, Ravi [2018], Simplified Approach to Income Tax (University Edition), Flair Publications Pvt. Ltd.*

LESSON 13

SET OFF AND CARRY FORWARD OF LOSSES

STRUCTURE OF THE CHAPTER

13.1 INTRODUCTION

The rules of setting off of losses and carry forward are applied before computing gross total income.

13.2 STEPS TO BE APPLIED FOR SET-OFF AND CARRY FORWARD

The process of setting off of losses and their carry forward is covered in the following three steps:

Step 1: Inter-source (Intra-head) adjustment under the same head of income.

Step 2: Inter-head adjustment in the same assessment year (Step 2 is applied only if a loss cannot be set off under step 1).

Step 3: Carry forward of a loss (Step 3 is applied only if a loss cannot be set off under step 1 and 2).

13.3 INTER-SOURCE (INTRA HEAD) ADJUSTMENT

If the net result for any assessment year, in respect of any source under any head of income, is a loss, the assessee can set-off this loss against his income from any other source under the same head of income for the same assessment year subject to the following provisions –

House property

Loss from a house property can be set-off against profits of other house properties.

Profits and gains from business or profession

Speculation business:

Loss in a speculation business can be set off only against the profit in a speculation business.

Specified business under section 35AD:

Loss of any specified business under section 35AD can be set-off only against profits of any specified business under section 35AD.

Non-speculation business:
Loss from a non-speculative business (including depreciation) can be set off against income from speculative business, non-speculation business as well as against specified business under section 35AD.

Capital gains
Long-term capital loss can be set off only against long-term capital gain. However, short-term capital loss can be set off against STCG as well as LTCG.

Income from other sources
Activity of owning and maintaining race horses:
Losses from the activity of owning and maintaining race horses can be set-off **only** against the business profits of owning and maintaining race horses.

Casual income:

1. Expenses incurred while earning casual incomes (i.e., lotteries, crossword puzzles, etc.) are not allowed to be adjusted even against casual incomes. For example, if expense of Rs. 2,000 is incurred in purchasing a lottery ticket and later on, Rs. 1,00,000 prize of lottery is earned, the assessee has to show Rs. 1,00,000 as lottery income (Rs. 2,000 expenses on purchasing lottery ticket is of no consideration).

2. Losses of gambling nature cannot be set off against winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature.

Other incomes:
Losses under the head “Income from other sources” (excluding income from the activity of owning and maintaining race horses and gambling incomes) can be set-off against the income from the activity of owning and maintaining race horses as well as other incomes under the head “Income from other sources” but not against gambling incomes.

13.4 INTER-HEAD ADJUSTMENT

Where the net result of computation made for any assessment year in respect of any head of income is a loss, the same can be set off against the income from other heads subject to the following provisions:

House property
Loss under the head “Income from house property” can be set off against income of any head except gambling incomes (i.e., it can be set off against salary, business or profession, capital gains, and income from other sources) but only up to Rs. 2,00,000 per year. However, there is no restriction on the amount for carried forward house property losses of earlier years.

Profits and gains from business or profession
Speculation business:
Inter-head adjustment is not allowed in speculation business loss.

Specified business under section 35AD:
Inter-head adjustment is not allowed in specified business loss covered under section 35AD.

Non-speculation business:
Loss from a non-speculative business (including depreciation) can be set off against income of any head except salary and gambling incomes (i.e., it can be set off against house property, capital gains and income from other sources).

Capital gains
Inter-head adjustment is not allowed in capital loss.

Income from other sources
Activity of owning and maintaining race horses:
Inter-head adjustment is not allowed in case of losses from the activity of owning and maintaining race horses.

Casual income:
Neither inter-head adjustment nor intra-head adjustment is allowed in case of losses of gambling nature viz., lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature.

Other incomes:
Losses (not being from the activity of owning and maintaining race horses or gambling nature) can be set off against income of any other head except gambling incomes (i.e., it can be set off against salary, house property, business or profession and capital gains).

13.5 CARRY FORWARD AND SET-OFF OF LOSSES

If a loss cannot be set off either under the same head or under the different heads, because of absence or inadequacy of the income of the same year, it may be carried forward and set off against the income of the subsequent year subject to the filling of loss of return. Under the Act, the following losses can be carried forward:

1. Loss under the head “House property”
2. Loss under the head “Profits and gains of business or profession” whether speculative or non-speculative or from specified business under section 35AD
3. Loss under the head “Capital gains”
4. Loss from the activity of owning and maintaining race horses

Following are provisions related to carry-forward and set-off of losses of earlier years:

Type of loss to be carried forward to the next year(s)	*Income against which carried forward loss can be set off in the next year(s)*	*For how many years loss can be carried forward*
House property loss	Income under the head "House property"	8 years
Speculation loss ***Non-speculative business loss****:* 1. On account of unabsorbed depreciation, capital expenditure on scientific research and family planning 2. Loss from a specified business under section 35AD 3. Other remaining business loss	Speculation profits Any income except salaries Income from a specified business under section 35AD Any business profit (whether from speculation or otherwise)	4 years No time-limit No time-limit 8 years
Capital loss: 1. Short-term capital loss 2. Long-term capital loss	 STCG as well as LTCG Long-term capital gains	 8 years 8 years
Loss from the activity of owning and maintaining race horses	Income from the activity of owning and maintaining race horses	4 years

Note:
Losses under the head "Income from other sources" cannot be carried forward to the next year except loss from the activity of owning and maintain race horses.

13.6 MISCELLANEOUS POINTS

1. If income from a particular source is exempt from tax, e.g., income exempt from tax under section 10, loss from such source cannot be set off against income chargeable to tax.

2. It is to be noted that no option is available to an assessee to set off a loss or not to set off a loss.

3. Dividend income is always taxable under the head "Income from other sources". Consequently, the dividend income on shares held as stock-in-trade or investment is taxable under the head "Income from other sources". However, for the purpose of set off of business losses, dividend on shares held as stock-in-trade is treated as business income, although such dividend income is taxable (like any other dividend income) under the head "Income from other sources".

4. Like dividend income, interest income is always taxable under the head "Income from other sources". Consequently, the interest income on the amount held as stock-in-trade or investment is taxable under the head "Income from other sources". However, for the purpose of set off of business losses, interest income on the amount held as stock-in-trade is treated as business income, although such interest income is taxable (like any other interest income) under the head "Income from other sources".

5. If nothing is mentioned about business losses, these losses are treated as non-speculative business losses.

6. ***Carry forward and set off of business loss other than speculation loss:***
   The business loss other than the speculative can be carried forward and set off against the profits of the assessee who incurred the loss. However, this rule has the following exceptions:
   a. Accumulated business loss of an amalgamating company
   b. Accumulated business loss of an amalgamated banking company
   c. Accumulated business loss of a demerged company
   d. Accumulated business loss of a proprietary concern or a firm when its business is taken over by a company
   e. Accumulated business loss of a private company/ unlisted public company when its business is taken over by a limited liability partnership
   f. Accumulated business loss of an amalgamated/ demerged co-operative bank.

7. *Speculative transaction:*
   "Speculation transaction" means a transaction in which a contract for the purchase or sale of any commodity, stocks and shares, is periodically (or ultimately) settled, otherwise than by the actual delivery.
   In other words, if there is a contract for purchase or sale of an article (not being commodities, stocks or shares), it would not be a speculative transaction.

13.7 SUMMARY

This topic discussed the provisions of set-off and carry-forward of losses under different heads of income. Loss of any source is adjusted in three steps. First, provisions of intra-head adjustments are applied; if still loss remains, provisions of inter-head adjustments are applied and thereafter, if still loss remains, such losses are carried forward to the next year and in subsequent years, such losses can be adjusted within the same head only.

13.8 EXERCISE

Exercise 1: Long practical questions

The working notes given below in the solutions of unsolved questions are only for clarity purposes and for solving some typical concepts. However, in the final examination, *students are expected to be more cautious in preparing working notes. Working notes in the examination must mention the concepts along with numerical calculation.*

Problem 1 –

X (44 years) is a resident individual. For the previous year 2019-20, he has the following information:

1. *Income from part-time employment: Rs. 2,32,000*
2. *Income from business of dealing in pesticides: Rs. 9,00,000*
3. *Income from the activity of owning and maintaining race camels: (Rs. 25,000)*
4. *Long-term capital gain on transfer of silver: Rs. 2,57,000*
5. *Income from house property: Rs. 60,000*
6. *Income from activity of owning and maintaining race horses: Rs. 51,000*
7. *Deposit with SBI for claiming deduction under section 80C: Rs. 50,000*

X wants to set off the following losses brought forward from earlier years:

1. *House property loss of previous year 2016-17: Rs. 20,000*
2. *Loss from the activity of owning and maintaining race camels of previous year 2015-16: Rs. 25,000.*

Determine the net income and tax liability of X for the assessment year 2020-21.

Solution:

Computation of net taxable income for the assessment year 2018-19:

			Amount (Rs.)
	1. Income from Salary:		
	Part time employment		2,32,000
	2. Income from house property:		
	Current year's income	60,000	
Less:	Brought Forward loss	20,000	40,000
	3. Income from business:		
	Current year's business income	9,00,000	
Less:	Loss from business of race camels	25,000	
		8,75,000	
Less:	Brought Forward loss of race camels	25,000	8,50,000
	4.LTCG		2,57,000
	5.Income from other sources:		
	Income from activity of owning and maintaining race horses		51,000
	Gross Total Income		**14,30,000**
Less:	Deduction under section 80C		50,000
	Total Income		**13,80,000**

Computation of tax liability:

I- Income taxable at special rate:

Tax on LTCG [@20% on Rs.2,57,000] 51,400

II-Income taxable at Normal rate:	
[TI i.e., Rs.13,80,000 – LTCG i.e.,Rs.2,57,00]=Rs. 11,23,000	
[1,12,500 + 30% (11,23,000 – 10,00,000)]	1,49,400
	2,00,800
Add: Cess @ 4%	8,032
Net tax payable	**2,08,832**

Rounded off = Rs. 2,08,830

Problem 2 –

A submits the following particulars of his income and loss for the assessment year 2020-21:

	Rs.
Income from house property (computed)	*7,000*
Income from interest from a partnership firm	*1,500*
Profit from cloth business (before depreciation)	*40,000*
Income from speculation business	*3,200*
Long-term capital gains	*9,100*
Dividend from UTI	*2,000*
Current year's depreciation	*2,000*

The following items have been brought forward from the preceding year:

Loss from Cloth business	*10,000*
Unabsorbed depreciation	*7,500*
Loss from speculation	*7,000*
Short Term Capital Loss	*4,200*
Long term capital Loss	*11,400*

You are required to compute his gross total income and deal with carry forward of losses.

Solution:

Computation of gross total income of A for the assessment year 2020-21:

	Rs.	*Rs.*	*Rs.*
1. Income from house property			7,000
2.Business income:			
(i) Interest from firm		1,500	
(ii) Non-speculative profit from cloth business after depreciation [40,000 – 2,000]	38,000		
Less: B/F loss from cloth business	(10,000)	28,000	
Less: Unabsorbed depreciation		(7,500)	22,000
(iii) Profit from speculation business		3,200	
Less: Loss from speculation business		3,200*	Nil
3.Capital Gain: Long term capital gain		9,100	
b/f Long term capital loss		9,100	Nil
Gross Total Income			29,000

Notes:

1. Dividend income form UTI is exempt from tax under section 10(35).
2. Speculation loss of Rs. 3,800 [7,000 – 3,200] will be carried forward.
3. Long-term capital loss of Rs. 2,300 [11,400 – 9,100] will be carried forward.
4. Short-term capital loss of Rs. 4,200 will be carried forward.

Exercise 2: Short theory questions

1. *What are the provisions of carry forward and set-off of unabsorbed depreciation.*
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2. *Briefly illustrate the provisions relating to set-off and carry forward of losses under the head "Capital Gains".*
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3. *Explain the provision relating to set off and carry forward of non-speculative losses.*
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4. *Explain the provision relating to set off and carry forward of speculative business losses.*
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5. *Briefly explain the provisions relating to set off and carry forward of losses under the head "income from house property".*
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Exercise 3: Multiple choice questions

1. Loss under the house property cannot be set off against -
- *a. Income under the head "Capital gains"*
- *b. Income under the head "Salaries"*
- *c. Income from speculative business*
- *d. Gambling income*

2. Short term capital loss can be set off against –
- *a. Long term capital gains*
- *b. Short term capital gains*
- *c. Both of the above*
- *d. None of the above*

[Answers: 1 (d), 2 (c)]

Exercise 4: Fill in the blanks

1. Non-speculative business loss can be carried forward up to ……. years.

2. Loss from the activity of owning and maintaining race horses can be carried forward up to …… years.
[Answers: 1(8), 2(4)]

Exercise 5: True or False

1. Unabsorbed depreciation can be carried forward upto 8 years.
2. Long term capital loss can be carried forward upto 8 years.
[Answers: 1 (False), 2 (True)]

Books recommended –

1. *Singhania, V.K. and Singhania, Monica [2018], Students' Guide to Income Tax (University Edition), Taxmann Publications (P) Ltd.*

2. *Ahuja, Girish and Gupta, Ravi [2018], Simplified Approach to Income Tax (University Edition), Flair Publications Pvt. Ltd.*

LESSON 14

DEDUCTIONS FROM GROSS TOTAL INCOME

STRUCTURE OF THE CHAPTER

14.1 INTRODUCTION

Deductions under section 80C to 80U are allowed from gross total income to arrive at net taxable income. The aggregate amount of deductions under these sections cannot exceed the gross total income of the assessee. Deductions under sections 80C to 80GGC are in relation to various investments and payments, whereas sections 80-IA to 80U covers deduction in respect of certain income.

14.2 CERTAIN INVESTMENTS OR DEPOSITS [SEC. 80C]

1. Deduction under section 80C is available only to an individual or a Hindu undivided family.

2. Deduction is available on the basis of specified investments/ contributions/ deposits/ payments made by the assessee during the previous year. However, investment in Indira Vikas Patra, Kisan Vikas Patra and National Relief Bonds are not eligible for deduction under section 80C.

3. Deduction is available on actual payment basis. Payment made during the previous year is qualified for deduction under section 80C, regardless of the fact

whether the payment relate to the previous year or preceding years or subsequent years.

4. The maximum amount deductible under sections 80C, 80CCC and 80CCD(1) [i.e., contribution by an employee (or any other individual) toward national pension scheme] cannot exceed Rs. 1,50,000. However, employer's contribution towards NPS (to the extent of 10 per cent of salary) [Sec. 80CCD(2)] shall not be considered for ceiling of Rs. 1,50,000.

Following are eligible investment under this section:

1. **Life insurance premium** [subject to a maximum of 20% of sum assured/ or 10% of sum assured] (if policy is issued before April 1, 2012, 20% and if policy is issued on or after April 1, 2012, 10%[3]).
   Note:
   In the case of individual, policy should be taken on his **own life**, life of the **spouse** or any **child** (child may be dependent/ independent, male/ female, minor/ major or married/ unmarried). In the case of a Hindu undivided family, policy may be taken on the life of any member of the family.
   Note:
   Minimum period of holding in this case is **2 years**.

2. Contribution (not being repayment of loan) towards **statutory provident fund (SPF)** and **recognized provident fund (RPF).**

3. Contribution (not being repayment of loan) towards 15-year **public provident fund (PPF)**.

4. Contribution towards an **approved superannuation fund.**

5. Subscription to **National Savings Certificates, VIII Issue or IX issue or Sukanya Samriddhi Account**.

6. Contribution for participating in the unit-linked insurance plan (**ULIP**) of **Unit Trust of India**.
   Note:
   Minimum period of holding is 5 years.

7. Contribution for participating in the unit-linked insurance plan (**ULIP**) of **LIC Mutual Fund** (i.e., formally known as Dhanraksha plan of LIC Mutual Fund).
   Note:
   Minimum period of holding is 5 years.

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[3] In case the policy is taken on or after April 1, 2013 on the life of a person with disability or severe disability or on the life of a person suffering from disease or ailment given in section 80DDB, then the limit is 15% of sum assured instead of 10%.

8. Payment for **notified annuity plan of LIC** (i.e., New Jeevan Dhara, New Jeevan Akshay) or any other insurer.

9. **Subscription** towards notified **units of Mutual Fund or UTI**.

10. Contribution to notified pension fund set up by Mutual Fund or UTI (i.e., Retirement Benefit Pension Fund of UTI).

11. Any **sum paid** as **subscription** to notified **Home Loan Account Scheme of the National Housing Bank** (NHB) or contribution to any notified pension fund set up by the National Housing Bank.

12. Any sum paid as **subscription** to any scheme of –
    a. Public sector company engaged in providing long-term finance for purchase/ construction of **residential houses** in India (i.e., public deposit scheme of HUDCO);
    b. Housing board constituted in India for the purpose of planning, development or improvement of cities/ towns.

13. Any sum paid as **tuition fees** (not including any payment towards development fees/ donation/ capitation fees/ payment of similar nature) whether at the time of admission or otherwise to any **university/ college/ educational institution in India** for **full time education of any two children** of an individual.
    Note:
    Full-time education includes even play-school activities, pre-nursery and nursery classes.

14. Any payment towards the cost of **purchase/ construction of a residential property** (**including repayment of loan** taken from Government, bank, cooperative bank, LIC, **National Housing Bank**, assessee's employer where such employer is public company/ public sector company/ university/ co-operative society).

15. Amount invested in approved **debentures** of, and **equity shares** in, a **public sector company engaged in infrastructure** including power sector or units of a mutual fund proceeds of which are utilized for developing, maintaining, etc., of a new infrastructure facility.

16. Amount deposited as **term deposit** for a period of **5 years or more** in accordance with a scheme framed by the **Government.**

17. **Subscription** to any notified **bonds** of National Bank for Agriculture and Rural Development (**NABARD**).

18. Amount deposited under **Senior Citizens Saving Scheme**.
    Note:
    Minimum period of holding is 5 years.

19. Amount deposited in **5 year time deposit scheme in post office**.

14.3 CONTRIBUTION TO CERTAIN PENSION FUND [SEC. 80CCC]

This deduction is available to an individual for contribution towards Pension Fund. Amount should be paid or deposited under an annuity plan of the LIC of India or any other insurer for receiving pension. Amount should be paid or deposited out of income chargeable to tax. Maximum limit is Rs. 1,50,000.

Tax treatment of pension:

1. If deduction is claimed under section 80CCC and later on pension is received by the assessee (or his nominee), such pension will be taxable in the hands of recipients in the year of receipt.
2. Where (after claiming deduction under section 80CCC) the assessee or his nominee surrenders the annuity before maturity date of such annuity, the surrender value shall be taxable in the hands of the assessee or his nominee, as the case may be, in the year of the receipt.

14.4 CONTRIBUTION TO NATIONAL PENSION SCHEME [SEC. 80CCD]

Discussed in detail in the chapter "Salary"

10.4.1 Aggregate Amount of Deductions [80CCE]

- *The aggregate amount of deductions u/s 80C; 80CCC and 80CCD (1) shall not exceed Rs.1,50,000.*
- *The deduction of upto Rs.50,000 u/s 80CCD(1B) is in addition to the overall limit of Rs.1,50,000 provided u/s 80CCE*
- *The amount contributed by the employer in pension fund scheme u/s 80CCD (2) shall not be included in Rs.1,50,000 limit.*

14.5 HEALTH INSURANCE PREMIUM [SEC. 80D]

This section is available for individuals and HUF regarding medical insurance premia (payment should not be in cash).

Individual for this purpose, includes assessee himself, **spouse, dependent children and parents** (whether dependent or not)**.** In case of HUF, members of HUF are covered.

In the case of individual **(not HUF)**, deduction is available for the following also:

a. If payment is made to the Central Government Health Scheme (CGHS) or any scheme notified by the Central Government (payment not by cash) *[This is not available to parents]*; or/ and
b. Payment on account of preventive health check-up (*payment by any mode including cash).

Deductible amount can be upto Rs. 25,000 (maximum limit is Rs. 5,000 for preventive health check-up). In case of senior citizens (60 years), additional deduction of Rs. 5,000 is available but only in case of mediclaim insurance premium and not available for CGHS or preventive health check-up.

Any payment made on account of medical expenditure in respect of a super senior citizen (80 years or more), if no payment has been made to keep in force an insurance on the health of such person, as does not exceed in the aggregate Rs. 30,000 shall be allowed as deduction under section 80D.

14.6 MAINTENANCE INCLUDING MEDICAL TREATMENT OF A DEPENDENT WHO IS A PERSON WITH DISABILITY [SEC. 80DD]

This deduction is for **resident individual** and resident HUF for –

a. **Expenditure** on medical treatment (including nursing), training and rehabilitation of a **disabled dependent relative** or/ and
b. Amount paid under any scheme framed by the LIC or other insurer, etc.

Amount of deduction is **Rs. 75,000** and **Rs. 1,25,000 for severe disability** (if disability is more than 80%). This amount is **fixed** irrespective of actual expenditure.

Dependent includes spouse, children, parents, brothers and sisters of the individual. In case of HUF dependent refers to any member of HUF.

14.7 MEDICAL TREATMENT [SEC. 80DDB]

This deduction is available to a **resident** individual and resident HUF for medical treatment of **notified diseases.**

Amount of deduction is **Rs. 40,000** or amount paid, whichever is **less**. For senior citizens (60 years), amount of deduction is **Rs. 60,000** or amount paid, whichever is less. For super senior citizens (80 years), amount of deduction is **Rs. 80,000** or amount paid, whichever is less.

From the aforesaid amount of deduction, amount received from an insurer or amount reimbursed by the employer shall be deducted and the balance shall be allowed as deduction.

Expenditure should be incurred for medical treatment of the assessee **himself** or **dependent** spouse, children, parents, brothers and sisters of the individual assessee. In case of HUF dependent refers to any dependent member of HUF.

14.8 INTEREST ON LOAN TAKEN FOR HIGHER EDUCATION [SEC. 80E]

This deduction is available to **individuals** regarding payment of **interest on loan taken for higher** studies (i.e., after passing class 12). Maximum time limit is **8 years**.

Interest is deductible if loan is taken from a bank, financial institution or an approved charitable institution for pursuing assessee’s own education or for the education of his relatives (i.e., spouse, children or any student for whom the individual is the legal guardian).

First deduction is available in the year in which the assessee starts paying interest on loan and subsequent 7 years or until interest is paid in full. However, interest should be paid out of income chargeable to tax.

14.9 DONATIONS TO CERTAIN FUNDS, CHARITABLE INSTITUTIONS, ETC. [SEC. 80G]

This deduction is available to all the taxpayers. Donations are divided into two categories. On some donations, deduction is available on the amount donated but, on some donations, there is a limit on which benefit of deduction is available. In this second category of donations, if the assessee has donated the amount more than the limit, then on the excess amount donated, benefit of deduction is not available. Table 1 given below contains donations on which there is no limit. Total amount donated, here, is eligible for the benefit of deduction. Table 2 given below contains donations on which there is limit applicable. Total amount donated, here, is eligible for the benefit of deduction only if this amount is within the limits. Excess amount (i.e., the amount donated which exceeds the limit) is not eligible for the benefit of deduction under section 80G.

*On the following donations, **no maximum limit** is applicable. Taxpayer can donate the amount without any limit:*

Donee	***Deduction (in %age)***
National Defence Fund set up by the Central Government	100%
Prime Minister's **National Relief Fund**	**100%**
National **Children's Fund**	**100%**
Prime Minister's Armenia **Earthquake Relief** Fund	100%
National Foundation for Communal Harmony	100%
An approved university/ educational institution	100%
Any fund set up by the Government of Gujarat for providing relief to victims of **earthquake in Gujarat**	100%
Zila Saksharta Samiti	100%
National Blood Transfusion Council (**NBTC**) and State Council for Blood Transfusion	100%
Fund set up by a State Government for the medical relief to the poor	100%
Central Welfare Fund of the Army and Air Force and the Indian Naval Benevolent Fund	100%
Andhra Pradesh Chief Minister's Cyclone Relief Fund	100%
National Illness Assistance Fund	100%
Chief Minster's Relief Fund or Lieutenant Governor's Relief Fund	100%
National Sports Fund or National Cultural Fund or Fund for Technology Development and Application	100%
National Trust for Welfare of Persons with **Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities**	100%
Swachh Bharat Kosh, National Fund for Control of Drug Abuse	**100%**

Clean Ganga Fund (amount donated by residents only)	**100%**
Prime Minister's **Drought Relief Fund**	**50%**
Jawaharlal **Nehru Memorial Fund**	**50%**
Indira Gandhi Memorial Trust	**50%**
Rajiv Gandhi Foundation	**50%**

On the following donations, there is a ***restriction*** *on the amount which is eligible for deduction under this section:*

Government or any approved local authority, institution or association to be utilised for the purpose of **promoting family planning**	**100%**
Government or any **local authority** to be utilised for any **charitable purpose other than** the purpose of **promoting family planning**	**50%**
Any other approved fund* or any institution which satisfies the conditions mentioned in section **80G(5)**	**50%**
Any authority constituted in India by (or under) any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose planning, development or improvement of cities, towns and villages, or for both	50%
Any corporation for promoting interest of minority community	50%
Any **notified** temple, mosque, gurudwara, church or other place (for renovation or repair)	**50%**

Maximum amount:

The maximum amount for all the deductions given in *Table 2* above must **not exceed 10% of the adjusted gross total income** i.e., where the aggregate of sums mentioned in the above table exceeds **10% of the adjusted gross total income,** then the amount in excess of 10% of the adjusted gross total income will be ignored while computing the aggregate of the sums in respect of which deduction is to be allowed.

Adjusted gross total income:

The following shall be deducted from gross total income to find out adjusted gross total income:

a. Amount deductible under sections 80C to 80U (except section 80G);
b. Such incomes on which income-tax is not payable;
c. Long-term capital gains;
d. Short-term capital gain which is taxable under section 111A @ 15%; and
e. Incomes referred to in section 115A, 115AB, 115AC or 115AD.

Mode of payment:

1. Donation can be given in cash or by cheque or draft. Donation in kind is not included.
2. It is to be noted that no deduction shall be allowed under section 80G in respect of donation in cash of an amount exceeding Rs. 2,000.

14.10 RENT PAID [Sec. 80GG]

This deduction is available to **self-employed person** or **salaried person** who is not in receipt of **HRA.**
Further, assessee, spouse, minor child & HUF should not own any residential accommodation at the place of working/ residence of the assessee. If assessee owns the house at another place, then she/ he should not be claiming in respect of that house the concession in respect of self-occupied property.

Amount of deduction is lower of the following:

a. Rs. 5,000 p.m.;
b. 25% of total income;
c. Excess of actual rent paid over 10% of total income.

Total Income = Gross Total Income – LTCG – STCG taxable under section 111A – deductions under sections 80C to 80U (except 80GG) and income under section 115A.

14.11 CONTRIBUTION TO POLITICAL PARTIES [SEC. 80GGB AND 80GGC]

This deduction is available to all taxpayers. Contribution to a political party is deductible under section **80GGB** (if a contribution is made by an **Indian company**) or under section **80GGC** (if a contribution is made by a **person other than an Indian company**).

Expenditure by way of advertisement in a magazine owned by a political party is treated as "contribution" to a political party for the purpose of section 80GGB, but **not** for the purpose of section 80GGC. In other words, advertisement expenditure (in a magazine owned by a political party) is deductible under section 80GGB (if the taxpayer is an Indian company) but the same is not deductible under section 80GGC (if the taxpayer is a person other than an Indian company).

14.12 ROYALTY INCOME OF AUTHORS [SEC. 80QQB]

1. *This section is applicable if the following conditions are satisfied:*
   a. The taxpayer is a resident individual (may be an Indian citizen or foreign citizen).

   b. He is an author or joint author.

   c. The book authored by him is work of literary, artistic or scientific nature. However, the "books" shall not include brouchers, commentaries, diaries, guides, journals, magazines, newspapers, pamphlets, text-books for schools, tracts and other publications of similar nature, by whatever name called.

   d. The gross total income of the taxpayer includes the following:
      i. Royalty or copyright fees (payable in lump sum or otherwise) in respect of aforesaid book; and

   ii. Lump sum consideration for transfer (or grant) of any interest in the copyright of the book.

2. *Amount of deduction:*
   If the aforesaid conditions are satisfied, then the amount of deduction is –
   a. Rs. 3,00,000; or
   b. Income from royalty as stated above,
   whichever is **lower**.

3. *Note:*
   Where the income by way of royalty (or the copyright fee) is not a lump sum consideration (in lieu of all rights of the assessee in the book) so much of the income (before allowing expenses attributable to such income) as is in excess of **15%** of the value of such books sold during the previous year, shall be ignored.

14.13 INTEREST ON DEPOSITS IN SAVINGS ACCOUNT [SEC. 80TTA]

It provides a deduction up to Rs. 10,000 in aggregate to an assessee (being an individual or a HUF) in respect of any income by way of interest on deposits (not being time deposits) in a savings account with –

a. a banking company;
b. a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank); or
c. a post office saving bank interest is exempt up to Rs.3,500 (in an individual account) and Rs.7,000 (in a joint account) u/s 10(15)(i).

Note:
1. From the assessment year 2019-20, the above deduction is not available in the case of senior citizen who is eligible to claim deduction u/s 80TTB

INTEREST ON DEPOSITS IN CASE OF SENIOR CITIZENS - [80TTB] (FROM THE ASSESSMENT YEAR 2019-20)

Deduction under this section is available , if the following conditions are satisfied:

a. The assessee is a senior citizen during the previous year.
b. His income includes interest on deposits with a bank / co-operative bank /post office (it may be interest on fixed deposits, interest on saving accounts or any other interest).

Amount of deduction: Rs. 50,000 or the amount of interest, whichever is lower.
Exemption u/s 10(15)(i) is also application in this section.

14.14 PERSON WITH DISABILITY [SEC. 80U]

This deduction is available to a resident individual. Amount of deduction is Rs. 75,000 fixed or Rs. 1,25,000 fixed (for severe disability), irrespective of actual expenditure.

Where a deduction is claimed under section 80U, no deduction can be claimed under section 80DD and vice versa.

14.15 MISCELLANEOUS POINTS

No deduction under section 80C to 80U is given from LTCG, STCG under section 111A as well as gambling incomes.

14.16 SUMMARY

This topic discussed the provisions of chapter VIA which is concerned with deductions under section 80C to 80U. An assessee can reduce his tax liability by availing these deductions.

10.17 EXERCISE

Exercise 1: Short theory questions

1. *Explain the provision relating to the deduction in the respect of repayment of loan taken for higher studies.*
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2. *Explain the deduction in respect of medical insurance premium under section 80D.*
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3. *Explain the provision relating to deduction under section 80GG.*
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Exercise 2: Multiple choice questions

1. Maximum amount of deduction under section 80C is -

a. Rs. 50,000
b. Rs. 1,00,000
c. Rs. 1,50,000
d. None of the above

2. Which of the following contribution is not eligible for deduction under section 80C?

a. Recognised provident fund
b. Public provident fund
c. Indira vikas patra
d. National savings certificate

3. Deduction under section 80E is allowed for a maximum of -

a. 5 years
b. 8 years
c. 12 years
d. No limit

4. Deduction under section 80QQB cannot exceed -

a. Rs. 1,50,000
b. Rs. 3,00,000
c. Rs. 4,50,000
d. *None of the above*

[Answers: 1 (c), 2 (c), 3 (b), 4 (b)]

Exercise 3: Fill in the blanks

1. Deduction under section 80TTA cannot exceed Rs. …………..

2. Deduction under section 80DD does not depend upon .... It is fixed.

[Answers: 1 (10,000), 2(actual expenditure)]

Exercise 4: True or False

1. Deduction under section 80C is allowed on payment basis.

2. Deduction under section 80D is not available if the premium is paid in cash.
[Answers: 1 (True), 2 (True)]

Books recommended –

1. *Singhania, V.K. and Singhania, Monica [2018], Students' Guide to Income Tax (University Edition), Taxmann Publications (P) Ltd.*

2. *Ahuja, Girish and Gupta, Ravi [2018], Simplified Approach to Income Tax (University Edition), Flair Publications Pvt. Ltd.*