

TAXATION LAWS—I

INTRODUCTION TO INCOME TAX

LEARNING OBJECTIVES:

- To know about the Income Tax Act
- To know about the history of income tax act
- To know about various basic concepts used in Income tax Act
- To know about various objectives of income tax act

SCHEME OF INCOME TAX:

The present law of income tax is contained in the Income tax act, 1961 and the income tax rules, 1962 as amended up-to-date. It extends to the whole of India and came into force on 1st April 1962. Though Income tax is a central levy, its net proceeds are shared between both the Centre and the states except that any surcharge on income tax levied for the purpose of the Union accrues wholly to the Central Government, and is excluded from the divisible pool. Income tax plays an important role in the national economy and is also a valuable toll for achieving the socio-economic objectives.

IMPORTANCE:

The taxes levied by the government form a pool of resources to be used of the collective benefit of the public. The taxation is an exercise in the collective solution of individual problems. The state takes upon itself the duty of solving the problems of the underprivileged and need finance for this purpose. The government can mobilize resources by imposing taxes on the privileged ones.

The taxation structure of the country can play a very important role in the working of our economy. Some time back the emphasis was on higher rates of tax and more incentives. But recently the emphasize has shifted to decrease in rates of taxes and withdrawal of incentives. While designing the taxation structure it has to be seen that it is in conformity with our economic and social objectives. It should not impair the incentives to personal savings and investment flow and on the other hand it should not result into decrease in revenue for the state.

In our present day economic structure income tax plays a vital role as source of revenue and a measure of removal of economic disparity. Our taxation structure provides for two types of taxes direct and indirect; the income tax, wealth tax and gift tax are direct taxes where as sales tax and excise duties are indirect taxes.

HISTORY:

The income tax was introduced in India for the first time 1860 by British rulers following mutiny of 1857. the period between 1860 to 1886 was period of experiments in the context of income tax. This period ended in 1886 when first income tax act came into existence. The pattern laid down in it for levying of tax continues to operate even to day though in some changed form. In 1918 another act income tax act 1918 was passed but it was short lived and was replaced by income tax act 1922 and it remained in existence and operation till 31st March 1961.

PRESENT ACT:

On the recommendation of Law commission and Direct taxes enquiry committee and in consultation with law ministry a bill was framed. This bill was referred to a select committee and finally passed in September 1961. This act came into force from 1st April 1962 in whole of the country. Income tax act 1961 is comprehensive act and consists of 298 sections, sub sections running into thousands, schedules, rules and sub rules etc. and is supported by other acts and rules. This act has been amended by several amending acts since 1961. the annual finance bills presented to parliament along with budget make far reaching amendments in this act every year.

FUNDAMENTAL CONCEPTS:

ASSESSEE [SEC-2(7)]:

An assessee is a person who is liable to pay any sum under the Income tax act or in respect of whom the proceedings have been initiated under this act. It is not necessary that the income in respect of which a person is considered an assessee should be his own, that is a person can be a deemed assessee on some other person's income as well.

The following are the ingredients of the definition of an assessee:

Liability to pay tax or any other sum [sec.2 (7)]

The assessee means a person by whom any tax or any other sum of money is payable under this act. Any other sum includes a fine, an interest, a penalty or a surcharge on income tax.

Initiation of assessment proceedings [sec.2 (7)a]

The assessee includes every person in respect of whom any proceedings under this act has been initiated, irrespective of whether or not he is liable to pay tax or any other sum. Such proceedings may be (i) for the assessment of his income or for the income of any other person in respect of which he is assessable or (ii) for the loss sustained by him or by such other person or (iii) for the amount of refunds which is due to him or to any other person. Therefore, mere initiation of the assessment proceeding against a person makes him an assessee, even if he is not liable to pay any tax or any other sum.

Deemed Assessee [sec.2 (7b)]

The Deemed assessee is a person who has been treated as an assessee only by law. The deemed assessee is assessed on the income or loss of any other person. For example, the legal representative of the deceased the guardian of a minor, the agent of a non-resident and the trustee of a trust etc, are termed as deemed assessee.

Deemed to be an assessee in default [sec.2 (7c)]

A person is deemed to be an assessee in default if he does not comply with his statutory duty under the income tax act. For example, if any person who is required to deduct tax at source does not deduct it, or after having deducted, fails to pay it to the Central government, he is deemed to be an assessee by default in respect of the tax.

Person [sec.2 (31)]

The definition of a person under the Income tax act is very comprehensive and includes both a natural as well as an artificial or a judicial person. The incidence of tax rests on a person and only a person can be assessee. The term person includes the following:

Individual [Sec.2 (31)(i):

An individual is a natural person including male, female, major, minor or even a lunatic. However, the income of a minor or a lunatic can only be assessed in the hands of legal guardian or manager acting as deemed assessee.

HUF: Sec 2(31)(ii)

The expression Hindu undivided family is not defined by the income tax act. A joint family consists of all persons linearly descended from a common ancestor including their wives and unmarried daughters. A single person does not constitute a family which implies plurality of persons. All those who are governed by the provisions of the “HINDU” code are included in the term HINDU even though their religions may be different. Therefore, Jains and Sikhs are HINDUS for the purpose of Income tax law in the absence of any custom or usage to the contrary.

Company: [Sec.2 (31)(iii)]

In brief, a company means an Indian company incorporated under the companies act, 1956, or a corporation established under a central state or provincial act, or any corporate incorporated under the laws of a foreign country or any institution, association or body, whether incorporated or not whether Indian or foreign, declared by the board to be a company.

Firm: Sec.2 (31) iv:

Firm has the same meaning assigned to it by the Indian partnership act, 1932 .

Association of persons:

An association of persons is the one in which two or more persons join for a common purpose or common action with a view to produce income, profits or gains. The association need not necessarily be on the basis of a contract; consent and understanding may be presumed.

Body of Individuals: Sec.2 (31) v

Body of individuals means a conglomeration of individuals who carry on some activity with the object of earning income. The word body would require an association for some common purpose or there must be unity under some common tie or occupation. A mere collection of individuals without a common tie or common aim cannot be assumed to be a body of individuals.

Local authority: Sec.2 (31) vi

The term local is not defined by the act. The general clauses act, 1897 defines a local authority as a municipal committee, district board, body of port commissioners, or other authority legally entitled to or entrusted by the government.

Other artificial Judicial person: Sec.2(31)vii

It includes every artificial juridical person, not falling within any of the preceding sub-clauses. This is a residuary clause, an idol, deity, a university, guru granth sahib and trust etc, are covered under this clause.

Assessment year: [Sec.2 (9)]

The term assessment year means the period of 12 months commencing on the first day of April every year. Thus, the assessment year always begins on 1st April and ends on 31st March every year. This period is also known as the financial year.

Previous Year [sec. 3]

The year in which income is earned is termed as the previous year. Income tax is charged on the total income of the previous year, and the income earned during the previous year is assessed to tax at the rates and as per the provisions applicable for the assessment year relevant to the previous year. In other words, the income chargeable to tax in the assessment year is the one actually earned in the previous year.

Financial year to be the previous year [sec.3 (1)]:

It should be noted that financial year is the previous year for tax purpose only, and the assessee is free to follow an accounting year different from the financial year. However, if the assessee's accounting year is different from the financial year; he will still be required to maintain accounts for every financial year for the purpose of submitting the income tax returns.

Previous year for a new source of income:

Where a new source of income comes into being in a financial year either by way of set up of new business or profession or otherwise, the period of the first previous year will begin (i) with the date of setting up of the business or profession; or (ii) the date on which new source of income comes into existence and will end with the said financial year. Therefore, in such cases the first previous year may be less than 12 months.

Income [Sec.2 (24)]

The concept of income is very important as it is the income that is taxed under the income tax act. The definition of income under this act is a very wide and includes profits and gains, dividends, voluntary contributions, perquisites, allowances, discharge of an obligation, compensation receipts, profits on sale of license, cash assistance received against exports, recovery of loss or expenditure, recovery of bad debts, any wins from lottery, cross word puzzles, races, card games, gambling, betting etc.

Heads of Income: [sec.14]

For the purpose of charge of income tax, all incomes are classified under five heads of income, namely, Salaries, House property, profits and gains of business or profession, Capital gains and income from other sources.

Exempted Incomes [Sec.10 and Sec.86]

These incomes are either fully or partially exempted from income tax and therefore, to the extent of exemption, do not form a part of the total income and hence are not taxable.

Deductions from income:

Income tax act allows certain specific reductions to be made from the income of an assessee while computing the total income. These reductions are termed as deductions. Two type of deductions have been provided under the act, i.e. deductions from the specific heads of income and deductions from gross total income.

Gross total income [Sec.80B (5)]

The aggregate of net taxable income under various heads of income is termed as Gross total income. This aggregation is not a mathematical process but a legal concept. It is computed after allowing for the deductions specific to various heads of income, set off of losses and allowances or set off of carry forward losses and allowances and clubbing of income of any other person that may be liable to be included in assesses total income.

Total Income [Sec.2 (45)]

Total income, computed in accordance with sec.5 according to residential status, is arrived at after allowing deductions under Sec.80CCC to 80U from the gross total income. The charge of income tax is on total income of an assessee. Incomes exempted from income tax do not form a part of total income.

Computation of tax liability:

Income tax is a charge on total income of previous year and is calculated by applying rates of tax prescribed for the relevant assessment year to the total income of the previous year. The net tax liability is then computed by allowing any rebates of relief due to the assessee, adding the surcharge, education cess and giving credit for any tax paid in advance of deducted at source.

Rates of Income tax:

The rates of income tax are prescribed every year by the finance act which follows a combination of flat and slab rates for charging tax on total income.

Rebate [sec.87]

Rebate is a reduction allowed in the amount of income tax computed in case of certain types of assessee.

Relief from tax [sec.89]

Where an assessee receives arrears of salary or advance of salary or profits in lieu of salary during previous year and it becomes taxable during the same previous year by virtue of a provision of the income tax act there by causing the assessee to be taxed at a higher rate than he would otherwise have been assessed, relief may be allowed under Rule 21A from tax so computed at the higher rate. The act provides for the relief only in case of arrears of salary or salary received in advance or family pension.

Deduction v/s Rebates v/s Relief:

While the basic purpose of all the three is to benefit the assessee by reducing the incidence of tax, they differ greatly in the way they achieve their common objective and the conditions under which they pass on the relief. While the deductions reduce the amount of income chargeable to tax, rebates and relief reduces the amount of tax computed on the chargeable income.

Surcharge:

Surcharge is a charge levied on the amount of income tax computed under the act. This is levied by the government to raise revenue for special purpose for the union and accrues wholly to the central government. In simple terms surcharge is tax on income tax.

Surcharge v/s Income tax:

Income tax is a charge on total income while surcharge is a levy on income tax. First, income tax is computed on total income at prescribed rates and then surcharge is worked out on the amount of income tax so computed to arrive at the total tax liability.

Education and SHEC:

Education cess and secondary and higher education cess are levied on the aggregate of income tax and surcharge. These are fully assigned to the central government to enable it to finance universalized basic education.

Income tax v/s surcharge v/s Education cess:

Income tax is levied on total income. Surcharge is levied on income tax. Education cess and SHEC are charged on the aggregate of income tax and surcharge.

SETTLEMENT OF TAX LIABILITY:

An assessee is required to file his return of income and deposit the tax with the authorities within the prescribed time, failing which the act provides wide ranging power for recovery of tax besides the fines and penalties for late payment.

Advance tax:

Where the tax liability of the assessee is Rs.5,000 or more, provisions have been enacted to spread the payment of tax in three or four installments. This also eases the cash flow for the assessee by allowing him to pay in installments. Advance tax is payable during any financial year on the estimated total income that would be chargeable to tax in the immediately following assessment year.

Tax at source:

Deduction of tax at source is a method of collection tax whereby it is obligatory for certain persons to deduct tax, surcharge and education cess at prescribed rates from certain type of payments and deposit the tax so deducted with the authorities to the credit of the person from whose payment it was deducted. Therefore, it is a tax on income at its very source deducted by the payer and deposited to the government on behalf of the person earning that income. An assessee can claim credit for any tax deducted at source from his income during the previous year.

Advance tax v/s tax at source:

The primary difference between the two is that while the onus to pay advance tax is on the assessee himself, the responsibility for deducting and paying tax at source lies with the person making the payment which is liable to be taxed at source. Tax deduction at source is particularly helpful in ensuring tax revenue from individuals and small unregistered entities who otherwise may not disclose these incomes.

Refunds: where on completion of the assessment, it is determined that the amount of tax paid by the assessee is in excess of what was actually due from him, the excess so paid by the assessee is termed as refund and is due back to him from the government.

CONCEPT OF INCOME:

The concept of income is central to the Income tax as it is the income that is taxed by it. Anything, which can be defined as income is taxable unless specifically exempted from tax. On the other hand, a receipt that cannot be termed as income, cannot be assessed.

WIDE SCOPE OF THE AMBIT OF INCOME:

The Income tax Act u/s 2(24) specifically includes 26 types of receipts or benefits to be considered as income. This act also specifies various other national items which are also deemed as income for the tax purposes. Since, the definition of income under this act is an inclusive definition, items not specifically defined as income or deemed as income by the act will have to be evaluated according to the natural expression of a very elastic ambit and it is difficult to confine its scope to the boundaries of any precise definition. All relevant circumstances under which a receipt or benefit accrues to a person needs to be taken into consideration in determining if it can be dubbed as income.

Income under the act is distinct from an accountant's concept of income:

For the purpose of income tax, income is computed with reference to provisions of the income tax act. Account books of an assessee may form an important starting point to compute assessable income under the act but cannot be determinative of taxable income.

ITEMS SPECIFICALLY DEFINED AS INCOME:

The income tax has adopted twin phraseology to specify the items which will be assessable to income tax. First, it includes a list of items in the definition of income and second, it has coined many deeming provisions to bring also the notional receipts within the ambit of definition of income.

DEFINITION OF INCOME [SEC.2 (24)]:

The act has specifically included the following 24 types of receipts and benefits as income:

- i. Profits and gains
- ii. Dividends
- iii. Voluntary contributions received by a trust of institution, created wholly or partly for charitable or religious purpose, or scientific research association, sport association or any fund or institution/any trust or institution wholly for public religious/charitable purposes and notified by the central government or any university/educational institution or hospital/other medical institution approved by the prescribed authority.
- iv. The value of any perquisite or profits in lieu of salaries
- v. Any special allowance or benefit specifically granted to the assessee to meet his expenses wholly and necessarily and exclusively for the performance of his duties.
- vi. Any allowance granted to the assessee either to meet his personal expenses at the place where he performs his duties or to compensate him for the increased cost of living.
- vii. Perquisite or benefit received by a director, relative of a director or a substantially interested person: The value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or a person substantially interested or by a relative of director or such person

- viii. Discharge by a company of an obligation of director, relative of a director or a substantially interested person; any sum paid by company in respect of any obligation which, but for such payment, would have been payable by any of the three individuals stated in (vii)
- ix. Benefit or perquisite obtained by a representative assessee: The value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee or beneficiary. Further, any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary is also an income. It is operative from the assessment year 1980-81 and subsequent years.
- x. Compensation receipts: any compensation due to or received by any person, by whatever name called, who is managing the affairs of any company in India, for the termination of his managing agency or for the modification of the terms and conditions relating thereto.
- xi. Income of trade or professional association from specific services to members: Income derived by a trade, professional or similar association from specific services performed for its members.
- xii. Cash assistance received or receivable by any person against exports under any scheme of the government of India.
- xiii. Any duty or excise drawback or custom or excise repaid or repayable as a drawback to any person against exports under the custom and central excise duties drawback rules.
- xiv. The value of any benefit or perquisite from business or profession, whether convertible into money or not, arising from business or the exercise of a profession.
- xv. Any remuneration chargeable under Sec.28(V)
- xvi. Any recovery in respect of loss or expenditure which was allowed to be deducted in any year
- xvii. Excess of sale proceeds of a scientific research asset over its amortized value to the extent of deduction allowed.
- xviii. Any recovery in respect of a debt which was allowed as a bad debt

- xix. Any profits and gains chargeable under section 45
- xx. The profits and gains of any business of insurance carried on by a mutual insurance company or by a cooperative society.

DEEMED INCOMES: [SEC.23 (2)]

Income tax act has enacted many deeming provisions to bring into tax net notional or fictional incomes which, but for such provisions, would not be assessable as income.

1. income from self occupied house
2. presumptive incomes under sec.44D
3. unexplained cash credits
4. unrecorded and unexplained investments
5. unexplained expenditure
6. amount borrowed or repaid on hundi otherwise by way of an account payee cheques.

INCOME EXEMPT FROM TAX:

Income tax act provides a scheme of exemptions, deductions and tax rebates. Incomes fully exempt from income tax do not form part of the total income at all. Incomes partly exempt from tax are to be included in the total income only to the extent to which they are in excess of the quantum of exemption available. Incomes for which deductions have been specified by the act are also liable to be included in the gross total income, but a deduction is allowed to the extent of the quantum specified. Similarly, incomes which are entitled to rebate or relief from tax are basically included in the total income only for the purpose of determining the gross tax liability and a rebate from the gross tax liability is then allowed in the manner specified. Rebate able incomes are therefore included in the total income only for determining the slab rate of tax applicable to the assessee.

Agricultural Income [Sec.10 (1)]

Agricultural income is exempt from income tax. However, it is included in the total income only for the purpose of determining the slab rate of tax applicable to the assessee.

Exemption for certain “salary incomes”

The following incomes falling under the head salaries are exempt from tax subject to certain conditions:

1. Leave travel concession or assistance to employees
2. Allowances or perquisites to government employees serving abroad
3. Death cum retirement gratuity
4. Commuted value of pension
5. Encashment of earned leave by retiring employees
6. Retrenchment compensation to workmen
7. Compensation received by an employee on his voluntary retirement or termination of his service
8. Tax paid by an employer on the value of non monetary perquisite provided by him under section 17 (2)
9. payment of statutory provident fund
10. payment from recognized provident fund
11. House rent allowance
12. Payment from approved superannuation fund
13. special allowance to reimburse expenses incurred by an employee in the performance of official duties or to compensate him for personal expenses incurred at the place of his posting or residence or to compensate him for the increased cost of living.

RECEIPTS BY MEMBERS FROM HUF:

Any sum received by an assessee in his capacity as member of an HUF is exempt from tax to avoid double taxation as HUF is also assessable separately on its income in its own capacity.

The sum should be received in the capacity as a member of the HUF: If the recipient is not a member of HUF, he cannot claim the exemption.

The sum should be received wither out of the income of the HUF, or out of the income of impartible estate, owned by the HUF.

Share of profits from partnership firm:

Where any person is a partner in a firm, his share of profit in the total income of the firm is exempt from tax. The share of profit of a partners in the total of the firm is to be computed by dividing the total income of the firm in profit sharing ratio specified in the partnership deed.

No partner will pay tax on the share of his income from a firm. Share of income from the firm is exempt in the hands of partner. Share of loss from the firm cannot be set off by partners against their personal income. The share of loss from a source, the income of which is exempt from tax, cannot be set off against any taxable income from any other source.

Interest or premium accruing to non-residents:

In the case of a non-resident the following incomes are exempt:

Any income from interest on securities and bonds notified by the central government prior to 1st June 2002 is exempt. Any income from premium on the redemption of such bonds as aforesaid is also exempt. Any interest on moneys standing under non-resident (external) account in any bank in India is exempt, such account can be maintained only by individuals, resident outside India of the foreign exchange regulation act, 1973.

Interest from notified savings certificates to a non-resident Indian citizen or non-resident POI [sec.10 (4B)]

Any income from interest on savings certificates issued before 1st June 2002 by the central government and notified by it is fully exempt, provided the following conditions are satisfied:

- a) Assessee is a non-resident Indian citizen or a non-resident foreign national of Indian origin. Therefore, a non-resident individual who is neither an Indian citizen nor a person of Indian origin cannot avail this exemption.
- b) Certificate should be subscribed in foreign currency remitted from outside India in accordance with foreign exchange regulation act 1973. if the certificates are subscribed from foreign currency not remitted from out side India or in violation of FERA, the exemption cannot be availed.

Exemption to foreign citizens [sec.10 (6)]

The following exemptions are provided to individuals who are not citizens of India.

Remuneration of diplomatic personnel of foreign countries [sec.10 (6) ii]

The remuneration received by a foreign citizen as an official of an embassy, high commission, legation, commission, consulate or the trade representative of a foreign state or as member of staff of any of these officials for services in such capacity is exempt subject to the following conditions.

Remuneration of trade commissioner or official representative of a foreign government is exempt only on reciprocal basis, ie, only if the corresponding official of Indian government posted in that country enjoys a similar exemption.

Remuneration of an employee of a foreign enterprise [sec.10 (6) vi]

The remuneration received by such individual as an employee of a foreign enterprise for services rendered by him during his stay in India may be exempt if the following conditions are fulfilled.

CONDITIONS:

- a) The foreign enterprise is not engaged in any trade or business in India
- b) His stay in India does not exceed in aggregate a period of 90 days in such previous year
- c) Such remuneration is not liable to be deducted from the income of the employer chargeable under this act.

Salary of Non-resident foreign crew of a foreign ship [Sec.10 (6) viii]

Any income chargeable under the head 'salaries' received by or due to an individual, who is not a citizen of India and also not-resident in India, as remuneration for services rendered in connection with his employment on a foreign ship is exempt, provided his total stay in India does not exceed in the aggregate 90 days in the previous year.

Remuneration of foreign government employee in connection with his training in India at specified undertakings [Sec.10 (6) xi]

Remuneration received by non-Indian citizen employee of a foreign state during his stay in India in connection with his training is exempt.

Establishment for training: The training may be imparted in any establishment or office of, or in any undertaking owned by;

- a) The government or
- b) Any company in which the entire paid up share capital is held by the central government or any state government, partly by the central government and partly by one or more state government; or
- c) Any company which is the subsidiary of a company referred to in item (b) or
- d) Any corporation established by or under a central, state, or provincial act, or
- e) Any society registered under the society's registration act 1860 or under any other corresponding law for the time being in force and wholly financed by the central government or any state government or partly by the central government and partly by one or more state government.

Tax on Royalty or technical service fee payable to a foreign company [sec10 (6A)]

When a foreign company derives any royalty or fees for technical services from government or an Indian concern and the tax on such income is payable by the government or an Indian concern, the tax so paid is not to be treated as income of the foreign company.

Remuneration of an individual in connection with technical assistance programme:

Where an individual is assigned duties in India in connection with any technical assistance programme and project in accordance with an agreement entered into by the central government and an international organization, the following incomes are exempt:

- a) Any remuneration received by the individual, directly or indirectly, from approved non-resident consultant. The individual may or may not be an employee of the consultant.
- b) Any other income of such individual which accrues or arises outside India but not deemed to accrue or arise in India, in respect of which such individual is required to pay any income or social security tax to the country of his origin is also exempt subject to the following conditions:
 - i) the individual is an employee of the consultant
 - ii) the individual is either not a citizen of India or being a citizen of India is not ordinarily resident in India
 - iii) the contract of service of such individual is approved by the prescribed authority before commencement of his service.

Payment under Bhopal gas leak disaster [Sec.10 (10BB)]

Where any payment is made to a person under the Bhopal gas leak disaster act 1985, and any scheme framed there under, it fully exempt from income tax. However, where the assessee has been allowed a deduction in respect of such payment under the act on account of any loss or damage caused to him by such disaster, it will not be exempted.

SECTION----A

- (a) Define Income.
- (b) What is Agricultural income?
- (c) Who is a person?
- (d) State the heads of Income?
- (e) What is Gross total income?
- (f) What is total income?
- (g) What are exempted incomes?

SECTION----B

- a. Explain various exempted incomes under section 10 of the Income tax act?
- b. Explain the following: Income, Gross total income, total income, advance tax.

CHAPTER -----2

RESIDENTIAL STATUS AND SCOPE OF TOTAL INCOME:

Residential status of an assessee refers to his presence in India during the previous year in accordance with the provisions of Sec.6 of the Income tax act. Such presence may either be as a physical stay in India for a specified period or by virtue of the control and management of its affairs being exercised in India. Accordingly, an assessee may be a resident or non-resident in India during the previous year. A resident individual and resident HUF are further sub-classified as resident and ordinarily resident or resident but not ordinarily resident. Residential status of an assessee on his total world's income and lowest on a non-resident who is assessed only in respect of his India's income.

Residential status v/s scope of total income v/s tax liability:

Income tax liability arises on the total income of an assessee. The scope of total income is greatly influenced by the residential status of an assessee, the country of citizenship is of no consequence. For example, a person resident in India to pay income tax on his total world income. On the other hand, citizen of India, non-resident in India, a foreign national non-resident in India, is liable to income tax only on his Indian income.

RESIDENTIAL STATUS:

The following general rules must be kept in mind while determining the residential status of assessee:

1. **RESIDENTIAL STATUS IS DETERMINED SEPARATELY FOR EACH PREVIOUS YEAR:** Residential status may differ from year to year. In one year the assessee may be resident while in another year he may be non-resident.
2. **RESIDENTIAL STATUS IS ALWAYS DETERMINED FOR THE PREVIOUS YEAR:** Residential status of an assessee in the assessment year is immaterial for tax purposes.
3. **DIFFERENT RESIDENTIAL STATUS FOR DIFFERENT SOURCES OF INCOME NOT PERMISSIBLE:** If a person is resident in India in a previous year in respect of any source of income, he is deemed to be resident in India in respect of each of his other sources of income as well.

RESIDENTIAL STATUS OF AN INDIVIDUAL [SEC.6(1)(6)a]:

An individual may be resident and ordinarily resident, or resident but not ordinarily resident, or non-resident. The specific conditions defined by the act to determine residential status of an individual are given as follows:

CONDITIONS OF PART A: BASIC CONDITIONS TO MAKE AN INDIVIDUAL “RESIDENT” IN INDIA.

- a) Stay in India for a period or periods of 182 days or more during the previous year
or
- b) i. Stay in India for a period of 60 days or more during the previous year and
ii. Stay in India for a period or periods of 365 days or more out of 4 years immediately preceding the previous year.

1. RESIDENT: If any one of the conditions a or b of Part A is satisfied, such individual is resident in India during that previous year. There after, additional conditions of Part B needs to be applied to determine if he is resident and ordinarily resident or resident but not ordinarily resident.

2. Non-resident: If none of the conditions of Part A are satisfied, such individual is non-resident in India during that previous year.

EXCEPTION: The period of 60 days or more in (b) (i) is extended to 182 days or more in the case of:

- i. An Indian citizen, leaving overseas for employment or as a crew of an Indian ship
- ii. An Indian citizen or person of Indian origin, outside India, visiting India during the previous year.

CONDITIONS OF PART B: Additional conditions for determining if a “Resident individual” is Resident but not-ordinarily resident” in India during the previous year.

(a) RESIDENT BUT ORDINARILY RESIDENT:

If both the following conditions are satisfied, a resident individual is classified as “Resident and ordinarily resident”:

- i. He has been a resident in India for 2 or more years out of 10 preceding the previous year; and
- ii. He has been in India for 730 days or more out of 7 years preceding the previous year.

(b) Resident but not ordinarily resident:

If any one of the following conditions is satisfied, a resident individual is classified as “Resident but not ordinarily resident”:

- i. He has been a Non-resident in India in 9 out of 10 years preceding the previous year; or
- ii. He has been in India for 729 days or less out of 7 years preceding the previous year.

The place of stay or the purpose of stay is immaterial: It is not essential that an assessee should stay at the same place during this period. He may go from place to place or from house to house or from hotel to hotel. Similarly, the purpose of the visit is of no

relevance. It may be that he come on business or to visit his relatives or to obtain medical advice or he simply visits India for pleasure.

Stay in India need not be continuous: The stay of 182 days or more may not be continuous. It is sufficient if it is for a minimum period of 182 days in aggregate. The calculation of 182 days in respect of such broken days should be made on an hourly basis. A total of 24 hours of stay spread over two or more days is to be counted as equivalent to the stay of one day.

The days of entry and exit, both should be taken into account for determining the period of stay. In counting the period of stay in India, the days of entry and exit, both should be taken into account. In absence of the details of hourly stay of the assessee, the entry and exit days are taken as full days in counting.

The visit to India during the four preceding years might be regular or irregular:

Regularity of visits to India is not essential. The individual may come to India every year for a definite duration so that his minimum stay is 365 days in the preceding 4 years or he might have stayed in India for a full year in the first year and there being a complete gap in remaining three years.

INCOME WHICH ACCRUE OR ARISE OUTSIDE INDIA [SEC.5]

Where the assessee is “not ordinarily resident” income accruing or arising outside India in the previous year is taxable only if such income is earned from a business controlled in India or from a profession set up in India. If such income is earned from any other source, eg. House property or capital gains or other sources, etc, it is not taxable.

The chargeability of foreign income is in the following table:

Income which accrues or arises outside India from	R.O.R.	R.BUT NOT O.R.	NON-RESIDENT
1. Business controlled in India	Taxable	Taxable	Not taxable
2. controlled out side India	Taxable	Not taxable	Not taxable
2. Profession:			
Set up in India	Taxable	Taxable	Not taxable
Set up out side India	Taxable	Not taxable	Not taxable
3. any other:			
Irrespective of the place of control	Taxable	Not taxable	Not taxable

Meaning of “Profession set up in India”:

Profession set up in India would imply that it was started in India and later on extended to foreign countries. The expression “controlled in India” would imply that the head and brain who directs the business activities is situated in India.

Mere entry in balance sheet of a foreign income does not in itself amount to receipt in India:

Income accruing or arising outside India is not deemed to be received in India because of the fact that it is taken into account in a balance sheet prepared in India. Thus, where the profits of a foreign branch, not received in India, are incorporated in the account books of head office in India, the incorporation of entries in the books of account do not amount to receipts of such profits in India. If such foreign profits (not received in India) are taken not only in accounts books but are also taken in determining the amount to be paid as dividend, it does not amount to receipt of foreign profits in India. Similarly, the fact that the foreign profits are distributed among the partners in a firm’s account in India does not by itself amount to receipt of the profit in India.

PROBLEMS:

Mr. Krishna discloses following particulars of his receipts during the financial year 2008-09:

PARTICULARS	AMOUNT
i. Salary income earned at Delhi, but received in Paris	1,50,000
ii. Profits earned from a business in Paris which is controlled in India, half of the profits being received in India	1,20,000
iii. Income from property, situated in England and received there	25,000
iv. Income from agriculture in Nepal and brought to India	48,000
v. Dividend paid by an Indian company but received in London	22,000
vi. Interest on USA development bonds and one half of which was received in India	24,000
vii. Past foreign untaxed income brought to India	2,10,000
viii. Gift of \$ 1,000 from father, settled in USA, received in India	40,000
ix. Land sold in Delhi, consideration received in Ceylon, resulting into capital gain	50,000
x. Income from structure designing consultancy service, set up in Germany, controlled from India, profits being received outside India	4,00,000
xi. Loss from foreign business, controlled from India, sales being received in India	(-2,00,000)

Determine his taxable income for the previous year 2008-09 if he is Resident and ordinarily resident, resident but not ordinarily resident, non-resident.

SOLUTION:

PARTICULARS OF INCOME	R.O.R	R.BUT NOT O.R.	NON-RESIDENT
Salary earned at Delhi but received at Paris	1,50,000	1,50,000	1,50,000

Profits earned from a business in Paris, controlled in India a. One half of profits are taxable on receipt basis b. other half profits	60,000	60,000	60,000
	60,000	60,000	60,000
Income from property in England and received in India	25,000	-----	-----
Income from agriculture in Nepal and brought to India:	48,000	-----	-----
Dividend paid by an Indian company but received in London	-----	-----	-----
Interest on USA development bonds: a. One half is taxable on receipt basis	12,000	12,000	12,000
b. other half is taxable only in case of "ordinarily resident as it is foreign income accruing or arising outside India	12,000	-----	-----
Past untaxed foreign income brought to India. It is not income in India. Further more, it is not the income of previous year 2008-09. Hence, it is not taxable in any case	-----	-----	-----
Gift from a relative not taxable	-----	-----	-----
Capital gain is deemed to accrue or arise in India	50,000	50,000	50,000
Income from consultancy profession, set up outside India, profit being received outside India	4,00,000	-----	-----
Loss from foreign business, controlled from India	-2,00,000	-2,00,000	-2,00,000
TOTAL INCOME	6,17,000	1,32,000	72,000

PROBLEM 2:

Mr. Gopal, an Indian citizen, earns the following income during the financial year 2008-09.

PARTICULARS	AMOUNT
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i.	Profits from a business in Mumbai managed from London	4,20,000
ii.	Pension for services rendered in Canada, but kept with state Bank in Canada with the permission of the RBI	60,000
iii.	Income from property in Pakistan, received in India	58,000
iv.	Profits from business in Bangladesh and deposited in a bank there	1,12,000
v.	Income received in Kenya from a profession, which was set up in India, extended to Kenya and managed from Kenya	70,000
vi.	Profit on sale of machinery in India but received in France	26,000
vii.	Profits, before allowing depreciation, from business in Iran, 40% of profits were received in India	2,00,000
	Total Depreciation	2,50,000
viii.	Interest on foreign bank deposit, received by his minor son in India. Bank deposit was made out of funds gifted by grandfather	70,000
ix.	A German company credited commission to his bank account outside India for sale of goods by him in India	1,75,000
x.	Commission earned and received by him outside India for sale of goods by him in India	2,30,000
xi.	Dividends remitted in India by an Egyptian company to him under his instruction through bank of Baroda	80,000

Determine his taxable income for the previous year 2008-09, if he is ROR, NOR, NR.

SOLUTION:

PARTICULARS OF INCOME	ROR	NOR	NR
i. Profits from a business at Mumbai, managed from London	4,20,000	4,20,000	4,20,000
ii. Pension for services rendered in Canada, received there	60,000	-----	-----
iii. Rent of house property, situated in Pakistan but received in India	58,000	58,000	58,000
iv. Profits from business in	1,12,000	-----	-----

Bangladesh and deposited in bank there			
v. Income from profession in Kenya which was set up in India, received there, managed from there.	70,000	70,000	-----
vi. Profit on sale of machinery in India but received in France	26,000	26,000	26,000
vii. Profit from foreign business:	2,00,000	80,000	80,000
Depreciation of foreign business	-2,50,000	-1,00,000	-1,00,000
viii. Income of a minor child is included in total income of that parent whose income, before including such income is greater, however, an exemption up to Rs.1,500 is to be allowed	68,500	68,500	68,500
ix. Commission from German company received outside India is deemed to accrue or arise in India because of business connection in India.	1,75,000	1,75,000	1,75,000
x. Commission earned and received outside India on export orders collected in India is deemed to accrue or arise in India	2,30,000	2,30,000	2,30,000
xi. Dividends from foreign company received outside India	80,000	-----	-----

PROBLEM 3:

Mrs.Sowmya discloses the following particulars of his income during the previous year 2008-09.

PARTICULARS	AMOUNT (RS.)
i. Dividends from Sri Lanka companies received in India,	2,00,000

Dividends were received partly in cash and partly in shares. Face value of shares is Rs.80,000 but their market value is Rs.1,20,000. However, currently there is no buyer in the market	
ii. Pension remitted to him in India by Sri Lankan government after deduction of tax source Rs.5,000	70,000
iii. Fees received in Sri Lanka for arguing a patent case in Delhi High court on behalf of a fellow lawyer friend of Mumbai	1,00,000
iv. Commission credited to his account in India under his instructions by law firms in India, for referring clients from outside India but commission was received in Myanmar	1,20,000
v. State of income from his HUF, received in Kolkata	50,000
vi. Income from law practice in Myanmar and Sri Lanka received there but practice was set up in Delhi	4,80,000
vii. 5% commission for the year 2008-09 from publishers of law books on their annual profits, received in India, commission has been paid after setting off Rs.30,000 for books purchased by him. He has purchased the dealership rights from Mumbai law house on 1 st January 2009.	1,20,000
viii. Gift from a foreign client, received outside India	20,000

Determine his total income for the previous year 2008-09 if his residential status during the previous year is ROR, NOR OR NR.

SOLUTION: COMPUTATION OF TOTAL INCOME FOR AY

PARTICULARS	ROR	NOR	NR
Dividend received in India	-----	-----	-----
a. Cash dividend 1,20,000			
b. dividend in kind 1,20,000			
Pension received outside India and not deemed to accrue or arise in India	70,000	-----	-----
Fees for arguing patent case in Delhi, but received in Ceylon—Income from	1,00,000	1,00,000	1,00,000

business connection deemed to accrue or arise in India			
Commission credited to the account of payee under his instruction in the books of payer is a deemed receipt	1,20,000	1,20,000	1,20,000
Share of income received from HUF exempt from tax	-----	-----	-----
Income from profession set up in India, extended outside India: Income being received outside India	4,80,000	4,80,000	4,80,000
Commission on account of dealership rights, received in India @ 5% of annual profits of the publishers: Commission not be apportioned between seller and purchaser on time basis	1,50,000	1,50,000	1,50,000
Gift from a foreigner client, received outside India	20,000	-----	-----
TOTAL	11,80,000	10,90,000	6,10,000

PROBLEM 4:

Mr.J, a Japanese national discloses the following particulars of his income during financial year 2008-09.

PARTICULARS	AMOUNT
Income from house property in Japan, remitted by tenant to him in India through SBI	1,00,000
Loss from business in India	-5,00,000
Profits from speculation business in India	2,00,000
Interest received on bonds of Indian companies outside India	45,000
Net dividends received from Japanese companies outside India (tax deducted at source Rs.15,000)	1,35,000
Interest received on compensation of land, acquired by government of India during the financial year 2002-03	60,000

Profit from business in Japan, controlled and managed from India but profits being received in Japan	10,00,000
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Determine his total income for the previous year in the following cases ROR, NOR AND NR.

COMPUTATION OF TOTL INCOME FOR AY

PARTICULARS	ROR	NOR	NR
Income from house property in Japan received in India	1,00,000	1,00,000	1,00,000
Loss from business in India to be set off against business profits and thereafter against any other income except salary income and winnings from lotteries/horse race etc.	-5,00,000	-5,00,000	-5,00,000
Profits from speculation business in India	2,00,000	2,00,000	2,00,000
Profits from business in Japan, Rs.10,00,000 received outside India, control and management of foreign business in India is not relevant in the case of non-resident	10,00,000	10,00,000	-----
Interest on public sector companies in India deemed to accrue or arise in India though received outside India	45,000	45,000	45,000
Dividends received from Japanese companies outside India not accruing or deemed to accrue or arise in India	1,35,000	-----	-----
Interest for land compensation taxable on accrual basis (60,000/6=10,000)	10,000	10,000	10,000
TOTAL INCOME	9,90,000	8,55,000	-1,45,000

Note: Non-resident is entitled to carry forward business loss of Rs.1,45,000 for next 8 assessment years.

PROBLEM—5:

The following amounts of income have been computed for MR.Ram chand for the previous year ended on 31st March.

Salary accrued and received in India	25,000
Profit from hotel business in Japan	50,000
Dividends declared in Japan received in India	10,000
Gain from transfer of capital asset in India	25,000
Interest on debentures of a company in New York received in India	7,000
Royalty received in Germany from a resident in India for technical services provided for a business in Germany	20,000
Interest received in UK from Robert, non-resident, on loan provided to him for business in India	6,000
Fees from an Indian company carrying on business in the UK for technical services rendered in London, directly deposited in his bank account in India	25,000

Compute the total income of Mr. Ram for the relevant assessment year if he is ROR, NOR AND NR.

COMPUTATION OF TOTAL INCOME OF MR.RAM FOR THE AY 2009-10.

PARTICULARS	ROR	NOR	NR
Salary accrued and received in India	25,000	25,000	25,000
Profit from hotel business in Japan	50,000	-----	-----
Dividends declared in Japan received in India	10,000	10,000	10,000
Gains from transfer of capital asset in India deemed to accrue or arise in India	25,000	25,000	25,000
Interest on debentures of a company in New York but received in India	7,000	7,000	7,000
Royalty received in Germany from a resident in India for technical services provided for a business in Germany	20,000	-----	-----
Interest received in UK from Mr. Robert, a	6,000	6,000	6,000

non-resident, on loan provided on loan provided to him for business in India			
Fees from an Indian company, carrying on business in UK for technical services rendered in London, directly deposited in his book account in India	25,000	25,000	25,000
TOTAL INCOME	1,68,000	98,000	98,000

PROBLEM 6:

Mr.X furnishes the following particulars of his income earned during previous year ended on 31st March 2009:

- i. Income from agriculture in Bangladesh, received there Rs.3,80,000 but later on remitted in India.
- ii. Interest on Pakistani development bonds, Rs.60,000, one sixth of which received in India
- iii. Gift of Rs.70,000 received in foreign currency from a relative in India
- iv. Arrears of salary Rs.1,50,000 received in Pakistan from a former employer in India
- v. Income from property received outside India Rs.3,00,000 (Rs.1,00,000 is used in Bahrain for the educational expenses of his son in Bahrain, and Rs.2,00,000 later on remitted to India)
- vi. Income from business in Iran which is controlled from India (Rs.1,00,000 being received in India) Rs.2,00,000
- vii. Untaxed profit for the previous years brought to India in July 2008 2,50,000
- viii. Dividends received on 30-06-2008 outside India from an Indian company Rs.2,50,000.
- ix. Profit (computed) on sale of building in India received in Pakistan Rs.21,00,000.
- x. Profit from business in Kolkata managed from outside India Rs.90,000, 60% of which is received outside India

Find out Gross total income of Mr.X for AY if he is ROR, NOR, NR.

COMPUTATION OF GROSS TOTAL INCOME FOR AY 2009-10.

PARTICULARS	ROR	NOR	NR
Income from agriculture in Bangladesh, received there but later on remitted to India	3,80,000	-----	-----
Interest on Pakistan development bonds 1/6 of Rs.60,000 being received in India	10,000	10,000	10,000
5/6 of Rs.60,000 being received in Pakistan	50,000	-----	-----
Gift received from a relative	Ex	Ex	Ex
Salary arrears received in Pakistan from a former employer in India	1,50,000	1,50,000	1,50,000
Income form property received outside India but later on remitted to India	3,00,000	-----	-----
Profit from Iran business controlled from India:			
Profits received in India	1,00,000	1,00,000	1,00,000
Profits received outside India	1,00,000	1,00,000	-----
Dividends received from an Indian company, outside India, deemed to accrue or arise in India	-----	-----	-----
Untaxed foreign profit brought to India	-----	-----	-----
Profit from Kolkata business managed from outside India 60% received outside India	90,000	90,000	90,000
Profit on sale of building in India, received outside India deemed to	21,00,000	21,00,000	21,00,000

accrue or arise in India			
GROSS TOTAL INCOME	32,80,000	25,50,000	24,50,000

RESIDENTIAL STATUS PROBLEMS:

PROBLEM 1:

Mr. Steve Waugh, a foreign citizen leaves India for the first time in the last 20 years on November 25, 2006. during the calendar year 2007, he comes to India on September 1, and stays for a period of 20 days. During the calendar year 2008 he does not visit India at all but comes to India on January 15, 2009. Determine his residential status for the assessment year 2009-10.

DETERMINATION OF RESIDENTIAL STATUS OF MR. STEVE WAUGH

Relevant previous year 01.04.2008 to 31.03.2009

Stay in India 15-01-2009 to 31-03-2009 [17+29+31=77 days]

He fails to fulfill the first basic condition, but he fulfills the following tests:

- (i) His stay exceeds 60 days during relevant previous year, and
- (ii) His stay during 4 previous years preceding the relevant year also exceeds 365 days. Hence he is RESIDENT u/s 6(1)(b). He cannot claim the beneficial status of NOR as he was Resident of India for 9 previous years and he was in India for more than 730 days during 7 previous years preceding the relevant previous year. Hence he is ORDINARY RESIDENT.

PROBLEM 2:

Mr. Rao, a senior scientist goes to Nigeria on a job approved by the Central government for a period of 3 years on 15th September 2008. He has never been out of India before. Determine his residential status for the previous year 2008-09.

DETERMINATION OF RESIDENTIAL STATUS:

Relevant previous year 08-09

Stay in India 01-04-2008 to 15-09-2008 [30+31+30+31+31+15=168 days]

He fails to fulfill the first basic condition as his stay in India is less than 182 days.

He is covered under explanation to 6(1)b as he is in India citizen going abroad on a job approved by government. His status is non-resident as his stay is less than 182 days.

PROBLEM 3:

Mr. Singh, an Indian citizen went to USA on 10th October 2000 and returned to India after two years stay there. Again on 10th August 2004, he went to Iran but returned on 10th May 2008. He made another attempt to go abroad and finally succeeded to go to Canada. He left Delhi for Canada on 10th February 2009. Find out his residential status for the assessment year 2008-09 and 2009-10.

ASSESSMENT YEAR 2008-09:

Stay in India during relevant previous year: NIL (he was absent through out the previous year) As such he does not satisfy any of the two tests of sections, hence he is Non-resident.

ASSESSMENT YEAR 2009-10

Previous year 1-4-2008 to 31-3-2009

Stay in India during relevant previous year =277 days

He fulfills the first test given u/s 6(1)a, hence he is resident. He cannot claim the status of NOR as he was:

- (i) resident of India for more than 2 previous years out of 10 previous years preceding the relevant previous years, and
- (ii) his stay in India exceeds 730 days during 7 previous years out of 10 previous years preceding the relevant previous year.

Hence, he is ORDINARY RESIDENT.

PROBLEM 4:

Mr. Vinayak came to India from USA the first time on 30th September 2001 to join an American concern, as General Manager. After reporting for duty, He left for Japan on 2nd October 2002 to finalize the company's transaction. He returned to India on 10th October 2002 and stayed in India till 31st July 2007 when he went back to the USA. He again came back to join duty on 10th November 2008. What is his residential status for the previous year 2008-09. Give reasons.

DETERMINATION OF RESIDENTIAL STATUS OF MR. VINAYAK:

MR. Vinayak was in India during the relevant previous year ie. 1-4-2008 to 31-3-2009 for the period from 10th November 2008 to 31st March 2009 for 143 days. He does not fulfill the first test given u/s 6(1) as his stay is less than 182 days during the relevant previous year. But he fulfills the 2nd test u/s 6(1) as his stay exceeds 60 days during the relevant previous year and 365 days during 4 previous years preceding the relevant previous year. Hence, he is Resident.

Under the provisions of section 6(6) he can not claim the beneficial status of Resident but not ordinarily resident as he was:

- (i) resident of India for 2 out of 10 previous years preceding the relevant previous year and
- (ii) his stay during 7 previous years preceding the relevant previous year is more than 730 days. As such he is ordinary resident.

PROBLEM 5:

Mr. Babu a married citizen of India left for Germany for the first time on 15-9-2007 on a business trip. He returned to India on 5-6-2008. during his absence from India he

maintained a dwelling house for himself in Calcutta. What will be his residential status for the assessment year 2009-10.

DETERMINATION OF RESIDENTIAL STATUS OF MR.BABU:

Relevant previous year 1-4-2009 to 31-3-2010

Stay in India in this previous year: total 168 days

He fails to fulfill test (a) of 6(1)

Test (b) of 6(1)

- (i) his stay exceeds 60 days during the relevant previous year and
- (ii) stay exceeds 365 days during 4 previous years preceding relevant previous year, as he was never out of India before.

Hence, he is resident u/s 6(1) b and he cannot claim the beneficial status of not ordinarily resident as he was:

- (i) resident of India for 2 out of 10 previous years preceding the relevant previous year and
- (ii) his stay during the 7 previous years preceding the relevant previous year is more than 730 days. Hence he is ordinary resident.

PROBLEM 6:

DR. Mahesh, an Indian national is working in USA every year he comes to India on leave and stays with parents who are in Bangalore. What would be the residential status of doctor during the assessment year 2009-10 under the following circumstances:

- (i) He came to India on 19th December 2008 and stayed up to 5th February 2009. His total stay during the preceding 7 years was 300 days.
- (ii) He came to India on 20th September 2008 and stayed upto 31st march 2009. His total stay during the preceding 7 years was 500 days, he had left India on 31-3-2001.

As Dr.Mahesh is an Indian citizen rendering service in USA ie, outside India and comes to India on leave, according to explanation to section 6(1) of the income tax act, 1961 his residential status for assessment year 2009-10 would be as follows:

- (a) he would be treated as non-resident as his total stay in India is less than 182 days during the previous year
- (b) he would be treated as resident u/s 6(1)a as he stayed in India for more than 182 days

He is resident but not ordinarily resident as he was not in India for 730 days during 7 previous years preceding the relevant previous year.

PROBLEM 7:

Mr. Krishnaiah, an engineer, left India for London on 15th March 2008 for taking practical training in an engineering firm there. He returned to India on 28th March 2009. he was never out of India in the past. State giving reasons what will be the residential status of Mr.Krishnaiah for the previous year 2008-09.

DETERMINATION OF RESIDENTIAL STATUS OF MR.KRISHNAIAH

Relevant previous year 1-4-2008 to 31-3-2009

Stay in India 28-03-2009 to 31-03-2009 ie 4 days

He fails to fulfill either of the two tests of 6(1) as his stay is less than 60 days/182 days. Hence, he is NON-RESIDENT u/s 2(30).

PROBLEM 8:

A person after about 26 years stay in India retired to England in April 2007 and returned to India on 15th February 2009 to take up a salaried appointment. What is his residential status for the previous year 2008-09?

DETERMINATION OF RESIDENTIAL STATUS OF A PERSON:

Relevant previous year 01-04-2008 to 31-03-2009

Stay in India 15-2-2009 to 31-03-2008 [46 days]

His residential status is Non-resident as he cannot fulfill either of the two tests of Sec.6(1) as his stay does not exceed 60/182 days in relevant previous year.

PROBLEM 9:

Mr. Gowda went to Germany for diploma course on 5th August 2008 and came back to India on 25th February 2009. his family remained in India. He had never been out of India before. What is his residential status for the year ending 31st March 2009.

DETERMINATION OF RESIDENTIAL STATUS OF MR.GOWDA:

Relevant previous year 01-04-2008 to 31-03-2009

Stay in India 1-4-2008 to 5-8-2008=127 days

25-2-2009 to 31-03-2009=36 days

TOTAL=163 DAYS

He fails to fulfill test (a) of 6(1) but proves test (b) of 6(1) as his stay in India during relevant previous year is more than 60 days and during 4 previous years preceding relevant previous year is more than 365 days (he was never out of India) hence, he is resident u/s 6(1)b. He cannot claim the status of NOR as:

- (i) he is resident of India for 2 out of 10 years preceding the relevant previous year and
- (ii) his stay during 7 previous years preceding the relevant previous year is more than 730 days. HENCE, HE IS ORDINARY RESIDENT.

PROBLEM 10:

What is residential status of an individual who came to India for the first time in 2006-07 and who has in India as follows:

PREVIOUS YEAR	PRESENCE IN INDIA
2008.9	185 days
2007.8	15 days
2006.7	26 days

Find out his residential status in the assessment year 2009-10.

DETERMINATION OF RESIDENTIAL STATUS:

Relevant previous year: 01-04-2008 to 31-03-2009

Stay in India: 185 days

He fulfills the test (a) of section 6(1) as his stay exceeds 182 days. Hence, he is resident u/s 6(6) as:

- (i) he was non-resident for 9 previous years out of 10 previous years preceding the relevant previous year and
- (ii) his stay during 7 previous years preceding the relevant previous years is less than 730 days.

SECTION—A

- a. Who is a resident?
- b. Who is a Non-resident?
- c. Who is Not ordinarily resident?
- d. State the Basic conditions?

- e. State the additional conditions?
- f. What is previous year?
- g. What is assessment year?

SECTION—B

a. Mr. Gowda went to Germany for diploma course on 5th August 2008 and came back to India on 25th February 2009. his family remained in India. He had never been out of India before. What is his residential status for the year ending 31st March 2009?

b. A person after about 26 years stay in India retired to England in April 2007 and returned to India on 15th February 2009 to take up a salaried appointment. What is his residential status for the previous year 2008-09?

c. Mr. Krishnaiah, an engineer, left India for London on 15th March 2008 for taking practical training in an engineering firm there. He returned to India on 28th March 2009. He was never out of India in the past. State giving reasons what will be the residential status of Mr.Krishnaiah for the previous year 2008-09.

d. DR. Mahesh, an Indian national is working in USA every year he comes to India on leave and stays with parents who are in Bangalore. What would be the residential status of doctor during the assessment year 2009-10 under the following circumstances?

(iii) He came to India on 19th December 2008 and stayed up to 5th February 2009. His total stay during the preceding 7 years was 300 days.

(iv) He came to India on 20th September 2008 and stayed upto 31st march 2009. His total stay during the preceding 7 years was 500 days; he had left India on 31-3-2001.

e. Mr. Singh, an Indian citizen went to USA on 10th October 2000 and returned to India after two years stay there. Again on 10th August 2004, he went to Iran but returned on 10th May 2008. He made another attempt to go abroad and finally succeeded to go to Canada. He left Delhi for Canada on 10th February 2009. Find out his residential status for the assessment year 2008-09 and 2009-10.

SECTION--C

a. Mr.X furnishes the following particulars of his income earned during previous year ended on 31st March 2009:

- xi. Income from agriculture in Bangladesh, received there Rs.3,80,000 but later on remitted in India.
- xii. Interest on Pakistani development bonds, Rs.60,000, one sixth of which received in India
- xiii. Gift of Rs.70,000 received in foreign currency from a relative in India
- xiv. Arrears of salary Rs.1,50,000 received in Pakistan from a former employer in India
- xv. Income from property received outside India Rs.3,00,000 (Rs.1,00,000 is used in Bahrain for the educational expenses of his son in Bahrain, and Rs.2,00,000 later on remitted to India)
- xvi. Income from business in Iran which is controlled from India (Rs.1,00,000 being received in India) Rs.2,00,000
- xvii. Untaxed profit for the previous years brought to India in July 2008 2,50,000
- xviii. Dividends received on 30-06-2008 outside India from an Indian company Rs.2,50,000.
- xix. Profit (computed) on sale of building in India received in Pakistan Rs.21,00,000.
- xx. Profit from business in Kolkata managed from outside India Rs.90,000, 60% of which is received outside India

Find out Gross total income of Mr.X for AY if he is ROR, NOR, NR.

b. The following amounts of income have been computed for MR.Ram chand for the previous year ended on 31st March.

Salary accrued and received in India	25,000
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Profit from hotel business in Japan	50,000
Dividends declared in Japan received in India	10,000
Gain from transfer of capital asset in India	25,000
Interest on debentures of a company in New York received in India	7,000
Royalty received in Germany from a resident in India for technical services provided for a business in Germany	20,000
Interest received in UK from Robert, non-resident, on loan provided to him for business in India	6,000
Fees from an Indian company carrying on business in the UK for technical services rendered in London, directly deposited in his bank account in India	25,000

Compute the total income of Mr. Ram for the relevant assessment year if he is ROR, NOR AND NR.

c. Mr.Somayaiah discloses the following particulars of his income during the previous year 2008-09.

PARTICULARS	AMOUNT (RS.)
ii. Dividends from Sri Lanka companies received in India, Dividends were received partly in cash and partly in shares. Face value of shares is Rs.80,000 but their market value is Rs.1,20,000. However, currently there is no buyer in the market	2,00,000
ii. Pension remitted to him in India by Sri Lankan government after deduction of tax source Rs.5,000	70,000
iii. Fees received in Sri Lanka for arguing a patent case in Delhi High court on behalf of a fellow lawyer friend of Mumbai	1,00,000
iv. Commission credited to his account in India under his instructions by law firms in India, for referring clients from outside India but commission was received in Myanmar	1,20,000
v. State of income from his HUF, received in Kolkata	50,000
vi. Income from law practice in Myanmar and Sri Lanka received there but practice was set up in Delhi	4,80,000
vii. 5% commission for the year 2008-09 from publishers of law	1,20,000

books on their annual profits, received in India, commission has been paid after setting off Rs.30,000 for books purchased by him. He has purchased the dealership rights from Mumbai law house on 1 st January 2009.	
viii. Gift from a foreign client, received outside India	20,000

Determine his total income for the previous year 2008-09 if his residential status during the previous year is ROR, NOR OR NR.

d. Mr.J, a Japanese national discloses the following particulars of his income during financial year 2008-09.

PARTICULARS	AMOUNT
Income from house property in Japan, remitted by tenant to him in India through SBI	1,00,000
Loss from business in India	-5,00,000
Profits from speculation business in India	2,00,000
Interest received on bonds of Indian companies outside India	45,000
Net dividends received from Japanese companies outside India (tax deducted at source Rs.15,000)	1,35,000
Interest received on compensation of land, acquired by government of India during the financial year 2002-03	60,000
Profit from business in Japan, controlled and managed from India but profits being received in Japan	10,00,000

Determine his total income for the previous year in the following cases ROR, NOR AND NR.

e. Mr. Gopal, an Indian citizen, earns the following income during the financial year 2008-09.

PARTICULARS	AMOUNT
viii. Profits from a business in Mumbai managed from London	4,20,000
ix. Pension for services rendered in Canada, but kept with state Bank in Canada with the permission of the RBI	60,000
x. Income from property in Pakistan, received in India	58,000
xi. Profits from business in Bangladesh and deposited in a bank there	1,12,000
xii. Income received in Kenya from a profession, which was set up	70,000

	in India, extended to Kenya and managed from Kenya	
xiii.	Profit on sale of machinery in India but received in France	26,000
xiv.	Profits, before allowing depreciation, from business in Iran, 40% of profits were received in India	2,00,000
	Total Depreciation	2,50,000
viii.	Interest on foreign bank deposit, received by his minor son in India. Bank deposit was made out of funds gifted by grandfather	70,000
ix.	A German company credited commission to his bank account outside India for sale of goods by him in India	1,75,000
x.	Commission earned and received by him outside India for sale of goods by him in India	2,30,000
xi.	Dividends remitted in India by an Egyptian company to him under his instruction through bank of Baroda	80,000

Determine his taxable income for the previous year 2008-09, if he is ROR, NOR, NR.

CHAPTER---3

CAPITAL AND REVNUUE

LEARNING OBJECTIVES:

- To understand the meaning of Capital and revenue receipts/expenses
- Capital v/s revenue
- Tests of distinction
- Capital loses v/s revenue losses
- Legal opinions

Income tax is levied on income of assessee and not on every receipt which he receives. The method of tax on different types of receipts is different. Income tax act, 1961 provides a separate head “capital gains” for levying tax on capital receipts. Similarly, while calculating net taxable income of an assessee only revenue expenses are allowed to be deducted out of revenue receipts. Particularly while calculating business profit or professional gain only revenue receipts and revenue expenses are considered. This makes the distinction between capital and revenue of vital importance. For this distinction capital and revenue items can be divided into three sub-parts:

CAPITAL RECEIPTS V/S REVENUE RECEIPTS:

As discussed above the capital receipts are to be charged to tax under the head “capital gains” and revenue receipts are taxable under other heads, it is of vital importance to understand which receipts is a capital receipts and which one is a revenue receipt.

IMMATERIAL CONSIDERATIONS:

In deciding whether a particular receipt is of a revenue capital or revenue type, the following considerations are considered to be immaterial and not going to decide or change the character of nature of the receipt.

1. **RECEIPT IN LUMP SUM OR IN INSTALMENTS:** Whether any income is received in lump sum or in installments, it will not make any difference as regards its nature, eg, an employee is to get a salary of Rs.1,000 pm . instead of this he enter into an agreement to get a sum of Rs.36,000 in lump sum to serve for a period of three years. The receipt where it is monthly remuneration or lump sum for 3 years is revenue receipt. It has been decided in so many court cases that a lump sum receipt may be an item of revenue nature and an annual receipt recurring over few years may be a capital receipt. Thus, whether a receipt is a periodic receipt or a single receipt is immaterial for the purposes of determining its nature.

2. NATURE OF RECEIPT IN THE HANDS OF RECIPIENT: whether a receipt is capital or revenue will be determined in the hands of the persons receiving such income. No attention will be paid towards the source from which the amount is coming. Salary even if paid out of capital by a new business will be it revenue receipt in the hands of employee.
3. MAGNITUDE OF RECEIPT: The magnitude of receipt, whether big or small, cannot decide the nature of the receipt although the size of a receipt in a transaction is not an entirely irrelevant consideration. A receipt of Rs.10,000 may be of revenue nature where as a receipt of only Rs.10,000 may be capital receipt. Supreme Court has ruled in a case the magnitude of a receipt is immaterial for the purpose of determining its nature.
4. NAME GIVEN BY PARTIES AND TREATMENT IN BOOKS OF ACCOUNTS: What name the recipient or payer of the receipt has given in the books of accounts or with what name he has called a particular payment by a dealer may be a revenue receipt in the hands of the recipient. The character of the receipt shall be decided by considerations other than by what name the parties call it. The nature of the receipt will be determined in the hands of the person receiving such income.
5. Payment made out of capital: No attention will be paid towards the source from which amount is coming. Salary even paid out of capital by a new business will be a revenue receipt in the hands of the employee. It was also decided in a case that if a receipt is made out of capital, the receipt may also be a capital receipt. If a recipient is beneficially entitled not only to the income but also to the capital, payments given to him by his trustees out of the corpus would be capital receipts.
6. TIME OF RECEIPT: The nature of the receipt has to be the receipt has to be determined at the time when it is received and not afterwards when it has been appropriated by the recipient.
7. QUALITY OF RECEIPT: Whether the income is received voluntarily or under a legal obligation, it will not make any difference as regards its nature.

DISTINGUISHING TESTS:

It is very difficult to draw a line of demarcation between capital receipts and revenue receipts. Even the courts have found it difficult to lay down some points of distinction on the basis of which a capital receipt may be distinguished from a revenue receipt, some tests, however, can be applied in particular cases. These tests are:

1. **ON THE BASIS OF NATURE OF ASSETS:** if a receipt is referable to fixed asset, it is capital receipt and if it is referable to circulating asset it is revenue receipt. Fixed asset is that with the help of which owner earns profits by keeping it in his possession eg. Plant and machinery , building or factory etc.

Circulating asset is that with the help of which owners earn profit by parting with it and letting others to become its owner eg stock in trade.

Circulating asset is asset which is turned over and while being turned over yields profit or loss where as fixed asset is one on which the owner earns profit by keeping it in his own possession. Profit on the sale of motor car used in business by an assessee is a capital receipt where as the profit earned by an automatic dealer, dealing in cars, by selling a car is his revenue receipt.

2. **TERMINATION OF SOURCE OF INCOME:** any sum received in compensation source of income is capital receipt eg, compensation received by an employee from its employer on termination of his services is capital receipt.
3. **AMOUNT RECEIVED IN SUBSTITUTION OF INCOME:** Any sum received in substitution of income is revenue receipt. E.g. A Company purchased the right to produce a film from its earlier producer with the condition that no other producer will be given these rights. Afterwards, it is found that the rights for producing this film had already been sold. The A company claimed damages and was awarded Rs.40,000. it was held that damages received are the compensation for the profits which were to be earned. Hence, this is revenue receipt.

4. COMPENSATION RECEIVED ON TERMINATION OF LEASE: where a sum is received as compensation for termination of a lease, it is capital receipt because it is termination of source of income.
5. COMPENSATION ON SURRENDER OF A RIGHT: any amount received as compensation on surrendering a right is capital receipt where as any amount received for loss of future income is a revenue receipt. An author gives up his right to publish a book and receives Rs.1,00,000 as compensation. It is capital receipt but if he receives it as advance royalty for 5 years it is revenue receipt.
6. TESTS AS TO THE PURPOSE OF KEEPING AN ARTICLE: if a person purchases a piece of sculpture to keep as decoration piece in his house, if sold later on, will bring capital receipt but if the same sculpture is sold by an art dealer it will be his revenue receipt. If an article is acquired for the purpose of trade, the profit arising from it is revenue receipt.

EXAMPLES AND ILLUSTRATIONS:

CAPITAL RECEIPTS:

The following are some important examples of capital receipts decided by courts:

1. salami or Nazrana received for grant of permanent lease
2. compensation received for loss of right to future remuneration
3. Compensation received from the employer for loss of employment due to premature termination of service.
4. Price received on sale of know-how
5. Damages received by an employer who is wrongly dismissed or a payment received by an employee in lieu of notice.
6. amount received by the assessee for digging and removing earth from his land for brick making.
7. Contribution received by electric supply company from consumer for installation of service lines (excess of amount over cost of installation).

REVENUE RECEIPTS:

1. Lump sum royalty received in advance
2. A pugree received by the owner of the house property from tenant
3. Damages awarded by a court to a company for breach of contract by another company
4. A passenger is injured in a railway accident and is temporarily disabled thus losing income for a short period. Any receipt as compensation shall be revenue receipt, but if the passenger is permanently disabled, the compensation received would have been a capital receipt.

SOME LEGAL OPINIONS:

1. **COMPENSATION RELATING TO STOCK-IN-TRADE:** A company of building contractors was refused permission by the local authority to build house on a certain piece of land and was paid compensation. Compensation was held to be a revenue receipt as building of houses for sale was presumed to be a trading asset or stock in trade.
2. **EXCESS OF AMOUNT RECOVERED OVER ACTUAL COST:** An electricity generating company collected contributions from the consumers for laying of service lines from its distributing main lines. The contributions collected exceeded the actual cost of laying the service lines. Supreme court held that the amount so collected from the consumers is essentially the reimbursement of capital expenditure incurred by the company in laying service lines and hence the receipt including the excess recovered over the actual cost was a capital receipt.
3. **COMPENSATION FOR RESTRAINT ON TRADING OR ON EXERCISE OF PROFESSION:** such a compensation received is considered to be a capital receipt as it is in substitution of the source of income and not of only income. A company sold its business including goodwill to another company for a certain sum. The company also entered into a convenat restraining itself from starting a similar business for 10 years for separate consideration of Rs.10,000 PA. It was held in a case that the capital receipt had been spread over 10 years period and so the annual receipt of Rs.10,000 was a capital receipt.
4. **COMPENSATION FOR BREACH OR CANCELLATION OF CONTRACT:** compensation received for breach or cancellation of a contract, damages received

for non-completion of non-execution of a contract within the stipulated time were held to be in the nature of a trading receipt. The receipt in the nature of damages shall be capital assets of the trade.

5. COMPENSATION FOR LOSS OF EMPLOYMENT, AGENCY OR OTHER OFFICE OR FOR CESSATION OF BUSINESS: following receipts have been held to be capital receipts. Such a compensation may be voluntary and recipient may not have any legal right to demand such a compensation.

- (i) Compensation for cancellation of a service agreement
- (ii) Compensation for loss of office or employment or cessation of business
- (iii) Compensation for abandonment of the contractual rights of the recipient.
- (iv) Compensation for loss of office on cessation of business or compensation for loss of employment are although capital receipts yet these receipts are taxable if falling under section 15 or 28(ii)

6. COMPENSATION FOR REQUISITION, ACQUISITION, INTERFERENCE WITH BUSINESS BY GOVERNMENT: FOLLOWING receipts were held to be revenue or capital receipts in a number of court cases:

REVENUE RECEIPTS

- (i) Sum paid by the government, for use of requisitioned premises
- (ii) Compensation for loss of profits to the assessee due to controlling and interfering with assessee's right of carrying on of a business.
- (iii) Compensation received in respect of stock in trade damaged or destroyed by enemy action.

CAPITAL RECEIPTS:

- (i) Compensation received for acquisition of ZAMINDARI lands
- (ii) Compensation for divesting the assessee of his right to manage his business
- (iii) Compensation for cancellation by the government of a license resulting in a cessation of business

- (iv) Compensation for requisition of business premises resulting into stoppage of assessee's business or injury to the profit making apparatus.
7. NATURE OF SUBSIDIES OR GRANTS RECEIVED FROM PUBLIC BODIES: where government gives grants or subsidies to assist a trader in his business, these are generally regarded as revenue receipts. Where the grant or subsidy is given for a specific purpose eg, to enable the undertaking to take steps to relieve unemployment it is not taxable as income.
8. ROYALTIES OF WRITERS: royalty received by the authors of books etc. are taxable under the head "Income from other sources as revenue receipts.
9. RECOVERY OF AN EMBEZZLED SUM: Where an assessee had been allowed deduction regarding the amount embezzled by an employee as trading loss and subsequently it is recovered from that employee, it will form as his revenue receipt.
10. DAMAGES FOR PERMANENT AND TEMPORARY DISABILITY: If, in an accident an assessee suffers a permanent disability any amount of damages received by the assessee shall be of capital nature, where as if the injury is of a temporary nature the amount of damages shall be a revenue receipt.
11. REFUND OF A REVENUE PAYMENT: Any revenue payment made to discharge a liability, if refunded later on, shall be revenue receipt when it is so refunded. For example, an assessee was allowed a deduction in respect of payment of a license fee, it was held to be a revenue receipt when refunded in a subsequent year.
12. LUMP SUM RECEIPT OR RECURRENT AND PERIODIC INCOME: Lump sum amount received in lieu of future royalty, single amount received in advance as ginning charges of cotton for ten years, a lump sum amount taken in communication of a right to future, commission, remuneration etc. have all been held to be revenue receipts and taxable as income.

CAPITAL EXPENSES V/S REVENUE EXPENSES:

For computing profits of a business taxable under this act, only revenue expenses are allowed to be deducted. Hence, it becomes essential to distinguish a revenue expenditure from a capital expenditure. The following tests can be applied for this purpose:

- (i) **NATURE OF ASSETS:** any expenditure incurred to acquire a fixed asset or in connection with installation of fixed assets is capital expenditure. Where as, any expenditure incurred as price of goods purchased for resale along with other necessary expenses incurred in connection with such purchase are revenue expenses.
- (ii) **NATURE OF LIABILITY:** A payment made by a person to discharge a capital liability is a capital expenditure. Where as, an expenditure incurred to discharge a revenue liability is revenue expenditure, eg, amount paid to a contractor for cancellation of contract to construct a factory building is capital expenditure where as amount paid by a person with whom he has entered into contract for supply of goods for a period of 5 years but he fails to supply goods after 3 years, the compensation will be a revenue expenditure as it is to discharge the revenue liability.
- (iii) **NATURE OF TRANSACTION:** if the amount is spent on increasing the earning capacity of an asset, it is capital expenditure, eg. Purchase of patents to produce picture tubes of TV sets. Where as, an expenditure incurred to earn an income is revenue expenditure eg. Salary of the staff, advertisement expenses etc.
- (iv) **PURPOSE OF TRANSACTION:** If the amount is spent on increasing the earning capacity of an asset, it is capital expenditure, eg, expenditure incurred for fitting new windows of factory building, where as, any expenditure incurred on keeping an asset in running condition is revenue expenditure, eg, amount spent on protection of fixed assets which have already been acquired.
- (v) **NATURE OF PAYMENT IN THE HANDS OF PAYER:** If an expenditure is incurred by an assessee as a capital expenditure, it will remain as capital expenditure even if the amount may be revenue receipt in the hands of receiver, eg, purchase of motor car by a businessman is capital expenditure in his hands although it is revenue receipt in the hands of car dealer. Similarly, if

the nature of payment in the hands of payer is of revenue nature, it will be a revenue expenditure even if it is capital receipt in the hands of receiver.

CAPITAL EXPENDITURE:

- 1) Cost of reconstructing, refurbishing, etc. of a business building
- 2) Payment made by the assessee with a view to keeping his competitor out of his field of business
- 3) Expenditure incurred in converting business premises when switching over from manufacture of one product to another
- 4) Expenditure on litigation in connection with acquiring or curing a defect in assessee's title to the assets of the business
- 5) Compensation paid for cancellation of contract for the purchase of machinery
- 6) Price paid for the purchase of partner's share in the firm
- 7) Expenditure incurred on the maintenance of business reputation.

REVENUE EXPENDITURE:

- 1) Payments made for use of quota rights, or for use of patents and trade marks
- 2) Payment made for technical assistance and access to the fruits of continuing research
- 3) Expenditure incurred by professionals on study tour abroad to acquire latest knowledge
- 4) Any expenditure necessary at the time of purchase to render the asset so purchased, serviceable, will be added to the initial cost as capital expenditure. But any expenditure on the replacement of part of a plant which does not bring any additional advantage to the business of assessee is revenue expenditure.
- 5) Expenditure incurred to send employees abroad for practical training in the field of the business of the assessee.
- 6) Expenditure incurred by way of fee paid to valuer for assessing the business premises

- 7) Expenditure incurred in raising loans, eg, stamp duty, registration and legal fees, brokerage etc.
- 8) Expenditure to oppose threatened nationalization of the industry
- 9) Expenditure incurred to secure overdraft facilities from a bank
- 10) Payment to the government to obtain monopoly to run buses on a route
- 11) Compensation or other payment made to get rid of a servant or a managing agent in the interest of the business
- 12) Any such expenditure incurred wholly, totally, necessarily for the business.

REVENUE LOSSES V/S CAPITAL LOSSES:

It is very difficult to distinguish between a capital loss and a revenue loss on the basis of certain principles. On the basis of court judgments, following decisions have become distinguishing points:

- (i) Loss due to sale of assets: where there is loss on selling a capital asset, it is a capital loss whereas any loss incurred during the sale of stock in trade is a revenue loss.
- (ii) Loss due to embezzlement: where there is embezzlement done by an employee and this causes loss to the business, it is of revenue nature.
- (iii) Loss due to withdrawal of money from bank: Once the amount is deposited in bank and then it is withdrawn by an employee and is misappropriated it is capital loss.
- (iv) Loss due to liquidation of company: Amount deposited by a person with manufacturing industry to get its agency and lost due to company being liquidated is a capital loss.
- (v) Loss due to theft by an employee: Loss occurring due to theft or embezzlement or misappropriation committed by an employee is revenue loss.

PROBLEM:

The following items are found debited to the profit and loss account of a company. Are these items deductible in computing the income of the company for income tax purposes? Give reasons for your answer:

- a) Rs.10,000 spent on reconditioning of imperfect machinery purchased
- b) Rs.10,000 commission paid by the company for securing a contract in the course of its business.
- c) Rs.20,000 bad debts written off. The bad debts were sustained by the company in respect of loans advanced to customers and written off.
- d) Rs.80,000 loss on shares written off. The company has formed another company to take over its buying agency at Delhi and had taken up 80 shares of Rs.1,000 each therein. The new company being unsuccessful, the amount Rs.80,000 paid on shares was lost and hence written off.

SOLUTION:

- a) The sum of Rs.10,000 spent on reconditioning the machinery is a capital expenditure. Hence it is not deductible. However depreciation will be allowed.
- b) Rs.10,000 paid as commission by the company for securing a contract in the course of its business is a revenue expenditure, hence it is deductible.
- c) Rs.20,000 bad debts written off in respect of loans advanced to customers is not deductible unless the business of the company is banking or money lending.
- d) Rs.80,000 loss on investment in shares is a capital loss, hence it is not deductible.

PROBLEM:

State, giving reasons, whether the following are capital or revenue receipts:

- (i) Compensation received for compulsory vacation of place of business
- (ii) Bonus shares received by a dealer of shares
- (iii) Money received by a tyre manufacturing company for sale of technical know how regarding manufacture of tyre.
- (iv) Dividend for interest for investments

SOLUTION:

- (i) Revenue receipt as it is in compensation of assessee's profit which it would have earned
- (ii) If the assessee has also converted the bonus shares into stock in trade then it is a revenue receipt otherwise it is an accretion in the capital asset.
- (iii) Revenue receipt but in case the sale of technical know how results into substantial deduction in value of the tyre company or company closes down its business in that particular line then the receipt would be a capital receipt.
- (iv) Assessee gets the income of dividend and interest regularly and from a definite source and it is a return for the use of his asset by some body else and do it is a revenue receipt.

PROBLEM:

State whether the following are capital or revenue receipts:

- (i) Compensation received for nationalization
- (ii) Premium on issue of new shares
- (iii) Sales tax collected from purchase of goods
- (iv) Annuity
- (v) Unclaimed dividends

SOLUTION:

- (i) Compensation is in substitution of assessee's source of income and hence it is a capital receipt
- (ii) It is not a receipt which results out of assessee's trading activities and so cannot be a revenue receipt
- (iii) This receipt results out of assessee's ordinary course of business and so it is a revenue receipt
- (iv) Annuity would be a revenue receipt if it is paid as a specified sum payable at periodical intervals. Annuity received from an employer is a salary income

and in all other cases, annuity shall be chargeable under the head “Income from other sources” this shall not be a taxable income in cases where the assessee exchanges his share for a capital sum payable in installments.

- (v) Unclaimed dividend cannot be deemed to be profit of business as dividend is neither allowed as an allowance or as deduction. It is not taxable as a receipt.

QUESTIONS:

SECTION--- A

1. What is a revenue receipt?
2. What is a capital receipt?
3. What is capital expenditure?
4. What is revenue expenditure?
5. What is revenue loss?
6. What is capital loss?

SECTION --- B

1. What tests would you apply to distinguish capital receipts from revenue receipts?
2. Distinguish between revenue expenditure and capital expenditure. Give distinction between capital losses and revenue losses.
3. Why is it necessary to distinguish between a capital receipt and revenue receipt? How would you determine whether a particular receipt is a capital receipt or a revenue receipt?
4. State whether the following are capital or revenue receipts:
 - (i.) Compensation received for nationalization
 - (ii.) Premium on issue of new shares
 - (iii.) Sales tax collected from purchase of goods
 - (iv.) Annuity
 - (v.) Unclaimed dividends
5. State, giving reasons, whether the following are capital or revenue receipts:

Compensation received for compulsory vacation of place of business

Bonus shares received by a dealer of shares

Money received by a tyre manufacturing company for sale of technical know how regarding manufacture of tyre.

Dividend for interest for investments

6. The following items are found debited to the profit and loss account of a company. Are these items deductible in computing the income of the company for income tax purposes?

Give reasons for your answer:

- e) Rs.10,000 spent on reconditioning of imperfect machinery purchased
- f) Rs.10,000 commission paid by the company for securing a contract in the course of its business.
- g) Rs.20,000 bad debts written off. The bad debts were sustained by the company in respect of loans advanced to customers and written off.
- h) Rs.80,000 loss on shares written off. The company has formed another company to take over its buying agency at Delhi and had taken up 80 shares of Rs.1,000 each therein. The new company being unsuccessful, the amount Rs.80,000 paid on shares was lost and hence written off.

7. The following items are found debited to the profit and loss account of a company. Are these items deductible in computing the income of the company for income tax purposes?

Give reasons for your answer:

- i) Rs.10,000 spent on reconditioning of imperfect machinery purchased
- j) Rs.10,000 commission paid by the company for securing a contract in the course of its business.
- k) Rs.20,000 bad debts written off. The bad debts were sustained by the company in respect of loans advanced to customers and written off.
- l) Rs.80,000 loss on shares written off. The company has formed another company to take over its buying agency at Delhi and had taken up 80 shares of Rs.1,000 each therein. The new company being unsuccessful, the amount Rs.80,000 paid on shares was lost and hence written off.

CHAPTER--4

SALARIES:

LEARNING OBJECTIVES:

- To understand the concept of salaries
- Understand the characteristics of salary
- Computation of Salary Income
- Allowances, Perquisites and their treatment
- Profits in lieu of salary
- Deductions u/s 16

The scope of the word “Salaries” under the Income tax Act is very wide. It comprehends every payment, due or received, by an employee from an employer or former employer on account of services rendered. Every non-monetary benefits and perquisites are valued in accordance with specified rules and assessed to tax. Any income from salary is taxed either on due basis or on receipt basis, whichever is earlier. Even the arrears of salary, if not taxed in relevant earlier years, will be assessed in the previous year in which they are received. Similarly, where salary is received in advance, it will be taxed in the previous year of receipt and not in the previous year in which it will accrue to the employee. However, such salary received in advance will not be taxed again when it will accrue to the employee to avoid double taxation of the same income. However, relief has been provided to mitigate any increased tax liability that may result due to charge on salary on receipt basis.

CONDITION FOR CHARGEABILITY OF SALARY: RELATIONSHIP OF EMPLOYER AND EMPLOYEE IS ESSENTIAL: [SEC.15]

The touchstone of chargeability of an amount as salary is the relationship of an employer-employee between the person making the payment and the person receiving such payment. It is a cardinal principle that any amount chargeable to tax under the head salaries must come to the assessee only from or on behalf of his employer or former employer and that too only account of employment or services rendered by him to the employer and not by virtue of personal considerations.

Salary is a payment for services rendered. There must be a master at whose command services are rendered, and a servant who renders the services. Only those payments can be charged as salaries which are paid or due to the employee for services rendered. Payments made by an employer on account of personal consideration cannot be taxed as salaries.

Employer may be any entity, eg. A local authority, or a company, or any other public body or association, or central or state government, or foreign government or any other private employer like a firm, HUF, AOP, company or even an individual.

The following points in subsequent sections may be taken into account while determining the relationships of employer and employee.

SALARY OR PENSION OF UNITED NATIONS EMPLOYEE IS EXEMPT FROM TAXATION: Under Sec.2 of the UN Act 1947, any salary of a United Nations employee is fully exempt from income tax. In view of this, pension of former UN official is also exempt, as salary includes pension also. Besides, the amount allowable as a child's benefit is not the income of the assessee—employee because the beneficiary is the child and not the participant employee. The amount does not fall under “salary” within the provisions of Sec.17.

EMPLOYMENT IS DISTINCT FROM PROFESSION [Sec.15]

If employment is merely incidental to the exercise of a profession, the gains from such employment are not chargeable to tax under the head, “salaries”. For example, movie artists sign short term contracts for acting in movies. Such an engagement cannot be considered as an employment, but it is merely an engagement in the course of exercising a profession. The position is different when a professional permanently accepts an employment and exchanges his profession for service. The remuneration in that case is chargeable to tax under the head salaries.

The relationship of the principal and the agent may or may not be of an employer and employee:

If agent has to work under the direct control and supervision of the principal and has no discretion of his own in the performance of his duties, he is deemed to be an employee and the remuneration payable to him in such a case is chargeable to tax under the head salaries. On the other hand, if the principal exercises only a supervisory control in respect of work entrusted to the agent and the agent has wide discretion of his own in the execution of the policies of the principal, the presumption is that the agent is not employee. The remuneration payable to the agent in such a case is liable to be taxed under the head, “profits and gains of business of profession”. However, no firm rule can be laid down in this regard and each case must be evaluated on its own facts and merits.

GENERAL YARDSTICK: NATURE OF SERVICE AND DEGREE OF AUTHORITY MAY DETERMINE WHETHER THE RELATIONSHIP IS THAT OF A PRINCIPAL AND AGENT OR MASTER AND SERVANT:

A person who is engaged in managing a business may be a servant or an agent according to the nature of his service and the authority of his employment. For ascertaining whether a person is a servant or an agent, a rough and ready test is whether, under the terms of his employment, the employer exercises a supervisory of his master. An agent, on the other hand, in the exercise of his work is not subject to the direct control and supervision of his master. An agent, on other hand, in the exercise of his work is not subject to the direct control or supervision of the principal, though he is bound to exercise his authority in accordance with all lawful orders and instructions which may be given to him from time to time by his principal. But this test is not universal in its application and does not determine in every case, having regard to the nature of employment, that he is a servant.

WHETHER A DIRECTOR/MANAGING DIRECTOR IS AN EMPLOYEE OF THE COMPANY—DEPENDS ON THE SERVICE AGREEMENT AND ARTICLES OF THE COMPANY:

Though a director simpliciter is not a servant of a company, but there is nothing to prevent a director from being a servant of the company under a special contract of service with the company. In such case, he may be treated as a managing director under a contract of service. In order to decide the question whether a director is an employee of the company or not, one has to find out as to whether the relationships of master and servant exist between the company and the director.

The nature of a director's employment may be determined by the articles of association of a company and/or the agreement, if any, under which a contractual relationship between the director and the company has been brought about. For example, if a company is itself carrying on the business and the assessee is employed to manage its affairs in terms of its articles and the agreement, and he could be dismissed, or his employment can be terminated by the company if his work is not satisfactory, it can hardly be said that he is not a servant of the company.

A PARTNER IS NOT AN EMPLOYEE OF THE FIRM [SEC.15]

Any salary, bonus, commission, etc, to a partner from firm is not treated as salary income. It is treated as business income under 28(v). A firm is not a legal person and has no legal existence apart from its partners. Though under income tax law, it is a unit of assessment by virtue of special provisions, it cannot be considered that the firm is employer of its partner.

Salary received by partner is not received from an employer and it constitutes business income. The partners in a firm work for themselves and not for any employer. They are their own masters. Thus, the salary drawn by the partners is only a different name for their share in profits. The doubt, if any, was set at rest by the incorporation of sec.28 (v), where in it was provided that "any interest, salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm such firm "is" chargeable to income tax "under the head profits and gains of business or profession".

A MEMBER OF A LEGISLATURE IS NOT AN EMPLOYEE OF THE GOVERNMENT:

The salaries of members of parliament are governed by the salaries and allowances of members of parliament act 1954. A member of parliament is not a government employee. Government does not exercise any control on the member of the legislature, rather it is the legislature which exercises control over the Government. Therefore, the salary received by him as M.P. is not chargeable to income tax under the heads, salaries but as income from other sources under section 56. similarly, salary paid to the state legislatures is taxable as income from “other sources”.

PRESIDENTS, GOVERNORS AND MINISTERS ARE GOVERNMENT SERVANTS:

The salaries of President, Governors and Ministers are taxable under the head “salaries” as they are government servants.

BASIS OF CHARGE: [Sec.15]

Charge on Salary is either on due basis or receipt basis, which ever is earlier:

Any salary due from an employer or former employer to an assessee in the previous year, whether paid or not, is chargeable to tax. The expression due implies that there is an obligation on the part of the employer to pay that amount and a right has accrued to the employee to claim the same. The fact that the employee has not received the salary or the salary has been paid to a third person, that is, to a decree-holder under court’s order, is immaterial. When any salary is received by an employee in the previous year before it becomes due to him, such salary is taxed on the receipt basis. Thus, an advance of salary is taxable on receipt basis.

Charge is either on due basis or on receipt basis but not on both the basis: When a salary is taxed on due basis, it cannot be assessed again on receipt. Similarly, when any salary

paid in advance is included in the total income of any person for any previous year on receipt basis, it is not again chargeable when such salary becomes due basis.

Arrears of salary: When any arrears of salary, not charged to tax in any earlier previous year, are paid or allowed to an employee in the previous year, such arrears are on receipt basis. For example, when arrears of salary are paid on account of revision of pay scales with retrospective effect, such arrears are taxed on receipt basis.

It is immaterial that the arrears relate to a year in which they were not chargeable to tax. Section 15(c) applies to arrears of salary provided such arrears had not been charged to income tax for any earlier previous year. The words used in clause (c) are “if not charged to income tax” and are wide enough to cover cases where the charge could or could not have been imposed.

Fictitious salary not chargeable to tax: salary does not include fictitious salary, that is , which is not really due. For example, when a person is appointed as a teacher under a written agreement specifying his salary, but there is simultaneously another agreement by which the identical sum is to be retained as donation and there is never any intention either to pay or receive salary, the teacher is not assessable on such fictitious salary.

Place of accrual of salary [sec.9 (1) (ii)]

Income falling under the head salaries is deemed to accrue or arise in India if it is earned in India. Such income is treated as earned in India if it is payable for services rendered in India. In other words, salary income payable for services rendered in India is deemed to accrue or arise in India.

SCOPE OF INCOME FROM SALARIES [SEC.17]

Salaries as defined by section 17(1) include the following:

- i. Wages
- ii. Any annuity or pension
- iii. Any gratuity

- iv. Any fees, commission, perquisites or profits in lieu of or in addition to salary or wages
- v. Any advance of salary
- vi. Any payment received by an employee in respect of any period of leave not availed by him.
- vii. The annual accretion to the balance at the credit of an employee participating in a recognized provident fund, to the extent to which it is chargeable to tax rule 6 of part A of the fourth schedule.
- viii. The aggregate of all sums that are comprised in the transferred balance as referred to in sub-rule(2) of rule 11 of part A of the fourth schedule of an employee participating in the recognized provident fund, to the extent to which it is chargeable to tax under sub rule 4
- ix. The contribution made by the central government or any other employer in the previous year, to the account of an employer under a pension scheme specified under section 80CCD.

Wide scope of the definition of salary: The definition of salary is inclusive of the aforesaid items but not limited to them only. The scope of an inclusive definition of salary cannot be restricted only to those words which occur in such a definition, but will extend to many other things not mentioned in it. Therefore, any other item not listed in the definition of salary will have to be evaluated in accordance with the general and commercial meaning of the word salary. These seem hardly anything which can escape taxation as salary if the payment is made to an employee by an employer or a former employer by virtue of employment. The payment may be made during the employment or at the termination of the employment.

SALARY AND WAGES [SEC.17 (1) (i)]

Salary and wages signify payments for services rendered by an employee to his employer:

The words Salary and Wages are Interchangeable: Conceptually, there is no difference between salary and wages, both being a recompense for work done or services rendered, though ordinarily the former expression is used in connection with services of non-manual type while the latter is used in connection with manual service. The expression “wages” does not imply that the compensation is to be determined solely upon the basis of time spent in service; it may be determined by the work done; it could be estimated in either way.

Date on which salary falls due: When salary is taxable on due basis, the date on which salary falls due becomes important. There are no specified rules to determine a date when salary falls due. It is a matter of contract between employer and employee. The contract of service specifies the date on which salary falls due. Unless specified otherwise, salary falls due on the date of the month.

When salary falls due on the last day of the month, the period of calculation will be from 1st April to 31st March (12 months). When salary does not fall due on the last day of the month, but on any specified date in the following month, the period of calculation during the previous year will be from 1st March to the end of February (12 months)

DEDUCTION FROM SALARY TO BE IGNORED:

Any deduction from salary by the employer is a part of taxable salary. When rate of salary per month is given, deductions from salary may be ignored. The rate of salary may be multiplied by the period of previous year. When net salary is given after various deductions, eg. Employee’s contribution to provident fund, tax deducted at source, etc, net salary and deductions from salary should be aggregated to find out taxable salary which is due to the assessee.

GRADE OF SALARY: When salary scale or grade is given, salary for the relevant previous year may be worked on the basis of given facts taking into account the annual increments for the service period.

ARREARS OF SALARY: Arrears of salary will be taxed on receipt basis if the same has not been taxed due basis. Thus, where an employee is promoted with retrospective effect, such arrears of salary will be taxed on receipt basis. The assessee is also entitled to relief under Sec.89(1).

ADVANCE OF SALARY [SEC.17(1)(V)]

Advance of salary is to be included in the salary income in the previous year in which it is received. Advance of salary does not become taxable again when such salary becomes due.

CHARACTERISTICS OF SALARY

1. Relationship of employer and employee:

For a payment to fall under the head salaries, the relationship of employer and employee must exist between payee and the receiver of the salary. The employer may be a government, a local authority, a company or any other public body or an association or HUF or even an individual. Every kind of payment to every kind of servant, public or private, however high or low placed he may be is covered under the provisions of this act.

2. Salary from more than one employer:

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

3. Salary from present, part or prospective employer:

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

4. Tax free salary:

Sometimes, the employer allows an employee to draw tax free salary, eg. The employer pays full salary to the employee and also pays tax on this directly to the department. The employee's assessment is to be made not on the amount of salary he is drawing but on gross amount ie. Salary drawn plus the tax paid by the employer.

5. Salary received as Member of Parliament:

Salary received by a member of parliament is not taxable under the head salaries. It is taxable as income from other sources. Any allowance received by them is fully exempted from tax.

6. Receipts from persons other than employer:

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

7. Place of accrual of salary income:

Salary accrues at that place where the services are rendered. If the services are rendered in India, the salary accrues in India and if the services are rendered outside India, the salary accrues outside India. Thus, if a person employed in India goes on leave to England and gets his leave salary there, the salary is said to accrue in India and not in England, because it is paid for services rendered in India.

8. Salary or pension received by UNO employees: It is fully exempted.

9. Salary as partner: Any salary, commission or remuneration received by a working partner from a firm assessed as firm shall not be taxable under the head salaries. It is fully taxable under the head profits and gains.

10. Payment received by legal heirs of a deceased employee: Any Ex-gratia payment or compensation given to widow or legal heirs of an employee who dies during service is not taxable as salary income but family pension received is taxable under the head other sources.

COMPUTATION OF SALARY INCOME:

Salary income of an employee is to be computed in accordance with the provisions laid down in section 15, 16 and 17. Section 15 gives scope of the word salary, section 16 gives deductions to be allowed out of incomes taxable under this head. Section 17 (1) defines the word salary, 17(2) and 17(3) further define the terms PERQUISITES and profits in lieu of salary.

Definition of word salary [section 17 (1)]

According to this section salary includes the following amounts received by an employee from his employer, during the previous year:

- (i) Wages
- (ii) Any annuity or pension
- (iii) Any gratuity
- (iv) Any fees, commission, perquisites or profits in lieu of or in addition to any salary or wages
- (v) Any advance of salary
- (vi) Any payment received by an employee in respect of any period of leave not availed of by him

- (vii) The annual accretion to the balance at the credit of an employee participate in a recognized provident fund, to the extent to which it is chargeable to tax under rule 6 of part A of the fourth schedule

The above definition of word “Salary” u/s 17(1) includes the above mentioned items.

These can be explained in the following manner:

- I. Wages: any amount received by a person for work done or job rendered is called wages. It may be received under the name of PAY, BASIC PAY, SALARY, BASIC SALARY or REMUNERATION. It may be for actual work or leave salary or actually received or due during the relevant previous year. Salary in lieu of notice. It is fully taxable u/s15 if received during the relevant previous year.
- II. Any annuity or pension: any amount received by employee from past employer after attaining the age of retirement or superannuation is fully taxable. It may be received direct as pension or out of a superannuation fund created by employer; in both cases it is taxable.
- III. Any gratuity: any sum received by employee from his past employer as a token of gratitude for services rendered in past is called gratuity. This amount is exempted upto certain limits given u/s 10(10) and it is dealt with in this chapter.
- IV. Any fee—any amount received from employer under the name of fee is also fully taxable.

Any commission given by employer to employee is fully taxable.

Any commission received by a director for standing gurantee for repayment of loan and if he is not employee of the company, shall be taxable under the head Income from other sources.

- V. Any salary in lieu of leave received during service is fully taxable.
- VI. Any advance salary: In case an assessee receives some salary in advance in previous year and which was actually not due in that year shall be taxable in the year of receipt. It does not include any loan or advance taken from employer.

PROVIDENT FUNDS:

To encourage savings for the social security of employees, the government has set up various kinds of provident funds. The employee contributes a fixed percentage of his salary towards these funds and in many cases employer also contributes. The whole contribution along with interest is credited to employee's account. If the employee dies his heirs will get the full payment.

PROVIDENT FUNDS are of four kinds:

- (i) Statutory provident fund
- (ii) Recognized provident fund
- (iii) Unrecognized provident fund
- (iv) Public provident fund

STATUTORY PROVIDENT FUND:

SPF is the oldest type of fund. It was started in the year 1925 through a provident fund act of 1925, this fund was started with a view of promoting savings amongst government employees. Generally this fund is maintained by government or semi government departments like railways, reserve bank of India, colleges, Universities, local bodies, insurance companies etc.

The employer's contribution towards the employee's SPF and the amount of interest earned on the accumulated balance to the employee's credit balance are not to be included in the income of employee and so it is ignored.

When the employee retires or leaves the service and receives any amount from the accumulated balance to his credit in the SPF, the amount so received will not be included in employee's total income being exempted income.

RECOGNISED PROVIDENT FUND:

It is the provident fund which is not recognized by the Commissioner of Income tax. The employee and the employer both contribute towards this fund. The employee's contribution is added in this salary and he will not be allowed any deduction u/s 80C. Interest on Provident fund credit balance upto prescribed rate is exempted, but interest credited over and above such rate is deemed to employee's salary income and is included in salary income of that previous year.

UNRECOGNISED PROVIDENT FUND:

It is the provident fund which is not recognized by the commissioner of Income tax. The employee and the employer both contribute towards this fund. The employee's contribution is added in this salary and he will not be allowed any deduction u/s 80C regarding this contribution while computing the total income of the employee.

The employer's contribution and interest on the accumulated credit balance of the fund are not to be included in employee's salary income from year to year. A payment received out of this fund is taxable so far it represents the employer's contribution and interest thereon. The employee is entitled to relief under section 89(1). The employee's contribution is ignored because it was taxed when it was contributed. Interest on the employee's own contribution will be taxable as "Income from Other Sources" and not as salary income.

TRANSFERRED BALANCE:

When the URPF is recognized for the first time, the credit balance in the employee's URPF is transferred to the recognized provident fund account. This balance is known as transferred balance. In such case fund will be treated as RPF from the day of its inception and exemption will be allowed in same manner. Only excess of amount transferred to RPF over exempted amount shall form taxable portion of transferred balance.

PUBLIC PROVIDENT FUND:

So far all these funds were for the salaried people. On July 1, 1968 a new fund known as PPF was started so that self employed people may also enjoy the benefit of deduction u/s 80C. Self employed people are doctors, lawyers, accountants, actors, traders, pensioners. This fund can suit all types of pockets and its working is also very simple. The interested people can open their account in SBI and its subsidiaries. The subscription can be between Rs.500 and Rs.70,000 in one year. At one time one can deposit in multiples of 50 and in one month only one deposit is possible and in the year minimum subscription should be Rs.500 and the maximum Rs.70,000.

Full withdrawal is possible after 15 years but in case of death of the subscriber full repayment will be made to the legal heir of nominee. Partial withdrawal and loans are also possible. The subscription towards this type of fund is eligible for rebate in the similar manner, as in the case of statutory provident fund. Interest credited in this account is fully exempted.

PROBLEM:

Calculate the taxable amount of annual accretion to RPF if following information is provided by assessee:

- (i) Pay Rs. 7,500
- (ii) Commission received by him on the basis of turnover achieved by him Rs.6,000.
- (iii) Employer's contribution to RPF @ 14% of salary
- (iv) Interest credited during the year to RPF balance @12% is Rs.24,000.

CALCULATION OF TAXABLE PORTION OF ANNUAL ACCRETION

Employer's contribution to RPF @ 14% of		
Salary (14% of 96,000)		13,440
Less: 12% of Salary being exempted		11,520
Taxable portion		1,920
Interest credited to RPF Balance @ 12%	24,000	

Less: Exempted upto 9.5%	19,000	5,000
TAXABLE PORTION OF ANNUAL ACCRETION		6,920

NOTE: SALARY FOR THE ABOVE PURPOSE IS PAY PLUS COMMISSION ON THE BASIS OF TURNOVER ACHIEVED BY HIM.

REFUND FROM PROVIDENT FUND: [Section 17(3)(ii)]

Any lump sum amount received or refund taken from accumulated credit balance of recognized provident fund shall be fully exempted subject to some conditions as mentioned in rule 8 of part A of the fourth schedule:

As per rule 8, exemption is allowed in the following cases:

- (i) In case employee is taking the refund after putting up continuous service for a period of 5 years or more
- (ii) In case employee has not completed 5 years service but he is taking the refund as his service has been terminated due to ill health, discontinuance of employer's business, the contract of service was for less than 5 years or any other case beyond the control of the employee. It simply means that the employee is leaving not of his own sweet will.
- (iii) In case employee has got job with another employer and his provident fund account was transferred to such new employer and total service with both the employers is 5 years or more.

ALLOWANCES: [SECTION 17(3)]

The term allowance has been derived from the word "to allow". As per Oxford Dictionary the word "Allowance" means "any amount or sum allowed regularly". As such allowances are given in cash along with salary by the employer. These allowances are given to an employee to meet some specific type of loss or expenditure of employee or to help him to meet certain type of expenses. For example, house rent allowance is

given to help the employee to pay house rent or to get a house on rent. These are divided into three categories on the basis of their tax treatment. These are:

FULLY EXEMPTED ALLOWANCES:

- Foreign allowance only in case of government employees posted out side India
- House rent allowance given to judges of high court and supreme court
- Sumptuary allowance given to judges of high court and supreme court
- Allowances from UNO

FULLY TAXABLE:

- Dearness allowance
- CCA
- Capital compensatory allowance
- Lunch allowance
- Tiffin allowance
- Marriage allowance
- Family allowance
- Deputation allowance
- Warden ship allowance
- Non practicing allowance
- Project allowance
- Overtime allowance
- Fixed medical allowance
- Entertainment allowance
- Water and electricity allowance
- Servant allowance

PARTIALLY TAXABLE;

- HRA
- Entertainment allowance

- Helper allowance
- Uniform allowance
- Academic allowance
- Conveyance allowance
- Traveling allowance
- Any special allowance in the nature of composite hill compensatory allowance or high altitude allowance or uncongenial climate allowance
- Any special compensatory allowance in the nature of border area or remote area or difficult area or disturbed area allowance
- Transport allowance
- Tribal area allowance
- Running allowance given to employees of transport sector
- Children education allowance
- Hostel expenditure allowance
- Hostel expenditure allowance
- Compensatory field area allowance
- Compensatory modified field area allowance

FULLY TAXABLE ALLOWANCES:

1. Dearness allowance: employees having fixed income suffer the most due rise in prices and to compensate their loss, they are paid such allowances. So DA is nothing but an additional salary and it is fully taxable.

Some times it is mentioned that:

- (i) DA enters into pay for service benefits or
- (ii) DA enters into pay for retirement benefits or
- (iii) DA is given under the terms of employment or
- (iv) Dearness pay

It is treated as part of salary for certain purposes such as provident fund, value of rent free house, house rent allowance, bonus, gratuity, leave encashment etc.

PROBLEM:

Mr.Krishna, receives salary of Rs.4,000 PM and DA @ Rs.1,000 PM His employer declares half of DA as pay (ie. Enters into pay for service benefits). Compute his salary.

His salary shall be computed as under:

Salary @ Rs.4,000 PM	48,000
DA (which enters into pay for service benefits)	6,000
Rest of DA	6,000

FOR ALL PRACTICAL PURPOSES SALARY OF MR.KRISHNA SHALL BE RS.54,000 AND NOT RS.48,000.

2. CCA: City Compensatory Allowance: These are given to compensate for the high cost of living in a particular big city of India or any other capital city. These are also fully taxable.

3. Lunch/Tiffin/Marriage/Family/Deputation/Wardenship/Non-practising/Project/Overtime/Fixed medical allowance: These allowances are fully taxable.

4. Entertainment allowance: This allowance is fully taxable irrespective of any expenditure incurred on entertainment of guests or customers. But in case any amount is reimbursed against any expenditure incurred by employee on entertainment of guest or customers it shall be fully exempted.

U/S 16(ii) a deduction is allowed to those persons who receive this allowance. Till assessment year 2001-02 this deduction was admissible both to government as well as private sector employees. But with effect from assessment year 2003-04 this deduction is admissible only to government employees for an amount equal to least of following:

- a. Statutory limit Rs.5,000
- b. 1/5th of basic salary only or

- c. Actual entertainment allowance received during the previous year

PARTIALLY TAXABLE ALLOWANCES:

1. HOUSE RENT ALLOWANCE:

- (a) Employees living in hired (rented) houses: Some times the employer does not provide rent free accommodation but instead makes provision to pay some amount in cash, so that the employee may be compensated to some extent as far as rent is concerned. The amount of cash paid is known as HRA. Out of total HRA received an amount equal to the minimum of the following three items is exempted from tax u/s 10(13A): The three items are:
 - (i) 50% of salary in case of Metropolitan cities and 40% of salary in case of all other cities
 - (ii) Actual HRA received
 - (iii) The amount by which the actual rent paid by the employee exceeds 10% of his salary

This exemption shall be available even if employee is living in a rented house at a place other than the place of employment.

- (b) Employees living in their own house or in such houses for which they are not paying any rent: House rent allowance received is fully taxable and no portion of it is exempted under any provision of law.
- (c) House rent allowance received by Judges of High court and supreme court: Any amount received by them is fully exempted under High Court Judges Act 1954 and Supreme court judges act 1958.

PROBLEM:

MR. Yogesh is employed at Amritsar on salary of Rs.3,000 p.m. the employer is paying HRA of Rs.350 PM but the actual rent paid by Yogesh is Rs.500 PM. He is also getting 2% commission on turn over achieved by him and turnover is Rs.1,50,000.

COMPUTATION OF GROSS SALARY:

Salary @ Rs.3,000 PM		36,000
Commission @ 2% of turn over		3,000
HRA RECEIVED:	4,200	
Less: Exempted u/s 10(13A) (note 1)	2,100	2,100
Gross salary		41,100

NOTE 1: EXEMPTION OF HRA U/S 10(13A)

(i) Actual HRA received	4,200
(ii) Excess if rent paid over 10% of salary	2,100
(iii) 40% of salary	15,600

Exempted HRA IS 2,100.

ALLOWANCES COVERED U/S 10(14)

Following are the prescribed allowances for the purpose of section 10(14) and their respective treatment in computing the income under the head salaries:

- (i) Helper allowance: It is exempted up to actual amount spent on engaging a helper required to perform the official duties.
- (ii) Uniform allowance: It is also exempted up to actual expenditure incurred on acquiring or maintaining of the official uniform. Excess, if any will be taxable.
- (iii) Academic research allowance: It is exempted up to actual expenditure incurred for research. Excess if any is taxable.
- (iv) Conveyance allowance: It is exempted up to actual expenditure incurred in performance of official duties. In case amount received is more than actual expenditure, excess if any will be taxable.
- (v) Traveling, transfer or daily allowance: It is exempted up to actual expenditure incurred for the purpose of employment. Excess, if any, will be taxable.

- (vi) Any special allowance in the nature of composite hill compensatory allowance/High altitude allowance/Unrecongential climate allowance/snow bound area allowance: Exemption allowed up to Rs.300 PM
- (vii) Compensatory field area allowance: Exemption allowed up to Rs.2,600 PM.
- (viii) Compensatory modified field area allowance: Exemption allowed up to Rs.1,000 PM
- (ix) Highly active field area allowance: Exemption allowed up to Rs.4,200 PM
- (x) Under ground allowance given to coal mine workers: Exemption allowed up to Rs.800 PM
- (xi) Tribal area allowance: This allowance is exempted upto Rs.200PM in the states of Madhya Pradesh, Tamil Nadu, Uttar Pradesh, Karnataka, Tripura, Assam, West Bengal. Bihar and Orissa.
- (xii) Any running flight allowance: Granted to an employee of transport system to meet his personal expenditure during the duty performed in the course of running of such transport from one place to another provided that such employee is not is receipt of daily allowance, it exempted up to 70% of such allowance or Rs.6,000 PM which ever is less.
- (xiii) Children education allowance: If any amount is given by employer to employee as education allowance for the education of own children in India, it shall be exempted up to Rs.100 PM per child for two children only.
- (xiv) Hostel expenditure allowance; Any allowance granted by employer to meet the hostel expenditure of employees children it shall be exempted up to Rs.300 pm per child maximum for two children only.
- (xv) Any special allowance: In the nature of counter insurgency allowance given to the members of the armed forces operating in areas away from their permanent locations for a period of more than 30 days shall be exempted up to Rs.1,300 PM.

PROBLEM:

Mr. Karthik is employed at Hyderabad at a Basic salary of Rs.25,000 PM and he is also getting following allowances:

- a. Dearness allowance 2,000 PM
- b. Lunch allowance 1,000 PM
- c. Servant allowance 1,000 PM
- d. Transport “ 1,000 PM
- e. Education “ 200 PM per child for three children
- f. Hostel “ to one child 500 PM
- g. Conveyance “ 800 PM
- h. Overtime “ 24,000 PM
- i. Officiating “ 2,000 PM
- j. Cash allowance 1,200 PM
- k. Entertainment “ 2,000 PM
- l. Medical “ 800 PM
- m. CCA 600 PM
- n. HRA 5,000 PM

He is having a family house at the place of his posting but he is living in a rented house and in paying a rent of Rs.7,000 pm find out his gross salary.

COMPUTATION OF GROSS SALARY OF MR.KARTHIK

Basic salary @ Rs.25,000 pm		3,00,000
Dearness allowance		24,000
Lunch allowance		12,000
Servant allowance		12,000
Transport allowance	12,000	
Less: Exemption	9,600	2,400
Education allowance	7,200	
Less: Exemption	2,400	4,800
Hostel allowance	6,000	
Less: Exemption	3,600	2,400
Conveyance allowance		9,600
Over time allowance		24,000

Officiating allowance	24,000
Cash allowance	14,400
Entertainment allowance	24,000
Medical allowance	9,600
CCA	7,200
HRA	
Less: Least of the following:	
Received Rs.60,000	
40% of salary Rs.1,20,000	
Rent paid—10% of salary Rs.54,000	
(60,000—54,000)	6,000
GROSS SALARY	4,76,400

PERQUISITES [SECTION 17(2)]

U/S 17(1) “Salary” includes the value of any perquisite allowed or amenity provided by employer to employee. The word perquisite has not been defined under Income tax act 1961. Perquisite simply means any casual emolument attached to an office. Oxford English Dictionary also defines perquisite as “any casual emolument, fee or profit attached to an office or position, in addition to salary or wages”. Perquisites may be given in a variety of forms. If the perquisite does not accrue to the employee it will not be taxable. They may be received in cash or in kind. For income tax purposes it is immaterial whether the perquisites are paid voluntarily or under a contractual obligation. Where goods are presented to an employee, the value to be taxed is not their cost to the employer but their value to the employee.

Value of perquisites is chargeable to tax under the head salary only if these perks are received by an employee from his or her employer and employer may be a present, past or prospective one. In case any perks has been received from a person other than employer, then also the value of perk is taxable but either under the head business or profession or Income from other sources.

Any benefit derived by an employee from his employer whether received in lump sum or is being received every month and if such benefit comes out of employment agreement and it is providing a personal benefit to the employee or his family members, value of such a benefit is chargeable to tax under the head salary.

TYPES OF PERKS:

Perks can be divided into four categories:

- (i) Perks exempted for all employees
- (ii) Perks which are exempted for employees but are taxable for employer under Fringe benefits tax
- (iii) Perks taxable for all employees
- (iv) Perks taxable only for specified employees

TAXABILITY OF PERQUISITES:

EXEMPTED FOR ALL EMPLOYEES:

- Free medical facilities
- Free refreshments during working hours
- Free recreational facilities
- Provision of telephone whether basic or cellular exclusively for official use
- Free meals provided in remote area or at off shore installation are fully exempted
- Free education training or refresher course for employees
- Leave travel concession
- Free ration received by members of armed forces
- Perquisites allowed by government to its employees posted abroad
- Rent free house given to an officer of parliament, a Union Minister and leader of Opposition in parliament
- Free residence and conveyance facilities to Judges of supreme court and High court

- Free conveyance provided by employer to employee for going to or coming from place of employment.
- Any amount contributed by employer towards pension of deferred annuity scheme
- Employer's contribution to staff group insurance scheme
- Computers, laptops given to an employee for official/personal use
- Transfer of a moveable asset more than 10 years old without consideration
- Accident insurance premium paid by employer for his own benefit
- Value of any shares or debentures given free of cost or at concessional rate to employees under stock option scheme approved by the Central government
- Tax on perks paid by employer
- Rent free accommodation given in remote or offshore areas.

TAXABLE FOR ALL EMPLOYEES:

- Rent free house
- Concessional rent house
- Obligation of employee met by employer
- Any other fringe benefits given by employer to employee, such as, free meals if provided during working hours and value exceeds Rs.50 per day excess is taxable, interest free loan or loan at concessional rate of interest if more than Rs.20,000 and if not for medical treatment difference between prescribed rate and rate charged is taxable.
- Any amount of life insurance premium paid by employer during the previous year.

TAXABLE FOR SPECIFIED EMPLOYEES ONLY:

- Gas, water and electricity facility
- Education facility for children
- Free transport allowed by employer engaged in transport business

- Services of domestic servants including sweeper, watchman, Gardner provided by employer
- Any other benefit or amenity

PERKS EXEMPTED FOR EMPLOYEES BUT TAXABLE FOR EMPLOYER BUT TAXABLE FOR EMPLOYER UNDER FRINGE BENEFIT TAX:

Value of following benefits is not taxable in the hands of an employee. The employer has to pay tax on deemed income calculated as percentage of expenditure incurred.

1. Any free or concessional ticket provided by the employer for private journeys of his employees or their family members;
2. Any contribution by the employer to an approved superannuation fund for employee
3. (A) Expenditure incurred on entertainment
 (B) Expenditure incurred on provision of hospitality of every kind by the employer to any person, whether by way of provision of food or beverages or in any other manner what so ever and whether or not such provision is made by reason of any expenses or implied contract or custom or usage of trade.
 (C) Expenditure incurred on conference for the purpose of this clause, any expenditure on conveyance, tour and travel or boarding and lodging in connection with any conference shall be deemed to be expenditure incurred for the purpose of conference;
 (D) Expenditure incurred on sales promotion including publicity;
 (E) Expenditure incurred on employee's welfare;
 (F) Expenditure incurred on conveyance, tour and travel
 (G) Expenditure incurred on repair, running and maintenance of aircrafts on leased telephone lines;
 (H) Expenditure incurred on festival celebrations
 (L) Expenditure incurred on use of health club and similar facilities
 (M) Expenditure incurred on gifts and
 (N) Expenditure incurred on scholarships

RULES REGARDING CALCULATION OF VALUE OF RENT FREE HOUSE:

1. For Unfurnished accommodation:

A. OWNED BY EMPLOYER:

(a) Government employees: The value of house is rent fixed by the government for such house. It can be rent charged b government from another employee of same status for similar type of house.

(b) Other employees: Value of house is calculated in following manner:

- (i) In cities whose population is more than 4 lakhs : 20% of salary is taxable
- (ii) In cities whose population is up to 4 lakhs : 15% of salary is taxable
- (iii) Hotel accommodation (for more than 15 days On transfer from one place to other) : 24% of salary (for the period of days for which accommodation is provided in hotel) or actual bill which ever is less is taxable.

B. HIRED BY EMPLOYER: 20% of salary OR Actual rent paid or payable which ever is less is taxable in all cities.

FOR FURNISHED ACCOMODATION:

In case of all types of employees calculate value of unfurnished house

If furniture is owned by employer add 10% of cost of furniture

If furniture is hired actual hire charges are added.

MEANING OF SALARY:

For the calculation of value of rent free accommodation the word salary includes:

- (i) Basic salary or pay
- (ii) DA if term of employment so provide or it enters into salary for calculation of value of service or retirement benefits
- (iii) Commission

- (iv) Bonus
- (v) Fees
- (vi) Value of all taxable allowances
- (vii) Any other monetary payment, by what ever name called
- (viii) Leave encashment of salary only if it relates to the leave earned during the previous year in which rent free house is provided to the employee.

SALARY DOES NOT INCLUDE:

- (i) DA if not paid as per terms of employment
- (ii) Any other allowance which is exempt one
- (iii) Employer's contribution in employee's provident fund
- (iv) Value of other perquisites falling u/s 17(2)
- (v) Leave encashment of salary if it relates to the leave earned in earlier previous years
- (vi) Income tax of employee is paid by employer

PROBLEM: Mr.Gowda is working in a Central Government office at simla. His salary particulars are as follows:

Salary	72,000
DA [FULL ENTERS INTO RB]	48,000
Hill compensatory allowance	12,000
Transport allowance	9,600
Provided with rent free house (annual license fee)	7,200
Cost of furnishing	45,000

Calculate value of rent free house.

CALCULATION OF VALUE OF RENT FREE ACCOMODATION GROSS SALARY:

For Government employees the value of rent free house is license fee fixed by it which is in present case is

	7,200
Add:10% of cost of furnishing [10% of Rs.45,000]	4,500
	11,700

PROBLEM:

Mr.Shankar gets salary of Rs.12,000 PM and is provided with rent free unfurnished accommodation at Ludhiana (population more than 4 lakhs) whose fair rental value is Rs.1,300 PM. He gets leave encashment for the current previous year of Rs.6,000 during the year. House was provided to him with effect from 1-7-2008. his salary is due on 1st day of every month. Calculate the value of rent free accommodation and gross salary.

CALCULATION OF VALUE OF RENT FREE ACCOMODATION, GROSS SALARY:

Salary @ Rs.12,000 PM	1,44,000
Leave Encashment for the current previous year	6,000
Value of perquisite: Rent free Accommodation	
Salary=1,44,000+6,000=1,50,000	
20% of salary = 30,000	
Reduced to 8 months (30,000 X 8/12)	20,000
GROSS SALARY	1,70,000

CONCESSIONAL RENT HOUSE:
PROBLEM: CALCULATE VALUE OF RENT FREE HOUSE AS PER ABOVE AND DUDUCT RENT PAID BY EMPLOYEE:

From the particulars given below compute his gross salary:

Salary	1,48,000
Bonus	12,000
Free gas and water etc,	6,000
Furnished flat provided to the employee for which actual rent paid by the company	
Rs.78,000	
Rent received from the employee	12,000

Furniture at cost 50,000

COMPUTATION OF SALARY INCOME:

Salary	1,48,000	
Bonus	12,000	
Total salary		1,60,000

VALUATION OF PERQUISITES:

Furnished flat at concessional rent		
20% of salary including bonus	32,000	
Or Actual rent paid	78,000	
Which ever is less is taxable	32,000	
Add perquisite of furniture		
(10% of cost ie, 10% of 50,000)	5,000	
	37,000	
Less: Rent recovered by Co,	12,000	25,000
Perquisite of free gas and water		6,000
GROSS SALARY		1,91,000

OBLIGATION OF EMPLOYEE MET BY EMPLOYER:

In case any of the following payments are made by employer these are fully taxable.
These are:

- (a) Gas and electricity bills: Issued on the name of employee but paid by employer – actual expenses met by employer are taxable.
- (b) Education of children bills issued on the name of employee but paid by employer---- actual expenses met by employer are taxable. Reimbursement of tuition fee of children is also fully taxable.
- (c) Income tax, professional tax of employee paid by employer--- actual expenses met by employer are taxable
- (d) Salary of domestic servants employed by employee but paid by employer-----actual amount paid by employer is taxable.

FRINGE BENEFITS GIVEN BY EMPLOYER TO EMPLOYEE:

Under this provision only those benefits are covered which are not included under the provisions of FBT:

- a. Medical bills for treatment in private or unnotified hospitals issued on the name of employee but paid by employer shall be taxable for an amount exceeding Rs.15,000.
- b. Interest free or concessional loan from employer: Interest free or interest charged at a concessional rate on loan given by employer to an employee or any member of his/her family is a perquisite given to an employee which is chargeable to tax. Valuation of this perk shall be made keeping in mind the following points:

- 1) Interest is to be calculated at the rate charged by SBI on similar type of loan as on the 1st day of the relevant previous year. SBI notifies the lending rate from time to time.
- 2) Interest is to be calculated for each month of the relevant previous year on the maximum out standing monthly balance.
- 3) Interest paid by employee, if any, is to be deducted out of total interest for the full previous year calculated as above.
- 4) “Maximum outstanding monthly balance” means the amount of each loan due to the employer on the last day of each month. This means that in case any amount of loan has been repaid in any month the same is to be deducted and only the balance amount due to the employer shall be known as maximum outstanding monthly balance.

PERKS TAXABLE IN SPECIFIED CASES ONLY:

Following perks are taxable only if employee is either a director of company or has substantial interest (20% or more equity shares) or his salary is more than Rs.50,000 p.a. this salary means all monetary emoluments, which are taxable under the head salary after allowing deductions u/s 16:

Who is specified employee:

- a. Who is director of the company or
- b. Who is substantial interest in the affairs of the company ie, he holds at least 20% of the voting power (equity shares) in the company or
- c. His monetary salary is more than Rs.50,000 p.a.

Salary for this purpose means all what he gets in cash from one employer or more than one employer if he works for more than one employer simultaneously whether full time or part time, and is taxable under the head salary. The total of these items is to be treated as gross salary out of which deductions u/s 16(ii) and (iii) are to be allowed:

Monetary salary includes:

1. basic salary
2. DA/DP
3. Bonus, commission, fees and all taxable allowances or taxable portion of allowance
4. Any perquisites received in cash or in monetary form
5. Gratuity, pension, leave salary but arrears of salary and salary received in advance is to be excluded
6. In case employee is working simultaneously with more than one employer, salary from all the employers is to be included.
7. Monetary salary of Rs.50,000 shall be calculated after allowing deductions u/s 16(ii) and 16(iii)

VALUE OF FOLLOWING PERKS IS TAXABLE ONLY IF EMPLOYEE BECOMES AN EMPLOYEE OF SPECIFIED CATEGORY: THESE PERKS ARE:

1. Free education: If employer provided free education to the members of the family of the employee in an institution owned or maintained by it, a reasonable amount which employee would have spent on similar type of education shall be taxable but after allowing exemption of Rs.1,000 PM per child.
2. Free gas, light and water: In case connection is on the name of employer and employer also pays bill, actual cost of such benefit is taxable
3. Free servants:

- a) In case employee employs servants but their salary is paid by employer---- full salary is taxable for all employees u/s 17(2)(iv)
 - b) In case employer provides services of sweeper and watchman full salary of these employees is taxable and it shall be reduced by any amount paid by employee.
 - c) In case gardener is provided for rent free house owned by employer its salary is added in FRV and is not taxable separately. But, if house is owned by employer or is hired by employer, full salary of gardener is taxable.
 - d) In case employer provides any other servant his full salary is taxable
 - e) Taxable for full month even if given for part of month
4. Any other bill on the name of employer for personal expenses of employee paid by employer shall be taxable. In case medical bills are in the name of employer and are paid by employer these shall be taxable only after allowing exemption as per rule given earlier for specified employees only.

PROFITS IN LIEU OF SALARY:

- (i) The amount of any compensation due to or received by an assessee from his employer or former employee at or in connection with the termination of his employment or the modification of terms and conditions relating thereto.
- (ii) Any payment (other than any payment referred to in clause (10), clause (10A), clause 10B , clause 11, clause 12, 13 (with effect from 1-4-1996 or clause 13A of section 10, due to or received by an assessee from an employer or a former employer or from a provident or other fund to the extent to which it does not consist of contributions by the assessee or interest on such contributions or any sum received under a key man insurance policy including the sum allocated by way of bonus or such policy.
- (iii) Any amount due to or received whether in lump sum or otherwise by any assessee from any person:
 - a. Before his joining any employment with that person or

b. After cessation of his employment with that person

PAYMENTS EXEMPTED U/S 10

Any payment received whether from present or past employer, is taxable as profit in lieu of salary. The following receipts, however are exempted:

1. LEAVE TRAVEL CONCESSION [SECTION 10(5)]

Any time amount received by an employee from his employer for proceeding on leave any where in India or on proceeding to any place in India after retirement is exempted up to the extent of an amount provided u/s 10(5) and rules framed there under.

This benefit is available to employee for self and any member of his family. The word “family” includes spouse children of the individual and parents, brother or sisters who are mainly dependent on such individual.

The exemption under this section shall be available subject to rules and regulations framed by the Central Government.

2. PERQUISITES AND ALLOWANCES PAID BY GOVERNMENT TO ITS EMPLOYEES POSTED OUTSIDE INDIA [SECTION 10(7)]

Any perquisite or allowance given by government to its employees who are working outside India is full exempt from tax. As such motor car provided to employee working outside India or house rent allowance or any other such benefit is fully exempted form tax.

3. DEATH CUM RETIREMENT GRATUITY:

Important points to be kept in view while calculating exempted amount of gratuity u/s 10(10):

- 1) Employees of statutory corporation will be covered under the category of non-government employees.
- 2) Any gratuity received by the legal heirs of government employees is fully exempted. For others it shall qualify for exemption in the same manner but taxable under the Income form other sources.

- 3) In case employee has worked with more than one employer but is receiving gratuity only from present employer, his total service ie. From all previous employer from whom he has not received any gratuity, shall be counted.
 - 4) In case employee has retired but has been re-employed by same employer, exemption shall be allowed.
 - 5) In case employee receives gratuity from two employer under whom he is working simultaneously, exemption shall be allowed subject to maximum of Rs.3,50,000.
 - 6) In case gratuity is received while employee is still in service with the same employer it is fully taxable.
 - 7) Exemption of gratuity shall be allowed only if relationship of employer and employee does exist. It simply means that gratuity paid to an agent shall not be exempted as there is no relationship of employer and employee between an agent and his principal.
- (i) **GRATUITY RECEIVED FROM CENTRAL/STATE GOVERNMENT/LOVSL BODIES:** Any such received by the employees working in Civil or Defence services of government of India or any post of state government or local authority covered under Revised Pension Rules of the Central Government shall by fully exempted.
- (ii) **GRATUITY RECEIVED UNDER PAYMENT OF GRATUITY ACT 1972:** Payment of Gratuity act 1972 applies to employees or workers of following categories:
- a. Workers working in every factory, mine, oil field, port, plantation and railway
 - b. Workers working in every shop or establishment in which 10 or more persons are employed or were employed on any day of the preceding 12 months
 - c. Workers//employees working in any other establishment or class of establishment in which 10 or more persons are employed or were employed on any date of the preceding 12 months and as the Central Government may by notification specify in this behalf.

In case of employees covered by the Payment of Gratuity act 1972, an amount being least of following three items shall be exempted and excess if any, will be taxable.

These items are:

- a. 15 days salary (7 days in case of employees working in seasonal factories) for each year of completed service or part thereof in excess of six months. While calculating length of service period exceeding 6 months or more is to be taken as one year. If it is less than 6 months it shall be ignored.
- b. Notified limit Rs.3,50,000
- c. Gratuity actually received by the employee

“Salary” means salary last drawn by the employee and it also includes dearness allowance. Average salary shall be calculated by taking 26 days as the maximum number of working days in a month. For example if the employee was drawing Rs.1,300 at the time of his retirement, then 15 days average salary shall be $Rs.1,300 \times 15 / 26 = 750$.

PROBLEM: Mr. Yadav retired on 30-11-2008 from a coal mine after putting a service of 28 years and 10 months. At the time of his retirement he was getting a salary of Rs.16,000PM and he used to get an increment of Rs.500 PM on 1st April every year. His DA was Rs.2,000 PM Gratuity received Rs.3,40,000. find out his taxable gratuity.

COMPUTATION OF TAXABLE GRATUITY (WHERE PAYMENT OF GRATUITY ACT 1972 APPLIES)

AVERAGE MONTHLY SALARY:

TOTAL SALARY FOR 10 MONTHS = 1,79,000

AVERAGE SALARY = $1,79,000 / 10 = 17,900$

$17,900 \times 15 / 26 \times 29 = 2,99,481$

EXEMPTION SHALL BE LEAST OF 3 AMOUNTS:

1. Statutory limit = 3,50,000
2. Actual received = 3,40,000

3. $\frac{1}{2}$ months' salary for each year of service = 2,99,481
Exempted Gratuity = 2,99,841

Therefore, taxable gratuity = 3,40,000 – 2,99,481 = 40,519

NOTE: Full amount of DA is taken into account for calculation of average monthly salary.

In case of employee where payment of gratuity act 1972 applies, a year in which more than 6 months has been completed is to be treated as full completed year.

GRATUITY RECEIVED BY ALL OTHER EMPLOYEE: Exempted upto least of the following:

- (i) Notified limit Rs.3,50,000
- (ii) $\frac{1}{2}$ month's average salary for every completed year of service [months to be ignored]
- (iii) Actual Gratuity received

In case gratuity is received from private employer, an amount equal to least of the above there items shall be exempted.

AVERAGE SALARY: the average salary is to be computed by taking salary of last 10 months preceding the month in which retirement or death occurs. In case employee retires on any date during the month salary of that part of month is to be ignored.

Salary: the word salary here has the same meanings as is assigned to it for provident fund purposes ie, the basic pay plus dearness pay or any portion of DA which enters into pay for service benefits plus commission received on fixed percentage of turn over achieved by him.

NOTIFIED LIMIT: the limit of Rs.3,50,000 is applicable for whole serving life of employee. In case gratuity is received from more than one employer the aggregate amount of gratuity received must not exceed Rs.3,50,000.

By amending the provisions of section 10(10) the government has taken over the powers to raise the limits of exempted gratuity by just issuing a notification.

PROBLEM: Mr.Girish retired on 15-6-2008 from a manufacturing company after putting service of 30 years and 7 months. He received a Gratuity of Rs.3,60,000. Basic salary of Mr.Girish was Rs.20,000 PM during 2008 and Rs.22,000 during 2009. he was also getting DA @ Rs.5,000 PM which was increased from Rs.4,000 on 1-4-2009. 50% of DA is presumed to enter into salary for computation of service benefits. Compute his taxable gratuity.

EXEMPTION ALLOWED SHALL BE LEAST OF FOLLOWING 3 AMOUNTS;

a. Statutory amount	3,50,000
b. Actual amount received	3,60,000
c. $\frac{1}{2}$ month's salary for each year completed service (23,100/2X30)	3,46,500

Exemption allowed = Rs.3,46,500

Taxable Gratuity= Rs.3,60,000 – Rs.3,46,500 = 13,500

PENSION: [SECTION 10 (10A)]

(A) Pension received on a monthly basis: Any amount of pension received from government or any other employer will be fully taxable if it is received on a monthly basis.

(B) Pension received on a commuted basis: In case employee gets his pension commuted, it is exempted as under:

- (i) Commuted pension received by employees of government and semi government basis; the amount received by an employee as commuted value of pension is fully exempted if received from:
 - a) Central government
 - b) A State government or
 - c) A corporation set up under central, state or provisional act

It is also fully exempted in case of Judges of High courts and supreme court

Commutated pension received by employees working in private sector.

ANY PAYMENT RECEIVED IN COMMUTATION OF PENSION

[SECTION 10(10A)]

Any amount of pension received monthly or otherwise from any employer is fully taxable but any amount received in lump sum as commuted value is to be treated in the following manner:

The amount received by the employer as commuted value of pension is fully exempted if he receives it from;

- a. Central government
- b. State government
- c. Local authority
- d. A corporation set up under Central, State or Provincial act; under the civil pensions rules of the Central government or
- e. As Judge of Supreme court or High court in India

In case of other employees, any amount received on commutation of pension is exempted subject to following limits:

- (i) In case where the employee receives any gratuity, the exempted amount shall be commuted value of one-third of pension which he is normally entitled to receive.
- (ii) In case where the employer does not receive gratuity, the exempted amount shall be the commuted value of one half of such pension.

PROBLEM: FIND OUT THE TAXABILITY OF PENSION IN THE FOLLOWING CASES:

- (i) MR. Gopal retires from a public limited company on 31st August 2008 and his pension was fixed at Rs.1,500 PM He does not commute any part of pension.
- (ii) Mrs. Radha retires from government service on 30th September 2008 and her pension was fixed at Rs.1,000 PM she does not commute any portion of pension.

- (iii) Mr. Raju retires from Punjab Government service on 30th June 2008 and his pension has been fixed at Rs.1,200 PM He gets 1/3rd of his pension commuted for Rs.60,000.
- (iv) Mr.Reddy retires from private service on 30th April 2008 and his pension has been fixed at Rs.1,500 PM He gets ½ of his pension commuted and gets Rs.80,000. He also received Rs.75,000 as gratuity. He gets his pension commuted during January 2009.

In all cases pension becomes payable on the 1st day of each month.

- (i) Uncommuted pension received from private sector is fully taxable.
- (ii) Uncommuted pension received by Mrs.Radha is fully taxable. Her taxable pension shall be Rs.1,000X5=5,000.
- (iii) Commuted portion of pension received by Mr.Raju ie. Rs.60,000 is fully exempted. Uncommuted portion of pension @ Rs.800 PM will be fully taxable. Mr.Raju's un commuted portion shall be Rs.800X8=6,400 during the previous year.

- (iv) Commuted portion of pension of Mr.Reddy shall be taxable as under:

For ½ portion of pension he gets = Rs.80,000

For full portion of pension he gets = 80,000 X 2

1/3rd portion of commuted pension shall be exempted = 80,000X2/1X1/3

= Rs.53,333

Taxable portion of commuted pension shall be = 80,000 – 53,333 = 26,667

Uncommuted portion of pension of Rs.1,500X1/2=750 PM for 2 months is fully taxable. Uncommuted pension of Rs.1,500 PM for 8 months is also fully taxable.

5. Amount received as Leave Encashment on retirement [Section 10(10AA)]

- (1) Leave encashed during service: In case employee gets any leave salary or gets his/her leave encashed while still in service, it is fully taxable in the year in which it is encashed.

(2) Leave encashment at the time of retirement or leaving the service: U/S 10 (10AA) employed shall be entitled to exemption if he gets his leave encashed at the time of leaving the service including at the time of resigning from the job.

- a. Central/state Government employees--- any payment received as the cash equivalent of the leave salary in respect of the earned leave to his credit at the time of his retirement or on leaving the service shall be fully exempted.
- b. Other employees--- any payment received as the cash equivalent of the leave salary to his credit at the time of superannuation or on leaving the service shall be exempted up to least of the following amounts:
 - A. Actual amount received
 - B. Amount calculated at average salary for 10 months (average salary means average of salary drawn by employee during 10 months immediately preceding his retirement); or
 - C. Notified limit Rs.3,00,000
 - D. The cash equivalent of the leave salary to his credit at the time of retirement.

LEAVE ENTITLEMENT STANDING TO THE CREDIT OF EMPLOYEE, while calculating leave entitlement the employee is entitled only 30 days leave in one completed year of service.

MEANING OF SALARY: It shall mean basic salary + DA (if given under the terms of employment or if it enters into pay for retirement benefits + Commission as fixed percentage of turnover achieved by him.

CALCULATION OF AVERAGE SALARY:

Salary for 10 months preceding the date of retirement is to be taken. Salary for this purpose has the same meaning as for provident fund ie, pay+DA (which enters into pay for retirement/service benefits) + commission on turnover achieved by him.

PROBLEM: Mr. Yadav retires on 1st July 2008 after 18 years of service and receives Rs.75,000 as amount of leave encashment for 15 months. His employer allows 45 days leave for every one year of service. During service he has already encashed leave for 12 months. Calculate the taxable amount of leave encashment if his salary during 1-7-2007 to 1-7-2008 was Rs.5,000 PM.

COMPUTATION OF TAXABLE AMOUNT OF LEAVE ENCASHMENT OF MR.YADAV

Leave due as per section 10(10AA) @ one month leave for every	
One year of service	18 months
Less: Leave already availed	12 months
Leave due at the time of retirement	06 months

LIMITS:

(i)	Notified limit	3,00,000
(ii)	10 months average salary (10X5,000)	50,000
(iii)	Cash equivalent of leave due at the time Of retirement (6X5,000)	30,000
(iv)	Actual amount received	75,000

Least of above ie, Rs.30,000 is exempted

Taxable Rs.75,000—30,000 = Rs.45,000

ANY AMOUNT RECEIVED AS COMPENSATION ON TERMINATION OF EMPLOYMENT: [SECTION 10B]

Such compensation is tax free up to the limits given below provided he gets compensation under the provision of the Industrial Disputes Act:

- (i) An amount calculated in accordance with the provisions of clause (b) of section 25F of the Industrial disputes act
- (ii) Notified limit: The monetary ceiling has been removed with effect from assessment year 1989-90. the limit shall be prescribed by the Central

government from time to time in Official Gazette. The limit will not be less than Rs.5,00,000.

- (iii) Actual compensation received which ever is less.

Under industrial disputes act, a workman is allowed retrenchment compensation equal to 15 days average pay for each completed year of service or any part thereof in excess of six months. The limits of sec 10(10B) shall not apply in cases where the compensation is paid under any scheme approved by Central government.

ANY AMOUNT RECEIVED ON VOLUNTARY RETIREMENT [SECTION 10(10C)]

Under this section any payment received by an employee at the time of his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or in the case of public sector company, a scheme of voluntary separation, is exempted being least of 4 months as mentioned below. This exemption shall be allowed if the employee voluntary retire from the following bodies:

- a. A public sector company
- b. Any other company
- c. An authority established under a central, state or provincial act
- d. A local authority
- e. A co-operative society
- f. Any state government or
- g. Central government

INCOME BY WAY OF TAX ON PERKS [SECTION 10(10CC)]

In case employer pays, at its option, tax on value of perks given by it to an employee (not provided by way of monetary payment) it shall be fully exempted in the hands of employee.

ANY PAYMENT RECEIVED FROM A STATUTORY PROVIDENT FUND OR PUBLIC PROVIDENT FUND IT IS FULLY EXEMPTED FROM TAX PAYMENT RECEIVED FROM RPF:

It is tax free in following cases only:

- a. The employee has rendered 5 years continuous service
- b. Though he has not rendered 5 years continuous service but the service has come to an end because of reasons beyond his control.

The finance act 1974 has added a clarification to this exemption. If the accumulated balance standing in the name of employee is transferred from one recognized provident fund to another similar type of fund, such balance will not be added in the total income of the assessee. The period of five years will be counted by adding the period for which the fund remained with previous employer to the period for which the fund remains with the present employer from whom he is getting refund.

ANY PAYMENT FROM SUPERANNUATION FUND [SECTION 10(13)]

Any payment from an approved superannuation fund made:

- (i) On the death of a beneficiary or
- (ii) On retirement or on becoming incapacitated or
- (iii) By way of refund of contribution on the death of a beneficiary or
- (iv) Any refund of contributions of employee earlier than his retirement or on his becoming incapacitated to the extent of his own contribution made prior to the commencement of this act and interest thereon, shall be fully exempted.

ANY SPECIAL ALLOWANCE [SECTION 10(14)]

If any allowance is given by employer to employee to meet certain expenditure wholly and exclusively incurred in the performance of duties it is tax free up to the extent it is incurred for such purposes such as out of pocket allowance or out fit allowance received by NCC officers.

This section does not grant any exemption for any allowance given to meet the expenses at a place where the employee ordinarily resides and performs duties eg. CCA which is fully taxable.

Deductions out of Gross salary:

Some employees are required to incur expenditure on the entertainment of customers, clients etc, who come to meet them in connection with their official or business work. In

case employee is given a fixed amount every month to meet this type of expenditure then it is fully added in salary and out of gross total salary, a deduction u/s 16(ii) shall be allowed only to government employees. This means that in case this allowance is given to employees working in private sector, it is fully taxable.

But in case any amount is reimbursed against any expenditure incurred by employee, it shall be fully exempted.

Deduction u/s 16(ii) admissible to government employees shall be an amount equal to least of the following:

- a. Statutory limit Rs.5,000 PA
- b. $1/5^{\text{th}}$ of basic salary
- c. Actual amount of entertainment allowance received during the previous year

TAX ON EMPLOYMENT U/S 16(iii)

In case any amount of professional tax is paid by the employee or by his employer on his behalf it is fully allowed as deduction.

PROBLEM:

From the following particulars, find out the taxable salary of Mrs. Radhika working at Coimbatore. (population more than 4 lakhs)

- a. Salary Rs.12,000 PM
- b. DA Rs.1,500 Pm
- c. Employers contribution to RPF 14% of basic salary
- d. RFA ---- fair rental value is Rs.80,000 PA expenses on maintenance of garden met by employer Rs.3,000
- e. Interest on PF balance @ 13% PA Rs.3,900
- f. A car (1.4 lt. capacity) is provided by employer. All expenses are borne by employer. It is used both for performance of duties and private purposes. Car was used by employee for only 11 months during the year.
- g. She paid professional tax Rs.200
- h. She received Rs.500 PM as fixed medical allowance

COMPUTATION OF SALARY INCOME:

Salary @ Rs.12,000 pm		1,44,000
DA @ 1,500 pm		18,000
Employer's contribution to RPF	20,160	
Less: exempted upto 12% of salary	17,280	2,880
Interest credited on RPF balance 13%	3,900	
Less: exempted (3,900X9.5/13)	2,850	1,050
Fixed medical allowance		6,000
VALUE OF RFA		
Salary = 1,44,000 + 6,000 = 1,50,000:20% of salary		30,000
Value of car perquisite exempted		Nil
Gross salary		2,01,930
Deductions u/s 16		
Professional tax u/s 16(iii)		200
Salary income		2,01,730

NOTE: DA is not added in salary for the calculation of value of RFA because it does not enter into service benefits.

PROBLEM:

Mr. Arvind is working with two employees simultaneously and submits the following particulars of his income for the year ending 31-3-2009.

	ABC LTD	XYZ LTD
Salary	10,000 PM	3,000 PM
DA	4,000 PM	600 PM
Bonus	12,000	5,000
Conveyance allowance	2,000 pm	300 pm

He spends 60% of conveyance allowance received from 1st employer and 40% of such amount received from 2nd employer for employment purposes. He joined service with ABC Ltd, in 1953 and since then he has been receiving Rs.400 pm as Entertainment allowance. ABC Ltd has provided him rent free house at Chennai for which it pays rent of Rs.4,000 pm. Services of Gardner have also been placed at the disposal of Mr.Arvind, for which company is paying Rs.800 pm. The house has been furnished with all items costing Rs.1,00,000.

Compute his gross salary.

COMPUTATION OF GROSS SALARY OF MR.ARVIND:

1 st employer		
Salary		1,20,000
DA		48,000
Bonus		12,000
Conveyance allowance	24,000	
Less: 60% spent for employment	14,400	9,600
Entertainment allowance		4,800
Services of gardner @ 800 pm		9,600
2 nd employer		
Salary		36,000
DA		7,200
Bonus		5,000
Conveyance allowance	3,600	
Less: 40% spent for employment	1,440	2,160
Value of RFA from 1 st employer (note 2)		47,912
Gross salary		3,02,272

NOTE: VALUE OF RENT FREE HOUSE AT CHENNAI: RENT PAID BY EMPLOYER = Rs.48,000

Salary 1,20,000+12,000+9,600+36,000+5,000+2,160+4,800 = 1,89,560

20% of salary 37,912

Or actual rent paid Rs.48,000 37,912

(which ever is less)

Add: 10% cost of furnishing 10,000

Value of furnished rent free house 47,912

PROBLEM:

Mr. G.R.VISHWANATH returned to India after serving a British company for 25 years. He joined service with an Indian company at Mumbai during previous year. He furnishes the following details and asks you to compute his salary income if he is:

- Ordinary resident or
- Resident but not ordinarily resident

- (i) Salary [he was on leave for two months and during this period he received his salary in Britain] Rs.25,000 pm
- (ii) CCA Rs.500 pm
- (iii) Ration bill paid by employer 14,000
- (iv) Fixed medical allowance 400 pm
- (v) Education allowance for his son who is studying in MBA in Mumbai 1,000 pm
- (vi) Rent free house hired by employer, rent paid Rs.2,000 pm and cost of furnishing is Rs.1,20,000
- (vii) He and his employer contribute Rs.4,000 pm each towards RPF
- (viii) He was getting a monthly pension of Rs.15,000 from his British employer which was being credited to his bank account in London.

COMPUTATION OF SALARY INCOME:

	RESIDENT	R BUT NOR
Salary	3,00,000	3,00,000
(fully taxable for 12 months as it accrues in India)		
CCA	6,000	6,000
Ration bill paid by employer	14,000	14,000
Fixed medical allowance	4,800	4,800
Education allowance	10,800	10,800
Excess of employer's contribution to RPF over 12% of salary	12,000	12,000
Rent free house hired by employer:		
20% of salary [3,00,000+6,000+4,800+10,800=3,21,600] 64,320 or rent paid by employer Rs.24,000 which ever is less = 24,000 + 10% of cost of furnishing Rs.12,000]	36,000	36,000
Pension accrued and received in London taxable only for resident	1,80,000	NIL
SALARY INCOME	5,63,600	3,83,600

PROBLEM:

Mr. Mohan is a production manager of an industrial unit at Chennai. The particulars of his salary income are as under:

Basic salary	15,000 pm
DA given under the terms of employment	5,000 pm
Entertainment allowance	1,000 pm
Medical allowance	500 pm
HRA	4,000 pm
Rent paid	5,000 pm
Car of 1.2 liter capacity is provided by employer for private and official use	
Employer meets expenses of car	
He and his employer each contribute 15% of salary to RPF	
Mr. Mohan had taken interest free loan of Rs.15,000 to purchase refrigerator	

Compute his income under salary.

SOLUTION:

Salary		1,80,000
DA		60,000
Medical allowance		6,000
EA		12,000
Employer's contribution to RPF	36,000	
Less: 12% of salary [2,40,000 X 12%]	28,800	7,200
HRA	48,000	
Less: least of the following:		
i. Actual HRA received	48,000	
ii. Rent paid – 10% of salary	36,000	
iii. 50% of 2,40,000	1,20,000	36,000
Taxable HRA		NIL
Free use of car	Exempted	
Gross salary		2,77,200
Deductions u/s 16		NIL
INCOME FROM SALARIES		2,77,200

PROBLEM:

MRS. REVATHI submits the following:

- 1) Net salary received after deduction of the following 1,50,000

Income tax deducted at source	6,000
Own contribution to RPF	20,000
Rent of residential house provided	4,000
2) profit bonus	24,000
3) EA	12,000 PA
4) she went on tour for official purposes and received TA	6,000
5) she was ill and was treated in a notified hospital	18,000
6) she was provided with RFA owned by co, and also with a Gardner whose salary was 500 pm	
7) The electricity and water bill of the above house paid by co,	1,200 pm
8) she was provided with a car of 1.2 LT for all purposes	
9) The co, contributed Rs.24,000 towards RPF	

SOLUTION:

Net salary received after deductions	1,50,000	
ADD: income tax deducted at source	6,000	
Own contribution to RPF	20,000	
Rent of residential house provided	4,000	1,80,000
Profit bonus		24,000
EA		12,000
Traveling allowance on official tour	Exempted	
Reimbursement of medical bills	Exempted	
RFA: 20% of salary (1,80,000+24,000+12,000=2,16,000)	43,200	
Less: rent paid by employee deducted out of salary	4,000	39,200
Electricity and water bill of the house paid by employer		14,400
Small car	Exempted	
Employer's contribution to RPF	24,000	
Less: exempted up to 12% of salary	21,600	2,400
SALARY INCOME		2,72,000

PROBLEM:

Mr. Xavier an employee of RANCHI based company provides the following particulars of his salary:

Basic salary	12,000 pm
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Profit bonus	12,000
Commission on turnover achieved by him	42,000
EA	2,000 pm
Club facility	6,000
Transport allowance	1,000 pm
Free use of car of more than 1.6 lt. capacity for both personal and employment purposes; expenses are met by employer	
RFA provided by employer lease rent paid by employer	6,000 pm
Free education facility for three children of the employee	
Bills issued in the name of the employer	22,500
Gas, water and electricity bills issued in the name of employee but paid the employer	16,800

COMPUTE HIS SALARY INCOME:

SOLUTION:

Salary		1,44,000
Profit bonus		12,000
Commission		42,000
EA		24,000
Club facility exempted		NIL
Transport allowance	12,000	
Less exempted up to Rs.800 pm	9,600	2,400
Benefit of car exempted		
Education facility for children		22,500
Gas, water and electricity bill paid by employer		16,800
Value of RFA: rent paid by employer Rs.72,000		
Salary for this purpose (1,44,000+12,000+42,000+24,000+2,400=2,24,400)		
20% of employee's salary ie, Rs.44,880 or rent paid by employer Rs.72,000 WEL		44,880
GROSS SALARY		3,08,580
LESS: deductions		NIL
Income from salary		3,08,580

PROBLEM:

Mr. Gowda provides the following:

Salary	15,000 pm
DA as per terms of employment	20% of salary
Bonus	15,000
CCA	2,400 pa

Lunch allowance	500 pm
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Reimbursement of medical expenses incurred on treatment of wife from a private nursing home is Rs.22,000.

He is given a choice to select either;

- (a) Rent from house owned by employer at Chandigarh [population below 4 lakhs] OR
- (b) HRA @ Rs.4,500 pm. He can hire similar type of house @ Rs.2,500 pm
advise him which option he should choose from taxation point of view.

COMPUTATION OF RFA:

Salary	1,80,000
DA 20% of salary	36,000
Bonus	15,000
CCA	2,400
Lunch allowance	6,000
Reimbursement of medical expenses	7,000
Value of RFA 15% of salary	35,910
Salary (1,80,000+36,000+15,000+6,000+2,400 = 2,39,400)	
GROSS SALARY	2,82,310
Deductions u/s 16	NIL
Income under the head salary	2,82,310

COMPUTATION OF HRA:

Salary	1,80,000
DA	36,000
Bonus	15,000
CCA	2,400
Lunch allowance	6,000
Reimbursement of medical expenses (22,000 – 15,000)	7,000
HRA	54,000
Less: Exempted	8,400
GROSS SALARY	2,86,000
LESS DEDUCTIONS US 16	NIL
INCOME UNDER THE SALARY	2,86,000

TAX PLANNING: He should select the option of taking cash HRA. In this option he saves Rs.24,000 [HRA received Rs.54,000 PA less rent paid Rs.30,000 PA] in cash. Where as he has to pay extra tax on excess income of Rs.3,690 [Rs.2,86,000 – 2,82,310] which is 30% of Rs.3,690 = Rs.1,107 + 2% education cess Rs.22=1,129. as such he saves cash Rs.22,871. (Rs.24,000 -- 1,129)

Problem:

Dr. Manmohan singh is employed at Hyderabad. Particulars of his salary income are given below:

Salary (net of tax, rent of house provided by employer and singh's contribution to PF)	2,48,000
Singh's contribution to PF	40,000
Employer's contribution to PF	40,000
Rent of residential house provided by employer and deducted out of salary	9,600
Professional tax deducted at source	2,400
Interest credited to PF @ 8.75% PA	44,000
Leave travel allowance received	7,800
Rent free house provided to employee: rent paid on house in Hyderabad	66,000
Bonus equal to one month salary	
Remote locality allowance @ Rs.3,000 pm [notified to be exempted up to Rs.200 pm]	
Running allowance	2,000 pm
Children education allowance for children @ Rs.400 pm each (one of his son is living in hostel)	
EA	700 PM
Amount contributed to PPF	70,000

SOLUTION:

Net salary received	2,48,000	
ADD: professional tax deducted at source	2,400	
Add: contribution to PF	40,000	
Add: rent of residential house provided by employer and deducted out of salary	9,600	
Full salary		3,00,000
Employer's contribution to PF	40,000	
Less: exempted up to 12% of salary	36,000	4,000
Leave travel allowance		7,800

Bonus equal to one month's salary [3,00,000x1/12]		25,000
Remote locality allowance @ Rs.3,000 pm	36,000	
Less: notified to be exempted up to Rs.200 pm	2,400	33,600
Running allowance Rs.2,000 pm	24,000	
Less exempted upto 70%	16,800	7,200
Children's education allowance for 3 children Rs.400 pm each	14,400	
Less exempted [1200+1200]	2,400	12,000
EA		8,400
Value of concessional rent		56,400
GROSS SALARY		4,54,400
LESS: DEDUCTIONS U/S 16		
Professional tax paid		2,400
Income from salary		4,52,000

NOTES: COMPUTATION OF VALUE OF CONCESSIONAL RENT HOUSE AT HYDERABAD HIRED BY EMPLOYER:

Salary= 3,00,000+7,800+25,000+7,200+12,000+8,400+33,400=3,94,000

20% of salary = 78,800 or actual rent Rs.66,000 WEL is taxable 66,000

Less: rent paid by employee 9,600

Taxable value 56,400

In case of actual expenditure is not give full amount of leave travel allowance is taxable.

Interest credited to PF @ 8.75% PA is fully exempted as rate is below 9.5% PA

PROBLEM:

Mr. Sharma an Indian citizen is working with Indian government in the department of external affairs at Delhi. He was getting the following emoluments and perks:

Salary	15,000 pm
DA received in India only	16% of salary
CCA received in India only	5% of salary
He was provided with a rent free house at Delhi whose rental value fixed by the government was Rs.1,200 pm. The house was furnished at a cost of Rs.50,000. an air conditioner was hired @ Rs.1,200 pm and installed at his residence for the period 1.5.2008 to 31.8.2008.	
He had been provided with a car of 1.6 lt capacity which he used only	

for employment purposes.	
From 1.12.2008 he was transferred to Indian embassy at Tokyo in Japan. He was paid Rs.10,000 pm as foreign allowance. Air fare for him self and all his family members was paid by the government. During his stay there he was provided with free use of car and rent free furnished house.	

Calculate his income under the head salary for the year ending 31.3.2009 if his salary is due on first day of every month.

COMPUTATION OF SALARY INCOME

FOR 9 MONTHS AT DELHI:		
Salary		1,35,000
DA @ 16% of salary		21,600
CCA @ 5% of salary		6,750
Car used only for employment purposes	Exempted	
RFA: rent fixed by government	10,800	
ADD: 10% of cost of furnishing	3,750	
Rent of air conditioner (1,200 x 4)	4,800	19,350
FOR 3 MONTHS AT TOKYO		
Salary		45,000
DA	Exempted	
CCA	Exempted	
Air fare	“	
Rent free house	“	
Foreign allowance	“	
Free use of car	“	
SALARY INCOME		2,27,700

PROBLEM:

MR, Ramesh an employee of a company at Bangalore (population above 25 lakhs) furnishes the following particulars of his income for the year ending 31.3.2009.

Basic salary	12,000 pm
DA 50% OF SALARY (50% enters into service benefits)	
Marriage allowance	600 pm
Children's education allowance	600 pm
Bonus one month salary	12,000
EA	1,200 pm

Own contribution to RPF at the rate of 12% of salary; his employer is contributing 14.5%. His employer is also contributing 7.5% of salary to an approved superannuation

fund. Mr.Ramesh owns a car which he is using for his personal purposes only and his employer meets all expenses on this car which are Rs.12,300.

He is provided with a rent free house at Bangalore the fair rental value of which is Rs.9,500 pm. He is required to give up the right of occupation during the period he was on leave. He was on leave from 1.11.2008 to 31.12.2008.

he paid life insurance premia of Rs.12,000, Rs.4,000 and Rs.1,000 on the life of self wife and married daughter.

Calculate income under the head salaries and qualifying amount for deduction u/s 80C if two children of Mr.Ramesh are studying in a school.

COMPUTATION OF SALARY INCOME:

Salary		1,44,000
DA		72,000
Marriage allowance		7,200
Entertainment allowance		14,400
Children's education allowance	7,200	
Less: exempted for 2 children (100X2X12)	2,400	4,800
Bonus		12,000
Employer's contribution to RPF @ 14.5%	26,100	
Less: Exempted @ 12%	21,600	4,500
Car expenses met by employer for personal use	Exempted	
Value of rent free house for 10 months at Bangalore		
Salary=[1,44,000+36,000+7,200+4,800+12,000+14,400	32,760	
=2,18,400] 15% of salary		
Reduced to 10 months [32,760X10/12]		27,300
SALARY INCOME		2,86,200

QUALIFYING AMOUNT FOR DEDUCTION U/S 80C

Own contribution to RPF	21,600
Life insurance premium	17,000
QUALIFYING AMOUNT	38,600

PROBLEM:

Mr. Dass is an employee is Assam [50 km from city limits in a remote area and furnishes the following:

Basic salary	5,000 pm
DA	100% of salary
(under the terms of employment 40% enter into pay benefits)	

Children's education allowance (his two children are studying in a school)	600 pm
Bonus	30% of basic
EA	1,000 pm
Own contribution to RPF	12% OF SALARY
Employer's contribution to RPF	14.5% of salary
Employer's contribution to an approved superannuation fund	7.5% of salary
Interest credited to RPF balance @ 12%	4,000

Mr. Dass received an amount of Rs.50,000 as compensation from Oriental Insurance company for a motor accident in which he was injured two years ago. The court has awarded a sum of Rs.5,000 as interest for delayed payment of compensation. It was also received by him along with compensation.

He owns a car of 1.2 lt capacity which he uses both for official and personal purposes, the expenses being met by the company which amounted to Rs.18,400. It is estimated that 20% of these expenses relate to personal use.

He is provided with a RFA within the plantation area, the fair rent of which is Rs.900 pm. He is not eligible for the house during the period of annual vacations for two months. The original cost of the furniture provided at the house is Rs.40,000.

He was paid a sum of Rs.10,000 by his employer as he saved the company from heavy damages.

Compute his income under salaries.

Salary		60,000
DA @ 100% of salary (40% under the terms of employment)		60,000
Children's education allowance	7,200	
Less: exempted (2X100X12)	2,400	4,800
Bonus 30% of salary		18,000
Employer's contribution to RPF @ 14.5%	12,180	
Less: exempted 12%	10,080	2,100
EA		12,000
Interest credited to RPF @ 12% less 9.5%		833
Car perk exempted		NIL
Amount paid by employer to save goodwill		10,000
Value of RFA exempted in remote area		NIL
Salary income		1,67,733

NOTE: INTEREST ON DELAYED PAYMENT OF COMPENSATION IS TAXABLE UNDER THE HEAD OTHER SOURCES.

PROBLEM:

From the following particulars given below calculate salary income of Mr. Yadav for the assessment year:

- (i) Basic pay Rs.15,000 PM [due on last day of month]
- (ii) DA 60% of salary [50% of DA forms part of salary]
- (iii) Bonus: basic salary for one month
- (iv) Commission Rs.66,000
- (v) Leave encashment Rs.20,000. it relates to encashment of current year's leave.
- (vi) He has engaged an helper at Rs.1,200 PM and his employer pays him Rs.1,500 PM on this account
- (vii) Medical bills for Rs.50,000 were reimbursed in following manner: from a notified hospital Rs.12,000 and from a private nursing home Rs.38,000.
- (viii) Mobile telephone bills paid by employer Rs.15,000
- (ix) He has employed a cook for his personal use at Rs.1,000 pm and his employer has reimbursed such salary.
- (x) He has employed a cook for his personal use at Rs.1,000 pm and his employer has reimbursed such salary.
- (xi) On 1-12-2008 he had taken a loan of Rs.3,00,000 from his employer to purchase a car. Rate of interest is 5% pa Repayment of loan @ Rs.5,000 pm is to start after 4 months from the date of taking of loan. Prescribed rate of interest by SBI as on 1-4-2008 is 9%
- (xii) Interest credited on the accumulated balance of RPF @ 10% is Rs.20,000
- (xiii) He received Rs.20,000 as leave travel concession but has not traveled any where.
- (xiv) He has been provided with free use of a car of 1.8 lt. car is used by partly for personal and partly for employment purpose.
- (xv) He has been provided with a rent free house hired by employer at Rs.20,000 pm

COMPUTATION OF SALARY INCOME:

Basic pay		1,80,000
DA		1,08,000
Bonus		15,000
Commission		66,000
Leave encashment		20,000
Helper allowance	18,000	
Less: actual expenditure	14,400	3,600
Medical reimbursement received	50,000	
Less: Exempted notified hospital	12,000	
Amount of reimbursement relating to treatment from notified hospital	38,000	23,000
	15,000	
Mobile bill	Exempted	
Salary of cook 1000 pm		12,000
Concession in respect of interest on loan taken for purchase of car: (3,00,000 X 4% X 4/12)		4,000
Employers contribution to RPF	36,000	
Less: exempted	23,220	12,780
Interest credited to RPF	20,000	
Less exempted	19,000	1,000
Car perk	Exempted	
Leave travel concession		20,000
Value of RFA house hired by employer		
20% of salary or actual rent WEL		59,620
SALARY INCOME		5,25,000

PROBLEM:

Mr.Dev is working as a business executive with a company at Delhi. He submits the following particulars of his income for the previous year: compute his salary income.

Salary	25,000 pm
DA	2,500 pm
Entertainment allowance	5,000 pm
Bonus	60,000
Conveyance allowance	36,000 pa
His and employer's contribution to RPF @ 15% of salary each	
Interest credited to RPF balance @ 12%	
He is provided with RFA whose rent paid by the company	1,20,000 pa
Rent of air conditioner for 5 months	1,000 pm

He owns a car of 1.8 lt capacity which he uses both for official and personal purposes and claims to have spent whole of conveyance allowance. The assessing officer has agreed that 35% of the time car is used for personal purposes.

He is provided with the services of gardner, sweeper and watchman whose salary @ Rs.500 pm each is paid by the employer.

During the previous year he had received 2 months basic salary as advance salary which was included in last year's income.

He deposited Rs.30,000 in PPF and invested Rs.10,000 in notified infrastructure units of UTI.

COMPUTATION OF SALARY INCOME:

Basic salary		2,50,000
(for 10 months as he has paid tax on two month's salary)		
DA for 12 months		30,000
Conveyance allowance (35% for personal use)		12,600
Entertainment allowance		60,000
Bonus		60,000
Employer's contribution to RPF @ 15% of Rs.3,00,000	45,000	
Less exempted @ 12%	36,000	9,000
interest credited on RPF balance	18,000	
Exempted @ 9.5%	14,250	3,750
Facility of gardener, sweeper, watchman @ 500 pm each		18,000
Value of rent free house		79,890
GROSS SALARY		5,23,240
Deductions U/S 16		
Professional tax 16 (iii)		2,500
Income under the head salary		5,20,740

VALUE OF RFA:

Rent paid by employer = Rs.1,20,000

15% of salary = 64,890

Actual rent paid or 15% of salary WEL 64,890

Add 10% of cost of furnishing 10,000

Add rent of aid conditioner 5,000

Value of furnished rent free house 79,890

PROBLEM:

Mr. Venkatesh is the Chairman of Indian Steel company Kolkota. His salary and other particulars for the year ending are as follows:

Salary	60,000 pm
DA not considered for retirement benefits	10,000 pm
Bonus for the year	72,000
Arrears of earlier year's bonus	10,000
Commission	80,000
Advance salary	60,000
Employer's contribution to provident fund	14% of salary
Professional tax paid by the employer	2,000 pa
Income tax paid by the company	15,000 pm
Electricity bills for the year paid by the company	8,000
Fees for attending board meeting of other companies	13,000

The company has provided him a contessa car 1.8 lt capacity which is used by him both for official and personal purpose. The entire running and maintenance cost amounting to Rs.45,000 for the year has been met by the company. His two children are studying in Doon school Dehradun, the education expenses during the year being Rs.40,000 fully met by the company.

He has also been given a spacious bungalow free of rent. The company owns the bungalow. The fair rental value of the bungalow is Rs.18,000 pm.

There is a swimming pool inside the bungalow compound the maintenance cost of which came to Rs.20,000 for the year. The company met it.

The garden inside the compound wall is maintained by the company. The gardner is paid a salary of Rs.1,000 pm the maintenance cost came to Rs.6,000 during the year.

The Chairman has also been provided with a security guard and a sweeper whose salaries amounting to Rs.1,600 pm each have been paid by the company.

The entire bungalow is richly furnished with furniture costing Rs.4,50,000. determine the value of rent free house and salary income also.

COMPUTATION OF SALARY INCOME:

Salary		7,20,000
DA		1,20,000
Bonus		72,000
Arrears of bonus		10,000
Commission		80,000
Advance salary		60,000
Employer's contribution to RPF @14%	1,00,800	
Less exempted upto 12 % of salary	86,400	14,400
Professional tax paid by employer		2,000
Income tax paid by employer		1,80,000
Electricity bill paid employer		80,000
Car facility	Exempted	
Educational expenses of children met by employer		40,000
Services of sweeper 1,600 pm		19,200
Services of security 1,600 pm		19,200
Value of RFA		1,75,800
GROSS SALARY		15,20,600
Deductions U/S 16		
Professional tax (iii)		2,000
Salary income		15,18,600

Value of RFA: 15% of salary 1,30,800
ADD: 10% COST OF FURNISHING 45,000
VALUE OF RENT FREE HOUSE 1,75,800

PROBLEM:

A resident individual is serving in X Ltd, New delhi and furnishes the following particulars of his income earned during the year ended.

Salary Rs.1,20,000

His own contribution to RPF Rs.15,000

Employer's contribution to the said fund Rs.15,000

Bonus (out of this Rs.6,000 is gratuitous) 18,000

- (i) He is provided with a motor car 1.45 lt capacity which is owned by the employer, all expenses of maintenance and running being met by employer. He is also provided with a driver for the said car for which no charge is made to him by the employer. Mr.A uses the car for his personal purpose also.

- (ii) Life insurance premium paid by the employer amounting to Rs.15,000
- (iii) He is provided with RFA the FRV of which is Rs.60,000 pa and actual rent of hired furniture Rs.800 pm
- (iv) Gas bill paid by employer Rs.12,000
- (v) He was provided with the services of gardener, watchman and domestic servant and salary of each of them was Rs.500 pm.
- (vi) He availed LTC during December 2008 and visited Goa by air along with his wife and two major children. His employer paid him a lump sum amount of Rs.84,000. the normal one way air fare for economy class is Rs.7,500 per person.
- (vii) He insured his own life and life of his wife and paid Rs.12,000 as premium in May 2008 out of his agricultural income
- (viii) His deposited Rs.20,000 in ELSS and another Rs.30,000 in PPF in march 2009.

Compute his income from salary.

COMPUTATION OF SALARY INCOME:

Salary		1,20,000
Bonus		18,000
Employer's contribution to RPF	15,000	
Less: exempted	14,400	600
Free use of small car with driver	Exempted	
LIC premium paid by employer		15,000
Gas bill paid by employer		12,000
Services of watchman		6,000
Services to domestic servant		6,000
LTC	84,000	
Less exempted	60,000	24,000
Value of RFA		
Salary [1,20,000+12,000=1,32,000]		
15% of salary	19,800	
Add rent of furniture	9,600	29,400
SALARY INCOME		2,31,000

PROBLEM:

Mr.Uday is working as a manager at Rs.7,200 pm with Hidustan tools ltd. Jammu. He is receiving Rs.1,800 pm as DA and Rs.3,000 pm as HRA. He stays in his own house. He

received Rs.14,000 as traveling allowance and he could spend only Rs.12,500. his salary accrues on 1st day of every month.

He retired from service with effect from Jan 31 2008 and received the following amounts:

- (i) Retirement gratuity Rs.1,62,400 (he retired after rendering 34 years service and his salary during 2008-09 was 7,200 pm.
- (ii) His pension was fixed @ Rs.2,800 pm he gets 3/4th of his pension commuted for a lump sum Rs.2,10,000.
- (iii) He received Rs.1,24,000 as refund from RPF half of it consists of his own contribution plus interest thereon.
- (iv) Leave encashment of Rs.36,000 being 5 months salary received on 31-1-2009

Compute his salary income.

Salary		79,200
DA		19,800
HRA 3,000X11 (fully taxable as he lives in his own house)		33,000
Traveling allowance	14,000	
Less actual expenses	12,500	1,500
Uncommuted portion of pension for one month		700
Retirement benefits:		
(a) Gratuity received	1,62,400	
Less exempted	1,22,400	40,000
(b) commuted value of pension	2,10,000	
Less exempted	93,333	1,16,667
Refund from RPF	Exempted	
Leave encashment	36,000	
Less exempted	36,000	NIL
SALARY INCOME		2,90,867

Exemption of Gratuity

Average salary (7,200 X 10/10=7,200 pm)

Exempted upto least of following:

- a. Notified limit 3,50,000
- b. ½ month's average salary for each completed
Year of service 1,22,400
- c. Actual gratuity received 1,62,400

Least is exempted

1,22,400

PROBLEM:

Mrs. Sowmya is a software engineer employed at Mumbai. Following are the details:

Salary Rs.20,000 pm

DA Rs.5,000 pm

Company provided her a laptop costing Rs.35,000

Company sold her a washing machine for Rs.20,000 cost of which was Rs.30,000

Traveling expenses to abroad Rs.40,000 are borne by the company.

Employer contributed Rs.10,000 towards ULIP

She is provided with RFA quarter in Mumbai value Rs.5,000 pm and furniture and fittings value Rs.15,000

Special marriage gift given to employee Rs.50,000

Planning allowance Rs.500 pm

Medical expenses paid by company Rs.10,000

Medical allowance @ Rs.1,250 pm

Assume that the salary is due on the last day of every month.

COMPUTATION OF TAXABLE SALARY:

Salary		2,40,000
DA		60,000
Sale of washing machine(difference taxable)		10,000
ULIP		10,000
RFA:		
Salary of employee for this purpose=	2,61,000	
15% of employee's salary	39,150	
ADD: 10% of cost of furnishing	1,500	40,650
Marriage gift given to the employee		50,000
Medical allowance		15,000
Planning allowance		6,000
GROSS SALARY		4,31,650
DEDUCTIONS US 16		NIL
INCOME FROM SALARY		4,31,650

NOTES: SPECIAL MARRIAGE GIFT IS TAXABLE

Employee is presumed to be treated in private hospital.

PROBLEM:

From the following information compute taxable salary.

Salary Rs.8,000 pm

Arrears of salary Rs.4,000

DA Rs.2,000 pm

Employer is paying insurance premium of Rs.10,000 PA on employee's life

Bonus received Rs.15,000

Education allowance for grand child Rs.400 pm

Cash gift Rs.10,000

CCA Rs.1,000 pm

Medical allowance paid by employer RS.6,000

He contributes 15% of his salary to a PF and his employee contributes the same

He is given lunch allowance @100 per day for 250 days during the previous year

He is provided with a mobile, bill of which is paid by company Rs.6,000.

Basic salary	96,000
Arrears of salary	4,000
DA	24,000
LIC premium paid by employer	10,000
Bonus	15,000
Education allowance of grand child	4,800
Cash gift	10,000
CCA	12,000
Medical expenses paid by employer (up to 15,000 exempted)	Nil
Employers contribution to RPF	2,880
Lunch allowance	2,500
Mobile bill	Nil
GROSS SALARY	2,03,680
DEDUCTIONS U/S 16	NIL
INCOME FROM SALARY	2,03,680

PROBLEM:

Ganesh an employee working in Dreams Ltd. Mumbai has presented the following particulars of his salary.

Basic salary Rs.20,000 pm which is due on the last day of the month

DA 80% of salary [50% forms part of salary]

Bonus basic salary of one month

Commission Rs.66,000

Leave encashment [relating to current year] Rs.20,000

He has engaged a helper at Rs.1,200 PM and his employer pays him Rs.1,500 pm on this account.

Medical bills for Rs.60,000 were re-imbursed in following manner

Of a notified hospital Rs.22,000

Of a private hospital Rs.38,000

Mobile telephone bill paid by employer Rs.15,000

His employment tax paid by employer Rs.2,500

On 1-12-2008 he has taken a loan of Rs.3,00,000 from his employer to purchase a car.

Rate of interest is 5% PA repayment of loan @ Rs.5,000 pm is to start after 4 months from the date of taking of loan. Prescribed rate of interest by SBI as on 1-4-2008 is 12%.

He and his employer contribute Rs.3,200 pm each towards RPF

Interest credited on the accumulated balance of RPF @ 10% is Rs.20,000

He received Rs.20,000 as LTC but has not traveled any where.

He has been provided with free use of a car of 1.8 lt car is used partly for personal also.

He has been provided with a RFA owned by employer (FRV of house Rs.8,000 pm) along with facility of gardner costing employer Rs.6,000 pa furniture costing Rs.1,00,000 (WDV Rs.75,000) has also been provided for his use by employer.

His personal club bills paid by employer Rs.25,000 pa

LIC premium on his life paid by employer Rs.5,000 pa. other savings of MR.Ganesh include contribution to PPF Rs.3,500 LIC premium on the life of his father Rs.5,000.

COMPUTATIONS OF TAXABLE INCOME FROM SALARY:

Basic salary		2,40,000
DA		96,000
DA does not enter		96,000
Bonus		20,000
Commission		66,000
Leave encashment		20,000
Helper allowance	18,000	
Less exempt	14,400	3,600
Medical bills reimbursed		Exempted

Medical bills reimbursed by employer treatment in private hospital		23,000
Mobile phone bill		Exempted
Employment tax paid by employer		2,500
Employer contributions to RPF	38,400	
Less exempt 12%	40,320	Exempted
Interest on RPF balance in excess of 9.5% pa		1,000
LTC		20,000
Car facility		Exempted
LIC PREMIUM PAID BY EMPLOYER		5,000
Loan from employer for car at concessional rate		7,000
Club bills paid by employer		Exempted
RFA		
Salary for this purpose		
4,45,600 X 15% =	66,840	
Add: 10% cost of furniture	10,000	76,840
GROSS SALARY		7,09,340
Less deductions		
Tax on employment		2,500
INCOME UNDER THE HEAD SALARY		7,06,840

SECTION—A

- (a) What is conveyance allowance?
- (b) What is URPF?
- (c) What is RPF?
- (d) What is SPF?
- (e) What is PPF?
- (f) What is commutation of pension?
- (g) What is RFA?
- (h) State the provisions of RFA?
- (i) State the provisions of HRA/
- (j) What is gratuity?
- (k) What is encashment of earned leave?
- (l) What is gross salary?
- (m) What is net salary?
- (n) State provisions of section 16?

SECTION – B

a. MR, Ramesh an employee of a company at Bangalore (population above 25 lakhs) furnishes the following particulars of his income for the year ending 31.3.2009.

Basic salary	12,000 pm
DA 50% OF SALARY (50% enters into service benefits)	
Marriage allowance	600 pm
Children's education allowance	600 pm
Bonus one month salary	12,000
EA	1,200 pm

Own contribution to RPF at the rate of 12% of salary; his employer is contributing 14.5%. His employer is also contributing 7.5% of salary to an approved superannuation fund. Mr.Ramesh owns a car which he is using for his personal purposes only and his employer meets all expenses on this car which are Rs.12,300.

He is provided with a rent free house at Bangalore the fair rental value of which is Rs.9,500 pm. He is required to give up the right of occupation during the period he was on leave. He was on leave from 1.11.2008 to 31.12.2008.

he paid life insurance premia of Rs.12,000, Rs.4,000 and Rs.1,000 on the life of self wife and married daughter.

Calculate income under the head salaries and qualifying amount for deduction u/s 80C if two children of Mr.Ramesh are studying in a school.

b. Mr. Sharma an Indian citizen is working with Indian government in the department of external affairs at Delhi. He was getting the following emoluments and perks:

Salary	15,000 pm
DA received in India only	16% of salary
CCA received in India only	5% of salary
He was provided with a rent free house at Delhi whose rental value fixed by the government was Rs.1,200 pm. The house was furnished at a cost of Rs.50,000. an air conditioner was hired @ Rs.1,200 pm and installed at his residence for the period 1.5.2008 to 31.8.2008.	
He had been provided with a car of 1.6 lt capacity which he used only for employment purposes.	

From 1.12.2008 he was transferred to Indian embassy at Tokyo in Japan. He was paid Rs.10,000 pm as foreign allowance. Air fare for him self and all his family members was paid by the government. During his stay there he was provided with free use of car and rent free furnished house.	
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Calculate his income under the head salary for the year ending 31.3.2009 if his salary is due on first day of every month.

d. Mr. Gowda provides the following:

Salary	15,000 pm
DA as per terms of employment	20% of salary
Bonus	15,000
CCA	2,400 pa
Lunch allowance	500 pm

Reimbursement of medical expenses incurred on treatment of wife from a private nursing home is Rs.22,000.

He is given a choice to select either;

- i. Rent from house owned by employer at Chandigarh [population below 4 lakhs]
- OR
- iii. HRA @ Rs.4,500 pm. He can hire similar type of house @ Rs.2,500 pm advise him which option he should choose from taxation point of view.

SECTION-- C

a. Ganesh an employee working in Dreams Ltd. Mumbai has presented the following particulars of his salary.

Basic salary Rs.20,000 pm which is due on the last day of the month

DA 80% of salary [50% forms part of salary]

Bonus basic salary of one month

Commission Rs.66,000

Leave encashment [relating to current year] Rs.20,000

He has engaged a helper at Rs.1,200 PM and his employer pays him Rs.1,500 pm on this account.

Medical bills for Rs.60,000 were re-imbursed in following manner

Of a notified hospital Rs.22,000

Of a private hospital Rs.38,000

Mobile telephone bill paid by employer Rs.15,000

His employment tax paid by employer Rs.2,500

On 1-12-2008 he has taken a loan of Rs.3,00,000 from his employer to purchase a car. Rate of interest is 5% PA repayment of loan @ Rs.5,000 pm is to start after 4 months from the date of taking of loan. Prescribed rate of interest by SBI as on 1-4-2008 is 12%.

He and his employer contribute Rs.3,200 pm each towards RPF

Interest credited on the accumulated balance of RPF @ 10% is Rs.20,000

He received Rs.20,000 as LTC but has not traveled any where.

He has been provided with free use of a car of 1.8 lt car is used partly for personal also.

He has been provided with a RFA owned by employer (FRV of house Rs.8,000 pm) along with facility of gardner costing employer Rs.6,000 pa furniture costing Rs.1,00,000 (WDV Rs.75,000) has also been provided for his use by employer.

His personal club bills paid by employer Rs.25,000 pa

LIC premium on his life paid by employer Rs.5,000 pa. other savings of MR.Ganesh include contribution to PPF Rs.3,500 LIC premium on the life of his father Rs.5,000.

b. Mrs. Sowmya is a software engineer employed at Mumbai. Following are the details:

Salary Rs.20,000 pm

DA Rs.5,000 pm

Company provided her a laptop costing Rs.35,000

Company sold her a washing machine for Rs.20,000 cost of which was Rs.30,000

Traveling expenses to abroad Rs.40,000 are borne by the company.

Employer contributed Rs.10,000 towards ULIP

She is provided with RFA quarter in Mumbai value Rs.5,000 pm and furniture and fittings value Rs.15,000

Special marriage gift given to employee Rs.50,000

Planning allowance Rs.500 pm

Medical expenses paid by company Rs.10,000

Medical allowance @ Rs.1,250 pm

c. Mr. Venkatesh is the Chairman of Indian Steel company Kolkota. His salary and other particulars for the year ending are as follows:

Salary	60,000 pm
DA not considered for retirement benefits	10,000 pm
Bonus for the year	72,000
Arrears of earlier year's bonus	10,000
Commission	80,000
Advance salary	60,000
Employer's contribution to provident fund	14% of salary
Professional tax paid by the employer	2,000 pa
Income tax paid by the company	15,000 pm
Electricity bills for the year paid by the company	8,000
Fees for attending board meeting of other companies	13,000

The company has provided him a contessa car 1.8 lt capacity which is used by him both for official and personal purpose. The entire running and maintenance cost amounting to Rs.45,000 for the year has been met by the company. His two children are studying in Doon school Dehradun, the education expenses during the year being Rs.40,000 fully met by the company.

He has also been given a spacious bungalow free of rent. The company owns the bungalow. The fair rental value of the bungalow is Rs.18,000 pm.

There is a swimming pool inside the bungalow compound the maintenance cost of which came to Rs.20,000 for the year. The company met it.

The garden inside the compound wall is maintained by the company. The gardner is paid a salary of Rs.1,000 pm the maintenance cost came to Rs.6,000 during the year.

The Chairman has also been provided with a security guard and a sweeper whose salaries amounting to Rs.1,600 pm each have been paid by the company.

The entire bungalow is richly furnished with furniture costing Rs.4,50,000. determine the value of rent free house and salary income also.

Assume that the salary is due on the last day of every month.

d. Mr.Dev is working as a business executive with a company at Delhi. He submits the following particulars of his income for the previous year: compute his salary income.

Salary	25,000 pm
DA	2,500 pm
Entertainment allowance	5,000 pm
Bonus	60,000
Conveyance allowance	36,000 pa
His and employer's contribution to RPF @ 15% of salary each	
Interest credited to RPF balance @ 12%	
He is provided with RFA whose rent paid by the company	1,20,000 pa
Rent of air conditioner for 5 months	1,000 pm

He owns a car of 1.8 lt capacity which he uses both for official and personal purposes and claims to have spent whole of conveyance allowance. The assessing officer has agreed that 35% of the time car is used for personal purposes.

He is provided with the services of gardner, sweeper and watchman whose salary @ Rs.500 pm each is paid by the employer.

During the previous year he had received 2 months basic salary as advance salary which was included in last year's income.

He deposited Rs.30,000 in PPF and invested Rs.10,000 in notified infrastructure units of UTI.

INCOME FROM HOUSE PROPERTY

LEARNING OBJECTIVES:

- Defining house property income
- Section 22 of the act
- Deemed ownership
- Section 24 of the act

- (e) Problems involving various adjustments on GAV, NAV, deductions under section 24

Definition of the Head [Section 22]

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

Section 22 of the Income-tax Act says:

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

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

1. Building or Land Appurtenant thereto. The scope of this head of income is limited to the income from buildings or lands appurtenant (attached or situated in the vicinity of building) to buildings only. Buildings include residential houses, bungalows, docks, warehouses, any block of bricks or stone work covered by a roof etc. Land which is not appurtenant to any buildings does not come within the scope of this section.
2. Annual value. The meaning of word ‘Annual value’ is very significant because the annual value of the building or land appurtenant thereto is to be taxed and not the rent received. The annual value is to be determined according to the provisions of section 23 of Income-tax Act.
3. The Assessee should be the owner of the property. It is only the owner of the house property who can be taxed under this head of income. The tax under this

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

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

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

Deemed Owner of House Property

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

- (i) An individual who transfers otherwise than for adequate consideration any house property to his or her spouse, not being a transfer in connection with an agreement to live apart or to a minor child not being a married daughter, shall be deemed to the owner of the house property so transferred.
 - (ii) The holder of an impartible estate shall be deemed to be the individual owner of all the properties comprised in the estate.
 - (iii) A member of a co-operative society to whom a building or part thereof is allotted or leased under a house building scheme of the society, shall be deemed to be the owner of that building or part thereof.
4. It is not used for purposes of assessee's business or profession. Where the assessee is carrying on business or profession in his own house, building or in a portion of it and the income of such business or profession, is taxable under the head 'Profits or gains of business or profession', the annual value in respect of property or portion of it is not taxable under this head of income. As the business is being carried on in the assessee's own premises, so no rent will be allowed as expenditure to the assessee in respect of these premises.

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

5. Dispute about ownership. It is the owner who is liable to pay tax on the income of the house property and in case of a dispute about ownership the person who receives rent shall be liable to pay tax till the dispute about ownership is settled.
6. House Property situated in a foreign country. In case an assessee who is resident of India owns a house in a foreign country, income from such a house is taxable in India under the head house property. So income from house property in case of not ordinary resident and a non resident shall be exempted but again it will be taxable in India if it is received or it is payable in India.
7. Cases when rented income from building is not treated as house property income
 - (i) Letting out of house property for smooth conduct of assessee's business/profession. If a person lets out any house property for smooth

conduct of his business/profession, the rental income from such house property shall not be treated as house property income rather it shall be treated as income under the head business/profession.

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

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

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

8. Income from sub-letting of house property. If a person occupies a building as tenant and lets out full or part of the hired building to another person, it is called sub-letting. The income from sub-letting, if any, is taxable under the head 'income from other sources' and not under the head 'house property'. It is so because the person sub-letting the building is not the owner of that building. Such income is calculated as per section 56 after deducting all the expenses relating to sub-let portion.
9. Composite letting out of building along with furniture etc. If a person lets out building along with furniture, plant, machinery and other facilities etc., for a composite rent and such composite rent can not be separated between (a) rent of building and (b) rent of other items/facilities then such composite rent shall be treated either as income under the head other sources or an income under the head business or profession, if such letting is the business of the assessee.

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

10. Income from hotel business/paying guest accommodation. If a person runs the hotel business or runs the business of providing paying guest accommodation,

such rented income shall be taxable as income under the head Business/Profession.

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

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

Solution. *Income from other sources: sub-letting*

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

Exempted Incomes from House Property

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

- 1) Agricultural House Property [Section 2(1)(c)]. Income from such house property which is situated on or in the immediate vicinity of agricultural land which is used for agricultural purposes by cultivator is exempted from tax.
- 2) House property held for charitable purposes [Section 11]. Any income from a house property held for charitable or religious purposes e.g., rent from shops owned by a temple is also exempted.
- 3) Self-occupied but vacant house [Section 23(3)]. In case an assessee keeps one of his own houses reserved for self-occupation but is living in a rented house

elsewhere due to his employment or profession the income from such house is taken to be nil.

- 4) House used for own business or profession. There is no income chargeable to tax under this head from such house property.
- 5) Property held by registered trade union [Section 10(24)]. Income from a house property owned by a registered trade union is not to be included in its G.T.I.
- 6) Income from house property held by following shall be exempted
 - (i) House property held by a local authority.
 - (ii) House property held by a scientific research institution.
 - (iii) House property held at a political party.
 - (iv) House property held by a university and any other educational institution working for spreading education and not to earn profit.
 - (v) House property held by a hospital or medical institution working for the spreading of medical services to people and is not meant for earning profit.
- 7) One house property (a palace) owned by a former ruler of Indian states. Ex-rulers of Indian states may be owning many palaces but only one palace of their choice shall be treated as a self occupied house and shall be exempted.
- 8) One self occupied house. In case assessee owns one residential house, the net annual value of the same shall be taken as nil but in case he owns more than one house, then only one of his choice but normally of higher value shall be treated as a self occupied one and other/others are treated as deemed to be let out.

In case of a Cooperative Society

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

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

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

ANNUAL VALUE

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

Definition of Annual Value [Section 23]

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

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

Explanation. For the purposes of clause (b) or clause (c) of this sub-section, the amount of actual rent received or receivable by the owner shall not include, subject to such rules as may be made in this behalf, the amount of rent which the owner cannot realize.

2. Where the property consists of a house or part of a house which
 - (a) Is in the occupation of the owner for the purposes of his own residence; or
 - (b) Cannot actually be occupied by the owner by reason of the fact that owing to his employment, business or profession carried on at any other place, he has to reside at that other place in a building not belonging to him the annual value of such house or part of the house shall be taken to be nil.
3. The provisions of sub-section (2) shall not apply if :
 - (a) The house or part of the house is actually let during the whole or any part of the previous year; or
 - (b) Any other benefit there from is derived by the owner.
4. Where the property referred to in sub-section (2) consists of more than one house:
 - (a) The provisions of that sub-section shall apply only in respect of one of such houses, which the assessee may, at his option, specify in this behalf.
 - (b) The annual value of the house or houses, other than the house in respect of which the assessee has exercised an option under clause (a), shall be determined under sub-section (1) as if such house or houses had been let.

Section 23(1) of Income-tax Act has defined the word 'annual value', as "the sum for which the property might reasonably be expected to let from year to year". The annual value is the value which any house can fetch from the market under the prevailing circumstances such as local conditions, the demand for house, municipal valuation, type and standard of construction, rent for similar type of house in the similar type of locality, etc. From the explanation it should be clearly understood that the annual value does not mean the rent derived or rental value of the house but the notional rent at which the house can reasonably be let out. A property can be let out at a rent which is lower than its reasonable rent but its annual value will be its reasonable rent.

The Finance Act 2001 has changed the definition of the, Annual value as under:

In case of a let out house property, section 23(1) has defined this term as follows:

1. Where the house property or any part of it is let out, any sum of money received or receivable in the previous year or from year to year shall be treated as annual value.
2. Where any house property is let out and the rent received or receivable is in excess of the sum referred above {in point (1)}, the sum of money so received or receivable shall be treated as annual value.
3. Where a let out house property remains vacant during the previous year or during any part of the previous year and due to vacancy the actual rent received or receivable is less than the sum of money referred above in point (1), the sum of money so received or receivable shall be treated as annual value.

Municipal or Local Taxes

To determine the net annual value, all municipal or local taxes actually paid by the owner during the previous year are to be deducted. This means any part of municipal tax due but not paid will not be deducted and such tax belonging to any past or future year if actually paid during the current previous year shall be allowed to be deducted.

Local or municipal taxes include service taxes like:

- (i) Fire Tax
- (ii) Water Tax
- (iii) Conservancy Tax
- (iv) Education Cess, etc.

Different Types of Rental Values

1. **Actual Rent.** It is the rent actually received by the owner of the house property from the tenant. In case tenant pays composite rent i.e., rent of building, plant and machinery, furniture etc. and rent is separable, actual rent is reduced by the amount of rent of plant and machinery, furniture, etc. Balance is

actual rent of house property. Any amount of local taxes paid by tenant, cost of repairs borne by tenant or any interest on advance deposit are not to be added.

As per explanation attached to section 23(1) for the purposes of calculating Annual Value the actual rent received or receivable shall not include any amount of unrealized rent if it fulfils certain conditions.

2. Real Rental Value [RRV]. In case cost of common facilities such as lift and pump maintenance, salary of common gardener and watchman, lighting of common stairs and corridors and water and electricity bills (if included in rent) are borne by the owner and rent includes the cost of these items. Such cost is reduced out of actual rent received and balance is called Real Rental Value (R.R.V.).

In case cost of following facilities is borne by the owner it shall be deducted out of actual rent before comparing it with other rental values.

- (a) Lift and pump maintenance charges,
- (b) Swimming pool maintenance charges,
- (c) Salary of common gardener and watchman,
- (d) Lighting of common stairs and corridors
- (e) Water and electricity charges (only if it is mentioned that rent includes them).

In case the cost of facilities is charged separately by owner i.e., over and above the rent, it is treated as a separate source of income. The expenses incurred on such facilities are deducted out of amount so collected and balance (Income/Loss) is taxable under the head, "Income from Other Sources."

In case house property is divided in parts and a part is let out and other part is self-occupied, the fair rental value of the house shall be proportionately increased in following manner:

Example: Mr. X owns a house, $\frac{2}{3}$ rd portion of the house is let out @ Rs. 4,000p.m. and remaining $\frac{1}{3}$ rd portion is self occupied for 7 months and let out for 5 months. Calculate its fair rental value.

Rent of $\frac{2}{3}$ rd portion of house Rs. 4,000 p.m.

Fair rental value of full house shall be Rs. $4,000 \times \frac{3}{2} =$ Rs. 6,000 p.m.

Illustration 2. Mr. X has constructed a multistory building at Delhi consisting of 40 flats. Each flat is let out @ 1,000 p.m. The municipal authorities have fixed the rental value of this property as Rs. 4,50,000 p.a. The owner bears the following expenses:

	Rs.
Lift maintenance	12,000 p.a.
Pump maintenance	8,000 p.a.
Salary of Gardener and Watchman	3,600 p.a.
Swimming pool expenses	9,000 p.a.

Compute the Annual Rental Value for the property.

Solution. Computation of Annual Rental Value		Rs.
Municipal Rental Value		4,50,000
	Rs.	Rs.
Actual Rent (40 x 1,000 x 12)		4,80,000
Less: Lift maintenance	12,000	
Pump maintenance	8,000	
Salary of Gardener and Watchman	3,600	
Swimming pool expenses	<u>9,000</u>	
		<u>32,600</u>
		<u>4,47,400</u>

Whichever is higher is ARV i.e., Municipal Rental Value of Rs. 4,50,000 shall be taken as ARV.

3. Municipal Rental Value (MRV). For the purposes of levying local taxes the local authority i.e., Municipal Corporation/Committee etc. conducts a periodical survey of the house properties in their local limits. On the basis of such survey the rental values are fixed which serves as the basis for levying tax. The rental value so fixed is called Municipal Rental Value (M.R.V.).

4. Fair Rental Value [FRV]. It is the rental value a house property can fetch. It is based on the rent prevailing for similar type of accommodation in same or similar type of locality. It is based on the principle that rent prevailing in same locality for similar sized property is almost the same. Such rental value is called Fair Rental Value (F.R.V.).

5. Standard Rent [S. RENT]. The rent fixed under Rent Control Act, where so ever applicable, is called Standard Rent.

6. Expected Rental Value (ERV). The expected rental value shall be determined as under:

A. In case standard rent has not been fixed

(i) Municipal Rental Value

(ii) Fair Rental Value

(iii) Actual Rent Received.

Whichever higher shall be treated as expected rental value.

B. In case standard rent has been fixed

(i) Municipal Rental Value

(ii) Fair Rental Value

(iii) Standard Rent

In case standard rent has been fixed, the expected rent cannot exceed standard rent. So firstly compare Municipal rental value and fair rent and find out the higher one and the amount so calculated cannot exceed amount of standard rent but if actual rent received is more than standard rent, then actual rental value shall be treated as expected rental value.

In a Supreme Court decision, it has been clearly laid down that the expected rent cannot exceed the standard rent but it can be less than the standard rent. *Balbir Singh v/s MCD (1985) 152 ITR 388(SC)*.

Illustration. From the figures given below calculate the Expected Rental Value in each case separately:

Rental value	Case A	Case B	Case C
	Rs.	Rs.	Rs.
MRV	30,000	30,000	30,000

FRV	36,000	36,000	36,000
Standard Rent	N.A.	33,000	42,000

Solution. Calculation of Expected Rental Value

A. Standard Rent is not applicable	Rs.
MRV	30,000
FRV	36,000
Whichever is higher is ERV	36,000

B. Standard Rent is applicable	Rs.
MRV	30,000
FRV	36,000
Whichever is higher	36,000

This figure is more than the Standard Rent which is Rs. 33,000 and the ERV cannot exceed the Standard Rent, as such the Standard Rent of Rs. 33,000 shall be ERV.

C. Standard Rent is applicable	Rs.
MRV	30,000
FRV	36,000
Whichever is higher	36,000

This figure is less than the Standard Rent which is Rs. 42,000 as such this figure of Rs. 36,000 is ERV.

The above illustration is based on the judgment given by the Hon'ble Supreme Court of India in a case Balbir Singh vs. MCD [1985] 152ITR 388(SC).

According to this case ERV cannot exceed Standard Rent but it can be less than or equal to the Standard Rent except when Real Rent is more than Standard Rent.

DETERMINATION OF ANNUAL VALUE

The annual value of house property can be determined in following manner in different type of situations. These situations are:

A. Annual Value of Let out House Property

1. House property is let out for full year and there is no vacancy or unrealized rent.

2. House property is let out and there is vacancy:
 - (a) If rent actually received or receivable is more than ERV
 - (b) If rent actually received or receivable is less than ERV
3. House property is let out and there is unrealized rent:
 - (a) If rent actually received or receivable (after deducting unrealized rent as per conditions given) is more than ERV
 - (b) If rent actually received or receivable (after deducting unrealized rent as per conditions given) is less than ERV.
4. House Property is let out, there is vacancy also and there is unrealized rent.

B. Annual Value of Self-Occupied House Property

1. Only one house under own occupation.
2. More than one house under own occupation.
3. House property consists of various independent units and one is under own occupation and others are let out.
4. House property is partly let out and partly self under own occupation.
5. House property is used for own business or profession.

Selection of Annual Rental Value (Gross Annual Value) for Let Out House Property

1. House property is let out for full year and there is neither vacancy nor unrealized rent
 - Step 1. Compare MRV with FRV and whichever is higher is compared with Standard Rent and whichever is less is ERV.
 - Step 2. (i) If actual rent received or receivable is more than ERV (Expected Rental Value) such rent received or receivable is Annual Rental Value (ARV).
 - (ii) If actual received or receivable is less than ERV (Expected Rental Value) such ERV is Annual Rental Value (ARV) and step 2 is not applicable.

(a) This rule is applicable only if property is actually let out and not in case of deemed to be let property.

(b) This rule is applicable only if there is no unrealized rent.

(c) Taxes paid by tenant, cost of repairs borne by tenant, or interest on deposit made by tenant are not to be added back.

Illustration. Calculate ARV from the particulars given below:

MRV	Rs. 60,000 p.a.	FRV	Rs. 66,000 p.a.
A.	If Actual Rent is Rs. 72,000 p.a. and Standard Rent is Rs. 69,000 p.a. or		
B.	If Actual Rent is Rs. 63,000 p.a. and Standard Rent is Rs. 69,000 p.a.		

Solution:

Solution A. If actual rent is Rs. 72,000		Solution B. If actual rent is Rs. 63,000	
	Rs.		Rs.
MRV	60,000	MRV	60,000
FRV	66,000	FRV	66,000
Whichever is higher	66,000 or	Whichever is higher; or	66,000
Standard Rent	69,000	Standard Rent	69,000
Whichever is less is ERV	66,000	Whichever is less is ERV i.e.	66,000
But in this case actual rent is higher hence Actual rent is	72,000	Actual Rent	63,000
ARV i.e.	72,000	Is less than ERV as such	
		ERV is ARV	66,000

Illustration. Calculate Gross Annual Value from following information:

	House-A	House-B
MRV	80,000	80,000
FRV	1,00,000	1,00,000
Standard Rent	70,000	1,20,000
Actual Rent	1,20,000	90,000
Municipal Taxes	8,000	8,000 (only 50% paid)

It is assumed that both the houses were let out throughout the year and there was also no unrealized rent.

Solution. Computation of Gross Annual Value

	House-A	House-B
MRV	80,000	80,000
FRV	1,00,000	1,00,000
w.e. is higher	1,00,000	1,00,000
Standard rent	70,000	1,20,000
w.e. is less is Expected Rent	70,000	1,00,000
Actual Rent Received	1,20,000	90,000
w.e. is higher is Gross Annual Value	1,20,000	1,00,000
Therefore, Gross Annual Value		
To find out Net Annual Value, deduct municipal or local taxes actually paid by the owner during the previous year.		
Gross Annual Value	1,20,000	1,00,000
Less: Municipal Taxes	8,000	4,000
Net Annual value	1,12,000	96,000

2. House property is let out and there is vacancy

A. If house property was vacant for full year the ARV is taken as NIL.

B. If house property was vacant for part of the year

(i) If rent actually received or receivable is more than ERV

Step I. Compare MRV with FRV and whichever is higher is compared with Standard Rent and whichever is less is ERV.

Step II. If rent actually received or receivable for full year is more than ERV (Expected Rental Value) such rent received or receivable is Annual Rental Value (ARV).

Step III. Such ARV is reduced by loss due to vacancy i.e. an amount of actual rent in proportion of vacancy.

(ii) If rent actually received or receivable is less than ERV

Step I. Compare MRV with FRV and whichever is higher is compared with Standard Rent and whichever is less is ERV.

Step II. If rent actually received or receivable for full year is less than ERV (Expected Rental Value) then ERV so calculated shall be treated as Annual Rental Value (ARV).

Step III. Such ARV is reduced by loss due to vacancy i.e. an amount of actual rent in proportion of vacancy.

Illustration. Calculate ARV from the particulars given below:

MRV Rs. 60,000 p.a. Actual Rent Rs. 7,000 p.m.

FRV Rs. 66,000 p.a. Standard Rent Rs. 69,000 p.a.

- (a) House was vacant for full year during the previous year 2008-09.
- (b) House was vacant for two months during the previous year 2008-09.
- (c) Actual Rent of the house is Rs. 4,000 p.m. and was vacant for two months.

Solution A. Calculation of ARV

As the house property was vacant for full year during previous year 2008-09 hence its ARV is NIL.

Solution B. Calculation of ARV		Solution C. Calculation of ARV	
	Rs.		Rs.
MRV	60,000 or	MRV	60,000 or
FRV	66,000	FRV	66,000
Whichever is higher is taken	66,000 or	Whichever is higher is taken	66,000 or
Standard Rent	69,000	Standard Rent	69,000
Whichever is less is ERV	66,000	Whichever is less is ERV i.e.	66,000
Actual Rent for full year	84,000	Actual Rent for full year	48,000
It is more than ERV	66,000	It is less than ERV	66,000
∴ Actual rent is ARV i.e.	84,000	So ERV is ARV	66,000
Less loss due to vacancy	14,000	Less loss due to vacancy	8,000
[84,000 x 2/12]		[48,000 x 2/12]	
Annual Rental Value	70,000	Annual Rental Value	58,000

3. House property is let out and there is unrealized rent

- (i.) If rent actually received or receivable (after deducting unrealized rent as per conditions given below) is more than ERV:

Step I. Compare MRV with FRV and whichever is higher is compared with Standard Rent and whichever is less is ERV.

Step II. If rent actually received or receivable (after deducting unrealized rent as per conditions given below) is more than ERV (Expected Rental Value) such rent received or receivable is Annual Rental Value (ARV).

Important Points

If following conditions are fulfilled, the amount of unrealized rent shall be deducted out of actual rent received:

- (a) That the tenancy is bonafide
- (b) That the tenant has vacated the house or steps have been taken to get the house vacated
- (c) The tenant is not occupying any other house owned by the assessee and
- (d) That all efforts to realize the rent have failed or the assessing officer is satisfied that there is no way to recover the rent
- (e) Unrealized rent of earlier years is not deductible

Illustration. Calculate the ARV from the particulars given below:

Actual Rent	Rs. 7,000 p.m.	MRV	Rs. 60,000 p.a.
FRV	Rs. 66,000 p.a.	Standard Rent	Rs. 69,000 p.a.

During previous year 2008-09 assessee could not realize rent for two months.

Solution.

Calculation of ARV	Rs.
MRV	60,000
FRV	66,000
Whichever higher is	66,000 or
Standard Rent	69,000
Whichever is less is ERV is i.e.	66,000
Actual rent	70,000
[Rs. 84,000 less unrealized rent (Rs. 7,000 x 2 = 14,000)]	
Actual rent is more than ERV	
Hence such actual rent is ARV	70,000

- (ii.) If rent actually received or receivable (after deducting unrealized rent as per conditions given) is less than ERV:

Step I. Compare MRV with FRV and whichever is higher is compared with Standard Rent and whichever is less is ERV.

Step II. If rent actually received or receivable (after deducting unrealized rent as per conditions given) is less than ERV (Expected Rental Value) such ERV is treated as Annual Rental Value (ARV).

Illustration. Calculate the ARV from the particulars given below:

Actual Rent	Rs. 6,000 p.m.	MRV	Rs. 60,000 p.a.
FRV	Rs. 66,000 p.a.	Standard Rent	Rs. 69,000 p.a.

During the previous year 2008-09 assessee could not realize rent for two months.

Solution.

Calculation of ARV	Rs.
MRV	60,000 or
FRV	66,000
Whichever higher is	66,000 or
Standard Rent	69,000
Whichever is less is ERV i.e.	66,000
Actual Rent	60,000
[Rs. 72,000 less unrealized rent (Rs. 6,000 x 2 = 12,000)]	
Actual rent is less than ERV	
Hence such ERV is treated as ARV i.e.	66,000

4. House property is let out, there is both vacancy and unrealized rent

Step I. Compare MRV with FRV and whichever is higher is compared with Standard Rent and whichever is less is ERV.

Step II. If rent actually received or receivable for full year (after deducting unrealized rent as per conditions given) is more than ERV (Expected Rental Value) such rent received or receivable is Annual Rental Value (ARV).

Step III. Such ARV is reduced by an amount of actual rent in proportion of vacancy. Firstly deduct unrealized rent out of annual rent received/receivable and compare and take the higher one and then deduct the loss due to vacancy and the value so arrived at shall be the gross annual value.

Step IV. If rent actually received or receivable (after deducting unrealized rent and vacancy as per conditions give) is less than ERV, such ERV is ARV.

Illustration.

(a) Calculate ARV from the particular given below:

Actual Rent	Rs. 7,000 p.m.	MRV	Rs. 60,000 p.a.
FRV	Rs. 66,000 p.a.	Standard Rent	Rs. 69,000 p.a.

Assessee could not realize rent for two months and house also remained vacant for 2 months during the previous year 2008-09.

(b) What difference it would make if every thing else remaining the same but actual rent received is Rs. 6,000 p.m.

Solution.

Solution A. Calculation of ARV if actual Rent is Rs. 7,000 p.m.		Solution B. Calculation of ARV if actual Rent is Rs. 6,000 p.m.	
	Rs.		Rs.
MRV	60,000	MRV	60,000
FRV	66,000	FRV	66,000
Whichever is higher is Standard Rent	66,000 or 69,000	Whichever is higher is Standard Rent	66,000 or 69,000
Whichever is less is ERV i.e.	66,000 or	Whichever is less is ERV	66,000 or
Actual Rent received is [Rs. 84,000 less unrealized rent (7,000 x 2 = 14,000)]	70,000	Actual Rent [Rs. 72,000 less unrealized rent [6,000 x 2 = 12,000]]	60,000
Whichever is higher is ARV i.e.	70,000	Whichever is higher is ARV	66,000
It shall be reduced by rent of vacancy period (7,000 x 2 = 14,000) as per explanation attached to sec. 23(1)(c)	14,000	It shall be reduced by rent of vacancy period 6,000 x 2 = 12,000) as per explanation attached to sect. 23(1)(c)	12,000
The balance shall be ARV	56,000	The balance shall be ARV	54,000

5. If house property is let out for a part of the year because it is either purchased or constructed during the previous year 2008-09

Take all the rental values only for that period for which house property is in existence or owned by assessee during the previous year. Compare them and select ARV accordingly.

Illustration. Compute ARV from particulars given below:

MRV	Rs. 60,000 p.a.	FRV	Rs. 66,000 p.a.
Standard Rent	Rs. 63,000 p.a.	Real Rent	Rs. 6,000 p.m.
Date of completion	31-5-2008	Date of letting:	1-8-2008

Solution. Computation of annual Rental Value

As the house was in existence for 10 months, hence rental values may be taken for 10 months.

	Rs.
MRV 60,000 x 10/12	50,000
FRV 66,000 x 10/12	55,000
Whichever is higher	55,000
Or Standard Rent 63,000 x 10/12	52,500
Whichever is less is ERV	52,500
Or Real Rent for 10 months	60,000
Whichever is higher is ARV	60,000
Less loss due to vacancy [two months]	12,000
	48,000

ADJUSTMENTS OUT OF ANNUAL RENTAL VALUE FOR LET OUT HOUSE PROPERTY

- (i.) Select annual rent value as per above
- (ii.) Deduct amount of Municipal/local taxes actually paid by the owner during the previous year. Local taxes shall include service charges such as Sanitation Cess, Sewerage Tax or Conservancy Cess etc. levied by local authority. No deduction for any amount of local or municipal taxes paid by the tenant. In case property is situated outside India, local taxes levied in that country shall be allowed to be deducted. The important point to be noted is that the deduction will be allowed in case of those municipal levies only which are borne by the landlord or the owner

of the house property, i.e., if any part of municipal or local taxes is met or paid by the tenant, the same shall not be allowed to be deducted while calculating net annual values.

It may be noted that the municipal or local taxes are allowed as deduction only in the previous year in which these taxes are actually paid.

Balance amount is called Net Annual Value (NAV)

Illustration. Mr. Ashok is the owner of a house which is let-out at a rent of Rs. 500 p.m. The municipal taxes are equal to 10% of the rent received.

Compute the annual value of the house, if

- (i) The municipal taxes are paid by Mr. Ashok, and
- (ii) $\frac{1}{2}$ of the municipal taxes are borne by the tenant.

Solution.	Rs.
(i) Annual Rental Value [$@$ Rs. 500 p.m.]	6,000
Less: Municipal Taxes $@$ 10% of rent received	<u>600</u>
Net Annual Value	<u>5,400</u>
(ii) Annual Rental Value $@$ Rs. 500 p.m.	6,000
Less: Municipal Taxes—50% paid by owner	<u>300</u>
Net Annual Value	5,700

Illustration. From the particulars given below calculate net annual value for the previous year ending on 31-3-09.

A	Municipal Rental value [Date of completion is 1-7-2007]	Rs. 60,000 p.a.
	Actual Rent received	Rs. 72,000 p.a.
	Taxes levied by local authority and paid by owner	
	(a) House Tax	Rs. 6,000 p.a.
	(b) Sanitation Cess	Rs. 1,000 p.a.
B	Date of completion 1-6-2008	
	Rent Received $@$ Rs.4,000 p.m.	Rs. 40,000
	Municipal Rental value	Rs. 36,000 p.a.
	Municipal Taxes are 10% of MRV	
	He paid 50% of taxes during the year 2008-09.	

Solution. Computation of Net Annual Value

A	For full year as house was completed in 2007-08	Rs.	Rs.
	Municipal Rental Value	60,000	
	Actual Rent Received	72,000	
	Whichever is higher is ARV		72,000
	Less local taxes:		
	(i) House Tax	6,000	
	(ii) Sanitation Cess	1,000	7,000
			65,000
B	Date of completion 1-6-2008 [For 10 months]		
	Municipal Rental Value [10 months]	30,000	
	Annual Rent [10 months]	40,000	
	Whichever is higher is ARV. Hence, ARV is		40,000
	Less Municipal taxes (actually paid by owner)		1,500
	50% of (3,600 x 10/12)		
	Net Annual Value		38,500

Selection of Annual Rental Value for Self-Occupied House Property

- (i.) Only one House under own Occupation. Annual value is taken as nil
- (ii.) More than one house under own occupation. Annual value of one house is taken as NIL and other house/houses are deemed to be let.
- (iii.) House Property consists of various independent units and one is under own occupation and others are let out. Annual value of one unit is taken as NIL and other unit/units are treated as let out.
- (iv.) If house property is partly let out and partly self-occupied, it is to be treated as:
 - (a) If units are inseparable and it is treated as one house then no benefit of self-occupation shall be allowed
 - (b) If units are separable, each unit or part is to be treated as a separate house and it shall get respective treatment.
- (v.) House property is let out for part of the year and under own occupation for part of the year. Whole property is treated as let out house property and no benefit of self-occupancy shall be allowed. But actual rent is taken only for number of months house property is actually let out. As such it gets the same treatment as is for unrealized rent.

Illustration. Mr. X owns a house at Chandigarh. This house property is used in following manner:

1/3rd of the house is used for own business,

1/3rd of the house is used for own residence

1/3rd of the house is used by a tenant to whom it is let out @ Rs. 3,000 p.m. and it was self-occupied for one month during the previous year. The municipal rental value of the house is Rs. 96,000 p.a. on which municipality levies 10% tax. These taxes are paid by the occupants. Compute net annual value of the house property for the previous year 2008-09 if each portion is an independent unit.

Solution. Computation of net annual value

	Rs.	Rs.
Unit A. 1/3 rd portion used for own business-NAV is		NIL
Unit B. 1/3 rd portion used for own residence-NAV is		NIL
Unit C. 1/3 rd portion let out for 11 months & self-occupied for 1 month		
Actual rent received for 11 months	33,000	
MRV [96,000 x 1/3]	32,000	
Whichever is higher is ARV i.e.	33,000	
Less municipal taxes paid by the owner	<u>NIL</u>	
Net Annual Value of let out portion		<u>33,000</u>
Net Annual value of house property		<u>33,000</u>

[In the above case rent is taken for 11 months as actual rent realized is only for 11 months]

(vi.) House property is used for own business or profession. It is not treated under the head house property and NAV is taken as NIL. No rent can be debited under the head Profits and Gains.

A. Self-occupied house whose net annual value has been reduced to nil

(i.) Loan taken for repair or alteration or renovation of the house

Only one deduction of interest on loan taken to repair or renovate the house is allowed. Actual interest paid or payable during the previous year or Rs. 30,000 p.a. whichever is less is allowed as deduction. Loss of self-occupied

house shall be set off from income of any other head and unadjusted portion shall be allowed to be carried forward.

(ii.) Loan taken for acquisition or construction of the house

(a) House is completed or loan is taken before 1-4-1999.

In case a loan is taken for acquisition or construction of the property before 1-4-1999 or it is completed before 1-4-1999 interest on such loan shall be allowed upto Actual interest paid or payable during the previous year + $1/5^{\text{th}}$ of pre-construction interest or Rs. 30,000 p.a. whichever is less.

(b) House is completed on or after 1-4-1999 (construction may have started before 1.4.1999) and loan is also taken on or after 1-4-1999.

Where the property is acquired or constructed with borrowed capital on or after the 1st day of April, 1999 and such acquisition or construction is completed within three years from the end of financial year in which capital is borrowed, the deduction of interest on loan shall be allowed upto actual interest paid or payable during the previous year + $1/5^{\text{th}}$ of pre-construction interest (to be explained later under let out house property) or Rs. 1,50,000 whichever is less. To claim this deduction the assessee shall have to furnish a certificate from loan giving authority specifying the amount of interest payable by the assessee.

In case loan is taken for repairs, renovation etc. or house is not acquired or completed within 3 years from the end of the financial year in which amount was borrowed, a deduction upto Rs. 30,000 only shall be allowed.

Illustration. Mr. Shama Reddy started the construction of his house on 1-6-1998 and for this he took a loan of Rs. 2,00,000 @ 13.5% from Bank. He took another loan of rs. 7,00,000 @ 13% p.a. on 1-4-2006 to complete the house. The construction was

completed on 30-11-2008 and was self-occupied from 1-12-2008. Compute his income under the head house property for the assessment year 2009-10.

Solution. Computation of Income from Self-occupied House

	Rs.	Rs.
Net Annual Value	NIL	
Deduction u/s 24		
Interest on loan:		
For the previous year 2008-09:		
13.5% of Rs. 2,00,000	27,000	
1/5 th of pre-construction interest	Rs.	
1998-1999	13.5% x 2,00,000 x 10/12	22,500
1999-2000	13.5% x 2,00,000	27,000
2000-01	13.5% x 2,00,000	27,000
2001-02	13.5% x 2,00,000	27,000
2002-03	13.5% x 2,00,000	27,000
2003-04	13.5% x 2,00,000	27,000
2004-05	13.5% x 2,00,000	27,000
2005-06	13.5% x 2,00,000	27,000
2006-07	13.5% x 2,00,000	27,000
2007-08	13.5% x 2,00,000	<u>27,000</u>
Total	<u>2,65,500</u>	
1/5 th of PCI [1/5 of 2,65,500]		<u>53,100</u>
Total interest		<u>80,100</u>
But restricted to maximum		30,000
Add: 13% of new loan of Rs. 7,00,000 [1-4-2008 to 31-3-2009]	91,000	
Add 1/5 th of pre construction interest [1/5 th of interest for 2006-07 Rs.91,000 + for 2007-08 Rs. 91,000]	36,400	<u>1,27,400</u>
Total interest		<u>1,57,400</u>

But restricted to maximum of	<u>1,50,000</u>
Loss from self-occupied house	<u>1,50,000</u>

This loss can be adjusted from income from any other head. If it still remains unadjusted it can be carried forward for 8 succeeding previous years to be set off from Income under the head House Property.

B. In case of all other house properties

1. Standard Deduction

30% of net annual value is allowed as deduction every year irrespective of any expenditure.

2. Interest on loan

- (a) Loan must be taken to repair, construct, renovate or purchase the house.
- (b) Interest on mortgage is not allowed unless purpose of loan is connected with house.
- (c) Interest for the previous year 2007-08 is fully allowed.
- (d) Interest for the period [no limit of time] prior to the completion of house is called. Pre-Construction Interest (PCI). It is allowed to be deducted over a period of 5 years i.e., 1/5th every year. No deduction after 5 years. In case interest is paid to a non-resident who does not pay tax in India deduction regarding interest will not be allowed without TDS.
 “Amounts not deductible from income from house property u/s 25
 If interest on loan is paid to a non-resident deduction shall be allowed only if tax is deducted at source.
- (e) Interest on delayed payment of interest is not allowed.

Treatment of unrealized rent recovered [up to assessment year 2001-02]

1. If amount of unrealized rent recovered is less than or equal to an amount, which was disallowed earlier, it shall not be taxable.
2. If amount unrealized rent recovered is more than the amount which was disallowed earlier, excess of amount realized over amount disallowed earlier shall be deemed as income from house property.

3. No deduction shall be allowed out of such deemed income.
4. Such amount shall be taxable under the head 'Income from House Property' even if the assessee does not own that house in the current previous year.

Illustration. In the previous year 2000-01, there was unrealized rent of Rs. 30,000 but the owner could claim a deduction of Rs. 20,000 only as the income from house property was only Rs. 20,000. Find out the deemed income from house property u/s 25A in each case separately if the assessee recovers:

Case I. Rs. 8,000

Case II. Rs. 15,000

Case III. Rs. 30,000

Solution. Computation of deemed income from house property u/s 25A

	Unrealised Rent	Claimed as deduction	Remaining unadjusted	Recovered	Taxable
	Rs.	Rs.	Rs.	Rs.	Rs.
Case I	30,000	20,000	10,000	8,000	NIL
Case II	30,000	20,000	10,000	15,000	5,000
Case III	30,000	20,000	10,000	30,000	20,000

The amount of unrealized rent recovered is taxable only if assessee had claimed and had been allowed deduction in case amount recovered is less than the amount of deduction, it is exempted from tax.

Case I. Amount of unrealized rent recovered is less than the amount of deduction allowed hence it is fully exempted.

Case II. The amount of unrealized rent recovered is more than the amount of deduction allowed hence taxable amount as deemed income from house property is Rs. 15,000 less Rs. 10,000 = Rs. 5,000

Case III. The amount of unrealized rent recovered is more than the amount of deduction allowed hence taxable amount as deemed income from house property is rs. 30,000 less Rs. 10,000 = Rs. 20,000.

Treatment of unrealized rent recovered [From A/Y 2002-03 onwards]

It shall be deemed as income of the year in which recovered.

While calculating deemed income from houses property for unrealized rent recovered, it shall be seen that on how much amount the assessee had saved tax in that previous year in which deduction was claimed. A comparison will be made between the amount of rental value on which tax has been paid and the rental value on which he would have paid tax, had there been no unrealized rent.

Illustration. Calculate the taxable amount of unrealized rent recovered in following case:

	P/Y 2007-08		P/Y 2008-09	
	Mr. X	Mr. Y	Mr. X	Mr. Y
MRV	1,20,000	1,20,000	1,20,000	1,20,000
FRV	1,36,000	1,36,000	1,36,000	1,36,000
Standard Rent	1,30,000	1,25,000	1,30,000	1,25,000
Annual Rent	1,60,000	1,35,000	1,60,000	1,35,000
Unrealised Rent	20,000	20,000	NIL	NIL
Unrealised Rent Recovered	NIL	NIL	18,000	18,000

Solution.

Mr. X assessment year 2008-09	Rs.	Mr. X assessment year 2009-10
MRV	1,20,000	Deemed income from House property
FRV	1,36,000	Out of amount of unrealized rent recovered he shall pay tax on Rs. 18,000 as he has saved tax on full amount of Unrealized rent.
Whichever is higher	1,36,000	
Or Standard Rent	1,30,000	
Whichever is less	1,30,000	
Or Annual Rent-unrealised rent [1,60,000 – 20,000]	1,40,000	
Whichever is higher is ARV		
As such he will pay tax on ARV of Rs.	1,40,000	
Had there been no unrealized rent he would have paid tax on Rs. 1,60,000 and as such he has saved tax on full amount of unrealized rent of Rs. 20,000.		
Mr. Y assessment year 2008-09	Rs.	Mr. Y assessment year 2009-10

MRV	1,20,000	Deemed income from House property
FRV	1,36,000	Out of amount of unrealized rent
Whichever is higher	1,36,000	Recovered he shall pay tax on Rs.
Or Standard Rent	1,25,000	8,000 only as he has saved tax on
Whichever is less is ERV	1,25,000	Only Rs. 10,000 and had paid tax
Or Annual Rent-unrealised rent [1,35,000 – 20,000]	1,15,000	On Rs. 10,000.
Whichever is higher is ARV	1,25,000	
As such he will pay tax on ARV of Rs.	1,25,000	
Had there been no unrealized rent he would have paid tax on Rs. 1,35,000 and as such he has saved tax on Rs. 10,000 [1,35,000 – 1,25,000]. Out of unrealized rent of Rs. 20,000 he has paid tax on Rs. 10,000.		

Special provision for arrears of rent received [Section 25B]

In case any arrears of rent of any earlier years are recovered these are deemed as income from house property after allowing 30% as Standard deduction.

While calculating deemed income from house property for arrears of rent, it shall be seen that on how much amount the assessee had saved tax in that previous year to which arrears the related. A comparison will be made between the amount of rental value on which tax has been paid and the rental value on which he would have paid tax, had he received full rent in that very year.

Illustration. Mr. G has given his premises on hire from 1-4-2004 to a company for its office. He submits the following particulars.

	Rs.		Rs.
MRV	1,50,000	Municipal taxes	12,000 p.a.
FRV	1,66,000	Interest on loan for purchase	
Standard rent	1,60,000	of house	22,000
Actual rent	1,56,000		

As per agreement rent increases to Rs. 14,000 p.m. from 1-10-2007. But amount of increased rent is paid in May 2008. Compute his income for the previous year 2008-09.

Solution. Computation of income from house property for the assessment year 2009-10

MRV	1,50,000		
FRV	1,66,000		
Whichever is higher		1,66,000	
Or standard rent		1,60,000	
Whichever is less is ERV		1,60,000	
Or actual rent [14,000x12]		1,68,000	
Whichever is higher is ARV			1,68,000
Less Municipal Taxes			12,000
Net Annual Value			1,56,000
Deductions u/s 24:			
Standard deduction: 30% of N.A.V.		46,800	
Interest on loan for purchase of house		22,000	68,800
Income from house property			87,200
Deemed income from house property			
Arrears of rent from 1-10-2007 to 31-3-2008 [See note 1]		2,000	
Less 30% standard deduction		600	1,400
Income under the head house property			88,600

Note 1.

Previous year 2007-08: if he had received increased rent in that very year:			
	Rs.	Rs.	Rs.
MRV	1,50,000		
FRV	1,66,000		
Whichever is higher		1,66,000	
Or Standard Rent		1,60,000	
Whichever is less is ERV		1,60,000	
Or Actual Rent [13,000 x 6 + 14,000 x 6]		1,62,000	
Whichever is higher is ARV			1,62,000
Previous year 2007-08: if he had not received increased rent in that very year:			
	Rs.	Rs.	Rs.
MRV	1,50,000		
FRV	1,66,000		
Whichever is higher		1,66,000	
Or Standard Rent		1,60,000	
Whichever is less is ERV		1,60,000	
Or Actual Rent [13,000 x 12]		1,56,000	
Whichever is higher is ARV			1,60,000
As such he has saved tax only on Rs. 2,000, hence in the previous year 2008-09 he shall pay tax on only Rs. 2,000.			

Property owner by co-owners [Section 26]

If share of co-owners is determinate, the income of such house property is calculated as one house and income is divided amongst the co-owners. They shall be entitled to relief u/s 23(2) as if they are individually owners of such property.

Illustration. A, B and C are three friends owning equally a house property consisting of six identical units. It was constructed on 1st July 2005. One unit is self-occupied by each one of them for their residence. The remaining three units are let out on a monthly rent of Rs. 7,500 per unit. The municipal value of house property is Rs. 5,00,000 and municipal tax is Rs. 1,25,000 (Rs. 25,000 due).

The other expenses were as follows:

(i) Collection and repair charges	Rs. 7,500
(ii) Insurance premium	Rs.15,000
(iii) Interest on loan taken for construction of house	Rs. 1,62,500

One of the let out units remained vacant for two months. Mr. B could not occupy his unit as he was transferred to some other city. He does not own any other house property. The other taxable incomes of A, B and C are Rs. 1,50,000, Rs. 2,00,000 and Rs. 3,00,000 respectively. Compute the taxable income under the head income from house property for the assessment year 2009-10.

Solution. Computation of house property income of A, B and C for A/Y 2009-10

Three persons own this house property and they are to be treated as co-owners. Half of the property consisting of three units is let out and other three units are self occupied by them. As such income for half let out property shall be computed as one house and then the income shall be distributed but other half of three units shall be computed separately as each co-owner can claim benefit of self-occupation.

Let out three units	[50% of property]		Rs.	Rs.
MRV of half property	[50% of Rs. 5,00,000]		2,50,000	
Actual Rent for three units	[7,500 x 3 x 12]		2,70,000	
Whichever is higher				2,70,000
Less loss due to vacancy				<u>15,000</u>
[1 unit x 2 months x				

7,500]				
Actual Rental Value				2,55,000
Less amount of municipal taxes-actually paid				<u>50,000</u>
Net Annual Value				2,05,000
Deductions u/s 24				
Standard Deduction 30% of NAV			61,500	
Interest on loan	[50% of Rs. 1,62,500]		81,250	<u>1,42,750</u>
Income from let out property				<u>62,250</u>
Self-occupied three units		A	B	C
Annual value		NIL	NIL	NIL
Less interest on loan [81,250 x 1/3 each]		(-)27,083	(-)27,083	(-)27,083
Share of income from let out property [62,250 x 1/3]		<u>(+)20,750</u>	<u>(+)20,750</u>	<u>(+)20,750</u>
Loss from house property		(-)6,333	(-)6,333	(-)6,333
Other incomes		<u>1,50,000</u>	<u>2,00,000</u>	<u>3,00,000</u>
Total income		<u>1,43,667</u>	<u>1,93,667</u>	<u>2,93,667</u>

Joint Expenses

Divide the expenses in the ratio of MRV or Municipal taxes or Fire Insurance Premium whichever is given in this order of preference.

Loss from House Property

This loss can be set off from any income of the same year. With effect from assessment year 1999-2000 any loss under the head "House Property" whether from let out or self occupied house which remains unadjusted, can be carried forward for 8 succeeding previous years to be set off from Income under the head "House Property" only.

Negative Annual Value

This situation is possible only when amount of municipal taxes actually paid by the owner are more than Annual Rental Value. In such case only one deduction of interest on loan is allowed as per above rules. Hence there will be loss from such house property.

Illustration. MRV of the residential house is Rs. 24,000 and actual rent is Rs. 2,500 p.m. During the previous year 2008-09 house was vacant for two months. The Municipal Taxes are @ 10% of MRV. During the year owner paid Rs. 30,000 as arrears of Municipal Taxes. Interest on loan taken for the construction of house payable to his employer is Rs. 16,000. Compute income from house property.

Solution.

Computation of income from house property		Rs.
MRV		24,000
Actual Rent [2,500 x 12]		30,000
Whichever is higher is ARV		30,000
Less loss due to vacancy		<u>5,000</u>
Annual Rental Value		25,000
Less amount of municipal taxes actually paid by the owner during the previous year : for 2008-09	2,400	
Amount of arrears paid during the year	<u>30,000</u>	
		<u>32,400</u>
Annual Value (Negative)		(-)7,400
Deduction u/s 24:		
Standard deduction 30% of NAV	NIL	
Interest on loan	<u>16,000</u>	
		<u>(-)16,000</u>
Loss from House Property		<u>23,400</u>

Illustration. Compute the total income of Mr. Reddy from the particulars given below for the previous years 2008-09 and 2009-10:

	Previous year (2008-09)	Previous year (2009-10)
	Rs.	Rs.
House Property		
Self occupied house		
Interest on loan	5,000	5,000
Let out house		
Loss due to interest and other expenses	36,000	NIL
Income from other sources	(+)11,000	(+)11,000

Solution. Computation of total income

Assessment year 2009-10 (Previous year 2008-09)	Rs.	Rs.
House Property		
Self occupied House		
Interest on Loan	5,000	

Let out house		
Loss due to interest on Loan and other expenses	<u>36,000</u>	
Loss under the head House Property [To be set off from any other head]		(-)41,000
Other Sources		
Income from other sources		<u>11,000</u>
Total Income		<u>NIL</u>
Loss of Rs. 30,000 under the head house property shall be carried forward.		
Assessment year 2010-11 (Previous year 2009-10)		Rs.
House Property		
Loss from Self occupied House		(-)5,000
Other Sources		
Income		<u>(+)11,000</u>
Total Income		<u>6,000</u>

Note: B/F loss from previous year 2008-09 cannot be set off as assessee does not have any income under the head 'House Property'. It is allowed to be carried forward.

Illustration. Mr. B owns a house property at Cochin. It consists of 3 independent units and information about the property is given below:

UNIT 1 : Own residence

UNIT 2 : Let out

UNIT 3 : Own business

MRV	Rs. 1,20,000 p.a.
FRV	Rs. 1,32,000 p.a.
Standard Rent	Rs. 1,08,000 p.a.
Rent	Rs. 3,500 p.a.
Unrealised rent	for three months
Repairs	Rs. 10,000
Insurance	Rs. 2,000
Interest on money borrowed for purchase of property	Rs. 96,000
Municipal Taxes	Rs. 14,400
Date of completion	1-11-2003

Solution.

Compute income from house property			Rs.
Unit 1: Own residence			
Annual Value is		NIL	
Interest on loan [96,000x1/3] or Rs.30,000 whichever is less		<u>30,000</u>	
Loss from self occupied unit			-30,000
Unit 2: Let out			
MRV:1,20,000 p.a. x 1/3	40,000		
FRV : 1,32,000 p.a. x 1/3	44,000		
Whichever is higher	44,000		
OR Standard Rent 1,08,000 p.a. x 1/3	36,000		
Whichever is less is ERV	36,000		
OR Actual rent less unrealized rent [42,000-10,500]	<u>31,500</u>		
Whichever is higher is ARV		36,000	
Less: Municipal Taxes [14,400 x 1/3]		<u>4,800</u>	
Net Annual Value		31,200	
Deductions u/s 24:			
Standard Deduction @ 30% of AV[30% of 31,200]	9,360		
Interest on loan [96,000 x 1/3]	<u>32,000</u>		
Loss from Let out unit		<u>41,360</u>	-10,160
Unit 3: Own business			
Annual value is			<u>NIL</u>
Loss under the head house property			<u>-40,160</u>

Note: (1) It is assumed that all the three units are independent units and thus are being treated as separate houses.

(2) Interest on loan taken to construct the house-being used in own business i.e., 1/3rd of 96,000 shall be treated as business expenditure.

Illustration. Find out the taxable income from property of Sri Gyan Parkash of Amritsar from the following particulars:

He owns three houses, the municipal valuation of which is Rs.12,000, Rs. 24,000 and Rs. 21,000 respectively. The following are further details about three houses:

- (a) The first house built in 2000, has been let out on a monthly rent of Rs.2,500. The expenses in connection with this house were: Interest on Mortgage Rs. 1,200; Land Revenue Rs. 50; Fire Insurance Premium Rs. 750; Interest on loan for the construction of the house Rs. 3,600; Municipal Taxes Rs. 1,200. The house remained vacant for two months, Unrealised rent of the current year amounts to Rs. 5,000. The Assessing Officer has been satisfied about this unrealized rent.

- (b) The second house was built in 1994 and is used for owner's residential purposes. In connection with this house Rs. 300 were spent on repairs and Rs. 100 were paid as Fire Insurance Premium. The house remained vacant for three months as the owner had to stay in Bombay in a rented house in connection with his profession.
- (c) The construction of third house was completed on 30th June 2005 and from 1st July 2005 it was let out for residential purposes on a rent of Rs. 1,500 p.m. Municipal Tax Rs. 2,100 and interest on loan Rs. 14,000 were paid during the year 2008-09. His income from other sources amounted to Rs. 72,000.

Solution. Computation of income from house property of Sri Gyan Prakash of Amritsar

1 st House:	Rs.	Rs.	Rs.
MRV	12,000		
Real Rent less unrealized rent[30,000-5,000]	25,000		
Whichever is higher		25,000	
Less: Loss due to vacancy		5,000	
Annual Rental Value		20,000	
Less Municipal Taxes		1,200	
Net Annual Value		18,800	
Deductions u/s 24:			
Standard Deduction: 30% of Net Annual Value	5,640		
Interest on loan taken for construction of the house	3,600	9,240	
Income from 1 st house			9,560
3 rd House:			
Municipal Rental Value is ERV		21,000	
Or Actual Rent Received		18,000	
As ERV is higher than actual rent hence ERV is ARV		21,000	
Less: Municipal Taxes		2,100	
Net Annual Value		18,900	
Deductions u/s 24:			
Standard Deduction: 30% of Annual Value	5,670		
Interest on loan (for construction)	14,000	19,670	
Loss from 3 rd house			(-770)
2 nd House: Self occupied			
Annual Value of such house is taken as Nil for the period it is actually self-occupied u/s 23(2)(a) and it is taken as Nil for the period it could not be			NIL

occupied as owner had to stay in a hired house at Mumbai due to his profession u/s 23(2)(b)			
Income under the head House Property			8,790

Illustration. A is the owner of 4 houses. One house is let to a tenant for Rs. 3,000 p.a. The second house, the municipal valuation of which is Rs. 4,500 p.a. is in his own occupation. The third house remained vacant throughout the whole year as it was not in rentable condition. The fourth house, the municipal valuation of which is Rs. 6,000 is used by A for his business.

His expenses in respect of these houses are as follows:	Rs.
Interest on loan taken to repair the residential house	400
Fire Insurance premium for 1 st , 2 nd and 4 th house	1,410
Collection charges	350
Ground rent in respect of 2 nd house	200
The first house, which is let, remained vacant for two months,	

Calculate A's income from house property.

Solution. Computation of House Property income of Mr. A

Computation of House Property income of Mr. A	Rs.	Rs.	Rs.
1 st House: Let out			
Annual Rental Value less vacancy			
[3,000-2/12 of 3,000]	2,500		
Less: Municipal Taxes	NIL		
Net Annual Value		2,500	
Deductions u/s 24:			
Standard Deduction: 30% of Net Annual Value		750	
Income from 1 st house			1,750
2 nd house: Self-occupied			
Annual value is taken as		NIL	
Less: Interest as Loan		400	
Loss from self-occupied house			(-400)
3 rd House:			
This house was not let out for full year as such			
Annual value of this house is taken as Nil			NIL
4 th House:			
This house is being used for assessee's business. So no income will be taken under this head of 'Income from House Property'. Its income and expenses are treated under the business head of income. This			NIL

house is outside the purview of this head of income			
Income from House Property			1,350

Illustration. Mr. P is the owner of a house property in Kanpur. It has been let out for Rs. 90,000. The tax payable by the owner comes to Rs. 8,400 on municipal valuation of Rs. 84,000 but the landlord has taken an agreement from the tenant stating that the tenant would pay tax direct to the municipality. The landlord, however, bears the following expenses on tenant's amenities:

Water charges (as per agreement)	Rs. 1,000
Lift Maintenance	Rs. 1,000
Salary of Gardener	Rs. 1,200
Lighting of Stairs	Rs. 800
The landlord claims the following deductions:	
Repairs	Rs. 30,000
Land Revenue	Rs. 1,000
Collection Charges	Rs. 2,000

Legal charges incurred on purchase of land on which house property is situated Rs. 24,000. Compute the taxable income from house property.

Solution.

Computation of Income from House Property of Mr. P	Rs.	Rs.
Actual rental value		90,000
Deduct: Expenses met by landlord on amenities provided to the tenants		
1. Water charges	1,000	
2. Lift Maintenance	1,000	
3. Salary of Gardener	1,200	
4. Lighting of Stairs	800	4,000
		86,000
Annual Rental value (MRV Rs. 84,000 or Real Rent Rs. 86,000 w.e. is higher)		86,000
Less: Municipal Taxes		<u>NIL</u>
Net A.V.		86,000
Deductions u/s 24:		
Standard Deduction: 30% of Net Annual Value		<u>25,800</u>
Income from House		60,200

Illustration. A house was completed on April 1, 2008 and following information is available about this house:

Municipal Value of the House	Rs. 30,000 p.a.
Fair Rental Value of the House	Rs. 32,000 p.a.
Actual Rent	Rs. 4,000 p.m.
Municipal Taxes	Rs. 6,000 p.a.
Let out for the period 1-4-2008 to 31-12-2008 and self occupied from 1-1-2009 onwards.	
Fire Insurance Premium	Rs. 3,600
Land Revenue	Rs. 6,000
Interest on Loan for the period	
(a) 1-4-2005 to 31-3-2008	Rs. 45,000
(b) 1-4-2008 to 31-3-2009	Rs. 15,000

Calculate income from house property for the previous year ending on 31-3-2009.

Solution. Computation of Income from House Property

[Treated as let out house no benefit of self occupancy]

	Rs.	Rs.
Municipal Rent Value	30,000	
Fair Rental Value	32,000	
Whichever is higher is ARV	32,000	
Actual Rental Value [Rs. 4,000 x 9 months]	36,000	
w.e. is higher is gross annual value		36,000
Less: Municipal Taxes		<u>6,000</u>
Net Annual Value		30,000
Deductions u/s 24:		
Standard Deduction: 30% of Net Annual Value	9,000	
Interest on Loan for the year 2008-09	15,000	
PCI: Interest on Loan for the period 1-4-2005 to 31-3-2008		
1/5 th of PCI (45,000 x 1/5)	<u>9,000</u>	
		<u>33,000</u>
Loss from H.P.		<u>3,000</u>

Note: In case a house is let out for the part of year and self-occupied for remaining part of the year, such house is to be treated as fully let out house and benefit of self-occupancy shall not be allowed. Actual rent received is to be taken for the actual number of months house is let-out.

Illustration. From the particulars given below compute income from house property which consists of two independent units having 1/3rd and 2/3rd area:

Date of Completion	1-11-2003
Municipal Rental Value	Rs. 96,000
Fair Rental value	Rs. 84,000
Self-occupied	2/3 portion

Let-out	1/3 portion from 1-4-2008 to 31-8-2008 @ Rs. 7,200 p.m. and self-occupied from 1-9-2008 onwards.
Municipal Taxes	Rs. 6,000 p.a.
Fire Insurance Premium	Rs. 2,000 p.a.
Ground Rent	Rs. 4,000 p.a.
Interest on Loan	Rs. 7,500

Solution. Computation of House Property Income

As each portion is an independent unit, the income shall be computed in following manner:

A	2/3 rd house (Unit-1) under own occupation		Rs.	Rs.	Rs.
	Net Annual Value			NIL	
	Deduction regarding interest on loan taken				
	[2/3 rd of Rs. 7,500]			<u>5,000</u>	
	Loss from self-occupied unit				(-)5,000
B	1/3 rd house (Unit-2) let out				
	[No benefit of self-occupation]				
	MRV (96,000 x 1/3)		32,000		
	Actual rent received (for the period it is actually let out)		36,000		
	Or FRV [1/3 rd of Rs.84,000]		28,000		
	Whichever is higher is ARV			36,000	
	Less municipal taxes				
	[1/3 rd of Rs. 6,000]			<u>2,000</u>	
	Net Annual Value			34,000	
	Deductions u/s 24				
	Standard Deduction: 30% of NAV	10,200			
	Interest on loan				
	[1/3 rd of Rs. 7,500]	<u>2,500</u>			
	Income from let out unit			<u>12,700</u>	<u>21,300</u>
	Income from house property				<u>16,300</u>

Illustration. Mr. Raghav owns a residential house property. It has two equal residential units-Unit-I and Unit-II. While Unit-I is self occupied by Raghav for his residential purpose; Unit-II is let out (rent beings Rs. 6,000 per month, rent of two months could not be recovered). Municipal value of the property is Rs. 1,30,000, standard rent is Rs. 1,25,000 and fair rent is Rs. 1,40,000. Municipal Tax is imposed @ 15% which is paid by Raghav, Other expenses for the previous year 2008-09 being repairs Rs. 800,

insurance Rs. 1,500, interest on capital (borrowed during 1998) for constructing the property: Rs. 63,000.

Find the house property income of Raghav for the assessment year 2009-10.

Solution. Computation of house property income of Mr. Raghav for the A/Y 2009-10.

Note. Two equal residential units of a house are treated as two separate houses.

Unit-II. Let out			
Municipal Value of property Rs. 1,30,000 x 1/2	65,000		
Fair rent of property Rs. 1,40,000 x 1/2	70,000		
w.e. is higher	70,000		
Standard rent of property = 1,25,000 x 1/2	62,500		
It cannot exceed standard rent, ∴ value to be taken		62,500	
Actual rent receivable Rs. 6,000 p.m.	72,000		
Less unrealized rent for 2 months	<u>12,000</u>		
		60,000	
Standard rent or Actual rent received, w.e. is higher is Gross Annual Value			62,500
Less: Municipal Taxes @ 15% of M.V. (i.e. 15% of 65,000)			<u>9,750</u>
Net Annual Value			52,750
Deductions u/s 24:			
Standard deduction 30% of N.A.V.	15,825		
Interest on borrowed money – 1/2 of 63,000	<u>31,500</u>		
			<u>47,325</u>
Income from let out unit			5,425
Unit-I. Self occupied			
Net Annual Value is treated as		NIL	
Deductions u/s 24			
Interest on borrowed money 1/2 of 63,000	31,500		
But restricted to		<u>30,000</u>	
Loss from self-occupied house			<u>-30,000</u>
Loss from house property			<u>(-) 24,575</u>

Illustration. Mr. Surinder Kumar owns a house at Delhi. During the previous year 2008-09, 3/4th portion of the house is occupied for self-residence for full year and 1/4th portion is let out for residential purposes from 1.4.2008 to 31-12-2008 on a rent of Rs. 700 p.m. From 1-1-2009 this portion was used for own residency by him. Municipal valuation of the entire house is Rs. 20,000 and fair rental value is Rs. 24,000. Expenses incurred in respect of the house property were: Municipal Taxes Rs. 60,000; Repairs Rs. 2,000; Fire insurance premium Rs. 3,500; Land Revenue Rs. 4,000 and Ground Rent Rs. 200. These expenses were paid during the year.

A loan of Rs. 60,000 was taken on 1-4-2005 @ 15% p.a. for the construction of the house which was completed on 31-1-2006. Loan is still outstanding. Find out his income from house property for the assessment year 2009-10.

Solution. Computation of house property income of Mr. Surinder Kumar for the A/Y 2009-10

Self-occupied – 3/4 th portion			
Net Annual Value is treated as			NIL
Deduction u/s 24			
Interest on borrowed money $60,000 \times \frac{15}{100} \times \frac{3}{4}$			<u>6,750</u>
Loss from self-occupied portion			(-)6,750
Let out – 1/4 th portion			
Municipal Valuation = 20,000 x ¼ =	5,000		
Fair Rental Value = 24,000 x ¼ =	6,000		
Actual rent received [1-4-08 –31-12-08]			
700 p.m. x 9	6,300		
w.e. is higher is gross annual value		6,300	
Less: Municipal Taxes-1/4 th of 6,000		<u>1,500</u>	
		4,800	
Net Annual Value			
Deductions u/s 24			
Standard deduction-30% of 4,800	1,440		
Interest on borrowed money $60,000 \times \frac{15}{100} \times \frac{1}{4}$	<u>2,250</u>		
		<u>3,690</u>	
Income from let out portion			<u>+1,110</u>
Loss from house property			<u>-5,640</u>

Illustration. Following are the particulars of two house properties owned by Mr. Swami.

	House - I	House - II
Municipal Valuation	96,000	90,000
Fair Rent	88,000	96,000
Standard Rent	90,000	1,08,000
Actual Rent received	9,000 p.m.	10,000 p.m.
Self occupied	1-4-08---30-11-08	1-12-08---31-3-09
Let out	1-12-08---31-3-09	1-4-08---30-11-08
Municipal Taxes due	6,000	8,000

Paid	3,000	NIL
Interest on borrowed Money	10,000	42,000

Loan taken to construct House-II is still outstanding. Loan was taken in 1997.

Find out Mr. Swami's income from house property.

Solution. Computation of Mr. Swami's income from house property for the A/Y 2009-10

Where a house property is self-occupied for a part of the year and let out for remaining part of the year, the benefit of self-occupancy u/s 23(2)(a) is not available and the income of such a house property will be computed as if the house is let out.

House – I

	Rs.	Rs.	Rs.
Municipal Valuation	96,000		
Fair Rental Value	88,000		
w.e. is higher	96,000		
Standard rent	90,000		
w.e. is less is taken	90,000		
Actual rent received			
1-12-08---31-3-09 for 4 months @ 9,000	36,000		
w.e. is higher is gross annual value		90,000	
Less: Municipal Taxes – Actually paid		3,000	
Net Annual value		87,000	
Deductions u/s 24			
Standard deduction---30% of 87,000	26,100		
Interest on borrowed money	10,000		
		36,100	
Income from House I			50,900

House – II

	Rs.	Rs.	Rs.
Municipal Valuation	90,000		
Fair Rental Value	96,000		
w.e. is higher	96,000		
Standard rent	1,08,000		
w.e. is less is taken	96,000		
Actual rent received			
1-4-08---30-11-08 for 8 months x 10,000	80,000		
w.e. is higher is gross annual value		96,000	

Less: Municipal Taxes – Actually paid		<u>NIL</u>	
Net Annual value		96,000	
Deductions u/s 24			
Standard deduction---30% of 96,000	28,800		
Interest on borrowed money	<u>42,000</u>		
		<u>70,800</u>	
Income from House II			<u>25,200</u>

Income from House Property			<u>76,100</u>
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Note: As per Supreme Court decision in Balbir Singh v/s MCD (1985) 152 ITR 388 expected rent cannot exceed standard rent whereas if actual rent received is more than standard rent, then actual rent shall be expected rent.

Illustration. Mr. Patnaik is the owner of a house which consists of 3 independent units. Ground floor which is equal to 40% is self occupied and 1st floor is also equal to 40% and is let-out. Second floor which is equal to 20% is also let out.

Other informations regarding the house are as follows:

Fair Rental value	90,000 p.a.
Municipal valuation	1,00,000 p.a.
Standard Rent	80,000 p.a.
Municipal Taxes	10% of MRV
Repairs expenses	10,000 p.a.
Ground rent	5,000 p.a.
Actual rent received:	
First Floor unit	5,000 p.m.
Second Floor unit	2,000 p.m.

First floor unit remained vacant for 2 months. Mr. Patnaik started the construction of the house in 2005. He borrowed Rs. 5 lacs @ 14% on 1-7-2005 for the completion of the house and the house was finally completed on 15th July, 2007. Mr. patnaik returned loan of Rs. 1 Lac on 31st March, 2008.

Determine Mr. Patnaik's house property income for the A/Y 2009-10.

Solution. Computation of income from House Property

Area	Unit I	Unit II	Unit III
	Self-occupied Rs.	Let out Rs.	Let out Rs.
FRV	90,000		
MRV	1,00,000		
Whichever is higher	1,00,000		
Or			
Standard Rent	Rs.80,000		
Whichever is less is ERV			
∴ ERV=Rs.80,000[2:2:1]	32,000	32,000	16,000
Or Actual Rent		<u>60,000</u>	<u>24,000</u>
Whichever is higher is taken	NIL	60,000	24,000
Less loss due to vacancy		<u>10,000</u>	---
Gross annual value	<u>NIL</u>	50,000	24,000
Less Municipal Taxes		<u>4,000</u>	<u>2,000</u>
Net Annual value	NIL	46,000	22,000
<i>Deductions U/s 24:</i>			
Standard Deduction		<u>13,800</u>	<u>6,600</u>
-30% of NAV		32,200	<u>15,400</u>
Interest on loan for 2008-09			
[(5,00,000-1,00,000) x 14%] [2 : 2 : 1]	(-22,400)	(-22,400)	(-11,200)
		9,800	4,200
1/5 th of PCI			
[5,00,000 x 14% x 1 year 9 m] [2 : 2 : 1]	(-9,800)	(-9,800)	(-4,900)
Income/Loss	(-32,200)	<u>NIL</u>	(-700)
			<u>(-) 32,200</u>
Loss under the head House Property			<u>(-) 32,900</u>

Illustration. Mr. Basu of Kolkata submits the following particulars of his let out residential house.

Rent received for house as well as for various amenities provided to the tenant:

(i) For house	6,000 p.m.
(ii) For lift maintenance	500 p.m.
(iii) For security charges	500 p.m.
(iv) For electricity & water	1,000 p.m.
Municipal Valuation	70,000 p.a.
Fair Rental value	56,000 p.a.
Standard Rent	60,000 p.a.
Municipal Taxes (50% to be paid by tenant – 10% of MRV)	
Repairs expenses met by tenant	5,000
Insurance premium paid by Mr. Basu	1,000
Annual Charge imposed by Court in favour of his mother	10,000 p.a.
Interest on loan taken in 2005 for the renovation of the house	20,000 p.a.

In 2003-04 a tenant defaulter in the payment of rent to the tune of Rs. 36,000 but Mr. Basu could claim a deduction of Rs. 26,000 only in the previous year 2005-06. After a long litigation Mr. Basu could recover from the tenant only Rs. 20,000 during the previous year 2008-09.

Mr. Basu spent Rs. 16,000 only to provide the above mentioned amenities to the tenant.

Compute Mr. Basu's income from house property and any other income for the Assessment Year 2009-10.

Solution

A. Computation of House Property Income	Rs.	Rs.
MRV	70,000	
FRV	56,000	
Whichever is higher is	70,000	
or Standard Rent	60,000	
Whichever is less is ERV	60,000	
or		
Actual Rent Received	72,000	
Whichever is higher is ARV		72,000
Less Municipal Tax		3,500
50% (10% of 70,000)		
Net Annual value		68,500
Standard Deduction: 30% of NAV	20,550	
Interest on loan taken	20,000	40,550

Income from House		27,950
<i>Add</i>		
Deemed Income from HP: unrealized rent recovered	20,000	
Less disallowed earlier	<u>10,000</u>	<u>10,000</u>
Income from House Property		<u>37,950</u>
B. Calculation of Income from other Sources		
Amount received from tenants for common facilities		
(i) For Lift Maintenance	6,000	
(ii) For Security Charge	6,000	
(iii) For Water and Electricity	<u>12,000</u>	<u>24,000</u>
Less actual expenses incurred		<u>16,000</u>
Income from other sources		<u>8,000</u>

Illustration. Mr. Ramachandran owns two houses at Chennai. Compute his income from house property for the assessment year 2009-10.

FRV	36,000 p.a.	1,20,000 p.a.
Actual Rent	4,000 p.m.	12,000 p.m.
Municipal Rental Value	40,000 p.a.	1,30,000 p.a.
Standard Rent	38,000 p.a.	N.A.
Municipal Tax	10% of MRV + 2% of Municipal tax as sewerage cess	10% of MRV + 2% of M. Taxes as sewerage cess
Actual repairs expenses	4,000	12,000
Ground Rent	2,000	2,500
Collection charges	500	1,200
Interest on loan	12,000	48,000
Vacancy period	3 months	
Bonafide unrealized rent of current year	-	36,000

Construction of house II started on 1st November 2004 and he borrowed Rs. 4,00,000 @ 12% on 1st July, 2005 for the completion of construction. The house was completed on 30th November 2007 and since then it is let out.

Solution. Computation of Income from House Property

Particulars	House I		House II	
	Rs	Rs.	Rs.	Rs.

FRV	36,000		1,20,000	
MRV	40,000		1,30,000	
Whichever is higher	40,000		1,30,000	
Standard Rent	38,000		NIL	
Whichever is less is ERV	38,000		1,30,000	
or				
Annual rent	48,000			
Whichever is higher is ARV	48,000			
Less loss due to vacancy ARV	<u>12,000</u>			
	36,000			
II. Actual rent less Unrealised rent [1,44,000-36,000] = 1,08,000			1,08,000	
Whichever is higher is annual rental value		36,000		1,30,000
Less municipal taxes 10% of MRV	4,000		13,000	
Sewerage cess 2% of taxes	<u>80</u>	<u>4,080</u>	<u>260</u>	<u>13,260</u>
Net Annual Value		31,920		1,16,740
Deductions u/s 24:				
Standard Deduction: 30% of NAV	9,576		35,022	
Interest on loan taken: for P/Y 2008-09	12,000		48,000	
1/5 th of PCI (II only)	<u>NIL</u>		<u>16,800</u>	
[4,00,000 x 12% x 1 year - 9 months]		<u>21,576</u>		<u>99,822</u>
Income from House		<u>10,344</u>		<u>16,918</u>

Income under the head House Property [10,344 + 16,918] = 27,262.

Illustration 33. Mr. W owns two self-occupied houses in Ambala. From the following information find out that which house he should choose as self occupied?

	House A	House B
	Rs.	Rs.
Standard Rent fixed under Rent Control Act	36,000	56,000
Fair rent	42,000	62,000
Municipal Valuation	24,000	44,000
Municipal Taxes (Paid)	1,200	1,200
Municipal Taxes (Due)	1,200	1,200
Ground Rent (Paid)	1,000	500

Date of completion of these houses was 31-1-2006. Mr. W had taken a loan of Rs. 2,50,000 @ 10% p.a. for construction of House A on 1-6-2004 and he repaid Rs. 2,00,000 on 1-10-2008.

Solution. Determination of income from house property

Step 1. Calculate the value of both the houses assuming them to be let out:				
	House A		House B	
	Rs.	Rs.	Rs.	Rs.
Fair Rent		42,000		62,000
Municipal Valuation		24,000		44,000
Whichever is higher		42,000		62,000
Or standard rent		36,000		56,000
Whichever is less is ARV		36,000		56,000
Less: Municipal taxes paid		<u>1,200</u>		<u>1,200</u>
Net Annual Value		34,800		54,800
Deductions u/s 24				
Statutory deduction @ 30%	10,440		16,440	
Interest on loan: For Previous year 2008-09 [2,50,000 x 10/100 x 6/12 + 50,000 x 10/100 x 6/12]	15,000		NIL	
1/5 of pre-construction interest [2,50,000 x 10/100 x 10/12] x 1/5	<u>4,167</u>	<u>29,607</u>	<u>NIL</u>	<u>16,440</u>
		<u>5,193</u>		<u>38,360</u>
Step 2. Assume that house A is self-occupied and house B is let out:				
Income from House A [Loss due to interest on loan 15,000 + 4,167]				(-)19,167
Income from House B				<u>38,360</u>
Income from House Property				<u>19,193</u>
Step 3. Assume that house B is self-occupied and house A is let out:				
Income from House A				5,193
Income from House B				<u>NIL</u>
Income from House Property				<u>5,193</u>

As such it will be beneficial for him to choose house B as self-occupied and house A as let out.

Illustration. Mr. X completed a house on 1-4-2008 jointly with his wife and invested Rs. 30,00,000. House consists of two equal units. One unit is self-occupied by Mr. X and his family and other unit (owned by Mrs. X) is let out at Rs. 10,000 p.m. The municipal value of the house is Rs. 2,16,000 p.a. on which municipality levies 10% tax and 2% of

tax as surcharge. A loan of Rs. 6,00,000 was taken on 1-11-2005 @ 9% p.a.. Compute the income from house property for the assessment year 2009-10 if:

- (a) Whole of capital is supplied by Mr. X and loan is also taken on his name.
 (b) 50% of capital is supplied by Mr. X and 50% by Mrs. X and loan is also taken jointly in same proportion and Mrs. X is herself a tax payee.

Solution. Computation of income from house property

½ Let out	Rs.	Rs.	Rs.
MRV	1,08,000		
Actual Rent for the year	1,20,000		
Whichever is higher is ARv		1,20,000	
<i>Less</i> : Municipal Taxes 10% of MRV	10,800		
Surcharge @ 2% of tax	216	11,016	
Annual value		1,08,984	
Deductions u/s 24:			
Standard Deduction @ 30% of AV	32,695		
Interest on loan:			
For the year 2008-09			
9% of Rs. 6,00,000 [1/2 of 54,000]	27,000		
1/5 th of Pre Construction Interest			
[1-11-2005 to 31-3-2008 = 2 years and 5 months]			
6,00,000 x 9/100 x 2Y – 5M] = 1,30,500			
1/5 th of 1,30,500 = 26,100 x ½	13,050	72,745	
Income from let out house:			36,239
½ Self Occupied			
Annual Value		NIL	
Deductions u/s 24:			
Interest on loan:			
For the year 2008-09			
9% of Rs. 6,00,000 [1/2 of 54,000]	27,000		
1/5 th of Pre Construction Interest			
[1-11-2005 to 31-3-2008 = 2 years and 5 months]			
6,00,000 x 9/100 x 2Y – 5M] = 1,30,500			
1/5 th of 1,30,500 = 26,100 x ½			
Loss from self occupied house:	13,050	40,050	(-)40,050
Loss under the head House property			3,811

(a) Full Capital is supplied by Mr. X he shall be deemed as single owner of house property u/s 27

Mr. X's shall have a loss of Rs. 3,811 under the head House property and he can adjust this loss from his individual income.

(b) 50% of Capital is supplied by Mr. X and Mrs. X supplies 50% of capital as joint owners.

Mr. X's income.

½ Self Occupied

Loss of Rs. 40,050 as computed above shall be Mr. X's loss and he can adjust it from his individual income.

Mrs. X's income ½ let out

Income of Rs. 36,239 as computed above shall be Mrs. X's income and shall be added in her other individual income.

Illustration 35. Mr. S.M. Krishna is the owner of a big house consisting of 3 equal and independent units. Unit I is let out at a rent of Rs. 8,000 p.m.

Unit II is being used in owner's own business, whereas Unit III is being used for his own residence. Other particulars of the house are as follows.

Municipal Valuation	Rs. 1,50,000
Fair Rental Value	Rs. 1,95,000
Standard rent as per rent control Act	Rs. 1,86,000
Municipal taxes	Rs. 15,000
Repairs	Rs. 12,000
Interest on borrowed money	Rs. 60,000

Unit I remained vacant for 2 months and one month's rent could not be realized from a tenant.

Mr. Krishna's income from his business without debiting any expenditure related to own house being used in his own business is Rs. 2,00,000.

Determine Mr. Krishna's income from business and home property for the assessment year 2009-10.

Solution. Computation of house property income of Mr. Krishna for the assessment year 2009-10.

Unit I-Let out		
Municipal value – 1/3 rd		50,000
Fair Rental Value – 1/3 rd		65,000
Standard Rent – 1/3 rd		62,000
Municipal Valuation or Fair Rental value, w.e. is higher		
But not exceeding standard rent		
∴ value to be taken		62,000
Rent received/receivable	96,000	
Less: Unrealized rent for one month	<u>8,000</u>	88,000
Whichever is higher to be taken		88,000
Less: Loss due to vacancy for 2 months		<u>16,000</u>
Gross annual value		72,000
Less: Municipal taxes – 1/3 rd		<u>5,000</u>
Net annual value		67,000
Deductions u/s 24		
Standard deduction – 30% of N.A.V	20,100	
Interest on borrowed money – 1/3 rd	<u>20,000</u>	<u>40,100</u>
Income from let out unit		<u>26,900</u>
Unit II-Unit being used in owner's own business		
Since Unit-II is being used in owner's own business, and so excluded from house property head hence no income under the head.		
Unit-III- Self Occupied Unit		
Net Annual Value is treated as		NIL
Deduction u/s 24		
Interest on borrowed money – 1/3 rd of 60,000		<u>(-)20,000</u>
Loss from self occupied unit		<u>(-)20,000</u>
Business Income		
Profit (given)		2,00,000
Less expenses related to Unit III (Not taken into A/c earlier)		
Municipal taxes – 1/3 rd of 15,000	5,000	
Repairs – 1/3 rd of 12,000	4,000	
Interest on borrowed money – 1/3 rd of 60,000	<u>20,000</u>	
		<u>29,000</u>
Business Profit		<u>1,71,000</u>

Note: Depreciation of Unit-III will be an allowable business deduction but in this case depreciation cannot be calculated as cost or W.D.V of the Unit III is not given in the question.

Income from house property

Income from Unit – I	26,900
Income from Unit – II	NIL
Loss from Unit – III	<u>(-)20,000</u>
Income from home property	<u>6,900</u>

Illustration. Mr. Lamba owns following four house properties. Other particulars are as follows:

	House I Self occupied	House II Self occupied	House III Let out to a Business house	House IV Being used in own business
Municipal valuation	20,000	50,000	70,000	45,000
Standard rent	-	-	72,000	48,000
Fair Rental value	26,000	60,000	80,000	50,000
Actual rent received	-	-	96,000	-
Vacancy	NIL	NIL	1 month	NIL
Unrealized rent	-	-	16,000	-
Municipal taxes	5,000	2,000	6,000	4,000
Repairs	4,000	2,000	8,000	5,000
Interest on borrowed money	8,000	10,000	-	-

Mr. Lamba borrowed Rs. 2,00,000 @ 12% for the construction of House No. 111 on 1st October, 2004 and the houses was completed on in October 2006 and since then it is letout. A part of the loan of Rs. 50,000 was repayed on 15th Oct, 2007. Determine the house property income of Mr. Lamba.

Solution. House No. I and II are self occupied houses. Only one at the choice of the owner and in the absence of the choice normally of higher value shall be treated as a self-occupied one, whereas the other one shall be a deemed to be let-out. In this case house I shall be treated as a self occupied house.

House II. Self Occupied				
Net Annual Value treated as			NIL	
Deductions u/s 24				
Interest on borrowed money			<u>10,000</u>	

Loss from self occupied house				<u>10,000</u>
House No. I. Deemed to be let out house				
Municipal valuation		20,000		
Fair Rental value		26,000		
w.e. is higher is gross annual value			26,000	
Less: Municipal taxes			<u>2,000</u>	
Net Annual value			24,000	
Deductions u/s 24				
Standard deduction : 30% of 24,000		7,200		
Interest on borrowed money		<u>8,000</u>	<u>15,200</u>	
Income from house				<u>8,800</u>
House No. III. Le out to a business house				
Municipal valuation		70,000		
Fair Rental Value		80,000		
Standard Rent		<u>72,000</u>		
Municipal valuation or F.R.V. w.e. is higher but not exceeding standard rent				
Standard rent to be taken		72,000		
Actual rent received	96,000			
Less: Unrealised rent	<u>16,000</u>	80,000		
w.e. is higher shall be taken			80,000	
Less: Vacancy for one month			<u>6,667</u>	
Gross Annual value			73,333	
Less: Municipal taxes			<u>6,000</u>	67,333
Deduction u/s 24:				
Standard Deduction: 30% of N.A.V.			20,200	
Interest on borrowed money for 2008-09:		18,000		
1,50,000 @ 12%				
For pre-construction period				
1-10-2004 – 31-3-2006				
2004-05 2,00,000 @ 12% for 6 month	12,000			
2005-06 2,00,000 @ 12% for one month	<u>24,000</u>			
	<u>36,000x1/5</u>	<u>7,200</u>	<u>25,200</u>	<u>45,400</u>
Income from let out house				<u>21,933</u>
House No. III. Le out to a business house				
This type of house is excluded from the house property head. All expenses of this type of house are debited to the P&L A/c of the business for which own house is being used.				
House Property Income				
House No. I	-10,000			
House No. II	8,800			
House No. III	21,933			
House No. IV	<u>NIL</u>			
	<u>20,733</u>			

SECTION-- A

- (a) What is GAV?
- (b) What is NAV?
- (c) What is standard deduction?
- (d) What is pre-construction period?
- (e) What is section 24?
- (f) State deductions under section 24?
- (g) What is unrealized rent?
- (h) What is Vacancy period?
- (i) What is standard rent?
- (j) What is fair value?
- (k) What is fair rental value?

SECTION-- B

- (a) State the steps followed in the process of determining GAV and NAV?
- (b) Explain the following: Vacancy period, Unrealized rent, sub-letting, NAV.

(c). Mr. X completed a house on 1-4-2008 jointly with his wife and invested Rs. 30,00,000. House consists of two equal units. One unit is self-occupied by Mr. X and his family and other unit (owned by Mrs. X) is let out at Rs. 10,000 p.m. The municipal value of the house is Rs. 2,16,000 p.a. on which municipality levies 10% tax and 2% of tax as surcharge. A loan of Rs. 6,00,000 was taken on 1-11-2005 @ 9% p.a.. Compute the income from house property for the assessment year 2009-10 if:

Whole of capital is supplied by Mr. X and loan is also taken on his name.

50% of capital is supplied by Mr. X and 50% by Mrs. X and loan is

- (d) Following are the particulars of two house properties owned by Mr. Swami.

	House - I	House - II
Municipal Valuation	96,000	90,000
Fair Rent	88,000	96,000
Standard Rent	90,000	1,08,000
Actual Rent received	9,000 p.m.	10,000 p.m.
Self occupied	1-4-08---30-11-08	1-12-08---31-3-09

Let out	1-12-08---31-3-09	1-4-08---30-11-08
Municipal Taxes due	6,000	8,000
Paid	3,000	NIL
Interest on borrowed Money	10,000	42,000

Loan taken to construct House-II is still outstanding. Loan was taken in 1997.

Find out Mr. Swami's income from house property

SECTION--C

1. Mr. S.M. Krishna is the owner of a big house consisting of 3 equal and independent units. Unit I is let out at a rent of Rs. 8,000 p.m.

Unit II is being used in owner's own business, whereas Unit III is being used for his own residence. Other particulars of the house are as follows.

Municipal Valuation	Rs. 1,50,000
Fair Rental Value	Rs. 1,95,000
Standard rent as per rent control Act	Rs. 1,86,000
Municipal taxes	Rs. 15,000
Repairs	Rs. 12,000
Interest on borrowed money	Rs. 60,000

Unit I remained vacant for 2 months and one month's rent could not be realized from a tenant.

Mr. Krishna's income from his business without debiting any expenditure related to own house being used in his own business is Rs. 2,00,000.

Determine Mr. Krishna's income from business and home property for the assessment year 2009-10.

2. Mr. Ramachandran owns two houses at Chennai. Compute his income from house property for the assessment year 2009-10.

FRV	36,000 p.a.	1,20,000 p.a.
Actual Rent	4,000 p.m.	12,000 p.m.
Municipal Rental Value	40,000 p.a.	1,30,000 p.a.
Standard Rent	38,000 p.a.	N.A.
Municipal Tax	10% of MRV + 2% of Municipal tax as sewerage cess	10% of MRV + 2% of M. Taxes as sewerage cess

Actual repairs expenses	4,000	12,000
Ground Rent	2,000	2,500
Collection charges	500	1,200
Interest on loan	12,000	48,000
Vacancy period	3 months	
Bonafide unrealized rent of current year	-	36,000

Construction of house II started on 1st November 2004 and he borrowed Rs. 4,00,000 @ 12% on 1st July, 2005 for the completion of construction. The house was completed on 30th November 2007 and since then it is let out.

3. Mr. Basu of Kolkata submits the following particulars of his let out residential house.

Rent received for house as well as for various amenities provided to the tenant:

(i) For house	6,000 p.m.
(ii) For lift maintenance	500 p.m.
(iii) For security charges	500 p.m.
(iv) For electricity & water	1,000 p.m.
Municipal Valuation	70,000 p.a.
Fair Rental value	56,000 p.a.
Standard Rent	60,000 p.a.
Municipal Taxes (50% to be paid by tenant – 10% of MRV)	
Repairs expenses met by tenant	5,000
Insurance premium paid by Mr. Basu	1,000
Annual Charge imposed by Court in favour of his mother	10,000 p.a.
Interest on loan taken in 2005 for the renovation of the house	20,000 p.a.

In 2003-04 a tenant defaulter in the payment of rent to the tune of Rs. 36,000 but Mr. Basu could claim a deduction of Rs. 26,000 only in the previous year 2005-06. After a long litigation Mr. Basu could recover from the tenant only Rs. 20,000 during the previous year 2008-09.

Mr. Basu spent Rs. 16,000 only to provide the above mentioned amenities to the tenant.

Compute Mr. Basu's income from house property and any other income for the Assessment Year 2009-10

4. Mr. Surinder Kumar owns a house at Delhi. During the previous year 2008-09, 3/4th portion of the house is occupied for self-residence for full year and 1/4th portion is let out for residential purposes from 1.4.2008 to 31-12-2008 on a rent of Rs. 700 p.m. From 1-1-2009 this portion was used for own residency by him. Municipal valuation of the entire house is Rs. 20,000 and fair rental value is Rs. 24,000. Expenses incurred in respect of the house property were: Municipal Taxes Rs. 60,000; Repairs Rs. 2,000; Fire insurance premium Rs. 3,500; Land Revenue Rs. 4,000 and Ground Rent Rs. 200. These expenses were paid during the year.

A loan of Rs. 60,000 was taken on 1-4-2005 @ 15% p.a. for the construction of the house which was completed on 31-1-2006. Loan is still outstanding. Find out his income from house property for the assessment year 2009-10.

5. A, B and C are three friends owning equally a house property consisting of six identical units. It was constructed on 1st July 2005. One unit is self-occupied by each one of them for their residence. The remaining three units are let out on a monthly rent of Rs. 7,500 per unit. The municipal value of house property is Rs. 5,00,000 and municipal tax is Rs. 1,25,000 (Rs. 25,000 due).

The other expenses were as follows:

(i) Collection and repair charges	Rs. 7,500
(ii) Insurance premium	Rs. 15,000
(iii) Interest on loan taken for construction of house	Rs. 1,62,500

One of the let out units remained vacant for two months. Mr. B could not occupy his unit as he was transferred to some other city. He does not own any other house property. The other taxable incomes of A, B and C are Rs. 1,50,000, Rs. 2,00,000 and Rs. 3,00,000 respectively. Compute the taxable income under the head income from house property for the assessment year 2009-10.

6. A house was completed on April 1, 2008 and following information is available about this house:

Municipal Value of the House	Rs. 30,000 p.a.
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Fair Rental Value of the House	Rs. 32,000 p.a.
Actual Rent	Rs. 4,000 p.m.
Municipal Taxes	Rs. 6,000 p.a.
Let out for the period 1-4-2008 to 31-12-2008 and self occupied from 1-1-2009 onwards.	
Fire Insurance Premium	Rs. 3,600
Land Revenue	Rs. 6,000
Interest on Loan for the period	
(a) 1-4-2005 to 31-3-2008	Rs. 45,000
(b) 1-4-2008 to 31-3-2009	Rs. 15,000

Calculate income from house property for the previous year ending on 31-3-2009.

PROFITS AND GAINS OF BUSINESS OR PROFESSION

LEARNING OBJECTIVES:

- Understand the meaning of Business and Profession
- Assessment of Income of Business and Profession
- Various provisions relating to the assessment of Business and Professional income

The provisions regarding income chargeable under the head 'Profits and Gains of Business or Profession' are contained in sections 28 to 44D of the Income Tax Act, 1961. Before studying these provisions it is necessary to understand the meaning of certain terms.

Business [Sec. 2(13)]. Business means the purchase and sale of manufacture of a commodity with a view to make profit. It includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. It is not necessary that there should be a series of transactions in a business and that it should be carried on permanently. Neither repetition nor continuity of similar transactions is necessary. Profit of an isolated transaction is also taxable under this head, provided that it

is a venture in the nature of business or trade. In this connection, it is important that the purchase or manufacture should be to sell at a profit.

Profession [Sec. 2(36)]. Profession means the activities for earning livelihood which require intellectual skill, e.g., the work of lawyer, doctor, auditor, engineer and so on, are in the nature of profession. Profession includes vocation. Vocation means activities which are performed in order to earn livelihood, e.g., brokerage, insurance agency, music, dancing, etc. As the rules for the assessment of business, profession or vocation are the same, there is no important of making any distinction between them for income tax purposes.

Demerger [Sec. 2(19AA)]. In relation to a company demerger means the transfer by a demerged company of its one or more undertaking to any resulting company in which fulfils the prescribed conditions.

Demerged Company [Sec.2 (19AAA)]. It means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.

Resulting Company [Sec. 2 (41A)]. It means

(i) one or more companies(including a wholly owned subsidiary thereof to which the undertaking of the demerged company is transferred in a demerger;

(ii) the resulting company in consideration of such transfer of undertaking issues shares to the shareholders of the demerged company; and

iv) includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

PROFITS OF BUSINESS OR PROFESSION (Sec. 28)

The following incomes are chargeable to income tax under the head 'Profits and Gains of Business or Profession':

The Profits and gains of any business or profession which was carried on by the assessee at any time during the previous year;

Any compensation due to or received by :

any person, managing the whole or substantially the whole of the affairs of an Indian Company in connection with the termination of his management or the modification of the terms and conditions relating thereto;

any person, managing the whole or substantially the whole of the affairs in India, of any other company in connection with the termination of his office or the modification of the terms and conditions relating thereto;

any person, holding an agency in India for any part of the activities relating to the business or any person in connection with the termination of agency or the modification of the terms and conditions relating thereto;

any person, for or in connection with the vesting in the Government, or in any corporation owned or controlled by the Government, under any law for the time being in force, of the management of any property or business. Compensation received by person on cancellation of consultancy agreement is a capital receipt and not assessable u/s 28 (ii)(c).

[CIT vs. Seshasayee Bros. (P). Ltd. (1999) 239 ITR 471 (Mad.)]

Income derived by a trade, professional or similar association from specific services performed for its members ;

- (iiia) Profit on sale of a licence granted under the Imports Control Order 1955 ;
- (iiib) Cash assistance received or receivable by any person against exports under any scheme of the Government of India'
- (iiic) Repayment of any customs or excise duty to any person against exports.
- (iiid) Any profit on the transfer of the Duty Entitlement Pass Book Scheme, being Duty Remission Scheme, under the export and import policy;
- (iiie) Any Profit on the transfer of the Duty Free Replenishment Certificate, being the Duty Remission Scheme, under the export and import policy;

The value of any benefit or perquisite whether convertible into money or not, arising from business or the exercise of a profession, eg., where a lawyer in consideration of his services to a company gets free accommodation, the value will be assessable in the hands of the assessee as his income under the head 'Profits and Gains of Business or Profession'.

Any interest, salary, bonus, commission or remuneration due to or received by a partner of firm from the firm provided that it has been allowed as deduction in computing the taxable profits of such firm.

Income from speculative transactions.

Interest on securities, if the business of the assessee is to invest in securities, otherwise interest on securities shall be chargeable to income tax under the head "Income from Other Sources".

Any sum received under a Key man Insurance Policy including bonus.

Any sum, whether received or receivable in cash or kind, under an agreement for:

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

However, any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right or right to carry on any business, which is chargeable under the head 'Capital gains' shall not be treated as income under this clause.

For the purpose of (iii) above ; trade association means an association of businessmen for the protection and advancement of their common interest, e.g., a Chamber of Commerce. Section 28(iii) does not apply to other social associations, e.g., a sports club, or cricket club and so on.

Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, they shall be called 'Speculation business' and it shall be deemed to be distinct and separate from any other business.

'Speculative transactions' means transaction in which a contract for the purchase or sale of any commodity, including stocks and shares is settled otherwise than by the actual delivery or transfer of the commodity or scrip.

IMPORTANT RULES REGARDING ASSESSMENT OF PROFITS AND GAINS OF BUSINESS OR PROFESSION

Business or Profession carried on by the assessee. Tax is chargeable from the person who carries on the business or profession. It is immaterial if the assessee (owner of the business through a manager or other servant, or any other agent duly authorized by him.

Tax is chargeable on the aggregate income from all businesses or professions carried on by an assessee. The profits and gains of different businesses or professions carried on by an assessee are not taxable separately; but tax is chargeable under one head on the aggregate income from all businesses or professions carried on by the assessee.

Profits and Losses of speculation business are kept separate. Profits and losses of speculation business carried on by an assessee are kept separate, i.e., if there is a loss in a speculation business it can be set-off only against profits of speculation business.

The business or profession is carried on by an assessee for any during the previous year. The assessee should have carried on by an the business or profession for any time during the business year, i.e., whether for full year or for a part of previous year only.

Profits on sale of assets on the winding up of a business. Profits made in winding up of business by; the sale of assets in one lot are not taxable as business profit but as capital gain.

No tax is payable on anticipated or notional profits. Tax is levied on the actual profit of the previous year and not on the anticipated profits. If in a business there is an expectation of earning some profits in the near future no tax can be levied on such profits.

Expenses of an isolated transaction. An isolated transaction of purchase and sale is in the nature of trade. For determining the profit earned by the assessee in such a transaction, the expenses incurred by him in respect of that transaction during the years prior to the year of account shall be allowed as a deduction.

Income of illegal business or profession. Tax is payable on the income of every business or profession whether legal or illegal. The expenses incurred to earn income from illegal business which are incidental to such business are to be allowed as deduction out of the income earned from illegal business. However, penalties levied for

infraction of law and expenses incurred in Defence of criminal proceedings are not allowed. Loss computed under illegal business cannot be set-off against the profits of legal business.

Expenses incurred before setting up a business. These expenses are not admissible. In the case of a company expenses incurred before incorporation are not allowable but those incurred after incorporation but before commencement of business are allowable. However, specified preliminary expenses incurred by an Indian Company or any other resident person is allowed under section 35 D.

General commercial principles to be kept in view while determining the real profits of a business. It is essential to keep in view the general commercial principles while determining the real profits of a business.

Deductible Business Losses. Business losses which are not of a capital nature and which have been sustained during the previous year and which are incidental to the business carried on by the assessee are deductible while computing income under the head 'Business or Profession'.

Sums previously allowed as deduction are taxable if recovered during the previous year.

If an assessee receives during the previous year any

(12) Sums previously allowed as deduction are taxable if recovered during the previous year.

If an assessee receives during the previous year any sum connected with the business, which during any preceding year was allowed as a deduction (being in the nature of the loss, expenditure or a liability) then while computing the taxable profits of that year, it will be taxable as a business income during the previous year in which they are recovered.

(13) 'Dharmada' collected from the customers is not a trading receipt and hence not liable to tax.

(14) The underwriting commission earned by the assessee on the shares subscribed by the public is assessable as business income whereas the underwriting commission on shares subscribed by the underwriter himself reduces the cost of shares and is not taxable.

COMPUTATION OF PROFITS OF BUSINESS OR PROFESSION

The profits and gains of business or profession are computed in accordance with the provisions contained sections 30 to 43D. Sections 30 to 37 contain those deductions which are expressly allowed while computing profits of business or profession. Section 40 provides those expenses which are expressly disallowed. Besides these, there are some other deductions which are allowed on the basis of general commercial principles while computing profits of business or profession. It is necessary to know those principles before studying deductions expressly allowed while computing profits of business or profession.

The general commercial principles are as under:

- (1) Profits should be computed according to the method of accounting regularly employed by the assessee, provided that actual profit can be ascertained by this method.
- (2) Only those expenses and losses are allowed as deductions which were incurred or sustained during the relevant previous year.
- (3) These losses and expenses should be incidental to the operation of the business. For example, embezzlement by an employee during the course of business is a loss incidental to the business. Similarly, loss from dacoity in a bank is also a loss incidental to the business of a bank.
- (4) Only the expenses incurred in connection with the business of the assessee are allowed as deductions.
- (5) If a business has been discontinued before the commencement of the previous year, its expenses cannot be allowed as deductions against the income of any other running business of the assessee.
- (6) There are some essential expenses, though neither expressly allowed nor disallowed, but are deductible while computing the profits of business or profession on the basis of general commercial principles provided that these are not expenses or losses of a capital nature or personal nature.
- (7) Any expenditure incurred in consideration of commercial expediency is allowed as deduction.
- (8) Deduction can be made from the income of that business only for which the expenses were incurred. The expenses of one business cannot be charged against the income of any other business.

**RULES FOR ADJUSTMENT OF THE PROFIT AND LOSS ACCOUNT
PREPARED BY THE ASSESSEE**

The profit and loss account prepared by the assessee is not correct from the income tax point of view as (i) several such expenses are charged to it which are wholly or partly inadmissible under the Income Tax act,(ii) some admissible expenses are omitted from it, (iii)some taxable incomes are not credited to it, and(iv) some such incomes are credited which are either not taxable under the head 'Business or profession' or are not taxable at all. Hence, this profit and loss account has got to be adjusted from the income tax point of view, so that the profit taxable under the head 'Business or profession' is determined incorrectly. The following are the rules for adjustment of the Profit and Loss account:

Those expenses or losses which are charged to Profit and Loss Account but are not allowed under the Income Tax Act, should be added to the profit, as shown by the Profit and Loss Account prepared by the assessee. If any expense is partly disallowed, only the disallowed part of it shall be added to the profit.

If any admissible expenses are omitted from profit and Loss Account, they should be deducted from the above profit.

If some taxable incomes are omitted from the profit and Loss Account, they should be added to the above profit.

If some such incomes have been credited to the Profit and Loss Account, which are either not taxable under the head 'Business or Profession', or are not taxable at all, they should be deducted from the above profits.

Note : If instead of profit there is loss as per the Profit and Loss Account, the above rules shall be reversed, i.e., items to be added shall be deducted and those to be deducted shall be added, If after making some adjustments the profit is converted into loss, the above rules shall be reversed for subsequent adjustments.

The above rules can well be illustrated with the help of the following statement: profit as per P & L A/c

Add : (i) Expenses or losses disallowed but charged in P. & L. A/c
(ii) Incomes taxable as business income but not credited to the. . . .
P.& L. A/c

(iii) Expenses or losses allowed but not debited to P. & L. A/c	
(iv) Over-valuation of closing stock and under-valuation of opening stock	_____
Taxable Income from Business	_____

Notes : 1. For loss as per P. & L. A/c the above rules will be reversed.

2. The same rules will apply to Income and Expenditure Account.

Second Method of Computing the taxable profits or losses of business or profession

In this method a fresh profit and loss account or income and expenditure account is prepared to determine the profit or loss. The format of this method may be as under:

- (1) Add together all taxable incomes under this head which relate to the previous year concerned.
- (2) (i) Deduct all admissible expenses under this head which relate to

(ii) Deduct admissible business losses. _____

Taxable profits or losses of business or profession

Second method is generally used in case of professions.

DEDUCTIONS EXPRESSLY ALLOWED

While computing profits of business or profession the following deductions are expressly allowed by sections 30 to 37:

1. Expenses in respect of business (Sec. 30). The following deductions are allowed for premises used for the purpose of the business or profession.

Where the premises are occupied by the assessee as a tenant:

Rent paid for such premises.

If he has undertaken to bear the cost of repairs to the premises, the amount paid on account of such repairs.

Explanation : The amount of paid on account of repairs shall not include any expenditure in the nature of capital expenditure.

Any sums paid on account of land revenue, local taxes or municipal taxes.

The amount of any premium paid in respect of insurance against risk of damage or destruction of the premises.

Where the premises are occupied by the assessee as owner :

Repairs charges.

The amount of land revenue, local taxes or municipal taxes.

Insurance premium regarding building.

Please Note :

- (i) If the business premises belong to the assessee no deduction in respect of rent will be allowed to him.
- (ii) If the assessee is a partnership firm and the business premises belongs to a partner of the firm, the rent payable to the partner will be an allowable deduction.
- (iii) If the assessee is a tenant in that premises an a part of the premises is used by him as dwelling –house and the other part is used for his business, the amount of deduction in respect of expenses shall be allowed proportionately.

2. *Repairs and insurance of machinery, plant and furniture* (Sec.31). In respect of machinery, plant and furniture used for the purposes of the business or profession the following deductions are allowable :

- (i) Amount of expenditure incurred on current repairs of machinery, plant or furniture explanation. The amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure.

- (ii) The amount of any premium paid in respect of insurance against risk of damage or destruction of these assets.

3. *Depreciation. Natural reduction in the value of any fixed asset is termed as depreciation..*

4. *Tea Development Account, Coffee Development Account and Rubber Development Account.* (Sec.33AB). This deduction is allowed to assessee's who are growing and manufacturing and tea or coffee or rubber in India. The salient features of this section are as under :

- (1) The assessee should deposit in a special account with the National Bank for Agriculture and Rural Development in accordance with the scheme approved by the Tea Board or the Coffee Board or the Rubber Board or deposit any amount in an account opened by the assessee (known as deposit Account) in accordance with deposit scheme framed by the Tea Board or the Coffee Board or the Rubber Board, as case may be.
- (2) The deposit should be made within a period of six months from the end of the previous year or before furnishing the Return of his income, whichever is earlier.
- (3) In computing the taxable profits from the above business the following deduction will be allowed in respect of the above deposit:
 - (a) a sum equal to the amount so deposited, or
 - (b) 40% of the profits of such business (before making deduction under this section and before setting off brought forward business losses), which ever is less.

5. *Deduction will be allowed in respect of prospecting for, or extraction or production of petroleum or natural gas or both in India* (Sec. 33 ABA). The main provisions of this section are as under :

- (1) Deduction will be allowed if the Central Government has entered into an agreement with the assessee.
- (2) The assessee has before the end of the previous year has deposited the amount:
 - (a) in a special account with the state bank of India, for the specified purposes in a scheme approved in this behalf by the Government of India in the Ministry of Petroleum and Natural Gas; or
 - (b) in an account-Site Restoration Account (S.R.A) for the purposes specified in a scheme framed by the Ministry aforesaid.
- (3) Quantum of deduction:
 - (a) A sum equal to the amount or the aggregate of the amounts so deposited; or

(b) 20% of the profits of such business (computed under the head 'Profits and gains of business or profession') before making any deduction under this section;
wherever is less.

6. *Expenditure on Scientific Research. (sec.35)*. The following deductions shall be allowed in respect of expenditure on scientific research.

(i) Revenue expenditure incurred by the assessee himself [Sec. 35(1)(i)]. Where the assessee himself carries on scientific research in relation to his own business any revenue expenditure.

7. *Expenditure incurred on the acquisition of patent rights or copyrights (Sec. 35A)*. (a) any capital expenditure incurred before 1.4.1998 on the acquisition of a patent right or copyright used for the business shall be allowed as a deduction in 14 equal annual installments over a period of 14 previous years commencing from the previous year in which the expenditure is incurred. If these 'rights' are acquired in any year prior to previous year in which the expenditure is incurred the deduction shall be allowed in equal annual installments in as many years as are left after deduction from 14, of the years that have elapsed before the year in which such expenditure is incurred.

(b) Where such expenditure is of capital nature and incurred after 31.3.1998, depreciation shall be allowed on it @ 25% on the basis of W.D.V. method.

8. *Capital Expenditure to obtain licence to operate telecommunication services (Sec. 35ABB)*. Any capital expenditure incurred on the acquisition of any right to operate telecommunication services either before the commencement of the business to operate telecommunication services or thereafter at any time during any previous year and for which payment has actually been made to obtain a licence will be allowed as a deduction in equal instalments over the relevant previous years.

'Relevant previous years' means :

(A) in a case where the licence fee is actually paid before the commencement of the business to operate telecommunication

services, the previous years beginning with the previous year in which such business commenced ;

(B) in any other case, the previous years beginning with the previous year in which the licence fee is actually paid, and the subsequent previous years during which the licence, for which the fee is paid, shall be in force.

9. *Admissibility of expenditure on eligible project or scheme (Sec. 35AC).* 100% deduction will be allowed from business or professional income in respect of the expenditure incurred for an eligible project scheme.

Eligible project or Scheme, It means such project or scheme which is meant for promoting social and economic welfare or uplift of the public, as specified by the Central Government consisting of persons of eminence in public life.

Conditions to be fulfilled: (i) It should be paid to either a public sector company, or local authority or to an approved association or institution for carrying out any eligible project or scheme.

(ii) The Claim for deduction should be supported by a certificate from the payee concern and attached with the Return of Income.

(iv) In case of companies, direct expenditure can also be incurred for any eligible project or scheme and in their case a certificate from the Chartered Accountant will suffice.

10. *Payment to Rural Development Fund (Sec. 35D).* Under this section 100% deduction is allowed to an assessee who pays any sum to :

(i) The National Fund or Rural Development (set-up and notified by the Central Government in this behalf); or

(ii) The National Poverty Eradication Fund (set-up and notified by the Central Government in this behalf).

11. *Amortization of certain preliminary expenses (Sec. 35D)* Where an Indian Company or an non-corporate person resident in India incurs after 31st March, 1998 any preliminary expenditure of the nature specified below, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous year beginning with the

previous year in which the business commences or the extension work is completed or the new industrial unit commences production or operation, as the case may be.

Note: 1. Where such expenditure was incurred before 1.4 1998, one –tenth of such expenditure for each of the ten successive previous years is deductible.

2. W.e.f A.Y. 2009-10, the word industrial shall be omitted. Thus, the benefit of deduction will be available to all sectors.

The following expenditure is included in preliminary expenses :

- (a) Expenditure in connection with:
 - (i) Preparation of feasibility report;
 - (ii) Preparation of project report;
 - (iii) Conducting market survey or any other survey necessary for the business of the assessee;
 - (iv) Engineering services relating to the business of the assessee.
- (b) Legal charges for drafting any agreement between the assessee and any other person for any relating to the setting up or conduct of the assessee.
- (c) If the assessee is a company, in addition to the above expenses, the following expenditure is also included in preliminary expenses:
 - (i) Legal charges for drafting the Memorandum and Articles of Association of the Company;
 - (ii) Printing charges of the Memorandum and Articles of Association;
 - (iii) Fees paid for registering the company;
 - (iv) Expenses regarding issue of shares or debentures of the company, including under-writing commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus.
 - (v) Such other item of expenditure as may be prescribes.

Maximum Limit: the Maximum amount eligible for deduction under this section shall not exceed 5% of the ‘cost of the project’, or if the assessee is an Indian Company, at the option of the amalgamation or demerger of an undertaking, it shall be allowed a deduction of 25% of such expenditure

for each of five successive previous years beginning with the year in which amalgamation or demerger takes place.

12. *Expenditure for amalgamation or demerger of an undertaking* (Sec 35DD).

Where an Indian Company incurs expenditure after 31.3.1999 wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, it shall be allowed a deduction of 20% of such expenditure for each of five successive previous year beginning with the year in which amalgamation or demerger takes place.

13. *Expenditure on voluntary retirement* (Sec.35DDA). Where an assessee pays any sum to an employee in any previous year in connection with his voluntary retirement, he shall be beginning with the year in which the expenditure was incurred.

The deduction shall not be allowed to the (i) amalgamating company, or (ii) resulting company, or (iii) the successor company in the same manner as it have been allowed to the transferor of business.

14. *Expenditure on prospecting, etc. for development of certain minerals* (Sec. 35E).

Where and Indian Company or any other person resident in India incurs, any expenditure wholly and exclusively on the prospecting of specified mineral or on the development of mines or other natural deposit of any such mineral, the assessee shall be allowed a deduction of an amount equal to 1/10th of such expenditure for each of the ten successive previous years beginning with the year of commercial production.

15. *Other deductions*: Under Section 36, the following other deductions are permissible while computing profits of business or profession.

- (i) Insurance Premium. The amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purpose of business or profession, is allowed as deduction.
- (ii) Insurance Premium for cattle paid by a federal milk co-operative society. The amount of any premium paid by a federal milk co-operative society on the life of the cattle owned by a member of a

primary milk co-operative society affiliated to the federal milk co-operative society, is allowed as deduction.

- (iii) Insurance Premium for the health of employees. The amount of any premium paid by an employer by any mode of payment other than cash for insurance on the health of his employees in accordance with a scheme framed by (A) the General Insurance Corporation of India and approved by the Central Government, (B) any other insurer and approved by the Insurance Regulatory and Development Authority is allowed as deduction.
- (iv) Bonus or Commission. Any bonus or commission paid to an employee for services rendered shall be deductible only if such sum could not, in any way be paid as profits or dividend.
- (v) Interest on borrowed capital. The amount of the interest paid in respect of capital borrowed for the purpose of the business or profession, is allowed as deduction. Any amount of interest paid in respect of capital borrowed for extension of exiting business or profession (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 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 a deduction.
- (vi) Discount on Zero coupon bond. Pro rata amount of discount on zero coupon bond having regard to the period of life of such bond shall be allowed as a deduction.
- (vii) Contribution to Provident Fund. Sum paid by the assessee as an employer by way of contribution towards a recognized provident fund or an approved superannuation fund is allowed as deduction.
- (viii) Approved Gratuity Fund. Sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund is allowed as deduction.

(ix) Employee's Contribution to Provident Fund, or Superannuation Fund etc. Sum received by the employer from any of his employees as contribution to any provident fund or superannuation fund or any fund set-up under the Employees State Insurance Act or any other fund for the welfare of such employee's treated as his income. If such sum is credited by the employer to employee's account in the relevant fund on or before the 'due date' it is allowed as a deduction.

Due date means the date, by which the employer is required to credit an employee's contribution to the employees account in the relevant fund under any Act, rule, order or notification or Contract of Service.

(x) Loss regarding Animals. In respect of animals which have been used for the purposes of business or profession (not as stock-in-trade) and have died or become permanently useless for such purpose; amount of loss equal to the difference between the actual cost to the assessee of the animals and the amount, if any, realized in respect of the carcasses of animals, will be allowed as deduction.

(xi) *Bad debts*. The amount of any debt or its part which is written –off as irrecoverable in the accounts of the assessee for the previous year shall be allowed as a deduction, subject to the following conditions:

- (i) If such debt has been taken into account in computing the income of the assessee of that previous year or an earlier previous year or represents money lent in ordinary course of the business of banking or money-lending which is carried on by the assessee.
- (ii) It has been written –off as irrecoverable in the accounts of the assessee for that previous year.

In respect of bad debts following further rules are to be observed.

- (a) If the amount ultimately recovered on any such debt is less than the difference between the debt and the amount of bad debt allowed, the deficiency shall be between the deductible in the previous year in which the ultimate recovery is made.

(b) Where a deduction has been allowed in respect of a bad debt and the amount subsequently recovered on any such debt is greater than the difference between the debt and the amount so allowed, the excess shall be deemed to the 'profit and gains of business or profession', and accordingly chargeable to income tax as the income of the previous year in which it is recovered. It is immaterial whether the business or profession in respect of which the deduction has been allowed is in existence in that year or not.

(c) In the case of an assessee to which (xii) applies the deduction for bad debt shall be only of the amount in excess of provision for bad and doubtful debts account made under (xii).

(xii) Provision for bad and doubtful debts. The Provisions regarding deduction for provision for bad and doubtful debts in respect of banks and financial institutions are given below:

		Allowable Deduction
1	In the case of scheduled banks (excluding foreign bank) or 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 Total Income before making this deduction and deductions u/ss 80C to 80U and 10% of aggregate average advances made by rural bankers of these banks.
2	In the case of Foreign Banks.	5% of Total Income before making this deduction and deductions u/ss 80C to 80U.
3	Public Financial Institutions, State Financial Corporation and State Industrial Investment Corporation.	-Do-

Rural Branch, It means a branch of a scheduled bank or a non-scheduled bank situated in a place which has a population of not more than 10,000, according to the last census.

Note: W.e.f. A.Y. 2004-05, a bank mentioned in (1) shall, at its option, be allowed a further deduction for an amount not exceeding the income derived from redemption of securities in accordance with a scheme framed by the Central Government, provided such income has been disclosed in the return of income under the head “profits and gains of business or profession.

- (xiii) Special reserve created by a specified entity. Deduction shall be allowed regarding special reserve created and maintained by a specified entity.

Quantum of Deduction

- (i) 20% of the profit derived from eligible business or
- (ii) The amount credited to specified reserve account, whichever is less.

However, no deduction is allowed in this respect as soon as the special Reserve becomes equal to twice the paid-up share capital and general reserves.

Specified entities and eligible business are :

- (A) (i) A financial corporation specified in Sec. 4A of the Companies Act, 1956; or
- (ii) A financial corporation which is a public sector company; or
- (iii) A banking company or
- (iv) A Co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

Provides long-term finance for industrial or agricultural development or development of infrastructure facility in India or construction or purchase of houses in India for residential purposes.

- (B) A Housing finance company.

Provides long-term finance for the construction or purchase of houses in India for residential purposes.

- (C) Any other financial corporation including a public company.

Provides long-term finance for development of infrastructure facility in India.

Explanation. ‘Long-term finance’ means any loan or advance which is not repayable prior to the expiry of five years.

- (xiv) Expenditure on family planning: Any expenditure bonafide incurred by a company for the purpose of promoting family planning amongst its employees is allowed as a deduction. If such expenditure is of a capital nature it shall be allowed as a deduction in five equal annual installments commencing from the previous year in which the expenditure is incurred.

The unabsorbed part of the capital expenditure on family planning is treated in the same manner as unabsorbed depreciation.

Note : Revenue expenses incurred by employer (other than a company) on promoting family planning amongst his employees, is deductible u/s 37/ (1).

On capital expenditure for family planning he is entitled to claim depreciation u/s 32.

- (xv) Any expenditure (not being capital expenditure) incurred by a corporation or body corporate shall be allowed as a deduction if :

- (a) It is constituted or established by a Central, State or Provincial Act;
- (b) It is notified by the Central Government.
- (c) The expenditure is incurred for the objects and purposes authorized by the Act under which it was constituted or established.

- (xvi) Any amount of banking transaction tax paid during the previous year shall be allowed as a deduction.

- (xvii) Any sum paid by a public financial institution by way of contribution to such credit as a guarantee fund trust for small industries as the Central Government may notify.

- (xviii) Expenses in connection with income tax proceedings. Expenses incurred for services in as business expenditure u/s 37(1).

- (xix) Entertainment expenses, advertisement expenses [except as provided in sec. 37 (2B0)], expenses on traveling for business or professional purposes and expenses on guest house are fully deductible.

- (xx) Amount paid in respect of taxable securities transactions, if income from securities transaction has been computed under the head "Profits and gains of business or profession".
- (xxi) Amount paid in respect of taxable commodities transaction, if income from commodities transactions has been computed under the head "Profits and gains of business or profession". [w.e.f. A.Y. 2009-10]

16. *General Deduction (Sec. 37(1)]*. It is a residuary section. Under section 37(1), the following conditions should be fulfilled, in order that a particular item of expenditure may be deductible under this head :

- (i) The expenditure should not be of the nature described in sections 30 to 36.
- (ii) It should be in respect of a business or profession carried on by the assessee and the profits and gains of which are to be computed and assessed.
- (iii) It should not be in the nature of personal expenses of the assessee.
- (iv) It should have been laid out or expended wholly and exclusively for the purpose of such business or profession.
- (v) It should not be in the nature of capital expenditure
- (vi) It should relate to the previous year concerned.

Explanation; Any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law, shall not be allowed as a deduction. It means protection money, extortion, hafta, bribes, etc., will not be allowed as a deduction.

The following are the few examples of admissible general deductions under section 37:

- (1) Expenses incurred in the purchase, manufacture and sale goods.
- (2) General expenses incurred in the day to day running of the business.
- (3) Expenses incurred in defending a case for damages for breach of contract.
- (4) Amount of sales-tax paid and expenses incurred in connection with sales –tax proceedings including appeals.
- (5) Compensation paid to an undesirable employee for the retrenchment of his services or to a director to get rid of his services.

- (6) Contribution made to provident fund maintained for the benefit of employees under an Act and with previous approval of a State Government may not be allowable u/s 36(1)(iv) but allowable u/s 37(1).
- (7) Commission: etc., paid for securing orders for the business,.
- (8) Compensation paid to employees in connection with injury sustained by them or accident met by them while on duty.
- (9) Royalties paid in connection with mines.
- (10) Insurance Premium under a policy insuring its employees against injury or against liability for compensation in respect of accident to its workmen.
- (11) Reasonable expenses incurred on the occasion of Dussehra, Diwali, commencement of the business etc.,
- (12) Compulsory subscription or a subscription given to a association in the interest of the business.
- (13) Legal expenses incurred in connection with the business or profession:
 - (i) in the normal course of business or
 - (ii) to avoid a business liability, i.e., for alleged breach of trading contract; or
 - (iii) to defend the assessee's title to his assets; or
 - (iv) to terminate a disadvantageous trading relationship; or
 - (v) to resist a winding-up petition by some shareholders.
- (14) Legal expenses incurred by a director of a company in defending a suit brought against him to challenge the validity of his election as a director; as it is incurred to save his income from the source.
- (15) Interest on unpaid purchase price of any business assets purchased by an assessee and put to use will be allowed.
- (16) Expenditure incurred to oppose nationalization or to prevent extinction of business.
- (17) [Morgan Vs. Tata & Lyle Ltd. (1954) 26 ITR 195]
- (18) Under executive instructions, cost of installing new telephone.
- (19) Normal advertisement expenditure incurred to maintain the sales not covered by section 37 (2B).

(20) Penalty paid by the assessee for saving from confiscation the goods which he purchased from a third party without knowing that they had been illegally imported.

(20) Amount paid by a director of a company in liquidation for compounding misfeasance proceeding started against him by the liquidator.

(21) Welfare expenditure incurred by the assessee.

(22) Payment of excise duty.

(23) Guarantee fee paid to the Government for loan obtained for purchase of machinery.

(24) Expenditure incurred in connection with alterations made in the Memorandum or

Articles of Association of a company if these alterations are warranted by the changes made in Companies Act. [*CIT vs. Elphinston Spinning and Weaving Mills Ltd.* (1975)

100 ITR 139] (25) If an assessee stands surety for the debt of another and it is usual in this trade to guarantee debts, any payment made as a result of such guarantee may be allowed as a business loss.

(26) Professional tax levied by local authorities the payment of which is a necessary condition for the carrying on the business within the area of a local authority.

(27) Rebate granted by co-operative stores to their members on the value of the purchases made by them.

(28) The interest payable on arrear of cess is in the nature of compensation paid to the Government for delay in the payment of cess and not as penalty, hence it is deductible. Similarly, interest paid for delay in payment of municipal taxes is also allowable as deduction.

(29) Amount spent by an assessee in purchasing loom hours is deductible as revenue expenditure.

(30) Amount paid as damages to the Government Department for delay in the execution of contracts was held to be allowable deduction, if the delay was inherent in the nature of business carried on by the assessee.

(31) Annual listing fee paid to Stock Exchange by public limited company is allowable.

(32) Interest levied for failure to pay installment of the assets purchased on hire-purchase

basis is allowable.

(33) Expenditure incurred on inauguration ceremony is allowable.

(34) Expenditure incurred on foreign tour of director purposes of expansion of business of the managed company is allowable.

(35) Wife of chairman-cum-managing director accompanying him for fulfilling social aspects. Expenses incurred on foreign tour of wife are deductible. [CIT vs. Appollo Tyres Ltd. (1998) 149 CTR 545(Ker.)]

(36) Liability of pay debenture premium is to be spread over the years between date of issue and date of redemption. [National Engineering Industries Ltd. Vs. CIT (1999) 236 ITR 577 (Cal.)]

(37) Deposit under Tatkal Telephone Deposit Scheme.

Certain Allowable Losses

Losses which are directly incidental to the business or profession of the assessee are allowable. Following are some examples of such losses:

(1) Robbery or Dacoity. Loss caused by robbery or dacoity is not deductible. But, if it is incidental to business it will be allowed as a deduction and this upon the specific circumstances and conditions. For example, if cash is sent for disbursement at different centres by a sugar factory in rural area, it is incidental to business and is, therefore, allowed, [Motipur Sugar Factory Ltd. Vs CIT (1955)28 ITR 28]. Any loss due to robbery in a bank will be allowed as the bank is under an obligation to maintain some cash outside the strong room for payments.

(2) Embezzlement, Theft, etc. The loss of money due to embezzlement by an employee handling the funds of the business while discharging his official duties is allowed as deduction. It is deductible when discovered (Tadalam G. Dwarkanath & Co.Vs CIT (1999) 239 ITR (Kar.)) When an employee goes to bank to deposit the cash or takes with him for disbursement and he takes away the money for his own use, even then, the loss is allowable. Theft by a cashier, who is incharge of cash is also an allowable loss. A theft committed after office hours, is also allowable someone the loss sustained by the assessee is incidental to business and is, therefore, allowable.

EXPENSES EXPRESSLY DISALLOWED

(I) Disallowance of expenditure on advertisement in any souvenir, etc published by as political party. [Sec. 37 (2B)]. Any expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet, etc., published by a political party, shall not be allowed as a deduction in computing the profits and gains of business or profession.

A) In the case of any assessee

(i) Payments outside India etc., Any interest, royalty, fees for technical services, etc., which is payable(a) outside India or (b) I India to a non-foreign company on which tax is deductible at source an such tax has not been deducted at source or after prescribed time, shall not be allowed as a deduction.

However, if in respect of any such tax has been deducted in any subsequent year, or has been deducted in the previous year but paid in subsequent year after the prescribed time, such sum shall be allowed as a deduction in computing the income of that year in which such tax has been paid.

(ia) Payments to residents. (a) Any interest, commission or brokerage, rent royalty, fees for professional services or fees for technical services payable to a resident, or (b) amounts payable to a resident contractor or sub-contractor for carrying our any work, on which tax is deductible at source and such tax has not been deducted or, after deduction has not been paid :

(A) Where the tax was deducted during the last month of the previous year, it has not been paid on or before the due date specified in Sec. 139 (1) ; or (B) in any other case, it has not been paid on or before the last day of the previous year, it shall not be allowed as a deduction.

However, if in respect of such sum tax has been deducted in any subsequent year, or has been deducted:

(A) during the last month of the previous year but paid after the due date specified in *Sec. 139(1)*; or

(B) during any month of the previous year but paid after the end of the said previous year,

such sum shall be allowed as a deduction in computing the income of the

previous year in which such tax has been paid.

- (ib) Any sum paid on account of securities transaction tax shall not be allowed as a deduction. (Omitted w.e.f. AY. 2009-10)
- (ic) Any ~ paid on account of fringe benefit tax shall not be allowed as a deduction.
 - (ii) *Tax on Profits and Gains.* Any sum paid on account of any tax levied on the profits and gains of any business or profession shall not be allowed as a deduction.
 - (iia) *Wealth tax.* Wealth tax chargeable under Wealth Tax Act shall not be allowed as a deduction.
 - (iii) *Salaries Payable outside India or to a Non-resident.* It is not allowed as a deduction, if tax has not been paid thereon nor deducted at source.
 - (iv) *Payment to P.F., etc.* Any payment to a provident or other funds shall not be allowed as a deduction unless it is ensured that tax shall be deducted at source from. any payments made from the fund provided it is chargeable to tax.
 - (v) *Tax on perquisites of employee.* Any tax actually paid by an employer on the value of perquisites provided to an employee which is exempt u/s 10(10CC).

(B) In the case of any partnership firm

- (i) Any payment of salary, bonus, commission or remuneration made by the firm to any partner of the firm, who is, not a working partner, shall not be allowed as a deduction.
- (ii) Payment of salary, etc.' to working partners will be allowed as a deduction, only if it is authorised by and is in accordance with the terms of partnership deed. It is further provided that the terms of partners deed will not have retrospective effect in this respect.
- (iii) Interest to partners will be allowed at the maximum rate of 12% simple interest. However, it will be allowed only if it is authorised by and is in accordance with the terms of partnership deed.
- (iv) In the case of working partners payment of salary, bonus, commission or remuneration to all partners taken together will be allowed as a deduction subject to the following limit:

(a) *In the case of a professional firm :*

On the first Rs. 1,00,000 of the book-profit

or in case of a loss

(ii) On the next Rs. 1,00,000 of the book-profit

(iii) On the balance of the book-profit

(b) *In the case of any other firm:*

(i) On the first Rs. 75,000 of the book-profit

or in case of a loss

Rs. 50,000 or @ 90% of the

Book-profit, whichever is more.

(ii) On the next Rs. 75,000 of the book-profit @60%

(iii) On the balance of the book-profit @ 40%

In clause (iv) above, 'Book-profit' means the net profit as shown in the profit and loss account computed in the manner laid down in the Act, as increased by the aggregate amount of remuneration paid or payable to all the partners of the firm, if sum amount has been deducted while computing the net profit. Rs. 50,000 or @ 90% of the book-profit, whichever is more. @60% @40%

'Working partner' means a partner who is actively engaged in the business of the firm.

(C) *In the case of an Association of Persons or Body of Individuals (other than a Company or a Co-operative Society)*

In such a case any payment of interest, salary, bonus, remuneration to a member of such association or body shall not be allowed as a deduction.

Expenses not deductible in certain circumstances (*Sec.40A*)

(1) *Excessive payments.* Any payment of an expenditure, to a relative or to an associate concern shall be disallowed if the Assessing Officer consider/it to be excessive or unreasonable having regard to all the circumstances of the case. Only the excessive or unreasonable part is to be disallowed.

For this purpose, *relative* means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual who is the assessee. Associate

concern is a concern which has a substantial interest in the business of the tax-payer or in which the tax-payer or any relative has a substantial interest.
[Sec.40A(2)]

(2) *Payments in cash.* Any expenditure in respect of which payment (or aggregate of payments made to a person in a day w.e.f. A.Y. 2009-10) is made exceeding Rs. 20,000 otherwise than by an account payee cheques drawn on a bank or by an account payee bank draft it will be disallowed.

Where a deduction of expenditure is claimed in one year and the payment is made against such expenditure in any subsequent year in violation of Sec. 40A(3), such expenditure will be deemed to be profits and gains of business of the year in which the payment is made.

Exceptions. In the following cases even if the payment in cash exceeds Rs. 20,000, it shall not be disallowed:

- (i) Payment made in rural areas or small towns where, no banking facilities are available to a person who ordinarily resides there.
- (ii) Payment made to cultivator, grower or producer for purchase of agricultural or forest produce, or the produce of animal husbandry (including hides and skins) or dairy or poultry farming, or fish or fish products or products of horticulture or agriculture or products of cottage industries which are run without the aid of power.
- (iii) Payment made to Banks or Life Insurance Corporation, etc.
- (iv) Payment to employee or to the member of his family in respect of gratuity, retrenchment compensation, etc., where the aggregate of such sums does not exceed Rs. 50,000.
- (v) Payment is made to Government and such payment is required to be made in legal tender.
- (v) Payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee.
- (vii) Payments which is required to be made on a date on which the banks are closed.
- (vi) Payment is made by any mode through a bank. (*Rule 6DD*)

Further, the limit of Rs. 20,000 applies to the payment made to a party at a

time and not the aggregate of the payments made to a party in the course of a day. [*CIT VB. Aloo Supply Co. (1980) 121 ITR 680 (Ori.)*] [*Sec. 40A(3)*]

(3) *Provision of gratuity.* Mere provision made for the payment of gratuity to the employees on retirement or on termination of services will not be allowed as a deduction in computing taxable profits of the business or profession. However, provision made for gratuities due during the current previous year will not be disallowed. Provision made for making contribution towards an approved gratuity fund will also be allowed. [*Sec.40A(7)*]

(4) No deduction shall be allowed in respect of any sum paid by the assessee as an employer towards the setting up of, or as contribution to, any unapproved fund. However, where such sum is so paid for the purpose of recognised provident fund or statutory provident fund or an approved superannuation fund or approved gratuity fund is allowed as deduction. [*Sec. 40A(9)*] (5) *Other Expenses.* In addition to the above expenses, which are expressly disallowed under *sections 40 and 40A* the following expenses, losses and allowances are also not allowable as deduction in computing the profits and gains of business or profession:

- (i) Drawings or personal expenses of proprietor or partners.
- (ii) Any provision or transfer to reserve except transfer to reserves, as provided in the Act.
- (iii) Amounts paid as charity or presents.
- (iv) Past losses charged to Profit & Loss Account.
- (v) Any expenditure not incurred wholly and exclusively for the purposes of the business or profession.
- (vi) Expenditure incurred to buy off competition.
- (vii) Penalties paid by the assessee for infringement of law.
- (viii) Payments made by an assessee in the nature of sharing the profits to the sole selling agents under an agreement are not deductible.

[*CIT vs. Panipat Woollen and General Mills Co. Ltd. (1976) 103 ITR 66 (SC)*]

- (ix) Litigation expenses for registration of shares.
- (x) Contribution to a political party where there is no direct relationship between contribution and the business of the assessee.
- (xi) Insurance premia paid by a firm on life insurance policies of its

- partners. (xii) Expenditure on shifting of registered office.
- (xiii) Fees paid for increase of authorised capital.
- (xiv) Expenses incurred for issuing shares.
- (xv) Payments made for acquisition of goodwill.
- (xvi) Expenditure incurred in violation of another statute.
- fCIT VB. India Cement Ltd. (2000) 241 ITR 62 (Mad.)]*
- (xvii) Gifts made on the occasion of marriages in the families of friends and others with whom assessee has business dealings cannot qualify as business expenditure even on grounds of commercial expediency.
- fCIT VB. Jeevandas Laljee & Sons (1999) 157 CTR 562 (Mad.)]*

DEDUCTIONS ALLOWABLE ONLY ON ACTUAL PAYMENT (*Sec. 43B*)

The following deductions are allowable only on actual payment:

- (a) Any sum payable by the assessee by way of tax, duty, cess or fee.
- (b) Any sum payable by him as an employer by way of contribution to any provident fund, superannuation fund or gratuity fund or any other fund for the welfare of employees.
- (c) Any sum payable to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profit or dividends if it had not been paid as bonus or commission.
- (d) Any sum payable by the assessee as interest on any loan or borrowing from any Public Financial Institution or a State Financial Corporation or a State Industrial Investment Corporation.
- (e) Any sum payable by the assessee as interest to a scheduled bank on any loan or advance from a scheduled bank.
- (f) Any sum payable by the assessee in lieu of earned leave.

If actual payment is made either during the relevant previous year or on or before the due date for furnishing the return of income U/S 139(1), the deduction will be allowed in the relevant previous year.

If the amount is paid after the due date of furnishing the return, the deduction will

be allowed in the year of payment.

Any sum payable by the assessee as interest [under (d) or (e)] is converted into a loan or borrowing, it shall not be deemed as actual payment.

PROFITS CHARGEABLE TO TAX

The following profits are also chargeable to tax under the head 'Profits and gains of business or profession':

(1) Recovery of any loss or expenditure allowed as deduction in an earlier year [Sec. 41(1)] (a) If any sum allowed as deduction as a loss or expenditure in an earlier year, is recovered in a subsequent year, the amount so recovered shall be treated as deemed profit and shall be chargeable to income tax in the year of recovery.

(b) If any loss or expenditure has been allowed as deduction in an earlier year and thereafter if the business has changed hands and subsequently the successor in business has realised any amount in respect of such loss or expenditure, the amount shall be deemed to be profits chargeable to tax in the hands of the successor.

(2) Profit on Sale of Assets on which depreciation is claimed on Straight Line Method [Sec. 41(2)]

Where any building, machinery, plant or furniture which is (i) owned by the assessee, (ii) in respect of which depreciation has been claimed on Straight Line Method, and (iii) which has been used in business is sold, discarded, demolished or destroyed and the moneys payable in respect of such asset together with the amount of scrap value exceeds the written-down value, the excess upto the difference between the actual cost and the written-down value shall be taxable as deemed profit. The deemed profit is assessable even if the business to which it relates has been closed down.

Uls 41(2) money refers only to cash and not money's worth.

Where an asset is reinstated by Insurance Company, benefit derived from reinstatement is not covered by Sec. 41(2). *[elT VS. Kasturi & Sons Ltd. (1999) 237 ITR 24 (S.C.)]*

(3) Sale of asset used for scientific research [Sec. 41(3)]

If a capital asset used for scientific research is sold without having been used for other purposes, and the sale proceeds together with the deductions allowed *uts 35* exceed

the amount of capital expenditure incurred on it, such surplus or the amount of deductions allowed, whichever is less, is chargeable to tax as business income of the previous year in which the sale took place. If the deduction allowed is less than the aforesaid surplus, the excess of surplus over the deduction allowed is chargeable to tax as capital gain.

(4) *Bad Debts Recovered* [Sec. 41(4)] If a bad debt allowed as deduction in an earlier year is recovered in a subsequent year, it is taxable as deemed business profit in the year of recovery, even if the business or profession, to which the recovery relates, is closed before the year of recovery.

(5) *Recovery after discontinuance of business or profession* [Sees. 176(3A) and (4)] If any business or profession is discontinued in any year, and any sum is recovered afterwards, it will be deemed to be income of the recipient and charged to tax in the year of receipt, provided that if it had been received before the discontinuance of the business or profession, it would have been chargeable to tax.

(6) *Withdrawal from Special Reserve* [Sec. 41(4A)] Where any amount is withdrawn from the special reserve created and maintained by a specified entity [under section 36(1Xviii)] it shall be deemed to be the chargeable profits of the previous year in which such amount is withdrawn from the Reserve Account. Where the amount is withdrawn from the Reserve Accounts in the previous year in which the business is no longer in existence, it will be chargeable to tax as if the business is in existence in that previous year.

Set-off of losses against profits chargeable to tax [Sec. 41(5)]

Any loss of business or profession of the year in which it ceased to exist and which could not be set-off against any other income of that Year, shall be set-off against the aforesaid profits under section 41. However, such a loss from speculation business cannot be so set-off.

Maintenance of Accounts (Sec. 44AA)

For the purpose of provisions relating to maintenance of accounts, the business or profession has been classified into the following three categories:

I (1) Specified Professions, (2) Non-specified profession or business,

(3) Business under *sections* 44AD, 44AE and 44AF.

(1) *Specified Professions*. The following professions are specified professions:

- | | |
|--------------------|--|
| (a) Legal; | (e) Accountancy; |
| (b) Medical; | (f) Technical Consultancies; |
| (c) Engineering; | (g) Interior Decoration; |
| (d) Architectural; | (h) such other profession as may be notified |
- by the Central Board of Direct Taxes.

The Board has notified the following professions for the purposes of this section: (i) The profession of authorized representative;

- (ii) The profession of film artists; and
- (iii) The profession of information technology.

Such persons are required to maintain prescribed books of account if their gross receipts in the profession exceeds Rs. 1,50,000 in anyone of the three years immediately preceding the previous year, or where the profession has been newly set-up in the previous year, his gross receipts in the profession for that year are likely to exceed the said amount.

[Notification No. 11319 dated 6.4.2000]

Prescribe books :

- (i) Cash Book;
- (ii) Journal (if accounts are maintained on the basis of mercantile system);
- (iii) A ledger;
- (iv) Carbon copies of bills issued exceeding Rs. 25; (v) Original bills; and
- (vi) Receipts regarding expenses exceeding Rs. 50.

(2) *Non-Specified Profession or Business*.

- (i) Whose income from such profession or business exceeds Rs. 1,20,000; or
- (ii) Total sales, turnover or gross receipts exceed Rs. 10,00,000 in anyone of the three years immediately preceding the previous year; or
- (iii) In the case of newly set-up profession or business income/total sales/turnover/gross receipts are likely to exceed the aforesaid amounts.

They are required to maintain such books of account and other documents as may enable the Assessing Officer to compute their total income. No books are prescribed

for them.

(3) *Businesses under sections 44AD, 44AE and 44AF.* Where the assessee claims that the profits and gains of business of civil construction (*Sec. 44AD*) or plying, hiring or leasing goods carriage (*Sec. 44AE*) or the business of retail trade (*Sec. 44AF*) are lower than the deemed profits under these sections; he has to maintain the books of account of such business.

Compulsory Audit of Accounts (*Sec. 44AB*)

(1) *Turnover / gross receipts exceed prescribed limit.* It is obligatory for a person carrying on business to get his accounts audited before 30th September (w.e.f. A.Y. 2008-09), if the total sales, turnover or gross receipts in business for the previous year exceed Rs. 40 lakh.

A person carrying on profession has also to get his accounts audited before 30th September if his gross receipts in profession for the previous year exceed Rs. 10 lakh.

Such persons are required to obtain before 30th September a report of the audit in the prescribed form and submit it along with the return of income.

(2) *Businesses under sections 44AD, 44AE and 44AF.* Where the assessee claims that the profits and gains of business of civil construction (*Sec. 44AD*) or plying, hiring or leasing goods carriage (*Sec. 44AE*) or the business of retail trade (*Sec. 44AF*) are lower than the deemed profits

Under these sections, he has, to get his accounts audited and furnish by 30th September a report of the audit in the prescribed form.

(3) *Assessee claims deduction under sections 33AB, 33ABA, 35D or 35E.* Where the assessee claims deduction under 'Tea development account', 'Site restoration fund', 'Preliminary expenses' or 'Expenditure on prospecting, etc., for certain minerals', he has to get his accounts audited and furnish by 30th September a report of the audit in the prescribed form.

Where such person is required by or under any other law to get his accounts audited, he need not get them audited again; but he should get the audit done before the specified date and get its report as well as another report in the form prescribed under this section.

Special provisions for computing profits and gains of business of Civil Construction,

etc. (Sec. 44AD)

This scheme is applicable to an assessee who is engaged in the business of civil construction or supply of labour for civil construction and the gross receipts paid or payable to the assessee from such business in the previous year do not exceed Rs. 40 lakh. The income from such business shall be deemed to be 8% of the gross receipts paid or payable to the assessee during the previous year.

Explanation : 'Civil Construction' includes :

- (a) the construction or repairs of any building, bridge, dam or other structure or any canal or road and also;
- (b) the execution of any works contract.

Illustration 1

Mr. Nath is engaged in business of civil construction. His gross receipts from such business are Rs. 351 lakh during the previous year 2007-08. He wants to pay tax on his income assuming the income @ 8% of gross receipts *u/s* 44AD. Further against such income he wants to claim depreciation @ 15% on plant and machinery W.D.V. Rs. 10 lakh on 1.4.2007, which he used for the aforesaid business. Find out his income assessable under the head 'Profits and Gains of Business or Profession' and W.D.V. of plant and machinery on 1.4.2009.

Solution

When Mr. Nath wants to pay tax on assumed income *u/s* 44AD, he is not entitled to claim any deduction as expense in computing the business income. Hence, he is not entitled to claim depreciation on plant and machinery used for this business purposes. Further, it will be assumed that the assessee has claimed the depreciation on the asset used for the purposes of business and it had been actually allowed. Accordingly his assessable business income and W.D.V. of PIM on 1.4.2009 shall be as under:

Assessable business profits:

8% of Rs. 35 lakh	Rs.
Computation of W.D.V. of plant and machinery on 1.4.2009:	<u>2,80,000</u>

W.D.V. on 1.4.2008	10,00,000
Less: Deemed depreciation allowed @ 15%	<u>1,50,000</u>
W.D.V. on 1.4.2009	<u>8,50,000</u>
<i>Special provisions for computing profits and gains of business of plying, hiring or leasing goods carriages</i>	
	(Sec.44AE)

This scheme is applicable to an assessee, who is engaged in the business of plying, hiring or leasing of goods carriages (trucks) owning not more than 10 goods carriages at any time during the previous year.

The income of such business chargeable to tax under the head 'Profits and gains of business or profession' shall be deemed to be the aggregate of the profits and gains from all the goods carriages owned by him in the previous year and will be computed as under:

- (i) the profits and gains from each heavy goods vehicle shall be Rs. 3,500 for every month or part of a amount during which the heavy goods vehicle is owned by the assessee in the previous year;
- (ii) the profits and gains from other than a heavy goods vehicle shall be Rs. 3,150 for every month or part of a month during which the vehicle is owned by the assessee in the previous year.

Where an assessee has taken goods carriage on hire purchase or on instalments, he shall be deemed to be the owner of such goods carriage.

Illustration 2

A truck operator assessee owns 2 heavy goods vehicles for 9 months 14 days, 3 medium goods vehicles for 10 months 8 days and 4 light goods vehicles for 7 months 23 days, during the previous year 2007-08. He did not keep any accounts for freight receipts and expenses. Cost of Vehicles is Rs. 20 lakh. Compute his Income from Business u/s 44 AE of Income Tax Act

Solution

The assessee is not owning more than 10 vehicles, hence, the income shall be deemed as under :

- (i) Heavy goods vehicles: Income is deemed Rs. 3,500 p.m. or part of a month per vehicle
: $2 \times 3,500 \times 10 = \text{Rs. } 70,000$

	Rs.
(ii) Medium goods vehicles and light goods vehicles :	1,26,000
Income is deemed Rs. 3,150 p.m. or part of a month per vehicle	21,000
$3 \times 3,150 \times 11 = \text{Rs. } 1,03,950$	1,51,200
$4 \times 3,150 \times 8 = \text{Rs. } 1,00,800$	2,98,200
Income u/s 44AE Rs. 2,74,750 .	Rs. 36,00 36,00
	<u>72,000</u>
	2,26,200
	67,50
	45,00
	<u>30,48</u>

Illustration 3

A PFAS is engaged in the business of plying and hiring goods carriage. 1,20,000
1,06,200

The firm wants to compute its income u/s 44AE. From the following information compute the business income of firm :

The firm has five heavy goods vehicles, out of which two were purchased on hire purchase : system on 20.1.2008. It has four goods carriages other than heavy goods vehicles.

As per partnership deed partners A and B are entitled to (i) salary Rs. 5,000 p.m. each, and interest @ 12% p.a. on capital of Rs. 3,00,000 each.

Computation of Business Income of the Firm

Deemed income of heavy goods vehicles Rs. 3,500 p.m.

or for a part of month per vehicle

$$3 \times 3,500 \times 12$$

$$2 \times 3,500 \times 3$$

Deemed income of other vehicles Rs. 3,150 p.m.

or for a part of month per vehicle ($4 \times 3,150 \times 12$)

Less : Interest to partners :

A

B

Book-profits

Less : Remuneration to partners :

90% of Rs. 75,000

60% of Rs. 75,000

40% of Rs. 76,200

or Rs. 1,20,000 as per deed, whichever is less

Business Income of the Firm

Illustration 4

Mr. G retired from Government Service in March 2008. He got Rs. 181akh on account of retirement benefits. Out of the aforesaid sum, he purchased on 23rd April, 2007 a few motor vehicles and got their delivery on that date. The particulars of the vehicles are given below:

<i>Cost of the Vehicle</i>	Rs.
(i) Heavy goods vehicles-2	8,00,000
(ii) Medium goods vehicles-4	4,00,000
(iii) Light commercial vehicles-3	3,00,000

He formed GM and Associates (a sole proprietorship concern), along with his son M as an employee on 1.6.2008 and started plying the vehicles from 4.6.2008

On an average every vehicle remains off the road for about a week for repairs and maintenance. GM and Associates maintains no account and vouchers. However, it maintains a rough record of its receipts and outgoings which is given below:

	Rs. 13,40,000
Receipts	
<u>4,30,000</u>	
Less: Expenses (excluding depreciation and salaries to M)	<u>9,10,000</u>

You are required to compute the total income of GM and Associates from business of goods carriage for P.Y. 2008-09 relevant to the A.Y. 2009-10. Assume the rate of depreciation 30% and salary to M at Rs. 1,00,000 p.a.

Solution

Computation of income of GM & Associates from business of goods carriage for A.Y. 2009-10 :

- (i) The assessee does not own more than 10 goods carriages.
- (ii) The assessee does not maintain proper accounts regarding the aforesaid business, hence, income shall be computed on the basis of deemed income u/s 44AE.

Sec. 44AE provides that income from each heavy goods vehicle shall be Rs.

3,500 p.m. or part of a month and other than a heavy goods vehicle Rs. 3,150 p.m. or part of a month during which the vehicle is owned by the assessee in the previous year.

Accordingly income shall be computed w.e.f. April 2007 (date of delivery of vehicles) and not w.e.f. June 2007 (date of plying the vehicles).

Income for A.Y.2009-10 shall be :	Rs.
Heavy goods vehicles (2 x 3,500 x 12)	84,000
Medium goods vehicles (4 x 3,150 x 12)	1,51,200
Light commercial vehicles (3 x 3,150 x 12)	<u>1,13,400</u>
	<u>3,48,600</u>

Neither the amount of depreciation on vehicles nor salary paid to M is deductible from the income Rs. 3,48,600.

Special Provisions for Computing Profits and Gains of Retail Trade (Sec. 44AF)

This scheme is applicable to an assessee who is engaged in the business of retail trade in any goods or merchandise provided the total turnover of such business in the previous year does not exceed Rs.40 lakh.

The income from such business shall be deemed to be 5% of the total turnover during the previous year.

Some common provisions applicable to Section 44AD, Section 44AE

and *Section 44AF* The common provisions are as under:

- (1) When the income is deemed u/s 44AD or u/s 44AE or u/s 44AF no deduction under *sections 30 to 38* shall be allowed against the deemed income as it is presumed that all such deductions have already been allowed. Further, it shall be deemed that the assessee had claimed the depreciation on the assets used for the purposes of the above business and it had been actually allowed, and the written-down value will be calculated accordingly.

Where the assessee is a firm, the salary and interest paid to its partners shall be deducted from the income computed aforesaid subject to the conditions and limits prescribed in *section 40(b)*.

(2) The assessee shall not be required to maintain accounts under *section* 44AA and get the accounts audited *u/s* 44AB relating to the aforesaid businesses.

(3) If the assessee is engaged in any other business also along with any of the aforesaid business in computing the monetary limits under *sectionS* 44AA and 44AB (for other business) the gross receipts/income from aforesaid respective business shall be excluded.

(4) The scheme is optional and if the assessee claims that the profits from any of the aforesaid businesses are less than the deemed profits, he has to maintain proper account books, get these audited and the report of audit must be furnished by the specified date *u/s* 44AB.

VALUATION OF STOCK IN HAND

There are no provisions in the Income Tax Act regarding the valuation of stock-in-hand in a business. Hence, it is valued according to the general principles of accounting. Generally, the valuation of stock is done as under:

- (i) on the basis of cost; or
- (ii) on the basis of market price; or
- (iii) on the basis of cost or market price, whichever is less.

The assessee is free to adopt any method, but once a method is adopted it has got to be adhered to year to year. It means that once a particular basis of valuation is adopted, it cannot be changed by the assessee at his own sweet will; but only with the previous approval of the Assessing Officer.

Sec. 145A provides that the value of the inventory on the first and the last day of the previous year shall be determined according to the method of accounting regularly employed by the assessee. It shall also include the amount of any tax, duty, cess or fees paid or liability incurred for the same under any law in force.

Where an assessee converts his, capital assets into stock-in-trade and starts dealing in them the value of such stock will be the market value as on the date of their conversion into stock-in-trade and not original cost.

However, such conversion shall be a transfer *u/s* 2(47) and liable to tax under the head 'Capital gains'.

Bank valuing stock-in-trade (investments) at cost in balance sheet in accordance with Banking Regulation Act and valuing same investments at cost or market price, whichever is less, for income tax purposes. The method is valid and cannot be rejected.

[United Commercial Bank VB. CIT (1999) 240 ITR 355 (SC)]

DEDUCTIONS EXPRESSLY ALLOWED AT A GLANCE

Expenses in respect of buildings-rent, repairs, land revenue, local taxes, insurance premium.

Expenses in respect of plant, machinery, furniture-Repairs and insurance premium.

1. (a) *Depreciation on Tangible Assets:* Tangible assets are buildings, plant and machinery and furniture.

(b) *Depreciation on Intangible Assets:* Intangible assets are know-how, patents, copyrights, trademarks, licences, franchises and commercial rights.

2. Deduction regarding deposit in Tea Development Account, Coffee Development Account or Rubber Development Account-Deduction shall be allowed on the amount deposited or 40% of the profits of such business, whichever is less.

3. Deduction regarding deposit in special account for prospecting for, or extraction or production of petroleum or natural gas-Deduction shall be allowed on the amount deposited or 20% of the profits of such business, whichever is less.

4. Expenditure on Scientific Research:

- (i.) Revenue expenditure and capital expenditure
- (ii.) Sum paid for scientific research or social or statistical research
- (iii.) Deduction 125% of sum paid
- (iv.) Expenditure on in-house research and development-Deduction 150% of the expenditure.

5. Deduction regarding capital expenditure to obtain licence to operate telecommunication services.
6. Expenditure on eligible project or scheme.
7. Payment to Rural Development Fund, National Poverty Eradication Fund.
8. Deduction to an Indian company or resident in India regarding preliminary expenses-Deductible in five previous years upto a specified limit.
9. Deduction to an Indian company regarding expenditure for amalgamation or demerger of an undertaking-Deductible in five equal instalments annually.
10. Expenditure on voluntary retirement during any previous year-Deductible in five instalments annually.
11. Deduction to an Indian company or resident in India regarding expenditure on prospecting of minerals etc.- Deductible in ten instalments annually.
12. Other deductions:
 - (i) Insurance premium regarding stocks and stores.
 - (ii) Insurance premium for the health of employees.
 - (iii) Bonus or commission to employees.
 - (iv) Interest on borrowed capital.
 - (v) Discount on zero coupon bond.
 - (vi) Contribution to recognised provident fund, approved superannuation fund, approved gratuity fund.
 - (vii) Loss regarding animals used for business or profession.
 - (viii) Bad debts.
 - (ix) Deduction to banks and financial institutions regarding provision for bad and doubtful debts upto a specified limit.

- (x) Reserve created by specified entity deductible 20% of profits or amount credited to special reserve account, whichever is less.
- (xi) Expenditure on family planning by a company to promote family planning amongst its employees:
 - (a) Capital expenditure---deductible in five equal instalments annually.
 - (b) Revenue expenditure.
- (xii) Expenses in connection with income tax proceedings.
- (xii) Entertainment expenses.
- (xiii) Banking Transaction Tax paid.

13. General deduction-provided:

- (i) it is not personal expense of the assessee;
- (ii) it is not in the nature of capital expenditure;
- (iii) it is expended wholly and exclusively for the purpose of business or profession during previous year.

DEDUCTIONS EXPRESSLY DISALLOWED AT A GLANCE

(A) For all assesseees :

1. Expenditure on advertisement in any souvenir, etc. published by a political party.
2. Payment out of India or in India to a non-resident or a foreign company-On which tax is deductible at source but tax has not been deducted or after deduction has not been paid.
 Payment to residents of interest, commission or brokerage, rent, royalty, fees for technical or professional services or to contractor or sub-contractor on which tax is deductible at source but tax has not been deducted or after deduction has not been paid.
4. Sum paid on account of Securities Transaction Tax.
5. Income Tax and Wealth Tax.
6. Sum paid on account of Fringe Benefit Tax.

7. Salaries payable outside India or to a non-resident on which tax has not been deducted at source or paid.
 8. Tax paid by the employer voluntarily on the value of perquisites provided to employees. (B) For Firms :
 9. Salary, bonus, commission or remuneration to working partners in excess of prescribed limit.
 10. Interest on capital or loan to partners in excess of @ 12% p.a. (C) For AOP or BOI :
- Payment of interest, salary, bonus, commission or remuneration to members of AOP or BOI is disallowed.

EXPENSES NOT DEDUCTIBLE IN CERTAIN CIRCUMSTANCES AT A GLANCE

Payment to relative or associate concern in excess of market rate.

Payment in cash exceeding Rs. 20,000-100% of payment shall be disallowed. There are certain exceptions.

Provision for gratuity provided the gratuity fund is not an approved fund.

Contribution to any unapproved fund by the employer.

Illustration 5

State with reasons whether the following items are admissible under the Indian Income Tax Act, 1961:

- (a) Commission of Rs. 500 paid in order to secure orders for the business.
- (b) The assessee was carrying on money-lending business and in the course of this business he acquired certain property in lieu of debts owing from a debtor which he kept as stock-in-trade. The property so acquired was destroyed in war; the assessee claimed this loss as a deduction in computing his taxable income under the head 'Business'.
- (c) Loss of Rs. 1,000 which were snatched away from the *khazanchee's* possession while going to bank to deposit the amount.
- (d) Loss due to embezzlement by an employee.
- (e) Brokerage paid for raising loan for the business.

- (f) Rs.1,000 spent in connection with installation of a new telephone connection.
- (g) Fees paid to lawyer on 1.6.2008 for drafting the Deed of Agreement with an outsider relating to the setting-up the business.
- (h) Pension paid to the widow and children of a deceased engineer of the factory voluntarily.
- (i) Interest paid for funds borrowed specifically for the acquisition of a capital asset.

Solution

- (a) The commission of Rs. 500 paid in order to secure orders for the business is an expenditure in the ordinary course of business and hence it is admissible.
- (b) In the course of his money-lending business the assessee acquired certain property in lieu of debts and kept it as stock-in-trade. This loss is allowable as it is the loss of stock-in-trade.
- (c) This loss is admissible as it was part of his duty to carry cash for depositing it in bank and hence it is incidental to the business.
- (d) It is admissible as it has been sustained during the ordinary course of business.
- (e) Brokerage paid for raising a loan for the business is an admissible expenditure. [*India Cement Ltd. VB. CIT (1966) 60 ITR 52 (Sec)*]
- (f) It is an admissible deduction under executive instruction.
- (g) It is not admissible as it is in the nature of capital expenditure, but 1/5th of it will be allowed under *section 35D* for five successive previous years.
- (h) Pension paid to the widow and children of a deceased engineer is not allowed as deduction as it is not an obligatory expenditure in connection with the business.
- (i) Interest paid for funds borrowed specifically for the acquisition of a capital asset will be capitalised from the date of borrowing till the date asset is put to use [u/s 36(1Xiii)].

Illustration 6

Advise an assessee about the admissibility or otherwise of the claims, with regard to the following items, giving reasons :

- (a) Compensation paid to an employee for premature termination of his services.
- (b) Amount spent in a successful suit filed against another for infringing the

assessee's trademark.

(c) Penalty paid to customs authorities for importing prohibited goods which yielded a large margin of profits.

(d) Travelling expenses of a director who went to Europe for negotiating the purchase of a new heavy machinery which was eventually installed next year.

(e) Cost of erecting a medical annexe to the factory for the emergency treatment of the employees.

(f) Lump-sum consideration paid on 1.7.2008 for acquiring know-how Rs. 6,00,000.

Solution

(a) Assuming that the termination of the services of an employee was in the interest of the business, this item will be treated as an admissible expenditure.

(b) It is admissible as the expenditure has been incurred to maintain an asset (*viz.*, the trademark).

(c) Penalty paid for illegal activities of the assessee are not to be allowed as expenditure under the Income Tax Act.

(d) It is inadmissible as it is incurred for the acquisition of a new asset.

(e) It is not an admissible expenditure, being of a capital nature. However, depreciation can be claimed u/s 32(1).

(f) On the cost of know-how depreciation shall be allowed @ 25% on W.D.V. basis u/s 32(1).

Illustration 7

Discuss with reasons the admissibility or otherwise of the following expenditure by assessee under the provisions of Income Tax Act, 1961 :

(a) A sum of Rs. 30,000 was provided towards Sales tax liability in the accounts for the Y ending 31.3.2008.

(b) An expenditure of Rs. 15,000 incurred towards the cost of Neon Sign Board fixed office premises, advertising its products.

(c) Stock-in-trade was lost in fire amounting to Rs. 10,000 and was debited to Profit Loss Account.

(d) Interest paid on borrowed capital in the construction of property till the date of letting.

Solution

(a) Provision for sales tax liability is deductible only if it is paid on or before the due for furnishing the return of income. If it is paid after the due date of furnishing the ret income, then deduction will be available in the assessment year relevant to the previous in which the payment is made. However, if a State Government has amended its Sales Tax to the effect that deferment of sales-tax by the State Government will be deemed to be sales paid, it will also be deemed to have been paid under the Income Tax Act and will, therefore; allowable as deduction.

(b) Expenditure incurred towards the cost of Neon Sign Board fixed on office premises, advertising its products, is capital expense. Hence, cannot be allowed. However, depreciation can be claimed u/s 32(1).

(c) Loss of stock-in-trade due to fire amounting to Rs. 10,000 is a trading loss and hence it is deductible.

(d) Under *section 24(b)*, interest paid on borrowed capital for the construction of property for the period after the property's construction is completed is allowed in full in the relevant previous year for that previous year. For the period prior to the previous year in which the construction is completed, it is allowable in five equal annual instalments commencing from the year in which the construction is completed.

Illustration 8

State, giving brief reasons, whether the following items are allowable while computing profits and gains of business or profession:

- (i) Donation to a political party.
- (ii) (ii) Fees paid to the lawyer for drafting a new Partnership Deed.
- (iii) Sums paid to a Labour leader to call off the strike.
- (iv) Salary paid to son, who is working in the office. The salary is reasonable.

- (v) Rent paid to daughter for office block which was gifted to her at the time of her marriage.
- (vi) Bonus to partner for extra services.
- (vii) Interest paid to wife on money borrowed from her.
- (viii) Subscription for magazines paid by a Doctor for the benefit of his patients.
- (ix) (ix) Major repairs to the air-conditioner in the office.
- (x) In the course of money-lending business, the assessee acquired certain properties in lieu of debts and held them as stock-in-trade. The properties so acquired were destroyed by enemy action and the assessee claims the loss as deduction.
- (xi) Expenses incurred in respect of a branch the business of which was discontinued during the year.

Solution

- (i) Not allowed as it has nothing to do with the purpose of the business. However, he is entitled to deduction from gross total income u/s 80GGC.
- (ii) Allowed u/s 37(1)
- (iii) Not allowed. The payment is just a protection money which is against public policy. *[Explanation Sec. 37(1)]*
- (iv) It is allowed since it is reasonable. Salary paid to relatives is allowable.
- (v) It is allowed provided it is reasonable.
- (vi) Allowed provided it is as per Partnership Deed and fulfils all conditions of Sec. 40(b).
- (vii) It is allowed provided it is reasonable.
- (viii) It is allowed as it is in the interest of profession.
- (ix) It is allowed provided it is in the nature of current repairs.
- (x) It is allowed as it is the loss of stock-in-trade. The properties were kept as stock-intrade.
- (xi) Discontinuing a branch is not discontinuance of business. Hence, expenses are allow- able. *[See CIT VB. Prithvi Insurance Co. Ltd. (1967) 63 ITR 632*

(S.C)

Illustration 9

Sri Nehru is the proprietor of a business. His Profit and Loss Account for the year ended .March 31, 2009, is as follows :

	Rs.		Rs.
Establishment	4,800	Gross Profit	1,50,840
Rent, Rates & Taxes	2,900	Interest on Govt.	
General Charges	750	Securities Rent from	5,400
Household Expenses	51,730	House Property	5,400
Commission	1,500		
Discount & Allowances	450		
Provision for Bad Debts	1,200		
Postage & Telegrams	270		
Law Charges	450		
Advertising	1,550		
Fire Insurance Premium			
(for goods)	630		
Sales Tax Paid	1,450		
Repairs & Renewals			
(not for business premises)	630		
Loss on Sale of Motor-car			
(used for private purposes)	1,800		
Life Insurance Premium	1,790		
Wealth Tax	740		
Interest on Capital	350		
Audit Fee	300		
Interest on Bank Loan	1,380		

Provision for Depreciation	2,500
Provision for Income tax	3,900
Net Profit transferred to	
Capital A/c	80,840
	Rs. 1,61,640

Following further information is Given:

- Actual Bad Debts written-off during the year amount to Rs. 550.
- Amount of Income tax actually paid during the year is Rs. 4,200.
- Depreciation allowable is Rs. 1,700 as per Income tax Rules.
- Advertising Expenses include Rs. 550 spent on special advertising campaign to open a new shop in the market.
- Law charges are in connection with protection of a trademark.
- Sri Nehru carries on his business from a rented premises, half of which is used as his residence. Rent, Rates and Taxes include Rs. 2,400 paid as rent of the premises during the year.
- Bank loan is taken for business purposes.

Compute the business income of Sri Nehru and his total income for the A.Y. 2008-09.

[Kanpur, 2004]

Computation of Income from Business

for the Assessment Year 2009-10

Net Profits as per Profit & Loss Account

<i>Add: Expenses not allowed :</i>	Rs.	Rs.
Rent of one-half premises	1,200	80,840
Household Expenses	51,730	
Provision for Bad Debts	1,200	
Loss on sale of Motor-car	1,800	
Repairs and Renewals	630	
Life Insurance Premium	1,790	
Wealth Tax	740	
Interest on Capital	350	
Provision for Depreciation	2,500	

Provision for Income tax	<u>3,900</u>	65,840
		<u>1,46,680</u>
<i>Less: Items allowed but not charged:</i>		
Bad Debts	550	
Depreciation	1,700	2,250
		<u>1,44,430</u>
<i>Less : Items not taxable under business head:</i>		
Interest on Govt. Securities	5,400	
Rent from House Property	<u>5,400</u>	<u>10,800</u>
Income from Business		Rs. <u>1,33,630</u>

Statement of Total Income

for the Assessment Year 2009-10

1. Income from House Property (A.V.)	5,400	
<i>Less: 30% of A.V.</i>	1,620	3,780
2. Profits of Business		1,33,63
3. Income from Other Sources (Interest on Securities)		<u>5,400</u>
	Gross Total Income	Rs. 1,42,810
Less : Deduction under section 80 C-LIP		1,790
	Total Income	<u>1,41,020</u>

Notes; 1. Expenses incurred on special advertising campaign to open a new shop in the market are admissible as these are incurred for better marketing of the goods.

[*Hindustan Commercial Bank Ltd. vs. CIT (1952) 21 ITR 353 (All.)*]

2. Law charges are incurred for the maintenance of an existing trademark and hence they are allowed.
3. Now deduction under *section SOL* is not allowable.
4. Repairs and Renewals are not for business premises, hence not allowable as business expenditure.

Illustration 10

Shri Radhey Lal, the proprietor of a flour mill, has prepared the following Profit and Loss Account for the year ending 31st March, 2008. You are required to compute his

income from business and his gross total income for the Assessment Year 2009-10 :

Profit and Loss Account

Trade Expenses	450	Gross Profit	1,35,900
Establishment Charges	2,200	Dividends from a Co-operative	
Rent, Rates & Taxes	1,400	Society	2,600
Discount & Allowance	200	Rent from Property	500
Income tax	700	Bad debts recovered	2,000
Advertisement Expenses	1,400	(Allowed as deduction	
Postage & Telegrams	100	in an earlier year)	
Gifts and Presents for publicity	125		
Fire Insurance Premium	250		
Charities	375		
Donations	400		
Repairs and Renewals	250		
Audit Fees	250		
Net Profit transferred to Capital			
Account	1,32,850		
	<u>Rs. 1,41,000</u>		<u>Rs. 1,41,000</u>

Solution

Computation of Income from Business

For the Assessment year 2009-10

Profit as per Profit and Loss Account Rs. 1,32,850

Add : Expenses not allowed :		Rs.	
Income Tax		700	
Charities		375	
Donations		400	<u>1,475</u>
			<u>1,34,325</u>

Less : Income from Property

(Being not business income) 500

Divided (Being not business income) 2,600 3,100

Rs. 1,31,225

Statement of Gross Total Income

1. Income from House Property	350
2. Income from Business	1,31,225
3. Income from other Sources : Dividends	2,600
Gross Total Income	<u>Rs. 1,34,175</u>

Notes : Total Income *Notes:* 1. Income from House Property has been computed as under:

Rent AV.	500
Less: 30% of AV.	150

Bad Debts recovered, which had been allowed in an earlier year, is taxable as business income.

Gifts and presents for publicity are in the nature of advertisement, hence allowed.

Illustration 11

Mr. Om is a cloth merchant. From the following P & L *A/c* for the year ended 31st March, 2008 compute his income from business and his Gross Total Income for the assessment year 2009-10 :

	Rs.		
Salaries and Wages	15,000	Gross Profit	1,70,000
Rent and Taxes	4,000	Dividend on Shares (Gross)	4,000
Domestic Exps.	2,500	Rent from building let out	10,000
Income Tax	1,200		
Postal Charges	1,500		
Donation	2,500		
Life Insurance Premium	2,000		
Audit Fees	1,500		
Bad Debts Reserve	1,800		
Bad Debts	2,500		

Depreciation	5,000	
Net Profit	1,44,1500	
	1,84,000	1,84,000

Other informations:

(a) Rent and Taxes include Rs. 2,000 paid as Municipal Tax on building let out.

(b) Value of Life Insurance Policy is Rs. 18,000.

(c) Donation was given to an approved institution.

(d) Permissible Depreciation was Rs. 4,000. *(Bhopal, 1999)*

Solution

Computation of Income from Business & House Property for the Assessment Year 2009-10

Income from Business

Net Profit as per Profit and Loss A/c		Rs. Rs.1,44,500
Less : Rent of Building not chargeable under the head business	10,000	
Dividend on shares	<u>4,000</u>	<u>14,000</u>
		1,30,500

Add : Items disallowed:

(i) Rent paid to the extent of municipal taxes paid	2,000	
(ii) Domestic expenses	2,500	
(iii) Income tax	1,200	
(iv) Donation	2,500	
(v) Life Insurance Premium	2,000	
(vi) Bad Debts Reserve	1,800	
(vii) Excess Depreciation	1,000	13,000
Business Income		Rs, 1,43,500

Illustration.

State whether the following items are deductible or not and why:

1. Sales-tax and Wealth-tax.
2. Donation to a political party.
3. Cost of installing a new telephone.
4. Fees paid to the lawyer for drafting partnership deed.
5. Loss due to embezzlement by an employee.
6. Penalty paid to custom authorities for violating custom rules.
7. Commission paid while purchasing raw materials.
8. Some amount paid to a labour leader to call off the strike.
9. Bad debts.
10. In the course of money-lending business, the assessee acquired certain properties in lieu of debts and held them as stock-in-trade. The properties so acquired were destroyed by enemy action and the assessee claims the loss as deduction.
11. Brokerage paid for raising a loan.
12. Rs. 1,000 were snatched from the cashier while he was going to the bank to deposit the amount.
13. Legal expenses paid to protect the building of the business.
14. Rs. 5,000 paid as a commission to purchase machinery and Rs. 500 were also spent as traveling expenses on the person who went to purchase the machinery.
15. Subsidy received under export promotion scheme from Government.

Solution.

1. Wealth-tax is expressly disallowed. Wealth-tax is levied on the value of assets and so this tax has nothing to do with the carrying on the business. It is tax on wealth and is not payable while earning profit.

The payment of tax on sales in the normal running of the business and is made for the purpose of the business. Sales-tax is an admissible deduction.

2. Few years back, this type of donation was allowed but now the donation to a political party is not an allowable deduction. This amount is disallowed on the ground that it has nothing to do with the purposes of the business.

3. To a layman and to the students of accountancy, this expenditure seems to be capital expenditure. Under executive instructions, the cost of installing a new telephone is an admissible deduction.
4. Expenditure incurred on drafting a partnership deed is a capital expenditure and so it is not an admissible deduction.
5. The employees of the business have access over cash in the business and in routine or normal running of the business, embezzlement of cash by employee is possible. As this loss occurs in the ordinary course of the business, so it is an admissible item.
6. Penalty was imposed upon the assessee for his illegal work. So penalty paid on illegal work cannot be allowed as deduction.
7. This type of commission is paid in the ordinary course of the business and for the purpose of the business, so it is an admissible deduction.
8. If the receipt of voucher of this type of expenditure is available, then this item can be an allowable item because the payment was made in the interest of the business. It may not be allowable item due to non-availability of proof of this type of payment.
9. In the ordinary course of the business few debtors or some percentage of debtors normally do not pay. So the debts which are not recoverable and actually written off in the books of the assessee, are allowed as deduction.
10. This loss is allowable as it is the loss of stock-in-trade. The properties were kept as stock-in-trade.
11. Brokerage paid for raising a loan for the purpose of the business is an allowable deduction. However, brokerage paid for raising capital is not allowed.
12. This type of loss is considered as revenue loss, so it is an allowable deduction.
13. Expenditure incurred to protect the interest of the business is an allowable expenditure. So the legal expenses are allowed as deduction.
14. Commission paid to purchase a capital asset is a capital expenditure. Expenses incurred on traveling are also treated as capital. So Rs. 5,500 cannot be allowed as deduction, being a capital expenditure. These are added to the cost of asset.

15. Any subsidy received by an assessee as an export subsidy under an export-promotion scheme promulgated by Government was held to be taxable income from business u/s 28.

Illustration. Profit and Loss Account of M/s Raju & Company.

	Rs.		Rs.
General Expenses	7,000	Gross Profit	1,40,000
Fire Insurance Premium	2,000	Bad debts, recovered	
Bad debts	1,000	but disallowed earlier	4,000
Salaries	65,000	Interest from Govt. Securities	4,000
Advertisement (in cash)	22,250	Rent received from employees	12,000
Proprietor's salary	12,250	Interest from debtors for delayed payment	6,000
Interest on capital	2,000		
Income-tax	1,000		
Depreciation	2,000		
Sales-tax (due)	5,000		
Advance income-tax paid	1,000		
Donations	500		
Motor car expenses	750		
Municipal taxes of quarters let to employees	5,000		
Net profit	39,000		
	1,66,000		1,66,000

General expenses include Rs. 4,000 paid as compensation to an old employee whose services were terminated in the interest of the business and Rs. 2,200 by way of help to a poor student. Depreciation calculated according to the rates comes to Rs. 2,900. Sales tax was paid on 1-5-2009. Date of filing of return is 31-7-2009.

50% of Motor-car expenses are for proprietor's personal use.

Compute business income.

Solution.

Computation of Business Income

	Rs.	Rs.
Net Profit as per P & L A/c		39,000
<i>Add : Inadmissible expenses</i>		
Advertisement in case(100% of 22,250)	22,250	
Proprietor's salary	12,500	

Interest on capital	2,000	
Income-tax	1,000	
Advance Income-tax	1,000	
Donation	500	
Motor car expenses	375	
Help to poor student	2,200	
Depreciation	<u>2,000</u>	
		<u>43,825</u>
		<u>82,825</u>
<i>Less expenses allowed but not debited</i>		
Depreciation		<u>2,900</u>
		<u>79,925</u>
<i>Less incomes not taxable under this head</i>		
Bad debt recovered disallowed earlier	4,000	
Interest on Govt. Securities	<u>4,000</u>	
		<u>8,000</u>
Taxable Business Income		<u>71,925</u>

Illustration. From the following Profit and Loss Account of a manufacturer, calculate the income under the head 'Profits and Gains of Business or Profession' for the year ending on 31st March.

	Rs.		Rs.
Salaries to employees	95,000	Gross Profit	3,80,000
Advertisement expenses (in cash)	24,000	Interest on securities	14,000
General expenses	16,000	Income from house property	25,000
Entertainment expenses	22,000	Bad debts recovered (allowed earlier)	12,000
Bad debts	1,500		
Drawings by the proprietor	24,000		
Sales-tax (due and paid on 1-7-2008)	6,000		
Interest on proprietor's capital	7,000		
Repairs	2,500		
Rent	21,000		
Legal expenses	5,000		
Depreciation	15,000		
Bonus (due)	6,000		
Bonus to the proprietor	4,000		
Car purchased	72,000		
Expenses on car during the year	12,000		
Donations	2,000		
Provisions for bad debts	6,000		

Net Profit	<u>90,000</u>	
	<u>4,31,000</u>	<u>4,31,000</u>

From the examination of books of accounts, the following other information are available:

1. advertisement expenses were spent on insertions in news papers.
2. Rs. 3,000 were spent on purchase of land and are included in legal expenses.
3. Half of the repair expenses were on let-out building.
4. Depreciation allowable on all assets including car is Rs. 14,400.
5. Bonus was paid to employees on 30-6-2009 and date of filing of return is 31-7-2009.

Solution. Computation of business income of a cycle manufacturer

	Rs.	Rs.
Profit as given in the Profit and Loss A/c		90,000
<i>Add: Inadmissible Expenses</i>		
Drawings	24,000	
Interest on proprietor's capital	7,000	
Bonus to proprietor	4,000	
Car purchased	72,000	
Donations	2,000	
Provisions for bad debts	6,000	
Legal charges (being Capital Exp.)	3,000	
Repairs on let-out building	1,250	
Depreciation	15,000	
Advertisement expenses paid in cash	<u>24,000</u>	
		<u>1,58,250</u>
		<u>2,48,250</u>
<i>Less: Income to be treated under separate heads:</i>		
Income from interest on securities	14,000	
Income from house property	<u>25,000</u>	
		<u>39,000</u>
		<u>2,09,250</u>
<i>Less: Allowable depreciation</i>		<u>14,400</u>
Income from business		<u>1,94,850</u>

Illustration. From the profit and loss account given below, calculate the taxable business income of the Partnership firm for the year ending on 31st March 2009:

	Rs.		Rs.
Opening stock	1,60,000	Sales	8,00,000
Purchases	5,60,000	Commission	50,000
Wages	50,000	Interest	20,000
Salaries	40,000	Closing stock	1,80,000
Bad debts	1,500		
Rent	10,000		
Interest	10,000		
General charges	15,000		
Income-tax (firm's)	25,000		
Legal charges	8,000		
Insurance	2,500		
Conveyance	8,000		
Depreciation	30,000		
Bad dept reserve	5,000		
Net profit	<u>1,25,000</u>		
	<u>10,50,000</u>		<u>10,50,000</u>

Following information was detected from the scrutiny of the accounts:

- (i.) Salaries include payment of salary to partners Alfa and beta, Rs. 24,000 and Rs. 10,000 respectively.
- (ii.) Interest account includes payments made to partners on their capital at the rate of 10% p.a. as per terms of partnership deed: Alfa Rs. 2,000; Beta Rs. 2,500; Gama Rs. 2,500.
- (iii.) Rent includes rent paid to partner Gama Rs. 6,000
- (iv.) Travelling expenses of Rs. 6,000 were spent on a tour to the U.K. by partner Gama to canvass for business, which are included in general charges.
- (v.) Legal charges include: Penalty paid for violation of custom rules Rs. 4,500 partnership deed expenses Rs. 500
- (vi.) General charges include a purchase of furniture of Rs. 3,000 and cash shortage of Rs. 200.
- (vii.) Half of the conveyance expenses are related to private use of the partners.
- (viii.) New machinery of Rs. 50,000 was installed during the year. The unit is engaged in the production of pesticides.
- (ix.) Allowable Depreciation on all assets including new P & M and Furniture amounts to Rs. 35,500.

- (x.) Mr. Alfa is working partner of the firm. As per partnership agreement he is entitled to salary as per above and a copy of deed was submitted to the assessing officer.

Solution. Computation of business income of the Partnership firm assessed as firm

	Rs.	Rs.
Profit as shown in the Profit and Loss A/c		1,25,000
<i>Add: Inadmissible expenses</i>		
Income-tax	25,000	
Depreciation	30,000	
Bad Debts Reserve	5,000	
Salary to Partner Beta	10,000	
Salary to Partner Alpha	24,000	
Legal charges regarding partnership deed (being capital expenditure)	500	
Penalty (it is not allowable deduction)	4,500	
Furniture purchased (being capital expenditure)	3,000	
Cash shortage (being capital loss)	200	
Conveyance Expenses (50% being personal expenses of partners)	<u>4,000</u>	
		<u>1,06,200</u>
		2,31,200
<i>Less: Depreciation</i>		<u>35,500</u>
Book Profit		1,95,700
<i>Less: allowable remuneration u/s 40 (b)</i>		<u>24,000</u>
Business Profit		<u>1,71,700</u>

Illustration. From the following statement, compute the income from profession of Dr. S.K. Kapoor if accounts are maintained on mercantile system:

	Rs.		Rs.
To Dispensary rent	36,000	By visiting fees	45,000
To Electricity and water charge	6,000	By Consultation fees	1,25,000
To Telephone expenses	6,000	By Sales of medicines	72,000
To Salary to nurse and compounder	36,000	By Dividends	5,000
To Dep. on surgical equipment	6,000		
To purchase of medicines	36,000		
To Depreciation on X-ray machine	4,000		
To Income tax	5,500		
To Donation to Rama Krishna Mission	4,000		

To Motor car expenses	9,600		
To Dep. On car	4,800		
To Net Income	<u>93,100</u>		
	<u>2,47,000</u>		<u>2,47,000</u>

Notes: 1. Electricity and water charges include domestic bill of Rs. 2,500

2. Half of motor car expenses are for professional use.

3. Telephone expenses include 40% for personal use.

4. Opening stock of medicines was Rs. 6,000 and closing stock was Rs. 4,000

Solution. Computation of Professional Income of Dr. S.K. Kapoor

	Rs.	Rs.
<i>Professional Receipts:</i>		
Visiting fees	45,000	
Consultation fees	1,25,000	
Sale of medicines	<u>72,000</u>	
		2,42,000
<i>Less: Professional Expenses</i>		
Dispensary rent	36,000	
Electricity and Water charges (6,000 – 2,500)	3,500	
Telephone expenses (6,000 x 60%)	3,600	
Salary of staff	36,000	
Depreciation on surgical equipment	6,000	
Cost of medicines	38,000	
[6,000 + 36,000 - 4,000]		
Depreciation on X-ray machine	4,000	
Motor car expenses (9,600 – 4,800)	4,800	
Depreciation on Car (4,800 – 2,400)	<u>2,400</u>	
		1,34,300
Professional Gain		<u>1,07,700</u>

Illustration. Following is the Profit and Loss Account of Mr. S.K. for the year ending 31-3-2009.

Debits	Rs.	Credits	Rs.
To Salary	5,60,000	By Gross profit	12,10,000
To repairs	20,000	By Commission	12,000
To patents [1/14 th part]	7,000	By Sundry receipts	18,000
To Bad debts	12,000	By Rent from let out house	30,000
To provision for bad debts	11,000	By Profit from sale of	16,000

		old machine	
To Revenue expenditure on Scientific Research	20,000	By Bad debt recovered	10,000
To Expenditure on promotion of family planning amongst employees	14,000	By Interest on Govt. Securities (investment made out of business funds)	20,000
To Donation to an approved institution	15,000	By interest on income tax refund	8,000
To Health insurance premium of employees	16,000		
To Contribution to employees provident fund @ 15% of employees salary	30,000		
To Advertisements	40,000		
To Expenses on Guest House	36,000		
To interest on borrowed money	50,000		
To Entertainment expenses	20,000		
To Loss of stock due to theft by an employee	8,000		
To Sales tax penalty	12,000		
To Donation to a university for research	40,000		
To Gratuity	30,000		
To Depreciation	1,20,000		
To Income tax	40,000		
To Provision for income tax	20,000		
To Net Profit	<u>2,03,000</u>		
Total	<u>13,24,000</u>	Total	<u>13,24,000</u>

Additional information:

1. 50% of health insurance of employees has been paid in cash.
2. Income tax provision is excessive to the tune of Rs. 8,000.
3. Patents were acquired on 1-11-2008.
4. Income accrued during the year but not credited to P & L account Rs. 20,000.

5. Expenses on advertisement include an expenditure of Rs. 15,000 on neon sign board. (Rate of dep. Is 15%)
6. WDV of machine sold was Nil.
7. Research conducted by the university is not related to assessee's field of business.
8. WDV of assets on 1-4-2008 was: Factory building Rs. 2,00,000, Non-factory building Rs. 3,00,000. Plant and machinery Rs. 3,00,000. A new machinery costing Rs. 2,00,000 was acquired on 15-12-2008 and was actually put to use on 15-1-2009.

From the information given above calculate the business income of Mr. S.K. for the assessment year 2009-10.

Solution.

Calculation of business income of Mr. S.K. for the assessment year 2009-10.

	Rs.	Rs.	Rs.
Net profit as per P & L account			2,03,000
<i>Add:</i>			
Expenses debited but not allowed under the act:			
Patents [1/4 th part]		7,000	
Provision for bad debts		11,000	
Expenditure on promotion of family planning amongst employees		14,000	
Donation to an approved institution		15,000	
Sales tax penalty		12,000	
Depreciation		1,20,000	
Income tax		40,000	
Provision for income tax		20,000	
Health insurance premium of employees-50% paid in cash		8,000	
Advertisements-cost of sign board being capital expenditure		<u>15,000</u>	
			<u>2,62,000</u>
			4,65,000
<i>Less:</i>			
Expense allowed but not debited			
Depreciation:			

On patent rights $7,000 \times 14/1 = 98,000 \times 25\% \times 1/2$ year		12,250	
On neon sign boards $15,000 \times 15\%$		2,250	
Factory building $2,00,000 \times 10\%$		20,000	
Non-factory building $3,00,000 \times 5\%$	15,000		
P & M Old	45,000		
P & M New	15,000		
Additional Dep. On new P & M: $2,00,000 \times 20\% \times 1/2$	<u>20,000</u>		
		1,29,500	
Amount given to university for research allowed			
@ 125% of Rs. 40,000	50,000		
Less already debited	<u>40,000</u>		
		<u>10,000</u>	<u>1,39,500</u>
			3,25,500
<i>Less: Incomes credited but not taxable under this head</i>			
Rent from let out house		30,000	
By profit from sale of old machine		16,000	
By interest on Govt Securities (investment)		20,000	
By interest on Income tax refund		<u>8,000</u>	
			<u>74,000</u>
			2,51,500
Add income accrued but not credited			<u>20,000</u>
Taxable business income			<u>2,71,500</u>

Illustration. The following is the Profit and Loss Account of a merchant for the year ending 31st March 2009.

PROFIT AND LOSS ACCOUNT

	Rs.		Rs.
To Office Salary	6,500	By Gross Profit	36,750
To Bad Debts written off	1,700	By Commission	1,250
To Provision for Bad Debts	3,000	By Discounts	500
To Advertisement	3,800	By Sundry Receipts	200
To Fire Insurance Premium (House Property)	550	By Rent of Building	3,600
To General Expenses	2,750	By Profit on Sale of Investments	3,000
To Depreciation	1,200		
To interest on Capital	2,000		
To interest on Bank Loan (due)	1,300		
To Net Profit	<u>22,500</u>		
	<u>45,300</u>		<u>45,300</u>

Compute the taxable profits from business. The amount of depreciation is Rs. 2,000. Interest on Bank loan was paid on 1-8-2009. Due date of filing of return is 31-7-2009.

Solution. Computation of Business Profits

	Rs.	Rs.
Net profit as per P & L A/c		22,500
<i>Add: Expenses not allowed</i>		
Provision for Bad Debts	3,000	
Fire Insurance Premium	550	
Depreciation	1,200	
Interest on Capital	2,000	
Interest on Bank loan paid on 1-8-2009	<u>1,300</u>	
		8,050
		30,550
<i>Less: Allowable depreciation</i>		<u>1,000</u>
		29,550
<i>Less: Incomes chargeable to tax under other heads:</i>		
Rent of building	3,600	
Profit on sale of investments	<u>3,600</u>	
		6,600
Business Income		<u>22,950</u>

Illustration. Mr. D.D. Dewan & Company are Chartered Accountants in Delhi. They have submitted the following Income and Expenditure Account for the year. Compute the income from profession.

Expenses	Rs.	Income	Rs.
To Drawings	48,000	By Audit fees	2,24,000
To Office rent	42,000	By Financial Consultancy service	98,000
To Telephone installation charges under O.Y.T. scheme	15,000	By Dividends from an Indian company (Gross)	6,000
To Electricity Bill	4,200	By Dividend on units of UTI	4,000
To Salary of Staff	66,000	By Accountancy works	24,000
To Charities	1,200		
To Gifts given to relatives	9,600		
To Car Expenses	21,000		
To Subscription for Journals	2,500		

To Institute fee	1,200		
To Stipends given to trainees	12,000		
To Net Income	<u>1,33,300</u>		
	<u>3,56,000</u>		<u>3,56,000</u>

Notes: 1. Depreciation of car during the year amounts to Rs. 5,000.

2. 30% of the time car is used for personal purposes.

Solution. Computation of income from profession of M/s D.D. Dewan & Co.

	Rs.	Rs.
<i>Professional receipts</i>		
Audit fees	2,24,000	
Financial Consultancy works	98,000	
Accountancy works	<u>24,000</u>	
Gross Professional Receipts		3,46,000
<i>Less: Professional Expenses</i>		
Office rent	42,000	
Telephone Installation Charges	15,000	
Electricity Bill	4,200	
Salary of Staff	66,000	
Car Expenses [21,000 x 70%]	14,700	
Subscription for journal	2,500	
Institute fees	1,200	
Stipends to trainees	12,000	
Depreciation	<u>3,500</u>	
		<u>1,61,100</u>
Professional Gain		<u>1,84,900</u>

Illustration. From the following particulars, compute the business income of Mr. S. Rangnathan.

	Rs.		Rs.
To Salaries	90,000	By Gross Profit	3,50,000
To Rent and Taxes	20,000	By Dividend	4,000
To Service Charges	4,000	By Bad debts recovered	
To Legal expenses	5,000	(allowed earlier)	4,400
To Reserve for Income-tax	6,000	By Interest from Post	
To Depreciation	12,000	office Savings Bank	1,200
To Expenses on acquisition of			
patent rights	56,000		
To Office expenses	42,000		
To Contribution to R.P.F.	12,000		

To Bad Debts	4,500		
To Donation to N.D.F.	2,500		
To Net Profit	<u>1,05,600</u>		
Total	<u>3,59,600</u>	Total	<u>3,59,600</u>

Notes: 1. Legal expenses include Rs.2,000 incurred by assessee for defending a case for damages for breach of contract which was decided in favour of assessee.

2. Depreciation of the year on assets other than patent rights is Rs. 16,900.

3. Contribution to RPF due on 31-3-2009 Rs. 2,000.

Solution. Computation of business income of Mr. S. Ranganathan

	Rs.	Rs.
Net profit as per Profit and Loss A/c		1,05,600
<i>Add: Expenses claimed but not allowed</i>		
Reserve for Income-tax	6,000	
Depreciation	12,000	
Patent rights	56,000	
Donation	2,500	
Contribution to RPF (due)	<u>2,000</u>	
		<u>78,500</u>
		1,84,100
<i>Less: Allowable expenses</i>		
Depreciation on other assets	16,900	
Dep. on patent rights (25% of 56,000)	<u>14,000</u>	
		<u>30,900</u>
		1,53,200
<i>Less: Incomes not taxable under this head:</i>		
Dividend	4,000	
Interest from Post Office Savings Bank	<u>1,200</u>	
		<u>5,200</u>
Business Profit		1,48,000

Illustration. Given below is the Profit and Loss Account of Shri Durga Cotton Mills Ltd. For the year ended 31st March 2009.

	Rs.		Rs.
To Opening Stock	5,50,000	By Sales	81,69,000
To Purchases	55,60,000	By Rent of Staff Quarters	37,500
To Railway Freight, Octroi etc.	6,00,000	By Closing stock	8,49,500
To Salaries and wages	4,50,000		
To Director's Fees	3,000		
To Audit Fees (Paid in cash)	25,000		
To Legal Expenses	32,000		

To Repairs to Building and Machinery	13,000		
To Welfare Expenses	10,000		
To General Charges	25,000		
To Interest Paid	2,00,000		
To Underwriting Commission for issue of share capital	10,000		
To Reserve for Bad Debts	7,000		
To Bad Debt written off	40,000		
To Depreciation	10,000		
To Managing Agent's remuneration	30,000		
To Annual Contribution to Debenture Sinking Fund	25,000		
To Provision for Taxation	5,00,000		
To Contribution of Staff Welfare Fund	1,00,000		
To General Reserve	1,00,000		
To Proposed Dividends	6,00,000		
To Balance to Balance Sheet	<u>1,66,000</u>		
Total	<u>90,56,000</u>	Total	<u>90,56,000</u>

You are required to compute company's taxable income from business for the assessment year 2009-10 after taking into account the following information:

- (a) A sum of Rs. 5,000 on account of liability foregone by a creditor has been carried to a special reserve. The said sum was charged by the company in the revenue account of the preceding year.
- (b) General charges include:
 - (i.) Rs. 7,000 – Emergency Insurance Risk Premium.
 - (ii.) Rs. 1,000 – Donation to Chief Minister's Flood Relief Fund.
 - (iii.) Rs. 2,000 – Family Planning expenditure amongst company employees.
- (c) Welfare expenses include Rs. 1,500 being cost of pucca well built for use by company workers.
- (d) Legal expenses include Rs. 500 paid to a chartered accountant for conducting income-tax appeal and Rs. 2,000 (paid to an advocate) in connection with

- prosecution of Managing Agents for smuggling goods from Pakistan. The company made a profit of Rs. 20,000 on these smuggled goods.
- (e) Repairs to Building include Rs. 10,000 being cost of additions to business premises.
- (f) Depreciation (including additions to building) is Rs. 27,500.

Solution: Computation of Business Income

	Rs.	Rs.
Profit as per given in the P & L A/c		1,66,000
<i>Add: Inadmissible deductions</i>		
Reserve for Bad debts	7,000	
Depreciation	10,000	
Annual Contribution to Debenture Sinking Fund	25,000	
Provision for Taxation	5,00,000	
General Reserve	1,00,000	
Proposed dividend	6,00,000	
Staff Welfare Fund	1,00,000	
Liability forgone by creditor	5,000	
Donation to Flood Relief Fund	1,000	
Expenses on the construction of pucca well (being capital expenditure)	1,500	
Legal expenses being expenses incurred against the prosecution of managing agents	2,000	
Cost of addition to business building (being capital expenditure)	10,000	
Underwriting Commission- 4/5 th of Rs. 10,000	8,000	
Audit fees [being paid in cash: disallowed u/s 40A(3) upto 100%]	<u>25,000</u>	
		<u>13,94,500</u>
		15,60,500
<i>Less: Allowable depreciation</i>		<u>27,500</u>
		15,33,000
<i>Add: Other Business Incomes:</i>		
Income from smuggling business	20,000	
Expenses incidental to smuggling business	<u>NIL</u>	
Not allowed		<u>20,000</u>
Company's Business Income		<u>15,53,000</u>

Illustration. Following is the Profit and Loss Account of Mr. A for the year ending 31-3-2009.

Debits	Rs.	Credits	Rs.
To Salary	3,20,000	By Gross profit	10,85,000
To Office expenses	48,000	By Bad debt recovered	15,000
To Depreciation	80,000	By Commission	22,000
To Audit fees	25,000	By Sundry receipts	13,000
To Repairs	48,000	By Custom duty recovered (disallowed earlier)	30,000
To Amount transferred to special reserve	90,000		
To Expenditure on Diwali festival	10,000		
To Contribution to unapproved gratuity fund	18,000		
To Interest payable	70,000		
To Expenses on research	50,000		
To Provision for income tax	60,000		
To Bonus	18,000		
To Provision for sales tax	15,000		
To Employer's contribution to employees' PF	11,000		
To Legal expenses	10,000		
To Net Profit	<u>2,92,000</u>		
Total	<u>11,65,000</u>	Total	<u>11,65,000</u>

Other information is:

1. Depreciation includes Rs. 20,000 being unabsorbed depreciation of earlier years.
2. Repairs include Rs. 18,000 being expenditure on construction of wash rooms which were completed on 31-12-2008.
3. Research expenses include Rs. 30,000 being cost of a computer acquired for research, which is not connected to assessee's field of business.
4. Interest payable includes Rs. 5,000 paid as penalty for late payment of Interest.
5. Sales tax is actually paid on 10-4-2009.
6. Salary includes payment of Rs. 40,000 given as compensation to the widow of a deceased employee.

7. Out of bad debts recovered only Rs. 10,000 were allowed as deduction earlier. From the information given above calculate the business income of Mr. A for the assessment year 2009-10.

Solution.

Calculation of business income of Mr. A for the assessment year 2009-10.

	Rs.	Rs.
Net profit as per P & L account		2,92,000
<i>Add: Expenses debited but not allowed under the act:</i>		
Amount transferred to special reserve	90,000	
Contribution to unapproved gratuity fund	18,000	
Provision for income tax	60,000	
Unabsorbed depreciation	20,000	
Repairs-cost of washrooms being capital expenditure	18,000	
Cost of computer for research not related to own field	30,000	
Penalty for late payment of interest	<u>5,000</u>	<u>2,41,000</u>
<i>Less: Expenses allowed but not debited</i>		5,33,000
Depreciation on wash rooms [18,000 x 10% x ½ year]		900
Less income credited but not taxable under this head		5,32,100
Bad debt recovered disallowed earlier [15,000 less allowed earlier 10,000]	5,000	
Custom duty recovered - not allowed as deduction earlier	<u>30,000</u>	<u>35,000</u>
Business income of the year		4,97,100
Less unabsorbed depreciation		<u>20,000</u>
Income under the head Profit and Gains		<u>4,77,100</u>

Illustration. Mr. Sunil a retail trader of Cochin gives the following Trading, Profit and Loss A/c of the year ending 31st March, 2009.

	Rs.		Rs.
To opening Stock	1,08,000	By Sales	11,50,500
To Purchases	9,46,000	By Bank Interest	11,000
To Gross Profit	2,46,000	By Misc. Business receipts	3,500
		By Closing Stock	<u>1,35,000</u>
	<u>13,00,000</u>		<u>13,00,000</u>
To Salary	54,000	By Gross Profit	2,46,000
To Rent, Rates and Taxes	24,000	By Interest on debtors	50,000
To Interest on Loan	10,000	By Bad debts recovered	10,000

To Depreciation	1,13,000		
To Advertisement	24,000		
To Sundry expenses	2,940		
To Loss on sale of assets (short-term)	9,000		
To Other Expenses	9,060		
To Net profit	<u>60,000</u>		
	<u>3,06,000</u>		<u>3,06,000</u>

Additional information:

Opening stock was under debited by 10% and closing stock was under credited by 10%.

Salary includes rs. 24,000 paid to his brother, which is unreasonable to the extent of Rs. 6,000.

The whole amount of advertisement was paid in cash.

The Depreciation provided in the Profit and Loss Account Rs. 1,20,000 was based on the following information: The written down value of Plant and Machinery is Rs. 3,60,000. A new plant having same rate of depreciation, i.e., 15% was bought on 11-6-2008 for Rs. 1,38,000. One old plant was sold on 11-1-2009 for Rs. 6,400.

Rent and rates includes Sales Tax liability of Rs. 4,100 paid on 7-7-2009.

Other Business receipts include Rs. 4,200 received as refund of excise duty relating to 2006-07.

Other expenses include Rs. 4,000 paid as Donation to a place of worship for all religions.

You are required to advise Sunil whether he can offer his business income under section 44AF, i.e., presumptive taxation.

Solution.

(A) Business income if he does not opt for presumptive assessment u/s 44AF		
	Rs.	Rs.
Net profit as per profit and loss account		60,000
Add disallowed expenses:		

(a) Closing stock under credited [(1,35,000x100/90)-1,35,000]	15,000	
(b) Amount of unreasonable salary paid to brother[Section 40A(2)]	6,000	
(c) 100% of advertisement expenses paid in cash [Section 40A(3)]	24,000	
(d) Donations	4,000	
(e) Depreciation	1,13,000	
(f) Loss on sale of assets	9,000	
		1,71,000
		2,31,000
Less expenses allowed but not debited:		
(a) Opening stock under debited [(1,08,000 x 200/90) – 1,08,000]	12,000	
(b) Depreciation under debited (See note)	92,700	
		1,04,700
		1,26,300
(c) Income from Bank Interest		11,000
Income from business		1,15,300
Note: Depreciation as per Income-tax Rules has been computed as under:		
Opening written down value	3,60,000	
Additions during the year	1,38,000	
	4,98,000	
Less: Money realized	64,000	
Written down value as on 31-3-2009	4,34,000	
Depreciation @ 15%	65,100	
Additional Depreciation @ 20% of Rs. 1,38,000	27,600	
	92,700	
(B) Business income if he opts for presumptive assessment u/s 44AF		
In that case his income from business shall be computed as under:		
5% of sale of retail trade, i.e. Rs. 11,50,500	57,525	
Add: Misc. business receipts	3,500	
Taxable Income	61,025	

Therefore, he should opt for computation of business income under section 44AF, i.e., the presumptive income assessment.

Illustration.

PROFIT & LOSS ACCOUNT			
Salary to staff	6,10,000	Gross Profit	25,65,600
Advertisement expenses paid in cash	28,000	Sundry receipts	26,000
Office expenses	1,06,000	Custom duty recovered (not allowed as deduction earlier)	12,000
Rent and repairs	84,000	Interest on Bank deposits	1,08,000
Legal expenses for filing income tax appeal	16,000	Profit of sale of import licence	65,000

Bad debts	42,000	Gift from father	18,000
Depreciation	2,10,000	Profit on sale of shares	80,000
Reserve for bad and doubtful debts	18,000	Bad debts recovered	16,000
Interest on bank loans	80,000		
Fringe benefit tax	16,000		
Commission	22,000		
Interest on own capital	14,000		
Household expenses	20,000		
Income tax for 2006-07	15,000		
Banking cash transaction tax	8,000		
Sales tax	36,000		
Sales tax penalty	12,000		
Entertainment expenses	20,000		
Extension of business premises	2,00,000		
Net profit	<u>13,33,600</u>		
	<u>28,90,600</u>		<u>28,90,600</u>

Other additional informations are:

Salary to staff includes salary paid to a relative employee which is unreachable upto Rs. 10,000.

Office expenses include a payment of Rs. 16,000 given to notified university for carrying on research.

Salary to staff includes a payment of pension of Rs. 8,400 to a widow of a former employee.

Office expenses include a gift of Rs. 2,000 given to a sales tax officer on Dewali.

Depreciation includes depreciation of personal car of manager Rs. 24,000.

Entertainment expenses include expenses incurred in a five-star hotel for entertaining a customer.

Interest on bank loans includes interest on loan taken to buy a personal car Rs. 20,000.

Determine business income for the assessment year 2009-10.

Solution. Computation of business income for the assessment year 2009-10.

	Rs.	Rs.	Rs.
Profit as per P. & L. A/c			13,33,600
<i>Add inadmissible expenses:</i>			
Advertisement expenses paid in cash		28,000	
Reserve for bad & doubtful debts		18,000	
Depreciation		2,10,000	
Fringe benefit tax		16,000	

Interest on own capital		14,000	
Household expenses		20,000	
Income tax for 2006-07		15,000	
Sales tax penalty		12,000	
Extension of business building being capital expenditure		2,00,000	
Salary to a relative employee being unreasonable		10,000	
Payment to a notified university for research (-a weighted deduction @ 125% to be allowed)		16,000	
Pension to an old employee's widow-allowed		-	
Gift to a sales tax officer on Dewali		2,000	
Interest on loan taken to buy personal car		<u>20,000</u>	
			<u>5,81,000</u>
			19,14,600
<i>Less incomes credited but are not taxable:</i>			
Custom duty recovered not charged in an earlier year		12,000	
Gift from father is not a business income		<u>18,000</u>	
			<u>30,000</u>
			18,84,600
<i>Less incomes credited but taxable under other heads:</i>			
Interest on bank deposits		1,08,000	
Profit on sale of shares		<u>80,000</u>	
			<u>1,88,000</u>
			16,96,600
<i>Less allowable business expenses:</i>			
Depreciation	2,10,000		
	<u>24,000</u>		
		1,86,000	
Amount given to a University for research—a weighted deduction @ 125% allowed: 16,000x125/100		<u>20,000</u>	
			<u>2,06,000</u>
Business income			<u>14,90,600</u>

SECTION--A

What is business?

Define business.

What is profession?

What is deferred revenue expenditure?

State the treatment for surgical equipment?

What is block of assets?

What is acceralated depreciation?

State the features of a profession?

What is the treatment for under valuation of closing stock?

What is the treatment for over valuation of opening stock?

What is the treatment for under valuation of opening stock?

What is the treatment for over valuation of closing stock?

SECTION--B

Briefly explain the steps involved in computing business income?

What is profession? Explain the features of a profession?

State different provisions relating to computation of business income?

A truck operator assessee owns 2 heavy goods vehicles for 9 months 14 days, 3 medium goods vehicles for 10 months 8 days and 4 light goods vehicles for 7 months 23 days, during the previous year 2007-08. He did not keep any accounts for freight receipts and expenses. Cost of Vehicles is Rs. 20 lakh. Compute his Income from Business u/s 44 AE of Income Tax Act

SECTION--C

a. Mr. Sunil a retail trader of Cochin gives the following Trading, Profit and Loss A/c of the year ending 31st March, 2009.

	Rs.		Rs.
To opening Stock	1,08,000	By Sales	11,50,500
To Purchases	9,46,000	By Bank Interest	11,000
To Gross Profit	2,46,000	By Misc. Business receipts	3,500

		By Closing Stock	<u>1,35,000</u>
	<u>13,00,000</u>		<u>13,00,000</u>
To Salary	54,000	By Gross Profit	2,46,000
To Rent, Rates and Taxes	24,000	By Interest on debtors	50,000
To Interest on Loan	10,000	By Bad debts recovered	10,000
To Depreciation	1,13,000		
To Advertisement	24,000		
To Sundry expenses	2,940		
To Loss on sale of assets (short-term)	9,000		
To Other Expenses	9,060		
To Net profit	<u>60,000</u>		
	<u>3,06,000</u>		<u>3,06,000</u>

Additional information:

Opening stock was under debited by 10% and closing stock was under credited by 10%.

Salary includes rs. 24,000 paid to his brother, which is unreasonable to the extent of Rs. 6,000.

The whole amount of advertisement was paid in cash.

The Depreciation provided in the Profit and Loss Account Rs. 1,20,000 was based on the following information: The written down value of Plant and Machinery is Rs. 3,60,000. A new plant having same rate of depreciation, i.e., 15% was bought on 11-6-2008 for Rs. 1,38,000. One old plant was sold on 11-1-2009 for Rs. 6,400.

Rent and rates includes Sales Tax liability of Rs. 4,100 paid on 7-7-2009.

Other Business receipts include Rs. 4,200 received as refund of excise duty relating to 2006-07.

Other expenses include Rs. 4,000 paid as Donation to a place of worship for all religions.

You are required to advise Sunil whether he can offer his business income under section 44AF, i.e., presumptive taxation.

b. Following is the Profit and Loss Account of Mr. A for the year ending 31-3-2009.

Debits	Rs.	Credits	Rs.
To Salary	3,20,000	By Gross profit	10,85,000
To Office expenses	48,000	By Bad debt recovered	15,000
To Depreciation	80,000	By Commission	22,000

To Audit fees	25,000	By Sundry receipts	13,000
To Repairs	48,000	By Custom duty recovered (disallowed earlier	30,000
To Amount transferred to special reserve	90,000		
To Expenditure on Diwali festival	10,000		
To Contribution to unapproved gratuity fund	18,000		
To Interest payable	70,000		
To Expenses on research	50,000		
To Provision for income tax	60,000		
To Bonus	18,000		
To Provision for sales tax	15,000		
To Employer's contribution to employees' PF	11,000		
To Legal expenses	10,000		
To Net Profit	2,92,000		
Total	11,65,000	Total	11,65,000

Other information is:

8. Depreciation includes Rs. 20,000 being unabsorbed depreciation of earlier years.
9. Repairs include Rs. 18,000 being expenditure on construction of wash rooms which were completed on 31-12-2008.
10. Research expenses include Rs. 30,000 being cost of a computer acquired for research, which is not connected to assessee's field of business.
11. Interest payable includes Rs. 5,000 paid as penalty for late payment of Interest.
12. Sales tax is actually paid on 10-4-2009.
13. Salary includes payment of Rs. 40,000 given as compensation to the widow of a deceased employee.
14. Out of bad debts recovered only Rs. 10,000 were allowed as deduction earlier.

From the information given above calculate the business income of Mr. A for the assessment year 2009-10.

c. From the following statement, compute the income from profession of Dr. S.K. Kapoor if accounts are maintained on mercantile system:

	Rs.		Rs.
To Dispensary rent	36,000	By visiting fees	45,000
To Electricity and water charge	6,000	By Consultation fees	1,25,000
To Telephone expenses	6,000	By Sales of medicines	72,000
To Salary to nurse and compounder	36,000	By Dividends	5,000
To Dep. on surgical equipment	6,000		
To purchase of medicines	36,000		
To Depreciation on X-ray machine	4,000		
To Income tax	5,500		
To Donation to Rama Krishna Mission	4,000		
To Motor car expenses	9,600		
To Dep. On car	4,800		
To Net Income	<u>93,100</u>		
	<u>2,47,000</u>		<u>2,47,000</u>

- Notes: 1. Electricity and water charges include domestic bill of Rs. 2,500
2. Half of motor car expenses are for professional use.
3. Telephone expenses include 40% for personal use.
4. Opening stock of medicines was Rs. 6,000 and closing stock was Rs. 4,000

INCOME FROM OTHER SOURCES

LEARNING OBJECTIVES:

- To know about general incomes u/s 56(1)
- To know about specific incomes u/s 56(2)
- Expenses expressly disallowed u/s 58
- Deemed profits u/s 58
- Accounting methods
- Dividends u/s 2(22)

Nature of the head:

The fifth and residuary head of incomes is Income from other sources. Every income which does not specifically fall under any of the preceding four heads shall be included in this head. Section 56 in its sweeping language embraces anything which can be described as income and it is taxable under the act unless expressly exempted. This section operates

only when a particular income cannot be included in any other head. Under section 56(1) every kind of income which is included in the total income under this act and which is not chargeable to tax under any of the few four heads specified in section 14 is chargeable to income tax under the head Income from other sources.

Under section 56(2) in particular following incomes shall be chargeable to income tax under the head Income from other sources:

- (i) Dividends
- (ii) Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any or from gambling or betting of any form or nature what so ever. These can be called as casual incomes.
- (iii) Any income by way of interest on securities if the income is not chargeable to tax under the head profits and gains of business or profession.
- (iv) Income from machinery, plant and furniture belonging to the assessee and let on hire, if the income is not chargeable to tax under the head profits and gains of business of profession.
- (v) Where an assessee lets on hire, machinery, plant or furniture belonging to him and also building and the letting of the building is inseparable from the letting of the said plant or furniture the income from such letting if it is not chargeable to income tax under the head profits and gains of business or profession.
- (vi) Where any sum of money aggregate value of which exceeds fifty thousands rupees is received without consideration by an individual or a HUF in any previous year from any non relative person or persons the whole of the aggregate value is chargeable to tax.
- (vii) Any sum received under a key man insurance policy including if such a sum is not taxable as salary or business income.

GENERAL INCOMES: [56-(1)]

Under the provisions of section 56(1) the head will operate when the first four heads of income are exhausted. The onus will be on the assessee to prove that the particular income does not fall under any of the preceding four heads.

INSTANCE OF INCOMES FALLING UNDER SECTION 56(1)

- (i) Income derived by a coal mine owner from rent and royalties are included in this head.
- (ii) Income earned by an assessee from licenses granted to brick makers to erect brick kilns upon his land and to take away brick earth and use it for making bricks.
- (iii) Remuneration received by an assessee from a person other than his employer eg. University remuneration
- (iv) Interest on loans, securities, deposits and current account also come under this head
- (v) Income received by a professional man as a university examiner
- (vi) Income received on sub letting of the house
- (vii) Tips received by a waiter or taxi driver not being given by his employer
- (viii) Family pension received by legal heirs of employee
- (ix) Deemed incomes
- (x) Income of other persons to be included in the income of individual
- (xi) Income from writing articles by a non journalist
- (xii) Income from agricultural land situated outside India.
- (xiii) Remuneration for lectures delivered outside India.
- (xiv) Commission received by a director for standing as guarantor
- (xv) Commission received by a director for underwriting the shares of a new company
- (xvi) Gratuity received by a non employee director
- (xvii) Any gratuity or pension received for LIC or other insurer u/s 80CCC

INSTANCES OF INCOMES FALLING UNDER SECTION 56(2)

1. DIVIDEND: Income from all dividends is specifically included in this head. The shares may be held as stock in trade but any dividend received during the period when they are held by the assessee shall be exempted.

The term dividend has been defined in any inclusive number under section 2(22). The definition is divided in sub clauses [a] or [c] and contains three explanations.

- (i) Sub-clause (a) Any distribution by a company of accumulated profit entailing release of company's assets. This provision relates to bonus shares. The two conditions which must be fulfilled for including a particular distribution of profits by a company as dividend are: [a] it must be out of accumulated profits and [b] it must entail the release of the assets of company.

The issue of bonus shares out of capitalized accumulated profits does not entail the release of any asset and as such the bonus shares are not dividend when they are issued to holders of equity of ordinary shares.

But the position will be entirely different if the company, instead of issuing its own shares, purchases, the shares of another company out of its accumulated profits and then issue to share holders. In this case it will amount to release of assets ie, shares of another company, and as such the shareholders receiving such shares will have to pay tax on the value of such shares.

Sometimes company offers two options either to take bonus share or their cash value. If the shareholders opt for bonus shares they will not be liable to tax but if they opt for cash, the amount will be treated as dividend.

When the redeemable preference shares are issued as bonus shares out of accumulated profits and they are paid off, the amount so received by an assessee will be treated as dividend under section 2[22] sub-clause [a].

- (ii) Sub-clause [b] any distribution by a company of debentures, stock, deposit certificates and bonus shares to preference shareholders. Under the provisions of this section, the dividend includes any distribution by a company of

debentures, or stock or deposit certificates to the extent to which the company possesses accumulated profit, whether capitalized or not.

Any bonus shares distributed among the preference shareholders will amount to dividend but bonus shares issued to ordinary shareholders are not treated as dividend.

- (iii) Sub-clause [c] any distribution made to shareholders on the liquidation of the company. Any distribution made by a company to its shareholders on its liquidation to the extent the company possessed accumulated profits before its liquidation shall amount to dividend. It is immaterial whether such accumulated profits are capitalized or not.
- (iv) Sub-clause [d] distribution on reduction capital, if, at any time, it is felt that company is over capitalized and has accumulated profits, if the capital of such company is reduced by way of paying its share capital in excess of its needs.
- (v) Sub-clause [e] any payments by a company to its shareholders. If a company in which public are not substantially interested makes a payments of any of the three kinds mentioned below to a person who is the beneficial owner of share {not being the shares entitled to fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power or to a concern in which such shareholder is a member or a partner holding a substantial interest such a payment shall be considered as dividend.

The payments may be of any of the following three types:

- (a) Any payment amounting to any sum
- (b) Any payment of behalf to any sum
- (c) Any loan or advance for the individual benefit of a shareholder

The company must possess accumulated profits to the extent of any such payment. If the payment exceeds accumulated profits the payment limited to the extent of accumulated profits shall be considered as dividend.

(vi) Dividend not include-

- (a) referring to sub-clauses [c] and [d] above if any distribution is made in respect of any shares issued for full cash consideration, where such shareholder is not entitled, in the event of liquidation of company, to participate in the surplus assets.
- (b) Referring to sub-clauses [c] and [d], if any distribution is made and such distribution is attribution to the capitalized profits of the company representing bonus shares allotted to its equity shareholders after 31st March, 1964 and before 1st April, 1965.
- (c) If any payment is made to shareholder under sub-clause [e], by a company in ordinary course of its business where the lending of money is the substantial part of the business of the company.
- (d) Any dividend paid by a company which is set off by the company against the whole or any part of sum previously paid by a company as advance or loan under the provisions of sub-clause [e].

Illustration 1. 'B' is a holder of 5,000 equity shares of Rs. 100 each (fully paid) in 'M' & Co. Ltd. On 1-1-2009 the company decided to issue to its equity shareholders bonus shares out of the balance in the General Reserve Account at the rate of one bonus share of Rs. 100 each (fully paid) for every five shares held by them. On 31st March, 2009 'b' received 1,000 bonus shares from the company, the market value of the bonus share on that date being Rs. 120 per share. Discuss 'B's liability to tax in respect of the bonus shares received by him. Would your answer be any different if 'B' had received the bonus shares as a holder of company's preference shares?

Solution

The issue of bonus shares out of capitalized accumulated profits does not entail the release of any asset and as such bonus shares are not dividend when they are issued to holders of equity and ordinary shares. Two conditions must be fulfilled to include the issue of bonus shares in category of dividend in the hands of the recipient shareholder. These conditions are:

- (a) Dividend must have been issued out of accumulated profit of the company, and

(b) It must entail the release of the assets of the company. Since in the above issue of bonus shares to equity shareholders does not entail the release of the assets of the company, so this does not constitute dividend in the hands of the shareholder.

But bonus shares distributed amongst the preference shareholders will amount to dividend.

TAX TREATMENT OF DIVIDEND FROM INDIAN COMPANIES AND INCOME FROM UNITS OF UTI AND OTHER MUTUAL FUNDS

Dividend

It can be received on equity or preference shares of a company, units of UTI or shares of a Cooperative Society. Following points are to be noted while treating dividend for tax purposes.

- (a) Dividend declared or distributed by an Indian Company or by a mutual fund on its units is fully exempted with effect from 1-4-2003.
- (b) Bonus shares allotted to preference share holders shall be deemed as dividend and their market price shall be fully taxable.
- (c) In case loan is taken by a person who has substantial interest in the affairs of a Pvt. Ltd. Company whose business is not money lending, such loan is deemed as advance dividend up to accumulated reserves of the company. If such loan is adjusted against future dividend, it will not be taxable. A person is said to have a substantial interest if he, his spouse and minor child all together hold 10% or more shares in such Pvt. Ltd. Company.
- (d) Deemed dividend as per (b) and (c) above is fully taxable.

2. Winnings from lotteries, crossword puzzles, races including horse races, card games and games of other sorts, or from gambling or betting of any form or nature [Section 56(2) (iv)].

This point can be split up in following parts:

- (a) Winning from lotteries
- (b) Winning from cross word puzzles
- (c) Winning from races including horse races
- (d) Winning from card games

- (e) Winning from games of other sorts such as game shows or entertainment programmes on TV or other electronic media in which people compete to win prizes
- (f) Winning from gambling and betting

No expenditure is allowed to be deducted out of these incomes.

Tax is deducted at source at prescribed rates out of following incomes:

- | | |
|-------------------------------------|----------------------------|
| (a) Winnings from lotteries | If prize exceeds Rs. 5,000 |
| (b) Winnings from crossword puzzles | If prize exceeds Rs. 5,000 |
| (c) Winnings from card games | If prize exceeds Rs. 5,000 |
| (d) Winnings from T.V. game shows | If prize exceeds Rs. 5,000 |
| (e) Winnings from horse races | If prize exceeds Rs. 2,500 |

In case of winnings from other races, gambling, betting etc. ----No TDS

Prescribed rates of TDS

Basic rate of income tax 30%

Add surcharge @ 10% of tax if total income of individual and HUF exceeds rs. 10,00,000 and @ 10% of tax for firms and domestic companies, if their net income exceeds Rs. 1 crore.

Add Education cess @ 3% of tax and surcharge for all assesses.

In case amount of prize is 'Net', 'Received' or 'after deduction of tax' or is 'collected by bank' it has to be grossed up in this manner:

$\text{Net} \times 100 / [100 - (30 + \text{surcharge} + \text{Education cess})]$.

Since no TDS is required to be made in case of winnings from other races, gambling, betting, etc. so there will be no difference between net and gross amounts.

Note. Education cess is 3% i.e., 2% + 1% Senior and Higher education cess.

Where the winnings from lottery are wholly in kind or partly in cash and partly in kind and cash is not sufficient to meet the liability of tax on such winnings, the person responsible for paying such prize must ensure that tax has been paid in respect of the winnings before such prize is released.

Income from the activity of Maintenance of Horses for Race Purposes

1. Income from maintenance of horses for race purposes is taxable income under the head 'Income from other sources.'
2. Loss from activity of maintenance of race horses (as explained at 4 below) can be set off only from income of same activity and not from any other income. It cannot be set off even from income by way of betting at race course.
3. In case such loss remains unadjusted from income of such activity, it can be carried forward for 4 succeeding previous years to be set off only from income of same activity.
4. Loss from maintenance of race horses is to be calculated in following manner:
 - (a) In case the assessee has no income by way of stake money (amount received as prize money by race horse for being placed at 1st or 2nd or any other position in such races), the expenses incurred wholly and exclusively for the purpose of maintenance of such horses shall be treated as loss from race horses.
 - (b) In case the assessee has income by way of stake money (as explained above) the expenses on maintenance of horses shall be adjusted from stake money. If expenses are more than stake money, it shall be called as loss from maintenance of race horses.

Illustration 2. Mr. G. Bedi owns horses at Bombay and Bangalore. These horses run for races at the race course. During the year 2008-09 Mr. Bedi submits the following information:

- | | |
|--------|--------------------------------------|
| (i.) | Expenses on race horses at Bombay |
| | Rs. 2,60,000 |
| (ii.) | Expenses on race horses at Bangalore |
| | Rs. 4,30,000 |
| (iii.) | Stake money earned by horses at |
| (a) | Bombay |
| | Rs. 1,20,000 |
| (b) | Bangalore |
| | Rs. 5,00,000 |

(iv.) Mr. Bedi received Rs. 1,03,650 on 1-7-2008 on betting during horse races at Bombay.

Compute his taxable income under other sources.

Solution. Computation of income under other sources

Activity of maintenance of race horses:

<i>Income</i>	Rs.	Rs.
(i) at Bombay	1,20,000	
(ii) at Bangalore	<u>5,00,000</u>	6,20,000
<i>Less Expenses</i>		
(i) at Bombay	2,60,000	
(ii) at Bangalore	<u>4,30,000</u>	<u>6,90,000</u>
Loss from activity of maintenance of race horses to be C/F		<u>70,000</u>

Race winning:

Amount received Rs. 1,03,650

Gross [1,03,650 x 100/69.1] 1,50,000

Note. Loss from activity of maintenance of horses for race purposes cannot be set off from any other income including race winnings.

3. Amount deducted by employer. Any amount deducted by an employer (not carrying on business or profession) as Income-tax, or E.S.I. Fund contribution or their contribution to provident fund etc. shall be treated as income of the year.

4. Interest on securities. The following amounts due to an assessee in the previous year shall be chargeable to income-tax under Interest on Securities:

- (i) Interest on any security of the Central or State Government.
- (ii) Interest on debentures or other securities for money issued by or on behalf of a local authority or a company or a corporation established by a Central, State or Provincial Act. [Section 2 (28B)].

What is Interest?

Interest is the return which a person receives from another person for bearing the risk of parting with the money and losing the income which he would have received on such

money had he deposited it in a Bank. It simply means the return received by a creditor who has given his money as debt.

What is Security?

A security is a document acknowledging the debt taken by a specific authority from general public. It may be named as a 'Debt' 'Loan', 'Paper', 'Debenture' or 'Security' or 'Certificate'. It is secured in some manner.

Contents of Security. It contains face value of security, date of maturity, rate of interest, date, place and period of payment of interest etc. These are transferable.

Who can issue a Security? As per section 18, securities may be issued by following authorities:

The Central Government

A State Government

A Local Authority

A Company or

A Statutory Corporation

Taxability of Interest

Interest on securities accrues after a fixed period as mentioned on the face of the security itself. In India, generally, interest accrues after a period of six months. Any interest which accrues to a person during the previous year is added in his gross total income.

Interest is taxable on due basis. It is immaterial whether the assessee has received it or not.

The interest accrues on the name of that person on whose name securities stand on the date of accrual of interest. It is immaterial that he purchased these securities a few days earlier than the date of accrual of interest. He has to include full interest in his gross total income.

Interest on securities does not accrue on day-to-day basis. It matures into debt overnight, i.e., the day of accrual of interest.

Deduction of tax at source [Section 193]

Before making payment of interest on securities, it is the duty of the security-issuing authority to deduct tax at source on such interest payable at the 'Rates in force' during that previous year. 'Rates in force' means the rate or rates specified for the purpose of deduction by Finance Act of the year in which deduction is to be made. The tax deducted at source will be deposited in the Government Treasury on behalf of the security-holder. The security-holder's account is credited with the amount and while paying tax on the total income the amount deducted at source will be deducted.

However, in the case of the following securities tax is not deducted at source:

- (i.) Interest payable on 4 $\frac{1}{4}$ % National Defence Bonds, 1972 where the bonds are held by an individual, not being a non-resident, or
- (ii.) 4 $\frac{1}{4}$ % National Defence Loan, 1968, or 4 $\frac{3}{4}$ % National Defence Loan, 1972, provided the interest is payable to an individual, or
- (iii.) Interest payable on National Development Bonds.
- (iv.) 7-year National Savings Certificates (Fourth Issue).
- (v.) Debentures issued by any co-operative society or any other institution notified by Central Government or
- (vi.) 6 $\frac{1}{2}$ % Gold Bonds, 1977 or 7% Gold Bonds, 1980, where the bonds are held by an individual, not being a non-resident and the holder thereof makes a declaration in writing before, the person responsible for paying the interest that the total nominal value of Gold Bonds held by him did not exceed Rs. 10,000 at any time during the period to which the interest relates, or
- (vii.) No tax will be deducted at source from any security issued by Central Government, or a State Government.
- (viii.) No tax will be deducted at source if interest on term deposit with a bank does not exceed Rs. 5,000 in a previous year.

No deduction of tax at source in case of interest on debentures [Section 193 (v)]

In case following conditions are fulfilled, the issuing authority will not deduct any tax at source:

- (i.) Debentures are issued by a company in which the public are substantially interested

- (ii.) Interest is paid to a Resident debenture-holder
- (iii.) Debentures are listed on a recognized stock exchange
- (iv.) Interest is paid by the company in account payee cheques, and
- (v.) The total amount of interest payable in the financial year, does not exceed Rs. 2,500

	Individual, HUF, AOP, BOI		Company and Firms
	When there is No surcharge + Education cess 3% of tax	Where there is Surcharge @ 10% + Education cess 3% of tax & Surcharge	When there is Surcharge [Rate of surcharge 10% of tax + education cess 3% of tax & Surcharge]
Income	A/Y 2009-10	A/Y 2009-10	A/Y 2009-10
(a) Dividend on shares referred to u/s 1150	NIL	NIL	NIL
(b) Interest on units of UTI and Mutual Funds	NIL	NIL	NIL
(c) Bank Interest [If amount of interest exceeds Rs. 5,000]	10.3%	11.33%	11.33%
(d) Interest on securities issued by: Central or State Government	NIL	NIL	NIL
Local authority or statutory corporation	10.3%	11.33%	11.33%
Company: Listed securities	10.3%	11.33%	11.33%
Unlisted securities	20.6%	22.66%	22.66%
(e) Winnings from Lotteries, Races, Puzzles, Card games, TV game shows	30.9%	33.99%	33.99%

For individuals, HUF's etc. the surcharge is to be levied only if total income exceeds Rs. 10, 00,000. If net interest, interest received or interest after deduction of TDS is given it has to be grossed up:

Gross interest = Net x 100/100—rate of TDS.

Types of Securities

A. Exempted from Tax. Income-tax Act, 1961 provides for exemption of certain interest from tax u/s 10(15). Interest on all such securities, certificates, bonds etc. is altogether not included in the gross total income of the assessee and no tax is payable there upon.

There are some securities whose interest is exempted from tax but these are no longer in existence. These are:

- (i.) National Plan Certificates
- (ii.) National Defence Bonds
- (iii.) Treasury saving deposit certificates
- (iv.) Special Bearer Bonds 1991

Interest on following bonds issued by public sector Companies/undertakings has been notified to be exempted:

- (i.) 10% Secured Redeemable NTPC Bonds, 1986 (1st Series).
- (ii.) 10% Secured Redeemable non-convertible Bonds issued by Mahanagar Telephone Nigam Ltd.
- (iii.) 10% Secured Redeemable non-convertible Bonds issued by Indian Railway Finance Corp. Ltd.
- (iv.) 9% Secured Redeemable non-convertible Bonds 1987 (B series) issued by National Hydroelectric Power Corp. Ltd.
- (v.) 9% Secured Redeemable non-convertible Bonds issued by Indian Railways Finance Corp. Ltd.
- (vi.) 9% (tax-free) Secured Redeemable Bonds issued by Power Finance Corp. Ltd.
- (vii.) 10% (tax-free) Secured Redeemable non-convertible Bonds issued by Indian Telephone Industries Ltd
- (viii.) 10 years - 9% (tax-free) Secured Redeemable non-convertible NTPC Bonds – IVth Issue (private placement).
- (ix.) 10 years - 9% (tax-free) Secured Redeemable non-convertible PFC Bonds – II Series (private placement).issued by Power Finance Corp.

- (x.) 10 years - 9% (tax-free) Secured Redeemable non-convertible REC Bonds, issued by Rural Electrification Corp. Ltd.
- (xi.) 10 years - 9% (tax-free) Secured Redeemable non-convertible Bonds (C Series) issued by Neyveli Lignite Corp. Ltd.
- (xii.) 7% Capital Investment Bonds.
- (xiii.) 6.5%, 8%, 9% or 10% National Relief Bonds.

B. Tax free securities

(a) Tax-free Commercial (Non Govt.) Securities. These securities are those which are issued by a local authority, Statutory corporation or a company in the form of debentures or Bonds. Actually, these are not tax-free. Tax is paid by the issuing authority to the Government on behalf of such security-holders. The person who is holder of such security is liable to tax not only for the interest he is to receive but also the amount of tax which has been deposited on his behalf. The amount of interest actually received by holder is the net interest, i.e., after deduction of tax at source. We have to find out the gross interest, i.e., before deduction of tax, to include it in the gross total income of assessee. It can be done in the following manner:

$$\text{Grossing up} = \text{Net Interest received} \times \frac{100}{(100 - \text{rate of tax})}$$

Illustration 3. Mr. A invested Rs. 1,00,000 in 8% tax-free debentures of a company. What will be his taxable interest for the previous year ending on 31-3-2009 if the rate of deduction of tax at source is @ 20.6% Interest accrues on 1st January every year.

Solution.

$$\text{Net Interest due} = 1,00,000 \times \frac{8}{100} = \text{Rs.}8,000$$

$$\text{Gross up} = 8,000 \times \frac{100}{(100 - 20.6)} = 8,000 \times \frac{100}{79.4} = \text{Rs.}10,076$$

Interest to be added in gross total income of Mr. A for the previous year ending on 31-3-2009 shall be Rs. 10,076.

(b) Tax-free Govt. Securities. These securities are no longer in existence. Now the word tax free written in Govt. securities is presumed to mean that interest on such securities is exempted u/s 10(15).

(c) Less Tax Securities. This is the most common form of securities. Out of the amount of interest due to a security-holder, tax at the prescribed rates has to be deducted by the issuing authority before payment of interest. The assessee is to pay tax not only on the net amount of interest received, but he shall be liable to pay tax on gross interest, i.e., amount due before deduction of tax at source. When the face value of securities and the rate of interest is given, it will directly give us the gross interest which we shall include in his gross total income, e.g., 50,000, 6% port Trust Bonds. Gross interest due = 3,000. It shall be fully added in the Gross Total Income of such person.

Grossing up of interest

In case it is mentioned that:

- (a) amount of interest received; or
- (b) net amount of interest ; or
- (c) interest after deduction of tax; or
- (d) interest collected by bank; or
- (e) interest on tax free non-government securities.

such interest is net amount of income and not the gross amount which has to be included in the total income of a person. As such the amount of interest as mentioned at (a) to (e) above has to be grossed up.

$$\text{Gross interest} = \text{Net} \times 100/100 - \text{rate of TDS.}$$

In case of interest on securities issued by foreign government interest is not grossed up as no tax is deducted at source in India on such income.

Commission on Sale and Purchase of Securities

Any sum of money incurred by the assessee in respect of purchase or sale of securities e.g. Commission etc. is not an allowable deduction out of the income of interest on such securities. Any amount of expenses incurred (e.g. Commission paid) at the time of

purchase of these securities are included in the cost of these securities and any such expenses paid on the sale of such securities are allowed to be deducted out of the selling price of these securities.

Profit or loss on sale of securities

In case assessee is a dealer in securities i.e. the purchase and sale of securities is the business of the assessee, then any amount of profit earned shall be chargeable to tax under the head business or profession and in case there is a loss, the same shall be debited to P&L A/c. Any amount of expenses incurred at the time of purchase or sale of securities shall be taken into account while determining profit or loss on sale of securities.

However, in case assessee has purchased these securities and holds them as an investment to earn interest income, then any profit earned on the sale of securities (investment) shall be treated as capital gain which is chargeable to tax u/s 45. Loss if any, shall be deducted out of the selling price of the securities.

Interest on securities earned by following types of assessee shall be exempted

1. A local authority
2. Trustees of a recognized provident fund and an approved superannuation fund.
3. An approved scientific research association.
4. A registered trade union.
5. Members of Scheduled Tribes living in tribal areas.
6. Public Charitable and religion trusts.
7. Political Parties
8. A non-resident of Indian origin and securities and Bond were issued before 1.6.2002.

Interest on Indira Vikas PAtra/Kisan Vikas Patra/National Savings Certificates VIII issue

Interest on these securities is taxable under the head “Other Sources” on accrued basis as actual interest is paid only at the time of maturity. The following table gives the amount of interest accrued at different intervals of time:

Amount received as gift to be treated as income: [Section 2(24)(xiii) and section 56(2) (v): Where any sum of money, the aggregate value of which exceeds Rs.50,000 is received without consideration by an individual or HUF from any person or persons on or after 1-4-2007, the whole of such sum shall be deemed as income of the previous year in which it is received.

Provided that this clause shall not apply to any sum of money received:

- a. From any relative or
- b. On the occasion of marriage of the individual or
- c. Under a will or by way of inheritance or
- d. In contemplation of death of the payer
- e. From any fund of foundation, a university or other educational institution or hospital or other medical institution or any trust or institution referred in sec.10(23C) or
- f. From any trust or institution registered u/s 12AA

Explanation for the purposes of this clause “relative” means:

- (i.) Spouse of the individual
- (ii.) Brother or sister of the individual
- (iii.) Brother or sister of spouse of the individual
- (iv.) Brother or sister of either of the parents of individual
- (v.) Any lineal ascendant or descendant of the individual
- (vi.) Spouse of the person referred to in clauses (ii) to (iii)

The above provisions can be explained in the following manner:

GIFTS AS TAXABLE INCOMES:

Any amount received by an individual or HUF or is credited to their account on or after 1-4-2008 shall be deemed as income taxable under the head Income from other sources.

GIFTS WHICH ARE NOT TO BE TREATED AS INCOMES:

Following amounts received without consideration shall not be considered as income:

- (i.) The sum received before 1-4-2008
- (ii.) The sum received by any individual from a relative the term relative means (as mentioned above)

- (iii.) The sum received on the marriage of an individual
- (iv.) The sum received by any individual or HUF under a will or by way of inheritance
- (v.) Any sum received in contemplation of death of the payer
- (vi.) Any number of gift or gifts received during the year provided the aggregate amount of all gifts does not exceed Rs.50,000
- (vii.) Any sum of money received against consideration
- (viii.) To conclude it can be said that the aggregate amount of gift or gifts from all no relatives if exceeds Rs.50,000 in any previous year, it is taxable in the hands of the recipients of such gifts.

GIFTS IN KIND:

This section relates only to any sum of money as gift. As such gifts in kind are not covered under this section. Hence exempted.

ILLUSTRATION 4:

Mr.X received the following gifts during the previous year. Compute his taxable income under the head income from other sources.

- (i.) Received Rs.1,00,000 as gift from a friend on 1-6-2008
- (ii.) Received a microwave costing Rs.14,500 as gift from his another friend
- (iii.) Received Rs.50,000 as gift from another friend on 1-11-2008
- (iv.) Received Rs.30,000 as gift from his sister on 1-1-2009
- (v.) Received Rs.40,000 as gift from his friend on 1-12-2008
- (vi.) Received Rs.1,60,000 as gift from his non resident friend on 1-2-2009

Computation of income from other sources:

Gift from a friend	1,00,000
Gift from another friend	50,000
Gift from sister	Nil
Gift from a friend	40,000
Gift from non resident friend	1,60,000
Micro wave oven in kind exempted	Nil

Income from letting of plant, machinery or furniture: if an assessee owns plant, machinery or furniture and it is let out to some other person, the rent so received by the

assessee shall be chargeable to tax under this head provided letting of plant and machinery is not the business of the assessee. If the assessee is engaged in the business of letting out plant machinery or furniture, the rent so received shall be chargeable to tax under the head profits and gains of business or profession.

Income from letting of plant, machinery or furniture with building: the rent from a property is taxable under the head Income from house property but when an assessee lets out plant, machinery or furniture which is inseparable from building, the rent of building so received will be taxable under the head income from other sources. The letting of plant, machinery or furniture should not be the business of the assessee.

Any sum received under a key man insurance policy including any sum allocated by way of bonus [u/s 2(24) (xi)] if such amount is not taxable under the head profits and gains of business and profession or under the head salaries.

DEDUCTIONS: [section 57]

The taxable income under the head income from other sources shall be computed after allowing the following deductions as provided in section 57

1. In case of dividends and interest on securities: from the dividend income, a deduction shall be allowed in respect of any sum spent by way of commission or remuneration to a banker or any other person as collection charges for realizing the dividend or interest on securities.
2. Repairs depreciation etc, in case of letting of machinery plant or furniture with or without building:
 - (i.) Expenditure incurred on current repairs of plant, machinery and furniture.
 - (ii.) Depreciation in respect of buildings will be allowed only if the assessee is the owner. It will not be allowed if the assessee is lessee or mortgagee in possession of the building.
 - (iii.) Insurance premium paid regarding these assets
3. Deduction in respect of employee's contribution in staff welfare schemes [57 (ia)]
Any amount received by employer from his employees as their contribution of

- provident fund, ESI fund or superannuation fund is deemed as income u/s 59(ic) if not taxable under the head profits and gains of business or profession. In case employer deposits any amount (out of these incomes) in these funds before prescribed due date, such amount is allowed as deduction u/s 57 (ia).
4. Standard deduction out of family pension Section 57 (ia) In case of income in the nature of family pension a deduction of a sum equal to 33.33% of such pension or Rs.15,000 which ever is less, shall be allowed.
 5. deduction from any other income [section 57(iii)] Any expenditure which is spent to earn an income chargeable to tax under this head shall be deducted from such income.
 6. deduction from royalties received by authors: (Other than those writing for films) Actual expenses can be claimed as deduction.

AMOUNT EXPRESSLY DISALLOWED: [SECTION 58]

The following expenses are not allowed to be deducted from such income:

In case of any assessee (i) any personal expenses of the assessee

- (iii) any interest chargeable under this act which is payable outside India on which tax has not been paid or deducted at source.
- (iv) Any payment which is chargeable under the head salaries if it is payable outside India unless tax has been paid or deducted at source.
- (v) In case an assessee has income from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever such assessee shall not be allowed any deduction in respect of any expenditure or allowance in connection with such incomes.
- (vi) In case of every assessee any payment to relatives and associates made in cash may be disallowed under section 40A in certain circumstances. The provisions of section 40A are made applicable under this head also by sub-section 2 of section 58.

ILLUSTRATION: Mr.X has the following incomes during the year ending 31-3-2009.

1. Dividend declared by M Co. on 31-3-2008 Rs.6,000

2. dividend declared by Z Co. on 31-3-2009 Rs.9,000
3. Interim dividend received on 1-5-2008 Rs.3,000
4. He won gold worth Rs.10,00,000 from Punjab state lottery
5. during march 2009 he earned Rs.1,00,000 as prize money on horse races. These horses are owned by him and expenditure incurred on maintenance of these horses amounted to Rs.1,60,000.

Compute income from other sources for the assessment year 2009-10.

Dividend Declared by M co, on 31-3-2008	NIL
Dividend Declared by Z co, on 31-3-2009	NIL
Interim dividend	NIL
Winnings from lottery:	
Gold from Punjab state lottery	10,00,000
Less: expenses on maintenance of these horses	1,00,000
	1,60,000
LOSS: to be carried forward	60,000
Income from other sources	10,00,000

PROFITS CHARGEABLE TO TAX [SECTION 59]

Under section 59 (i) the provision of sub-section (1) of section 41 have been made applicable in computing the income of assessee under section 56 as they are applicable in computing the income under the head profits and gains of business or profession. This provision deals with any allowance or deduction which has been allowed under this head in the assessment of income in any earlier year in respect of any expenditure, loss or trading liability incurred by the assessee subsequently during any previous year, the same amount is received or recovered in cash or in any other manner shall be deemed to be the income of that previous year in which it is recovered irrespective of the fact whether the source of income continues to exist in that year or not.

AVOIDANCE OF TAX BY CERTAIN TRANSACTIONS IN SECURITIES (BOND WASHING) [SECTION 94]

1. In case a person sells his securities to another person a few days before the accrual of interest and purchases them back after the date of accrual, and assessing officer is satisfied that the transaction has been made with the intention

- of avoiding tax, such interest shall be deemed as income of the transferor and not transferee.
2. In case a person has any beneficial interest in any securities and as a result of some arrangement either no income is received by such person or the income received by him is lower than the amount which he would have received, the interest, which would have accrued on such securities had there been no such arrangement, would be included in the income of person making such arrangement.
 3. the above provisions will not be applicable, if such person proves to satisfaction of the assessing officer that the transaction has not resulted into any avoidance of tax or if at all there was some avoidance it was exceptional as there had not been any avoidance of tax in any of three preceding previous years.
 4. In case of dealer of securities if there is a transaction of sale or purchase of securities and as a result the interest becomes receivable by him but is not deemed to be his income due to the above provisions, no account shall be taken of the transaction in computing profits arising from or loss sustained in the business.
 5. the assessing officer may direct any person to furnish a detail of securities held by him by serving upon him a notice for not less than 28 days.

ACCOUNTING METHODS:

1. **CASH METHOD:** Under this system only such transactions are recorded in which actual receipts and actual payments of the business occur. Entries in the book are made only when money is actually received or is actually paid. No account is maintained for outstanding, prepaid, accrued or unearned income. This system is best suitable for professional persons like doctors, chartered accountants etc.
2. **MERCANTILE SYSTEM:** In this system proper record of cash as well as credit transactions is made. Under this system any income which relates to the current year whether it is received or not and any expenditure whether actually paid or not, is taken into consideration for computing the profits and losses of the

business. The profit and loss account prepared under this system shows correct profits and losses and balance sheet gives correct financial position of the business.

3. Hybrid system: Under this system of accounting, the assessee adopts both the previous methods in a mixed form. Some transactions are recorded in cash system and some under mercantile system depending upon the choice of book keeper. The income tax authorities accept all the three methods of accounting for the purpose of assessment of profits and gains. The accounting system once adopted cannot be changed without the prior approval of Income tax authorities. He will have to adopt his accounting method on regular basis and not merely for one particular year.

ILLUSTRATION: Mrs. Gandhi holds the following securities on April 1 2008:

Rs.98,000 12% securities of the Uttranchal government

Rs.80,000 9% less tax non listed debentures of HLL ltd.

Interest in both the cases is payable on November 1 every year

On September 1 2008, Gandhi borrows Rs.40,000 at 10% PA and invests it in purchasing Rs.40,000. 9.5% securities of the kerala government (due date of interest February 28 every year)

Interest due on February 28 2009 is received on April 12, 2009. Interest on loan taken from 1-9-2008 to March 2009 has been paid on 1-7-2009. Determine the gross taxable income of Mrs. Gandhi for the assessment year 2009-10 if;

- a. She maintains book of account on cash basis or
- b. She maintains books of account on mercantile system

COMPUTATION OF INCOME FROM INTEREST ON SECURITIES:

Security	A. Interest on securities is taxable on receipt basis Rs.	B. Interest on securities is taxable on due basis Rs.
Rs. 98,000, 12% securities of the Utranchal		

Government	11,760	11,760
Rs. 80,000, 9% kess-tax non-listed debentures of HL Ltd.	7,200	7,200
Rs. 40,000, 9.5% securities of the Kerala Govt.	NIL	3,800
[Taxable only in case B as cash is received in the P/Y 2009-10]		
Gross Interest	18,960	22,760
<i>Deduction for interest on Loan taken:</i>		
Case A not allowed as it has not been paid yet		
Case B allowed [40,000 x 10/100 x 7/12]	NIL	2,333
Income from interest on securities	18,960	20,427

Illustration. The following investments are held by Mr.Laxman on 1-4-2008

- (a) Rs.40,000, 10% UP government loan
- (b) Rs.35,000 8% debentures of a Sugar mill co,
- (c) Rs.50,000 12% debentures of a trading co,

On 1-9-2008, he sold the debentures cum interest of trading co, and purchased Rs.60,000, 15% debentures cum interest of Beauty trading co, interest on investments received half yearly on 1st July and 1st January every year. Calculate income from securities for the previous year 2008-09.

COMPUTATION OF INCOME FROM OTHER SOURCES:

Rs.40,000 10% UP government loan	4,000
Rs.50,000 12% debentures of trading co, (for six months due on 1 st July, 2008)	3,000
Rs.60,000, 15% debentures of beauty trading co, (for 6 months due on 1 st Jan.2009)	4,500
Rs.35,000 8% debentures of a sugar mill	2,800
GROSS INTEREST	14,300
Less:deductions	NIL
INCOME FROM OTHER SOURCES	14,300

ILLUSTRATION:

Harikrishna, a resident individual, submits the following particulars of income for the previous year ending March 31, 2009:

Dividend from REC International Ltd, Rs.4,800 dividend declared on 16-5-2008 by Suncaram Finance Ltd. Rs.2,700 interest paid on capital borrowed for the purpose of investment in shares of Sundaram finance ltd, Rs.4,200. collection charges in respect of dividend Rs.50.

Winnings from lottery:net amount Rs.69,100, tax deducted at source Rs.30,900, winnings from card game, Rs.23,500. interest on securities issued by the government of Singapore Rs.20,570.

Determine the income chargeable under the head income from other sources for the assessment year 2009-10.

Dividend of REC international ltd. Exempted		Nil
Sundaram finance dividend exempted		Nil
Expenses not allowed		
Winnings from lotteries	69,100	1,00,000
ADD: TDS	30,900	
Winning from card games		23,500
Interest on securities issued by government of Singapore		20,750
Income from other sources		1,44,070

Illustration: Sowmya has the following investments and incomes in the previous year ended 31-3-2009. calculate her income from other sources.

- (a) Dividend from Indian company Rs.7,800
- (b) Examiner ship remuneration Rs.2,000
- (c) Royalty by the publication of a book Rs.48,000
- (d) Winning from lottery (net) [received on 1-3-2009] 34,550
- (e) Rs,40,000 10% debentures of company [listed]
- (f) Rs.40,000 12% Punjab government securities
- (g) Rs.50,000 13% Less tax commercial securities
- (h) Rs.40,000 10% Tax free debentures of a company
- (i) Rs.4,036 as interest on tax free debentures (listed) [received on 1-3-2008]

In October 2008 she sold the above Rs.40,000, 10% tax free debentures of a company for Rs.45,000. In December 2008 she inherited Rs.60,000, 10% tax free debentures (listed) of XY co Ltd, from her father. Interest on above securities falls due on December 31st of every year.

She submits the following deductions:

- (j) Collection charges for interest and dividend @ 2% of net amount realized
- (k) Purchase of lottery tickets Rs.2,000

ILLUSTRATION: Mr.Karthik who is resident of India furnished the following particulars of his investments for the previous year ended 31st March 2009.

- a. Rs.10,000 units of Mutual fund gross income Rs.1,200
- b. Rs.10,000 in Post office savings bank account which earns interest @ 3.5% per annum.
- c. Rs.45,000 in fixed deposit account with Allahabad bank on which interest @9% is payable.
- d. 12% Rs.40,000 debentures listed of Tea company
- e. Rs.1,000 interest received on the debentures of a co-operative society
- f. Rs.2,000 interest received on National development bonds
- g. 10% UP state electricity board bonds Rs.20,000
- h. Rs.10,000 in 7 year post office National savings certificates interest @ 7% per annum is payable on the same every year.
- i. Rs.36,000, 10% tax free debentures of Agra Municipal corporation. Interest being payable on 31st December
- j. Rs.900 received by an account payee cheques as interest on debentures listed of a company in which public are substantially interested.
- k. He collected the entire interest himself and claimed Rs.200 as his own fees for collection of interest.
- l. Interest on post office National saving certificates VIII issue Rs.5,000.

Calculate the taxable income under the head income from other sources for the assessment year 2009-10.

Income from units of mutual fund	Exempted
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Income from interest on deposits in post office savings bank a/c	Exempted
Interest on fixed deposit with Allahabad bank (45,000x9/100)	4,050
12% Rs.40,000 listed debentures of tea company	4,800
Interest received on National development bonds	2,000
Interest on debentures of a co-operative society	1,000
10% Rs.20,000 UP state electricity board bonds	2,000
10,000 7% post office NSC	Exempted
36,000 10% tax free debentures of Agra municipal corporation (net interest= $3,600 \times 100 / 89.7$)	4,013
Interest on debentures (listed) of a company	900
Interest on NSC	5,000
Income from other sources	23,763

Illustration: Dr. Mahesh is a professor and a resident of India. He submits before you the following incomes for computing his income under the head income from other sources for the assessment year 2009-10.

- (a) Salary Rs.15,600 per month from vaishnav commerce college.
- (b) He is the author of a test book which fetched him a gross royalty of Rs.20,000 in lump sum and which is in consideration of the transfer of copyright. He claims the following deductions from the amount:
 - (i.) Salary to clerk who collected for him necessary data and goes through the final proof reading Rs.3,000
 - (ii.) Purchased books worth Rs.400 in connection with the revision of the book
 - (iii.) Telephone expenses of Rs.1,600 attributed to the publication and sale of his book and other matters in connection with the printing of the new edition of the book.
- (c) Income from articles which were published in Yojna Rs.4,000
- (d) He lives in a rented house paying rent at Rs.3,000 p.m. he has sub let 1/3 portion of the house on a rent of Rs.1,500 per month. He has under taken the liability of paying municipal taxes of Rs.5,400 on the whole house and also the current repairs of the whole house amounting to Rs.6,000.
- (e) He received Rs.60 per lecture delivered at Ambedkar institute during the previous year. He delivered 20 lectures.

- (f) He is an examiner in university. This source gave him a remuneration of Rs.2,600. he incurred Rs.60 on postage etc. in connection with the examination work which were reimbursed by the university. He received Rs.400 as remuneration for invigilation work in the university examination.
- (g) His other income were: wins from card games and betting Rs.6,500, wins from chess Rs.1,000, received interest on government of Nepal bonds Rs.1,500.
- (h) Received Rs.2,000 as dividend from a company in which the public is substantially interested.
- (i) Income from agricultural land situated at Ujjain Rs.7,000
- (j) Rs.800 per month scholarship for research work from UGC

COMPUTATION OF INCOME FROM OTHER SOURCES

Royalty (gross)	20,000	
LESS: salary to clerk	3,000	
Purchase of books	400	
Telephone expenses	1,600	15,000
Income from writing of articles in Yojna		4,000
Income from sub letting (1,500 x 12)	18,000	2,200
Less: Rent paid	12,000	
Municipal taxes	1,800	
Repairs expenses	2,000	
Payment received for delivering lectures		1,200
Remuneration from university for paper setting		2,600
For invigilation		400
Winning from card game and betting		6,500
Winning from chess game		1,000
Interest on bonds issued by Nepal government		1,500
Income from other sources		34,400

SECTION – A

What is income from other sources?

What is grossing up?

What is sub-letting?

Why is dividend income is exempted in India?

What is interest?

What is a security?

SECTION – B

(a) Briefly explain various provisions of Income from other sources?

(b) Explain accounting methods?

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Rs.40,000, 10% UP government loan

Rs.35,000 8% debentures of a Sugar mill co,

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d. Mr.X has the following incomes during the year ending 31-3-2009.

Dividend declared by M Co. on 31-3-2008 Rs.6,000

dividend declared by Z Co. on 31-3-2009 Rs.9,000

Interim dividend received on 1-5-2008 Rs.3,000

He won gold worth Rs.10,00,000 from Punjab state lottery

during march 2009 he earned Rs.1,00,000 as prize money on horse races. These horses are owned by him and expenditure incurred on maintenance of these horses amounted to Rs.1,60,000.

Compute income from other sources for the assessment year 2009-10.

d. what are tax free, free tax securities?

SECTION – C

a. Sowmya has the following investments and incomes in the previous year ended 31-3-2009. calculate her income from other sources.

(l) Dividend from Indian company Rs.7,800

(m) Examiner ship remuneration Rs.2,000

(n) Royalty by the publication of a book Rs.48,000

(o) Winning from lottery (net) [received on 1-3-2009] 34,550

- (p) Rs.40,000 10% debentures of company [listed]
- (q) Rs.40,000 12% Punjab government securities
- (r) Rs.50,000 13% Less tax commercial securities
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- j. Rs.900 received by an account payee cheques as interest on debentures listed of a company in which public are substantially interested.

k. He collected the entire interest himself and claimed Rs.200 as his own fees for collection of interest.

l. Interest on post office National saving certificates VIII issue Rs.5,000.

Calculate the taxable income under the head income from other sources for the assessment year 2009:

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