UNIT – 2: INCOME FROM HOUSE PROPERTY

LEARNING OUTCOMES

After studying this unit, you would be able to-

- **comprehend** when income is chargeable under the head "Income from house property";
- **appreciate** the meaning and tax treatment of composite rent;
- **determine** annual value of different categories of house property;
- **compute** income from house property for different categories of house property;
- **comprehend** and **apply** the tax treatment on recovery of unrealized rent and arrears of rent;
- **compute** income from co-owned property.

2.1 CHARGEABILITY [SECTION 22]

(i) The process of computation of income under the head "Income from house property" starts with the determination of annual value of the property. The concept of annual value and the method of determination is laid down in section 23.

(ii) The annual value of any property comprising of buildings or lands appurtenant thereto of which the assessee is the owner is chargeable to tax under the head "Income from house property".

Exceptions: Annual value of the following properties are chargeable under the head "Profits and gains of business or profession"-

(i) Portions of property occupied by the assessee for the purpose of any business or profession carried on by him

(ii) Commercial properties of an assessee engaged in the business of letting out of properties.

It is pertinent to note that any income from letting out of a residential house or part thereof by the assessee, being owner shall always be chargeable under the head "Income from house property.

- *Annual value is the amount for which the property might reasonably be expected to let from year to year.*

2.2 CONDITIONS FOR CHARGEABILITY

(i) Property should consist of any building or land appurtenant thereto.

(a) Buildings include not only residential buildings, but also factory buildings, offices, shops, godowns and other commercial premises.

(b) Land appurtenant means land connected with the building like garden, garage etc.

Income from letting out of vacant land is, however, taxable under the head "Income from other sources" or "Profits and gains from business or profession", as the case may be.

(ii) Assessee must be the owner of the property

(a) Owner is the person who is entitled to receive income from the property in his own right.

(b) The requirement of registration of the sale deed is not warranted.

(c) Ownership includes both free-hold and lease-hold rights.

(d) Ownership includes deemed ownership (discussed later in point 2.11)

(e) The person who owns the building need not also be the owner of the land upon which it stands.

(f) The assessee must be the owner of the house property during the previous year. It is not material whether he is the owner in the assessment year.

(g) If the title of the ownership of the property is under dispute in a court of law, the decision as to who will be the owner chargeable to income-tax under section 22 will be of the Income-tax Department till the court gives its decision to the suit filed in respect of such property.

In case of recovery of unrealized rent and arrears of rent, ownership of that property is not relevant. (discussed later in point 2.9)

(iii) Use of property

The property may be used for any purpose i.e., commercial or residential purpose, but it should not be used by the owner for the purpose of any business or profession carried on by him, the profit of which is chargeable to tax.

The income earned by an assessee engaged in the business of letting out of commercial properties on rent would be taxable as business income[1].

(iv) Property held as stock-in-trade etc.

Annual value of house property will be charged under the head "Income from house property", where it is held by the assessee as stock-in-trade of a business also.

However, the annual value of property being held as stock in trade would be treated as NIL for a period of **two** years from the end of the financial year in which certificate of completion of construction of the property is

[1] *Supreme Court ruling in Rayala Corporation (P) Ltd. v. Asstt. CIT (2016) 386 ITR 500*

obtained from the competent authority, if such property is not let-out during such period [Section 23(5)].

Where the assessee is a builder/construction company, the house property would be its stock-in-trade and rental income therefrom would be assessable under the head "Income from House Property". However, where the assessee is engaged in the business of letting out of commercial properties, income therefrom would be assessable under the head "Profits and gains of business or profession".

2.3 COMPOSITE RENT

(i) Meaning of composite rent: The owner of a property may sometimes receive rent in respect of building as well as –

(1) other assets like say, furniture, plant and machinery.

(2) for different services provided in the building, for e.g., –

(a) Lifts;

(b) Security;

(c) Power backup;

The amount so received is known as **"composite rent".**

(ii) Tax treatment of composite rent

Where composite rent includes rent of building and charges for different services (lifts, security etc.), the composite rent is has to be split up in the following manner-

(a) the sum attributable to use of property is to be assessed under section 22 as income from house property;

(b) the sum attributable to use of services is to be charged to tax under the head "Profits and gains of business or profession" or under the head "Income from other sources", as the case may be.

(iii) Manner of splitting up

If let out building and other assets are inseparable

Where composite rent is received from letting out of building and other assets (like furniture) and the two lettings are not separable i.e. the other party does not accept letting out of building without other assets, then the rent is taxable either as business income or income from other sources, the case may be.

This is applicable even if sum receivable for the two lettings is fixed separately.

If let out building and other assets are separable

Where composite rent is received from letting out of building and other assets and the two lettings are separable i.e. letting out of one is acceptable to the other party without letting out of the other, then

(a) income from letting out of building is taxable under "Income from house property";

(b) Income from letting out of other assets is taxable under "Profits and gains of business or profession" or "Income from other sources", as the case may be.

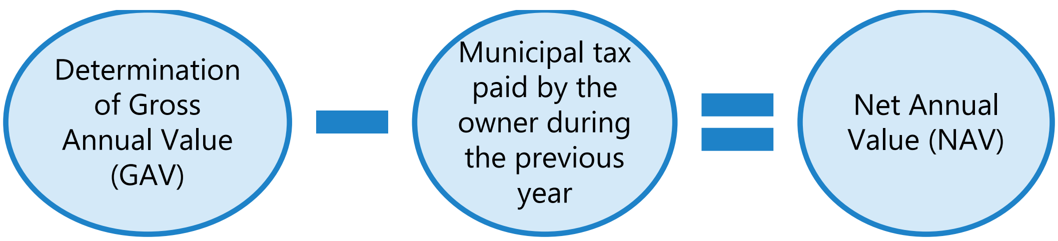
This is applicable even if a composite rent is received by the assessee from his tenant for the two lettings.

2.4 INCOME FROM HOUSE PROPERTY SITUATED OUTSIDE INDIA

(i) In case of a resident in India (resident and ordinarily resident in case of individuals and HUF), income from house property situated outside India is taxable, whether such income is brought into India or not.

(ii) In case of a non-resident or resident but not ordinarily resident in India, income from a property situated outside India is taxable only if it is received in India.

2.5 DETERMINATION OF ANNUAL VALUE [SECTION 23]



(i) Determination of annual value for different types of house properties

(1) Where the property is let out throughout the previous year [Section 23(1)(a)/(b)]

Where the property is let out for the whole year, then the GAV would be the higher of –

(a) Expected Rent (ER) and

(b) Actual rent received or receivable during the year

- The Expected Rent (ER) is the higher of fair rent (FR) and municipal value (MV), but restricted to standard rent (SR).
- For example, let us say the higher of FR and MV is X. Then ER = SR, if X>SR. However, if X<SR, ER = X.
- Expected Rent (ER) as per section 23(1)(a) cannot exceed standard rent (SR) but it can be lower than standard rent, in a case where standard rent is more than the higher of MV and FR.
- Municipal value is the value determined by the municipal authorities for levying municipal taxes on house property.
- Fair rent means rent which similar property in the same locality would fetch.
- The standard rent (SR) is fixed by the Rent Control Act.

From the GAV computed above, municipal taxes paid by the owner during the previous year are to be deducted to arrive at the NAV.

ILLUSTRATION 1

Jayashree owns five houses in India, all of which are let-out. Compute the GAV of each house from the information given below –

Particulars	***House I (₹)***	***House II (₹)***	***House III (₹)***	***House IV (₹)***	***House V (₹)***
Municipal Value	*80,000*	*55,000*	*65,000*	*24,000*	*80,000*
Fair Rent	*90,000*	*60,000*	*65,000*	*25,000*	*75,000*
Standard Rent	*N.A.*	*75,000*	*58,000*	*N.A.*	*78,000*
Actual rent received/ receivable	*72,000*	*72,000*	*60,000*	*30,000*	*72,000*

SOLUTION

As per section 23(1), Gross Annual Value (GAV) is the higher of Expected rent and actual rent received. Expected rent is higher of municipal value and fair rent but restricted to standard rent.

Computation of GAV of each house owned by Jayashree

	Particulars	House I (₹)	House II (₹)	House III (₹)	House IV (₹)	House V (₹)
(i)	Municipal value	80,000	55,000	65,000	24,000	80,000
(ii)	Fair rent	90,000	60,000	65,000	25,000	75,000
(iii)	**Higher of (i) & (ii)**	90,000	60,000	65,000	25,000	80,000
(iv)	Standard rent	N.A.	75,000	58,000	N.A.	78,000
(v)	**Expected rent [Lower of (iii) & (iv)]**	90,000	60,000	58,000	25,000	78,000
(vi)	Actual rent received/receivable	72,000	72,000	60,000	30,000	72,000
	GAV [Higher of (v) & (vi)]	**90,000**	**72,000**	**60,000**	**30,000**	**78,000**

(2) Where let out property is vacant for part of the year [Section 23(1)(c)]

Where let out property is vacant for part of the year and owing to vacancy, the actual rent is lower than the ER, then the actual rent received or receivable will be the GAV of the property.

(3) In case of self-occupied property or unoccupied property [Section 23(2)]

(a) Where the property is self-occupied for **own residence** or **unoccupied due to any reason** throughout the previous year, its Annual Value will be Nil, provided no other benefit is derived by the owner from such property.

(b) The benefit of "Nil" Annual Value is available only for upto two self-occupied or unoccupied house properties i.e., for either one house property or two house properties.

(c) The benefit of "Nil" Annual Value in respect of upto **two** self-occupied house properties is available only to an individual/HUF.

(d) No deduction for municipal taxes is allowed in respect of such property/ properties as annual value means value determined after deduction of municipal taxes.

(4) Where a house property is let-out for part of the year and self-occupied for part of the year [Section 23(3)]

(a) If a single unit of a property is self-occupied for part of the year and let-out for the remaining part of the year, then the ER for the whole year shall be taken into account for determining the GAV.

(b) The ER for the whole year shall be compared with the **actual rent for the let out period** and whichever is higher shall be adopted as the GAV.

(c) However, municipal tax for the whole year is allowed as deduction provided it is paid by the owner during the previous year.

(5) In case of deemed to be let out property [Section 23(4)]

(a) Where the assessee owns more than **two** properties for self-occupation, then the income from any **two** properties, at the option of the assessee, shall be computed under the self-occupied property category and their annual value will be nil.

(b) The other self-occupied/ unoccupied properties shall be treated as "deemed let out properties".

(c) This option can be changed year after year in a manner beneficial to the assessee.

(d) In case of deemed let-out property, the ER shall be taken as the GAV.

(e) The question of considering actual rent received/ receivable does not arise. Consequently, no adjustment is necessary on account of property remaining vacant or unrealized rent.

(f) Municipal taxes actually paid by the owner during the previous year, in respect of the deemed let out properties, can be claimed as deduction.

(6) In case of a house property held as stock-in-trade [Section 23(5)]

(a) In some cases, property consisting of any buildings or lands appurtenant thereto may be held as stock-in-trade, and the whole or any part of the property may not be let out during the whole or any part of the previous year.

(b) In such cases, the annual value of such property or part of the property shall be Nil.

(c) This benefit would be available for the period upto **two** years from the end of the financial year in which certificate of completion of construction of the property is obtained from the competent authority.

(7) In case of a house property, a portion let out and a portion self-occupied

(a) Income from any portion or part of a property which is let out shall be computed separately under the "let out property" category and the other portion or part which is self-occupied shall be computed under the "self-occupied property" category.

(b) There is no need to treat the whole property as a single unit for computation of income from house property.

(c) Municipal valuation/fair rent/standard rent, if not given separately, shall be apportioned between the let-out portion and self-occupied portion either on plinth area or built-up floor space or on such other reasonable basis.

(d) Property taxes, if given on a consolidated basis, can be bifurcated as attributable to each portion or floor or on a reasonable basis.

The following are the circumstances where notional income is charged to tax instead of real income:

- *Where the assessee owns more than two house properties for the purpose of self-occupation, the annual value of any two of those properties, at the option of the assessee, will be nil and the other properties are deemed to be let-out and income has to be computed on a notional basis by taking the Expected Rent (ER) as the GAV.*

- *In the case of property let-out throughout the previous year, if the Expected Rent (ER) exceeds the actual rent received or receivable, then ER is taken as the GAV.*
- *In the case of let-out property which is vacant for part of the year, if the actual rent received or receivable for let out period is less than the Expected Rent (ER) for whole year not owing to vacancy, then ER for whole year is taken as the GAV.*
- *In case of a house property held as stock-in-trade by assessee (which is not let out), income has to be computed on a notional basis by taking the Expected Rent (ER) as the GAV after* ***2 years*** *from the end of the financial year in which certificate of completion of construction of the property is obtained from the competent authority.*

(ii) Treatment of unrealised rent [*Explanation* below section 23(1)]

(1) The Actual rent received/receivable should not include any amount of rent which is not capable of being realised.

(2) However, the conditions prescribed in Rule 4 should be satisfied. They are –

(a) the tenancy is *bona fide*;

(b) the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;

(c) the defaulting tenant is not in occupation of any other property of the assessee;

(d) 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.

(iii) Property taxes (Municipal taxes)

(1) Property taxes are allowable as deduction from the GAV subject to the following two conditions:

(a) It should be borne by the assessee (owner); and

(b) It should be actually paid during the previous year.

(2) If property taxes levied by a local authority for a particular previous year are not paid during that year, no deduction shall be allowed in the computation of income from house property for that year.

(3) However, if in any subsequent year, the arrears are paid, then, the amount so paid is allowed as deduction in computation of income from house property for that year.

(4) Thus, we find that irrespective of the previous year in which the liability to pay such taxes arises according to the method of accounting regularly employed by the owner, the deduction in respect of such taxes will be allowed only in the year of actual payment by the owner.

(5) In case of property situated outside India, taxes levied by local authority of the country in which the property is situated is deductible[2].

(6) In respect of self-occupied/unoccupied house property/properties for which "Nil" Annual Value benefit is claimed, deduction of municipal taxes paid is not allowable.

ILLUSTRATION 2

Rajesh, a British national, is a resident and ordinarily resident in India during the P.Y.2025-26. He owns a house in London, which he has let out at £ 10,000 p.m. The municipal taxes paid to the Municipal Corporation of London is £ 8,000 during the P.Y.2025-26. The value of one £ in Indian rupee to be taken at ₹ 95. Compute Rajesh's Net Annual Value of the property for the A.Y. 2026-27.

SOLUTION

For the P.Y.2025-26, Mr. Rajesh, a British national, is resident and ordinarily resident in India. Therefore, income received by him by way of rent of the house property located in London is to be included in the total income in India. Municipal taxes paid in London is be to allowed as deduction from the gross annual value.

[2]*CIT v. R. Venugopala Reddiar (1965) 58 ITR 439 (Mad)*

Computation of Net Annual Value of the property of Mr. Rajesh for A.Y.2026-27

Particulars	₹
Gross Annual Value (£ 10,000 × 12 × 95)	1,14,00,000
Less: Municipal taxes paid (£ 8,000 × 95)	7,60,000
Net Annual Value (NAV)	**1,06,40,000**

2.6 DEDUCTIONS FROM ANNUAL VALUE [SECTION 24]

(i) There are two deductions from annual value. They are –

(1) 30% of NAV; and

(2) Interest on borrowed capital

Deductions provided under section 24 are exhaustive.

(1) 30% of NAV is allowed as deduction under section 24(a)

(a) This is a flat deduction and is allowed irrespective of the actual expenditure incurred.

(b) The assessee will not be entitled to deduction of 30%, in the following cases, as the annual value itself is nil.

(i) In case of self-occupied properties or

(ii) In case of property held as stock-in-trade and the whole or any part of the property is not let out during the whole or any part of the previous year, upto **2 years** from the end of the financial year in which certificate of completion of construction of the property is obtained from the competent authority.

(2) Interest on borrowed capital is allowed as deduction u/s 24(b)

Interest payable on loans borrowed for the purpose of acquisition, construction, repairs, renewal or reconstruction can be claimed as deduction.

Interest payable on a fresh loan taken to repay the original loan raised earlier for the aforesaid purposes is also admissible as a deduction.

Interest for pre-construction period:

Pre-construction period is the period prior to the previous year in which property is acquired or construction is completed.

Interest payable on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed (Pre-construction interest) as reduced by any part thereof allowed as deduction under any other provision of the Act, can be claimed as deduction over a period of 5 years in equal annual installments commencing from the year of acquisition or completion of construction.

Interest for the year in which construction is completed/ property is acquired:

Interest relating to the year of completion of construction/ acquisition of property can be **fully claimed** in that year irrespective of the date of completion/ acquisition.

(ii) Deduction in respect of self-occupied or unoccupied property where annual value is nil

(1) Under default tax regime under section 115BAC

There would be **no deduction** on account of interest on loan under section 24(b) under default tax regime under section 115BAC in respect of the property referred to in section 23(2) i.e., self-occupied or unoccupied property.

(2) Under optional tax regime (normal provisions of the Act)

(1) In case assessee has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A), the assessee will be allowed a deduction on account of interest **(including 1/5th of the accumulated interest of pre-construction period)** as under –

Conditions	Amount of Deduction
(i) Where the property is acquired or constructed with capital borrowed on or after 1.4.1999 and such acquisition or	Actual interest payable in aggregate for **one or two self-occupied properties**, subject to maximum of ₹ **2,00,000**, if certificate

	construction is completed within 5 years from the end of the financial year in which the capital was borrowed.	mentioned in (2) below is obtained.
(ii)	Where the property is repaired, renewed or reconstructed with capital borrowed on or after 1.4.1999.	Actual interest payable in aggregate for **one or two self-occupied properties**, subject to a maximum of **₹ 30,000**.

ILLUSTRATION 3

Mr. Manas owns two house properties one at Bombay, wherein his family resides and the other at Delhi, which is unoccupied. For acquisition of house property at Bombay, he has taken a loan of ₹ 30 lakh@10% p.a. on 1.4.2024. He has not repaid any amount so far. In respect of house property at Delhi, he has taken a loan of ₹ 5 lakh@11% p.a. on 1.10.2024 towards repairs. Compute the deduction which would be available to him under section 24(b) for A.Y.2026-27 in respect of interest payable on such loan if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).

SOLUTION

Mr. Manas can claim benefit of Nil Annual Value in respect of his house property at Bombay and Delhi.

He is eligible for deduction under section 24(b) since he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

Computation of deduction u/s 24(b) for A.Y.2026-27

Particulars	₹
I Interest on loan taken for acquisition of residential house property at Bombay	
30,00,000 x 10% = ₹ 3,00,000	
Restricted to ₹ 2,00,000	2,00,000

II Interest on loan taken for repair of residential house property at Delhi ₹ 5,00,000 x 11% = ₹ 55,000 Restricted to ₹ 30,000	30,000
Total interest	2,30,000
Deduction under section 24(b) in respect of (I) and (II) above to be restricted to	2,00,000

(2) **Certificate to be furnished:** For the purpose of claiming deduction of ₹ 2,00,000 as per (b)(i) in the table given above, the assessee should furnish a certificate from the person to whom any interest is payable on the capital borrowed, specifying the amount of interest payable by the assessee for the purpose of such acquisition or construction of the property or conversion of the whole or any part of the capital borrowed which remains to be repaid as a new loan.

- ***The ceiling limit would not apply to let-out/deemed let-out property:*** *The ceiling limit prescribed for self-occupied property as above in respect of interest on loan borrowed does not apply to a let out/ deemed let-out property irrespective of the regime under which he pays tax.*

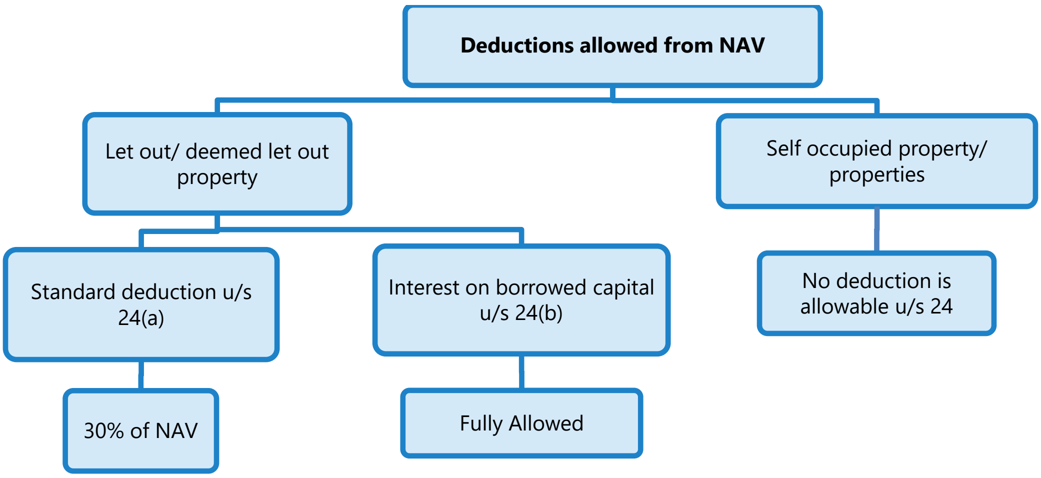
- ***Interest allowable on accrual basis:*** *Deduction under section 24(b) for interest is available on accrual basis. Therefore interest accrued but not paid during the year can also be claimed as deduction.*

In case of let out/ deemed let out property, interest accrued is allowable as deduction without ceiling limit under both the tax regimes. However, in case of default tax regime u/s 115BAC, the resultant loss from house property cannot be set off against income under any other head, whereas, under the normal provisions of the Act, the resultant loss from house property can be set off against income from any other head to the extent of ₹ 2 lakhs.

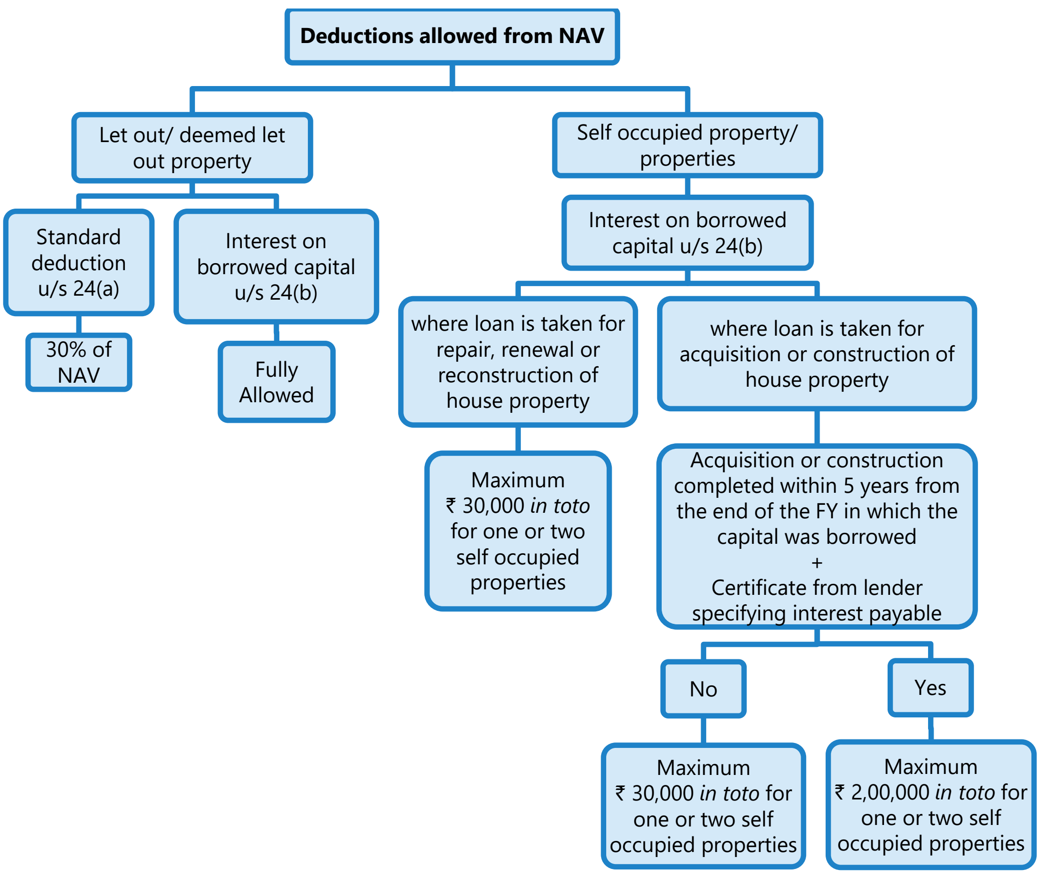
- ***Unpaid purchase price would be considered as capital borrowed:*** *Where a buyer enters into an arrangement with a seller to pay the sale price in installments along with interest due thereon, the seller becomes the lender in relation to the unpaid purchase price and the buyer becomes the borrower. In such a case, unpaid purchase price can be treated as capital borrowed for acquiring property and interest paid thereon can be allowed as deduction under section 24.*

- ***Interest on unpaid interest is not deductible.***

Deductions from Net Annual Value under default tax regime under section 115BAC



Deductions from Net Annual Value under optional tax regime (Normal provisions of the Act)



2.7 COMPUTATION OF "INCOME FROM HOUSE PROPERTY" FOR DIFFERENT CATEGORIES OF PROPERTY

(I) PROPERTY LET OUT THROUGHOUT THE PREVIOUS YEAR

Particulars		Amount
Computation of GAV		
Step 1 Compute ER		
ER = Higher of MV and FR, but restricted to SR		
Step 2 Compute Actual rent received/receivable		
Actual rent received/receivable *less* unrealized rent as per Rule 4 **[See Note below for alternate view]**		
Step 3 Compare ER and Actual rent received/receivable		
Step 4 GAV is the higher of ER and Actual rent received/ receivable		
Gross Annual Value (GAV)		A
Less: Municipal taxes (paid by the owner during the previous year)		B
Net Annual Value (NAV) = (A-B)		C
Less: **Deductions u/s 24**		
(a) 30% of NAV	D	
(b) Interest on borrowed capital (actual without any ceiling limit)	E	F
Income from house property (C-F)		G

Note *- The income-tax returns, however, permit deduction of unrealized rent from gross annual value. If this view is taken, the unrealized rent should be deducted only after computing gross annual value.*

ILLUSTRATION 4

Anirudh has a property whose municipal valuation is ₹ 1,30,000 p.a. The fair rent is ₹ 1,10,000 p.a. and the standard rent fixed by the Rent Control Act is ₹ 1,20,000 p.a. The property was let out for a rent of ₹ 11,000 p.m. throughout the previous year. Unrealised rent was ₹ 11,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @10% of municipal valuation. Interest on borrowed capital was ₹ 40,000 for the year. Compute his income from house property for A.Y.2026-27.

SOLUTION

Computation of Income from house property of Mr. Anirudh for A.Y.2026-27

Particulars		Amount in ₹	
Computation of GAV			
Step 1	Compute ER		
	ER = Higher of MV of ₹ 1,30,000 p.a. and FR of ₹ 1,10,000 p.a., but restricted to SR of ₹ 1,20,000 p.a.	1,20,000	
Step 2	Compute actual rent received/receivable		
	Actual rent received/receivable *less* unrealized rent as per Rule 4 = ₹ 1,32,000 - ₹ 11,000	1,21,000	
Step 3	Compare ER of ₹ 1,20,000 and Actual rent received/receivable of ₹ 1,21,000		
Step 4	GAV is the higher of ER and Actual rent received/receivable	1,21,000	
Gross Annual Value (GAV)			**1,21,000**
Less:	Municipal taxes (paid by the owner during the previous year) = 10% of ₹ 1,30,000		13,000
Net Annual Value (NAV)			**1,08,000**
Less:	**Deductions under section 24**		
	(a) 30% of NAV	32,400	
	(b) Interest on borrowed capital (actual without any ceiling limit)	40,000	72,400
Income from house property			**35,600**

Note – *Alternatively, if as per income-tax returns, unrealized rent is deducted from GAV, then GAV would be ₹ 1,32,000, being higher of expected rent of ₹ 1,20,000 and actual rent of ₹ 1,32,000. Thereafter, unrealized rent of ₹ 11,000 and municipal taxes of ₹ 13,000 would be deducted from GAV of ₹ 1,32,000 to arrive at the NAV of ₹ 1,08,000.*

(II) LET OUT PROPERTY VACANT FOR PART OF THE YEAR

Particulars			Amount
Computation of GAV			
Step 1	Compute ER		
	ER = Higher of MV and FR, but restricted to SR		
Step 2	Compute Actual rent received/receivable		
	Actual rent received/receivable for let out period *less* unrealized rent as per Rule 4 **[See Note below for alternate view]**		
Step 3	Compare ER and Actual rent received/receivable computed for the let-out period		
Step 4	If Actual rent is lower than ER owing to vacancy, then Actual rent is the GAV. If Actual rent is lower than ER due to other reasons, then ER is the GAV. However, in spite of vacancy, if the actual rent is higher than the ER, then Actual rent is the GAV.		
Gross Annual Value (GAV)			A
Less:	Municipal taxes (paid by the owner during the previous year)		B
Net Annual Value (NAV) = (A-B)			C
Less:	**Deductions under section 24**		
	(a) 30% of NAV	D	
	(b) Interest on borrowed capital (actual without any ceiling limit)	E	F
Income from house property (C-F)			G

Note *- The income-tax returns, however, permit deduction of unrealized rent from gross annual value. If this view is taken, the unrealized rent should be deducted only after computing gross annual value.*

ILLUSTRATION 5

Ganesh has a property whose municipal valuation is ₹ 2,50,000 p.a. The fair rent is ₹ 2,00,000 p.a. and the standard rent fixed by the Rent Control Act is ₹ 2,10,000 p.a. The property was let out for a rent of ₹ 20,000 p.m. However, the tenant vacated the property on 31.1.2026. Unrealised rent was ₹ 20,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @8% of municipal *valuation. Interest on borrowed capital was ₹ 65,000 for the year. Compute the income from house property of Ganesh for A.Y.2026-27.*

SOLUTION

Computation of income from house property of Ganesh for A.Y.2026-27

Particulars		Amount in ₹	
Computation of GAV			
Step 1	Compute ER		
	Higher of MV of ₹ 2,50,000 p.a. & FR of ₹ 2,00,000 p.a., but restricted to SR of ₹ 2,10,000 p.a.	2,10,000	
Step 2	Compute Actual rent received/receivable		
	Actual rent received/receivable for let out period *less* unrealized rent as per Rule 4 = ₹ 2,00,000 – ₹ 20,000	1,80,000	
Step 3	Compare ER & Actual rent received/receivable		
Step 4	In this case the actual rent of ₹ 1,80,000 is lower than ER of ₹ 2,10,000 owing to vacancy, since, had the property not been vacant the actual rent would have been ₹ 2,20,000 (₹ 1,80,000 + ₹ 40,000, being notional rent for February and March 2026). Therefore, actual rent is the GAV.	1,80,000	
Gross Annual Value (GAV)			**1,80,000**
Less:	Municipal taxes (paid by the owner during the previous year) = 8% of ₹ 2,50,000		20,000
Net Annual Value (NAV)			**1,60,000**
Less:	**Deductions under section 24**		
	(a) 30% of NAV = 30% of ₹ 1,60,000	48,000	
	(b) Interest on borrowed capital (actual without any ceiling limit)	65,000	1,13,000
Income from house property			**47,000**

Note – *Alternatively, if as per income-tax returns, unrealized rent is deducted from GAV, then GAV would be ₹ 2,00,000, being the actual rent, since the actual rent is lower than the expected rent of ₹ 2,10,000 owing to vacancy. Thereafter, unrealized rent of ₹ 20,000 and municipal taxes of ₹ 20,000 would be deducted from GAV of ₹ 2,00,000 to arrive at the NAV of ₹ 1,60,000.*

(III) SELF-OCCUPIED PROPERTIES OR UNOCCUPIED PROPERTIES

Particulars	Amount
Annual value under section 23(2)	Nil
Less: **Deduction under section 24**	
Interest on borrowed capital [Allowable only in case the assessee exercises the option of shifting out of the default tax regime provided under section 115BAC(1A)]	E
(i) Interest on loan taken for acquisition or construction of house on or after 1.4.99 and same was completed within 5 years from the end of the financial year in which capital was borrowed, interest paid or payable *in toto* for one or two self-occupied properties subject to a maximum of ₹ 2,00,000 (including apportioned pre-construction interest).	
(ii) Interest on loan taken for repair, renovation or reconstruction on or after 1.4.99, interest paid or payable *in toto* for one or two self-occupied properties subject to a maximum of ₹ 30,000.	
Income from house property	-E
However, aggregate interest on borrowed capital allowable under (i) and (ii) cannot exceed ₹ 2,00,000	

ILLUSTRATION 6

Poorna has one house property at Indira Nagar in Bangalore. She stays with her family in the house. The rent of similar property in the neighbourhood is ₹ 25,000 p.m. The municipal valuation is ₹ 2,80,000 p.a. Municipal taxes paid is ₹ 8,000. The house construction began in April 2019 with a loan of ₹ 20,00,000 taken from SBI Housing Finance Ltd. @9% p.a. on 1.4.2019. The construction was completed on 30.11.2021. The accumulated interest up to 31.3.2021 is ₹ 3,60,000. On 31.3.2026, Poorna paid ₹ 2,40,000 which included ₹ 1,80,000 as interest. There was no principal repayment prior to this date. Compute Poorna's income from house property for A.Y. 2026-27 assuming that she has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

SOLUTION

Computation of income from house property
of Smt. Poorna for A.Y.2026-27

Particulars	Amount ₹
Annual Value of house used for self-occupation under section 23(2)	Nil
Less: **Deduction under section 24**	
Interest on borrowed capital	
Interest on loan was taken for construction of house on or after 1.4.99 and same was completed within the prescribed time - interest paid or payable subject to a maximum of ₹ 2,00,000 (including apportioned pre-construction interest) will be allowed as deduction.	
In this case the total interest is ₹ 1,80,000 + ₹ 72,000 (Being 1/5th of ₹ 3,60,000) = ₹ 2,52,000. However, the interest deduction is restricted to ₹ 2,00,000.	2,00,000
Loss from house property	**(2,00,000)**

(IV) HOUSE PROPERTY LET-OUT FOR PART OF THE YEAR AND SELF-OCCUPIED FOR PART OF THE YEAR

Particulars	Amount
Computation of GAV	
Step 1 Compute ER for the whole year	
ER = Higher of MV and FR, but restricted to SR	
Step 2 Compute Actual rent received/receivable	
Actual rent received/receivable for the period let out *less* unrealized rent as per Rule 4 **[See Note below for alternate view]**	
Step 3 Compare ER for the whole year with the actual rent received/receivable for the let out period	
Step 4 GAV is the higher of ER computed for the whole year and Actual rent received/receivable computed for the let-out period	

Gross Annual Value (GAV)		A
Less: Municipal taxes (paid by the owner during the previous year)		B
Net Annual Value (NAV) = (A-B)		C
Less: **Deductions under section 24**		
(a) 30% of NAV	D	
(b) Interest on borrowed capital (actual without any ceiling limit)	E	F
Income from house property (C-F)		G

Note - *The income-tax returns, however, permit deduction of unrealized rent from gross annual value. If this view is taken, the unrealized rent should be deducted only after computing gross annual value.*

ILLUSTRATION 7

Smt. Rajalakshmi owns a house property at Adyar in Chennai. The municipal value of the property is ₹ 5,00,000, fair rent is ₹ 4,20,000 and standard rent is ₹ 4,80,000. The property was let-out for ₹ 50,000 p.m. up to December 2025. Thereafter, the tenant vacated the property and Smt. Rajalakshmi used the house for self-occupation. Rent for the months of November and December 2025 could not be realisedin spite of the owner's efforts. All the conditions prescribed under Rule 4 are satisfied. She paid municipal taxes @12% during the year. She had paid interest of ₹ 25,000 during the year for amount borrowed for repairs for the house property. Compute her income from house property for the A.Y. 2026-27.

SOLUTION

Computation of income from house property of Smt. Rajalakshmi for A.Y.2026-27

Particulars	Amount in ₹	
Computation of GAV		
Step 1 Compute ER for the whole year		
ER = Higher of MV of ₹ 5,00,000 and FR of ₹ 4,20,000, but restricted to SR of ₹ 4,80,000	4,80,000	
Step 2 Compute Actual rent received/receivable		
Actual rent received/receivable for the period let out *less* unrealized rent as per Rule 4 = (₹ 50,000 × 9) - (₹ 50,000 × 2) = ₹ 4,50,000 - ₹ 1,00,000	3,50,000	

Step 3 Compare ER for the whole year with the actual rent received/receivable for the let out period i.e. ₹ 4,80,000 and ₹ 3,50,000		
Step 4 GAV is the higher of ER computed for the whole year and Actual rent received/receivable computed for the let-out period	4,80,000	
Gross Annual Value (GAV)		**4,80,000**
Less: Municipal taxes (paid by the owner during the previous year) = 12% of ₹ 5,00,000		60,000
Net Annual Value (NAV)		**4,20,000**
Less: **Deductions under section 24**		
(a) 30% of NAV = 30% of ₹ 4,20,000	1,26,000	
(b) Interest on borrowed capital	25,000	1,51,000
Income from house property		**2,69,000**

Note – *Alternatively, if as per income-tax returns, unrealized rent is deducted from GAV then, GAV would be ₹ 4,80,000, being higher of expected rent of ₹ 4,80,000 and actual rent of ₹ 4,50,000. Thereafter, unrealized rent of ₹ 1,00,000 and municipal taxes of ₹ 60,000 would be deducted from GAV of ₹ 4,80,000 to arrive at the NAV of ₹ 3,20,000. The deduction u/s 24(a) would be ₹ 96,000, being 30% of ₹ 3,20,000. The income from house property would, therefore, be ₹ 1,99,000.*

In this case, it may be noted that GAV is the higher of Expected rent and Actual rent, since the Actual rent is lower than the Expected rent due to self-occupation and not vacancy.

(V) DEEMED TO BE LET OUT PROPERTY

Particulars		**Amount**
Gross Annual Value (GAV)		A
ER is the GAV of house property		
ER = Higher of MV and FR, but restricted to SR		
Less: Municipal taxes (paid by the owner during the previous year)		B
Net Annual Value (NAV) = (A-B)		C
Less: **Deductions under section 24**		
(a) 30% of NAV	D	

(b) Interest on borrowed capital (actual without any ceiling limit)	E	F
Income from house property (C-F)		G

ILLUSTRATION 8

Ganesh has three houses, all of which are self-occupied. The particulars of the houses for the P.Y.2025-26 are as under:

Particulars	***House I***	***House II***	***House III***
Municipal valuation p.a.	*₹ 3,00,000*	*₹ 3,60,000*	*₹ 3,30,000*
Fair rent p.a.	*₹ 3,75,000*	*₹ 2,75,000*	*₹ 3,80,000*
Standard rent p.a.	*₹ 3,50,000*	*₹ 3,70,000*	*₹ 3,75,000*
Date of completion/purchase	*31.3.2000*	*31.3.2002*	*01.5.2019*
Municipal taxes paid during the year	*12%*	*8%*	*6%*
Interest on money borrowed for repair of property during the current year	*-*	*₹ 55,000*	
Interest for current year on money borrowed in April, 2018 for purchase of property			*₹ 1,75,000*

Compute Ganesh's income from house property for A.Y.2026-27 and suggest which houses should be opted by Ganesh to be assessed as self-occupied so that his tax liability is minimum.

SOLUTION

Let us first calculate the income from each house property assuming that they are deemed to be let out.

Computation of income from house property of Ganesh for the A.Y. 2026-27

Particulars	**Amount in ₹**		
	House I	**House II**	**House III**
Gross Annual Value (GAV) ER is the GAV of house property ER = Higher of MV and FR, but restricted to SR	3,50,000	3,60,000	3,75,000

Less: Municipal taxes (paid by the owner during the previous year)	36,000	28,800	19,800
Net Annual Value (NAV)	**3,14,000**	**3,31,200**	**3,55,200**
Less: **Deductions under section 24**			
(a) 30% of NAV	94,200	99,360	1,06,560
(b) Interest on borrowed capital	-	55,000	1,75,000
Income from house property	**2,19,800**	**1,76,840**	**73,640**

Ganesh can opt to treat any two of the above house properties as self-occupied.

Under default tax regime under section 115BAC

OPTION 1 (House I and II– self-occupied and House III – deemed to be let out)

If House I and II are opted to be self-occupied, the income from house property shall be –

Particulars	Amount in ₹
House I (Self-occupied)	Nil
House II (Self-occupied) (No interest deduction)	Nil
House III (Deemed to be let-out)	73,640
Income from house property	**73,640**

OPTION 2 (House I and III – self-occupied and House II – deemed to be let out)

If House I and III are opted to be self-occupied, the income from house property shall be –

Particulars	Amount in ₹
House I (Self-occupied)	Nil
House II (Deemed to be let-out)	1,76,840
House III (Self-occupied) (No interest deduction)	Nil
Income from house property	**1,76,840**

OPTION 3 (House II and III –self-occupied and House I – deemed to be let out)

If House II and III are opted to be self-occupied, the income from house property shall be –

Particulars	Amount in ₹
House I (Deemed to be let-out)	2,19,800
House II (Self-occupied) (No interest deduction)	-
House III (Self-occupied) (No interest deduction)	-
Income from house property	**2,19,800**

Since Option 1 is most beneficial, Ganesh should opt to treat House I and II as self-occupied and House III as deemed to be let out. His income from house property would be ₹ 73,640 for the A.Y. 2026-27 under default tax regime under section 115BAC.

<u>If Mr. Ganesh has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A)</u>

OPTION 1 (House I and II– self-occupied and House III – deemed to be let out)

If House I and II are opted to be self-occupied, the income from house property shall be –

Particulars	Amount in ₹
House I (Self-occupied)	Nil
House II (Self-occupied) (Interest deduction restricted to ₹ 30,000)	(30,000)
House III (Deemed to be let-out)	73,640
Income from house property	**43,640**

OPTION 2 (House I and III – self-occupied and House II – deemed to be let out)

If House I and III are opted to be self-occupied, the income from house property shall be –

Particulars	Amount in ₹
House I (Self-occupied)	Nil
House II (Deemed to be let-out)	1,76,840
House III (Self-occupied)	(1,75,000)
Income from house property	**1,840**

OPTION 3 (House II and III –self-occupied and House I – deemed to be let out)

If House II and III are opted to be self-occupied, the income from house property shall be –

Particulars		Amount in ₹
House I (Deemed to be let-out)		2,19,800
House II (Self-occupied) (Interest deduction restricted to ₹ 30,000)	(30,000)	
House III (Self-occupied) (No interest deduction)	(1,75,000)	
(Total interest deduction restricted to ₹ 2,00,000)		(2,00,000)
Income from house property		**19,800**

Since Option 2 is most beneficial in this case, Ganesh should opt to treat House I and III as self-occupied and House II as deemed to be let out. His income from house property would be ₹ 1,840 for the A.Y. 2026-27 under the optional tax regime i.e., the normal provisions of the Act.

(VI) HOUSE PROPERTY, A PORTION LET OUT AND A PORTION SELF-OCCUPIED

ILLUSTRATION 9

Prem owns a house in Madras. During the previous year 2025-26, 2/3rd portion of the house was self-occupied and 1/3rd portion was let out for residential purposes at a rent of ₹ 8,000 p.m. Municipal value of the property is ₹ 3,00,000 p.a., fair rent is ₹ 2,70,000 p.a. and standard rent is ₹ 3,30,000 p.a. He paid municipal taxes @10% of municipal value during the year. A loan of ₹ 25,00,000 was taken by him during the year 2021 for acquiring the property. Interest on loan paid during the previous year 2025-26 was ₹ 1,20,000. Compute Prem's income from house property for the A.Y.2026-27 assuming that he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

What would be Prem's income from house property under the default tax regime?

SOLUTION

There are two units of the house. Unit I with 2/3rd area is used by Prem for self-occupation throughout the year and no other benefit is derived from that unit, hence it will be treated as self-occupied and its annual value will be Nil. Unit 2 with 1/3rd area is let-out throughout the previous year and its annual value has to be determined as per section 23(1).

Computation of income from house property of Mr. Prem for A.Y.2026-27 under the optional tax regime (i.e., Normal provisions of the Act)

Particulars	Amount in ₹	
Unit I (2/3rd area – self-occupied)		
Annual Value		Nil
Less: **Deduction under section 24(b) 2/3rd of ₹ 1,20,000**		**80,000**
Income from Unit I (self-occupied)		**(80,000)**
Unit II (1/3rd area – let out)		
Computation of GAV		
Step I Compute ER		
ER = Higher of MV and FR, restricted to SR	1,00,000	
However, in this case, SR of ₹ 1,10,000 (1/3rd of ₹ 3,30,000) is more than the higher of MV of ₹ 1,00,000 (1/3rd of ₹ 3,00,000) and FR of ₹ 90,000 (1/3rd of ₹ 2,70,000). Hence the higher of MV and FR is the ER. In this case, it is the MV.		
Step 2 Compute actual rent received/ receivable ₹ 8,000×12 = ₹ 96,000	96,000	
Step 3 Compare ER and Actual rent received/receivable		
Step 4 GAV is the higher of ER and actual rent received/receivable i.e. higher of ₹ 1,00,000 and ₹ 96,000	1,00,000	
Gross Annual Value(GAV)		**1,00,000**
Less: Municipal taxes paid by the owner during the previous year relating to let-out portion 1/3rd of (10% of ₹ 3,00,000) = ₹ 30,000/3 = ₹ 10,000		10,000
Net Annual Value(NAV)		**90,000**
Less: Deductions under section 24		
(a) 30% of NAV = 30% of ₹ 90,000	27,000	
(b) Interest paid on borrowed capital (relating to let out portion) 1/3rd of ₹ 1,20,000	40,000	67,000
Income from Unit II (let-out)		**23,000**
Loss under the head "Income from house property" = (₹ 80,000) + ₹ 23,000 = (₹ 57,000)		

Under the default tax regime, Prem would not be entitled to interest deduction of ₹ 80,000 under section 24(b) in respect of self-occupied portion (Unit 1). Hence, income from house property would be ₹ 23,000, being income from Unit II, which is let out.

2.8 INADMISSIBLE DEDUCTIONS [SECTION 25]

Interest chargeable under this Act which is payable outside India shall not be deducted if –

(a) tax has not been paid or deducted from such interest and

(b) in respect of which there is no person in India who may be treated as an agent[3].

2.9 PROVISION FOR ARREARS OF RENT AND UNREALIZED RENT RECEIVED SUBSEQUENTLY [SECTION 25A]

(i) As per section 25A(1), the amount of rent received in arrears from a tenant or the amount of unrealised rent realised subsequently from a tenant by an assessee shall be deemed to be income from house property in the financial year in which such rent is received or realised, and shall be included in the total income of the assessee under the head "Income from house property", whether the assessee is the owner of the property or not in that financial year.

(ii) Section 25A(2) provides a deduction of 30% of arrears of rent or unrealised rent realised subsequently by the assessee.

(iii) **Summary**:

Section 25A Arrears of Rent / Unrealised Rent	
(i)	Taxable in the year of receipt/realisation
(ii)	Deduction@30% of rent received/realised
(iii)	Taxable even if assessee is not the owner of the property in the financial year of receipt/realisation.

[3]under section 163

ILLUSTRATION 10

Mr. Anand sold his residential house property in March, 2025.

In June, 2025, he recovered rent of ₹ 10,000 from Mr. Gaurav, to whom he had let out his house for two years from April 2019 to March 2021. He could not realise two months rent of ₹ 20,000 from him and to that extent his actual rent was reduced while computing income from house property for A.Y.2021-22.

Further, he had let out his property from April, 2021 to February, 2025 to Mr. Satish. In April, 2023, he had increased the rent from ₹ 12,000 to ₹ 15,000 per month and the same was a subject matter of dispute. In September, 2025, the matter was finally settled and Mr. Anand received ₹ 69,000 as arrears of rent for the period April 2023 to February, 2025.

Would the recovery of unrealised rent and arrears of rent be taxable in the hands of Mr. Anand, and if so in which year?

SOLUTION

Since the unrealised rent was recovered in the P.Y.2025-26, the same would be taxable in the A.Y.2026-27 under section 25A, irrespective of the fact that Mr. Anand was not the owner of the house in that year. Further, the arrears of rent was also received in the P.Y.2025-26, and hence the same would be taxable in the A.Y.2026-27 under section 25A, even though Mr. Anand was not the owner of the house in that year. A deduction of 30% of unrealised rent recovered and arrears of rent would be allowed while computing income from house property of Mr. Anand for A.Y.2026-27.

Computation of income from house property of Mr. Anand for A.Y.2026-27

Particulars		₹
(i)	Unrealised rent recovered	10,000
(ii)	Arrears of rent received	69,000
		79,000
Less:	Deduction@30%	23,700
Income from house property		**55,300**

2.10 TREATMENT OF INCOME FROM CO-OWNED PROPERTY [SECTION 26]

(i) Where property is owned by two or more persons, whose shares are definite and ascertainable, then the income from such property cannot be taxed as income of an AOP.

(ii) The share income of each such co-owner should be determined in accordance with sections 22 to 25 and included in his individual assessment.

(iii) Where the house property owned by co-owners is self occupied by each of the co-owners, the annual value of the property of each co-owner will be Nil and each co-owner shall be entitled to a deduction of ₹ 30,000/ ₹ 2,00,000, as the case may be, under section 24(b) on account of interest on borrowed capital if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A).

However, the aggregate deduction of interest to each co-owner in respect of interest payable on loan taken for co-owned house property and interest, if any, payable on loan taken for another self-occupied property owned by him cannot exceed ₹ 30,000/ ₹ 2,00,000, as the case may be.

(iv) Where the house property owned by co-owners is let out, the income from such property shall be computed as if the property is owned by one owner and thereafter the income so computed shall be apportioned amongst each co-owner as per their specific share.

(v) **Summary:**

Co-owned property [Section 26]	
Self-occupied property	**Let-out property**
The annual value of the property of each co-owner will be Nil and each co-owner shall be entitled to a deduction of ₹ 30,000/ ₹ 2,00,000, as the case may be, on account of interest on borrowed capital if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A). However, if the co-owner owns another self-occupied/unoccupied property, the aggregate interest from the co-owned property and the	The income from such property shall be computed as if the property is owned by one owner and thereafter the income so computed shall be apportioned amongst each co-owner as per their specific share.

other self-occupied property cannot exceed ₹ 30,000/₹ 2,00,000, as the case may be. As mentioned earlier, no interest deduction in respect of self-occupied property would be allowable to the co-owners under the default tax regime.	

ILLUSTRATION 11

Ms. Aparna co-owns a residential house property in Calcutta along with her sister Ms. Dimple, where her sister's family resides. Both of them have equal share in the property and the same is used by them for self-occupation. Interest is payable in respect of loan of ₹ 50,00,000@10% taken on 1.4.2024 for acquisition of such property. In addition, Ms. Aparna owns a flat in Pune in which she and her parents reside. She has taken a loan of ₹3,00,000@12% on 1.10.2024 for repairs of this flat. Compute the deduction which would be available to Ms. Aparna and Ms. Dimple under section 24(b) for A.Y.2026-27, if both exercise the option of shifting out of the default tax regime provided under section 115BAC(1A).

SOLUTION

Computation of deduction u/s 24(b) available to Ms. Aparna for A.Y.2026-27

	Particulars	₹
I	Interest on loan taken for acquisition of residential house property at Calcutta	
	₹ 50,00,000 x 10% = ₹ 5,00,000	
	Ms. Aparna's share = 50% of ₹ 5,00,000 = ₹ 2,50,000	
	Restricted to ₹ 2,00,000	2,00,000
II	Interest on loan taken for repair of flat at Pune	
	₹ 3,00,000 x 12% = ₹ 36,000	
	Restricted to ₹ 30,000	30,000
Total interest		2,30,000
Deduction under section 24(b) in respect of (I) and (II) above to be restricted to		2,00,000

Computation of deduction u/s 24(b) available to Ms. Dimple for A.Y.2026-27

Particulars	₹
Interest on loan taken for acquisition of residential house property at Calcutta	
₹ 50,00,000 x 10% = ₹ 5,00,000	
Ms. Dimple's share = 50% of ₹ 5,00,000 = ₹ 2,50,000	
Restricted to ₹ 2,00,000	2,00,000
Deduction under section 24(b)	**2,00,000**

2.11 DEEMED OWNERSHIP [SECTION 27]

As per section 27, the following persons, though not legal owners of a property, are deemed to be the owners for the purposes of section 22 to 26.

(i) **Transfer to a spouse [Section 27(i)]** – In case of transfer of house property by an individual to his or her spouse otherwise than for adequate consideration, the transferor is deemed to be the owner of the transferred property.

Exception – *In case of transfer to spouse in connection with an agreement to live apart, the transferor will not be deemed to be the owner. The transferee will be the owner of the house property.*

(ii) **Transfer to a minor child [Section 27(i)]** – In case of transfer of house property by an individual to his or her minor child otherwise than for adequate consideration, the transferor would be deemed to be owner of the house property transferred.

Exception – *In case of transfer to a minor married daughter, the transferor is not deemed to be the owner.*

Note - Where cash is transferred to spouse/minor child and the transferee acquires property out of such cash, then, the transferor shall not be treated as deemed owner of the property. However, clubbing provisions will be attracted.

(iii) **Holder of an impartible estate [Section 27(ii)]** – The impartible estate is a property which is not legally divisible. The holder of an impartible estate shall be deemed to be the individual owner of all properties comprised in the estate.

After enactment of the Hindu Succession Act, 1956, all the properties comprised in an impartible estate by custom is to be assessed in the status of a HUF. However, section 27(ii) will continue to be applicable in relation to impartible estates by grant or covenant.

(iv) Member of a co-operative society etc. [Section 27(iii)] – 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 a society/company/association, shall be deemed to be owner of that building or part thereof allotted to him although the co-operative society/company/ association is the legal owner of that building.

(v) Person in possession of a property [Section 27(iiia)] – A person who is allowed to take or retain the 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 shall be the deemed owner of that house property. This would include cases where the –

(1) possession of property has been handed over to the buyer

(2) sale consideration has been paid or promised to be paid to the seller by the buyer

(3) sale deed has not been executed in favour of the buyer, although certain other documents like power of attorney/agreement to sell/will etc. have been executed.

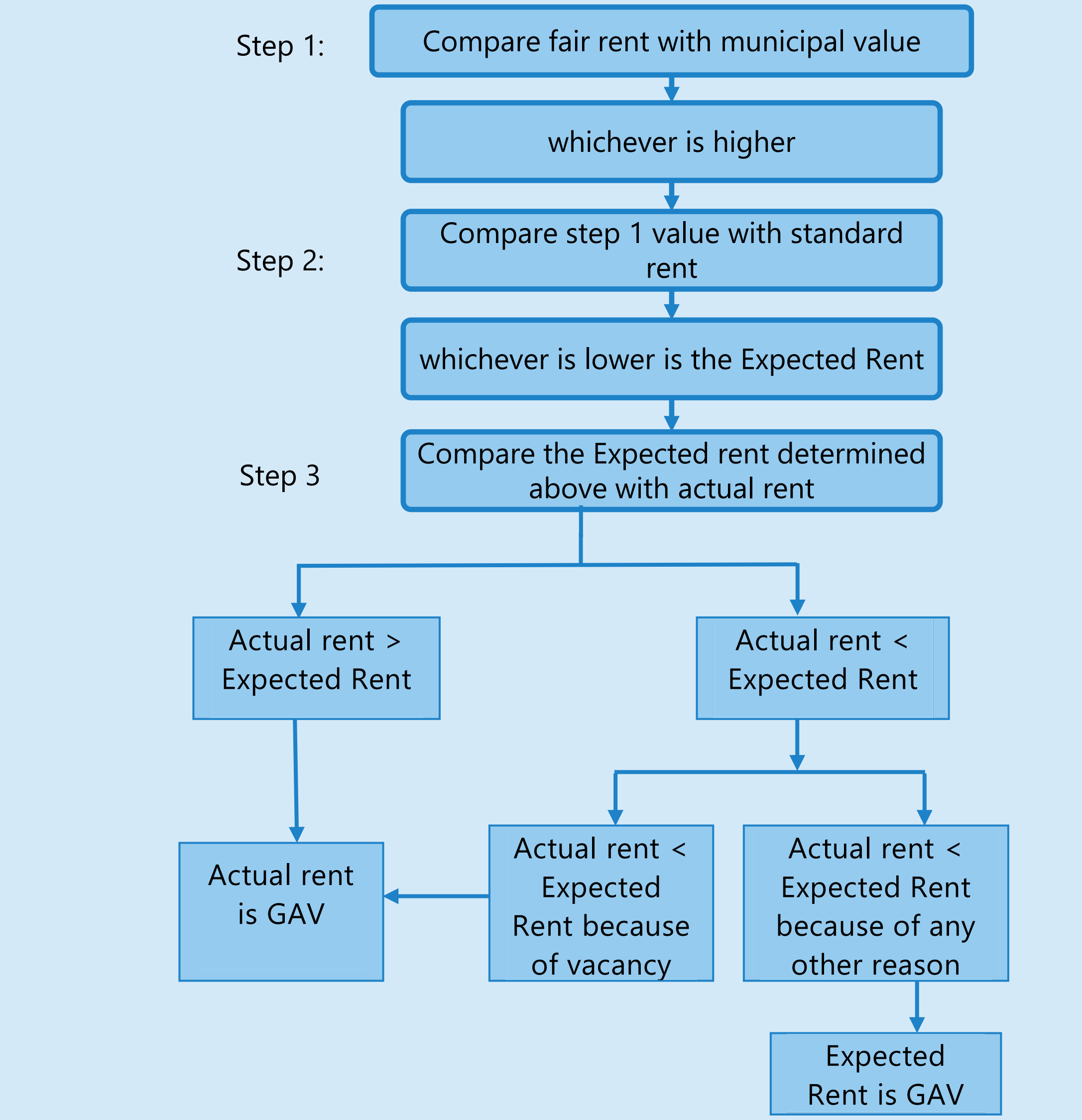
In all the above cases, the buyer would be deemed to be the owner of the property although it is not registered in his name.

(vi) Person having right in a property for a period not less than 12 years [Section 27(iiib)] – A person who acquires any rights in or with respect to any building or part thereof, by virtue of any transaction as is referred to in section 269UA(f) i.e. transfer by way of lease for not less than 12 years, shall be deemed to be the owner of that building or part thereof.

Exception – *In case the person acquiring any rights by way of lease from month to month or for a period not exceeding one year, such person will not be deemed to be the owner.*

LET US RECAPITULATE

Section	Contents
22	**Basis of Charge** The annual value of any property comprising of buildings or lands appurtenant thereto, of which the assessee is the owner, is chargeable to tax under the head "Income from house property". (i) **Property should consist of any buildings or lands appurtenant thereto** Income from letting out of **vacant land** is, however, taxable under the head "Income from other sources" or "Profits and gains from business or profession", as the case may be. (ii) **Assessee must be the owner of the property** (iii) The property may be used for any purpose, but it should **not be used by the owner for the purpose of any business or profession carried on by him**, the profit of which is chargeable to tax. Further, the income earned by an assessee engaged in the business of letting out of commercial properties on rent would be taxable as business income. (iv) **Property held as stock-in-trade etc.** Annual value of house property will be charged under the head "Income from house property", where it is held by the assessee as stock-in-trade of a business also.
23(1)	**Annual Value of let-out property** Annual value is the amount arrived after deducting the municipal taxes **actually paid by the owner** during the previous year from the Gross Annual Value (GAV). The GAV of let-out property would be determined in the following manner:



23(2)	**Annual Value of self-occupied property** Where the property is self-occupied for own residence or unoccupied due to any reason throughout the previous year, its Annual Value will be Nil, provided no other benefit is derived by the owner from such property. An assessee can claim benefit of "Nil" Annual Value in respect of one or two residential house properties self-occupied by him.

23(4)	**Annual Value of deemed to be let-out property** If more than two properties are so self-occupied/unoccupied, the assessee may claim benefit of Nil annual value in respect of any two properties at his option. The other property(s) would be deemed to be let out, in respect of which Expected Rent would be the GAV.
23(5)	**Annual value where the property held as stock-in-trade etc.** Where property consisting of any buildings or lands appurtenant thereto is held as stock-in-trade and the whole or any part of the property is not let out during the whole or any part of the previous year, the annual value of such property or part of the property for the period upto **2 years** from the end of the financial year in which certificate of completion of construction of the property is obtained from the competent authority shall be taken as "Nil".
24	**Deductions from Annual Value** 1. 30% of Annual Value [Section 24(a)] 2. Interest on borrowed capital [Section 24(b)]: Interest payable on loans borrowed for the purpose of acquisition, construction, repairs, renewal or reconstruction can be claimed as deduction. **Pre-construction interest:** Interest for the period prior to the previous year in which property is acquired or construction is completed. Pre-construction interest is allowable as deduction in 5 equal installments from the previous year of completion of construction or acquisition. **(a) Let out property:** Whole of the amount of interest on borrowed capital payable during the previous year and apportioned pre-construction interest without any ceiling limit would be allowed as deduction. **(b) Self-occupied property:** (i) Interest on loan taken for acquisition or construction of house on or after 1.4.99, where such construction is completed within 5 years from the end of the financial year in which capital was borrowed, aggregate interest paid or payable for one or two self-occupied properties subject to a maximum of ₹ 2,00,000 (including apportioned pre-construction interest). (ii) In case of loan taken for repair, renovation or reconstruction at any point of time, aggregate interest

	paid or payable for one or two self-occupied properties subject to a maximum of ₹ 30,000 (including apportioned pre-construction interest). **Notes –** (1) Total amount of interest deduction under (i) and (ii) in respect of one or two self-occupied properties owned by the assessee cannot exceed ₹ 2,00,000. (2) Interest deduction in respect of self occupied property(ies) would be available only if the assessee exercises the option of shifting out of the default tax regime provided under section 115BAC(1A). If the assessee pays tax under default tax regime under section 115BAC, deduction under section 24(b) in respect of interest on loan for self occupied property is **<u>not</u>** allowed.
25	**Inadmissible deductions** Interest chargeable under this Act which is payable outside India shall not be deducted if – (a) tax has not been paid or deducted from such interest and (b) in respect of which there is no person in India who may be treated as an agent
25A	**Taxability of recovery of unrealised rent & arrears of rent received** (i) Taxable in the year of receipt/ realisation (ii) Deduction@30% of rent received/ realised (iii) Taxable even if assessee is not the owner of the property in the financial year of receipt/ realization
26	**Co-owned property** (i) **Self-occupied property:** The annual value of the property of each co-owner will be Nil and each co-owner shall be entitled to a deduction of ₹ 30,000/ ₹ 2,00,000, as the case may be, on account of interest on borrowed capital if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A). However, aggregate deduction of interest to each co-owner in respect of co-owned self-occupied property and any other self-occupied house property, if any, cannot exceed ₹ 30,000/ ₹ 2,00,000, as the case may be.

	No deduction would be allowed in respect of interest on loan taken for purchase/construction/reconstruction/repairs of self occupied property where the assessee pays tax under the default tax regime. (ii) **Let-out property:** The income from such property shall be computed as if the property is owned by one owner and thereafter the income so computed shall be apportioned amongst each co-owner as per their specific share.
27	**Deemed Ownership:** The following persons, though not legal owners of a property, are deemed to be the owners: (i) Transferor of the property, where the property is transferred to the spouse or to minor child except minor married daughter, without adequate consideration (ii) Holder of an impartible estate (iii) Member of a co-operative society etc. (iv) Person in possession of a property (v) Person having right in a property for a period not less than 12 years
Other important points	
(i)	The Actual rent received/receivable should not include any amount of rent which is not capable of being realized i.e., unrealized rent while determining gross annual value in case let-out property, provided the conditions specified in Rule 4 are satisfied. ***Note*** *- The income-tax returns, however, permit deduction of unrealized rent from gross annual value. If this view is taken, the unrealized rent should be deducted only after computing gross annual value.*
(ii)	If a portion of a property is let-out and a portion is self-occupied, then, the income will be computed separately for let out and self-occupied portion.

TEST YOUR KNOWLEDGE

1. Mr. Raman is a co-owner of a house property along with his brother holding equal share in the property.

Particulars	₹
Municipal value of the property	1,60,000
Fair rent	1,50,000
Standard rent under the Rent Control Act	1,70,000
Rent received	15,000 p.m.

The loan for the construction of this property is jointly taken and the interest charged by the bank is ₹ 25,000, out of which ₹ 21,000 has been paid. Interest on the unpaid interest is ₹ 450. To repay this loan, Raman and his brother have taken a fresh loan and interest charged on this loan is ₹ 5,000.

The municipal taxes of ₹ 5,100 have been paid by the tenant.

Compute the income from this property chargeable in the hands of Mr. Raman for the A.Y. 2026-27.

2. Mr. X owns one residential house in Mumbai. The house is having two identical units. First unit of the house is self-occupied by Mr. X and another unit is rented for ₹ 8,000 p.m. The rented unit was vacant for 2 months during the year. The particulars of the house for the previous year 2025-26 are as under:

Standard rent	₹ 1,62,000 p.a.
Municipal valuation	₹ 1,90,000 p.a.
Fair rent	₹ 1,85,000 p. a
Municipal tax (Paid by Mr. X)	5% of municipal valuation
Light and water charges	₹ 500 p.m.
Interest on borrowed capital	₹ 1,500 p.m.
Lease money	₹ 1,200 p.a.
Insurance charges	₹ 3,000 p.a.
Repairs	₹ 12,000 p.a.

Compute income from house property of Mr. X for the A.Y. 2026-27 if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).

3. *Mr. Vikas owns a house property whose Municipal Value, Fair Rent and Standard Rent are ₹ 96,000, ₹ 1,26,000 and ₹ 1,08,000 (per annum), respectively. During the F.Y. 2025-26, one-third of the portion of the house was let out for residential purpose at a monthly rent of ₹ 5,000. The remaining two-third portion was self-occupied by him. Municipal tax @11% of municipal value was paid during the year.*

   The construction of the house began in June, 2018 and was completed on 31-5-2021. Vikas took a loan of ₹ 1,00,000 on 1-7-2018 for the construction of building. He paid interest on loan @ 12% per annum and every month such interest was paid.

   Compute income from house property of Mr. Vikas for the A.Y. 2026-27 if he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

4. *Mrs. Rohini Ravi, a citizen of the U.S.A., is a resident and ordinarily resident in India during the financial year 2025-26. She owns a house property at Los Angeles, U.S.A., which is used as her residence. The annual value of the house is $20,000. The value of one USD ($) may be taken as ₹ 75.*

   She took ownership and possession of a flat in Chennai on 1.7.2025, which is used for self-occupation, while she is in India. The flat was used by her for 7 months only during the year ended 31.3.2026. The municipal valuation is ₹ 3,84,000 p.a. and the fair rent is ₹ 4,20,000 p.a. She paid the following to Corporation of Chennai:

Property Tax	*₹ 16,200*
Sewerage Tax	*₹ 1,800*

   She had taken a loan from Standard Chartered Bank in June, 2023 for purchasing this flat. Interest on loan was as under:

Particulars	***₹***
Period prior to 1.4.2025	*49,200*
1.4.2025 to 30.6.2025	*50,800*
1.7.2025 to 31.3.2026	*1,31,300*

She had a house property in Bangalore, which was sold in March, 2022. In respect of this house, she received arrears of rent of ₹ 60,000 in March, 2026. This amount has not been charged to tax earlier.

Compute the income chargeable from house property of Mrs. Rohini Ravi for the A.Y. 2026-27 if she has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

Would your answer change if she pays tax under the default tax regime under section 115BAC?

5. *Two brothers Arun and Bimal are co-owners of a house property with equal share. The property was constructed during the financial year 2017-2018. The property consists of eight identical units and is situated at Cochin.*

During the financial year 2025-26, each co-owner occupied one unit for residence and the balance of six units were let out at a rent of ₹ 12,000 per month per unit. The municipal value of the house property is ₹ 9,00,000 and the municipal taxes are 20% of municipal value, which were paid during the year. The other expenses were as follows:

		₹
(i)	*Repairs*	*40,000*
(ii)	*Insurance premium (paid)*	*15,000*
(iii)	*Interest payable on loan taken for construction of house*	*3,00,000*

One of the let out units remained vacant for four months during the year.

Arun could not occupy his unit for six months as he was transferred to Chennai. He does not own any other house.

The other income of Mr. Arun and Mr. Bimal are ₹ 2,90,000 and ₹ 1,80,000 respectively, for the financial year 2025-26.

Compute the income under the head 'Income from House Property' and the total income of two brothers for the A.Y. 2026-27 if they pay tax under the default tax regime under section 115BAC.

Also, show the computation of income under this head, if they both exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

6. *Mr. Roxx, a citizen of the Country Y, is a resident but not ordinarily resident in India during the financial year 2025-26. He owns two house properties in Country Y, one is used as his residence. Another house property is rented for a monthly rent of $ 18,000. Fair rent of the house property is $ 20,000. The value of one CYD ($) may be taken as ₹ 78.*

   He took ownership and possession of a flat in Delhi on 1.10.2025, which is used for self-occupation, while he is in India. The flat was used by him for 2 months at the time when he visited India during the previous year 2025-26. The municipal valuation is ₹ 4,58,000 p.a. and the fair rent is ₹ 3,60,000 p.a. He paid property tax of ₹ 13,800 and ₹ 2,800 as Sewerage tax to Municipal Corporation of Delhi.

   He had taken a loan of ₹ 18,00,000 @9.5% from HDFC Bank on 1st August, 2023 for purchasing this flat. No amount is repaid by him till 31.03.2026.

   He also had a house property in Bangalore which is let out on a monthly rent of ₹ 40,000. The fair rent of which is ₹ 4,58,000 p.a. and Municipal value of ₹ 25,00,000 @ 10% from one of his friends, residing in Country Y for this house. Municipal tax of ₹ 5,400 is paid by him in respect of this house during the previous year 2025-26.

   Compute the income chargeable from house property of Mr. Roxx for the A.Y.2026-27 if he has shifted out of the default tax regime.

7. *Mr. Roy owns a house in Kolkata. During the previous year 2025-26, 3/4th portion of the house was self-occupied and 1/4th portion was let out for residential purposes at a rent of ₹ 12,000 p.m. The tenant vacated the property on 28th February, 2026. The property was vacant during March, 2026. Rent for the months of January 2026 and February 2026 could not be realised in spite of the owner's efforts. All the conditions prescribed under Rule 4 are satisfied.*

   Municipal value of the property is ₹ 4,50,000 p.a., fair rent is ₹ 4,70,000 p.a. and standard rent is ₹ 5,00,000. He paid municipal taxes @10% of municipal value during the year. A loan of ₹ 30,00,000 was taken by him during the year 2018 for acquiring the property. Interest on loan paid during the previous year 2025-26 was ₹ 1,51,000. Compute Roy's income from house property for the A.Y. 2026-27 if he has shifted out of the default tax regime.

ANSWERS

1. Computation of income from house property of Mr. Raman for A.Y. 2026-27

Particulars	₹	₹
Gross Annual Value **(See Note 1 below)**		1,80,000
Less: Municipal taxes – paid by the tenant, hence not deductible		Nil
Net Annual Value (NAV)		1,80,000
Less: Deductions under section 24		
(i) 30% of NAV	54,000	
(ii) Interest on housing loan **(See Note 2 below)**		
- Interest on loan taken from bank	25,000	
- Interest on fresh loan to repay old loan for this property	5,000	84,000
Income from house property		**96,000**
50% share taxable in the hands of Mr. Raman **(See Note 3 below)**		**48,000**

Notes:

1. Computation of Gross Annual Value (GAV)

GAV is the higher of Expected rent and actual rent received. Expected rent is the higher of municipal value and fair rent, but restricted to standard rent.

Particulars	₹	₹	₹	₹
(a) Municipal value	1,60,000			
(b) Fair rent	1,50,000			
(c) Higher of (a) and (b)		1,60,000		
(d) Standard rent		1,70,000		
(e) Expected rent [lower of (c) and (d)]			1,60,000	
(f) Actual rent [₹ 15,000 x 12]			1,80,000	
(g) Gross Annual Value [higher of (e) and (f)]				1,80,000

2. Interest on housing loan is allowable as a deduction under section 24 on accrual basis. Further, interest on fresh loan taken to repay old loan is also allowable as deduction. However, interest on unpaid interest is not allowable as deduction under section 24.

3. Section 26 provides that where a house property is owned by two or more persons whose shares are definite and ascertainable, the share of each such person in the income of house property, as computed in accordance with sections 22 to 25, shall be included in his respective total income. Therefore, 50% of the total income from the house property is taxable in the hands of Mr. Raman since he is an equal owner of the property.

2. **Computation of Income from house property for A.Y. 2026-27**

	Particulars	₹	₹
(A)	**Rented unit (50% of total area – See Note below)**		
	Step I - Computation of Expected Rent		
	Municipal valuation (₹ 1,90,000 x ½)	95,000	
	Fair rent (₹ 1,85,000 x ½)	92,500	
	Standard rent (₹ 1,62,000 x ½)	81,000	
	Expected Rent is higher of municipal valuation and fair rent, but restricted to standard rent	81,000	
	Step II - Actual Rent		
	Rent received/receivable for the let out period (₹ 8,000 x 10)	80,000	
	Step III – Computation of Gross Annual Value		
	The actual rent of ₹ 80,000 is lower than ER of ₹ 81,000 owing to vacancy, since, had the property not been vacant the actual rent would have been ₹ 96,000 (₹ 80,000 + ₹ 16,000, being notional rent for two months. Therefore, actual rent is the GAV.	80,000	
	Gross Annual Value		**80,000**
	Less: Municipal taxes (5% of ₹ 95,000)		4,750
	Net Annual value		**75,250**

Less : Deductions under section 24 -		
(i) 30% of net annual value	22,575	
(ii) Interest on borrowed capital (₹ 750 x 12)	9,000	31,575
Taxable income from let out portion		**43,675**
(B) Self occupied unit (50% of total area – See Note below)		
Annual value	Nil	
Less : Deduction under section 24 -		
Interest on borrowed capital (₹ 750 x 12)	9,000	9,000
Loss from self occupied portion		**(9,000)**
Income from house property		**34,675**

Note: No deduction will be allowed separately for light and water charges, lease money paid, insurance charges and repairs.

3. **Computation of income from house property of Mr. Vikas for the A.Y. 2026-27**

Particulars	**₹**	**₹**
Income from house property		
I. Self-occupied portion (Two third)		
Net Annual value		Nil
Less: Deduction under section 24(b)		
Interest on loan **(See Note below)** (₹ 18,600 x 2/3) [Allowable since he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A)]		12,400
Loss from self occupied property		**(12,400)**
II. Let-out portion (One third)		
Gross Annual Value		
(a) Actual rent received (₹ 5,000 x 12) ₹ 60,000		
(b) Expected rent ₹ 36,000		
[higher of municipal valuation (i.e., ₹ 96,000) and fair rent (i.e., ₹ 1,26,000) but restricted to standard rent (i.e., ₹ 1,08,000)] = ₹ 1,08,000 x 1/3		

Higher of (a) or (b)	60,000	
Less: Municipal taxes (₹ 96,000 x 11% x 1/3)	3,520	
Net Annual Value	**56,480**	
Less: Deductions under section 24		
(a) 30% of NAV	16,944	
(b) Interest on loan **(See Note below)** (₹ 18,600 x 1/3)	6,200	**33,336**
Income from house property		**20,936**

Note: Interest on loan taken for construction of building

Interest for the year (1.4.2025 to 31.3.2026) = 12% of ₹ 1,00,000 = ₹ 12,000

Pre-construction period interest = 12% of ₹ 1,00,000 for 33 months (from 1.07.2018 to 31.3.2021) = ₹ 33,000

Pre-construction period interest to be allowed in 5 equal annual installments of ₹ 6,600 from the year of completion of construction i.e., from F.Y. 2021-22 till F.Y. 2025-26.

Therefore, total interest deduction under section 24 = ₹ 12,000 + ₹ 6,600 = ₹ 18,600.

4. (i) Since the assessee is a resident and ordinarily resident in India, her global income would form part of her total income i.e., income earned in India as well as outside India will form part of her total income.

She possesses a self-occupied house at Los Angeles as well as at Chennai. She can take the benefit of "Nil" Annual Value in respect of both the house properties.

As regards the Bangalore house, arrears of rent will be chargeable to tax as income from house property in the year of receipt under section 25A. It is not essential that the assessee should continue to be the owner. 30% of the arrears of rent shall be allowed as deduction.

Accordingly, the income from house property of Mrs. Rohini Ravi for A.Y.2026-27 will be calculated as under:

Particulars	₹	₹
1. Self-occupied house at Los Angeles		
Annual value		Nil
Less: Deduction under section 24		Nil
Chargeable income from this house property		**Nil**
2. Self-occupied house property at Chennai		
Annual value		Nil
Less: Deduction under section 24		
Interest on borrowed capital **(See Note below)**		1,91,940
		(1,91,940)
3. Arrears in respect of Bangalore property (Section 25A)		
Arrears of rent received	60,000	
Less: Deduction @ 30% u/s 25A(2)	18,000	42,000
Loss under the head "Income from house property"		**(1,49,940)**

Note: Interest on borrowed capital

Particulars	₹
Interest for the current year (₹ 50,800 + ₹ 1,31,300)	1,82,100
Add: 1/5th of pre-construction interest (₹ 49,200 x 1/5)	9,840
Interest deduction allowable under section 24	**1,91,940**

Interest deduction under section 24(b) is allowable since she has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

(ii) Yes, the answer would change if she pays tax under the default tax regime under section 115BAC. Under the default tax regime, deduction under section 24(b) for interest is not available. Hence, she cannot claim deduction of ₹ 1,91,940 in respect of the Chennai house. Accordingly, income from house property would be ₹ 42,000.

5. (i) If Arun and Bimal pay tax under the default tax regime under section 115BAC

Computation of total income for the A.Y. 2026-27

Particulars	Arun (₹)	Bimal(₹)
Income from house property		
I. Self-occupied portion (25%)		
Annual value	Nil	Nil
Less: Deduction under section 24(b)	Nil	Nil
Loss from self occupied property	Nil	Nil
II. Let-out portion (75%) – See Working Note below	1,25,850	1,25,850
Income from house property	1,25,850	1,25,850
Other Income	2,90,000	1,80,000
Total Income	**4,15,850**	**3,05,850**

Working Note

Computation of Income from Let-Out Portion of House Property

Particulars	₹	₹
Let-out portion (75%)		
Gross Annual Value		
(a) Municipal value (75% of ₹ 9 lakh)	6,75,000	
(b) Actual rent [(₹ 12000 x 6 x 12) – (₹ 12,000 x 1 x 4)] = ₹ 8,64,000 - ₹ 48,000	8,16,000	
- whichever is higher		8,16,000
Less: Municipal taxes 75% of ₹ 1,80,000 (20% of ₹ 9 lakh)		1,35,000
Net Annual Value (NAV)		6,81,000
Less: Deduction under section 24		
(a) 30% of NAV	2,04,300	
(b) Interest on loan taken for the house [75% of ₹ 3 lakh]	2,25,000	4,29,300
Income from let-out portion of house property		**2,51,700**
Share of each co-owner (50%)		**1,25,850**

(ii) If Arun and Bimal have exercised the option of shifting out of the default tax regime provided under section 115BAC(1A)

Computation of total income for the A.Y. 2026-27

Particulars	Arun (₹)	Bimal(₹)
Income from house property		
I. Self-occupied portion (25%)		
Annual value	Nil	Nil
Less: Deduction under section 24(b)		
Interest on loan taken for construction ₹ 37,500 (being 25% of ₹ 1.5 lakh) [Allowable since they have exercised the option of shifting out of the default tax regime provided under section 115BAC(1A)]	37,500	37,500
Loss from self occupied property	(37,500)	(37,500)
II. Let-out portion (75%) – See Working Note above	1,25,850	1,25,850
Income from house property	**88,350**	**88,350**
Other Income	2,90,000	1,80,000
Total Income	**3,78,350**	**2,68,350**

6. Since Mr. Roxx, is a resident but not ordinarily resident in India, only the income in respect of properties situated in India would be taxable in his hands.

Thus, the rental income which accrues or arises in Country Y from the let-out property and annual value of self-occupied property would not be taxable in his hands. However, income arising from properties in India are taxable in the hands of Mr. Roxx.

Accordingly, the income from house property of Mr. Roxx for A.Y.2026-27 will be calculated as under:

	Particulars	₹	₹
1.	**Self-occupied house at Delhi**		
	Annual value		Nil
	Less: Deduction under section 24	Nil	
	Interest on borrowed capital **(See Note below)**		2,00,000
	Chargeable income from this house property		**(2,00,000)**
2.	**Let out house property at Bangalore**		
	Expected rent, being higher of ₹ 3,58,000 municipal value and fair rent of ₹ 4,58,000 but restricted to Standard rent of ₹ 4,20,000	4,20,000	
	Actual rent [₹ 40,000 x 12]	4,80,000	
	Gross Annual Value, being higher of expected rent and actual rent		4,80,000
	Less: Municipal taxes		5,400
	Net Annual Value		4,74,600
	Less: Deduction under section 24		
	- 30% of net annual value [30% x ₹ 4,74,600]	1,42,380	
	- Interest on borrowed capital (actual allowable as deduction without any ceiling limit)	2,50,000	3,92,380
			82,220
	Loss under the head "Income from house property" (₹ 2,00,000 - ₹ 82,220)		**(1,17,780)**

Note: Interest on borrowed capital

Particulars		₹
Interest for the current year [18,00,000 x 9.5%]		1,71,000
Add: 1/5th of pre-construction interest (₹ 2,85,000 x 1/5)		57,000
1.8.2023 to 31.03.2024 – (₹ 18,00,000 x 9.5% x 8/12)	1,14,000	
1.4.2024 to 31.03.2025 – (₹ 18,00,000 x 9.5%)	1,71,000	
		2,28,000
Interest deduction allowable under section 24, restricted to		**2,00,000**

7. There are two units of the house. Unit I with 3/4th area is used by Mr. Roy for self-occupation throughout the year and no benefit is derived from that unit, hence, it will be treated as self-occupied and its annual value will be nil. Unit 2 with 1/4th area is let-out during the previous year and its annual value has to be determined as per section 23(1).

Computation of Income from house property of Mr. Roy for the A.Y. 2026-27

Particulars	₹	
Unit I (3/4th area – self-occupied)		
Annual Value		Nil
Less: Deduction under section 24(b) 3/4th of ₹ 1,51,000		1,13,250
Income from Unit I (self-occupied)		**(1,13,250)**
Unit II (1/4th area – let out)		
Computation of GAV		
Step 1 – Computation of Expected Rent (ER)		
ER = Higher of municipal value (MV) and fair rent (FR), but restricted to standard rent (SR).	1,17,500	
However, in this case, standard rent of ₹ 1,25,000 (1/4th of ₹ 5,00,000) is more than the higher of MV of ₹ 1,12,500 (1/4th of ₹ 4,50,000) and FR of ₹ 1,17,500 (1/4th of ₹ 4,70,000). Hence the higher of MV and FR is the ER. In this case, it is the fair rent.		
Step 2 – Computation of actual rent received/ receivable		
₹ 12,000 × 9 = 1,08,000	1,08,000	
[The property was let-out for 11 months. However, rent for 2 months i.e., January and February, 2026 could not be realized. Actual rent should not include any amount of rent which is not capable of being realized. Therefore, actual rent has been computed for 9 months]		

Step 3 – Computation of GAV		
The actual rent of ₹ 1,08,000 is lower than expected rent of ₹ 1,17,500 owing to vacancy, since had the property not been vacant in March 2026, the actual rent would have been ₹ 1,20,000 (i.e. ₹ 1,08,000 + ₹ 12,000), which is higher than the ER of ₹ 1,17,500. Therefore, actual rent is the GAV.	1,08,000	
Gross Annual Value (GAV)		**1,08,000**
Less: Municipal taxes paid by the owner during the previous year relating to let-out portion 1/4th of (10% of ₹ 4,50,000) =₹ 45,000/4 = ₹ 11,250		11,250
Net Annual Value (NAV)		**96,750**
Less: Deductions under section 24		
(a) 30% of NAV = 30% of ₹ 96,750	29,025	
(b) Interest paid on borrowed capital (relating to let out portion) [1/4th of ₹ 1,51,000]	37,750	66,775
Income from Unit II (let-out)		**29,975**
Loss under the head "Income from house property" (-₹ 1,13,250 + ₹ 29,975)		**-83,275**

Note *– Alternatively, as per income-tax returns, unrealized rent can be deducted from GAV. In such a case, GAV would be ₹ 1,32,000, being higher of expected rent of ₹ 1,17,500 and actual rent of ₹ 1,32,000. Thereafter, unrealized rent of ₹ 24,000 and municipal taxes of ₹ 11,250 would be deducted from GAV of ₹ 1,32,000 to arrive at the NAV of ₹ 96,750.*

UNIT – 3: PROFITS AND GAINS OF BUSINESS OR PROFESSION

LEARNING OUTCOMES

After studying this unit, you would be able to-

- **comprehend** the meaning of "business" and "profession" and the scope of income chargeable to tax under this head;
- **comprehend** the meaning of speculative transaction and the tax treatment of loss incurred in speculation business;
- **identify** the expenditures/payments which are admissible as deduction, **comprehend** the conditions to be satisfied to avail such deductions, the limits, if any, specified in respect thereof;
- **compute** the deductions available while computing business income applying the relevant provisions under default tax regime under section 115BAC;
- **compute** the deductions available while computing business income applying the relevant provisions under normal provisions of the Act;
- **identify** the expenditures/payments which are not admissible as deduction;
- **identify** the deductions allowable only on actual payment;
- **examine** when certain receipts are deemed to be income chargeable to tax under this head;
- **identify** the assessees who are required to compulsorily maintain books of account and get them audited;
- **apply** the presumptive tax provisions under the Act to compute income from eligible business or profession;
- **compute** the business income by applying the charging and deeming provisions and allowing permissible deductions;
- **compute** the business income in cases where income is partly agricultural and partly business in nature.

Proforma for computation of income under the head "Profits and gains of business or profession" under default tax regime under section 115BAC

Particulars	Amount (₹)	Amount (₹)
Net profit as per statement of profit and loss		A
Add: **Expenses debited to statement of profit and loss but not allowable**		
• Depreciation as per books of account	xxx	
• Income-tax [disallowed u/s 40(a)(ii)]	xxx	
• 30% of sum payable to residents on which tax is not deducted at source or has not been remitted on or before the due date u/s 139(1), after deduction, disallowed under section 40(a)(ia) [The same is allowable in the year in which the tax is deducted and remitted]	xxx	
• Any expenditure incurred, in respect of which payment is made for goods, services or facilities to a related person, to the extent the same is excessive or unreasonable, in the opinion of the A.O, having regard to its FMV [disallowed u/s 40A(2)]	xxx	
• Any expenditure incurred in respect of which payment or aggregate of payments to a person exceeding ₹ 10,000 in a single day is made otherwise than by way of A/c payee cheque/bank draft/ use of ECS through bank A/c or through such other prescribed electronic mode (debit card, credit card, Net banking, RTGS, NEFT, IMPS, BHIM Aadhar Pay) [disallowed u/s 40A(3)]	xxx	
• Certain sums payable by the assessee which have not been paid during the relevant P.Y. in which the liability was incurred on or before the due date for filing return u/s 139(1) in respect of that P.Y. [disallowed u/s 43B]	xxx	
• Sum payable by the assessee to a micro or small enterprise beyond the time limit specified in section 15 of MSME Development Act, 2006 [disallowed u/s 43B]	xxx	
• Personal expenses [not allowable as per section 37]	xxx	

	• Capital expenditure [not allowable as per section 37]	xxx	
	• Repairs of capital nature [not allowable as per Sections 30 & 31]	xxx	
	• Amortization of preliminary expenditure u/s 35D/ expenditure incurred under voluntary retirement scheme u/s 35DDA [4/5th of such expenditure to be added back]	xxx	
	• Family planning expenses not allowable in the case of a person other than a company	xxx	
	• Fine or penalty paid for infringement or breach of law [However, penalty in the nature of damages for delay in completion of a contract, being compensatory in nature, is allowable]	xxx	
	• All expenses related to income which is not taxable under this head e.g. municipal taxes in respect of residential house property	xxx	
	• Any sum paid by the assessee as an employer by way of contribution to pension scheme u/s 80CCD exceeding 14% of the salary of the employee	xxx	**B**
	(A + B)		**C**
Less:	**Expenditure allowable as deduction but not debited to statement of profit and loss**		
	• Depreciation computed as per Rule 5 of Income-tax Rules, 1962	xxx	
	• 30% of expenditure disallowed in an earlier P.Y. due to non-deduction of tax at source/ non-remittance before due date u/s 139(1) of that year, allowed this year on remittance (This item of adjustment is generally given under "Additional information" in the question)	xxx	
	• Amount disallowed in an earlier P.Y. as per section 43B, due to non-payment on or before due date u/s 139(1), allowed as deduction in this year on actual payment (This item of adjustment is generally given under "Additional information" in the question)	xxx	**D**
	(C - D)		**E**

Less:	**Income credited in statement of profit and loss but not taxable/taxable under any other head**		
	• Dividend income	xxx	
	• Agricultural income exempt under section 10(1)	xxx	
	• Interest on securities/savings bank account/FD taxable under the head "Income from other sources"	xxx	
	• Profit on sale of capital asset taxable under the head "Capital Gains"	xxx	
	• Rent from house property taxable under the head "Income from house property"	xxx	
	• Winnings from lotteries, horse races, games etc. taxable under the head "Income from other sources"	xxx	
	• Gifts exempt or taxable under the head "Income from other sources"	xxx	
	• Income-tax refund not taxable	xxx	
	• Interest on income-tax refund taxable under the head "Income from other sources"	xxx	**F**
	(E - F)		**G**
Add:	**Income chargeable under this head/Deemed Income [If the same is given as additional information and has not already been credited to Statement of Profit & Loss]**		
	• Salary, remuneration, interest received by a partner from the firm, to the extent the same is deductible in the hands of the firm as per section 40(b)	xxx	
	• Bad debt allowed as deduction u/s 36(1)(vii) in an earlier P.Y., now recovered [deemed as income u/s 41(4)]	xxx	
	• Remission or cessation of a trading liability [deemed as income u/s 41(1)]	xxx	**H**
Profits and gains from business or profession (G + H)			**I**

Proforma for computation of income under the head "Profits and gains of business or profession" under optional tax regime taking business income computed under default tax regime under section 115BAC as the starting point

Particulars	Amount (₹)	Amount (₹)
Profits and gains from business or profession as per section 115BAC		**A**
Less: **Expenditure allowable as deduction**		
• Additional depreciation@20% of actual cost of new P & M acquired by an assessee engaged in the business of manufacture or production of any article or thing or generation, transmission or distribution of power (10% of actual cost, if put to use for less than 180 days in the year of acquisition) [Balance additional depreciation can be claimed in the next year i.e., P.Y.2026-27]	xxx	
• Balance additional depreciation @10% of actual cost of P & M acquired and installed during the P.Y. 2024-25 and put to use for less than 180 days in that year	xxx	**B**
Profits and gains from business or profession as per normal provisions of the Act (A – B)		**C**

Note - An assessee carrying on specified business and exercising the option to shift out of the default tax regime provided under section 115BAC(1A), is eligible for deduction u/s 35AD in respect of capital expenditure (other than land, goodwill and financial instruments) incurred for such business, subject to fulfillment of specified conditions. However, if he pays tax under default tax regime under section 115BAC, he would **not** be eligible for deduction u/s 35AD.

The table in the next page depicts the allowability of deduction for expenditure incurred for in-house scientific research related to the business of the assessee and contribution to outsiders for scientific research/social science/statistical research under the default tax regime and optional tax regime.

Deduction for expenditure incurred for in-house scientific research related to business and contribution to outsiders for scientific research/social science/statistical research

Nature of Expenditure/ contribution for scientific research/social science/ statistical research		Under the default tax regime u/s 115BAC			Under the optional tax regime as per the normal provisions of the Act		
		Allowability of deduction	Treatment while computing income under the head "PGBP"		Allowability of deduction	Treatment while computing income under the head "PGBP"	
			If debited to Profit & Loss A/c	If given as additional information		If debited to Profit & Loss A/c	If given as additional information
I. In house research expenditure on scientific research related to assessee's business							
35(1)(i)	Revenue expenditure	Allowable as deduction	No adjustment required, since it is already debited to profit and loss A/c	To be deducted while computing income under the head "PGBP"	Allowable as deduction	No adjustment required, since it is already debited to profit and loss A/c	To be deducted while computing income under the head "PGBP"
35(1)(iv) r.w.s. 35(2)	Any capital expenditure (other than cost of acquisition of land)						

Nature of Expenditure/ contribution for scientific research/social science/ statistical research		Under the default tax regime u/s 115BAC			Under the optional tax regime as per the normal provisions of the Act		
		Allowability of deduction	Treatment while computing income under the head "PGBP"		Allowability of deduction	Treatment while computing income under the head "PGBP"	
			If debited to Profit & Loss A/c	If given as additional information		If debited to Profit & Loss A/c	If given as additional information
II.	**Contribution to outsiders**						
35(1)(ii)	Notified approved research association/university/ college/other institution for scientific research	Not allowable as deduction	To be added back while computing income under the head "PGBP"	No adjustment required	Allowable as deduction	No adjustment required, since it is already debited to profit and loss A/c	To be deducted while computing income under the head "PGBP"
35(1)(iia)	Approved notified Company for scientific research						
35(1)(iii)	Notified approved research association/university/ college/other institution for research in social science or statistical research						
35(2AA)	Approved National Laboratory/ University/ IIT/specified person to be used for scientific research undertaken under an approved programme						

3.1 MEANING OF 'BUSINESS' AND 'PROFESSION'

The tax payable by an assessee on his income under this head is in respect of the profits and gains of **any business or profession**, carried on by him or on his behalf during the previous year.

Business	Profession
The term **"business"** has been defined in section 2(13) to "include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture".	The term **"profession"** has not been defined in the Act. It means an occupation requiring some degree of learning. The term 'profession' includes vocation as well [Section 2(36)].

- *A painter, a sculptor, an author, an auditor, a lawyer, a doctor, an architect and even an astrologer are persons who can be said to be carrying on a profession but not business.*
- *It is, however, not material whether a person is carrying on a 'business' or 'profession' or 'vocation' since for purposes of assessment, profits from all these sources are treated and taxed alike (except in case of tax audit and presumptive income provisions, where the rates and threshold limits are different for business and profession).*
- *Business necessarily means a continuous exercise of an activity with a profit motive; nevertheless, profit from a single venture in the nature of trade may also be treated as business.*

Meaning of 'Profits'

(i) **Profits in cash or in kind:** Profits may be realised in money or in money's worth, i.e., in cash or in kind. Where profit is realised in any form other than cash, the cash equivalent of the receipt on the date of receipt must be taken as the value of the income received in kind.

(ii) **Capital receipts:** Capital receipts are not generally to be taken into account while computing profits under this head.

(iii) **Voluntary receipts:** Payment voluntarily made by persons who were under no obligation to pay anything at all would be income in the hands of the recipient, if they were received in the course of a business or by the exercise of a profession or vocation. Thus, any amount paid to a lawyer by a person who was not a client, but who has been benefited by the lawyer's professional service to another would be assessable as the lawyer's income.

(iv) **Application of the gains of trade is immaterial:** Gains made even for the benefit of the community by a public body would be liable to tax. To attract the provisions of section 28, it is necessary that the business, profession or vocation should be carried on at least for some time during the accounting year but not necessarily throughout that year and not necessarily by the assessee-owner personally, but it should be under his direction and control.

(v) **Income from distinct businesses:** The profits of each distinct business must be computed separately but the tax chargeable under this section is not on the separate income of every distinct business but on the aggregate profits of all the businesses carried on by the assessee.

(vi) **Computation of profits:** Profits should be computed after deducting the losses and expenses incurred for earning the income in the regular course of the business, profession, or vocation unless the loss or expenses is expressly or by necessary implication, disallowed by the Act. The charge is not on the gross receipts but on the profits and gains.

(vii) **Legality of income:** The illegality of a business, profession or vocation does not exempt its profits from tax. The revenue is not concerned with the taint of illegality in the income or its source. Thus, income tax is not restricted in its application to lawful business only.

However, expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law would not be allowable as deduction while computing profits of such business.

3.2 METHOD OF ACCOUNTING

Under section 145(1), income chargeable under the heads "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee.

However, as per section 145B, certain income would be taxable in the following manner:

(i) interest received by an assessee on compensation or on enhanced compensation, shall be deemed to be the income of the year in which it is received [Such income is taxable under the head "Income from other sources"]

(ii) income referred to in section 2(24)(xviii) i.e., assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement, by whatever name called, by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee shall be deemed to be the income of the previous year in which it is received, if not charged to income tax for any earlier previous year.

Under section 145(2), the Central Government is empowered to notify in the Official Gazette from time to time, income computation and disclosure standards (ICDSs) to be followed by any class of assessees or in respect of any class of income.

Accordingly, the Central Government has, vide Notification No. S.O.3079(E) dated 29.9.2016, notified ten ICDSs to be applicable from A.Y.2017-18.

The notified ICDSs have to be followed by all assessees (other than an individual or a Hindu undivided family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB) following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profits and gains of business or profession" or "Income from other sources".

The ten notified ICDSs are:

ICDS I	:	Accounting Policies
ICDS II	:	Valuation of Inventories
ICDS III	:	Construction Contracts
ICDS IV	:	Revenue Recognition
ICDS V	:	Tangible Fixed Assets
ICDS VI	:	The Effects of Changes in Foreign Exchange Rates
ICDS VII	:	Government Grants
ICDS VIII	:	Securities
ICDS IX	:	Borrowing Costs
ICDS X	:	Provisions, Contingent Liabilities and Contingent Assets

Note: ICDSs would be dealt with in detail at Final Level.

3.3 INCOME CHARGEABLE UNDER THIS HEAD [SECTION 28]

The various items of income chargeable to tax as income under the head 'profits and gains of business or profession' are as under:

(i) Income from business or profession: Income arising to any person by way of profits and gains from the business or profession carried on by him at any time during the previous year.

If an assessee is engaged in the business of letting out of residential houses, the income generated from letting out of a residential house or a part of the house by the owner shall not be chargeable under the head "Profits and gains of business or profession" and would be chargeable under the head "Income from house property".

(ii) Any compensation or other payment due to or received by:

(a) any person, by whatever name called, managing the whole or substantially the whole of -

(i) the affairs of an Indian company or

(ii) the affairs in India of any other company

at or in connection with the termination of his management or office or the modification of any of the terms and conditions relating thereto;

(b) any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of any of the terms and conditions relating thereto;

(c) any person, for or in connection with the vesting in the Government or in any corporation owned or controlled by the Government under any law for the time being in force, of the management of any property or business;

(d) any person, by whatever name called, at or in connection with the termination or modification of the terms and conditions, of any contract relating to his business.

(iii) Income from specific services performed for its members by a trade, professional or business: Income derived by any trade, professional or similar associations from specific services rendered by them to their members. It may be noted that this forms an exception to the general principle governing the assessment of income of mutual associations such as chambers of commerce, stockbrokers' associations etc.

As a result, a trade, professional or similar association performing specific services for its members is to be deemed as carrying on business in respect of these services and on that assumption the income arising therefrom is to be subjected to tax. For this purpose, it is not necessary that the income received by the association should definitely or directly be related to these services.

(iv) Incentives received or receivable by assessee carrying on export business:

(a) Profit on sale of import entitlements: Profits on sale of a licence granted under the Imports (Control) Order, 1955[1] made under the Imports and Exports (Control) Act, 1947[2].

(b) Cash assistance against exports under any scheme of GoI: Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India.

(c) Customs duty or excise re-paid or repayable as drawback: Any Customs duty or Excise duty drawback repaid or repayable to any person against export under the Customs and Central Excise Duties Drawback Rules, 1971[3].

(d) Profit on transfer of Duty Entitlement Pass Book Scheme or Duty Free Replenishment Certificate: Any profit on the transfer of the Duty Entitlement Pass Book Scheme[4] or Duty Free Replenishment Certificate, being Duty Remission Scheme, under the export and

[1] Now Foreign Trade (Exemption from application of Rules in certain cases) Order, 1993

[2] Now Foreign Trade (Development and Regulation) Act, 1992

[3] Now Customs and Central Excise Duties Drawback Rules, 2017

[4] The pre-export DEPB scheme was abolished with effect from 1 April 2000. After several extensions through the years, the post-export scheme was phased out on 30 September 2011 and thereafter DEPB items were incorporated into the Duty Drawback Schedule with effect from 1 October 2011

import policy formulated and announced under section 5 of the Foreign Trade (Development and Regulation) Act, 1992.

(v) **Value of any benefit or perquisite:** The value of any benefit or perquisite arising from business or the exercise of any profession, whether –

- convertible into money or not or
- in cash or in kind or partly in cash and partly in kind.

Example:

If a company provides rent free residential accommodation to a lawyer in consideration of professional services rendered by him to the company, the value of such accommodation would be assessable in the hands of the said lawyer as his income under the head "Profits and gains or business or profession".

(vi) **Sum due to, or received by, a partner of a firm:** Any interest, salary, bonus, commission or remuneration, by whatever name called, due to or received by a partner of a firm from such firm will be deemed to be income from business. However, where any interest, salary, bonus, commission or remuneration by whatever name called, or any part thereof has not been allowed to be deducted under section 40(b), in the computation of the income of the firm the income to be taxed shall be adjusted to the extent of the amount disallowed.

Example:

A firm pays interest to a partner at 20% simple interest p.a. The allowable rate of interest is 12% p.a. Hence, the excess 8% paid will be disallowed in the hands of the firm. Since excess interest has suffered tax in the hands of the firm, the same will not be taxed in the hands of the partner.

Exemption of share income of a partner [Section 10(2A)]

Section 10(2A) exempts from tax a partner's share in the total income of the firm. In other words, the partner's share in the total income of the firm determined in accordance with the profit-sharing ratio will be exempt from tax.

(vii) **Any sum whether received or receivable, in cash or kind, under an agreement:**

(a) for not carrying out any activity in relation to any business or profession; or

However, the following sums received or receivable would not be chargeable to tax under the head "profits and gains from business or profession":

(i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business or profession, which is chargeable under the head "Capital gains".

(ii) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

(b) for not sharing any know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.

(viii) Any sum received under a Keyman insurance policy: Any sum received by the assessee, as an employer, under a Keyman insurance policy including the sum allocated by way of bonus on such policy will be taxable as income from business.

(ix) Fair market value of inventory on its conversion/treatment as capital asset: Fair market value of inventory on the date of its conversion or treatment as capital asset, determined in the prescribed manner, would be chargeable to tax as business income.

(x) Sum received on account of capital asset referred under section 35AD: Any sum received or receivable, in cash or kind, on account of any capital asset (in respect of which whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD) being demolished, destroyed, discarded or transferred.

3.4 SPECULATION BUSINESS

Explanation 2 to section 28 specifically provides that where an assessee carries on speculation business, that business of the assessee must be deemed as distinct and separate from any other business. This becomes necessary because section 73 provides that losses in speculation business unlike other business cannot be set-off against the profits of any business other than a speculation business.

Likewise, a loss in speculation business carried forward to a subsequent year can be set-off only against the profit and gains of any speculation business in the subsequent year. Profits and losses resulting from speculative transaction must, therefore, be treated as separate and distinct from profits and gains of business and profession from any other business.

Meaning of Speculative Transaction

"Speculative transaction" means a transaction in which a contract for the purchase or sales of any commodity including stocks and shares is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips [Section 43(5)].

Where any part of the business of a company consists in the purchase and sale of the shares of other companies, such a company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares.

However, this deeming provision does **not** apply to the following companies –

(1) A company whose gross total income consists of mainly income chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources";

(2) A company, the principal business of which is –

    (i) the business of trading in shares; or

    (ii) the business of banking; or

    (iii) the granting of loans and advances.

Accordingly, if these companies carry on the business of purchase and sale of shares of other companies, they would not be deemed to be carrying on speculation business. [*Explanation* to section 73]

Transactions not deemed to be speculative transactions

The following forms of transactions shall not be deemed to be speculative transaction:

(i) **Hedging contract in respect of raw materials or merchandise:** A contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchandising business to guard against loss through future price fluctuations in respect of his contracts for the actual delivery of goods manufactured by him or merchandise sold by him; or

(ii) **Hedging contract in respect of stocks and shares:** A contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuation; or

(iii) **Forward contract:** A contract entered into by a member of a forward market or stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against any loss which may arise in the ordinary course of his business as a member; or

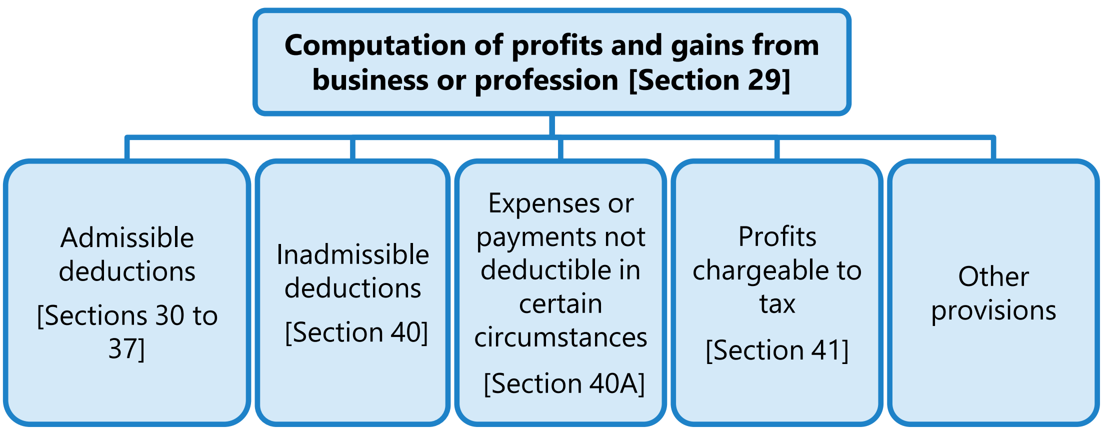
(iv) **Trading in derivatives:** An eligible transaction (transaction carried out electronically through SEBI registered stockbroker or sub broker or intermediary) carried out in respect of trading in derivatives in a recognized stock exchange.

(v) **Trading in commodity derivatives:** An eligible transaction (transaction carried out electronically through a member or intermediary registered under the bye-laws, rules and regulations of the recognized stock exchange) in respect of trading in commodity derivatives carried out in a recognised stock exchange, which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013.

However, the requirement of chargeability of commodities transaction tax is **not** applicable in respect of trading in agricultural commodity derivatives.

3.5 COMPUTATION OF PROFITS AND GAINS FROM BUSINESS OR PROFESSION [SECTION 29]

According to section 29, the profits and gains of any business or profession are to be computed in accordance with the provisions contained in sections 30 to 43D. It must, however, be remembered that in addition to the specific allowances and deductions stated in sections 30 to 36, the Act further permits allowance of items of expenses under the residuary section 37(1), which extends the allowance to items of business expenditure not covered by sections 30 to 36, where these are allowable according to accepted commercial practices.



3.6 ADMISSIBLE DEDUCTIONS [SECTIONS 30 TO 37]

(i) Rent, rates, taxes, repairs and insurance for buildings [Section 30]

Section 30 allows deduction in respect of the rent, rates, taxes, repairs and insurance of buildings used by the assessee for the purposes of his business or profession.

- **Where the premises are occupied by the assessee as a tenant,** the rent paid for such premises and the amount paid on account of cost of repairs, if the assessee has undertaken to bear such repairs to the premises.

- **Occupation of premises by the assessee being the owner:** Where the assessee himself is owner of the premises and occupies them for his business purposes, no notional rent would be allowed under this section. However, where a firm runs its business in the premises owned by one of its partners, the rent payable to the partner will be an allowable deduction to the extent it is reasonable and is not excessive.

- **Repairs of the premises:** Apart from rent, this section allows deductions in respect of expenses incurred on account of repairs to building in case where

    - ♦ the assessee is the owner of the building or
    - ♦ the assessee is a tenant who has undertaken to bear the cost of repairs to the premises.
    - ♦ Even if the assessee occupies the premises otherwise than as a tenant or owner, i.e., as a lessee, licensee or mortgagee with possession, he is entitled to a deduction under the section in respect of current repairs to the premises.

- **Cost of repairs and current repairs of capital nature not to be allowed as deduction [*Explanation* to section 30]:** Amount paid on account of the cost of repairs to the premises occupied by the assessee as a tenant and the amount paid on account of current repairs to the premises occupied by the assessee, otherwise than as a tenant, shall not include any capital nature expenditure. In other words, cost of repairs and current repairs other than of capital nature is allowed as deduction while computing business income.

- **Other expenses:** In addition, deductions are allowed in respect of expenses by way of land revenue, local rates, municipal taxes and insurance in respect of the premises used for the purposes of the business or profession. Cesses, rates and taxes levied by a foreign Government are also allowed.

- **Premises used partly for business and partly for other purposes:** Where the premises are used partly for business and partly for other purposes, only a proportionate part of the expenses attributable to that part of the premises used for purposes of business will be allowed as a deduction [Section 38(1)].

(ii) Repairs and insurance of machinery, plant and furniture [Section 31]

Section 31 allows deduction in respect of the expenses on current repairs and insurance of machinery, plant and furniture in computing the income from business or profession.

- **Usage of the asset for business:** In order to claim this deduction, the assets must have been used for purposes of the assessee's own business, the profits of which are being taxed.

  The word 'used' has to be read in a wide sense so as to include active as well as passive use. However, insurance and repair charges of assets which are owned by the assessee but have not been used for the business during the previous year would not be allowed as a deduction.

  Even if an asset is used for a part of the previous year, the assessee is entitled to the deduction of the full amount of expenses on repair and insurance charges and not merely an amount proportionate to the period of use.

- **Repairs exclude replacement or reconstruction:** The term 'repairs' will include renewal or renovation of an asset but not its replacement or reconstruction.

  The deduction allowable under this section is only of current repairs but not arrears of repairs for earlier years even though they may still rank for a deduction under section 37(1).

- **Insurance premium:** The deduction allowable in respect of premia paid for insuring the machinery, plant or furniture is subject to the following conditions:

  ✓ The insurance must be against the risk of damage or destruction of the machinery, plant or furniture.

  ✓ The assets must be used by the assessee for the purposes of his business or profession during the accounting year.

  ✓ The premium should have been actually paid (or payable under the mercantile system of accounting).

  The premium may even take the form of contribution to a trade association which undertakes to indemnify and insure its members against loss; such premium or contribution would be deductible as an allowance under this section even if a part of it is returnable to the insured in certain circumstances.

It does not matter if the payment of the claim will endure to the benefit of someone other than the owner.

- **Current repairs of capital nature not to be allowed [*Explanation* to section 31]:** Amount paid on account of current repairs of machinery, plant or furniture shall not include any capital nature expenditure. In other words, current repairs other than of capital nature expenditure is allowed as deduction in the computation of income under the head "profits and gains of business or profession".

(iii) Depreciation [Section 32]

(1) ***Charge of depreciation mandatory:*** Section 32 allows a deduction in respect of depreciation resulting from the diminution or exhaustion in the value of certain capital assets.

Explanation 5 to this section provides that deduction on account of depreciation shall be made compulsorily, whether or not the assessee has claimed the deduction in computing his total income.

(2) ***Conditions to be satisfied for allowance of depreciation:*** The allowance of depreciation which is regulated by Rule 5 of the Income-tax Rules, 1962, is subject to the following conditions which are cumulative in their application.

(a) The assets in respect of which depreciation is claimed must belong to either of the following categories, namely -

(i) buildings, machinery, plant or furniture, being tangible assets;

(ii) know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after 1st April, 1998, not being goodwill of a business or profession.

✓ The depreciation in the value of any other capital assets cannot be claimed as a deduction from the business income.

✓ No depreciation is allowable on the cost of the land on which the building is erected because the term 'building' refers only to superstructure but not the land on which it has been erected.

- ✓ The term 'plant' as defined in section 43(3) includes ships, books, vehicles, scientific apparatus and surgical equipment used for the purposes of the business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.
- ✓ The word 'plant' does not include an animal, human body or stock-in-trade. Thus, plant includes all goods and chattels, fixed or movable, which a businessman keeps for employment in his business with some degree of durability.
- ✓ The expression 'plant' includes part of a plant (e.g., the engine of a vehicle); machinery includes part of machinery and building includes a part of the building.
- ✓ Similarly, the term 'buildings' includes within its scope roads, bridges, culverts, wells and tubewells.

(b) The assets should be actually used by the assessee for purposes of his business during the previous year - The asset must be put to use at any time during the previous year. The amount of depreciation allowance is not proportionate to the period of use during the previous year.

Asset used for less than 180 days - It has been provided that where any asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, depreciation shall be allowed **at 50%** of the allowable depreciation according to the percentage prescribed in respect of the block of assets comprising such asset. It is significant to note that this restriction applies only to the year of acquisition and not for subsequent years.

If the assets are not used exclusively for the business or profession of the assessee but for other purposes as well, the depreciation allowable would be a proportionate part of the depreciation allowance to which the assessee would be otherwise entitled. This is provided in section 38.

Depreciation would be allowable to the owner even in respect of assets which are actually utilized by another person e.g., a lessee or licensee. The deduction on account of depreciation would be allowed under this section to the owner who has let on hire his building, machinery, plant or furniture provided that letting out of such assets is the business of the assessee. In other cases where the letting out of such assets does not constitute the business of the assessee, the deduction on account of depreciation would still be allowable under section 57(ii).

Use includes passive use in certain circumstances: One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". Courts have held that, in certain circumstances, an asset can be said to be in use even when it is "kept ready for use".

For example, stand by equipment and fire extinguishers can be capitalized if they are "ready for use''.

Likewise, machinery spares which can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, has to be capitalised. Hence, in such cases, the term "use" embraces both active use and passive use. However, such passive use should also be for business purposes.

(c) **The assessee must own the assets, wholly or partly -** In the case of buildings, the assessee must own the superstructure and not necessarily the land on which the building is constructed. In such cases, the assessee should be a lessee of the land on which the building stands and the lease deed must provide that the building will belong to the lessor of the land upon the expiry of the period of lease. Thus, no depreciation will be allowed to an assessee in respect of an asset which he does not own but only uses or hires for purposes of his business.

In this connection, students may note that Explanation 1 to section 32 provides that where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy, and any capital expenditure is incurred by the assessee for *the purposes of the business or profession or the construction of any structure or doing of any work by way of renovation, extension or improvement to the building, then depreciation will be allowed as if the said structure or work is a building owned by the assessee.*

Depreciation is allowable not only in respect of assets "wholly" owned by the assessee but also in respect of assets "partly" owned by him and used for the purposes of his business or profession.

(3) Computation of Depreciation Allowance - Depreciation allowance will be calculated on the following basis:

(i) Power generation undertakings: In the case of assets of an undertaking engaged in generation or generation and distribution of power, such percentage on the actual cost to the assessee as prescribed by Rule 5(1A).

Rule 5(1A) - As per this rule, the depreciation on the abovementioned assets shall be calculated at the percentage of the actual cost at rates specified in Appendix IA of these rules. However, the aggregate depreciation allowed in respect of any asset for different assessment years shall not exceed the actual cost of the asset. It is further provided that such an undertaking as mentioned above has the option of being allowed depreciation on the written down value of such block of assets as are used for its business at rates specified in Appendix I to these rules.

However, such option must be exercised before the due date for furnishing return under section 139(1) for the assessment year relevant to the previous year in which it begins to generate power. It is further provided that any such option once exercised shall be final and shall apply to all subsequent assessment years.

(ii) Block of assets: In the case of any block of assets, at such percentage of the written down value of the block, as may be prescribed by Rule 5(1).

Block of Assets: A "block of assets" is defined in section 2(11), as a group of assets falling within a class of assets comprising -

(a) tangible assets, being buildings, machinery, plant or furniture;

(b) intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, not being goodwill of a business or profession, in respect of which the same percentage of depreciation is prescribed.

Know-how - In this context, 'know-how' means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil-well or other sources of mineral deposits (including searching for discovery or testing of deposits for the winning of access thereto).

(iii) Additional depreciation on Plant or Machinery acquired: In case of an assessee exercising the option of shifting out of the default tax regime provided under section 115BAC(1A) and paying tax as per the optional tax regime under the regular provisions of the Act, additional depreciation is allowed on any new machinery or plant (other than ships and aircraft) acquired and installed by an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation, transmission or distribution of power at the rate of **20%** of the actual cost of such machinery or plant.

Asset put to use for less than 180 days: Additional depreciation **@10%** (i.e., 50% of additional depreciation of 20%) to be allowed, where the plant or machinery is put to use for less than 180 days during the previous year in which such asset is acquired.

Further, the balance additional depreciation@10% (i.e., remaining 50% of the additional depreciation of 20%) on new plant or machinery acquired and used for less than 180 days, which has not been allowed in the year of acquisition and installation of such plant or machinery, shall be allowed in the immediately succeeding previous year if the assessee exercises the option of shifting out of the default tax regime provided u/s 115BAC(1A) in the immediately succeeding previous year.

Plant and Machinery not qualifying for additional depreciation

Such additional depreciation will not be available in respect of:

(i) any machinery or plant which, before its installation by the assessee, was used within or outside India by any other person; or

(ii) any machinery or plant installed in office premises, residential accommodation, or in any guest house; or

(iii) office appliances or road transport vehicles; or

(iv) any machinery or plant, the whole or part 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.

Eligibility for grant of additional depreciation under section 32(1)(iia) in the case of an assessee engaged in printing or printing and publishing [Circular No. 15/2016, dated 19-5-2016]

An assessee, engaged in the business of manufacture or production of an article or thing, is eligible to claim additional depreciation under section 32(1)(iia) in addition to the normal depreciation under section 32(1).

The CBDT has, vide this Circular, clarified that the business of printing or printing and publishing amounts to manufacture or production of an article or thing and is, therefore, eligible for additional depreciation under section 32(1)(iia).

Additional depreciation would be allowed to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A). It is not allowable when the assessee pays concessional rates of tax under the default tax regime u/s 115BAC.

(iv) Terminal depreciation: In case of a power concern as covered under clause (i) above, if any asset is sold, discarded, demolished or otherwise destroyed in the previous year (other than the previous year in which it is first brought into use) the depreciation amount will be the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, falls short of the written down value thereof. The depreciation will be available only if the deficiency is actually written off in the books of the assessee.

Meaning of certain term

Term	Meaning
Moneys payable	In respect of any building, machinery, plant or furniture includes — (a) any insurance, salvage or compensation moneys payable in respect thereof; (b) where the building, machinery, plant or furniture is sold, the price for which it is sold.

(4) Rates of depreciation – All assets have been divided into four main categories and rates of depreciation as prescribed by Rule 5(1) are given below:

PART A	TANGIBLE ASSETS	
I	**Buildings**	
Block 1.	Buildings which are used mainly for residential purposes except hotels and boarding houses	5%
Block 2.	Buildings which are not used mainly for residential purposes and not covered by Block (1) above and (3) below	10%
Block 3.	Buildings acquired on or after 1st September, 2002 for installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities	40%
Block 4.	Purely temporary erections such as wooden structures	40%
II	**Furniture and Fittings**	
Block 1.	Furniture and fittings including electrical fittings ["Electrical fittings" include electrical wiring, switches, sockets, other fittings and fans, etc.]	10%
III	**Plant & Machinery**	
Block 1.	Motor cars other than those used in a business of running them on hire, acquired during the period from 23.8.2019 to 31.03.2020 and put to use on or before 31.03.2020	30%
Block 2.	Motor cars other than those used in a business of running them on hire, acquired or put to use on or after 1-4-1990 [Other than motor cars mentioned in Block 1 above]	15%

Block 3.	Motors buses, motor lorries, motor taxis used in a business of running them on hire, acquired during the period from 23.8.2019 to 31.03.2020 and put to use on or before 31.03.2020	45%
Block 4.	Motors buses, motor lorries, motor taxis used in the business of running them on hire [Other than mentioned in Block 3 above]	30%
Block 5.	Moulds used in rubber and plastic goods factories	30%
Block 6.	Aeroplanes, Aeroengines	40%
Block 7.	Specified air pollution control equipments, water pollution control equipments, solid waste control equipment and solid waste recycling and resource recovery systems	40%
Block 8.	Plant & Machinery used in semi-conductor industry covering all Integrated Circuits (ICs) (other than mentioned in Block 7 Above)	30%
Block 9.	Life-saving medical equipment	40%
Block 10.	Machinery and plant, acquired and installed on or after the 1st September, 2002 in a water supply project or a water treatment system and which is put to use for the purpose of business of providing infrastructure facility	40%
Block 11.	Containers made of glass or plastic used as re-fills	40%
Block 12	Energy Saving Devices (as specified)	40%
Block 13.	Renewable Energy Saving Devices (as specified) including the devices specified in (i) to (iii) below	40%
	(i) Electrically operated vehicles including battery powered or fuel-cell powered vehicles	40%
	(ii) Windmills and any specially designed devices which run on windmills installed on or after 1.4.2014	40%
	(iii) Any special devices including electric generators and pumps running on wind energy installed on or after 1.4.2014	40%
Block 14.	Windmills and any specially designed devices running on windmills installed on or before 31.3.2014 and any special devices including electric generators and pumps running on wind energy installed on or before 31.3.2014	15%

Block 15.	Computers including computer software	40%
Block 16.	Books (annual publications or other than annual publications) owned by assessees carrying on a profession	40%
Block 17.	Books owned by assessees carrying on business in running lending libraries	40%
Block 18.	Plant & machinery (General rate)	15%
IV	**Ships**	
Block 1.	Ocean-going ships	20%
Block 2.	Vessels ordinarily operating on inland waters not covered by Block (3) below	20%
Block 3.	Speed boats operating on inland water	20%
PART B	**INTANGIBLE ASSETS**	
Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, not being goodwill of a business or profession		25%

Note: Students should refer to Income-tax Rules, 1962 for the detailed classification of assets under Rule 5(1) and the rates applicable thereto.

ILLUSTRATION 1

Mr. X, a proprietor engaged in manufacturing business, furnishes the following particulars:

	Particulars	***₹***
(1)	*Opening balance of plant and machinery as on 1.4.2025 (i.e., WDV as on 31.3.2024 after reducing depreciation for P.Y. 2024-25)*	*30,00,000*
(2)	*New plant and machinery purchased and put to use on 8.06.2025*	*20,00,000*
(3)	*New plant and machinery acquired and put to use on 15.12.2025*	*8,00,000*
(4)	*Computer acquired and installed in the office premises on 2.1.2026*	*3,00,000*

Compute the amount of depreciation and additional depreciation for the A.Y. 2026-27, if Mr. X has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). Assume that all the assets were purchased by way of account payee cheque.

SOLUTION

Computation of depreciation and additional depreciation for A.Y. 2026-27

Particulars	Plant & Machinery (15%)	Computer (40%)
Normal depreciation		
@15% on ₹ 50,00,000 **[See Working Notes 1 & 2]**	7,50,000	-
@7.5% (50% of 15%, since put to use for less than 180 days) on ₹ 8,00,000	60,000	-
@20% (50% of 40%, since put to use for less than 180 days) on ₹ 3,00,000	-	60,000
Additional Depreciation		
@20% on ₹ 20,00,000 (new plant and machinery put to use for more than 180 days)	4,00,000	-
@10% (50% of 20%, since put to use for less than 180 days) on ₹ 8,00,000	80,000	-
Total depreciation	**12,90,000**	**60,000**

Working Notes:

(1) Computation of written down value of Plant & Machinery

Particulars	Plant & Machinery (₹)	Computer (₹)
Opening balance as on 1.4.2025	30,00,000	-
Add: Plant & Machinery purchased on 08.6.2025	20,00,000	-
Add: Plant & Machinery acquired on 15.12.2025	8,00,000	-
Computer acquired and installed in the office premises	-	3,00,000
Written down value as on 31.03.2026	**58,00,000**	**3,00,000**

(2) Composition of plant and machinery included in the WDV

Particulars	Plant & Machinery (₹)	Computer (₹)
Plant and machinery put to use for 180 days or more [₹ 30,00,000 (WDV) + ₹ 20,00,000 (purchased on 8.6.2025)]	50,00,000	
Plant and machinery put to use for < 180 days	8,00,000	-
Computers put to use for < 180 days	-	3,00,000
	58,00,000	**3,00,000**

Notes:

(1) Where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount of deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

Therefore, normal depreciation on plant and machinery acquired and put to use on 15.12.2025 and computer acquired and installed on 02.01.2026, is restricted to 50% of 15% and 40%, respectively. The additional depreciation on the said plant and machinery is restricted to ₹ 80,000, being 10% (i.e., 50% of 20%) of ₹ 8 lakh.

Mr. X is eligible for additional depreciation since he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

(2) As per third proviso to section 32(1)(ii), the balance additional depreciation of ₹ 80,000 being 50% of ₹ 1,60,000 (20% of ₹ 8,00,000) would be allowed as deduction in the A.Y.2027-28.

(3) As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, *inter alia,* in the business of manufacture or production of any article or thing, @20% of the actual cost of such machinery or plant.

However, additional depreciation shall not be allowed in respect of, *inter alia*, any machinery or plant installed in office premises, residential accommodation or in any guest house.

Accordingly, additional depreciation is not allowable on computer installed in the office premises.

(5) Actual Cost [Section 43(1)]

The expression "actual cost" means the actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

However, where an assessee incurs any expenditure for acquisition of any asset or part thereof in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic mode, exceeds **₹ 10,000**, such expenditure shall not form part of actual cost of such asset [Second proviso to section 43(1)].

The prescribed electronic modes include credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

Actual cost in certain special situations [*Explanations* to section 43(1)]

(i) Asset used for business after it ceases to be used for scientific research: Where an asset is used for the purposes of business after it ceases to be used for scientific research related to that business, the actual cost to the assessee for depreciation purposes shall be the actual cost to the assessee as reduced by any deduction allowed under section 35(1)(iv) [*Explanation 1*].

(ii) Inventory converted into capital asset and used for business or profession: Where inventory is converted or treated as a capital asset and is used for the purpose of business or profession, the fair market value of such inventory as on the date of its conversion into capital asset determined in the prescribed manner, shall be the actual cost of such capital asset to the assessee [*Explanation 1A*].

(iii) Asset is acquired by way of gift or inheritance: Where an asset is acquired by way of gift or inheritance, its actual cost shall be the actual cost to the previous owner minus depreciation allowable to the assessee as if asset was the only asset in the relevant block of assets [*Explanation 2*].

Further, any expenditure incurred by the assessee such as expenditure on freight, installation etc. of such asset would also be includible in the actual cost.

(iv) **Second hand asset:** Where, before the date of its acquisition by the assessee, the asset was at any time used by any other person for the purposes of his business or profession, and the Assessing Officer is satisfied that the main purpose of the transfer of the asset directly or indirectly to the assessee was the reduction of liability of income-tax directly or indirectly to the assessee (by claiming depreciation with reference to an enhanced cost) the actual cost to the assessee shall be taken to be such an amount which the Assessing Officer may, with the previous approval of the Joint Commissioner, determine, having regard to all the circumstances of the case [*Explanation 3*].

(v) **Re-acquisition of asset:** Where any asset which had once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter ceased to be his property by reason of transfer or otherwise, is re-acquired by him, the actual cost to the assessee shall be —

(a) the actual cost when he first acquired the asset minus depreciation allowable to the assessee as if asset was the only asset in the relevant block of assets; or

(b) the actual price for which the asset is re-acquired by him

whichever is less [*Explanation 4*].

(vi) **Acquisition of asset previously owned by any person to whom such asset is given on lease, hire or otherwise:** Where before the date of acquisition by the assessee say, Mr. A, the assets were at any time used by any other person, say Mr. B, for the purposes of his business or profession and depreciation allowance has been claimed in respect of such assets in the case of Mr. B and such person acquires on lease, hire or otherwise, assets from Mr. A, then, the actual cost of the transferred assets, in the case of Mr. A, shall be the same as the written down value of the said assets at the time of transfer thereof by Mr. B [*Explanation 4A*].

Example: *We can explain the above as follows—*

A person (say "A") owns an asset and uses it for the purposes of his business or profession. A has claimed depreciation in respect of such asset. The said asset is transferred by A to another person (say "B"). A then acquires the same asset back from B on lease, hire or otherwise. B being the new owner will be entitled to depreciation. In the above situation, the cost of acquisition of the transferred assets in the hands of B shall be the same as the written down value of the said assets at the time of transfer.

Explanation 4A overrides Explanation 3

Explanation 3 to section 43(1) deals with a situation where a transfer of any asset is made with the main purpose of reduction of tax liability (by claiming depreciation on enhanced cost), and the Assessing Officer, having satisfied himself about such purpose of transfer with the prior approval of the joint commissioner, may determine the actual cost having regard to all the circumstances of the case.

In the *Explanation 4A*, a *non-obstante* clause has been included to the effect that *Explanation 4A* will have an overriding effect over *Explanation 3*. The result of this is that there is no necessity of finding out whether the main purpose of the transaction is reduction of tax liability. *Explanation 4A* is activated in every situation described above without inquiring about the main purpose.

(vii) Building previously the property of the assessee: Where a building which was previously the property of the assessee is brought into use for the purposes of the business or profession, its actual cost to the assessee shall be the actual cost of the building to the assessee, as reduced by an amount equal to the depreciation calculated at the rates in force on that date that would have been allowable had the building been used for the purposes of the business or profession since the date of its acquisition by the assessee *[Explanation 5*].

ILLUSTRATION 2

A car purchased by Dr. Soman on 10.08.2022 for ₹ 5,25,000 for personal use is brought into professional use on 1.07.2025 by him, when its market value was ₹ 2,50,000.

Compute the actual cost of the car and the amount of depreciation for the A.Y. 2026-27 assuming the rate of depreciation to be 15%.

SOLUTION

As per section 43(1), the expression "actual cost" would mean the actual cost of asset to the assessee.

The purchase price of ₹ 5,25,000 is, therefore, the actual cost of the car to Dr. Soman. Market value (i.e. ₹ 2,50,000) on the date when the asset is brought into professional use is not relevant.

Therefore, amount of depreciation on car as per section 32 for the A.Y.2026-27 would be ₹ 78,750, being ₹ 5,25,000 x 15%.

Note: *Explanation 5 to section 43(1) providing for reduction of notional depreciation from the date of acquisition of asset for personal use to determine actual cost of the asset is applicable only in case of building which is initially acquired for personal use and later brought into professional use. It is not applicable in respect of other assets.*

(viii) Capitalization of interest paid or payable in connection with acquisition of an asset: Certain taxpayers have, with a view to obtain more tax benefits and reduce the tax outflow, resorted to the method of capitalising interest paid or payable in connection with acquisition of an asset relatable to the period after such asset is first put to use.

This capitalisation implies inclusion of such interest in the 'Actual Cost' of the asset for the purposes of claiming depreciation, investment allowance etc. under the Income-tax Act, 1961. This was never the legislative intent nor was it in accordance with recognised accounting practices. Therefore, with a view to counteracting tax avoidance through this method and placing the matter beyond doubt, *Explanation 8* to section 43(1) provides that any amount paid or payable as interest in connection with the acquisition of an asset and relatable to period after asset is first put to use shall not be included and shall be deemed to have never been included in the actual cost of the asset [*Explanation 8*].

(ix) Amount of duty of excise or additional duty leviable shall be reduced if credit is claimed: Where an asset is or has been acquired by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944[5] *[Explanation 9]*.

(x) **Subsidy or grant or reimbursement:** Where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee.

However, where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee *[Explanation 10]*.

(xi) **Asset is acquired outside India by an assessee, being a non-resident and such asset is brought by him to India:** Where an asset is acquired outside India by an assessee, being a non-resident and such asset is brought by him to India and used for the purposes of his business or profession, the actual cost of asset to the assessee shall be the actual cost the asset to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee *[Explanation 11]*.

(xii) **Capital asset on which deduction is allowable under section 35AD:** *Explanation 13* to section 43(1) provides that the actual cost of any capital asset, on which deduction has been allowed or is allowable to the assessee under section 35AD, shall be Nil.

[5] Now Central Excise Rules, 2002

This would be applicable in the case of transfer of asset by the assessee where -

(1) the assessee himself has claimed deduction under section 35AD; or

(2) the previous owner has claimed deduction under section 35AD. This would be applicable where the capital asset is acquired by the assessee by way of -

(a) gift, will or an irrevocable trust;

(b) any distribution on liquidation of the company;

(c) any distribution of capital assets on total or partial partition of a HUF;

(d) any transfer of a capital asset by a holding company to its 100% subsidiary company, being an Indian company;

(e) any transfer of a capital asset by a subsidiary company to its 100% holding company, being an Indian company;

(f) any transfer of a capital asset by the amalgamating company to an amalgamated company in a scheme of amalgamation, if the amalgamated company is an Indian company;

(g) any transfer of a capital asset by the demerged company to the resulting company in a scheme of demerger, if the resulting company is an Indian company;

(h) any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualization or corporatisation of a recognized stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company (fulfilling the conditions specified);

(i) any transfer of a capital asset or intangible asset by a sole proprietary concern to a company, where the sole proprietary concern is succeeded by a company (fulfilling the conditions specified).

(j) any transfer of a capital asset or intangible asset by a private company or unlisted public company to an LLP as a result of conversion of the such company into LLP (fulfilling the conditions prescribed).

However, where an asset, in respect of which deduction is claimed and allowed under section 35AD is deemed to be the income of the assessee in accordance with the provisions of section 35AD(7B) (on account of asset, being used for a purpose other than specified business under section 35AD), the actual cost of the asset to the assessee shall be actual cost to assessee **as reduced** by the amount of depreciation allowable had the asset been used for the purpose of business, calculated at the rate in force, since the date of its acquisition [Proviso to *Explanation 13* to section 43(1)].

(6) Written down value [Section 43(6)]

(i) Assets acquired by the assessee during the previous year: In the case of assets acquired by the assessee during the previous year, the written down value means the actual cost to the assessee.

(ii) Assets acquired before the previous year: In the case of assets acquired before the previous year, the written down value would be the actual cost to the assessee *less* the aggregate of all deductions actually allowed in respect of depreciation.

For this purpose, any depreciation carried forward is deemed to be depreciation actually allowed [Section 43(6)(c)(i) read with *Explanation 3*].

(iii) In case of any block of assets: The written down value of any block of assets shall be worked out as under in accordance with section 43(6)(c):

(1)	W.D.V. of the block of assets in immediately preceding previous year	xxx
(2)	*Less:* Depreciation actually allowed in respect of that block of assets in said preceding previous year	xxx
Opening balance as on 1st April of the current P.Y.		xxx

Increased by	
(3) Actual cost of assets acquired during the previous year, not being on account of acquisition of goodwill of a business or profession	xxx
(4) Total (1) - (2) + (3)	xxx
Reduced by	
(5) Money receivable in respect of any asset falling within the block which is sold, discarded, demolished or destroyed during that previous year together with scrap value. However, such amount cannot exceed the amount in (4).	xxx
(6) **In case of slump sale**, actual cost of the asset (-) amount of depreciation that would have been allowable to the assessee for any assessment year as if the asset was the only asset in the block. However, such amount of reduction cannot exceed the WDV.	xxx
(7) W.D.V at the end of the year (on which depreciation is allowable) [(4) – (5) – (6)]	xxx
(8) Depreciation at the prescribed rate (Rate of Depreciation × WDV arrived at in (7) above)	xxx

(iv) Depreciation provided in the books of account deemed to be depreciation actually allowed: Section 32(1)(ii) provides that depreciation shall be allowed at the prescribed percentage on the written down value (WDV) of any block of assets. Section 43(6)(b) provides that written down value in the case of assets acquired before the previous year means the actual cost to the assessee *less* all depreciation actually allowed to him under the Income-tax Act, 1961.

Persons who were exempt from tax were not required to compute their income under the head "Profits and gains of business or profession". However, when the exemption is withdrawn subsequently, such persons became liable to income-tax and hence, were required to compute their income for income-tax purposes. In this regard, a question arises as to the basis on which depreciation is to be allowed under the Income-tax Act, 1961 in respect of assets acquired during the years when the person was exempt from tax.

Explanation 6 to section 43(6) provides that,-

(a) the actual cost of an asset has to be adjusted by the amount attributable to the revaluation of such asset, if any, in the books of account;

(b) the total amount of depreciation on such asset provided in the books of account of the assessee in respect of such previous year or years preceding the previous year relevant to the assessment year under consideration shall be deemed to be the depreciation actually allowed under the Income-tax Act, 1961 for the purposes of section 43(6);

(c) the depreciation actually allowed as above has to be adjusted by the amount of depreciation attributable to such revaluation.

(v) Composite Income: *Explanation 7* provides that in cases of 'composite income', for the purpose of computing written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee is chargeable under the head "Profits and Gains of business or profession". The depreciation so computed shall be deemed to have been "actually allowed" to the assessee.

Rule 8 prescribes the taxability of income from the manufacture of tea. Under the said rule, income derived from the sale of tea grown and manufactured by seller shall be computed as if it were income derived from business and 40% of such income shall be deemed to be income liable to tax.

Example: *If the turnover is, say, ₹ 20 lakh, the depreciation ₹ 1 lakh and other expenses ₹ 4 lakh, then the income would be ₹ 15 lakh. Business income would be ₹ 6 lakh (being 40% of ₹ 15 lakh). In this case, ₹ 1 lakh, being the amount of depreciation would be deemed to have been actually allowed.*

Accordingly, the WDV is required to be computed by deducting the full depreciation attributable to composite income i.e., ₹ 1 lakh.

(vi) Cases where the Written Down Value reduced to nil: The written down value of any block of assets, may be reduced to nil for any of the following reasons:

(a) The moneys receivable by the assessee in regard to the assets sold or otherwise transferred during the previous year together with the amount of scrap value may exceed the written down value at the beginning of the year as increased by the actual cost of any new asset acquired, or

(b) All the assets in the relevant block may be transferred during the year.

(7) Carry forward and set off of depreciation [Section 32(2)]

Section 32(2) provides for carry forward of unabsorbed depreciation. Where, in any previous year the profits or gains chargeable are not sufficient to give full effect to the depreciation allowance, the unabsorbed depreciation shall be added to the depreciation allowance for the following previous year and shall be deemed to be part of that allowance. If no depreciation allowance is available for that previous year, the unabsorbed depreciation of the earlier previous year shall become the depreciation allowance of that year. The effect of this provision is that the unabsorbed depreciation shall be carried forward indefinitely till it is fully set off.

In a case where the assessee is paying tax under default tax regime under section 115BAC and there is a depreciation allowance in respect of a block of asset from an earlier assessment year attributable to additional depreciation u/s 32(1)(iia), which has not been given full effect to prior to A.Y. 2024-25 and which is not allowed to be set-off in the A.Y.2024-25, corresponding adjustment shall be made to the WDV of such block of assets as on 1.4.2023 in the prescribed manner i.e., the WDV as on 1.4.2023 will be increased by the unabsorbed additional depreciation not allowed to be set-off.

<u>Order of set-off</u>

In the order of set-off of losses under different heads of income, effect shall first be given to business losses and then to unabsorbed depreciation.

The provisions in effect are as follows:

- Since the unabsorbed depreciation forms part of the current year's depreciation, it can be set off against any other head of income except "Salaries".
- The unabsorbed depreciation can be carried forward for indefinite number of previous years.
- Set off will be allowed even if the same business to which it relates is no longer in existence in the year in which the set off takes place.

Current depreciation to be deducted first - The Supreme Court, in *CIT v. Mother India Refrigeration (P.) Ltd. [1985] 23 Taxman 8,* has categorically held that current depreciation must be deducted first before deducting the unabsorbed carried forward business losses of the earlier years in giving set off while computing the total income of any particular year.

ORDER OF SET-OFF

Current Year Depreciation

Brought forward Business Loss

Unabsorbed depreciation

ILLUSTRATION 3

A newly qualified Chartered Accountant, Mr. Dhaval commenced practice and has acquired the following assets in his office during F.Y. 2025-26 at the cost shown against each item. Calculate the amount of depreciation that can be claimed from his professional income for A.Y.2026-27. Assume that all the assets were purchased by way of account payee cheque.

Sl. No.	*Description*	*Date of acquisition*	*Date when put to use*	*Amount ₹*
1.	*Computer including computer software*	*27 Sept., 25*	*1 Oct., 25*	*35,000*
2.	*Computer UPS*	*2 Oct., 25*	*8 Oct., 25*	*8,500*
3.	*Computer printer*	*1 Oct., 25*	*1 Oct., 25*	*12,500*
4.	*Books (other than annual publications are of ₹ 12,000)*	*1 Apr., 25*	*1 Apr., 25*	*13,000*
5.	*Office furniture (Acquired from a practicing C.A.)*	*1 Apr., 25*	*1 Apr., 25*	*3,00,000*
6.	*Laptop*	*26 Sep., 25*	*8 Oct., 25*	*43,000*

SOLUTION

Computation of depreciation allowable for A.Y.2026-27

Asset		Rate	Depreciation (₹)
Block 1	Furniture **[See working note below]**	10%	30,000
Block 2	Plant (Computer including computer software, Computer UPS, Laptop, Printers and Books) **[See working note below]**	40%	34,500
Total depreciation allowable			**64,500**

Working Note:

Computation of depreciation

Block of Assets	₹
Block 1: Furniture – [Rate of depreciation - 10%]	
Put to use for more than 180 days [₹ 3,00,000@10%]	**30,000**
Block 2: Plant [Rate of depreciation- 40%]	
(a) Computer including computer software (put to use for more than 180 days) [₹ 35,000 @ 40%]	14,000
(b) Computer UPS (put to use for less than 180 days) [₹ 8,500 @20%] **[See note below]**	1,700
(c) Computer Printer (put to use for more than 180 days) [₹ 12,500 @40%]	5,000
(d) Laptop (put to use for less than 180 days) [₹ 43,000 @20%] **[See note below]**	8,600
(e) Books (being annual publications or other than annual publications) (Put to use for more than 180 days) [₹ 13,000 @40%]	5,200
	34,500

Note - *Where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, the deduction on account of depreciation would be restricted to 50% of the prescribed rate. In this case, since Mr. Dhaval commenced his practice in the P.Y. 2025-26 and acquired the assets during the same year, the restriction of depreciation to 50% of the prescribed rate would apply to those assets which have been put to use for less than 180 days in that year, namely, laptop and computer UPS.*

ILLUSTRATION 4

Mr. Gamma, a proprietor started a business of manufacture of tyres and tubes for motor vehicles on 1.1.2025. The manufacturing unit was set up on 1.5.2025. He commenced his manufacturing operations on 1.6.2025. The total cost of the plant and machinery installed in the unit is ₹ 120 crore. The said plant and machinery included second hand plant and machinery bought for ₹ 20 crore and new plant and machinery for scientific research relating to the business of the assessee acquired at a cost of ₹ 15 crore.

Compute the amount of depreciation allowable under section 32 of the Income-tax Act, 1961 in respect of the assessment year 2026-27. Assume that all the assets were purchased by way of account payee cheque and Mr. Gamma has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

SOLUTION

Computation of depreciation allowable for the A.Y. 2026-27 in the hands of Mr. Gamma

Particulars		₹ in crore	
Total cost of plant and machinery		120.00	
Less: Used for Scientific Research **(Note 1)**		15.00	
		105.00	
Normal Depreciation at 15% on ₹ 105 crore			15.75
Additional Depreciation:			
Cost of plant and machinery		120.00	
Less: Second-hand plant and machinery **(Note 2)**	20.00		
Plant and machinery used for scientific research, the whole of the actual cost of which is allowable as deduction u/s 35(1)(iv) read with section 35(2)(ia) **(Note 2)**	15.00	35.00	
		85.00	
Additional Depreciation at 20%			17.00
Depreciation allowable for A.Y.2026-27			**32.75**

Notes:

1. As per section 35(2)(iv), no depreciation shall be allowed in respect of plant and machinery purchased for scientific research relating to assessee's business, since deduction is allowable under section 35 in respect of such capital expenditure.

2. Mr. Gamma is entitled to additional depreciation since he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged in, *inter alia,* the business of manufacture or production of any article or thing, at the rate of 20% of the actual cost of such machinery or plant.

   However, additional depreciation shall not be allowed in respect of, *inter alia*, –

   (i) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;

   (ii) 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 "Profit and gains of business or profession" of any one previous year.

   In view of the above provisions, additional depreciation cannot be claimed in respect of -

   (i) Second hand plant and machinery;

   (ii) New plant and machinery purchased for scientific research relating to assessee's business in respect of which the whole of the capital expenditure can be claimed as deduction under section 35(1)(iv) read with section 35(2)(ia) & (iv).

(8) Building, machinery, plant and furniture not exclusively used for business purpose [Section 38(2)]

Where any building, plant and machinery, furniture is not exclusively used for the purposes of business or profession, the deduction on account of expenses on account of current repairs to the premises, insurance premium of the premises, current repairs and insurance premium of machinery, plant and furniture and depreciation in respect of these assets shall be restricted to a fair proportionate part thereof, which the Assessing Officer may determine having regard to the user of such asset for the purposes of the business or profession.

(9) Balancing Charge

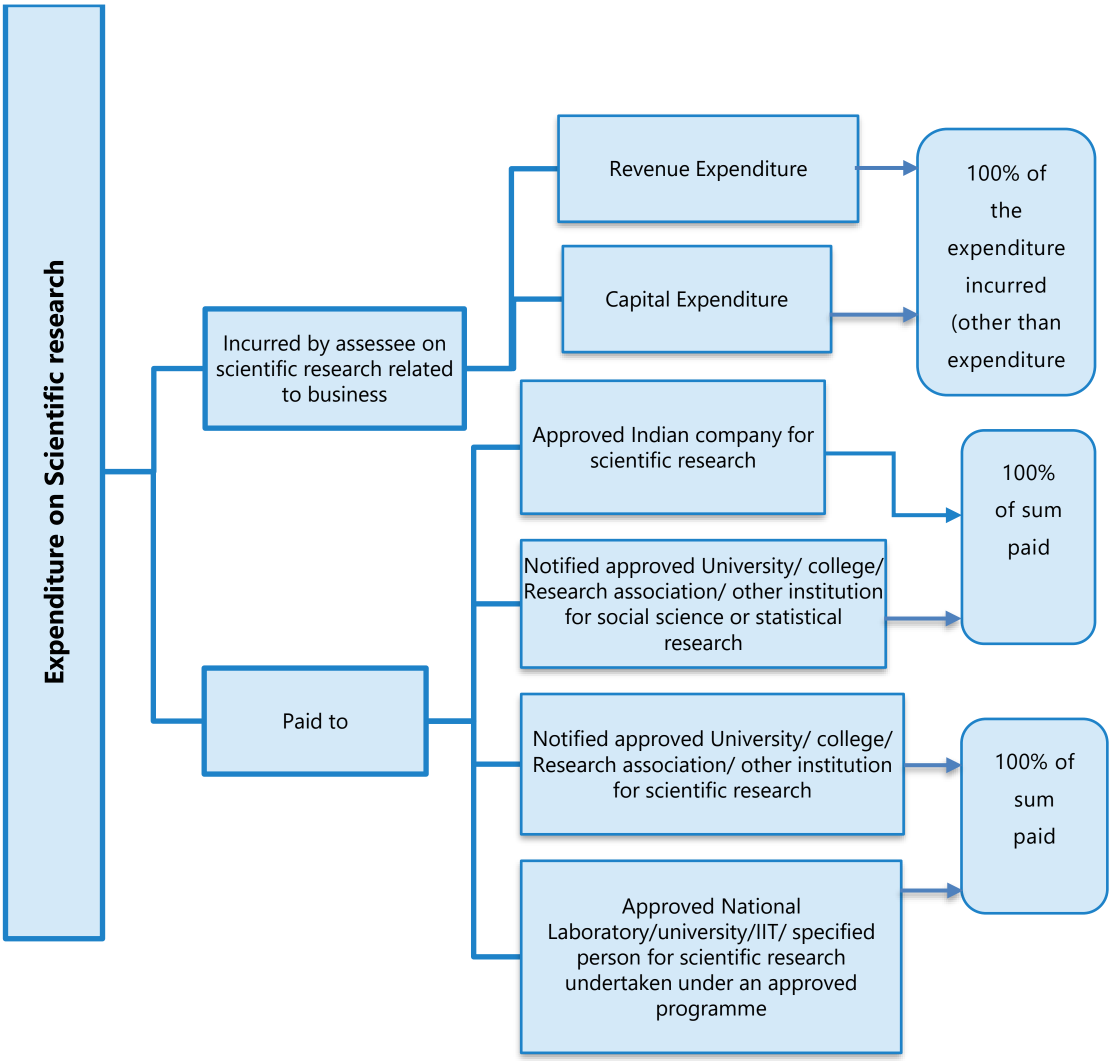
Section 41(2) provides for the manner of calculation of the amount which shall be chargeable to income-tax as income of the business of the previous year in which the monies payable for the building, machinery, plant or furniture on which depreciation has been claimed under section 32(1)(i), i.e. in the case of power undertakings, is sold, discarded, demolished or destroyed. The balancing charge will be the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, exceeds the written down value. However, the amount of balancing charge should not exceed the difference between the actual cost and the WDV. The tax shall be levied in the year in which the moneys payable become due.

The *Explanation* below section 41(2) makes it clear that where the moneys payable in respect of the building, machinery, plant or furniture referred to in section 41(2) becomes due in a previous year in which the business, for the purpose of which the building, machinery, plant or furniture was being used, is no longer in existence, these provisions will apply as if the business is in existence in that previous year.

(iv) Expenditure on Scientific Research [Section 35]

This section allows a deduction in respect of any expenditure on scientific research (activities for extension of knowledge in the fields of natural or applied science, including agriculture, animal husbandry or fisheries) incurred in relation to the business of the assessee or contribution by the assessee for scientific research or social science or statistical research. However, it does include expenditure incurred in acquisition of rights in or arising out of scientific research.

The deduction allowable under this section is depicted in the diagram below:



(I) Incurred by assessee:

(i) **Revenue Expenditure:** Any revenue expenditure incurred by the assessee on scientific research **related to his business** would be allowed as deduction in the year in which it was incurred. Expenditure incurred within 3 years immediately preceding the commencement of the business on payment of salary to research personnel engaged in scientific research related to his business carried on by the taxpayer or on purchase of material inputs for such scientific research will be allowed as deduction in the year in which the business is commenced. The deduction will be limited to the amount certified by the prescribed authority [Section 35(1)(i)].

(ii) Capital Expenditure: Any expenditure of a capital nature on scientific research **<u>related to the business</u>** carried on by the assessee would be deductible in full in the previous year in which it is incurred [Section 35(1)(iv)].

(a) Capital expenditure prior to commencement of business

The *Explanation 1* to section 35(2)(ia) specifically provides that where any capital expenditure has been incurred prior to the commencement of the business, the aggregate of the expenditure so incurred within the three years immediately preceding the commencement of the business shall be deemed to have been incurred in the previous year in which the business is commenced and will rank for deduction as expenditure for scientific research incurred during the previous year.

Expenditure on land disallowed

No deduction will be allowed in respect of capital expenditure incurred on the acquisition of any land whether the land is acquired as such or as part of any property.

(b) Carry forward of unabsorbed capital expenditure on scientific research

Capital expenditure incurred on scientific research which cannot be absorbed by the business profits of the relevant previous year, can be carried forward to the immediately succeeding previous year and shall be treated as the allowance for that year. In effect, this means that there is no time bar on the period of carry forward. It shall be accordingly allowable for that previous year against any head of income other than salaries [Section 35(4)].

(c) Depreciation not admissible

Section 35(2)(iv) clarifies that no depreciation will be admissible on any capital asset represented by expenditure which has been allowed as a deduction under section 35 whether in the year in which deduction under section 35 was allowed or in any other previous year.

(d) Sale of asset representing expenditure of capital nature on scientific research

Section 41, *inter alia*, seeks to tax the profits arising on the sale of an asset representing expenditure of a capital nature on scientific research.

Where the asset representing expenditure of a capital nature on scientific research is sold without having been used for other purposes, the provisions of section 41(3) would be attracted. If the proceeds of sale together with the total amount of the deductions made under section 35(1)(iv) exceed the amount of capital expenditure, the excess or the amount of deduction so made, whichever is less, will be charged to tax as income of the business of the previous year in which the sale took place.

In simple words, since amount of deduction under section 35(1)(iv) is equal to the amount of expenditure, lower of amount of sale proceeds or deduction allowed under section 35(1)(iv) will be the charged to tax as income of the business in the previous year in which the asset is sold.

Deduction under section 35(1)(i) and 35(1)(iv) read with section 35(2) would be available to an assessee under both regimes, subject to fulfillment of stipulated conditions.

(II) Amount contributed or paid to:

(i) Notified approved research association, university, college or other institution: A sum equal to any amount paid to –

- a research association which has as its object the undertaking of scientific research or
- to a university, college or other institution to be used for scientific research

provided that such university, college, institution or association is approved for this purpose and notified by the Central Government. [Section 35(1)(ii)]

> *Deduction u/s 35(1)(ii) would be available to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

(ii) Approved Indian company for scientific research: A sum equal to any amount paid to a company to be used by it for scientific research [Section 35(1)(iia)]

However, such deduction would be available only if:

- the company is registered in India and
- has as its main object the scientific research and development.

Further, it should be approved by the prescribed authority and should fulfill the other prescribed conditions.

> *Deduction u/s 35(1)(iia) would be available to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

(iii) Approved notified research association, university, college or other institution: A sum equal to any amount paid to

- a research association which has as its object the undertaking of research in social science or statistical research or
- to a university, college or other institution to be used for research in a social science or statistical research

provided that they are approved for this purpose and notified by the Central Government [Section 35(1)(iii)].

Further, it has been clarified that the deduction to which an assessee (i.e. donor) is entitled on account of payment of any sum to a research association or university or college or other institution for scientific research or research in a social science or statistical research or to a company for scientific research, shall not be denied merely on the ground that subsequent to payment of such sum by the assessee, the approval granted to any of the aforesaid entities is withdrawn.

> *Deduction u/s 35(1)(iii) would be available to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

(iv) Sum paid to National Laboratory, etc. [Section 35(2AA)]: Section 35(2AA) provides that any sum paid by an assessee to a National Laboratory or University or Indian Institute of Technology or a specified person for carrying out approved programmes of scientific research approved by the prescribed authority will be eligible for deduction of the amount so paid.

No other deduction under the Act: No contribution which qualifies for deduction under this clause will be entitled to deduction under any other provision of the Act.

It has been clarified that the deduction to which an assessee is entitled on account of payment of any sum by him to an approved National Laboratory, University, Indian Institute of Technology or a specified person for the approved programme shall not be denied to the donor-assessee merely on the ground that after payment of such sum by him, the approval granted to any of the aforesaid donee-entities or the programme has been withdrawn.

Term	***Meaning***
Specified person	A person who is approved by the prescribed authority

Deduction u/s 35(2AA) would be available to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).

ILLUSTRATION 5

Mr. A, furnishes the following particulars for the P.Y.2025-26. Compute the deduction allowable under section 35 for A.Y.2026-27, while computing his income under the head "Profits and gains of business or profession", if.

(i) he is paying tax under default tax regime under section 115BAC

(ii) he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A)

	Particulars	₹
1.	*Amount paid to notified approved Indian Institute of Science, Bangalore, for scientific research*	*1,00,000*
2.	*Amount paid to IIT, Delhi for an approved scientific research programme*	*2,50,000*

3.	*Amount paid to X Ltd., a company registered in India which has as its main object scientific research and development, as is approved by the prescribed authority*	*4,00,000*
4.	*Expenditure incurred on in-house scientific research and development facility as approved by the prescribed authority related to his business*	
	(a) Revenue expenditure on scientific research	*3,00,000*
	(b) Capital expenditure (including cost of acquisition of land ₹ 5,00,000) on scientific research	*7,50,000*

SOLUTION

(i) If Mr. A is paying tax under default tax regime under section 115BAC

Computation of deduction under section 35 for the A.Y.2026-27

Particulars	₹	Section	Allowability	Amount of deduction (₹)
Payment for scientific research				
Indian Institute of Science, Bangalore	1,00,000	35(1)(ii)	Not allowable under default tax regime	Nil
IIT, Delhi	2,50,000	35(2AA)		Nil
X Ltd.	4,00,000	35(1)(iia)		Nil
Expenditure incurred on in-house research and development facility				
Revenue expenditure	3,00,000	35(1)(i)	Allowable under default tax regime	3,00,000
Capital expenditure (excluding cost of acquisition of land ₹ 5,00,000)	2,50,000	35(1)(iv) read with 35(2)(ia)		2,50,000
Deduction allowable under section 35				**5,50,000**

(ii) If Mr. A has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A)

Computation of deduction under section 35 for the A.Y.2026-27

Particulars	₹	Section	% of deduction	Amount of deduction (₹)
Payment for scientific research				
Indian Institute of Science	1,00,000	35(1)(ii)	100%	1,00,000
IIT, Delhi	2,50,000	35(2AA)	100%	2,50,000
X Ltd.	4,00,000	35(1)(iia)	100%	4,00,000
Expenditure incurred on in-house research and development facility				
Revenue expenditure	3,00,000	35(1)(i)	100%	3,00,000
Capital expenditure (excluding cost of acquisition of land ₹ 5,00,000)	2,50,000	35(1)(iv) read with 35(2)(ia)	100%	2,50,000
Deduction allowable under section 35				**13,00,000**

(v) "Investment-linked tax incentives" for specified businesses [Section 35AD]

(1) List of specified businesses: Although there are a plethora of tax incentives available under the Income-tax Act, 1961 they do not fulfill the intended purpose of creating infrastructure since these incentives are linked to profits and consequently, have the effect of diverting profits from the taxable sector to the tax-free sector.

With the specific objective of creating rural infrastructure and environment friendly alternate means for transportation of bulk goods, investment-linked tax incentives have been introduced for specified businesses, namely –

- setting-up and operating 'cold chain' facilities for specified products;

- setting-up and operating warehousing facilities for storing agricultural produce;
- laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network;
- building and operating a hotel of two-star or above category, anywhere in India;
- building and operating a hospital, anywhere in India, with at least 100 beds for patients;
- developing and building a housing project under a notified scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government.
- developing and building a housing project under a notified scheme for affordable housing framed by the Central Government or State Government;
- production of fertilizer in India;
- setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962;
- bee-keeping and production of honey and beeswax;
- setting up and operating a warehousing facility for storage of sugar;
- laying and operating a slurry pipeline for the transportation of iron ore;
- setting up and operating a semiconductor wafer fabrication manufacturing unit, if such unit is notified by the Board in accordance with the prescribed guidelines;
- developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility.

(2) **Deduction for Capital Expenditure:** 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above businesses would be allowed as deduction from the business income to the assessee opting for deduction under section 35AD.

However, expenditure incurred on acquisition of any **land, goodwill or financial instrument** would **not** be eligible for deduction.

Further, any expenditure in respect of which payment or aggregate of payment made to a person of an amount exceeding **₹ 10,000 in a day** otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic mode would not be eligible for deduction. The prescribed electronic modes include credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [*Notification No. 8/2020 dated 29.01.2020*]

In case of an individual/HUF/AoP/BoI carrying on specified business, deduction u/s 35AD would be available only if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A). If such assessee is paying concessional rates of tax under the default tax regime u/s 115BAC, deduction u/s 35AD would not be available.

A company would not be eligible for deduction under section 35AD, if it opts for the special provisions of section 115BAA/115BAB.

(3) **Expenditure prior to commencement of operation:** Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business.

The amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

(4) **Conditions to be fulfilled:** For claiming deduction under section 35AD, the specified business should fulfill the following conditions –

(i)	it should not be set up by splitting up, or the reconstruction, of a business already in existence;
(ii)	it should not be set up by the transfer to the specified business of machinery or plant previously used for any purpose;

	In order to satisfy this condition, the total value of the plant or machinery so transferred should not exceed 20% of the value of the total plant or machinery used in such specified business. For the purpose of this condition, machinery or plant would not be regarded as previously used if it had been used outside India by any person other than the assessee provided the following conditions are satisfied: (a) such plant or machinery was not, at any time prior to the date of its installation by the assessee, used in India; (b) the plant or machinery was imported into India from a foreign Country; and (c) no deduction on account of depreciation in respect of such plant or machinery has been allowed to any person at any time prior to the date of installation by the assessee.

(5) **No deduction under section 10AA or Chapter VI-A under the heading "C - Deductions in respect of certain incomes"**: Where a deduction under this section is claimed and allowed in respect of the specified business for any assessment year, no deduction under the provisions of Chapter VI-A under the heading "C - Deductions in respect of certain incomes" or section 10AA is permissible in relation to such specified business for the same or any other assessment year.

Correspondingly, section 80A has been amended to provide that where a deduction under any provision of this Chapter under the heading "C – Deductions in respect of certain incomes" is claimed and allowed in respect of the profits of such specified business for any assessment year, no deduction under section 35AD is permissible in relation to such specified business for the same or any other assessment year.

In short, once the assessee has claimed the benefit of deduction under section 35AD for a particular year in respect of a specified business, he cannot claim benefit under Chapter VI-A under the heading "C - Deductions in respect of certain incomes" or section 10AA for the same or any other year and vice versa.

(6) **No deduction allowable under the Act in respect of expenditure for which deduction allowed under this section:** The assessee cannot claim deduction in respect of such expenditure incurred for specified business under any other provision of the Income-tax Act, 1961 in the current year or

under this section for any other year, if the deduction has been claimed or opted by him and allowed to him under section 35AD.

(7) Date of Commencement of specified businesses:

S. No.	Specified business	Date of commencement of operations
1.	Laying and operating a cross country natural gas pipeline network for distribution, including storage facilities being an integral part of such network	on or after 1st April, 2007
2.	(a) building and operating anywhere in India, a hotel of two-star or above category as specified by the Central Government (b) building and operating a hospital with at least 100 beds for patients (c) notified scheme for slum redevelopment or rehabilitation housing projects	on or after 1st April, 2010
3.	(a) notified scheme for affordable housing projects and (b) production of fertilizer in a new plant or in a newly installed capacity in an existing plant	on or after 1st April, 2011
4.	(a) setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962, (b) bee-keeping and production of honey and beeswax and (c) setting up and operating a warehousing facility for storage of sugar	on or after 1st April, 2012
5.	(a) laying and operating a slurry pipeline for the transportation of iron ore or (b) setting up and operating a semi-conductor wafer fabrication manufacturing unit	on or after 1st April, 2014
6.	developing or operating and maintaining or developing, operating and maintaining, any infrastructure facility	on or after 1st April, 2017

7.	In any other case, namely, setting and operating- (a) "cold-chain" facilities for specified products or (b) warehousing facilities for storing agricultural produce	on or after 1st April, 2009

(8) Meaning of certain terms

Term	Meaning
Cold chain facility	A chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce.
Associated person	In relation to the assessee means a person— (i) who participates directly or indirectly or through one or more intermediaries in the management or control or capital of the assessee; (ii) who holds, directly or indirectly, shares carrying not less than 26% of the voting power in the capital of the assessee; (iii) who appoints more than half of the Board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of the assessee; or (iv) who guarantees not less than 10% of the total borrowings of the assessee.
Infrastructure facility	(i) A road including toll road, a bridge or a rail system. (ii) A highway project including housing or other activities being an integral part of the highway project. (iii) A water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system. (iv) A port, airport, inland waterway, inland port or navigational channel in the sea.

(9) Set-off or carry forward and set-off of loss from specified business:

The loss of an assessee claiming deduction u/s 35AD in respect of a specified business can be set-off against the profit of another specified business u/s 73A, irrespective of whether the latter is eligible for deduction u/s 35AD.

Example: *A assessee, exercising the option of shifting out of the default tax regime provided under section 115BAC(1A), can therefore, set-off the losses of a hospital or hotel which begins to operate after 1st April, 2010 and which is eligible for deduction section 35AD, against the profits of the existing business of operating a hospital (with atleast 100 beds for patients) or a hotel (of two-star or above category), even if the latter is not eligible for deduction under section 35AD.*

ILLUSTRATION 6

Mr. A commenced operations of the businesses of setting up a warehousing facility for storage of food grains, sugar and edible oil on 1.4.2025. He incurred capital expenditure of ₹ 80 lakh, ₹ 60 lakh and ₹ 50 lakh, respectively, on purchase of land and building during the period January, 2025 to March, 2025 exclusively for the above businesses, and capitalized the same in its books of account as on 1st April, 2025. The cost of land included in the above figures is ₹ 50 lakh, ₹ 40 lakh and ₹ 30 lakh, respectively. During the P.Y. 2025-26, he incurred capital expenditure of ₹ 20 lakh, ₹ 15 lakh & ₹ 10 lakh, respectively, for extension/reconstruction of the building purchased and used exclusively for the above businesses.

Compute the income under the head "Profits and gains of business or profession" for the A.Y.2026-27 and the loss to be carried forward, assuming that Mr. A is exercising the option of shifting out of the default tax regime provided under section 115BAC(1A) and has fulfilled all the conditions specified under section 35AD and wants to claim deduction under section 35AD and has not claimed any deduction under Chapter VI-A under the heading "C – Deductions in respect of certain incomes".

The profits from the business of setting up a warehousing facility for storage of food grains, sugar and edible oil (before claiming deduction under section 35AD and section 32) for the A.Y. 2026-27 is ₹ 16 lakhs, ₹ 14 lakhs and ₹ 31 lakhs, respectively. Also, assume in respect of expenditure incurred, the payments are made by account payee cheque or use of ECS through bank account.

SOLUTION

Computation of profits and gains of business or profession for A.Y.2026-27

Particulars	₹ (in lakhs)
Profit from business of setting up of warehouse for storage of edible oil (before providing for depreciation under section 32)	31
Less: Depreciation under section 32	
10% of ₹ 30 lakh, being (₹ 50 lakh – ₹ 30 lakh + ₹ 10 lakh)	3
Income chargeable under "Profits and gains from business or profession"	**28**

Computation of income/loss from specified business under section 35AD

	Particulars	Food Grains	Sugar	Total
		₹ (in lakhs)		
(A)	Profits from the specified business of setting up a warehousing facility (before providing deduction u/s 35AD)	16	14	30
	***Less*: Deduction under section 35AD**			
(B)	Capital expenditure incurred prior to 1.4.2025 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2025 (excluding the expenditure incurred on acquisition of land) = ₹ 30 lakh (₹ 80 lakh – ₹ 50 lakh) and ₹ 20 lakh (₹ 60 lakh – ₹ 40 lakh)	30	20	50
(C)	Capital expenditure incurred during the P.Y. 2025-26	20	15	35
(D)	**Total capital expenditure (B + C)**	**50**	**35**	**85**
(E)	**Deduction under section 35AD**			
	100% of capital expenditure (food grains/ sugar)	50	35	85
	Total deduction u/s 35AD for A.Y.2026-27	**50**	**35**	**85**
(F)	**Loss from the specified business of setting up and operating a warehousing facility (after providing for deduction under section 35AD) to be carried forward as per section 73A (A-E)**	**(34)**	**(21)**	**(55)**

Notes:

(i) Deduction of 100% of the capital expenditure is available under section 35AD for A.Y.2026-27 in respect of specified business of setting up and operating a warehousing facility for storage of sugar and setting up and operating a warehousing facility for storage of agricultural produce where operations are commenced on or after 1.4.2012 or on or after 1.4.2009, respectively.

(ii) However, since setting up and operating a warehousing facility for storage of edible oils is not a specified business, Mr. A is not eligible for deduction under section 35AD in respect of capital expenditure incurred in respect of such business.

(iii) Mr. A can, however, claim depreciation@10% under section 32 in respect of the capital expenditure incurred on buildings. It is presumed that the buildings were put to use for more than 180 days during the P.Y.2025-26.

(iv) Loss from a specified business can be set-off only against profits from another specified business. Therefore, the loss of ₹ 55 lakh from the specified businesses of setting up and operating a warehousing facility for storage of food grains and sugar cannot be set-off against the profits of ₹ 28 lakh from the business of setting and operating a warehousing facility for storage of edible oils, since the same is not a specified business. Such loss can, however, be carried forward indefinitely for set-off against profits of the same or any other specified business.

ILLUSTRATION 7

Mr. Suraj, a proprietor, commenced operations of the business of a new three-star hotel in Madurai, Tamil Nadu on 1.4.2025. He incurred capital expenditure of ₹ 50 lakh during the period January, 2025 to March, 2025 exclusively for the above business, and capitalized the same in his books of account as on 1st April, 2025. Further, during the P.Y. 2025-26, he incurred capital expenditure of ₹ 2 crore (out of which ₹ 1.50 crore was for acquisition of land) exclusively for the above business.

Compute the income under the head "Profits and gains of business or profession" for the A.Y.2026-27, assuming that he has fulfilled all the conditions specified under section 35AD and opted for claiming deduction under section 35AD; and he has not claimed any deduction under Chapter VI-A under the heading "C – Deductions in respect of certain incomes". He has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

The profits from the business of running this hotel (before claiming deduction under section 35AD) for the A.Y.2026-27 is ₹ 25 lakhs. Assume that he also has another *existing business of running a four-star hotel in Coimbatore, which commenced operations fifteen years back, the profits from which are ₹ 120 lakhs for the A.Y. 2026-27. Also, assume that payments for capital expenditure were made by net banking.*

SOLUTION

Computation of profits and gains of business or profession for A.Y. 2026-27

Particulars		₹
Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)		25 lakh
***Less**:* **Deduction under section 35AD**		
Capital expenditure incurred during the P.Y.2025-26 (excluding the expenditure incurred on acquisition of land) = ₹ 200 lakh – ₹ 150 lakh	50 lakh	
Capital expenditure incurred prior to 1.4.2025 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2025	50 lakh	
Total deduction under section 35AD for A.Y.2026-27		100 lakh
Loss from the specified business of new hotel in Madurai		**(75 lakh)**
Profit from the existing business of running a hotel in Coimbatore		120 lakh
Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A		**45 lakh**

(10) Other conditions contained under section 35AD

S. No.	Particulars	Condition
1.	**Audit of accounts**	The deduction shall be allowed to the assessee only if the accounts of the assessee for the relevant P.Y. have been audited by a chartered accountant and the assessee furnishes the audit report in the prescribed form, duly signed and verified by such accountant.
2.	**Asset to be used for specified business for eight years**	Section 35AD(7A) provides that any asset in respect of which a deduction is claimed and allowed u/s 35AD shall be used only for the specified business for a period of eight years beginning with the previous year in which such asset is acquired or constructed.

3.	**(i) Asset demolished, destroyed, discarded or transferred for which a deduction has been allowed**	If any asset on which a deduction u/s 35AD has been claimed and allowed, is demolished, destroyed, discarded or transferred, the sum received or receivable for the same is chargeable to tax u/s 28(vii). This does not take into account a case where asset on which deduction u/s 35AD has been claimed is used for any purpose other than the specified business by way of a mode other than that specified above.
	(ii) Asset used for any other business other than specified business during 8 years	As per section 35AD(7B), if asset is used for any purpose other than the specified business during 8 years beginning with the previous year in which such asset is acquired, the total amount of deduction so claimed and allowed in any previous year(s) in respect of such asset, as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction had been allowed u/s 35AD, shall be deemed to be income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which the asset is so used. In such a case, as per the proviso to *Explanation 13* to Section 43(1), the actual cost of such asset for the assesse shall be the actual cost as reduced by amount of depreciation would have been allowable had the asset been used for the purpose of business since the date of its acquisition.

ILLUSTRATION 8

Mr. Arnav is a proprietor having two units – Unit A carries on specified business of setting up and operating a warehousing facility for storage of sugar; Unit B carries on non-specified business of operating a warehousing facility for storage of edible oil.

Unit A commenced operations on 1.4.2024 and it claimed deduction of ₹ 100 lakhs incurred on purchase of two buildings for ₹ 50 lakhs each (for operating a warehousing facility for storage of sugar) under section 35AD for A.Y.2025-26. However, in February, 2026, Unit A transferred one of its buildings to Unit B.

Examine the tax implications of such transfer in the hands of Mr. Arnav.

SOLUTION

Since the capital asset, in respect of which deduction of ₹ 50 lakhs was claimed u/s 35AD, has been transferred by Unit A carrying on specified business to Unit B carrying on non-specified business in the P.Y.2025-26, the deeming provision u/s 35AD(7B) is attracted during the A.Y.2026-27.

Particulars	₹
Deduction allowed u/s 35AD for A.Y.2025-26	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2025-26 [10% of ₹ 50 lakhs]	5,00,000
Deemed income under section 35AD(7B)	**45,00,000**

Mr. Arnav, however, by virtue of *proviso to Explanation 13 to* section 43(1), can claim depreciation u/s 32 on the building in Unit B for A.Y.2026-27. For the purpose of claiming depreciation on building in Unit B, the actual cost of the building would be:

Particulars	₹
Actual cost to the assessee	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2025-26 [10% of ₹ 50 lakhs]	5,00,000
Actual cost in the hands of Mr. Arnav in respect of building in its Unit B	**45,00,000**

(vi) Amortisation of Preliminary Expenses [Section 35D]

(1) Nature of expenditure: Section 35D provides for the amortisation of preliminary expenses incurred by Indian companies and other resident non-corporate taxpayers for the establishment of business concerns or the expansion of the business of existing concerns.

(2) Applicable: This section applies

(a) only to Indian companies and resident non-corporate assessees;

(b) in the case of new companies to expenses incurred before the commencement of the business;

(c) in the case of extension of an existing undertaking to expenses incurred till the extension is completed, i.e., in the case of the setting up of a new unit - expenses incurred till the new unit commences production or operation.

(3) Amount eligible for deduction: Such preliminary expenditure incurred shall be amortised over a period of 5 years. In other words, 1/5th of such expenditure is allowable as a deduction for each of the five successive previous years beginning with the previous year in which the business commences or, the previous year in which the extension of the undertaking is completed or the new unit commences production or operation, as the case may be.

(4) Eligible expenses - The following expenditure are eligible for amortisation:

(i) Expenditure in connection with–

(a) the preparation of feasibility report

(b) the preparation of project report;

(c) conducting market survey or any other survey necessary for the business of the assessee;

(d) engineering services relating to the assessee's business;

The assessee has to furnish a statement containing the particulars of above expenditure within prescribed period to the prescribed income-tax authority in the prescribed form and manner.

Accordingly, Rule 6ABBB prescribes that the statement containing particulars of above specified expenditure is required to be furnished one month prior to the due date for furnishing the return of income as specified under section 139(1).

(ii) legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up to conduct the business of assessee.

(iii) **Where the assessee is a company,** in addition to the above, expenditure incurred –

(a) by way of legal charges for drafting the Memorandum and Articles of Association of the company;

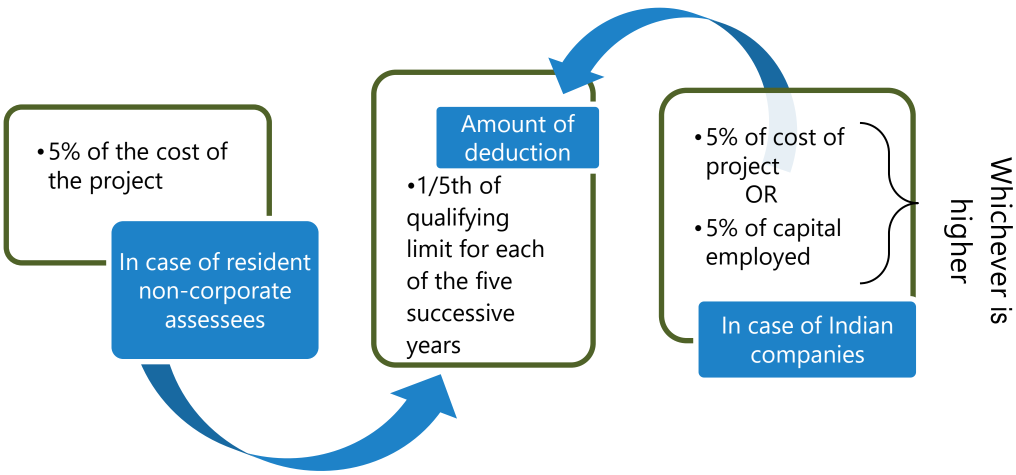
(b) on printing the Memorandum and Articles of Association;

(c) by way of fees for registering the company under the Companies Act; 1956[6],

(d) in connection with the issue, for public subscription, of the shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, printing and advertisement of the prospectus; and

(iv) Such other items of expenditure (not being expenditure qualifying for any allowance or deduction under any other provision of the Act) as may be prescribed by the Board for the purpose of amortisation. However, the Board, so far, has not prescribed any specific item of expense as qualifying for amortisation under this clause.

(5) Overall Limits - The maximum aggregate amount of the qualifying expenses that can be amortised has been fixed at 5% of the cost of the project or in the case of an Indian company, at the option of the company, 5% of the capital employed in the business of the company, whichever is higher. The excess, if any, of the qualifying expenses shall be ignored.



(6) Meaning of certain terms:

Terms	Meaning
Cost of the project	**(i) Expenses incurred before the commencement of business:** the actual cost of the fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings, railway sidings (including expenditure on the development of land, buildings) which are shown in the

[6] Now Companies Act, 2013

	books of the assessee as on the last day of the previous year in which the business of the assessee commences; **(ii) Expenses incurred for extension of the business or setting up of a new unit:** the cost of the fixed assets being land, buildings, leaseholds, plant, machinery, furniture, fittings, and railway sidings (including expenditure on the development of land and buildings) which are shown in the books of the assessee as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, in so far as such assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit.
Capital employed in the business of the company	**(i) In the case of new company**: the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the business of the company commences; **(ii) in the case of extension of the business or the setting up of a new unit**: the aggregate of the issued share capital, debentures, and long-term borrowings as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the unit commences production or operation in so far as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or the setting up of the new undertaking or the setting up of the new unit of the company.

(7) Audit of accounts: In cases where the assessee is a person other than a company or a co-operative society, the deduction would be allowable only if the accounts of the assessee for the year or years in which the expenditure is incurred have been audited by a Chartered Accountant before the date specified in section 44AB i.e., one month prior to the due date for furnishing return of income u/s 139(1); and the assessee has, by that date, furnished for the first year in which the deduction is claimed, the report of such audit in the prescribed form duly signed and verified by the auditor and setting forth such other particulars as may be prescribed.

Particulars	Due date of filing of return	Specified Date
Assessees (other than a company) subject to tax audit	31st October of the relevant A.Y.	30th September of the relevant A.Y.
	For A.Y.2026-27, on or before 31st October, 2026	For A.Y.2026-27, on or before 30th September, 2026

(8) No other deduction under any provision of the Act: It has been clarified that in case where a deduction under this section is claimed and allowed for any assessment year in respect of any item of expenditure, the expenditure in respect of which deduction is so allowed shall not qualify for deduction under any other provision of the Act for the same or any other assessment year.

(vii) Amortisation of expenditure incurred under voluntary retirement scheme [Section 35DDA]:

(1) Nature of expenditure: This section applies to an assessee who has incurred expenditure in any previous year in the form of payment to any employee in connection with his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement.

(2) Amount of deduction: The amount of **deduction allowable is one-fifth of the amount paid** for that previous year, and the balance in four equal installments in the four immediately succeeding previous years.

(3) No deduction under any other provision of the Act: No deduction shall be allowed in respect of the above expenditure under any other provision of the Act.

(viii) Other Deductions [Section 36]

This section authorises deduction of certain specific expenses. The items of expenditure and the conditions under which such expenditures are deductible are:

(1) Insurance premia paid [Section 36(1)(i)] - If insurance policy has been taken out against risk, damage or destruction of the stock or stores used for the business or profession, the premia paid is deductible. But the premium in respect of any insurance undertaken for any other purpose is not allowable under the clause.

(2) Premia paid by employer for health insurance of employees [Section 36(1)(ib)] - This clause seeks to allow a deduction to an employer in respect of premia paid by him by any mode of payment other than cash to effect or to keep in force an insurance on the health of his employees in accordance with a scheme framed by

(i) the General Insurance Corporation of India and approved by the Central Government; or

(ii) any other insurer and approved by the IRDA.

(3) Bonus and Commission [Section 36(1)(ii)] - These are deductible in full provided the sum paid to the employees as bonus or commission shall not be payable to them as profits or dividends if it had not been paid as bonus or commission.

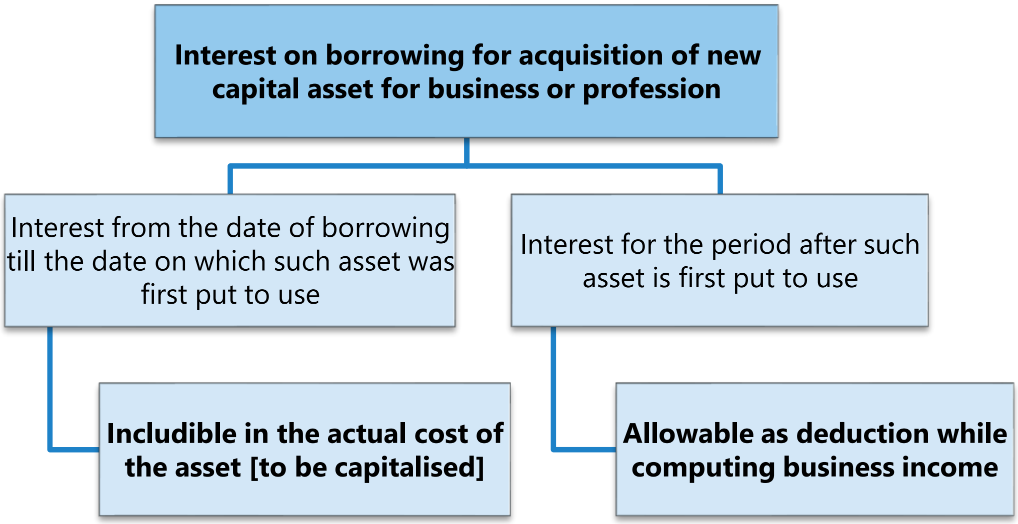
It is a provision intended to safeguard against a private company or an association escaping tax by distributing a part of its profits by way of bonus amongst the members, or employees of their own concern instead of distributing the money as dividends or profits.

(4) Interest on borrowed capital [Section 36(1)(iii)] - Deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession".

Capital may be borrowed for several purposes like for acquiring a capital asset, or to pay off a trading debt or loss etc. The scope of the expression 'for the purposes of business' is very wide. Capital may be borrowed in the course of the existing business as well as for acquiring assets for extension of existing business.

As per proviso to section 36(1)(iii), deduction in respect of any amount of interest paid, in respect of capital borrowed for acquisition of new asset (whether capitalised in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use shall not be allowed.

Explanation 8 to section 43(1) clarifies that interest relatable to a period after the asset is first put to use cannot be capitalised. Interest in respect of capital borrowed for any period from the date of borrowing to the date on which the asset was first put to use should, therefore, be capitalised.



(5) Discount on Zero Coupon Bonds (ZCBs) [Section 36(1)(iiia)] - Section 36(1)(iiia) provides deduction for the discount on ZCB on pro rata basis having regard to the period of life of the bond to be calculated in the manner prescribed.

Term	Meaning
Discount	Difference of the amount received or receivable by an infrastructure capital company/ infrastructure capital fund/ public sector company/ scheduled bank on issue of the bond and the amount payable by such company or fund or bank on maturity or redemption of the bond.
Period of life of the bond	The period commencing from the date of issue of the bond and ending on the date of the maturity or redemption.

(6) Contributions to provident and other funds [Section 36(1)(iv) and (v)] - Contribution to the employees' recognised provident fund/approved superannuation fund is allowable subject to the limits laid down for the purpose of recognizing the provident fund or approving superannuation fund.

Contribution to an approved gratuity fund is allowable subject to the condition that the gratuity fund should be for exclusive benefit of the employees under an irrevocable trust.

(7) Employer's contribution to the account of the employee under a Pension Scheme referred to in section 80CCD [Section 36(1)(iva)]

(i) Section 36(1)(iva) to provide that the employer's contribution to the account of an employee under a Pension Scheme as referred to in section 80CCD would be allowed as deduction while computing business income.

(ii) However, deduction would be restricted to 14% of salary of the employee in the previous year.

(iii) Salary, for this purpose, includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.

(8) Amount received by an assessee-employer as contribution from his employees towards their welfare fund to be allowed only if such amount is credited on or before due date under the relevant Act, Rule etc. – Section 36(1)(va) and section 57(ia) provide that deduction in respect of any sum received by the taxpayer as contribution from his employees towards any welfare fund of such employees will be allowed only if such sum is credited by the taxpayer to the employee's account in the relevant fund on or before the due date.

Due date	The date by which the assessee is required as an employer to credit such contribution to the employee's account in the relevant fund under the provisions of any law on term of contract of service or otherwise.

As per the Employees Provident Funds Scheme, 1952, the amounts under consideration in respect of wages of the employees for any particular month shall be paid within 15 days of the close of every month.

Note - It is clarified that the provisions of section 43B regarding allowability of certain expenditure in a previous year only on actual payment basis on or before due date of filing of return of income for relevant assessment year, does not apply and would deemed never to be applied on employee's contribution received by employer towards any welfare fund of such employee. In effect, the extended time upto due date of filing of return for is not available for credit of employees contribution towards any welfare fund received by the employer.

(9) Bad debts [Section 36(1)(vii) and section 36(2)] – These can be deducted subject to the following conditions:

(a) The debts or loans should be in respect of a business which was carried on by the assessee during the relevant previous year.

(b) The debt should have been taken into account in computing the income of the assessee of the previous year in which such debt is written off or of an earlier previous year or should represent money lent by the assessee in the ordinary course of his business of banking or money lending.

I. Amount of debt taken into account in computing the income of the assessee on the basis of notified ICDSs[7] to be allowed as deduction in the previous year in which such debt or part thereof becomes irrecoverable [Section 36(1)(vii)]

(i) Under section 36(1)(vii), deduction is allowed in respect of the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year.

(ii) Therefore, write off in the books of account is an essential condition for claim of bad debts under section 36(1)(vii).

(iii) Amount of debt taken into account in computing the income of the assessee on the basis of notified ICDSs to be allowed as deduction in the previous year in which such debt or part thereof becomes irrecoverable.

If a debt, which has not been recognized in the books of account as per the requirement of the accounting standards but has been taken into account in the computation of income as per the notified ICDSs, has become irrecoverable, it can still be claimed as bad debt under section 36(1)(vii) since **it shall be deemed that the debt has been written off as irrecoverable in the books of account by virtue of the second proviso to section 36(1)(vii).** This is because some ICDSs

[7] Income Computation Disclosure Standards (ICDSs) will be discussed at Final level.

require recognition of income at an earlier point of time (prior to the point of time such income is recognised in the books of account). Consequently, if the whole or part of such income recognised at an earlier point of time for tax purposes becomes irrecoverable, it can be claimed as bad debts on account of the second proviso to section 36(1)(vii).

Where the amount of such debt or part thereof has been taken into account in computing the income of the assessee **(on the basis of ICDSs without recording the same in the accounts)**

of the previous year in which such debt has become irrecoverable **or** of an earlier previous year

Such debt or part thereof shall be allowed **in the previous year in which such debt or part thereof becomes irrecoverable**

and

It shall be **deemed that such debt or part thereof has been written off as irrecoverable in the accounts**

II. Deduction of differential amount of debts due as bad debts in the year of recovery, to the extent of deficiency in recovery

If, on the final settlement, the amount recovered in respect of any debt, where deduction had already been allowed, falls short of the difference between the debt due and the amount of debt allowed, the deficiency can be claimed as a deduction from the income of the previous year in which the ultimate recovery out of the debt is made. It is permissible for the Assessing Officer to allow deduction in respect of a bad debt or any part thereof in the assessment of a particular year and subsequently to allow the balance of the amount, if any, in the year in which the ultimate recovery is made, that is to say, when the final result of the process of recovery comes to be known.

Recovery of a bad debt subsequently [Section 41(4)] - If a deduction has been allowed in respect of a bad debt under section 36, and subsequently the amount recovered in respect of such debt is more than the amount due after the allowance had been made, the excess shall be deemed to be the profits and gains of business or profession and will be chargeable as income of the previous year in which it is recovered, whether or not the business or profession in respect of which the deduction has been allowed is in existence at the time.

(10) Expenses on family planning by a company [Section 36(1)(ix)] - Any expenditure of revenue nature ***bona fide*** incurred by a company for the purpose of promoting family planning amongst its employees will be allowed as a deduction in computing the company's business income:

- Where the expenditure is of a capital nature, **one-fifth** of such expenditure will be deducted in the previous year in which it was incurred and in each of the four immediately succeeding previous years.
- This deduction is allowable **only to companies** and not to other assessees.
- The assessee would be entitled to carry forward and set off the unabsorbed part of the allowance in the same way as unabsorbed depreciation.

The capital expenditure on promoting family planning will be treated in the same way as capital expenditure for scientific research for purposes of dealing with the profit or loss on the sale or transfer of the asset including a transfer on amalgamation.

*An individual carrying on business or profession will **not** be allowed deduction of expenses incurred on promoting family planning amongst its employees.*

(11) Deduction of securities transaction tax paid [Section 36(1)(xv)] - The amount of securities transaction tax paid by the assessee during the year in respect of taxable securities transactions entered into in the course of business shall be allowed as deduction under section 36 subject to the condition that such income from taxable securities transactions is included under the head 'Profits and gains of business or profession'.

Thus, securities transaction tax paid would be allowed as a deduction like any other business expenditure.

(12) Deduction for commodities transaction tax paid in respect of taxable commodities transactions [Section 36(1)(xvi)]

(a) Section 36(1)(xvi) provides that an amount equal to the CTT paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year shall be allowable as deduction, if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".

(b) A 'taxable commodities transaction' means a transaction of sale of commodity derivatives or sale of commodity derivatives based on prices or indices of prices of commodity derivatives or option on commodity derivatives or option in goods in respect of commodities, other than agricultural commodities, traded in recognised stock exchange.

(c) **A "commodity derivative"** means –

(1) A contract for delivery of goods which is not a ready delivery contract

(2) A contract for differences which derives its value from prices or indices of prices -

(i) of such underlying goods; or

(ii) of related services and rights, such as warehousing and freight; or

(iii) with reference to weather and similar events and activities having a bearing on the commodity sector.

(ix) Residuary Expenses [Section 37]

(1) Revenue expenditure incurred for purposes of carrying on the business, profession or vocation - This is a residuary section under which only business expenditure is allowable but not the business losses, e.g., those arising out of embezzlement, theft, destruction of assets, misappropriation by employees etc. The deduction is limited only to the amount actually expended and does not extend to a reserve created against a contingent liability.

(2) **Conditions for allowance**: The following conditions should be fulfilled in order that a particular item of expenditure may be deductible under this section:

(a) The expenditure should **not** be of the nature described in **sections 30 to 36**.

(b) It should have been **incurred by the assessee** in the accounting year.

(c) It should be in respect of a business carried on by the assessee the profits of which are being computed and assessed.

(d) It must have been incurred after the business was set up.

(e) It should **not** be in the nature of **any personal expenses** of the assessee.

(f) It should have been laid out or expended **wholly and exclusively for the purposes of such business**.

(g) It should **not** be in the nature of **capital expenditure**.

(h) The expenditure should **not** have been incurred by the assessee for any purpose which is an **offence or is prohibited by law**.

This section is thus limited in scope. It does not permit an assessee to make all deductions which a prudent trader would make in ascertaining his own profit. It might be observed that the section requires that the expenditure should be wholly and exclusively laid out for purpose of the business but not that it should have been necessarily laid out for such purpose. Therefore, expenses wholly and exclusively laid out for the purpose of trade are, subject to the fulfilment of other conditions, allowed under this section even though the outlay is unnecessary.

(3) **Expenditure incurred on Keyman insurance policy:** *CBDT Circular no. 762/1998 dated 18.02.1998* clarifies that the premium paid on the Keyman Insurance Policy is allowable as business expenditure.

The Punjab and Haryana High Court held that, "the Keyman Insurance Policy when obtained to secure the life of a partner to safeguard the firm against a disruption of the business is equally for the benefit of the partnership business which may be effected as a result of premature death of a partner. Thus, the premium on the Keyman Insurance Policy of partner of the firm is wholly and exclusively for the purpose of business and is allowable as business expenditure".

The CBDT accepted the view of the High Court, accordingly, vide *Circular no. 38/2016* has clarified that, in case of a firm, premium paid by the firm on the Keyman Insurance Policy of a partner, to safeguard the firm against a disruption of the business, is an admissible expenditure under section 37.

(4) ***Explanation 1* to section 37(1) -** This *Explanation* provides that any expenditure incurred by the assessee for any purpose which is an offence or which is prohibited by law shall not be allowed as a deduction or allowance.

(5) ***Explanation* 3 to section 37(1) –** It is clarified that the expression "expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law" in (4) above would include and would be deemed to have always included the expenditure incurred by an assessee, -

(i) for any purpose which is an offence under any law for the time being in force, in India or outside India or which is prohibited by any law for the time being in force, in India or outside India; or

(ii) to provide any benefit or perquisite, in whatever form, to a person, whether or not carrying on a business or exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guidelines, as the case may be, for the time being in force, governing the conduct of such person; or

(iii) to compound an offence under any law for the time being in force, in India or outside India; or

(iv) to settle proceedings initiated in relation to contravention under such law as may be notified by the Central Government in this behalf.

W.e.f. 23.4.2025, the Central Government has, vide notification no. 38/2025 dated 23.4.2025, notified that any expenditure incurred to settle proceedings initiated in relation to contravention or defaults under the following laws shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure –

(a) the Securities and Exchange Board of India Act, 1992;

(b) the Securities Contracts (Regulation) Act, 1956;

(c) the Depositories Act, 1996;

(d) the Competition Act, 2002.

For eg: expenses incurred in providing freebies to medical practitioner by pharmaceutical and allied health sector industry are in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations. Hence, such expenditure is considered to be expenses prohibited by the law and not allowed in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebies.

(6) Disallowance of CSR expenditure *[Explanation 2* to Section 37(1)]

(i) Section 135 of the Companies Act, 2013 read with Schedule VII thereto and Companies (Corporate Social Responsibility) Rules, 2014 are the special provisions under the company law regime imposing mandatory CSR obligations in respect of companies having net worth/turnover/net profit exceeding specified threshold limits. Such companies have to spend a specified percentage of their average net profits on CSR activities.

(ii) Under section 37(1), only expenditure, not covered under sections 30 to 36, and incurred wholly and exclusively for the purposes of the business is allowed as a deduction while computing taxable business income. The issue under consideration is whether CSR expenditure is allowable as deduction under section 37.

(iii) It has been clarified that for the purposes of section 37(1), any expenditure incurred by an assessee on the activities relating to CSR referred to in section 135 of the Companies Act, 2013 shall not be deemed to have been incurred for the purpose of business and hence, shall not be allowed as deduction under section 37.

(iv) The rationale behind the disallowance is that CSR expenditure, being an application of income, is **not** incurred wholly and exclusively for the purposes of carrying on business.

(v) However, the Explanatory Memorandum to the Finance (No.2) Bill, 2014 clarifies that CSR expenditure, which is of the nature described in sections 30 to 36, shall be allowed as deduction under those sections subject to fulfillment of conditions, if any, specified therein.

(7) Advertisements in souvenirs of political parties: Section 37(2B) disallows any deduction on account of advertisement expenses representing contributions made by any person carrying on business or profession in computing the profits and gains of the business or profession. It has specifically been provided that this provision for disallowance would apply notwithstanding anything to the contrary contained in section 37(1).

In other words, the expenditure representing contribution for political purposes would become disallowable even in those cases where the expenditure is otherwise incurred by the assessee in his character as a trader and the amount is wholly and exclusively incurred for the purpose of the business.

Accordingly, a taxpayer would not be entitled to any deduction in respect of expenses incurred by him on advertisement in any souvenir, brochure, tract or the like published by any political party, whether it is registered with the Election Commission of India or not.

3.7 INADMISSIBLE DEDUCTIONS [SECTION 40]

By dividing the assessees into distinct groups, this section places absolute restraint on the deductibility of certain expenses as follows:

In the case of any assessee, the following expenses are not deductible:

(1) Section 40(a)(i)

Any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable, -

(a) outside India;

(b) in India to a non-resident non-corporate or to a foreign company,

on which tax is deductible at source under Chapter XVIIB and such tax has not been deducted or, after deduction, has not been paid on or before the due date of filing of return specified under section 139(1).

It is also provided that where in respect of any such sum, where tax has been deducted in any subsequent year, or has been deducted in the previous year but paid after the due date of filing of return under section 139(1), such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

In case, assessee fails to deduct the whole or any part of tax on any such sum but is not deemed as assessee in default under the first proviso to section 201(1) by reason that such payee –

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed,

it would be deemed that the assessee has deducted and paid the tax on such sum on the date on which return of income has been furnished by the payee.

Since the date of furnishing the return of income by the payee is taken to be the date on which the payer has deducted tax at source and paid the same, such expenditure/payment in respect of which the payer has failed to deduct tax at source shall be disallowed under section 40(a)(i) in the year in which the said expenditure is incurred. However, such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the payee, since tax is deemed to have been deducted and paid by the payer in that year.

(2) Section 40(a)(ia)

Section 40(a)(ia) provides that **30% of any sum payable to a resident**, on which tax is deductible at source under Chapter XVII-B**,** shall be disallowed if –

(i) such tax has not been deducted; or

(ii) such tax, after deduction, has not been paid on or before the due date specified in section 139(1).

If in respect of such sum, tax has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified in section 139(1), 30% of such sum shall be allowed as deduction in computing the income of the previous year in which such tax has been paid.

In case, assessee fails to deduct the whole or any part of tax on any such sum but is not deemed as assessee in default under the first proviso to section 201(1) by reason that such payee –

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed,

it would be deemed that the assessee has deducted and paid the tax on such sum.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the payee.

Since the date of furnishing the return of income by the payee is taken to be the date on which the payer has deducted tax at source and paid the same, 30% of such expenditure/payment in respect of which the payer has failed to deduct tax at source shall be disallowed under section 40(a)(ia) in the year in which the said expenditure is incurred. However, 30% of such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the payee, since tax is deemed to have been deducted and paid by the payer in that year.

Example: *Tax on royalty paid to Mr. A, a resident, has been deducted during the previous year 2025-26, the same has to be paid by 31st July/ 31st October, 2026, as the case may be. Otherwise, 30% of royalty paid would be disallowed in computing the income for A.Y.2026-27. If in respect of such royalty, tax deducted during the P.Y.2025-26 has been paid after 31st July/31st October, 2026, 30% of such royalty, disallowed in A.Y.2026-27, would be allowed as deduction in the year of payment, i.e., A.Y.2027-28.*

Note - *Students are advised to read Chapter 7 on "Advance tax, tax deduction at source and tax collection at source" before solving this illustration.*

ILLUSTRATION 9

Delta Ltd. credited the following amounts to the account of resident payees in the month of March, 2026 without deduction of tax at source. What would be the consequence of non-deduction of tax at source by Delta Ltd. on these amounts during *the financial year 2025-26, assuming that the resident payees in all the cases mentioned below, have not paid the tax, if any, which was required to be deducted by Delta Ltd.?*

	Particulars	***Amount in ₹***
(1)	*Salary to its employee, Mr. X (credited and paid in March, 2026)*	*14,00,000*
(2)	*Directors' remuneration (credited in March, 2026 and paid in April, 2026)*	*28,000*

Would your answer change if Delta Ltd. has deducted tax on directors' remuneration in April, 2026 at the time of payment and remitted the same in July, 2026?

SOLUTION

Non-deduction of tax at source on any sum payable to a resident on which tax is deductible at source as per the provisions of Chapter XVII-B would attract disallowance u/s 40(a)(ia).

Therefore, non-deduction of tax at source on any sum paid by way of salary on which tax is deductible u/s 192 or any sum credited or paid by way of directors' remuneration on which tax is deductible u/s 194J, would attract disallowance@30% u/s 40(a)(ia). Whereas in case of salary, tax has to be deducted u/s 192 at the time of payment, in case of directors' remuneration, tax has to be deducted at the time of credit of such sum to the account of the payee or at the time of payment, whichever is earlier. Therefore, in both the cases i.e., salary and directors' remuneration, tax is deductible in the P.Y.2025-26, since salary was paid in that year and directors' remuneration was credited in that year. Therefore, the amount to be disallowed u/s 40(a)(ia) while computing business income for A.Y.2026-27 is as follows –

	Particulars	**Amount paid in ₹**	**Disallowance u/s 40(a)(ia) @30%**
(1)	Salary [tax is deductible under section 192]	14,00,000	4,20,000
(2)	Directors' remuneration [tax is deductible under section 194J without any threshold limit]	28,000	8,400
Disallowance under section 40(a)(ia)			**4,28,400**

If the tax is deducted on directors' remuneration in the next year i.e., P.Y.2026-27 at the time of payment and remitted to the Government, the amount of ₹ 8,400 would be allowed as deduction while computing the business income of A.Y. 2027-28.

Disallowance of any sum paid to a resident at any time during the previous year without deduction of tax under section 40(a)(ia) [Circular No.10/2013, dated 16.12.2013]

There have been conflicting interpretations by judicial authorities regarding the applicability of provisions of section 40(a)(ia), with regard to the amount not deductible in computing the income chargeable under the head 'Profits and gains of business or profession'. Some court rulings have held that the provisions of disallowance under section 40(a)(ia) apply only to the amount which remained payable at the end of the relevant financial year and would not be invoked to disallow the amount which had actually been paid during the previous year without deduction of tax at source.

Departmental View: The CBDT's view is that the provisions of section 40(a)(ia) would cover not only the amounts which are payable as on 31st March of a previous year but also amounts which are payable at any time during the year. The statutory provisions are amply clear and in the context of section 40(a)(ia), the term "payable" would include "amounts which are paid during the previous year".

ILLUSTRATION 10

During the financial year 2025-26, the following payments/expenditure were made/ incurred by Mr. Raja, a resident individual (whose turnover during the year ended 31.3.2025 was ₹ 99 lakhs):

(i) Interest of ₹ 45,000 was paid to Rehman & Co., a resident partnership firm, without deduction of tax at source;

(ii) ₹ 15,00,000 was paid as salary to a resident individual without deduction of tax at source;

(iii) Commission of ₹ 26,000 was paid to Mr. Vidyasagar, a resident, on 2.7.2025 without deduction of tax at source.

Briefly discuss whether any disallowance arises under the provisions of section 40(a)(ia) assuming that the payees in all the cases mentioned above, have not paid the tax, if any, which was required to be deducted by Mr. Raja?

SOLUTION

Disallowance under section 40(a)(ia) of the Income-tax Act, 1961 is attracted where the assessee fails to deduct tax at source as is required under the Act, or having deducted tax at source, fails to remit the same to the credit of the Central Government within the stipulated time limit.

(i) The obligation to deduct tax at source from interest paid to a resident arises u/s 194A in the case of an individual, whose total turnover in the immediately preceding P.Y., i.e., P.Y.2024-25 exceeds ₹ 1 crore. Thus, in present case, since the turnover of the assessee is less than ₹ 1 crore, he is not liable to deduct tax at source. Hence, disallowance u/s 40(a)(ia) is not attracted in this case.

(ii) The disallowance of 30% of the sums payable under section 40(a)(ia) would be attracted in respect of all sums on which tax is deductible under Chapter XVII-B. Section 192, which requires deduction of tax at source from salary paid, is covered under Chapter XVII-B. The obligation to deduct tax at source under section 192 arises, in the hands all assessee-employer even if the turnover amount does not exceed ₹ 1 crore in the immediately preceding previous year.

Therefore, in the present case, the disallowance under section 40(a)(ia) is attracted for failure to deduct tax at source under section 192 from salary payment. However, only 30% of the amount of salary paid without deduction of tax at source would be disallowed.

(iii) The obligation to deduct tax at source under section 194H from commission paid in excess of ₹ 20,000 to a resident arises in the case of an individual, whose total turnover in the immediately preceding previous year, i.e., P.Y.2024-25 exceeds ₹ 1 crore. Thus, in present case, since the turnover of the assessee is less than ₹ 1 crore, he is not liable to deduct tax at source u/s 194H. Mr. Raja is not required to deduct tax at source u/s 194M also since the aggregate of such commission to Mr. Vidyasagar does not exceed ₹ 50 lakh during the P.Y. 2025-26. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

(3) Section 40(a)(ii)

Any sum paid on account of any rate or tax levied on profits on the basis of or in proportion to the profits and gains of any business or profession.

It is clarified that the term "tax" would include and would be deemed to have always included any surcharge or cess on such tax. Hence, tax including surcharge and cess would be disallowed while computing business income [*Explanation 3* to section 40(a)(ii)].

(4) Section 40(a)(iii)

Any sum which is chargeable under the head 'Salaries' if it is payable outside India or to a non-resident and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B.

(5) Section 40(a)(iv)

Any contribution to a provident fund or the fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to make sure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head 'Salaries'.

(6) Section 40(a)(v)

Tax paid on perquisites on behalf of employees is not deductible - In case of an employee, deriving income in the nature of perquisites (other than monetary payments), the amount of tax on such income paid by his employer is exempt from tax in the hands of that employee.

Correspondingly, such payment is not allowed as deduction from the income of the employer. Thus, the payment of tax on non-monetary perquisites by an employer on behalf of employee will be exempt from tax in the hands of employee but will not be allowable as deduction in the hands of the employer.

In the case of any firm assessable as such or a limited liability partnership (LLP), the following amounts shall not be deducted in computing the business income

Section 40(b)

(1) Remuneration to non-working partner - Any salary, bonus, commission, remuneration by whatever name called, to any partner who is not a working partner. (In the following discussion, the term 'remuneration' is applied to denote payments in the nature of salary, bonus, commission);

(2) Remuneration to a working partner not authorized by deed - Any remuneration paid to the working partner or interest to any partner which is not authorised by or which is inconsistent with the terms of the partnership deed;

(3) Remuneration to a working partner or interest to a partner authorized by deed but relates to an earlier period - It is possible that the current partnership deed may authorise payments of remuneration to any working partner or interest to any partner for a period which is prior to the date of the current partnership deed. The approval by the current partnership deed might have been necessitated due to the fact that such payment was not authorised by or was inconsistent with the earlier partnership deed. Such payments of remuneration or interest will also be disallowed. However, it should be noted that the current partnership deed cannot authorise any payment which relates to a period prior to the date of earlier partnership deed.

Next, by virtue of a further restriction contained in section 40(b)(iii), such remuneration paid to the working partners will be allowed as deduction to the firm from the date of such partnership deed and not for any period prior thereto.

Example: *If a firm incorporates the clause relating to payment of remuneration to the working partners, by executing an appropriate deed, say, on July 1, 2025 but effective from April 1, 2025, the firm would get deduction for the remuneration paid to its working partners from July 1, 2025 onwards, but not for the period from April 1 to June 30. It will not be possible to give retrospective effect to oral agreements entered into vis a vis such remuneration prior to putting the same in a written partnership deed.*

(4) Interest to any partner in excess of 12% p.a.- Any interest payment authorised by the partnership deed falling after the date of such deed to the extent such interest exceeds 12% simple interest p.a.

(5) Remuneration to a working partner in excess of prescribed limits - Any remuneration paid to a working partner, authorised by a partnership deed and falling after the date of the deed in excess of the following limits:

Book Profit	Quantum of deduction
On the first ₹ 6 lakh of book profit or in case of loss	₹ 3,00,000 or 90% of book profit, whichever is higher
On the balance of book profit	60% of book profit

(6) Meaning of certain terms:

Term	Meaning
Book Profit	The net profit as shown in the profit and loss account for the relevant previous year computed in accordance with the provisions for computing income from profits and gains [*Explanation 3* to section 40(b)]. The above amount should be increased by the remuneration paid or payable to all the partners of the firm if the same has been deducted while computing the net profit.
Working partner	An individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner [*Explanation 4* to section 40(b)]

ILLUSTRATION 11

A firm has paid ₹ 8,50,000 as remuneration to its partners for the P.Y.2025-26, in accordance with its partnership deed, and it has a book profit of ₹ 10 lakhs. What is the remuneration allowable as deduction?

SOLUTION

The allowable remuneration calculated as per the limits specified in section 40(b)(v) would be –

Particulars	₹
On first ₹ 6 lakh of book profit [₹ 6,00,000 × 90%]	5,40,000
On balance ₹ 4 lakh of book profit [₹ 4,00,000 × 60%]	2,40,000
	7,80,000

The excess amount of ₹ 70,000 (i.e., ₹ 8,50,000 – ₹ 7,80,000) would be disallowed as per section 40(b)(v).

(7) *Explanations* to section 40(b)

(1) Where an individual is a partner in a firm in a representative capacity:

(i) interest paid by the firm to such individual otherwise than as partner in a representative capacity shall not be taken into account for the purposes of this clause.

(ii) interest paid by the firm to such individual as partner in a representative capacity and interest paid by the firm to the person so represented shall be taken into account for the purposes of this clause [*Explanation 1* to section 40(b)]

(2) Where an individual is a partner in a firm otherwise than in a representative capacity, interest paid to him by the firm shall not be taken into account if he receives the same on behalf of or for the benefit of any other person [*Explanation 2* to section 40(b)].

ILLUSTRATION 12

Rao & Jain, a partnership firm consisting of two partners, reports a net profit of ₹ 17,00,000 before deduction of the following items:

(1) Salary of ₹ 40,000 each per month payable to two working partners of the firm (as authorized by the deed of partnership).

(2) Depreciation on plant and machinery under section 32 (computed) ₹ 1,50,000.

(3) Interest on capital at 15% per annum (as per the deed of partnership). The amount of capital eligible for interest is ₹ 5,00,000.

Compute:

(i) Book-profit of the firm under section 40(b) of the Income-tax Act, 1961.

(ii) Allowable working partner salary for the A.Y. 2026-27 as per section 40(b).

SOLUTION

(i) As per *Explanation 3* to section 40(b), "book profit" shall mean the net profit as per the profit and loss account for the relevant previous year computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to the partners of the firm if the same has been already deducted while computing the net profit.

In the present case, the net profit given is before deduction of depreciation on plant and machinery, interest on capital of partners and salary to the working partners. Therefore, the book profit shall be as follows:

Computation of Book Profit of the firm under section 40(b)

Particulars	₹	₹
Net Profit (before deduction of depreciation, salary and interest)		17,00,000

Less:	Depreciation under section 32	1,50,000	
	Interest @ 12% p.a. [being the maximum allowable as per section 40(b)] (₹ 5,00,000 ×12%)	60,000	2,10,000
Book Profit			**14,90,000**

(ii) Salary actually paid to working partners = ₹ 40,000 × 2 × 12 = ₹ 9,60,000.

As per the provisions of section 40(b)(v), the salary paid to the working partners is allowed subject to the following limits -

On the first ₹ 6,00,000 of book profit or in case of loss	₹ 3,00,000 or 90% of book profit, whichever is more
On the balance of book profit	60% of the balance book profit

Therefore, the maximum allowable working partners' salary for the A.Y. 2026-27 in this case would be:

Particulars	₹
On the first ₹ 6,00,000 of book profit [(₹ 3,00,000 or 90% of ₹ 6,00,000) whichever is more]	5,40,000
On the balance of book profit [60% of (₹ 14,90,000 - ₹ 6,00,000)]	5,34,000
Maximum allowable partners' salary	10,74,000

Hence, allowable working partners' salary for the A.Y.2026-27 as per the provisions of section 40(b)(v) is ₹ 9,60,000.

3.8 EXPENSES OR PAYMENT NOT DEDUCTIBLE IN CERTAIN CIRCUMSTANCES [SECTION 40A]

(i) Payments to relatives and associates

Section 40A(2) provides that where the assessee incurs any expenditure in respect of which a payment has been or is to be made to a specified person *[See column (2) of Table below)* so much of the expenditure as is considered to be excessive or unreasonable shall be disallowed by the Assessing Officer. While doing so he shall have due regard to:

(a) the fair market value of the goods, service of facilities for which the payment is made; or

(b) the legitimate needs of the business or profession carried on by the assessee; or

(c) the benefit derived by or accruing to the assessee from such a payment.

<table>
<tr><th>Assessee</th><th>Specified Person</th></tr>
<tr><th>(1)</th><th>(2)</th></tr>
<tr><td>Individual</td><td>1. Any relative of the individual assessee
2. Any person who carries on a business or profession, if
• the individual assessee has a substantial interest in the business of that person <u>or</u>
• any relative of the individual assessee has a substantial interest in the business of that person</td></tr>
<tr><td>Company, Firm, HUF or AOP</td><td>1. Any director of the company, partner of the firm or member of the family or association <u>or</u> any relative of such director, partner or member <u>or</u>
2. In case of a company assessee, any individual who has substantial interest in the business or profession of the company or any relative of such individual <u>or</u>
3. Any person who carries on a business or profession, in which the Company/ Firm/ HUF/ AOP or director of the company, partner of the firm or member of the family or association or any relative of such director, partner or member has substantial interest in the business of that person.</td></tr>
<tr><td>All assessees</td><td>The following are specified persons:
<table>
<tr><th>Person who has substantial interest in the assessee's business</th><th>Other related persons of such person, who has a substantial interest in the assessee's business</th></tr>
<tr><td>Company/ AOP/ Firm/ HUF</td><td>• Any director of such company, partner of such firm or the member of such family or association <u>or</u>
• any relative of such director, partner or member <u>or</u>
• Any other company carrying on business or profession in which the first mentioned company has a substantial interest</td></tr>
</table>
</td></tr>
</table>

	a director, partner or member	• Company/ Firm/ AOP/ HUF of which he is a director, partner or member **<u>or</u>** • Any other director/ partner/ member of the such Company/Firm/ AOP/ HUF **<u>or</u>** • Any relative of such director, partner or member

Relative, in relation to an "individual", means the spouse, brother or sister or any lineal ascendant or descendant of that individual [Section 2(41)].

Substantial interest in a business or profession
A person shall be deemed to have a substantial interest in a business or profession if - - in a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of equity shares carrying not less than 20% of the voting power and - in any other case, such person is, at any time during the previous year, beneficially entitled to not less than 20% of the profits of such business or profession.

(ii) Payments in excess of ₹ 10,000 made otherwise than through prescribed modes

According to section 40A(3), where the assessee incurs any expenditure, in respect of which payment or aggregate of **payments made to a person in a day <u>otherwise than by</u> an account payee cheque drawn on a bank or by an account payee bank draft or use of electronic system through bank account or through such other prescribed electronic modes exceeds ₹ 10,000, such expenditure shall not be allowed as a deduction.**

The prescribed electronic modes are credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

The provision applies to all categories of expenditure involving payments for goods or services which are deductible in computing the taxable income.

Example: *If, in respect of an expenditure of ₹ 32,000 incurred by X Ltd., 4 cash payments of ₹ 8,000 are made on a particular day to one Mr. Y – one in the morning at 10 a.m., one at 12 noon, one at 3 p.m. and one at 6 p.m., the entire expenditure of ₹ 32,000 would be disallowed under section 40A(3), since the aggregate of cash payments made during a day to Mr. Y exceeds ₹ 10,000.*

Payments in excess of ₹ 10,000 made otherwise than through prescribed modes deemed to be the income of the subsequent year, if expenditure has been allowed as deduction in any previous year on due basis:

In case of an assessee following mercantile system of accounting, if an expenditure has been allowed as deduction in any previous year on due basis, and payment has been made in a subsequent year otherwise than by account payee cheque or account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay, then the payment so made shall be deemed to be the income of the subsequent year if such payment or aggregate of payments made to a person in a day exceeds ₹ 10,000 [Section 40A(3A)].

Increased limit of ₹ 35,000 applicable, where payment is made to transport operator: The limit would be ₹ 35,000 in case of payment made to transport operators for plying, hiring or leasing goods carriages, otherwise than through prescribed modes. Therefore, payment or aggregate of payments up to ₹ 35,000 in a day can be made to a transport operator **<u>otherwise than by</u>** way of account payee cheque or account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay. In all other cases, the limit would continue to be ₹ 10,000.

Cases where disallowances would not be attracted:

(i) **Loan transactions:** It does not apply to loan transactions because advancing of loans or repayments of the principal amount of loan does not constitute an expenditure deductible in computing the taxable income. However, interest payments of amounts exceeding ₹ 10,000 at a time are required to be made by account payee cheques or drafts or electronic clearing system or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay as interest is a deductible expenditure.

(ii) Payment made by commission agents: This requirement does not apply to payment made by commission agents for goods received by them for sale on commission or consignment basis because such a payment is not an expenditure deductible in computing the taxable income of the commission agent.

For the same reason, this requirement does not apply to advance payment made by the commission agent to the party concerned against supply of goods.

However, where commission agent purchases goods on his own account but not on commission basis, the requirement will apply. The provisions regarding payments by account payee cheque or draft or electronic clearing system or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay apply equally to payments made for goods purchased on credit.

Cases and circumstances in which a payment or aggregate of payments exceeding ten thousand rupees may be made to a person in a day, otherwise than by an account payee cheque/ account payee bank draft/ use of ECS through a bank account or through such other electronic modes prescribed in Rule 6ABBA [Rule 6DD]:

As per this rule, no disallowance under section 40A(3) shall be made and no payment shall be deemed to be the profits and gains of business or profession under section 40A(3A) where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and

BHIM (Bharat Interface for Money) Aadhar Pay, exceeds ₹ 10,000 in the cases and circumstances specified hereunder, namely:

(a) where the payment is made to

(i) the Reserve Bank of India or any banking company;

(ii) the State Bank of India or any subsidiary bank;

(iii) any co-operative bank or land mortgage bank;

(iv) any primary agricultural credit society or any primary credit society;

(v) the Life Insurance Corporation of India;

(b) where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender;

(c) where the payment is made by

(i) any letter of credit arrangements through a bank;

(ii) a mail or telegraphic transfer through a bank;

(iii) a book adjustment from any account in a bank to any other account in that or any other bank;

(iv) a bill of exchange made payable only to a bank;

(d) where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;

(e) where the payment is made for the purchase of -

(i) agricultural or forest produce; or

(ii) the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or

(iii) fish or fish products; or

(iv) the products of horticulture or apiculture,

to the cultivator, grower or producer of such articles, produce or products;

Notes -

(i) The expression 'fish or fish products' (iii) above would include 'other marine products such as shrimp, prawn, cuttlefish, squid, crab, lobster etc.'.

(ii) The 'producers' of fish or fish products for the purpose of Rule 6DD(e) would include, besides the fishermen, any headman of fishermen, who sorts the catch of fish brought by fishermen from the sea, at the sea shore itself and then sells the fish or fish products to traders, exporters etc.

However, the above exception will not be available on the payment for the purchase of fish or fish products from a person who is not proved to be a 'producer' of these goods and is only a trader, broker or any other middleman, by whatever name called.

(f) where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;

(g) where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;

(h) where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed ₹ 50,000;

(i) where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of section 192 of the Act, and when such employee-

(i) is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship; and

(ii) does not maintain any account in any bank at such place or ship;

(j) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;

(k) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travelers cheques in the normal course of his business.

Note: Where any payment in respect of any expenditure is required to be made by an account payee cheque/account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic modes in order that such expenditure may not be disallowed as a deduction under section 40A(3), then the payment may be made by such cheque or draft or electronic clearing system or through such other prescribed electronic modes.

No person is allowed to raise, in any suit or other proceeding, a plea based on the ground that the payment was not made or tendered in cash or in any other manner.

This is notwithstanding anything contained in any other law for the time being in force or in any contract.

(iii) Disallowance of provision for gratuity

Section 40A(7) provides that no deduction would be allowable to any taxpayer carrying on any business or profession in respect of any provision (whether called as provision or by any other names) made by him towards the payment of gratuity to his employers on their retirement or on the termination of their employment for any reason.

The reason for this disallowance is that, under section 36(1)(v), deduction is allowable in computing the profits and gains of the business or profession in respect of any sum paid by a taxpayer in his capacity as an employer in the form of contributions made by him to an approved gratuity fund created for the exclusive benefit of his employees under an irrevocable trust. Further, section 37(1) provides that any expenditure other than the expenditure of the nature described in sections 30 to 36 laid out or expended, wholly and exclusively for the purpose of the business or profession must be allowed as a deduction in computing the taxable income from business.

A reading of these two provisions clearly indicates that the intention of the legislature has always been that the deduction in respect of gratuity be allowable to the employer either in the year in which the gratuity is actually paid or in the year in which contributions to an approved gratuity fund are actually made by employer.

This provision, therefore, makes it clear that any amount claimed by the assessee towards provision for gratuity, by whatever name called would be disallowable in the assessment of employer even if the assessee follows the mercantile system of accounting.

However, no disallowance would be made as per section 40A(7) in the case where any provision is made by the employer for the purpose of payment of sum by way of contribution to an approved gratuity fund during the previous year or for the purpose of making payment of any gratuity that has become payable during the previous year by virtue of the employee's retirement, death, termination of service etc.

Further, where any provision for gratuity for any reason has been allowed as a deduction to the assessee for any assessment year, any sum paid out of such provision by way of contribution towards an approved gratuity fund or by way to gratuity to employee shall not be allowed as deduction to the assessee in the year in which it is paid.

(iv) Contributions by employers to funds, trust etc. [Section 40A(9)]

This sub-section has been introduced to curb the growing practice amongst employers to claim deductions from taxable profits of the business of contributions made apparently to the welfare of employees from which, however, no genuine benefit flows to the employees.

Accordingly, no deduction will be allowed where the assessee pays in his capacity as an employer, any sum towards setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860 or other institution for any purpose.

However, where such sum is paid in respect of funds covered by sections 36(1)(iv), 36(1)(iva) and 36(1)(v) or any other law, then, the deduction will not be denied.

ILLUSTRATION 13

X Ltd. contributes 20% of basic salary to the account of each employee under a pension scheme referred to in section 80CCD. Dearness Allowance is 40% of basic salary and it forms part of pay of the employees.

Compute the amount of deduction allowable under section 36(1)(iva), if the basic salary of the employees aggregate to ₹ 10 lakh. Would disallowance under section 40A(9) be attracted, and if so, to what extent?

SOLUTION

Computation of deduction u/s 36(1)(iva) and disallowance u/s 40A(9)

Particulars	₹
Basic Salary	10,00,000
Dearness Allowance@40% of basic salary [DA forms part of pay]	4,00,000
Salary for the purpose of section 36(1)(iva) (Basic Salary + DA)	**14,00,000**
Actual contribution (20% of basic salary i.e., 20% of ₹ 10 lakh)	2,00,000
Less: **Permissible deduction under section 36(1)(iva) (14% of basic salary plus dearness pay = 14% of ₹ 14,00,000 = ₹ 1,96,000)**	**1,96,000**
Excess contribution disallowed under section 40A(9)	4,000

3.9 PROFITS CHARGEABLE TO TAX [SECTION 41]

This section enumerates certain receipts which are deemed to be income under the head "business or profession." Such receipts would attract charge even if the business from which they arise had ceased to exist prior to the year in which the liability under this section arises. The particulars of such receipts are given below:

(i) Remission or cessation of trading liability [Section 41(1)]

Suppose an allowance or deduction has been made in any assessment year in respect of loss, expenditure or trading liability incurred by A. Subsequently, if A has obtained, whether in cash or in any manner whatsoever, any amount in respect of such loss or expenditure of some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by A, or the value of benefit accruing to him shall be taxed as income of that previous year. It does not matter whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not.

It is possible that after the above allowance in respect of loss, expenditure, or trading liability has been given to A, he could have been succeeded in his business by another person. In such a case, the successor will be liable to be taxed in respect of any such benefit received by him during a subsequent previous year.

Successor in business:

(i) Where there has been an amalgamation of a company with another company, the successor will be the amalgamated company.

(ii) Where a firm carrying on a business or profession is succeeded by another firm, the successor will be the other firm.

(iii) In any other case, where one person is succeeded by any other person in that business or profession, the other person will be the successor.

(iv) In case of a demerger, the successor will be the resulting company.

Remission or cessation of a trading liability includes remission or cessation of liability by a unilateral act of the assessee by way of writing off such liability in his accounts.

(ii) Balancing charge, Sale of capital asset used for scientific research, Recovery of a bad debt subsequently etc. [Section 41(2),(3) & (4)]

The provisions of section 41(2) relating to balancing charge, of section 41(3) relating to assets acquired for scientific research and of section 41(4) dealing with recovery of bad debts have been dealt with earlier under the respective items.

(iii) Brought forward losses of defunct business [Section 41(5)]

In cases where a receipt is deemed to be profit of a business under section 41 relating to a business that had ceased to exist and there is an unabsorbed loss, not being a speculation loss, which arose in that business during the previous year in which it had ceased to exist and which has not been set off, it would be set off against income that is chargeable under this section even after the expiry of 8 years.

3.10 CHANGES IN THE RATE OF EXCHANGE OF CURRENCY [SECTION 43A]

(1) The section provides that where an assessee has acquired any asset from a foreign country for the purpose of his business or profession, and due to a change thereafter in the exchange rate of the two currencies involved, there is an increase or decrease in the liability (expressed in Indian rupees) of the assessee at the time of making the payment, towards the whole or part of the cost of the asset or towards repayment of the whole or a part of the

money borrowed by him from any person, directly or indirectly, in any foreign currency specifically for the purpose of acquiring the asset along with the interest, if any, the following values may be changed accordingly with respect to the increase or decrease in such liability:

(i) the actual cost of the asset under section 43(1)

(ii) the amount of capital expenditure incurred on scientific research under section 35(1)(iv)

(iii) the amount of capital expenditure incurred by a company for promoting family planning amongst its employees under section 36(1)(ix)

(iv) the cost of acquisition of a non-depreciable capital asset falling under section 48.

The amount arrived at after making the above adjustment shall be taken as the amount of capital expenditure or the cost of acquisition of the capital asset, as the case may be.

(2) Where the whole or any part of the liability aforesaid is met, not by the assessee, but, directly or indirectly, by any other person or authority, the liability so met shall not be taken into account for the purposes of this section.

(3) Where the assessee has entered into a contract with authorised dealer as defined in section 2 of the Foreign Exchange Management Act, 1999 for providing him with a specified sum in a foreign currency on or after a stipulated future date at the rate of exchange specified in the contract to enable him to meet the whole or any part of the liability aforesaid, the amount, if any, for adjustment under this section shall be computed with reference to the rate of exchange specified therein.

3.11 CERTAIN DEDUCTIONS TO BE MADE ONLY ON ACTUAL PAYMENT [SECTION 43B]

The following sums are allowed as deduction only in that previous year in which such sum is actually paid i.e., on actual payment basis.

(a) Any sum payable by way of **tax, duty, cess or fee,** by whatever name called, under any law for the time being in force, or

(b) Any sum payable by the assessee as an **employer** by way of **contribution to any provident fund or superannuation fund or gratuity fund** or any other fund for the welfare of employees, or

(c) **Bonus or Commission** for services rendered payable to employees, or

(d) Any sum payable by the assessee as **interest on any loan or borrowing** from any **public financial institution or a State Financial Corporation or a State Industrial Investment Corporation**, or

(da) Any sum payable by the assessee as **interest on any loan or borrowing from notified class of non-banking financial companies**, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or

(e) **Interest on any loan or advance from a scheduled bank or co-operative bank** other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or

(f) Any sum paid by the assessee as an **employer in lieu of earned leave of his employee**, or

(g) Any sum payable by the assessee **to the Indian Railways for use of Railway assets**.

For the purpose of claiming deduction of **the sums referred to above in clauses (a) to (g)** in the relevant previous year in which the expenditure is incurred, the above sums have to be **paid by the assessee on or before the due date for furnishing the return of income under section 139(1)** in respect of the previous year in which the liability to pay such sum was incurred and the evidence of such payment is furnished by the assessee along with such return.

Example: *An assessee may collect GST from customers during the month of March, 2026. However, in respect of such collections he may have to discharge the liability only within say 20th April, 2026 under the GST law. The Explanation covers this type of liability also. Consequently, if an assessee following accrual method of accounting has created a provision in respect of such a liability the same is not deductible unless remitted within the due date specified in this section.*

Conversion of interest into a loan or borrowing or debenture or any other instrument

Explanation 3C, 3CA & 3D clarifies that if any sum payable by the assessee as interest on any such loan or borrowing or advance referred to in (d), (e) and (f) above, is converted into a loan or borrowing or advance or debenture or any other instrument by which the liability to pay is deferred to a future date, the interest so converted and not "actually paid" shall not be deemed as actual payment, and hence would not be allowed as deduction. The clarificatory explanations only reiterate the rationale that conversion of interest into a loan or borrowing or advance or debenture or any other instrument by which the liability to pay is deferred to a future date does not amount to actual payment.

The manner in which the converted interest will be allowed as deduction has been clarified in *Circular No.7/2006 dated 17.7.2006*. The unpaid interest, whenever actually paid to the bank or financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid.

ILLUSTRATION 14

Hari, an individual, carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Andhra Pradesh State Financial Corporation (APSFC) and Indian Bank and has not paid interest as detailed hereunder:

		₹
(i)	*Andhra Pradesh State Financial Corporation (P.Y. 2024-25 & 2025-26)*	*15,00,000*
(ii)	*Indian Bank (P.Y. 2025-26)*	*30,00,000*
		45,00,000

Both APSFC and Indian Bank, while restructuring the loan facilities of Hari during the year 2025-26, converted the above interest payable by Hari to them as a loan repayable in 60 equal installments. During the year ended 31.3.2026, Hari paid 5 installments to APSFC and 3 installments to Indian Bank.

Hari claimed the entire interest of ₹ 45,00,000 as an expenditure while computing the income from business of purchase and sale of agricultural commodities. Examine whether his claim is valid and if not what is the amount of interest, if any, allowable.

SOLUTION

According to section 43B, any interest payable on the term loans to specified financial institutions and any interest payable on any loans and advances to, *inter alia*, scheduled banks shall be allowed only in the year of payment of such interest irrespective of the method of accounting followed by the assessee. Where there is default in the payment of interest by the assessee, such unpaid interest may be converted into loan. Such conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest so converted as loan shall be allowed as deduction only in the year in which the converted loan is actually paid.

In the given case of Hari, the unpaid interest of ₹ 15,00,000 due to APSFC and of ₹ 30,00,000 due to Indian Bank was converted into loan. Such conversion would not amount to payment of interest and would not, therefore, be eligible for deduction in the year of such conversion. Hence, claim of Hari that the entire interest of ₹ 45,00,000 is to be allowed as deduction in the year of conversion is not tenable. The deduction shall be allowed only to the extent of repayment made during the financial year. Accordingly, the amount of interest eligible for deduction for the A.Y.2026-27 shall be calculated as follows:

	Interest outstanding	**Number of Instalments**	**Amount per instalment**	**Instalments paid**	**Interest allowable (₹)**
APSFC	15 lakh	60	25,000	5	1,25,000
Indian Bank	30 lakh	60	50,000	3	1,50,000
Total amount eligible for deduction					**2,75,000**

Clarification on non-applicability of section 43B on employee's Contribution to welfare funds [Explanation 5 to section 43B]

As per section 2(24)(x), any sum received by an assessee, being an employer from his employee as contribution to any provident fund or superannuation fund or any fund set up under Employee's State Insurance Act, 1948 or any other fund for the welfare of employees would be considered as the income of an employer.

The deduction in respect of above sum will be allowed to the assessee under section 36(1)(va) only if such sum is credited by the assessee to the employee's account in the relevant fund on or before the due date, being the date specified under the relevant Act, Rule, order or notification issued thereunder.

As per section 43B, any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees, would be allowable during any P.Y. if the same has been paid on or before the 'due date' applicable in his case for furnishing the return of income under section 139(1) in respect of that P.Y.

Explanation 5 clarifies that the provisions of section 43B regarding allowability of certain expenditure in a previous year only on actual payment basis (i.e., payment on or before the due date of filing of return of income for relevant assessment year), does not apply and would deemed never to be applied to employee's contribution received by employer towards any welfare fund. In effect, clause (b) of section 43B covers only employer's contribution to provident fund, superannuation fund, gratuity fund or any other fund for welfare of employees, for remittance of which extended time limit upto due date of filing return u/s 139(1) is available; however, it does not include within its scope, employees' contribution to such funds received by the employer, which has to be credited to the employee's account in the relevant fund on or before the due date specified under the relevant Act, Rule etc. Amount credited after the said due date but on or before the due date under section 139(1) would not be eligible for deduction.

Section 43B [Clause (h)]

Any sum payable by the assessee to a micro or small enterprise beyond the time-limit specified in section 15 of the Micro, Small and Medium Enterprises Development Act, 2006 would be allowed as deduction only in that previous year in which such sum is actually paid.

Section 15 of the of the Micro, Small and Medium Enterprises Development Act, 2006 mandates payment of goods or services to supplier, being a micro or small enterprises by the buyer on or before the date agreed upon between them in writing i.e., as per the written agreement, which cannot be more than 45 days from the day of acceptance or the day of deemed acceptance of any goods or services by a buyer from a supplier. If there is no such written agreement, the payment shall be made before the appointed day i.e., within 15 days.

If the sum payable by the assessee to a micro or small enterprise is paid as per written agreement (maximum within 45 days) or within 15 days in case of no agreement, the deduction can be claimed on accrual basis if mercantile method of accounting is followed by the assessee.

However, if the sum payable by the assessee to a micro or small enterprise is not paid as per written agreement or within 15 days in case of no agreement, the deduction would be allowed in the previous year in which it is actually paid.

Example: *Mr. A has purchased goods of ₹ 10,000 from A & Co., a micro enterprise on 1.3.2026. As per the written agreement between them, the payment has to be made by 5.4.2026. Mr. A follows mercantile method of accounting.*

(i) If Mr. A paid the sum on 2.4.2026

Since Mr. A paid the sum on or before 5.4.2026, the deduction would be allowed in P.Y. 2025-26.

(ii) If Mr. A paid the sum on 20.4.2026

Since Mr. A paid the sum beyond the time limit, the deduction would be allowed in the year of actual payment i.e., P.Y. 2026-27.

Example: *Suppose Mr. Raju has purchased goods of ₹ 10,000 from A & Co., a medium enterprise on 1.3.2026. As per the written agreement between them, the payment has to be made by 5.4.2026, however Mr. Raju paid the sum on 10.4.2026. Mr. Raju follows mercantile method of accounting.*

In such case, since disallowance under section 43B(h) is not applicable on sum payable to medium enterprise, the deduction would be allowed in P.Y. 2025-26 on due basis.

Meaning of Micro and Small enterprise

S. No.	***Meaning***		
Manufacturing enterprises and enterprises rendering services			
(1)	***Micro Enterprise***		
	Investment in Plant and Machinery or Equipment ≤ ₹ 2.5 crore	***AND***	*Turnover ≤ ₹ 10 crore*
(2)	***Small Enterprise***		
	Investment in Plant and Machinery or Equipment ≤ ₹ 25 crore	***AND***	*Turnover ≤ ₹ 100 crore*

Any sum payable means a sum for which the assessee incurred liability in the previous year even though such sum might not have been payable within that year under the relevant law.

3.12 STAMP DUTY VALUE OF LAND AND BUILDING TO BE TAKEN AS THE FULL VALUE OF CONSIDERATION IN RESPECT OF TRANSFER, EVEN IF THE SAME ARE HELD BY THE TRANSFEROR AS STOCK-IN-TRADE [SECTION 43CA]

(i) Section 43CA has been inserted as an anti-avoidance measure to provide that where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable (i.e., the stamp duty value) shall be deemed to be the full value of the consideration for the purposes of computing income under the head "Profits and gains of business of profession".

However, if the stamp duty value does not exceed ***110%*** of the consideration received or accruing, then, such consideration shall be deemed to be the full value of consideration for the purpose of computing profits and gains from transfer of such asset.

(ii) Further, where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of registration of the transfer of the asset are not same, the stamp duty value may be taken as on the date of the agreement for transfer instead of on the date of registration for such transfer, provided at least a part of the consideration has been received by way of an account payee cheque/account payee bank draft or use of ECS through a bank account or through such other prescribed electronic modes on or before the date of the agreement.

The prescribed electronic modes include credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

(iii) The Assessing Officer may refer the valuation of the asset to a valuation officer in the following cases -

(1) Where the assessee claims before any Assessing Officer that the value adopted or assessed or assessable by the authority for payment of stamp duty exceeds the fair market value of the property as on the date of transfer and

(2) the value so adopted or assessed or assessable by such authority has not been disputed in any appeal or revision or no reference has been made before any other authority, court or High Court.

(iv) Where the value ascertained by the Valuation Officer exceeds the value adopted or assessed or assessable by the Stamp Valuation Authority, the value adopted or assessed or assessable shall be taken as the full value of the consideration received or accruing as a result of the transfer.

The term **'assessable'** has been defined to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

Date of transfer of land/ building held as stock-in-trade	Actual consideration	Stamp duty value on the date of agreement	Stamp duty value (SDV) on the date of registration	Full value of considera-tion	Remark
	₹ in lakhs				
Example:					
1/9/2025	100 (₹ 10 lakhs received by **A/c payee cheque** on 1/7/2025)	120 (1/7/2025)	130 (1/9/2025)	120	As part of the consideration is received by A/c payee cheque on the date of agreement, Stamp duty value (SDV) on the date of agreement to be

					adopted as full value of consideration, since the SDV exceeds 110% of consideration i.e., ₹ 110 lakhs.
Example:					
1/9/2025	100 (₹ 10 lakhs received by cash on 1/7/2025)	109 (1/7/2025)	130 (1/9/2025)	130	SDV on the date of registration to be adopted as full value of consideration and such SDV exceeds 110% of consideration i.e., ₹ 110 lakhs. Since part of consideration is received by cash on the date of agreement, the SDV on the date of agreement cannot be considered *vis-à-vis* actual consideration.
Example:					
31/1/2026	100 (₹ 10 lakhs received by **A/c payee cheque** on 1/7/2025)	109 (1/7/2025)	130 (31/1/2026)	100	Actual sales consideration would be the full value of consideration, since SDV on

					the date of agreement does not exceed 110% of actual consideration. SDV on the date of agreement can be considered *vis-à-vis* actual consideration, since part of the consideration has been received by account payee cheque on the date of agreement.
Example:					
31/3/2026	100 (Full amount received in cash on the date of registration)	120 (1/5/2025)	130 (31/3/2026)	130	SDV of the date of registration would be the full value of consideration since the SDV exceeds 110% of consideration i.e., ₹ 110 lakhs.

3.13 COMPULSORY MAINTENANCE OF ACCOUNTS [SECTION 44AA]

(1) Maintenance of books of account and other documents by notified professions [section 44AA(1)]: This section provides that every person carrying on the legal, medical, engineering or architectural profession or accountancy or technical consultancy or interior decoration or any other profession as has been notified by the CBDT in the official gazette must statutorily maintain such books of accounts and other documents as may enable the assessing officer to compute his total income in accordance with the provisions of the Income-tax Act, 1961.

Notified professions: The professions notified so far are as the profession of authorised representative; the profession of film artist (actor, camera man, director, music director, art director, editor, singer, lyricist, story writer, screen play writer, dialogue writer and dress designer); the profession of company secretary; and information technology professionals.

Prescribed books of accounts & other documents: The CBDT has been authorised, having due regard to the nature of the business or profession carried on by any class of persons, to **prescribe by rules the books of account and other documents** including inventories, wherever necessary, to be kept and maintained by the taxpayer, the particulars to be contained therein and the form and manner in which and **the place at which they must be kept and maintained**.

Rules pertaining to maintenance of books of accounts & other documents:

Rule 6F of the Income-tax Rules contains the details relating to the books of account and other documents to be maintained by certain professionals under section 44AA(1).

Prescribed class of persons: As per Rule 6F, every person carrying on legal, medical, engineering, or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorised representative or film artist shall keep and maintain the books of account and other documents specified in Rule 6F(2) in the following cases :

- if his **gross receipts exceed ₹ 1,50,000 in all the 3 years immediately preceding the previous year**; or
- if, where the profession has been newly set up in the previous year, his **gross receipts are likely to exceed ₹ 1,50,000 in that year**.

Professionals whose gross receipts are less than the specified limits given above are also required to maintain books of account but these have not been specified in the Rule.

In other words, they are required to maintain such books of account and other documents as may enable the Assessing Officer to compute the total income in accordance with the provisions of this Act.

Prescribed books of accounts and other documents [Sub-rule (2) of Rule 6F]: The following books of account and other documents are required to be maintained.

(i) a cash book;

(ii) a journal, if accounts are maintained on mercantile basis ;

(iii) a ledger;

(iv) Carbon copies of bills and receipts issued by the person whether machine numbered or otherwise serially numbered, in relation to sums exceeding ₹ 25;

(v) Original bills and receipts issued to the person in respect of expenditure incurred by the person, or where such bills and receipts are not issued, payment vouchers prepared and signed by the person, provided the amount does not exceed ₹ 50. Where the cash book contains adequate particulars, the preparation and signing of payment vouchers is not required.

In case of a person carrying on medical profession, he will be required to maintain the following in addition to the list given above:

(i) a daily case register in Form 3C.

(ii) an inventory under broad heads of the stock of drugs, medicines and other consumable accessories as on the first and last day of the previous year used for his profession.

Place at which books to be kept and maintained: The books and documents shall be kept and maintained at the place where the person is carrying on the profession, or where there is more than one place, at the principal place of his profession. However, if he maintains separate set of books for each place of his profession, such books and documents may be kept and maintained at the respective places.

Period for which the books of account and other documents are required to be kept and maintained by notified professions: The Central Board of Direct Taxes has also been empowered to prescribe, by rules, the period for which the books of account and other documents are required to be kept and maintained by the taxpayer.

The above books of account and documents shall be kept and maintained for a minimum of 6 years from the end of the relevant assessment year.

ILLUSTRATION 15

Vinod is a person carrying on profession as film artist. His gross receipts from profession are as under:

Particulars	***₹***
Financial year 2022-23	*1,15,000*
Financial year 2023-24	*1,80,000*
Financial year 2024-25	*2,10,000*

What is his obligation regarding maintenance of books of accounts for Assessment Year 2026-27 under section 44AA of Income-tax Act, 1961?

SOLUTION

Section 44AA(1) requires every person carrying on any profession, notified by the Board in the Official Gazette (in addition to the professions already specified therein), to maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act, 1961.

As per Rule 6F, a person carrying on a notified profession shall be required to maintain specified books of accounts:

(i) if his gross receipts in all the three years immediately preceding the relevant previous year has exceeded ₹ 1,50,000; or

(ii) if it is a new profession which is setup in the relevant previous year, it is likely to exceed ₹ 1,50,000 in that previous year.

In the present case, Vinod is a person carrying on profession as film artist, which is a notified profession. Since his gross receipts have not exceeded ₹ 1,50,000 in financial year 2022-23, the requirement under section 44AA to compulsorily maintain the prescribed books of account is not applicable to him.

Mr. Vinod, however, required to maintain such books of accounts as would enable the Assessing Officer to compute his total income.

(2) Maintenance of books of account and other documents by persons carrying on business or profession [other than notified professions referred to in section 44AA(1)] [Section 44AA(2)]

I. **<u>In case of Individual or HUF:</u>** An Individual or HUF carrying on any business or profession (other than notified professions specified in section 44AA(1)) must maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance the provisions of the Income-tax Act, 1961 in the following circumstances:

(i) **<u>Existing business or profession</u>:** In cases where the **income** from the existing business or profession **exceeds ₹ 2,50,000 or the total sales, turnover or gross receipts**, as the case may be, in the business or profession **exceed ₹ 25,00,000** in **any one of three years immediately preceding** the accounting year; or

(ii) **<u>Newly set up business or profession</u>:** In cases where the business or profession is newly set up in any previous year, if his **income** from business or profession **is likely to exceed ₹ 2,50,000** or his **total sales, turnover or gross receipts**, as the case may be, in the business or profession **are likely to exceed ₹ 25,00,000** during the previous year.

II. **<u>Person (other than individual or HUF):</u>** Every person (other than individual or HUF) carrying on any business or profession [other than the notified professions referred to in section 44AA(1)] must maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance the provisions of the Income-tax Act, 1961 in the following circumstances:

(i) **<u>Existing business or profession</u>:** In cases where the **income** from the business or profession **exceeds ₹ 1,20,000** or the **total sales, turnover or gross receipts**, as the case may be, in the business or profession **exceed ₹ 10,00,000 in any one of three years** immediately preceding the accounting year; or

(ii) **<u>Newly set up business or profession</u>:** In cases where the business or profession is newly set up in any previous year, if his income from business or profession is **likely to exceed ₹ 1,20,000** or his **total sales, turnover or gross receipts**, as the case may be, in the business or profession are **likely to exceed ₹ 10,00,000** during the previous year;

III. **Showing lower income as compared to income computed on presumptive basis under section 44AE (or section 44BB or section 44BBB)[8]:** Where profits and gains from the business are calculated on a presumptive basis under section 44AE (or section 44BB or section 44BBB) and the assessee has claimed that his income is lower than the profits or gains so deemed to be the profits and gains of his business.

IV. **Where the provisions of section 44AD(4) are applicable in his case and his income exceeds the basic exemption limit in any previous year:** In cases, where an assessee not eligible to claim the benefit of the provisions of section 44AD(1) for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance with the provisions of 44AD(1) and his income exceeds the basic exemption limit during the previous year.

(2) Penalty for failure to maintain books of account [Section 271A]

If a person fails to keep and maintain any such books of account and other documents as required by section 44AA in respect of any previous year or to retain such books of account and other documents for the specified period, penalty of ₹ 25,000 would be leviable under section 271A.

3.14 AUDIT OF ACCOUNTS OF CERTAIN PERSONS CARRYING ON BUSINESS OR PROFESSION [SECTION 44AB]

(i) **Requirement of Tax Audit:** It is obligatory for the persons mentioned in column (2) of the table below, carrying on business or profession, to get his accounts audited before the "specified date" by a Chartered Accountant, if the conditions mentioned in the corresponding row of column (3) are satisfied

[8]Section 44BB, 44BBB will be discussed at Final level.

	Persons	When tax audit is required?
(1)	**(2)**	**(3)**
I	**In case of a person carrying on business**	
(a)	In case of a person carrying on business	If his total sales, turnover or gross receipts in business > ₹ 1 crore in the relevant PY ***Note*** – *The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on presumptive basis u/s 44AD(1).*
	If in case of such person carrying on business - (i) Aggregate cash receipts in the relevant PY ≤ 5% of total receipts (incl. receipts for sales, turnover, gross receipts); and (ii) Aggregate cash payments in the relevant PY ≤ 5% of total payments (incl. amount incurred for expenditure)	If his total sales, turnover or gross receipts in business > **₹ 10 crore** in the relevant PY
	Note – For this purpose, the payment or receipt, as the case may be, by a cheque drawn on a bank or by a bank draft, which is not account payee, would be deemed to be the payment or receipt, as the case may be, in cash.	
(b)	In case of an assessee covered u/s 44AE i.e., an assessee engaged in the business of plying, hiring or leasing goods carriages who owns not more than 10 goods carriages at any time during the P.Y.	If such assessee claims that the profits and gains from business in the relevant P.Y. are lower than the profits and gains computed on a presumptive basis u/s 44AE [i.e., ₹ 1000 per ton of gross vehicle weight or unladen weight in case of each heavy goods vehicle and ₹ 7,500 for each vehicle, other than heavy goods vehicle, for every month or part of the month for which the vehicle is owned by the assessee].

<table>
<tr><td rowspan="2">(c)</td><td>In case of an eligible assessee carrying on business, whose total turnover, sales, gross receipts ≤ ₹ 200 lakhs, and who has opted for section 44AD in any earlier PY (say, P.Y. 2024-25)</td><td rowspan="2">If he declares profit for any of the five successive PYs (say, P.Y.2025-26) not in accordance with section 44AD (i.e., he declares profits lower than 8% or 6% of total turnover, sales or gross receipts, as the case may be, in that year), then, he cannot opt for section 44AD for five successive PYs after the year of such default (i.e., from P.Y.2026-27 to P.Y.2030-31). For the year of default (i.e., P.Y.2025-26) and five successive previous years (i.e., P.Y.2026-27 to P.Y.2030-31), he has to maintain books of account u/s 44AA and get them audited u/s 44AB, if his income exceeds the basic exemption limit.</td></tr>
<tr><td>In case of an eligible assessee carrying on business, whose aggregate cash receipts in the relevant PY ≤ 5% of total turnover or gross receipts and whose total turnover, sales, gross receipts ≤ ₹ 300 lakhs, and who has opted for section 44AD in any earlier PY (say, P.Y. 2024-25)</td></tr>
<tr><td>II</td><td>In case of persons carrying on profession</td><td></td></tr>
<tr><td>(a)</td><td>In case of a person carrying on profession</td><td>If his gross receipts in profession > ₹ 50 lakh in the relevant PY.

Note – The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on presumptive basis u/s 44ADA(1).</td></tr>
<tr><td rowspan="2">(b)</td><td>In case of an assessee carrying on a notified profession under section 44AA(1) i.e., legal medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose gross receipts ≤ ₹ 50 lakhs</td><td rowspan="2">If such resident assessee claims that the profits and gains from such profession in the relevant PY are lower than the profits and gains computed on a presumptive basis u/s 44ADA (50% of gross receipts) and his income exceeds the basic exemption limit in that PY.</td></tr>
<tr><td>In case of an assessee carrying on a notified profession under section 44AA(1) i.e., legal medical, engineering,</td></tr>
</table>

	accountancy, architecture, interior decoration, technical consultancy, whose aggregate cash receipts in the relevant PY ≤ 5% of total gross receipts and whose gross receipts ≤ ₹ 75 lakhs	

(ii) **Audit Report:** The persons mentioned above would have to furnish by the specified date a report of the audit in the prescribed forms. For this purpose, the Board has prescribed under Rule 6G, Forms 3CA/ 3CB/ 3CD containing forms of audit report and particulars to be furnished therewith.

(iii) **Accounts audited under other statutes are considered:** In cases where the accounts of a person are required to be audited by or under any other law before the specified date, it will be sufficient if the person gets his accounts audited under such other law before the specified date and also furnish by the said date the report of audit in the prescribed form in addition to the report of audit required under such other law.

Thus, for example, the provision regarding compulsory audit does not imply a second or separate audit of accounts of companies whose accounts are already required to be audited under the Companies Act, 2013. The provision only requires that companies should get their accounts audited under the Companies Act, 2013 before the specified date and in addition to the report required to be given by the auditor under the Companies Act, 2013 furnish a report for tax purposes in the form to be prescribed in this behalf by the CBDT.

(iv) **Specified date:** The expression **"specified date"** in relation to the accounts of the previous year or years relevant to any assessment year means the date one month prior to the due date for furnishing the return of income under section 139(1).

The due date for filing return of income in case of assessees (other than companies) who are required to get their accounts audited is 31st October of the relevant assessment year. **Hence, the specified date for tax audit would be 30th September of the relevant assessment year**[9].

(v) Penalty for failure to get books of account audited: If any person fails to get his accounts audited in respect of any previous year or furnish the audit report by the specified date, penalty of lower of (a) and (b) mentioned below would be leviable on such person –

(a) ½% of total sales, turnover or gross receipts, as the case may be, in business or of the gross receipts in profession, in such previous year; or

(b) ₹ 1,50,000 [Section 271B].

3.15 SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF BUSINESS ON PRESUMPTIVE BASIS [SECTIONS 44AD/ 44ADA/44AE]

	Particulars	Section 44AD	Section 44ADA	Section 44AE
(1)	**Eligible Assessee**	Resident individual, HUF or Partnership firm (but not LLP) engaged in eligible business and who has not claimed deduction under section 10AA or Chapter VIA under "C – Deductions in respect of certain incomes" **Non-applicability of section 44AD in respect of the following persons**:	Resident individual or Partnership firm (but not LLP) engaged in any profession specified u/s 44AA(1), namely, legal, medical, engineering, architectural profession or profession of accountancy or technical consultancy or interior decoration	An assessee owning not more than 10 goods carriages at any time during the P.Y.

[9] Except where the assessee has to file transfer pricing report u/s 92E, for whom the due date u/s 139(1) is 30th November of the A.Y.; and hence, the specified date would be 31st October, in such cases. This is, however, not applicable for Intermediate level.

		- A person carrying on profession specified u/s 44AA(1); - A person earning income in the nature of commission or brokerage; - A person carrying on any agency business.	or notified profession (authorized representative, film artist, company secretary, profession of information technology)	
(2)	**Eligible business/ profession**	Any business, other than business referred to in section 44AE, whose **total turnover/gross receipts in the P.Y. ≤ ₹ 200 lakhs in the relevant P.Y.**	Any profession specified u/s 44AA(1), whose **gross receipts ≤ ₹ 50 lakhs in the relevant P.Y**.	Business of plying, hiring or leasing goods carriages
		Any business, other than business referred to in section 44AE, whose **total turnover/gross receipts in the P.Y. ≤ ₹ 300 lakhs in the relevant P.Y., if aggregate cash receipts in the relevant PY ≤ 5% of total turnover or gross receipts.**	Any profession specified u/s 44AA(1), whose **gross receipts ≤ ₹ 75 lakhs in the relevant P.Y**., **if aggregate cash receipts in the relevant PY ≤ 5% of total gross receipts.**	
		In effect, if the turnover of business is > ₹ 200 lakhs ≤ ₹ 300 lakhs, the benefit of section 44AD can be availed only if aggregate cash	In effect, if the gross receipts from profession is > ₹ 50 lakhs ≤ ₹ 75 lakhs, the benefit of section 44ADA can be availed only if	

		receipts in relevant P.Y. ≤ 5% of total turnover or gross receipts.	aggregate cash receipts in relevant P.Y. ≤ 5% of total gross receipts.	
		Note: *For this purpose, the receipt of amount or aggregate of amounts by a cheque drawn on a bank or by a bank draft, which is not account payee, would be deemed to be the receipt in cash.*		
(3)	**Presumptive income**	**8% of total turnover/sales/gross receipts** or a sum higher than the aforesaid sum claimed to have been earned by the assessee. **6% of total turnover/ gross receipts** in respect of the amount of total turnover/ sales/gross receipts received by A/c payee cheque/ bank draft/ ECS through a bank account or through such other prescribed electronic modes (credit card, debit card, net banking, IMPS, UPI, RTGS, NEFT, and BHIM Aadhar Pay) **during the P.Y. or before due date of filing of return u/s 139(1)** in respect of that P.Y. (or) such higher sum claimed to have been earned by the assessee.	**50% of gross receipts of such profession** or a sum higher than the aforesaid sum claimed to have been earned by the assessee.	**For each heavy goods vehicle** **₹ 1,000 per ton of gross vehicle weight** or unladen weight, as the case may be, for every month or part of a month; **For each vehicle, other than heavy goods vehicle:** **₹ 7,500 per month or part of a month** during which such vehicle is owned by the assessee or an amount claimed to have been actually earned from such vehicle, whichever is higher.

<table>
<tr><td rowspan="2">(4)</td><td rowspan="2">Non-allowability of deductions while computing presumptive income</td><td colspan="3">Deductions allowable under sections 30 to 38 shall be deemed to have been given full effect to and no further deduction shall be allowed</td></tr>
<tr><td>Even in case of a firm, salary and interest paid to partners is <u>not</u> deductible.</td><td>Even in case of a firm, salary and interest paid to partners is <u>not</u> deductible.</td><td>In case of a firm, salary and interest paid to partners is deductible subject to the conditions and limits specified in section 40(b)</td></tr>
<tr><td>(5)</td><td>Written down value of asset</td><td colspan="3">WDV of any asset of an eligible business/profession shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed depreciation for each of the relevant assessment years</td></tr>
<tr><td>(6)</td><td>Requirement of maintenance of books of account u/s 44AA and audit u/s 44AB</td><td>If eligible assessee declares profits and gains in accordance with the provisions of section 44AD, he is <u>not</u> required to maintain books of account u/s 44AA or get them audited u/s 44AB.

However, if after declaring profits on presumptive basis u/s 44AD, say, for A.Y.2026-27, non-declaration of profits on presumptive basis for any of the 5 successive A.Y.s thereafter (i.e., from A.Y.2027-28 to A.Y.2031-32), say, for A.Y. 2028-29, would</td><td>If eligible assessee declares profits and gains in accordance with the provisions of section 44ADA, he is <u>not</u> required to maintain books of account u/s 44AA or get them audited u/s 44AB.

However, if the assessee claims his profits to be lower than the profits computed by applying the presumptive rate, he has to maintain books of account and other documents u/s 44AA(1) and get his accounts</td><td>If eligible assessee declares profits and gains in accordance with the provisions of section 44AE, he is <u>not</u> required to maintain books of account u/s 44AA or get them audited u/s 44AB.

However, if the assessee claims his profits to be lower than the profits computed by applying the presumptive rate, he has to</td></tr>
</table>

		disentitle the assessee from claiming profits on presumptive basis for five successive AYs subsequent to the AY relevant to the PY of such non-declaration (i.e., from A.Y.2029-30 to A.Y.2033-34). In such a case, the assessee would have to **maintain books of account and other documents u/s 44AA(2)** and get his accounts audited u/s **44AB**, **if his total income exceeds the basic exemption limit in those years**.	**audited u/s 44AB, if his total income > basic exemption limit for that year**.	**maintain books of account u/s 44AA(2)** and get his **accounts audited u/s 44AB.**
(7)	**Advance tax obligation**	The eligible assessee opting for section 44AD is required to pay advance tax by **15th March of the financial year (F.Y.)**.	The eligible assessee opting for section 44ADA is required to pay advance tax by **15th March** of the F.Y.	The eligible assessee has to pay advance tax in four installments **[See Chapter 7 in Module 3 for details].**

Meaning of certain terms for the purpose of section 44AE:

S. No	Term	Meaning
(1)	**Heavy goods vehicle**	any goods carriage, the gross vehicle weight of which exceeds 12,000 kilograms.
(2)	**Gross vehicle weight**	total weight of the vehicle and load certified and registered by the registering authority as permissible for that vehicle.

(3)	**Unladen weight**	the weight of a vehicle or trailer including all equipment ordinarily used with the vehicle or trailer when working but excluding the weight of driver or attendant and where alternative parts or bodies are used the unladen weight of the vehicle means the weight of the vehicle with the heaviest such alternative body or part

Example:

Let us consider the following particulars relating to a resident individual, Mr. A, being an eligible assessee carrying on retail trade business whose total turnover do not exceed ₹ 2 crore in any of the previous year relevant to A.Y.2026-27 to A.Y.2028-29-

Particulars	***A.Y.2026-27***	***A.Y.2027-28***	***A.Y.2028-29***
Total turnover (₹)	*1,80,00,000*	*1,90,00,000*	*2,00,00,000*
Amount received through prescribed electronic modes on or before 31st October of the A.Y.	*1,60,00,000*	*1,45,00,000*	*1,80,00,000*
Income offered for taxation (₹)	*11,20,000*	*12,30,000*	*10,00,000*
% of gross receipts	*6% on ₹ 1.60 crore and 8% on ₹ 20 lakhs*	*6% on ₹ 1.45 crore and 8% on ₹ 45 lakhs*	*5% on ₹ 2 crore*
Offered income as per presumptive taxation scheme u/s 44AD	*Yes*	*Yes*	*No*

In the above case, Mr. A, an eligible assessee, opts for presumptive taxation under section 44AD for A.Y.2026-27 and A.Y.2027-28 and offers income of ₹ 11.20 lakh and ₹ 12.30 lakh on gross receipts of ₹ 1.80 crore and ₹ 1.90 crore, respectively.

However, for A.Y.2028-29, he offers income of only ₹ 10 lakh on turnover of ₹ 2 crore, which amounts to 5% of his gross receipts. He maintains books of account under section 44AA and gets the same audited under section 44AB. Since he has not offered income in accordance with the provisions of section 44AD(1) for five consecutive assessment years, after A.Y. 2026-27, he will not be eligible to claim the benefit of section 44AD for next five assessment years succeeding A.Y.2028-29 i.e., from A.Y.2029-30 to 2033-34.

ILLUSTRATION 16

Mr. Praveen engaged in retail trade, reports a turnover of ₹ 2,98,50,000 for the financial year 2025-26. Amount received in cash during the P.Y. 2025-26 is ₹ 14,00,000 and balance through prescribed electronic modes on or before 31st July 2026. His income from the said business as per books of account is ₹ 15,00,000 computed as per the provisions of Chapter IV-D "Profits and gains from business or Profession" of the Income-tax Act, 1961. Retail trade is the only source of income for Mr. Praveen. A.Y. 2025-26 was the first year for which he declared his business income in accordance with the provisions of presumptive taxation u/s 44AD.

(i) Is Mr. Praveen also eligible for presumptive determination of his income chargeable to tax for the assessment year 2026-27?

(ii) If so, determine his income from retail trade as per the applicable presumptive provision.

(iii) In case Mr. Praveen wants to declare profits as per books of account from retail trade, what are his obligations under the Income-tax Act, 1961?

(iii) What is the due date for filing his return of income under both the options?

SOLUTION

(i) Yes. Since his cash receipts during the P.Y. does not 5% of the total turnover (14,00,000/2,98,50,000 x 100) and his total turnover for the F.Y.2025-26 is below ₹ 300 lakhs, he is eligible for presumptive taxation scheme under section 44AD in respect of his retail trade business.

(ii) His income from retail trade, applying the presumptive tax provisions under section 44AD, would be ₹ 18,19,000 (₹ 1,12,000, being 8% of ₹ 14,00,000 + ₹ 17,07,000, being 6% of ₹ 2,84,50,000).

(iii) Mr. Praveen had declared profit for the previous year 2024-25 in accordance with the presumptive provisions and if he wants to declare profits as per books of account which is lower than the presumptive income for any of the five consecutive assessment years i.e., A.Y. 2026-27 to A.Y. 2030-31, he would not be eligible to claim the benefit of presumptive taxation for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance the presumptive provisions i.e. if he declares profits lower than the presumptive income in say P.Y. 2025-26 relevant to A.Y.2026-27, then he would not be eligible to claim the benefit of presumptive taxation for A.Y. 2027-28 to A.Y. 2031-32.

Consequently, Mr. Praveen is required to maintain the books of accounts and get them audited under section 44AB, since his income exceeds the basic exemption limit.

(iv) In case he declares presumptive income under section 44AD, the due date would be 31st July, 2026.

In case he declares profits as per books of account which is lower than the presumptive income, he is required to get his books of account audited, in which case the due date for filing of return of income would be 31st October, 2026.

ILLUSTRATION 17

Mr. X commenced the business of operating goods vehicles on 1.4.2025. He purchased the following vehicles during the P.Y.2025-26. Compute his income under section 44AE for A.Y.2026-27.

	Gross Vehicle Weight (in kilograms)	***Number***	***Date of purchase***
(1)	*7,000*	*2*	*10.04.2025*
(2)	*6,500*	*1*	*15.03.2026*
(3)	*10,000*	*3*	*16.07.2025*
(4)	*11,000*	*1*	*02.01.2026*
(5)	*15,000*	*2*	*29.08.2025*
(6)	*15,000*	*1*	*23.02.2026*

Would your answer change if the goods vehicles purchased in April, 2025 were put to use only in July, 2025?

SOLUTION

Since Mr. X does not own more than 10 vehicles at any time during the previous year 2025-26, he is eligible to opt for presumptive taxation scheme under section 44AE. ₹ 1,000 per ton of gross vehicle weight or unladen weight per month or part of the month for each heavy goods vehicle and ₹ 7,500 per month or part of month for each goods carriage other than heavy goods vehicle, owned by him would be deemed as his profits and gains from such goods carriage.

Heavy goods vehicle means any goods carriage, the gross vehicle weight of which exceeds 12,000 kg.

(1) Number of Vehicles	(2) Date of purchase	(3) No. of months for which vehicle is owned	(4) No. of months × No. of vehicles [(1) × (3)]
For Heavy goods vehicle			
2	29.08.2025	8	16
1	23.02.2026	2	2
			18
For goods vehicle other than heavy goods vehicle			
2	10.4.2025	12	24
1	15.3.2026	1	1
3	16.7.2025	9	27
1	02.1.2026	3	3
			55

The presumptive income of Mr. X under section 44AE for A.Y.2026-27 would be -

₹ 6,82,500, i.e., 55 × ₹ 7,500, being for other than heavy goods vehicle + 18 x ₹ 1,000 x 15 ton being for heavy goods vehicle.

The answer would remain the same even if the two vehicles purchased in April, 2025 were put to use only in July, 2025, since the presumptive income has to be calculated per month or part of the month for which the vehicle is owned by Mr. X.

3.16 COMPUTATION OF BUSINESS INCOME IN CASES WHERE INCOME IS PARTLY AGRICULTURAL AND PARTLY BUSINESS IN NATURE

Taxability in case of composite income

Rule	Nature of composite income	Business income (Taxable)	Agricultural Income (Exempt)
7A	Income from sale of rubber products derived from rubber plants grown by the seller in India	35%	65%

7B	Income from sale of coffee - grown and cured by the seller in India - grown, cured, roasted and grounded by the seller in India	25% 40%	75% 60%
8	Income from sale of tea grown and manufactured by the seller in India	40%	60%

Notes –

(1) In computing income from sale of tea/sale of rubber/sale of coffee, an allowance shall be made in respect of the cost of planting bushes/rubber plants/coffee plants in replacement of bushes/plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned. For the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provision of section 10(30) or 10(31), respectively, is not includible in the total income.

(2) Section 10(30) provides exemption of subsidy received by an assessee carrying on the business of growing and manufacturing tea in India from or through the Tea Board for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea, subject to fulfillment of specified conditions.

(3) Section 10(31) provides exemption of subsidy received by an assessee carrying on the business of growing and manufacturing rubber, coffee, cardamom or other notified commodity in India from or through concerned Board for replantation or replacement of rubber plants, coffee plants, cardamom plants or plants for the growing of other notified commodity or for rejuvenation or consolidation of areas used for cultivation of rubber, coffee, cardamom or other notified commodity, subject to fulfillment of specified conditions.

ILLUSTRATION 18

Miss Vivitha, a resident and ordinarily resident in India, has derived the following income from various operations (relating to plantations and estates owned by her) during the year ended 31-3-2026:

S. No.	*Particulars*	₹
(i)	*Income from sale of centrifuged latex processed from rubber plants grown in Darjeeling.*	*3,00,000*

(ii)	*Income from sale of coffee grown and cured in Yercaud, Tamil Nadu.*	*1,00,000*
(iii)	*Income from sale of coffee grown, cured, roasted and grounded, in Colombo. Sale consideration was received at Chennai.*	*2,50,000*
(iv)	*Income from sale of tea grown and manufactured in Shimla.*	*4,00,000*
(v)	*Income from sapling and seedling grown in a nursery at Cochin. Basic operations were not carried out by her on land.*	*80,000*

You are required to compute the business income and agricultural income of Miss Vivitha for the A.Y. 2026-27.

SOLUTION

Computation of business income and agricultural income of Ms. Vivitha for the A.Y.2026-27

Sr. No.	Source of income	Gross (₹)	Business income		Agricultural income
			%	₹	₹
(i)	Sale of centrifuged latex from rubber plants grown in India.	3,00,000	35%	1,05,000	1,95,000
(ii)	Sale of coffee grown and cured in India.	1,00,000	25%	25,000	75,000
(iii)	Sale of coffee grown, cured, roasted and grounded outside India. **(See Note 1 below)**	2,50,000	100%	2,50,000	-
(iv)	Sale of tea grown and manufactured in India	4,00,000	40%	1,60,000	2,40,000
(v)	Saplings and seedlings grown in nursery in India **(See Note 2 below)**	80,000		Nil	80,000
	Total			**5,40,000**	**5,90,000**

Notes:

1. Where income is derived from sale of coffee grown, cured, roasted and grounded by the seller in India, 40% of such income is taken as business income and the balance as agricultural income. However, in this question, these operations are done in Colombo, Sri lanka. Hence, there is no question of such apportionment and the whole income is taxable as business income. Receipt of sale proceeds in India does not make this agricultural income. In the case of an assessee, being a resident and ordinarily resident, the income arising outside India is also chargeable to tax.

2. *Explanation 3* to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery would be deemed to be agricultural income whether or not the basic operations were carried out on land. Therefore, such income would be exempt u/s 10(1).

LET US RECAPITULATE

Method of Accounting [Section 145]

Income chargeable under this head shall be computed in accordance with the method of accounting, either cash or mercantile basis, regularly and consistently employed by the assessee.

Income chargeable under this head [Section 28]

(i) The profits and gains of any business or profession carried on by the assessee at any time during the previous year. However, any income from letting out of a residential house or a part of the house by the owner shall not be chargeable under the head "Profits and gains of business or profession" and would be chargeable under the head "Income from house property".

(ii) Any compensation or other payment due to or received by a person, at or in connection with -

(a) Termination of his management or modification of the terms and conditions relating thereto, in case the person is managing the whole or substantially the whole of the affairs of an Indian company.

(b) Termination of his office or modification of the terms and conditions relating thereto, in case the person is managing the whole or substantially the whole of the affairs in India of any other company.

(c) Termination of agency or modification of the terms and conditions relating thereto, in case the person is holding an agency in India for any part of the activities relating to the business of any other person.

(d) Vesting in the Government or in any corporation owned and controlled by the Government, under any law for the time being in force, of the management of any property or business.

(e) Termination or the modification of the terms and conditions, of any contract relating to his business

(iii) Income derived by a trade, professional or similar association from specific services performed for its members.

(iv) In the case of an assessee carrying on export business, the following incentives –

(a) Profit on sale of import entitlements;

	(b) Cash assistance against exports under any scheme of GoI; (c) Customs duty or excise re-paid or repayable as drawback; (d) Profit on transfer of Duty Free Replenishment Certificate.
(v)	The value of any benefit or perquisite arising from business or the exercise of profession, whether (a) convertible into money or not; or (b) in cash or in kind or partly in cash and partly in kind.
(vi)	Any interest, salary, bonus, commission or remuneration due to, or received by, a partner of a firm from such firm (to the extent allowed as deduction in the hands of the firm). However, the partner's share in the total income of the firm or LLP is exempt from tax [Section 10(2A)].
(vii)	Any sum, received or receivable, in cash or kind under an agreement for – (a) not carrying out any activity in relation to any business or profession; or (b) not sharing any know-how, patent, copyright, trademark, licence, franchise or any other business of commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision of services.
(viii)	Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.
(ix)	Fair market value of inventory as on date on which it is converted into or treated as a capital asset.
(x)	Any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, in respect of which the whole of the expenditure had been allowed as deduction under section 35AD.

Computation of income under the head "Profits and gains of business or profession"

As per section 29, the income referred to in section 28 has to be computed in accordance with the provisions contained in sections 30 to 43D.

<table>
<tr><th colspan="2"><u>Admissible Deductions</u></th></tr>
<tr><th>Section</th><th>Deduction</th></tr>
<tr><td>30</td><td>Amount paid on account of rent, rates, taxes, repairs (not including expenditure in the nature of capital expenditure) and insurance for buildings used for the purpose of business or profession.
In case the premises are occupied by the assessee as a tenant, the amount of repairs would be allowed as deduction only if he has undertaken to bear the cost of repairs to the premises.</td></tr>
<tr><td>31</td><td>Amount paid on account for current repairs and insurance of machinery, plant and furniture used for the purpose of business or profession.</td></tr>
<tr><td>32</td><td>Depreciation
Depreciation is mandatorily allowable as deduction.
Conditions for claiming depreciation
• Asset must be used for the purpose of business or profession at any time during the previous year.
Note: If the asset is acquired during the previous year and is put to use for less than 180 days during that previous year then, only 50% of the depreciation calculated at the rates prescribed will be allowed.
• The asset should be owned (wholly or partly) by the assessee.
• The depreciation shall be allowed on the written down value of block of assets at the prescribed rates (except in the case of assets of power generating units, in respect of which depreciation has to be calculated as a percentage of actual cost).
As per section 2(11), block of assets means a group of assets falling within a class of assets comprising:
(a) tangible assets, being buildings, machinery, plant or furniture,
(b) intangible assets, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, not being goodwill of a business or profession;
in respect of which, the same rate of depreciation is prescribed.</td></tr>
</table>

	Written Down Value of Assets (W.D.V.) [Section 43(6)]
	(1) W.D.V. of the block of assets in immediately preceding previous year — xxx (2) *Less:* Depreciation actually allowed in respect of that block of assets in said preceding previous year — xxx **Opening balance as on 1st April of the current P.Y.** — xxx **Increased by -** (3) Actual cost of assets acquired during the previous year, not being on account of acquisition of goodwill of a business or profession — xxx (4) Total (1) - (2) + (3) — xxx **Reduced by -** (5) Money receivable in respect of any asset falling within the block which is sold, discarded, demolished or destroyed during that previous year together with scrap value. However, such amount cannot exceed the amount in (4). — xxx (6) **In case of slump sale**, actual cost of the asset (-) amount of depreciation that would have been allowable to the assessee for any assessment year as if the asset was the only asset in the block. However, such amount of reduction cannot exceed the WDV. — xxx (7) W.D.V at the end of the year (on which depreciation is allowable) [(4) – (5) – (6)] — xxx (8) Depreciation at the prescribed rate (Rate of Depreciation × WDV arrived at in (7) above) — xxx
	Note – If the actual cost includes cost of asset put to use for less than 180 days in the relevant P.Y. of acquisition, then, depreciation on such cost would be 50% of the prescribed rate.
32(1)(iia)	In case of an **assessee exercising the option of shifting out of the default tax regime provided under section 115BAC(1A)**, **additional depreciation** at the rate of **20% of actual cost of plant or machinery** acquired and installed by an assessee

	engaged in the business of manufacture or production of any article or thing or in the business of generation, transmission or distribution of power, shall be allowed. If plant and machinery is acquired and put to use for the purpose of business or profession for **less than 180 days during the previous year** in which it is acquired, additional depreciation will get restricted to **10% of actual cost** (i.e., 50% of 20%). The balance additional depreciation@10% of actual cost will be allowed in the immediately succeeding previous year if the assessee exercises the option of shifting out of the default tax regime provided under section 115BAC(1A) in the immediately succeeding previous year. However, additional depreciation will **<u>not</u>** be allowed on the following plant or machinery: • Ships, aircraft, road transport vehicles, office appliances; • Machinery previously used by any other person; • Machinery installed in any office premises, residential accommodation, or guest house; • Machinery in respect of which, the whole of the actual cost is fully allowed as deduction (whether by way of depreciation or otherwise) of any one previous year.
35	**Expenditure on Scientific Research** **<u>Expenditure incurred by assessee [Allowable both under the default tax regime u/s 115BAC and the optional tax regime i.e., normal provisions of the Act]</u>** • Any revenue and capital expenditure (other than cost of acquisition of land) on scientific research for in-house research **related to its business** is allowable as deduction **[Section 35(1)(i) & Section 35(1)(iv) read with section 35(2)].** • Deduction is also allowed in respect of payment of salary or purchase of material inputs for such scientific research during 3 years immediately preceding the year of commencement of business. Such expenditure is deemed to have been incurred in the year of commencement of business and is, hence, allowed as deduction in that year **[Section 35(1)(i)]**. • Capital expenditure incurred during 3 years immediately preceding the year of commencement of the business is also

	deemed to have been incurred in the year in which the business commences, and is hence, allowed as deduction in that year **[Section 35(1)(iv) read with section 35(2)]**. Unabsorbed capital expenditure on scientific research can be carried forward indefinitely for set-off against any income of the assessee other than Salaries. **<u>Contributions to Outsiders [Allowable only if the assessee exercises the option of shifting out of the default tax regime provided under section 115BAC(1A)]</u>** In case of an assessee exercises the option of shifting out of the default tax regime provided under section 115BAC(1A) and paying tax as per the optional tax regime under the normal provisions of the Act, contributions made by any assessee to certain specified/ approved institutions shall be entitled to deduction of 100% of contribution made to:

Section	Association/University/Company/College/IIT
35(1)(ii)	Notified approved research association/university/ college/ other institution for scientific research
35(1)(iia)	Approved notified Company for scientific research
35(1)(iii)	Notified approved research association/university/ college/ other institution for research in social science or statistical research
35(2AA)	Approved National Laboratory/ University/ IIT/ specified person to be used for scientific research undertaken under an approved programme

***Note** – Contribution to outsiders for scientific/ social science/ statistical research is not allowable under the default tax regime u/s 115BAC.*

35AD	This section provides for **investment-linked tax deduction** in respect of the following specified businesses commencing operations on or after the dates specified thereto, **if the assessee exercises the option of shifting out of the default tax regime provided under section 115BAC(1A)** - • setting-up and operating 'cold chain' facilities for specified products (commencing operations on or after 1.4.2009); • setting-up and operating warehousing facilities for storing agricultural produce (commencing operations on or after 1.4.2009);

- laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network (commencing operations on or after 1.4.2007);
- building and operating a hotel of two-star or above category, anywhere in India (commencing operations on or after 1.4.2010);
- building and operating a hospital, anywhere in India, with at least 100 beds for patients (commencing operations on or after 1.4.2010);
- developing and building a housing project under a notified scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government (commencing operations on or after 1.4.2010);
- developing and building a housing project under a notified scheme for affordable housing framed by the Central Government or State Government (commencing operations on or after 1.4.2011);
- production of fertilizer in India (commencing operations on or after 1.4.2011);
- setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962 (commencing operations on or after 1.4.2012);
- bee-keeping and production of honey and beeswax (commencing operations on or after 1.4.2012);
- setting up and operating a warehousing facility for storage of sugar (commencing operations on or after 1.4.2012);
- laying and operating a slurry pipeline for transportation of iron-ore (commencing operations on or after 1.4.2014);
- setting up and operating a semiconductor wafer fabrication manufacturing unit, if such unit is notified by the Board in accordance with the prescribed guidelines (commencing operations on or after 1.4.2014).
- developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility (commencing operations on or after 1.4.2017)

<u>Quantum of deduction</u> - 100% of the capital expenditure (other than expenditure on acquisition of any land, goodwill or financial instrument) incurred during the previous year,

wholly and exclusively for the above specified businesses would be allowed as deduction from the business income of an assessee, if he has opted for the provisions of section 35AD.

Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business **prior to commencement of operation** would be allowed as deduction during the previous year in which the assessee commences operation of his specified business, provided the amount incurred prior to commencement has been **capitalized in the books of account of the assessee on the date of commencement of its operations**.

<u>Payment exceeding ₹ 10,000 to be made through prescribed electronic modes to qualify for deduction u/s 35AD</u> - Any expenditure in respect of which payment or aggregate of payment made to a person of an amount exceeding ₹ 10,000 in a day otherwise than by account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic modes would **<u>not</u>** be eligible for deduction.

<u>Non-eligibility for deduction u/s 10AA or Chapter VI-A</u> - An assessee availing investment-linked tax deduction u/s 35AD in respect of any specified business in any assessment year, is not eligible for claiming profit-linked deduction under Chapter VI-A or section 10AA for the same or any other A.Y. in respect of such specified business if the assessee has claimed or opted for section 35AD and deduction thereunder has been allowed to him.

<u>Asset to be used only for specified business for 8 years</u> - Any asset in respect of which a deduction is claimed and allowed under section 35AD shall be **used only for the specified business**, for a period of **8 years** beginning with the previous year in which such asset is acquired or constructed. If such asset is used for any purpose other than the specified business, **the total amount of deduction so claimed and allowed u/s 35AD** in any previous year in respect of such asset, **as reduced by the depreciation** allowable under section 32 as if no deduction had been allowed under section 35AD, shall be **deemed to be the business income of the assessee** of the previous year in which the asset is so used.

Note – *This deduction is not allowable under the default tax regime u/s 115BAC.*

35D	**Preliminary expenditure incurred by Indian companies and other resident non-corporate assessees** shall be allowed as deduction over a period of **5 years** beginning with the previous year in which business commences or in which extension of the undertaking is completed or the new unit commences operation or production. **Examples of Preliminary expenses** – expenses on preparation of project report, feasibility report, market survey, engineering services, legal charges for drafting agreement. In case of a Company, preliminary expenses would include, in addition to the above, legal charges for drafting MOA, AOA, printing of MOA and AOA, fee for registration of Co., expenditure in connection with issue of shares or debentures of Co. (i.e. underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus) **Qualifying amount** - Maximum aggregate amount of the qualifying expenses that can be amortized is **5% of the cost of project** (i.e., actual cost of fixed assets in the books of account on the last day of the P.Y.). In case of an Indian company, **5% of the cost of project or at its option, 5% of the capital employed by the company** (aggregate of issued share capital, debentures, long-term borrowings as on the last day of the P.Y.)**, whichever is higher.**
35DDA	**One-fifth of the expenditure incurred by an assessee-employer** in any previous year in the form of payment to any employee **in connection with his voluntary retirement** in accordance with a scheme of voluntary retirement, shall be allowed as deduction in that previous year and the balance in four equal installments in the immediately four succeeding previous years.
36(1)(iii)	**Interest paid in respect of capital borrowed for the purposes of business or profession.** However, any interest paid for acquisition of an asset (whether capitalized in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall **not** be allowed as deduction. Such amount of interest would be added to the actual cost of asset.

36(1)(iv)	Any sum paid by the assessee as an employer by way of contribution towards a recognized provident fund or approved superannuation fund.
36(1)(iva)	Any sum paid **by the assessee as an employer by way of contribution towards a pension scheme referred to in section 80CCD, to the extent of 14% of salary** of any employee. Salary includes dearness allowance, if the terms of employment so provide. Correspondingly, section 40A(9) disallows the sum paid in excess of 14% of the salary of any employee.
36(1)(v)	Any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust.
36(1)(va)	Amount received by assessee-employer as contribution from his employees towards their welfare fund to be allowed as deduction only **if such amount is credited by the assessee to the employee's account in the relevant fund on or before due date under the relevant Act/Rule/order/notification**. Amount credited after the said due date but on or before the due date under section 139(1) would **not** be eligible for deduction.
36(1)(vii)	Any **bad debts written off as irrecoverable** in the accounts of the assessee for the previous year, provided the **debt has been taken into account in computing the income** of the previous year or any earlier previous year. Amount of debt taken into account in computing the income of the assessee on the basis of notified ICDSs to be allowed as deduction in the previous year in which such debt or part thereof becomes irrecoverable. If a debt, which has not been recognized in the books of account as per the requirement of the accounting standards but has been taken into account in the computation of income as per the notified ICDSs, has become irrecoverable, it can still be claimed as bad debts under section 36(1)(vii) since it shall be deemed that the debt has been written off as irrecoverable in the books of account by virtue of the second proviso to section 36(1)(vii). This is because some ICDSs require recognition of income at an earlier point of time (prior to the point of time such income is recognised in the books of account). Consequently, if the whole or part of such income recognised at an earlier point of time for tax purposes becomes irrecoverable, it can be claimed as bad debts on account of the second proviso to section 36(1)(vii).

36(1)(ix)	Any *bona fide* expenditure incurred by a **company** for the purpose of promoting family planning amongst its employees. In case the expenditure or part thereof is of **capital nature, one-fifth of such expenditure** shall be deducted for the previous year in which it was incurred; and the balance in four equal installments in four succeeding previous years. **Family planning expenses, whether revenue or capital, is <u>not</u> allowable as deduction for non-corporate assesses, like individuals, HUFs, firms, LLPs.**
36(1)(xv)	An amount equal to the **securities transaction tax (STT) paid** by the assessee in respect of taxable securities transactions entered into in the course of his business during the previous year, **if the income arising from such taxable securities transactions is included in the income computed under the head "Profits and gains of business or profession"**.
36(1)(xvi)	An amount equal to **commodities transaction tax (CTT) paid** in respect of taxable commodities transactions entered into the course of business during the previous year, **if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".**
General	
37(1)	An expenditure shall be allowed under section 37**,** provided: • it is **<u>not</u>** in the nature of expenditure described under **sections 30 to 36;** • it is **<u>not</u>** in the nature of **capital expenditure**; • it is **<u>not</u>** a **personal expenditure** of the assessee; • it is laid out and expended **wholly and exclusively for the purpose of business/profession**; • it is **<u>not</u>** incurred for any purpose which is an **offence or which is prohibited by law**; and • it is **<u>not</u>** an expenditure incurred by the assessee on **CSR activities referred to in section 135** of the Companies Act, 2013. Expenditure incurred for any purpose which is an offence or which is prohibited by law" would include and would be deemed to have always included the expenditure incurred by an assessee, - (i) for any purpose which is an offence under any law for the time being in force, in India or outside India or which is prohibited

	by any law for the time being in force, in India or outside India; or (ii) to provide any benefit or perquisite to a person, whether or not carrying on a business or exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guidelines, as the case may be, for the time being in force, governing the conduct of such person; or (iii) to compound an offence under any law for the time being in force, in India or outside India; or (iv) to settle proceedings initiated in relation to contravention under such law as may be notified by the Central Government in this behalf.
37(2B)	Any expenditure incurred for **advertisement in any souvenir, brochure, tract, pamphlet etc. published by a political party** is **not** allowable as deduction.

Amounts not deductible	
Section	**Particulars**
In the hands of any assessee	
40(a)(i)	Any interest, royalty, fees for technical services or other sum chargeable under the Act, which is payable **outside India** or in India to a **non corporate non-resident or to a foreign company**, **on which tax deductible at source has not been deducted or after deduction has not been paid on or before the due date specified u/s 139(1).** However, if such tax has been deducted in any subsequent year or has been deducted in the previous year but paid in the subsequent year after the due date specified under section 139(1), such sum shall be allowed as deduction in computing the income of the previous year in which such tax is paid.
40(a)(ia)	**30% of any sum payable to a resident on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction has not been paid on or before the due date for filing of return of income u/s 139(1).** However, if such tax has been deducted in any subsequent year or has been deducted in the previous year but paid in the subsequent year after the due date specified under section 139(1), 30% of such sum shall be allowed as deduction in computing the income of the previous year in which such tax is paid.

<table>
<tr><td>40(a)(ii)</td><td colspan="4">Any sum paid on account of income-tax including surcharge or cess</td></tr>
<tr><td>40(a)(iii)</td><td colspan="4">Any payment chargeable under the head "Salaries", if it is payable outside India or to a non-resident, if tax has not been paid thereon nor deducted therefrom</td></tr>
<tr><td>40(a)(v)</td><td colspan="4">Tax paid by the employer on non-monetary perquisites provided to its employees, which is exempt under section 10(10CC) in the hands of the employee.</td></tr>
<tr><td colspan="5">In case of partnership firms or LLPs -</td></tr>
<tr><td rowspan="7">40(b)</td><td>(i)</td><td colspan="3">Salary, bonus, commission or remuneration, by whatever name called, paid to any partner who is not a working partner;</td></tr>
<tr><td>(ii)</td><td colspan="3">Payment of remuneration to a working partner or interest to any partner, which is not –
• authorized by the partnership deed; or
• in accordance with the terms of the partnership deed.</td></tr>
<tr><td>(iii)</td><td colspan="3">Payment of remuneration to a working partner or interest to any partner authorized by and in accordance with the terms of the partnership deed, but relates to a period falling prior to the date of such partnership and is not authorized by the earlier partnership deed.</td></tr>
<tr><td>(iv)</td><td colspan="3">Payment of interest to any partner authorised by and in accordance with the terms of the partnership deed and falling after the date of the partnership deed to the extent of the excess of the amount calculated at 12% simple interest per annum.</td></tr>
<tr><td rowspan="3">(v)</td><td colspan="3">Payment of remuneration to a working partner which is authorized by and in accordance with the partnership deed to the extent the aggregate of such payment to working partners exceed the following limits -</td></tr>
<tr><td>(a)</td><td>On the first ₹ 6,00,000 of the book-profit or in case of a loss</td><td>₹ 3,00,000 or 90% of the book-profit, whichever is more.</td></tr>
<tr><td>(b)</td><td>On the balance of book-profit</td><td>60%</td></tr>
</table>

	Meaning of Book profit: Book profit means the **net profit as shown in the P & L A/c** for the relevant previous year computed in accordance with the provisions for computing income from profits and gains. The above amount should be **increased by the remuneration** paid or payable to all partners of the firm if the same has been deducted while computing net profit.

Expenses or payments not deductible in certain circumstances

Section	Particulars
40A(2)	Any expenditure incurred in respect of which a payment is made to a **related person or entity**, to the extent it is considered **excessive or unreasonable by the Assessing Officer**. Few examples of related persons are as under:
40A(3)	Any expenditure, in respect of which a **payment or aggregate of payments** made to a person in a single day otherwise than by account payee cheque or account payee bank draft or ECS through bank account or through such other prescribed electronic modes **exceeds ₹ 10,000.** In case of payments made to **transport operator for plying, hiring or leasing goods carriages**, an enhanced limit of **₹ 35,000** shall apply. If the payment/payments exceed this limit, the entire expenditure would be disallowed.

Assessee	Related Person
Individual	Any **relative** of the individual (husband or wife, brother or sister, any lineal ascendant or descendant of the individual)
Firm	Any **partner** of the firm or **relative** of such partner
HUF or AOP	Any **member** of the AOP or HUF or any **relative** of such member
Company	**Director** of the company or any **relative** of the director
Any assessee	Any individual who has a **substantial interest** (20% or more voting power or beneficial entitlement to 20% of profits) in the business or profession of the assessee; or A **relative** of such individual.

	However, disallowance would not be attracted if the cases and circumstances in which payment is made otherwise than by way of an account payee cheque or bank draft are covered in Rule 6DD. **Few Examples of exceptions covered in Rule 6DD**: Payment to RBI, SBI, Co-operative banks Payment made to Government, which according to its Rules, has to be made in legal tender Payment for purchase of agricultural produce, forest produce, fish and fish products, productions of horticulture or apiculture to the cultivator, grower or producer of such produce or products.
40A(3A)	Where an expenditure has been allowed as deduction on accrual basis in any previous year, and payment is made in a subsequent previous year otherwise than by account payee cheque or account payee bank draft or ECS through bank account or through such other prescribed electronic modes and such payment (or aggregate of payments made to a person in a day is made in a subsequent previous year) is in excess of the limits of ₹ 10,000/ ₹ 35,000 specified above, the payment/aggregate of payments so made shall be **deemed as profits and gains of the business or profession and charged to tax as income of the subsequent previous year**. However, the deeming provision will not apply in the cases and circumstances covered in Rule 6DD.
40A(7)	**Provision for payment of gratuity to employees.** However, **disallowance would not be attracted** if provision is made for **contribution to approved gratuity fund or for payment of gratuity that has become payable during the year**.
Profits chargeable to tax [Section 41]	
41(1)	Where deduction was allowed in respect of loss, expenditure or trading liability for any year and subsequently, during any previous year, the **assessee or successor of the business has obtained any amount in respect of such loss or expenditure** or some benefit in respect of such trading liability by way of **remission or cessation** thereof, the amount obtained or the value of benefit accrued shall be **deemed to be income of the P.Y. in which such benefit was obtained**.
41(3)	**Amount realized on transfer of an asset used for scientific research** without being used for other purposes is taxable as business income in the year of sale **to the extent of lower of** deduction allowed under section 35(1)(iv) and sale proceeds

41(4)	Any amount **recovered** by the assessee against **bad debt** earlier allowed as deduction shall be taxed as income in the year in which it is received.

Certain Deductions to be allowed only on Actual Payment [Section 43B]

In respect of the following sums payable by an assessee during the P.Y., deduction is allowable **only if the sum is actually paid on or before the due date of filing of return u/s 139(1)** for the said P.Y. Otherwise, the same would be allowed only in the year in which the sum is actually paid.

(i)	**Tax, duty, cess or fee,** under any law for the time being in force; or
(ii)	Contribution to any **provident fund or superannuation fund or gratuity fund** or any other fund for the welfare of employees; or
(iii)	**Bonus or commission** for services rendered by employees, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission; or
(iv)	**Interest on any loan or borrowing** from any **public financial institution or a State Financial Corporation or a State Industrial Investment Corporation**, in accordance with the terms and conditions of the agreement governing such loan or borrowing; or
(v)	**Interest on any loan or borrowing from notified class of non-banking financial companies**, in accordance with the terms and conditions of the agreement governing such loan or borrowing
(vi)	**Interest on any loan or advance from a scheduled bank or co-operative bank** other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank in accordance with the terms and conditions of the agreement governing such loan or advances; or
(vii)	**Payment in lieu of any leave at the credit of his employee**.
(viii)	Any sum payable to the **Indian Railways for use of Railway assets**.

However, any sum payable by the assessee to a micro or small enterprise beyond the time-limit specified in section 15 of the Micro, Small and Medium Enterprises Development Act, 2006 would be allowed as deduction only in the P.Y. in which the sum is actually paid.

Section 15 of the of the Micro, Small and Medium Enterprises Development Act, 2006 mandates payment of goods or services to supplier, being a micro or small enterprises on or before the date as per the written agreement, which cannot be more than 45 days. If there is no such written agreement, the payment shall be made before the appointed day i.e., within 15 days.

If the sum is paid within the said period, deduction would be allowed in the year of accrual. If it is paid after the said period, then, deduction would be allowed only in the year of actual payment, even if it is paid on or before the due date of filing return of income u/s 139(1).

Other Provisions

Section	Particulars	
43CA	Where the consideration for the transfer of an asset (other than capital asset), being **land or building or both**, is less than the stamp duty value, the value so adopted or assessed or assessable (i.e., the **stamp duty value**) shall be deemed to be the full value of the consideration for the purposes of computing income under the head "Profits and gains of business or profession". However, if the stamp duty value does not exceed **110%** of the actual consideration received or accruing then, such consideration shall be deemed to be the full value of consideration for the purpose of computing profits and gains from transfer of such asset. Further, where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of registration of the transfer of the asset are not same, the stamp duty value may be taken as on the date of the agreement for transfer instead of on the date of registration for such transfer, provided at least a part of the consideration has been received by way of an account payee cheque/ account payee bank draft or use of ECS through a bank account or through such other prescribed electronic modes on or before the date of the agreement.	
44AB	**Mandatory audit of accounts of certain persons**	
	Category of person	**Condition for applicability of section 44AB**
(1)	**(2)**	**(3)**
I	**In case of a person carrying on business**	
(a)	In case of a person carrying on business	If his total sales, turnover or gross receipts in business > ₹ 1 crore in the relevant PY. ***Note*** – *The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on presumptive basis u/s 44AD(1).*

	If in case of such person carrying on business – (i) Aggregate cash receipts in the relevant PY ≤ 5% of total receipts (incl. receipts for sales, turnover, gross receipts); and (ii) Aggregate cash payments in the relevant PY ≤ 5% of total payments (incl. amount incurred for expenditure)	If his total sales, turnover or gross receipts in business > ₹ **10 crore** in the relevant PY
	Note – For this purpose, the payment or receipt, as the case may be, by a cheque drawn on a bank or by a bank draft, which is not account payee, would be deemed to be the payment or receipt, as the case may be, in cash.	
(b)	In case of an assessee covered u/s 44AE i.e., an assessee engaged in the business of plying, hiring or leasing goods carriages who owns not more than 10 goods carriages at any time during the P.Y.	If such assessee claims that the profits and gains from business in the relevant P.Y. are lower than the profits and gains computed on a presumptive basis u/s 44AE [i.e., ₹ 1000 per ton of gross vehicle weight or unladen weight in case of each heavy goods vehicle and ₹ 7,500 for each vehicle, other than heavy goods vehicle, for every month or part of the month for which the vehicle is owned by the assessee].
(c)	In case of an eligible assessee carrying on business, whose total turnover, sales, gross receipts ≤ ₹ 200 lakhs, and who has opted for section 44AD in any earlier PY (say, P.Y. 2024-25)	If he declares profit for any of the five successive PYs (say, P.Y.2025-26) not in accordance with section 44AD (i.e., he declares profits lower than 8% or 6% of total turnover, sales or gross receipts, as the case may be, in that year), then, he cannot opt for section 44AD for five successive PYs after the year of such default (i.e., from P.Y.2026-27 to

	In case of an eligible assessee carrying on business, whose aggregate cash receipts in the relevant PY ≤ 5% of total turnover or gross receipts and whose total turnover, sales, gross receipts ≤ ₹ 300 lakhs, and who has opted for section 44AD in any earlier PY (say, P.Y.2024-25)	P.Y.2030-31). For the year of default (i.e., P.Y. 2025-26) and five successive previous years (i.e., P.Y.2026-27 to P.Y.2030-31), he has to maintain books of account u/s 44AA and get them audited u/s 44AB, if his income exceeds the basic exemption limit.
II	**In case of persons carrying on profession**	
(a)	In case of a person carrying on profession	If his gross receipts in profession > ₹ 50 lakh in the relevant PY ***Note*** *– The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on presumptive basis u/s 44ADA(1).*
(b)	In case of an assessee carrying on a notified profession under section 44AA(1) i.e., legal medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose gross receipts ≤ ₹ 50 lakhs.	If such resident assessee claims that the profits and gains from such profession in the relevant PY are lower than the profits and gains computed on a presumptive basis u/s 44ADA (50% of gross receipts) and his income exceeds the basic exemption limit in that PY.
	In case of an assessee carrying on a notified profession under section 44AA(1) i.e., legal medical,	

	engineering, accountancy, architecture, interior decoration, technical consultancy, whose aggregate cash receipts in the relevant PY ≤ 5% of total gross receipts and whose gross receipts ≤ ₹ 75 lakhs.	
Presumptive Income provisions		
Section	**Particulars**	**Deemed profits and gains**
44AD	Any individual, HUF or firm who is a resident (other than LLP) who has not claimed deduction under section 10AA or Chapter VI-A under the heading "C – Deductions in respect of certain incomes" engaged in any business (except the business of plying, hiring or leasing goods carriages referred to in section 44AE) and whose total turnover or gross receipts in the previous year does not exceed ₹ 2 crore. If aggregate cash receipts in the relevant PY ≤ 5% of total turnover or gross receipts of the assessee, higher turnover threshold of ₹ 3 crore would be applicable.	**8%** of gross receipts or total turnover or such higher sum claimed to have been earned by him However, the presumptive income would be **6%** (instead of 8%) of total turnover or sales, in respect of amount which is received • by an account payee cheque or • by an account payee bank draft or • by use of electronic clearing system through a bank account or • through such other prescribed electronic modes **during the previous year or before the due date of filing of return u/s 139(1)** in respect of that previous year.

	<u>Non-applicability of section 44AD</u> This section will not apply to – (i) a person carrying on specified professions referred to in section 44AA(1), (ii) a person earning income in the nature of **commission or brokerage;** (iii) a person carrying on **agency business**.	
44ADA	An assessee, being an individual or a partnership firm (other than LLP) resident in India, who is engaged – in any **profession referred to in section 44AA(1)** such as legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board in the Official Gazette; and whose total **gross receipts does not exceed ₹ 50 lakhs in a previous year.**	**50%** of the gross receipts or such higher sum claimed to have been earned by him.

	If aggregate cash receipts in the relevant PY ≤ 5% of total turnover or gross receipts of the assessee, a higher gross receipts threshold of ₹ 75 lakhs would be applicable.	
44AE	Any assessee who owns **not more than ten goods carriages** at any time during the previous year and who is **engaged in the business of plying, hiring and leasing goods carriages**.	**For each heavy goods vehicle**, **₹ 1,000 per ton** of gross vehicle weight or unladen weight, as the case may be, **for every month or part of a month** during which the vehicle is **owned** by the assessee. **For each vehicle, other than heavy goods vehicle**, **₹ 7,500 per month or part of a month** during which such vehicle is **owned** by the assessee **(or)** an amount claimed to have been actually earned from such vehicle, **whichever is higher.**

Taxability in case of composite income

In cases where income is derived from the sale of rubber manufactured or processed from rubber plants grown by the seller in India, coffee grown and cured/grown, cured, roasted and grounded by the seller in India, or tea grown and manufactured by the seller in India, the income shall be computed as if it were income derived from business, and a specified percentage of such income, as given in the table below, shall be deemed to be income liable to tax -

Rule	Nature of composite income	Business income (Taxable)	Agricultural Income (Exempt)
7A	Income from sale of **rubber** products derived from rubber plants grown by the seller in India	35%	65%
7B	Income from sale of **coffee** - **grown and cured** by the seller in India - **grown, cured, roasted and grounded** by the seller in India	 25% 40%	 75% 60%
8	Income from sale of **tea** grown and manufactured by the seller in India	40%	60%

TEST YOUR KNOWLEDGE

1. *Mr. Venus., engaged in manufacture of pesticides, furnishes the following particulars relating to its manufacturing unit at Chennai, for the year ending 31-3-2026:*

	(₹ in lakhs)
WDV of Plant and Machinery on 31.3.2025	*30.00*
Depreciation including additional depreciation for P.Y. 2024-25	*4.75*
New machinery purchased on 1-9-2025	*10.00*
New machinery purchased on 1-12-2025	*8.00*
Computer purchased on 3-1-2026	*4.00*

Additional information:

- *All assets were purchased by A/c payee cheque.*
- *All assets were put to use immediately.*
- *New machinery purchased on 1-12-2025 and computer have been installed in the office.*
- *During the year ended 31-3-2025, a new machinery had been purchased on 31-10-2024, for ₹ 10 lakhs. Additional depreciation, besides normal depreciation, had been claimed thereon.*
- *Depreciation rate for machinery may be taken as 15%.*
- *The assessee has no brought forward business loss or unabsorbed depreciation as on 1.4.2025.*

Compute the depreciation available to the assessee as per the provisions of the Income-tax Act, 1961 and the WDV of different blocks of assets as on 31-3-2026 if -

(i) he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A)

(ii) he pays tax under the default tax regime under section 115BAC.

2. *Mr. Abhimanyu is engaged in the business of generation and distribution of electric power. He opts to claim depreciation on written down value for income-tax purposes. From the following details, compute the depreciation allowable as per the provisions of the Income-tax Act, 1961 for the A.Y. 2026-27, assuming he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A):*

	Particulars	***(₹ in lakhs)***
(i)	*WDV of block as on 31.3.2025 (15% rate)*	*50.00*
(ii)	*Depreciation for P.Y. 2024-25*	*7.50*
(iii)	*New machinery purchased on 12-10-2025*	*10.00*
(iv)	*Machinery imported from Colombo on 12-4-2025*	*9.00*
	This machine had been used only in Colombo earlier and the assessee is the first user in India.	
(v)	*New computer installed in generation wing unit on 15-7-2025*	*2.00*

All assets were purchased by A/c payee cheque.

3. *Examine with reasons, the allowability of the following expenses incurred by Mr. Manav, a wholesale dealer of commodities, under the Income-tax Act, 1961 while computing profit and gains from business or profession for the A.Y. 2026-27 if he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A) -*

   (i) *Construction of school building in compliance with CSR activities amounting to ₹ 5,60,000.*

   (ii) *Purchase of building for the purpose of specified business of setting up and operating a warehousing facility for storage of food grains amounting to ₹ 4,50,000.*

   (iii) *Interest on loan paid to Mr. X (a resident) ₹ 50,000 on which tax has not been deducted. The sales for the P.Y. 2024-25 was ₹ 202 lakhs. Mr. X has not paid the tax, if any, on such interest.*

   (iv) *Commodities transaction tax paid ₹ 20,000 on sale of bullion.*

4. *Examine with reasons, for the following sub-divisions, whether the following statements are true or false having regard to the provisions of the Income-tax Act, 1961:*

   (i) *For a dealer in shares and securities, securities transaction tax paid in a recognized stock exchange is permissible business expenditure.*

   (ii) *Where a person follows mercantile system of accounting, an expenditure of ₹ 25,000 has been allowed on accrual basis and in a later year, in respect of the said expenditure, assessee makes the payment of ₹ 25,000 through a crossed cheque, ₹ 25,000 can be the profits and gains of business under section 40A(3A) in the year of payment.*

   (iii) *It is mandatory to provide for depreciation under section 32 of the Income-tax Act, 1961, while computing income under the head "Profits and Gains from Business and Profession".*

   (iv) *The mediclaim premium paid to GIC by Mr. Lomesh for his employees, by an account payee cheque on 27.12.2025 is a deductible expenditure under section 36.*

   (v) *Under section 35DDA, amortization of expenditure incurred under eligible Voluntary Retirement Scheme at the time of retirement alone, can be done.*

   (vi) *An individual engaged in trading activities and exercising the option of shifting out of the default tax regime provided under section 115BAC(1A) can claim additional depreciation under section 32(1)(iia) in respect of new plant acquired and installed in the trading concern, where the increase in value of such plant as compared to the approved base year is more than 10%.*

5. *Examine, with reasons, the allowability of the following expenses under the Income-tax Act, 1961 while computing income from business or profession for the A.Y. 2026-27:*

   (i) *Provision made on the basis of actuarial valuation for payment of gratuity ₹ 5,00,000. However, no payment on account of gratuity was made before due date of filing return.*

(ii) *Purchase of oil seeds of ₹ 50,000 in cash from a farmer on a banking day.*

(iii) *Tax on non-monetary perquisite provided to an employee ₹ 20,000.*

(iv) *Payment of ₹ 50,000 by using credit card for fire insurance.*

(v) *Salary payment of ₹ 10,00,000 to Mr. X outside India by a company without deduction of tax assuming Mr. X has not paid tax on such salary income.*

(vi) *Payment made in cash ₹ 30,000 to a transporter in a day for carriage of goods.*

6. *Examine with reasons, whether the following statements are true or false, with regard to the provisions of the Income-tax Act, 1961:*

(a) *Payment made in respect of a business expenditure incurred on 16th February, 2026 for ₹ 25,000 through a crossed cheque is hit by the provisions of section 40A(3).*

(b) (i) *It is a condition precedent to write off in the books of account, the amount due from debtor to claim deduction for bad debt.*

(ii) *Failure to deduct tax at source in accordance with the provisions of Chapter XVII-B, inter alia, from the amounts payable to a non-resident as rent or royalty, will result in disallowance while computing the business income where the non-resident payee has not paid the tax due on such income.*

7. *Mr. Sivam, a retail trader of Cochin gives the following Trading and Profit and Loss Account for the year ended 31st March, 2026:*

Trading and Profit and Loss Account for the year ended 31.03.2026

Particulars	₹	Particulars	₹
To Opening stock	90,000	By Sales	1,12,11,500
To Purchases	1,10,04,000	By Closing stock	1,86,100
To Gross Profit	3,03,600		-
	1,13,97,600		1,13,97,600
To Salary	60,000	By Gross profit b/d	3,03,600
To Rent and rates	36,000	By Income from UTI	2,400

To Interest on loan	*15,000*		
To Depreciation	*1,05,000*		
To Printing & stationery	*23,200*		
To Postage & telegram	*1,640*		
To Loss on sale of shares (Short-term)	*8,100*		
To Other general expenses	*7,060*		
To Net Profit	*50,000*		
	3,06,000		*3,06,000*

Additional Information:

(i) *It was found that some stocks were omitted to be included in both the Opening and Closing Stock, the values of which were:*

Opening stock	*₹ 9,000*
Closing stock	*₹ 18,000*

(ii) *Salary includes ₹ 10,000 paid to his brother, which is unreasonable to the extent of ₹ 2,000.*

(iii) *The whole amount of printing and stationery was paid in cash by way of one-time payment to Mr. Ramesh.*

(iv) *The depreciation provided in the Profit and Loss Account ₹ 1,05,000 was based on the following information:*

The opening balance of plant and machinery (i.e., the written down value as on 31.3.2025 minus depreciation for P.Y. 2024-25) is ₹ 4,20,000. A new plant falling under the same block of depreciation was bought on 01.7.2025 for ₹ 70,000. Two old plants were sold on 1.10.2025 for ₹ 50,000.

(v) *Rent and rates includes GST liability of ₹ 3,400 paid on 7.4.2026.*

(vi) *Other general expenses include ₹ 2,000 paid as donation to a Public Charitable Trust.*

You are required to compute the profits and gains of Mr. Sivam under presumptive taxation u/s 44AD and profits and gains as per the regular provisions of the Act assuming he has exercised the option of shifting out of *the default tax regime provided under section 115BAC(1A). Assume that the whole of the amount of turnover received by account payee cheque or use of electronic clearing system through bank account during the previous year.*

8. *Mr. Sukhvinder is engaged in the business of plying goods carriages. On 1st April, 2025, he owns 10 trucks (out of which 6 are heavy goods vehicles, the gross vehicle weight of such goods vehicle is 15,000 kg each). On 2nd May, 2025, he sold one of the heavy goods vehicles and purchased a light goods vehicle on 6th May, 2025. This new vehicle could, however, be put to use only on 15th June, 2025.*

   Compute the total income of Mr. Sukhvinder for the A.Y. 2026-27, taking note of the following data:

Particulars	***₹***	***₹***
Freight charges collected		*12,70,000*
Less: Operational expenses	*6,25,000*	
Depreciation as per section 32	*1,85,000*	
Other office expenses	*15,000*	*8,25,000*
Net Profit		*4,45,000*
Other business and non-business income		*70,000*

9. *Mr. Raju, a manufacturer at Chennai, gives the following Manufacturing, Trading and Profit & Loss Account for the year ended 31.03.2026:*

Manufacturing, Trading and Profit & Loss Account
for the year ended 31.03.2026

Particulars	***₹***	***Particulars***	***₹***
To Opening Stock	*71,000*	*By Sales*	*2,32,00,000*
To Purchase of Raw Materials	*2,16,99,000*	*By Closing stock*	*2,00,000*
To Manufacturing Wages & Expenses	*5,70,000*		
To Gross Profit	*10,60,000*		
	2,34,00,000		*2,34,00,000*
To Administrative charges	*3,26,000*	*By Gross Profit*	*10,60,000*

To SGST penalty	*5,000*	*By Dividend from domestic companies*	*15,000*
To GST paid	*1,10,000*	*By Income from agriculture (net)*	*1,80,000*
To General Expenses	*54,000*		
To Interest to Bank (On machinery term loan)	*60,000*		
To Depreciation	*2,00,000*		
To Net Profit	*5,00,000*		
	12,55,000		***12,55,000***

Following are the further information relating to the financial year 2025-26:

(i) *Administrative charges include ₹ 46,000 paid as commission to brother of the assessee. The commission amount at the market rate is ₹ 36,000.*

(ii) *The assessee paid ₹ 33,000 in cash to a transport carrier on 29.12.2025. This amount is included in manufacturing expenses. (Assume that the provisions relating to TDS are not applicable to this payment)*

(iii) *A sum of ₹ 4,000 per month was paid as salary to a staff throughout the year and this has not been recorded in the books of account.*

(iv) *Bank term loan interest actually paid upto 31.03.2026 was ₹ 20,000 and the balance was paid in November 2026.*

(v) *Housing loan principal repaid during the year was ₹ 50,000 and it relates to residential property acquired by him in P.Y. 2024-25 for self-occupation. Interest on housing loan was ₹ 23,000. Housing loan was taken from Canara Bank. These amounts were not dealt with in the profit and loss account given above.*

(vi) *Depreciation allowable under the Act is to be computed on the basis of following information:*

Plant & Machinery (Depreciation rate@15%)	***₹***
WDV as on 31.03.2025 minus Depreciation for P.Y. 2024-25	*11,90,000*
Additions during the year (used for more than 180 days)	*2,00,000*
Total additions during the year	*4,00,000*

Compute the total income of Mr. Raju for the A.Y. 2026-27 assuming he pays tax under default tax regime.

Note: *Ignore application of section 14A for disallowance of expenditures in respect of any exempt income.*

10. *Mr. Tenzingh is engaged in composite business of growing and curing (further processing) coffee in Coorg, Karnataka. The whole of coffee grown in his plantation is cured. Relevant information pertaining to the year ended 31.3.2026 are given below:*

Particulars	***₹***
Opening balance of car (only asset in the block) as on 1.4.2025 (i.e. WDV as on 31.3.2025 (-) depreciation for P.Y. 2024-25)	*3,00,000*
Opening balance of machinery as on 1.4.2025 (i.e., WDV as on 31.3.2025 (-) depreciation for P.Y. 2024-25)	*15,00,000*
Expenses incurred for growing coffee	*3,10,000*
Expenditure for curing coffee	*3,00,000*
Sale value of cured coffee	*22,00,000*

Besides being used for agricultural operations, the car is also used for personal use; disallowance for personal use may be taken at 20%. The expenses incurred for car running and maintenance are ₹ 50,000. The machines were used in coffee curing business operations.

Compute the income arising from the above activities for the A.Y. 2026-27.

11. *Mr. Prem has following assets used for business purpose as on 01.04.2025:*

    (i) *A machinery costing ₹ 4 lakh, which was used for scientific research related to business and deduction u/s 35 was allowed and claimed.*

    (ii) *A laptop received as a gift from his friend costing ₹60,000. It was purchased on 01.04.2024 by his friend.*

    (iii) *A temporary wooden structure costing ₹ 70,000 erected in December, 2025.*

    Compute the depreciation allowed on these assets for A.Y. 2026-27.

12. *AB Light LLP consists of 2 working partners, Mr. Anand and Mr. Bheem with 60% and 40% share, respectively. As per the partnership deed, they are*

eligible for interest on capital @15% p.a. on their capital contribution of ₹ 15 lakhs each and remuneration of ₹ 50,000 p.m. to Anand and ₹ 40,000 p.m. to Bheem. The firm is engaged in manufacturing business. During the year ended 31.3.2026, the net profit as per profit and loss account was ₹ 25,86,000 before considering interest on capital and remuneration to partners as well as the following items:

		₹
(i)	*Current year revenue expenditure on scientific research*	*2,40,000*
(ii)	*Unabsorbed capital expenditure on scientific research relating to P.Y. 2022-23*	*85,000*
(iii)	*Unabsorbed depreciation of A.Y. 2017-18*	*52,000*
(iv)	*Current year depreciation under section 32*	*4,70,000*
(v)	*Brought forward business loss of A.Y. 2021-22*	*49,000*
(vi)	*Current year capital expenditure on scientific research*	*3,45,000*

You are required to compute the book profit and remuneration allowable in the hands of AB Light LLP for A.Y. 2026-27. Also, determine the amount of remuneration taxable in the hands of Mr. Anand and Mr. Bheem.

13. *Mr. Piyush runs a sole proprietorship firm and owns four machines which was put in use for business in March, 2025. The depreciation on these machines is charged @15%. The written down value of these machines as on 1st April, 2025 was ₹ 7,70,000. Two of the old machines were sold on 15th July, 2025 for ₹ 10,00,000. A second hand plant was bought for ₹ 6,10,000 on 30th December, 2025.*

Further, Mr. Piyush has furnished the following particulars relating to payments made and expenditure incurred towards scientific research for the year ended 31.3.2026:

Sl. No.	***Particulars***	***₹ (in lakhs)***
(i)	*Payment made to UV University, an approved University*	*15*
(ii)	*Payment made to Satywati College*	*17*

Compute the following for Assessment Year 2026-27

(i) *Claim of depreciation*

(ii) *Deduction available under section 35 if he has shifted out of the default tax regime*

ANSWERS

1. **Computation of written down value of block of assets of Venus Ltd. as on 31.3.2026**

Particulars	Plant & Machinery (₹ in lakhs)	Computer (₹ in lakhs)
Written down value (as on 31.3.2025)	**30.00**	**Nil**
Less: Depreciation including additional depreciation for P.Y. 2024-25	4.75	-
Opening balance as on 1.4.2025	25.25	
Add: Actual cost of new assets acquired during the year		
New machinery purchased on 1.9.2025	10.00	-
New machinery purchased on 1.12.2025	8.00	-
Computer purchased on 3.1.2026	-	4.00
	43.25	4.00
Less: Assets sold/discarded/destroyed during the year	Nil	Nil
Written Down Value (as on 31.03.2026)	**43.25**	**4.00**

(i) If Mr. Venus exercises the option of shifting out of the default tax regime provided under section 115BAC(1A)

In this case, since his income would be computed under the optional tax regime as per the normal provisions of the Act, he would be entitled for normal depreciation and additional depreciation, subject to fulfilment of conditions.

Computation of depreciation for A.Y. 2026-27

	Particulars	Plant & Machinery (₹ in lakhs)	Computer (₹ in lakhs)
I.	**Assets put to use for more than 180 days, eligible for 100% depreciation calculated applying the eligible rate of normal depreciation and additional depreciation**		
	Normal Depreciation		
	- WDV of plant and machinery (₹ 25.25 lakhs x 15%)	3.79	-
	- New Machinery purchased on 1.9.2025 (₹ 10 lakhs x 15%)	1.50	-
	(A)	5.29	-
	Additional Depreciation		
	New Machinery purchased on 1.9.2025 (₹ 10 lakhs x 20%)	2.00	-
	Balance additional depreciation in respect of new machinery purchased on 31.10.2024 and put to use for less than 180 days in the P.Y. 2024-25 (₹ 10 lakhs x 20% x 50%)	1.00	
	(B)	3.00	
II.	**Assets put to use for less than 180 days, eligible for 50% depreciation calculated applying the eligible rate of normal depreciation and additional depreciation, if any**		
	Normal Depreciation		
	New machinery purchased on 1.12.2025 [₹ 8 lakhs x 7.5% (i.e., 50% of 15%)]	0.60	-
	Computer purchased on 3.1.2026 [₹ 4 lakhs x 20% (50% of 40%)]	-	0.80
	(C)	0.60	0.80
	Total Depreciation (A+B+C)	**8.89**	**0.80**

Notes:

(1) As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005, by an assessee engaged, *inter alia,* in the business of manufacture or production of any article or thing, at the rate of 20% of the actual cost of such machinery or plant.

However, additional depreciation shall not be allowed in respect of, *inter alia*,–

(i) any office appliances or road transport vehicles;

(ii) any machinery or plant installed in, *inter alia*, office premises.

In view of the above provisions, additional depreciation cannot be claimed in respect of -

(i) Machinery purchased on 1.12.2025, installed in office and

(ii) Computer purchased on 3.1.2026, installed in office.

(2) Balance additional depreciation@10% on new plant or machinery acquired and put to use for less than 180 days in the year of acquisition which has not been allowed in that year, shall be allowed in the immediately succeeding previous year.

Hence, in this case, the balance additional depreciation@10% (i.e., ₹ 1 lakhs, being 10% of ₹ 10 lakhs) in respect of new machinery which had been purchased during the previous year 2024-25 and put to use for less than 180 days in that year can be claimed in P.Y. 2025-26 being immediately succeeding previous year.

(i) If Mr. Venus pays tax under default tax regime under section 115BAC

In this case, under the default tax regime as per section 115BAC, he would be entitled only for normal depreciation but not additional depreciation.

Computation of depreciation for A.Y. 2026-27

	Particulars	Plant & Machinery (₹ in lakhs)	Computer (₹ in lakhs)
I.	**Assets put to use for more than 180 days, eligible for 100% depreciation calculated applying the eligible rate of normal depreciation**		
	Normal Depreciation		
	- WDV of plant and machinery (₹ 25.25 lakhs x 15%)	3.79	-
	- New Machinery purchased on 1.9.2025 (₹ 10 lakhs x 15%)	1.50	-
	(A)	5.29	-
II.	**Assets put to use for less than 180 days, eligible for 50% depreciation calculated applying the eligible rate of normal depreciation**		
	Normal Depreciation		
	New machinery purchased on 1.12.2025 [₹ 8 lakhs x 7.5% (i.e., 50% of 15%)]	0.60	-
	Computer purchased on 3.1.2026 [₹ 4 lakhs x 20% (50% of 40%)]	-	0.80
	(C)	0.60	0.80
	Total Depreciation (A+B+C)	**5.89**	**0.80**

2. **Computation of depreciation under section 32 for A.Y.2026-27**

Particulars	₹	₹
Normal Depreciation		
Depreciation@15% on ₹ 51,50,000, being machinery put to use for more than 180 days [WDV as on 31.3.2025 of ₹ 50,00,000 – Depreciation for P.Y. 2024-25 of ₹ 7,50,000+ Purchase cost of imported machinery of ₹ 9,00,000]	7,72,500	

Depreciation@7.5% on ₹ 10,00,000, being new machinery put to use for less than 180 days	75,000	
	8,47,500	
Depreciation@40% on computers purchased ₹ 2,00,000	80,000	9,27,500
Additional Depreciation (Refer Note below)		
Additional Depreciation@10% of ₹ 10,00,000 [being actual cost of new machinery purchased on 12-10-2025]	1,00,000	
Additional Depreciation@20% on new computer installed in generation wing of the unit [20% of ₹ 2,00,000]	40,000	1,40,000
Depreciation on Plant and Machinery		**10,67,500**

Note:-

Mr. Abhimanyu is eligible for additional depreciation since he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). The benefit of additional depreciation is available to new plant and machinery acquired and installed in power sector undertakings. Accordingly, additional depreciation is allowable in the case of any new machinery or plant acquired and installed by an assessee engaged, *inter alia,* in the business of generation, transmission or distribution of power, at the rate of 20% of the actual cost of such machinery or plant.

Therefore, new computer installed in generation wing units eligible for additional depreciation@20%.

Since the new machinery was purchased only on 12.10.2025, it was put to use for less than 180 days during the previous year, and hence, only 10% (i.e., 50% of 20%) is allowable as additional depreciation in the A.Y.2026-27. The balance additional depreciation would be allowed in the next year.

However, additional depreciation shall not be allowed in respect of, *inter alia*, any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person. Therefore, additional depreciation is not allowable in respect of imported machinery, since it was used in Colombo, before its installation by the assessee.

3. Allowability of the expenses incurred by Mr. Manav, a wholesale dealer in commodities, while computing profits and gains from business or profession

(i) Construction of school building in compliance with CSR activities

Under section 37(1), only expenditure not being in the nature of capital expenditure or personal expense and not covered under sections 30 to 36, and incurred wholly and exclusively for the purposes of the business is allowed as a deduction while computing business income.

However, any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to have been incurred for the purpose of business and hence, shall **not** be allowed as deduction under section 37.

Accordingly, the amount of ₹ 5,60,000 incurred by Mr. Manav, towards construction of school building in compliance with CSR activities shall **not** be allowed as deduction under section 37.

(ii) Purchase of building for setting up and operating a warehousing facility for storage of food grains

Mr. Manav, would be eligible for investment-linked tax deduction under section 35AD, since he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). The deduction u/s 35AD would be 100% of ₹ 4,50,000, being the amount invested in purchase of building for setting up and operating a warehousing facility for storage of food grains which commences operation on or after 1st April, 2009 (P.Y.2025-26, in this case).

Therefore, the deduction under section 35AD while computing business income of such specified business would be ₹ 4,50,000, if Mr. Manav opts for section 35AD.

(iii) Interest on loan paid to Mr. X (a resident) ₹ 50,000 on which tax has not been deducted

As per section 194A, Mr. Manav, being an individual is required to deduct tax at source on the amount of interest on loan paid to Mr. X, since his turnover during the previous year 2024-25 exceeds ₹ 100 lakhs.

Therefore, ₹ 15,000, being 30% of ₹ 50,000, would be disallowed under section 40(a)(ia) while computing the business income of Mr. Manav for non-deduction of tax at source under section 194A on interest of ₹ 50,000 paid by it to Mr. X.

The balance ₹ 35,000 would be allowed as deduction under section 36(1)(iii), assuming that the amount was borrowed for the purposes of business.

(iv) Commodities transaction tax of ₹ 20,000 paid on sale of bullion

Commodities transaction tax paid in respect of taxable commodities transactions entered into in the course of business during the previous year is allowable as deduction, provided the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".

Taking that income from this commodities transaction is included while computing the business income of Mr. Manav, the commodity transaction tax of ₹ 20,000 paid is allowable as deduction under section 36(1)(xvi).

4. **(i)** **True:** Section 36(1)(xv) allows a deduction of the amount of securities transaction tax paid by the assessee in respect of taxable securities transactions entered into in the course of business during the previous year as deduction from the business income of a dealer in shares and securities.

(ii) **True:** As per section 40A(3A), in the case of an assessee following mercantile system of accounting, if an expenditure has been allowed as deduction in any previous year on due basis, and payment exceeding ₹ 10,000 has been made in the subsequent year otherwise than by an account payee cheque or an account payee bank draft or use of ECS through a bank account or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS, UPI, RTGS, NEFT, and BHIM Aadhar Pay, then, the payment so made shall be deemed to be the income of the subsequent year in which such payment has been made.

(iii) **True:** According to the *Explanation 5* to section 32(1), allowance of depreciation is mandatory. Therefore, depreciation has to be provided mandatorily while calculating income from business/ profession whether or not the assessee has claimed the same while computing his total income.

(iv) **True:** Section 36(1)(ib) provides deduction in respect of premium paid by an employer to keep in force an insurance on the health of his employees under a scheme framed in this behalf by GIC or any other insurer. The medical insurance premium can be paid by any mode other than cash, to be eligible for deduction under section 36(1)(ib).

(v) **False:** Expenditure incurred in making payment to the employee in connection with his voluntary retirement either in the year of retirement or in any subsequent year, will be entitled to deduction in 5 equal annual installments beginning from the year in which each payment is made to the employee.

(vi) **False**: Additional depreciation can be claimed only in respect of eligible plant and machinery acquired and installed by an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation or transmission or distribution of power.

In this case, the individual is engaged in trading activities and the new plant has been acquired and installed in a trading concern. Hence, he will not be entitled to claim additional depreciation under section 32(1)(iia), even though he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

5. **(i)** **Not allowable as deduction:** As per section 40A(7), no deduction is allowed in computing business income in respect of any provision made by the assessee in his books of account for the payment of gratuity to his employees except in the following two cases:

(1) where any provision is made for the purpose of payment of sum by way of contribution towards an approved gratuity fund; or

(2) where any provision is made for the purpose of making any payment on account of gratuity that has become payable during the previous year.

Therefore, in the present case, the provision made on the basis of actuarial valuation for payment of gratuity has to be disallowed under section 40A(7), since, no payment has been actually made on account of gratuity.

Note: It is assumed that such provision is not for the purpose of contribution towards an approved gratuity fund.

(ii) **Allowable as deduction:** As per Rule 6DD, in case the payment is made for purchase of agricultural produce directly to the cultivator, grower or producer of such agricultural produce, no disallowance under section 40A(3) is attracted even though the cash payment for the expense exceeds ₹ 10,000.

Therefore, in the given case, disallowance under section 40A(3) is not attracted since, cash payment for purchase of oil seeds is made directly to the farmer.

(iii) **Not allowable as deduction:** Income-tax of ₹ 20,000 paid by the employer in respect of non-monetary perquisites provided to its employees is exempt in the hands of the employee under section 10(10CC).

As per section 40(a)(v), such income-tax paid by the employer is not deductible while computing business income.

(iv) **Allowable as deduction:** Payment for fire insurance is allowable as deduction under section 36(1). Since payment is made by credit card, which is a prescribed electronic mode, disallowance under section 40A(3) is not attracted in this case.

(v) **Not allowable as deduction:** Disallowance under section 40(a)(iii) is attracted in respect of salary payment of ₹ 10,00,000 outside India by a company without deduction of tax at source.

(vi) **Allowable as deduction:** The limit for attracting disallowance under section 40A(3) for payment otherwise than by way of account payee cheque or account payee bank draft or use of ECS through a bank account or through such other prescribed electronic mode is ₹ 35,000 in case of payment made for plying, hiring or leasing goods carriage. Therefore, in the present case, disallowance under section 40A(3) is not attracted for payment of ₹ 30,000 made in cash to a transporter for carriage of goods.

6. **(a)** **True:** In order to escape the disallowance specified in section 40A(3), payment in respect of the business expenditure ought to have been made through an account payee cheque. Payment through a crossed cheque will attract disallowance under section 40A(3).

(b) **(i)** **True:** It is mandatory to write off the amount due from a debtor as not receivable in the books of account, in order to claim the same as bad debt under section 36(1)(vii). However, where the debt has been taken into account in computing the income of the assessee on the basis of ICDSs notified under section 145(2), without recording the same in the accounts, then, such debt shall be allowed in the previous year in which such debt becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the said purpose.

(ii) **True:** Section 40(a)(i) provides that failure to deduct tax at source from, *inter alia,* rent or royalty payable to a non-resident, in accordance with the provisions of Chapter XVII-B, will result in disallowance of such expenditure, where the non-resident payee has not paid the tax due on such income.

7. **Computation of business income of Mr. Sivam for the A.Y. 2026-27**

Particulars	₹	₹
Net Profit as per profit and loss account		50,000
Add: Inadmissible expenses/ losses		
Under valuation of closing stock	18,000	
Salary paid to brother – unreasonable [Section 40A(2)]	2,000	
Printing and stationery - whole amount of printing & stationery paid in cash would be	23,200	

	disallowed, since such amount exceeds ₹ 10,000 [Section 40A(3)]		
	Depreciation **(considered separately)**	1,05,000	
	Short term capital loss on shares	8,100	
	Donation to public charitable trust	2,000	1,58,300
			2,08,300
Less:	Items to be deducted:		
	Under valuation of opening stock	9,000	
	Income from UTI **[Chargeable under the head "Income from Other Sources]**	2,400	11,400
	Business income before depreciation		1,96,900
Less:	Depreciation (**See Note 1)**		66,000
			1,30,900

Computation of business income as per section 44AD:

As per section 44AD, where the amount of turnover is received, *inter alia,* by way of account payee cheque or use of electronic clearing system through bank account or through such other prescribed electronic modes, the presumptive business income would be 6% of turnover, i.e., ₹ 1,12,11,500 x 6 /100 = ₹ 6,72,690

Notes:

1. **Calculation of depreciation**

Particulars	₹
Opening balance of plant & machinery as on 1.4.2025 (i.e. WDV as on 31.3.2025 (-) depreciation for P.Y. 2024-25)	4,20,000
Add: Cost of new plant & machinery	70,000
	4,90,000
Less: Sale proceeds of assets sold	50,000
WDV of the block of plant & machinery as on 31.3.2026	4,40,000
Depreciation@15%	66,000
No additional depreciation is allowable as the assessee is not engaged in manufacture or production of any article.	

2. Since GST liability has been paid before the due date of filing return of income under section 139(1), the same is deductible.

8. Section 44AE would apply in the case of Mr. Sukhvinder since he is engaged in the business of plying goods carriages and owns not more than ten goods carriages at any time during the previous year.

Section 44AE provides for computation of business income of such assesses on a presumptive basis. The income shall be deemed to be ₹ 1,000 per ton of gross vehicle weight or unladen weight, as the case may be, per month or part of the month for each heavy goods vehicle and ₹ 7,500 per month or part of month for each goods carriage other than heavy goods vehicle, owned by the assessee in the previous year or such higher sum as declared by the assessee in his return of income.

Mr. Sukhvinder's business income calculated applying the provisions of section 44AE is ₹ 13,72,500 **(See Notes 1 & 2 below)** and his total income would be ₹ 14,42,500.

However, as per section 44AE(7), Mr. Sukhvinder may claim lower profits and gains if he keeps and maintains proper books of account as per section 44AA and gets the same audited and furnishes a report of such audit as required under section 44AB. If he does so, then his income for tax purposes from goods carriages would be ₹ 4,45,000 instead of ₹ 13,72,500 and his total income would be ₹ 5,15,000.

Notes:

1. Computation of total income of Mr. Sukhvinder for A.Y. 2026-27

Particulars	**Presumptive income ₹**	**Where books are maintained ₹**
Income from business of plying goods carriages **[See Note 2 Below]**	13,72,500	4,45,000
Other business and non-business income	70,000	70,000
Total Income	14,42,500	5,15,000

2. Calculation of presumptive income as per section 44AE

Type of carriage	No. of months	Rate per ton per month/ per month	Ton	Amount ₹
(1)	(2)		(3)	(4)
<u>Heavy goods vehicle</u>				
1 goods carriage upto 1st May	2	1,000	15 (15,000/1,000)	30,000
5 goods carriage held throughout the year	12	1,000	15 (15,000/1,000)	9,00,000
<u>Goods vehicle other than heavy goods vehicle</u>				
1 goods carriage from 6th May	11	7,500	-	82,500
4 goods carriage held throughout the year	12	7,500	-	3,60,000
			Total	**13,72,500**

9. Computation of total income of Mr. Raju for the A.Y. 2026-27

Particulars	₹	₹
Profits and gains of business or profession		
Net profit as per profit and loss account		5,00,000
Add: Excess commission paid to brother disallowed under section 40A(2)	10,000	
Disallowance under section 40A(3) is not attracted since the limit for one time cash payment is ₹ 35,000 in respect of payment to transport operators. Therefore, amount of ₹ 33,000 paid in cash to a transport carrier is allowable as deduction.	Nil	

	Bank term loan interest paid after the due date of filing of return under section 139(1) – disallowed as per section 43B	40,000	
	State GST penalty paid disallowed **[See Note 2 below]**	5,000	
	Depreciation debited to profit and loss account	2,00,000	2,55,000
			7,55,000
Less:	Dividend from domestic companies **[Chargeable to tax under the head "Income from Other Sources"]**	15,000	
	Income from agriculture **[Exempt under section 10(1)]**	1,80,000	
	Salary paid to staff not recorded in the books (Assumed it was an erroneous omission and that the assessee has offered satisfactory explanation for the same. In such a case, the same would be allowable as deduction while computing profits and gains of business and profession) **[See Note 1 below]**	48,000	
	Depreciation under the Income-tax Act, 1961 **(As per working note)**	2,23,500	4,66,500
			2,88,500
Income from house property			
Annual value of self-occupied property		Nil	
Less:	Deduction u/s 24(b) – interest on housing loan [Not allowable, since Mr. Raju is paying tax as per default tax regime]	Nil	Nil
Income from Other Sources			
Dividend from domestic companies			15,000
Gross Total Income			**3,03,500**
Less: Deduction u/s 80C [Not allowable, since Mr. Raju is paying tax as per default tax regime]			Nil
Total Income			**3,03,500**

Working Note:

Computation of depreciation under the Income-tax Act, 1961

Particulars	₹
Depreciation@15% on ₹ 13.90 lakhs (WDV as on 31.3.2025 *less* depreciation for P.Y. 2024-25 i.e., ₹ 11.90 lakh *plus* assets purchased during the year and used for more than 180 days ₹ 2 lakh)	2,08,500
Depreciation @7.5% on ₹ 2 lakh (Assets used for < 180 days)	15,000
	2,23,500

Since Mr. Raju is paying tax as per default tax regime, additional depreciation u/s 32(1)(iia) would not be available to him.

Notes (Alternate views):

1. It is also possible to take a view that the salary paid to staff not recorded in the books is in the nature of unexplained expenditure and hence, would be deemed to be income as per section 69C and would be taxable @ 60% under section 115BBE. In such a case, no deduction allowable in respect of such expenditure.
2. Where the imposition of penalty is not for delay in payment of sales tax or VAT or GST but for contravention of provisions of the Sales Tax Act or VAT Act or GST Law, the levy is not compensatory and therefore, not deductible. However, if the levy is compensatory in nature, it would be fully allowable. Where it is a composite levy, the portion which is compensatory is allowable and that portion which is penal is to be disallowed.

   Since the question only mentions "GST penalty paid" and the reason for levy of penalty is not given, it has been assumed that the levy is not compensatory and therefore, not deductible. It is, however, possible to assume that such levy is compensatory in nature and hence, allowable as deduction. In such a case, the total income would be ₹ 3,94,500.

10. Where an assessee is engaged in the composite business of growing and curing of coffee, the income will be segregated between agricultural income and business income, as per Rule 7B of the Income-tax Rules, 1962.

As per the above Rule, income derived from sale of coffee grown and cured by the seller in India shall be computed as if it were income derived from business, and 25% of such income shall be deemed to be income liable to tax. The balance 75% will be treated as agricultural income.

Particulars		₹	₹
Sale value of cured coffee			22,00,000
Less: Expenses for growing coffee		3,10,000	
Car expenses (80% of ₹ 50,000)		40,000	
Depreciation on car (80% of 15% of ₹ 3,00,000) **[See Computation below]**		36,000	
Total cost of agricultural operations		3,86,000	
Expenditure on coffee curing operations	3,00,000		
Add: Depreciation on machinery (15% of ₹ 15,00,000) **[See Computation below]**	2,25,000		
Total cost of the curing operations		5,25,000	
Total cost of composite operations			9,11,000
Total profits from composite activities			**12,89,000**
Business income (25% of above)			3,22,250
Agricultural income (75% of above)			9,66,750

Computation of depreciation for P.Y. 2025-26

Particulars	₹	₹
Car		
Opening balance as on 1.4.2025 (i.e., WDV as on 31.3.2025 (-) depreciation for P.Y.2024-25)		3,00,000
Depreciation thereon at 15%	45,000	
Less: Disallowance @20% for personal use	9,000	
Depreciation actually allowed		36,000

Machinery		
Opening balance as on 1.4.2025 (i.e., WDV as on 31.3.2025 (-) depreciation for P.Y.2024-25)		15,00,000
Depreciation @ 15% for P.Y. 2025-26		2,25,000

Explanation 7 to section 43(6) provides that in cases of 'composite income', for the purpose of computing written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee (and not just 25%) is chargeable under the head "Profits and gains of business or profession". The depreciation so computed shall be deemed to have been "actually allowed" to the assessee.

11. Computation of Depreciation to Mr. Prem for A.Y. 2026-27

Particulars	Amount (₹)
Depreciation on machinery used for scientific research – Actual cost is nil as ₹ 4,00,000, being actual cost – ₹ 4,00,000, being deduction allowed and claimed u/s 35]	Nil
Depreciation on laptop received as a gift @40% on ₹ 36,000 [₹ 60,000, being actual cost to previous owner – ₹ 24,000, being depreciation for P.Y. 2024-25 allowable to assessee if it was the only asset]	14,400
Depreciation on temporary wooden structure @40% x 50% on ₹ 70,000 [Since it is put to use for less than 180 days]	14,000
	28,400

12. Computation of book profit of AB Light LLP for the A.Y. 2026-27

Particulars	Amount (₹)	Amount (₹)
Net profit as per profit and loss account before interest on capital and remuneration to partners and other items		25,86,000
Less: Expenditure allowable from business income		
- Interest @ 12% p.a. [being the maximum allowable as per section 40(b)] (₹ 15,00,000 × 12% x 2)	3,60,000	

- Current year revenue expenditure on scientific research under section 35(1)(i)	2,40,000	
- Current year depreciation under section 32(1)	4,70,000	
- Current year capital expenditure on scientific research under section 35(1)(iv)	3,45,000	
- Unabsorbed depreciation of A.Y. 2017-18 under section 32(2)	52,000	
- Unabsorbed capital expenditure on scientific research relating to P.Y. 2022-23 under section 35(4)	85,000	15,52,000
Book Profit		**10,34,000**

Note: Brough forward business loss of A.Y. 2021-22 is not allowed to be set off while computing book profit.

Remuneration actually paid or payable to working partners = [₹ 50,000 x 12 + ₹ 40,000 x 12] = ₹ 10,80,000

Partners' remuneration allowable under section 40(b)

On the first ₹ 6,00,000 of book profit [₹ 6,00,000 x 90%]	5,40,000
On the balance ₹ 4,34,000 [₹ 4,34,000 x 60%]	2,60,400
	8,00,400

Hence, allowable working partners salary in the hands of AB Light LLP for the A.Y. 2026-27 is ₹ 8,00,400

Remuneration taxable in the hands of Mr. Anand as business income = ₹ 8,00,400 x 6,00,000/10,80,000 = ₹ 4,44,667

Remuneration taxable in the hands of Mr. Bheem as business income = ₹ 8,00,400 x 4,80,000/10,80,000 = ₹ 3,55,733

13. (i) Computation of depreciation for A.Y.2026-27

Particulars	₹
W.D.V. of the block as on 1.4.2025	7,70,000
Add: Purchase of second hand plant during the year [in December, 2025]	6,10,000
	13,80,000

Less: Sale consideration of old machinery during the year [in July, 2025]	10,00,000
W.D.V of the block as on 31.03.2026	**3,80,000**
Depreciation @ 15% but restricted to 50% thereon. [Since the value of the block as on 31.3.2026 represents part of actual cost of second hand plant purchased in December, 2025, which has been put to use for less than 180 days, depreciation is restricted to 50% of the prescribed percentage of 15% i.e. depreciation is restricted to 7½%. Therefore, the depreciation allowable for the year is ₹ 28,500 being 7½% of ₹ 3,80,000]	**28,500**

(ii) Computation of deduction allowable under section 35

Particulars	Amount (₹ in lakhs)	Section	% of weighted deduction	Amount of deduction (₹ in lakhs)
Payment for scientific research				
UV University, an approved University	15	35(1)(ii)	100%	15
Satyawati College [Since it is not mentioned as an approved University]	17	-	NIL	NIL
Deduction allowable under section 35				**15**

UNIT – 4 : CAPITAL GAINS

LEARNING OUTCOMES

After studying this unit, you would be able to –

- **comprehend** the scope of income chargeable under this head;
- **comprehend** and identify the assets classified as "capital assets" for the purposes of chargeability under this head;
- **comprehend** the meaning of short-term capital asset and long-term capital asset;
- **compute** the period of holding for determining whether an asset is a short-term capital asset or long-term capital asset;
- **identify** the transactions to be considered as transfer for the purpose of capital gains;
- **identify** the transactions not regarded as transfer;
- **compute** the capital gains from transfer of capital assets in the manner prescribed;
- **determine** the cost of acquisition and indexed cost of acquisition, in case of long term capital asset for the purpose of computing the capital gains;
- **compute** capital gains in case of depreciable assets;
- **compute** capital gains in case of market linked debentures and other specified securities;
- **compute** capital gains in case of slump sale;
- **compute** the exemption available for investment of capital gains/net consideration on transfer of certain assets;
- **compute** the capital gains chargeable to tax after deducting the exemptions available in respect of capital gains;
- **appreciate** the concessional tax treatment available for short-term capital gains and for long term capital gains on transfer of listed equity shares/units of an equity oriented fund;
- **compute** the tax liability applying the special rates of tax on long-term capital gains and short-term capital gains and the normal rates of tax.

Proforma for computation of income under the head "Capital Gains"

	Particulars	Amt (₹)	Amt (₹)
In case of a Short-term capital asset (STCA)	Full value of consideration received or accruing as a result of transfer	xxx	
	Less: Expenditure incurred wholly and exclusively in connection with such transfer (for e.g., brokerage on sale)	xxx	
	(Note: *Deduction on account of STT paid will* ***not*** *be allowed)*		
	Net Sale Consideration		xxx
	Less: Cost of acquisition (COA) *[Refer table at page 3.470]*	xxx	
	Cost of improvement (COI) *[Refer table at page 3.473]*	xxx	xxx
	Short-term capital gain (STCG)		xxx
	Less: Exemption under sections 54B/54D		xxx
	Short-term capital gain chargeable to tax		**xxx**
In case of a Long-term capital asset (LTCA)	Full value of consideration received or accruing as a result of transfer	xxx	
	Less: Expenditure incurred wholly and exclusively in connection with such transfer (for e.g., brokerage on sale)	xxx	
	(Note: *Deduction on account of STT paid will* ***not*** *be allowed)*		
	Net Sale Consideration		xxx
	Less: Cost of acquisition (COA) *[Refer table at page 3.470]*	xxx	
	Less: Cost of improvement (COI) *[Refer table at page 3.473]*	xxx	xxx
	Long-term capital gains (LTCG)		xxx
	Less: Exemption under sections 54/54B/54D/54EC/54F *[Refer Table at pages 3.474-3.476]*		xxx
	Long-term capital gains chargeable to tax		**xxx**

Rate of tax on Short-term Capital Gains (STCG)

Section	Rate of tax
111A	• **STCG arising on transfer of listed equity shares, units of equity-oriented fund and unit of business trust**[1] would be taxable at **20%.** STT should have been paid on such sale. • **STCG arising from transaction undertaken in foreign currency on a recognized stock exchange located in an International Financial Services Centre (IFSC)** would be taxable at a concessional rate of **20%**, even though STT is not paid in respect of such transaction.
Note - *STCG arising on transfer of* ***other Short-term Capital Assets*** *would be chargeable at normal rates of tax.*	

Rates of tax on Long-term Capital Gains (LTCG)

Section	Rate of tax
112A	• **LTCG exceeding ₹ 1,25,000** would be taxable **@12.5%,** on the transfer of following long-term capital assets - - listed equity shares, if STT has been paid on acquisition and transfer of such shares - units of equity-oriented fund and unit of business trust, if STT has been paid on transfer of such units • **If such transaction is undertaken on a recognized stock exchange located in an IFSC,** LTCG would be taxable at a concessional rate 12.5%, where the consideration for transfer is received or receivable in foreign currency, even though STT is not paid in respect of such transaction. • Benefit of currency fluctuation would not be available.

[1]The provisions relating to business trust would be dealt at Final level.

112	• **LTCG** on transfer of all long-term capital assets (other than referred u/s 112A) would **be taxable @12.5%.** However, in case of an **individual or HUF, being a resident** in India, **long-term capital gains arising on transfer of long-term capital asset, being land or building or both** if acquired before 23.7.2024 would be taxable - @ **12.5% without indexation; or** - @ **20% with indexation** **whichever is beneficial.** • Further, in case of **non-residents, LTCG** on transfer of **unlisted securities, or shares of a closely held company**, would be taxable **@12.5% without foreign currency fluctuation.**

Notes:

- In case of **a resident individual or a Hindu Undivided Family (HUF)**, the LTCG taxable u/s 112 or 112A or STCG taxable u/s 111A shall be reduced by the unexhausted basic exemption limit and the balance shall be subject to tax.
- **No deduction under Chapter VI-A** can be claimed in respect of such LTCG chargeable to tax u/s 112 or u/s 112A or STCG chargeable to tax u/s 111A.
- In case the assessee is paying tax under default tax regime, **rebate u/s 87A is not available in respect of tax payable on LTCG taxable u/s 112 or 112A or STCG taxable u/s 111A**. However, in case the assessee **opts out of the default tax regime, rebate u/s 87A is available in respect of tax payable on LTCG u/s 112 or STCG u/s 111A but not against LTCG u/s 112A**.
- In case the assessee pays tax **under default tax regime**, **enhanced surcharge of 25% would not be levied** on dividend income, STCG taxable u/s 111A and LTCG taxable u/s 112 and u/s 112A.

- In case the assessee exercises the option of **shifting out of the default tax regime under section 115BAC**, **enhanced surcharge of 25% or 37% would not be levied** on dividend income, STCG taxable u/s 111A and LTCG taxable u/s 112 and u/s 112A.

Period of holding [Section 2(42A)]

STCA, if held for ≤ **12 months**

LTCA, if held for > **12 months**

- Security listed in a recognized stock exchange
- Unit of equity oriented fund/UTI
- Zero Coupon bond

STCA, if held for ≤ **24 months**

LTCA, if held for > **24 months**

- Other capital assets

Note – *It is to be noted that as per section 50AA, capital gains arising from transfer of the following assets would always be capital gains arising from transfer of short-term capital assets irrespective of the period of holding of such assets:*

- *units of a specified mutual fund acquired on or after 1.4.2023,*
- *market linked debentures,*
- *unlisted bond and unlisted debenture*

4.1 INTRODUCTION

Section 45 provides that any profits or gains arising from the **transfer** of a **capital asset** effected in the previous year will be chargeable to income-tax under the head 'Capital Gains'. Such capital gains will be deemed to be the income of the previous year in which the transfer took place. In this charging section, two terms are important. One is "capital asset" and the other is "transfer".

Hence, in this unit on capital gains, we begin our discussion with the definition of "capital asset" and "transfer". Thereafter, we will proceed to discuss the various circumstances under which capital gains tax is levied. There are certain transactions which are not to be regarded as transfer for the purposes of capital gains. These transactions have also been discussed in this chapter. There is a separate method of computation of capital gains in respect of depreciable assets. Also, there are exemptions in cases where capital gains are invested in specified assets. All these aspects are being discussed in this unit.

4.2 CAPITAL ASSET

Definition: According to section 2(14), a capital asset means –

(a) property of any kind held by an assessee, whether or not connected with his business or profession.

(b) any securities held by

- *a Foreign Institutional Investor which has invested in such securities in accordance with the SEBI regulations; or*
- *an investment fund specified in section 115UB[2] which has invested such securities in accordance with the SEBI regulations or IFSC regulations.*

(c) *any unit linked insurance policy (ULIP) to which exemption under section 10(10D) does not apply.*

> ***Note –** Provisions relating to taxability or otherwise of ULIPs issued on or after 1.2.2021 are not being made applicable at Intermediate level. Accordingly, section 45(1B) has been excluded by way of Study Guidelines.*

[2] The provisions of section 115UB will be dealt with at the Final level.

Consequently, reference to such ULIPs has not been made in the discussion of section 10(10D) and in the definition of equity oriented fund for the purpose of section 111A and 112A in the Study Material.

However, it does not include—

(i) **Stock-in trade:** Any stock-in-trade [other than securities referred to in (b) above], consumable stores or raw materials held for the purpose of the business or profession of the assessee;

Whether a particular asset is stock-in-trade or capital asset does not depend upon the nature of the item, but the manner in which the same is held. The item would be stock-in-trade in the hands of the assessee who deals or trades in that item; however, the same item would be capital asset for the assessee who holds it as an investment.

Example: *A dealer in real estate holds a piece of land as stock-in-trade. But the same will be capital asset for an assessee who holds it as an investment.*

The exclusion of stock-in-trade from the definition of capital asset is only in respect of sub-clause (a) above and not sub-clause (b). This implies that even if the nature of such security in the hands of the Foreign Portfolio Investor is stock in trade, the same would be treated as a capital asset and the profit on transfer would be taxable as capital gains.

Further, the Explanatory Memorandum to the Finance (No.2) Bill, 2014 clarifies that the income arising from transfer of such security by a Foreign Portfolio Investor (FPI) would be in the nature of capital gain, irrespective of the presence or otherwise in India, of the Fund manager managing the investments of the assessee.

(ii) **Personal effects:** Personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him.

EXCLUSIONS:

(a) jewellery;

(b) archaeological collections;

(c) drawings;

(d) paintings;

(e) sculptures; or

(f) any work of art.

Definition of Jewellery- Jewellery is a capital asset and the profits or gains arising from the transfer of jewellery held for personal use are chargeable to tax under the head "capital gains". For this purpose, the expression 'jewellery' includes the following:

(i) Ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones and whether or not worked or sewn into any wearing apparel;

(ii) Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

(iii) **Rural agricultural land** in India i.e., agricultural land in India which is not situated in any specified area.

As per the definition, only rural agricultural lands in India are excluded from the purview of the term 'capital asset'. Hence urban agricultural lands constitute capital assets. Accordingly, the agricultural land described in (a) and (b) below, being land situated within the specified urban limits, would fall within the definition of "capital asset", and transfer of such land would attract capital gains tax -

(a) agricultural land situated in any area within the jurisdiction of a municipality or cantonment board having population of not less than ten thousand, or

(b) agricultural land situated in any area within such distance, measured aerially, in relation to the range of population as shown hereunder -

	Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.
(i)	≤ 2 kms	> 10,000
(ii)	> 2 kms but ≤ 6 kms	> 1,00,000
(iii)	> 6 kms but ≤ 8 kms	> 10,00,000

Example

	Area	Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.	Is the land situated in this area a capital asset?
(i)	A	1 km	9,000	No
(ii)	B	1.5 kms	12,000	Yes
(iii)	C	2 kms	11,00,000	Yes
(iv)	D	3 kms	80,000	No
(v)	E	4 kms	3,00,000	Yes
(v)	F	5 kms	12,00,000	Yes
(vi)	G	6 kms	8,000	No
(vii)	H	7 kms	4,00,000	No
(viii)	I	8 kms	10,50,000	Yes
(ix)	J	9 kms	15,00,000	No

Explanation regarding gains arising on the transfer of urban agricultural land – *Explanation 1* to section 2(1A) clarifies that capital gains arising from transfer of any agricultural land situated in any non-rural area (as explained above) will not constitute agricultural revenue within the meaning of section 2(1A).

In other words, the capital gains arising from the transfer of such urban agricultural land would not be treated as agricultural income for the purpose of exemption u/s 10(1). Hence, such gains would be subject to u/s 45.

(iv) **Specified Gold Bonds:** 6½% Gold Bonds, 1977, or 7% Gold Bonds, 1980, or National Defence Gold Bonds, 1980, issued by the Central Government;

(v) **Special Bearer Bonds, 1991** issued by the Central Government;

(vi) **Gold Deposit Bonds** issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetisation Scheme, 2015 and Gold Monetisation Scheme, 2019 notified by the Central Government.

Note – 'Property' includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.

CAPITAL ASSET
[Section 2(14)]

- Property of any kind held by an assessee, whether or not connected with his business or profession
  - **EXCLUSIONS**
    - Stock-in-trade, consumable stores, raw materials held for business or profession
    - **Personal Effects** [i.e., movable property including wearing apparel and furniture held for personal use by the assessee or his family]
      - **EXCLUSIONS FROM PERSONAL EFFECTS**
        - **Jewellery**
        - **Archaeological collections**
        - **Drawings**
        - **Paintings or Sculptures**
        - **Any work of art**
          - **These assets are, hence, capital assets u/s 2(14)**
    - Rural Agricultural Land
    - 6½ Gold Bonds, 1977, 7% Gold Bonds, 1980, National Defence Gold Bonds, 1980, Special Bearer Bonds, 1991 issued by the Central Govt.
    - Gold Deposit Bonds issued under Gold Deposit Scheme, 1999/ Deposit Certificates issued under Gold Monetisation Scheme, 2015 /2018 notified by the Central Govt.
- Any securities held by a FII which has invested in such securities as per SEBI Regulations or an investment fund specified in section 115UB[3] which has invested such securities in accordance with the SEBI regulations or IFSC regulations
- Any unit linked insurance policy (ULIP) which is not exempt by virtue of section 10(10D)

[3] The provisions of section 115UB will be dealt with at the Final level.

4.3 SHORT TERM AND LONG TERM CAPITAL ASSETS

- **Definition:** As per section 2(42A), **short-term capital asset** means a capital asset held by an assessee **for not more than 24 months** immediately preceding the date of its transfer.

  As per section 2(29A), long-term capital asset means a capital asset which is not a short-term capital asset.

  Accordingly, based on the period of holding capital assets would be classified as short-term or long-term capital asset as follows:

Capital Asset	STCG, if held for	LTCG, if held for
• Security listed in a recognized stock exchange • Unit of equity-oriented fund/unit of UTI • Zero Coupon bond	**≤ 12 months** immediately preceding the date of its transfer	**> 12 months** immediately preceding the date of its transfer
• Other capital assets	**≤ 24 months** immediately preceding the date of its transfer	**> 24 months** immediately preceding the date of its transfer

***Note** – As per section 50AA, capital gains arising from transfer of the following assets would always be capital gains arising from transfer of short-term capital assets irrespective of the period of holding of such assets -*

- *units of a specified mutual fund acquired on or after 1.4.2023,*
- *market linked debentures,*
- *unlisted bond and unlisted debenture.*

- **Meaning of certain terms:**

Term	Meaning
Equity oriented fund	A fund set up under a scheme of a mutual fund[4] or under a scheme of an insurance company comprising unit linked insurance policies which are not exempt under section 10(10D) and (i) in a case where the fund invested in the units of another fund which is traded on a recognised stock exchange – I. a minimum of 90% of the total proceeds of such fund is invested in the units of such other fund; and II. such other fund also invests a minimum of 90% of its total proceeds in the equity shares of domestic companies listed on a recognised stock exchange; and (ii) in any other case, a minimum of 65% of the total proceeds of such fund is invested in the equity shares of domestic companies listed on a recognised stock exchange. However, the percentage of equity shareholding or unit held in respect of the fund, as the case may be, shall be computed with reference to the annual average of the monthly averages of the opening and closing figures. In case of a scheme of an insurance company comprising ULIPs to which exemption u/s 10(10D) does not apply, the minimum requirement of 90% or 65%, as the case may be, mentioned in (i) and (ii) above, is required to be satisfied throughout the term of such insurance policy.
Zero Coupon Bond [Section 2(48)]	A bond - issued by any infrastructure capital company or infrastructure capital fund or infrastructure debt fund[5] or a public sector company or a scheduled bank on or after 1st June, 2005,

[4]Specified under section 10(23D)

[5] Infrastructure debt fund notified by Central Government under section 10(47)

	- in respect of which no payment and benefit is received or receivable before maturity or redemption from such issuing entity and - which the Central Government may notify in this behalf.

Note: The income from transfer of a zero-coupon bond (not being held as stock-in-trade) is to be treated as capital gains. Section 2(47)(iva) provides that maturity or redemption of a zero coupon bond shall be treated as a transfer for the purposes of capital gains tax.

- **Determination of period of holding [Clause (i) of *Explanation 1* to section 2(42A)]:** In determining period of holding of any capital asset by the assessee in the circumstances stated in column (1), the period shall be determined by considering the period specified in Column (2).

Determination of period of holding

S. No.	Circumstances (Column 1)	Period of holding (Column 2)
1	Where **shares held in a company in liquidation**	The period subsequent to the date of liquidation of company shall be excluded.
2	Where **asset becomes the property of an assessee by virtue of section 49(1)**	The period for which the capital asset was held by the previous owner shall be included.
3	Where **inventory of business is converted** into or treated **as a capital asset** by the assesse	Period from the date of conversion or treatment as a capital asset shall be considered.
4	Where **share/s in the Indian company (amalgamated company)**, becomes the property of an assessee in lieu of share/s held by him in the amalgamating company at the time of transfer referred under section 47(vii).	The period for which the share(s) was held by the assessee in the amalgamating company shall be included.
5	Where the **share or any other security is subscribed** by the assessee **on the basis of right to**	Period from the date of allotment of such share or security shall be reckoned.

	subscribe to any share or security or by the person in whose favour such right is renounced by the assessee	
6	Where the **right to subscribe** to any share or security is renounced in favour of any other person	Period from the date of offer of such right by the company or institution shall be reckoned
7	Where any **financial asset is allotted** without any payment and on the basis of holding of any other financial asset	Period from the date of allotment of such financial asset shall be reckoned
8	Where **share/s in the Indian company** being a resulting company becomes the property of an assessee in consideration of **demerger**	The period for which the share/s were held by the assessee in demerged company shall be included
9	Where **equity share** in a company becomes the property of the assessee by way of **conversion of preference shares into equity shares** referred under section 47(xb)	The period for which the preference shares were held by the assesse shall be included
10	(i) Where **Electronic Gold Receipt is issued** by a Vault Manager in respect of **gold deposited** [Conversion of gold into Electronic Gold Receipt as referred to in section 47(viid)]	The period for which such gold was held by the assessee prior to conversion into the Electronic Gold Receipt
	(ii) Where **gold is released** in respect of an **Electronic Gold Receipt** [Conversion of Electronic Gold Receipt into gold as referred to in section 47(viid)]	The period for which such Electronic Gold Receipt was held by the assessee prior to its conversion into gold

11	Where any **specified security or sweat equity shares is allotted** or transferred, directly or indirectly, by the employer free of cost or at concessional rate to his employees (including former employees)	Period from the date of allotment or transfer of such specified security or sweat equity shares shall be reckoned
	"Sweat equity shares" means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.	

- **Period of holding in respect of other capital assets** - The period for which any capital asset is held by the assessee shall be determined in accordance with any rules made by the CBDT in this behalf. Accordingly, the CBDT has inserted Rule 8AA in the Income-tax Rules, 1962 to provide for method of determination of period of holding of capital assets, other than the capital assets mentioned in clause (i) of *Explanation 1* to section 2(42A).

  Specifically, in the case of a capital asset, being a share or debenture of a company, which becomes the property of the assessee in the circumstances mentioned in section 47(x), there shall be included the period for which the bond, debenture, debenture-stock or deposit certificate, as the case may be, was held by the assessee prior to the conversion.

  Note: *Section 47(x) provides that any transfer by way of conversion of bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company shall not be regarded as transfer for the purposes of levy of capital gains tax.*

4.4 TRANSFER: WHAT IT MEANS? [SECTION 2(47)]

Section 2(47) contains an inclusive definition of the term 'transfer'. Accordingly, transfer in relation to a capital asset includes the following types of transactions—

(i) the sale, exchange or relinquishment of the asset; or

(ii) the extinguishment of any rights therein; or

(iii) the compulsory acquisition thereof under any law; or

> ***Example:*** *Acquisition of industrial undertaking under the Industries (Development and Regulation) Act, 1951.*

(iv) the owner of a capital asset may convert the same into the stock-in-trade of a business carried on by him. Such conversion is treated as transfer; or

> ***Example:*** *Where an investor in shares starts a business of dealing in shares and treats existing investments as stock-in-trade of the newly set up business, such conversion shall be regarded as transfer for the purpose of capital gains.*

(v) the maturity or redemption of a zero-coupon bond; or

(vi) Part-performance of the contract: Sometimes, possession of an immovable property is given in consideration of part-performance of a contract.

> ***Example:***
>
> *A enters into an agreement for the sale of his house. The purchaser gives the entire sale consideration to A. A hands over complete rights of possession to the purchaser since he has received the entire sale consideration. Under the Income-tax Act, the above transaction is considered as transfer.*

(vii) Lastly, there are certain types of transactions which have the effect of transferring or enabling the enjoyment of an immovable property.

> ***Example:***
>
> *A person may become a member of a co-operative society, company or other association of persons which may be building houses/flats. When he pays an agreed amount, the society etc. hands over possession of the house to the person concerned. No conveyance is registered. For the purpose of income-tax, the above transaction is a transfer.*

ILLUSTRATION 1

How will you calculate the period of holding in case of the following assets?

(1) Shares held in a company in liquidation

(2) Bonus shares

(3) Flat in a co-operative society

SOLUTION

(1) **Shares held in a company in liquidation** - The period after the date on which the company goes into liquidation shall be excluded while calculating the period of holding. Therefore, the period of holding shall commence from the date of acquisition and end with the date on which the company goes into liquidation.

(2) **Bonus shares** - The period of holding shall be reckoned from the date of allotment of bonus shares and will end with the date of transfer.

(3) **Flat in a co-operative society** - The period of holding shall be reckoned from the date of allotment of shares in the society and will end with the date of transfer.

Note – Any transaction whether by way of becoming a member of, or acquiring shares in, a co-operative society or by way of any agreement or any arrangement or in any other manner whatsoever which has the effect of transferring, or enabling enjoyment of, any immovable property is a transfer as per section 2(47)(vi).

Hence, it is possible to take a view that any date from which such right is obtained may be taken as the date of acquisition.

4.5 SCOPE AND YEAR OF CHARGEABILITY [SECTION 45]

(i) General Provision [Section 45(1)]

Any profits or gains arising from the transfer of a capital asset effected in the previous year (other than exemptions covered under this chapter) shall be chargeable to income-tax under this head **in the previous year in which the transfer took place.**

Year of chargeability - Capital gains are chargeable as the income of the previous year in which the sale or transfer takes place. In other words, for determining the year of chargeability, the relevant date of transfer is not the date of the agreement to sell, but the actual date of sale *i.e.,* the date on which the effect of transfer of title to the property as contemplated by the parties has taken place[6].

[6] *Alapati Venkatramiah v. CIT [1965] 57 ITR 185 (SC)*

However, as already noted, Income-tax Act has recognised certain transactions as transfer in spite of the fact that conveyance deed might not have been executed and registered. Power of Attorney sales as explained above or co-operative society transactions for acquisition of house are examples in this regard.

(ii) Insurance Receipts [Section 45(1A)]

Where any person receives any money or other assets under any insurance from an insurer on account of damage to or destruction of any capital asset, as a result of

- flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature,
- riot or civil disturbance,
- accidental fire or explosion or
- of action by an enemy or action taken in combating an enemy (whether with or without declaration of war),

then, any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head "Capital gains" and shall be deemed to be the income of **such person for the previous year in which such money or other asset was received.**

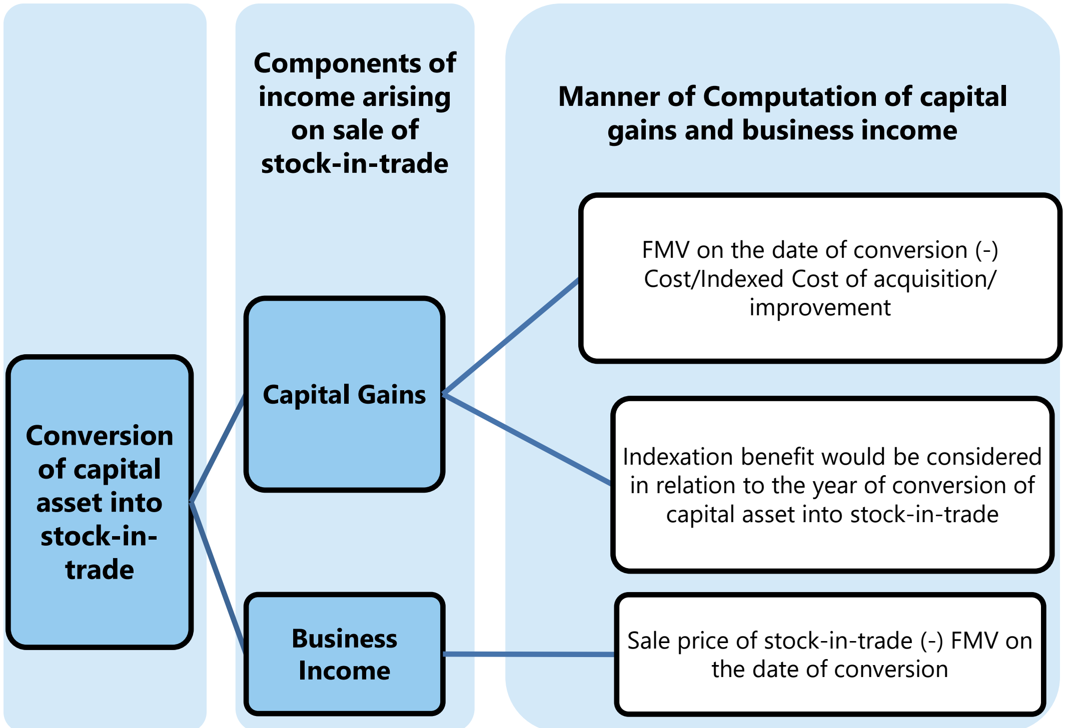
<u>Full value of consideration:</u> In order to compute capital gains, the value of any money or the fair market value of other assets on the date of such receipt shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital assets.

(iii) Conversion or treatment of a capital asset as stock-in-trade [Section 45(2)]

A person who is the owner of a capital asset may convert the same or treat it as stock-in-trade of the business carried on by him. As noted above, the above transaction is a transfer.

As per section 45(2), notwithstanding anything contained in section 45(1), being the charging section, the profits or gains arising from the above conversion or treatment will be chargeable to income-tax as **his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him.**

<u>Full value of consideration</u>: In order to compute the capital gains, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received as a result of the transfer of the capital asset.



Note – Both Capital Gains and Business income are chargeable to tax in the year in which stock-in-trade is sold or otherwise transferred.

ILLUSTRATION 2

A is the owner of a car. On 1-4-2025, he starts a business of purchase and sale of motor cars. He treats the above car as part of the stock-in-trade of his new business. He sells the same on 31-3-2026 and gets a profit of ₹ 1 lakh. Discuss the tax implication in his hands under the head "Capital gains".

SOLUTION

Since car is a personal asset, conversion or treatment of the same as the stock-in-trade of his business will not be trapped by the provisions of section 45(2). Hence, A is not liable to capital gains tax.

ILLUSTRATION 3

X converts his capital asset (acquired on June 10, 2006 for ₹ 60,000) into stock-in-trade on March 10, 2025. The fair market value on the date of the above conversion was ₹ 5,50,000. He subsequently sells the stock-in-trade so converted for ₹ 6,00,000 on June 10, 2025. Discuss the year of chargeability of capital gain and business income.

SOLUTION

Since the capital asset is converted into stock-in-trade during the previous year 2024-25 relevant to the A.Y. 2025-26, it will be a transfer u/s 2(47) during the P.Y. 2024-25. However, the profits or gains arising from the above conversion will be chargeable to tax during the A.Y. 2026-27, since the stock-in-trade has been sold only on June 10, 2025. For this purpose, the fair market value on the date of such conversion (i.e. 10th March, 2025) will be the full value of consideration for computation of capital gains. The capital gains would be computed by reducing the cost of acquisition therefrom. The business income of ₹ 50,000 (i.e., ₹ 6,00,000 (-) ₹ 5,50,000, being the fair market value on the date of conversion) would also be taxable in the A.Y.2026-27. Thus, both capital gains and business income would be chargeable to tax in the A.Y.2026-27.

(iv) Compensation on compulsory acquisition [Section 45(5)]

Sometimes, a building or some other capital asset belonging to a person is taken over by the Central Government by way of compulsory acquisition. In that case, the consideration for the transfer is determined by the Central Government of RBI. When the Central Government pays the above compensation, capital gains may arise. Such capital gains are **chargeable as income of the previous year in which such compensation is received**.

Enhanced Compensation - Many times, persons whose capital assets have been taken over by the Central Government and who get compensation from the Government go to the Court of law for enhancement of compensation. If the court awards a compensation which is higher than the original compensation, the difference thereof will be chargeable to capital gains in the year in which the same is received from the government.

Cost of acquisition in case of enhanced compensation - For this purpose, the cost of acquisition and cost of improvement shall be taken to be nil.

Compensation received in pursuance of an interim order deemed as income chargeable to tax in the year of final order - In order to remove the uncertainty regarding the year in which the amount of compensation received in pursuance of an interim order of the Court, Tribunal or other authority is to be charged to tax, it is provided that such compensation shall be deemed to be income chargeable under the head 'Capital gains' in the previous year in which the final order of such Court, Tribunal or other authority is made.

Reduction of enhanced compensation - Where capital gain has been charged on the compensation received by the assessee for the compulsory acquisition of any capital asset or enhanced compensation received by the assessee and subsequently such compensation is reduced by any Court, Tribunal or any authority, the assessed capital gain of that year shall be recomputed by taking into consideration the reduced amount. This re-computation shall be done by way of rectification[7].

Death of the transferor - It is possible that the transferor may die before he receives the enhanced compensation. In that case, the enhanced compensation will be chargeable to tax in the hands of the person who receives the same.

4.6 CAPITAL GAINS ON DISTRIBUTION OF ASSETS BY COMPANIES IN LIQUIDATION [SECTION 46]

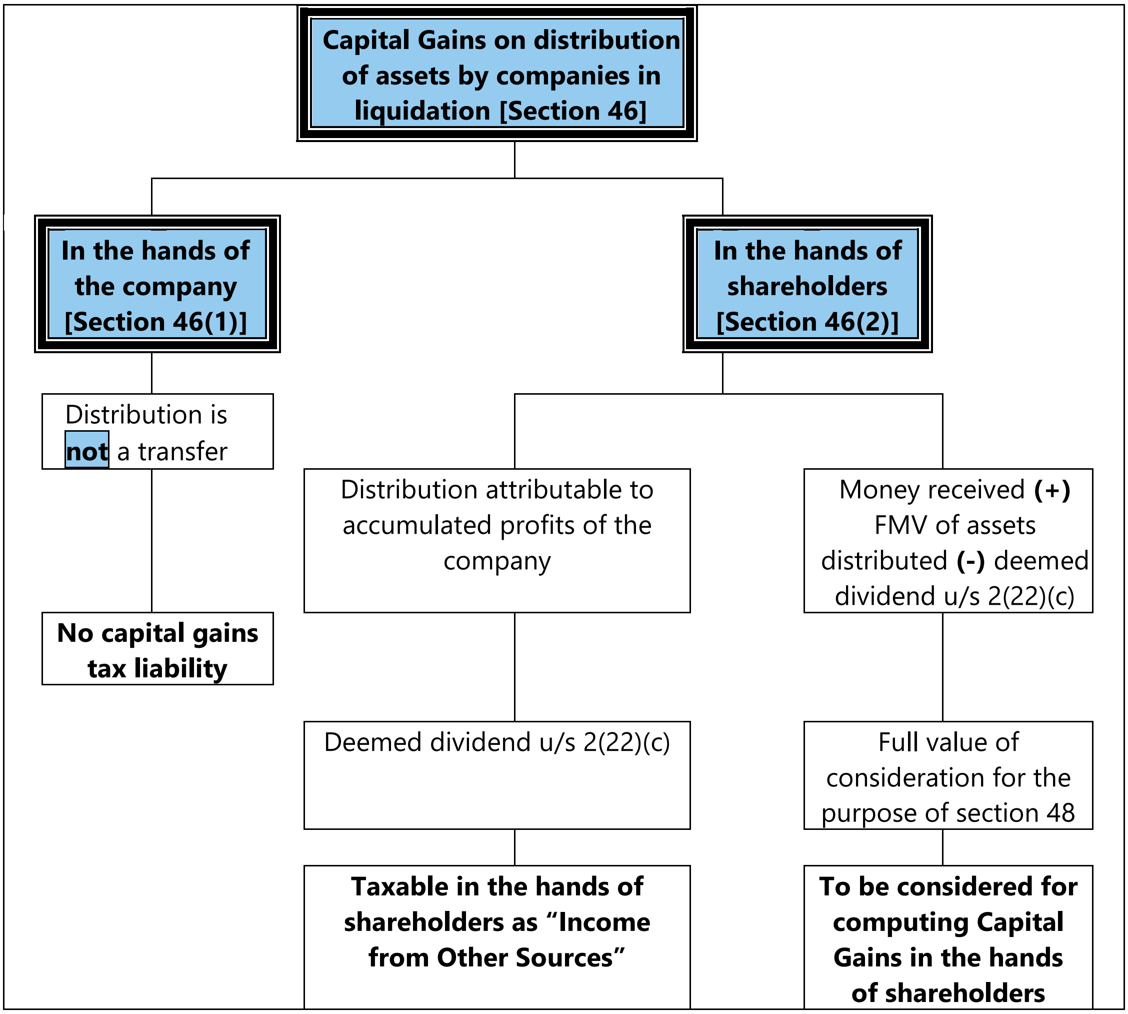
(1) In the hands of liquidated company: Where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall **not** be regarded as a transfer by the company for the purposes of section 45 [Section 46(1)].

The above section is restricted in its application to the circumstances mentioned therein *i.e.*, the assets of the company must be distributed in specie to shareholders on the liquidation of the company. If, however, the liquidator sells the assets of the company resulting in a capital gain and distributes the funds so collected, the company will be liable to pay tax on such gains.

(2) In the hands of shareholders: Shareholders receive money or other assets from the company on its liquidation. They will be chargeable to income-tax under the head 'capital gains' in respect of the market value of the assets received on the date of distribution, or the moneys so received by them. The portion of the distribution which is attributable to the accumulated profits of the company is to be treated as dividend income under section

[7]under section 155

2(22)(c), which would be taxable in the hands of shareholders. The same will be deducted from the amount received/fair market value for the purpose of determining the consideration for computation of capital gains.



4.7 CAPITAL GAINS ON BUYBACK OF SHARES OR SPECIFIED SECURITIES [SECTION 46A]

(1) **In case of shares of a company other than a domestic company and specified securities:** Any consideration received by a holder of specified securities (other than shares of a domestic company) from any company on purchase of its specified securities is chargeable to tax in the hands of the holder of specified securities. The difference between the cost of acquisition and the value of consideration received by the holder of

securities is chargeable to tax as capital gains in his hands. The computation of capital gains shall be made in accordance with the provisions of section 48.

Such capital gains shall be chargeable in the year in which such securities were purchased by the company. For this purpose, "specified securities" shall have the same meaning as given in *Explanation* to section 77A of the Companies Act, 1956[8].

As far as shares are concerned, this provision would be attracted in the hands of the shareholder only if the shares are bought back by a company, other than a domestic company.

(2) In case of buy back of shares by domestic companies: In case of buyback of shares (whether listed or unlisted) by a domestic company, the sum paid by a domestic company for purchase of its own shares would be treated as dividend and taxable under the head "Income from Other Sources" in the hands of shareholders. No deduction for expenses would be available against such dividend income.

Consequently, as per section 46A, value of consideration received by a shareholder on buy back of shares by a domestic company would be Nil and the difference between the cost of acquisition and the value of consideration received by the shareholder will result into capital loss. The same can be set off and carried forward as per the applicable set-off & carry forward provisions of the Act. If it is long-term capital loss, it can be set-off only against long-term capital gains. If it is a short-term capital loss, it can set-off against both long term capital gains and short term capital gains. For details, refer Chapter: 5: Aggregation of income, Set-off and Carry Forward of Losses.

4.8 TRANSACTIONS NOT REGARDED AS TRANSFER [SECTION 47]

Section 47 specifies certain transactions which will not be regarded as transfer for the purpose of capital gains tax:

(1) Total or partial partition of a HUF: Any distribution of capital assets on the total or partial partition of a HUF [Section 47(i)].

[8] Now section 68 of the Companies Act, 2013

(2) **A gift or will or an irrevocable trust by individual or HUF:** Any transfer of a capital asset by an individual or HUF under a gift or will or an irrevocable trust [Section 47(iii)].

Note – *Upto A.Y. 2024-25, transfer of a capital asset (other than shares, debentures or warrants allotted by a company under any ESOP) under a gift or will or irrevocable trust by any person was not considered as a transfer.*

(3) **Transfer of capital asset by holding company to its wholly owned Indian subsidiary company:** Any transfer of capital asset by a company to its subsidiary company [Section 47(iv)].

Conditions:

(i) The parent company or its nominee must hold the whole of the shares of the subsidiary company; and

(ii) The subsidiary company must be an Indian company.

(4) **Transfer of capital asset by a subsidiary company to its 100% holding company, being an Indian company:** Any transfer of capital asset by a subsidiary company to the holding company [Section 47(v)].

Conditions:

(i) The whole of shares of the subsidiary company must be held by the holding company; and

(ii) The holding company must be an Indian company.

Exception - The exemption mentioned in 3 or 4 above will not apply if a capital asset is transferred as stock-in-trade.

(5) **Transfer of capital asset by amalgamating company to amalgamated Indian company, in a scheme of amalgamation:** Any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company [Section 47(vi)].

(6) **Transfer of capital asset by the demerged company to the resulting Indian company, in a scheme of demerger:** Any transfer in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company [Section 47(vib)].

(7) **Transfer or issue of shares by a resulting company, in a scheme of demerger:** Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company, if the transfer is made in consideration of the demerger of the undertaking [Section 47(vid)].

(8) **Transfer of shares by a shareholder in a scheme of amalgamation:** Any transfer by a shareholder, in a scheme of amalgamation, of shares held by him in the amalgamating company [Section 47(vii)].

Conditions:

(i) The transfer is made in consideration of the allotment to him of any share/s in the amalgamated company, except where the shareholder itself is the amalgamated company;

(ii) The amalgamated company is an Indian company.

Example:

Let us take a case where A Ltd., an Indian company, holds 60% of shares in B Ltd. B Ltd. amalgamates with A Ltd. Since A Ltd. itself is the shareholder of B Ltd., A Ltd., being the amalgamated company, cannot issue shares to itself. However, A Ltd. has to issue shares to the other shareholders of B Ltd.

ILLUSTRATION 4

M held 2000 shares in a company ABC Ltd., an Indian company. This company amalgamated with another Indian company XYZ Ltd. during the previous year ending 31.3.2026. Under the scheme of amalgamation, M was allotted 1000 shares in the new company. The market value of shares allotted is higher by ₹ 50,000 than the value of holding in ABC Ltd. The Assessing Officer proposes to treat the transaction as an exchange and to tax ₹ 50,000 as capital gain. Is he justified?

SOLUTION

In the above example, the transaction is squarely covered by the exemption explained above and the proposal of the Assessing Officer to treat the transaction as a transfer is not justified.

(9) **Transfer of Government Security outside India by a non-resident to another non-resident:** Any transfer of a capital asset, being a Government Security carrying a periodic payment of interest, made outside India through an intermediary dealing in settlement of securities, by a non-resident to another non-resident [Section 47(viib)]

(10) Redemption of sovereign gold bonds by an Individual: Redemption by an individual of sovereign gold bonds issued by RBI under the Sovereign Gold Bond Scheme, 2015 [Section 47(viic)]

(11) Conversion of gold into Electronic Gold Receipt or *vice a versa*: Any transfer of a capital asset, being conversion of gold into Electronic Gold Receipt issued by a Vault Manager, or conversion of Electronic Gold Receipt into gold [Section 47(viid)]

(12) Transfer of specified capital asset to the Government or university etc.: Any transfer of any of the following capital asset to the Government or to the University or the National Museum, National Art Gallery, National Archives or any other public museum or institution notified by the Central Government to be of national importance or to be of renown throughout any State

(i) work of art

(ii) archaeological, scientific or art collection

(iii) book

(iv) manuscript

(v) drawing

(vi) painting

(vii) photograph or

(viii) print [Section 47(ix)].

(13) Transfer on conversion of bonds or debentures etc. into shares or debentures: Any transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form, of a company into shares or debentures of that company [Section 47(x)].

(14) Conversion of preference shares into equity shares: Any transfer by way of conversion of preference shares of a company into equity shares of that company [Section 47(xb)].

(15) Transfer of capital asset under Reverse Mortgage: Any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government [Section 47(xvi)].

The Reverse Mortgage scheme is for the benefit of senior citizens, who own a residential house property. In order to supplement their existing income, they can mortgage their house property with a scheduled bank or housing finance company, in return for a lump-sum amount or for a regular monthly/quarterly/annual income. The senior citizens can continue to live in the house and receive regular income, without the botheration of having to pay back the loan.

The loan will be given up to, say, 60% of the value of residential house property mortgaged. Also, the bank/housing finance company would undertake a revaluation of the property once every 5 years. The borrower can use the loan amount for renovation and extension of residential property, family's medical and emergency expenditure etc., amongst others However, he cannot use the amount for speculative or trading purposes.

The Reverse Mortgage Scheme, 2008, now includes within its scope, disbursement of loan by an approved lending institution, in part or in full, to the annuity sourcing institution, for the purposes of periodic payments by way of annuity to the reverse mortgagor. This would be an additional mode of disbursement i.e., in addition to direct disbursements by the approved lending institution to the Reverse Mortgagor by way of periodic payments or lump sum payment in one or more tranches.

An annuity sourcing institution has been defined to mean Life Insurance Corporation of India or any other insurer registered with the Insurance Regulatory and Development Authority.

Maximum Period of Reverse Mortgage Loan:

	Mode of disbursement	**Maximum period of loan**
(a)	Where the loan is disbursed directly to the Reverse Mortgagor	20 years from the date of signing the agreement by the reverse mortgagor and the approved lending institution.
(b)	Where the loan is disbursed, in part or in full, to the annuity sourcing institution for the purposes of periodic payments by way of annuity to the Reverse mortgagor	The residual life time of the borrower.

The bank will recover the loan along with the accumulated interest by selling the house after the death of the borrower. The excess amount will be given to the legal heirs. However, before resorting to sale of the house, preference will be given to the legal heirs to repay the loan and interest and get the mortgaged property released.

Therefore, section 47(xvi) clarifies that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government would not amount to transfer for the purpose of capital gains.

Exemption of income received in a transaction of reverse mortgage [Section 10(43)]: Section 10(43), further, provides that the amount received by the senior citizen as a loan, either in lump sum or in installments, in a transaction of reverse mortgage would be exempt from income-tax.

ILLUSTRATION 5

In which of the following situations capital gains tax liability does not arise?

(i) Mr. A purchased gold in 1970 for ₹ 25,000. In the P.Y. 2025-26, he gifted it to his son at the time of marriage. Fair market value (FMV) of the gold on the day the gift was made was ₹ 1,00,000.

(ii) A house property is purchased by a Hindu undivided family in 1945 for ₹ 20,000. It is given to one of the family members in the P.Y. 2025-26 at the time of partition of the family. FMV on the date of partition was ₹ 12,00,000.

(iii) Mr. B purchased 50 convertible debentures for ₹ 40,000 in 1995 which are converted into 500 shares worth ₹ 85,000 in November 2025 by the company.

SOLUTION

We know that capital gains arises only when we transfer a capital asset. The liability of capital gains tax in the situations given above is discussed as follows:

(i) As per the provisions of section 47(iii), gift of a capital asset by an individual is **not** regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

(ii) As per the provisions of section 47(i), distribution of a capital asset (being in kind) on the total or partial partition of Hindu undivided family is **not** regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

(iii) As per the provisions of section 47(x), conversion of bonds or debentures, debenture stock or deposit certificates in any form of a company into shares or debentures of that company is **not** regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

ILLUSTRATION 6

Mr. Abhishek a senior citizen, mortgaged his residential house with a bank, under a notified reverse mortgage scheme. He was getting loan from bank in monthly installments. Mr. Abhishek did not repay the loan on maturity and hence gave possession of the house to the bank, to discharge his loan. How will the treatment of long-term capital gain be on such reverse mortgage transaction?

SOLUTION

Section 47(xvi) provides that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government shall not be considered as a transfer for the purpose of capital gain.

Accordingly, the mortgaging of residential house with bank by Mr. Abhishek will not be regarded as a transfer. Therefore, no capital gain will be charged on such transaction.

Further, section 10(43) provides that the amount received by the senior citizen as a loan, either in lump sum or in installment, in a transaction of reverse mortgage would be exempt from income-tax. Therefore, the monthly installment amounts received by Mr. Abhishek would not be taxable.

ILLUSTRATION 7

Examine, with reasons, whether the following statements are True or False.

(i) Alienation of a residential house in a transaction of reverse mortgage under a scheme made and notified by the Central Government is treated as "transfer" for the purpose of capital gains.

(ii) Zero coupon bonds of eligible corporation, held for 14 months, will be long-term capital assets.

(iii) Zero Coupon Bond means a bond on which no payment and benefits are received or receivable before maturity or redemption.

SOLUTION

(i) **False:** As per section 47(xvi), such alienation in a transaction of reverse mortgage under a scheme made and notified by the Central Government is not regarded as "transfer" for the purpose of capital gains.

(ii) **True:** Section 2(42A) defines the term 'short-term capital asset'. Under the proviso to section 2(42A), zero coupon bond held for not more than 12 months will be treated as a short-term capital asset. Consequently, such bonds held for more than 12 months will be a long-term capital asset.

(iii) **True:** As per section 2(48), 'Zero Coupon Bond' means a bond issued by any infrastructure capital company or infrastructure capital fund or infrastructure debt fund or a public sector company, or Scheduled Bank on or after 1st June 2005, in respect of which no payment and benefit is received or receivable before maturity or redemption from such issuing entity and which the Central Government may notify in this behalf.

4.9 IMPORTANT DEFINITIONS

(a) **Amalgamation [Section 2(1B)] -** "Amalgamation", in relation to companies, means -

- the merger of one or more companies with another company or
- the merger of two or more companies to form one company

(the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that -

(i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;

(ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;

(iii) shareholders holding not less than three-fourth in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,

otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company.

(b) Demerger [Section 2(19AA)] - "Demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 230 to 232 of the Companies Act, 2013, by a demerged company of its one or more undertaking to any resulting company in such a manner that -

(i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;

(ii) all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

(iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

However, this provision does not apply where, in compliance to the Indian Accounting Standards specified in Annexure to the Companies (Indian Accounting Standards) Rules, 2015, the resulting company records the value of the property and the liabilities of the undertaking or undertakings at a value different from the value appearing in the books of account of the demerged company, immediately before the demerger.

For the purpose of determining the value of the property, any change in the value of assets consequent to their revaluation shall be ignored.

(iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;

Note - If the resulting company is a shareholder of the demerged company, it cannot issue shares to itself. However, the resulting company has to issue shares to the other shareholders of the demerged company.

(v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

(vi) the transfer of the undertaking is on a going concern basis;

(vii) the demerger is in accordance with the conditions, if any, notified[9] by the Central Government in this behalf.

Reconstruction or splitting up of a public sector company into separate companies shall be deemed to be a demerger, if such reconstruction or splitting up has been made to transfer any asset of the demerged company to the resulting company and the resulting company –

(a) is a public sector company on the appointed day indicated in such scheme as may be approved by the Central Government or any other body authorized under the Companies Act, 1956 or any other law for the time being in force governing such public sector companies; and

(b) fulfils such other conditions as may be notified by the Central Government [*Explanation 6*].

(c) Demerged Company - Demerged company means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.

[9]under sub-section (5) of section 72A

(d) Resulting Company - Resulting company means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

4.10 MODE OF COMPUTATION OF CAPITAL GAINS [SECTION 48]

(i) Computation of capital gains: The income chargeable under the head 'Capital gains' shall be computed by deducting the following items from the full value of the consideration received or accruing as a result of the transfer of the capital asset:

(1) Expenditure incurred wholly and exclusively in connection with such transfer like brokerage, stamp duty, registration fee, legal expenses etc.

(2) The cost of acquisition and cost of any improvement thereto.

However, the cost of acquisition of the asset or the cost of improvement thereto would not include the deductions claimed on interest u/s 24(b) or under the provisions of Chapter VI-A.

Interest on loan taken for acquisition, construction, repairs, reconstruction of house property is allowable as deduction under section 24(b). Sections 80EE and 80EEA in Chapter VI-A provide for deduction of interest payable on loan taken for acquisition of house property, subject to fulfillment of certain conditions.

The interest allowed as deduction under section 24(b) while computing income from house property and interest allowed as deduction under section 80EE or 80EEA of Chapter VI-A would <u>not</u> be included in the cost of acquisition or cost of improvement while computing capital gains on transfer of house property.

(ii) No deduction in respect of STT: No deduction shall, however, be allowed in computing the income chargeable under the head "Capital Gains" in respect of any amount paid on account of securities transaction tax (STT) under Chapter VII of the Finance (No.2) Act, 2004.

(iii) Cost inflation index: Under section 48, the cost of acquisition and cost of improvement will be increased by applying the cost inflation index (CII). Once the cost inflation index is applied to the cost of acquisition and cost of improvement, it becomes indexed cost of acquisition and indexed cost of improvement.

"Cost Inflation Index" in relation to a previous year means such index as may be notified by the Central Government having regard to 75% of average rise in the Consumer Price Index (Urban) for the immediately preceding previous year to such previous year.

Indexed cost of acquisition means an amount which bears to the cost of acquisition, the same proportion as CII for the year in which the asset is transferred bears to the CII for the first year in which the asset was held by the assessee or for the year beginning on 1st April, 2001, whichever is later.

Similarly, indexed cost of any improvement means an amount which bears to the cost of improvement, the same proportion as CII for the year in which the asset is transferred bears to the CII for the year in which the improvement to the asset took place.

Indexation benefit is available on transfer took place before 23.7.2024.

Indexation benefit was available while computing long-term capital gains arising on transfer long-term capital assets before 23.7.2024.

While computing tax liability u/s 112, option of taking indexation benefit is available to an individual or HUF, resident in India on transfer of long term capital asset, being land or building or both which is acquired before 23.7.2024:

A resident individual or HUF, while computing tax on LTCG on transfer of land or building or both, has the option to take the benefit of indexation under section 112 in respect of long-term capital gains arising on transfer of land or building or both which is acquired before 23.7.2024.

Accordingly, LTCG on transfer of such land or building or both are subject to lower of tax

- @12.5% (on LTCG computed without indexation benefit) or
- @20% (on LTCG computed with indexation benefit).

It may be noted that this benefit to a resident individual or HUF is to be given only while computing tax on LTCG under section 112 on transfer of land or building or both and not while computing Income under the head "Capital Gains" which would form part of gross total income/total income. Thus, for computing income under the head "Capital Gains" to be included in gross total income, indexation benefit is **not** to be given.

The cost inflation indices for the financial years so far have been notified as under:

Financial Year	Cost Inflation Index
2001-02	100
2002-03	105
2003-04	109
2004-05	113
2005-06	117
2006-07	122
2007-08	129
2008-09	137
2009-10	148
2010-11	167
2011-12	184
2012-13	200
2013-14	220
2014-15	240
2015-16	254
2016-17	264
2017-18	272
2018-19	280
2019-20	289
2020-21	301

2021-22	317
2022-23	331
2023-24	348
2024-25	363
2025-26	***376***

(iv) Full value of consideration of shares, debentures or warrants issued under ESOP in case of transfer under a gift etc. upto A.Y. 2024-25 - In case where shares, debentures or warrants allotted by a company directly or indirectly to its employees under the Employees' Stock Option Plan or Scheme in accordance with the guidelines issued in this behalf by the Central Government are transferred under a gift or irrecoverable trust upto A.Y. 2024-25, then the market value on the date of such transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer of such asset.

(v) Special provision for non-residents – In case of non-residents who invest foreign exchange to acquire capital assets, capital gains arising from the transfer of shares or debentures of an Indian company is to be computed in the following manner:

- The cost of acquisition, the expenditure incurred wholly and exclusively in connection with the transfer and the full value of the consideration are to be converted into the same foreign currency with which such shares were acquired. The conversion has to be done at the average of Telegraphic Transfer Buying Rate (TTBR) and Telegraphic Transfer Selling Rate (TTSR) on the respective dates.
- The resulting capital gains shall be reconverted into Indian currency by applying the TTBR on the date of transfer.

The aforesaid manner of computation of capital gains shall be applied for every purchase and sale of shares or debentures in an Indian company. This will provide relief from risk of foreign currency fluctuation to non-residents.

On long-term capital gains arising from transfer of unlisted securities or shares of a company in which public are not substantially interested, non-residents and foreign companies are subject to tax at a concessional rate of @12.5% (without currency conversion) [Section 112].

Note – *The benefit of currency conversion would* ***not*** *be applicable to the long-term capital gains arising from the transfer of the following assets referred to in section 112A –*

(i) equity share in a company on which STT is paid both at the time of acquisition and transfer

(ii) unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer.

4.11 ASCERTAINMENT OF COST IN SPECIFIED CIRCUMSTANCES [SECTION 49]

A person becomes the owner of a capital asset not only by purchase but also by several other methods. Section 49 gives guidelines as to how to compute the cost under different circumstances.

Section	Circumstance	Cost of acquisition
49(1)	Where the capital asset became the property of the assessee: (i) on any distribution of assets on the total or partition of a HUF; (ii) under a gift or will by an individual or HUF (by any person upto 31.3.2024); (iii) by succession, inheritance or devolution; (iv) on any distribution of assets on the liquidation of a company; (v) under a transfer to revocable or an irrevocable trust; (vi) under any transfer of capital asset by a holding company to its wholly owned subsidiary Indian company or by a subsidiary company to its 100% holding Indian company, referred to in section 47(iv) and 47(v), respectively;	Cost for which the previous owner of the property acquired it. ***Notes –*** ***Cost of improvement*** *– To the cost of acquisition, the cost of improvement to the asset, incurred by the previous owner or the assessee on or after 1.4.2001 must be added.* ***Period of holding*** *- It may be noted that section 2(42A) provides that in all such cases, for determining the period for which the capital asset is held by the transferee, the period of holding of the asset by the previous owner shall also be considered.* ***Benefit of indexation*** *- The Bombay High Court, in CIT v. Manjula J. Shah 16 Taxman 42, held that the indexed cost of acquisition in case of gifted asset*

	(vii) under any transfer referred to in section 47(vi) of a capital asset by amalgamating company to the amalgamated Indian company, in a scheme of amalgamation; (viii) under any transfer referred to in section 47(vib), of a capital asset by the demerged company to the resulting Indian company, in a scheme of demerger; (ix) by conversion by an individual of his separate property into a HUF property, by the mode referred to in section 64(2).	*has to be computed with reference to the year in which the previous owner first held the asset and not the year in which the assessee became the owner of the asset.* *As per the plain reading of the provisions of section 48, however, the indexed cost of acquisition would be determined by taking CII for the year in which asset is first held by the assessee.* *The benefit of indexation can be opted by a resident individual or HUF while computing tax liability u/s 112 only for long-term capital assets, being land or building or both which are acquired before 23.7.2024.*
49(2)	Where shares in an amalgamated company which is an Indian company become the property of the assessee in consideration of the transfer of shares referred to in section 47(vii) held by him in the amalgamating company under a scheme of amalgamation.	The cost of acquisition to him of the shares in the amalgamated company shall be taken as the cost of acquisition of the shares in the amalgamating company.
49(2A)	Where a person becomes the owner of shares or debentures in a company during the process of conversion of bonds or debentures, debenture stock or deposit certificates referred under section 47(x).	That part of the cost of debentures, debenture stock, bond or deposit certificate in relation to which such asset (shares or debentures) is acquired by that person.
49(2AA)	Where the capital gain arises from the transfer of specified security or sweat equity shares referred to in section 17(2)(vi)	Fair market value which has been taken into account for perquisite valuation.
49(2AE)	Where equity shares of a company, became the property of the	That part of the cost of the preference share in relation to

	assessee in consideration of transfer by way of conversion of preference shares of the company [Section 47(xb)]	which such equity shares are acquired by the assessee.
49(2C)	In case of demerger	The cost of acquisition of the shares in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.
		Cost of acquisition of shares in the resulting company = $A \times \frac{B}{C}$ A = Cost of acquisition of shares held in the demerged company B = Net book value of the assets transferred in a demerger C = Net worth of the demerged company i.e., the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.
49(2D)	In case of demerger	The cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived under the sub-section (2C)

49(4)	Where the capital gain arises from the transfer of such property which has been subject to tax under section 56(2)(x)	The value taken into account for the purposes of section 56(2)(x).
49(9)	Where the capital gain arises from the transfer of a capital asset which was used by the assessee as inventory earlier before its conversion into capital asset	The fair market value of the inventory as on the date on such conversion determined in the prescribed manner
49(10)	Where a capital asset, being an Electronic Gold Receipt issued by a Vault Manager became the property of the person as consideration for transfer of gold [Section 47(viid)]	The cost of gold in the hands of the person in whose name Electronic Gold Receipt is issued.
	Where gold is released against an Electronic Gold Receipt, which became the property of the person as consideration for transfer of Electronic Gold Receipt [Section 47(viid)]	The cost of the Electronic Gold Receipt in the hands of such person.

4.12 COST OF ACQUISITION [SECTION 55(2)]

Cost of acquisition is the price that the assessee has paid, or the amount that the assessee has incurred, for acquisition of the asset. Expenses incurred for completing the title are a part of the cost of acquisition. For eg: Stamp duty.

Cost of acquisition in relation to the following assets is as follows:

(1) Goodwill of a business or profession or a trademark or brand name associated with a business or profession or any other intangible asset or a right to manufacture, produce or process any article or thing, or right to carry on any business or profession, tenancy rights, stage carriage permits and loom hours, or any other right

(i) In case of acquisition from previous owner: In the case of the above capital assets, if the assessee has purchased them from a previous owner, the cost of acquisition means the amount of the purchase price.

Example:

If A purchases a stage carriage permit from B for ₹ 2 lakhs, ₹ 2 lakhs will be the cost of acquisition for A.

However, in case of a capital asset, being goodwill of a business or profession, in respect of which depreciation under section 32(1) has been obtained by the assessee in any previous year (upto P.Y.2019-20), the cost of acquisition of such goodwill would be the amount of the purchase price as reduced by the total amount of depreciation (upto P.Y.2019-20) obtained by the assessee under section 32(1).

(ii) In case of circumstances mentioned under section 49(1)(i)/(ii)/(iii)/(iv): In cases where the capital asset became the property of the assessee by any of the following modes from the previous owner, and such capital assets were acquired by the previous owner by purchase, cost of acquisition to the assessee will be the amount of the purchase price for such previous owner:-

(1) On any distribution of assets on the total or partial partition of a Hindu undivided family.

(2) Under a gift or will by an individual or HUF (Upto A.Y. 2024-25, gift or will by any person).

(3) By succession, inheritance or devolution.

(4) On any distribution of assets on the liquidation of a company.

(5) Under a transfer to a revocable or an irrevocable trust.

(6) Under any transfer of a capital asset referred to in –

(i) **section 47(iv)** – transfer by a holding company to its 100% subsidiary Indian company;

(ii) **section 47(v)** – transfer by a subsidiary company to its 100% holding company, being an Indian company,

(iii) **section 47(vi)** – transfer in a scheme of amalgamation by the amalgamating company to the amalgamated company, being an Indian company

(iv) **section 47(vib**) – transfer in a demerger, by the demerged company to the resulting company, being an Indian company.

(7) Where the assessee is a Hindu undivided family, by the mode referred to in section 64(2) i.e., conversion of self-acquired property of a member of a HUF into the property of the HUF (For details, read Chapter 4).

However, in case of a capital asset, being goodwill of a business or profession, in respect of which depreciation under section 32(1) has been obtained by **the assessee** in any previous year (upto P.Y.2019-20), the cost of acquisition of such goodwill would be the amount of the purchase price for such previous owner as reduced by the total amount of depreciation (upto P.Y.2019-20) obtained by **the assessee** under section 32(1).

(iii) In any other case [i.e., in case of self-generated assets]: In case of self-generated assets, namely, goodwill of a business or profession or any other intangible asset or a trademark or brand name associated with a business or profession or a right to manufacture, produce or process any article or thing, or right to carry on any business or profession, tenancy rights, stage carriage permits, or loom hours, or any other right, the cost of acquisition will be taken to be nil.

(2) Financial assets

Many a time, persons who own shares or other securities become entitled to subscribe to any additional shares or securities. Further, they are also allotted additional shares or securities without any payment. Such shares or securities are referred to as financial assets in Income-tax Act. Section 55 provides the basis for ascertaining the cost of acquisition of such financial assets.

(i) Original shares (which form the basis of entitlement of rights shares): In relation to the original financial asset on the basis of which the assessee becomes entitled to any additional financial assets, cost of acquisition means the amount actually paid for acquiring the original financial assets.

(ii) Rights entitlement (which is renounced by the assessee in favour of a person): In relation to any right to renounce the said entitlement to subscribe to the financial asset, when such a right is renounced by the assessee in favour of any person, cost of acquisition shall be taken to be *nil* in the case of such assessee.

(iii) Rights shares acquired by the assessee: In relation to the financial asset, to which the assessee has subscribed on the basis of the said entitlement, cost of acquisition means the amount actually paid by him for acquiring such asset.

(iv) Bonus Shares: In relation to the financial asset allotted to the assessee without any payment and on the basis of holding of any other financial assets, cost of acquisition shall be taken to be nil in the case of such assessee.

In other words, where bonus shares are allotted without any payment on the basis of holding of original shares, the cost of such bonus shares will be nil in the hands of the original shareholder.

Bonus shares allotted before 01.04.2001 - In respect of bonus shares allotted before 1.4.2001, although the cost of acquisition of the shares is nil, the assessee may opt for the fair market value as on 1.4.2001 as the cost of acquisition of such bonus shares.

Bonus shares allotted before 1.2.2018, on which STT has been paid at the time of transfer – In case of transfer of bonus shares allotted before 1.2.2018 on which STT has been paid at the time of transfer, the cost would be the higher of –

(i) Actual cost of acquisition (i.e., Nil, in case of bonus shares allotted on or after 1.4.2001; and FMV on 1.4.2001, in case of business shares allotted before 1.4.2001)

(ii) Lower of –

(a) FMV as on 31.1.2018; and

(b) Actual sale consideration

(v) Rights shares which are purchased by the person in whose favour the assessee has renounced the rights entitlement: In the case of any financial asset purchased by the person in whose favour the right to subscribe to such assets has been renounced, cost of acquisition means the aggregate of the amount of the purchase price paid by him to the person renouncing such right and the amount paid by him to the company or institution for acquiring such financial asset.

(3) Long-term capital assets referred to in section 112A

The cost of acquisition in relation to the long-term capital assets being,

- equity shares in a company on which STT is paid both at the time of purchase and transfer or
- unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer.

acquired before 1st February, 2018 shall be the higher of

(i) cost of acquisition of such asset; and

(ii) lower of

(a) the fair market value of such asset; and

(b) the full value of consideration received or accruing as a result of the transfer of the capital asset.

Meaning of Fair Market value

S. No.	Circumstance	Fair Market Value
(i)	In a case where the capital asset is listed on any recognized stock exchange as on 31.01.2018	**If there is trading in such asset on such exchange on 31.01.2018** The highest price of the capital asset quoted on such exchange on the said date **If there is no trading in such asset on such exchange on 31.01.2018** The highest price of such asset on such exchange on a date immediately preceding 31.01.2018 when such asset was traded on such exchange.
(ii)	In a case where the capital asset is a unit which is not listed on any recognized stock exchange as on 31.01.2018	The net asset value of such unit as on the said date

(iii)	In a case where the capital asset is an equity share in a company which is - not listed on a recognized stock exchange as on 31.01.2018 but listed on such exchange on the date of transfer - not listed on a recognized stock exchange as on 31.01.2018 or which became the property of the assessee in consideration of shares which is not listed on such exchange as on 31.1.2018 by way of transaction covered under section 47 but listed on such exchange subsequent to the date of transfer (where transfer is in respect of sale of unlisted equity shares under an offer for sale to the public included in an initial public offer) - listed on a recognized stock exchange on the date of transfer and which became the property of the assessee in consideration of share which is not listed on such exchange as on 31.01.2018 by way of transaction not regarded as transfer under section 47	An amount which bears to the cost of acquisition the same proportion as CII for the financial year 2017-18 bears to the CII for the first year in which the asset was held by the assessee or on 01.04.2001, whichever is later.

(4) Any other capital asset

(i) Where the capital asset become the property of the assessee before 1.4.2001, cost of acquisition means the cost of acquisition of the asset to the assessee or the fair market value of the asset on 1.4.2001, at the option of the assessee.

Example: *A house property was purchased by Mr. A on 1.1.1992 for ₹ 30,000 and the fair market value of the same was ₹ 1,40,000 as on 1.4.2001. Cost of acquisition of the said property would be ₹ 1,40,000.*

However, in case of capital asset, being land or building or both, the fair market value of such asset on 1.4.2001 shall not exceed the stamp duty value, wherever available, of such asset as on 1.4.2001.

Example: *In the above example, if the stamp duty value of the property was ₹ 1,20,000 as on 1.4.2001, cost of acquisition of such property would be ₹ 1,20,000, being the stamp value as on 1.4.2001 and not ₹ 1,40,000.*

(ii) Where the capital asset became the property of the assessee by any of the modes specified in section 49(1): The cost of acquisition to the assessee will be the cost of acquisition to the previous owner. Even in such cases, where the capital asset became the property of the previous owner before 1-4-2001, the assessee can opt the fair market value as on 1-4-2001 as the cost of acquisition.

However, in case of capital asset, being land or building or both, the fair market value of such asset on 1-4-2001 shall not exceed the stamp duty value, wherever available, of such asset as on 1-4-2001.

Note: *The provisions contained in (i) & (ii) of (4) above shall also apply to the financial assets mentioned in (i) to (v) of (2) and long term capital assets referred to in section 112A of (3) above.*

(iii) Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to capital gains in respect of that asset under section 46, the cost of acquisition means the fair market value of the asset on the date of distribution.

(iv) A share or a stock of a company may become the property of an assessee under the following circumstances:

(a) the consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares.

(b) the conversion of any shares of the company into stock,

(c) the re-conversion of any stock of the company into shares,

(d) the sub-division of any of the shares of the company into shares of smaller amount, or

(e) the conversion of one kind of shares of the company into another kind.

In the above circumstances the cost of acquisition to the assessee will mean the cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived.

(5) Where the cost for which the previous owner acquired the property cannot be ascertained, the cost of acquisition to the previous owner means the fair market value on the date on which the capital asset became the property of the previous owner.

Cost of Acquisition of certain assets: At a Glance

Sl. No.	Nature of asset	Cost of acquisition
1	Goodwill of business or profession, trademark, brand name or any other intangible asset etc.,	
	- Self generated	Nil
	- Acquired from previous owner	Purchase price
	However, in case of capital asset, being goodwill of a business or profession, in respect of which depreciation u/s 32(1) has been obtained by the assessee in any P.Y. (upto P.Y.2019-20)	Purchase price as reduced by the total amount of depreciation obtained by the assessee under section 32(1).
	- became the property of the assessee by way of distribution of assets on total or partial partition of HUF, under a gift or will by an individual or HUF (by any person upto 31.3.2024), by succession, inheritance, distribution of assets	Purchase price for such previous owner

	on liquidation of a company, etc. and previous owner has acquired it by purchase However, in case of capital asset, being goodwill of a business or profession which was acquired by the previous owner by purchase and in respect of which depreciation u/s 32(1) has been obtained by the assessee in any P.Y. (upto P.Y.2019-20)	 Purchase price for such previous owner as reduced by the total amount of depreciation obtained by the assessee u/s 32(1).
2.	**Bonus Shares:** Allotted before 1.4.2001 Allotted on or after 1.4.2001 Bonus shares allotted before 1.2.2018, on which STT has been paid at the time of transfer	 FMV as on 1.4.2001 Nil The higher of – (i) Actual cost of acquisition (i.e., Nil, in case of bonus shares allotted on or after 1.4.2001; and FMV on 1.4.2001, in case of bonus shares allotted before 1.4.2001) (ii) Lower of – (a) FMV as on 31.1.2018; and (b) Actual sale consideration
3.	**Rights Shares:** Original shares (which form the basis of entitlement of rights shares) Rights entitlement (which is renounced by the assessee in favour of a person) Rights shares acquired by the assessee Rights shares which are purchased by the person in whose favour the assessee has renounced the rights entitlement	 Amount actually paid for acquiring the original shares Nil Amount actually paid for acquiring the rights shares Purchase price paid to the renouncer of rights entitlement as well as the amount paid to the company which has allotted the rights shares.

<table>
<tr><td>4</td><td>Long term capital assets being,
- equity shares in a company on which STT is paid both at the time of purchase and transfer or
- unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer,
acquired before 1st February, 2018</td><td>Cost of acquisition shall be the higher of
(i) actual cost of acquisition of such asset; and
(ii) lower of
- the fair market value of such asset; and
- the full value of consideration received or accruing as a result of the transfer of the capital asset.</td></tr>
<tr><td>5</td><td>Any other capital asset
Where such capital asset became the property of the assessee before 1.4.2001</td><td>
Cost of the asset to the assessee, or FMV as on 1.4.2001, at the option of the assessee.
However, in case of capital asset being land or building, FMV as on 1.4.2001 shall not exceed stamp duty value as on 1.4.2001.</td></tr>
<tr><td></td><td>Where capital assets became the property of the assessee by way of distribution of assets on total or partial partition of HUF, under a gift or will by an individual or HUF (by any person upto 31.3.2024), by succession, inheritance, distribution of assets on liquidation of a company, etc. and the capital asset became the property of the previous owner before 1.4.2001.</td><td>Cost to the previous owner or FMV as on 1.4.2001, at the option of the assessee.
However, in case of capital asset being land or building, FMV as on 1.4.2001 shall not exceed stamp duty value as on 1.4.2001.</td></tr>
<tr><td></td><td colspan="2">The provisions contained in (5) above shall also apply to the assets mentioned in (3) and (4) above.</td></tr>
<tr><td>6</td><td>Where cost of the property in the hands of previous owner cannot be ascertained</td><td>The FMV on the date on which the capital asset become the property of the previous owner would be considered as cost of acquisition.</td></tr>
</table>

ILLUSTRATION 8

Mr. A converts his capital asset acquired for an amount of ₹ 50,000 in June, 2004 into stock-in-trade in the month of November, 2024. The fair market value of the asset on the date of conversion is ₹ 4,50,000. The stock-in-trade was sold for an amount of ₹ 6,50,000 in the month of September, 2025. What will be the tax treatment?

SOLUTION

The capital gains on the sale of the capital asset converted to stock-in-trade is taxable in the given case. It arises in the year of conversion (i.e. P.Y. 2024-25) but will be taxable only in the year in which the stock-in-trade is sold (i.e. P.Y. 2025-26). Profits from business will also be taxable in the year of sale of the stock-in-trade (P.Y. 2025-26).

The LTCG and business income for A.Y.2026-27 are calculated as under:

Particulars	₹	₹
Profits and Gains from Business or Profession		
Sale proceeds of the stock-in-trade	6,50,000	
Less: Cost of the stock-in-trade (FMV on the date of conversion)	4,50,000	2,00,000
Long Term Capital Gains		
Full value of the consideration (FMV on the date of the conversion)	4,50,000	
Less: Cost of acquisition	50,000	4,00,000

Note: For the purpose of indexation, the cost inflation index of the year in which the asset is converted into stock-in-trade should be considered. However, since capital asset is converted on or after 23.7.2024, no indexation benefit is allowed.

4.13 COST OF IMPROVEMENT [SECTION 55(1)]

(1) **Goodwill or any other intangible asset of a business, etc. [Section 55(1)(b)(1)]:** In relation to a capital asset being goodwill or any other intangible asset of a business or a right to manufacture, produce or process any article or thing, or right to carry on any business or profession or any other right, the cost of improvement shall be taken to be **Nil**.

(2) Any other capital asset [Section 55(1)(b)(2)]:

Circumstance			Cost of improvement
(i)	**Where the capital asset became the property of the previous owner or the assessee before 1.4.2001**		
	(a)	**In a case covered u/s 49(1)**, where the capital asset became the property of the previous owner and the assessee before 1.4.2001	All expenditure of a capital nature incurred in making any addition or alteration to the capital asset **on or after 1.4.2001 by the assessee**.
	(b)	**In a case covered u/s 49(1)**, where the capital asset became the property of the previous owner before 1.4.2001 but became the property of the assessee on or after 1.4.2001	All expenditure of a capital nature incurred in making any addition or alteration to the capital asset **on or after 1.4.2001 by the previous owner and the assessee.**
	(c)	**In a case <u>not</u> covered u/s 49(1)**	All expenditure of a capital nature incurred in making any addition or alteration to the capital asset **on or after 1.4.2001 by the assessee.**
(ii)	**Where the capital asset became the property of the previous owner and the assessee on or after 1.4.2001**		
	(a)	**In a case covered u/s 49(1)**	All expenditure of a capital nature incurred in making any addition or alteration to the capital asset **by the previous owner and the assessee**.
	(b)	**In a case not covered u/s 49(1)**	All expenditure of a capital nature incurred in making any addition or alteration to the capital asset **by the assessee after it became the assessee's property.**

In a nutshell, in a case covered under section 49(1), cost of improvement would include expenditure of a capital nature on addition or alteration to the capital asset by the previous owner or the assessee or both on or after 1.4.2001. In a case not covered under section 49(1), cost of improvement would include expenditure of a capital nature on addition or alteration to the capital asset by the assessee on or after 1.4.2001.

However, cost of improvement does not include any expenditure which is deductible in computing the income chargeable under the head "Income from house property", "Profits and gains of business or profession" or "Income from other sources". Routine expenses on repairs and maintenance do not form part of cost of improvement.

4.14 COMPUTATION OF CAPITAL GAINS IN CASE OF DEPRECIABLE ASSETS [SECTIONS 50 & 50A]

(1) Transfer of depreciable assets [Section 50]: Section 50 provides for the computation of capital gains in case of depreciable assets. It may be noted that where the capital asset is a depreciable asset forming part of a block of assets, section 50 will have over-riding effect in spite of anything contained in section 2(42A) which defines a short-term capital asset.

Accordingly, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed, the provisions of sections 48 and 49 shall be subject to the following modification:

- Where the full value of consideration received or accruing for the transfer of the asset plus the full value of such consideration for the transfer of any other capital asset falling with the block of assets during previous year exceeds the aggregate of the following amounts namely:

  (1) expenditure incurred wholly and exclusively in connection with such transfer;

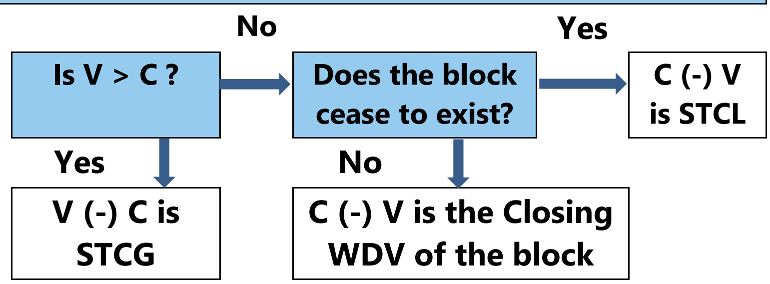
  (2) WDV of the block of assets at the beginning of the previous year;

  (3) the actual cost of any asset falling within the block of assets acquired during the previous year

  such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

- Where all assets in a block are transferred during the previous year, the block itself will cease to exist. In such a situation, the difference between the sale value of the assets and the WDV of the block of assets at the beginning of the previous year together with the actual cost of any asset falling within that block of assets acquired by the assessee during the previous year will be deemed to be the capital gains arising from the transfer of short-term capital assets.

Transfer of depreciable assets : Tax consequences



Symbol	Description
V	Full value of consideration
C	Opening WDV of Block (+) Actual Cost of Asset acquired in the Block during the P.Y. (+) Expenses in connection with transfer of asset
STCG	Short Term Capital Gain
STCL	Short Term Capital Loss
WDV	Written Down Value

(2) **Cost of acquisition in case of power sector assets [Section 50A]:** With respect to the power sector, in case of depreciable assets referred to in section 32(1)(i), the provisions of sections 48 and 49 shall apply subject to the modification that the WDV of the asset [as defined in section 43(6)], as adjusted, shall be taken to be the cost of acquisition.

ILLUSTRATION 9

Singhania & Co., a sole proprietorship owns six machines, put in use for business in March, 2024. The depreciation on these machines is charged@15%. The opening balance of these machines after providing depreciation for P.Y. 2024-25 was

₹ 8,50,000. Three of the old machines were sold on 10th June, 2025 for ₹ 11,00,000. A second hand plant was bought for ₹ 8,50,000 on 30th November, 2025.

You are required to:

(i) determine the claim of depreciation for Assessment Year 2026-27.

(ii) compute the capital gains liable to tax for Assessment Year 2026-27.

(iii) If Singhania & Co. had sold the three machines in June, 2025 for ₹ 21,00,000, will there be any difference in your above workings? Explain.

SOLUTION

(i) **Computation of depreciation for A.Y.2026-27**

Particulars	₹
Opening balance of the block as on 1.4.2025 [i.e., W.D.V. as on 31.3.2025 after providing depreciation for P.Y. 2024-25]	8,50,000
Add: Purchase of second-hand plant during the year	8,50,000
	17,00,000
Less: Sale consideration of old machinery during the year	11,00,000
W.D.V of the block as on 31.03.2026	6,00,000

Since the value of the block as on 31.3.2026 comprises of a new asset which has been put to use for less than 180 days, depreciation is restricted to 50% of the prescribed percentage of 15% i.e. depreciation is restricted to 7½%. Therefore, the depreciation allowable for the year is ₹ 45,000, being 7½% of ₹ 6,00,000.

(ii) The provisions under section 50 for computation of capital gains in the case of depreciable assets can be invoked only under the following circumstances:

(a) When one or some of the assets in the block are sold for consideration more than the value of the block.

(b) When all the assets are transferred for a consideration more than the value of the block.

(c) When all the assets are transferred for a consideration less than the value of the block.

Since in the first two cases, the sale consideration is more than the written down value of the block, the computation would result in short term capital gains.

In the third case, since the written down value of the block exceeds the sale consideration, the resultant figure would be a short-term capital loss of the block.

In the given case, capital gains will not arise as the block of asset continues to exist, and some of the assets are sold for a price which is lesser than the written down value of the block.

(iii) If the three machines are sold in June, 2025 for ₹ 21,00,000, then short term capital gains would arise, since the sale consideration is more than the aggregate of the written down value of the block at the beginning of the year and the additions made during the year.

Particulars	₹	₹
Sale consideration		21,00,000
Less: Opening balance of the block as on 1.4.2025 [i.e., W.D.V. as on 31.3.2025 after providing depreciation for P.Y. 2024-25]	8,50,000	
Purchase of second plant during the year	8,50,000	17,00,000
Short term capital gains		**4,00,000**

4.15 COMPUTATION OF CAPITAL GAINS IN CASE OF MARKET LINKED DEBENTURES [SECTIONS 50AA]

(1) **Transfer of unit of a Specified Mutual Fund or Market Linked Debenture or unlisted bond or unlisted debenture:** Section 50AA provides for the computation of capital gains in case of transfer or redemption or maturity of

- unit(s) of a Specified Mutual Fund acquired on or after 1.4.2023 or
- a Market Linked Debenture or
- an unlisted bond or unlisted debentures.

Section 50AA will have an overriding effect in spite of anything contained in section 2(42A) which defines a short-term capital asset and section 48 providing the manner of computation of capital gains.

Accordingly, capital gain arising from the transfer or redemption or maturity of unit of a Specified Mutual Fund acquired on or after 1.4.2023 or Market Linked Debenture or an unlisted bond or unlisted debentures would be deemed to be short term capital gains and chargeable to tax at normal rate of tax.

(2) **Computation of capital gains:** The full value of consideration received or accruing as a result of the transfer or redemption or maturity of such debenture or unit or bond as reduced by the cost of acquisition of the debenture or unit and the expenditure incurred wholly and exclusively in connection with such transfer or redemption or maturity would be deemed to be the capital gains.

(3) **No deduction in respect of STT:** No deduction would be allowed in computing the income chargeable under the head "Capital Gains" in respect of any sum paid on account of securities transaction tax (STT) under Chapter VII of the Finance (No.2) Act, 2004.

(4) **Meaning of certain terms:**

S. No.	Term	Meaning
(i)	**Market Linked Debenture**	A security (i) which has an underlying principal component in the form of debt security; and (ii) where the returns are linked to market returns on other underlying securities or indices. It includes any security classified or regulated as a market linked debenture by the SEBI.
(ii)	***Specified Mutual Fund***	*A Mutual Fund which invests more than 65% of its total proceeds in debt and money instruments or a fund which invests 65% or more of its total proceeds in units of above fund.*

		However, the percentage of investment in debt and money market instruments or in units of a fund in respect of the Specified Mutual Fund, shall be computed with reference to the annual average of the daily closing figures.
(iii)	***Debt and money market instrument***	*It includes any securities classified or regulated as debt and money market instruments by the SEBI.*

4.16 CAPITAL GAINS IN RESPECT OF SLUMP SALE [SECTION 50B]

(1) **Meaning of slump sale [Section 2(42C)] –** Slump sale means transfer of one or more undertakings, by any means, for a lump sum consideration without values being assigned to the individual assets and liabilities in such transfer.

Term	Meaning
Undertaking *[Explanation 1]*	It includes any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.
Transfer *[Explanation 3]*	Meaning assigned to it in section 2(47) [It would include sale, exchange, relinquishment of capital asset, extinguishment of any rights therein, compulsory acquisition under any law etc. – See detailed definition in page 3.374]

Note - The determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees shall not be regarded as assignment of values to individual assets or liabilities.

(2) **Capital gains – Whether long-term or short-term? [Section 50B(1)] -** Any profits or gains arising from the slump sale of one or more undertakings held for more than 36 months, shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

Any profits and gains arising from such transfer of one or more undertakings held by the assessee for not more than 36 months shall be deemed to be short-term capital gains.

(3) Deemed cost of acquisition and cost of improvement [Section 50B(2)(i)] -The net worth of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for the purposes of sections 48 and 49 in relation to capital assets of such undertaking or division transferred. No indexation benefit would be available even if it is results in a long-term capital gain, irrespective of the date of transfer of the undertaking i.e., whether before or on or after 23.7.2024.

(4) Deemed full value of consideration [Section 50B(2)(ii)] – Fair market value of the capital assets as on the date of transfer, calculated in the prescribed manner, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital asset.

Accordingly, the CBDT has prescribed that, for the purpose of section 50B(2)(ii), the fair market value (FMV) of capital assets would be the higher of –

(i) FMV 1, being the fair market value of capital assets transferred by way of slump sale (determined on the date of slump sale); and

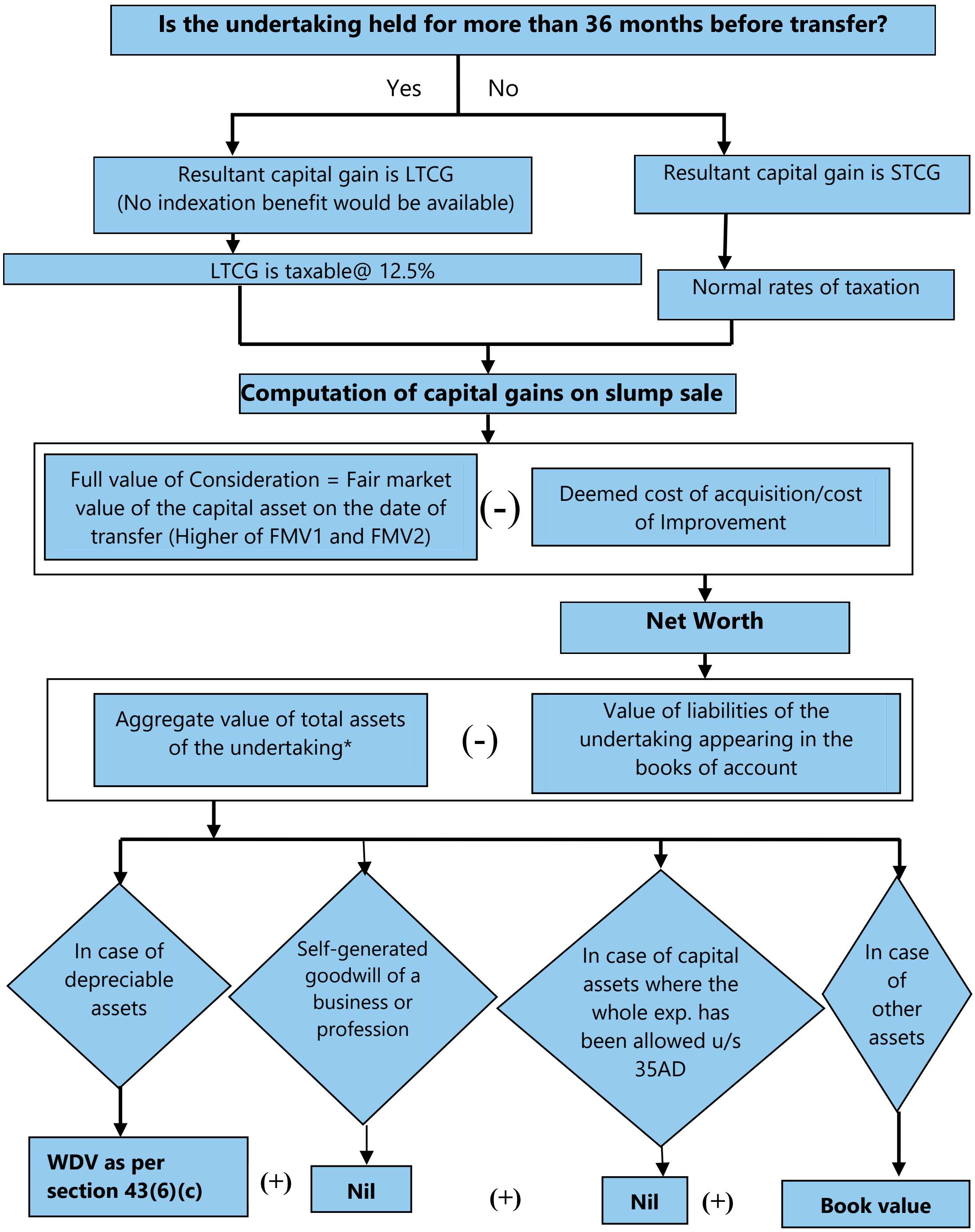
(ii) FMV 2, being the fair market value of the consideration (monetary and non-monetary) received or accruing as a result of transfer by way of slump sale

(5) Report of a Chartered Accountant [Section 50B(3)] - Every assessee, in the case of slump sale, shall furnish in the prescribed form on or before 30th September of the A.Y. [i.e., the specified date referred under section 44AB, being the date one month prior to the due date for filing return of income under section 139(1)], a report of a chartered accountant indicating the computation of net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division has been correctly arrived at in accordance with the provisions of this section.

(6) Meaning of Certain Terms:

Explanation	Term	Particulars
1	Net worth	Aggregate value of total assets of the undertaking or division **as reduced by** the value of liabilities of such undertaking or division as appearing in the books of account. However, any change in the value of assets on account of revaluation of assets shall **not** be considered for this purpose
2	Aggregate value of total assets of undertaking or division	**In the case of depreciable assets:** The written down value of block of assets determined in accordance with the provisions contained in sub-item (C) of item (i) of section 43(6)(c); **In case of capital asset, being goodwill of a business or profession, which has not been acquired by the assessee by purchase from a previous owner [Self-generated goodwill]:** Nil **Capital asset in respect of which 100% deduction is claimed:** In case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD: **Nil**; **For all other assets:** Book value

Capital Gains on Slump Sale of an Undertaking [Section 50B]



* *Ignore revaluation effect*

ILLUSTRATION 10

Mr. A is a proprietor of Akash Enterprises, having 2 units. He transferred on 1.4.2025 his Unit 1 by way of slump sale for a total consideration of ₹ 25 lakhs. The fair market value of capital assets of unit 1 on 1.4.2025 is ₹ 30 lakhs. Unit 1 was started in the year 2005-06. The expenses incurred for this transfer were ₹ 28,000. His Balance Sheet as on 31.3.2025 is as under:

Liabilities	***Total (₹)***	***Assets***	***Unit 1(₹)***	***Unit 2 (₹)***	***Total (₹)***
Own Capital	*15,00,000*	*Land*	*12,00,000*	*2,00,000*	*14,00,000*
Revaluation Reserve (for land of unit 1)	*3,00,000*	*Machinery*	*3,00,000*	*1,00,000*	*4,00,000*
Bank loan (70% for unit 1)	*2,00,000*	*Debtors*	*1,00,000*	*40,000*	*1,40,000*
Trade creditors (25% for unit 1)	*1,50,000*	*Other assets*	*1,50,000*	*60,000*	*2,10,000*
Total	***21,50,000***	***Total***	***17,50,000***	***4,00,000***	***21,50,000***

Other information:

(i) Revaluation reserve is created by revising upward the value of the land of Unit 1.

(ii) No individual value of any asset is considered in the transfer deed.

(iii) Other assets of Unit 1 include patents acquired on 1.7.2023 for ₹ 50,000 on which no depreciation has been charged.

(iv) The value of machinery represents the written down value as per the Income-tax Act, 1961.

Compute the capital gain for the assessment year 2026-27.

SOLUTION

Computation of capital gains on slump sale of Unit 1

Particulars	₹
Full value of consideration [Higher of FMV of capital assets of Unit 1 on 1.4.2025 or FMV of monetary consideration received]	30,00,000

Less: Expenses for transfer	28,000
	29,72,000
Less: Net worth ***(See Note 1 below)***	12,50,625
Long-term capital gain	**17,21,375**

Notes:

1. **Computation of net worth of Unit 1 of Akash Enterprises**

Particulars	₹	₹
Land (excluding ₹ 3 lakhs on account of revaluation)		9,00,000
Machinery		3,00,000
Debtors		1,00,000
Patents **(See Note 2 below)**		28,125
Other assets (₹ 1,50,000 – ₹ 50,000)		1,00,000
Total assets		14,28,125
Less: Creditors (25% of ₹ 1,50,000)	37,500	
Bank Loan (70% of ₹ 2,00,000)	1,40,000	1,77,500
Net worth		**12,50,625**

2. **Written down value of patents as on 1.4.2025**

Value of patents:	₹
Cost as on 1.7.2023	50,000
Less: Depreciation @ 25% for Financial Year 2023-24	12,500
Balance as on 1.4.2024	37,500
Less: Depreciation for Financial Year 2024-25	9,375
Balance as on 1.4.2025	28,125

3. Since the Unit is held for more than 36 months, capital gain arising would be long term capital gain. However, indexation benefit is not available in case of slump sale.

4.17 DEEMED FULL VALUE OF CONSIDERATION FOR COMPUTING CAPITAL GAINS [SECTIONS 50C, 50CA & 50D]

S. No.	Capital Asset	Section	Circumstance	Deemed Full Value of consideration for computing Capital Gains
1.	Land or Building or both	50C	(1) If Stamp Duty Value > **110%** of consideration received or accruing as a result of transfer	Stamp Duty Value
			(a) If date of agreement is different from the date of transfer and whole or part of the consideration is received by way of account payee cheque or account payee bank draft or ECS or through such other prescribed electronic modes (IMPS, UPI, RTGS, NEFT, Net banking, debit card, credit card or BHIM Aadhar Pay) on or before the date of agreement	Stamp Duty Value on the date of agreement
			(b) If date of agreement is different from the date of transfer but the whole or part of the consideration has not been received by way of account payee cheque or account payee bank draft or ECS or through such other prescribed electronic mode on or before the date of agreement.	Stamp Duty Value on the date of transfer
			However, if the stamp duty value on the date of agreement or the date of transfer, as the case may be ≤ 110% of the sale consideration received	Consideration so received

			Example Let us take a case where for transfer of building – • the actual consideration is ₹ 100 lakh; • the stamp duty value on the date of agreement is ₹ 109 lakh; and • the stamp duty value on the date of transfer is ₹ 112 lakh **(i) If any part of the consideration is paid by prescribed electronic mode on or before the date of agreement** The actual consideration of ₹ 100 lakh would be the full value of consideration, since stamp duty value of ₹ 109 lakhs on the date of agreement does not exceed 110% of actual consideration of ₹ 100 lakhs. **(ii) If no part of the consideration is paid by prescribed electronic mode on or before the date of agreement** Stamp duty value of ₹ 112 lakhs on the date of transfer would be the full value of consideration, since the same exceeds 110% of actual consideration of ₹ 100 lakhs.	
			(2) Where the Assessing Officer refers the valuation to a Valuation Officer, on the assessee's claim that the stamp duty value exceeds the FMV of the property on the date of transfer and the stamp duty value has not been disputed in any appeal or revision or no reference has been made before any other authority, court or High Court	
			(a) If Valuation by Valuation Officer > Stamp Duty Value	Stamp Duty Value
			(b) If Valuation by Valuation Officer < Stamp Duty Value	Valuation by Valuation Officer

		155(15)	(3) If stamp duty value has been adopted as full value of consideration, and subsequently the value is revised in any appeal or revision	Value so revised in such appeal or revision
2.	Unquoted shares	50CA	If consideration received or accruing as a result of transfer < FMV of such share determined in the prescribed manner The provisions of this section would not, however, be applicable to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.	FMV of such share determined in the prescribed manner
3.	Any Capital asset	50D	Where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined	FMV of the said asset on the date of transfer

Meaning of certain terms:

S. No.	Term	Section	Meaning
(i)	Stamp Duty Value	50C	The value adopted or assessed or assessable by any authority of a State Government (Stamp Valuation Authority) for the purpose of payment of stamp duty
(ii)	Assessable	50C	The term 'assessable' has been defined to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty. The term "assessable" has been added to cover transfers executed through power of attorney.
(iii)	Quoted Shares	50CA	The share quoted on any recognized stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business.

Note – *The valuation rules prescribed in Rule 11UA for valuation of unquoted equity shares would be dealt with at the Final level.*

4.18 ADVANCE MONEY RECEIVED [SECTION 51]

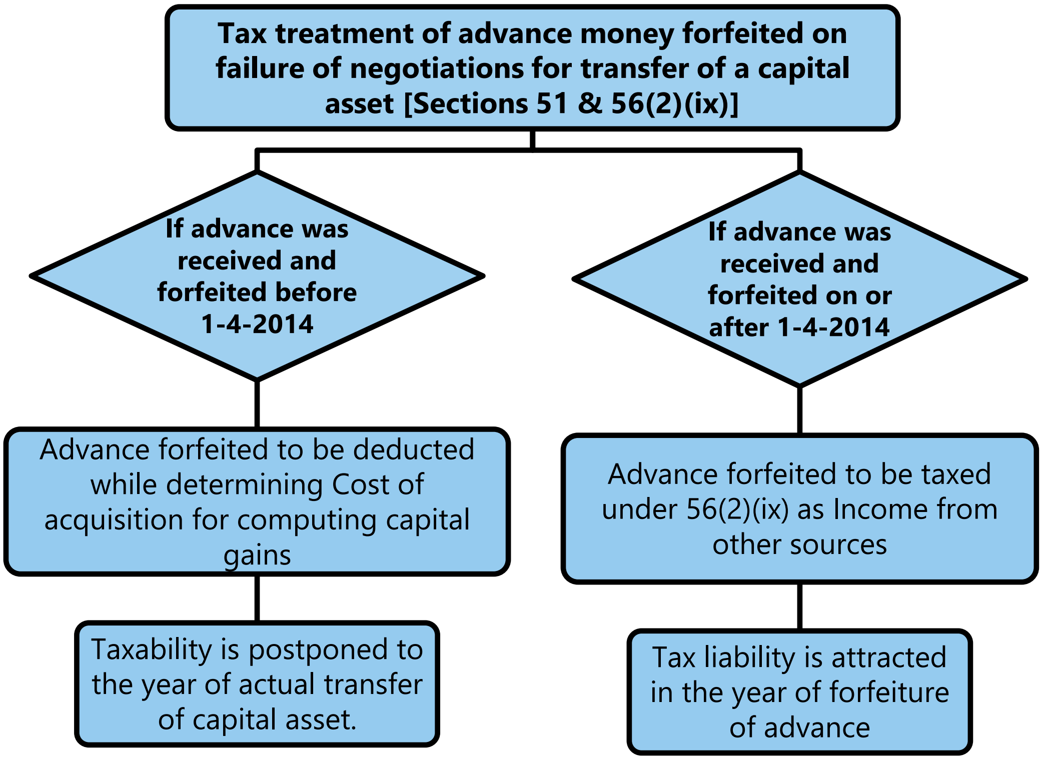
It is possible for an assessee to receive some advance in regard to the transfer of capital asset. Due to the break-down of the negotiation, the assessee may have retained the advance.

Section 51 provides that while calculating capital gains, the above advance retained by the assessee must go to reduce the cost of acquisition. However, if advance has been received and retained by the previous owner and not the assessee himself, then the same will not go to reduce the cost of acquisition of the assessee.

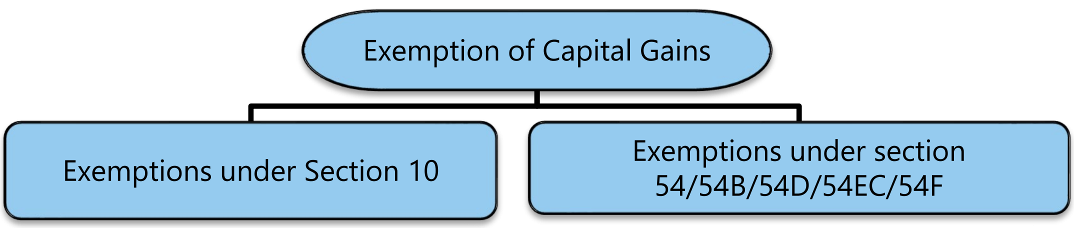
Section 56(2)(ix) provides for the taxability of any sum of money, received as an advance or otherwise in the course of negotiations for transfer of a capital asset. Consequently, such sum shall be chargeable to income-tax under the head 'Income from other sources', if such sum is forfeited on or after 1st April, 2014 and the negotiations do not result in transfer of such capital asset.

In order to avoid double taxation of the advance received and retained, section 51 provides that where any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset has been included in the total income of the assessee for any previous year in accordance with section 56(2)(ix), then, such amount shall not be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.

However, any such sum of money forfeited before 1st April, 2014, will be deducted from the cost of acquisition for computing capital gains.



4.19 EXEMPTION OF CAPITAL GAINS



I. Exemptions under section 10

Exemption of capital gains on compulsory acquisition of agricultural land situated within specified urban limits [Section 10(37)]

With a view to mitigate the hardship faced by the farmers whose agricultural land situated in specified urban limits has been compulsorily acquired, clause (37) of section 10 exempts the capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition.

Such exemption is available where the compensation or the enhanced compensation or consideration, as the case may be, is received on or after 1.4.2004.

The exemption is available only when such land has been used for agricultural purposes during the preceding two years immediately preceding the date of transfer by such individual or a parent of his or by such HUF.

II. Exemption of Capital Gains under section 54/54B/54D/54EC/54F

(i) Capital Gains on sale of residential house [Section 54]

Eligible assessees – Individual & HUF

Conditions to be fulfilled

- There should be a transfer of residential house (buildings or lands appurtenant thereto)
- It must be a long-term capital asset
- Income from such house should be chargeable under the head "Income from house property"
- **Where the amount of capital gains exceeds ₹ 2 crore**

  Where the amount of capital gain exceeds ₹ 2 crore, **one residential house in India** should be –

  - purchased within 1 year before or 2 years after the date of transfer; (or)
  - constructed within a period of 3 years after the date of transfer.

  Where the amount of capital gains does not exceed ₹ 2 crore

  Where the amount of capital gains does not exceed ₹ 2 crore, the assessee i.e., individual or HUF, may at his option,

  - purchase **two residential houses in India** within 1 year before or 2 years after the date of transfer (or)
  - construct **two residential houses in India** within a period of 3 years after the date of transfer.

  Where during any assessment year, the assessee has exercised the option to purchase or construct two residential houses in India, he shall not be subsequently entitled to exercise the option for the same or any other assessment year.

  This implies that if an assessee has availed the option of claiming benefit of section 54 in respect of purchase of two residential houses in Jaipur and Jodhpur, say, in respect of capital gains of ₹ 1.50 crores arising from transfer of residential house at Bombay in the P.Y. 2025-26, then, he will not be entitled to avail the benefit of section 54 again in respect of purchase of two residential houses in, say, Pune and Baroda, in respect of capital gains of ₹ 1.20 crores arising from transfer of residential house in Jaipur in the P.Y. 2028-29, even though the capital gains arising on transfer of the residential house at Jaipur does not exceed ₹ 2 crore.

- If such investment is not made before the date of filing of return of income, then, the capital gain has to be deposited under the Capital Gains Account Scheme (CGAS) *[Refer points (vi) and (vii) of this sub-heading]*. However, the capital gain in excess of ₹ 10 crore would not be taken into account for the purpose of deposit in CGAS.
- Amount utilized by the assessee for purchase or construction of new asset and the amount so deposited shall be deemed to be the cost of new asset. The deemed cost of the new asset would be restricted to ₹ 10 crores for the purpose of exemption under section 54.

Quantum of Exemption

- If cost of new residential house or houses, as the case may be ≥ long term capital gains, entire long term capital gains is exempt.
- If cost of new residential house or houses, as the case may be < long term capital gains, long term capital gains to the extent of cost of new residential house is exempt.

However, if the cost of new residential house(s) exceeds ₹ 10 crores, the amount exceeding ₹ 10 crore would not be taken into account for exemption. It means the maximum exemption that can be claimed by the assessee u/s 54 is ₹ 10 crore.

Examples:

1. *If the long-term capital gains is ₹ 2.05 crore and the cost of the new house is ₹ 3 crore, then, the entire long-term capital gains of ₹ 2.05 crore is exempt.*
2. *If long-term capital gains is ₹ 2.05 crore and cost of new house is ₹ 1.55 crore, then, long-term capital gains is exempt only upto ₹ 1.55 crore. Balance ₹ 50 lakhs is taxable/s 112.*

Example

(1)	*(2)*	*(3)*	*(4)*	*(5)*
S.No.	***LTCG computed***	***Cost of new residential house***	***Amount in column (3) or ₹ 10 crore, whichever is lower***	***Exempt LTCG [Lower of column (2) and column (4)]***
(1)	*₹ 7 crore*	*₹ 12 crore*	*₹ 10 crore*	*₹ 7 crore*
(2)	*₹ 12 crore*	*₹ 14 crore*	*₹ 10 crore*	*₹ 10 crore*
(3)	*₹ 11 crore*	*₹ 9 crore*	*₹ 9 crore*	*₹ 9 crore*
(4)	*₹ 15 crore*	*₹ 13 crore*	*₹ 10 crore*	*₹ 10 crore*

Examples

1. *If the LTCG is ₹ 8 crore and the assessee has incurred ₹ 5 crore in construction of new residential house upto the due date u/s 139(1) i.e., 31.7.2026/ 31.10.2026, as the case may be, then, as per section 54(2), he can deposit the amount of ₹ 3 crore not appropriated by him towards construction of house upto 31.7.2026/31.10.2026, as the case may be, in Capital Gains Account Scheme (CGAS) for claiming exemption under section 54. If he deposits, say, ₹ 2 crore, in CGAS on or before the due date u/s 139(1), the deemed cost of the new residential house would be ₹ 7 crore (₹ 5 crore + ₹ 2 crore). The amount exempt u/s 54 would be ₹ 7 crore.*

2. *If the LTCG is ₹ 14 crore and the assessee has already incurred ₹ 7 crore in construction of new residential house upto 31.7.2026/31.10.2026, as the case may be, then, as per section 54(2), he can deposit the difference of ₹ 3 crore (₹ 10 crore - ₹ 7 crore) in CGAS for claiming exemption u/s 54. If he deposits, say, ₹ 2 crore in CGAS on or before the due date u/s 139(1), the deemed cost of the new residential house would be ₹ 9 crore (₹ 7 crore + ₹ 2 crore). The amount exempt under section 54 would be ₹ 9 crore.*

Consequences of transfer of new asset before 3 years

- If the new asset is transferred before 3 years from the date of its acquisition or construction, then cost of the asset will be reduced by capital gains exempted earlier for computing capital gains.

- **Example:** The long-term capital gains is ₹ 2.05 crore and the cost of the new house is ₹ 3 crore, the entire long-term capital gains of ₹ 2.05 crore will be exempt. If the new house was sold after 18 months for ₹ 5 crore, then, short term capital gain chargeable to tax would be –

Particulars	₹
Net Consideration	5,00,00,000
Less: Cost of acquisition **minus** capital gains exempt earlier (₹ 3,00,00,000 – ₹ 2 ,05,00,000)	95,00,000
Short term capital gains chargeable to tax	**4,05,00,000**

ILLUSTRATION 11

Mr. Cee purchased a residential house on July 20, 2023 for ₹ 10,00,000 and made some additions to the house incurring ₹2,00,000 in August 2023. He sold the house property in April 2025 for ₹ 20,00,000. Out of the sale proceeds, he spent ₹5,00,000 to purchase another house property in September 2025.

What is the amount of capital gains taxable in the hands of Mr. Cee for the A.Y.2026-27?

SOLUTION

The house is sold before 24 months from the date of purchase. Hence, the house is a short-term capital asset and no benefit of indexation would be available.

Particulars	₹
Sale consideration	20,00,000
Less: Cost of acquisition	10,00,000
Cost of improvement	2,00,000
Short-term capital gains	**8,00,000**

Note - *The exemption of capital gains under section 54 is available only in case of long-term capital asset. As the house is short-term capital asset, Mr. Cee cannot claim exemption under section 54. Thus, the amount of taxable short-term capital gains is ₹8,00,000.*

(ii) Capital gains on transfer of agricultural land [Section 54B]

Eligible assessee – Individual & HUF

Conditions to be fulfilled

- There should be a transfer of urban agricultural land.
- Such land must have been used for agricultural purposes by the assessee, being an individual or his parent, or a HUF in the 2 years immediately preceding the date of transfer.
- He should purchase another agricultural land (urban or rural) within 2 years from the date of transfer.
- If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS *(Refer points (vi) and (vii) of this sub-heading.)*. Amount utilized by the assessee for purchase of new asset and the amount so deposited shall be deemed to be the cost of new asset.

Quantum of exemption

- If cost of new agricultural land ≥ capital gains, entire capital gains is exempt.
- If cost of new agricultural land < capital gains, capital gains to the extent of cost of new agricultural land is exempt.

Examples:

1. *If the capital gains is ₹ 3 lakhs and the cost of the new agricultural land is ₹ 4 lakhs, then, the entire capital gains of ₹ 3 lakhs is exempt.*
2. *If capital gains is ₹ 3 lakhs and cost of new agricultural land is ₹ 2 lakhs, then, capital gains is exempt only upto ₹ 2 lakhs.*

Consequences of transfer of new agricultural land before 3 years

- If the new agricultural land is transferred before 3 years from the date of its acquisition, then cost of the land will be reduced by capital gains exempted earlier for computing capital gains of new agricultural land.
- However, if the new agricultural land is a rural agricultural land, there would be no capital gains on transfer of such land.

- Continuing in the above example 1, if the new agricultural land (urban land) is sold after, say, 1 year for ₹ 6 lakhs, then short term capital gain chargeable to tax would be –

Particulars	₹
Net consideration	6,00,000
Less: Cost of acquisition **minus** capital gains exempt earlier (₹ 4,00,000 – ₹ 3,00,000)	1,00,000
Short-term capital gains chargeable to tax	**5,00,000**

(iii) Capital Gains on transfer by way of compulsory acquisition of land and building of an industrial undertaking [Section 54D]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There must be compulsory acquisition of land and building or any right in land or building forming part of an industrial undertaking.
- The land and building should have been used by the assessee for purposes of the business of the industrial undertaking in the 2 years immediately preceding the date of transfer.
- The assessee must purchase any other land or building or construct any building (for shifting or re-establishing the existing undertaking or setting up a new industrial undertaking) within 3 years from the date of transfer.
- If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS. *(Refer point (vi) and (vii) of this sub-heading)*. Amount utilized by the assessee for purchase of new asset and the amount so deposited shall be deemed to be the cost of new asset.

Quantum of exemption

- If cost of new asset ≥ Capital gains, entire capital gains is exempt.
- If cost of new asset < Capital gains, capital gains to the extent of cost of new asset is exempt.

Note: The exemption in respect of capital gains from transfer of capital asset would be available even in respect of short-term capital asset, being land or building or any right in any land or building, provided such capital asset is used by assessee for the industrial undertaking belonging to him, even if he was not the owner for the said period of 2 years.

Consequences of transfer of new asset before 3 years

- If the new asset is transferred before 3 years from the date of its acquisition, then cost of the asset will be reduced by capital gains exempted earlier for computing capital gains.

(iv) Capital Gains not chargeable on investment in certain bonds [Section 54EC]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There should be transfer of a long-term capital asset **being land or building or both**.
- Such asset can also be a depreciable asset (in this case, building) held for more than 24 months[10].
- The capital gains arising from such transfer should be invested in a long-term specified asset within 6 months from the date of transfer.
- **Long-term specified asset** means specified bonds, redeemable after 5 years, issued on or after 1.4.2018 by the National Highways Authority of India (NHAI) or the Rural Electrification Corporation Limited (RECL) or any other bond notified by the Central Government in this behalf [Bonds of Power Finance Corporation (PFC), Indian Railways Finance Corporation (IRFC)]. *Bonds, redeemable after 5 years, issued on or after 1.4.2025 by Housing and Urban Development Corporation Limited (HUDCO) and bonds, redeemable after 5 years, issued on or after 9.7.2025 by the Indian Renewable Energy Development Agency (IREDA) are also specified by the Central Government for this purpose.*
- The assessee should not transfer or convert or avail loan or advance on the security of such bonds for a period of **5 years** from the date of acquisition of such bonds.

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[10] *CIT v. Dempo Company Ltd (2016) 387 ITR 354 (SC)*

Quantum of exemption

- Capital gains or amount invested in specified bonds, whichever is lower.
- The maximum investment which can be made in notified bonds or bonds of NHAI and RECL, out of capital gains arising from transfer of one or more assets, during the previous year in which the original asset is transferred and in the subsequent financial year **cannot exceed ₹ 50 lakhs**.

Violation of condition

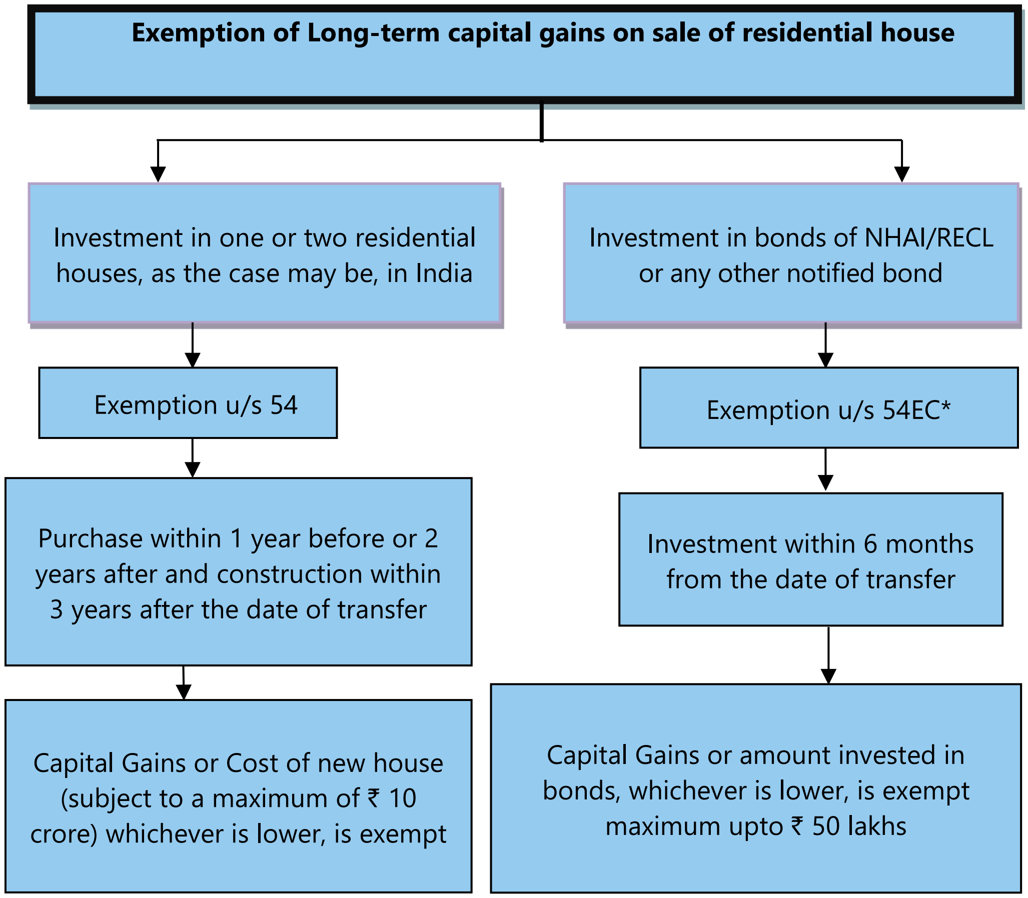
- In case of transfer or conversion of such bonds or availing loan or advance on security of such bonds before the expiry of 5 years, the capital gain exempted earlier shall be taxed as long-term capital gain in the year of violation of condition.

ILLUSTRATION 12

Long term capital gain of ₹ 75 lakhs arising from transfer of building on 1.5.2025 will be exempt from tax if such capital gain is invested in the bonds redeemable after five years, issued by NHAI under section 54EC. Examine with reasons whether the given statement is true or false having regard to the provisions of the Income-tax Act, 1961.

SOLUTION

False: The exemption under section 54EC has been restricted, by limiting the maximum investment in long term specified assets (i.e. bonds of NHAI or RECL or any other bond notified by Central Government in this behalf, redeemable after 5 years) to ₹ 50 lakhs, whether such investment is made during the relevant previous year or the subsequent previous year, or both. Therefore, in this case, the exemption under section 54EC can be availed only to the extent of ₹ 50 lakhs, provided the investment is made before 1.11.2025 (i.e., within six months from the date of transfer).



**The exemption under section 54EC is available in respect of capital gains on transfer of capital asset being land or building or both.*

(v) Capital gains in case of investment in residential house [Section 54F]

Eligible assessees: Individuals/ HUF

Conditions to be fulfilled

- There must be transfer of a **<u>long-term capital asset</u>**, not being a residential house.
- Transfer of plot of land is also eligible for exemption
- The assessee should -
  - Purchase **<u>one residential house situated in India</u>** within a period of 1 year before or 2 years after the date of transfer; or
  - **<u>Construct one residential house in India</u>** within 3 years from the date of transfer.

- If such investment is not made before the date of filing of return of income, then, the net sale consideration has to be deposited under the CGAS. *(Refer points (vi) and (vii) of this sub-heading)*. However, the net consideration in excess of ₹ 10 crore would not be taken into account for the purpose of deposit in CGAS.
- Amount utilized by the assessee for purchase or construction of new asset and the amount so deposited shall be deemed to be the cost of new asset. The deemed cost of new asset would be restricted to ₹ 10 crores for the purpose of exemption under section 54F.

- The assessee should **not** own more than one residential house on the date of transfer.
- The assessee should **not** –
  - purchase any other residential house within a period of 2 years or
  - construct any other residential house within a period of 3 years from the date of transfer of the original asset.

Quantum of exemption

- If cost of new residential house ≥ Net sale consideration of original asset, entire capital gains is exempt.
- If cost of new residential house < Net sale consideration of original asset, only proportionate capital gains is exempt i.e.

$$LTCG \times \frac{\text{Amount invested in new residential house}}{\text{Net sale consideration}}$$

However, if the cost of new residential house/ amount invested in new residential house exceeds ₹ 10 crore, the amount exceeding ₹ 10 crore would not be taken into account for exemption.

Example

(1)		(2)	(3)	(4)	(5)
	Net Consider-ation	**LTCG computed**	**Cost of new residential house**	**Amount in column (3) or ₹ 10 crores, whichever is lower**	**Exempt LTCG**
(1)	₹ 15 crore	₹ 7.5 crore	₹ 12 crore	₹ 10 crore	₹ 7.5 crore x 10/15 = ₹ 5 crore
(2)	₹ 20 crore	₹ 12 crore	₹ 15 crore	₹ 10 crore	₹ 12 crore x 10/20 = ₹ 6 crore
(3)	₹ 16 crore	₹ 12 crore	₹ 8 crore	₹ 8 crore	₹ 12 crore x 8/16 = ₹ 6 crore
(4)	₹ 10 crore	₹ 6 crore	₹ 10 crore	₹ 10 crore	₹ 6 crore x 10/10 = ₹ 6 crore
(5)	₹ 12 crore	₹ 6 crore	₹ 12 crore	₹ 10 crore	₹ 6 crore x 10/12 = ₹ 5 crore

Examples

1. *If the net consideration is ₹ 9 crore, the capital gain is ₹ 4.50 crore and the amount incurred for construction of new residential house upto 31.7.2026/31.10.2026, as the case may be, is ₹ 5 crore, then, as per section 54F(4), the assessee can deposit the amount of ₹ 4 crore (i.e., ₹ 9 crore – ₹ 5 crore) not appropriated towards construction upto 31.7.2026/ 31.10.2026, as the case may be, in CGAS for claiming exemption u/s 54F. If the assessee has deposited, say, ₹ 3 crore on or before 31.7.2026/ 31.10.2026, as the case may be, the deemed cost of new residential house would be ₹ 8 crore (₹ 5 crore + ₹ 3 crore). The exemption u/s 54F would be ₹ 4 crore [i.e., ₹ 4.50 crore x ₹ 8 crore/₹ 9 crore].*

2. *If the net consideration is ₹ 15 crore, the capital gain is ₹ 7.50 crore and the amount incurred for construction of new residential house upto 31.7.2026/31.10.2026, as the case may be, is ₹ 6 crore, the assessee can deposit ₹ 4 crore [i.e., ₹ 10 crore – ₹ 6 crore] on or before 31.7.2026/31.10.2026, as the case may be, in CGAS for claiming exemption u/s 54F. If the assessee has deposited, say, ₹ 3 crore on or*

before the due date of filing return u/s 139(1), the deemed cost of new residential house would be ₹ 9 crore (₹ 6 crore + ₹ 3 crore). The exemption u/s 54F would be ₹ 4.50 crore [i.e., ₹ 7.50 crore x ₹ 9 crore/ ₹ 15 crore].

Consequences where the assessee purchases any other residential house within a period of 2 years or constructs any other residential house within a period of 3 years from the date of transfer of original asset:

The capital gains exempt earlier under section 54F shall be deemed to be taxable as long-term capital gains in the previous year in which such residential house is purchased or constructed.

Consequences if the new house is transferred within a period of 3 years from the date of its purchase

- Capital gains would arise on transfer of the new house; and
- The capital gains exempt earlier under section 54F would be taxable as long-term capital gains.

Note – In case the new residential house is sold after 2 years, the capital gains would be long-term capital gains.

(vi) Capital Gains Account Scheme (CGAS)

Under sections 54, 54B, 54D and 54F, capital gains is exempt to the extent of investment of such gains/ net consideration (in the case of section 54F) in specified assets within the specified time. If such investment is not made before the date of filing of return of income, then the capital gain or net consideration (in case of exemption under section 54F) has to be deposited under the CGAS. However, the capital gain in excess of ₹ 10 crore would not be taken into account for the purpose of deposit in CGAS in case of section 54 and the net consideration in excess of ₹ 10 crore would not be taken into account for the purpose of deposit in CGAS in case of section 54F.

Time limit

Such deposit in CGAS should be made before filing the return of income or on or before the due date of filing the return of income, whichever is earlier. In such cases, the amount already utilized for purchase or construction of new asset plus the amount deposited under the CGAS on or before due date u/s 139(1) would be deemed to be the cost of new asset. However, for the purpose of sections 54 and 54F, the amount so deemed to be the cost of the new asset cannot exceed ₹ 10 crore.

Proof of such deposit should be attached with the return. The deposit can be withdrawn for utilization for the specified purposes in accordance with the scheme.

Consequences if the amount deposited in CGAS is not utilized within the stipulated time of 2 years / 3 years

If the amount deposited is not utilized for the specified purpose within the stipulated period, then the **unutilized amount shall be charged as capital gain** of the previous year in which the specified period expires. In the case of section 54F, proportionate amount will be taxable.

CBDT Circular No.743 dated 6.5.96 clarifies that in the event of death of an individual before the stipulated period, the unutilized amount is not chargeable to tax in the hands of the legal heirs of the deceased individual. Such unutilized amount is not income but is a part of the estate devolving upon them.

(vii) Extension of time for acquiring new asset or depositing or investing amount of Capital Gain [Section 54H]

In case of compulsory acquisition of the original asset, where the compensation is not received on the date of transfer, the period available for acquiring a new asset or making investment in CGAS under sections 54, 54B, 54D, 54EC and 54F would be considered from the date of receipt of such compensation and not from the date of the transfer.

4.20 REFERENCE TO VALUATION OFFICER [SECTION 55A]

Section 55A provides that the Assessing Officer may refer the valuation of a capital asset to a Valuation Officer in the following circumstances with a view to ascertaining the fair market value of the capital asset for the purposes of capital gains -

(i) In a case where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the Assessing Officer is of the opinion that the value so claimed is at variance with its fair market value.

Under this provision, the Assessing Officer can make a reference to the Valuation Officer in cases where the fair market value is taken to be the sale consideration of the asset. An Assessing Officer can also make a reference to the Valuation Officer in a case where the fair market value of the asset as on 01.04.2001 is taken as the cost of the asset, if he is of the view that there is any variation between the value as on 01.04.2001 claimed by the assessee in accordance with the estimate made by a registered valuer and the fair market value of the asset on that date.

(ii) If the Assessing Officer is of the opinion that the fair market value of the asset exceeds the value of the asset as claimed by the assessee by more than 15% of the value of asset as claimed or by more than ₹ 25,000 of the value of the asset as claimed by the assessee.

(iii) The Assessing Officer is of the opinion that, having regard to the nature of asset and other relevant circumstances, it is necessary to make the reference.

4.21 TAX ON SHORT TERM CAPITAL GAINS IN RESPECT OF EQUITY SHARES/ UNITS OF AN EQUITY ORIENTED FUND [SECTION 111A]

(i) Applicability of concessional rate of tax: This section provides for a concessional rate of tax on the short-term capital gains on transfer of -

(1) an equity share in a company; or

(2) a unit of a business trust[11]; or

(3) a unit of an equity oriented fund

(ii) Concessional rate of tax in respect of STCG on transfer of certain assets: The concessional rate of tax on the short-term capital in respect of transfer of above-mentioned assets is 20%.

[11] Chapter XII-FA of the Income-tax Act, 1961 and the related provisions dealing with the taxation aspects of business trust would be dealt with at the Final level.

(iii) Conditions: The conditions for availing the benefit of this concessional rate are –

(1) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004, being the date on which Chapter VII of the Finance (No. 2) Act, 2004 came into force; and

(2) such transaction should be chargeable to securities transaction tax under the said Chapter.

However, short-term capital gains arising from transactions undertaken in foreign currency on a recognized stock exchange located in an International Financial Services Centre (IFSC) would be taxable at a concessional rate of 20%, even though STT is not leviable in respect of such transaction.

(iii) Adjustment of Unexhausted Basic Exemption Limit: In the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then, such short-term capital gain will be reduced by the unexhausted basic exemption limit and only the balance would be taxed at 20%. However, the benefit of adjustment of unexhausted basic exemption limit is not available in the case of non-residents.

(iv) No deduction under Chapter VI-A against STCG taxable under section 111A: Deductions under Chapter VI-A cannot be availed in respect of such short-term capital gains on equity shares of a company or units of an equity oriented mutual fund or unit of a business trust included in the total income of the assessee.

4.22 TAX ON LONG TERM CAPITAL GAINS [SECTION 112]

(i) Concessional rate of tax: Long term capital gains on transfer of all long-term capital assets (other than referred u/s 112A) would be taxable 12.5%.

However, in case of an individual or HUF, being a resident in India, long-term capital gains arising on transfer of long-term capital asset, being land or building or both if acquired before 23.7.2024 would be taxable -

- @ 12.5% without indexation; or
- @ 20% with indexation

whichever is beneficial.

Further, in case of non-residents, LTCG on transfer of unlisted securities, or shares of a closely held company, would be taxable @12.5% without foreign currency fluctuation.

Important Points to remember –

(1) For Individuals or HUF (Residents): In the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then, such long-term capital gain will be reduced by the unexhausted basic exemption limit and only the balance would be taxed at 12.5% or 20%, as the case may be. However, the benefit of adjustment of unexhausted basic exemption limit is not available in the case of non-residents.

(2) Non-Residents and Foreign Companies: Long-term capital gains from the transfer of listed shares (other than listed equity shares covered u/s 112A) or debentures of an Indian company (acquired in foreign currency) will be taxed at 12.5% (with foreign currency fluctuation adjustments).

(3) No Chapter VI-A deduction against LTCG: The provisions of section 112 make it clear that the deductions under Chapter VI-A cannot be availed in respect of the long-term capital gains included in the total income of the assessee.

4.23 TAX ON LONG TERM CAPITAL GAINS ON CERTAIN ASSETS [SECTION 112A]

(i) Applicability and concessional rate of tax: Section 112A provides that notwithstanding anything contained in section 112, a concessional rate of tax of 12.5% will be leviable on the long-term capital gains exceeding ₹ 1,25,000 on transfer of –

(a) an equity share in a company; or

(b) a unit of a business trust; or

(c) a unit of an equity oriented fund

(ii) Conditions: The conditions for availing the benefit of this concessional rate are –

(a) In case of equity share in a company, STT has been paid on acquisition and transfer of such capital asset

(b) In case of unit of an equity oriented fund or unit of business trust, STT has been paid on transfer of such capital asset.

However, the Central Government may, by notification in the Official Gazette, specify the nature of acquisition of equity share in a company on which the condition of payment of STT on acquisition would not be applicable.

Further, long-term capital gains arising from transaction undertaken on a recognized stock exchange located in an International Financial Service Centre (IFSC) would be taxable at a concessional rate of 12.5%, where the consideration for transfer is received or receivable in foreign currency, even though STT is not leviable in respect of such transaction.

(iii) Adjustment of Unexhausted Basic Exemption Limit: In the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then such long-term capital gain exceeding ₹ 1,25,000 will be reduced by the unexhausted basic exemption limit and only the balance would be taxed at 12.5%.

However, the benefit of adjustment of unexhausted basic exemption limit is not available in the case of non-residents.

(iv) No deduction under Chapter VI-A against LTCG taxable under section 112A: Deductions under Chapter VI-A cannot be availed in respect of such long-term capital gains on equity shares of a company or units of an equity oriented mutual fund or unit of a business trust included in the total income of the assessee.

(v) No benefit of rebate under section 87A against LTCG taxable under section 112A: In case the assessee opts out of the default tax regime, rebate under section 87A is not available in respect of tax payable @12.5% on LTCG under section 112A.

Subsequent to insertion of section 112A, the CBDT has issued clarification F. No. 370149/20/2018-TPL dated 04.02.2018 in the form of a Questions and Answers format to clarify certain issues raised in different fora on various issues relating to the new tax regime for taxation of long-term capital gains. The relevant questions raised and answers to such questions as per the said Circular are given hereunder. [Answers to certain questions have been revised to reflect the latest position of law]:

Q 1. What is the meaning of long term capital gains under the new tax regime for long term capital gains?

Ans 1. Long term capital gains mean gains arising from the transfer of long-term capital asset.

It provides for a new long-term capital gains tax regime for the following assets–

i. Equity Shares in a company listed on a recognised stock exchange;

ii. Unit of an equity oriented fund; and

iii. Unit of a business trust.

The concessional tax rate u/s 112A applies to the above assets, if–

a. the assets mentioned are held for a period of "more than 12 months" from the date of acquisition; and

b. the Securities Transaction Tax (STT) is paid at the time of transfer. However, in the case of equity shares acquired after 1.10.2004, STT is required to be paid even at the time of acquisition (subject to notified exemptions).

Q 2. What is the point of chargeability of the tax?

Ans 2. The tax will be levied only upon transfer of the long-term capital asset on or after 1st April, 2018, as defined in clause (47) of section 2 of the Act.

Q 3. What is the method for calculation of long-term capital gains?

Ans 3. The long-term capital gains will be computed by deducting the cost of acquisition from the full value of consideration on transfer of the long-term capital asset.

Q 4. How do we determine the cost of acquisition for assets acquired on or before 31st January, 2018?

Ans 4. The cost of acquisition for the long-term capital asset acquired on or before 31st of January, 2018 will be the actual cost.

However, if the actual cost is less than the fair market value of such asset as on 31st of January, 2018, the fair market value will be deemed to be the cost of acquisition.

Further, if the full value of consideration on transfer is less than the fair market value, then such full value of consideration or the actual cost, whichever is higher, will be deemed to be the cost of acquisition.

Q 5. Please provide illustrations for computing long-term capital gains in different scenarios, in the light of answers to questions 4.

Ans 5. The computation of long-term capital gains in different scenarios is illustrated as under

Scenario 1 – An equity share is acquired on 1st of January, 2017 at ₹ 100, its fair market value is ₹ 200 on 31st of January, 2018 and it is sold on 1st of April, 2025 at ₹ 250. As the actual cost of acquisition is less than the fair market value as on 31st of January, 2018, the fair market value of ₹ 200 will be taken as the cost of acquisition and the long-term capital gain will be ₹ 50 (₹ 250 – ₹ 200).

Scenario 2 – An equity share is acquired on 1st of January, 2017 at ₹ 100, its fair market value is ₹ 200 on 31st of January, 2018 and it is sold on 1st of April, 2025 at ₹ 150. In this case, the actual cost of acquisition is less than the fair market value as on 31st of January, 2018. However, the sale value is also less than the fair market value as on 31st of January, 2018. Accordingly, the sale value of ₹ 150 will be taken as the cost of acquisition and the long-term capital gain will be NIL (₹ 150 – ₹ 150).

Scenario 3 – An equity share is acquired on 1st of January, 2017 at ₹ 100, its fair market value is ₹ 50 on 31st of January, 2018 and it is sold on 1st of April, 2025 at ₹ 150. In this case, the fair market value as on 31st of January, 2018 is less than the actual cost of acquisition, and therefore, the actual cost of ₹ 100 will be taken as actual cost of acquisition and the long-term capital gain will be ₹ 50 (₹ 150 – ₹ 100).

<u>Scenario 4</u> – An equity share is acquired on 1st of January, 2017 at ₹ 100, its fair market value is ₹ 200 on 31st of January, 2018 and it is sold on 1st of April, 2025 at ₹ 50. In this case, the actual cost of acquisition is less than the fair market value as on 31st January, 2018. The sale value is less than the fair market value as on 31st of January, 2018 and also the actual cost of acquisition. Therefore, the actual cost of ₹ 100 will be taken as the cost of acquisition in this case. Hence, the long-term capital loss will be ₹ 50 (₹ 50 – ₹ 100) in this case.

Q 6. What will be the tax treatment of transfer made on or after 1st April 2018?

Ans 6. The long-term capital gains exceeding ₹ 1,25,000 arising from transfer of listed equity shares/ units of equity oriented fund/business trust on or after 1st April, 2018 will be taxed at 12.5%. However, there will be no tax on gains accrued upto 31st January, 2018.

Q 7. What is the date from which the holding period will be counted?

Ans 7. The holding period will be counted from the date of acquisition.

Q 8. Whether tax will be deducted at source in case of gains by resident tax payer?

Ans 8. No. There will be no deduction of tax at source from the payment of long-term capital gains to a resident tax payer.

Q 9. What will be the cost of acquisition in the case of bonus shares acquired before 1st February 2018?

Ans 9. The cost of acquisition of bonus shares acquired before 31st January, 2018 will be determined as per section 55(2)(ac).Therefore, the fair market value of the bonus shares as on 31st January, 2018 will be taken as cost of acquisition (except in some typical situations explained in Ans 5), and hence, the gains accrued upto 31st January, 2018 will continue to be exempt[12].

Q10. What will be the cost of acquisition in the case of right share acquired before 1st February 2018?

Ans 10. The cost of acquisition of right share acquired before 31st January, 2018 will be determined as per section 55(2)(ac). Therefore, the fair market value of right share as on 31st January, 2018 will be taken as cost of acquisition

[12] *Subject to the notification issued by the Central Government to specify the nature of acquisition of equity share in a company on which the condition of payment of STT on acquisition would not be applicable. This notification will be discussed at Final level.*

(except in some typical situations explained in Ans 5), and hence, the gains accrued upto 31st January, 2018 will continue to be exempt[13].

Q11. What will be the treatment of long-term capital loss arising from transfer made on or after 1st April, 2018?

Ans 11. Long-term capital loss arising from transfer made on or after 1st April, 2018 will be allowed to be set-off and carried forward in accordance with existing provisions of the Act. Therefore, it can be set-off against any other long-term capital gains and unabsorbed loss can be carried forward to subsequent eight years for set-off against long-term capital gains.

ILLUSTRATION 13

Calculate the income-tax liability for the assessment year 2026-27 in the following cases:

	Mr. A (age 45)	***Mrs. B (age 62)***	***Mr. C (age 81)***	***Mr. D (age 82)***
Status	***Non-resident***	***Non-resident***	***Resident***	***Non-resident***
Total income other than long-term capital gain	*2,40,000*	*4,10,000*	*5,90,000*	*4,80,000*
Long-term capital gain	*85,000 from sale of vacant site*	*10,000 from sale of listed equity shares (STT paid on sale and purchase of shares)*	*60,000 from sale of agricultural land in rural area*	*Nil*

(i) If Mr. A, Mrs. B, Mr. C and Mr. D pay tax under default tax regime u/s 115BAC.

(ii) If Mr. A, Mrs. B, Mr. C and Mr. D exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the normal provisions of the Act.

SOLUTION

(i) If Mr. A, Mrs. B, Mr. C and Mr. D pay tax under default tax regime u/s 115BAC.

Computation of income-tax liability for the A.Y.2026-27

Particulars	Mr. A (age 45)	Mrs. B (age 62)	Mr. C (age 81)	Mr. D (age 82)
Residential Status	Non-resident	Non-resident	Resident	Non-resident
Applicable basic exemption limit	₹ 4,00,000	₹ 4,00,000	₹ 4,00,000	₹ 4,00,000
Asset sold	Vacant site	Listed equity shares (STT paid on both sale and purchase of shares)	Rural agricultural land	-
Long-term capital gain (on sale of above asset)	₹ 85,000 [Taxable @12.5% u/s 112]	₹ 10,000 [Exempt u/s 112A since it is less than ₹ 1,25,000]	₹ 60,000 (Exempt – not a capital asset)	-
Other income	₹ 2,40,000	₹ 4,10,000	₹ 5,90,000	₹ 4,80,000
Tax liability				
On LTCG	₹ 10,625	-	-	-
On Other income	Nil	₹ 500	₹ 9,500	₹ 4,000
	₹ 10,625	₹ 500	₹ 9,500	₹ 4,000
Less: Rebate u/s 87A	-	-	₹ 9,500	-
	₹ 10,625	₹ 500	Nil	₹ 4,000
Add: Health & education cess (HEC) @4%	₹ 425	₹ 20	Nil	₹ 160
Total tax liability	**₹ 11,050**	**₹ 520**	**Nil**	**₹ 4,160**

Note: Since Mr. C is a resident whose total income does not exceed ₹ 12 lakhs, he is eligible for rebate of ₹ 60,000 or the actual tax payable, whichever is lower, under section 87A.

(ii) If Mr. A, Mrs. B, Mr. C and Mr. D exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the normal provisions of the Act

Computation of income-tax liability for the A.Y.2026-27

Particulars	Mr. A (age 45)	Mrs. B (age 62)	Mr. C (age 81)	Mr. D (age 82)
Residential Status	Non-resident	Non-resident	Resident	Non-resident
Applicable basic exemption limit	₹ 2,50,000	₹ 2,50,000	₹ 5,00,000	₹ 2,50,000
Asset sold	Vacant site	Listed equity shares (STT paid on both sale and purchase of shares)	Rural agricultural land	-
Long-term capital gain (on sale of above asset)	₹ 85,000 [Taxable @12.5% u/s 112]	₹ 10,000 [Exempt u/s 112A since it is less than ₹ 1,25,000]	₹ 60,000 (Exempt – not a capital asset)	-
Other income	₹ 2,40,000	₹ 4,10,000	₹ 5,90,000	₹ 4,80,000
Tax liability				
On LTCG	₹ 10,625	-	-	-
On Other income	Nil	₹ 8,000	₹ 18,000	₹ 11,500
	₹ 10,625	₹ 8,000	₹ 18,000	₹ 11,500
Less: Rebate u/s 87A	-	-	-	-
	₹ 10,625	₹ 8,000	₹ 18,000	₹ 11,500
Add: Health & education cess (HEC) @4%	₹ 425	₹ 320	₹ 720	₹ 460
Total tax liability	**₹ 11,050**	**₹ 8,320**	**₹ 18,720**	**₹ 11,960**

Notes:

Since Mrs. B and Mr. D are non-residents, they cannot avail the higher basic exemption limit of ₹ 3,00,000 and ₹ 5,00,000 for persons over the age of 60 years and 80 years, respectively. Also, they along with Mr. A, being non-residents are not eligible for rebate under section 87A even though their total income does not exceed ₹ 5 lakh.

LET US RECAPITULATE

Scope and year of chargeability [Section 45]

Any profits or gains arising from the transfer of a capital asset effected in the previous year will be chargeable to tax under the head 'Capital Gains', and shall be deemed to be the income of the previous year in which the transfer took place [Section 45(1)]

Section	Profits and gains arising from the following transactions chargeable as income	P.Y. in which income is chargeable to tax	Deemed Full Value of consideration for computation of capital gains under section 48
45(1A)	Money or other asset received under an insurance from an insurer on account of damage/ destruction of any capital asset, as a result of, flood, hurricane, cyclone, earthquake or other convulsion of nature, riot or civil disturbance, accidental fire or explosion, action by an enemy or action taken in combating an enemy	The previous year in which such money or other asset is received.	The value of money or the fair market value of other asset received.

45(2)	Transfer by way of conversion by the owner of a capital asset into stock-in-trade of a business carried on by him.	The previous year in which such stock-in-trade is sold or otherwise transferred by him	The fair market value of the capital asset on the date of such conversion
45(5)	Transfer by way of compulsory acquisition under any law, or a transfer, the consideration for which was determined or approved by the Central Government or RBI	The previous year in which the consideration or part thereof is first received.	Compensation or consideration determined or approved in the first instance by the Central Government or RBI
	If the compensation or consideration is further enhanced by any court, Tribunal or other authority, the enhanced amount will be deemed to be the income However, any amount of compensation received in pursuance of an interim order of a court, Tribunal or other	The previous year in which the amount was received by the assessee.	Amount by which the compensation or consideration is enhanced or further enhanced. For this purpose cost of acquisition and cost of improvement shall be taken as 'Nil'.

	authority shall be deemed to be income chargeable under the head "Capital Gains" of the previous year in which the final order of such court, Tribunal or other authority is made.		

Definitions [Section 2]		
Section	**Term**	**Definition**
2(14)	Capital Asset	**Capital Asset** means – (a) property of any kind held by an assessee, whether or not connected with his business or profession; (b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the SEBI Act, 1992 or an investment fund[13] which has invested such securities in accordance with the SEBI regulations or IFSC regulations; (c) any unit linked insurance policy (ULIP) to which exemption under section 10(10D) does not apply. **Exclusions from the definition of Capital Asset:** ➢ Stock in trade [other than securities referred to in (b) above], raw materials or consumables held for the purposes of business or profession; ➢ Personal effects except jewellery, archeological collections, drawings, paintings, sculptures or any work of art; ➢ Rural agricultural land in India i.e. agricultural land not situated within specified urban limits.

[13] specified in section 115UB

The agricultural land described in (a) and (b) below, being land situated within the specified urban limits, would fall within the definition of "capital asset", and transfer of such land would attract capital gains tax -

(a) agricultural land situated in any area within the jurisdiction of a municipality or cantonment board having population of not less than ten thousand, or

(b) agricultural land situated in any area within such distance, measured aerially, in relation to the range of population as shown hereunder -

	Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)	**Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.**
(i)	≤ 2 kms	> 10,000
(ii)	> 2 kms but ≤ 6 kms	> 1,00,000
(iii)	> 6 kms but ≤ 8 kms	> 10,00,000

- Gold Deposits Bonds issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetisation Scheme, 2015 and Gold Monetisation Scheme, 2018 notified by the Central Government;
- 6½% Gold Bonds, 1977 or 7% Gold Bonds, 1980 or National Defence Gold Bonds, 1980, issued by the Central Government;
- Special Bearer Bonds, 1991 issued by the Central Government.

Note: 'Property' includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.

<table>
<tr><td rowspan="4">2(42A)/ 2(29A)</td><td rowspan="3">Short-term capital asset/ long-term capital asset</td><td>Capital Asset</td><td>STCG, if held for</td><td>LTCG, if held for</td></tr>
<tr><td>• Security listed in a recognized stock exchange
• Unit of equity-oriented fund/unit of UTI
• Zero Coupon bond</td><td>≤ 12 months immediately preceding the date of its transfer</td><td>> 12 months immediately preceding the date of its transfer</td></tr>
<tr><td>• Other capital assets</td><td>≤ 24 months immediately preceding the date of its transfer</td><td>> 24 months immediately preceding the date of its transfer</td></tr>
<tr><td colspan="4">Note – As per section 50AA, capital gains arising from transfer of the following assets would always be short-term capital irrespective of the period of holding of such assets:
- units of a specified mutual fund acquired on or after 1.4.2023,
- market linked debentures,
- unlisted bond and unlisted debenture.</td></tr>
</table>

Transactions not regarded as transfer [Section 47]: Some Examples
➢ Any distribution of capital assets on the **total or partial partition of a HUF**
➢ Any transfer of capital asset by an individual or HUF under a **gift or will or an irrevocable trust (by any person upto A.Y. 2024-25)**
➢ Any transfer of capital asset by a **holding company to its 100% subsidiary Indian company or by a subsidiary company to its 100% holding Indian company**
➢ Any transfer or **issue of shares by the resulting company, in a scheme of demerger** to the shareholders of the demerged company
➢ Any transfer **by a shareholder in a scheme of amalgamation** of shares held by him in the amalgamating company
➢ Any transfer by an individual of **sovereign gold bonds issued by RBI by way of redemption**
➢ Any transfer of a capital asset, being **conversion of gold into Electronic Gold Receipt issued by a Vault Manager, or conversion of Electronic Gold Receipt into gold**.

- Any transfer by way of **conversion of bonds, debentures, debenture stock, deposit certificates of a company, into shares or debentures of that company.**
- Any transfer by way of **conversion of preference shares of a company into equity shares** of that company
- Any transfer of a capital asset in a **transaction of reverse mortgage** under a scheme made and notified by the Central Government

Mode of computation of Capital Gains [Section 48]

Computation of long-term capital gains

Full value of consideration received or accruing as a result of transfer	xx
Less: Expenditure incurred wholly and exclusively in connection with such transfer (e.g. brokerage on sale)	xx
Net Sale Consideration	xx
Less: Cost of acquisition and Cost of improvement	xx
However, the cost of acquisition of the asset or the cost of improvement thereto would not include the deductions claimed in respect of interest u/s 24(b) or under the provisions of Chapter VI-A [i.e., under sections 80EE/ 80EEA]	
Less: Exemption under sections 54/54B/54D/54EC/54F	xx
Long-term capital gains	**xx**

Notes:

(i) Deduction on account of securities transaction tax paid will not be allowed.

(ii) A resident individual or a HUF is given an option to take the benefit of indexation in respect of land or building acquired before 23.7.2024, for the purposes of computation of tax liability under section 112.

[Where land or building or both, being a long-term capital asset, acquired before 23.7.2024, the long-term capital gain forming part of gross total income/total income has to be computed without indexation benefit i.e., only cost of acquisition/cost of improvement will be reduced from net consideration and not indexed cost of acquisition/ indexed cost of improvement. The benefit of indexation would be given only while computing tax liability u/s 112, if tax @20% on LTCG computed with indexation benefit is more beneficial to the resident individual/HUF than tax @12.5% on LTCG computed without indexation benefit.

(iii) Indexed Cost of Acquisition =

$$\text{Cost of acquisition} \times \frac{\text{CII for the year in which the asset is transferred}}{\text{CII for the year in which the asset was first held by the assessee or 2001-02, whichever is later}}$$

(iv) Indexed Cost of Improvement =

$$\text{Cost of improvement} \times \frac{\text{CII for the year in which the asset is transferred}}{\text{CII for the year in which the improvement took place}}$$

Computation of short-term capital gains

Full value of consideration received or accruing as a result of transfer	xxx
Less: Expenditure incurred wholly and exclusively in connection with such transfer (e.g. brokerage on sale)	xxx
(Note: Deduction on account of STT paid will not be allowed)	
Net Sale Consideration	xxx
Less: Cost of acquisition and cost of improvement However, the cost of acquisition of the asset or the cost of improvement thereto would not include the deductions claimed on account of interest u/s 24(b) or under the provisions of Chapter VI-A [i.e., under the provisions of sections 80EE/80EEA]	xxx
Less: Exemption under sections 54B/54D	xxx
Short-term capital gains	**xxx**

Capital Gains: Special Provisions

Section	Particulars
50	Any income from transfer of depreciable assets is deemed to be **capital gains arising from transfer of short-term capital assets**, irrespective of the period of holding (i.e., indexation benefit would not be available even if the period of holding of such assets is more than 24 months).
50AA	Any income from transfer of unit of a Specified Mutual Fund acquired on or after 1.4.2023 or Market Linked Debenture or unlisted bond and unlisted debenture is deemed to be capital gains arising from transfer of short-term capital assets.

50B	**Capital Gains on Slump Sale** Any profits and gains arising from slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place. Where the undertaking being transferred under slump sale is held for more than 36 months, the resultant gain is long-term; However, no indexation benefit would be available. If the undertaking is held for less than 36 months, the resultant gain is short-term. **Net worth is deemed to be the cost of acquisition and the cost of improvement -** 'Net worth' shall be aggregate value of total assets *minus* value of liabilities of such undertaking as per books of account. **Fair market value is deemed to be the full value of consideration -** Fair market value of the capital asset as on the date of transfer, calculated in the prescribed manner, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital asset. Accordingly, the CBDT has prescribed that, for the purpose of section 50B(2)(ii), the fair market value (FMV) of capital assets would be the higher of – (i) **FMV 1**, being the fair market value of capital assets transferred by way of slump sale (determined on the date of slump sale); and (ii) **FMV 2**, being the fair market value of the consideration (monetary and non-monetary) received or accruing as a result of transfer by way of slump sale **Capital gains = Fair market value – Net Worth** Aggregate value of total assets would be the aggregate of the following : i) Written Down Value of depreciable assets; ii) Nil, in case of self generated goodwill iii) Nil, in case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as deduction under section 35AD; and iv) Book value for other assets. Revaluation of assets shall be ignored for computing Net Worth.

50C	**Computation of capital gains on sale of land or building or both**

Sl. No.	Condition	Deemed Sale Consideration
1.	Stamp Duty Value > Actual Consideration If Stamp Duty Value > **110%** of actual consideration If Stamp Duty Value ≤ **110%** of actual sale consideration	 Stamp Duty Value Actual sale consideration
2.	Actual Consideration **>** Stamp Duty Value	Actual Sale Consideration
3.	Value ascertained by Valuation Officer **>** Stamp Duty Value	Stamp Duty Value
4.	Value ascertained by Valuation Officer **<** Stamp Duty Value	Value ascertained by Valuation Officer

Note – If the date of agreement is different from the date of transfer, stamp duty value on the date of agreement can be considered, if whole or part of the consideration is received by way of account payee cheque/bank draft or ECS or prescribed electronic modes (IMPS, UPI, RTGS, NEFT, Net banking, debit card, credit card or BHIM Aadhar Pay) on or before the date of agreement. Otherwise, stamp duty value on the date of transfer has to be considered.

50CA	**Fair Market Value deemed to be full value of consideration in case of transfer of unlisted shares in certain cases**

If consideration received or accruing as a result of transfer of unquoted share < FMV of such share determined in the prescribed manner The provisions of this section would not, however, be applicable to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.	FMV of such share determined in the prescribed manner would be deemed as the full value of consideration

<table>
<tr><td>50D</td><td>Fair Market Value deemed to be full value of consideration in certain cases
<table><tr><td>Where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined</td><td>FMV of the said asset on the date of transfer would be deemed as the full value of consideration</td></tr></table></td></tr>
<tr><td>51</td><td>Advance money received and forfeited upto 31.3.2014

Where the assessee has received advance money on an earlier occasion for transfer of capital asset, but the transfer could not be effected due to failure of negotiations, then, the advance money forfeited by the assessee has to be reduced from the cost of acquisition (and indexation would be calculated on the cost so reduced) while computing capital gains, when the capital asset is transferred or sold.

Advance money received and forfeited on or after 1.4.2014

Such advance money received on or after 1.4.2014 would be taxable under section 56(2) under the head “Income from other sources”. Therefore, advance money received and forfeited on or after 1.4.2014 should not be deducted from the cost for determining the indexed cost of acquisition while computing capital gains arising on transfer of the asset.</td></tr>
<tr><td>111A</td><td>Tax on short-term capital gains on transfer of equity shares and units of equity oriented fund on which STT is chargeable
Any short-term capital gains on transfer of equity shares or units of an equity oriented fund on which securities transaction tax has been paid on such sale shall be liable to tax @20%.
In case of resident individuals and HUF, the short-term capital gain shall be reduced by the unexhausted basic exemption limit and the balance shall be taxed at 20%.
No deduction under Chapter VI-A can be claimed in respect of such short-term capital gain.
Short-term capital gains arising from transaction undertaken in foreign currency on a recognized stock exchange located in an International Financial Services Centre (IFSC) would be taxable at a concessional rate of 20%, even when STT is not paid in respect of such transaction.</td></tr>
</table>

112	**Tax on long term capital gains on transfer of capital asset other than referred to in section 112A** ➢ LTCG on transfer of all long-term capital assets (other than referred u/s 112A) would be **taxable @12.5%.** ➢ However, in case of an **individual or HUF, being a resident** in India, **long-term capital gains arising on transfer of long-term capital asset, being land or building or both** if acquired before 23.7.2024 would be taxable @ **12.5% without indexation; or** @ **20% with indexation** **whichever is beneficial.** ➢ Further, in case of **non-residents, LTCG** on transfer of **unlisted securities, or shares of a closely held company**, would be taxable **@12.5% without foreign currency fluctuation.** ➢ **For Individuals or HUF (Residents):** If their total income (excluding long-term capital gains) is below the basic exemption limit, the unadjusted basic exemption limit can be reduced from the long-term capital gains. The remaining amount of long-term capital gains will be taxed at 12.5% or 20%, as the case may be. ➢ **Non-Residents and Foreign Companies:** Long-term capital gains from the transfer of listed shares or debentures of an Indian company (acquired in foreign currency) will be taxed at 12.5% (with foreign currency fluctuation adjustments). ➢ **No Chapter VI-A deduction against LTCG:** The provisions of section 112 make it clear that the deductions under Chapter VIA cannot be availed in respect of the long-term capital gains included in the total income of the assessee.
112A	**Tax on long-term capital gains on certain assets** ➢ Any long-term capital gains **exceeding ₹ 1,25,000** on transfer of equity shares or units of an equity oriented fund shall be liable to tax **@12.5%** on capital gains, if securities transaction tax has been paid on acquisition and such sale in case of equity share, and on such sale in case of units of an equity oriented mutual fund. ➢ In case of **resident individuals and HUF**, the long-term capital gain shall be **reduced by the unexhausted basic exemption limit and the balance shall be taxed at 12.5%**.

	➢ **No deduction under Chapter VI-A or rebate under section 87A** can be claimed in respect of such long-term capital gain, in case the assessee opts out of the default tax regime. Long-term capital gains (in excess of ₹ 1,25,000) arising from transaction undertaken on a recognized stock exchange located in an International Financial Services Centre (IFSC) would be taxable at a concessional rate of 12.5%, where the consideration for transfer is received or receivable in foreign currency, even when STT is not paid in respect of such transaction.

Cost of Acquisition [Section 55]

Sl. No.	Nature of asset	Cost of acquisition
1	Goodwill of business or profession, trademark, brand name or any other intangible asset etc.,	
	- Self generated	Nil
	- Acquired from previous owner	Purchase price
	However, in case of capital asset, being goodwill of a business or profession, in respect of which depreciation u/s 32(1) has been obtained by the assessee in any P.Y. (upto P.Y.2019-20)	Purchase price as reduced by the total amount of depreciation obtained by the assessee under section 32(1).
	- became the property of the assessee by way of distribution of assets on total or partial partition of HUF, under a gift or will by an individual or HUF (by any person upto 31.3.2024, by succession, inheritance, distribution of assets on liquidation of a company, etc. and previous owner has acquired it by purchase	Purchase price for such previous owner
	However, in case of capital asset, being goodwill of a business or profession which was acquired by the previous owner by purchase and in respect of which	Purchase price as reduced by the total amount of depreciation obtained by the assessee under section 32(1).

	depreciation u/s 32(1) has been obtained by the assessee in any P.Y. (upto P.Y.2019-20) The cost of improvement of such assets would be Nil.	
2.	**Bonus shares**	
	If bonus shares are allotted before 1.4.2001	FMV on 1.4.2001
	If bonus shares are allotted on or after 1.4.2001	Nil
	Bonus shares allotted before 1.2.2018, on which STT has been paid at the time of transfer	The higher of – (i) Actual cost of acquisition (i.e., Nil, in case of bonus shares allotted on or after 1.4.2001; and FMV on 1.4.2001, in case of bonus shares allotted before 1.4.2001) (ii) Lower of – (a) FMV as on 31.1.2018; and (b) Actual sale consideration
3.	**Rights Shares**	
	Original shares (which forms the basis of entitlement of rights shares)	Amount actually paid for acquiring the original shares
	Rights shares subscribed for by the assessee	Amount actually paid for acquiring the rights shares
	Rights entitlement (which is renounced by the assessee in favour of a person)	Nil
	Rights shares which are purchased by the person in whose favour the assessee has renounced the rights entitlement	Purchase price paid to the renouncer of rights entitlement as well as the amount paid to the Co. which has allotted the rights shares.
4.	**Long term capital assets** being, - **equity shares** in a company on which STT is paid both at the time of purchase and transfer or	Cost of acquisition shall be the higher of - (i) cost of acquisition of such asset; and

	- **unit of equity oriented fund** on which STT is paid at the time of transfer. **acquired before 1st February, 2018**	(ii) lower of - the FMV of such asset on 31.1.2018; and - the full value of consideration recd or accruing as a result of the transfer of the capital asset.
5.	**Any other capital asset** Where such capital asset became the property of the assessee before 1.4.2001	Cost of the asset to the assessee, or FMV as on 1.4.2001, at the option of the assessee. However, in case of capital asset being land or building, FMV as on 1.4.2001 shall not exceed stamp duty value as on 1.4.2001.
	Where capital assets became the property of the assessee by way of distribution of assets on total or partial partition of HUF, under a gift or will, by succession, inheritance by an individual or HUF (by any person upto 31.3.2024), distribution of assets on liquidation of a company, etc. and the capital asset became the property of the previous owner before 1.4.2001.	Cost to the previous owner or FMV as on 1.4.2001, at the option of the assessee. However, in case of capital asset being land or building, FMV as on 1.4.2001 shall not exceed stamp duty value as on 1.4.2001.
	The provisions contained in (5) above shall also apply to the assets mentioned in (3) and (4) above.	
	Cost of the property in the hands of previous owner **cannot be ascertained**	The FMV on the date on which the capital asset become the property of the previous owner would be considered as cost of acquisition.

Cost of improvement of certain assets [Section 55]

Sl. No.	Nature of asset	Cost of improvement
1	Goodwill or any other intangible asset of a business, right to manufacture, produce or process any article or thing, right to carry on any business or profession or any other right.	Nil
2	Where the capital asset became the property of the previous owner or the assessee before 1-4-2001	All expenditure of a capital nature incurred in making any addition or alteration to the capital asset on or after 1.4.2001 by the previous owner or the assessee.
3	In relation to any other capital asset	All capital expenditure incurred in making additions or alterations to the capital asset on or after 1.4.2001 – - by the assessee after it became his property; and - by the previous owner [in a case where the assessee acquired the property by modes specified in section 49(1)].

Capital Gains: Exemptions under section 10

Section	Particulars
10(37)	Where any individual or HUF owns urban agricultural land which has been **used for agricultural purposes for a period of two years** immediately preceding the date of transfer by such individual or a parent of his or by such HUF and the same is compulsorily acquired under any law or the consideration for such transfer is determined or approved by the Central Government or the RBI, resultant capital gain will be exempt provided the compensation or consideration for such transfer is received on or after 1.4.2004.
10(43)	The amount received by the senior citizen as a loan, either in lump sum or in installments, in a transaction of reverse mortgage would be exempt from income-tax.

Exemption of Capital Gains [Sections 54 to 54F]						
S. No.	**Particulars**	**Section 54**	**Section 54B**	**Section 54D**	**Section 54EC**	**Section 54F**
1	**Eligible Assessee**	Individual/ HUF	Individual/ HUF	Any assessee	Any assessee	Individual/ HUF
2	**Asset transferred**	Residential House (LTCA)	Urban Agricultural Land	Land & building forming part of an industrial undertaking	Land or building or both (LTCA)	Any LTCA other than Residential House.
3	**Other Conditions**	Income from such house should be chargeable under the head "Income from house property"	Land should be used for agricultural purposes by assessee or his parents or HUF for 2 years immediately preceding the date of transfer	Land & building have been used for business of undertaking for at least 2 years immediately preceding the date of transfer. The transfer should be by way of compulsory acquisition of the industrial undertaking	-	Assessee should **not** own more than one residential house on the date of transfer. He should **not** purchase within 2 years or construct within 3 years after the date of transfer, another residential house.

4	**Qualifying asset i.e., asset in which capital gains has to be invested**	One Residential House situated in India/Two residential houses in India, at the option of the assessee, where capital gains does **not** exceed ₹ 2 crore	Land for being used for agricultural purpose (Urban/ Rural)	Land or Building or right in land or building	Bonds of NHAI or RECL or any other bond notified by C.G. (Redeemable after 5 years)	One Residential House situated in India
5	**Time limit for purchase/ construction**	Purchase within 1 year before or 2 years after the date of transfer **(or)** construct within 3 years after the date of transfer	Purchase within a period of 2 years after the date of transfer	Purchase/ construct within 3 years after the date of transfer, for shifting or re-establishing the existing undertaking or setting up a new industrial undertaking.	Purchase within a period of 6 months after the date of transfer	Purchase within 1 year before or 2 years after the date of transfer **(or)** Construct within 3 years after the date of transfer
6	**Amount of Exemption**	Cost of new Residential House or two houses, as the case may be or Capital Gain,	Cost of new Agricultural Land or Capital Gain, whichever is lower, is exempt	Cost of new asset or Capital Gain, whichever is lower.	Capital Gain or amount invested in specified bonds, whichever is lower.	Cost of new Residential House ≥ Net sale consideration of original asset, entire Capital gain is

		whichever is lower, is exempt. However, if the cost of new residential house exceeds ₹ 10 crore, the amount exceeding ₹ 10 crore would not be taken into account for exemption. The maximum exemption that can be claimed by the assessee is ₹ 10 crore.			Maximum permissible investment out of capital gains arising in any financial year is ₹ 50 lakhs, whether such investment is made in the current FY or subsequent FY or both.	exempt. Cost of new Residential House < Net sale consideration of original asset, proportionate capital gain is exempt. However, if the cost of new residential house exceeds ₹ 10 crore, the amount exceeding ₹ 10 crore would not be taken into account for exemption.

TEST YOUR KNOWLEDGE

1. *Mr. Mithun purchased 100 equity shares of M/s Goodmoney Co. Ltd. on 01-04-2007 at rate of ₹ 1,000 per share in public issue of the company by paying securities transaction tax.*

   Company allotted bonus shares in the ratio of 1:1 on 01.12.2024. He has also received dividend of ₹ 10 per share on 01.05.2025.

   He has sold all the shares on 01.10.2025 at the rate of ₹ 4,000 per share through a recognized stock exchange and paid brokerage of 1% and securities transaction tax of 0.02%.

   Compute his total income and tax liability for A.Y. 2026-27 if Mr. Mithun opts out of the default tax regime, assuming that he is having other income of ₹ 8,00,000. Fair market value of each share of M/s Goodmoney Co. Ltd. on 31.1.2018 is ₹ 2,000.

2. *Aarav converts his plot of land purchased in July, 2004 for ₹ 80,000 into stock-in-trade on 31^{st} March, 2025. The fair market value as on 31.3.2025 was ₹ 3,00,000. The stock-in-trade was sold for ₹ 3,25,000 in the month of January, 2026.*

   Find out the taxable income, if any, and if so under which head of income and for which Assessment Year?

   Cost Inflation Index: F.Y. 2004-05:113; F.Y. 2024-25: 363; F.Y. 2025-26: 376;

3. *Mrs. Harshita purchased a land at a cost of ₹ 35 lakhs in the F.Y. 2004-05 and held the same as her capital asset till 20th March, 2024.*

   She started her real estate business on 21st March, 2024 and converted the said land into stock-in-trade of her business on the said date, when the fair market value of the land was ₹ 210 lakhs.

   She constructed 15 flats of equal size, quality and dimension. Cost of construction of each flat is ₹ 10 lakhs. Construction was completed in February, 2026. She sold 10 flats at ₹ 30 lakhs per flat in March, 2026. The remaining 5 flats were held in stock as on 31st March, 2026.

She invested ₹ 50 lakhs in bonds issued by National Highways Authority of India on 31st March, 2026 and another ₹ 50 lakhs in bonds of Rural Electrification Corporation Ltd. in April, 2026.

Compute the amount of chargeable capital gain and business income in the hands of Mrs. Harshita arising from the above transactions for A.Y. 2026-27 indicating clearly the reasons for treatment for each item.

[Cost Inflation Index: F.Y. 2004-05: 113; F.Y. 2023-24: 348; F.Y. 2025-26: 376].

4. *Mr. A is an individual carrying on business. His stock and machinery were damaged and destroyed in a fire accident which occurred in December 2025.*

The value of stock lost (total damaged) was ₹ 6,50,000. Certain portion of the machinery could be salvaged. The opening balance of the block as on 1.4.2025 (i.e., WDV as on 31.3.2025 after providing depreciation for P.Y. 2024-25) was ₹ 10,80,000.

During the process of safeguarding machinery and in the fire fighting operations, Mr. A lost his gold chain and a diamond ring, which he had purchased in April, 2005 for ₹ 1,20,000. The market value of these two items as on the date of fire accident was ₹ 1,80,000.

Mr. A received the following amounts from the insurance company:

(i)	*Towards loss of stock*	*₹ 4,80,000*
(ii)	*Towards damage of machinery*	*₹ 6,00,000*
(iii)	*Towards gold chain and diamond ring*	*₹ 1,80,000*

You are requested to briefly comment on the tax treatment of the above three items under the provisions of the Income-tax Act, 1961.

5. *Mr. Sarthak entered into an agreement with Mr. Jaikumar to sell his residential house located at Kanpur on 16.08.2025 for ₹ 1,50,00,000.*

The sale proceeds were to be paid in the following manner:

(i) 20% through account payee bank draft on the date of agreement.

(ii) 60% on the date of the possession of the property.

(iii) Balance after the completion of the registration of the title to the property.

Mr. Jaikumar was handed over the possession of the property on 15.12.2025 and the registration process was completed on 14.01.2026. He paid the sale proceeds as per the sale agreement.

The value determined by the Stamp Duty Authority-

(a) on 16.08.2025 was ₹ 1,70,00,000;

(b) on 15.12.2025 was ₹ 1,71,00,000; and

(c) on 14.01.2026 was ₹ 1,71,50,000.

Mr. Sarthak had acquired the residential house at Kanpur on 01.04.2001 for ₹ 30,00,000. After recovering the sale proceeds from Jaikumar, he purchased two residential house properties, one in Kanpur for ₹ 20,00,000 on 24.3.2026 and another in Delhi for ₹ 35,00,000 on 28.5.2026.

Compute the income chargeable under the head "Capital Gains" of Mr. Sarthak for the Assessment Year 2026-27.

Cost Inflation Index for Financial Year(s): 2001-02 - 100; 2025-26 - 376

6. *Mrs. Yuvika bought a vacant land for ₹ 80 lakhs in May 2005. Registration and other expenses were 10% of the cost of land. She constructed a residential building on the said land for ₹ 100 lakhs during the financial year 2007-08.*

She entered into an agreement for sale of the above said residential house with Mr. Johar (not a relative) in April 2015. The sale consideration was fixed at ₹ 700 lakhs and on 23.4.2015, Mrs. Yuvika received ₹ 20 lakhs as advance in cash by executing an agreement. However, due to failure on part of Mr. Johar, the said negotiation could not materialise and hence, the said amount of advance was forfeited by Mrs. Yuvika.

Mrs. Yuvika, again entered into an agreement on 01.05.2025 for sale of this house at ₹ 810 lakhs. She received ₹ 80 lakhs as advance by RTGS. The stamp duty value on the date of agreement was ₹ 890 lakhs. The sale deed was executed and registered on 14.07.2025 for the agreed consideration. However, the State stamp valuation authority had revised the values, hence, the value of property for stamp duty purposes was ₹ 900 lakhs. Mrs. Yuvika paid 1% as brokerage on sale consideration received.

Subsequent to sale, Mrs. Yuvika made following acquisition/investments:

(i) Acquired two residential houses at Delhi and Chandigarh for ₹ 130 lakhs and ₹ 50 lakhs, respectively, on 31.1.2026 and 15.5.2026

(ii) Acquired a residential house at UK for ₹ 180 lakhs on 23.3.2026.

(iii) Subscribed to NHAI capital gains bond (approved under section 54EC) for ₹ 50 lakhs on 30.11.2025 and for ₹ 40 lakhs on 9-1-2026.

Compute the income chargeable under the head 'Capital Gains' of Mrs. Yuvika for A.Y.2026-27. The choice of exemption must be in the manner most beneficial to the assessee.

Cost Inflation Index: F.Y. 2005-06 – 117; F.Y. 2007-08 – 129; F.Y. 2025-26 - 376.

7. *Mr. Shiva purchased a house property on February 15, 1979 for ₹ 3,24,000. In addition, he has also paid stamp duty @10% on the stamp duty value of ₹ 3,50,000.*

In April, 2008, Mr. Shiva entered into an agreement with Mr. Mohan for sale of such property for ₹ 14,35,000 and received an amount of ₹ 1,11,000 as advance. However, the sale consideration did not materialize and Mr. Shiva forfeited the advance. In May 2015, he again entered into an agreement for sale of said house for ₹ 20,25,000 to Ms. Deepshikha and received ₹ 1,51,000 as advance. However, as Ms. Deepshikha did not pay the balance amount, Mr. Shiva forfeited the advance. In August, 2015, Mr. Shiva constructed the first floor by incurring a cost of ₹ 3,90,000.

On November 15, 2025, Mr. Shiva entered into an agreement with Mr. Manish for sale of such house for ₹ 30,50,000 and received an amount of ₹ 1,50,000 as advance through an account payee cheque. Mr. Manish paid the balance entire sum and Mr. Shiva transferred the house to Mr. Manish on February 20, 2026. Mr. Shiva has paid the brokerage @1% of sale consideration to the broker.

On April 1, 2001, fair market value of the house property was ₹ 11,85,000 and Stamp duty value was ₹ 10,70,000. Further, the Valuation as per Stamp duty Authority of such house on 15th November, 2025 was ₹ 39,00,000 and on 20th February, 2026 was ₹ 41,00,000.

Compute the capital gains in the hands of Mr. Shiva for A.Y.2026-27. Also, compute the tax liability under section 112, assuming that the basic exemption limit has been fully exhausted against other income.

CII for F.Y. 2001-02: 100; F.Y. 2008-09: 137; F.Y. 2015-16: 254; F.Y. 2025-26: 376

8. *Determine the capital gains/loss on transfer of listed equity shares (STT paid both at the time of acquisition and transfer of shares) and units of equity oriented mutual fund (STT paid at the time of transfer of units) for the A.Y.2026-27 and tax, if any, payable thereon, in the following cases, assuming that these are the only transactions covered under section 112A during the P.Y.2025-26 in respect of these assessees:*

   (i) *Mr. Shagun purchased 300 shares in A Ltd. on 20.5.2017 at a cost of ₹ 400 per share. He sold all the shares of A Ltd. on 31.5.2025 for ₹ 1200. The price at which these shares were traded in National Stock Exchange on 31.1.2018 is as follows –*

Particulars	**Amount in ₹**
Highest Trading Price	*700*
Average Trading Price	*680*
Lowest Trading Price	*660*

   (ii) *Mr. Raj purchased 200 units of equity-oriented fund, Fund A on 1.2.2017 at a cost of ₹ 550 per unit. The units were not listed at the time of purchase. Subsequently, units of Fund A were listed on 1.1.2018 on the National Stock Exchange. Mr. Raj sold all the units on 3.4.2025 for ₹ 900 each. The details relating to quoted price on National Stock Exchange and net asset value of the units are given hereunder:*

Particulars	**Fund A**
	Amount in ₹
Highest Trading Price	*750 (on 31.1.2018)*
Average Trading Price	*700 (on 31.1.2018)*
Lowest Trading Price	*650 (on 31.1.2018)*
Net Asset Value on 31.1.2018	*800*

ANSWERS

1. Computation of total income & tax liability of Mr. Mithun for A.Y. 2026-27

Particulars		₹
Long term capital gains on sale of original shares		
Gross sale consideration (100 x ₹ 4,000)		4,00,000
Less: Brokerage@1%		4,000
Net sale consideration		3,96,000
Less: Cost of acquisition (100 x ₹ 2,000) **(Refer Note 1)**		2,00,000
Long term capital gains		**1,96,000**
Short term capital gains on sale of bonus shares		
Gross sale consideration (100 x ₹ 4,000)		4,00,000
Less: Brokerage@1%		4,000
Net sale consideration		3,96,000
Less: Cost of acquisition of bonus shares [Nil as such shares are allotted after 1.04.2001]		NIL
Short term capital gains [Since bonus shares are held for less than 12 months before sale]		**3,96,000**
Income from other sources		
Dividend received from M/s Goodmoney Co. Ltd. is taxable in the hands of shareholders [200 shares x 10 per share]		2,000
Other income		8,00,000
Total Income		**13,94,000**
Tax Liability		
Tax on STCG u/s 111A		
20% of ₹ 3,96,000		79,200
Tax on LTCG u/s 112A		
12.5% of (₹ 1,96,000 - ₹ 1,25,000)		8,875
Tax on other income of ₹ 8,02,000		
₹ 2,50,000 to ₹ 5,00,000@5%	12,500	
₹ 5,00,000 to ₹ 8,02,000 @20%	60,400	72,900
		1,60,975
Add: Health and education cess @4%		6,439
Tax liability		**1,67,414**
Tax liability (rounded off)		**1,67,410**

Notes:

(1) Cost of acquisition of such equity shares acquired before 1.2.2018 is higher of

- Cost of acquisition i.e., ₹ 1,000 per share and
- lower of

  Fair market value of such asset i.e., ₹ 2,000 per share and

  Full value of consideration i.e., ₹ 4,000 per share.

Therefore, the cost of acquisition of original share is ₹ 2,000 per share.

(2) Securities transaction tax is not allowable as deduction.

2. Conversion of a capital asset into stock-in-trade is a transfer within the meaning of section 2(47) in the previous year in which the asset is so converted. However, the capital gains will be charged to tax only in the year in which the stock-in-trade is sold.

The fair market value on the date of conversion would be deemed to be the full value of consideration for transfer of the asset as per section 45(2). The sale price less the fair market value on the date of conversion would be treated as the business income of the year in which the stock-in-trade is sold.

Therefore, in this problem, both capital gains and business income would be charged to tax in the A.Y. 2026-27.

Particulars	**₹**	
Profits & Gains of Business or Profession		
Sale price of stock-in-trade	3,25,000	
Less: Fair market value on the date of conversion	3,00,000	
		25,000
Capital Gains		
Full value of consideration (Fair market value on the date of conversion)	3,00,000	
Less: Cost of acquisition [No indexation benefit since conversion took place on or after 23.7.2024)	80,000	
Long-term capital gain		**2,20,000**
Taxable Income		**2,45,000**

3. **Computation of capital gains and business income of Harshita for A.Y. 2026-27**

Particulars	₹
Business Income	
Sale price of flats [10 × ₹ 30 lakhs]	3,00,00,000
Less: Cost of flats	
Fair market value of land on the date of conversion [₹ 210 lakhs × 2/3]	1,40,00,000
Cost of construction of flats [10 × ₹ 10 lakhs]	1,00,00,000
Business income chargeable to tax for A.Y.2026-27	**60,00,000**
Capital Gains	
Fair market value of land on the date of conversion deemed as the full value of consideration for the purposes of section 45(2)	2,10,00,000
Less: Indexed cost of acquisition [₹ 35,00,000 × 348/113]	1,07,78,761
	1,02,21,239
Proportionate capital gains arising during A.Y. 2026-27 [₹ 1,02,21,239 x 2/3]	68,14,159
Less: Exemption under section 54EC	50,00,000
Capital gains chargeable to tax for A.Y.2026-27	**18,14,159**

Notes:

(1) The conversion of a capital asset into stock-in-trade is treated as a transfer under section 2(47). It would be treated as a transfer in the year in which the capital asset is converted into stock-in-trade (i.e., P.Y.2023-24, in this case).

(2) As per section 45(2), the capital gains arising from the transfer by way of conversion of capital assets into stock-in-trade will be chargeable to tax only in the year in which the stock-in-trade is sold.

(3) Since the capital asset is converted into stock in trade in P.Y. 2023-24 i.e., before 23.7.2024, the indexation benefit would be available. However, it will be available only up to the year of conversion of capital asset into stock-in-trade (i.e., P.Y.2023-24) and not up to the year of sale of stock-in-trade (i.e., P.Y.2025-26).

(4) For the purpose of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted into stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

In this case, since only 2/3rd of the stock-in-trade (10 flats out of 15 flats) is sold in the P.Y.2025-26, only proportionate capital gains (i.e., 2/3rd) would be chargeable to tax in the A.Y.2026-27.

(5) On sale of such stock-in-trade, business income would arise. The business income chargeable to tax would be the difference between the price at which the stock-in-trade is sold and the fair market value on the date of conversion of the capital asset into stock-in-trade.

(6) In case of conversion of capital asset into stock-in-trade and subsequent sale of stock-in-trade, the period of 6 months is to be reckoned from the date of sale of stock-in-trade for the purpose of exemption under section 54EC [*CBDT Circular No.791 dated 2.6.2000]*. In this case, since the investment in bonds of NHAI has been made within 6 months of sale of flats, the same qualifies for exemption under section 54EC. With respect to long-term capital gains arising on land or building or both in any financial year, the maximum deduction under section 54EC would be ₹ 50 lakhs, whether the investment in bonds of NHAI or RECL are made in the same financial year or next financial year or partly in the same financial year and partly in the next financial year.

Therefore, even though investment of ₹ 50 lakhs has been made in bonds of NHAI during the P.Y. 2025-26 and investment of ₹ 50 lakhs has been made in bonds of RECL during the P.Y. 2026-27, both within the stipulated six month period, the maximum deduction allowable for A.Y. 2026-27, in respect of long-term capital gain arising on sale of long-term capital asset(s) during the P.Y. 2025-26, is only ₹ 50 lakhs.

4. **(i)** **Compensation towards loss of stock:** Any compensation received from the insurance company towards loss/damage to stock in trade is to be construed as a trading receipt. Hence, ₹ 4,80,000 received as insurance claim for loss of stock has to be assessed under the head "Profit and gains of business or profession".

Note - The assessee can claim the value of stock destroyed by fire as revenue loss, eligible for deduction while computing income under the head "Profits and gains of business or profession".

(ii) **Compensation towards damage to machinery:** The question does not mention whether the salvaged machinery is taken over by the Insurance company or whether there was any replacement of machinery during the year. Assuming that the salvaged machinery is taken over by the Insurance company, and there was no fresh addition of machinery during the year, the block of machinery will cease to exist. Therefore, ₹ 4,80,000 being the excess of written down value (i.e. ₹ 10,80,000) over the insurance compensation (i.e. ₹ 6,00,000) will be assessable as a short-term capital loss.

Note – If new machinery is purchased in the next year, it will constitute the new block of machinery, on which depreciation can be claimed for that year.

(iii) **Compensation towards loss of gold chain and diamond ring:** Gold chain and diamond ring are capital assets as envisaged by section 2(14). They are not "personal effects", which alone are to be excluded. If any profit or gain arises in a previous year owing to receipt of insurance claim, the same shall be chargeable to tax as capital gains. The capital gains has to be computed by reducing the cost of acquisition of jewellery from the insurance compensation of ₹ 1,80,000.

5. **Computation of income chargeable under the head "Capital Gains" of Mr. Sarthak for A.Y. 2026-27**

Particulars		₹
Capital Gains on sale of residential house		
Actual sale consideration	₹ 1,50,00,000	
Value adopted by Stamp Valuation Authority on the date of agreement	₹ 1,70,00,000	

[As per section 50C, where the actual sale consideration is less than the value adopted by the Stamp Valuation Authority for the purpose of charging stamp duty, and such stamp duty value exceeds 110% of the actual sale consideration, then, the value adopted by the Stamp Valuation Authority shall be taken to be the full value of consideration. In a case where the date of agreement is different from the date of registration, stamp duty value on the date of agreement can be considered provided the whole or part of the consideration is paid by way of account payee cheque/bank draft or by way of ECS through bank account or through such other electronic mode as may be prescribed, on or before the date of agreement. In this case, since 20% of ₹ 150 lakhs is paid through account payee bank draft on the date of agreement, stamp duty value on the date of agreement would be considered for determining the full value of consideration]	
Full value of sale consideration [Stamp duty value on the date of agreement, since it exceeds 110% of the actual sale consideration]	1,70,00,000
Less: Cost of acquisition of residential house	30,00,000
Long-term capital gains [Since the residential house property was held by Mr. Sarthak for more than 24 months immediately preceding the date of its transfer]	**1,40,00,000**
Less: **Exemption u/s 54**	55,00,000
Since, long-term capital gains does not exceed ₹ 2 crore, he would be eligible for exemption in respect of both the residential house properties purchased in India. The capital gain arising on transfer of a long-term residential property shall not be chargeable to tax to the extent such capital gain is invested in the purchase of these residential house properties in India within one year before or two years after the date of transfer of original asset. Thus, he would be eligible for exemption of ₹ 55,00,000 being ₹ 20,00,000 and ₹ 35,00,000 invested on acquisition of residential house property in Kanpur and Delhi, respectively.	
Long term capital gains chargeable to tax	**85,00,000**

Note: It may be noted that since Sarthak has transferred residential house which was acquired before 23.7.2024, he can opt to pay tax @20% on LTCG (computed with indexation) or 12.5% on LTCG (computed without indexation) whichever is beneficial to him while computing his tax liability.

6. Computation of income chargeable under the head "Capital Gains" of Mrs. Yuvika for A.Y.2026-27

Particulars	₹ (in lakhs)	₹ (in lakhs)
Capital Gains on sale of residential building Actual sale consideration ₹ 810 lakhs Value adopted by Stamp Valuation Authority ₹ 890 lakhs [Where the actual sale consideration is less than the value adopted by the Stamp Valuation Authority for the purpose of charging stamp duty, and such stamp duty value exceeds 110% of the actual sale consideration, then, the value adopted by the Stamp Valuation Authority shall be taken to be the full value of consideration as per section 50C. However, where the date of agreement is different from the date of registration, stamp duty value on the date of agreement can be considered provided the whole or part of the consideration is received by way of account payee cheque/bank draft or by way of ECS through bank account or through prescribed electronic modes on or before the date of agreement. In this case, since advance of ₹ 80 lakh is received by RTGS, i.e., one of the prescribed modes, stamp duty value on the date of agreement can be adopted as the full value of consideration. However, in the present case since stamp duty value on the date of agreement does not exceed 110% of the actual consideration, actual sale consideration would be taken as the full value of consideration]		

Gross Sale consideration (Actual consideration, since stamp duty value on the date of agreement does not exceed 110% of the actual consideration)		810.00
Less: Brokerage @1% of sale consideration (1% of ₹ 810 lakhs)		8.10
Net Sale consideration		801.90
Less: Cost of acquisition		
- Cost of vacant land, ₹ 80 lakhs, *plus* registration and other expenses i.e., ₹ 8 lakhs, being 10% of cost of land	88	
- Construction cost of residential building	100	188.00
Long-term capital gains		**613.90**
Since the residential house property was held by Mrs. Yuvika for more than 24 months immediately preceding the date of its transfer, the resultant gain is a long-term capital gain]		
Less: **Exemption under section 54**		130.00
Where long-term capital gains exceed ₹ 2 crore, the capital gain arising on transfer of a long-term residential property shall not be chargeable to tax to the extent such capital gain is invested in the purchase of one residential house property in India, one year before or two years after the date of transfer of original asset. Therefore, in the present case, the exemption would be available only in respect of the one residential house acquired in India and not in respect of the residential house in UK. It would be more beneficial for her to claim the cost of acquisition of residential house at Delhi, i.e., ₹ 130 lakhs as exemption.		

***Less:* Exemption under section 54EC** Amount invested in capital gains bonds of NHAI within six months after the date of transfer (i.e., on or before 13.1.2026), of long-term capital asset, being land or building or both, would qualify for exemption, to the maximum extent of ₹ 50 lakhs, whether such investment is made in the current financial year or subsequent financial year. Therefore, in the present case, exemption can be availed only to the extent of ₹ 50 lakh out of ₹ 90 lakhs, even if the both the investments are made on or before 13.1.2026 (i.e., within six months after the date of transfer).		50.00
Long term capital gains chargeable to tax		**433.90**

Notes:

(1) Advance of ₹ 20 lakhs received from Mr. Johar, would have been chargeable to tax under the head "Income from other sources", in the A.Y. 2016-17, as per section 56(2)(ix), since the same was forfeited on or after 01.4.2014 as a result of failure of negotiation. Hence, the same should not be deducted while computing indexed cost of acquisition.

(2) It may be noted that since Yuvika has transferred residential building which was acquired before 23.7.2024, she can opt to pay tax @20% on LTCG (computed with indexation) or 12.5% on LTCG (computed without indexation) whichever is beneficial to her while computing her tax liability.

7. **Computation of Capital gains in the hands of Mr. Shiva for A.Y. 2026-27**

Particulars	Amount (₹)	Amount (₹)
Actual sale consideration	30,50,000	
Valuation as per Stamp duty Authority on the date of agreement	39,00,000	
(Where the actual sale consideration is less than the value adopted by the Stamp Valuation Authority for the purpose of		

charging stamp duty, and such stamp duty value exceeds 110% of the actual sale consideration then, the value adopted by the Stamp Valuation Authority shall be taken to be the full value of consideration as per section 50C. However, where the date of agreement is different from the date of registration, stamp duty value on the date of agreement can be considered, provided the whole or part of the consideration is received by way of account payee cheque/bank draft or by way of ECS through bank account or such other electronic mode as may be prescribed on or before the date of agreement. In the present case, since part of the payment is made by account payee cheque on the date of agreement, the stamp duty value on the date of agreement would be considered as full value of consideration)		
Deemed Full value of consideration [Since stamp duty value on the date of agreement exceeds 110% of the actual consideration, stamp duty value would be deemed as Full Value of Consideration]		**39,00,000**
Less: Expenses on transfer (Brokerage @1% of ₹ 30,50,000)		30,500
Net sale consideration		**38,69,500**
Less: Cost of acquisition **(Note 1)**	9,59,000	
Less: Cost of improvement	3,90,000	13,49,000
Long term capital gain		**25,20,500**

Computation of tax liability u/s 112

Particulars		Amount (₹)
On LTCG of ₹ 25,20,500 x 12.5%		3,15,063
Add: Health and Education cess @4%		12,603
		3,27,666
On LTCG with indexation benefit		
Net Sale consideration	38,69,500	
Less: Indexed cost of acquisition (₹ 9,59,000 x 376/100)	36,05,840	
Less: Indexed cost of Improvement [₹ 3,90,000 x 376/254]	5,77,323	
Long-term capital loss	(3,13,663)	
Since the computation results in a long term capital loss, if indexation benefit is given, the tax u/s 112 would be Nil. However, this computation is only for determining tax liability, the said loss can neither be set-off nor carried forward.		

Notes:

(1) **Computation of cost of acquisition**

Particulars	Amount (₹)	Amount (₹)
Cost of acquisition,		10,70,000
Being the higher of		
(i) lower of Fair market value i.e., ₹ 11,85,000 and Stamp duty value i.e., ₹ 10,70,000, on April 1, 2001	10,70,000	
(ii) Actual cost of acquisition (₹ 3,24,000 + ₹ 35,000, being stamp duty @10% of ₹ 3,50,000)	3,59,000	
Less: Advance money taken from Mr. Mohan and forfeited		1,11,000
Cost of acquisition		**9,59,000**

(2) Where advance money has been received by the assessee, and retained by him, as a result of failure of the negotiations, section 51 will apply. The advance retained by the assessee will go to reduce the cost of acquisition. Accordingly, cost of acquisition after reducing the advance money forfeited would be ₹ 9,59,000 [i.e. ₹ 10,70,000 – ₹ 1,11,000 (being the advance money forfeited during the P.Y. 2008-09)]. However, where the advance money is forfeited during the previous year 2014-15 or thereafter, the amount forfeited would be taxable under the head "Income from Other Sources" and such amount will not be deducted from the cost of acquisition of such asset while calculating capital gains. Hence, ₹ 1,51,000, being the advance received from Ms. Deepshikha and retained by him, would have been taxable under the head "Income from other sources" in the hands of Mr. Shiva in A.Y.2016-17.

8. For the purpose of computation of long-term capital gains chargeable to tax under section 112A, the cost of acquisition in relation to the long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust acquired before 1st February, 2018 shall be the higher of

(a) cost of acquisition of such asset, i.e., actual cost; and

(b) lower of

(i) the fair market value of such asset as on 31.1.2018; and

(ii) the full value of consideration received or accruing as a result of the transfer of the capital asset.

(i) The fair market value of listed equity shares as on 31.1.2018 is the highest price quoted on the recognized stock exchange as on that date.

Accordingly, long-term capital gain on transfer of STT paid listed equity shares by Mr. Shagun would be determined as follows:

The FMV of shares of A Ltd. would be ₹ 700, being the highest price quoted on National Stock Exchange on 31.1.2018. The cost of acquisition of each equity share in A Ltd. would be ₹ 700, being higher of actual cost i.e., ₹ 400 and ₹ 700 [being the lower of FMV of ₹ 700 as on 31.1.2018 (i.e., the highest trading price) and actual sale consideration of ₹ 1,200]. Thus, the long-term capital gain would be ₹ 1,50,000 i.e., (₹ 1,200 – ₹ 700) x 300 shares. The long-term capital gain of ₹ 25,000 (i.e., the amount in excess of ₹ 1,25,000) would be subject to tax@12.5% under section 112A (*plus* cess@4%), without benefit of indexation. The tax on capital gain @13% would be ₹ 3,250 (₹ 25,000 x 13%)

(ii) In the case of units listed on recognised stock exchange on the date of transfer, the FMV as on 31.1.2018 would be the highest trading price on recognised stock exchange as on 31.1.2018 (if units are listed on that date), else, it would be the net asset value as on 31.1.2018 (where units are unlisted on that date).

Accordingly, the FMV of units of Fund A as on 31.1.2018 would be ₹ 750 (being the highest trading price on 31.1.2018, since the units of Fund A are listed on that date).

The cost of acquisition of a unit of Fund A would be ₹ 750, being higher of actual cost i.e., ₹ 550 and ₹ 750 (being the lower of FMV of ₹ 750 as on 31.1.2018 and actual sale consideration of ₹ 900). Thus, the long-term capital gains on sale of units of Fund A would be ₹ 30,000 (₹ 900 – ₹ 750) x 200 units.

Since the long-term capital gains on sale of units of Fund A is ₹ 30,000, which is less than ₹ 1,25,000, the said sum is not chargeable to tax under section 112A.

UNIT – 5 : INCOME FROM OTHER SOURCES

LEARNING OUTCOMES

After studying this unit, you would be able to-

- **identify** the income, which are chargeable to tax under the head "Income from other sources";
- **examine** the transactions of receipt of money and property without consideration or for inadequate consideration to determine whether such receipts are chargeable to tax under this head;
- **identify and comprehend** the admissible deductions while computing income under this head;
- **identify and comprehend** the inadmissible deductions while computing income under this head;
- **compute** the tax on casual income by applying the rate of tax applicable on such income;
- **compute** the income chargeable to tax under this head.

Proforma for computation of "Income from Other Sources"

	Particulars		Amt
(i)	Dividend Income		xxx
(ii)	Casual Income (winnings from lotteries, crossword puzzles, races including horse races, card games and other games, gambling, betting etc.)		xxx
(iii)	Interest received on compensation/ enhanced compensation deemed to be income in the year of receipt [Section 56(2)(viii)]		xxx
(iv)	Advance forfeited due to failure of negotiations for transfer of a capital asset [Section 56(2)(ix)]		xxx
(v)	Sum of money or property received by any person [Section 56(2)(x)]		xxx
(vi)	Compensation or other payment, due to or received by any person, in connection with termination of his employment or the modification of the terms and conditions relating thereto [Section 56(2)(xi)]		xxx
(vii)	Sum received, including the amount allocated by way of bonus, under a LIP other than under a ULIP and keyman insurance policy, which is not exempt u/s 10(10D) [Section 56(2)(xii)]		xxx
(viii)	The following income, if not chargeable under the head "Profits and gains of business or profession"		
	(a) Any sum received by an employer from his employees as contributions to any provident fund, superannuation fund or any other fund for the welfare of the employees	xxx	
	(b) Interest on securities	xxx	
	(c) Income from letting out on hire of machinery, plant or furniture	xxx	
	(d) Where letting out of buildings is inseparable from the letting out of machinery, plant or furniture, the income from such letting	xxx	
	(e) Any sum received under a Keyman insurance policy including bonus on such policy (if not chargeable to tax under the head "Salaries" also)	xxx	xxx
(ix)	Any income chargeable to tax under the Act, but not falling under any other head of income		xxx

(x)	Deemed income u/s 59 – Remission or cessation of a trading liability or receipt of any amount in respect of loss or expenditure allowed as deduction in an earlier P.Y.		xxx
			xxx
***Less:* Deductions allowable [Section 57]**			
(a)	**In case of dividends [other than dividend referred u/s 2(22)(f)] or income in respect of units of a mutual fund or income in respect of units from a specified company** - interest expenditure allowable as deduction subject to a maximum of 20% of such income included in the total income for that year, without deduction under this section	xxx	
(b)	**In case of interest on securities** - Any reasonable sum paid by way of commission or remuneration to a banker or any other person	xxx	
(c)	**Income consists of recovery from employees as contribution to any PF, superannuation fund etc.** - Amount of contribution remitted before the due date under the respective Acts, in accordance with the provisions of section 36(1)(va)	xxx	
(d)	**Income from letting on hire of machinery, plant and furniture, with or without building** - current repairs to the machinery, plant, furniture or building - insurance premium - depreciation/unabsorbed depreciation	xxx	
(e)	**Family Pension –** 33-1/3% of such income or ₹ 15,000 (in case of optional tax regime) or 25,000 (in case of default tax regime u/s 115BAC), whichever is less.	xxx	
(f)	**Interest on compensation/enhanced compensation received –** 50% of such interest	xxx	
(g)	Any other expenditure not in the nature of capital expenditure incurred wholly and exclusively for earning such income	xxx	xxx
Income from Other Sources			xxx

Deductions not allowable [Section 58]	
(a)	Any personal expense of the assessee.
(b)	Any interest chargeable to tax under the Act which is payable outside India on which tax has not been paid or deducted at source.
(c)	Any payment chargeable to tax under the head "Salaries", if it is payable outside India unless tax has been paid thereon or deducted at source therefrom.
(d)	30% of sum payable to a resident on which tax is deductible at source, if such tax has not been deducted or after deduction has not been paid on or before the due date of return specified in section 139(1).
(e)	Any expenditure in respect of which a payment is made to a related person, to the extent the same is considered excessive or unreasonable by the Assessing Officer, having regard to the FMV.
(f)	Any expenditure in respect of which a payment or aggregate payments exceeding ₹ 10,000 is made to a person in a day otherwise than by account payee cheque/bank draft or ECS through bank account or through such other prescribed electronic mode such as credit card, debit card, net banking, IMPS, UPI, RTGS, NEFT, and BHIM Aadhar Pay.

Tax on Income from Other Sources				
Income	Winnings from lotteries, crossword puzzles, races including horse races, card games and other games, gambling, betting etc. (other than winning from any online game)	Unexplained cash credits/ investments/ money, bullion, jewellery etc./ expenditure, etc.	Net winnings from online games	Other Income
Section	Section 115BB	Section 115BBE	Section 115BBJ	-
Tax rate	30% of such winnings (further increased by surcharge, if applicable, and	60% of such income *plus* surcharge @25% of tax (Effective rate of	30% of such winnings (further increased by surcharge, if	Normal rates of tax

Tax on Income from Other Sources				
	health and education cess@4%)	tax is 78%, including health and education cess@4%)	applicable, and health and education cess@4%)	
Other conditions	➢ No expenditure or allowance can be allowed from such income. ➢ Deduction under Chapter VI-A is not allowable from such income. ➢ Adjustment of unexhausted basic exemption limit is also not permitted against such income. ➢ Set-off of losses is not permissible against such income.			Deductions specified in section 57 allowable, subject to limits mentioned thereunder. Section 58 specifies the deductions not allowable.

5.1 INTRODUCTION

Any income, profits or gains includible in the total income of an assessee, which cannot be included under any of the preceding heads of income, is chargeable under the head 'Income from other sources'. Thus, this head is the residuary head of income and brings within its scope all the taxable income, profits or gains of an assessee which fall outside the scope of any other head. Therefore, when any income, profit or gain does not fall precisely under any of the other specific heads but is chargeable under the provisions of the Act, it would be charged under this head.

5.2 METHOD OF ACCOUNTING [SECTION 145]

Income chargeable under the head "Income from other sources" has to be computed in accordance with the cash or mercantile system of accounting regularly employed by the assessee.

5.3 INCOMES CHARGEABLE UNDER THIS HEAD [SECTION 56]

(i) The income chargeable only under the head 'Income from other sources'

(1) Dividend income [Section 56(2)(i)]

Dividend income is always taxable under the head "Income from other sources". The term 'dividend' as used in the Act has a wider scope and meaning than under the general law.

<u>Deemed dividend [Sections 2(22)(a) to (f)]:</u>

According to section 2(22), the following receipts are deemed to be dividend:

(a) **Distribution of accumulated profits, entailing the release of company's assets** - Any distribution of accumulated profits, whether capitalised or not, by a company to its shareholders is dividend if it entails the release of all or any part of its assets.

Note: If accumulated profits are distributed in cash, it is dividend in the hands of the shareholders. Where accumulated profits are distributed in kind, for example by delivery of shares etc. entailing the release of company's assets, the market value of such shares on the date of such distribution is deemed as dividend in the hands of the shareholder.

(b) **Distribution of debentures, deposit certificates to shareholders and bonus shares to preference shareholders** - Any distribution to its shareholders by a company of debentures, debenture stock or deposit certificate in any form, whether with or without interest, and any distribution of bonus shares to preference shareholders to the extent to which the company possesses accumulated profits, whether capitalised or not, will be deemed as dividend.

The market value of such bonus shares is deemed as dividend in the hands of the preference shareholder.

In the case of debentures, debenture stock etc., their value is to be taken at the market rate and if there is no market rate they should be valued according to accepted principles of valuation.

Note: Bonus shares given to equity shareholders are not treated as dividend.

(c) **Distribution on liquidation** - Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not, is deemed to be dividend income.

Note: Any distribution made out of the profits of the company after the date of the liquidation cannot amount to dividend. It is a repayment towards capital.

(d) **Distribution on reduction of capital** - Any distribution to its shareholders by a company on the reduction of its capital to the extent to which the company possessed accumulated profits, whether capitalised or not, shall be deemed to be dividend.

(e) **Advance or loan by a closely held company to its shareholder** - Any payment by a company in which the public are not substantially interested, of any sum by way of advance or loan to any shareholder who is the beneficial owner of 10% or more of the equity capital of the company will be deemed to be dividend to the extent of the accumulated profits. If the loan is not covered by the accumulated profits, it is not deemed to be dividend.

Advance or loan by a closely held company to a specified concern - Any payment by a company in which the public are not substantially interested, to any concern (i.e. HUF/Firm/AOP/BOI/Company) in which a shareholder, having the beneficial ownership of atleast 10% of the equity shares is a member or a partner and in which he has a substantial interest (i.e. atleast 20% share of the income of the concern) will be deemed to be dividend.

Also, any payments by such a closely held company on behalf of, or for the individual benefit of any such shareholder will also be deemed to be dividend. However, in both cases the ceiling limit of dividend is to the extent of accumulated profits.

Exceptions: The following payments or loan given would not be deemed as dividend:

(i) **Loan granted in the ordinary course of business -** If the loan is granted in the ordinary course of its business and lending of money is a substantial part of the company's business, the loan or advance to a shareholder or to the specified concern is not deemed to be dividend.

(ii) Dividend paid is set off against the deemed dividend - Where a loan had been treated as dividend and subsequently, the company declares and distributes dividend to all its shareholders including the borrowing shareholder, and the dividend so paid is set off by the company against the previous borrowing, the adjusted amount will not be again treated as a dividend.

Note: Subsequent repayment of loan or charge of interest at market rate does not make any difference in the applicability of section 2(22)(e).

(f) Amount received by shareholder on buy-back of shares by domestic companies: In case of buyback of shares (whether listed or unlisted) by a domestic company, any sum paid by the domestic company for purchase of its own shares would be deemed as dividend in the hands of shareholders and shall be charged to income-tax at applicable tax rates. No deduction for expenses would be available against such dividend income while determining the income from other sources.

Below here is the example to understand the provisions of section 46A and section 2(22)(f):

No. of shares of A Ltd. bought in 2020 By Mr. B @₹ 40 per share	100 shares
Total cost of acquisition	₹ 4,000 (100 x ₹ 40)
No. of shares bought back in November 2025 by A Ltd. @₹ 60 per share	20 shares
Income taxable as deemed dividend u/s 2(22)(f) [₹ 60 per share x 20 shares]	₹ 1,200
Long-term capital loss on such buyback as per section 46A (Value of consideration - COA) (Nil - ₹ 40 x 20) [Such LTCL can be set-off against other LTCG or it can be carried forward to the next year for set-off against other LTCG]	₹ 800
No. of shares sold in December 2026 by Mr. B @₹ 70 per share	50 Shares
Long-term capital Gain (₹ 70 x 50 – ₹ 40 x 50)	₹ 1,500
Chargeable long-term capital gain in P.Y. 2026-27 after set-off of long-term capital loss [₹ 1,500 – ₹ 800] would be	₹ 700

Exceptions: The following do not constitute "dividend" –

(i) **Distribution in respect of non-participating shares issued for full cash consideration –** Any distribution made in accordance with (c) or (d) in respect of any share issued for full cash consideration and the holder of such share is not entitled to participate in the surplus asset in the event of liquidation.

(ii) ***Advance or loan between two group entities –*** *Any advance or loan between two group entities, where one of the group entity is a Finance company or a Finance Unit and the parent entity or principal entity of such group is listed on the stock exchange in a country or territory outside India other than the country or territory outside India notified by the CBDT.*

(iii) **Distribution of shares to the shareholders on demerger by the resulting company -** Any distribution of shares on demerger by the resulting companies to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

Meaning of "accumulated profits"

Accumulated profits in point (a), (b), (d) and (e) above include all profits of the company up to the date of distribution or payment of dividend.

Accumulated profits in point (c) include all profits of the company up to the date of liquidation whether capitalised or not.

In the case of an amalgamated company, the accumulated profits, whether capitalized or not, of the amalgamating company on the date of amalgamation shall be included in the accumulated profits, whether capitalized or not or loss, as the case may be, of the amalgamated company.

Clarification regarding trade advance not to be treated as deemed dividend under section 2(22)(e) – [Circular No. 19/2017, dated 12.06.2017]

Section 2(22)(e) provides that "dividend" includes any payment by a company in which public are not substantially interested, of any sum by way of **advance or loan** to a shareholder who is the beneficial owner of shares holding not less than 10% of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits.

The CBDT observed that some Courts in the recent past have held that trade advances in the nature of commercial transactions would not fall within the ambit of the provisions of section 2(22)(e) and such views have attained finality.

In view of the above, the CBDT has, vide this circular, clarified that it is a settled position that trade advances, which are in the nature of commercial transactions, would not fall within the ambit of the word 'advance' in section 2(22)(e) and therefore, the same would not to be treated as deemed dividend.

Basis of charge of dividend [Section 8]

Dividend declared or distributed or paid by a company is deemed to be the income of the shareholder in the previous year in which it is so declared or distributed or paid, as the case may be.

Deemed dividend u/s 2(22)(a)/(b)/(c)/(d) – Distribution by a company which is deemed as dividend u/s 2(22)(a)/(b)/(c)/(d) would be the income of the previous year in which it is so distributed.

Deemed dividend u/s 2(22)(e) – Payment of advance or loan to a shareholder or a concern, as the case may be, which is deemed as dividend u/s 2(22)(e) will be the income of the previous year in which it is so paid.

Interim dividend – Interim dividend would be deemed to be the income of the previous year in which such dividend id unconditionally made available by the company to the members who is entitled to it.

Tax rate on dividend income - Any income by way of dividends received by a resident from a company, whether domestic or foreign, is taxable in the hands of a resident shareholder at normal rates of tax.

ILLUSTRATION 1

Rahul, a resident Indian, holding 28% of equity shares in a company, took a loan of ₹ 5,00,000 from the same company. On the date of granting the loan, the company had accumulated profit of ₹ 4,00,000. The company is engaged in some manufacturing activity.

(i) Is the amount of loan taxable as deemed dividend, if the company is a company in which the public are substantially interested?

(ii) What would be your answer, if the lending company is a private limited company (i.e. which is not a company in which the public are substantially interested)?

SOLUTION

Any payment by a company, other than a company in which the public are substantially interested, of any sum by way of advance or loan to an equity shareholder, being a person who is the beneficial owner of shares holding not less than 10% of the voting power, is deemed as dividend under section 2(22)(e), to the extent the company possesses accumulated profits.

(i) The provisions of section 2(22)(e), however, will not apply where the loan is given by a company in which public are substantially interested. In such a case, the loan would not be taxable as deemed dividend.

(ii) However, if the loan is taken from a private company (i.e., a company in which the public are not substantially interested), which is a not a company where lending of money is a substantial part of the business of the company, the provisions of section 2(22)(e) would be attracted. In this case, since the company is a manufacturing company and not a lending company and Rahul holds more than 10% of the equity shares in the company, the provisions of section 2(22)(e) would be attracted.

The amount chargeable as deemed dividend cannot, however, exceed the accumulated profits held by the company on the date of giving the loan. Therefore, the amount taxable as deemed dividend would be limited to the accumulated profit i.e., ₹ 4,00,000 and not the amount of loan which is ₹ 5,00,000.

(2) Casual Income [Section 56(2)(ib)]

Casual income means income in the nature of winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort, gambling, betting etc.

Casual income is chargeable to tax under the head "Income from Other Sources".

(3) Interest received on compensation/ enhanced compensation deemed to be income in the year of receipt and taxable under the head "Income from Other Sources" [Sections 56(2)(viii)]

(i) As per section 145(1), income chargeable under the head "Profits and gains of business or profession" or "Income from other sources", shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(ii) Section 145B(1) provides that notwithstanding anything contained in section 145(1), the interest received by an assessee on compensation or on enhanced compensation shall be deemed to be his income for the year in which it is received, irrespective of the method of accounting followed by the assessee.

(iii) Section 56(2)(viii) provides that income by way of interest received on compensation or on enhanced compensation referred to in section 145B(1) shall be assessed as "Income from other sources" in the year in which it is received.

(4) Advance forfeited due to failure of negotiations for transfer of a capital asset to be taxable as "Income from other sources" [Section 56(2)(ix)]

(i) Prior to A.Y. 2015-16, any advance retained or received in respect of a negotiation for transfer which failed to materialise is reduced from the cost of acquisition of the asset or the written down value or the fair market value of the asset, at the time of its transfer to compute the capital gains arising therefrom as per section 51. In case the asset transferred is a long-term capital asset, indexation benefit would be on the cost so reduced.

(ii) With effect from A.Y. 2015-16, section 56(2)(ix) provides for the taxability of any sum of money, received as an advance or otherwise in the course of negotiations for transfer of a capital asset. Such sum shall be chargeable to income-tax under the head 'Income from other sources', if such sum is forfeited and the negotiations do not result in transfer of such capital asset.

(iii) In order to avoid double taxation of the advance received and retained, section 51 was amended to provide that where any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, has been included in the total income of the assessee for any previous year, in accordance with section 56(2)(ix), such amount shall not be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.

(iv) It may be noted that advance received and forfeited upto 31.3.2014 has to be reduced from cost of acquisition while computing capital gains, since such advance would not have been subject to tax under section 56(2)(ix). Only the advance received and forfeited on or after 1.4.2014 would be subject to tax under section 56(2)(ix). Hence, such advance would not be reduced from the cost of acquisition for computing capital gains.

(5) Any sum of money or value of property received without consideration or for inadequate consideration to be subject to tax in the hands of the recipient [Section 56(2)(x)]

(i) In order to prevent the practice of receiving sum of money or the property without consideration or for inadequate consideration, section 56(2)(x) brings to tax any sum of money or the value of any property received by any person without consideration or the value of any property received for inadequate consideration.

(ii) **Sum of Money**: If any sum of money is received without consideration and the aggregate value of which exceeds ₹ 50,000, the whole of the aggregate value of such sum is chargeable to tax.

(iii) Immovable property [Land or building or both]:

I. If an immovable property is received -

(a) **Without consideration:** The stamp duty value of such property would be taxed as the income of the recipient if it exceeds ₹ 50,000.

(b) **For Inadequate consideration**: If consideration is less than the stamp duty value of the property and the difference between the stamp duty value and consideration is more than the higher of –

(i) ₹ 50,000 and

(ii) 10% of consideration,

the difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the assessee as "Income from other sources".

II. **Value to be considered where the date of agreement is different from date of registration:** Taking into consideration the possible time gap between the date of agreement and the date of registration, the stamp duty value may be taken as on the date of agreement instead of the date of registration, if the date of the agreement fixing the amount of consideration for the transfer of the immovable property and the date of registration are not the same, provided whole or part of the consideration has been paid by way of an account payee cheque or an account payee bank draft or by use of electronic clearing system (ECS) through a bank account or through such prescribed electronic mode on or before the date of agreement.

The prescribed electronic modes notified are credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay as other electronic modes of payment [CBDT Notification No. 8/2020 dated 29.01.2020].

III. **If the stamp duty value of immovable property is disputed by the assessee**, the Assessing Officer may refer the valuation of such property to a Valuation Officer. If such value is less than the stamp duty value, the same would be taken for determining the value of such property, for computation of income under this head in the hands of the buyer.

(iv) Movable Property [Property, other than immovable property]:

If movable property is received -

(a) **Without consideration:** The aggregate fair market value of such property on the date of receipt would be taxed as the income of the recipient, if it exceeds ₹ 50,000.

(b) **For inadequate consideration:** If the difference between the aggregate fair market value and such consideration exceeds ₹ 50,000, such difference would be taxed as the income of the recipient.

(v) Applicability of section 56(2)(x): The provisions of section 56(2)(x) would apply only to property which is the nature of a capital asset of the recipient and not stock-in-trade, raw material or consumable stores of any business of the recipient. Therefore, only transfer of a capital asset, without consideration or for inadequate consideration would attract the provisions of section 56(2)(x).

(vi) The table below summarizes the scheme of taxability of gifts –

	Nature of asset	Taxable value
1	**Money**	The whole amount if the same exceeds ₹ 50,000.
2	**Movable property**	**(i) Without consideration:** The aggregate fair market value of the property, if it exceeds ₹ 50,000.
		(ii) Inadequate consideration: The difference between the aggregate fair market value and the consideration, if such difference exceeds ₹ 50,000.

3	**Immovable property**	**(i)**	**Without consideration:** The stamp value of the property, if it exceeds ₹ 50,000.
		(ii)	**Inadequate consideration:** The difference between the stamp duty value and the consideration, if such difference is more than the higher of ₹ 50,000 and 10% of consideration.

(vii) Non-applicability of section 56(2)(x): However, any sum of money or value of property received, in the following circumstances would be outside the ambit of section 56(2)(x) -

(a) from any relative; or

(b) on the occasion of the marriage of the individual; or

(c) under a will or by way of inheritance; or

(d) in contemplation of death of the payer or donor, as the case may be; or

(e) from any local authority[1]; or

(f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution[2]; or

(g) from or by any trust or institution registered[3]; or

(h) by any fund or trust or institution or any university or other educational institution or any hospital or other medical institution[4].

(i) by way of transaction not regarded as transfer[5] under section 47(i)/(iv)/(v)/(vi)/(vib)/(vid)/(vii).

(j) from an individual by a trust created or established solely for the benefit of relative of the individual.

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[1] *as defined in the Explanation to section 10(20)*

[2] *referred to in section 10(23C)*

[3] *under section 12AA or section 12AB*

[4] *referred to in section 10(23C)(iv)/(v)/(vi)/(via)*

[5] *under section 47(via)/(viaa)/(vic)/(vica)/(vicb)/(viiac)/(viiad)/(viiae)/(viiaf)*

(k) from such class of persons and subject to such conditions, as may be prescribed.

(l) by an individual, from any person, in respect of any expenditure actually incurred by him on his medical treatment or treatment of any member of his family, for any illness related to COVID-19 subject to conditions notified by the Central Government

(m) by a member of the family of a deceased person -

(A) from the employer of the deceased person (without any limit); or

(B) from any other person or persons to the extent that such sum or aggregate of such sums ≤ ₹ 10 lakhs,

where the cause of death of such person is illness related to COVID-19 and the payment is—

(i) received within 12 months from the date of death of such person; and

(ii) subject to such other conditions notified by the Central Government.

(viii) Meaning of certain terms:

Term	Meaning
Property	A **capital asset** of the assessee, namely,- (a) immovable property being land or building or both, (b) shares and securities, (c) jewellery, (d) archaeological collections, (e) drawings, (f) paintings, (g) sculptures, (h) any work of art or (i) bullion. It also includes virtual digital asset[6].

[6] The provisions relating to Virtual digital asset will be dealt with at Final level.

Relative	**(a) In case of an individual –** (i) spouse of the individual; (ii) brother or sister of the individual; (iii) brother or sister of the spouse of the individual; (iv) brother or sister of either of the parents of the individual; (v) any lineal ascendant or descendant of the individual; (vi) any lineal ascendant or descendant of the spouse of the individual; (vii) spouse of any of the persons referred in (i) to (vi) above. **(b) In case of Hindu Undivided Family**, any member thereof.
Family	For the purpose of (l) and (m) in page 3.498, family in relation to an individual means (i) the spouse and children of the individual; and (ii) the parents, brothers and sisters of the individual or any of them, wholly or mainly dependent on the individual.

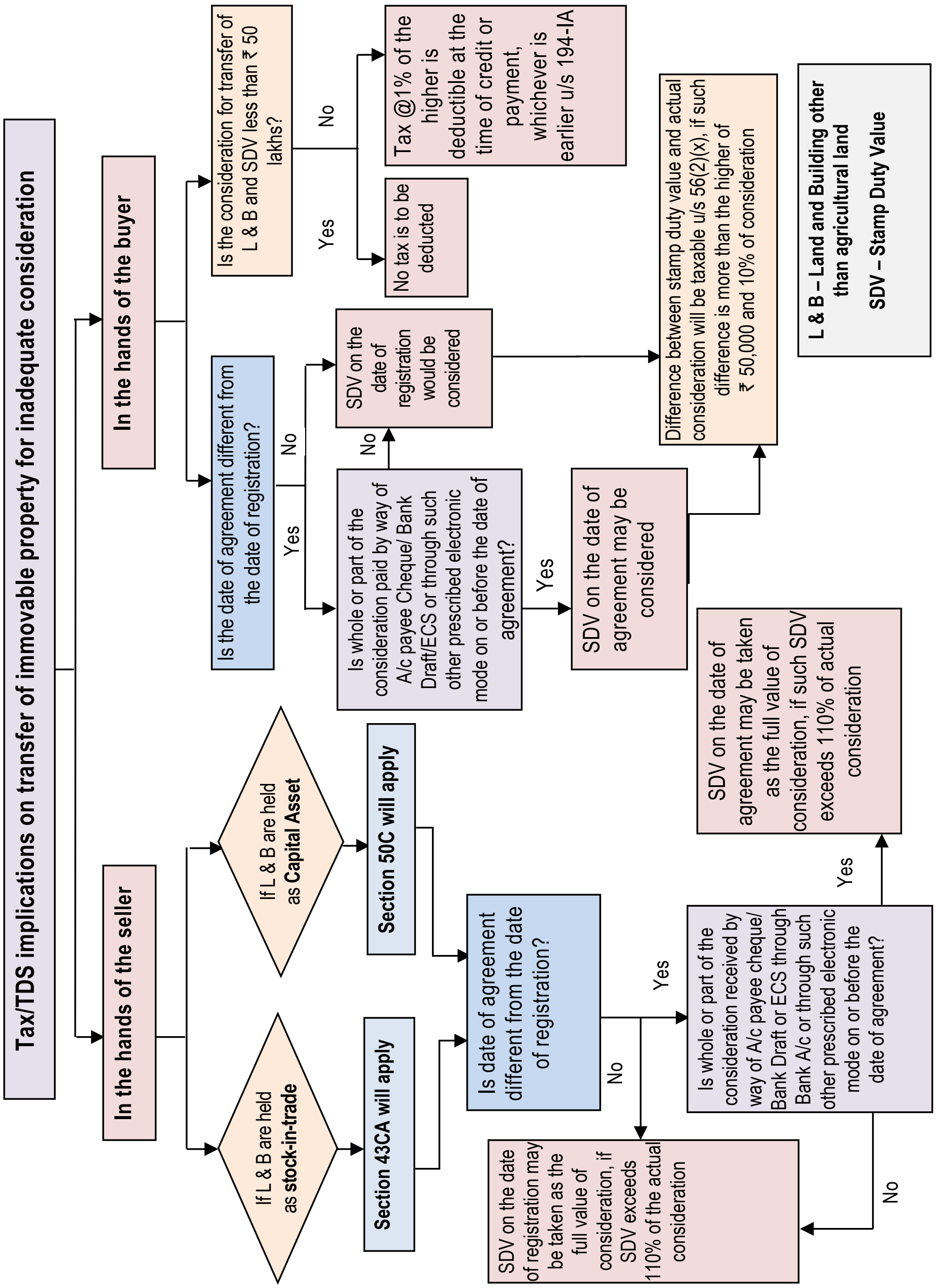
Tax/TDS implications on transfer of immovable property for inadequate consideration
In the hands of the seller
In the hands of the buyer
If L & B are held as stock-in-trade
If L & B are held as Capital Asset
Section 43CA will apply
Section 50C will apply
Is date of agreement different from the date of registration?
No
Yes
SDV on the date of registration may be taken as the full value of consideration, if SDV exceeds 110% of the actual consideration
Is whole or part of the consideration received by way of A/c payee cheque/ Bank Draft or ECS through Bank A/c or through such other prescribed electronic mode on or before the date of agreement?
Yes
No
SDV on the date of agreement may be taken as the full value of consideration, if such SDV exceeds 110% of actual consideration
Is the date of agreement different from the date of registration?
Yes
No
Is whole or part of the consideration paid by way of A/c payee Cheque/ Bank Draft/ECS or through such other prescribed electronic mode on or before the date of agreement?
Yes
No
SDV on the date of agreement may be considered
SDV on the date of registration would be considered
Difference between stamp duty value and actual consideration will be taxable u/s 56(2)(x), if such difference is more than the higher of ₹ 50,000 and 10% of consideration
Is the consideration for transfer of L & B and SDV less than ₹ 50 lakhs?
Yes
No
No tax is to be deducted
Tax @1% of the higher is deductible at the time of credit or payment, whichever is earlier u/s 194-IA
L & B – Land and Building other than agricultural land
SDV – Stamp Duty Value

ILLUSTRATION 2

Mr. A, a dealer in shares, received the following without consideration during the P.Y. 2025-26 from his friend Mr. B, -

(1) Cash gift of ₹ 75,000 on his anniversary, 15th April, 2025.

(2) Bullion, the fair market value of which was ₹ 60,000, on his birthday, 19th June, 2025.

(3) A plot of land at Faridabad on 1st July, 2025, the stamp value of which is ₹ 5 lakh on that date. Mr. B had purchased the land in April, 2009.

Mr. A purchased from his friend Mr. C, who is also a dealer in shares, 1000 shares of X Ltd. @ ₹ 400 each on 19th June, 2025, the fair market value of which was ₹ 600 each on that date. Mr. A sold these shares in the course of his business on 23rd June, 2025.

Further, on 1st November, 2025, Mr. A took possession of property (office building) booked by him two years back at ₹ 20 lakh. The stamp duty value of the property as on 1st November, 2025 was ₹ 32 lakh and on the date of booking was ₹ 23 lakh. He had paid ₹ 1 lakh by account payee cheque as down payment on the date of booking.

On 1st March, 2026, he sold the plot of land at Faridabad for ₹ 7 lakh.

Compute the income of Mr. A chargeable under the head "Income from other sources" and "Capital Gains" for A.Y. 2026-27.

SOLUTION

Computation of "Income from other sources" of Mr. A for the A.Y. 2026-27

Particulars	₹
(1) Cash gift is taxable under section 56(2)(x), since it exceeds ₹ 50,000	75,000
(2) Since bullion is included in the definition of property, therefore, when bullion is received without consideration, the same is taxable, since the aggregate fair market value exceeds ₹ 50,000	60,000
(3) Stamp value of plot of land at Faridabad, received without consideration, is taxable under section 56(2)(x)	5,00,000
(4) Difference of ₹ 2 lakh in the value of shares of X Ltd. purchased from Mr. C, a dealer in shares, is not taxable as it	-

	represents the stock-in-trade of Mr. A. Since Mr. A is a dealer in shares and it has been mentioned that the shares were subsequently sold in the course of his business, such shares represent the stock-in-trade of Mr. A.	
(5)	Difference between the stamp duty value of ₹ 23 lakh on the date of booking and the actual consideration of ₹ 20 lakh paid is taxable under section 56(2)(x) since the difference exceeds ₹ 2,00,000, being the higher of ₹ 50,000 and 10% of consideration	3,00,000
Income from Other Sources		**9,35,000**

Computation of "Capital Gains" of Mr. A for the A.Y.2026-27

Particulars	₹
Sale Consideration	7,00,000
Less: Cost of acquisition [deemed to be the stamp value charged to tax under section 56(2)(x) as per section 49(4)]	5,00,000
Short-term capital gains	**2,00,000**

***Note** – The resultant capital gains will be short-term capital gains since for calculating the period of holding, the period of holding of previous owner is not to be considered.*

ILLUSTRATION 3

Discuss the taxability or otherwise of the following in the hands of the recipient under section 56(2)(x) the Income-tax Act, 1961 -

(i) Akhil HUF received ₹ 75,000 in cash from niece of Akhil (i.e., daughter of Akhil's sister). Akhil is the Karta of the HUF.

(ii) Nitisha, a member of her father's HUF, transferred a house property to the HUF without consideration. The stamp duty value of the house property is ₹ 9,00,000.

(iii) Mr. Akshat received 100 shares of A Ltd. from his friend as a gift on occasion of his 25th marriage anniversary. The fair market value on that date was ₹ 100 per share. He also received jewellery worth ₹ 45,000 (FMV) from his nephew on the same day.

(iv) Kishan HUF gifted a car to son of Karta for achieving good marks in XII board examination. The fair market value of the car is ₹ 5,25,000.

SOLUTION

	Taxable/ Non-taxable	Amount liable to tax (₹)	Reason
(i)	Taxable	75,000	Sum of money exceeding ₹ 50,000 received without consideration from a non-relative is taxable under section 56(2)(x). Daughter of Mr. Akhil's sister is not a relative of Akhil HUF, since she is not a member of Akhil HUF.
(ii)	Non-taxable	Nil	Immovable property received without consideration by a HUF from its relative is not taxable under section 56(2)(x). Since Nitisha is a member of the HUF, she is a relative of the HUF. However, income from such asset would be included in the hands of Nitisha under 64(2).
(iii)	Taxable	55,000	As per provisions of section 56(2)(x), in case the aggregate fair market value of property, other than immovable property, received without consideration exceeds ₹ 50,000, the whole of the aggregate value shall be taxable. In this case, the aggregate fair market value of shares (₹ 10,000) and jewellery (₹ 45,000) exceeds ₹ 50,000. Hence, the entire amount of ₹ 55,000 shall be taxable.
(iv)	Non-taxable	Nil	Car is not included in the definition of property for the purpose of section 56(2)(x), therefore, the same shall not be taxable.

ILLUSTRATION 4

Mr. Hari, a property dealer, sold a building in the course of his business to his friend Mr. Rajesh, who is a dealer in automobile spare parts, for ₹ 90 lakh on 1.1.2026 when the stamp duty value was ₹ 150 lakh. The agreement was, however, entered into on 1.9.2025 when the stamp duty value was ₹ 140 lakh. Mr. Hari had received a down payment of ₹ 15 lakh by a crossed cheque from Rajesh on the date of agreement. Discuss the tax implications in the hands of Hari and Rajesh, assuming that Mr. Hari has purchased the building for ₹ 75 lakh on 12th July, 2024.

Would your answer be different if Hari was a share broker instead of a property dealer?

SOLUTION

Case 1: Tax implications if Mr. Hari is a property dealer

In the hands of the seller, Mr. Hari	In the hands of the buyer, Mr. Rajesh
In the hands of Hari, the provisions of section 43CA would be attracted, since the building represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value; and the stamp duty value exceeds 110% of consideration. Under section 43CA, the option to adopt the stamp duty value on the date of agreement can be exercised only if whole or part of the consideration has been received on or before the date of agreement by way of account payee cheque or draft or by use of ECS through a bank account or through credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay on or before the date of agreement. In this case, since the down payment of ₹ 15 lakh is received on the date of agreement by crossed cheque and not account payee cheque, the option cannot be exercised. Therefore, **₹ 75 lakh**, being the difference between the stamp duty value on the date of transfer i.e., ₹ 150 lakh, and the purchase price i.e., ₹ 75 lakh, would be chargeable as **business income** in the hands of Mr. Hari, since stamp duty value exceeds **110% of the consideration**	Since Mr. Rajesh is a dealer in automobile spare parts, the building purchased would be a capital asset in his hands. The provisions of section 56(2)(x) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration and the difference between the consideration and stamp duty value exceeds ₹ 9,00,000, being the higher of ₹ 50,000 and 10% of consideration. Therefore, **₹ 60 lakh,** being the difference between the stamp duty value of the property on the date of registration (i.e., ₹ 150 lakh) and the actual consideration (i.e., ₹ 90 lakh) would be taxable under section 56(2)(x) in the hands of **Mr. Rajesh**, since the payment on the date of agreement is made by crossed cheque and not account payee cheque/draft or ECS or through credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay.

Case 2: Tax implications if Mr. Hari is a share broker

In the hands of the seller, Mr. Hari	In the hands of the buyer, Mr. Rajesh
In case Mr. Hari is a share broker and not a property dealer, the building would represent his capital asset and not stock-in-trade. In such a case, the provisions of section 50C would be attracted in the hands of Mr. Hari, since building is transferred for a consideration less than the stamp duty value; and the stamp duty value exceeds 110% of consideration. Thus, ₹ **75 lakh, being the difference between the stamp duty value on the date of registration (i.e., ₹ 150 lakh) and the purchase price (i.e., ₹ 75 lakh) would be chargeable as short-term capital gains.** It may be noted that under section 50C, the option to adopt the stamp duty value on the date of agreement can be exercised only if whole or part of the consideration has been received on or before the date of agreement by way of account payee cheque or draft or by use of ECS through a bank account or through credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay on or before the date of agreement. In this case, since the down payment of ₹ 15 lakhs has been received on the date of agreement by crossed cheque and not account payee cheque, the option cannot be exercised.	There would be no difference in the taxability in the hands of Mr. Rajesh, whether Mr. Hari is a property dealer or a stock broker. Therefore, the provisions of section 56(2)(x) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration and the difference between the consideration and stamp duty value exceeds ₹ 9,00,000, being the higher of ₹ 50,000 and 10% of consideration. Therefore, **₹ 60 lakh,** being the difference between the stamp duty value of the property on the date of registration (i.e., ₹ 150 lakh) and the actual consideration (i.e., ₹ 90 lakh) would be taxable under section 56(2)(x) in the hands of Mr. Rajesh, since the payment on the date of agreement is made by crossed cheque and not account payee cheque/draft or ECS or through credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay.

(6) Compensation or any other payment received in connection with termination of his employment [Section 56(2)(xi)]

Any compensation or any other payment, due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto shall be chargeable to tax under this head.

(7) Sum received, including the amount allocated by way of bonus, under a LIP other than under a ULIP and keyman insurance policy, which is not exempt u/s 10(10D) [Section 56(2)(xiii)]

Any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy would not be included in the total income of a person [Section 10(10D)].

The following table summarizes the exemption available under section 10(10D) *vis-a-vis* the date of issue of such policies and the corresponding condition to be satisfied for exemption -

<table>
<tr><th></th><th colspan="2">Exemption u/s 10(10D)</th></tr>
<tr><td>In respect of policies issued before 1.4.2003</td><td colspan="2">Any sum received under a LIP including the sum allocated by way of bonus is exempt.</td></tr>
<tr><td>In respect of policies issued between 1.4.2003 and 31.3.2012</td><td colspan="2">Any sum received under a LIP including the sum allocated by way of bonus is exempt.
However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 20% of “actual capital sum assured”.</td></tr>
<tr><td>In respect of policies issued on or after 1.4.2012 but before 1.4.2013</td><td colspan="2">Any sum received under a LIP including the sum allocated by way of bonus is exempt.
However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 10% of actual capital sum assured.</td></tr>
<tr><td rowspan="2">In respect of policies issued on or after 1.4.2013</td><td>(a)</td><td>Where the insurance is on the life of a person with disability or severe disability as referred to in section 80U or a person suffering from disease or ailment as specified under section 80DDB.</td></tr>
<tr><td></td><td>Any sum received under a LIP including the sum allocated by way of bonus is exempt. However,</td></tr>
</table>

		exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 15% of "actual capital sum assured"
	(b)	**Where the insurance is on the life of any person, other than mentioned in (a) above**
		Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 10% of "actual capital sum assured".
In respect of policies issued on or after 1.4.2023	Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 10% or 15%, as the case may be, of "actual capital sum assured. Further, exemption would also not be available if the amount of premium payable exceeds ₹ 5,00,000 for any of the previous years during the term of such policy. In a case where premium is payable by a person for more than one LIP (other than ULIP) and the aggregate of premium payable on such policies exceed ₹ 5,00,000 for any of the previous years during the term of any such policy(ies), exemption would be available in respect of any of those LIPs (other than ULIP), at the option of the assessee, whose aggregate premium payable does not exceed ₹ 5,00,000 for any of the previous years during their term.	
Any sum is received on the death of a person is exempt irrespective of the annual premium payable on the policy. The condition of payment of premium of 10% or 15% or 20% or ₹ 5,00,000 would not be applicable.		

Exemption is not available in respect of amount received from an insurance policy taken for disabled person under section 80DD: Any sum received under section 80DD(3) shall not be exempt under section 10(10D). Accordingly, if the dependent disabled, in respect of whom an individual or the member of the HUF has paid or deposited any amount in any scheme of LIC or any other insurer, predeceases the individual or the member of the HUF, the amount so paid or deposited shall be deemed to be the income of the assessee of the previous year in which such amount is received. Such amount would not be exempt u/s 10(10D).

Exemption is not available in respect of the sum received under a Keyman insurance policy: Any sum received under a Keyman insurance policy shall also not be exempt.

Explanation 1 to section 10(10D) defines "Keyman insurance policy" as a life insurance policy taken by one person on the life of another person who is or was the employee of the first-mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person. The term includes within its scope a keyman insurance policy which has been assigned to any person during its term, with or without consideration. Therefore, such policies shall continue to be treated as a keyman insurance policy even after the same is assigned to the keyman. Consequently, the sum received by the keyman on such policies, being "keyman insurance policies", would not be exempt u/s 10(10D).

Guidelines u/s 10(10D) of the Income-tax Act, 1961 [Circular No. 15/2023 dated 16.08.2023]

Section 10(10D) provides for exemption of the sum received under a life insurance policy, including the sum allocated by way of bonus on such policy subject to the condition that the annual premium does not exceed 10% of actual capital sum assured.

In case where an assessee has a single life insurance policy (other than ULIP) issued on or after 1.4.2023 - Exemption u/s 10(10D) would not be available with respect to any life insurance policy (other than ULIP) issued on or after 1.4.2023, if the amount of premium payable exceeds ₹ 5,00,000 for any of the previous years during the term of such life insurance policy.

In case where an assessee has multiple life insurance policies (other than ULIPs) issued on or after 1.4.2023 - In a case where premium is payable by a person for more than one life insurance policies (other than ULIPs) issued on or after 1.4.2023 and the aggregate of premium payable on such life insurance policies exceed ₹ 5,00,000 for any of the previous years during the term of any such LIP(s), exemption u/s 10(10D) would be available in respect of any of those LIPs, at the option of the assessee, whose aggregate premium payable does not exceed ₹ 5,00,000 for any of the previous years during their term. However, to get exemption u/s 10(10D), the condition of annual premium not exceeding 10% of the actual capital sum assured also needs to be satisfied.

Exemption in case of death of a person - In case any sum is received on the death of a person, exemption u/s 10(10D) would be available irrespective of the annual premium payable of the LIP.

Guidelines issued by the CBDT: In case any difficulty arises in giving effect to the provisions of this clause, CBDT may issue guidelines for the purpose of removing the difficulty with the previous approval of the Central Government.

Accordingly, the CBDT has, with the approval of the Central Government, vide this circular, issued the following guidelines in respect of LIPs (other than ULIPs)–

Situation 1: No sum of any nature including bonus (such sum hereinafter referred as "consideration") is received by the assessee on any LIPs which are issued on or after 1.4.2023 (such LIPs hereinafter referred as "eligible LIPs") during any previous year preceding the current previous year (being the P.Y. in which consideration is received and its taxability is being examined) or consideration has been received on such eligible LIPs in an earlier previous year but has not been claimed exempt. In such a situation, the exemption u/s 10(10D) would be determined as under:

I. **<u>Where the assessee has received consideration, during the current P.Y., under one eligible LIP only</u>**

Circumstance	Eligibility for exemption u/s 10(10D)
If the amount of premium payable on such eligible LIP does not exceed ₹ 5,00,000 for any of the PYs during the term of such eligible LIP and annual premium does not exceed 10% of actual capital sum assured	Such consideration would be eligible for exemption u/s 10(10D). **[Refer Example 1 and 2 given below]**

If the amount of premium payable on such eligible LIP > ₹ 5,00,000 for any of the PYs during the term of such eligible LIP	Such consideration would **not** be eligible for exemption u/s 10(10D). **[Refer Example 3 given below]**

Example 1:

LIP	A
Date of issue	1.4.2014
Annual premium	6,00,000
Sum assured	60,00,000
Consideration received as on 01.11.2025 on maturity	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2025-26.	

Eligibility for exemption u/s 10(10D) - The consideration received under LIP "A" would be exempt u/s 10(10D) in A.Y. 2026-27 since annual premium does not exceed 10% of the actual capital sum assured. Moreover, as the policy has been issued before 1.4.2023, limit of ₹ 5,00,000 of amount of premium payable is not applicable, since it is not an eligible LIP.

Example 2:

LIP	A
Date of issue	1.4.2023
Annual premium	5,00,000
Sum assured	50,00,000
Consideration received as on 01.11.2033 on maturity	52,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2033-34.	

Eligibility for exemption u/s 10(10D) - The consideration received would be exempt u/s 10(10D) in A.Y. 2034-35, since the annual premium payable on the policy does not exceed ₹ 5,00,000 and also does not exceed 10% of actual capital sum assured.

Example 3:

LIP	A
Date of issue	1.4.2023
Annual premium	6,00,000
Sum assured	60,00,000
Consideration received as on 01.11.2033 on maturity	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2033-34.	

Eligibility for exemption u/s 10(10D) - The consideration received would **not** be exempt u/s 10(10D) in A.Y. 2034-35 since the annual premium payable on the eligible LIP exceeds ₹ 5,00,000.

II. Where the assessee has received consideration, during the current P.Y., under more than one eligible LIP

Circumstance	Eligibility for exemption u/s 10(10D)
If the aggregate of the amount of premium payable on such eligible LIPs does not exceed ₹ 5,00,000 for any of the PYs during the term of such eligible LIPs and the annual premium ≤ 10% of actual capital sum assured	Such consideration would be eligible for exemption under u/s 10(10D). **[Refer Example 4 given below]**
If the aggregate of the amount of premium payable on such eligible LIPs > ₹ 5,00,000 for any of the PYs during the term of such eligible LIP	Consideration in respect of any of those eligible LIPs whose aggregate amount of premium payable does not exceed ₹ 5,00,000 for any of the PYs during their term would be eligible for exemption u/s 10(10D), provided their annual premium ≤ 10% of actual capital sum assured. **[Refer Examples 5, 6 and 7 given below]**

Example 4:

LIP	A	B
Date of issue	1.4.2023	1.4.2023
Annual premium	3,00,000	2,00,000
Sum assured	30,00,000	20,00,000
Consideration received as on 01.11.2033 on maturity	32,00,000	21,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2033-34.		

Eligibility for exemption u/s 10(10D) – In this case, the aggregate of the annual premium payable for LIP "A" and LIP "B" does not exceed ₹ 5,00,000 during the term of these policies.

Further, annual premium payable in respect of LIP "A" and LIP "B" does not exceed 10% of actual capital sum assured. Therefore, the consideration received under LIP "A" and "B" would be exempt u/s 10(10D) in A.Y. 2034-35.

Example 5:

LIP	A	B
Date of issue	1.4.2023	1.4.2023
Annual premium	4,50,000	5,50,000
Sum assured	45,00,000	55,00,000
Consideration received as on 01.11.2033 on maturity	52,00,000	60,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2033-34.		

Eligibility for exemption u/s 10(10D) – In this case, the aggregate of the annual premium payable for LIP "A" and LIP "B" exceeds ₹ 5,00,000 during the term of these policies.

However, the consideration received under LIP "A" would be exempt u/s 10(10D) in A.Y. 2034-35, since its annual premium payable does not exceed ₹ 5,00,000 for any previous year during the term of the policy and also does not exceed 10% of actual capital sum assured.

Consequently, the consideration received under LIP "B" alone would **not** be exempt u/s 10(10D) in A.Y. 2034-35.

Example 6:

LIP	A	B	C
Date of issue	1.4.2023	1.4.2023	1.4.2023
Annual premium	1,00,000	3,50,000	6,00,000
Sum assured	10,00,000	35,00,000	60,00,000
Consideration received as on 01.11.2033 on maturity	12,00,000	40,00,000	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2033-34.			

Eligibility for exemption u/s 10(10D) - The aggregate of annual premium payable for LIP "A", LIP "B" and LIP "C" exceeds ₹ 5,00,000 during the term of these policies.

However, the consideration received under LIPs "A" and "B" would be exempt u/s 10(10D) in A.Y. 2034-35, since aggregate of annual premium payable for these two policies does not exceed ₹ 5,00,000 for any previous year during the term of these two policies and annual premium payable in respect of these policies does not exceed 10% of actual capital sum assured.

Consequently, the consideration received under LIP "C" alone would not be exempt u/s 10(10D) in A.Y. 2034-35.

Example 7:

LIP	X	A	B	C
Date of issue	1.4.2022	1.4.2023	1.4.2023	1.4.2023
Annual premium	5,50,000	1,00,000	3,50,000	6,00,000
Sum assured	55,00,000	10,00,000	35,00,000	60,00,000

Consideration received as on 01.11.2032 on maturity	62,00,000			
Consideration received as on 01.11.2033 on maturity		12,00,000	40,00,000	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2033-34, except LIP X in P.Y. 2032-33.				

Eligibility for exemption u/s 10(10D) - The consideration received under LIP "X" would be exempt u/s 10(10D) in A.Y. 2032-33, since annual premium does not exceed 10% of the actual capital sum assured. Moreover, as the policy has been issued before 1.4.2023, limit of ₹ 5,00,000 on amount of premium payable is not applicable, since LIP "X" is not an eligible LIP.

The aggregate of annual premium payable for LIP "A", LIP "B" and LIP "C" (being LIPs issued on or after 1.4.2023) exceeds ₹ 5,00,000 during the term of these policies.

However, the consideration received under LIPs "A" and "B" would be exempt u/s 10(10D) in A.Y. 2034-35, since aggregate of annual premium payable for these two policies does not exceed ₹ 5,00,000 for any previous year during the term of these two policies and annual premium payable in respect of these policies does not exceed 10% of actual capital sum assured.

Consequently, the consideration received under LIP "C" alone would not be exempt u/s 10(10D) in A.Y. 2034-35.

Situation 2: Consideration has been received by the assessee under any one or more eligible LIPs (i.e., issued on or after 1.4.2023) during any P.Y. preceding the current P.Y. and it has been claimed to be exempt u/s 10(10D). Such eligible LIPs are referred as "Earlier Exempt Eligible LIPs (EEE LIPs)" in this paragraph and corresponding examples and reference to eligible LIPs shall not include EEE LIPs. The exemption u/s 10(10D) would be determined as under:

I. <u>Where the assessee has received consideration, during the current P.Y., under one eligible LIP only</u>

Circumstance	Eligibility for exemption u/s 10(10D)
If aggregate amount of premium payable on such eligible LIP and EEE LIPs does not exceed ₹ 5,00,000 for any of the PYs during the term of such eligible LIP and annual premium in respect of eligible LIP does not exceed 10% of actual capital sum assured.	Consideration under such eligible LIP would be eligible for exemption u/s 10(10D).
If aggregate amount of premium payable on such eligible LIP and EEE LIPs > ₹ 5,00,000 for any of the PYs during the term of such eligible LIP	Consideration under such eligible LIP would **<u>not</u>** be eligible for exemption u/s 10(10D).

II. <u>Where the assessee has received consideration, during the current P.Y., under more than one eligible LIP</u>

Circumstance	Eligibility for exemption u/s 10(10D)
If aggregate of the amount of premium payable on such eligible LIPs and EEE LIPs does not exceed ₹ 5,00,000 for any of the PYs during the term of such eligible LIPs and annual premium in respect of eligible LIPs also does not exceed 10% of actual capital sum assured.	Consideration received would be eligible for exemption under u/s 10(10D).
If aggregate of the amount of premium payable on such eligible LIPs and EEE LIPs > ₹ 5,00,000 for any of the PYs during the term of such eligible LIPs	Consideration in respect of any of those eligible LIPs (whose aggregate amount of premium along with the aggregate amount of premium of EEE LIPs does not exceed ₹ 5,00,000 for any of the PYs during their term) would be eligible for exemption u/s 10(10D). **[Refer Examples 8, 9 and 10 given below]**

Example 8:

LIP	X	A	B	C
Date of issue	1.4.2023	1.4.2024	1.4.2024	1.4.2024
Annual premium	4,50,000	1,00,000	1,50,000	6,00,000
Sum assured	45,00,000	10,00,000	15,00,000	60,00,000
Consideration received as on 01.11.2033 on maturity	50,00,000			
Consideration received as on 01.11.2034 on maturity		12,00,000	18,00,000	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2034-35, except LIP X in P.Y. 2033-34.				

Eligibility for exemption u/s 10(10D) - The consideration under LIP "X" would be exempt u/s 10(10D) in P.Y. 2033-34, since the annual premium does not exceed ₹ 5,00,000 and also does not exceed 10% of actual capital sum assured.

In this case, the aggregate of the annual premium payable for LIP "A", LIP "B" and LIP "C" along with the premium for LIP "X" exceeds ₹ 5,00,000 during the term of these policies.

The aggregate of the annual premium payable for LIP "A" and the premium for LIP "X" also exceeds ₹ 5,00,000 during the term of these policies.

Consequently, the consideration received under LIP "A", LIP "B" and LIP "C" would not be exempt u/s 10(10D) in A.Y. 2035-36.

Example 9:

LIP	X	A	B	C
Date of issue	1.4.2023	1.4.2024	1.4.2024	1.4.2024
Annual premium	2,50,000	2,00,000	2,50,000	6,00,000
Sum assured	25,00,000	20,00,000	25,00,000	60,00,000
Consideration received as on 01.11.2033 on maturity	30,00,000			

Consideration received as on 01.11.2034 on maturity		24,00,000	38,00,000	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2034-35, except LIP X in P.Y. 2033-34.				

Eligibility for exemption u/s 10(10D) - The consideration under LIP "X" would be exempt u/s 10(10D) in P.Y. 2033-34, since the annual premium does not exceed ₹ 5,00,000 and also does not exceed 10% of actual capital sum assured.

In this case, the aggregate of the annual premium payable for LIP "A", LIP "B" and LIP "C" along with the premium for LIP "X" exceeds ₹ 5,00,000 during the term of these policies.

However, the consideration received under LIPs "A" or "B" (any one) can be claimed as exempt u/s 10(10D) in A.Y. 2035-36.

If the consideration received under LIP "A" is claimed to be exempt as aggregate of the annual premium payable for LIP "X" and "A" did not exceed ₹ 5,00,000 for any of the PYs., the consideration received under LIP "B" would not be exempt.

If the consideration received under LIP "B" is claimed to be exempt as aggregate of the annual premium payable for LIP "X" and "B" did not exceed ₹ 5,00,000 for any of the PYs., the consideration received under LIP "A" would not be exempt. Exemption for consideration received under LIP "B" is preferred as it is more beneficial to the assessee.

Alternative treatment: If the consideration under LIP "X" was not claimed to be exempt u/s 10(10D) in A.Y. 2034-35 by the assessee, then, the consideration received under LIP "A" and LIP "B" would be exempt u/s 10(10D) in A.Y. 2035-36 since the aggregate of the annual premium payable for the LIPs "A" and "B" together did not exceed ₹ 5,00,000 for any of the previous years during the term of these two policies. However, the most beneficial treatment is to claim LIP "X" and "B" as exempt.

It may be noted that in every case, the consideration received for LIP "C" would not be exempt u/s 10(10D).

Example 10:

LIP	X	Y	A	B	C
Date of issue	1.4.2023	1.4.2023	1.4.2024	1.4.2024	1.4.2024
Annual premium	2,00,000	2,00,000	2,00,000	3,00,000	6,00,000
Sum assured	20,00,000	20,00,000	20,00,000	30,00,000	60,00,000
Consideration received on surrender as on 1.7.2033	12,00,000				
Consideration received as on 01.11.2034 on maturity		24,00,000			
Consideration received as on 01.11.2035 on maturity			24,00,000	36,00,000	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2035-36, except LIP "X" and "Y".					

Eligibility for exemption u/s 10(10D) - The consideration under LIP "X" would be exempt u/s 10(10D) in A.Y.2034-35, since the annual premium does not exceed ₹ 5,00,000 and also does not exceed 10% of actual capital sum assured.

The consideration received under LIP "Y" would be exempt u/s 10(10D) in A.Y. 2035-36, since the aggregate of annual premium payable for LIP "X" and "Y" does not exceed ₹ 5,00,000 and annual premium payable for LIP "Y" does not exceed 10% of actual capital sum assured.

The consideration received under LIPs "A", LIP "B" and LIP "C" would not be exempt u/s 10(10D) in A.Y. 2036-37, since aggregate of annual premium payable for these three policies and LIP "X" and "Y" exceeds ₹ 5,00,000.

Alternative treatment: If the consideration on surrender under LIP "X" was not claimed to be exempt u/s 10(10D) in A.Y. 2034-35 by the assessee, then the consideration received under LIP "Y" would be exempt and the consideration received under LIP "A" **or** LIP "B" (any one) can be exempt u/s 10(10D) in A.Y. 2036-37. If the consideration received under LIP "A" is claimed to be exempt, as aggregate of the annual premium payable for LIP "Y" and "A" did not exceed ₹ 5,00,000 for any of the PYs., the consideration received under LIP "B" would not be exempt.

If the consideration received under LIP "B" is claimed to be exempt as aggregate of the annual premium payable for LIP "Y" and "B" did not exceed ₹ 5,00,000 for any of the PYs., the consideration received under LIP "A" would not be exempt. Exemption for consideration received under LIP "B" is preferred as it is more beneficial to the assessee.

If the consideration on surrender of LIP "X" and on maturity of LIP "Y" were not claimed to be exempt under section 10(10D) in A.Y.2034-35 and A.Y.2035-36, respectively, then consideration received under both LIP "A" and LIP "B" would be exempt in A.Y.2036-37 (being LIPs issued on or after 1.4.2023, whose aggregate consideration does not exceed ₹ 5,00,000).

It may be noted that, in every case, consideration received under LIP "C" would not be exempt under section 10(10D).

Clarification on GST Component: It is also clarified by the CBDT that the premium payable/ aggregate premium payable for a life insurance policy/policies, other than a ULIP, issued on or after 1.4.2023, for any previous year, would be exclusive of the amount of GST payable on such premium.

Clarification on premium of Term life insurance policy: It is further clarified by the CBDT that the limit of ₹ 5,00,000 of amount of premium payable would not be applicable in case of a term life insurance policy i.e. where sum under a life insurance policy is only paid to the nominee in case of the death of the person insured during the term of the policy and no amount is paid to anyone if the insured person survives the policy tenure.

Hence, any sum received under a term insurance policy shall continue to be exempt under section 10(10D), irrespective of the amount of the premium payable in respect of such policy. Further the premium paid for such policies would not be counted for checking the limit of ₹ 5,00,000 of amount of premium payable.

Taxability of sum received under a LIP which is not exempt u/s 10(10D)

Where any sum is received (including the amount allocated by way of bonus) at any time during a previous year, under a life insurance policy, other than the sum

(i) received under a ULIP

(ii) received under a Keyman insurance policy

which is not exempt under section 10(10D), the sum so received as exceeds the aggregate of the premium paid during the term of such life insurance policy, and not claimed as deduction under any other provision of the Act, computed in the prescribed manner, would be chargeable to tax under the head "Income from other sources".

Accordingly, the CBDT has, vide notification no 61/2023 dated 16.8.2023, inserted Rule 11UACA to compute the income chargeable to tax under section 56(2)(xiii). Where any person receives at any time during any previous year any sum under such LIP, then, the income chargeable to tax under section 56(2)(xiii) during the previous year in which such sum is received has to be computed in the following manner –

	Situation	**Income chargeable to tax during the previous year in which such sum is received**
(i)	where the sum is received for the first time under the LIP during the previous year (first previous year)	**A-B, where** A = the sum or aggregate of sum received under the LIP during the first previous year; and B = the aggregate of the premium paid during the term of the LIP till the date of receipt of the sum in the first previous year that has not been claimed as deduction under any other provision of the Act.

(ii)	where the sum is received under the LIP during the previous year subsequent to the first previous year (subsequent previous year	**C-D, where** C = the sum or aggregate of sum received under the LIP during the subsequent previous year; and D = the aggregate of the premium paid during the term of the LIP till the date of receipt of the sum in the subsequent previous year not being premium which – (a) has been claimed as deduction under any other provision of the Act; or (b) is included in "B" or "D" in any of the previous year(s).

"Sum received under a LIP" means any amount, by whatever name called, received under such policy which is not exempt under section 10(10D), other than the sum –

(a) received under a ULIP; or

(b) received under a Keyman insurance policy

(ii) Income chargeable under the head "Income from other sources" only if not chargeable under the head "Profits and gains of business or profession" -

(1) Any sum received by an employer-assessee from his employees as contributions to any provident fund, superannuation fund or any other fund for the welfare of the employees

(2) Income from letting out on hire, machinery, plant or furniture.

(3) Where letting out of buildings is inseparable from the letting out of machinery, plant or furniture, the income from such letting.

(4) Interest on securities

However, certain interest income arising to certain persons would be exempt under section 10(15), for example,:

(i) Income by way of interest, premium on redemption or other payment on notified securities, bonds, annuity certificates or other savings certificates is exempt subject to such conditions and limits as may be specified in the notification.

It may be noted that interest on Post Office Savings Bank Account which was so far fully exempt would henceforth be exempt from tax for any assessment year only to the extent of:

(1) ₹ 3,500 in case of an individual account.

(2) ₹ 7,000 in case of a joint account.

(ii) Interest on Gold Deposit Bond issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetization Scheme, 2015 notified by the Central Government.

(iii) Interest on bonds, issued by –

(a) a local authority; or

(b) a State Pooled Finance Entity

and specified by the Central Government by notification in the Official Gazette.

"State Pooled Finance Entity" means such entity which is set up in accordance with the guidelines for the Pooled Finance Development Scheme notified by the Central Government in the Ministry of Urban Development.

(iii) Keyman Insurance Policy

Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy is chargeable under the head "Income from other sources" if such income is not chargeable under the head "Profits and gains if business or profession" or under the head "Salaries" i.e. if such sum is received by any person other than the employer who took the policy and the employee in whose name the policy was taken.

(iv) Residual Income:

Any income chargeable to tax under the Act, but not falling under any other head of income shall be chargeable to tax under the head "Income from other sources".

For example, salary received by an MPs/MLAs will not be chargeable to income-tax under the head 'Salary' but will be chargeable as "Income from other sources" under section 56. However, the following incomes of Members of Parliament or State Legislatures will be exempt under section 10(17):

(i) ***Daily Allowance -*** Daily allowance received by any Member of Parliament or of any State Legislatures or any Committee thereof.

(ii) ***Constituency Allowance of MPs -*** In the case of a Member of Parliament, any allowance received under Members of Parliament (Constituency Allowance) Rules, 1986; and

(iii) ***Constituency allowance of MLAs -*** Any constituency allowance received by any person by reason of his membership of any State Legislature under any Act or rules made by that State Legislature.

There are other exemptions also in respect of certain incomes which are as follows:

1. Interest on moneys standing to the credit of individual in his NRE A/c [Section 10(4)(ii)]

As per section 10(4)(ii), in the case of an individual, any income by way of interest on moneys standing to his credit in a Non-resident (External) Account (NRE A/c) in any bank in India in accordance Foreign Exchange Management Act, 1999 (FEMA, 1999), and the rules made thereunder, would be exempt, provided such individual;

- o is a person resident outside India, as defined in FEMA, 1999, or
- o is a person who has been permitted by the Reserve Bank of India to maintain such account.

In this context, it may be noted that the joint holders of the NRE Account do not constitute an AOP by merely having these accounts in joint names. The benefit of exemption under section 10(4)(ii) will be available to such joint account holders, subject to fulfillment of other conditions contained in that section by each of the individual joint account holders.

2. Compensation received on account of disaster [Section 10(10BC)]

(i) This clause exempts any amount received or receivable as compensation by an individual or his legal heir on account of any disaster.

(ii) Such compensation should be granted by the Central Government or a State Government or a local authority.

(iii) However, exemption would not be available in respect of compensation for alleviating any damage or loss, which has already been allowed as deduction under the Act.

(iv) "Disaster" means a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or manmade causes, or by accident or negligence. It should have the effect of causing -

(1) substantial loss of life or human suffering; or

(2) damage to, and destruction of, property; or

(3) damage to, or degradation of, environment.

It should be of such a nature or magnitude as to be beyond the coping capacity of the community of the affected area.

ILLUSTRATION 5

Compensation on account of disaster received from a local authority by an individual or his/her legal heir is taxable. Examine the correctness of the statement with reference to the provisions of the Income-tax Act, 1961.

SOLUTION

The statement is **not** correct. As per section 10(10BC), any amount received or receivable as compensation by an individual or his/her legal heir on account of any disaster from the Central Government, State Government or a local authority is exempt from tax. However, the exemption is not available to the extent such individual or legal heir has already been allowed a deduction under this Act on account of such loss or damage caused by such disaster.

3. Educational scholarships [Section 10(16)]

The value of scholarship granted to meet the cost of education would be exempt from tax in the hands of the recipient irrespective of the amount or source of scholarship.

4. Awards for literary, scientific and artistic works and other awards by the Government [Section 10(17A)]

Any award instituted in the public interest by the Central/State Government or by any other body approved by the Central Government and a reward by Central/State Government for such purposes as may be approved by the Central Government in public interest, will enjoy exemption under this clause.

5. Payment in commutation of pension received from a set up by LIC [Section 10(10A)]

Any commuted pension received by an individual from a fund set up by LIC of India, approved by Controller of Insurance or IRDA of India will be exempted.

Exemption from withdrawals from National Savings Scheme (NSS)

Section 80CCA provides for a deduction for any amount deposited in the NSS. No deduction would be allowed in relation to such amount deposited on or after 1.4.1992.

The NSS 1987 accounts are still operational, however due to the notification G.S.R.538E dated 29.8.2024 issued by Ministry of Finance through National Savings Scheme (Amendment) Rules, 2024, the balances at the credit of the subscribers of the National Savings Scheme on or after 1st October, 2024, would not earn any interest.

Consequent to this notification, depositors who had intended to leave their NSS balances untouched for future use will lose interest benefit and be compelled to withdraw the balances, making these amounts taxable.

Section 80CCA has been amended to provide exemption to the withdrawals made from National Savings Scheme (NSS) on or after 29th August, 2024, for any amount deposited under the scheme and the interest accrued thereon in respect of which a deduction has been allowed.

Interest from non-SLR Securities of Banks: Whether chargeable under the head "Profits and gains of business or profession" or "Income from other sources"? [Circular No. 18, dated 2.11.2015]

The issue addressed by this circular is whether in the case of banks, expenses relatable to investment in non-SLR securities need to be disallowed under section 57(i), by considering interest on non-SLR securities as "Income from other sources."

Section 56(1)(id) provides that income by way of interest on securities shall be chargeable to income-tax under the head "Income from Other Sources", if the income is not chargeable to income-tax under the head "Profits and Gains of Business and Profession".

The CBDT clarified that the investments made by a banking concern are part of the business of banking. Therefore, the income arising from such investments is attributable to the business of banking falling under the head "Profits and Gains of Business and Profession".

5.4 APPLICABLE RATE OF TAX IN RESPECT OF CASUAL INCOME OTHER THAN WINNINGS FROM ANY ONLINE GAME [SECTION 115BB]

(i) This section provides that income by way of winnings from lotteries, crossword puzzles, races including horse races or card games and other games of any sort or from gambling or betting of any form would be taxed at a flat rate of 30% *plus* surcharge, if applicable, *plus* health and education cess@4%.

However, income by way of winnings from any online game would not be taxed under this section.

(ii) No expenditure or allowance can be allowed from such income.

(iii) Deduction under Chapter VI-A is not allowable from such income.

(iv) Adjustment of unexhausted basic exemption limit is also not permitted against such income.

5.5 APPLICABLE RATE OF TAX IN RESPECT OF WINNINGS FROM ONLINE GAMES [SECTION 115BBJ]

(i) This section provides that net winnings from any online game would be taxed at a flat rate of 30% plus surcharge, if applicable, plus health and education cess@4%.

(ii) **Meaning of online games:** A game that is offered on the internet and is accessible by a user through a computer resource including any telecommunication device

(iii) No expenditure or allowance can be allowed from such income.

(iv) Deduction under Chapter VI-A is not allowable from such income.

(v) Adjustment of unexhausted basic exemption limit is also not permitted against such income.

5.6 DEDUCTIONS ALLOWABLE [SECTION 57]

The income chargeable under the head "Income from other sources" shall be computed after making the following deductions:

(i) **In the case of dividend (other than deemed dividend arise on account of buy-back of shares by a domestic company) or income in respect of units of a mutual fund[7] or income in respect of units of a specified company[8]** : Interest expenditure to earn such income is allowed as deduction subject to a maximum of 20% of such income included in the total income, without deduction under this section.

No deduction in respect of any expenditure is allowed in case of deemed dividend arise on account of buy-back of shares by a domestic company.

(ii) **In the case of interest on securities:** Any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such interest on behalf of the assessee.

(iii) **Income consists of recovery from employees as contribution to any provident fund etc. in terms of section 2(24)(x)**: A deduction will be allowed in accordance with the provisions of section 36(1)(va) i.e., to the extent the contribution is remitted before the due date under the respective Acts.

(iv) **Where the income to be charged under this head is from letting on hire of machinery, plant and furniture, with or without building:** The following items of deductions are allowable in the computation of such income:

(a) the amount paid on account of any current repairs to the machinery, plant, furniture or building.

(b) the amount of any premium paid in respect of insurance against risk of damage or destruction of the machinery or plant, furniture or building.

(c) the normal depreciation allowance in respect of the machinery, plant or furniture, due thereon.

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[7] Specified u/s 10(23D)

[8] Defined in the *Explanation* to section 10(35)

(v) **In the case of income in the nature of family pension:** A deduction of a sum equal to 33-1/3 per cent of such income or **₹ 15,000 (in case of option regime) or ₹ 25,000 (in case of default regime)**, whichever is less, is allowable.

For the purposes of this deduction, "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death.

Exemption in respect of family pension

1. The family pension received by the widow or children or nominated heirs, **of a member of the armed forces (including para-military forces)** of the Union, where the death of such member has occurred in the course of operational duties, in specified circumstances would, however, be exempt under section 10(19).
2. The family pension received by any member of the family of an individual who had been in the service of Central or State Government and had been awarded "Param Vir Chakra" or "Maha Vir Chakra" or "Vir Chakra" or other notified gallantry awards would be exempt u/s 10(18)(ii).

(vi) **Any other expenditure not being in the nature of capital expenditure** laid out or expended wholly and exclusively for the purpose of making or earning such income.

(vii) **In case of income by way of interest on compensation/ enhanced compensation received chargeable to tax under section 56(2)(viii):** Deduction of 50% of such income. No deduction would be allowable under any other clause of section 57 in respect of such income.

ILLUSTRATION 6

Interest on enhanced compensation received by Mr. G during the previous year 2025-26 is ₹ 5,00,000. Out of this interest, ₹ 1,50,000 relates to the previous year 2020-21, ₹ 1,65,000 relates to previous year 2021-22 and ₹ 1,85,000 relates to previous year 2022-23. Discuss the tax implication, if any, of such interest income for A.Y.2026-27.

SOLUTION

The entire interest of ₹ 5,00,000 would be taxable in the year of receipt, namely, P.Y. 2025-26.

Particulars	₹
Interest on enhanced compensation taxable u/s 56(2)(viii)	5,00,000
Less: Deduction under section 57(iv) @50%	2,50,000
Interest chargeable under the head "Income from other sources"	**2,50,000**

5.7 DEDUCTIONS NOT ALLOWABLE [SECTION 58]

No deduction shall be made in computing the "Income from other sources" of an assessee in respect of the following items of expenses:

(i) In the case of any assessee:

(1) any personal expense of the assessee;

(2) any interest chargeable to tax under the Act which is payable outside India on which tax has not been paid or deducted at source.

(3) any payment chargeable to tax under the head "Salaries", if it is payable outside India unless tax has been paid thereon or deducted at source.

(ii) Any expenditure in respect of which a payment is made to a related person: In addition to these disallowances, section 58(2) specifically provides that the disallowance of any expenditure in respect of which a payment is made to a related person, to the extent the same is considered excessive or unreasonable by the Assessing Officer, having regard to the FMV and disallowance of payment or aggregate of payments exceeding ₹ 10,000 or ₹ 35,000, as the case may be, made to a person during a day otherwise than by account payee cheque or draft or ECS through bank account or through such other prescribed electronic mode such as credit card, debit card, net banking, IMPS, UPI, RTGS, NEFT, and BHIM Aadhar Pay covered by section 40A will be applicable to the computation of income under the head 'Income from other sources' as well.

(iii) Disallowance of 30% of expenditure: 30% of expenditure shall not be allowed, in respect of a sum which is payable to a resident and on which tax is deductible at source, if

- such tax has not been deducted or;
- such tax after deduction has not been paid on or before the due date of return specified in section 139(1).

In case, assessee fails to deduct the whole or any part of tax on any such sum but is not deemed as assessee in default under the first proviso to section 201(1) by reason that such payee –

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed,

it would be deemed that the assessee has deducted and paid the tax on such sum.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the payee.

(iv) No deduction in respect of any expenditure incurred in connection with casual income: No deduction in respect of any expenditure or allowance in connection with income by way of earnings from lotteries, cross word puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever shall be allowed in computing the said income.

The prohibition will not, however, apply in respect of the income of an assessee, being the owner of race horses, from the activity of owning and maintaining such horses. In respect of the activity of owning and maintaining race horses, expenses incurred shall be allowed even in the absence of any stake money earned. Such loss shall be allowed to be carried forward in accordance with the provisions of section 74A.

5.8 DEEMED INCOME CHARGEABLE TO TAX [SECTION 59]

The provisions of section 41(1) are made applicable, so far as may be, to the computation of income under this head. Accordingly, where a deduction has been made in respect of a loss, expenditure or liability and subsequently any amount is received or benefit is derived in respect of such expenditure incurred or loss or trading liability allowed as deduction, then, it shall be deemed as income in the year in which the amount is received or the benefit is accrued.

LET US RECAPITULATE

Where any income, profits or gains includible in the total income of an assessee, cannot be included under any of the other heads, it would be chargeable under the head 'Income from other sources'. Hence, this head is the residuary head of income [Section 56(1)]

Specific Incomes Chargeable under this head [Section 56(2)]

(1) Dividend Income

(2) Casual income (winnings from lotteries, cross word puzzles, races including horse races, card games and other games, gambling, betting etc.). Such winnings are chargeable to tax at a flat rate of 30% under section 115BB and in case of online games, net winnings therefrom is chargeable to tax @30% u/s 115BBJ and no expenditure or deduction under Chapter VIA can be allowed from such income. No loss can be set-off against such income and even the unexhausted basic exemption limit cannot be exhausted against such income.

(3) **Sum of money or property received by any person [Section 56(2)(x)]**

	Nature of asset	Particulars	Taxable value
1	Money	Without consideration	The whole amount, if the same exceeds ₹ 50,000.
2	Movable property	Without consideration	The aggregate fair market value of the property, if it exceeds ₹ 50,000.
3	Movable property	Inadequate consideration	The difference between the aggregate fair market value and the consideration, if such difference exceeds ₹ 50,000.
4	Immovable property	Without consideration	The stamp value of the property, if it exceeds ₹ 50,000.
5	Immovable property	Inadequate consideration	The difference between the stamp duty value and the consideration, if such difference exceeds the higher of ₹ 50,000 and 10% of consideration.

Receipts exempted from the applicability of section 56(2)(x)

Any sum of money or value of property received -

(a) from any relative; or

(b) on the occasion of the marriage of the individual; or

(c) under a will or by way of inheritance; or

(d) in contemplation of death of the payer or donor, as the case may be; or

(e) from any local authority; or

(f) from any fund or university or other educational institution or hospital or other medical institution or any trust or institution; or

(g) from or by any registered trust or institution

(h) by any fund or trust or institution or any university or other educational institution or any hospital or other medical institution.

(i) by way of transaction not regarded as transfer under specified clauses of section 47

(j) from an individual by a trust created or established solely for the benefit of relative of the individual.

(k) from such class of persons and subject to such conditions, as may be prescribed.

(l) by an individual, from any person, in respect of any expenditure actually incurred by him on his medical treatment or treatment of any member of his family, for any illness related to COVID-19 subject to conditions notified by the Central Government

(m) by a member of the family of a deceased person -

(A) from the employer of the deceased person (without any limit); or

(B) from any other person or persons to the extent that such sum or aggregate of such sums ≤ ₹ 10 lakhs,

where the cause of death of such person is illness related to COVID-19 and the payment is—

(i) received within 12 months from the date of death of such person; and

(ii) subject to such other conditions notified by the Central Government.

(4) Other receipts chargeable under this head

Section	Provision
56(2)(viii)	Interest received on compensation/enhanced compensation deemed to be income in the year of receipt and taxable under the head "Income from Other Sources".
56(2)(ix)	Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if such sum is forfeited and the negotiations do not result in transfer of such asset (in a case where advance is received and forfeited on or after 1.4.2014).
56(2)(xi)	Compensation or other payment, due to or received by any person, by whatever name called, in connection with termination of his employment or the modification of the terms and conditions relating thereto.
56(2)(xii)	Sum received, including the amount allocated by way of bonus, under a LIP other than under a ULIP and keyman insurance policy, which is not exempt u/s 10(10D).

Exemptions [Section 10]

Section	Provision
10(4)(ii)	Income by way of interest on moneys standing to his credit in a **Non-resident (External) Account (NRE A/c)**, is exempt in the hands of an individual, being a person resident outside India as per the FEMA, 1999 or in the hands of an individual who has been permitted by the RBI to maintain such account.
10(10BC)	Compensation received or receivable from the Central Government, State Government or local authority by an individual or his legal heir on account of any disaster is exempt except to the extent of loss or damage allowed as deduction under the Act.
10(16)	The value of scholarship granted to meet the cost of education would be exempt from tax in the hands of the recipient irrespective of the amount or source of scholarship.
10(17)	Daily allowance and Constituency allowance received by any Member of Parliament or of State Legislatures is exempt.

10(17A)	Payment, whether in cash or kind, in pursuance of an award instituted in public interest by the Govt or reward by the Govt. for approved purposes is exempt.
10(10A)	Any commuted pension received by an individual from a fund set up by LIC of India or any other insurer under a pension scheme, approved by Controller of Insurance or IRDA of India will be exempted.

Deductions allowable [Section 57]

S. No.	Particulars	Deduction
1.	In case of dividend (other than deemed dividend arise on account of buy-back of shares by a domestic company) or income in respect of units of mutual fund or income in respect of units from a specified company	Interest expenditure to earn such income. However, such interest expenses cannot exceed 20% of such income included in total income, without deduction under this section.
2.	In case of interest on securities	Any reasonable sum paid by way of commission or remuneration to a banker or any other person.
3.	Income consists of recovery from employees as contribution to any PF, superannuation fund etc.	Amount of contribution remitted before the due date under the respective Acts, in accordance with the provisions of section 36(1)(va)
4.	Income from letting on hire of machinery, plant and furniture, with or without building	Current repairs to the machinery, plant, furniture or building, insurance premium, depreciation/ unabsorbed depreciation
5.	Family Pension	Sum equal to - 33 1/3% of such income or - ₹ 15,000 (in case optional regime) or - ₹ 25,000 (in case of default regime), whichever is less
6.	Interest on compensation/ enhanced compensation received	50% of such interest income

Deductions not allowable [Section 58]

S. No.	Deductions not allowable
1.	Any personal expense of the assessee
2.	Any interest chargeable to tax under the Act which is payable outside India on which tax has not been paid or deducted at source.
3.	Any payment chargeable to tax under the head "Salaries", if it is payable outside India unless tax has been paid thereon or deducted at source.
4.	Any expenditure in respect of which a payment is made to a related person, to the extent the same is considered excessive or unreasonable by the Assessing Officer, having regard to the FMV.
5.	Any expenditure in respect of which a payment or aggregate payments exceeding ₹ 10,000 is made to a person in a day otherwise than by account payee cheque or draft or ECS through bank account or through such other prescribed electronic mode such as credit card, debit card, net banking, IMPS, UPI, RTGS, NEFT, and BHIM Aadhar Pay.
6.	Any expenditure or allowance in connection with income by way of earnings from lotteries, cross word puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature
7.	30% of expenditure in respect of sum which is payable to a resident on which tax is deductible at source, if such tax has not been deducted or after deduction has not been paid on or before the due date of return specified in section 139(1)

TEST YOUR KNOWLEDGE

1. *Examine under which heads the following incomes are taxable:*

   (i) Rental income in case property held as stock-in-trade for 3 years

   (ii) Salary received by a partner from his partnership firm

   (iii) Rental income of machinery

   (iv) Winnings from lotteries by a person having the same as business activity

   (v) Salaries received by a Member of Parliament

   (vi) Receipts without consideration

   (vii) In case of retirement, interest on employee's contribution if provident fund is unrecognized.

   (viii) Rental income in case of a person engaged in the business of letting out of commercial properties.

2. *Examine whether the following are chargeable to tax and the amount liable to tax:*

   (i) A sum of ₹ 1,20,000 was received as gift from non-relatives by Raj on the occasion of the marriage of his son Pravin.

   (ii) Interest on enhanced compensation of ₹ 96,000 received on 12.3.2026 for acquisition of urban land, of which 40% relates to P.Y.2024-25.

3. *On 10.10.2025, Mr. Govind (a bank employee) received ₹ 5,00,000 towards interest on enhanced compensation from State Government in respect of compulsory acquisition of his land effected during the financial year 2017-18.*

   Out of this interest, ₹ 1,50,000 relates to the financial year 2018-19; ₹ 1,65,000 to the financial year 2019-20; and ₹ 1,85,000 to the financial year 2020-21. He incurred ₹ 50,000 by way of legal expenses to receive the interest on such enhanced compensation.

   How much of interest on enhanced compensation would be chargeable to tax in the A.Y.2026-27?

4. *The following details have been furnished by Mrs. Hemali pertaining to the year ended 31.3.2026:*

   (i) *Cash gift of ₹ 51,000 received from her friend on the occasion of her "Shastiaptha Poorthi", a wedding function celebrated on her husband completing 60 years of age. This was also her 25th wedding anniversary.*

   (ii) *On the above occasion, a diamond necklace worth ₹ 2 lakhs was presented by her sister living in Dubai.*

   (iii) *When she celebrated her daughter's wedding on 21.2.2026, her friend assigned in Mrs. Hemali's favour, a fixed deposit held by the said friend in a scheduled bank; the value of the fixed deposit and the accrued interest on the said date was ₹ 52,000.*

   Compute the income, if any, assessable as "Income from other sources" for A.Y.2026-27.

5. *Examine the following transactions in the context of Income-tax Act, 1961:*

   (i) *Mr. B transferred 500 shares of R (P) Ltd. to M/s. B Co. (P) Ltd. on 10.10.2025 for ₹ 3,00,000 when the fair market value was ₹ 5,00,000. The indexed cost of acquisition of shares for Mr. B was computed at ₹ 4,45,000. The transfer was not subjected to securities transaction tax.*

   Determine the income chargeable to tax in the hands of Mr. B and M/s. B Co. (P) Ltd. because of the above said transaction.

   (ii) *Mr. Chezian is employed in a company with taxable salary income of ₹ 5,00,000. He received a sum of ₹ 1,00,000 from Atma Charitable Trust (registered under section 12AB) by account payee cheque in December 2024 for meeting his medical expenses.*

   Is the sum of money so received from the trust chargeable to tax in the hands of Mr. Chezian?

ANSWERS

1. Head under which following incomes are taxable:

	Particulars	**Head of Income**
(i)	Rental income in case property held as stock-in trade for 3 years	Income from house property

(ii)	Salary by partner from his partnership firm	Profits and gains of business or profession
(iii)	Rental income of machinery **(See Note below)**	Profits and gains of business or profession/Income from other sources
(iv)	Winnings from lotteries by a person having the same as business activity	Income from other sources
(v)	Salaries payable to a Member of Parliament	Income from other sources
(vi)	Receipts without consideration	Income from other sources
(vii)	In case of retirement, interest on employee's contribution if provident fund is unrecognized	Income from other sources
(viii)	Rental income in case of a person engaged in the business of letting out of commercial properties	Profits and gains from business or profession

***Note** - As per section 56(2)(ii), rental income of machinery would be chargeable to tax under the head "Income from Other Sources", if the same is not chargeable to income-tax under the head "Profits and gains of business or profession".*

2. Taxability of Receipts

S. No.	Taxable/ Not Taxable	Answer Amount liable to tax (₹)	Reason
(i)	Taxable	1,20,000	The exemption from applicability of section 56(2)(x) would be available if, *inter alia,* gift is received from a relative or gift is received on the occasion of marriage of the individual himself. In this case, since gift is received by Mr. Raj from a non-relative on the occasion of marriage of his son, it would be taxable in his hands under section 56(2)(x).

(ii)	Taxable	48,000	As per section 145B(1), interest received by the assessee on enhanced compensation shall be deemed to be the income of the year in which it is received, irrespective of the method of accounting followed by the assessee. Interest of ₹ 96,000 on enhanced compensation is chargeable to tax in the year of receipt i.e. P.Y. 2025-26 under section 56(2)(viii) after providing deduction of 50% under section 57(iv). Therefore, ₹ 48,000 is chargeable to tax under the head "Income from other sources".

3. Section 145B provides that interest received by the assessee on enhanced compensation shall be deemed to be the income of the assessee of the year in which it is received, irrespective of the method of accounting followed by the assessee and irrespective of the financial year to which it relates.

Section 56(2)(viii) states that such income shall be taxable as 'Income from other sources'.

50% of such income shall be allowed as deduction by virtue of section 57(iv) and no other deduction shall be permissible from such Income.

Therefore, legal expenses incurred to receive the interest on enhanced compensation would not be allowed as deduction from such income.

Computation of interest on enhanced compensation taxable as "Income from other sources" for the A.Y 2026-27

Particulars	₹
Interest on enhanced compensation taxable u/s 56(2)(viii)	5,00,000
Less: Deduction under section 57(iv) (50% x ₹ 5,00,000)	2,50,000
Taxable interest on enhanced compensation	**2,50,000**

4. **(i)** Any sum of money received by an individual on the occasion of the marriage of the individual is exempt. This provision is, however, not applicable to a cash gift received during a wedding function celebrated on completion of 60 years of age.

The gift of ₹ 51,000 received from a non-relative is, therefore, chargeable to tax under section 56(2)(x) in the hands of Mrs. Hemali, since the same exceeds ₹ 50,000.

(ii) The provisions of section 56(2)(x) are not attracted in respect of any sum of money or property received from a relative. Thus, the gift of diamond necklace received from her sister, being a relative, is not taxable under section 56(2)(x), even though jewellery falls within the definition of "property".

(iii) To be exempt from applicability of section 56(2)(x), the property should be received on the occasion of the marriage of the individual, not that of the individual's son or daughter. Therefore, this exemption provision is not attracted in this case.

Any sum of money received without consideration by an individual is chargeable to tax under section 56(2)(x), if the aggregate value exceeds ₹ 50,000 in a year. "Sum of money" has, however, not been defined under section 56(2)(x).

Therefore, there are two possible views in respect of the value of fixed deposit assigned in favour of Mrs. Hemali –

(1) The first view is that fixed deposit does not fall within the meaning of "sum of money" and therefore, the provisions of section 56(2)(x) are not attracted. It may be noted that fixed deposit is also not included in the definition of "property".

(2) However, another possible view is that fixed deposit assigned in favour of Mrs. Hemali falls within the meaning of "sum of money" received.

Income assessable as "Income from other sources"

If the first view is taken, the total amount chargeable to tax as "Income from other sources" would be ₹ 51,000, being cash gift received from a friend on her Shastiaptha Poorthi.

As per the second view, the provisions of section 56(2)(x) would also be attracted in respect of the fixed deposit assigned and the "Income from other sources" of Mrs. Hemali would be ₹ 1,03,000 (₹ 51,000 + ₹ 52,000).

5. **(i)** Any movable property received for inadequate consideration by any person is chargeable to tax under section 56(2)(x), if the difference between aggregate Fair Market Value of the property and consideration exceeds ₹ 50,000.

Thus, share received by M/s B. Co. (P) Ltd. from Mr. B for inadequate consideration is chargeable to tax under section 56(2)(x) to the extent of ₹ 2,00,000.

As per section 50CA, since the consideration is less than the fair market value of unquoted shares of R (P) Ltd., fair market value of shares of the company would be deemed to be the full value of consideration. It is presumed that the shares of R (P) Ltd are unquoted shares.

The full value of consideration (₹ 5,00,000) less the indexed cost of acquisition (₹ 4,45,000) would result in a long term capital gains of ₹ 55,000 in the hands of Mr. B.

(ii) The provisions of section 56(2)(x) would not apply to any sum of money or any property received from any trust or institution registered under section 12AB. Therefore, the sum of ₹ 1 lakh received from Atma Charitable Trust, being a trust registered under section 12AB, for meeting medical expenses would not be chargeable to tax under section 56(2)(x) in the hands of Mr. Chezian.