

INCOME TAX

Law and Practice

INCORPORATING INCOME TAX ACT, 1961
AS AMENDED UP-TO-DATE

ASSESSMENT YEAR 2019-20

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TAX LAW

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not include any loan or advance taken from employer.

1.2. CHARACTERISTICS OF SALARY

For any payment to be made taxable under the head 'Salaries' it must fulfil the following characteristics. In case any receipt is not covered under any of these features it will not come under this head :

1. Relationship of Employer and Employee

For a payment to fall under the head 'Salaries' the relationship of employer and employee must exist between payee and the receiver of the salary. The employer may be a Government, a Local authority, a company or any other public body or an Association or H.U.F. or even an individual. Every kind of payment to every kind of servant, public or private, however high or low placed he may be, is covered under the provisions of this Act. Even the remuneration payable to an employee of a foreign Govt. falls within this section. Even servant is an employee, but an agent may or may not be employee. A detailing agent of a selling concern is its employee whereas the person holding an agency to sell the goods of such a concern will not be employee. The relationship of master and servant is the only test to establish the relationship of employer and employee. A director of a company, though holding an office, is not an employee unless it is so provided in the independent contract, or the Articles of Association of the company provide for such a relationship.

[Ram Prashad v. C.I.T. (86 I.T.R. 122, 127 (S.C.))]

2. Nature of Employer

An employer may be an individual, i.e., Sole proprietor, partnership firm, limited liability partnership firm, H.U.F., company, local authority, AOP/BOI or any other artificial judicial person.

3. Salary from more than one Employer

Any amount of salary received or due from one or more than one employer/source shall be taxable under this head. Such situation may arise when an employee is working with two employers simultaneously or has worked with one employer and later on serves with another employer after leaving service with first employer, salary from both the employers shall be taxable under this head.

4. Salary from Present, Past or Prospective Employer

Salary received or due from present, past or future employer is also taxable under this head.

5. Tax Free Salary

Sometimes, the employer allows an employee to draw tax-free salary, e.g., the employer pays full salary to the employee and also pays tax on this directly to the department. The employee's

assessment is to be made not on the amount of salary he is drawing but on gross amount i.e., salary drawn plus the tax paid by the employer.

6. Salary Received as Member of Parliament or Member of State Legislature

A member of Parliament or of State Legislature is not treated as an employee of the government and hence, salary received by such persons (MPs & MLAs) is not taxable under the head 'Salaries'. It is taxable as income from other sources'. Any allowance received by them is fully exempted from tax.

7. Receipts from Persons other than Employer

Perquisites or benefits or any other remuneration received from persons other than the employer, would be taxable not under the head 'Salaries' but under the head 'income from other sources' even if they accrue to the employee by reason of his employment or while he was discharging his normal duties, e.g., amount received by a professor of a college for acting as an examiner in a university.

For example, Dr. Dhir is an employee of a leading physician of Delhi. In one case, the patient's life was saved because of the hard work and intelligence of Dr. Dhir. The patient, therefore, gives ₹ 5,000 to Dr. Dhir in appreciation of his services. The amount in this case is not chargeable as 'salary' but constitutes income from other sources.

8. Place of Accrual of Salary Income

Salary accrues at that place where the services are rendered. If the services are rendered in India, the salary accrues in India and if the services are rendered outside India, the salary accrues outside India. Thus, if a person employed in India goes on leave to England and gets his leave salary there, the salary is said to accrue in India and not in England, because it is paid for services rendered in India. Pension paid in a foreign country for services rendered in India, will be Indian income, as it is paid for the services rendered in India although in the past. On the other hand, if any person is employed in India and transferred to its branch in England, the salary received by him in England is not Indian income, but it is income arising in England as the service is rendered in England. Followings are the two exceptions to this rule :

(i) *A pension payable outside India* to a person who has gone to foreign country for permanent settlement is not deemed to arise in India, if pension is payable to a person appointed by the Secretary of State or to a person who was appointed before 15th August 1947, as a judge of the Federal Court or of a High Court and who continued to serve on or after the commencement of the Constitution as a judge in India. This is a special concession granted to certain officials of Government, who were employees before independence but continued to serve after this.

(ii) *The Govt. of India employs Indian citizens for services to be rendered in foreign countries* and salary paid outside India is deemed to accrue or arise in India. This provision helps in taxing the salaries received by Government servants posted abroad. But under Section 10(7) the allowances and perquisites paid or allowed by the Government outside India are to be excluded from total income.

9. Deductions made by the Employer

If, an employer makes certain deductions out of the salary payable to an employee, amount so deducted is deemed to be received by the employee and the amount so deducted is also taken as application of income by the employee. Some important types of deductions made by the employer are as follows

1. Deductions made to recover the loan advanced by the employer.
2. Employee's contribution towards the provident fund, income-tax and profession tax.
3. Deduction made to pay the premium on life insurance policy of the employee.
4. Any other deduction for which the employee has authorised the employer.



2

Income from House Property

- 2.1. DEFINITION OF HEAD
- 2.2. EXEMPTED INCOMES FROM HOUSE PROPERTY
- 2.3. ANNUAL VALUE
- 2.4 DETERMINATION OF ANNUAL VALUE
- 2.5. DEDUCTIONS U/S 24
- 2.6. TREATMENT OF ARREARS OF RENT RECEIVED OR UNREALISED RENT REALISED)
- 2.7. SUMMARY CHART

2.1. DEFINITION OF THE HEAD [SECTION 22]

The income from houses, buildings, bungalows, godowns etc. is to be computed and assessed to tax under the head "Income from house property". The income under this head is not based upon the actual income from the property but upon notional income or the annual value of that building.

$$\text{House Property Income} = \text{Annual Value of Building} - \text{Deductions Specified u/s 24}$$

Section 22 of the Income-tax Act says :

The annual value of property consisting of any building or lands *appurtenant* thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head 'Income from house property'.

For income to be taxed as 'Income from house property' the following points should be noted carefully :

1. Building or Land Appurtenant thereto. The scope of this head of income is limited to the income from buildings or lands appurtenant (attached or situated in the vicinity of building) to buildings only. Buildings include residential houses, bungalows, docks, warehouses, any block of bricks or stone work covered by a roof etc. Land which is not appurtenant to any buildings does not come within the scope of this section. In otherwords, any rent from such land shall not be taxable as house property income but instead it shall be taxable under the head "Other Sources."

2. Annual Value. The meaning of word 'Annual value' is very significant because the annual value of the building or land appurtenant thereto is to be taxed and not the rent received. The annual

value is to be determined according to the provisions of section 23 of Income-tax Act. These are discussed later in this chapter.

Annual Value = Annual Rental Value

3. The Assessee should be the owner of the property. It is only the owner of the house property who can be taxed under this head of income. The tax under this section is in respect of the legal or beneficial owner and not the occupation or possession of house property'. Therefore, income from subletting, will be chargeable under the head 'Income from other sources' and not under house property'. So only the owner, may be legal or deemed owner, is liable to tax under this head of income, unless the house property is used by him for the purposes of his own business or profession. The question of ownership may be noted in the following cases :

- (i) If the land was taken on lease (long time) and a super-structure constructed, the person who takes land on lease will be treated as its owner.
- (ii) Where the property is mortgaged, it is the mortgager alone and not the mortgagee who can be treated as the owner.
- (iii) Where the property was constructed in the name of partnership, it is the firm which is assessable as owner and not the individual partners.
- (iv) A person whose property is vested in the Custodian of Evacuee Property is not the 'owner' thereof for the purposes of this section.
- (v) Where the assessee takes a building on lease and he is deriving some income by subletting or re-letting, this income will be taxable under the head 'Income from other sources' and not under the head 'Income from house property'.
- (vi) In case houses were constructed by a cooperative building society and allotted or leased out to its members, the member shall be deemed to be the owner of the buildings or part thereof, as the case may be.

In one of the cases, Supreme Court decided that the owner must be a person who can exercise the rights of the owner, not on behalf of the owner but as his own right.

Deemed Owner of House Property [Section 27]

According to Section 27 of Income-tax Act the assessee in following cases is deemed to be the owner of the house property, though not owner of the house property :

- (i) An individual who transfers otherwise than for adequate consideration any house property to his or her spouse, not being a transfer in connection with an agreement to live apart or to a minor child not being a married daughter, shall be deemed to be the owner of the house property so transferred.
- (ii) The holder of an impartible estate shall be deemed to be the individual owner of all the properties comprised in the estate.
- (iii) A member of a co-operative society to whom a building or part thereof is allotted or leased under a house building scheme of the society, shall be deemed to be the owner of that building or part thereof.
- (iv) A person who is allowed to take or retain possession of any building or part thereof in part performance of contract of the nature referred to in section 53 A of the transfer of property Act, 1882.
- (v) A person who acquires any rights (Excluding any rights by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof, by virtue of a transfer by way of lease for a term of not less than 12 years as per section 269 UA (f) (whether originally or by extension).

4. It is not used for purposes of assessee's business or profession. Where the assessee is carrying on business or profession in his own house, building or in a portion of it and the income of such business or profession, is taxable under the head 'Profits or gains of business or profession', the

annual value in respect of property or portion of it is not taxable under this head of income. As the business is being carried on in the assessee's own premises, so no rent will be allowed as expenditure to the assessee in respect of these premises.

But where the profits of such business or profession are not chargeable to tax, the annual value of the (owned) premises shall be computed and charged under the head 'house property'.

IMPORTANT POINTS

- (i) **House property held as stock in trade.** Where the house property is held by an assessee as stock in trade in the course of carrying on business of purchase and sale of such house property, it (the house property) shall be assessed under the head house property. Thus, the annual value of such house properties shall be chargeable under the head 'Income from house property'.
- (ii) **House property of partner used by firm.** Where a house property owned by a partner is used by the partnership firm for the purpose of its business or profession, the annual value of such house property shall be chargeable in the hands of partner under the head 'Income from house property'. Such a house property cannot be treated as the property used by the partner for his own business or profession.
- (iii) **House property held in the name of business but not actually used for business.** If the house property belongs to business (i.e. held in the name of business but is not actually used for the purpose of business) it is to be assessed under the head 'Income from house property' and not under the head 'Income from business or profession.'

5. Dispute about ownership. It is the owner who is liable to pay tax on the income of the house property and in case of a dispute about ownership the person who receives rent shall be liable to pay tax till the dispute about ownership is settled.

6. House Property situated in a foreign country. In case an assessee who is resident of India owns a house in a foreign country, income from such a house is taxable in India under the head house property. So income from house property in case of not ordinary resident and a non resident shall be exempted but again it will be taxable in India if it is received or it is payable in India.

7. Cases when rental income from building is not treated as house property income

(i) **Letting out of house property for smooth conduct of assessee's business/profession.** If a person lets out any house property for smooth conduct of his business/profession, the rental income from such house property shall not be treated as house property income rather it shall be treated as income under the head business/profession.

Example 1. Quarters let out to the employees of assessee's own business or profession.

Example 2. Building let out to a Bank, Post Office, Police Station, Excise department or Police department etc.

Similarly, if a person carrying on any business/profession lets out his house property to a Bank, Post Office, Police Station, Excise Department or other department and the main purpose of letting is not to earn rental income but to facilitate its own business/Profession, the rental income shall not be taxable as house property income rather it will be treated as business income of the person.

(ii) **Income from sub-letting of house property.** If a person occupies a building as tenant and lets out full or part of the hired building to another person, it is called sub-letting. The income from sub-letting, if any, is taxable under the head 'income from other source' and not under the head 'house property'. It is so because the person sub-letting the building is not the owner of that building. Such income is calculated as per section 56 after deducting all the expenses relating to sub-let portion.

(iii) **Composite letting out of building along with furniture etc.** If a person lets out building along with furniture, plant, machinery and other facilities etc., for a composite rent and such composite rent can not be separated between (a) rent of building and (b) rent of other items/facilities then such composite rent shall be treated either as income under the head other sources or an income under the head business or profession, if such letting is the business of the assessee.

However, if such composite rent can be split up in parts and rent of building can be separately known, then such rent shall be treated as house property income and rent of other items/facilities shall be taxable as other source income/business or profession income.

(iv) **Income from hotel business/paying guest accomodation.** If a person runs the hotel business or runs the business of providing paying guest accomodation, such rental income shall be taxable as income under the head Business/Profession.

However, if a person has a building in the nature of a hotel and he lets out such building as such to another person for carrying on hotel business, such rental income shall be taxable as 'income under the head house property'.

ILLUSTRATION 1

Mr. Rama Rao had taken a shop on rent at monthly rent of ₹ 2,000. He has sub-let 25% of the area to Mr. D.K. Rai @ ₹ 1,000 p.m. He incurred ₹ 4,000 on repairs of the shop. Calculate his income from sub-letting.

SOLUTION

Income from other sources : sub-letting		₹
Rent Received @ ₹ 1,000 p.m.		12,000
Less : Actual expenses relating to sub-let portion	₹	
Rent paid (25% of ₹ 24,000)	6,000	
Repairs (25% of ₹ 4,000)	1,000	
		7,000
Income from sub-letting		5,000

Q. No. 1

Mr. Sudhakar Rao hired a house of 5 rooms at ₹ 5,000 p.m. He paid ₹ 6,000 as Municipal Taxes and spent ₹ 5,000 on the repair of the house. He has sub-let 2 rooms at the rate of ₹ 3,000 p.m. to his friend Mr. Prabhakar Rao. Compute income from sub-letting.

[Hints : Income from subletting ₹ 7,600]

2.2. EXEMPTED INCOMES FROM HOUSE PROPERTY

Under section 10 of the Income-tax Act 1961 following incomes from house property are exempted from tax. These incomes are not to be included in the total income of assessee. Hence no tax is payable on such incomes. These incomes are :

1. **Agricultural House Property [Section 2(1)(c)].** Income from such house property which is situated on or in the immediate vicinity of agricultural land which is used for agricultural purposes by cultivator is exempted from tax.

2. **House property held for charitable purposes [Section 11].** Any income from a house property held for charitable or religious purposes e.g., rent from shops owned by a temple is also exempted.

3. **Self-occupied but vacant house [Section 23(3)].** In case an assessee keeps one of his own houses reserved for self-occupation but is living in a rented house elsewhere due to his employment or profession the income from such house is taken to be nil.

4. **House used for own business or profession.** There is no income chargeable to tax under this head from such house property.

5. **Property held by resistered trade union [Section 10(24)].** Income from a house property owned by a resistered trade union is not to be included in its G.T.I.

6. **Income from house property held by following shall be exempted**

- House property held by a local authority.
- House property held by a scientific research institution.

- (iii) House property held at a political party.
- (iv) House property held by a university and any other educational institution working for spreading education and not to earn profit.
- (v) House property held by a hospital or medical institution working for the spreading of medical services to people and are not meant for earning profit.

7. One house property (a palace) owned by a former ruler of Indian states. Ex-rulers of Indian states may be owning many palaces but only one palace of their choice shall be treated as a self occupied house and shall be exempted.

8. One self occupied house. In case assessee owns one residential house, the net annual value of the same shall be taken as nil but in case he owns more than one house, then only one of his choice but normally of higher value shall be treated as a self occupied one and other/others are treated as deemed to be let out.

9. House Property held as Stock-in-Trade and not let out during the previous year [Section 23(5)]. Where any house property (building and land appurtenant thereto) is held as stock-in-trade and the property is not let during the whole or part of the year. The annual value of such property shall be taken as nil for the period upto one year from the end of the financial year in which the certificate of completion is obtained.

In case of a Cooperative Society

Income from following house properties is includible in Gross Total Income but a deduction is allowed from the Gross Total Income.

1. Income from any other Property [Section 80P(2)(b)]. In case the gross total income of a co-operative society does not exceed ₹ 20,000, any income derived by it from house property and included in its gross total income, the whole of such income is allowed as deduction while computing its total income. Co-operative society in this case should not be a housing society or an urban consumer's co-operative society or a society carrying a transport business.

2. Letting out of godown by co-operative societies [Section 80P(2)(c)]. If a co-operative society lets out godowns or warehouses for storage, processing or facilitating the marketing of commodities, the whole of its income derived from letting out of houses or storages etc. is deductible in computing its total income.

2.3. ANNUAL VALUE

The term annual value is very important as calculation of income from house property depends upon correctly calculated annual value. It takes into consideration not only the rent received but also the expected rent a house can fetch under the given situation and not only once but from year to year.

Definition of Annual Value [Section 23]

1. For the purposes of section 22, the annual value of any property shall be deemed to be :
 - (a) the sum for which the property might reasonably be expected to let from year to year ; or
 - (b) where the property or any part of the property is let and the actual rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause (a), the amount so received or receivable ; or
 - (c) where the property or any part of the property is let and was vacant during the whole or any part of the previous year and owing to such vacancy the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in clause (a), the amount so received or receivable :

Provided that the taxes levied by any local authority in respect of the property shall be deducted (irrespective of the previous year in which the liability to pay such taxes was incurred by the owner according to the method of accounting regularly employed by owner in determining the annual value of the property of that previous year in which such taxes are actually paid by him.