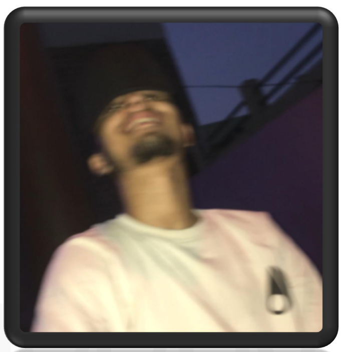
DIRECT TAX



UNIT TEST – SECTION B

DATE – 18/10/2069

TIME – 9:00

Principal
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1. What is capital gain discuss the major provisions related to the taxation of capital gains in India.

2. In case of an individual how would you calculate the income from other source elaborate with examples.

Numerical Chapter :-

1. Capital Gains
2. Income from other source

SOLUTION.

1. What is capital gain discuss the major provisions related to the taxation of capital gains in India.

1. Introduction

The concept of *capital gains* occupies an important place in the Indian system of direct taxation. Capital assets such as land, buildings, shares, and bonds are frequently transferred or sold by individuals and entities, leading to profits or losses. The Income-tax Act, 1961 recognizes such profits as a distinct head of income, called “Capital Gains,” under Section 45. The taxation of capital gains is based on the principle that any appreciation in the value of a capital asset, realized on transfer, constitutes an accretion to wealth and should therefore be subject to tax.

Capital gains taxation ensures that the government captures revenue from appreciation in capital assets while also encouraging productive reinvestment through various exemptions. This balance between equity and efficiency forms the foundation of the capital gains tax regime in India.

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2. Meaning and Nature of Capital Gains

The term *capital gain* refers to any profit or gain arising from the transfer of a *capital asset* during a financial year. The essential components of capital gain are therefore:

1. **Existence of a capital asset**
2. **Transfer of that capital asset**, and
3. **Realisation of profit or gain** on such transfer.

According to Section 2(14) of the Income-tax Act, a *capital asset* means property of any kind held by an assessee, whether or not connected with his business or profession. However, certain items are excluded from this definition, such as stock-in-trade, consumable stores, raw materials, and personal effects like clothing or furniture used for personal purposes. Agricultural land situated in specified rural areas is also excluded.

The capital gain arises only when there is a “transfer” of a capital asset. Section 2(47) defines *transfer* broadly to include sale, exchange, relinquishment of rights, extinguishment of rights, compulsory acquisition, conversion of asset into stock-in-trade, or any transaction through which possession or enjoyment of property is transferred.

Thus, capital gains tax is levied not merely on sale but on any form of transfer that results in the realization of profit.

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3. Classification of Capital Gains

The Act classifies capital gains into two broad categories based on the *holding period* of the asset:

(a) Short-Term Capital Gain (STCG)

If a capital asset is held for not more than a specified period before its transfer, the gain is treated as *short-term*.

- For listed shares, units of equity-oriented mutual funds, and zero-coupon bonds: the holding period is **12 months or less**.
- For immovable property (land or building) and unlisted shares: **24 months or less**.
- For other assets: **36 months or less**.

(b) Long-Term Capital Gain (LTCG)

If the holding period exceeds the limits mentioned above, the gain is classified as *long-term*. The classification determines both the method of computation and the applicable tax rate.

This distinction is crucial since long-term gains often benefit from indexation and concessional tax rates, whereas short-term gains are generally taxed at normal or higher rates.

4. Computation of Capital Gains

The method of computation is prescribed under **Section 48** of the Income-tax Act. Capital gain is calculated as follows:

Full Value of Consideration Received or Accruing
– Expenditure incurred wholly and exclusively in connection with the transfer
– Cost of Acquisition
– Cost of Improvement
= Capital Gain

For *long-term* capital gains, the **Cost of Acquisition** and **Cost of Improvement** are adjusted for inflation using the *Cost Inflation Index (CII)* to arrive at the **Indexed Cost**. This ensures that only the real (inflation-adjusted) gain is taxed.

However, the Finance Act, 2024 introduced significant reforms. From the assessment year 2025-26 onwards, indexation benefit for certain assets such as debt mutual funds has been withdrawn, aligning the taxation structure across asset classes.

4.1 Deemed Full Value of Consideration

In certain cases, the consideration received may not reflect the fair market value. The Act provides “deemed” values to prevent understatement:

- For immovable property, if the sale value is less than the value adopted by the stamp valuation authority, the latter is deemed to be the full value of consideration.

- In case of conversion of a capital asset into stock-in-trade, the fair market value on the date of conversion is deemed as the sale consideration.

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5. Chargeability and Timing

Under **Section 45(1)**, capital gain is chargeable to tax in the *previous year* in which the transfer of the capital asset takes place. The tax liability arises at the time of transfer, not necessarily at the time of actual receipt of sale proceeds.

However, there are special provisions:

- **Section 45(2):** When a capital asset is converted into stock-in-trade, the capital gain is chargeable in the year when such stock is actually sold.
- **Section 45(3):** Transfer of a capital asset to a firm or association as capital contribution is taxable in the hands of the partner at the value recorded in the books of the firm.
- **Section 45(4):** Distribution of capital assets upon dissolution or reconstitution of a firm is also treated as a transfer.
- **Section 45(5):** Capital gains arising from compulsory acquisition of property are chargeable in the year of receipt of compensation.

These provisions ensure that even indirect or deferred transactions are brought within the tax net.

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6. Tax Rates Applicable to Capital Gains

The rates differ for short-term and long-term gains and sometimes depend on the type of asset:

- **Short-Term Capital Gains (STCG):**
  - For listed equity shares and equity-oriented mutual funds (where Securities Transaction Tax is paid): taxed at **15%** under Section 111A.
  - For other assets: taxed at normal slab rates applicable to the assessee.
- **Long-Term Capital Gains (LTCG):**
  - For listed equity shares and equity-oriented mutual funds: taxable at **10%** on gains exceeding ₹1,00,000 under Section 112A, without indexation.
  - For other assets (e.g., property, unlisted shares): taxable at **20%** with indexation benefits under Section 112.

The government occasionally revises rates and exemptions through the annual Finance Acts, ensuring alignment with broader fiscal policy objectives.

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7. Exemptions and Reliefs

To promote reinvestment and housing development, the Income-tax Act provides several exemptions under **Sections 54 to 54GB**. Some important ones include:

1. **Section 54:**
   Exemption for long-term capital gains arising from sale of a residential house if the assessee invests the gains in purchase or construction of another residential house within prescribed time limits.
2. **Section 54B:**
   Exemption on sale of agricultural land, provided the proceeds are used to purchase another agricultural land within two years.
3. **Section 54EC:**
   Exemption for investment of long-term capital gains in notified bonds (e.g., NHAI, REC) within six months, subject to a maximum limit of ₹50 lakh.
4. **Section 54F:**
   Exemption for individuals or HUFs on sale of any long-term capital asset other than a residential house, if the entire sale consideration is invested in a residential property.
5. **Section 54GB:**
   Exemption when long-term capital gains from sale of residential property are invested in equity shares of eligible start-ups for business expansion.

These provisions aim to encourage savings, infrastructure investment, and economic growth.

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8. Set-Off and Carry Forward of Capital Losses

The Act also provides mechanisms for adjustment of capital losses:

- **Short-term capital loss** can be set off against both short-term and long-term capital gains.
- **Long-term capital loss** can be set off only against long-term capital gains.
- Unabsorbed capital losses can be carried forward for **eight assessment years**, subject to timely filing of returns.

This ensures that taxpayers are not unfairly burdened when investments result in temporary losses.

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9. Recent Developments and Policy Trends

Recent tax reforms have aimed at simplification and rationalization of the capital gains framework. The Finance Act, 2024 introduced major changes, including:

- Reduction in the number of asset categories for determining holding period.
- Standardization of the threshold for long-term classification.
- Elimination of indexation for certain debt instruments.
- Simplification of exemptions and reduction of overlapping provisions.

These reforms are intended to create a more transparent, equitable, and investor-friendly system.

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10. Conclusion

Capital gains taxation in India represents a delicate balance between revenue collection and economic development. It ensures that appreciation in asset values contributes to public finances, while various exemptions encourage reinvestment and productive use of capital.

The legal framework—comprising definitions of capital asset and transfer, computation mechanisms, holding-period classification, and exemption schemes—reflects the evolution of India's tax policy from a complex, multi-layered system to a more unified and predictable regime.

Understanding these provisions is vital for individuals, investors, and businesses to plan their finances efficiently and comply with the law. As the Indian economy continues to modernize, further rationalization of capital gains taxation will remain a key policy objective in achieving sustainable and equitable growth.

2. In case of an individual how would you calculate the income from other source elaborate with examples.

1. Introduction

The Indian Income-tax Act, 1961 classifies a person's total income under five broad heads:

1. Income from Salaries
2. Income from House Property
3. Profits and Gains of Business or Profession
4. Capital Gains
5. **Income from Other Sources**

Among these, *Income from Other Sources* is a **residual head of income**, serving as a comprehensive category to include all taxable incomes that do not specifically fall under any of the first four heads. The legislative intent behind this head is to ensure that no income escapes taxation merely because it does not fit precisely into another category.

Section **56(1)** of the Income-tax Act provides that any income which is not chargeable to tax under any of the other heads shall be chargeable to tax under the head *"Income from Other Sources"*. Thus, it acts as a catch-all provision and ensures the completeness of the tax base.

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2. Meaning and Scope of 'Income from Other Sources'

The head *"Income from Other Sources"* is defined in **Section 56 to 59** of the Income-tax Act, 1961. The scope of this section is quite wide, and it includes a variety of income types.

According to **Section 56(1)**:

"Income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under the head 'Income from Other Sources' if it is not chargeable to income-tax under any of the heads specified in Section 14."

Therefore, even if a certain income does not fit neatly into the heads of salary, house property, business income, or capital gains, it will still be taxable under this residual head.

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3. Specific Incomes Chargeable Under This Head (Section 56(2))

While the head "Income from Other Sources" is broad, the Act also specifically lists certain types of income that are to be taxed under this head. The major items include the following:

(a) Dividends

All dividends received from companies, both Indian and foreign, are taxable under this head. However, dividends from Indian companies are now fully taxable in the hands of shareholders after the abolition of Dividend Distribution Tax (DDT) from the assessment year 2021-22 onwards.

Example:
If Mr. Rajan receives ₹45,000 as dividends from Reliance Industries Ltd. and ₹10,000 as dividends from a U.S.-based company, the total ₹55,000 will be taxable under *Income from Other Sources*.

(b) Winnings from Lotteries, Crossword Puzzles, Games, and Similar Sources

As per Section 56(2)(ib), any winnings from lotteries, crossword puzzles, card games, online gaming, or betting are taxable under this head. Such income is taxed at a **flat rate of 30%** under Section 115BB, irrespective of the individual’s tax slab.

Example:
If Ms. Kiran wins ₹1,00,000 in a television game show, the entire ₹1,00,000 is taxable at 30% (plus surcharge and cess), and no deduction for expenses or allowances is permitted.

(c) Interest on Securities

Income from interest on government securities, bonds, or debentures is taxable under this head when it does not fall under business income.

Example:
Mr. Arjun invests ₹2,00,000 in Government of India Bonds and earns ₹20,000 as interest. Since he is not a trader in securities, this ₹20,000 will be taxed under *Income from Other Sources*.

(d) Gifts of Money or Property Received Without Consideration

Under **Section 56(2)(x)**, if any individual receives any money, immovable property, or specified movable property without consideration (or for inadequate consideration), the value is taxable under this head, subject to certain exemptions.

The taxable limit is **₹50,000**: if the total value of gifts received from non-relatives exceeds ₹50,000 during a financial year, the entire amount becomes taxable.

Example:
If Ms. Pooja receives ₹25,000 as a cash gift from a friend on her birthday and ₹40,000 as jewelry from another friend, the total value is ₹65,000, which exceeds ₹50,000. Hence, the **entire ₹65,000** will be taxable under *Income from Other Sources*.

However, gifts received from specified relatives (like parents, spouse, siblings, or on occasions such as marriage) are fully exempt.

(e) Income from Sub-letting of House Property

If an individual who is not the owner of the property sub-lets it to someone else, the rental income received from sub-letting is not taxable under “Income from House Property” but under “Income from Other Sources.”

Example:
Mr. Sandeep rents a flat from his landlord for ₹10,000 per month and sub-lets it to another person for ₹15,000 per month. The extra

₹5,000 per month (₹60,000 per annum) is taxable under *Income from Other Sources.*

(f) Interest on Bank Deposits, Loans, or Other Investments

Interest earned from fixed deposits, recurring deposits, or loans given to others is taxable under this head.

Example:
Ms. Neha earns ₹25,000 as interest from her fixed deposits and ₹10,000 from a personal loan she gave to a friend. The total ₹35,000 is taxable under *Income from Other Sources.*

(g) Rental Income of Machinery, Plant, or Furniture

If machinery, plant, or furniture is let out and such letting is not part of business operations, the rental income is taxable under this head.

Example:
Mr. Ravi owns a photocopier machine which he rents out to a nearby shop for ₹3,000 per month. Since this is not part of his regular business, ₹36,000 per annum will be taxable under *Income from Other Sources.*

(h) Family Pension

Family pension received by the legal heirs after the death of an employee is also taxable under this head. However, a **standard**

deduction of 1/3rd of such pension or ₹15,000 (whichever is less) is allowed.

Example:
Mrs. Meera receives ₹60,000 as family pension after her husband's death. Deduction allowable = ₹15,000 (since 1/3rd of ₹60,000 = ₹20,000 > ₹15,000). Hence, taxable income = ₹45,000.

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4. Computation of Income from Other Sources

The computation of income under this head depends on the type of income involved. However, the general rule (as per **Section 57**) is:

Gross Income under this head
– Deductions allowable under Section 57
= Taxable Income from Other Sources

4.1 Deductions Permissible under Section 57

The following deductions are allowed:

1. **Commission or remuneration** paid to a banker or agent for realizing dividends or interest on securities.
2. **Expenses incurred wholly and exclusively** for earning the income, such as collection charges or maintenance of machinery rented out.
3. **Standard deduction for family pension** – one-third of pension or ₹15,000, whichever is less.

4. **Interest on borrowed capital** – if money is borrowed to invest in securities or to earn interest income, such interest is deductible.

Example:
Mr. Anil borrowed ₹2,00,000 at 10% interest and invested it in company debentures yielding 12% interest.

- Interest income = ₹24,000
- Interest paid = ₹20,000
  Hence, taxable income = ₹24,000 – ₹20,000 = ₹4,000.

4.2 Inadmissible Deductions

Certain deductions are not allowed under this head, such as:

- Personal expenses
- Any capital expenditure
- Any loss or expense not directly connected with earning that income
- No deduction for expenses from lottery or betting winnings

Thus, only legitimate revenue expenses incurred for earning income are deductible.

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5. Illustrative Example

Example:

Compute Mr. Rohit's *Income from Other Sources* for the financial year 2024–25 from the following information:

1. Dividend from Indian company – ₹18,000
2. Interest on bank fixed deposits – ₹12,000
3. Winnings from lottery – ₹50,000
4. Family pension – ₹48,000
5. Interest paid on money borrowed for investment in FDs – ₹4,000

Solution:

Particulars	**Amount (₹)**
Dividend income	18,000
Interest on FDs	12,000
Winnings from lottery	50,000
Family pension	48,000
Gross Total	**1,28,000**
Less: Deductions (u/s 57)	
Interest on borrowed capital	4,000
Family pension deduction (1/3 or ₹15,000 whichever less)	15,000

Particulars	Amount (₹)
Total Deductions	**19,000**
Taxable Income from Other Sources	**₹1,09,000**

Note: The lottery income of ₹50,000 will be taxed at a flat rate of 30%, and the remaining ₹59,000 (₹1,09,000 – ₹50,000) will be taxed as per normal slab rates.

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6. Important Provisions Related to Clubbing and Aggregation

In certain cases, income may arise to a minor child or spouse from assets transferred by the taxpayer. Such income, if not falling under any other head, will be clubbed under *Income from Other Sources* in the hands of the transferor (as per Sections 60 to 64).

Similarly, when computing *Gross Total Income*, the income under this head is aggregated with other heads, and deductions under Chapter VI-A (like Section 80C, 80D, etc.) are allowed thereafter.

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7. Conclusion

The head *"Income from Other Sources"* plays a crucial role in ensuring that the Indian taxation system remains comprehensive and equitable. It acts as a residual or inclusive category, capturing all forms of income that escape classification under other heads. This head encompasses diverse sources such as dividends, interest, gifts, lotteries, family pension, and casual incomes.

For accurate tax computation, the taxpayer must identify the nature of each income, apply relevant deductions under Section 57, and understand the applicable tax rate provisions. Proper documentation and compliance help avoid misclassification and penalties.

Thus, taxation of “Income from Other Sources” represents the Income-tax Act’s commitment to a *broad-based and fair* taxation framework that leaves no income untaxed while ensuring legitimate deductions for genuine expenses.

Numerical Chapter :-

1. Capital Gains

2. Income from other source