

4

Unit 1 : Income From Salaries

Key Points

Basis of Charge [Section 15]

- | | |
|-------|---|
| (i) | Salary is chargeable to tax either on 'due' basis or on 'receipt' basis, whichever is earlier. |
| (ii) | However, where any salary, paid in advance, is assessed in the year of payment, it cannot be subsequently brought to tax in the year in which it becomes due. |
| (iii) | If the salary paid in arrears has already been assessed on due basis, the same cannot be taxed again when it is paid. |

Taxability/Exemption of certain Allowances

Section	Allowance	Exemption
10(13A)	House Rent Allowance	Least of the following is exempt: <ul style="list-style-type: none"> (a) HRA actually received (b) Rent paid <i>less</i> 10% of salary (c) 50% of salary, if accommodation is located in Mumbai, Kolkata, Delhi or Chennai 40% of salary, if the accommodation is located in any other city.
10(14)(ii)	Children education allowance	₹ 100 per month per child upto maximum of two children
	Transport allowance for commuting between the place of residence and the place of duty.	₹ 1,600 per month (₹ 3,200 per month for an employee who is blind or deaf or dumb or orthopaedically handicapped)
	Hostel expenditure of employee's children	₹ 300 per month per child up to a maximum of two children

Exemption of Terminal Benefits			
Section	Component of salary	Category of employee	Particulars [Taxability / Exemption under section 10]
10(10)	Gratuity	Government	Fully exempt u/s 10(10)(i)
		Non-Government	<p>Least of the following is exempt :</p> <p>(i) ₹ 10 lacs</p> <p>(ii) Gratuity actually received</p> <p>(iii) <u>In case of employees covered by the Payment of Gratuity Act, 1972</u> $15/26 \times \text{last drawn salary} \times \text{number of completed years or part in excess of six months}$</p> <p><u>In case of employees not covered by the Payment of Gratuity Act, 1972</u> $1/2 \times \text{average salary of last 10 months} \times \text{number of completed years of service}$ (fraction to be ignored).</p>
10(10A)	Pension Uncommuted pension	Government & Non-Government	Fully taxable.
	Commuted pension	Government/ local authorities/ statutory corporation/ members of Civil services / All-India services / Defence Services.	Fully exempt under section 10(10A)(i)
		Other Employees	<p><u>If the employee is in receipt of gratuity</u> The amount exempt would be one-third of the amount of commuted pension which he would have received had he commuted his entire pension.</p> <p><u>If the employee is not in receipt of gratuity</u> The amount exempt would be one-half of the amount of commuted pension which he would have received had he commuted his entire pension.</p>

10(10AA)	Leave Salary		
	Received during service	Government & Non-Government	Fully taxable
	Received at the time of retirement, (whether on superannuation or otherwise)	Government Non-Government	Fully exempt (at the time of retirement) Least of the following is exempt : (i) ₹ 3,00,000 (ii) Leave salary actually received (iii) Cash equivalent of leave standing at the credit of the employee [based on average salary of last 10 months] (maximum 30 days for every year of service) (iv) 10 months salary (based on average salary of last 10 months)
10(10B)	Retrenchment Compensation		Least of the following is exempt : (i) Compensation actually received. (ii) ₹ 5,00,000 (iii) $15/26 \times \text{Average salary of last 3 months} \times \text{Completed years of service}$ and part thereof in excess of 6 months
10(10C)	Voluntary Retirement Compensation	Central and State Government, Public sector company, any other company, local authority, co-operative society, IIT etc.	Least of the following is exempt : (i) Compensation actually received (ii) ₹ 5,00,000 (iii) $\text{Last drawn salary} \times 3 \text{ months} \times \text{completed years of service}$ (iv) $\text{Last drawn salary} \times \text{remaining months of service}$

Section 10(5) [Leave Travel Concession]

Exemption is available for 2 trips in a block of 4 calendar years.

S. No.	Journey performed by	Exemption
1	Air	Amount not exceeding air economy fare by the shortest route.
2	Any other mode :	
	(i) Where rail service is available	Amount not exceeding air conditioned first class rail fare by the shortest route.
	(ii) Where rail service is not available	
	a) and public transport does not exist	Amount equivalent to air conditioned first class rail fares by the shortest route
	b) but public transport exists.	Amount not exceeding the first class or deluxe class fare by the shortest route.

Provident Funds - Exemption & Taxability provisions

Particulars	Recognized PF	Unrecognized PF	Statutory PF	Public PF
Employer's Contribution	Amount in excess of 12% of salary is taxable	Not taxable yearly	Fully exempt	N.A.
Employee's Contribution	Eligible for deduction u/s 80C	Not eligible for deduction	Eligible for deduction u/s 80C	Eligible for deduction u/s 80C
Interest Credited	Amount in excess of 9.5% p.a. is taxable	Not taxable yearly	Fully exempt	Fully exempt
Amount received on retirement, etc.	Exempt from tax if employee served a continuous period of 5 years or more or retires before rendering 5 years of service because of reason beyond the control of the employee. In other case, it will be taxable.	Employer's contribution and interest thereon is taxable as salary. Employee's contribution is not taxable. Interest on employee's contribution is taxable under income from other source.	Fully exempt u/s 10(11)	Fully exempt u/s 10(11)

Valuation of Perquisites [Section 17(2) read with Rule 3]													
(A) Rent-free residential accommodation													
S. No. (A)	Category of Employee (B)	Unfurnished accommodation (C)	Furnished accommodation (D)										
1	Government employee	License fee determined as per government rules as reduced by the rent actually paid by the employee.	Value determined under column (C) <i>Add:</i> 10% p.a. of the furniture cost. However, if the furniture is hired, then hire charges payable/paid should be added to the value determined under column (C), as reduced by charges recovered from employee.										
2	Non-government employee	<table><tr><th colspan="2"><u>Where accommodation is owned by employer</u></th></tr><tr><th>Location</th><th>Perquisite value</th></tr><tr><td>In cities having a population > 25 lacs as per 2001 census.</td><td>15% of salary</td></tr><tr><td>In cities having a population > 10 lacs ≤ 25 lacs as per 2001 census.</td><td>10% of salary</td></tr><tr><td>In other areas</td><td>7.5% of salary</td></tr></table> <p>The perquisite value should be arrived at by reducing the rent, if any, actually paid by the employee, from the above value.</p>	<u>Where accommodation is owned by employer</u>		Location	Perquisite value	In cities having a population > 25 lacs as per 2001 census.	15% of salary	In cities having a population > 10 lacs ≤ 25 lacs as per 2001 census.	10% of salary	In other areas	7.5% of salary	Value determined under column (C) <i>Add:</i> 10% p.a. of the furniture cost. However, if the furniture is hired, then hire charges payable/paid should be added to the value determined under column (C), as reduced by charges recovered from employee.
<u>Where accommodation is owned by employer</u>													
Location	Perquisite value												
In cities having a population > 25 lacs as per 2001 census.	15% of salary												
In cities having a population > 10 lacs ≤ 25 lacs as per 2001 census.	10% of salary												
In other areas	7.5% of salary												

	<p><u>Where the accommodation is taken on lease or rent by employer</u></p> <p>Lower of the following is taxable:</p> <p>(a) actual amount of lease rent paid or payable by employer or</p> <p>(b) 15% of salary</p> <p>The lower of the above should be reduced by the rent, actually paid by the employee, to arrive at the perquisite value.</p>	<p>Value determined under column (C)</p> <p><i>Add:</i> 10% p.a. of the furniture cost.</p> <p>However, if the furniture is hired, then hire charges payable/paid should be added to the value determined under column (C), as reduced by charges recovered from employee.</p>
<p>(B) Interest free or concessional loan</p> <p>In respect of any loan given by employer to employee or any member of his household (excluding for medical treatment for specified ailments or where loans amount in aggregate does not exceed ₹ 20,000), the interest at the rate charged by SBI as on the first day of the relevant previous year at maximum outstanding monthly balance (aggregate outstanding balance for each loan as on the last day of each month) as reduced by the interest, if any, actually paid by him or any member of his household.</p>		
<p>(D) Use of movable assets by employee/ any member of his household</p>		
(i)	10% p.a. of actual cost of asset owned by the employer or the amount of hire charges incurred by the employer for the asset hired would be the perquisite value.	
(ii)	There would, however, be no perquisite for use of laptops and computers.	
<p>(E) Transfer of movable assets</p> <p>Perquisite value would be the depreciated value of the asset computed by applying the rates of depreciation mentioned in the following table, as reduced by any amount paid by or recovered from the employee.</p>		
S. No.	Assets	Rate of depreciation
1	Computers and electronic items	50% of WDV for each completed year of usage
2	Motor cars	20% of WDV for each completed year of usage
3	Other assets	10% on SLM for each completed year of usage

(F) Motor car											
S. No.	Car owned/ hired by	Expenses met by	Wholly official use	Wholly personal use	Partly personal use						
1	Employer	Employer	Not a perquisite	Running and maintenance expenses, wear and tear or hire charges, driver salary less amount charged from the employee for such use.	<table><tr><th>cc of engine</th><th>Perquisite value</th></tr><tr><td>upto 1.6 litres</td><td>₹ 1,800 p.m.</td></tr><tr><td>above 1.6 litres</td><td>₹ 2,400 p.m.</td></tr></table> <p>If chauffeur is also provided, ₹ 900 p.m. should be added to the above value.</p>	cc of engine	Perquisite value	upto 1.6 litres	₹ 1,800 p.m.	above 1.6 litres	₹ 2,400 p.m.
cc of engine	Perquisite value										
upto 1.6 litres	₹ 1,800 p.m.										
above 1.6 litres	₹ 2,400 p.m.										
2	Employee	Employer	Not a perquisite	Actual amount of expenditure incurred.	Actual amount of expenditure incurred by the employer as reduced by the perquisite value arrived at in (2) above.						
3	Employer	Employee	Not a perquisite	Wear and tear or hire charges, driver salary.	<table><tr><th>cc of engine</th><th>Perquisite value</th></tr><tr><td>upto 1.6 litres</td><td>₹ 600 p.m.</td></tr><tr><td>above 1.6 litres</td><td>₹ 900 p.m.</td></tr></table> <p>If chauffeur is also provided, ₹ 900 p.m. should be added to the above value.</p>	cc of engine	Perquisite value	upto 1.6 litres	₹ 600 p.m.	above 1.6 litres	₹ 900 p.m.
cc of engine	Perquisite value										
upto 1.6 litres	₹ 600 p.m.										
above 1.6 litres	₹ 900 p.m.										

Meaning of Salary:		
S. No.	Calculation of exemption of Allowance / Terminal benefit / Valuation of perquisite	Meaning of salary
1	Gratuity (in case of non-Government employees covered by the Payment of Gratuity Act, 1972)	Basic salary and dearness allowance.
2	a) Gratuity (in case of non-Government employee not covered by Payment of Gratuity Act, 1972) b) Leave Salary c) House Rent Allowance d) Recognized Provident Fund e) Voluntary Retirement Compensation	Basic salary and dearness allowance, if provided in terms of employment, and commission calculated as a fixed percentage of turnover.
3	Rent free accommodation and concessional accommodation	All pay, allowance, bonus or commission or any monetary payment by whatever name called but excludes- (1) Dearness allowance not forming part of computation of superannuation or retirement benefit (2) employer's contribution to the provident fund account of the employee; (3) allowances which are exempted from the payment of tax; (4) value of the perquisites specified in section 17(2); (5) any payment or expenditure specifically excluded under the proviso to section 17(2) i.e., medical expenditure/payment of medical insurance premium specified therein. (6) lump-sum payments received at the time of termination or service or superannuation or voluntary retirement.

<u>Deductions from gross salary [Section 16]</u>	
(1)	Entertainment allowance (allowable only in the case of government employees) [Section 16(ii)]
	Least of the following is allowed as deduction:
	(1) ₹ 5,000
	(2) 1/5 th of basic salary
	(3) Actual entertainment allowance received
(2)	Profession tax [Section 16(iii)]
	Any sum paid by the assessee on account of tax on employment is allowable as deduction.
	In case profession tax is paid by employer on behalf of employee, the amount paid shall be included in gross salary as a perquisite and then deduction can be claimed.
<u>Relief when salary is paid in arrears or in advance [Section 89]</u>	
Step 1	Calculate tax payable of the previous year in which the arrears/advance salary is received by considering:
	(a) Total Income inclusive of additional salary
	(b) Total Income exclusive of additional salary
Step 2	Compute the difference the tax calculated in Step 1 and Step 2 i.e., (a) – (b)
Step 3	Calculate the tax payable of every previous year to which the additional salary relates:
	(a) On total income including additional salary of that particular previous year
	(b) On total income excluding additional salary.
Step 4	Calculate the difference between (a) and (b) in Step 3 for every previous year to which the additional salary relates and aggregate the same.
Step 5	Relief u/s 89(1) = Amount calculated in Step 2 – Amount calculated in Step 4

4.10 Income Tax

Question 1

Mr. Harish, aged 52 years, is the Production Manager of XYZ Ltd. From the following details, compute the taxable income for the assessment year 2017-18.

Basic salary	₹ 50,000 per month
Dearness allowance	40% of basic salary
Transport allowance (for commuting between place of residence and office)	₹ 3,000 per month
Motor car running and maintenance charges fully paid by employer (The motor car is owned by the company and driven by the employee. The engine cubic capacity is above 1.60 litres. The motor car is used for both official and personal purpose by the employee.)	₹ 60,000
Expenditure on accommodation in hotels while touring on official duties met by the employer	₹ 80,000
Loan from recognized provident fund (maintained by the employer)	₹ 60,000
Lunch provided by the employer during office hours.	
Cost to the employer	₹ 24,000
Computer (cost ₹ 35,000) kept by the employer in the residence of Mr. Harish from 1.06.2016	
Mr. Harish made the following payments:	
Medical insurance premium: Paid in Cash	₹ 4,800
Paid by account payee crossed cheque	₹ 25,700

Answer

Computation of taxable income of Mr. Harish for the A.Y.2017-18

Particulars	₹	₹
Basic salary (₹ 50,000 x 12)		6,00,000
Dearness allowance @ 40% of basic salary		2,40,000
Transport allowance (₹ 3,000 x 12)	36,000	
Less : Exemption under section 10(14) (₹ 1,600 x 12)	<u>19,200</u>	16,800
Motor car running & maintenance charges paid by employer (See Note-1)		28,800
Expenditure on accommodation in hotels while touring on official duty is not a perquisite in the hands of employee and hence not chargeable to tax		Nil
Loan from recognized provident fund – not chargeable to tax		Nil

Value of lunch provided during office hours	24,000	
Less: Exempt under Rule 3(7)(iii) (See Note-2)	<u>15,000</u>	9,000
Computer provided in the residence of employee by the employer – not chargeable to tax [Rule 3(7)(vii)]		<u>Nil</u>
Gross Salary		8,94,600
Less : Deduction under Chapter VI-A		
Deduction under section 80D in respect of medical insurance premium paid by cheque amounting to ₹ 25,700 but restricted to ₹25,000 (See Note-3)		<u>25,000</u>
Taxable income		<u>8,69,600</u>

Notes:

- As per Rule 3(2), if the motor car (whose engine cubic capacity is above 1.60 litres) is owned by the employer and is used for both official and personal purpose by the employee, then, the value of perquisite for use of motor car would be ₹ 2,400 per month.
Therefore, value of perquisite for use of motor car would be ₹ 2,400 x 12 = ₹ 28,800
- As per Rule 3(7)(iii), lunch provided by the employer during office hours is not considered as perquisite upto ₹ 50 per meal. Since, the number of working days is not given in the question, it is assumed to be 300 days during the F.Y. 2016-17. Therefore, ₹ 15,000 (i.e. 300 x ₹ 50) would be exempt and the balance ₹ 9,000 (i.e. ₹ 24,000 - ₹ 15,000) would be taxable.
- Medical insurance premium paid in cash of ₹ 4,800 is not allowable as deduction under section 80D. Further, deduction for medical insurance premium paid through cheque is restricted to ₹ 25,000, which is the maximum deduction allowable.

Question 2

Mr. Balaji, employed as Production Manager in Beta Ltd., furnishes you the following information for the year ended 31.03.2017:

- Basic salary upto 31.10.2016 ₹ 50,000 p.m.
Basic salary from 01.11.2016 ₹ 60,000 p.m.
Note: Salary is due and paid on the last day of every month.
- Dearness allowance @ 40% of basic salary.
- Bonus equal to one month salary. Paid in October 2016 on basic salary plus dearness allowance applicable for that month.
- Contribution of employer to recognized provident fund account of the employee @ 16% of basic salary.
- Profession tax paid ₹ 3,000 of which ₹ 2,000 was paid by the employer.

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- (vi) Facility of laptop and computer was provided to Balaji for both official and personal use. Cost of laptop ₹ 45,000 and computer ₹ 35,000 were acquired by the company on 01.12.2016.
- (vii) Motor car owned by the employer (cubic capacity of engine exceeds 1.60 litres) provided to the employee from 01.11.2016 meant for both official and personal use. Repair and running expenses of ₹ 45,000 from 01.11.2016 to 31.03.2017, were fully met by the employer. The motor car was self-driven by the employee.
- (viii) Leave travel concession given to employee, his wife and three children (one daughter aged 7 and twin sons aged 3). Cost of air tickets (economy class) reimbursed by the employer ₹ 30,000 for adults and ₹ 45,000 for three children. Balaji is eligible for availing exemption this year to the extent it is permissible in law.

Compute the salary income chargeable to tax in the hands of Mr. Balaji for the assessment year 2017-18.

Answer

Computation of Taxable Salary of Mr. Balaji for A.Y. 2017-18

Particulars	₹
Basic salary [(₹ 50,000 × 7) + (₹ 60,000 × 5)]	6,50,000
Dearness Allowance (40% of basic salary)	2,60,000
Bonus (₹ 50,000 + 40% of ₹ 50,000) (See Note 1)	70,000
Employers contribution to recognised provident fund in excess of 12% of salary = 4% of ₹ 6,50,000 (See Note 4)	26,000
Professional tax paid by employer	2,000
Perquisite of Motor Car (₹ 2,400 for 5 months) (See Note 5)	12,000
Gross Salary	10,20,000
Less: Deduction under section 16	
Professional tax (See Note 6)	3,000
Taxable Salary	10,17,000

Notes:

1. Since bonus was paid in the month of October, the basic salary of ₹ 50,000 for the month of October is considered for its calculation.
2. As per Rule 3(7)(vii), facility of use of laptop and computer is an exempt perquisite, whether used for official or personal purpose or both.
3. Mr. Balaji can avail exemption under section 10(5) on the entire amount of ₹ 75,000 reimbursed by the employer towards Leave Travel Concession since the same was availed for himself, his wife and three children and the journey was undertaken by economy class airfare. The restriction imposed for two children is not applicable in case of multiple births which take place after the first child.

It is assumed that the Leave Travel Concession was availed for journey within India.

4. It is assumed that dearness allowance does not form part of salary for computing retirement benefits.
5. As per the provisions of Rule 3(2), in case a motor car (engine cubic capacity exceeding 1.60 liters) owned by the employer is provided to the employee without chauffeur for personal as well as office use, the value of perquisite shall be ₹ 2,400 per month. The car was provided to the employee from 01.11.2016, therefore the perquisite value has been calculated for 5 months.
6. As per section 17(2)(iv), a "perquisite" includes any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee. Therefore, professional tax of ₹ 2,000 paid by the employer is taxable as a perquisite in the hands of Mr. Balaji. As per section 16(iii), a deduction from the salary is provided on account of tax on employment i.e. professional tax paid during the year.

Therefore, in the present case, the professional tax paid by the employer on behalf of the employee ₹ 2,000 is first included in the salary and deduction of the entire professional tax of ₹ 3,000 is provided from salary.

Question 3

From the following details, find out the salary chargeable to tax for the A.Y.2017-18 -

Mr. X is a regular employee of Rama & Co., in Gurgaon. He was appointed on 1.1.2016 in the scale of 20,000-1,000-30,000. He is paid 10% D.A. & Bonus equivalent to one month pay based on salary of March every year. He contributes 15% of his pay and D.A. towards his recognized provident fund and the company contributes the same amount.

He is provided free housing facility which has been taken on rent by the company at ₹ 10,000 per month. He is also provided with following facilities:

- (i) *Facility of laptop costing ₹ 50,000.*
- (ii) *Company reimbursed the medical treatment bill of his brother of ₹ 25,000, who is dependent on him.*
- (iii) *The monthly salary of ₹ 1,000 of a house keeper is reimbursed by the company.*
- (iv) *A gift voucher of ₹ 10,000 on the occasion of his marriage anniversary.*
- (v) *Conveyance allowance of ₹ 1,000 per month is given by the company towards actual reimbursement.*
- (vi) *He is provided personal accident policy for which premium of ₹ 5,000 is paid by the company.*
- (vii) *He is getting telephone allowance @ ₹ 500 per month.*
- (viii) *Company pays medical insurance premium of his family of ₹ 10,000.*

Answer

Computation of taxable salary of Mr. X for A.Y. 2017-18

Particulars	₹
Basic pay [(₹ 20,000×9) + (₹ 21,000×3)] = ₹ 1,80,000 + ₹ 63,000	2,43,000
Dearness allowance [10% of basic pay]	24,300
Bonus	21,000
Employer's contribution to Recognized Provident Fund in excess of 12% (15%-12% =3% of ₹ 2,67,300) [See Note 1 below]	8,019
Taxable allowances	
Telephone allowance	6,000
Taxable perquisites	
Rent-free accommodation [See Note 1 & 2 below]	44,145
Medical reimbursement (₹ 25,000 - ₹ 15,000) [See Note 4 below]	10,000
Reimbursement of salary of housekeeper	12,000
Gift voucher [See Note 6 below]	10,000
Salary income chargeable to tax	3,78,464

Notes:

1. It has been assumed that dearness allowance forms part of salary for retirement benefits and accordingly, the perquisite value of rent-free accommodation and employer's contribution to recognized provident fund have been worked out.
2. Where the accommodation is taken on lease or rent by the employer, the value of rent-free accommodation provided to employee would be actual amount of lease rental paid or payable by the employer or 15% of salary, whichever is lower.

For the purposes of valuation of rent free house, salary includes:

- (i) Basic salary i.e., ₹ 2,43,000
- (ii) Dearness allowance (assuming that it is included for calculating retirement benefits) i.e. ₹ 24,300
- (iii) Bonus i.e., ₹ 21,000
- (iv) Telephone allowance i.e., ₹ 6,000

Therefore, salary works out to

$$2,43,000 + 24,300 + 21,000 + 6,000 = 2,94,300.$$

$$15\% \text{ of salary} = 2,94,300 \times 15/100 = 44,145$$

Value of rent-free house = Lower of rent paid by the employer (i.e. ₹ 1,20,000) or 15% of salary (i.e., ₹ 44,145).

Therefore, the perquisite value is ₹ 44,145.

3. Facility of use of laptop is not a taxable perquisite.
4. Clause (v) of the proviso to section 17(2) exempts any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family to the extent of ₹ 15,000. Therefore, in this case, the balance of ₹ 10,000 (i.e., ₹ 25,000 – ₹ 15,000) is a taxable perquisite. Medical insurance premium paid by employer is exempt.
5. Conveyance allowance is exempt since it is based on actual reimbursement for official purposes.
6. The value of any gift or voucher or token in lieu of gift received by the employee or by member of his household below ₹ 5,000 in aggregate during the previous year is exempt. In this case, the gift voucher was received on the occasion of marriage anniversary and the sum exceeds the limit of ₹ 5,000.

Therefore, the entire amount of ₹ 10,000 is liable to tax as perquisite.

Note - An alternate view possible is that only the sum in excess of ₹ 5,000 is taxable in view of the language of Circular No.15/2001 dated 12.12.2001 that such gifts upto ₹ 5,000 in the aggregate per annum would be exempt, beyond which it would be taxed as a perquisite. As per this view, the value of perquisite would be ₹ 5,000.

7. Premium of ₹ 5,000 paid by the company for personal accident policy is not liable to tax.

Question 4

From the following details, find out the salary chargeable to tax of Mr. Anand for the assessment year 2017-18:

Mr. Anand is a regular employee of Malpani Ltd. in Mumbai. He was appointed on 01-03-2016 in the scale of 25,000-2,500-35,000. He is paid dearness allowance (which forms part of salary for retirement benefits) @ 15% of basic pay and bonus equivalent to one and a half month's basic pay as at the end of the year. He contributes 18% of his salary (basic pay plus dearness allowance) towards recognized provident fund and the Company contributes the same amount.

He is provided free housing facility which has been taken on rent by the Company at ₹ 15,000 per month. He is also provided with following facilities:

- (i) The Company reimbursed the medical treatment bill of ₹ 40,000 of his daughter, who is dependent on him.
- (ii) The monthly salary of ₹ 2,000 of a house keeper is reimbursed by the Company.
- (iii) He is getting telephone allowance @ ₹ 1,000 per month.

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- (iv) A gift voucher of ₹ 4,700 was given on the occasion of his marriage anniversary.
- (v) The Company pays medical insurance premium to effect an insurance on the health of Mr. Anand ₹ 12,000.
- (vi) Motor car running and maintenance charges of ₹ 36,600 fully paid by employer. (The motor car is owned and driven by Mr. Anand. The engine cubic capacity is below 1.60 litres. The motor car is used for both official and personal purpose by the employee.)
- (vii) Value of free lunch provided during office hours is ₹ 2,200.

Answer

Computation of taxable salary of Mr. Anand for A.Y. 2017-18

Particulars	₹
Basic pay [(₹ 25,000×11) + (₹ 27,500×1)] = ₹ 2,75,000 + ₹ 27,500	3,02,500
Dearness allowance [15% of basic pay]	45,375
Bonus [₹ 27,500 × 1.5]	41,250
Employer's contribution to Recognized Provident Fund in excess of 12% (18% - 12% = 6% of ₹ 3,47,875)	20,873
Taxable allowances	
Telephone allowance	12,000
Taxable perquisites	
Rent-free accommodation [See Note 1 below]	60,169
Medical reimbursement (₹ 40,000 - ₹ 15,000) [See Note 2 below]	25,000
Reimbursement of salary of housekeeper [₹ 2,000 × 12]	24,000
Gift voucher [See Note 4 below]	-
Motor car owned and driven by employee, running and maintenance charges borne by the employer [₹ 36,600 - ₹ 21,600 (i.e., ₹ 1,800 × 12)]	15,000
Value of free lunch facility [See Note 5 below]	-
Salary income chargeable to tax	5,46,167
Notes:	
1. Where the accommodation is taken on lease or rent by the employer, the value of rent-free accommodation provided to employee would be actual amount of lease rental paid or payable by the employer or 15% of salary, whichever is lower. For the purposes of valuation of rent free house, salary includes:	
(i) Basic salary	₹ 3,02,500
(ii) Dearness allowance	₹ 45,375
(iii) Bonus	₹ 41,250
(iv) Telephone allowance	₹ 12,000
Total	₹ 4,01,125
15% of salary = ₹ 4,01,125 × 15/100 = ₹ 60,169	

	Value of rent-free house will be
	- Actual amount of lease rental paid by employer (i.e. ₹ 1,80,000) or
	- 15% of salary (i.e., ₹ 60,169),
	whichever is lower.
	Therefore, the perquisite value is ₹ 60,169.
2.	Any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family is exempt to the extent of ₹ 15,000. Therefore, in this case, the balance of ₹ 25,000 (i.e., ₹ 40,000 – ₹ 15,000) is a taxable perquisite.
3.	Medical insurance premium paid by the employer to effect an insurance on the health of the employee is fully exempt.
4.	If the value of any gift or voucher or token in lieu of gift received by the employee or by member of his household is less than ₹ 5,000 in aggregate during the previous year, the perquisite value is Nil. In this case, the gift voucher was received on the occasion of marriage anniversary and the sum is less than ₹ 5,000. Therefore, the perquisite value of gift voucher, is Nil.
5.	Free lunch provided by the employer during office hours is not a perquisite, assuming that the value does not exceed ₹ 50 per meal.

Question 5

Shri Hari is the General Manager of ABC Ltd. From the following details, compute the taxable income for the Assessment year 2017-18:

<i>Basic salary</i>	<i>₹ 20,000 per month</i>
<i>Dearness allowance</i>	<i>30% of basic salary</i>
<i>Transport allowance (for commuting between place of residence and office)</i>	<i>₹ 2,000 per month</i>
<i>Motor car running and maintenance charges fully paid by employer</i>	<i>₹ 36,000</i>
<i>(The motor car is owned and driven by employee Hari. The engine cubic capacity is below 1.60 litres. The motor car is used for both official and personal purpose by the employee)</i>	
<i>Expenditure on accommodation in hotels while touring on official duties met by the employer.</i>	<i>₹ 30,000</i>
<i>Loan from recognised provident fund (maintained by the employer)</i>	<i>₹ 40,000</i>
<i>Lunch provided by the employer during office hours.</i>	
<i>Cost to the employer</i>	<i>₹ 12,000</i>
<i>Computer (cost ₹ 50,000) kept by the employer in the residence of Hari from 1.10.2016</i>	
<i>Hari made the following payments:</i>	
<i>Medical insurance premium : Paid in cash</i>	<i>₹ 3,000</i>
<i>Paid by cheque</i>	<i>₹ 27,000</i>

Answer

Computation of taxable income of Shri Hari for the A.Y. 2017-18

Particulars	₹	₹
Basic salary (₹ 20,000 x 12)		2,40,000
Dearness allowance @ 30%		72,000
Transport allowance (₹ 2,000 x 12)	24,000	
Less: Exemption under section 10(14) (read with Rule 2BB @ ₹ 1,600 p.m.)	19,200	4,800
Motor car maintenance borne by employer [₹ 36,000 - ₹ 21,600 (i.e., ₹ 1,800 x 12)]		14,400
Expenditure on accommodation while on official duty not a perquisite and hence not chargeable to tax		Nil
Loan from recognized provident fund – not chargeable to tax		Nil
Value of lunch provided during working hours (not chargeable to tax as per rule 3(7)(iii)-free food provided by the employer during working hours is not treated as perquisite provided that the value thereof does not exceed fifty rupees per meal)		Nil
Computer provided in the residence of employee by the employer – not chargeable to tax [Rule 3(7)(vii)]		Nil
Gross Salary		3,31,200
Less: Deduction under Chapter VI-A		
Deduction under section 80D in respect of medical insurance premium paid by cheque, restricted to ₹ 25,000	25,000	
Premium paid in cash not eligible for deduction	Nil	25,000
Taxable income		3,06,200

Question 6

Mr. Vignesh, Finance Manager of KLM Ltd., Mumbai, furnishes the following particulars for the financial year 2016-17:

- Salary ₹ 46,000 per month
- Value of medical facility in a hospital maintained by the company ₹ 7,000
- Rent free accommodation owned by the company
- Housing loan of ₹ 6,00,000 given on 01.04.2016 at the interest rate of 6% p.a. (No repayment made during the year). The rate of interest charged by State Bank of India (SBI) as on 01.04.2016 in respect of housing loan is 10%.
- Gifts in kind made by the company on the occasion of wedding anniversary of Mr. Vignesh ₹ 4,750.

- (vi) A wooden table and 4 chairs were provided to Mr. Vignesh at his residence (dining table). This was purchased on 1.5.2013 for ₹ 60,000 and sold to Mr. Vignesh on 1.8.2016 for ₹ 30,000.
- (vii) Personal purchases through credit card provided by the company amounting to ₹ 10,000 was paid by the company. No part of the amount was recovered from Mr. Vignesh.
- (viii) An ambassador car which was purchased by the company on 16.7.2013 for ₹ 2,50,000 was sold to the assessee on 14.7.2016 for ₹ 80,000.

Other income received by the assessee during the previous year 2016-17:

	Particulars	₹
(a)	Interest on Fixed Deposits with a company	5,000
(b)	Income from specified mutual fund	3,000
(c)	Interest on bank fixed deposits of a minor married daughter	3,000

- (ix) Contribution to LIC towards premium under section 80CCC ₹ 1,00,000
- (x) Deposit in PPF Account made during the year 2016-17 ₹ 40,000

Compute the taxable income of Mr. Vignesh and the tax thereon for the Assessment year 2017-18.

Answer

Computation of taxable income of Mr. Vignesh for the Assessment Year 2017-18

	Particulars	₹	₹
(a)	Income from salaries (See Working Note below)		7,62,800
(b)	Income from other sources		
	(i) Interest on fixed deposit with a company	5,000	
	(ii) Income from specified mutual fund exempt under section 10(35)	Nil	
	(iii) Interest on Fixed Deposit received by minor daughter (₹ 3,000 - ₹ 1500)	1,500	<u>6,500</u>
	Gross total income		7,69,300
	Less: Deductions under Chapter VI-A		
	Section 80C – PPF	40,000	
	Section 80CCC	<u>1,00,000</u>	<u>1,40,000</u>
	Total Income		<u>6,29,300</u>
	Tax on total income		50,860
	Add: Education cess @ 2%		1,017

4.20 Income Tax

	Add : Secondary and Higher Education cess @ 1%		<u>509</u>
	Total tax liability		<u>52,386</u>
	Total tax liability (rounded off)		52,390

Working Note:

Computation of salary income of Mr. Vignesh for the Assessment Year 2017-18

Particulars	₹
Income under the head "salaries"	
Salary [₹ 46,000 x 12]	5,52,000
Medical facility [in the hospital maintained by the company is exempt]	–
Rent free accommodation	
15% of salary is taxable (i.e. ₹ 5,52,000 × 15% as per Rule 3(1))	82,800
Use of dining table for 4 months [₹ 60,000 x 10 /100 x 4 /12]	2,000
Valuation of perquisite of interest on loan [Rule 3(7)(i)] – 10% is taxable which is to be reduced by actual rate of interest charged i.e. [10% - 6% = 4%]	24,000
Gift given on the occasion of wedding anniversary ₹ 4,750 is exempt, since its value is less than ₹ 5,000	-
Perquisite on sale of dining tables	
Cost	60,000
Less: Depreciation on straight line method @ 10% for 3 years	<u>18,000</u>
Written Down Value	42,000
Less: Amount paid by the assessee	<u>30,000</u>
	12,000
Purchase through credit card – not being a privilege but covered by section 17(2)(iv)	10,000
Perquisite on sale of car	
Original cost of car	2,50,000
Less: Depreciation from 16.7.2013 to 15.7.2014 @ 20%	<u>50,000</u>
	2,00,000
Less: Depreciation from 16.7.2014 to 15.7.2015 @ 20%	<u>40,000</u>
Value as on 14.07.2015- being the date of sale to employee	1,60,000
Less: Amount received from the assessee on 14.07.2016	<u>80,000</u>
	<u>80,000</u>
Income from Salaries	<u>7,62,800</u>

Note: Under Rule 3(7)(viii), while calculating the perquisite value of benefit to the employee arising from the transfer of any movable asset, the normal wear and tear is to be calculated in respect of each completed year during which the asset was put to use by the employer. In the given case the third year of use of ambassador car is completed on 15.7.2016 where as the car was sold to the employee on 14.7.2016. The solution worked out above provides for wear and tear for only two years.

Question 7

Mrs. Lakshmi aged about 66 years is a Finance Manager of M/s. Lakshmi & Co. Pvt. Ltd., based at Calcutta. She is in continuous service since 1975 and receives the following salary and perks from the company during the year ending 31.03.2017:

- (i) Basic Salary ($\text{₹ } 50,000 \times 12$) = ₹ 6,00,000
- (ii) D.A. ($\text{₹ } 20,000 \times 12$) = ₹ 2,40,000 (forms part of pay for retirement benefits)
- (iii) Bonus – 2 months basic pay.
- (iv) Commission – 0.1% of the turnover of the company. The turnover for the F.Y. 2016-17 was ₹ 15.00 crores.
- (v) Contribution of the employer and employee to the recognized provident fund Account ₹ 3,00,000 each.
- (vi) Interest credited to Recognized Provident Fund Account at 9.5% - ₹ 60,000.
- (vii) Rent free unfurnished accommodation provided by the company for which the company pays a rent of ₹ 70,000 per annum.
- (viii) Entertainment Allowance – ₹ 30,000.
- (ix) Hostel allowance for three children – ₹ 5,000 each.

She makes the following payments and investments :

- (i) Premium paid to insure the life of her major son – ₹ 15,000.
- (ii) Medical Insurance premium for self – ₹ 6,000 ; Spouse – ₹ 6,000.
- (iii) Donation to a public charitable institution registered under 80G ₹ 2,00,000 by way of cheque.
- (iv) LIC Pension Fund – ₹ 50,000.

Determine the tax liability for the Assessment Year 2017-18.

4.22 Income Tax

Answer

Computation of Total Income of Mrs. Lakshmi for A.Y. 2017-18

Particulars	₹	₹
Income from salary		
Basic salary		6,00,000
Dearness allowance		2,40,000
Bonus		1,00,000
Commission (calculated as percentage of turnover)		1,50,000
Entertainment allowance		30,000
Children's hostel allowance	15,000	
Less : Exemption (₹ 300 x 12 x 2)	<u>7,200</u>	7,800
Interest credited to recognized provident fund account (exempt)		-
Rent free unfurnished accommodation (Refer Working Note 1)		70,000
Excess contribution to PF by employer (Refer Working Note 2)		<u>1,81,200</u>
Gross salary		13,79,000
Less : Deduction under section 80C		
Life insurance premium paid for insurance of major son	15,000	
Contribution to recognized provident fund	<u>3,00,000</u>	
	<u>3,15,000</u>	
Restricted to	1,50,000	
Deduction under section 80CCC in respect of LIC pension fund	<u>50,000</u>	
	2,00,000	
Deduction limited to ₹ 1,50,000 as per section 80CCE		1,50,000
Deduction under section 80D		<u>12,000</u>
Total income before deduction under section 80G		12,17,000
Deduction under section 80G :		
50% of ₹ 1,21,700 (10% total income) (Refer Working Note 3)		<u>60,850</u>
Total income		<u>11,56,150</u>
Tax on total income [20,000 + 1,00,000 + (11,56,150 - 10,00,000) x 30%]		1,66,845
Add : Education cess @ 2%		3,337
Add : Secondary and higher education cess @ 1%		<u>1,668</u>
Total tax liability		<u>1,71,850</u>

Working Notes:**1. Value of rent free unfurnished accommodation**

Particulars	₹
Basic salary	6,00,000
Dearness allowance	2,40,000
Bonus	1,00,000
Commission @ 0.1% of turnover	1,50,000
Entertainment allowance	30,000
Children's hostel allowance	<u>7,800</u>
Gross Salary	<u>11,27,800</u>
15% of salary	1,69,170
Actual rent paid by the company	70,000
The least of the above is chargeable perquisite.	

2. Employer's contribution to P.F. in excess of 12% of salary

Employer's contribution	₹ 3,00,000
Less : 12% of basic salary, dearness allowance & commission	
12% of ₹ 9,90,000	<u>₹ 1,18,800</u>
	<u>₹ 1,81,200</u>

3. No deduction shall be allowed under section 80G in respect of any sum exceeding ₹ 10,000 unless such sum is paid by any mode other than cash. Here, since the donation of ₹ 2,00,000 is made by cheque, the same is allowed.

Question 8

Mr. M is an area manager of M/s N. Steels Co. Ltd. During the financial year 2016-17, he gets the following emoluments from his employer:

Basic Salary	
Up to 31.8.2016	₹ 20,000 p.m.
From 1.9.2016	₹ 25,000 p.m.
Transport allowance	₹ 2,000 p.m.
Contribution to recognised provident fund	15% of basic salary
Children education allowance (Total)	₹ 500 p.m. for two children
City compensatory allowance	₹ 300 p.m.
Hostel expenses allowance (Total)	₹ 380 p.m. for two children
Tiffin allowance (actual expenses ₹ 3,700)	₹ 5,000 p.a.
Tax paid on employment	₹ 2,500

Compute taxable salary of Mr. M for the Assessment year 2017-18.

Answer

Computation of taxable salary of Mr. M. for the Assessment Year 2017-18

Particulars	₹	₹
Basic Salary (₹ 20,000 x 5) +(₹ 25,000 x 7)		2,75,000
Transport allowance (₹ 2,000 x 12)	24,000	
Less : Exempt under section 10(14) (₹ 1,600 x 12)	<u>19,200</u>	4,800
Children education allowance (₹ 500 x 12)	6,000	
Less: Exempt under section 10(14) (₹ 100 x 2 x 12)	<u>2,400</u>	3,600
City Compensatory Allowance (₹ 300 x 12)		3,600
Hostel Expenses Allowance (₹ 380 x 12)	4,560	
Less: Exempt under section 10(14) (₹ 300 x 2 x 12 i.e. ₹ 7,200 but restricted to the actual allowance of ₹ 4,560)	<u>4,560</u>	Nil
Tiffin allowance (fully taxable)		5,000
Tax paid on employment [See Note Below]		2,500
Employer's contribution to recognized provident fund in excess of 12% of salary (i.e., 3% of ₹ 2,75,000)		<u>8,250</u>
Gross Salary		3,02,750
Less : Tax on employment under section 16(iii)		<u>2,500</u>
Taxable salary		<u>3,00,250</u>

Note: Professional tax paid by employer should be included in the salary of Mr. M as a perquisite since it is discharge of monetary obligation of the employee by the employer. Thereafter, deduction of professional tax paid is allowed to the employee from his gross salary.

Question 9

From the following details furnished by Mr. Dinesh, a marketing manager of XL Corporation Ltd., Delhi, compute the gross total income for the Assessment Year 2017-18.

Particulars	Amount (₹)
Salary including Dearness Allowance	6,50,000
Conveyance allowance of ₹ 900 p.m.	10,800
Bonus	50,000
Salary of servant provided by the employer	48,000
Bills paid by the employer for gas, electricity and water provided free of cost at the residence of Mr. Dinesh	82,000

Dinesh purchased a flat in a co-operative housing society in Dwarka, Delhi for self occupation for ₹ 35,00,000 in April 2013, which was financed by a loan from Bank of India of ₹ 20,00,000 @ 11% interest and his own savings of ₹ 5,00,000 and a deposit of ₹ 10,00,000 from Bank of Baroda, to whom he let out his another house in Rohini, Delhi on lease for ten years. The rent payable by Bank of Baroda is ₹ 35,000 per month. Other relevant particulars are given below:

- (i) Municipal taxes paid by Dinesh for his flat in Dwarka are ₹ 18,000 per annum and for his house in Rohini are ₹ 12,000 per annum.
- (ii) Principal loan amount outstanding as on 01-04-2016 was ₹ 18,50,000.
- (iii) He also paid ₹ 8,000 towards insurance of both the houses.
- (iv) In the financial year 2015-16, he had gifted ₹ 40,000 each to his wife and minor son. The gifted amounts were advanced to Mr. Sandeep, who is paying interest @ 18% per annum.
- (v) Mr. Dinesh's son is studying in a school run by the employer company throughout the financial year 2016-17. The education facility was provided free of cost. The cost of such education in similar school is ₹ 2,500 per month.
- (vi) Dinesh also received gifts of ₹ 45,000 each from his two friends during the financial year 2016-17.

Answer

Computation of gross total income of Mr. Dinesh for the A.Y. 2017-18

Particulars	₹	₹
Salaries		
Salary including dearness allowance		6,50,000
Bonus		50,000
Conveyance allowance (Fully exempt under section 10(14)(i) read with Rule 2BB(1)(c), assuming that it is granted to meet the expenditure actually incurred on conveyance in performance of duties of an office or employment of profit).		Nil
Value of perquisites:		
(i) Salary of servant [Rule 3(3)]	48,000	
(ii) Free gas, electricity and water [Rule 3(4)]	82,000	
(iii) Cost of free education provided by employer (₹ 2,500 x 12) is fully taxable, since the cost of education exceeds ₹ 1,000 per month [Rule 3(5)].	<u>30,000</u>	<u>1,60,000</u>
Income chargeable under the head "Salaries"		8,60,000

4.26 Income Tax

Income from house property		
Let-out property (At Rohini)		
Gross Annual Value (GAV) (Lease rental is taken as GAV in the absence of other information) (₹ 35,000 × 12)	4,20,000	
Less: Municipal taxes paid	<u>12,000</u>	
Net Annual Value (NAV)	4,08,000	
Less: Deduction under section 24(a): 30% of NAV ¹	<u>1,22,400</u>	
(A)	<u>2,85,600</u>	
Self-occupied property (At Dwarka)		
Net Annual Value (NAV) [Since the property is self-occupied]	Nil	
Less: Deduction under section 24(a)		
Interest on loan from Bank of India @11% of ₹ 18,50,000 restricted to	2,03,500	<u>(2,00,000)</u>
(B)		<u>(2,00,000)</u>
Income from house property [A - B]		85,600
Income from Other Sources		
(i) Interest earned by minor son from advances made out of money gifted to him by his father, Mr. Dinesh, is includible in the hands of Dinesh as per section 64(1A), since all income arising to a minor child is includible in the hands of parent ² whose total income (before including the income of minor child) is greater (₹ 40,000 × 18%)	7,200	
Less: Exempt under section 10(32)	<u>1,500</u>	
	5,700	
(ii) Interest income earned by Dinesh's wife from advances made out of money gifted to her by her husband, Mr. Dinesh, has to be included in the total income of Mr. Dinesh as per section 64(1) (₹ 40,000 × 18%)	7,200	
(iii) Gift received from two friends [taxable under section 56(2)(vii)] since the aggregate amount received during the year exceeds ₹ 50,000 (₹ 45,000 × 2)	<u>90,000</u>	<u>1,02,900</u>
Gross Total Income		<u>10,48,500</u>

¹ No separate deduction is allowable in respect of insurance.

² It is assumed that Mr. Dinesh's total income before including the income of minor child is higher than his wife's total income.

Question 10

Mr. Anand, an employee of XYZ Co. Ltd. at Mumbai and covered by Payment of Gratuity Act, retires at the age of 64 years on 31-12-2016 after completing 33 years and 7 months of service. At the time of retirement, his employer pays ₹ 20,51,640 as Gratuity and ₹ 6,00,000 as accumulated balance of Recognised Provident fund. He is also entitled for monthly pension of ₹ 8,000. He gets 75% of pension commuted for ₹ 4,50,000 on 1st February, 2017.

Determine the salary chargeable to tax for Mr. Anand for the Assessment Year 2017-18 with the help of following information:

	₹
Basic Salary (₹ 80,000 x 9)	7,20,000
Bonus	36,000
House Rent Allowance (₹ 15,000 x 9)	1,35,000
Rent paid by Mr. Anand (₹ 10,000 x 12)	1,20,000
Employer contribution towards Recognized Provident Fund	1,10,000
Professional Tax paid by Mr. Anand	2,000

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

Answer

Computation of taxable salary of Mr. Anand for the Assessment Year 2017-18

Particulars	₹
Basic Salary (₹ 80,000 x 9)	7,20,000
Bonus	36,000
House Rent Allowance (Working Note 1)	1,17,000
Employer's contribution towards recognized provident fund in excess of 12% of salary [i.e., ₹ 1,10,000 – ₹ 86,400 (12% of ₹ 7,20,000)]	23,600
Gratuity (Working Note 2)	10,51,640
Uncommuted Pension [(₹ 8,000 x 1) + (₹ 2,000 x 2)]	12,000
Commuted Pension (Working Note 3)	<u>2,50,000</u>
Gross Salary	22,10,240
Less: Professional tax paid by Mr. Anand [deductible under section 16(iii)]	<u>2,000</u>
Taxable salary	<u>22,08,240</u>

Working Notes:

Particulars		₹	₹
(1)	Taxable House Rent Allowance		
	Actual HRA Received		1,35,000
	As per section 10(13A), least of the following is exempt:		
	(i) Actual HRA received	1,35,000	
	(ii) Excess of rent paid over 10% of salary (basic pay, in this case)		
	- Rent paid (₹ 10,000 x 9)	₹ 90,000	
	- Less: 10% of salary (i.e., 10% of ₹ 7,20,000)	₹ 72,000	
		18,000	
	(iii) 50% of salary (i.e., 50% of ₹ 7,20,000)	3,60,000	
	Least of the above		<u>18,000</u>
	Taxable HRA		<u>1,17,000</u>
(2)	Taxable Gratuity		
	Actual Gratuity received		20,51,640
	As per section 10(10), least of the following is exempt:		
	(i) Statutory limit	10,00,000	
	(ii) Actual gratuity received	20,51,640	
	(iii) 15 days salary for each completed year of service or part thereof in excess of 6 months i.e., $15/26 \times 80,000 \times 34$	15,69,231	
	Least of the above		<u>10,00,000</u>
	Taxable Gratuity		<u>10,51,640</u>
(3)	Commuted Pension		
	Since Mr. Anand is a non-government employee in receipt of gratuity, exemption under section 10(10A), would be available to the extent of 1/3 rd of the amount of the pension which he would have received had he commuted the whole of the pension.		
	Amount received (Commuted value of 75% of pension)		4,50,000
	Amount exempt from tax = (₹ 4,50,000 x 100/75) x 1/3		<u>2,00,000</u>
	Taxable amount		<u>2,50,000</u>
(4)	Accumulated balance of Recognized Provident Fund (RPF)		
	₹ 6 lakh, representing the accumulated balance of RPF, received on retirement is exempt since Mr. Anand has rendered a continuous service for a period of 5 years or more (33 years and 7 months) in XYZ Ltd.		

Question 11

Mr. X retired from the services of M/s Y Ltd. on 31.01.2017, after completing service of 30 years and one month. He had joined the company on 1.1.1987 at the age of 30 years and received the following on his retirement:

- (i) Gratuity ₹ 6,00,000. He was covered under the Payment of Gratuity Act, 1972.
- (ii) Leave encashment of ₹ 3,30,000 for 330 days leave balance in his account. He was credited 30 days leave for each completed year of service.
- (iii) As per the scheme of the company, he was offered a car which was purchased on 01.02.2014 by the company for ₹ 5,00,000. Company has recovered ₹ 2,00,000 from him for the car. Company depreciates the vehicles at the rate of 15% on Straight Line Method.
- (iv) An amount of ₹ 3,00,000 as commutation of pension for 2/3 of his pension commutation.
- (v) Company presented him a gift voucher worth ₹ 6,000 on his retirement.
- (vi) His colleagues also gifted him a Television (LCD) worth ₹ 50,000 from their own contribution.

Following are the other particulars:

- (i) He has drawn a basic salary of ₹ 20,000 and 50% dearness allowance per month for the period from 01.04.2016 to 31.01.2017.
- (ii) Received pension of ₹ 5,000 per month for the period 01.02.2017 to 31.03.2017 after commutation of pension.

Compute his gross total income from the above for Assessment Year 2017-18.

Answer

Computation of Gross Total Income of Mr. X for A.Y. 2017-18

Particulars	₹
Basic Salary = ₹ 20,000 x 10	2,00,000
Dearness Allowance = 50% of basic salary	1,00,000
Gift Voucher (See Note - 1)	6,000
Transfer of car (See Note - 2)	56,000
Gratuity (See Note - 3)	80,769
Leave encashment (See Note - 4)	1,30,000
Uncommuted pension (₹ 5000 x 2)	10,000
Commuted pension (See Note - 5)	<u>1,50,000</u>
Taxable Salary /Gross Total Income	<u>7,32,769</u>

Notes:

- (1) As per Rule 3(7)(iv), the value of any gift or voucher or token in lieu of gift received by the employee or by member of his household not exceeding ₹ 5,000 in aggregate during the previous year is exempt. In this case, the amount was received on his retirement and the sum exceeds the limit of ₹ 5,000.

Therefore, the entire amount of ₹ 6,000 is liable to tax as perquisite.

Note - An alternate view possible is that only the sum in excess of ₹ 5,000 is taxable in view of the language of Circular No.15/2001 dated 12.12.2001 that such gifts upto ₹ 5,000 in the aggregate per annum would be exempt, beyond which it would be taxed as a perquisite. As per this view, the value of perquisite would be ₹ 1,000 and gross taxable income would be ₹ 7,27,769.

- (2) **Perquisite value of transfer of car:** As per Rule 3(7)(viii), the value of benefit to the employee, arising from the transfer of an asset, being a motor car, by the employer is the actual cost of the motor car to the employer as reduced by 20% of such cost for each completed year during which such motor car was put to use by the employer on a written down value basis. Therefore, the value of perquisite on transfer of motor car, in this case, would be:

Particulars	₹
Purchase price (1.2.2014)	5,00,000
Less: Depreciation @ 20%	<u>1,00,000</u>
WDV on 31.1.2015	4,00,000
Less: Depreciation @ 20%	<u>80,000</u>
WDV on 31.1.2016	3,20,000
Less: Depreciation @ 20%	<u>64,000</u>
WDV on 31.1.2017	2,56,000
Less: Amount recovered	<u>2,00,000</u>
Value of perquisite	<u>56,000</u>

The rate of 15% as well as the straight line method adopted by the company for depreciation of vehicle is not relevant for calculation of perquisite value of car in the hands of Mr. X.

- (3) **Taxable gratuity**

Particulars	₹
Gratuity received	6,00,000
Less : Exempt under section 10(10) - Least of the following:	
(i) Notified limit = ₹ 10,00,000	

(ii) Actual gratuity =	₹ 6,00,000	
(iii) $15/26 \times 30,000 \times 30 =$	₹ 5,19,231	<u>5,19,231</u>
Taxable Gratuity		<u>80,769</u>

(4) Taxable leave encashment

Particulars	₹
Leave Salary received	3,30,000
Less : Exempt under section 10(10AA) - Least of the following:	
(i) Notified limit	₹ 3,00,000
(ii) Actual leave salary	₹ 3,30,000
(iii) 10 months x ₹ 20,000 (assuming that dearness allowance does not form part of pay for retirement benefit)	₹ 2,00,000
(iv) Cash equivalent of leave to his credit $\left(\frac{330}{30} \times 20,000 \right)$	<u>2,00,000</u>
Taxable Leave encashment	<u>1,30,000</u>

Note – It has been assumed that dearness allowance does not form part of salary for retirement benefits. In case it is assumed that dearness allowance forms part of pay for retirement benefits, then, the third limit for exemption under section 10(10AA) in respect of leave encashment would be ₹ 3,00,000 (i.e. 10 x ₹ 30,000) and the fourth limit ₹ 3,30,000, in which case, the taxable leave encashment would be ₹ 30,000 (₹ 3,30,000 - ₹ 3,00,000). In such a case, the gross total income would be ₹ 6,32,769.

(5) Commuted Pension

Since Mr. X is a non-government employee in receipt of gratuity, exemption under section 10(10A) would be available to the extent of $\frac{1}{3}$ rd of the amount of the pension which he would have received had he commuted the whole of the pension.

Particulars	₹
Amount received	3,00,000
Exemption under section 10(10A) = $\frac{1}{3} \times \left[3,00,000 \times \frac{3}{2} \right]$	<u>1,50,000</u>
Taxable amount	<u>1,50,000</u>

- (6) The taxability provisions under section 56(2)(vii) are not attracted in respect of television received from colleagues, since television is not included in the definition of property therein.

Question 12

Mr. Narendra, who retired from the services of Hotel Samode Ltd., on 31.1.2017 after putting on service for 5 years, received the following amounts from the employer for the year ending on 31.3.2017:

- ♦ Salary @ ₹ 16,000 p.m. comprising of basic salary of ₹ 10,000, Dearness allowance of ₹ 3,000, City compensatory allowance of ₹ 2,000 and Night duty allowance of ₹ 1,000.
- ♦ Pension @ 30% of basic salary from 1.2.2017.
- ♦ Leave salary of ₹ 75,000 for 225 days of leave accumulated during 5 years @ 45 days leave in each year. He has not availed any earned leave during his tenure of 5 years and utilized only his casual leave.
- ♦ Gratuity of ₹ 50,000.

Compute the total income of Mr. Narendra for the assessment year 2017-18.

Answer

Computation of total income of Mr. Narendra for A.Y. 2017-18

Particulars	₹	₹
Income from Salaries		
Gross salary received during 1.4.2016 to 31.1.2017 @ ₹ 16,000 p.m. (₹ 16,000 x 10)		1,60,000
Pension for 2 months @ 30% of the basic salary of ₹ 10,000 p.m.		6,000
Leave Salary	75,000	
Less: Exempt under section 10(10AA) (Note1)	50,000	25,000
Gratuity	50,000	
Less: Exempt under section 10(10) (Note2)	25,000	25,000
Total Income		2,16,000

Notes:

1. Leave encashment is exempt to the extent of least of the following:

	Particulars	₹
(i)	Statutory limit	3,00,000
(ii)	Cash equivalent of leave for 30 days for 5 years (₹ 10,000 × 150/30)	50,000
(iii)	10 months average salary (10 x ₹ 10,000)	1,00,000
(iv)	Actual amount received	75,000

Therefore, ₹ 50,000 is exempt under section 10(10AA).

2. Assuming that the employee is not covered under the Payment of Gratuity Act, 1972, Gratuity is exempt to the extent of least of the following :

	Particulars	₹
(i)	Statutory limit	10,00,000
(ii)	Half month's salary for 5 years of service (5 x ₹ 5,000)	25,000
(iii)	Actual gratuity received	50,000

Therefore, ₹ 25,000 is exempt under section 10(10).

3. It has been assumed that dearness allowance does not form part of salary for retirement benefits and therefore, not included in "Salary" for the purpose of computation of leave encashment and gratuity.

Question 13

Mr. Mohit is employed with XY Ltd. on a basic salary of ₹ 10,000 p.m. He is also entitled to dearness allowance @ 100% of basic salary, 50% of which is included in salary as per terms of employment. The company gives him house rent allowance of ₹ 6,000 p.m. which was increased to ₹ 7,000 p.m. with effect from 1.01.2017. He also got an increment of ₹ 1,000 p.m. in his basic salary with effect from 1.02.2017. Rent paid by him during the previous year 2016-17 is as under:

April and May, 2016 - Nil, as he stayed with his parents
 June to October, 2016 - ₹ 6,000 p.m. for an accommodation in Ghaziabad
 November, 2016 to March, 2017 - ₹ 8,000 p.m. for an accommodation in Delhi.

Compute his gross salary for assessment year 2017-18.

Answer

Computation of gross salary of Mr. Mohit for A.Y. 2017-18

Particulars	₹
Basic salary [(₹ 10,000 × 10) + (₹ 11,000 × 2)]	1,22,000
Dearness Allowance (100% of basic salary)	1,22,000
House Rent Allowance (See Note below)	<u>21,300</u>
Gross Salary	<u>2,65,300</u>

Note: Computation of Taxable House Rent Allowance (HRA)

Particulars	April-May (₹)	June-Oct (₹)	Nov-Dec (₹)	Jan (₹)	Feb-March (₹)
Basic salary per month	10,000	10,000	10,000	10,000	11,000
Dearness allowance (included in salary as per terms of					

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employment) (50% of basic salary)	<u>5,000</u>	<u>5,000</u>	<u>5,000</u>	<u>5,000</u>	<u>5,500</u>
Salary per month for the purpose of computation of house rent allowance	<u>15,000</u>	<u>15,000</u>	<u>15,000</u>	<u>15,000</u>	<u>16,500</u>
Relevant period (in months)	2	5	2	1	2
Salary for the relevant period (Salary per month × relevant period)	30,000	75,000	30,000	15,000	33,000
Rent paid for the relevant period	Nil	30,000 (₹6,000×5)	16,000 (₹8,000×2)	8,000 (₹8,000×1)	16,000 (₹ 8,000×2)
House rent allowance (HRA) received during the relevant period (A)	12,000 (₹6,000×2)	30,000 (₹6,000×5)	12,000 (₹6,000×2)	7,000 (₹7,000×1)	14,000 (₹7,000×2)
Least of the following is exempt [u/s 10(13A)]					
1. Actual HRA received	12,000	30,000	12,000	7,000	14,000
2. Rent paid – 10% of salary	N.A.	22,500	13,000	6,500	12,700
3. 40% of salary at Residence Ghaziabad–June to Oct, 2016)	N.A.	30,000 (40% × ₹ 75,000)			
50% of salary (Residence at Delhi–Nov'16- March'17)			15,000 (50% × ₹30,000)	7,500 (50% × ₹15,000)	16,500 (50% × ₹33,000)
Exempt HRA (B)	Nil	22,500	12,000	6,500	12,700
Taxable HRA (Actual HRA – Exempt HRA) (A-B)	12,000	7,500	Nil	500	1,300

Taxable HRA (total) = ₹ 12,000 + ₹ 7,500 + ₹ 500 + ₹ 1,300 = ₹ 21,300

Question 14

- (i) Mr. Khanna, an employee of IOL, New Delhi, a private sector company, received the following for the financial year 2016-17:

Sl. No.	Particulars	₹
1.	Basic pay	1,20,000

2.	House rent allowance	1,00,000
3.	Special allowance	30,000

Mr. Khanna was residing at New Delhi and was paying a rent of ₹ 10,000 a month.

Compute the eligible exemption under section 10(13A) of the Income-tax Act, 1961, in respect of house rent allowance received.

- (ii) If Mr. Khanna opts for rent free accommodation whereby IOL would be paying a rent of ₹ 10,000 per month to the landlord and recovers a sum of ₹ 2,500 per month from Mr. Khanna which was in excess of his entitlement, what will be the perquisite value in respect of such rent free accommodation?
- (iii) Which of the above would be beneficial to Mr. Khanna i.e., house rent allowance or rent free accommodation?

Answer

- (i) The eligible exemption under section 10(13A) in respect of house rent allowance received would be least of the following:

	Particulars	₹	₹
(a)	Actual house rent allowance (HRA) received		1,00,000
(b)	Excess of rent paid over 10% of basic salary		
	Rent paid (10,000 x 12)	1,20,000	
	Less: 10% of basic pay (i.e. 10% of ₹ 1,20,000)	<u>12,000</u>	1,08,000
(c)	50% of salary (i.e. 50% of ₹ 1,20,000)		60,000

Least of the above is ₹ 60,000.

The house rent allowance received by Mr. Khanna would be exempt to the extent of ₹ 60,000 under section 10(13A). The balance of ₹ 40,000 is includible in his total income.

- (ii) **Perquisite value in respect of concessional accommodation**

As per rule 3(1), where the accommodation is taken on lease or rent by the employer, the actual amount of lease rental paid or payable by the employer or 15% of salary, whichever is lower, as reduced by the rent, if any, actually paid by the employee is the value of the perquisite.

(a) Actual rent paid by the employer = ₹ 10,000 x 12 = ₹ 1,20,000

(b) 15% of salary = 15% of basic pay plus special allowance =

15% of ₹ 1,50,000 = ₹ 22,500

Lower of the above is ₹ 22,500, which should be reduced by the rent of ₹ 30,000 paid by the employee (i.e., 2,500 x 12 = ₹ 30,000). The perquisite value is, therefore, nil.

(iii) We have to see the cash flow from both the options to find out which is more beneficial.

Particulars	₹	₹
Option 1: HRA		
Cash inflows [Basic Pay + HRA + Special Allowance]		2,50,000
Less: Cash outflows:		
Rent paid	1,20,000	
Tax (See Working Note 1 below)	<u>Nil</u>	<u>1,20,000</u>
Net cash flow		<u>1,30,000</u>
Option 2: Concessional Accommodation		
Cash inflows [Basic Pay + Special Allowance]		1,50,000
Less: Cash outflows:		
Rent recovery	30,000	
Tax (See Working Note 2 below)	<u>Nil</u>	<u>30,000</u>
Net cash flow		<u>1,20,000</u>

Since the net cash flow is higher in Option 1, Mr. Khanna should opt for HRA, which would be more beneficial to him.

Working Notes:

1. Computation of tax under Option 1 (HRA):

Particulars	₹
Salary:	
Basic Pay	1,20,000
HRA (taxable)	40,000
Special allowance	<u>30,000</u>
Total salary	<u>1,90,000</u>
Tax on ₹ 1,90,000 (including cess)	Nil

2. Computation of tax under Option 2 (Concessional accommodation)

Particulars	₹
Salary:	
Basic Pay	1,20,000
Special allowance	30,000
Concessional accommodation	<u>Nil</u>
Total salary	<u>1,50,000</u>
Tax on ₹ 1,50,000	Nil

Question 15

Mr. X and Mr. Y are working for M/s. Gama Ltd. As per salary fixation norms, the following perquisites were offered:

- (i) For Mr. X, who engaged a domestic servant for ₹ 500 per month, his employer reimbursed the entire salary paid to the domestic servant i.e. ₹ 500 per month.*
- (ii) For Mr. Y, he was provided with a domestic servant @ ₹ 500 per month as part of remuneration package.*

You are required to comment on the taxability of the above in the hands of Mr. X and Mr. Y, who are not specified employees.

Answer

In the case of Mr. X, it becomes an obligation which the employee would have discharged even if the employer did not reimburse the same. Hence, the perquisite will be covered under section 17(2)(iv) and will be taxable in the hands of Mr. X. This is taxable in the case of all employees.

In the case of Mr. Y, it cannot be considered as an obligation which the employee would meet. The employee might choose not to have a domestic servant. This is taxable only in the case of specified employees covered by section 17(2)(iii). Hence, there is no perquisite element in the hands of Mr. Y.

Question 16

The following benefits have been granted by Ved Software Ltd. to one of its employees Mr. Badri:

- (i) Housing loan @ 6% per annum. Amount outstanding on 1.4.2016 is ₹ 6,00,000. Mr. Badri pays ₹ 12,000 per month towards principal, on 5th of each month.*
- (ii) Air-conditioners purchased 4 years back for ₹ 2,00,000 have been given to Mr. Badri for ₹ 90,000.*

Compute the chargeable perquisite in the hands of Mr. Badri for the A.Y. 2017-18.

The lending rate of State Bank of India as on 1.4.2016 for housing loan may be taken as 10%.

Answer

Perquisite value for housing loan: The value of the benefit to the assessee resulting from the provision of interest-free or concessional loan made available to the employee or any member of his household during the relevant previous year by the employer or any person on his behalf shall be determined as the sum equal to the interest computed at the rate charged per annum by the State Bank of India (SBI) as on the 1st day of the relevant previous year in respect of loans for the same purpose advanced by it. This rate should be applied on the

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maximum outstanding monthly balance and the resulting amount should be reduced by the interest, if any, actually paid by him.

"Maximum outstanding monthly balance" means the aggregate outstanding balance for loan as on the last day of each month.

The perquisite value for computation is $10\% - 6\% = 4\%$

Month	Maximum outstanding balance as on last date of month (₹)	Perquisite value at 4% for the month (₹)
April, 2016	5,88,000	1,960
May, 2016	5,76,000	1,920
June, 2016	5,64,000	1,880
July, 2016	5,52,000	1,840
August, 2016	5,40,000	1,800
September, 2016	5,28,000	1,760
October, 2016	5,16,000	1,720
November, 2016	5,04,000	1,680
December, 2016	4,92,000	1,640
January, 2017	4,80,000	1,600
February, 2017	4,68,000	1,560
March, 2017	4,56,000	<u>1,520</u>
	Total value of this perquisite	<u>20,880</u>

Perquisite Value of Air Conditioners

Particulars	₹
Original cost	2,00,000
Depreciation on SLM basis for 4 years @10% i.e. ₹ 2,00,000 x 10% x 4	80,000
Written down value	1,20,000
Amount recovered from the employee	90,000
Perquisite value	30,000

Chargeable perquisite in the hands of Mr. Badri for the assessment year 2017-18

Particulars	₹
Housing loan	20,880
Air Conditioner	30,000
Total	50,880

Question 17

Shri Bala employed in ABC Co. Ltd. as Finance Manager gives you the list of perquisites provided by the company to him for the entire financial year 2016-17:

- (i) *Medical facility given to his family in a hospital maintained by the company. The estimated value of benefit because of such facility is ₹ 40,000.*
- (ii) *Domestic servant was provided at the residence of Bala. Salary of domestic servant is ₹ 1,500 per month. The servant was engaged by him and the salary is reimbursed by the company (employer).*

In case the company has employed the domestic servant, what is the value of perquisite?

- (iii) *Free education was provided to his two children Arthy and Ashok in a school maintained and owned by the company. The cost of such education for Arthy is computed at ₹ 900 per month and for Ashok at ₹ 1,200 per month. No amount was recovered by the company for such education facility from Bala.*
- (iv) *The employer has provided movable assets such as television, refrigerator and air-conditioner at the residence of Bala. The actual cost of such assets provided to the employee is ₹ 1,10,000.*
- (v) *A gift voucher worth ₹ 10,000 was given on the occasion of his marriage anniversary. It is given by the company to all employees above certain grade.*
- (vi) *Telephone provided at the residence of Shri Bala and the bill aggregating to ₹ 25,000 paid by the employer.*

State the taxability or otherwise of the above said perquisites and compute the total value of taxable perquisites.

Answer**Taxability of perquisites provided by ABC Co. Ltd. to Shri Bala**

- (i) Medical facility to employees' family in a hospital maintained by the employer is not a taxable perquisite. Regardless of the estimated value of benefit arising from such facility to the employee, it is exempt from tax. Therefore, the value of perquisite is Nil.
- (ii) Domestic servant was employed by the employee and the salary of such domestic servant was paid/reimbursed by the employer. It is taxable as perquisite for all categories of employees.

Taxable perquisite value = ₹ 1,500 × 12 = ₹ 18,000.

If the company had employed the domestic servant and the facility of such servant is given to the employee, then the perquisite is taxable only in the case of specified employees. The value of the taxable perquisite in such a case also would be ₹ 18,000.

- (iii) Where the educational institution is owned by the employer, the value of perquisite in respect of free education facility shall be determined with reference to the reasonable cost of such education in a similar institution in or near the locality. However, there would be no perquisite if the cost of such education per child does not exceed ₹ 1,000 per month.

Therefore, there would be no perquisite in respect of cost of free education provided to his child Arthy, since the cost does not exceed ₹ 1,000 per month.

However, the cost of free education provided to his child Ashok would be taxable, since the cost exceeds ₹ 1,000 per month. The taxable perquisite value would be ₹ 14,400 ($₹ 1,200 \times 12$).

Note – An alternate view possible is that only the sum in excess of ₹ 1,000 per month is taxable. In such a case, the value of perquisite would be ₹ 2,400.

- (iv) Where the employer has provided movable assets to the employee or any member of his household, 10% per annum of the actual cost of such asset owned or the amount of hire charges incurred by the employer shall be the value of perquisite. However, this will not apply to laptops and computers. In this case, the movable assets are television, refrigerator and air conditioner and actual cost of such assets is ₹ 1,10,000.

The perquisite value would be 10% of the actual cost i.e., ₹ 11,000, being 10% of ₹ 1,10,000.

- (v) The value of any gift or voucher or token in lieu of gift received by the employee or by member of his household not exceeding ₹ 5,000 in aggregate during the previous year is exempt. In this case, the amount was received on the occasion of marriage anniversary and the sum exceeds the limit of ₹ 5,000.

Therefore, the entire amount of ₹ 10,000 is liable to tax as perquisite.

Note - An alternate view possible is that only the sum in excess of ₹ 5,000 is taxable in view of the language of Circular No.15/2001 dated 12.12.2001 that such gifts upto ₹ 5,000 in the aggregate per annum would be exempt, beyond which it would be taxed as a perquisite. As per this view, the value of perquisite would be ₹ 5,000.

Total value of taxable perquisite = ₹ 53,400 [i.e. ₹ 18,000 + 14,400 + 11,000 + 10,000].

- (v) Telephone provided at the residence of the employee and payment of bill by the employer is a tax free perquisite.

Note - In case the alternate views are taken for items (iii) & (v), the total value of taxable perquisite would be ₹ 36,400 [i.e., ₹ 18,000 + 2,400 + 11,000 + 5,000].

Question 18

Ms. Rakhi is an employee in a private company. She receives the following medical benefits from the company during the previous year 2016-17:

		₹
1	Reimbursement of following medical expenses incurred by Ms. Rakhi	
	(A) On treatment of her self employed daughter in a private clinic	4,000
	(B) On treatment of herself by family doctor	8,000
	(C) On treatment of her mother-in-law dependent on her, in a nursing home	5,000
2	Payment of premium on Mediclaim Policy taken on her health	7,500
3	Medical Allowance	2,000 per month
4	Medical expenses reimbursed on her son's treatment in a government hospital	5,000
5	Expenses incurred by company on the treatment of her minor son abroad	1,05,000
6	Expenses in relation to foreign travel and stay of Rakhi and her son abroad for medical treatment (Limit prescribed by RBI for this is ₹ 2,00,000)	1,20,000

Discuss about the taxability of above benefits and allowances in the hands of Rakhi.

Answer

Tax treatment of medical benefits, allowances and mediclaim premium in the hands of Ms. Rakhi for A.Y. 2017-18

	Particulars
1.	Reimbursement of medical expenses incurred by Ms. Rakhi
	(A) The amount of ₹ 4,000 reimbursed by her employer for treatment of her self-employed daughter in a private clinic qualifies for exclusion from perquisite, subject a maximum of ₹ 15,000 as per clause (v) of the first proviso to section 17(2), since daughter falls within the definition of "family", even though she is not a dependent. As per the definition of family, the condition of dependency is relevant only for parents, brothers and sisters of the individual and not for spouse and children.
	(B) The amount of ₹ 8,000 reimbursed by the employer for treatment of Ms. Rakhi by family doctor qualifies for exclusion from perquisite, subject to a maximum of ₹ 15,000 under clause (v) of the first proviso to section 17(2).

	<p>(C) The amount of ₹ 5,000 reimbursed by her employer for treatment of her dependant mother-in-law in a nursing home does not qualify for exclusion upto ₹ 15,000, since mother-in-law does not fall within the definition of "family", even though she is dependent on Ms. Rakhi.</p> <p>Therefore, the aggregate sum of ₹ 12,000, specified in (A) and (B) above, reimbursed by the employer would be excluded from perquisite [since the same is less than the maximum permissible limit of ₹ 15,000]. However, the sum of ₹ 5,000 specified in (C) above is a taxable perquisite.</p>
2.	Medical insurance premium of ₹ 7,500 paid by the employer for insuring health of Ms. Rakhi is an exempt perquisite as per clause (iii) of the first proviso to section 17(2).
3.	Medical allowance of ₹ 2,000 per month i.e., ₹ 24,000 p.a. is a fully taxable allowance.
4.	As per clause (ii)(a) of the first proviso to section 17(2), reimbursement of medical expenses of ₹ 5,000 on her son's treatment in a hospital maintained by the Government is an exempt perquisite.
5. & 6.	<p>As per clause (vi) of the first proviso to section 17(2), the following expenditure incurred by the employer would be excluded from perquisite subject to certain conditions –</p> <p>(i) Expenditure on medical treatment of the employee, or any member of the family of such employee, outside India [₹ 1,05,000, in this case];</p> <p>(ii) Expenditure on travel and stay abroad of the employee or any member of the family of such employee for medical treatment and one attendant who accompanies the patient in connection with such treatment [₹ 1,20,000, in this case].</p> <p>The conditions subject to which the above expenditure would be exempt are as follows –</p> <p>(i) The expenditure on medical treatment and stay abroad would be excluded from perquisite to the extent permitted by Reserve Bank of India;</p> <p>(ii) The expenditure on travel would be excluded from perquisite only in the case of an employee whose gross total income, as computed before including the said expenditure, does not exceed ₹ 2 lakh.</p> <p>Assuming that the limit of ₹ 2 lakh prescribed by RBI pertains to both expenditure on medical treatment of minor son as well as expenditure on stay abroad of Ms. Rakhi and her minor son, such expenditure would be excluded from perquisite subject to a maximum of ₹ 2 lakh. If such expenditure is less than ₹ 2 lakh, it would be fully excluded. The foreign travel expenditure of Ms. Rakhi and her minor son borne by the employer would be excluded from perquisite only if the gross total income of Ms. Rakhi, as computed before including the said expenditure, does not exceed ₹ 2 lakh.</p>

Question 19

AB Co. Ltd. allotted 1000 sweat equity shares to Sri Chand in June 2016. The shares were allotted at ₹ 200 per share as against the fair market value of ₹ 300 per share on the date of exercise of option by the allottee viz. Sri Chand. The fair market value was computed in accordance with the method prescribed under the Act.

- (i) *What is the perquisite value of sweat equity shares allotted to Sri Chand?*
- (ii) *In the case of subsequent sale of those shares by Sri Chand, what would be the cost of acquisition of those sweat equity shares?*

Answer

- (i) As per section 17(2)(vi), the value of sweat equity shares chargeable to tax as perquisite shall be the fair market value of such shares on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from, the assessee in respect of such shares.

Particulars	₹
Fair market value of 1000 sweat equity shares @ ₹ 300 each	3,00,000
Less: Amount recovered from Sri Chand 1000 shares @ ₹ 200 each	2,00,000
Value of perquisite of sweat equity shares allotted to Sri Chand	1,00,000

- (ii) As per section 49(2AA), where capital gain arises from transfer of sweat equity shares, the cost of acquisition of such shares shall be the fair market value which has been taken into account for perquisite valuation under section 17(2)(vi).

Therefore, in case of subsequent sale of sweat equity shares by Sri Chand, the cost of acquisition would be ₹ 3,00,000.

Question 20

Mr. Shah an Accounts Manager has retired from JK Ltd. on 15.1.2017, after rendering services for 30 years 7 months. His salary is ₹ 25,000/- p.m. upto 30.09.2016 and ₹ 27,000/- thereafter. He also gets ₹ 2,000/- p.m. as dearness allowance (55% of it is a part of salary for computing retirement benefits). He is not covered by the Payment of Gratuity Act, 1972. He has received ₹ 8 Lacs as gratuity from the employer company. Compute the gratuity taxable in the hands of Mr. Shah.

Answer**Computation of gratuity taxable in the hands of Mr. Shah for the P.Y. 2016-17**

As per section 10(10)(iii), gratuity received by an employee would be exempt upto the least of the following limits –

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S.No.	Particulars	₹
(i)	Gratuity received	8,00,000
(ii)	Half-month's salary for every year of completed service (See Note below)	4,00,500
(iii)	Monetary limit	10,00,000

Therefore, ₹ 4,00,500 would be exempt under section 10(10)(iii). The balance ₹ 3,99,500 (i.e. ₹ 8,00,000 – ₹ 4,00,500) would be taxable.

Note: One of the limits for calculation of gratuity exempt under section 10(10)(iii) is one-half-month's salary for each year of completed service (fraction of a year to be ignored), {(on the basis of average salary for the ten months immediately preceding the month of retirement. In this case, the month of retirement is January, 2017. Therefore, average salary for the months of March 2016 to December 2016 has to be considered. The salary is ₹ 25,000 p.m. upto 30.9.2016 and ₹ 27,000 p.m. from 1.10.2016. Hence, average salary would be ₹ 26,700 $\{[(\text{₹ } 25,000 \times 7) + (\text{₹ } 27,000 \times 3) + (2000 \times 55\% \times 10)]/10\}$.

Further, half-month's salary should be multiplied by the number of years of completed service and any fraction of a year has to be ignored. Therefore, in this case, half-month's salary should be multiplied by 30 and the fraction of 7 months should be ignored.

Computation of average salary	₹
Basic salary March 2016 to December 2016 $(25,000 \times 7 + 27,000 \times 3)$	2,56,000
Dearness allowance $(2,000 \times 10 \times 55\%)$	<u>11,000</u>
	<u>2,67,000</u>
Average salary = $2,67,000/10 = ₹ 26,700$	
Half-month's salary for every year of completed service (fraction is to be ignored) $[30 \times 26,700/2]$	4,00,500

Question 21

Mr. Alok, a Government employee, retired from service on 31-7-2016 after rendering service of 25 years and 7 months. He received gratuity of ₹ 7,00,000. His salary at the time of retirement was as under:

Basic salary ₹ 16,000 p.m.; Dearness Allowance ₹ 8,000 p.m. (eligible for retirement benefits)

- Compute the taxable portion of gratuity.
- If Mr. Alok is not a Government employee but covered by Payment of Gratuity Act, 1972 determine the taxable and exempt portion of gratuity.

Answer

- (i) As per section 10(10), gratuity received by a Government employee on retirement is fully exempt from tax. Since Mr. Alok is a government employee, gratuity amounting to ₹ 7,00,000 received would be fully exempt. The taxable portion of gratuity shall be Nil.

- (ii) If Mr. Alok is not a Government employee but covered by the Payment of Gratuity Act, 1972, then, gratuity received by him would be exempt upto least of the following :

Particulars	₹
(i) Statutory limit	10,00,000
(ii) Actual gratuity received	7,00,000
(iii) $15/26 \times \text{last drawn salary} \times \text{years of service (including part of the year in excess of 6 months)}$ $15/26 \times ₹ 24,000 \times 26 \text{ years}$	3,60,000

Therefore, ₹ 3,60,000 is exempt under section 10(10).

Therefore, taxable portion of gratuity = ₹ 7,00,000 – ₹ 3,60,000 = ₹ 3,40,000

Note: Salary, for the purpose of computation of exempt gratuity, means basic salary plus dearness allowance i.e. ₹ 24,000 (₹ 16,000 + ₹ 8,000).

Question 22

Distinguish between foregoing of salary and surrender of salary.

Answer

Foregoing of salary – Waiver by an employee of his salary is foregoing of salary. Once salary accrues, subsequent waiver does not absolve him from liability to income-tax.

Surrender of salary – If any employee surrenders his salary to the Central Government under the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the surrendered salary would not be included in computing his taxable income, whether he is a private sector/public sector or Government employee.

Question 23

How is advance salary taxed in the hands of an employee? Is the tax treatment same for loan or advance against salary?

Answer

Advance Salary: Advance salary is taxable when it is received by the employee, irrespective of the fact whether it is due or not.

It may so happen that when advance salary is included and charged in a particular previous year, the rate of tax at which the employee is assessed may be higher than the normal rate of tax to which he would have been assessed. Section 89(1) provides for relief in these types of cases.

Loan or Advance against salary: Loan is different from salary. When an employee takes a loan from his employer, which is repayable in certain specified installments, the loan amount cannot be brought to tax as salary of the employee.

4.46 Income Tax

Similarly, advance against salary is different from advance salary. It is an advance taken by the employee from his employer. This advance is generally adjusted against his salary over a specified time period. It cannot be taxed as salary.

Question 24

Mr. Ashok, an employee of a PSU, furnishes the following particulars for the previous year ending 31.03.2017:

Particulars	₹
(i) Salary income for the year	7,25,000
(ii) Salary for financial year 2009-10 received during the year	80,000
(iii) Assessed income for the financial year 2009-10	2,40,000

You are requested by the assessee to compute relief under section 89 of the Income-tax Act, 1961 and the tax payable for assessment year 2017-18.

The rates of income tax for the assessment year 2010-11 are:

	Tax rate (%)
On first ₹ 1,60,000	Nil
On ₹ 1,60,000 – ₹ 3,00,000	10
On ₹ 3,00,000 – ₹ 5,00,000	20
Above ₹ 5,00,000	30
Education cess	3

Answer

Computation of relief under section 89 of Mr. Ashok for the A.Y. 2017-18

Particulars	₹	₹
Assessment year 2017-18		
Salary Income for the year excluding arrears		7,25,000
Add: Arrears relating to Financial Year 2009-10		<u>80,000</u>
Total Income (including arrears)		<u>8,05,000</u>
 Tax on ₹ 8,05,000		
First ₹ 2,50,000 Nil	Nil	
Next ₹ 2,50,000 10%	25,000	
Balance ₹ 3,05,000 20%	<u>61,000</u>	
	<u>₹ 8,05,000</u>	86,000

Add: Education cess @ 2%		1,720	
Secondary and higher education cess @1%		<u>860</u>	
Tax on total income (including arrears) (A)		<u>88,580</u>	
Total Income excluding arrears			7,25,000
Tax on ₹ 7,25,000			
First	₹ 2,50,000	Nil	Nil
Next	₹ 2,50,000	10%	25,000
Balance	<u>₹ 2,25,000</u>	20%	<u>45,000</u>
	<u>₹ 7,25,000</u>		70,000
Add : Education cess @ 2%		1,400	
Secondary and higher education cess @ 1%		<u>700</u>	
Tax on total income (excluding arrears) (B)		<u>72,100</u>	
Difference between A & B (I)			16,480
Assessment Year 2010-11			
Total Income assessed			2,40,000
Add: Arrears relating to Financial year 2009-10			<u>80,000</u>
Total income (including arrears)			<u>3,20,000</u>
Tax on ₹ 3,20,000		18,000	
Add: Education Cess @ 2%		360	
Secondary and higher education cess @1%		<u>180</u>	
Tax on total income (including arrears) (C)		<u>18,540</u>	
Total Income excluding arrears			2,40,000
Tax on ₹ 2,40,000		8,000	
Add: Education Cess @ 2%		160	
Secondary and higher education cess @1%		<u>80</u>	
Tax on total income (excluding arrears) (D)		<u>8,240</u>	
Difference between C & D (II)			10,300
Relief under section 89 (I – II)			6,180

Note: It has been assumed that salary income of ₹ 7,25,000 for the year, as given in the question, does not include salary of ₹ 80,000 for the F.Y. 2009-10 received during the year.

Exercise

1. Where there is a decision to increase the D.A. in March, 2017 with retrospective effect from 1.4.2016, and the increased D.A. is received in April, 2017, the increase is taxable -
 - (a) in the previous year 2016-17
 - (b) in the previous year 2017-18
 - (c) in the respective years to which they relate.
2. The entertainment allowance received by a Government employee is exempt up to the lower of the actual entertainment allowance received, 1/5th of basic salary and -
 - (a). ₹ 4,000
 - (b). ₹ 6,000
 - (c). ₹ 5,000.
3. Rajesh is provided with a rent free unfurnished accommodation, which is owned by his employer, XY Pvt. Ltd., in New Delhi. The value of perquisite in the hands of Rajesh is -
 - (a). 20% of salary
 - (b). 15% of salary
 - (c). 10% of salary
4. Anirudh is provided with furniture to the value of ₹ 70,000 along with house from February, 2016. The actual hire charges paid by his employer for hire of furniture is ₹ 5,000 p.a.. The value of furniture to be included along with value of unfurnished house for A.Y.2017-18 is-
 - (a) ₹ 5,000
 - (b) ₹ 7,000
 - (c) ₹ 14,000
5. Employer's contribution to superannuation fund during the previous year 2016-17 is -
 - (a) subject to fringe benefits in the hands of the employer
 - (b) fully taxable as perquisite in the hands of the employee
 - (c) taxable as perquisite in the hands of the employee if it exceeds ₹ 1.50 lakh.
6. Write short notes on -
 - (a) Profits in lieu of salary
 - (b) Specified employees
7. Is retrenchment compensation received by workmen taxable under the Act? If yes, to what extent is it taxable?
8. When is provision of medical facilities or assistance by an employer not treated as a perquisite in the hands of the employee? Discuss.
9. Can an assessee claim relief under section 89 in respect of VRS compensation of ₹ 6 lakh received by him from his employer, if he has claimed exemption of ₹ 5 lakh in respect of the same under section 10(10C)? Discuss.
10. Explain the term "Profit in lieu of salary".

Answers

1. a; 2. c; 3. b; 4. a; 5. c

4

Unit 2 : Income From House Property

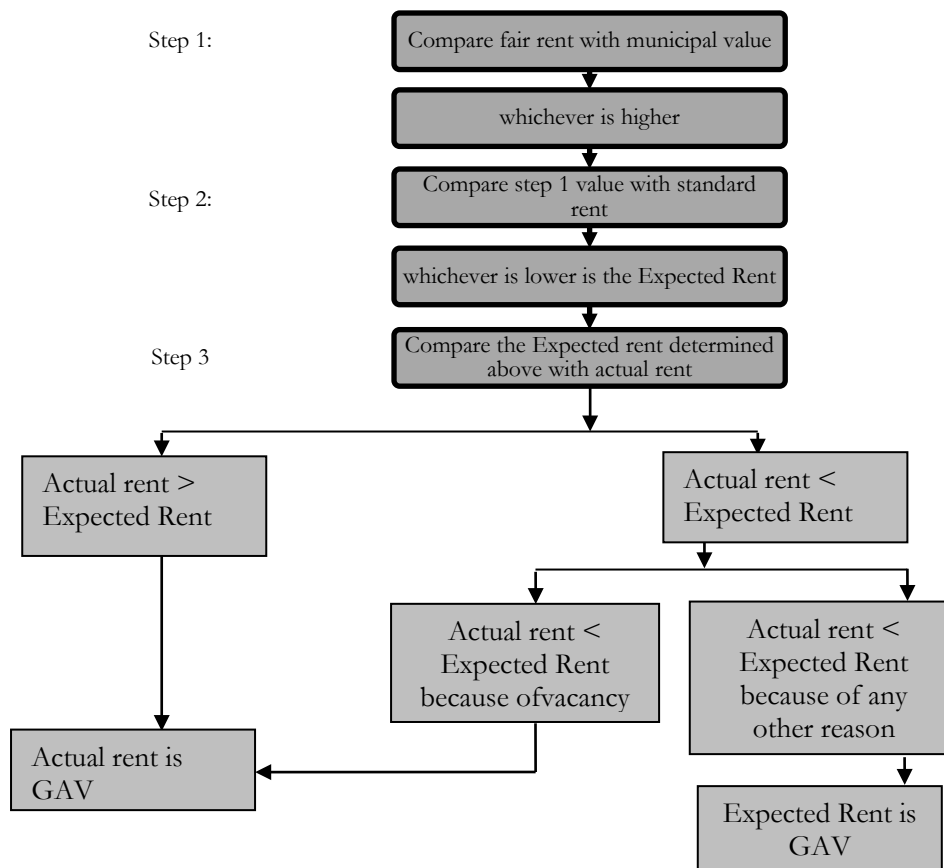
Key Points

Section 22 [Basis of Charge]

(i)	Determination of annual value of the property is the first step in computation of income under the head "Income from house property".
(ii)	The annual value of any property comprising of building or land 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 building or land appurtenant thereto
(a)	Buildings include residential buildings as well as factory buildings, offices etc.
(b)	Land appurtenant means land connected with the building.
(c)	Income from letting out of vacant land is, however, taxable under the head "Income from other sources"
(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
(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.
(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.

(iv)	Property held as stock-in-trade etc. Annual value of house property will be charged under the head “Income from house property” in the following cases also –		
	(a)	Where it is held by the assessee as stock-in-trade of a business;	
	(b)	Where the assessee is engaged in the business of letting out of property on rent;	
		Exceptions:	
	(1)	If letting out is supplementary to the main business, the income will be assessed as business income.	
	(2)	If letting out of building along with other facilities, like machinery and the two lettings are inseparable, the income will either be assessed as business income or as income from other sources, as the case may be.	

Section 23(1) [Determination of Gross Annual Value(GAV) of Let-out Property]



Computation of “Income from house property” in case of property let out throughout the previous year	
Particulars	Amount
Gross Annual Value (GAV) [Calculated as per the chart given above]	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 (irrespective of the actual expenditure incurred)	D
(b) Interest on borrowed capital (actual without any ceiling limit) (See conditions given below)	E
Income from house property (C-D-E)	F
Allowability of interest on borrowed capital under section 24(b)	
(a)	Interest payable on loans borrowed can be claimed as deduction.
(b)	Interest payable on a fresh loan taken to repay the original loan is also admissible as deduction.
(c)	Interest payable on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed, 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.
(d)	Interest related to year of completion of construction can be fully claimed irrespective of completion date.
Computation of income from self-occupied property or property unoccupied due to employment, business in another place	
Particulars	Amount
Annual value under section 23(2)	Nil
Less: Deduction under section 24	
Interest on borrowed capital	
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 subject to a maximum of ₹ 2,00,000 (including apportioned pre-construction interest).	X

	In case of loan for acquisition or construction taken prior to 1.4.99 or loan taken for repair, renovation or reconstruction at any point of time, interest paid or payable subject to a maximum of ₹ 30,000.	
Income from house property		(-)X
<u>Other important points</u>		
(i)	If the assessee has occupied more than one house for his own residential purposes, only one house (according to his own choice) is treated as self-occupied and all other houses will be “deemed to be let out”.	
(ii)	In case of a house property which is deemed to be let-out, the Expected Rent would be the gross annual value. All deductions permissible to a let-out property would be allowable in case of a “deemed to be let out” property.	
(iii)	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.	
<u>Taxability of recovery of unrealised rent & arrears of rent received [New Section 25A]</u>		
(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.	

Question 1

Mr. Vaibhav own five houses at Cochin, all of which are let out. Compute the gross annual value of each house from the information given below: (₹)

	House-I	House-II	House-III	House-IV	House-V
Municipal value	1,20,000	2,40,000	1,10,000	90,000	75,000
Fair rent	1,50,000	2,40,000	1,14,000	84,000	80,000
Standard rent	1,08,000	N.A.	1,44,000	N.A.	78,000
Actual rent received / receivable	1,80,000	2,10,000	1,20,000	1,08,000	72,000

Answer

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 Mr. Vaibhav

(₹)						
	Particulars	House-I	House-II	House-III	House-IV	House-V
(i)	Municipal Value	1,20,000	2,40,000	1,10,000	90,000	75,000
(ii)	Fair rent	1,50,000	2,40,000	1,14,000	84,000	80,000
(iii)	Higher of (i) & (ii)	1,50,000	2,40,000	1,14,000	90,000	80,000
(iv)	Standard rent	1,08,000	N.A.	1,44,000	N.A.	78,000
(v)	Expected rent [Lower of (iii) & (iv)]	1,08,000	2,40,000	1,14,000	90,000	78,000
(vi)	Actual rent received/receivable	1,80,000	2,10,000	1,20,000	1,08,000	72,000
	GAV [Higher of (v) & (vi)]	1,80,000	2,40,000	1,20,000	1,08,000	78,000

Question 2

Two brothers Arun and Bimal are co-owners of a house property with equal share. The property was constructed during the financial year 1998-1999. The property consists of eight identical units and is situated at Cochin.

During the financial year 2016-17, 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 2016-17.

Compute the income under the head 'Income from House Property' and the total income of two brothers for the assessment year 2017-18.

Answer

Computation of total income for the A.Y. 2017-18

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) restricted to maximum of ₹ 30,000 for each co-owner since the property was constructed before 1.04.1999	<u>30,000</u>	<u>30,000</u>
Loss from self occupied property	(30,000)	(30,000)
II. Let-out portion (75%) – See Working Note below	<u>1,25,850</u>	<u>1,25,850</u>
Income from house property	95,850	95,850
Other Income	<u>2,90,000</u>	<u>1,80,000</u>
Total Income	<u>3,85,850</u>	<u>2,75,850</u>

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 [(₹ 12,000 x 6 x 12) – (₹ 12,000 x 1 x 4)] = ₹ 8,64,000 - ₹ 48,000 - whichever is higher	8,16,000	8,16,000
Less: Municipal taxes 75% of 1,80,000 (20% of ₹ 9 lakh)		<u>1,35,000</u>
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]	<u>2,25,000</u>	<u>4,29,300</u>
Income from let-out portion of house property		<u>2,51,700</u>
Share of each co-owner (50%)		1,25,850

Question 3

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. 2017-18.

Answer**Computation of income from house property of Shri Raman for A.Y. 2017-18**

Particulars	₹	₹
Gross Annual Value (See Note 1 below)		1,80,000
Less: Municipal taxes – paid by the tenant, hence not deductible		<u>Nil</u>
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	<u>5,000</u>	<u>84,000</u>
Income from house property		<u>96,000</u>
50% share taxable in the hands of Shri Raman (See Note 3 below)		<u>48,000</u>

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 of property	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

- 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.
- 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.

Question 4

Mr. Krishna owns a residential house in Delhi. The house is having two identical units. First unit of the house is self-occupied by Mr. Krishna and another unit is rented for ₹ 12,000 p.m. The rented unit was vacant for three months during the year. The particulars of the house for the previous year 2016-17 are as under:

Standard Rent	₹ 2,20,000 p.a.
Municipal Valuation	₹ 2,44,000 p.a.
Fair Rent	₹ 2,35,000 p.a.
Municipal tax paid by Mr. Krishna	12% of the Municipal Valuation
Light and water charges	₹ 800 p.m.
Interest on borrowed capital	₹ 2,000 p.m.
Insurance charges	₹ 3,500 p.a.
Painting expenses	₹ 16,000 p.a.

Compute income from house property of Mr. Krishna for the A.Y.2017-18.

Answer

Computation of Income from house property of Mr. Krishna for A.Y. 2017-18

	Particulars	₹	₹
(A)	Rented unit (50% of total area)		
	Step I - Computation of Expected Rent		
	Municipal valuation (₹ 2,44,000 x ½)	1,22,000	
	Fair rent (₹ 2,35,000 x ½)	1,17,500	
	Standard rent (₹ 2,20,000 x ½)	1,10,000	
	Expected Rent is higher of municipal valuation and fair rent, but restricted to standard rent	1,10,000	
	Step II - Actual Rent		
	Rent receivable for the whole year (₹ 12,000 x 12)	1,44,000	
	Step III – Computation of Gross Annual Value		
	Actual rent received owing to vacancy (₹ 1,44,000 – ₹ 36,000)	1,08,000	
	Since, owing to vacancy, the actual rent received is lower than the Expected Rent, the actual rent received is the Gross Annual value		
	Gross Annual Value (GAV)		1,08,000
	Less: Municipal taxes (12% of ₹ 1,22,000)		<u>14,640</u>
	Net Annual Value (NAV)		93,360
	Less : Deductions under section 24		
	(a) 30% of NAV	28,008	
	(b) Interest on borrowed capital (₹ 1,000 x 12)	<u>12,000</u>	<u>40,008</u>
	Taxable income from let out portion		53,352
(B)	Self occupied unit (50% of total area)		
	Annual value	Nil	
	Less : Deduction under section 24:		
	Interest on borrowed capital (₹ 1,000 x 12)	<u>12,000</u>	<u>(12,000)</u>
	Income from house property		<u>41,352</u>

Note: No deduction will be allowed separately for light and water charges, insurance charges and painting expenses.

Question 5

Mrs. Rohini Ravi, a citizen of the U.S.A., is a resident and ordinarily resident in India during the financial year 2016-17. 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 ₹ 60.

She took ownership and possession of a flat in Chennai on 1.7.2016, 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 31.3.2017. The municipal valuation is ₹ 32,000 p.m. 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 for purchasing this flat. Interest on loan was as under:

	₹
Period prior to 1.4.2016	49,200
1.4.2016 to 30.6.2016	50,800
1.7.2016 to 31.3.2017	1,31,300

She had a house property in Bangalore, which was sold in March, 2014. In respect of this house, she received arrears of rent of ₹ 60,000 in March, 2017. This amount has not been charged to tax earlier.

Compute the income chargeable from house property of Mrs. Rohini Ravi for the assessment year 2017-18, exercising the most beneficial option available.

Answer

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. At her option, one house shall be treated as self-occupied, whose annual value will be nil. The other self-occupied house property will be treated as "deemed let out property".

The annual value of the Los Angeles house is ₹ 12,00,000 and the Chennai flat is ₹ 3,15,000. Since the annual value of Los Angeles house is obviously more, it will be beneficial for her to opt for choosing the same as self-occupied. The Chennai house will, therefore, be treated as "deemed let out property".

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 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.	Deemed let out house property at Chennai		
	Annual value (Higher of municipal value and fair rent) [4,20,000 x 9/12]		3,15,000
	Less: Municipal Taxes (Property tax + Sewerage tax)		<u>18,000</u>
	Net Annual Value (NAV)		2,97,000
	Less: Deductions under section 24		
	30% of NAV	89,100	
	Interest on borrowed capital (See Note below)	<u>1,91,940</u>	<u>2,81,040</u>
			15,960
3.	Arrears in respect of Bangalore property(Section 25A)		
	Arrears of rent received	60,000	
	Less: Deduction @ 30%u/s 25A(2)	<u>18,000</u>	<u>42,000</u>
	Income chargeable under the head "Income from house property"		<u>57,960</u>

Note : Interest on borrowed capital	₹
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)	<u>9,840</u>
Interest deduction allowable under section 24	<u>1,91,940</u>

Question 6

Mr. A and Mr. B constructed their houses on a piece of land purchased by them at New Delhi. The built up area of each house was 1,000 sq.ft. ground floor and an equal area in the first floor. A started construction on 1-04-2015 and completed on 1-04-2016. B started the construction on 1-04-2015 and completed the construction on 30-06-2016. A occupied the entire house on 01-04-2016. B occupied the ground floor on 01-07-2016 and let out the first floor for a rent of ₹ 15,000 per month. However, the tenant vacated the house on 31-12-2016 and B occupied the entire house during the period 01-01-2017 to 31-03-2017.

Following are the other information

4.60 Income-tax

(i)	Fair rental value of each unit (ground floor /first floor)	₹ 1,00,000 per annum
(ii)	Municipal value of each unit (ground floor / first floor)	₹ 72,000 per annum
(iii)	Municipal taxes paid by	A – ₹ 8,000 B – ₹ 8,000
(iv)	Repair and maintenance charges paid by	A – ₹ 28,000 B – ₹ 30,000

A has availed a housing loan of ₹ 20 lakhs @ 12% p.a. on 01-04-2015. B has availed a housing loan of ₹ 12 lakhs @ 10% p.a. on 01-07-2015. No repayment was made by either of them till 31-03-2017. Compute income from house property for A and B for the previous year 2016-17 (A.Y. 2017-18).

Answer

Computation of income from house property of Mr. A for A.Y. 2017-18

Particulars	₹	₹
Annual value is nil (since house is self occupied)		Nil
Less : Deduction under section 24(b)		
Interest paid on borrowed capital ₹ 20,00,000 @ 12%	2,40,000	
Pre-construction interest ₹ 2,40,000 / 5	<u>48,000</u>	
	2,88,000	
As per second proviso to section 24(b), interest deduction restricted to		<u>2,00,000</u>
Loss under the head "Income from house property" of Mr. A		<u>(2,00,000)</u>

Computation of income from house property of Mr. B for A.Y. 2017-18

Particulars	Ground floor (Self occupied)	First floor
Gross annual value (See Note below)	Nil	90,000
Less :Municipal taxes (for first floor)		<u>4,000</u>
Net annual value(A)	Nil	86,000
Less : Deduction under section 24		
(a) 30% of net annual value		25,800
(b) interest on borrowed capital		
Current year interest		
₹ 12,00,000 x 10% = ₹ 1,20,000	60,000	60,000
Pre-construction interest		

₹ 12,00,000 x 10% x 9/12 = ₹ 90,000		
₹ 90,000 allowed in 5 equal installments		
₹ 90000 / 5 = ₹ 18,000 per annum	<u>9,000</u>	<u>9,000</u>
Total deduction under section 24(B)	<u>69,000</u>	<u>94,800</u>
Income from house property (A)-(B)	<u>(69,000)</u>	<u>(8,800)</u>
Loss under the head "Income from house property" of Mr.B (both ground floor and first floor)	(77,800)	

Note :Computation of Gross Annual Value (GAV) of first floor of B's house

If a single unit of property (in this case the first floor of B's house) is let out for some months and self-occupied for the other months, then the Expected Rent of the property shall be taken into account for determining the annual value. The Expected Rent shall be compared with the actual rent and whichever is higher shall be adopted as the annual value. In this case, the actual rent shall be the rent for the period for which the property was let out during the previous year.

The Expected Rent is the higher of fair rent and municipal value. This should be considered for 9 months since the construction of property was completed only on 30.6.2016.

Expected rent = ₹ 75,000 being higher of -

Fair rent = 1,00,000 x 9 /12 = ₹ 75,000

Municipal value = 72,000 x 9/12 = ₹ 54,000

Actual rent = ₹ 90,000 (₹ 15,000 p.m. for 6 months from July to December, 2016)

Gross Annual Value = ₹ 90,000 (being higher of Expected Rent of ₹ 75,000 and actual rent of ₹ 90,000)

Question 7

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 Financial Year 2016-17, 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, 2009 and was completed on 31-5-2012.

Vikas took a loan of ₹ 1,00,000 on 1-7-2009 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 Assessment Year 2017-18.

Answer

Computation of income from house property of Mr. Vikas for the A.Y. 2017-18

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)		<u>12,400</u>
Loss from self occupied property		<u>(12,400)</u>
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)	<u>3,520</u>	
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)	<u>6,200</u>	
Income from house property		<u>33,336</u>
		<u>20,936</u>

Note: Interest on loan taken for construction of building

Interest for the year (1.4.2016 to 31.3.2017) = 12% of ₹ 1,00,000 = ₹ 12,000

Pre-construction period interest = 12% of ₹ 1,00,000 for 33 months (from 1.07.2009 to 31.3.2012)
= ₹ 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. 2012-13 till F.Y. 2016-17.

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

Question 8

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 2016-17 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)	15% 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. 2017-18.

Answer**Computation of Income from house property for A.Y. 2017-18**

Particulars	₹	₹
(A) Rented unit (50% of total area – See Note 1 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 receivable for the whole year (₹ 8,000 x 12)	96,000	
Step III – Computation of Gross Annual Value		
Actual rent received owing to vacancy (₹ 96,000 – ₹ 16,000)	80,000	
Since, owing to vacancy the actual rent received is lower than the Expected Rent, the actual rent received is the Gross Annual Value		
Gross Annual Value		80,000
Less: Municipal taxes (15% of ₹ 95,000)		<u>14,250</u>

Net Annual value		65,750
Less : Deductions under section 24 -		
(i) 30% of net annual value	19,725	
(ii) Interest on borrowed capital (₹ 750 x 12)	<u>9,000</u>	<u>28,725</u>
Taxable income from let out portion		37,025
(B) Self occupied unit (50% of total area – See Note 1 below)		
Annual value	Nil	
Less : Deduction under section 24 -		
Interest on borrowed capital (₹ 750 x 12)	<u>9,000</u>	<u>9,000</u>
Income from house property		<u>28,025</u>

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

Question 9

Mrs. Indu, a resident individual, owns a house in U.S.A. She receives rent @ \$ 2,000 per month. She paid municipal taxes of \$ 1,500 during the financial year 2016-17. She also owns a two storied house in Mumbai, ground floor is used for her residence and first floor is let out at a monthly rent of ₹ 10,000. Standard rent for each floor is ₹ 11,000 per month and fair rent is ₹ 10,000 per month. Municipal taxes paid for the house amounts to ₹ 7,500. Mrs. Indu had constructed the house by taking a loan from a nationalised bank on 20.6.2010. She repaid the loan of ₹ 54,000 including interest of ₹ 24,000. The value of one dollar is to be taken as ₹ 60.

Compute total income from house property of Mrs. Indu.

Answer

Computation of Income from House Property of Mrs. Indu for the A.Y.2017-18

Particulars	₹	₹
House property in USA		
GAV– Rent received {treated as fair rent} (\$2,000 p.m. x ₹ 60 per USD x 12 months)	14,40,000	
Less : Municipal taxes paid (\$1,500 x ₹ 60 per USD)	90,000	
Net Annual Value (NAV)	13,50,000	
Less : Deduction under section 24		
30% of NAV	4,05,000	9,45,000
House property in Mumbai (Let-out portion - First Floor)		

Expected rent (lower of standard rent and fair rent)		
Standard Rent (₹ 11,000 x 12) ₹ 1,32,000		
Fair rent (₹ 10,000 x 12) ₹ 1,20,000	1,20,000	
Actual rent received (10,000 × 12)	1,20,000	
Gross Annual Value (higher of Expected rent and actual rent)	1,20,000	
Less : Municipal taxes paid (50% of ₹ 7,500)	3,750	
Net Annual Value (NAV)	1,16,250	
Less : Deduction under section 24		
30% of NAV	₹ 34,875	
Interest on housing loan (50% of ₹ 24,000)	₹ 12,000	46,875
Income from House property in Mumbai (Self-occupied portion - Ground Floor)		69,375
Gross annual value	Nil	
Less: Municipal taxes	Nil	
Net Annual Value (NAV)	Nil	
Less : Deduction under section 24		
30% of NAV	Nil	
Interest on housing loan (50% of ₹ 24,000)	12,000	(-) 12,000
Income from house property		10,02,375

Question 10

Nisha has two houses, both of which are self-occupied. The particulars of these are given below:

Particulars	(Value in ₹)	
	House - I	House - II
Municipal Valuation per annum	1,20,000	1,15,000
Fair Rent per annum	1,50,000	1,75,000
Standard rent per annum	1,00,000	1,65,000
Date of completion	31-03-1999	31-03-2001
Municipal taxes payable during the year (paid for House II only)	12%	8%
Interest on money borrowed for repair of property during current year	-	55,000

Compute Nisha's income from house property for the Assessment Year 2017-18 and suggest which house should be opted by Nisha to be assessed as self-occupied so that her tax liability is minimum.

Answer

In this case, Nisha has more than one house property for self-occupation. As per section 23(4), Nisha can avail the benefit of self-occupation (i.e., benefit of "Nil" Annual Value) only in respect of one of the house properties, at her option. The other house property would be treated as "deemed let-out" property, in respect of which the Expected rent would be the gross annual value. Nisha should, therefore, consider the most beneficial option while deciding which house property should be treated by her as self-occupied.

OPTION 1 [House I – Self-occupied and House II – Deemed to be let out]

If House I is opted to be self-occupied, Nisha's income from house property for A.Y.2017-18 would be –

Particulars	Amount in ₹
House I (Self-occupied) [Annual value is Nil]	Nil
House II (Deemed to be let-out) [See Working Note below]	54,060
Income from house property	54,060

OPTION 2 [House I – Deemed to be let out and House II – Self-occupied]

If House II is opted to be self-occupied, Nisha's income from house property for A.Y.2017-18 would be –

Particulars	Amount in ₹
House I (Deemed to be let-out) [See Working Note below]	70,000
House II (Self-occupied) [Annual value is Nil, but interest deduction would be available, subject to a maximum of ₹30,000. In case of money borrowed for repair of self-occupied property, the interest deduction would be restricted to ₹30,000, irrespective of the date of borrowal].	(30,000)
Income from house property	40,000

Since Option 2 is more beneficial, Nisha should opt to treat House - II as Self-occupied and House I as Deemed to be let out, in which case, her income from house property would be ₹ 40,000 for the A.Y. 2017-18.

Working Note:

Computation of income from House I and House II assuming that both are deemed to be let out

Particulars	Amount in Rupees	
	House I	House II
Gross Annual Value (GAV)		
Expected rent is the GAV of house property		
Expected rent= Higher of Municipal Value and Fair Rent but restricted to Standard Rent	1,00,000	1,65,000
Less: Municipal taxes (paid by the owner during the previous year)	Nil	9,200
Net Annual Value (NAV)	1,00,000	1,55,800
Less: Deductions under section 24		
(a) 30% of NAV	30,000	46,740
(b) Interest on borrowed capital (allowed in full in case of deemed let out property)	-	55,000
Income from deemed to be let-out house property	70,000	54,060

Question 11

Mr. Raphael constructed a shopping complex. He had taken a loan of ₹ 25 lakhs for construction of the said property on 01-08-2014 from SBI @ 10% for 5 years. The construction was completed on 30-06-2015. Rental income received from shopping complex ₹ 30,000 per month-let out for the whole year. Municipal taxes paid for shopping complex ₹ 8,000.

Arrears of rent received from shopping complex ₹ 1,20,000

Interest paid on loan taken from SBI for purchase of house for use as own residence for the period 2016-2017, ₹ 3 lakhs.

You are required to compute income from house property of Mr. Raphael for AY 2017-2018 as per Income-tax Act, 1961.

Answer**Computation of income from house property of Mr. Raphael for A.Y.2017-18**

	Particulars	₹	₹
1.	Shopping complex		
	Gross Annual Value [₹ 30,000 × 12] ¹		3,60,000

¹ Rent received has been taken as the annual value in the absence of information relating to municipal value, fair rent and standard rent.

	Less: Municipal Taxes		<u>8,000</u>
	Net Annual Value (NAV)		3,52,000
	Less: Deductions under section 24		
	30% of NAV	1,05,600	
	Interest on borrowed capital (See Working Note below)	<u>2,83,333</u>	<u>3,88,933</u>
			(36,933)
	Arrears of rent received taxable under section 25A	1,20,000	
	Less: Deduction@30%	<u>36,000</u>	<u>84,000</u>
			47,067
2.	Self-occupied residential house		
	Annual value (since the house property is self-occupied) ²	Nil	
	Less: Deduction under section 24		
	Interest on loan from SBI ₹ 3 lakhs, restricted to	<u>2,00,000</u>	
	Chargeable income from this house property		<u>(2,00,000)</u>
	Income chargeable under the head "Income from house property"		<u>(1,52,933)</u>

Working Note : Interest on borrowed capital (Shopping Complex)	₹
Interest for the current year (10% of ₹ 25 lakhs)	2,50,000
Add: 1/5th of pre-construction interest (interest for the period from 1.8.2014 to 31.3.2015 for 8 months (₹ 1,66,667 x 1/5)	<u>33,333</u>
Interest deduction allowable under section 24	<u>2,83,333</u>

Note:

- (1) In case all the conditions specified in Section 80EE are satisfied, out of the remaining interest of ₹ 1 lakh (₹ 3 lakh – ₹ 2 lakh) Mr. Raphael can claim deduction of ₹ 50,000 towards interest paid for acquisition of self occupied resident house.
- (2) It has been assumed that loan of ₹ 25 lakhs has to be repaid after the five year period. Hence, there has been no repayment upto 31.3.2017. Interest computation has been made accordingly.

² As per section 23(2)

Question 12

Explain the treatment of unrealized rent and its recovery in subsequent years under the provisions of Income-tax Act, 1961.

Answer

Unrealised rent refers to the rent payable but not paid by the tenant and which the owner is also not able to realize from the tenant. As per *Explanation* below section 23(1), the amount of rent which the owner cannot realize shall not be included in the actual rent while determining the annual value of the property, subject to fulfillment of following conditions prescribed under Rule 4 of the Income-tax Rules, 1962:

- (a) the tenancy must be bonafide;
- (b) the defaulting tenant has vacated the property or steps have been taken to compel him to vacate the property;
- (c) the defaulting tenant does not occupy any other property of the assessee; and
- (d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of unpaid rent or satisfies the Assessing Officer that the legal proceedings would be useless.

If the conditions mentioned above are satisfied, then, the actual rent should be reduced by the unrealized rent and thereafter, compared with the Expected rent (being the higher of fair rent and municipal value, but restricted to standard rent) for computing the gross annual value.

As per section 25A, the unrealised rent, when realised in any subsequent year, shall be deemed to be the income chargeable under the head 'Income from house property' in the previous year in which such rent is realised, whether or not the assessee is the owner of the property in that previous year. A sum of 30% of the unrealized rent shall be allowed as deduction.

Question 13

Explain briefly the applicability of section 22 for chargeability of income-tax for:

- (i) *House property situated in foreign country and*
- (ii) *House property with disputed ownership.*

Answer

Applicability of section 22 for chargeability of income-tax for –

(i) House property situated in foreign country

A resident assessee is taxable under section 22 in respect of annual value of a house property situated in foreign country. A resident but not ordinarily resident or a non resident is taxable in respect of income from such property if the income is received in India during the previous year. Once incidence of tax is attracted under section 22, the annual value will be computed as if the property is situated in India.

(ii) House property with disputed ownership

If the title of ownership of the house property is under dispute in a court of law, the decision about who is the owner lies with the Income tax Department. The assessment cannot be held up for such dispute. Generally, a person who receives the income or who enjoys the possession of the house property as owner, though his claim is under dispute, is assessable to tax under section 22.

Question 14

Ownership itself is the criteria for assessment under the head income from house property. Discuss.

Answer

Section 27 enumerates certain cases, where the legal ownership may vest with one person whereas the taxability is cast on another person who is deemed to be the owner.

In these specific cases, the charge of tax is on the deemed owner and not on the legal owner. The exceptions are given below:

- (i) In case of transfer of house property to spouse (not being a transfer in connection with an agreement to live apart) or minor child (not being a married daughter) without adequate consideration - transferor is the deemed owner.
- (ii) 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/company/AOP to whom a building or part thereof is allotted or leased under a house building scheme – shall be deemed to be the owner of building or part thereof.
- (iv) A person who is allowed to take or retain possession of any building or part thereof is the deemed owner of such building or part thereof if such possession is obtained in part performance of a contract of the nature referred to in section 53A 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 any such transaction as is referred to in section 269UA(f).

Therefore, legal ownership itself is not the criteria for assessment of income under the head "Income from house property".

Also, the provisions of section 25A dealing with receipt of unrealised rent and arrears of rent also fall in this category. The receipt is considered as income under the head 'house property' though the recipient may not have legal ownership of the property to which the receipt relates.

Question 15

Discuss the following issues relating to Income from house property:

- (i) *Income earned by residents from house properties situated in foreign countries.*

(ii) *Properties which are used for agricultural purposes.*

Answer

- (i) In case of resident individual, his global income is taxable in India. Therefore, income earned by residents from house properties situated in foreign countries is taxable in India.

If the income from house properties situated outside India is chargeable to tax in India the annual value of such property would be computed as if the property is situated in India. Further, municipal taxes paid under the laws of that country can also be deducted while arriving at the Annual Value of the property. The Madras High Court in *CIT v. Venugopala Reddiar [1965] 58 ITR 439* observed that while computing taxable income, no distinction should be made between a house property situated in India and a house property situated abroad.

- (ii) If the property is used for agricultural purposes, the annual value of such property would be treated as "Agricultural Income" as per section 2(1A)(c) and it is exempt under section 10(1) of the Act. However, if the house property is used for purpose other than agriculture the annual value of such property cannot be treated as agricultural income.

Question 16

- (1) *X let out his property to Y. Y sublets it. How is sub-letting receipt to be assessed in the hands of Y?*
- (2) *Y has built a house on a leasehold land. He has let out the property and claims that the income therefrom is chargeable under the head "Income from other sources". He has deducted expenses on repairs, security charges, insurance and collection charges in all amounting to 40% of receipts. Is Mr. Y's claim valid?*
- (3) *Z uses his property for his own business. Would the annual value be subject to tax under the head "Income from house property"?*

Answer

- (1) Sub-letting receipt in the hands of Y can be assessed as "Income from Other Sources" or as "Profits and gains from business or profession" depending upon the facts and circumstances of each case. It is not assessable as income from house property.
- (2) No, Mr. Y's claim is not valid. The income from letting out of house built on leasehold land is assessable as "Income from house property" since ownership of land is not a pre-requisite for assessment of income under this head. 30% of Net Annual Value is allowed as deduction under section 24.
- (3) Where the assessee uses his property for business, it is not assessable under the head "Income from house property". He is entitled to depreciation under section 32(1)(ii) on the building.

Question 17

Discuss the tax liability in respect of arrears of rent and unrealized rent.

Answer

As per section 25A, where the assessee receives any amount by way of arrears of rent or realizes unrealized rent in respect of any property consisting of buildings or land appurtenant thereto of which he is the owner, the amount so received shall be chargeable to tax under the head "Income from House Property". It shall be charged to tax as the income of the previous year in which such rent is received even if the assessee is no longer the owner of such property. In computing the income chargeable to tax in respect of the arrears of rent and unrealized rent so received, 30% shall be allowed as a deduction, irrespective of the actual expenditure incurred.

Question 18

Mr. Kalpesh borrowed a sum of ₹ 30 lakhs from the National Housing Bank towards purchase of a residential flat. The loan amount was disbursed directly to the flat promoter by the bank. Though the construction was completed in May, 2017, repayments towards principal and interest had been made during the year ended 31.3.2017.

In the light of the above facts, state:

- (i) *Whether Mr. Kalpesh can claim deduction under section 24 in respect of interest for the assessment year 2017-18?*
- (ii) *Whether deduction under Section 80C can be claimed for the above assessment year, even though the construction was completed only after the closure of the year?*

Answer

- (i) **Interest on borrowed capital is allowed as deduction under section 24(b)**

As per section 24(b), Interest payable on loans borrowed for the purpose of acquisition, construction, repairs, renewal or reconstruction of house property can be claimed as deduction. Interest payable on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed, 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.

It is stated that the construction is completed only in May, 2017. Hence, deduction in respect of interest on housing loan cannot be claimed in the assessment year 2017-18.

- (ii) Clause (xviii) of section 80C is attracted where there is any payment for the purpose of purchase or construction of a residential house property, the income from which is chargeable to tax under the head 'Income from house property'. Such payment covers repayment of any amount borrowed from the National Housing Bank.

However, deduction is *prima facie* eligible only if the income from such property is chargeable to tax under the head "Income from House Property". During the assessment year 2017-18, there is no such income chargeable under this head. Hence, deduction under section 80C cannot be claimed for A.Y. 2017-18.

Exercise

1. *Ganesh is a member of a house building co-operative society. The society is the owner of the flats constructed by it. One of the flats is allotted to Ganesh. The income from that flat will be assessed in the hands of*
 - (a) *Co-operative Society*
 - (b) *Ganesh*
 - (c) *Neither of the above.*
2. *Vacant site lease rent is taxable as*
 - (a). *Income from house property*
 - (b). *Business income*
 - (c) *Income from other sources or business income, as the case may be*
3. *Treatment of unrealized rent for determining income from house property*
 - (a) *To be deducted from expected rent*
 - (b) *To be deducted from actual rent*
 - (c) *To be deducted under section 24 from annual value*
4. *Municipal taxes to be deducted from GAV should be*
 - (a) *Paid by the tenant during the previous year*
 - (b) *Paid by the owner during the previous year*
 - (c) *Accrued during the previous year*
5. *Deduction under section 24(a) is*
 - (a) *1/3rd of NAV*
 - (b) *repairs actually incurred by the owner*
 - (c) *30% of NAV*
6. *Interest on borrowed capital accrued up to the end of the previous year prior to the year of completion of construction is allowed*
 - (a) *as a deduction in the year of completion of construction*
 - (b) *in 5 equal annual installments from the year of completion of construction*
 - (c) *In the respective year in which the interest accrues*
7. *The ceiling limit of deduction under section 24(b) in respect of interest on loan taken on 1.4.2016 for repairs of a self-occupied house is*
 - (a) *₹ 30,000 p.a.*
 - (b) *₹ 1,50,000 p.a.*
 - (c) *₹ 2,00,000 p.a.*
 - (d) *No limit*
8. *Where an assessee has two house properties for self-occupation, the benefit of nil annual value will be available in respect of -*

- (a) Both the properties
 (b) The property which has been acquired/constructed first
 (c) Any one of the properties, at the option of the assessee
9. Leena received ₹ 30,000 as arrears of rent during the P.Y. 2016-17. The amount taxable under section 25A would be -
 (a) 30,000
 (b) 21,000
 (c) 20,000
10. Vidya received ₹ 90,000 in May, 2016 towards recovery of unrealised rent, which was deducted from actual rent during the P.Y. 2015-16 for determining annual value. The amount taxable under section 25A for A.Y.2017-18 would be -
 (a) 90,000
 (b) 63,000
 (c) 60,000
11. Ganesh and Rajesh are co-owners of a self-occupied property. They own 50% share each. The interest paid by each co-owner during the previous year on loan (taken for acquisition of property during the year 2004) is ₹ 2,05,000. The amount of allowable deduction in respect of each co-owner is -
 (a) 2,05,000
 (b) 1,02,500
 (c) 2,00,000
 (d) 1,00,000
12. An assessee, who was deriving income from house property, realised a sum of ₹ 52,000 on account of display of advertisement hoardings of various concerns on the roof of the building. He claims that this amount should be considered under the head "Income from house property" and not "Income from other sources". How do you deal with the following issue under the provisions of the Income-tax Act, 1961?
13. Ram owned a house property at Chennai which was occupied by him for the purpose of his residence. He was transferred to Mumbai in June, 2016 and therefore, he let out the property w.e.f. 1.7.2016 on a monthly rent of ₹ 8,000. The corporation tax payable in respect of the property was ₹ 2,000 of which 50% was paid by him before 31.3.2017. Interest on money borrowed for the construction of the property amounted to ₹ 12,000. Compute the income from house property for the A.Y.2017-18.
14. What do you understand by "Composite Rent"? What is the tax treatment of Composite Rent under the Income-tax Act, 1961?

Answers

1. b; 2. c; 3. b; 4. b; 5. c; 6. b; 7. a; 8. c; 9. b; 10. b; 11. c, 13. ₹ 37,700

4

Unit 3 : Profits and Gains of Business or Profession

Key Points

Method of Accounting [Section 145]

Income chargeable under this head shall be computed in accordance with the method of accounting regularly and consistently employed by the assessee either cash or mercantile basis.

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.
- (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.
- (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)	Value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of profession.
(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).
(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)	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”	
The income referred to in section 28 has to be computed in accordance with the provisions contained in sections 30 to 43D.	
Admissible Deductions	
Section	Deduction
30	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.
31	Amount paid on account for current repairs and insurance of machinery, plant and furniture used for the purpose of business or profession.
32	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:

- buildings, machinery, plant or furniture being tangible assets,
- know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature being intangible assets;

in respect of which, the same rate of depreciation is prescribed.

Written Down Value of Assets (W.D.V.) [Section 43(6)]

(1) W.D.V. of the block of assets on 1 st April of the previous year	xxxx
(2) <i>Add:</i> Actual cost of assets acquired during the previous year	xxxx
(3) Total (1) + (2)	xxxx
(4) <i>Less:</i> Money receivable in respect of any asset falling within the block which is sold, discarded, demolished or destroyed during that previous year	xxxx
(5) W.D.V at the end of the year (on which depreciation is allowable) [(3) – (4)]	xxxx
(6) Depreciation at the prescribed rate (Rate of Depreciation × WDV arrived at in (5) above)	xxxx

Block of Assets		Depreciation (% of WDV)
Tangible Assets		
Building		
Mainly used for residential purposes except hotels and boarding houses		5%
Buildings other than those mainly used for residential purposes		10%
Purely temporary erections such as wooden structures		100%
Furniture and fittings (including electrical fittings)		10%
Plant and Machinery		
General rate		15%
Motor cars, motor lorries and motor taxis used in the business of running them on hire		30%
Motor cars other than those used in a business of running them on hire		15%
Specified Air Control Pollution Equipments/Water Control Pollution Equipments		100%
Computers including computer software		60%
Books owned by assessee carrying on profession, other than annual publications		60%
Books, being annual publications, owned by assessee carrying on a profession		100%
Books owned by assessee carrying on business in running lending libraries		100%
Ships		20%
Intangible Assets		
Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature		25%

32(1)(ia)	<p>Additional depreciation at the rate of 20% of actual cost of plant or machinery acquired and installed after 31.03.2005 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.</p> <p>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 50% of the depreciation allowable. The balance 50% of additional depreciation will be allowed in the immediately succeeding previous year.</p> <p>However, additional depreciation will not be allowed on the following plant or machinery:</p> <ul style="list-style-type: none"> • 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. <p>In order to encourage acquisition and installation of plant and machinery for setting up of manufacturing units in the notified backward areas of the States of Andhra Pradesh, Bihar, Telangana and West Bengal, a proviso has been inserted to section 32(1)(ia) to allow higher additional depreciation at the rate of 35% (instead of 20%) in respect of the actual cost of new machinery or plant (other than a ship and aircraft) acquired and installed during the period between 1st April, 2015 and 31st March, 2020 by a manufacturing undertaking or enterprise which is set up in the notified backward areas of these specified States on or after 1st April, 2015.</p> <p>Such additional depreciation shall be restricted to 17.5% (i.e., 50% of 35%), if the new plant and machinery acquired is put to use for the purpose of business for less than 180 days in the year of acquisition and installation.</p> <p>The balance 50% of additional depreciation (i.e., 50% of 35%) would, however, be allowed in the immediately succeeding financial year.</p>
32AC	<p>Manufacturing companies investing more than ₹ 25 crore in new plant and machinery in any previous year during the period from 1.4.2014 to 31.3.2017 entitled to deduction@15% under section 32AC(1A).</p> <p>Where the installation of the new plant and machinery is in a year other than the year of acquisition, the deduction under section 32AC(1A) shall be allowed in the year in which the new plant and machinery is installed, provided the installation is on or before 31.3.2017</p>

32AD	<p>(i) In order to encourage the setting up of industrial undertakings in the backward areas of the States of Andhra Pradesh, Bihar, Telangana and West Bengal, new section 32AD has been inserted to provide for a deduction of an amount equal to 15% of the actual cost of new plant and machinery acquired and installed in the assessment year relevant to the previous year in which such plant and machinery is installed, if the following conditions are satisfied by the assessee -</p> <p>(a) The assessee sets up an undertaking or enterprise for manufacture or production of any article or thing on or after 1st April, 2015 in any backward area notified by the Central Government in the State of Andhra Pradesh or Bihar or Telangana or West Bengal; and</p> <p>(b) the assessee acquires and installs new plant and machinery for the purposes of the said undertaking or enterprise during the period between 1st April, 2015 and 31st March, 2020 in the said backward areas.</p> <p>(ii) Where the assessee is a company, deduction under section 32AD would be available over and above the existing deduction available under section 32AC, subject to the satisfaction of conditions thereunder.</p> <p>Accordingly, if an undertaking is set up in the notified backward areas in the States of Andhra Pradesh or Bihar or Telangana or West Bengal by a company, it shall be eligible to claim deduction under section 32AC as well as under section 32AD, if it fulfills the conditions specified in section 32AC and the conditions specified under section 32AD.</p>
35	<p>Expenditure on Scientific Research</p> <p><u>Expenditure incurred by assessee</u></p> <ul style="list-style-type: none"> 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 any such expenditure incurred during 3 years immediately preceding the year of commencement of business. Such deduction is allowed in the year in which it has commenced its business [Section 35(1)(i)/Section 35(2)]. In case of companies engaged in the business of bio-technology or manufacture or production of article or thing, deduction of 200% of expenditure incurred on scientific research on in-house research and development facility is allowed (other than expenditure on cost of land or building) [Section 35(2AB)].

	<p><u>Contributions to Outsiders</u></p> <p>Contributions made by any assessee to certain specified/ approved institutions shall be entitled to weighted deduction as follows:</p> <table><tr><th>Section</th><th>Contribution made to</th><th>Deduction (as a % of contribution made)</th></tr><tr><td>35(1)(ii)</td><td>Research Association for scientific research</td><td>175%</td></tr><tr><td>35(1)(iia)</td><td>Company for scientific research</td><td>125%</td></tr><tr><td>35(1)(iii)</td><td>Research association for research in social science or statistical research</td><td>125%</td></tr><tr><td>35(2AA)</td><td>National Laboratory / University / IIT</td><td>200%</td></tr></table>	Section	Contribution made to	Deduction (as a % of contribution made)	35(1)(ii)	Research Association for scientific research	175%	35(1)(iia)	Company for scientific research	125%	35(1)(iii)	Research association for research in social science or statistical research	125%	35(2AA)	National Laboratory / University / IIT	200%
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35AD	<p>This section provides for investment-linked tax deduction in respect of the following specified businesses -</p> <ul style="list-style-type: none">• 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 scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and notified by the CBDT in accordance with the prescribed guidelines;• 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 transportation of iron-ore; and															

- setting up and operating a semiconductor wafer fabrication manufacturing unit, if such unit is notified by the Board in accordance with the prescribed guidelines.

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

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.

In respect of the following specified businesses, weighted deduction @150% of investment made is allowable, if the operations have been commenced on or after 1st April, 2012:

1. setting up and operating a cold chain facility.
2. setting up and operating a warehouse facility for storage of agricultural produce.
3. building and operating anywhere in India, a new hospital with at least 100 beds.
4. business of developing and building a housing project under a scheme for affordable housing framed by the Central or State Government and notified by CBDT.
5. business of production of fertilizer in India.

An assessee availing investment-linked tax deduction under section 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 assessment year in respect of such specified business.

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 eight 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 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.

35CCC	150% of expenditure incurred by an assessee on notified agricultural extension project in accordance with the prescribed guidelines.
35CCD	150% of expenditure (other than expenditure in nature of cost of any land or building) incurred by a company on notified skill development project.
35D	<p>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.</p> <p>Maximum aggregate amount of the qualifying expenses that can be amortized is 5% of the cost of project. In case of an Indian company, 5% of the cost of project or at its option, 5% of the capital employed by the company, whichever is higher.</p>
35DD	One-fifth of the expenditure incurred by an Indian company wholly and exclusively for the purpose of amalgamation or demerger, shall be allowed as deduction for five successive previous years beginning with the previous year in which the amalgamation or demerger has taken place.
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)	<p>Interest paid in respect of capital borrowed for the purposes of business or profession.</p> <p>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.</p>
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, subject to prescribed limits.
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 10% 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 10% of the salary of any employee.

36(1)(vii)	<p>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).</p> <p>In the case of an assessee eligible for deduction under section 36(1)(viii), the amount of deduction under section 36(1)(vii) shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts made under section 36(1)(viii).</p>											
36(1)(viii)	<p>Provision for bad and doubtful debts made by certain banks and financial institutions.</p> <table><tr><th>Bank / Financial Institution</th><th>Maximum deduction</th></tr><tr><td>Scheduled Bank or a Non-scheduled bank or a Co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank</td><td>7.5% of gross total income + 10% of aggregate average advances made by rural branches of the bank</td></tr><tr><td>Foreign Bank</td><td>5% of gross total income</td></tr><tr><td>Public Financial Institution/State Financial Corporation/State Industrial Investment Corporation</td><td>5% of gross total income</td></tr><tr><td>A Non-Banking Financial Company</td><td>5% of gross total income</td></tr></table>		Bank / Financial Institution	Maximum deduction	Scheduled Bank or a Non-scheduled bank or a Co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank	7.5% of gross total income + 10% of aggregate average advances made by rural branches of the bank	Foreign Bank	5% of gross total income	Public Financial Institution/State Financial Corporation/State Industrial Investment Corporation	5% of gross total income	A Non-Banking Financial Company	5% of gross total income
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36(1)(ix)	<p>In respect of any special reserve created and maintained by a specified entity (banking company, specified financial corporations etc.), an amount not exceeding 20% of the profits derived from the eligible business (industrial or agricultural development, development of infrastructure facility in India, development of housing in India) computed under this head and carried to such reserve account.</p> <p>Where the aggregate of the amounts carried to such reserve account from time to time exceeds twice the amount of paid up share capital and of the general reserves of the specified entity, no deduction is allowable in respect of such excess.</p>											

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.
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: <ul style="list-style-type: none"> • it is not in the nature of expenditure described under sections 30 to 36; • it is not in the nature of capital expenditure; • it is not a personal expenditure of the assessee; • it is laid out and expended wholly and exclusively for the purpose of business/ profession; • it is not incurred for any purpose which is an offence or which is prohibited by law; and • it is not an expenditure incurred by the assessee on CSR activities referred to in section 135 of the Companies Act, 2013.
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
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 under section 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)	<p>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 under section 139(1).</p> <p>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.</p>
	<p>Where such person responsible for deducting tax is not deemed to be an assessee-in-default on account of payment of taxes by the resident payee, it shall be deemed that the payer has deducted and paid the tax on such sum on the date of furnishing return of income by the resident payee.</p> <p>Since the date of furnishing the return of income by the resident payee is taken to be the date on which the payer has deducted tax at source and paid the same, the 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. Such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the resident payee, since tax is deemed to have been deducted and paid by the payer in that year.</p>
40(a)(ii)/(ia)	Any sum paid on account of income-tax or wealth-tax
40(a)(ib)	Any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge, or any other fee or charge, which is levied exclusively on, or any amount appropriated, directly or indirectly, from a State Government undertaking, by the State Government.
40(a)(iii)	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
40(a)(v)	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.
40(b)	<p>In case of partnership firms or LLPs -</p> <p>(i) Salary, bonus, commission or remuneration, by whatever name called, paid to any partner who is not a working partner;</p>

	(ii) Payment of remuneration or interest to a working partner, which is not – <ul style="list-style-type: none"> • authorized by the partnership deed; or • in accordance with the terms of the partnership deed. 												
	(iii) Payment of remuneration or interest to a working 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.												
	(iv) 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.												
	(v) 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 -												
	<p>(a) On the first ₹ 3,00,000 of the ₹ 1,50,000 or 90% of the book-profit or in case of a loss book-profit, whichever is more.</p> <p>(b) On the balance of book-profit 60%</p>												
Expenses or payments not deductible in certain circumstances													
Section	Particulars												
40A(2)	<p>Any expenditure incurred in respect of which a payment is made to a related person or entity, to the extent it is excessive or unreasonable by the Assessing Officer.</p> <p>Few examples of related persons are as under:</p> <table> <tr> <th>Assessee</th><th>Related Person</th></tr> <tr> <td>Individual</td><td>Any relative of the individual</td></tr> <tr> <td>Firm</td><td>Any partner of the firm or relative of such partner and the member of the family or association</td></tr> <tr> <td>HUF or AOP</td><td>Any member of the AOP or HUF or any relative of such member</td></tr> <tr> <td>Company</td><td>Director of the company or any relative of the director</td></tr> <tr> <td>Any assessee</td><td>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.</td></tr> </table>	Assessee	Related Person	Individual	Any relative of the individual	Firm	Any partner of the firm or relative of such partner and the member of the family or association	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.
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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.												

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 exceeds ₹ 20,000. 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. 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.
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 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 ₹ 20,000/₹ 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.
41(3)	Amount realized on transfer of an asset used for scientific research is taxable as business income to the extent of deduction allowed under section 35 in the year in which transfer takes place.
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, deduction is allowable only if the sum is actually paid on or before the due date of filing of return under section 139(1).	
(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 advance from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan or advances; or			
(vi) Payment in lieu of any leave at the credit of his employee.			
(vii) Any sum payable to the Indian Railways for use of Railway assets.			
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". 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 any mode other than cash on or before the date of the agreement.		
44AA	Maintenance of accounts by certain persons carrying on profession or business		
	Class of Persons	Threshold limit of gross receipts/total income	Requirement
	Every person carrying on a specified profession, namely, legal, medical, engineering, architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other notified profession [i.e., authorised representative, film artist, company secretary and information technology].	If his total gross receipts from profession does not exceed ₹ 1,50,000 in any one of the three years immediately preceding the previous year, or Where the profession has been newly set up in the previous year, his total gross receipts in the profession for that year does not exceed ₹ 1,50,000.	Maintenance of 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 Act

Every person carrying on a specified profession, namely, legal, medical, engineering, architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorised representative or film artist.	<p>If his total gross receipts from profession exceeds ₹ 1,50,000 in any one of the three years immediately preceding the previous year, or</p> <p>Where the profession has been newly set up in the previous year, his total gross receipts in the profession for that year exceeds ₹ 1,50,000.</p>	Maintenance of such books of account and other documents referred to in sub-rule (2), namely, cash book, journal, if accounts are maintained according to the mercantile system of accounting, a ledger, carbon copies of bills for sums exceeding ₹ 25, original bills and receipts (payment vouchers in case the expenditure does not exceed ₹ 50).
Every person carrying on a non-specified profession or business.	(i) If his total sales, turnover or gross receipts from business or profession exceeds ₹ 10,00,000 in any one of the three years immediately preceding the previous year, or his income from business or profession exceeds ₹ 1,20,000 in any one of the three years immediately preceding the previous year.	Maintenance of 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 Act.
	(ii) Where the business or profession has been newly set up in the previous year, his total sales, turnover or gross receipts for that year is likely to exceed ₹ 10,00,000 or his income from business or profession for that year is likely to exceed ₹ 1,20,000 in that year.	

		<p>(iii) Where the profits and gains from business are deemed to be the profits and gains of the assessee under section 44AE, 44BB, 44BBB and the assessee has claimed his income to be lower than the deemed profits.</p> <p>(iv) Where the provisions of section 44AD(4) are applicable in an assessee's case and his income exceeds the basic exemption limit</p>	
44AB	Mandatory audit of accounts of certain persons		
	Category of person	Condition for applicability of section 44AB	
	Every person carrying on business	Total sales, turnover or gross receipts in business > ₹ 1 crore in any previous year	
	Every person carrying on profession	Gross receipts in profession > ₹ 50 lakh in any previous year	
	Every person carrying on a business, where deemed profits are taxed on presumptive basis under section 44AE, 44BB and 44BBB.	Income is claimed to be lower than the deemed profits under the respective sections	
	Every person carrying on a profession, where 50% of the gross receipts are deemed to be the profits under section 44ADA.	Income is claimed to be lower than the deemed profits and such income exceeds the basic exemption limit.	
	Every person who declared profit on presumptive basis under section 44AD for any previous year and thereafter, declares profits for any five consecutive assessment years relevant to the previous year succeeding such previous year not in accordance with presumptive tax provisions of section 44AD(1).	Income cannot be computed on the basis of presumptive tax provisions under section 44AD for five assessment years subsequent to the assessment year relevant to the previous year in which profits have not been declared under section 44AD(1) and whose income exceeds the basic exemption limit in that year.	

Presumptive taxation 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 -	8% of gross receipts or total turnover
	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. However, 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 a 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.
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 goods vehicle, whether heavy goods vehicle or 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) or tea grown and manufactured 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 the manufacture of rubber	35%	65%
7B	Income from the manufacture of coffee		
	- sale of coffee grown and cured	25%	75%
	- sale of coffee grown, cured, roasted and grounded	40%	60%
8	Income from the manufacture of tea	40%	60%

Notification of new income computation and disclosure standards to be applicable from A.Y.2017-18 [Notification No.S.O. 3079(E) dated 29-09-2016]

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. Section 145(2) empowers the Central Government to notify in the Official Gazette from time to time, **income computation and disclosure standards** to be followed by any class of assessee or in respect of any class of income. Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by **all assesseees (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 “Profit and gains of business or profession” or “Income from other sources” for A.Y.2017-18 and subsequent assessment years.**

Refer to Annexure at the end of the Practice Manual wherein the text of the ICDSs notified on 29.9.2016 to be applicable from A.Y.2017-18 has been given. Also, a comparison between the initially notified ICDS (notified on 31.3.2015 – since rescinded) and the newly notified ICDSs (applicable from A.Y.2017-18) has been given to facilitate an easy understanding of the changes which have been made in the newly notified ICDSs.

Question 1

A car purchased by Dr. Soman on 10.08.2014 for ₹ 5,25,000 for personal use is brought into professional use on 1.07.2016 by him, when its market value was ₹ 2,50,000.

Compute the actual cost of the car and the amount of depreciation for the assessment year 2017-18 assuming the rate of depreciation to be 15%.

Answer

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.2017-18 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.

Question 2

Venus Ltd., engaged in manufacture of pesticides, furnishes the following particulars relating to its manufacturing unit at Chennai, for the year ending 31-3-2017:

	(₹ in lacs)
Opening WDV of Plant and Machinery	20
New machinery purchased on 1-9-2016	10
New car purchased on 1-12-2016	8
Computer purchased on 3-1-2017	4

Additional information:

- All assets were put to use immediately.
- Computer has been installed in the office.
- During the year ended 31-3-2016, a new machinery had been purchased on 31-10-2015, for ₹ 10 lacs. Additional depreciation, besides normal depreciation, had been claimed thereon.
- Depreciation rate for machinery may be taken as 15%.

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 31-3-2017.

Answer

Computation of written down value of block of assets of Venus Ltd. as on 31.3.2017

Particulars	Plant & Machinery (₹ in lacs)	Computer (₹ in lacs)
Opening written down value (as on 01.04.2016)	20	Nil
Add: Actual cost of new assets acquired during the year		
New machinery purchased on 1.9.2016	10	-
New car purchased on 1.12.2016	8	-
Computer purchased on 3.1.2017	-	4
	38	4
Less: Assets sold/discarded/destroyed during the year	Nil	Nil
Closing Written Down Value (as on 31.03.2017)	38	4

Computation of Depreciation for A.Y. 2017-18

	Particulars	Plant & Machinery (₹ in lacs)	Computer (₹ in lacs)
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		
	<u>Normal Depreciation</u>		
	- Opening WDV of plant and machinery (₹ 20 lacs x 15%)	3.00	-
	- New Machinery purchased on 1.9.2016 (₹ 10 lacs x 15%)	1.50	-
	(A)	4.50	-
	<u>Additional Depreciation</u>		
	New Machinery purchased on 1.9.2016 (₹ 10 lacs x 20%) (B)	2.00	-
	Balance additional depreciation in respect of new machinery purchased on 31.10.2015 and put to use for less than 180 days in the -P.Y. 2015-16 (Rs. 10 lakhs)	1.00	-

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		
	<u>Normal Depreciation</u>		
	New car purchased on 1.12.2016 [₹ 8 lacs x 7.5% (i.e., 50% of 15%)]	0.60	-
	Computer purchased on 3.1.2017 [₹ 4 lacs x 30% (50% of 60%)]	-	1.20
	(C)	<u>0.60</u>	<u>1.20</u>
	Total Depreciation (A+B+C)	8.10	1.20

Notes:

- (1) As per section 32(1)(ia), 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) Car purchased on 1.12.2016 and
 - (ii) Computer purchased on 3.1.2017, installed in office.
- (2) The Finance Act, 2015 has inserted third proviso to section 32(1)(ii) with effect from A.Y.2016-17, to provide that balance 50% of additional depreciation 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 50% additional depreciation (i.e., ₹ 1 lacs, being 10% of ₹ 10 lacs) in respect of new machinery which had been purchased during the previous year 2015-16 and put to use for less than 180 days in that year can be claimed in P.Y. 2016-17 being immediately succeeding previous year.

Question 3

M/s. Dollar Ltd., a manufacturing concern, furnishes the following particulars:

		₹
(i)	Opening writing down value of plant and machinery (1.4.2016) (15% block)	5,00,000
(ii)	Purchase of plant and machinery (put to use before 01.10.2016)	2,00,000
(iii)	Sale proceeds of plant and machinery which became obsolete- the plant and machinery was purchased on 01-04-2014 for ₹ 5,00,000.	5,000

Further, out of purchase of plant and machinery:

- (a) Plant and machinery of ₹ 20,000 has been installed in office.
 (b) Plant and machinery of ₹ 20,000 was used previously for the purpose of business by the seller.

Compute depreciation and additional depreciation as per Income-tax Act, 1961 for the Assessment Year 2017-18.

Answer

**Computation of written down value of Plant and Machinery of M/s. Dollar Ltd.
as on 31.3.2017**

Particulars	₹
Opening written down value (as on 01.04.2016)	5,00,000
Add: Purchase of plant and machinery during the previous year	<u>2,00,000</u>
	7,00,000
Less: Sale proceeds of obsolete plant and machinery sold during the year	<u>5,000</u>
Closing Written Down Value (as on 31.03.2017)	<u>6,95,000</u>

**Computation of Depreciation and Additional Depreciation for A.Y. 2017-18 as per
section 32 of the Income-tax Act, 1961**

Particulars	₹
Normal Depreciation (₹ 6,95,000 x 15%)	1,04,250
Additional Depreciation (Refer Note 2)(₹ 2,00,000 – ₹ 20,000 - ₹ 20,000) x 20%	<u>32,000</u>
Depreciation on Plant and Machinery	<u>1,36,250</u>

Notes:-

- (1) Since the new plant and machinery was purchased and put to use before 1.10.2016, it was put to use for more than 180 days in the year. Hence, full depreciation is allowable for A.Y. 2017-18.

- (2) 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 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 installed in office premises, residential accommodation or in any guest house.

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

- (i) Plant and machinery of ₹ 20,000 used previously for the purpose of business by the seller.
- (ii) Plant and machinery of ₹ 20,000, installed in office.

Therefore, in the given case additional depreciation has to be provided only on ₹ 1,60,000 (i.e., ₹ 2,00,000 - ₹ 40,000).

Question 4

Mr. Abhimanyu is engaged in the business of generation and distribution of electric power. He always 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 assessment year 2017-18:

	(₹ in lacs)
(i) Opening WDV of block (15% rate)	42
(ii) New machinery purchased on 12-10-2016	10
(iii) Machinery imported from Colombo on 12-4-2016.	9
<i>This machine had been used only in Colombo earlier and the assessee is the first user in India.</i>	
(iv) New computer installed in generation wing of the unit on 15-7-2016	2

Answer

Computation of depreciation under section 32 for A.Y.2017-18

Particulars	₹	₹
Normal Depreciation		
Depreciation@15% on ₹ 51,00,000, being machinery (put to use for more than 180 days) [Opening WDV of ₹ 42,00,000 + Purchase cost of imported machinery of ₹ 9,00,000]	7,65,000	

Depreciation@7.5% on ₹ 10,00,000, being new machinery put to use for less than 180 days	75,000	
	8,40,000	
Depreciation@60% on computers purchased ₹ 2,00,000	1,20,000	9,60,000
Additional Depreciation (Refer Note below)		
Additional Depreciation@10% of ₹ 10,00,000 [being actual cost of new machinery purchased on 12-10-2016]	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		11,00,000

Note:-

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 or generation and distribution of power, at the rate of 20% of the actual cost of such machinery or plant.

Therefore, new computer installed in generation wing of the unit is eligible for additional depreciation@20%.

Since the new machinery was purchased only on 12.10.2016, 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. 2017-18. 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.

Question 5

Harish Jayaraj Pvt. Ltd. is converted into Harish Jayaraj LLP on 1.1.2017. The following particulars are available to you:

S. No.	Particulars	₹
(i)	Cost of land	5,00,000
(ii)	WDV of machinery as on 1.4.2016	3,30,000
(iii)	Patents acquired on 1.6.2016	3,00,000
(iv)	Building acquired on 12.3.2015 for which deduction was allowed	7,00,000

4.100 Income-tax

	<i>under section 35AD.</i>	
(v)	<i>Above building was revalued as on the date of conversion into LLP as</i>	<i>12,00,000</i>
(vi)	<i>Unabsorbed business loss as on 1.4.2016 (Related to A.Y. 2013-14)</i>	<i>9,00,000</i>

Though the conversion into LLP took place on 1.1.2017, there was disruption of business and the assets were put into use by the LLP only from 1st March, 2017 onwards.

The company earned profits of ₹ 8 lacs prior to computation of depreciation.

Assuming that the necessary conditions laid down in section 47(xiiib) of the Income-tax Act, 1961 have been complied with, explain the tax treatment of the above in the hands of the LLP.

Answer

Tax treatment of depreciation and unabsorbed business loss of a private company on its conversion into a LLP

1. Depreciation

The aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them [Fifth proviso to Section 32(1)]

Therefore, depreciation has to be first calculated as if the conversion had not taken place and then apportioned between the company and the LLP in the ratio of the number of days for which the assets were used by them.

		₹		₹
Block I	Machinery	3,30,000	15%	49,500
Block II	Patents	3,00,000	25%	<u>75,000</u>
				<u>1,24,500</u>

Allocation of depreciation

Depreciation on machinery and patents have to be apportioned between the company and the LLP in the ratio of the number of days for which the **assets were used by them**. Since patents were acquired only on 1.6.2016, it could have been used by the company for 214 days only. Therefore, the depreciation on assets has to be allocated between the company and LLP as follows –

Asset	Total depreciation for the year	Company		LLP	
		No. of days of usage	Depreciation	No. of days of usage	Depreciation
Machinery	49,500	275	44,485	31	5,015
Patents	<u>75,000</u>	214	<u>65,510</u>	31	<u>9,490</u>
	<u>1,24,500</u>		<u>1,09,995</u>		<u>14,505</u>

Therefore, depreciation to be allowed in the hands of the company is ₹ 1,09,995 and depreciation to be allowed in the hands of the LLP is ₹ 14,505.

2. Unabsorbed business loss to be carried forward by the LLP:

Particulars	₹
Profits of the company before depreciation	8,00,000
Less: Current year depreciation	<u>1,09,995</u>
Business income of the company after depreciation	6,90,005
Brought forward business loss	<u>9,00,000</u>
Unabsorbed business loss as on 31.12.2016 to be carried forward by the LLP	<u>2,09,995</u>

The LLP would be allowed to carry forward and set-off the unabsorbed business loss and unabsorbed depreciation of the predecessor company [Section 72A(6A)].

3. Actual cost of assets to the LLP

- (1) The actual cost of the block of assets in case of the LLP shall be the WDV of the block of assets as in the case of the company on the date of conversion. The WDV as on 1.1.2017 for Machinery and Patents are ₹ 2,85,515 and ₹ 2,34,490, respectively, which would be the actual cost in the case of the LLP.

WDV of Machinery as on 1.1.2017 = ₹ 3,30,000 – ₹ 44,485 = ₹ 2,85,515

WDV of Patents as on 1.1.2017 = ₹ 3,00,000 – ₹ 65,510 = ₹ 2,34,490

- (2) Land is not a depreciable asset. The cost of acquisition of land to the LLP would be the cost for which the company acquired it, as increased by the cost of improvement.
- (3) In respect of the building, deduction had been allowed in the earlier year under section 35AD. Hence, there is no question of depreciation during the current year. The actual cost of the building to the LLP would be Nil. [Explanation 13 to Section 43(1)]

Question 6

Sai Ltd. has a block of assets carrying 15% rate of depreciation, whose written down value on 01.04.2016 was ₹ 40 lacs. It purchased another asset (second-hand plant and machinery) of the same block on 01.11.2016 for ₹ 14.40 lacs and put to use on the same day. Sai Ltd. was amalgamated with Shirdi Ltd. with effect from 01.01.2017.

You are required to compute the depreciation allowable to Sai Ltd. & Shirdi Ltd. for the previous year ended on 31.03.2017 assuming that the assets were transferred to Shirdi Ltd. at ₹ 60 lacs.

Answer

**Statement showing computation of depreciation allowable
to Sai Ltd. & Shirdi Ltd. for A.Y. 2017-18**

Particulars	₹
Written down value (WDV) as on 1.4.2016	40,00,000
Addition during the year (used for less than 180 days)	<u>14,40,000</u>
Total	<u>54,40,000</u>
Depreciation on ₹ 40,00,000 @ 15%	6,00,000
Depreciation on ₹ 14,40,000 @ 7.5%	<u>1,08,000</u>
Total depreciation for the year	<u>7,08,000</u>
Apportionment between two companies:	
(a) Amalgamating company, Sai Ltd.	
₹ 6,00,000 × 275/365	4,52,055
₹ 1,08,000 × 61/151	<u>43,629</u>
	<u>4,95,684</u>
(b) Amalgamated company, Shirdi Ltd.	
₹ 6,00,000 × 90/365	1,47,945
₹ 1,08,000 × 90/151	<u>64,371</u>
	<u>2,12,316</u>

Notes:

- (1) The aggregate deduction, in respect of depreciation allowable to the amalgamating company and amalgamated company in the case of amalgamation shall not exceed in any case, the deduction calculated at the prescribed rates as if the amalgamation had not taken place. Such deduction shall be apportioned between the amalgamating company and the amalgamated company in the ratio of the number of days for which the assets were used by them.

- (2) The price at which the assets were transferred, i.e., ₹ 60 lacs, has no implication in computing eligible depreciation.

Question 7

Mr. Gopi carrying on business as proprietor converted the same into a limited company by name Gopi Pipes (P) Ltd. from 01-07-2016. The details of the assets are given below:

	₹
Block - I WDV of plant & machinery (rate of depreciation @ 15%)	12,00,000
Block - II WDV of building (rate of depreciation @ 10%)	25,00,000

The company Gopi Pipes (P) Ltd. acquired plant and machinery in December 2016 for ₹ 10,00,000. It has been doing the business from 01-07-2016.

Compute the quantum of depreciation to be claimed by Mr. Gopi and successor Gopi Pipes (P) Ltd. for the assessment year 2017-18.

Note: Ignore additional depreciation.

Answer

Computation of depreciation allowable to Mr. Gopi for A.Y. 2017-18

Particulars	₹	₹
Block 1 Plant and Machinery (15% rate)		
WDV as on 1.4.2016	12,00,000	
Depreciation@15%		1,80,000
Block 2 Building (10% rate)		
WDV as on 1.4.2016	25,00,000	
Depreciation@10%		<u>2,50,000</u>
Total depreciation for the year		<u>4,30,000</u>
Proportionate depreciation allowable to Mr. Gopi for 91 days (i.e., from 1.4.2016 to 30.6.2016) [i.e., $91/365 \times ₹ 4,30,000$]		1,07,205

Computation of depreciation allowable to Gopi Pipes (P) Ltd. for A.Y.2017-18

Particulars	₹
(i) Depreciation on building and plant and machinery Proportionately for 274 days (i.e. from 1.7.2016 to 31.3.2017) $(274/365 \times 4,30,000)$	3,22,795
(ii) Depreciation@ 50% of 15% on ₹ 10 lakh, being the value of plant and machinery purchased after conversion, which was put to use for less than 180 days during the P.Y. 2016-17	<u>75,000</u>
Depreciation allowable to Gopi Pipes (P) Ltd.	<u>3,97,795</u>

Note: As per the fifth proviso to section 32(1), in the case of conversion of sole proprietary concern into a company as per section 47(xiv), the depreciation should be first calculated for the whole year as if no succession had taken place. Thereafter, the depreciation should be apportioned between the sole proprietary concern and the company in the ratio of the number of days for which the assets were used by them. It is assumed that in this case, the conditions specified in section 47(xiv) are satisfied.

Question 8

M/s Sidhant & Co., a sole proprietary concern is converted into a company, Sidhant Co. Ltd. with effect from November 29, 2016. The written down value of assets as on April 1, 2016 is as follows:

Items	Rate of Depreciation	WDV as on 1st April, 2016
Building	10%	₹ 3,50,000
Furniture	10%	₹ 50,000
Plant and Machinery	15%	₹ 2,00,000

Further, on October 15, 2016, M/s Sidhant & Co. purchased a plant for ₹ 1,00,000 (rate of depreciation 15%). After conversion, the company added another plant worth ₹ 50,000 (rate of depreciation 15%).

Compute the depreciation available to (i) M/s Sidhant & Co. and (ii) Sidhant Co. Ltd. for Assessment Year 2017-18.

Answer

In the case of conversion of sole proprietary concern into a company as per section 47(xiv), the depreciation should be first calculated for the whole year assuming that no succession had taken place. Thereafter, the depreciation should be apportioned between the sole proprietary concern and the company in the ratio of the number of days for which the assets were used by them. It is assumed that in this case, the conditions specified in section 47(xiv) are satisfied.

Computation of depreciation allowable to M/s Sidhant & Co. for A.Y.2017-18

Particulars	₹	₹
Building		
WDV as on 1.4.2016	3,50,000	
Depreciation@10%		35,000
Furniture		
WDV as on 1.4.2016	50,000	
Depreciation@10%		5,000

Plant and Machinery		
WDV as on 1.4.2016	2,00,000	
Add: Additions during the year (purchased on 15.10.2016)	<u>1,00,000</u>	
	3,00,000	
Less: Depreciation for the year (15% of ₹ 2,00,000 + 50% of 15% of ₹ 1,00,000) (₹ 30,000 + ₹ 7,500) (Depreciation on new machinery is restricted to 50% of eligible depreciation, since the asset is put to use for less than 180 days in that year)		37,500
Total depreciation for the year		<u>77,500</u>
Proportionate depreciation allowable to M/s Sidhant & Co. for 242 days		
On existing assets (i.e. 1.4.2016 to 28.11.2016) (i.e. $242/365 \times ₹ 70,000$)	46,411	
On new machine for 45 days i.e., $45/168 \times ₹ 7,500$	<u>2,009</u>	48,420

Computation of depreciation allowable to M/s Sidhant Co. Ltd. for A.Y.2017-18

Particulars	₹
(i) Depreciation on the assets on conversion Proportionately for 123 days i.e. after conversion period $(123/365 \times ₹ 70,000) + (123/168 \times ₹ 7,500) = ₹ 23,589 + ₹ 5,491$	29,080
(ii) Depreciation @ 50% of normal rate of 15% on ₹ 50,000, being the value of plant purchased after conversion, which was put to use for less than 180 days	<u>3,750</u>
Depreciation allowable to Sidhant Co. Ltd.	<u>32,830</u>

Note: Since it has not been specifically mentioned that M/s Sidhant & Co. and Sidhant Co. Ltd. are manufacturing concerns or companies engaged in the business of generation, transmission or distribution of power, additional depreciation is not provided for.

Question 9

What are intangible assets? Give four examples. What is the rate of depreciation on a block of intangible assets?

Answer

Intangible assets are assets which are not corporeal i.e., not capable of being touched. Such assets are represented by rights of the persons through them.

According to Explanation 3(b) to section 32(1), the following are intangible assets :

- (a) Know-how
- (b) Patents
- (c) Copyrights
- (d) Trade Marks
- (e) Licences
- (f) Franchises
- (g) any other business or commercial rights of similar nature.

They are to be depreciated at the rate of 25%.

Question 10

Gopichand Industries furnishes you the following information:

	(₹)
Block I WDV of Plant and machinery (consisting of 10 looms)	5,00,000
Rate of depreciation 15%	
Block II WDV of Buildings (consisting of 3 buildings)	12,50,000
Rate of depreciation 10%	
Acquired on 5-07-2016 – 5 looms for	4,00,000
Sold on 7-12-2016 – 15 looms for	10,00,000
Acquired on 10-01-2017 – 2 looms for	3,00,000

Compute depreciation claim for the Assessment year 2017-18.

Answer

Computation of depreciation for Gopichand Industries for A.Y.2017-18

Particulars	₹	₹
Block 1 : Plant & machinery (Rate of depreciation – 15%)		
WDV as on 1 st April (10 looms)	5,00,000	
Add: Additions during the year		
- 5 looms acquired on 5 th July	4,00,000	
- 2 looms acquired on 10 th January	<u>3,00,000</u>	
	12,00,000	
Less : Assets sold during the year		
- 15 looms sold on 7 th December	<u>10,00,000</u>	
W.D.V. as on 31 st March (2 looms)	2,00,000	
Depreciation on ₹ 2 lakhs @ 15% (limited to 50%)		15,000

Block II: Buildings (Rate of depreciation – 10%)		
WDV as on 1 st April (3 buildings)	12,50,000	
Depreciation on ₹ 12,50,000 @ 10%		<u>1,25,000</u>
Total depreciation for the year		<u>1,40,000</u>

Notes:

1. Closing balance of Block 1: Plant and machinery represents the looms acquired on 10th January. These looms have been put to use or less than 180 days during the previous year, and therefore, only 50% of normal depreciation is permissible.
2. No additional depreciation @ 20% of the cost of new plant and machinery is provided for assuming that all conditions contained in the section 32(1)(ia) have not been fulfilled.

Question 11

M/s. QQ & Co., a sole proprietary concern, was converted into a company on 1.9.2016. Before the conversion, the sole proprietary concern had a Block of Plant and Machinery (Rate of depreciation 15%), whose WDV as on 1.4.2016 was ₹ 3,00,000. On 1st April itself, a new plant of the same block was purchased for ₹ 1,20,000. After the conversion, the company has purchased the same type of Plant on 1.1.2017 for ₹ 1,60,000.

Compute the depreciation that would be allocated between the sole proprietary concern and the successor company.

Note: Ignore additional depreciation.

Answer

Computation of depreciation in the case of transfer of business:

Depreciation is to be calculated as if there is no succession.	(₹)
WDV as on 1 st April	3,00,000
Add : Additions made before succession	<u>1,20,000</u>
	4,20,000
Less : Sale consideration of the asset sold	<u>Nil</u>
	4,20,000
Depreciation @ 15%	<u>63,000</u>

Allocation of depreciation between sole proprietary concern and the successor company:

The depreciation of ₹ 63,000 is to be allocated in the ratio of number of days the assets were used by the sole proprietary concern and the company.

4.108 Income-tax

Ex-sole proprietary concern

1st April to 31st August = 153 days ₹ 63,000 x 153 / 365 = ₹ 26,408

Successor company

₹ 63,000 - ₹ 26,408 = ₹ 36,592 (i.e. ₹ 63,000 x 212 / 365)

The depreciation of ₹ 12,000 [50% of 15% on ₹ 1,60,000] in respect of asset purchased by the successor company on 1st January is fully allowable in the hands of the successor company.

Question 12

Honest Industry furnishes you the following details pertaining to the financial year 2016-17:

Description	Plant & Machinery	Building	Intangible assets (patents)
Rate of depreciation	15%	10%	25%
Opening balance as on 01-04-2016	₹ 14,50,000	₹ 25,00,000	₹ 15,00,000
Acquired before 30-09-2016	₹ 12,00,000	Nil	₹ 5,00,000
Acquired after 01-12-2016	₹ 4,00,000	₹ 18,00,000	Nil
Transferred in March 2017, one of the patents held for the past 2 years	-	-	₹ 3,00,000

A machinery acquired in July 2016 original cost ₹ 1,50,000 was destroyed by fire and the assessee received compensation of ₹ 50,000 from the insurance company.

Newly acquired building given above includes value of land of ₹ 3,00,000.

Calculate the eligible depreciation claim for the assessment year 2017-18.

Note : Ignore additional/accelerated depreciation.

Answer

Computation of depreciation allowable to Honest Industry for the A.Y. 2017-18

Particulars	Plant & Machinery	Building	Intangible assets (patents)	Total (₹)
Rate of depreciation	15%	10%	25%	
Opening Balance as on 1.04.2016	14,50,000	25,00,000	15,00,000	
Add: Assets acquired during the year	<u>16,00,000</u>	<u>15,00,000</u>	<u>5,00,000</u>	

	30,50,000	40,00,000	20,00,000	
Less: Moneys payable in respect of asset sold or destroyed	<u>50,000</u>	<u>-</u>	<u>3,00,000</u>	
W.D.V as on 31.03.2017	<u>30,00,000</u>	<u>40,00,000</u>	<u>17,00,000</u>	
Asset held for less than 180 days	4,00,000	15,00,000	-	
Depreciation@50% of applicable rate	30,000	75,000	-	1,05,000
Asset held for more than 180 days	26,00,000	25,00,000	17,00,000	
Depreciation at the applicable rates	3,90,000	2,50,000	4,25,000	<u>10,65,000</u>
Total Depreciation allowable				<u>11,70,000</u>

Note - Land is not a depreciable asset. Therefore, ₹ 3 lacs, being the value of land, has been reduced from ₹ 18 lacs, being the value of building acquired during the year, for the purpose of computing depreciation.

Question 13

Mr. Praveen Kumar has furnished the following particulars relating to payments made towards scientific research for the year ended 31.3.2017:

Sl. No.	Particulars	₹ (in lacs)
(i)	Payments made to K Research Ltd.	20
(ii)	Payment made to LMN College	15
(iii)	Payment made to OPQ College	10
(iv)	Payment made to National Laboratory	8
(v)	Machinery purchased for in-house scientific research	25
(vi)	Salaries to research staff engaged in in-house scientific research	12

Note: K Research Ltd. and LMN College are approved research institutions and these payments are to be used for the purposes of scientific research.

Compute the amount of deduction available under section 35 of the Income-tax Act, 1961 while arriving at the business income of the assessee.

Answer

Computation of deduction allowable under section 35

Particulars	Amount (₹ in lacs)	Section	% of weighted deduction	Amount of deduction (₹ in lacs)
Payment for scientific research				
K Research Ltd. [See Note 3]	20	35(1)(ii)	175%	35.00
LMN College	15	35(1)(ii)	175%	26.25
OPQ College [See Note 1]	10	-	Nil	Nil
National Laboratory [See Note 4]	8	35(2AA)	200%	16.00
In-house research [See Note 2]				
Capital expenditure	25	35(1)(iv) r.w. 35(2)	100%	25.00
Revenue expenditure	12	35(1)(i)	100%	<u>12.00</u>
Deduction allowable under section 35				<u>114.25</u>

Notes:-

- Payment to OPQ College:** Since the note in the question below item (vi) clearly mentions that only K Research Ltd. and LMN College (mentioned in item (i) and (ii), respectively) are approved research institutions, it is a logical conclusion that OPQ College mentioned in item (iii) is not an approved research institution. Therefore, payment to OPQ College would not qualify for deduction under section 35.
- Deduction for in-house research and development:** Only company assesseees are entitled to weighted deduction@200% under section 35(2AB) in respect of in-house research and development expenditure incurred. However, in this case, the assessee is an individual. Therefore, he would be entitled to deduction@100% of the revenue expenditure incurred under section 35(1)(i) and 100% of the capital expenditure incurred under section 35(1)(iv) read with section 35(2), assuming that such expenditure is laid out or expended on scientific research related to his business.
- Payment to K Research Ltd. (Alternative Answer):** Any sum paid to a company registered in India which has as its main object scientific research, as is approved by the prescribed authority, qualifies for a weighted deduction of 125% under section 35(1)(iia). Therefore, it is also possible to take a view that payment of ₹ 20 lakhs to K Research Ltd. qualifies for a weighted deduction of 125% under section 35(1)(iia) since K Research Ltd. is a company. The weighted deduction under section 35(1)(iia) would be ₹ 25 lacs (i.e., 125% of ₹ 20 lacs), in which case, the total deduction under section 35 would be ₹ 104.25 lacs.

4. **Payment to National Laboratory:** The percentage of weighted deduction under section 35(2AA) in respect of amount paid to National Laboratory is 200%.

Question 14

Vivitha Bio-medicals Ltd. is engaged in the business of manufacture of bio-medical items. The following expenses were incurred in respect of activities connected with scientific research:

Year ended	Item	Amount (₹)
31.03.2014	Land	10,00,000
(Incurred after 1.9.2013)	Building	25,00,000
31.03.2015	Plant and machinery	5,00,000
31.03.2016	Raw materials	2,20,000
31.03.2017	Raw materials and salaries	1,80,000

The business was commenced on 01-09-2016.

In view of availability of better model of plant and machinery, the existing plant and machinery were sold for ₹ 8,00,000 on 1.03.2017.

Discuss the implications of the above for the assessment year 2017-18 along with brief computation of deduction permissible under section 35 assuming that necessary conditions have been fulfilled. You are informed that the assessee's line of business is eligible for claiming deduction under section 35 at 200% on eligible items.

Answer

- As per section 35(2AB), where a company engaged in, *inter alia*, the business of biotechnology incurs any expenditure on scientific research during the current year, it is eligible for claiming weighted deduction of a sum equal to 200% of the eligible expenditure.

Note : *The benefit of weighted deduction under this section would be available for expenditure incurred upto 31st March 2017 on in-house research and development facility.*

The eligible expenditure and quantum of deduction will be:

- Current year capital expenditure (except expenditure in the nature of cost of any land or building) or revenue expenditure incurred for scientific research (weighted deduction @ 200%) under section 35(2AB).
- Any expenditure incurred during earlier 3 years immediately preceding the date of commencement of business on payment of salary or purchase of materials, or capital expenditure incurred other than expenditure on acquisition of land [actual expenditure qualifies for deduction under section 35(1)].

The deduction available under section 35 for scientific research will, therefore, be:

	Particulars	₹
(a)	Land	Nil
(b)	Building	25,00,000
(c)	Revenue expenses of last 3 years	2,20,000
(d)	Capital expenditure of last 3 years: Plant and machinery	5,00,000
Expenditure allowable under section 35(1)		32,20,000
Current year revenue expenditure ₹ 1,80,000 [200% of ₹ 1,80,000 is allowable under section 35(2AB)]		3,60,000
Total deduction under section 35		35,80,000

2. Section 41(3) provides that where a capital asset used for scientific research is sold, without having been used for other purposes, the lower of sale proceeds or the total amount of deduction earlier allowed under section 35 will be considered as income from business of the previous year in which the sale took place.

Therefore, the income chargeable to tax under section 41(3) would be lower of the following:

(1) Sale proceeds i.e., ₹ 8,00,000

(2) Total amount of deduction earlier allowed under section 35 i.e., ₹ 5,00,000

₹ 5,00,000 will be deemed to be the income chargeable to tax under section 41(3).

3. The difference between sale proceeds and business income under section 41(3) will be treated as short-term capital gain.

	₹
Sale proceeds of plant and machinery	8,00,000
Less: Business Income as per section 41(3)	<u>5,00,000</u>
Short-term capital gain	<u>3,00,000</u>

Question 15

Swadeshi Ltd., which follows mercantile system of accounting, obtained licence on 1.4.2015 from the Department of telecommunication for a period of 10 years. The total licence fee payable is ₹ 18,00,000. The relevant details are:

Year ended 31 st March	Licence fee payable for the year (₹)	Payments made	
		Date	Amount (₹)
2016	10,00,000	30.03.2016	3,70,000
		15.05.2016	6,30,000
2017	8,00,000	28.02.2017	5,40,000

Balance of ₹ 2,60,000 is pending as on 31.3.2017.

Compute the amount of deduction available to the assessee under section 35ABB for the assessment years 2016-17 and 2017-18. Can any deduction be claimed under section 32 also?

Answer

As per section 35ABB, any amount actually paid for obtaining licence to operate telecommunication services, shall be allowed as deduction in equal installments during the number of years for which the licence is in force. Therefore, the year of actual payment is relevant and not the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.

1. ₹ 3,70,000 paid on 30.03.2016 [P.Y.2015-16]

Unexpired period of licence 10 years

Hence ₹ 37,000 [i.e. ₹ 3,70,000/10] can be claimed under section 35ABB for period of 10 years commencing from A.Y.2016-17.

2. ₹ 11,70,000 paid during year ended 31.03.2017 [P.Y.2016-17]

Unexpired period of licence 9 years

Hence, ₹ 1,30,000 [i.e. ₹ 11,70,000/9] can be claimed under section 35ABB for a period of 9 years commencing from A.Y.2017-18.

3. Amount of deduction under section 35ABB

Assessment year	Amount (₹)
2016-17	37,000
2017-18	37,000 + 1,30,000 = 1,67,000

Where deduction under section 35ABB is claimed and allowed, deduction under section 32(1) cannot be allowed for the same previous year or any subsequent previous year.

Question 16

Win Limited commenced the business of operating a three star hotel in Tirupati on 1-4-2016.

It furnishes you the following information:

- | | | |
|-------|---|-------------|
| (i) | Cost of land (acquired in June 2014) | ₹ 60 lakhs |
| (ii) | Cost of construction of hotel building | |
| | Financial year 2014-15 | ₹ 30 lakhs |
| | Financial year 2015-16 | ₹ 150 lakhs |
| (iii) | Plant and Machineries (all new) acquired during financial year 2015-16 | ₹ 30 lakhs |
| | [All the above expenditures were capitalized in the books of the company] | |
| | Net profit before depreciation for the financial year 2016-17 | ₹ 80 lakhs |

Determine the amount eligible for deduction under section 35AD of the Income-tax Act, 1961, for the assessment year 2017-18.

Answer

Under section 35AD, 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the specified business, which includes the business of building and operating a hotel of two-star or above category anywhere in India which commences its operations on or after 1.4.2010, would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

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. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

Accordingly, the deduction under section 35AD for the A.Y.2017-18 in the case of Win Ltd. would be calculated as follows, assuming that the expenditures were capitalised in the books of the company on 1.4.2016, being the date of commencement of operations-

Particulars	₹ (in lakhs)
Cost of land (not eligible for deduction under section 35AD)	Nil
Cost of construction of hotel building (₹ 30 lakhs + ₹ 150 lakhs)	180
Cost of plant and machinery	<u>30</u>
Deduction under section 35AD	<u>210</u>

Note:-

- (1) For A.Y.2017-18, the loss from specified business of operating a three star hotel would be ₹ 130 lakhs (i.e. ₹ 210 lakhs – ₹ 80 lakhs). As per section 73A, any loss computed in respect of the specified business referred to in section 35AD shall be set off only against profits and gains, if any, of any other specified business. The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year.
- (2) Since the entire cost of plant and machinery and building qualifies for deduction under section 35AD, the same does not qualify for deduction under section 32.

Question 17

MNP Ltd. commenced operations of the business of a new four-star hotel in Chennai on 1.4.2016. The company incurred capital expenditure of ₹ 40 lakh during the period January, 2016 to March, 2016 exclusively for the above business, and capitalized the same in its books

of account as on 1st April, 2016. Further, during the previous year 2016-17, it incurred capital expenditure of ₹ 2.5 crore (out of which ₹ 1 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 assessment year 2017-18, assuming that MNP Ltd. has fulfilled all the conditions specified for claim of 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 running this hotel (before claiming deduction under section 35AD) for the assessment year 2017-18 is ₹ 80 lakhs. Assume that the company also has another existing business of running a four-star hotel in Kanpur, which commenced operations 5 years back, the profits from which was ₹ 130 lakhs for assessment year 2017-18.

Would MNP Ltd. be entitled to deduction under section 35AD if it transfers the operation of the hotel in Chennai to PQR Ltd, while continuing to own the said hotel?

Answer

Computation of income under the head "Profit and gains of business or profession" of MNP Ltd. for A.Y. 2017-18

Particulars	₹ (in lakh)	₹ (in lakh)
Profits from the specified business of new four-star hotel in Chennai (before providing deduction under section 35AD)		80
Less: Deduction under section 35AD		
Capital expenditure incurred during the P.Y. 2016-17 (excluding the expenditure incurred on acquisition of land) = ₹ 250 lakh – ₹ 100 lakh (See Notes 1 & 2 below)	150	
Capital expenditure incurred during January 2016 to March 2016 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2016 (See Note 3 below)	<u>40</u>	
Total deduction under section 35AD for A.Y.2017-18		<u>190</u>
Income from the specified business of new hotel in Chennai		(110)
Profit from the existing business of running a four-star hotel in Kanpur (See Note 4 below)		<u>130</u>
Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A		<u><u>20</u></u>

Notes:

- (1) According to the provisions of section 35AD, an assessee shall be allowed a deduction in respect of 100% of the capital expenditure incurred wholly and exclusively for the purpose of the specified business which, *inter alia*, includes the business in the nature of building and operating a new hotel of two-star or above category, anywhere in India. Therefore, the newly commenced four-star hotel business of MNP Ltd qualifies for

deduction under section 35AD, since it has fulfilled all the conditions for claim of deduction under that section.

- (2) The expenditure on acquisition of land, however, does not qualify for deduction under section 35AD.
- (3) The capital expenditure incurred prior to commencement of specified business shall be allowed as deduction under section 35AD(1) in the year of commencement of specified business, if the same is capitalized in the books of accounts of the assessee on the date of commencement of its operations. Therefore, the expenditure of ₹ 40 lakh is allowable as deduction in A.Y. 2017-18, since it has been capitalized in the books of accounts of MNP Ltd. as on 1.4.2016.
- (4) As per section 73A, the loss computed under section 35AD in respect of a specified business can be set off against the profit of another specified business. Building and operating a hotel of two-star and above category, anywhere in India, is a specified business, therefore, the loss from the business of new four-star hotel in Chennai can be set-off against the income of the existing four-star hotel in Kanpur.
- (5) Section 35AD(6A) provides that where the assessee, MNP Ltd., builds a hotel of two-star or above category as classified by the Central Government and subsequently, while continuing to own the hotel, transfers the operation of the said hotel to another person, the assessee shall be deemed to be carrying on the specified business of building and operating a hotel. Therefore, in this case, MNP Ltd. would be eligible to claim investment linked deduction under section 35AD even if it transfers the operation of the Chennai hotel to PQR Ltd.

Question 18

Briefly discuss about the provisions relating to deductibility of interest on capital borrowed for the purpose of business or profession.

Answer

Under section 36(1)(iii), deduction is allowed in respect of interest on capital borrowed for the purposes of business or profession while computing income under the head "Profits and gains of business or profession".

Further, *Explanation 8* to section 43(1) clarifies that interest relatable to a period after the asset is first put to use cannot be included in the actual cost of the asset.

The proviso to section 36(1)(iii) provides that no deduction shall be allowed in respect of any amount of interest paid, in respect of capital borrowed 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.

Thus, 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 be capitalized

Question 19

Comment on the allowability of the following claim made by the assessee:

Mr. Achal, a hotelier, claimed expenditure on replacement of linen and carpets in his hotel as revenue expenditure.

Answer

The expenditure on replacement of linen and carpets in a hotel are in the nature of expenses incurred for the business and are allowable as revenue expenses under section 37(1).

Question 20

What are the conditions to be satisfied for the allowability of expenditure under section 37 of the Income-tax Act, 1961?

Answer

- (1) The following conditions are to be fulfilled for the allowability of expenditure under section 37 -
 - (i) The expenditure should not be of the nature described in section 30 to 36;
 - (ii) It should not be in the nature of personal expenditure of the assessee;
 - (iii) The expenditure should have been laid out or expended wholly or exclusively for the purposes of the business or profession;
 - (iv) It should not be in the nature of a capital expenditure;
 - (v) It should not have been incurred for any purpose which is an offence or which is prohibited by law.
- (2) No deduction is allowable for expenditure incurred by the assessee on advertisement in any souvenir, brochure, tract pamphlet or the like published by a political party [Section 37(2B)]
- (3) As per *Explanation 2* to Section 37(1), any expenditure incurred by the assessee on the activities relating to Corporate Social Responsibility referred to in Section 135 of the Companies Act, 2013 shall **not** be deemed to be an expenditure incurred for the purpose of business or profession. Hence, such expenditure shall be disallowed while computing total income.

Question 21

State with reasons, the allowability of the following expenses incurred by MN Limited, a wholesale dealer of commodities, under the Income-tax Act, 1961 while computing profit and gains from business or profession for the Assessment Year 2017-18.

- (i) *Construction of school building in compliance with CSR activities amounting to ₹ 5,60,000.*

- (ii) Purchase of building for setting up 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.
- (iv) Commodities transaction tax paid ₹ 20,000 on sale of bullion.

Answer

Allowability of the expenses incurred by MN Ltd., 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 MN Ltd. towards construction of school building in compliance with CSR activities shall **not** be allowed as deduction under section 37.

Note: The Explanatory Memorandum to the Finance (No.2) Bill, 2014, however, clarifies that CSR expenditure, which is of the nature described in sections 30 to 36, shall be allowed as deduction under these sections subject to fulfilment of conditions, if any, specified therein.

Under section 35AC, 100% deduction is allowable in respect of the expenditure incurred on eligible projects/schemes specified under Rule 11K, which includes, inter alia, any project or scheme for construction of school buildings primarily for children belonging to the economically weaker sections of the society, as the Central Government may, by notification in the Official Gazette, specify in this behalf on the recommendation of the National Committee, being a committee constituted by the Central Government, from amongst persons of eminence in public life.

Therefore, if the expenditure of ₹ 5,60,000 on construction of school building is incurred for children belonging to the economically weaker sections of the society and the other conditions mentioned under section 35AC are fulfilled by MN Ltd., it can claim deduction of such expenditure under section 35AC.

- (ii) Purchase of building for setting up a warehousing facility for storage of food grains**

MN Ltd. would be eligible for investment-linked tax deduction under section 35AD @150% in respect of amount of ₹ 4,50,000 invested in purchase of building for setting up a warehousing facility for storage of food grains which commences operation on or after 1st April, 2012 (P.Y.2016-17, in this case).

Therefore, the deduction under section 35AD while computing business income would be ₹ 6,75,000.

- (iii) **Interest on loan paid to Mr. X (a resident) ₹ 50,000 on which tax has not been deducted**

₹ 15,000, being 30% of ₹ 50,000, would be disallowed under section 40(a)(ia) while computing the business income of MN Ltd. 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 MN Ltd., the commodity transaction tax of ₹ 20,000 paid is allowable as deduction under section 36(1)(xvi).

Question 22

State 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 cheque crossed as "& Co.", disallowance of ₹ 25,000 under section 40A(3) can be made 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 a draft, on 27.12.2016 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 existing assessee engaged in trading activities, 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%.*

Answer

- (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(3), 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 ₹ 20,000 has been made in the subsequent year otherwise than by an account payee cheque or an account payee bank draft, 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 generation and distribution of power. In this case, the assessee is engaged in trading activities and the new plant has been acquired and installed in a trading concern. Hence, the assessee will not be entitled to claim additional depreciation under section 32(1)(iia).

Question 23

State, with reasons, the allowability of the following expenses under the Income-tax Act, 1961 while computing income from business or profession for the Assessment Year 2017-18:

- (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 ₹ 2,00,000 outside India by a company without deduction of tax.
- (vi) Sales tax deposited in cash ₹ 50,000 with State Bank of India.
- (vii) Payment made in cash ₹ 30,000 to a transporter in a day for carriage of goods

Answer

- (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 ₹ 20,000.

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 by credit card is covered under Rule 6DD, which contains the exceptions to section 40A(3), 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 ₹ 2,00,000 outside India by a company without deduction of tax at source.

(vi) **Allowable as deduction:** As per Rule 6DD, if the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender, no disallowance under section 40A(3) is attracted even though the cash payment for the expense exceeds ₹ 20,000.

Therefore, in the given case, no disallowance under section 40A(3) is attracted since payment of sales tax is covered by the above mentioned exception contained in Rule 6DD.

(vii) **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 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.

Question 24

Ramji Ltd., engaged in manufacture of medicines (pharmaceuticals), furnishes the following information for the year ended 31.03.2017:

- (i) *Municipal tax relating to office building ₹ 51,000 not paid till 30.09.2017.*
- (ii) *Patent acquired for ₹ 20,00,000 on 01.09.2016 and used from the same month.*
- (iii) *Capital expenditure on scientific research ₹ 10,00,000 which includes cost of land ₹ 2,00,000.*
- (iv) *Amount due from customer X, outstanding for more than 3 years, written off as bad debt in the books ₹ 5,00,000.*
- (v) *Income-tax paid ₹ 90,000 by the company in respect of non-monetary perquisites provided to its employees.*
- (vi) *Provident fund contribution of employees ₹ 5,50,000 remitted in July, 2017.*
- (vii) *Expenditure towards advertisement in souvenir of a political party ₹ 1,50,000.*
- (viii) *Refund of sales tax ₹ 75,000 received during the year, which was claimed as expenditure in an earlier year.*

State with reasons the taxability or deductibility of the items given above under the Income-tax Act, 1961.

Note: *Computation of total income is not required.*

Answer

- (i) As per section 43B, municipal tax is not deductible for A.Y. 2017-18 since it is not paid on or before 30.09.2017, being the due date of filing the return for A.Y. 2017-18.

Note – It is assumed that the company has not undertaken any international transaction or has not entered into a Specified Domestic transaction during the year, and therefore, does not have to file a transfer pricing report under section 92E. Therefore, the due date of filing of return of the company would be 30th September, 2017.

- (ii) Patent is an intangible asset eligible for depreciation@25%, as per section 32(2)(ii). Since it has been acquired and put to use for more than 180 days during the previous year 2016-17, full depreciation of ₹ 5,00,000 (i.e. 25% of ₹ 20,00,000) is allowable as deduction.
- (iii) Weighted deduction@200% is available under section 35(2AB) in respect of expenditure incurred by a company on scientific research on in-house research and development facility as approved by the prescribed authority. However, cost of land is not eligible for deduction.

Deduction under section 35(2AB) = 200% of ₹ 8 lakhs = ₹ 16,00,000.

Note: It is presumed that the in-house research and development facility is approved by the prescribed authority and is hence, eligible for weighted deducted @ 200% under section 35(2AB).

- (iv) Bad debts i.e. ₹ 5,00,000 written off in the books of account as irrecoverable is deductible under section 36(1)(vii), provided the debt has been taken into account in computing the income of the company in the current previous year or any of the earlier previous years.
- (v) As per section 40(a)(v), income-tax of ₹ 90,000 paid by the company in respect of non-monetary perquisites provided to its employees, exempt in the employee's hands under section 10(10CC), is not deductible while computing business income of the employer-company.
- (vi) The employees' contribution to provident fund is taxable in the hands of the company since it is included in the definition of income under section 2(24)(x).

As per section 36(1)(va), provident fund contribution of employees is deductible only if such sum is credited to the employee's provident fund account on or before the due date under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952. In this case, since it is remitted after the due date under the said Act, it is not deductible. This conclusion is supported by the Hon'ble Gujarat High Court ruling in *CIT v. Gujarat State Road Transport Corporation* [(2014) 223 Taxmann 398].

Note: The Delhi High Court, in *CIT vs. Aimil Ltd.* (2010) 321 ITR 508, has held that provident fund contribution of employees is deductible in the hands of the employer even if it is remitted after the due date under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952, provided the same is remitted before the due date of filing return of income.

- (vii) Expenditure towards advertisement in souvenir of a political party is disallowed under section 37(2B) while computing business income.

However, the same is deductible under section 80GGB from gross total income provided the payment is made by any mode other than cash.

- (viii) Refund of a trading liability is taxable under section 41(1), if a deduction was allowed in respect of the same to the taxpayer in an earlier year. Since sales tax was claimed as expenditure in an earlier year, refund of the same during the year would attract the provisions of section 41(1).

Question 25

Answer the following with reference to the provisions of the Income-tax Act, 1961:

- (a) *Bad debt claim disallowed in an earlier assessment year, recovered subsequently. Is the sum recovered chargeable to tax?*
- (b) *Tax deducted at source on salary paid to employees not remitted till the 'due date' for filing the return prescribed in section 139. Is the expenditure to be disallowed under section 40(a)(ia)?*
- (c) *X Co. Ltd. paid ₹ 120 lakhs as compensation as per approved Voluntary Retirement Scheme (VRS) during the financial year 2016-17. How much is deductible under section 35DDA for the assessment year 2017-18?*
- (d) *Bad debt of ₹ 50,000 written off and allowed in the financial year 2014-15 recovered in the financial year 2016-17.*

Answer

- (a) Recovery of a bad debt claim disallowed in the earlier year cannot be brought to tax under section 41(4). Section 41(4) can be invoked only in a case where bad debts or part thereof has been allowed as deduction earlier under section 36(1)(vii).
- (b) The scope of section 40(a)(ia) has been expanded w.e.f. A.Y. 2016-17 to cover all sums in respect of which tax is deductible under Chapter XVII-B. Section 192, which requires deduction of tax at source from salary income, forms part of Chapter XVII-B. Therefore, salary payment without deduction of tax at source would attract disallowance under section 40(a)(ia). However, only 30% of salary paid without deduction tax at source would be disallowed under section 40(a)(ia).
- (c) It is deductible in 5 equal annual instalments commencing from the previous year of payment. ₹ 24 lakhs, being 1/5th of ₹ 120 lakhs, is deductible under section 35DDA for the A.Y. 2017-18.
- (d) As per section 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. Therefore, in this case, ₹ 50,000 would be taxable in the F.Y. 2016-17 (A.Y. 2017-18).

Question 26

State 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, 2016 for ₹ 25,000 through a cheque duly crossed as "& Co." 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 resident as rent or royalty, will result in disallowance while computing the business income where the resident payee has not paid the tax due on such income.*
- (c) *Co-operative banks are not allowed to claim provision for bad and doubtful debts in respect of advances made by rural branches of such banks.*

Answer

- (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 cheque crossed as "& Co." 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)(ia) provides that failure to deduct tax at source from rent or royalty payable to a resident, in accordance with the provisions of Chapter XVII-B, will result in disallowance of 30% of such expenditure, where the resident payee has not paid the tax due on such income.
- (c) **False:** Sub-clause (a) of section 36(1)(vii) allows the co-operative banks to claim deduction for provision for bad and doubtful debts in respect of advances made by rural branches of such banks. However, the deduction should not exceed 10% of the aggregate average advances made by the rural branches of such banks computed in the prescribed manner.

Question 27

Write short notes on:

- (i) *Restrictions on deductions allowable to the partnership firm in respect of salary and interest to its partners under section 40(b) of the Income-tax Act, 1961.*
- (ii) *Carry forward and set off of unabsorbed depreciation.*
- (iii) *Additional depreciation.*

Answer

- (i) In the case of a partnership firm, the deduction on account of interest and salary paid to its partners are as subject to the following restrictions contained in section 40(b) -

- (i) It should be authorised by and in accordance with the terms of the partnership deed.
- (ii) It should not relate to a period before the date of such deed.
- (iii) Remuneration should be paid to a working partner.
- (iv) The amounts allowable are subject to the following limits -

(1) In the case of interest

Simple interest up to 12% p.a. is allowable. This restriction is not applicable if a person is a partner in his representative capacity in the firm and he receives interest from the firm in his individual capacity. Similarly, the restriction is also not applicable if a person who is a partner in his individual capacity receives interest for and on behalf of someone else from the firm in which he is a partner.

- (2) In the case of salary, bonus, commission or remuneration paid by a firm to its working partners –** It should not exceed the amount specified in the table below -

For all firms

- | | | |
|-----|---|---|
| (a) | On the first ₹ 3,00,000 of the book profit or in case of loss | ₹ 1,50,000 or 90% of book profit, whichever is more |
| (b) | On the balance of the book profit | @ 60% |

- (ii) 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, such 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 there is no depreciation allowance for that previous year, the unabsorbed depreciation of the earlier previous year shall become the depreciation allowance of that year. The effect of the provisions of section 32(2) is that unabsorbed depreciation brought forward shall be deemed as the current year depreciation. Consequently, such unabsorbed depreciation can be set-off not only against income under the head "Profits and gains of business or profession" but also against income under any other head. Further, the unabsorbed depreciation can be carried forward indefinitely till it is fully set off.

However, in the order of set-off losses under different heads of income, effect shall first be given to current year depreciation, then to brought forward business losses and finally to unabsorbed depreciation.

- (iii) Section 32(1)(ia) provides that in the case of any new machinery or plant (other than ships and aircraft) acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation or generation and distribution of power, a further sum equal to 20% of the actual cost of such machinery or plant shall be allowable as a deduction.

The additional depreciation is available to a new machinery or plant used in the manufacture or production of any article or thing or generation or generation and distribution of power. Additional depreciation will be taken into consideration for computing the WDV of the relevant block of assets.

Additional depreciation is not available in respect of the following assets:

(A) any machinery or plant

- (i) which has been used in India or outside India by any other person before its installation by the assessee; or
- (ii) installed in any office premises, residential accommodation including accommodation used in the nature of guest house ; or
- (iii) the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income under the head "Profits and gains of business or profession" of any one previous year.

(B) any office appliances or road transport vehicles.

If the new plant and machinery is put to use for less than 180 days during the previous year, additional depreciation would be restricted to 10% (i.e., 50% of 20%). The balance additional depreciation can be claimed in the immediately succeeding previous year.

Question 28

Rao & Jain, a partnership firm consisting of two partners, reports a net profit of ₹ 7,00,000 before deduction of the following items:

- (1) *Salary of ₹ 20,000 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 ₹ 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 assessment year 2017-18 as per section 40(b).

Answer

- (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)		7,00,000
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%)	<u>60,000</u>	<u>2,10,000</u>
Book Profit		<u>4,90,000</u>

- (ii) Salary actually paid to working partners = ₹ 20,000 × 2 × 12 = ₹ 4,80,000.

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 ₹ 3,00,000 of book profit or in case of loss	₹ 1,50,000 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. 2017-18 in this case would be:

Particulars	₹
On the first ₹ 3,00,000 of book profit [(₹ 1,50,000 or 90% of ₹ 3,00,000) whichever is more]	2,70,000

On the balance of book profit [60% of (₹ 4,90,000 - ₹ 3,00,000)]	<u>1,14,000</u>
Maximum allowable partners' salary	<u>3,84,000</u>

Hence, allowable working partners' salary for the A.Y. 2017-18 as per the provisions of section 40(b)(v) is ₹ 3,84,000.

Question 29

During the financial year 2016-17, the following payments/expenditure were made/incurred by Mr. Yuvan Raja, a resident individual (whose turnover during the year ended 31.3.2016 was ₹ 99 lacs) :

- (i) *Interest of ₹ 12,000 was paid to Rehman & Co., a resident partnership firm, without deduction of tax at source;*
- (ii) *Interest of ₹ 4,000 was paid as interest to Mr. R.D. Burman, a non-resident, without deduction of tax at source;*
- (iii) *₹ 3,00,000 was paid as salary to a resident individual without deduction of tax at source;*
- (iv) *Commission of ₹ 15,000 was paid to Mr. Vidyasagar on 2.7.2016. without deduction of tax at source.*

Briefly discuss whether any disallowance arises under the provisions of section 40(a)(i)/40(a)(ia) of the Income-tax Act, 1961.

Answer

Disallowance under section 40(a)(i)/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.

The assessee is a resident individual, who was not subjected to tax audit during the immediately preceding previous year i.e., P.Y.2015-16 (as his turnover was less than ₹ 100 lakh in that year) and the TDS obligations have to be considered bearing this in mind.

- (i) The obligation to deduct tax at source from interest paid to a resident arises under section 194A in the case of an individual, only where he was subject to tax audit under section 44AB in the immediately preceding previous year, i.e., P.Y.2015-16. From the data given, it is clear that he was not subject to tax audit under section 44AB in the P.Y.2015-16. Hence, disallowance under section 40(a)(ia) is not attracted in this case.
- (ii) In the case of interest paid to a non-resident, there is obligation to deduct tax at source under section 195, hence non-deduction of tax at source will attract disallowance under section 40(a)(i).
- (iii) The scope of section 40(a)(ia) has been expanded w.e.f. A.Y. 2017-18 to cover all sums in respect of 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. Therefore, 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.

- (iv) The obligation to deduct tax at source under section 194-H from commission paid in excess of ₹ 5,000 to a resident arises in the case of an individual, only where he was subject to tax audit under section 44AB in the immediately preceding previous year. From the data given, it is clear that he was not subject to tax audit under section 44AB in the P.Y. 2015-16. Hence, there is no obligation to deduct tax at source under section 194H during the P.Y. 2016-17. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

Question 30

M/s. Arora Ltd., submits the following details of expenditure pertaining to the financial year 2016-17:

- (i) *Payment of professional fees to Mr. Mani ₹ 50,000. Tax was not deducted at source.*
- (ii) *Interior works done by Mr. Hari for ₹ 2,00,000 on a contract basis. Payment made in the month of March 2017. Tax deducted in March 2016 was paid on 30.06.2017.*
- (iii) *Factory Rent paid to Mr. Rao ₹ 15,00,000. Tax deducted at source and paid on 01.10.2017.*
- (iv) *Interest paid on Fixed Deposits ₹ 2,00,000. Tax deducted on 31.12.2016 and paid on 28.09.2017.*

Examine the above with reference to allowability of the same in the assessment year 2017-18 under the Income-tax Act, 1961. Your answer must be with reference to section 40(a) read with relevant tax deduction at source provisions. Assume that the due date of filing the return of income is 30.09.2017.

Answer

Allowability of expenses of M/s. Arora Ltd. for the A.Y. 2017-18

- (i) Payment of professional fees is subject to TDS under section 194J. Since no tax is deducted at source, ₹ 15,000, being 30% of the expenditure of ₹ 50,000 is disallowed under section 40(a)(ia).
- (ii) Since the tax was deducted in March, 2017 and paid on or before the due date of filing the return (i.e., on or before September 30th, 2017), the expenditure on interior works will be allowed as deduction. Hence, disallowance under section 40(a)(ia) is not attracted.

- (iii) The maximum time allowable for deposit of tax deducted at source is upto the due date of filing of return i.e., 30th September, 2017. In this case, since tax deducted under section 194-I was paid after the due date of filing the return, ₹ 4,50,000 being 30% of ₹ 15,00,000 is disallowed under section 40(a)(ia) for the previous year 2016-17.
- (iv) The tax deducted at source can be deposited on or before the due date of filing of return to avoid disallowance under section 40(a)(ia). In this case, disallowance would not be attracted since tax deducted during December 2016 was deposited before 30th September 2017 i.e. on 28.09.2017.

Question 31

Vinod is a person carrying on profession as film artist. His gross receipts from profession are as under:

	₹
Financial year 2014-15	1,15,000
Financial year 2015-16	1,80,000
Financial year 2016-17	2,10,000

What is his obligation regarding maintenance of books of accounts for each Assessment Year under section 44AA of Income-tax Act, 1961?

Answer

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.

Thus, 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 2014-15, the requirement under section 44AA to compulsorily maintain the prescribed books of account is not applicable to him.

Question 32

Ramamurthy had 4 heavy goods vehicles as on 1.4.2016. He acquired 7 heavy goods vehicles on 27.6.2016. He sold 2 heavy goods vehicles on 31.5.2016.

He has brought forward business loss of ₹ 50,000 relating to assessment year 2013-14 of a discontinued business. Assuming that he opts for presumptive taxation of income as per section 44AE, compute his total income chargeable to tax for the assessment year 2017-18.

Answer

Computation of total income of Mr. Ramamurthy for A.Y.2017-18

Particulars	₹
Presumptive business income under section 44AE	
4 heavy goods vehicles for 2 months (4 x ₹ 7,500 x 2)	60,000
Balance 2 heavy goods vehicles for 10 months (2 x ₹ 7,500 x 10)	1,50,000
7 heavy goods vehicles for 10 months (7 x ₹ 7,500 x 10)	<u>5,25,000</u>
Business Income	7,35,000
Less: Brought forward business loss of discontinued business	<u>50,000</u>
Total Income	<u>6,85,000</u>

Note: The assessee is eligible for computing the income from goods carriages applying the presumptive provisions of section 44AE, since he does not own more than 10 goods carriages at any time during the previous year.

Question 33

Mr. Praveen engaged in retail trade, reports a turnover of ₹ 1,98,50,000 for the financial year 2016-17. His income from the said business as per books of account is computed at ₹ 13,20,000. Retail trade is the only source of income for Mr. Praveen.

- Is Mr. Praveen eligible to opt for presumptive determination of his income chargeable to tax for the assessment year 2017-18?*
- If so, determine his income from retail trade as per the applicable presumptive provision.*
- In case Mr. Praveen does not opt for presumptive taxation of income from retail trade, what are his obligations under the Income-tax Act, 1961?*
- What is the due date for filing his return of income under both the options?*

Answer

- Yes. Since his total turnover for the F.Y.2016-17 is below ₹ 200 lakhs, he is eligible to opt for presumptive taxation scheme under section 44AD in respect of his retail trade business.
- His income from retail trade, applying the presumptive tax provisions under section 44AD, would be ₹ 15,88,000, being 8% of ₹ 1,98,50,000.
- Section 44AB makes it obligatory for every person carrying on business to get his accounts of any previous year audited if his total sales, turnover or gross receipts exceed ₹ 1 crore. However, if an eligible person opts for presumptive taxation scheme as per section 44AD(1), he shall not be required to get his accounts audited if the total turnover or gross receipts of the relevant previous year does not exceed ₹ 2 crore. The CBDT,

has vide its Press Release dated 20th June, 2016, clarified that the higher threshold for non-audit of accounts has been given only to assesseees opting for presumptive taxation scheme under section 44AD.

In this case, if Mr. Praveen does not opt for the presumptive taxation scheme under section 44AD, he has to get his books of accounts audited and furnish a report of such audit under section 44AB, since his turnover exceeds ₹ 1 crore during the P.Y.2016-17.

- (iv) In case he opts for the presumptive taxation scheme under section 44AD, the due date would be 31st July, 2017.

In case he does not opt for the presumptive taxation scheme, he is required to get his books of account audited, in which case the due date for filing of return would be 30th September, 2017.

Question 34

Mr. Sukhvinder is engaged in the business of plying goods carriages. On 1st April, 2016, he owns 10 trucks (out of which 6 are heavy goods vehicles). On 2nd May, 2016, he sold one of the heavy goods vehicles and purchased a light goods vehicle on 6th May, 2016. This new vehicle could however be put to use only on 15th June, 2016.

Compute the total income of Mr. Sukhvinder for the assessment year 2017-18, 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	<u>15,000</u>	<u>8,25,000</u>
Net Profit		4,45,000
Other business and non-business income		70,000

Answer

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 assesseees on a presumptive basis. The income shall be deemed to be ₹ 7,500 from each goods carriage (whether it is heavy or light vehicle) - for every month or part the month during which such carriage vehicle is 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 ₹ 9,07,500 (See Notes 1 & 2 below) and his total income would be ₹ 9,77,500.

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 ₹ 9,07,500 and his total income would be ₹ 5,15,000.

Notes :

1. Computation of total income of Mr. Sukhvinder for A.Y. 2017-18

Particulars	Presumptive income	Where books are maintained
Income from business of plying goods carriages [See Note 2 Below]	9,07,500	4,45,000
Other business and non business income	<u>70,000</u>	<u>70,000</u>
Total Income	<u>9,77,500</u>	<u>5,15,000</u>

2. Calculation of presumptive income as per section 44AE

Type of carriage	No. of months	Rate per month	Amount
(1)	(2)	(3)	(4)
9 goods carriage – held throughout the year	12	7,500	8,10,000
1 goods carriage – held upto 2 nd May	2	7,500	15,000
1 goods carriage – held from 6 th May	11	7,500	<u>82,500</u>
		Total	<u>9,07,500</u>

Question 35

X Ltd. follows mercantile system of accounting. After negotiations with the bank, interest of ₹ 4 lakhs (including interest of ₹ 1.2 lakhs pertaining to year ended 31.03.2017 has been converted into loan. Can the interest of ₹ 1.2 lakhs so capitalized be claimed as business expenditure?

Answer

Under section 43B, interest on term loans and advances to scheduled banks shall be allowed only in the year of payment of such interest irrespective of the method of accounting followed by the assessee.

Explanation 3D to section 43B provides that if any interest payable by the assessee is converted into a loan, the interest so converted and not “actually paid” shall not be deemed as actual payment, and hence would not be allowed as deduction. Therefore, the interest of ₹ 1.2 lakhs converted into loan cannot be claimed as business expenditure.

Question 36

Mr. B.A. Patel, a non-resident, operates an aircraft between London to Ahmedabad. For the Financial year ended on 31st March, 2017, he received the amounts as under:

- (i) For carrying passengers from Ahmedabad ₹ 50 lacs.
- (ii) For carrying passengers from London ₹ 75 lacs received in India.
- (iii) For carrying of goods from Ahmedabad ₹ 25 lacs.

The total expenditure incurred by Mr. B.A. Patel for the purposes of the business for the financial year 2016-17 was ₹ 1.4 crores.

Compute the income of Mr. B.A. Patel under the head "Profits and Gains from business or profession" for the financial year ended on 31st March 2017 relevant to assessment year 2017-18.

Answer

Under section 44BBA, in case of an assessee, being a non-resident, engaged in the business of operation of aircraft, a sum equal to 5% of the aggregate of the following amounts shall be deemed to be his business income:

- (a) the amount paid or payable, whether in or out of India, to the assessee on account of carriage of passengers, goods etc. from any place in India; and
- (b) the amount received or deemed to be received in India by the assessee on account of carriage of passengers, goods etc. from any place outside India.

Hence, the income of Mr. B.A. Patel chargeable to tax in India under the head "Profits and Gains of business or profession" is determined as under:

Particulars	₹
(i) For carrying passengers from Ahmedabad	50,00,000
(ii) For carrying passengers from London, amount received in India	75,00,000
(iii) For carrying goods from Ahmedabad	25,00,000
Total	1,50,00,000

Hence, income from business computed on presumptive basis as per section 44BBA is ₹ 7,50,000, being 5% of ₹ 1,50,00,000.

Note: No deduction is allowable in respect of any expenditure incurred for the purpose of the business.

Question 37

List items of expenses which otherwise are deductible shall be disallowed, unless payments are actually made within the due date for furnishing the return of income under Section 139(1). When can the deduction be claimed, if paid after the said date?

Answer

Section 43B provides that the following expenses shall not be allowed as deduction unless the payments are actually made within the due date for furnishing the return of income under section 139(1):

- (i) Any tax, duty, cess or fees under any law in force.
- (ii) Any sum payable by the assessee as an employer by way of contribution to provident fund or superannuation fund or gratuity fund or any other fund for the welfare of the employees;
- (iii) Any bonus or commission for services rendered payable to employees;
- (iv) Any interest on any loan or borrowings from any public financial institution or State financial corporation or State industrial investment corporation;
- (v) Interest on loans and advances from a scheduled bank;
- (vi) Any sum paid as an employer in lieu of earned leave at the credit of his employee.
- (vii) Any sum payable by the assessee to the Indian Railways for the use of railway assets.

In case the payment is made after the due date of filing of return of income, deduction can be claimed only in the year of actual payment.

Question 38

Mr. Asim, a 60 year old individual, engaged in the business of roasting and grounding of coffee, derives income of ₹ 10 lacs during the financial year 2016-17. Compute the tax payable by him assuming he has not earned any other income during the financial year 2016-17. What would be your answer if Mr. Asim is also engaged in the business of growing and curing coffee?

Answer

If Mr. Asim is engaged only in the business of roasting and grounding of coffee (and not growing and curing of coffee), his entire income of ₹ 10 lakhs would be treated as business income and his tax liability would be ₹ 1,23,600 (₹ 1,20,000+₹ 2,400+₹ 1,200).

If Mr. Asim is also engaged in the business of growing and curing of coffee, in addition to roasting and grounding of coffee, the provisions of Rule 7B of the Income-tax Rules, 1962 would apply. As per Rule 7B, where income is derived from the sale of coffee grown, cured, roasted and grounded by the seller in India, 40% of such income shall be treated as business income and the balance as agricultural income.

Therefore, in such a case, the business income would be 40% of ₹ 10,00,000
= ₹ 4,00,000

Calculation of tax liability for A.Y 2017-18

Particulars	₹
Tax on ₹ 10,00,000 [being the aggregate of non-agricultural income (i.e. ₹ 4,00,000) and agricultural income (i.e. ₹ 6,00,000)]	1,20,000
Less: Tax on ₹ 9,00,000 [being aggregate of agricultural income (i.e. ₹ 6,00,000) and basic exemption limit (i.e. ₹ 3,00,000)]	
	<u>1,00,000</u>
	20,000
Less: Rebate u/s 87A	<u>5,000</u>
	15,000
Add: Education cess @ 2%	300
Secondary and higher education cess @ 1%	<u>150</u>
Total tax liability	<u>15,450</u>

Question 39

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 31.3.2017 are given below:

Particulars	₹
WDV of car as on 1.4.2016	3,00,000
WDV of machinery as on 1.4.2016 (15% rate)	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 assessment year 2017-18. Show the WDV of the assets as on 1.4.2017.

Answer

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

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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]		<u>36,000</u>	
Total cost of agricultural operations		3,86,000	
Expenditure for coffee curing operations	3,00,000		
Add: Depreciation on machinery (15% of 15,00,000) [See Computation below]	<u>2,25,000</u>		
Total cost of the curing operations		<u>5,25,000</u>	
Total cost of composite operations			<u>9,11,000</u>
Total profits from composite activities			<u>12,89,000</u>
Business income (25% of above)			3,22,250
Agricultural income (75% of above)			9,66,750

Computation of value of depreciable assets as on 31.3.2017

Particulars	₹	₹	₹
Car Opening value as on 1.4.2016		3,00,000	
Depreciation thereon at 15%	45,000		
Less: Disallowance @20% for personal use	<u>9,000</u>		
Depreciation actually allowed		<u>36,000</u>	
WDV as on 1.4.2017			2,64,000
Machinery Opening value as on 1.4.2016		15,00,000	
Less: Depreciation @ 15%		<u>2,25,000</u>	
WDV as on 1.4.2017			12,75,000

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.

Question 40

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 31-3-2017:

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 assessment year 2017-18.

Answer

Computation of business income and agricultural income of Ms. Vivitha for the A.Y.2017-18

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.

Question 41

Mr. Tony has estates in Rubber, Tea and Coffee. He derives income from them. He has also a nursery wherein he grows and sells plants. For the previous year ending 31.3.2017, he furnishes the following particulars of his sources of income from estates and sale of plants. You are requested to compute the taxable income for the Assessment Year 2017-18:

Sl. No.	Particulars	₹
(i)	Manufacture of Rubber	5,00,000
(ii)	Manufacture of Coffee grown and cured	3,50,000
(iii)	Manufacture of Tea	7,00,000
(iv)	Sale of plants from Nursery	1,00,000

Answer**Computation of taxable income of Mr. Tony for A.Y.2017-18**

	Particulars	Business Income (₹)	Agricultural Income (₹)
(a)	Income from manufacture of rubber (Rule 7A) Business income is 35% of ₹ 5,00,000 Agricultural income is 65% of ₹ 5,00,000	1,75,000	3,25,000
(b)	Income from growing and curing of coffee (Rule 7B) Business income is 25% of ₹ 3,50,000 Agricultural income is 75% of ₹ 3,50,000	87,500	2,62,500
(c)	Income from manufacture of tea (Rule 8) Business income is 40% of ₹ 7,00,000	2,80,000	

(d)	Agricultural income is 60% of ₹ 7,00,000		4,20,000
	Income from sale of plants in nursery is agricultural income [See Note below]	Nil	1,00,000
		5,42,500	11,07,500

Note: 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.

Question 42

Mr. Gupta is having a trading business and his Trading and Profit & Loss Account for the financial year 2016-17 is as under:

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening stock	1,00,000	By Sales	2,70,00,000
To Purchase	2,49,00,000	By Closing stock	50,000
To Gross profit	<u>20,50,000</u>		
Total	<u>2,70,50,000</u>	Total	<u>2,70,50,000</u>
Salary to employees (Including Contribution to PF)	5,00,000	By Gross Profit b/d	20,50,000
Donation to Prime Minister Relief Fund	1,00,000		
Provision for bad debts	50,000		
Bonus to employees	50,000		
Interest on bank loan	50,000		
Family planning expenditure incurred on employees	20,000		
Depreciation	30,000		
Income-tax	1,00,000		
To Net profit	<u>11,50,000</u>		
Total	<u>20,50,000</u>	Total	<u>20,50,000</u>

Other information:

- Depreciation allowable ₹ 40,000 as per Income-tax Rules, 1962.
- No deduction of tax at source on payment of interest on bank loan has been made.
- Out of salary, ₹ 25,000 pertains to his contributions to recognized provident fund which was deposited after the due date of filing return of income. Further, employees contribution of ₹ 25,000 was also deposited after the due date of filing return of income.

Calculate gross total income of Mr. Gupta for the Assessment Year 2017-18.

Answer

Computation of Gross Total Income of Mr. Gupta for the A.Y. 2017-18

Particulars	₹	₹
Income from Business or profession		
Net profit as per Profit and Loss Account		11,50,000
Add : Expenses not deductible		
Donation to Prime Minister Relief Fund (Refer Note 1)	1,00,000	
Provision for bad debts (Refer Note 2)	50,000	
Family planning expenditure incurred on employees (Refer Note 3)	20,000	
Depreciation as per Profit and Loss Account	30,000	
Income-tax (Refer Note 4)	1,00,000	
Employer's contribution to recognized provident fund (Note 5)	25,000	
		<u>3,25,000</u>
		14,75,000
Less : Expense allowed		
Depreciation as per Income-tax Rules, 1962		<u>40,000</u>
		14,35,000
Add : Employee's contribution included in income as per Section 2(24)(x) (Refer Note 6)		<u>25,000</u>
Business Income / Gross Total Income		<u>14,60,000</u>

Notes:-

- (1) Donation to Prime Minister Relief Fund is not allowed as deduction from the business income. It is allowed as deduction under section 80G from the gross total income.
- (2) Provisions for bad debts is allowable as deduction under section 36(1)(viii) (subject to the limits specified therein) only in case of banks, public financial institutions, State Financial Corporation and State Industrial Investment Corporation. Therefore, it is not allowable as deduction in the case of Mr. Gupta.
- (3) Expenditure on family planning is allowed as deduction under section 36(1)(ix) only to a company assessee. Therefore, such expenditure is not allowable as deduction in the hands of Mr. Gupta.
- (4) Income-tax paid is not allowed as deduction as per the provisions of section 40(a)(ii).

- (5) Since, Mr. Gupta's contribution (by the employer) to recognized provident fund is deposited after the due date of filing return of income, the same is disallowed as per provisions of section 43B.
- (6) Employee's contribution is includible in the income of the employer by virtue of Section 2(24)(x). The deduction for the same is not provided for as it was deposited after the due date.
- (7) TDS provisions under section 194A are not attracted in respect of payment of interest on bank loan. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

Question 43

Mr. Raju, a manufacturer at Chennai, gives the following Manufacturing, Trading and Profit & Loss Account for the year ended 31.03.2017:

Manufacturing, Trading and Profit & Loss Account for the year ended 31.03.2017

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 State VAT penalty	5,000	By Dividend from domestic companies	15,000
To State VAT 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 2016-17:

- (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 29.12.2016. 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 31.03.2017 was ₹ 20,000 and the balance was paid in October 2017.
- (v) Housing loan principal repaid during the year was ₹ 50,000 and it relates to residential property occupied by him. 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%)	₹
Opening WDV (as on 01.04.2016)	12,00,000
Additions during the year (used for more than 180 days)	2,00,000
Total additions during the year	4,00,000
Note: Ignore additional depreciation under section 32(1)(iia)	

Compute the total income of Mr. Raju for the assessment year 2017-18.

Note: Ignore application of section 14A for disallowance of expenditures in respect of any exempt income.

Answer

Computation of total income of Mr. Raju for the A.Y. 2017-18

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	
Salary paid to staff not recorded in the books (Assuming that the expenditure is in the nature of unexplained expenditure)	48,000	

and hence, is deemed to be income as per section 69C and would be taxable @ 30% under section 115BBE – no deduction allowable in respect of such expenditure) [See Note 1 below]		
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 VAT penalty paid disallowed [See Note 2 below]	5,000	
Depreciation debited to profit and loss account	<u>2,00,000</u>	<u>3,03,000</u>
		8,03,000
Less: Dividend from domestic companies [Exempt under section 10(34)]	15,000	
Income from agriculture [Exempt under section 10(1)]	1,80,000	
Depreciation under the Income-tax Act, 1961 (As per working note)	<u>2,25,000</u>	<u>4,20,000</u>
		3,83,000
Income from house property		
Annual value of self-occupied property	Nil	
Less: Deduction under section 24(b) – interest on housing loan	<u>23,000</u>	<u>(23,000)</u>
Gross Total Income		3,60,000
Less: Deduction under section 80C in respect of Principal repayment of housing loan		<u>50,000</u>
Total Income		<u>3,10,000</u>

Working Note:

Computation of depreciation under the Income-tax Act, 1961

Particulars	₹
Depreciation@15% on ₹ 14 lakh (Opening WDV of ₹ 12 lakh plus assets purchased during the year and used for more than 180 days ₹ 2 lakh)	2,10,000
Depreciation @7.5% on ₹ 2 lakh (Cost of assets used for less than 180 days)	<u>15,000</u>
	<u>2,25,000</u>

Notes (Alternate views):

1. It is also possible to take a view that the salary not recorded in the books of account was an erroneous omission and that the assessee has offered satisfactory explanation for the same. In such a case, the same should not be added back as unexplained expenditure, but would be allowable as deduction while computing profits and gains of business and profession.

2. Where the imposition of penalty is not for delay in payment of sales tax or VAT but for contravention of provisions of the Sales Tax Act (or VAT Act), 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 "State VAT 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 ₹ 3,05,000.

Question 44

Mr. Sivam, a retail trader of Cochin gives the following Trading and Profit and Loss Account for the year ended 31st March, 2017:

Trading and Profit and Loss Account for the year ended 31.03.2017

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			-
	<u>3,03,600</u>		<u>1,13,97,600</u>
	<u>1,13,97,600</u>		
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	<u>50,000</u>		
	<u>3,06,000</u>		<u>3,06,000</u>

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.
- (iv) The depreciation provided in the Profit and Loss Account ₹ 1,05,000 was based on the following information :
- The written down value of plant and machinery is ₹ 4,20,000 as on 01.04.2016. A new plant falling under the same block of depreciation was bought on 1.7.2016 for ₹ 70,000. Two old plants were sold on 1.10.2016 for ₹ 50,000.
- (v) Rent and rates includes sales tax liability of ₹ 3,400 paid on 7.4.2017.
- (vi) Other general expenses include ₹ 2,000 paid as donation to a Public Charitable Trust.
- You are required to advise Mr. Sivam whether he can opt for presumptive taxation under section 44AD and if so, whether it would be beneficial for him to declare income as per section 44AD. Assume that he has not opted for presumptive taxation scheme in any earlier previous year.

Answer

Computation of business income of Mr. Sivam for the A.Y. 2017-18

Particulars	₹	₹
Net Profit as per profit and loss account		50,000
<i>Add:</i> Inadmissible expenses / losses		
Under valuation of closing stock	18,000	
Salary paid to brother – unreasonable [Section 40A(2)]	2,000	
Printing and stationery paid in cash [Section 40A(3)]	23,200	
Depreciation (considered separately)	1,05,000	
Short term capital loss on shares	8,100	
Donation to public charitable trust	<u>2,000</u>	<u>1,58,300</u>
		2,08,300
<i>Less:</i> Deductions items:		
Under valuation of opening stock	9,000	
Income from UTI [Exempt under section 10(35)]	<u>2,400</u>	<u>11,400</u>
Business income before depreciation		1,96,900
<i>Less:</i> Depreciation (See Note 1)		<u>66,000</u>
		<u>1,30,900</u>

Computation of business income as per section 44AD -

As per section 44AD, the business income would be 8% of turnover i.e., $1,12,11,500 \times 8/100$
 = ₹ 8,96,920

The business income under section 44AD is ₹ 8,96,920.

In this case, Mr. Sivam is eligible to opt for presumptive taxation under section 44AD, since his turnover does not exceed ₹ 2 crore in the P.Y.2016-17. However, in his case, business income as per the normal provisions of the Act is lower than the presumptive income of ₹ 8,96,920 computed under section 44AD. Therefore, it is beneficial for him to compute business income as per the normal provisions of the Act. However, since his turnover exceeds ₹ 1 crore, he has to get his books of account audited under section 44AB, if he does not opt to declare his income as per the presumptive tax provisions of section 44AD.

Further, if he declares income as per presumptive tax provisions of section 44AD this year i.e., P.Y.2016-17, and he does not opt for presumptive taxation in any of the five succeeding previous years (i.e., from P.Y.2017-18 to P.Y.2021-22), say, for instance, in P.Y.2017-18, then he will not be eligible to opt for presumptive taxation for five assessment years succeeding the A.Y. 2018-19 relevant to the P.Y. 2017-18.

Notes:**1. Calculation of depreciation**

Particulars	₹
WDV of the block of plant & machinery as on 1.4.2016	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 31.3.2017	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 sales-tax liability has been paid before the due date of filing return of income under section 139(1), the same is deductible.

Question 45

Following is the profit and loss account of Mr. Q for the year ended 31-03-2017:

Particulars	₹	Particulars	₹
To Repairs on Building	1,81,000	By Gross Profit	6,01,000
To Amount paid to IIT, Mumbai for an approved scientific research programme	1,00,000	By I.T. Refund	8,100
To Interest	1,10,000	By Interest on Company Deposits	6,400
To Travelling	1,30,550		
To Net Profit	93,950		
	6,15,500		6,15,500

Following additional information is furnished:

- (1) Repairs on building includes ₹ 1,00,000 being cost of building a new room.
- (2) Interest payments include ₹ 50,000 on which tax has not been deducted and penalty for contravention of Central Sales Tax Act of ₹ 24,000.

Compute the income chargeable under the head "Profits and gains of Business or Profession" of Mr. Q for the year ended 31-03-2017 ignoring depreciation.

Answer

Computation of income under the head "Profits and gains of business or profession" of Mr. Q for the A.Y. 2017-18

Particulars	₹	₹
Net profit as per profit and loss account		93,950
Add: Expenses not allowable		
(i) Expenses on building a new room – Capital expenditure, hence not allowable as per section 37(1).	1,00,000	
(ii) Interest payable on which tax has not been deducted at source [disallowed under section 40(a)] [See Note 1]	15,000	
(iii) Penalty for contravention of Central Sales Tax Act [Penalty paid for violation or infringement of any law is not allowable as deduction under section 37(1)]	24,000	
(iv) Payment to IIT, Mumbai for scientific research programme (to be treated separately)	<u>1,00,000</u>	<u>2,39,000</u>
		3,32,950
Less: Income not forming part of business income		
Interest from company deposits (chargeable under the head "Income from other sources") (See Note 2 below)	6,400	

4.150 Income-tax

Income-tax refund (not an income chargeable to tax)	<u>8,100</u>	<u>14,500</u>
		3,18,450
Less: Weighted deduction@200% under section 35(2AA) for payment to IIT for an approved scientific research program.		<u>2,00,000</u>
Profit and gains of business or profession		<u>1,18,450</u>

Note –1. Section 40(a)(ia) provides for disallowance of 30% of any sum paid, on which tax is deductible under Chapter XVII-B, but the same has not been deducted. Hence, ₹ 15,000 being 30% of ₹ 50,000 has to be added back while computing business income.

2. Interest on company deposits may also be treated as business income presuming that the interest has been earned by Mr. Q out of available temporary surplus funds which are not immediately required for his business purposes but nevertheless meant only for Mr. Q's business activities. In such a case, income under the head "Profit and gains of business or profession" would be ₹ 1,24,850.

Question 46

Following is the profit and loss account of Mr. A for the year ended 31.3.2017:

Particulars	₹	Particulars	₹
To Repairs on building	1,30,000	By Gross profit	6,01,000
To Advertisement	51,000	By Income Tax Refund	4,500
To Amount paid to Scientific Research Association approved u/s 35	1,00,000	By Interest from company deposits	6,400
To Interest	1,10,000	By Dividends	3,600
To Traveling	1,30,000		
To Net Profit	<u>94,500</u>		
	<u>6,15,500</u>		<u>6,15,500</u>

Following additional information is furnished:

- (1) Repairs on building includes ₹ 95,000 being cost of raising a compound wall for the own business premises.
- (2) Interest payments include interest of ₹ 12,000 payable outside India to a non-resident Indian on which tax has not been deducted and penalty of ₹ 24,000 for contravention of Central Sales Tax Act.

Compute the income chargeable under the head 'Profits and gains of business or profession' of Mr. A for the year ended 31.3.2017 ignoring depreciation.

Answer

Profits and gains of business or profession of Mr. A for the year ended 31.3.2017

Particulars	₹	₹
Net profit as per profit and loss account		94,500
Add: Expenses not allowable		
(i) Expenses on raising compound wall – capital expenditure, hence disallowed	95,000	
(ii) Interest payable outside India to a non-resident, as tax has not been deducted at source [Section 40(a)(i)]	12,000	
(iii) Penalty for contravention of CST Act [Penalty paid for violation or infringement of any law is not allowable as deduction under section 37(1)]	24,000	
(iv) Contribution for scientific research (to be treated separately)	<u>1,00,000</u>	<u>2,31,000</u>
		3,25,500
Less: Income not forming part of business income		
Interest from company deposits	6,400	
Dividend	3,600	
Income-tax refund	<u>4,500</u>	<u>14,500</u>
		3,11,000
Less: Deduction under section 35 for scientific research [See Note below]		<u>1,75,000</u>
Profit and gains of business or profession		<u>1,36,000</u>

Note: Contribution to approved scientific research association qualifies for deduction @ 175% under section 35(1)(ii).

Question 47

Briefly explain the term "substantial interest". State three situations in which the same assumes importance.

Answer

As per *Explanation* to section 40A(2), a person shall be deemed to have a substantial interest in a business or profession, if, -

- (1) in case where the business or profession is carried on by a company, such person who, at any time during the previous year, is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend, whether with or without a right to participate in profits), carrying not less than 20% of the voting power.
- (2) In any other case, such person who, at any time during the previous year, is beneficially entitled to not less than 20% of the profits of such business or profession.

Following are the situations under which the substantial interest assumes importance -

- (i) Taxability of deemed dividend under section 2(22)(e);
- (ii) Disallowance of excessive or unreasonable expenditure under section 40A(2) to an individual who has a substantial interest in the business or profession of the assessee, and
- (iii) Clubbing of salary income of spouse, under section 64(1)(ii) in respect of remuneration received by the spouse from a concern in which the individual has a substantial interest.

Question 48

Raghav Industries Ltd. furnishes you the following information for the year ended 31-03-2017:

- (i) *Scientific research expenditure related to its business ₹ 2,40,000 fully revenue in nature.*
- (ii) *Building acquired for scientific research (including cost of land ₹ 5,00,000) in June 2016 for ₹ 12,00,000.*
- (iii) *Amount paid to Indian Institute of Science, Bangalore for scientific research ₹ 50,000.*
- (iv) *Demerger expenses incurred in financial year 2015-16 ₹ 5,00,000.*
- (v) *Contribution to the account of employees as per pension scheme referred to in section 80CCD amounted to ₹ 30,00,000. Amount above 10% of the salary of employees is ₹ 7,00,000.*
- (vi) *Amount recovered from employees towards provident fund contribution ₹ 12,00,000 of which amount remitted upto the end of the year was ₹ 7,00,000 and the balance was remitted before the 'due date' for filing the return prescribed in Section 139(1).*
- (vii) *Tax on non-monetary perquisites provided to the employees, borne by the employer ₹ 4,50,000.*
- (viii) *Gain due to change in the rate of exchange of foreign currency ₹ 1,00,000 related to import of machinery. The machinery was acquired two years ago and put to regular use since then.*

Explain in brief how the above said items would be dealt with for the A.Y. 2017-18.

Note: Computation of total income not required.

Answer

- (i) The entire revenue expenditure of ₹ 2,40,000 on scientific research related to the business of the company qualifies for deduction under section 35(1)(i).

Note – *If Raghav Industries Ltd. is a company engaged in the business of biotechnology or in any business of manufacture or production of any article or thing, not being an article or thing specified in the list of the Eleventh Schedule, it would be entitled to a weighted deduction of ₹ 4,80,000 (200% of ₹ 2,40,000, being the revenue expenditure*

on scientific research related to its business) under section 35(2AB), if the in-house research and development facility is approved by the prescribed authority and the company has entered into an agreement with the prescribed authority for cooperation in such research and development facility and for audit of accounts maintained for that facility.

- (ii) As per section 35(1)(iv) read with section 35(2), if any capital expenditure (other than expenditure on acquisition of land) is incurred on scientific research related to the business carried on by the assessee, the whole of such capital expenditure is allowable as deduction in the previous year in which it is incurred. Therefore, ₹ 7,00,000 (i.e. ₹ 12,00,000 – ₹ 5,00,000, being the cost of land) is allowable as deduction for the A.Y.2017-18. It is assumed that the scientific research is related to the business of Raghav Industries Ltd.
- (iii) The amount of ₹ 50,000 paid to Indian Institute of Science, Bangalore, for scientific research qualifies for a weighted deduction@175% of the sum paid as per section 35(1)(ii). Therefore, Raghav Industries Ltd. would be entitled to a deduction of ₹ 87,500 (i.e., 175% of ₹ 50,000) for the A.Y.2017-18.
- (iv) As per section 35DD, one-fifth of the expenditure incurred on demerger would be allowable as deduction for five successive previous years beginning from previous year 2015-16. Therefore, in the previous year 2016-17, ₹ 1,00,000, being one-fifth of ₹ 5,00,000 would be allowable as deduction.
- (v) The employer's contribution to the account of an employee under a pension scheme referred to in section 80CCD, upto 10% of salary of the employee in the previous year, is allowable as deduction under section 36(1)(iva) while computing business income.
Disallowance under section 40A(9) would be attracted only in respect of the amount in excess of 10% of salary. Accordingly, ₹ 23 lakhs would be allowed as deduction and ₹ 7 lakhs would be disallowed.
- (vi) As per section 2(24)(x), the amount of provident fund contribution recovered from employees i.e. ₹ 12 lakhs would be taxable as income of Raghav Industries Ltd. However, the company can claim deduction under section 36(1)(va) of amount credited to the account of the employee in the provident fund before the due date under the relevant Act.
If ₹ 7 lakhs has been remitted before the said due date, the same is allowable as deduction. If it has not been so remitted, then the same is not allowable as deduction. The deduction would be restricted to the amount remitted before the due date.
The balance ₹ 5 lakhs remitted after the due date under the said Act but before the due date of filing the return is not allowable as deduction.
- (vii) The tax of ₹ 4,50,000 borne by the employer on non-monetary perquisites provided to the employees is disallowed under section 40(a)(v).
- (viii) As per section 43A, the gain of ₹ 1,00,000, arising at the time of making payment in

respect of an imported machinery, due to change in rate of exchange of foreign currency, has to be reduced from the actual cost of machinery, and depreciation would be computed on such reduced cost.

Question 49

Explain the tax treatment of Limited Liability Partnership under the Income-tax Act, 1961.

Answer

The taxation scheme of LLPs in the Income-tax Act, 1961 is on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.

The rate of income-tax applicable to LLPs is the same as the rate applicable for firms i.e. 30% of total income.

The provisions of section 40(b) requiring payment of remuneration only to working partner in accordance with the terms of the partnership deed for a period commencing on or after the date of the partnership deed, would apply to LLPs as well. Further, disallowance of interest in excess of 12% per annum and salary exceeding the prescribed percentage of book profit would also be applicable in the case of LLPs.

However, whereas a partnership firm can opt for presumptive taxation scheme under section 44AD, an LLP cannot opt for such scheme.

Exercise

1. *An assessee uses plant and machinery for the purpose of carrying on his business. Under section 31, he shall be eligible for deduction on account of-*
 - (a). *both capital and revenue expenditure on repairs*
 - (b). *current repairs*
 - (c). *current repairs plus 1/5th of capital expenditure on repairs.*
2. *An electricity company charging depreciation on straight line method on each asset separately, sells one of its machinery in April, 2016 at ₹ 1,20,000. The WDV of the machinery at the beginning of the year i.e. on 1st April, 2016 is ₹ 1,35,000. No new machinery was purchased during the year. The shortfall of ₹ 15,000 is treated as -*
 - (a). *Terminal depreciation*
 - (b). *Short-term capital loss*
 - (c). *Normal depreciation.*
3. *X Ltd. acquires an asset which was previously used for scientific research for ₹ 2,75,000. The asset was brought into use for the business of X Ltd., after the research was completed. The actual cost of the asset to be included in the block of assets is -*
 - (a). *Nil*
 - (b). *Market value of the asset on the date of transfer to business*

- (c). ₹ 2,75,000 less notional depreciation under section 32 upto the date of transfer.
4. A Ltd. has unabsorbed depreciation of ₹ 4,50,000 for the P.Y.2016-17. This can be carried forward -
- for a maximum period of 8 years and set-off against business income.
 - Indefinitely and set-off against business income.
 - Indefinitely and set-off against any head of income except salary.
5. Deduction under section 33AB is allowed to an assessee provided the assessee deposits the profits with NABARD -
- before the end of the previous year
 - within 6 months from the end of the previous year
 - within 6 months from the end of the previous year or before the due date for filing the return of income, whichever is earlier.
6. XYZ Ltd. incurred capital expenditure of ₹ 1,50,000 on 1.4.2016 for acquisition of patents and copyrights. Such expenditure is -
- Eligible for deduction in 14 years from A.Y.2017-18
 - Eligible for deduction in 5 years from A.Y.2017-18
 - Subject to depreciation under section 32
7. Under section 44AE, presumptive taxation is applicable at a particular rate provided the assessee is the owner of a maximum of certain number of goods carriages. The rate per month or part of the month relevant for A.Y.2017-18 and the maximum number specified under the section are -
- ₹ 7,500 for each goods carriage in the case of an assessee owning not more than 10 goods carriages at any time during the year
 - ₹ 3,500 per carriage for an assessee owning not more than 10 goods carriages at the end of the previous year
 - ₹ 5,000 for a heavy goods carriage and ₹ 4,500 for other goods carriages for an assessee owning not more than 12 goods carriages at the end of the previous year
8. In the case of a non-resident engaged in the business of operation of aircraft, the income is determined under section 44BBA at -
- 7.5% of turnover
 - 10% of turnover
 - 5% of turnover
9. The W.D.V. of a block (Plant and Machinery, rate of depreciation 15%) as on 1.4.2016 is ₹ 3,20,000. A machinery costing ₹ 50,000 was acquired on 1.9.2016 but put to use on 1.11.2016. During Jan '2017, part of this block was sold for ₹ 2,00,000. The depreciation for A.Y.2017-18 would be -
- ₹ 21,750
 - ₹ 25,500
 - ₹ 21,125

10. *Employer's contribution to provident fund/superannuation fund/gratuity fund is allowed as deduction in computing income under the head "Profits and gains of business or profession", provided it has been paid -*
 - (a). *before the end of the previous year*
 - (b). *on or before the due date by which the employer is required to credit an employee's contribution to the employee's account in the relevant fund.*
 - (c). *on or before the due date for filing the return of income under section 139(1).*
11. *Is it compulsory for an assessee to claim depreciation under section 32 of the Income-tax Act, 1961?*
12. *Write short notes on -*
 - (i) *Enhanced depreciation*
 - (ii) *Set-off and carry forward of unabsorbed depreciation.*
13. *Discuss the provisions dealing with the computation of business income on a presumptive basis in case of resident assesseees.*
14. *Discuss the concept of "block of assets" under the Income-tax Act, 1961.*
15. *Which are the deductions allowable only on actual payment under section 43B?*

Answers

1. b; 2. a; 3. a; 4. c; 5. c; 6. c; 7. a; 8. c; 9. a; 10. c.

4

Unit 4 : Capital Gains

Key Points		
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	Deemed Income	Deemed Full Value of consideration for computation of capital gains under section 48
45(1A)	Any profits or gains arising from 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, riot or civil disturbance, accidental fire or explosion, action by an enemy or action taken in combating an enemy shall be deemed to be the income of 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)	The profits or gains arising from the transfer by way of conversion by the owner of a capital asset into stock-in-trade of a business carried on by him shall 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.	The fair market value of the capital asset on the date of such conversion
45(3)	The profits or gains arising from the transfer of a capital asset by a person to a firm or other association of persons (AOP) or body of individuals (BOI) in which he is or becomes a partner or member, by way of capital contribution or otherwise, shall be chargeable to tax as the income of the previous year in which such transfer takes place.	The amount recorded in the books of account of the firm, AOP or BOI as the value of the capital asset.

45(4)	The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other AOPs or BOIs or otherwise, shall be chargeable to tax as the income of the firm, AOP or BOI, of the previous year in which the said transfer takes place.	The fair market value of the capital asset on the date of such transfer.
45(5)	<p>Capital gains arising from the 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 will be chargeable as income of the previous year in which the consideration or part thereof is first received.</p> <p>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 chargeable of the previous year in which the amount was received by the assessee.</p> <p>However, any amount of compensation received in pursuance of an interim order of a court, Tribunal or other 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.</p>	<p>Compensation or consideration determined or approved in the first instance by the Central Government or RBI</p> <p>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'.</p>
Definitions [Section 2]		
Section	Term	Definition
2(14)	Capital Asset	<p>Capital Asset means –</p> <p>(a) property of any kind held by an assessee, whether or not connected with his business or profession;</p> <p>(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.</p> <p>Exclusions from the definition of Capital Asset:</p> <p>Stock in trade [other than securities referred to in (b) above], raw materials or consumables held for the purposes of business or profession;</p>

		<p>➤ Personal effects except jewellery, archeological collections, drawings, paintings, sculptures or any work of art;</p> <p>➤ Rural agricultural land in India i.e. agricultural land not situated within specified urban limits.</p> <p>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 -</p> <p>(a) agricultural land situated in any area within the jurisdiction of a municipality or cantonment board having population of not less than ten thousand according to last preceding census, or</p> <p>(b) agricultural land situated in any area within such distance, <u>measured aerially</u>, in relation to the range of population according to the last preceding census as shown hereunder -</p> <table border="1"> <tr> <th></th><th>Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)</th><th>Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.</th></tr> <tr> <td>(i)</td><td>≤ 2 kilometers</td><td>> 10,000 ≤ 1,00,000</td></tr> <tr> <td>(ii)</td><td>≤ 6 kilometers</td><td>> 1,00,000 ≤ 10,00,000</td></tr> <tr> <td>(iii)</td><td>≤ 8 kilometers</td><td>> 10,00,000</td></tr> </table> <p>➤ Gold Deposits Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government;</p> <p>➤ 6% Gold Bonds, 1977 or 7% Gold Bonds, 1980 or National Defence Gold Bonds, 1980, issued by the Central Government;</p> <p>➤ Special Bearer Bonds, 1991 issued by the Central Government.</p> <p>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.</p>		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 kilometers	> 10,000 ≤ 1,00,000	(ii)	≤ 6 kilometers	> 1,00,000 ≤ 10,00,000	(iii)	≤ 8 kilometers	> 10,00,000
	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 kilometers	> 10,000 ≤ 1,00,000												
(ii)	≤ 6 kilometers	> 1,00,000 ≤ 10,00,000												
(iii)	≤ 8 kilometers	> 10,00,000												

2(42A)	Short-term capital asset	<p>Capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer is a short-term capital asset.</p> <p>However, a security (other than a unit) listed in a recognized stock exchange in India, a unit of UTI or a unit of an equity oriented fund or a zero coupon bond will be treated as short term capital asset if it is held for not more than 12 months immediately preceding the date of its transfer.</p> <p>Further, a share of a company (not being a share listed in a recognized stock exchange in India) would be treated as a short-term capital asset if it was held by the assessee for not more than 24 months immediately preceding the date of its transfer.</p>
2(29A)	Long-term capital asset	<p>Capital asset which is not a short-term capital asset is a long-term capital asset. The following assets are, therefore, long-term capital assets:</p> <ul style="list-style-type: none"> ➤ a security (other than a unit) listed in a recognized stock exchange in India, a unit of UTI or a unit of an equity oriented fund or a zero coupon bond held for more than 12 months; and ➤ any other capital asset held for more than 36 months.
Transactions not regarded as transfer [Section 47]: Some Examples		
<ul style="list-style-type: none"> ➤ Any distribution of capital assets on the total or partial partition of a HUF ➤ Any transfer of capital asset under a gift or will or an irrevocable trust ➤ Any transfer of a capital asset by a holding company to its subsidiary or vice versa, if: <ul style="list-style-type: none"> - the parent company or its nominees hold whole of the share capital of subsidiary company, and - the transferee company is an Indian company ➤ 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 ➤ 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 ➤ 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 of a capital asset or intangible asset by a private company or 		

unlisted public company to a LLP or any transfer of a share or shares held in a company by a shareholder on conversion of a company into a LLP in accordance with LLP Act, 2008 provided all conditions satisfied:

- total sales, turnover or gross receipts in the business of the company does not exceed ₹ 60 lakh in any of the three preceding previous years;
 - the shareholders of a company become partners of the LLP and their capital contribution and profit sharing ratio in the LLP are in the same proportion as their shareholding in the company on the date of conversion;
 - no consideration or benefit, directly or indirectly, other than share in profit and capital contribution in the LLP arises to the shareholders;
 - the erstwhile shareholders of the company continue to be entitled to receive atleast 50% of the profit of the LLP for a period of 5 years from the date of conversion;
 - all assets and liabilities of the company immediately before conversion become the assets and liabilities of the LLP;
 - the total value of assets as appearing in the books of account of the company in any of the three previous years preceding the previous year in which the conversion takes place, should not exceed ₹ 5 crore.
 - no amount is paid, either directly or indirectly, to any partner out of the accumulated profit standing in the accounts of the company on the date of conversion for a period of 3 years from the date of conversion.
- Any transfer of a capital asset or an intangible asset by a sole proprietary concern to a company in a scheme of succession provided:
- atleast 50% of the voting power in a company is held by sole proprietor and shareholding continues for a period of 5 years from the date of the succession;
 - all assets and liabilities of the sole proprietary concern relating to the business immediately before succession become the assets and liabilities of the company;
 - the sole proprietor does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company.
- Any transfer of a capital asset in a scheme of reverse mortgage under a scheme made and notified by the Central Government.
- Any transfer by an individual of sovereign gold bonds issued by RBI by way of redemption

Mode of computation of Capital Gains [Section 48]**Computation of long-term capital gains**

Gross Sale consideration	xx
Less: Expenditure incurred wholly and exclusively in connection with such transfer (for example, brokerage on sale)	<u>xx</u>
Net Sale Consideration	xx
Less: Indexed cost of acquisition and indexed cost of improvement	<u>xx</u>
	xx
Less: Exemption under sections 54/54B/54EC/54F/54G etc.	<u>xx</u>
Long-term capital gains	xx

Notes:

(i) Deduction on account of securities transaction tax paid will not be allowed.

(ii) Indexed Cost of Acquisition =

$$\text{Cost of acquisition} \times \frac{\text{CII for the year in which the asset is transferred}}{\text{CII for the year in which the asset was first held by the assessee or 1981-82, whichever is later}}$$

(iii) Indexed Cost of Improvement =

$$\text{Cost of improvement} \times \frac{\text{CII for the year in which the asset is transferred}}{\text{CII for the year in which the improvement took place}}$$

(iv) Benefit of indexation will not apply to long term capital gains from transfer of bonds or debentures other than capital indexed bonds issued by the government and sovereign gold bonds issued by RBI.

Computation of short-term capital gains

Gross Sale consideration	xx
Less: Expenditure incurred wholly and exclusively in connection with such transfer (for example, brokerage on sale)	<u>xx</u>
Net Sale Consideration	xx
Less: Cost of acquisition and cost of improvement	<u>xx</u>
Less: Exemption under sections 54B/54D/54G	xx
Short-term capital gains	<u>xx</u>
	xx

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 36 months).
50B	<p>Capital Gains on Slump Sale</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>Capital gains = Sale consideration – Net Worth.</p> <p>Aggregate value of total assets would be the aggregate of the following :</p> <ul style="list-style-type: none"> i) Written Down Value of depreciable assets; ii) 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 iii) Book value for other assets. <p>Revaluation of assets shall be ignored for computing Net Worth.</p>
50C	<p>Computation of capital gains on sale of land or building or both</p> <p>Where consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by the stamp valuation authority for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable, shall, for the purpose of section 48, be deemed to be the full value of consideration received or accruing as a result of such transfer.</p> <p>However, where the date of the agreement fixing the amount of consideration for the transfer of immovable property and the date of registration are not the same, the stamp duty value on the date of the agreement may be taken for the purposes of computing the full value of consideration.</p>

	<p>However, the stamp duty value on the date of agreement can be adopted only in a case where the amount of consideration, or part thereof, has been paid by way of an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account, on or before the date of the agreement for the transfer of such immovable property.</p> <p>Where the assessee claims before any Assessing Officer that the value adopted or assessed or assessable by the stamp valuation authority exceeds the fair market value of the property on the date of transfer, the Assessing Officer may refer the valuation of the capital asset to the Valuation Officer, provided the value so adopted or assessed or assessable has not been disputed in any appeal or revision.</p> <table><tr><th>Sl. No.</th><th>Condition</th><th>Deemed Consideration</th><th>Sale</th></tr><tr><td>1.</td><td>Actual Consideration < Stamp Duty Value</td><td>Stamp Duty Value</td><td></td></tr><tr><td>2.</td><td>Actual Consideration > Stamp Duty Value</td><td>Actual Sale Consideration</td><td></td></tr><tr><td>3.</td><td>Value ascertained by Valuation Officer > Stamp Duty Value</td><td>Stamp Duty Value</td><td></td></tr><tr><td>4.</td><td>Value ascertained by Valuation Officer < Stamp Duty Value</td><td>Value ascertained by Valuation Officer</td><td></td></tr></table>	Sl. No.	Condition	Deemed Consideration	Sale	1.	Actual Consideration < Stamp Duty Value	Stamp Duty Value		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	
Sl. No.	Condition	Deemed Consideration	Sale																		
1.	Actual Consideration < Stamp Duty Value	Stamp Duty Value																			
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																			
50D	<p>Fair Market Value deemed to be full value of consideration in certain cases</p> <p>Where, on transfer of a capital asset, consideration received is not ascertainable or cannot be determined then, fair market value of the asset as on the date of transfer shall be deemed as the full value of consideration received or accruing as a result of such transfer.</p>																				
51	<p>Advance money received and forfeited upto 31.3.2014</p> <p>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.</p> <p>However, 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.</p>																				

111A	<p>Tax on short-term capital gains on sale of equity shares and units of equity oriented fund on which STT is chargeable</p> <p>➤ Any short-term capital gains on transfer of equity shares or units of an equity oriented fund shall be liable to tax @15%, if securities transaction tax has been paid on such sale.</p> <p>➤ 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 15%.</p> <p>➤ No deduction under Chapter VI-A can be claimed in respect of such short term capital gain.</p> <p>➤ 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 15% even when STT is not paid in respect of such transaction.</p>
112	<p>Tax on long term capital gains</p> <p>➤ Any long term capital gains, other than long term capital gains exempt under section 10(38), shall be liable to tax@20%.</p> <p>➤ In case of resident individuals and HUFs, the long term capital gain shall be reduced by the unexhausted basic exemption limit, and the balance shall be subject to tax at 20%.</p> <p>➤ Capital gains on transfer of listed securities (other than units) or zero coupon bonds shall be chargeable to tax @10% computed without the benefit of indexation or @20% availing the benefit of indexation, whichever is more beneficial to the assessee.</p> <p>➤ The assessee is not entitled to claim any deduction under Chapter VI-A in respect of long term capital gains.</p>

Sl. No.	Nature of asset	Cost of acquisition
1	Goodwill of business, trademark, brand name etc., - - Self generated - Acquired from previous owner The cost of improvement of such assets would be Nil.	Nil Purchase price
2	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, distribution of assets on liquidation of a	Cost to the previous owner.

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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(38)	Any income arising from the transfer of a long term capital asset being an equity share in a company or a unit of an equity oriented fund shall be exempt, if such transaction is chargeable to securities transaction tax. However, long-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 exempt even if STT is not paid in respect of such transaction.

4.168 Income-tax

Exemption of Capital Gains [Sections 54 to 54GB]										
S. No.	Particulars	Section 54	Section 54B	Section 54EC	Section 54EE	Section 54D	Section 54G	Section 54GA	Section 54F	Section 54GB
1	Eligible Assessee	Individual HUF's	/ Individual HUF's	/ Any assessee	Any assessee	Any assessee	Any assessee	Any assessee	Individual HUF's	Individual HUF's
2	Asset transferred	Residential House	Urban Agricultural Land	Any Asset	Any asset	Land & building forming part of an industrial undertaking	Land, Building, Machinery or Plant or any right in land or building used for business of industrial Undertaking.	Land, Building, Machinery, Plant or any right in land or building used for business of industrial undertaking situated in an urban area.	Any asset other than Residential House.	Residential property (house or plot of land)
3	Period of holding of the asset transferred	Long-term capital asset	At least 2 years immediately preceding the date of transfer	Long-term capital asset	Long-term capital asset	At least 2 years immediately preceding the date of transfer.	Long-term/ Short-term capital asset	Long-term/ Short term capital asset	Long-term capital asset	Long-term capital asset
4	Other Conditions	Income from such house should be chargeable under the head "Income from house property"	Land should be used for agricultural purposes by the assessee or his parents or a HUF for two years	-		The transfer should be by way of compulsory Acquisition of the industrial undertaking	Shifting the Industrial Undertaking from Urban Area to Rural Area	Shifting to Special Economic Zone	Assessee should not own more than one residential house on the date of transfer	

S. No.	Particulars	Section 54	Section 54B	Section 54EC	Section 54EE	Section 54D	Section 54G	Section 54GA	Section 54F	Section 54GB
5	Qualifying asset i.e., in which capital gains has to be invested	One Residential House situated in India	Agricultural Land (Urban/Rural)	Long Term Specified Asset - Bonds of NHAI or RECL (Redeemable after 3 years)	Long term Specified Asset - Unit of the 1 st April, 2019 of Specified Fund as notified by the Central Government	Land or Building	Land, Building, Plant & Machinery and expenses on shifting the Industrial Undertaking	Land, Building, new plant and machinery expenses on shifting the industrial undertaking to the SEZ.	One Residential House situated in India	Equity shares of an eligible company, being newly incorporated SME engaged in manufacturing of an article or thing or an eligible start-up engaged in an eligible business.
6	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 2 years from the date of transfer	Purchase within 2 months from the date of transfer	Purchase within 6 months after the date of such transfer	Purchase/construct within 3 years after transfer, for shifting or re-establishing the existing undertaking or setting up a new industrial undertaking.	Purchase/construct within 1 year before or 3 years after the transfer.	Purchase/construct within 1 year before or 3 years after the transfer.	Purchase within 1 year before or 2 years after the date of filing the date of return. Thereafter, Construct within one year from the date of subscription, new plant and machinery should be purchased by the company.	Equity Shares to be subscribed before the due date of filing the date of return. Thereafter, Construct within one year from the date of subscription, new plant and machinery should be purchased by the company.

4.170 Income-tax

S. No.	Particulars	Section 54	Section 54B	Section 54EC	Section 54EE	Section 54D	Section 54G	Section 54GA	Section 54F	Section 54GB
7	Amount of Exemption	Cost of new Residential House or Capital Gain, whichever is lower, is exempt	Cost of new Agricultural Land or Capital Gain, whichever is lower, is exempt	Capital Gain or amount invested in specified bonds, whichever is lower. Maximum permissible investment in such bonds out of capital gains arising in any financial year is ₹ 50 lakhs, whether such investment is made in the current FY or subsequent FY.	Capital Gain or amount invested in notified units of specified fund, whichever is lower. Maximum permissible investment in such units out of capital gains arising in any FY is ₹ 50 lakhs, whether such investment is made in the current FY or subsequent FY.	Cost of new asset or Capital Gain, whichever is lower.	Cost of new assets plus expenses incurred or Capital Gains, whichever is lower, is exempt.	Cost of new assets plus expenses incurred for shifting or Capital Gain, whichever is lower, is exempt.	Cost of new Residential House \geq Net sale consideration of original asset, entire Capital gain is exempt. Cost of new Residential House $<$ Net sale consideration of original asset, proportionate capital gain is exempt.	Cost of new plant & machinery \geq Net sale consideration of residential house, entire Capital gain is exempt. Cost of new Residential House $<$ Net sale consideration of Residential House, proportionate capital gain is exempt.

Question 1

Mr. Dinesh received a vacant site as gift from his friend in November 2002. The site was acquired by his friend for ₹ 3,00,000 in April 1990. Dinesh constructed a residential building during the year 2004-05 in the said site for ₹ 15,00,000. He carried out some further extension of the construction in the year 2007-08 for ₹ 5,00,000.

Dinesh sold the residential building for ₹ 55,00,000 in January 2017 but the State stamp valuation authority adopted ₹ 65,00,000 as value for the purpose of stamp duty.

Compute his long term capital gain, for the assessment year 2017-18 based on the above information. The cost inflation indices are as follows:

Financial Year	Cost inflation index
1990-91	182
2002-03	447
2004-05	480
2007-08	551
2016-17	1125

Answer

Computation of long term capital gain of Mr. Dinesh for the A.Y. 2017-18

Particulars	₹	₹
Full value of consideration (Note 1)		65,00,000
Less: Indexed cost of acquisition-land (₹ 3,00,000 × 1125/447) (Note 2 & 3)	7,55,036	
Indexed Cost of acquisition-building (₹ 15,00,000 × 1125/480) (Note 3)	35,15,625	
Indexed Cost of improvement-building (₹ 5,00,000 × 1125/551)	10,20,871	52,91,532
Long-term capital gain		<u>12,08,468</u>

Notes:

- As per section 50C, where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted by the Stamp Valuation Authority, such value adopted by the Stamp Valuation Authority shall be deemed to be the full value of the consideration received or accruing as a result of such transfer. Accordingly, full value of consideration will be ₹ 65 lakhs in this case.
- Since Dinesh has acquired the asset by way of gift, therefore, as per section 49(1), cost of the asset to Dinesh shall be deemed to be cost for which the previous owner acquired the asset i.e., ₹ 3,00,000, in this case.

3. Indexation benefit is available since both land and building are long-term capital assets. However, as per the definition of indexed cost of acquisition under clause (iii) of *Explanation* below section 48, indexation benefit for land will be available only from the previous year in which Mr. Dinesh first held the land i.e., P.Y. 2002-03.

Alternative view: In the case of *CIT v. Manjula J. Shah 16 Taxmann 42 (Bom.)*, the Bombay High court held that indexation cost of acquisition in case of gifted asset can be computed with reference to the year in which the previous owner first held the asset.

As per this view, the indexation cost of acquisition of land would be ₹ 18,54,396 and long term capital gain would be ₹ 1,09,108.

Question 2

Mr. Abhishek a senior citizen, pledged 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?

Answer

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 pledging 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.

However, capital gains tax liability would be attracted at the stage of alienation of the mortgaged property by the bank for the purposes of recovering the loan.

Question 3

Ms. Anshu transferred land and building on 02-01-2017 and furnishes the following information:

Particulars	(₹)
(i) Net consideration received	23,00,000
(ii) Value adopted by Stamp Valuation Authority	25,00,000
(iii) Value ascertained by Valuation Officer on reference by the Assessing Officer	27,00,000
(iv) This land was acquired by Anshu on 1-04-1981. Fair Market Value of the land as on 01-04-1981 was	1,10,000

- | | |
|--|--|
| <p>(v) Anshu constructed a residential building on the land at a cost of ₹ 3,20,000 (construction completed on 01-12-2002 during the financial year 2002-03)</p> <p>Brought forward short term capital loss incurred on sale of shares during financial year 2011-12 ₹ 1,50,000,</p> | |
|--|--|

Anshu seeks your advice regarding the amount to be invested in NHAI bonds so as to be exempt from capital gain tax under the Income-tax Act, 1961.

Cost inflation index for FY 1981-82 : 100

Cost inflation index for FY 2002-03 : 447

Cost inflation index for FY 2016-17 : 1125

Answer

Computation of Capital Gains of Ms. Anshu for the A.Y. 2017-18

Particulars	₹	₹
Full value of consideration [See Notes (i) & (ii) below]		25,00,000
Less: Indexed Cost of acquisition [See Note (iii) below]		
Indexed cost of land ($₹ 1,10,000 \times 1125/100$)	12,37,500	
Indexed cost of building ($₹ 3,20,000 \times 1125/447$)	<u>8,05,369</u>	<u>20,42,869</u>
Long-term capital gain		4,57,131
Less: Brought forward short-term capital loss set off [See Note (iv) below]		<u>1,50,000</u>
Taxable capital gains (Amount to be invested in NHAI bonds to get full exemption from tax on capital gains) [See Note (v) below]		<u>3,07,131</u>

Notes :

- As per section 50C(1), where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted by the Stamp Valuation Authority for the purpose of payment of stamp duty, such value adopted by the Stamp Valuation Authority shall be deemed to be the full value of the consideration received or accruing as a result of such transfer. Accordingly, full value of consideration would be ₹ 25 lacs in this case.
- As per section 50C(3), where the valuation is referred by the Assessing Officer to Valuation Officer and the value ascertained by such Valuation Officer exceeds the value adopted by the Stamp Valuation Authority for the purpose of payment of stamp duty, the value adopted by the Stamp Valuation Authority shall be taken as the full value of the consideration received or accruing as a result of the transfer. Since the value ascertained by the Valuation Officer (i.e. ₹ 27 lakhs), is higher than the value adopted by the Stamp

Valuation Authority (i.e. ₹ 25 lakhs), the full value of consideration in this case would be ₹ 25 lakhs.

- (iii) Since the cost of land acquired by Anshu on 1.4.1981 is not given in the question, the fair market value as on 1.4.1981 is taken as the cost of acquisition. Indexation benefit is available since land and building are both long-term capital assets, as they are held by Anshu for more than 36 months.
- (iv) As per section 74, brought forward unabsorbed short term capital loss can be set off against any capital gains, short term or long term, for 8 assessment years immediately succeeding the assessment year for which the loss was first computed. Therefore, short-term capital loss on sale of shares during the F.Y.2011-12 can be set-off against the current year long-term capital gains on sale of land and building.
- (v) As per section 54EC, an assessee can avail exemption in respect of long-term capital gains, if such capital gains are invested in the bonds issued by the NHAI redeemable after 3 years. Such investment is required to be made within a period of 6 months from the date of transfer of the asset. The exemption shall be the amount of capital gains or the amount of such investment made, whichever is less. Therefore, in this case, if Anshu invests the entire capital gains in bonds of NHAI, she can get full exemption from tax on capital gains.

Question 4

Mr. Mithun purchased 100 shares of M/s Goodmoney Co. Ltd. on 01-04-2005 at rate of ₹ 1,000 per share in public issue of the company.

Company allotted bonus shares in the ratio of 1:1 on 01.12.2015. He has also received dividend of ₹ 10 per share on 01.05.2016.

He has sold all the shares on 01.10.2016 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% to celebrate his 75th birthday. The cost inflation Index are as follows:

Financial Year	Cost Inflation Index
2005-06	497
2016-17	1125

Compute his total income and tax liability for Assessment Year 2017-18, assuming that he is having no income other than given above.

Answer

Computation of total income and tax liability of Mr. Mithun for A.Y. 2017-18

Particulars	₹
Short term capital gains on sale of bonus shares	
Gross sale consideration (100 x ₹ 4,000)	4,00,000
Less : Brokerage @ 1%	<u>4,000</u>
Net sale consideration	3,96,000

Less: Cost of acquisition of bonus shares	<u>NIL</u>
Total Income (Short term Capital Gains)	<u>3,96,000</u>
Tax Liability	
15% of (₹ 3,96,000-₹ 3,00,000)	14,400
Less: Rebate U/s 87A	<u>5,000</u>
	9,400
Add : Education cess @ 2%	188
Secondary and higher education cess @ 1%	<u>94</u>
Tax payable	<u>9,682</u>
Tax payable (Rounded Off)	<u>9,680</u>

Notes:

- (1) Long-term capital gains on sale of original shares through a recognized stock exchange (STT paid) is exempt under section 10(38).
- (2) Since bonus shares are held for less than 12 months before sale, the gain arising there from is a short term capital gain chargeable to tax@15% as per section 111A after adjusting the unexhausted basic exemption limit. Since Mr. Mithun is over 60 years of age, he is entitled for a higher basic exemption limit of ₹ 3,00,000 for A.Y. 2017-18.
- (3) Dividend income is exempt under section 10(34).
- (4) Brokerage paid is allowable since it is an expenditure incurred wholly and exclusively in connection with the transfer. Hence, it qualifies for deduction under section 48(i).
- (5) Cost of bonus shares will be Nil as such shares are allotted after 1.04.1981.
- (6) Securities transaction tax is not allowable as deduction.

Question 5

Mr. Selvan, acquired a residential house in January, 2000 for ₹ 10,00,000 and made some improvements by way of additional construction to the house, incurring expenditure of ₹ 2,00,000 in October, 2004. He sold the house property in October, 2016 for ₹ 75,00,000. The value of property was adopted as ₹ 80,00,000 by the State stamp valuation authority for registration purpose. He acquired a residential house in January, 2016 for ₹ 25,00,000. He deposited ₹ 20,00,000 in capital gains bonds issued by National Highways Authority of India (NHAI) in June, 2017.

Compute the capital gain chargeable to tax for the assessment year 2017-18.

What would be the tax consequence and in which assessment year it would be taxable, if the house property acquired in January, 2016 is sold for ₹ 40,00,000 in March, 2018?

Cost inflation index: F.Y.1999-00 : 389

F.Y. 2004-05 : 480

F.Y. 2016-17 : 1125

Answer

(I) Computation of Capital Gains Chargeable to tax for A.Y. 2017-18

Particulars	₹	₹
Sale consideration (i.e. Stamp Duty Value) (Note 1)		80,00,000
Less: Indexed Cost of Acquisition		
₹ 10,00,000 × 1125/389	28,92,031	
Indexed Cost of Improvement		
₹ 2,00,000 × 1125/480	<u>4,68,750</u>	<u>33,60,781</u>
		46,39,219
Less: Exemption under section 54 (Note 2)		<u>25,00,000</u>
Taxable Capital Gains		<u>21,39,219</u>

Notes:

- As per the provisions of section 50C, in case the stamp duty value adopted by the stamp valuation authority is higher than the actual sale consideration, the stamp duty value shall be deemed as the full value of consideration.
 - Exemption under section 54 is available if a new residential house is purchased within one year before or two years after the date of transfer. Since the cost of new residential house is less than the capital gain, capital gain to the extent of cost of new asset is exempt under section 54.
 - Exemption under section 54EC is available in respect of investment in bonds of National Highways Authority of India only if the investment is made within a period of six months after the date of such transfer. In this case, since the investment is made after six months, exemption under section 54EC would not be available.
- (II) If the new asset purchased by the assessee on the basis of which exemption under section 54 is claimed, is transferred within 3 years from the date of its acquisition, then for computing the taxable short-term capital gain on such transfer, the cost of acquisition of such asset shall be taken as Nil.

Particulars (A.Y.2018-19)	₹
Sale consideration	40,00,000
Less: Cost of acquisition	<u>Nil</u>
Short-term capital gains	<u>40,00,000</u>

Question 6

Mr. Rakesh purchased a house property on 14th April, 1979 for ₹ 1,05,000. He entered into an agreement with Mr. Bobby for the sale of house on 15th September, 1982 and received an

advance of ₹ 25,000. However, since Mr. Bobby did not remit the balance amount, Mr. Rakesh forfeited the advance.

Later on, he gifted the house property to his friend Mr. Aakash on 15th June, 1986.

Following renovations were carried out by Mr. Rakesh and Mr. Aakash to the house property:

	₹
By Mr. Rakesh during F.Y. 1979-80	10,000
By Mr. Rakesh during F.Y. 1983-84	50,000
By Mr. Aakash during F.Y. 1993-94	1,90,000

The fair market value of the property as on 1.4.1981 is ₹ 1,50,000.

Mr. Aakash entered into an agreement with Mr. Chintu for sale of the house on 1st June, 1995 and received an advance of ₹ 80,000. The said amount was forfeited by Mr. Aakash, since Mr. Chintu could not fulfil the terms of the agreement.

Finally, the house was sold by Mr. Aakash to Mr. Sanjay on 2nd January, 2017 for a consideration of ₹ 12,00,000.

Compute the capital gains chargeable to tax in the hands of Mr. Aakash for the assessment year 2017-18. Cost inflation indices are as under:

Financial Year	Cost inflation index
1981-82	100
1983-84	116
1986-87	140
1993-94	244
2016-17	1125

Answer

Computation of taxable capital gains of Mr. Aakash for the A.Y. 2017-18

Particulars	₹
Sale consideration	12,00,000
Less: Indexed cost of acquisition (Working Note: 1)	<u>5,62,500</u>
	6,37,500
Less: Indexed cost of improvement (Working Note: 2)	<u>13,60,939</u>
Long term capital loss	<u>(7,23,439)</u>

Working Note: 1

Indexed cost of acquisition is determined as under:

Cost to the previous owner i.e., Mr. Rakesh is ₹ 1,05,000

Fair Market Value on 1st April, 1981 is ₹ 1,50,000

Cost to the previous owner or FMV on 1st April, 1981, whichever is more, is to be taken as cost of acquisition of Mr. Aakash ₹ 1,50,000

Less: Advance money forfeited by Mr. Aakash (as per section 51)

(Note: Advance forfeited by Mr. Rakesh, the previous owner, should, however, not be deducted) ₹ 80,000

Cost of acquisition ₹ 70,000

Indexed cost of acquisition (₹ 70,000 × 1125/140) ₹ 5,62,500

140 is the CII for F.Y. 1986-87, being the first year in which property is held by Mr. Aakash and 1125 is the CII for F.Y. 2016-17, being the year in which the property is sold.

Alternative view: In the case of *CIT v. Manjula J. Shah* 16 Taxmann 42, the Bombay High Court held that the indexed cost of acquisition in case of gifted asset can be computed with reference to the year in which the previous owner first held the asset. As per this view, the indexed cost of acquisition of house would be ₹ 7,87,500, taking CII of 100 for the F.Y. 1980-81 since F.M.V. as on 1st April, 1981 is taken as cost of acquisition of Mr. Aakash.

Note: Clause (ix) of Section 56(2), provides that the advance which is forfeited in the previous year 2014-15 relevant to A.Y. 2015-16 would be chargeable to tax under the head "Income from Other sources" and hence, such forfeited amount shall not be reduced from the cost of acquisition of the transferred capital asset. In the present case, the advance was forfeited in a previous year prior to P.Y. 2014-15. Therefore, such amount would be deductible from the cost of acquisition while determining the Capital gains on transfer of such asset.

Working Note: 2

Indexed cost of Improvement is determined as under:

Expenditure incurred before 1st April, 1981 should not be considered NIL

Expenditure incurred on or after 1st April, 1981

- During 1983-84: Indexed cost of Improvement [₹ 50,000 × 1125/116] ₹ 4,84,914

- During 1993-94: Indexed cost of Improvement [₹ 1,90,000 × 1125/244] ₹ 8,76,025

Total indexed cost of improvement ₹13,60,939

Question 7

X Co. (P) Ltd., converted into a Limited Liability Partnership (LLP) by name All Trade LLP, with effect from 01.04.2016.

The following details are given to you:

Asst. year 2009-10 : Business loss brought forward ₹ 2,00,000

Asst. year 2016-17 : Business loss brought forward ₹ 5,00,000

(These are related to erstwhile X Co. (P) Ltd.)

*Total income of All Trade LLP, for the financial year 2016-17 is ₹ 6,00,000
(Before set off of brought forward business losses of erstwhile company i.e. X Co. (P) Ltd.)*

Assume that all the conditions prescribed in section 47(xiiib) were satisfied by X Co. (P) Ltd. at the time of conversion to LLP.

- (i) Explain whether All Trade LLP can set off and carry forward the business loss of its predecessor i.e. X Co. (P) Ltd.?*
- (ii) State whether the change in the profit sharing ratio of the shareholders of the company in the LLP at later date would have any tax consequence.*

Answer

- (i)** Section 72A(6A), provides that where a private company is succeeded by a LLP fulfilling the conditions laid down in the proviso to section 47(xiiib), then, notwithstanding anything contained in any other provision of the Income-tax Act, 1961, the accumulated loss and unabsorbed depreciation of the predecessor company shall be deemed to be the loss or allowance for depreciation of the successor LLP for the purpose of the previous year in which the business reorganisation was effected and other provisions of the Act relating to set-off and carry forward of losses and depreciation allowance shall apply accordingly.

Therefore, All Trade LLP can carry forward and set-off the business loss of ₹ 6 lakh of erstwhile X Co (P) Ltd. against its business income for the F.Y.2016-17. The unabsorbed business loss of ₹ 1 lakh, relating to A.Y. 2016-17, will be carried forward to the next year.

- (ii)** Section 47(xiiib) requires that the shareholders of the company become partners of the LLP in the same proportion as their shareholding in the company. Further, the aggregate of the profit sharing ratio of the shareholders of the company in the LLP should be not less than 50% at any time during the period of 5 years from the date of conversion. If the entity fails to fulfill this condition, the benefit of set-off of business loss availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill the condition.

Question 8

Ms. Chhaya transferred a vacant site to Ms. Dayama for ₹ 4,25,000. The stamp valuation authority fixed the value of vacant site for stamp duty purpose at ₹ 6,00,000. The total income of Chhaya and Dayama before considering the transfer of vacant site are ₹ 50,000 and ₹ 2,05,000, respectively. The indexed cost of acquisition for Ms. Chhaya in respect of vacant site is ₹ 4,00,000 (computed).

Determine the total income of both Ms. Chhaya and Ms. Dayama taking into account the above said transaction.

Answer

Section 56(2)(vii) would get attracted in case of transfer of immovable property for inadequate consideration, since the difference between the stamp duty value and sale consideration is more than ₹ 50,000 and therefore ₹ 1,75,000 (i.e. ₹ 6,00,000 - ₹ 4,25,000) will be taxed under the head "Income from other sources" in the hands of transferee, i.e., Ms. Dayama. Further, for the transferor, Ms. Chhaya, the value adopted for stamp duty purpose will be taken as the deemed sale consideration under section 50C for computation of capital gains.

Particulars	Chhaya (Transferor) ₹	Dayama (Transferee) ₹
Capital gains		
Deemed sale consideration under section 50C	6,00,000	
Less: Indexed cost of acquisition	<u>4,00,000</u>	
	2,00,000	
Income from other sources		
Difference between stamp duty value and sale consideration of immovable property, taxable under section 56(2)(vii)		1,75,000
Other income (computed)	<u>50,000</u>	<u>2,05,000</u>
Total income	<u>2,50,000</u>	<u>3,80,000</u>

Question 9

Mr. Chandru transferred a vacant site on 28.10.2016 for ₹ 100 lakhs. The site was acquired for ₹ 9,99,300 on 30.6.2000. He invested ₹ 50 lakhs in eligible bonds issued by Rural Electrification Corporation Ltd. (RECL) on 20.3.2017.

Again, he invested ₹ 20 lakhs in eligible bonds issued by National Highways Authority of India (NHAI) on 16.4.2017.

Compute the chargeable capital gain in the hands of Mr. Chandru for the A.Y. 2017-18.

Financial year	Cost Inflation Index
2000-01	406
2016-17	1125

Answer**Computation of chargeable capital gain of Mr. Chandru for the A.Y.2017-18**

Particulars	₹
Sale consideration	1,00,00,000
Less: Indexed cost of acquisition (₹ 9,99,300 × 1125/406)	<u>27,68,996</u>
	72,31,004

Less: Deduction under section 54EC (See Note 3 below)	<u>50,00,000</u>
Long term capital gain	<u>22,31,004</u>

Note:

- (1) Since the site was held for more than 36 months prior to the date of transfer, it is a long-term capital asset and the capital gain arising upon its transfer is long-term capital gain.
- (2) In order to claim exemption under section 54EC, Mr. Chandru has to invest in specified bonds of RECL or NHAI within a period of 6 months from the date of transfer of the asset.
- (3) As per second proviso to section 54EC(1), out of capital gains arising from transfer of one or more capital assets in a financial year, the investment eligible for exemption, cannot exceed ₹ 50 lakhs, whether such investment is made in the same financial year or in the subsequent financial year or in both the years.

In this case, Mr. Chandru has invested ₹ 50 lakhs in RECL bonds in the F.Y.2016-17 and ₹ 20 lakhs in NHAI bonds in the F.Y.2017-18, both within six months from the date of transfer. However, he would be eligible for exemption of only ₹ 50 lakhs for investment made in such bonds.

Question 10

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*
- (4) *Transfer of a security by a depository (i.e., demat account)*

Answer

- (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) **Transfer of security by a depository** - The period of holding shall be computed from the date on which the securities were credited to the demat account and will end with the date of transfer (sale). The first-in-first-out (FIFO) method will be adopted for determining the period of holding.

Question 11

Mr. A is a proprietor of Akash Enterprises having 2 units. He transferred on 1.4.2016 his Unit 1 by way of slump sale for a total consideration of ₹ 25 lacs. Unit 1 was started in the year 2004-05. The expenses incurred for this transfer were ₹ 28,000. His Balance Sheet as on 31.3.2016 is as under:

Liabilities	Total (₹)	Assets	Unit 1 (₹)	Unit 2 (₹)	Total (₹)
Own Capital	15,00,000	Building	12,00,000	2,00,000	14,00,000
Revaluation Reserve (for building 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)	<u>1,50,000</u>	Other assets	<u>1,50,000</u>	<u>60,000</u>	<u>2,10,000</u>
Total	<u>21,50,000</u>	Total	<u>17,50,000</u>	<u>4,00,000</u>	<u>21,50,000</u>

Other information:

- Revaluation reserve is created by revising upward the value of the building of Unit 1.
- No individual value of any asset is considered in the transfer deed.
- Other assets of Unit 1 include patents acquired on 1.7.2014 for ₹ 50,000 on which no depreciation has been charged.

Compute the capital gain for the assessment year 2017-18.

Answer

Computation of capital gains on slump sale of Unit 1

Particulars	₹
Sale value	25,00,000
Less: Expenses on sale	<u>28,000</u>
Net sale consideration	24,72,000
Less: Net worth (See Note 1 below)	<u>12,50,625</u>
Long-term capital gain	<u>12,21,375</u>

Notes:

1. Computation of net worth of Unit 1 of Akash Enterprises

Particulars	₹	₹
Building (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)		<u>1,00,000</u>
Total assets		14,28,125
Less: Creditors	37,500	
Bank Loan	<u>1,40,000</u>	<u>1,77,500</u>
Net worth		<u>12,50,625</u>

2. Written down value of patents as on 1.4.2016

Value of patents:	₹
Cost as on 1.7.2014	50,000
Less: Depreciation @ 25% for Financial Year 2014-15	<u>12,500</u>
WDV as on 1.4.2015	37,500
Less: Depreciation for Financial Year 2015-16	<u>9,375</u>
WDV as on 1.4.2016	<u>28,125</u>

For the purposes of computation of net worth, the written down value determined as per section 43(6) has to be considered in the case of depreciable assets. The problem has been solved assuming that the Balance Sheet values of ₹ 3 lakh and ₹ 9 lakh (₹ 12 lakh – ₹ 3 lakh) represent the written down value of machinery and building, respectively, of Unit 1.

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.

Question 12

Sachin received ₹ 15,00,000 on 23.01.2017 on transfer of his residential building in a transaction of reverse mortgage under a scheme notified by the Central Government. The building was acquired in March 1991 for ₹ 8,00,000.

Is the amount received on reverse mortgage chargeable to tax in the hands of Sachin under the head 'Capital gains'?

Cost inflation index for the F.Y. 1990-91 – 182; F.Y. 2016-17 – 1125

Answer

As per section 47(xvi), any transfer of a capital asset in a transaction of Reverse Mortgage under a scheme made and notified by the Central Government will not be regarded as a transfer. Therefore, capital gains tax liability is not attracted.

Section 10(43) provides that the amount received by a senior citizen as a loan, either in lump sum or in installments, in a transaction of Reverse Mortgage would be exempt from income-tax. Therefore, the amount received by Sachin in a transaction of Reverse Mortgage of his residential building is exempt under section 10(43).

Question 13

Mr. Roy, aged 55 years owned a Residential House in Ghaziabad. It was acquired by Mr. Roy on 10-10-1986 for ₹ 6,00,000. He sold it for ₹ 65,00,000 on 4-11-2016. The stamp valuation authority of the State fixed value of the property at ₹ 72,00,000. The assessee paid 2% of the sale consideration as brokerage on the sale of the said property.

Mr. Roy acquired a residential house property at Kolkata on 10-12-2016 for ₹ 7,00,000 and deposited ₹ 3,00,000 on 10-4-2017 and ₹ 5,00,000 on 15-6-2017 in the capital gains bonds of Rural Electrification Corporation Ltd. He deposited ₹ 4,00,000 on 6-7-2017 and ₹ 9,00,000 on 1-11-2017 in the capital gain deposit scheme in a Nationalized Bank for construction of an additional floor on the residential house property in Kolkata.

Compute the Capital Gain chargeable to tax for the Assessment Year 2017-18 and income-tax chargeable thereon assuming Mr. Roy has no other income.

Cost Inflation Index for Financial Year 1986-87: 140 and Financial Year 2016-17: 1125

Answer

**Computation of Capital Gains chargeable to tax in the hands of Mr. Roy
for the A.Y. 2017-18**

Particulars	₹	₹
Gross Sale Consideration on transfer of residential house [As per section 50C, in case the actual sale consideration is lower than the stamp duty value fixed by the stamp valuation authority, the stamp duty value shall be deemed as the full value of consideration]		72,00,000
Less: Brokerage@2% of actual sale consideration of ₹ 65,00,000		<u>1,30,000</u>
Net Sale Consideration		70,70,000
Less: Indexed cost of acquisition [₹ 6,00,000 x 1125/140]		<u>48,21,429</u>
Long-term capital gain		22,48,571

Less: Exemption under section 54		
- Acquisition of residential house property at Kolkata on 10.12.2016 (i.e., within the prescribed time of two years from 4.11.2016, being the date of transfer of residential house at Ghaziabad).	7,00,000	
- Amount deposited in Capital Gains Accounts Scheme on or before the due date of filing return of income for construction of additional floor on the residential house property at Kolkata. Since Mr. Roy has no other source of income, his due date for filing return of income is 31 st July, 2017 [Therefore, ₹ 4,00,000 deposited on 6.7.2017 will be eligible for exemption whereas ₹ 9,00,000 deposited on 1.11.2017 will not be eligible for exemption under section 54]	<u>4,00,000</u>	11,00,000
Exemption under section 54EC Amount deposited in capital gains bonds of RECL within six months from the date of transfer (i.e., on or before 3.5.2017) would qualify for exemption. [Therefore, in this case, ₹ 3,00,000 deposited in capital gains bonds of RECL on 10.4.2017 would be eligible for exemption under section 54EC, whereas ₹ 5,00,000 deposited on 15.6.2017 would not qualify for exemption]		3,00,000
Long-term capital gain		8,48,571

Computation of tax liability of Mr. Roy for A.Y. 2017-18

Particulars	₹
Tax on ₹ 5,98,571 (i.e Long term capital gain ₹ 8,48,571 less basic exemption limit of ₹ 2,50,000) is charged @ 20% [Section 112] (Since long-term capital gains is the only source of income, the entire basic exemption limit can be exhausted against this income)	1,19,714
Add: Education cess@2% and Secondary & higher education cess @ 1%	3,591
Total tax liability	1,23,306
Total tax liability (rounded off)	1,23,310

Note: As per the decision of Gauhati High Court in CIT vs Rajesh Kumar Jalan 286 ITR 274 and Haryana High Court in CIT vs Jagriti Agarwal 245 CTR 629, exemption under section 54

is allowable even if the amount of capital gain is deposited in Capital Gains Accounts Scheme within the period specified for filing a belated return under section 139(4) [i.e., on or before 31.3.2018].

If we apply the above interpretation in this case, Mr. Roy would be eligible for exemption under section 54 in respect of ₹ 9,00,000 deposited in Capital Gains Accounts Scheme on 01.11.2017 also, since the said date falls within the time specified under section 139(4). On the basis of this interpretation, the long term capital gain chargeable to tax in the hands of Mr. Roy would be Nil and the consequent tax liability would also be Nil.

Question 14

Mr. Raj Kumar sold a house to his friend Mr. Dhuruv on 1st November, 2016 for a consideration of ₹ 25,00,000. The Sub-Registrar refused to register the document for the said value, as according to him, stamp duty had to be paid on ₹ 45,00,000, which was the Government guideline value. Mr. Raj Kumar preferred an appeal to the Revenue Divisional Officer, who fixed the value of the house as ₹ 32,00,000 (₹ 22,00,000 for land and the balance for building portion). The differential stamp duty was paid, accepting the said value determined. What are the tax implications in the hands of Mr. Raj Kumar and Mr. Dhuruv for the assessment year 2017-18? Mr. Raj Kumar had purchased the land on 1st June, 2010 for ₹ 5,19,000 and completed the construction of house on 1st October, 2014 for ₹ 14,00,000.

Cost inflation indices may be taken as 711 for the financial year 2010-11, 1024 for the financial year 2014-15 and 1125 for the financial year 2016-17.

Answer

In the hands of the seller, Mr. Raj Kumar

As per section 50C(1), where the consideration received or accruing as a result of transfer of land or building or both, is less than the value adopted or assessed or assessable by the stamp valuation authority, the value adopted or assessed or assessable by the stamp valuation authority shall be deemed to be the full value of consideration received or accruing as a result of transfer.

Where the assessee appeals against the stamp valuation and the value is reduced in appeal by the appellate authority (Revenue Divisional Officer, in this case), such value will be regarded as the consideration received or accruing as a result of transfer.

In the given problem, land has been held for a period exceeding 36 months and building for a period less than 36 months immediately preceding the date of transfer. So land is a long-term capital asset, while building is a short-term capital asset.

Particulars	₹
Long term capital gain on sale of land	
Consideration received or accruing as a result of transfer of land	22,00,000
Less: Indexed cost of acquisition ₹ 5,19,000 x 1125/711	<u>8,21,203</u>

Long-term capital gain (A)	<u>13,78,797</u>
Short-term capital loss on sale of building	
Consideration received or accruing from transfer of building	10,00,000
Less: Cost of acquisition	<u>14,00,000</u>
Short term capital loss (B)	<u>4,00,000</u>

As per section 70, short-term capital loss can be set-off against long-term capital gains. Therefore, the net taxable long-term capital gains would be ₹ 9,78,797 (i.e., ₹ 13,78,797 – ₹ 4,00,000).

In the hands of the buyer Mr. Dhuruv

As per section 56(2)(vii), where an individual or HUF receives from a non-relative, any immovable property for a consideration which is less than the stamp value (or the value reduced by the appellate authority, as in this case) by an amount exceeding ₹ 50,000, then the difference between such value and actual consideration of such property is chargeable to tax as income from other sources. Therefore, ₹ 7,00,000 (i.e. ₹ 32,00,000 - ₹ 25,00,000) would be charged to tax as income from other sources under section 56(2)(vii) in the hands of Mr. Dhuruv.

Question 15

Compute the net taxable capital gains of Smt. Megha on the basis of the following information-

A house was purchased on 1.5.1997 for ₹ 4,50,000 and was used as a residence by the owner. The owner had contracted to sell this property in June, 2008 for ₹ 10 lacs and had received an advance of ₹ 70,000 towards sale. The intending purchaser did not proceed with the transaction and the advance was forfeited by the owner. The property was sold in April, 2016 for ₹ 16,00,000. The owner, from out of sale proceeds, invested ₹ 3 lacs in a new residential house in January, 2017.

Cost inflation index :- F.Y. 1997-98 – 331; F.Y. 2016-17 - 1125

Answer

Computation of net taxable capital gains of Smt. Megha for the A.Y.2017-18

Particulars	₹
Sale consideration	16,00,000
Less: Indexed cost of acquisition (See Working note below)	<u>12,91,541</u>
Long term capital gain	3,08,459
Less: Exemption under section 54 (See Note 1 below)	<u>3,00,000</u>
Taxable long term capital gain	<u>8,459</u>

Working Note:

Indexed cost of acquisition	₹
Purchase price	4,50,000
Less: Amount forfeited (See Note 2 below)	<u>70,000</u>
Cost of acquisition	<u>3,80,000</u>

Indexed cost of acquisition ₹ 3,80,000 × 1125/331 12,91,541

Notes:

- (1) Exemption under section 54 is available if one new residential house is purchased within two years from the date of transfer of existing residential house, which is a long-term capital asset. Since the cost of new residential house is less than the long-term capital gains, capital gains to the extent of cost of new house, i.e., ₹ 3 lakh, is exempt under section 54.
- (2) As per section 51, any advance received and retained by the assessee, as a result of earlier negotiations for sale of the asset, shall be deducted from the purchase price for computing the cost of acquisition of the asset.

Question 16

State, 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 more than 12 months, will be long-term capital assets.*
- (iii) *In the case of a dealer in shares, income by way of dividend is taxable under the head "Profits and gains of business or profession".*
- (iv) *Where an urban agricultural land owned by an individual, continuously used by him for agricultural purposes for a period of two years prior to the date of transfer, is compulsorily acquired under law and the compensation is fixed by the State Government, resultant capital gain is exempt.*
- (v) *Zero Coupon Bond means a bond on which no payment and benefits are received or receivable before maturity or redemption.*
- (vi) *Income from growing and manufacturing tea in India is treated as agricultural income wholly.*

Answer

- (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 bond held for more than 12 months will be a long-term capital asset.
- (iii) **False** : In view of the provisions of section 56(2)(i), dividend income is taxable under the head "Income from other sources" in the case of all assessees.
- (iv) **False**: As per section 10(37), where an individual owns urban agricultural land which has been used for agricultural purposes for a period of two years immediately preceding the date of transfer, and the same is compulsorily acquired under any law and the compensation is determined or approved by the Central Government or the Reserve Bank of India, resultant capital gain will be exempt.

In this case, the compensation has been fixed by the State Government and hence the exemption will not be available.
- (v) **True**: As per section 2(48), 'Zero Coupon Bond' means a bond issued by any infrastructure capital company or infrastructure capital 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.
- (vi) **False** : Only 60% of the income derived from the sale of tea grown and manufactured by the seller in India is treated as agricultural income and the balance 40% of the income shall be non-agricultural income chargeable to tax [Rule 8 of Income-tax Rules, 1962].

Question 17

Singhanian & Co. own six machines, put in use for business in March, 2016. The depreciation on these machines is charged @ 15%. The written down value of these machines as on 1st April, 2016 was ₹8,50,000. Three of the old machines were sold on 10th June, 2016 for ₹11,00,000.

A new plant was bought for ₹8,50,000 on 30th November, 2016.

You are required to:

- (i) *determine the claim of depreciation for Assessment Year 2017-18.*
- (ii) *compute the capital gains liable to tax for Assessment Year 2017-18.*
- (iii) *If Singhanian & Co. had sold the three machines in June, 2016 for ₹21,00,000, will there be any difference in your above workings? Explain.*

Answer**(i) Computation of depreciation for A.Y.2017-18**

Particulars	₹
W.D.V. of the block as on 1.4.2016	8,50,000
Add: Purchase of new plant during the year	<u>8,50,000</u>
	17,00,000
Less: Sale consideration of old machinery during the year	<u>11,00,000</u>
W.D.V of the block as on 31.03.2017	<u>6,00,000</u>

Since the value of the block as on 31.3.2017 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.

Note: It is assumed that the firm is not eligible for additional depreciation under section 32(1)(ia).

(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:

- When one or some of the assets in the block are sold for consideration more than the value of the block.
- When all the assets are transferred for a consideration more than the value of the block.
- 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 exceeds the sale consideration, the resultant figure would be a short term capital loss.

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, 2016 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: W.D.V. of the machines as on 1.4.2016	8,50,000	
Purchase of new plant during the year	<u>8,50,000</u>	<u>17,00,000</u>
Short term capital gains		<u>4,00,000</u>

Question 18

Ms. Paulomi has transferred 1,000 shares of Hetal Ltd., (which she acquired at a cost of ₹ 10,000 in the financial year 2002-03) to Dhaval, her brother, at a consideration of ₹ 3,12,934 on 15.5.2016 privately.

During the financial year 2016-17, she has paid through e-banking ₹ 15,000 towards medical premium, ₹ 50,000 towards life insurance premium and ₹ 25,000 towards PPF.

Assuming she has no other source of income, compute her total income and tax payable for the Assessment Year 2017-18.

Cost Inflation Index: for F.Y.2002-03: 447; F.Y.2016-17 : 1125

Answer**Computation of total income and tax liability of Ms. Paulomi for A.Y. 2017-18**

Particulars	₹
Sale consideration	3,12,934
Less: Indexed cost of acquisition ($\text{₹ } 10,000 \times 1125/447$)	<u>25,168</u>
Long term capital gain	<u>2,87,766</u>
Total income	2,87,770
Tax liability	
Income-tax @ 20% on ₹ 37,770 ($\text{₹ } 2,88,750 - \text{₹ } 2,50,000$)	7,554
Less: Rebate under section 87A	<u>5,000</u>
	2,554
Add: Education cess and secondary and higher education cess @ 3%	<u>77</u>
Total tax payable	<u>2,631</u>
Tax payable (rounded off)	2,630

Notes :

- As per section 112, deductions under Chapter VI-A are not allowable against long term capital gain. Therefore, Paulomi is not entitled to deduction under section 80C in respect of payment of life insurance premium and contribution to PPF. She is also not entitled to deduction under section 80D in respect of medical insurance premium paid by her.
- Since Paulomi has not transferred her shares through the Stock Exchange and, therefore, has not paid securities transaction tax, she is not entitled to claim exemption under section 10(38) in respect of long term capital gain.
- She is, however, entitled to reduce the long-term capital gain by the unexhausted basic exemption limit and pay tax on the balance @20% as per section 112. In this case, since she has no other source of income, the entire basic exemption limit of ₹ 2,50,000 to the extent of long-term capital gain can be reduced from the long-term capital gain.

Question 19

Aarav converts his plot of land purchased in July, 2002 for ₹ 80,000 into stock-in-trade on 31st March, 2016. The fair market value as on 31.3.2016 was ₹ 2,00,000. The stock-in-trade was sold for ₹ 2,25,000 in the month of January, 2017.

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. 2002-03: 447; F.Y. 2015-16: 1081; F.Y. 2016-17: 1125.

Answer

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 cost inflation index of the financial year in which the conversion took place should be considered for computing indexed cost of acquisition. Further, 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. 2017-18.

Particulars	₹
Capital Gains	
Sale consideration (Fair market value on the date of conversion)	2,00,000
Less: Indexed cost of acquisition (₹ 80,000 × 1081/447)	<u>1,93,468</u>
Long-term capital gain	<u>6,532</u>
Profits & Gains of Business or Profession	
Sale price of stock-in-trade	2,25,000
Less: Fair market value on the date of conversion	<u>2,00,000</u>
	<u>25,000</u>
Computation of taxable income of Mr. Aarav for A.Y.2017-18	
Particulars	₹
Profits and gains from business or profession	25,000
Long term capital gains	<u>6,532</u>
	<u>31,532</u>

Question 20

Discuss the tax implications arising consequent to conversion of a capital asset into stock-in-trade of business and its subsequent sale.

Answer

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. However, as per section 45(2), the profits or 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. 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. Indexation benefit is available upto the year of conversion of capital asset in stock-in-trade.

On subsequent sale of such stock-in-trade, business profits 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.

Question 21

What is the cost of acquisition of self-generated assets, for the purpose of computation of capital gains?

Answer

1. **Cost of acquisition of a capital asset, being goodwill of a business or a trade mark or brand name associated with a business or a right to manufacture, produce or process any article or thing, or right to carry on any business, tenancy rights, stage carriage permits and loom hours [Section 55(2)(a)]**

- (i) If the above capital assets have been purchased by the assessee, the cost of acquisition is the amount of the purchase price. For example, if Mr. A purchases a stage carriage permit from Mr. B for ₹ 2 lacs, that will be the cost of acquisition for Mr. A.
- (ii) If the above capital assets are self-generated, the cost of acquisition shall be taken as nil.
- (iii) In case the capital asset is acquired by any mode given under clauses (i) to (iv) of section 49(1), the cost of acquisition will be the cost to the previous owner if the previous owner paid for it. However, if it was self-generated by the previous owner, the cost of acquisition will be taken as nil.

2. **Cost of acquisition of other self-generated assets not covered under section 55(2)(a):**

In respect of self-generated goodwill of a profession and other self-generated assets not specifically covered under section 55(2)(a), the decision of the Supreme Court in *CIT v. B.C. Srinivasa Setty* [1981] 128 ITR 294 will apply. In that case, the Supreme Court held that if the cost of acquisition of a self-generated asset is incapable of determination, then transfer of such asset is not taxable and consequently the gains thereon cannot be brought to charge.

Question 22

Mr. Malik owns a factory building on which he had been claiming depreciation for the past few years. It is the only asset in the block. The factory building and land appurtenant thereto were sold during the year. The following details are available:

Particulars	₹
Building completed in September, 2009 for	10,00,000
Land appurtenant thereto purchased in April, 2002 for	12,00,000
Advance received from a prospective buyer for land in May, 2003, forfeited in favour of assessee, as negotiations failed	50,000
WDV of the building block as on 1.4.2016	8,74,800
Sale value of factory building in November, 2016	8,00,000
Sale value of appurtenant land in November, 2016	40,00,000

The assessee is ready to invest in long-term specified assets under section 54EC, within specified time.

Compute the amount of taxable capital gain for the assessment year 2017-18 and the amount to be invested under section 54EC for availing the maximum exemption.

Cost inflation indices are as under :

Financial Year	Cost inflation index
2002-03	447
2003-04	463
2016-17	1125

Answer

Computation of taxable capital gain of Mr. Malik for A.Y.2017-18

Particulars	₹	₹
Factory building		
Sale price of building	8,00,000	
Less: WDV as on 1.4.2016	<u>8,74,800</u>	
Short-term capital loss on sale of building		(-) 74,800
Land appurtenant to the above building		
Sale value of land	40,00,000	
Less: Indexed cost of acquisition (₹ 11,50,000 × 1125/447)	<u>28,94,295</u>	
Long-term capital gains on sale of land		<u>11,05,705</u>
Chargeable long term capital gain		<u>10,30,905</u>

Investment under section 54EC

In this case, both land and building have been held for more than 36 months and hence, are long-term capital assets. Exemption under section 54EC is available if the capital gains arising from transfer of a long-term capital asset are invested in long-term specified assets like bonds of National Highways Authority of India and Rural Electrification Corporation Ltd., within 6 months from the date of transfer. As per section 54EC, the amount to be invested for availing the maximum exemption is the net amount of capital gain arising from transfer of long-term capital asset, which is ₹ 10,30,905 (rounded off to ₹ 10,30,910) in this case.

Notes :

1. 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. Indexation is to be done on the cost of acquisition so arrived at after reducing the advance money forfeited i.e. ₹ 12,00,000 – ₹ 50,000 = ₹ 11,50,000. It may be noted that in cases where the advance money is forfeited during the previous year 2015-16 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.
2. Factory building on which depreciation has been claimed, is a depreciable asset. Profit / loss arising on sale is deemed to be short-term capital gain/loss as per section 50, and no indexation benefit is available.
3. Land is not a depreciable asset, hence section 50 will not apply. Being a long-term capital asset (held for more than 36 months), indexation benefit is available.
4. As per section 74, short term capital loss can be set-off against any income under the head "Capital gains", long-term or short-term. Therefore, in this case, short-term capital loss of ₹ 74,800 can be set-off against long-term capital gain of ₹ 11,05,705.

Question 23

Mr. A is an individual carrying on business. His stock and machinery were damaged and destroyed in a fire accident.

The value of stock lost (total damaged) was ₹ 6,50,000. Certain portion of the machinery could be salvaged. The opening WDV of the block as on 1-4-2016 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, 2004 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.

Answer

- (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. As per section 45(1A), 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 indexed cost of acquisition of jewellery from the insurance compensation of ₹ 1,80,000.

Question 24

Mr. A who transfers land and building on 02.01.2017, furnishes the following information:

- (i) *Net consideration received ₹ 18 lakhs.*
- (ii) *Value adopted by stamp valuation authority, which was not contested by Mr. A ₹ 22 lakhs.*
- (iii) *Value ascertained by Valuation Officer on reference by the Assessing Officer ₹ 25 lakhs.*
- (iv) *This land was distributed to Mr. A on the partial partition of his HUF on 1.4.1981. Fair market value of the land as on 1.4.81 was ₹ 1,10,000.*
- (v) *A residential building was constructed on the above land by Mr. A at a cost of ₹ 3,20,000 (construction completed on 1.12.2003) during the financial year 2003-04.*
- (vi) *Brought forward unabsorbed short-term capital loss (incurred on sale of shares during the financial year 2012-13) ₹ 75,000.*

Mr. A seeks your advice as to the amount to be invested in NHAI/RECL bonds so as to be exempt from clutches of capital gain tax. Cost inflation indices for the financial years 1981-82, 2003-04 & 2016-17 are 100, 463 and 1125, respectively.

Answer

Computation of Capital Gains of Mr. A for the Assessment Year 2017-18

Particulars	₹	₹
Full value of consideration (deemed) (See Note-1&2) (Indexation benefit is available since land and buildings are long-term capital assets)		22,00,000
Less: Indexed cost of land ($\text{₹ } 1,10,000 \times 1125/100$)	12,37,500	
Indexed cost of building ($\text{₹ } 3,20,000 \times 1125/463$)	<u>7,77,538</u>	<u>20,15,038</u>
Long-term capital gain		1,84,962
Less: Brought forward short-term capital loss set off(See Note-4)		<u>75,000</u>
Amount to be invested in NHAI / RECL bonds		1,09,962

Notes :

- (1) Where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed by any authority of a State Government (Stamp Valuation Authority) for the purpose of payment of stamp duty in respect of such asset and the same is not contested by the assessee, such value adopted or assessed shall be deemed to be the full value of the consideration received or accruing as a result of such transfer [Section 50C(1)]. Accordingly, the full value of consideration will be ₹ 22 lakhs in this case.
- (2) It is further provided in section 50C(3) that where the valuation is referred by the Assessing Officer to Valuation Officer and the value ascertained by such Valuation Officer exceeds the value adopted or assessed by the Stamp Valuation Authority, the value adopted or assessed by the Stamp Valuation Authority shall be taken as the full value of the consideration received or accruing as a result of the transfer. Since the value ascertained by the valuation officer (i.e. ₹ 25 lakhs) is higher than the value adopted by the stamp valuation authority (i.e. ₹ 22 lakhs), the full value of consideration in this case is ₹ 22 lakhs.
- (3) Cost of land which is acquired on partition of HUF is the cost to the previous owner. Since date and cost of acquisition to the previous owner are not given, fair market value as on 1.4.1981 is taken as the cost and indexed.
- (4) Brought forward unabsorbed short term capital loss can be set off against any capital gains, short term or long term, for 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

- (5) As per section 54EC, an assessee can avail exemption in respect of long-term capital gains, if such capital gains are invested in the bonds issued by the NHAI / RECL redeemable after 3 years. Such investment is required to be made within a period of 6 months from the date of transfer of the asset. The exemption shall be the amount of capital gain or the amount of such investment made, whichever is less.

Question 25

Mr. X is in possession of agricultural land situated within urban limits, which is used for agricultural purposes during the preceeding 3 years by his father. On 4.4.2016, this land is compulsorily acquired by the Central Government of India on a compensation fixed and paid by it for ₹ 10 lakhs. Advise X as to the tax consequences, assuming that the entire amount is invested in purchase of shares.

Answer

Section 10(37) exempts the capital gains arising to an individual or a Hindu Undivided Family from transfer of agricultural land by way of compulsory acquisition, or a transfer, the consideration for which is determined or approved by the RBI or the Central Government.

Such exemption is available where the compensation or the enhanced compensation or consideration, as the case may be, is received on or after 1st April, 2004 and the land has been used for agricultural purposes during the preceding two years by such individual or a parent of his or by such Hindu undivided family.

Since all the above conditions are fulfilled in this case, X is entitled to exemption under section 10(37) of the entire capital gains arising on sale of agricultural land.

Question 26

Mr. Sagar, a resident individual acquired a plot of land at a cost of ₹ 75,000 in June, 1999. He constructed a house for his residence on that land at a cost of ₹ 1,25,000 in the financial year 2001-02.

He transferred the house for ₹ 15,00,000 in May, 2016 and acquired another residential house in June, 2016 for ₹ 8,00,000.

He furnishes other particulars as under

Insurance agency commission earned 45,000

(Net of TDS of ₹ 5,000)

Investment in NSC VIII issue 20,000

(i.e. on 20-3-2017)

Cost inflation index details are given below:

Financial Year

Cost Inflation Index

1999 – 2000

389

2001 – 2002	426
2016 – 2017	1125

Compute the total income of Mr. Sagar for the assessment year 2017-18.

Answer

Computation of total income of Mr. Sagar for the A.Y. 2017-18

Particulars	₹	₹
<u>Capital Gains</u>		
Sale consideration		15,00,000
Less: Indexed cost of land (₹75,000 x 1125/389)	2,16,902	
Indexed cost of building (₹ 1,25,000 x 1125/426)	<u>3,30,106</u>	<u>5,47,008</u>
		9,52,992
Less: Exemption under section 54 (See Note 2 below)		<u>8,00,000</u>
Long-term capital gain		1,52,992
<u>Profit and gains from business or profession/Income from other sources</u>		
Insurance agency commission earned (Gross) (₹ 45,000 + ₹ 5,000)		<u>50,000</u>
Gross Total Income		2,02,992
Less: Deduction under Chapter VI-A		
Section 80C - Investment in NSC VIII		<u>20,000</u>
Total Income		<u>1,82,992</u>
Total Income (Rounded off)		<u>1,82,990</u>

Notes:

- (1) Since the building and the land are held for more than 36 months, the same are long-term capital assets and the capital gain arising on sale of such assets is a long-term capital gain.
- (2) As per the provisions of section 54, 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 a residential house property one year before or two years after the date of transfer of original asset or constructed a residential house property within three years after such date. Since Mr. Sagar has purchased another residential house in June, 2016 for ₹ 8,00,000, the capital gain arising on transfer of residential house property in May, 2016 is exempt under section 54 to that extent.

Question 27

Mr. Y submits the following information pertaining to the year ended 31st March, 2017:

- (i) On 30.11.2016, when he attained the age of 60, his friends in India gave a flat at Surat as a gift, each contributing a sum of ₹ 20,000 in cash. The cost of the flat purchased using the various gifts was ₹ 3.40 lacs.
- (ii) His close friend abroad sent him a cash gift of ₹ 75,000 through his relative for the above occasion.
- (iii) Mr. Y sold the above flat on 30.1.2017 for ₹ 3.6 lacs. The Registrar's valuation for stamp duty purposes was ₹ 3.7 lacs. Neither Mr. Y nor the buyer, questioned the value fixed by the Registrar.
- (iv) He had purchased some unlisted equity shares in X Pvt. Ltd., on 5.2.2007 for ₹ 3.5 lacs. These shares were sold on 15.3.2017 for ₹ 2.8 lacs.

You are requested to calculate the total income of Mr. Y for the assessment year 2017-18.

[Cost Inflation Index for F.Y. 2006-07: 519, 2016-17: 1125]

Answer

Computation of total income of Mr. Y for A.Y. 2017-18

Particulars	₹	₹	₹
Capital Gains			
Short term capital gains (on sale of flat)			
(i) Sale consideration	3,60,000		
(ii) Stamp duty valuation	<u>3,70,000</u>		
Consideration for the purpose of capital gains as per section 50C (stamp duty value, since it is higher than sale consideration)		3,70,000	
Less: Cost of acquisition [As per section 49(4), cost to be taken into consideration for 56(2)(vii) will be the cost of acquisition]		<u>3,40,000</u>	30,000
Long term capital loss on sale of equity shares of X Pvt. Ltd			
Sale consideration		2,80,000	
Less: Indexed cost of acquisition (₹ 3,50,000 × 1125/519)		<u>7,58,671</u>	
Long term capital loss to be carried forward (See Note 1 below)		<u>4,78,671</u>	
Income from other sources:			
Gift from friends by way of immovable property on			3,40,000

30.11.2016 [See Note 3 below].			
Gift received from a close friend (unrelated person) [See Note 2 below]			<u>75,000</u>
Total income			<u>4,45,000</u>

Notes:

1. In the given problem, unlisted shares of X Pvt. Ltd. have been held for more than **24 months** and hence, constitute a long term capital asset. The loss arising from sale of such shares is, therefore, a long-term capital loss. As per section 70(3), long term capital loss can be set-off only against long-term capital gains. Therefore, long-term capital loss cannot be set-off against short-term capital gains. However, such long-term capital loss can be carried forward to the next year for set-off against long-term capital gains arising in that year.
2. Any sum received from an unrelated person will be deemed as income and taxed as income from other sources if the aggregate sum received exceeds ₹ 50,000 in a year [Section 56(2)(vii)].
3. Receipt of immovable property without consideration would attract the provisions of section 56(2)(vii).

Question 28

Mr. Bala sold his vacant site on 21.09.2016 for ₹ 7,00,000. It was acquired by him on 01.10.1995 for ₹ 1,50,000.

The State stamp valuation authority fixed the value of the site at the time of transfer @ ₹ 13,00,000.

Compute capital gains in the hands of Bala and give your reasons for computation.

Cost inflation index : F.Y.1995-96: 281 and F.Y. 2016-17 : 1125.

Answer**Computation of capital gains of Bala for the A.Y.2017-18**

Particulars	₹
Deemed sale consideration as per section 50C	13,00,000
Less : Indexed cost of acquisition ($\text{₹ } 1,50,000 \times 1125 / 281$)	<u>6,00,534</u>
Taxable long term capital gain	<u>6,99,466</u>

Note: According to section 50C(1), where the consideration received or accruing as a result of the transfer of land or building or both is less than the value adopted or assessed or assessable by the State Stamp Valuation Authority for the purpose of payment of stamp duty in respect of such transfer, then the value so adopted or assessed or assessable by the State Stamp Valuation Authority shall be deemed to be the full value of the consideration received or accruing as a result of the transfer.

In this case, since the consideration of ₹ 7,00,000 received on transfer of land is less than the value of ₹ 13,00,000 fixed by the State Stamp Valuation Authority, the value adopted by the State Stamp Valuation Authority is deemed to be the full value of consideration and capital gains is calculated accordingly.

Question 29

Mr. 'X' furnishes the following data for the previous year ending 31.3.2017:

- (a) Unlisted Equity Shares of AB Ltd., 10,000 in number were sold on 31.5.2016, at ₹ 500 for each share.
- (b) The above shares of 10,000 were acquired by 'X' in the following manner:
 - (i) Received as gift from his father on 1.6.1980 (5,000 shares) the fair market value on 1.4.1981 ₹ 50 per share.
 - (ii) Bonus shares received from AB Ltd. on 21.7.1985 (2,000 shares).
 - (iii) Purchased on 1.2.1994 at the price of ₹ 125 per share (3,000 shares).
- (c) Purchased one residential house at ₹ 25 lakhs, on 1.5.2017 from the sale proceeds of shares.
- (d) 'X' is already owning a residential house, even before the purchase of above house.

You are required to compute the taxable capital gain. He has no other source of income chargeable to tax.

(Cost Inflation Index – Financial year 1985-86: 133; 1993-94: 244; Financial year 2016-17: 1125)

Answer**Computation of taxable capital gain of Mr. 'X' for A.Y. 2017-18**

Particulars	₹	₹
Sale consideration received on sale of 10,000 shares @ ₹ 500 each		50,00,000
Less: Indexed cost of acquisition		
(a) 5,000 shares received as gift from father on 1.6.1980 Indexed cost 5,000 x ₹ 50 x 1125/100	28,12,500	
(b) 2,000 bonus shares received from AB Ltd Bonus shares are acquired on 21.7.1985 i.e. after 01.04.1981. Hence, the cost is Nil.	Nil	
(c) 3000 shares purchased on 1.2.1994 @ ₹ 125 per share. The indexed cost is 3000 x 125 x 1125/244	17,28,996	45,41,496
Long term capital gain		4,58,504
Less : Exemption under section 54F (See Note below)		

₹ 4,58,504 x ₹ 25,00,000 / ₹ 50,00,000		<u>2,29,252</u>
Taxable long term capital gain		<u>2,29,252</u>

Note: Exemption under section 54F can be availed by the assessee subject to fulfillment of the following conditions:

- The assessee should not own more than one residential house on the date of transfer of the long-term capital asset;
- The assessee should purchase a residential house within a period of 1 year before or 2 years after the date of transfer or construct a residential house within a period of 3 years from the date of transfer of the long-term capital asset.

In this case, the assessee has fulfilled the two conditions mentioned above. Therefore, he is entitled to exemption under section 54F.

Question 30

Ms. Vimla sold a residential building at Jodhpur for ₹ 15,00,000 on 01-07-2016.

The building was acquired for ₹ 1,50,000 on 01-06-1997.

She paid brokerage @ 2% at the time of sale of the building. She invested ₹ 7 lakhs in purchase of a residential building in December 2016 and deposited ₹ 2 lakhs in NHA Capital Gains Bond in March, 2017. Compute her taxable capital gain.

Cost inflation index of F.Y. 1997-98: 331; F.Y. 2016-17: 1125

Answer

Computation of taxable capital gain of Ms. Vimla for A.Y. 2017-18

Particulars	₹	₹
Sale price of residential building	15,00,000	
Less : Brokerage @ 2%	<u>30,000</u>	
Net consideration		14,70,000
Less : Indexed cost of acquisition ₹ 1,50,000 x 1125/331		<u>5,09,819</u>
		9,60,181
Less: Deduction under section 54 for purchase of new residential house in December 2016		<u>7,00,000</u>
Taxable long term capital gain		<u>2,60,181</u>

Note: One of the conditions for claiming exemption under section 54EC for the investment in RECL/NHA Capital Gains bonds is that the deposit should be made within 6 months from the

date of transfer. In this case, the transfer took place on 1.7.2016 and the 6 months period within which the deposit should be made for the purpose of section 54EC would expire by 31.12.2016. The investment in REC/NHAI Capital Gains bonds was made only in March 2017. Therefore, the assessee is not eligible for exemption under section 54EC.

Question 31

Mrs. Malini Hari shifted her industrial undertaking located in corporation limits of Faridabad, to a Special Economic Zone (SEZ) on 1.12.2016.

The following particulars are available:

Particulars		₹
(a)	Land: Purchased on 20.01.2003	4,26,000
	Sold for	22,00,000
(b)	Building [Construction completed on 14.03.2006]	
	WDV of building as on 01.04.2016	8,20,000
	Sold for	11,39,000
(c)	WDV of cars as on 01.04.2016	7,40,000
	Sold for	6,00,000
(d)	Expenses on shifting the undertaking	1,15,000
(e)	Assets acquired for the undertaking in the SEZ (on or before 25.06.2017):	
(i)	Land	3,00,000
(ii)	Building	5,00,000
(iii)	Computers	1,00,000
(iv)	Car	4,20,000
(v)	Machinery (Second hand)	2,00,000
(vi)	Furniture	50,000

There is no intention of investing in any other asset in this undertaking.

Compute the exemption available under section 54GA for the assessment year 2017-18.

Cost inflation indices for F.Y.2002-03 – 447; F.Y.2016-17: 1125.

Answer

Where an assessee shifts an existing undertaking from an urban area to a SEZ and incurs expenses for shifting and acquires new assets for the undertaking in the SEZ, exemption under section 54GA would be available in such a case.

The capital gain, short-term or long-term, arising from transfer of land, building, plant and machinery in the existing undertaking would be exempt under section 54GA if the assessee, within a period of one year before or three years after the date on which the transfer took place,

- (i) acquires plant and machinery for use in the undertaking in the SEZ;
- (ii) acquires land or building or constructs building for the business of the undertaking in the SEZ;
- (iii) incurs expenses on shifting of the undertaking.

Computation of capital gain :

(a) *Land:*

Sale price	22,00,000
Less: Indexed cost of acquisition $4,26,000 \times 1125/447$	<u>10,72,148</u>
Long-term capital gain	<u>11,27,852</u>

(b) *Building:*

Sale value	11,39,000
Less: Opening WDV	<u>8,20,000</u>
Short-term capital gain under section 50	<u>3,19,000</u>

(c) *Plant:*

Car

Sale value	6,00,000
Less: Opening WDV	<u>7,40,000</u>
Short term capital loss under section 50	<u>(-)1,40,000</u>

Net short term capital gain (₹ 3,19,000 – ₹ 1,40,000) 1,79,000

Total capital gain (LTCG+STCG) i.e. ₹ 11,27,852+ ₹ 1,79,000 = ₹ 13,06,852

Exemption under section 54GA is available in respect of the following assets acquired and expenses incurred:

Particulars	₹
Land	3,00,000
Building	5,00,000
Plant:	
Computers	1,00,000
Car	4,20,000
Machinery	2,00,000
Expenses of shifting	<u>1,15,000</u>
Total Exemption	<u>16,35,000</u>

Note:

1. The total exemption available under section 54GA is the lower of capital gains of ₹ 13,06,852 or the amount of investment which is ₹ 16,35,000. Hence, the amount of exemption available under section 54GA is ₹ 13,06,852. The taxable capital gains would be Nil.
2. Furniture purchased is not eligible for exemption under section 54GA.
3. There is no restriction regarding purchase of second hand machinery.
4. Computers and car would constitute Plant.

Question 32

Mr. Thomas inherited a house in Jaipur under will of his father in May, 2003. The house was purchased by his father in January, 1980 for ₹ 2,50,000. He invested an amount of ₹ 7,00,000 in construction of one more floor in this house in June, 2005. The house was sold by him in November, 2016 for ₹ 37,50,000. The valuation adopted by the registration authorities for charge of stamp duty was ₹ 47,25,000 which was not contested by the buyer, but as per assessee's request, the Assessing Officer made a reference to Valuation officer. The value determined by the Valuation officer was ₹ 47,50,000. Brokerage @ 1% of sale consideration was paid by Mr. Thomas to Mr. Sunil. The fair market value of house as on 01.04.1981 was ₹ 2,70,000.

You are required to compute the amount of capital gain chargeable to tax for A.Y. 2017-18 with the help of given information and by taking CII for the F.Y. 2003-04 : 463, F.Y. 2005-06: 497 and for F.Y. 2016-17:1125.

Answer**Computation of Long term Capital Gain for A.Y. 2017-18**

Particulars	₹	₹
Sale consideration as per section 50C (Note-1)		47,25,000
Less: Expenses incurred on transfer being brokerage @ 1% of sale consideration of ₹ 37.50 lacs		<u>37,500</u>
		46,87,500
Less: Indexed cost of acquisition (Note-2) (₹ 2,70,000 × 1125/463)	6,56,048	
Indexed cost of improvement (₹ 7,00,000 × 1125/497)	<u>15,84,507</u>	<u>22,40,555</u>
Long term capital gain		<u>24,46,945</u>

Notes:

1. As per section 50C, where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the valuation by the stamp valuation authority, such value adopted or assessed by the stamp valuation authority

shall be deemed to be the full value of consideration. Where a reference is made to the valuation officer, and the value ascertained by the valuation officer exceeds the value adopted by the stamp valuation authority, the value adopted by the stamp valuation authority shall be taken as the full value of consideration.

Sale consideration	₹ 37,50,000
Valuation made by registration authority for stamp duty	₹ 47,25,000
Valuation made by the valuation officer on a reference	₹ 47,50,000

Applying the provisions of section 50C to the present case, ₹ 47,25,000, being, the value adopted by the registration authority for stamp duty, shall be taken as the sale consideration for the purpose of charge of capital gain.

- The house was inherited by Mr. Thomas under the will of his father and therefore, the cost incurred by the previous owner shall be taken as the cost. Fair market value as on 01.04.81, accordingly, shall be adopted as the cost of acquisition of the house property. However, indexation benefit will be given from the year in which Mr. Thomas first held the asset i.e. P.Y.2003-04.

Alternative view: In the case of *CIT v. Manjula J. Shah 16 Taxmann 42 (Bom.)*, the Bombay High Court held that the indexed cost of acquisition in case of gifted asset can be computed with reference to the year in which the previous owner first held the asset.

As per this view, the indexed cost of acquisition of house would be ₹ 30,37,500 and long term capital gain would be ₹ 65,493.

Question 33

Ms. Vasudha contends that sale of a work of art held by her is not exigible to capital gains tax. Is she correct?

Answer

As per section 2(14)(ii), the term "personal effects" excludes any work of art. As a result, any work of art will be considered as a capital asset and sale of the same will attract capital gains tax. Thus, the contention of Ms. Vasudha is not correct.

Question 34

Ms. Vasumathi purchased 10,000 equity shares of ABC Co. Pvt. Ltd. on 28.2.2005 for ₹ 1,20,000. The company was wound up on 31.7.2016. The following is the summarized financial position of the company as on 31.7.2016:

Liabilities	₹	Assets	₹
60,000 Equity shares	6,00,000	Agricultural lands	42,00,000
General reserve	40,00,000	Cash at bank	6,50,000
Provision for taxation	<u>2,50,000</u>		<u> </u>
	<u>48,50,000</u>		<u>48,50,000</u>

The tax liability was ascertained at ₹ 3,00,000. The remaining assets were distributed to the shareholders in the proportion of their shareholding. The market value of 6 acres of agricultural land (in an urban area) as on 31.7.2016 is ₹ 10,00,000 per acre.

The agricultural land received above was sold by Ms. Vasumathi on 28.2.2017 for ₹ 15,00,000.

Discuss the tax consequences in the hands of the company and Ms. Vasumathi.

The cost inflation indices are: F.Y.2004-05: 480; F.Y.2016-17 : 1125

Answer

In the hands of the company

As per section 46(1), distribution of capital assets amongst the shareholders on liquidation of the company is not regarded as "transfer" in the hands of the company. Consequently, there will be no capital gains in the hands of the company.

In the hands of Ms. Vasumathi (shareholder)

Section 46(2) provides that such capital gains would be chargeable in the hands of the shareholder.

Particulars	₹
Ms. Vasumathi holds 1/6 th of the shareholding of the company	
Market value of agricultural land received (1 acre @ ₹ 10 Lakhs)	10,00,000
Cash at bank [1/6 th of (₹ 6,50,000 – ₹ 3,00,000)]	<u>58,333</u>
	10,58,333
Less: Deemed dividend under section 2(22)(c) - 1/6 th of (₹ 40,00,000- ₹ 50,000)	<u>6,58,333</u>
Consideration for computing Capital Gain	4,00,000
Less: Indexed cost of acquisition of Shares (₹ 1,20,000 x 1125/ 480)	<u>2,81,250</u>
Long term capital gains	<u>1,18,750</u>

Notes:

- 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. Hence, the short-term capital gains in the hands of Ms. Vasumathi (shareholder) at the time of sale of urban agricultural land should be computed as follows:

Particulars	₹
Sale consideration	15,00,000
Less: Fair market value of the agricultural land on the date of distribution	<u>10,00,000</u>
Short term capital gain	<u>5,00,000</u>

2. Dividend under section 2(22)(c) amounting to ₹ 6,58,333 will be exempt under section 10(34).
3. The tax liability ascertained at ₹ 3,00,000 has to be reduced from bank balance while computing full value of consideration under section 46(2). ₹ 50,000, being the difference between ₹ 3,00,000 and ₹ 2,50,000, has to be reduced from General Reserve for calculating deemed dividend under section 2(22)(c).

Question 35

State with reasons whether the following statements are true or false having regard to the provisions of the Income-tax Act, 1961:

- (a) *Capital gain of ₹ 75 lakh arising from transfer of long term capital assets on 1.5.2016 will be exempt from tax if such capital gain is invested in the bonds redeemable after three years, issued by NHAI under section 54EC.*
- (b) *As per section 49(2A), read with section 47(xa) of the Income-tax Act, 1961, no capital gains would arise on conversion of foreign currency exchangeable bonds into shares or debentures, for facilitating the issue of FCEBs by companies.*

Answer

- (a) **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, redeemable after 3 years) to ₹ 50 lakh, 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 lakh, provided the investment is made before 1.11.2016 (i.e., within six months from the date of transfer).
- (b) **True** : As per section 47(xa), any transfer by way of conversion of bonds referred to in section 115AC into shares and debentures of any company is not regarded as transfer. Therefore, there will be no capital gains on conversion of foreign currency exchangeable bonds into shares or debentures.

Question 36

Mrs. X, an individual resident woman, wanted to know whether income-tax is attracted on sale of gold and jewellery gifted to her by her parents on the occasion of her marriage in the year 1979 which was purchased at a total cost of ₹ 2,00,000?

Answer

The definition of capital asset under section 2(14) includes jewellery. Therefore, capital gains is attracted on sale of jewellery, since jewellery is excluded from personal effects. The cost to the previous owner or the fair market value as on 1.4.1981, whichever is more beneficial to the assessee, would be treated as the cost of acquisition. Accordingly, in this case, long term capital gain @ 20% will be attracted in the year in which the gold and jewellery is sold by Mrs. X.

Question 37

Mr. Kumar, aged 50 years, is the owner of a residential house which was purchased in September, 1993 for ₹ 5,00,000. He sold the said house on 5th August, 2016 for ₹ 24,00,000. Valuation as per stamp valuation authority of the said residential house was ₹ 43,00,000. He invested ₹ 5,00,000 in NHAI Bonds on 12th January, 2017. He purchased a residential house on 5th July, 2017 for ₹ 10,00,000. He gives other particulars as follows:

Interest on Bank Fixed Deposit	₹ 32,000
Investment in public provident fund	₹ 50,000

You are requested to calculate the taxable income for the assessment year 2017-18 and the tax liability, if any.

Cost inflation index for F.Y. 1993-94 and 2016-17 are 244 and 1125, respectively.

Answer**Computation of total income of Mr. Kumar for the A.Y.2017-18**

Particulars	₹	₹
Capital Gains:		
Sale price of the residential house	24,00,000	
Valuation as per Stamp Valuation authority	43,00,000	
(Value to be taken is the higher of actual sale price or valuation adopted for stamp duty purpose as per section 50C)		
Therefore, Consideration for the purpose of Capital Gains	43,00,000	
Less: Indexed Cost of Acquisition		
₹ 5,00,000 x 1125/244	<u>23,05,328</u>	
	19,94,672	
Less: Exemption under section 54 ₹ 10,00,000		
Exemption under section 54EC ₹ <u>5,00,000</u>	<u>15,00,000</u>	

Long-term capital gains	4,94,672
Income from other sources:	
Interest on bank deposits	<u>32,000</u>
Gross Total Income	5,26,672
Less: Deduction under Chapter VI-A	
Section 80C – Deposit in PPF (restricted to ₹ 32,000)	<u>32,000</u>
Total Income	<u>4,94,672</u>

Computation of Tax liability of Mr. Kumar for A.Y. 2017-18

Particulars	₹
Tax on ₹ 2,44,672 @ 20% [i.e. long term capital gain less basic exemption limit (₹ 4,94,672- ₹ 2,50,000)]	48,934
Less: Rebate u/s 87A	<u>5,000</u>
	43,934
Add: Education Cess@2% & SHEC @ 1%	<u>1,318</u>
Tax Payable	<u>45,252</u>
Tax Payable (Rounded off)	45,250

Notes:

1. The basic exemption limit of ₹ 2,50,000 can be adjusted against long term capital gains.
2. Deduction under section 80C should be restricted to gross total income excluding long term capital gain.

Question 38

Mr. Pranav, a resident individual aged 55 years, had purchased a plot of land at a cost of ₹ 75,000 in June, 1999. He constructed a house for his residence on that land at a cost of ₹ 1,25,000 in August, 2001. He sold that house in May, 2016 at ₹ 16,00,000 and purchased another residential house in June, 2016 for ₹ 8,00,000. He furnishes other income and investment as follows :

Particulars	₹
Interest on fixed deposit with a bank (Net of TDS ₹ 5,000)	45,000
Investment in PPF	20,000

CII for financial year 1999-2000, 2001-02 and 2016-17 are 389, 426 and 1125 respectively.

You are required to compute taxable income and tax payable by Mr. Pranav for the

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assessment year 2017-18.

Answer

Computation of taxable income and tax payable by Mr. Pranav for the A.Y. 2017-18

	Particulars	₹	₹
1.	Income from Capital Gains		
	Full value of consideration		16,00,000
	Less : Indexed cost of acquisition of land (₹ 75,000 × 1125/389)		2,16,902
	Less: Indexed cost of construction of house (₹ 1,25,000 × 1125/426)		<u>3,30,106</u>
			10,52,992
	Less : Deduction under section 54 Cost of new residential house		<u>8,00,000</u>
	Long term capital gains		2,52,992
2.	Income from other sources		
	Interest on Bank deposit (Net)	45,000	
	Add : Tax deducted at source	<u>5,000</u>	<u>50,000</u>
	Gross total income		3,02,992
	Less: Deduction under section 80C : Investment in PPF		<u>20,000</u>
	Taxable income		<u>2,82,992</u>
	Components of Total income		
	Special income		
	Long-term Capital gains	2,52,992	
	Normal Income (₹ 50,000 – ₹ 20,000)	<u>30,000</u>	
		<u>2,82,992</u>	
	Tax on normal income of ₹ 30,000		Nil
	Tax on LTCG [LTCG (Maximum amount not chargeable to tax - Normal Income) @ 20%] under section 112 = {₹ 2,52,992 – (₹ 2,50,000 – ₹ 30,000)} × 20%		6,598
	Less: Rebate under section 87A		<u>5,000</u>
			1,598

Add : Education cess @ 2%	32
Secondary and higher education cess @ 1%	<u>16</u>
Tax payable	1,646
Less: Tax deducted at source	<u>5,000</u>
	3,354
Tax Refundable (rounded off)	3,350

Question 39

Mr. C inherited from his father 8 plots of land in 1980. His father had purchased the plots in 1960 for ₹ 5 lakhs. The fair market value of the plots as on 1-4-1981 was ₹ 8 lakhs. (₹ 1 lakh for each plot)

On 1st June 2001, C started a business of dealer in plots and converted the 8 plots as stock-in-trade of his business. He recorded the plots in his books at ₹ 45 lakhs being the fair market value on that date. In June 2005, C sold the 8 plots for ₹ 50 lakhs.

In the same year, he acquired a residential house property for ₹ 35 lakhs. He invested an amount of ₹ 5 lakhs in construction of one more floor in his house in June 2006. The house was sold by him in June 2016 for ₹ 75,00,000.

The valuation adopted by the registration authorities for charge of stamp duty was ₹ 98,00,000. As per the assessee's request, the Assessing Officer made a reference to a Valuation Officer. The value determined by the Valuation Officer was ₹ 1,05,00,000. Brokerage of 1 % of sale consideration was paid by C.

The relevant Cost Inflation Indices are:

F.Y. 1981-82	100
F.Y. 2001-02	426
F.Y. 2005-06	497
F.Y. 2006-07	519
F.Y. 2016-17	1125

Give the tax computation for the Assessment Year 2017-18.

Answer**Computation of total income and tax liability of Mr. C for A.Y. 2017-18**

Particulars	₹	₹
Capital Gains on sale of residential house property		
Value declared by Mr. C ₹ 75,00,000		
Value adopted by Stamp Valuation Authority ₹ 98,00,000		

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Valuation as per Valuation Officer ₹ 1,05,00,000		
Gross Sale consideration (See Note 1)		98,00,000
Less: Brokerage@1% of sale consideration		<u>75,000</u>
Net Sale consideration		97,25,000
Less: Indexed cost of acquisition (₹ 35,00,000 × 1125/497)	79,22,535	
Indexed cost of improvement (₹ 5,00,000 × 1125/519)	<u>10,83,815</u>	<u>90,06,350</u>
Long-term capital gains (Total Income)		7,18,650
Tax on total income (See Note 2)		
Long-term capital gain taxable@20% (₹ 7,18,650 – ₹ 2,50,000)		93,730
Add: Education cess @ 2%		1,875
Secondary and higher education cess @ 1%		<u>977</u>
Total tax liability		<u>96,542</u>
Tax liability (rounded off)		96,540

Notes:

1. As per section 50C, in case the value of sale consideration declared by the assessee is less than the value adopted by the Stamp Valuation Authority for the purpose of charging stamp duty, then, the value adopted by the Stamp Valuation Authority shall be taken to be the full value of consideration. In case the valuation is referred to the Valuation Officer and the value determined is more than the value adopted by the Stamp Valuation Authority, the value determined by the Valuation Officer shall be ignored. Therefore, in the present case, the sale consideration would be the stamp valuation of ₹ 98,00,000, since the same is more than the sale value declared by Mr. C and less than the value determined by the Valuation Officer.
2. As per section 112, the unexhausted basic exemption limit can be exhausted against the long-term capital gains. Since Mr. C does not have any other income in the current year, the whole of the basic exemption limit of ₹ 2,50,000 is exhausted against the long-term capital gains of ₹ 7,18,650 and the balance long-term capital gains shall be taxable@20%. It is assumed that Mr. C is a resident individual below the age of 60 years.

Question 40

Ms. Mohini transferred a house to her friend Ms. Ragini for ₹ 35,00,000 on 01-10-2016. The Sub Registrar valued the land at ₹ 48,00,000. Ms. Mohini contested the valuation and the matter was referred to Divisional Revenue Officer, who valued the house at ₹ 41,00,000. Accepting the said value, differential stamp duty was also paid and the transfer was completed.

The total income of Mohini and Ragini for the assessment year 2017-18, before considering the transfer of said house are ₹ 2,80,000 and ₹ 3,45,000, respectively. Ms. Mohini had purchased the house on 15th May 2011 for ₹ 25,00,000 and registration expenses were ₹ 1,50,000.

You are required to explain provisions of Income-tax Act, 1961 applicable to present case and also determine the total income of both Ms. Mohini and Ms. Ragini taking into account the above said transactions. Cost inflation indices for:

- (i) Financial Year 2011-12 : 785 and
- (ii) Financial Year 2016-17 : 1125

Answer

Computation of total income of Ms. Mohini for A.Y. 2017-18

Particulars	₹	₹
Long-term capital gain		
Full value of consideration (As per section 50C read with section 155(15), in case the actual sale consideration is less than the stamp duty value fixed by the stamp valuation authority (Sub-registrar, in this case), the stamp duty value shall be deemed as the full value of consideration. Where the assessee contests the stamp valuation, and the value is reduced by the Divisional Revenue Officer, such reduced value will be regarded as the full value of consideration accruing as a result of transfer. Hence, in this case, ₹ 41,00,000, being the valuation by Divisional Revenue Officer on which stamp duty is paid, would be deemed as full value of consideration, since the same is lower than the valuation by the Sub-registrar)	41,00,000	
Less: Indexed cost of acquisition [$\text{₹ } 26,50,000 \times \frac{1125}{785}$]	<u>37,97,771</u>	3,02,229
Other Income		<u>2,80,000</u>
Total Income		<u>5,82,229</u>
<i>Note: Cost of acquisition includes purchase price plus registration expenses i.e., ₹ 25,00,000 + ₹ 1,50,000</i>		or 5,82,230

Computation of total income of Ms. Ragini for A.Y. 2017-18

Particulars	₹
Income from other sources	
Immovable property received for inadequate consideration	6,00,000

As per section 56(2)(vii), where an individual receives from a non-relative, any immovable property for a consideration which is less than the stamp duty value (or the value reduced by the Divisional Revenue Officer, as in this case) by an amount exceeding ₹ 50,000, then, the difference between such value and actual consideration of such property would be chargeable to tax as income from other sources.	
Therefore, ₹ 6,00,000 (i.e., ₹ 41,00,000 – ₹ 35,00,000) would be chargeable to tax as income from other sources.	
Other Income	<u>3,45,000</u>
Total Income	<u>9,45,000</u>

Question 40

Mr. Martin, a resident individual sold his residential house property on 08-06-2016 for ₹ 70 lakhs which was purchased by him for ₹ 20 lakhs on 05-05-2005.

He paid ₹ 1 lakh as brokerage for the sale of said property. The stamp duty valuation assessed by sub registrar was ₹ 80 lakhs.

He bought another house property on 25-12-2016 for ₹ 15 lakhs.

He deposited ₹ 10 lakhs on 10-11-2016 in the capital gain bond of National Highway Authority of India (NHAI).

He deposited another ₹ 5 lakhs on 10-07-2017 in the capital gain deposit scheme with SBI for construction of additional floor of house property.

Compute income under the head "Capital Gains" for A.Y. 2017-18 as per Income-tax Act, 1961 and also income-tax payable on the assumption that he has no other income chargeable to tax.

Cost inflation index for Financial Year 2005-06: 497 and 2016-17: 1125.

Answer**Computation of income under the head "Capital Gains" of Mr. Martin for A.Y. 2017-18**

Particulars	₹	₹
Long-term capital gain		
Full value of consideration	80,00,000	
[As per section 50C, in case the actual sale consideration (i.e., ₹ 70 lakhs, in this case) is less than the stamp duty value (i.e., ₹ 80 lakhs, in this case) assessed by the stamp valuation authority (Sub-registrar, in this case), the stamp		

duty value shall be deemed as the full value of consideration]		
Less: Expenses in connection with transfer (brokerage paid for sale of property)	<u>1,00,000</u>	
	79,00,000	
Less: Indexed cost of acquisition [20,00,000 x 1125 / 497]	<u>45,27,163</u>	38,72,837
Less: Exemption under section 54:		
- Purchase of new residential house property within two years from the date of sale of residential house	15,00,000	
- Deposit in Capital Gains Accounts Scheme on or before the due date of filing of return of income u/s 139(1) for construction of additional floor on such house property.	<u>10,00,000</u>	
	<u>25,00,000</u>	
Exemption under section 54EC:		
- Investment in capital gains bond of NHAI within 6 months from the date of transfer (i.e., before 8.12.2016)	<u>5,00,000</u>	<u>30,00,000</u>
Taxable Capital Gains/Total Income		<u>3,72,837</u>
Total Income (rounded off)		3,72,840

Computation of tax liability of Mr. Martin for A.Y. 2017-18

Particulars	₹
Tax on ₹ 1,22,840 @ 20% [i.e., long term capital gain less basic exemption limit (3,72,840–2,50,000)]	24,568
Less: Rebate under section 87A	<u>5,000</u>
	19,568
Add: Education cess@2% & SHEC@ 1%	<u>587</u>
Tax Payable	<u>20,155</u>
Tax Payable (rounded off)	20,160

Notes:

- (1) Since Mr. Martin is a resident individual, the basic exemption limit of ₹ 2,50,000 has been adjusted against long term capital gains and the balance long-term capital gains is chargeable to tax @ 20% under section 112. Further, since his total income is less than ₹ 5 lakh, he is eligible for rebate under section 87A.
- (2) Exemption under section 54 is available in respect of reinvestment of capital gains on sale of residential house in one residential house in India. In this case, exemption would be available for amount invested in purchase of new residential

house and amount deposited for construction of additional floor in the same house, since they together constitute one residential house.

Exercise

1. *Distribution of assets at the time of liquidation of a company -*
 - (a) *is not a transfer in the hands of the company or the shareholders*
 - (b) *is not a transfer in the hands of the company but capital gains is chargeable to tax on such distribution in the hands of the shareholders*
 - (c) *is not a transfer in the hands of the shareholders but capital gains is chargeable to tax on such distribution in the hands of the company.*
2. *For an assessee, who is a salaried employee who invests in shares, what is the benefit available in respect of securities transaction tax paid by him on sale of 100 listed shares of X Ltd. which has been held by him for 14 months before sale?*
 - (a) *Rebate under section 88E is allowable in respect of securities transaction tax paid*
 - (b) *Securities transaction tax paid is treated as expenses of transfer and deducted from sale consideration.*
 - (c) *Long term capital gains is completely exempt under section 10(38)*
3. *Under section 50C, the guideline value for stamp duty is taken as the full value of consideration only if -*
 - (a) *the asset transferred is building and the actual consideration is less than the guideline value*
 - (b) *the asset transferred is either land or building or both and the actual consideration is less than the guideline value*
 - (c) *the asset transferred is building, irrespective of the actual consideration.*
4. *When there is a reduction of capital by a company and amounts are distributed to shareholders,*
 - (a) *the entire distribution is subject to capital gains tax.*
 - (b) *the entire distribution is subject to tax under the head "Income from other sources".*
 - (c) *The distribution attributable to accumulated profits is chargeable as deemed dividend and distribution attributable to capital is subject to capital gains tax.*
5. *Where there is a transfer of a capital asset by a partner to the firm by way of capital contribution or otherwise, the consideration would be taken as -*
 - (a) *The market value of the capital asset on the date of transfer*
 - (b) *The cost less notional depreciation of the capital asset*
 - (c) *The value of the asset recorded in the books of the firm.*

6. Under section 54EC, capital gains are exempted if invested in the bonds issued by NHAI & RECL-
 - (a) within a period of 6 months from the date of transfer of the asset
 - (b) within a period of 6 months from the end of the previous year
 - (c) within a period of 6 months from the end of the previous year or the due date for filing the return of income under section 139(1), whichever is earlier
7. Any payment made by a company on purchase of its own listed shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956-
 - (a) shall be regarded as dividend
 - (b) shall not be regarded as dividend but capital gains tax liability is attracted in the hands of the shareholder
 - (c) shall neither be regarded as dividend nor will it attract capital gains tax in the hands of the shareholder.
8. Discuss the conditions to be satisfied for claiming exemption of tax in respect of -
 - (a) Capital gains on compulsory acquisition of agricultural land situated within specified urban limits
 - (b) Capital gains on sale of listed equity shares/units of an equity oriented fund.
9. Write short notes on -
 - (i) Capital gains in the case of slump sale under section 50B
 - (ii) Reference to Valuation Officer under section 55A
10. What is the tax treatment, under the Income-tax Act, 1961, of capital gains arising on transfer of assets in case of shifting of industrial undertaking from an urban area to any special economic zone? Discuss.
11. List ten transactions which are not regarded as transfer for the purpose of capital gains. Discuss the provisions relating to the same.
12. Explain the computation of capital gain in case of depreciable asset under section 50.
13. What are the transactions not regarded as transfer as per section 47 of the Income-tax Act, 1961?

Answers

1. b; 2. c; 3. b; 4. c; 5. c; 6. a; 7. b

Key Points

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 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 an Individual or a Hindu undivided family [Section 56(2)(vii)]**

	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 ₹ 50,000.

Receipts exempted from the applicability of section 56(2)(vii)

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 as defined in the *Explanation* to section 10(20); or
- (f) from any fund or university or other educational institution or hospital or other medical institution or any trust or institution referred to in section 10(23C); or
- (g) from any trust or institution registered under section 12AA

Also, any shares received by an individual or HUF as a consequence of demerger or amalgamation of a company or a business re-organisation of a co-operative bank shall not be subject to tax by virtue of the provisions of section 56(2)(vii).

Meaning of “relative” for the purpose of section 56(2)(vii)

- (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 to above.
- (b) In case of Hindu Undivided Family, any member thereof.

(4) Other receipts chargeable under this head

Section	Provision
56(2)(viia)	<ul style="list-style-type: none"> (i) Transfer of shares of a company without consideration or for inadequate consideration would attract the provisions of section 56(2), if the recipient is a firm or a company. (ii) If such shares are received without consideration, the aggregate FMV on the date of transfer would be taxed as the income of the recipient firm or company, if it exceeds ₹ 50,000. (iii) If such shares are received for inadequate consideration, the difference between the aggregate FMV and the consideration would be taxed as the income of the recipient firm or company, if such difference exceeds ₹ 50,000.

	(iv)	However, the provisions of section 56(2)(viia) would not apply in the case of transfer of shares - (1) of a company in which the public are substantially interested; or (2) to a company in which the public are substantially interested.
56(2)(viib)		Consideration received in excess of FMV of shares issued by a closely held company to any person, being a resident, to be treated as income of such company, where shares are issued at a premium
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.
Deductions allowable [Section 57]		
S.No.	Particulars	Deduction
1.	In case of dividends (other than dividends u/s 115-O) or interest on securities	Any reasonable sum paid by way of commission or remuneration to a banker or any other person.
2.	Family Pension	Sum equal to - 33 ¹ / ₃₀ % of such income or - ₹ 15,000, whichever is less
3.	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 taxable in India as salaries, if it is payable outside India unless tax has been paid thereon or deducted at source.	
4.	Any payment to a relative or associate concern otherwise than by account payee cheque or draft, if the aggregate of such payments exceed ₹ 20,000 during a day	
5.	Income-tax and wealth-tax paid.	
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	

Question 1

State 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 ₹ 50,000 was received as per court decree in December 2016 by Mr. Yogesh. Out of the said amount, a sum of ₹ 35,000, relates to preceding financial years.
- (iii) Interest on enhanced compensation of ₹ 96,000 received on 12-3-2017 for acquisition of urban land, of which 40% relates to the earlier year.

Answer

S.No.	Taxable/Not Taxable	Amount liable to tax (₹)	Reason
(i)	Taxable	1,20,000	The exemption from applicability of section 56(2)(vii) would be available if, <i>inter alia</i> , 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)(vii).
(ii)	Taxable	25,000	As per section 56(2)(viii), interest on enhanced compensation is taxable in the year in which it is received. Deduction of 50% in respect of the said income is allowed under section 57(iv). Therefore, ₹ 25,000 (i.e., ₹ 50,000 – ₹ 25,000) is taxable in the hands of Mr. Yogesh in the F.Y.2016-17.
(iii)	Taxable	48,000	As per section 145A, 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. 2016-17 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".

Question 2

On 10.10.2016, 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 2011-12.

Out of this interest, ₹ 1,50,000 relates to the financial year 2013-14; ₹ 1,65,000 to the financial year 2014-15; and ₹ 1,85,000 to the financial year 2015-16. 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 for the assessment year 2017-18?

Answer

Section 145A 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 2017-18:

Particulars	₹
Interest on enhanced compensation taxable under section 56(2)(viii)	5,00,000
Less: Deduction under section 57(iv) (50% x ₹ 5,00,000)	<u>2,50,000</u>
Taxable interest on enhanced compensation	<u>2,50,000</u>

Question 3

The following details have been furnished by Mrs. Hemali pertaining to the year ended 31.3.2017 :

- (i) Cash gift of ₹ 51,000 received from her friend on the occasion of her "Shastipatha 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 lacs was presented by her sister living in Dubai.
- (iii) When she celebrated her daughter's wedding on 21.2.2017, 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 ₹ 51,000.

Compute the income, if any, assessable as income from other sources.

Answer

- (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)(vii) in the hands of Mrs. Hemali.

- (ii) The provisions of section 56(2)(vii) 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 is not taxable under section 56(2)(vii), even though jewellery falls within the definition of "property".

- (iii) To be exempt from applicability of section 56(2)(vii), 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)(vii), if the aggregate value exceeds ₹ 50,000 in a year. "Sum of money" has, however, not been defined under section 56(2)(vii).

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)(vii) 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 Shastipatha Poorthi.

As per the second view, the provisions of section 56(2)(vii) would also be attracted in respect of the fixed deposit assigned and the "Income from other sources" of Mrs. Hemali would be ₹ 1,02,000 (₹ 51,000 + ₹ 51,000).

Question 4

Decide the following transactions in the context of Income-tax Act, 1961:

- (i) *Mr. B transferred 500 shares of Reliance Industries Ltd. to M/s. B Co. (P) Ltd. on 10.10.2016 for ₹ 3,00,000 when the market price 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 cash gift of ₹ 1,00,000 from Atma Charitable Trust (registered under section 12AA) in December 2016 for meeting his medical expenses.*

Is the cash gift so received from the trust chargeable to tax in the hands of Mr. Chezian?

Answer

- (i) Transfer of shares without consideration or for inadequate consideration would attract the provisions of section 56(2)(viia), if the recipient is a firm or a company. The purpose of this provision is to prevent the practice of transferring unlisted shares at prices much below the fair market value.

The provisions of section 56(2)(viia) would, however, not be attracted in the case of, *inter alia*, transfer of shares of a company in which public are substantially interested. In this case, the shares of Reliance Industries Ltd. are transferred. Since Reliance Industries Ltd. is a company in which public are substantially interested, the provisions of section 56(2)(viia) would not be attracted in the hands of M/s. B Co. (P) Ltd.

The indexed cost of acquisition (₹ 4,45,000) less the actual sale consideration (₹ 3,00,000) would result in a long term capital loss of ₹ 1,45,000 in the hands of Mr. B, which is eligible for set off against any other long term capital gain.

- (ii) The provisions of section 56(2)(vii) would not apply to any sum of money or any property received from any trust or institution registered under section 12AA. Therefore, the cash gift of ₹ 1 lakh received from Atma Charitable Trust, being a trust registered under section 12AA, for meeting medical expenses would not be chargeable to tax under section 56(2)(vii) in the hands of Mr. Chezian.

Question 5

Check the taxability of the following gifts received by Mrs. Rashmi during the previous year 2016-17 and compute the taxable income from gifts for Assessment Year 2017-18:

- (i) *On the occasion of her marriage on 14.8.2016, she has received ₹ 90,000 as gift out of which ₹ 70,000 are from relatives and balance from friends.*
- (ii) *On 12.9.2016, she has received gift of ₹ 18,000 from cousin of her mother.*
- (iii) *A cell phone worth ₹ 21,000 is gifted by her friend on 15.8.2016.*
- (iv) *She gets a cash gift of ₹ 25,000 from the elder brother of her husband's grandfather on 25.10.2016.*
- (v) *She has received a cash gift of ₹ 12,000 from her friend on 14.4.2016.*

Answer

Computation of taxable income of Mrs. Rashmi from gifts for A.Y.2017-18

Sl. No.	Particulars	Taxable amount (₹)	Reason for taxability or otherwise of each gift
1.	Relatives and friends	Nil	Gifts received on the occasion of marriage are not taxable.
2.	Cousin of Mrs. Rashmi's mother	18,000	Cousin of Mrs. Rashmi's mother is not a relative. Hence, the cash gift is taxable.
3.	Friend	Nil	Cell phone is not included in the definition of property as per <i>Explanation</i> to section 56(2)(vii). Hence, it is not taxable.
4.	Elder brother of husband's grandfather	25,000	Brother of husband's grandfather is not a relative. Hence, the cash gift is taxable.
5.	Friend	<u>12,000</u>	Cash gift from friend is taxable.
Aggregate value of gifts		<u>55,000</u>	

Since the sum of money received by Mrs. Rashmi without consideration during the previous year 2016-17 exceeds ₹ 50,000, the whole of the amount is chargeable to tax under section 56(2)(vii) of the Income-tax Act, 1961.

Question 6

Smt. Laxmi reports the following transactions to you:

- Received cash gifts on the occasion of her marriage on 18-7-2016 of ₹ 1,20,000. It includes gift of ₹ 20,000 received from non-relatives.
- On 1-8-2016, being her birthday, she received a gift by means of cheque from her mother's maternal uncle, the amount being ₹ 40,000.
- On 1-12-2016 she acquired a vacant site from her friend for ₹ 1,05,000. The State stamp valuation authority fixed the value of site at ₹ 1,80,000 for stamp duty purpose.
- She bought 100 equity shares of a listed company from another friend for ₹ 60,000. The value of share in the stock exchange on the date of purchase was ₹ 1,15,000.

Determine the amounts chargeable to tax in the hands of Smt. Laxmi for the A.Y. 2017-18.

Your answer should be supported by reasons.

Answer

Computation of amount chargeable to tax in hands of Smt. Laxmi for A.Y. 2017-18

	Particulars	₹
(i)	Cash gift of ₹ 1,20,000 received on the occasion of her marriage is not	Nil

	taxable since gifts received by an individual on the occasion of marriage is excluded under section 56(2)(vii), even if the same are from non-relatives.	
(ii)	Even though mother's maternal uncle does not fall within the definition of "relative" under section 56(2)(vii), gift of ₹ 40,000 received from him by cheque is not chargeable to tax since the aggregate sum of money received by Smt. Laxmi without consideration from non-relatives (other than on the occasion of marriage) during the previous year 2016-17 does not exceed ₹ 50,000.	Nil
(iii)	Purchase of land for inadequate consideration on 1.12.2016 would attract the provisions of section 56(2)(vii). Where any immovable property is received for a consideration which is less than the stamp duty value of the property by an amount exceeding ₹ 50,000, the difference between the stamp duty value and consideration is chargeable to tax in the hands of Individual. Therefore, in the given case ₹ 75,000 is taxable in the hands of Smt. Laxmi.	75,000
(iv)	Since shares are included in the definition of "property" and difference between the purchase value and fair market value of shares is ₹ 55,000 (₹ 1,15,000 - ₹ 60,000) i.e. it exceeds ₹ 50,000, the difference would be taxable under section 56(2)(vii).	55,000
Amount chargeable to tax		1,30,000

Question 7

Discuss the taxability or otherwise in the hands of the recipients, as per the provisions of the Income-tax Act, 1961:

- (i) *ABC Private Limited, a closely held company, issued 10,000 shares at ₹ 130 per share. (The face value of the share is ₹ 100 per share and the fair market value of the share is ₹ 120 per share).*
- (ii) *Mr. A received an advance of ₹ 50,000 on 1-09-2016 against the sale of his house. However, due to non-payment of instalment in time, the contract has cancelled and the amount of ₹ 50,000 was forfeited.*
- (iii) *Mr. N, a member of his father's HUF, transferred a house property to the HUF without consideration. The value of the house is ₹ 10 lacs as per the Registrar of stamp duty.*
- (iv) *Mr. Kumar gifted a car to his sister's son (Sunil) for achieving good marks in CA Final exam. The fair market value of the car is ₹ 5,00,000.*

Answer

S. No.	Taxable/Not Taxable	Reason
(i)	Taxable	<p>Since ABC Private Limited, a closely held company, issued 10,000 shares at a premium (i.e., issue price exceeds the face value of shares), the excess of the issue price of the shares over the fair market value would be taxable under section 56(2)(viib) in its hands under the head "Income from other sources".</p> <p>Therefore, ₹ 1,00,000 $[10,000 \times ₹ 10 (₹ 130 - ₹ 120)]$ shall be taxable as income in the hands of ABC Private Limited under the head "Income from other sources".</p>
(ii)	Taxable	<p>Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset would be chargeable to tax under the head "Income from other sources", if such amount is forfeited and the negotiations do not result in transfer of such capital asset [Section 56(2)(ix)].</p> <p>Therefore, the amount of ₹ 50,000 received as advance would be chargeable to tax in the hands of Mr. A under the head "Income from other sources", since it is forfeited on account of cancellation of contract for transfer of house, being a capital asset, due to non-payment of installment in time.</p>
(iii)	Not Taxable	<p>As per section 56(2)(vii), immovable property received without consideration by a HUF from its relative is not taxable.</p> <p>In the present case, since Mr. N is a member of his father's HUF, he is a relative of the HUF. Hence, ₹ 10 lakhs, being the stamp duty value of house property received by HUF, without consideration, would not be chargeable to tax in the hands of the HUF.¹</p>
(iv)	Not Taxable	<p>Car is not included in the definition of "property", for the purpose of taxability under section 56(2)(vii), in the hands of the recipient under the head "Income from other sources". Further, the same has been received by Sunil from his mother's brother, who falls within the definition of "relative".</p> <p>Hence, ₹ 5,00,000, being the fair market value of car received without consideration from a relative is not taxable in the hands of Sunil, even though its value exceeds ₹ 50,000.</p>

¹ However, income from such asset would be included in the hands of Mr. N under section 64(2)

Question 8

State with proper reasons whether the following statements are True/False with regard to provisions of Income-tax Act, 1961:

- (i) "A" receives ₹ 2 lakh from his friends on the occasion of his marriage on 22.04.2016 and ₹ 1 lakh from the brother of his father-in-law on 31.12.2016. A's income includible under "other sources" for the previous year 2016-17 would be ₹ 3 lakh.
- (ii) Dividend received (on which no Dividend Distribution Tax has been paid) by a dealer in shares or one engaged in buying/selling of shares, is chargeable under the head "Income from other sources".

Answer

- (i) **False** : As per section 56(2)(vii), where any sum of money is received without consideration by an individual or a Hindu undivided family from any person or persons and the aggregate value of all such sums received during the previous year exceeds ₹ 50,000, the whole of the aggregate value of such sum shall be included in the total income of such individual or Hindu Undivided Family under the head "Income from other sources".

However, in order to avoid hardship in genuine cases, certain sums of money received have been exempted, which includes, *inter-alia*, any sum received on the occasion of the marriage of the individual and any sum received from any relative. As such, ₹ 2 lakh received from friends on the occasion of marriage is exempt.

However, brother of father-in-law is not included in the definition of relative. Hence, ₹ 1 lakh is taxable under the head "Income from other sources".

The statement that ₹ 3 lakh is includible in A's income is, therefore, false.

- (ii) **True**: By virtue of section 56(2)(i), dividend received [other than dividend in respect of which dividend distribution tax is paid by the company and hence, is exempt in the hands of recipients u/s 10(34)] is always taxable under the head "Income from other sources". Even if such dividend is received by a dealer in shares or one engaged in buying/selling of shares, the same would be taxable under the head "Income from other sources".

Note: In this content, it may be noted that section 115BBA brings to tax any income by way of aggregate dividend in excess of Rs. 10 lakhs in the hands of an individual, HUF or a firm, resident in India @ 10%.

Question 9

From the following particulars of Pankaj for the previous year ended 31st March, 2017, compute the income chargeable under the head "Income from other sources":

Sl. No.	Particulars	₹
(i)	Directors fee from a company	10,000

(ii)	Interest on bank deposits	3,000
(iii)	Income from undisclosed source	12,000
(iv)	Winnings from lotteries (Net)	35,000
(v)	Royalty on a book written by him	9,000
(vi)	Lectures in seminars	5,000
(vii)	Interest on loan given to a relative	7,000
(viii)	Interest on debentures of a company (listed in a recognised stock exchange) net of taxes	3,600
(ix)	Interest on Post Office Savings Bank Account	500
(x)	Interest on Government Securities	2,200
(xi)	Interest on Monthly Income Scheme of Post Office	33,000

He paid ₹ 1,000 for typing the manuscript of book written by him.

Answer

Computation of income of Pankaj chargeable under the head "Income from other sources" for the A.Y. 2017-18

Particulars	₹	₹
1. Directors' fees		10,000
2. Interest on bank deposit		3,000
3. Income from undisclosed source (taxable @ 30% u/s 115BBE)		12,000
4. Royalty on books written (See Note below)	9,000	
Less: expenses	<u>1,000</u>	8,000
5. Lectures in seminars		5,000
6. Interest on loan given to a relative		7,000
7. Interest on listed debentures		
Net Received	3,600	
Add: T.D.S. @ 10%		
$\frac{3600 \times 10}{100 - 10}$	<u>400</u>	4,000
8. Interest on Post Office Savings Bank [exempt under section 10(15)]		-
9. Interest on Government securities		2,200
10. Interest on Post Office Monthly Income Scheme		33,000
11. Winnings from lotteries (taxable @ 30% u/s 115BB)		

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Net	35,000	
Add: T.D.S. @ 30% $\left(\frac{35,000 \times 30}{100 - 30} \right)$	<u>15,000</u>	<u>50,000</u>
Income from Other Sources		<u>1,34,200</u>

Note : Royalty income would be chargeable to tax under the head "Income from Other Sources", only if it is not chargeable to tax under the head "Profits and gains of business or profession". This problem has been solved assuming that the same is not taxable under the head "Profits and gains of business or profession" and hence, is chargeable to tax under the head "Income from other sources".

Question 10

Rahul 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.

- Is the amount of loan taxable as deemed dividend in the hands of Rahul, if the company is a company in which the public are substantially interested?
- What would be your answer, if the lending company is a private limited company (i.e. a company in which the public are not substantially interested)?

Answer

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.

- 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 in the hands of Rahul.
- 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 manufacturing company and not a company where lending of money is a substantial part of the business of the company, then, the provisions of section 2(22)(e) would be attracted, since Rahul holds more than 10% of the equity shares in the company.

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 in the hands of Rahul would be limited to the accumulated profit i.e., ₹ 4,00,000 and not the amount of loan which is ₹ 5,00,000.

Question 11

When would the dividend income be taxed in the hands of a shareholder?

Answer

The provisions relating to the year of taxability of dividend are contained in section 8 of the Income-tax Act, 1961.

- (a) Any dividend declared by a company or distributed or paid by it within the meaning of section 2(22) shall be deemed to be the income of the previous year in which it is so declared, distributed or paid, as the case may be.
- (b) Any interim dividend shall be deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the member who is entitled to it.

Students may note that any dividend which is liable for dividend distribution tax covered by section 115-O (being a dividend declared by a domestic company) is exempt under section 10(34) and hence would not be chargeable to tax. However, dividend referred to in Section 2(22)(e) is not subject to dividend distribution tax in the hands of the domestic company under section 115-O, but would be chargeable to tax in the hands of the shareholder.

Question 12

How is "dividend stripping" enforced by section 94(7) of the Income-tax Act, 1961?

Answer

According to section 94(7), where :

- (a) any person buys or acquires any securities or units within a period of three months prior to the record date ; and
- (b) such person sells or transfers such securities within a period of three months after such record date or transfers such units within a period of nine months after such record date ; and
- (c) the dividend or income on such securities or units received or receivable by such person is exempt from tax,

then, the loss, if any, arising to him on account of such purchase and sale of securities or units, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or units, has to be ignored for the purposes of computing his income chargeable to tax.

Exercise

1. *Income from letting of machinery, plant and furniture is -*
 - (a). *always chargeable to tax under the head "Profits and gains of business and profession"*
 - (b). *always chargeable to tax under the head "Income from other sources"*
 - (c). *chargeable under the head "Income from other sources" only if not chargeable under the head "Profits and gains of business and profession".*

2. *In respect of winnings from lottery, crossword puzzle or race including horse race or card game etc.*
 - (a). *no deduction under Chapter VI-A is allowed and basic exemption limit cannot be exhausted.*
 - (b). *no deduction under Chapter VI-A but unexhausted basic exemption can be exhausted.*
 - (c). *Both deduction under Chapter VI-A and basic exemption are allowed.*
3. *The deduction allowable in respect of family pension taxable under "Income from other sources" is*
 - (a). *33-1/3% of the pension*
 - (b). *30% of the pension or ₹ 15,000, whichever is less*
 - (c). *33-1/3% of the pension or ₹ 15,000, whichever is less*
4. *Deemed dividend under section 2(22)(e) is chargeable to tax -*
 - (a). *On the basis of method of accounting regularly employed by the assessee*
 - (b). *On the basis of mercantile system of accounting only*
 - (c). *On payment basis as prescribed under section 8 of the Income-tax Act, 1961.*
5. *Ganesh received ₹ 60,000 from his friend on the occasion of his birthday.*
 - (a). *The entire amount of ₹ 60,000 is taxable.*
 - (b). *₹ 25,000 is taxable.*
 - (c). *The entire amount is exempt.*
6. *Write short notes on -*
 - (a). *Bond washing transactions*
 - (b). *Dividend stripping*
7. *State the incomes which are chargeable only under the head "Income from other sources".*
8. *Which are incomes chargeable under the head "Income from other sources" only if they are not chargeable under the head "Profits and gains of business or profession"?*
9. *What are the deductions allowable from the following income -*
 - (a). *Dividend*
 - (b). *Income from letting on hire machinery, plant or furniture.*
10. *What are the inadmissible deductions while computing income under the head "Income from other sources".*
11. *Karan's bank account shows the following deposits during the financial year 2016-17. Compute his total income for the A.Y. 2017-18, assuming that his income from house property (computed) is ₹ 62,000.*
 - (i) *Gift from his sister in Amsterdam* *₹ 2,30,000*

(ii)	<i>Gift from his friend on his birthday</i>	₹ 10,000
(iii)	<i>Dividend from shares of various Indian companies</i>	₹ 12,600
(iv)	<i>Gift from his mother's friend on his engagement</i>	₹ 25,000
(v)	<i>Gift from his fiancée</i>	₹ 75,000
(vi)	<i>Interest on bank deposits (Fixed Deposit)</i>	₹ 25,000

12. What are the deductions allowable under section 57 of the Income-tax Act, 1961 in respect of "Income from other sources"?

Answers

1. c; 2. a; 3. c; 4. c; 5. a; 11. ₹ 1,97,000